

California Tax Reform? Consider an Independent Tax Tribunal

**by Craig B. Fields, Mitchell A. Newmark,
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Reprinted from *State Tax Notes*, May 8, 2017, p. 555

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In this edition of *From the Front Lines*, the authors argue that a recent audit report critical of the California State Board of Equalization makes this an ideal time for the state to implement an independent tax tribunal.

On March 30 the California Department of Finance, Office of State Audits and Evaluations, released its evaluation of the California State Board of Equalization following an audit of the organization.¹ The audit “found faulty accounting, rising spending on events that have little to do with collecting taxes and a climate of fear among civil servants who worry they’ll lose their jobs if they displease elected officials.”² The state’s report follows the state controller’s review of the BOE in November 2015, which showed the agency had misallocated \$47.8 million in sales tax revenue, among other accounting and administrative control deficiencies.³

In response to the news, state Controller Betty T. Yee, a member of the BOE by virtue of her role as controller, urged “the Legislature and the Governor to strip the board members of all statutory functions and permanently move these duties and assigned staff to a separate new department under the Governor.”⁴ Another BOE member, Fiona Ma, sent a letter to Gov. Jerry Brown (D) requesting that he appoint a public trustee to manage the BOE.⁵ These proposals represent just the latest efforts by California leaders to consolidate and reform the state’s three main tax collecting departments — the BOE, the Franchise Tax Board, and the Employment Development Department.

¹ Office of State Audits and Evaluation, California Department of Finance, “California State Board of Equalization Evaluation” (2017).

² Adam Ashton, “California Controller Says Troubled Tax Board Should Be Stripped of Power,” *Sacramento Bee*, Mar. 31, 2017.

³ Yee, California State Controller, California State Board of Equalization Review Report (Nov. 2015).

⁴ Yee release, “CA Controller Calls for Major BOE Reform” (Mar. 31, 2017).

⁵ Ashton, “Board Member Asks Jerry Brown to Take Over Troubled California Tax Collection Agency,” *Sacramento Bee*, Mar. 29, 2017.

The BOE administers tax and fee programs in four general areas: (1) sales and use taxes, (2) property taxes, (3) special taxes, and (4) the tax appellate program. The tax and fee programs administered by the BOE generated \$60.5 billion in revenue for fiscal 2014-2015. Sales and use tax activities accounted for \$52.1 billion of that figure.⁶

The BOE is the only elected tax commission in the United States and consists of four elected members and the state controller. Each elected member represents an equalization district encompassing approximately the same population size, and the controller represents the state at large. Among its responsibilities, the BOE acts as the appellate body for appeals from various business tax assessments, FTB actions, and public utility assessments.⁷ The FTB audits and assesses California income tax, making the BOE the only administrative appeal option for challenging the FTB's actions.

In making the BOE the final word on administrative tax appeals, California is one of a diminishing number of states that do not afford taxpayers a hearing before a person who is both knowledgeable about state taxes and independent from the administrative bodies responsible for raising state revenues. Rather, a taxpayer that is assessed additional tax in California has no opportunity to have its case heard before any independent body before filing a judicial appeal in California Superior Court.⁸ Moreover, to file such a suit, the taxpayer must first pay the full amount of the disputed tax and seek a refund.⁹ In both these regards, California is increasingly an outlier among the states.

More than half of the states provide taxpayers with an opportunity for a hearing before a person who is both knowledgeable about state taxes and independent from the administrative bodies responsible for raising state revenues.¹⁰ Of the

states that do not provide such an opportunity, fewer than 10 (including California) further require that the amount of tax in dispute be paid prior to seeking a judicial appeal.¹¹

To the extent that the recently released BOE audit report provides the impetus for California to reform its tax administration, lawmakers should consider creating an independent tax tribunal to hear taxpayer appeals prior to payment of the disputed tax. Such a reform would increase public confidence in the fairness of the California tax system.

