

A Tax Tribunal for California – Independence Day Aspirations

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In this edition of From the Front Lines, Fields, Newmark, and Gibilaro praise California's creation of the Office of Tax Appeals, an independent tax tribunal, but say there is still work to be done to restore the full confidence of taxpayers in the fairness of California's tax administration.

Following controversial developments at the California State Board of Equalization and the efforts of California leaders to reform the state's tax administration, we recommended that California consider creating an independent tax tribunal to hear taxpayer appeals and identified the Model State Administrative Tax Tribunal Act (the Model Act) as a ready template to create such

a tribunal.¹ After such developments, California Gov. Jerry Brown (D) signed legislation on June 27 that redistributes most of the BOE's powers and duties, including vesting the former powers and duties of the BOE to hear taxpayer appeals not constitutionally required to be heard by the BOE in the newly created Office of Tax Appeals (OTA).²

In creating the OTA, the California State Legislature declared that "California taxpayers are entitled to a tax administration and appeals process that is fair, transparent, consistent, equitable, and impartial" and that "taxpayers deserve to have appeals considered by an independent, objective panel with sufficient expertise and a sole focus on tax issues."³ We agree, as we have been longtime advocates of independent tax tribunals, and one of the coauthors of this article, Craig B. Fields, was chair of the American Bar Association task force that drafted the Model Act.⁴ Therefore, we thought it would be useful to compare the powers and duties of the new OTA with the Model Act and recommend some additional reforms that California leaders aspiring to restore confidence in California's tax system may consider enacting.

I. The Office of Tax Appeals

The OTA was established effective July 1, 2017, and will begin to conduct tax appeals effective January 1, 2018. Nearly all the former duties, powers, and responsibilities of the BOE to conduct tax appeals, including conducting appeals regarding personal and corporate income tax, as

¹ Craig B. Fields, Mitchell A. Newmark, and Eugene J. Gibilaro, "California Tax Reform? Consider an Independent Tax Tribunal," *State Tax Notes*, May 8, 2017, p. 555.

² A.B. 102, 2017-2018 Leg., Reg. Sess. (Cal. 2017).

³ *Id.*, section 2(a)-(b).

⁴ Model State Administrative Tax Tribunal Act (American Bar Association 2006).

well as sales and use tax, are vested in the OTA. By January 1, 2018, the OTA is required to adopt regulations that are necessary and appropriate for conducting tax appeals in accordance with the purposes of the new law. The OTA will be under the control of a director, who is appointed by the governor and subject to confirmation by the Senate.⁵

Within the OTA, there will be established tax appeals panels consisting of three administrative law judges designated by the director. One news outlet reports that the ALJs will be hired through “a competitive civil service process.”⁶ Each ALJ must be an active member in the State Bar of California for at least five years immediately preceding her designation to a tax appeals panel, have knowledge and experience regarding the administration and operation of the tax and fee laws of the United States and of California, and subscribe to California’s Code of Judicial Ethics for the conduct of judges.⁷ In accordance with our recommendation, regulations adopted by the OTA in connection with regulating the conduct of the ALJs, to the extent possible, “shall be consistent with . . . [t]he Model State Administrative Tax Tribunal Act dated August 2006 adopted by the American Bar Association.”⁸

II. The Model Act

The Model Act was adopted by the ABA in 2006 with the goal of guaranteeing that every taxpayer who receives a state tax assessment (1) gets a *de novo* hearing of record, (2) before paying the tax, (3) from a tax expert, (4) who is independent from the tax collector.⁹ We consider below the progress that California has made toward achieving each of those goals through the creation of the OTA.

A. De Novo Hearing of Record

The Model Act requires that tax appeals before the tax tribunal be *de novo* (that is, the actions of the tax collection agencies are reviewed anew) and be the hearing of record (that is, the level of the case in which the written record is made, questions of fact are decided, and all evidence is preserved). The Model Act 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.¹⁰ While the review by the OTA appears to be *de novo*, a taxpayer appealing a decision of the OTA may appeal the decision only to California Superior Court, where the standard of review is also *de novo*.¹¹ Therefore, by providing only for appeal to California’s trial court for *de novo* review of an OTA decision, it does not appear that OTA hearings are hearings of record. As discussed in more detail below, the problem if the official hearing of record occurs at the superior court is that taxpayers are required to pay the amount of tax in dispute before appealing to the superior court, and trial court judges in the superior court are not required to have specialized tax knowledge. To bring the OTA more in accord with the Model Act, California reformers could consider designating the OTA as the official hearing of record in a tax appeal and provide appeal rights from a decision of the OTA directly to California’s appellate courts. That would ensure that the hearing of record occurs before an independent decision-maker knowledgeable of the tax laws before the taxpayer being required to pay the amount of tax in dispute.

B. Before Payment of Tax

The new law does not require taxpayers to pay the amount of tax in dispute before a hearing before the OTA. The Model Act ensures

⁵ A.B. 102, *supra* note 2, section 13.

⁶ Patrick McGreevy, “In Massive Shakeup, Gov. Jerry Brown Breaks Up California’s Scandal-Plagued Tax Collection Agency,” *Los Angeles Times*, June 27, 2017.

⁷ A.B. 102, *supra* note 2, section 13.