The Model State Administrative Tax Tribunal Act, adopted by the American Bar Association in 2006, could provide a template for California in establishing an independent tax tribunal.¹² We have long been advocates of independent tax tribunals, and one of the coauthors of this article, Craig B. Fields, was chair of the ABA task force that drafted the model act. The goal of the act is to guarantee that every taxpayer who receives a state tax assessment gets (1) a *de novo* hearing of record (2) before paying the tax (3) from a tax expert (4) who is independent from the tax collector.¹³

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The model act provides that the taxpayer or the state tax collecting department "shall be entitled to judicial review of a final decision of the Tax Tribunal . . . in accordance with the procedure for appeal from a decision of a [general trial] court."¹⁴ This provision makes clear that a hearing before the tribunal is the hearing of record inasmuch as it provides for a direct appeal of the tribunal's decisions in the same manner as those of the state's regular trial courts. Moreover, the act ensures that the hearing occurs before the payment of tax is due when it states that every

⁶ 2017 Report, *supra* note 1, at 1.

⁷ *Id.* at 2, 4.

⁸ Cal. Rev. & Tax. Code section 19045 (stating that a taxpayer's sole appeal right from an action of the FTB, other than a judicial appeal, is to the BOE).

⁹ Cal. Rev. & Tax. Code section 19382.

¹⁰ See, e.g., Mass. Gen. Laws ch. 58A, section 1; N.Y. Tax Law sections 2002, 2006; and Or. Rev. Stat. section 305.501.

¹¹ See, e.g., Fla. Stat. section 72.011(3); Okla. Stat. Ann. tit. 68, section 226; and Utah Code Ann. section 59-1-611(2).

¹² American Bar Association, Model State Administrative Tax Tribunal Act (2006).

¹³ Garland Allen and Fields, "The Model State Administrative Tax Tribunal Act: Fairness for All Taxpayers," 10 *State and Local Tax Lawyer* 83 (2005).

¹⁴ Model Act, *supra* note 12, at section 15(a).

“taxpayer shall have the right to have his case heard by the Tax Tribunal prior to the payment of any of the amounts asserted as due . . . and prior to the posting of any bond.”¹⁵

The model act ensures that tribunal judges are tax experts when it states that every judge, at the time of his or her appointment, must have “substantial knowledge of the tax law and substantial experience making the record in a tax case suitable for judicial review.”¹⁶ Finally, the act provides that the tribunal “shall be separate from and independent of the authority” of the state taxing authority.¹⁷ This provision provides the legal separation between the tribunal and the state’s tax collecting department that is key to ensuring the fairness of the proceeding. These four provisions serve to achieve the primary goals of the model act.

The benefits of establishing an independent tax tribunal similar to the one described in the model act are real and substantial, as evidenced by an increasing number of states in recent years that have embraced the primary goals of the act by establishing their own independent tax tribunals.¹⁸ State tax systems depend on voluntary compliance. If taxpayers do not believe that state tax administration is fair, they will be less likely to voluntarily comply. Not permitting a taxpayer an opportunity to appeal its case to a person both knowledgeable of the state tax law and independent of the state’s tax collecting departments prior to being required to pay the amount of disputed tax creates, at a minimum, the perception of unfairness. In fact, in one instance, tax scholars stated that a law requiring taxpayers to pay the disputed tax before trial “amounted to a human rights violation because it did not recognize the ‘presumption of innocence’ principle.”¹⁹ Establishing an independent tax tribunal similar to the one described in the model act increases taxpayers’ belief in the fairness of the

state’s tax system and, therefore, makes it more likely that they will voluntarily comply with the state’s tax laws.

At a time when corruption and mismanagement at the BOE is on full public display and California leaders are starting to draw attention to these issues, restoring confidence in the fairness of California’s tax administration should be a top priority for would-be reformers. Establishing an independent tax tribunal for California is the type of good government reform that would make substantial progress toward achieving this important goal. It is time for California to do the right thing — the model act is a ready-made template from which to start. ■

¹⁵ Model Act, *supra* note 12, at section 7(c).

¹⁶ Model Act, *supra* note 12, at section 4(a).

¹⁷ Model Act, *supra* note 12, at section 2(b).

¹⁸ See, e.g., Ala. Code section 40-2B-1 (effective Oct. 1, 2014); 35 Ill. Comp. Stat. 1010/1-5 (effective Aug. 28, 2012); and La. Rev. Stat. Ann. section 47:1401 (effective June 12, 2014).

¹⁹ Freddy Karyadi, “Indonesia Enacts Law Creating New Tax Court,” *Worldwide Tax Daily*, June 11, 2002.