⁸ *Id.*

⁹ Garland Allen and Fields, “The Model State Administrative Tax Tribunal Act: Fairness for All Taxpayers,” 10 *The State and Local Tax Lawyer* 83 (2005).

¹⁰ Model Act, *supra* note 4, section 15(a) (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”).

¹¹ A.B. 102, *supra* note 2, section 13 (stating that the person appealing an OTA decision “may appeal the decision of the tax appeals panel to the superior court in accordance with the law imposing the tax or fee. The standard of judicial review to be applied by the superior court shall be reviewed *de novo*”).

that the hearing occurs before the payment of tax is due when it states that every “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.”¹² Therefore, the creation of the OTA appears to achieve the goal of ensuring a hearing before the payment of the disputed tax is required. However, as discussed above, hearings before the OTA do not appear to be hearings of record. Moreover, despite the new law, it appears that the hearing of record in a California tax appeal continues to occur in the superior court, where the taxpayer must first pay the full amount of the disputed tax and seek a refund.¹³ California remains one of a shrinking minority of states where a taxpayer’s official hearing of record in an appeal is both before a trial court judge not required to have specialized tax knowledge and occurs only after the taxpayer has been required to remit the full amount of disputed tax to the state. However, the new law only provides appeal rights from the OTA for the person appealing to the OTA (that is, the taxpayer). Therefore, if the taxpayer wins at the OTA, then the OTA hearing was the hearing of record.

California tax reformers could remedy the potential issue by repealing the state’s pay-to-play rule, which requires the amount of tax in dispute to be paid before the appeal to the superior court. Doing so would ensure that, at a minimum, a taxpayer would have the opportunity to have its hearing of record before being required to pay the amount of tax in dispute. That kind of reform would serve to increase taxpayer confidence in the fairness of California’s tax appeals process by removing the “guilty until proven innocent” perception by some taxpayers of the current appeals process because of the state’s pay-to-play rule.

C. Decision-Makers Are Tax Experts

ALJs at the OTA will be required to have “knowledge and experience with regard to the administration and operation of the tax and fee

laws of the United States and of [California].”¹⁴ The Model Act ensures that tribunal judges are tax experts when it states that every judge, at the time of his appointment, must have “substantial knowledge of the tax law and substantial experience making the record in a tax case suitable for judicial review.”¹⁵ Inasmuch as ALJs at the OTA are only required to have “knowledge and experience,” not the “substantial knowledge” and “substantial experience” required by the Model Act, it remains to be seen whether that difference in wording regarding the knowledge and experience requirements proves to be meaningful. The OTA could promulgate regulations further detailing what it considers to be sufficient tax knowledge and experience for an ALJ. We recommend considering 10 years of experience in tax issues as a proxy for ensuring that an ALJ is conversant in the issues. The goal of the Model Act is for taxpayers to have an opportunity to have their case heard by an independent tax expert. In promulgating regulations regarding the qualifications for ALJs, due process would be well served by having seasoned professionals as OTA judges.

D. Independent Decision-Maker

The creation of the OTA is a step in the right direction for California regarding ensuring that decision-makers hearing tax appeals are independent from the administrative bodies responsible for raising state revenue. The new law removes the responsibilities of hearing tax appeals from the BOE, an administrative body responsible for raising state revenue, and places those responsibilities in the OTA, which exists for the exclusive purpose of conducting tax appeals. The Model Act provides a separation between the tribunal and the state’s tax collecting department that is key to ensuring the fairness of the proceeding by stating that the tribunal “shall be separate from and independent of the authority of the [commissioner of revenue] and the [department of revenue].”¹⁶ The legal separation between the OTA and California’s tax collecting

¹² Model Act, *supra* note 4, section 7(c).

¹³ Cal. Rev. & Tax. Code section 19382.

¹⁴ A.B. 102, *supra* note 2, section 13.

¹⁵ Model Act, *supra* note 4, section 4(a).

¹⁶ Model Act, *supra* note 4, section 2(b).

agencies likewise steers the process toward ensuring the perception of fairness of proceedings before the OTA.

III. Conclusion

In sum, it remains too early to determine whether the creation of the OTA represents a significant reform of California's tax appeals process. As of this writing, Brown has not yet appointed a director for the OTA, and the identities and qualifications of the ALJs are not yet known. We expect that the regulations forthcoming from the OTA within the next six months should begin to give taxpayers a better sense of how the OTA will function in practice.

Nonetheless, based on a review of the new law creating the OTA, it appears that the OTA represents an improvement over the old BOE as an administrative tax tribunal, inasmuch as it achieves more of the goals of the Model Act than the old BOE. Most significantly, the old BOE was both a tax collector and a tax appeals adjudicator, whereas the OTA will be separate from and independent of California's administrative bodies responsible for raising state revenue. We recommended previously that establishing an independent tax tribunal for California in accordance with the Model Act would make substantial progress toward restoring the confidence of taxpayers in the fairness of California's tax administration.¹⁷ As discussed above, there is still work to be done and additional changes that could be considered by reformers aspiring toward that goal (particularly regarding California's pay-to-play rule). However, the creation of the OTA appears to be a good start to doing the right thing. ■

¹⁷ Fields, Newmark, and Gibilaro, *supra* note 1, at 557.

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