

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Burton Analyst: John Pavalasky Bill Number: SB 1424

Related Bills: See Legislative History Telephone: 845-4335 Amended Date: March 24, 2004

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: California Tax Court

SUMMARY

This bill would create the California Tax Court (CTC) to hear and determine taxpayer appeals from deficiency assessments made by the Franchise Tax Board (FTB), Board of Equalization (BOE) sales and use tax determinations, and specified insurance tax determinations made by the Department of Insurance (DOI).

SUMMARY OF AMENDMENTS

The March 24, 2004, amendments struck out the previous provisions of the bill and inserted the provisions discussed in this analysis.

PURPOSE OF THE BILL

The bill would contain legislative intent language stating that it is the intent of the Legislature to create a tax court that will ensure fair and equal treatment for similarly situated taxpayers and to provide a legal forum for resolution of tax disputes that are consistent with federal tax resolution procedures.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and apply to appeals of FTB deficiency assessments filed on or after January 1, 2005. This bill would not impact appeals of FTB deficiency assessments filed before that date.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the policy concerns discussed in this analysis.

ANALYSIS

This analysis is limited to the provisions of the bill that relate to the FTB.

Board Position:

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Department Director

Date

Gerald H. Goldberg

4/13/04

FEDERAL/STATE LAW

Current Federal Law

Under federal law, in general, taxpayers may petition the Tax Court to redetermine deficiency assessments proposed by the Internal Revenue Service (IRS). This redetermination is a de novo (new) trial. Either party may appeal an adverse Tax Court determination to the federal appellate courts. However, for the taxpayer to appeal, a bond must be posted (not in excess of double the amount of deficiency at issue).

In lieu of petitioning the Tax Court to redetermine a deficiency, the taxpayer may pay the tax and file a claim for refund with the IRS. Assuming the IRS denies the claim for refund, the taxpayer may bring a lawsuit in federal district court or the U.S. Court of Federal Claims for the recovery of the amount paid (suit for refund). The action is a de novo trial. Either party may appeal an adverse court determination to the federal appellate courts.

Current California Law

FTB is a three-member board that is chaired by the State Controller. The other two board members are the Chair of the BOE and the Director of the Department of Finance (DOF).

In general, taxpayers may appeal to the BOE after the FTB has taken the following actions:

- Denied a taxpayer's protest of a proposed deficiency assessment;
- Denied a refund or credit or loss carryover claimed by the taxpayer; or
- Denied a taxpayer's request for abatement of interest on a deficiency owed by the taxpayer.

BOE's determination on an appeal from an action of the FTB is final unless within 30 days of the determination, the FTB or taxpayer petitions for a rehearing. In the event the petition is granted, BOE's determination becomes final upon the expiration of 30 days from the day BOE issues its opinion on the petition. FTB lacks statutory authority to file a lawsuit in superior court if it loses at the BOE.

If BOE sustains FTB's action on a protest of a proposed assessment, thereby ruling against the taxpayer, the taxpayer may pay the tax and file a claim for refund with FTB. If FTB denies the claim for refund, the taxpayer may either:

- bring a lawsuit in superior court against FTB for the recovery of the amount paid (suit for refund), or
- file an appeal with BOE. If BOE denies the appeal, the taxpayer may bring a lawsuit for refund in superior court against FTB.

In the lawsuit for refund, the AG is the attorney of record for the state. The action is a de novo trial.

"De novo trial" means trying a new matter-- trying it as if it had not been heard before and as if no decision had been previously rendered. California Superior Courts sometimes are authorized by law to act provide appellate review of an administrative adjudicatory action.

The California Constitution prohibits legal or equitable action in any court to prevent or enjoin the collection of any tax. After payment of tax, an action in court may be maintained to recover the tax paid, with interest. In one unique situation California law allows taxpayers to bring a lawsuit in superior court to determine residence prior to payment of a deficiency based on residence.

THIS BILL

This bill would create the CTC that would, in a trial de novo, replace the BOE as the body to hear and determine taxpayer disputes of proposed deficiency assessments made by the FTB, as well as specified determinations of the BOE and the DOI. It also would allow, at the election of the taxpayer, the CTC to hear and determine taxpayer appeals from claims for refund of taxes denied by FTB after the taxpayer pays the tax assessed. This bill would retain the current law alternative for taxpayers to pay the tax and file a suit for refund in the superior court.

The court would include five judges, appointed by the Governor and confirmed by the Senate. The court would be an administrative court independent from the BOE and FTB. The terms of appointment of each of the five judges would be 12 years except that terms of judges initially appointed after enactment would be four, six, eight, 10, and 12 years, respectively. Each judge is required to be selected on the basis of his or her qualifications, knowledge, and experience in the administration and application of the tax laws of California and of the United States. In addition each judge must be a resident of California, a citizen of the United States, licensed as an attorney and, for at least five of the past 10 years, have been engaged in the active practice of law (governmental or private) with a primary focus on taxation.

Each case would be handled by a single judge. At the request of the chief judge or a majority of the other judges, the full court would decide a particular case.

The CTC would publish final decisions so designated by the judges as having precedential value and the balance would be unpublished.

The CTC would be allowed to establish streamlined hearing processes for tax deficiencies and claimed refunds that are \$10,000 or less.

Petitions for hearing before the CTC would be filed after a proposed assessment was affirmed by the FTB but taxpayers would not be required to pay the tax before filing the appeal with the CTC.

Both the taxpayer and FTB would be allowed to appeal decisions of the CTC to the Court of Appeal.

This bill would eliminate provisions of existing law that allow a taxpayer to bring an action in superior court to determine residency prior to payment.

TECHNICAL CONSIDERATIONS

As amended, sections in the Revenue and Taxation Code now have references to "petitions for rehearing" and "petitions for reconsideration" but they both refer to the same thing -- a review of the CTC decision by the CTC. The language should be amended to be consistent.

In addition, on page 13, line 22, the unnecessary word "Tax" should be struck-out.

LEGISLATIVE HISTORY

SB 548 (Burton, 2003/2004) would allow FTB to appeal adverse BOE actions to the superior court for de novo trial and is currently in the Assembly Revenue and Taxation Committee.

AB 2472 (Wolk, 2003/2004) creates a California Tax Court with provisions similar to this bill and is currently in the Assembly Revenue and Taxation Committee.

ACA 22 (Dutra, 2003/2004) would create the California Tax Board that would continue BOE duties as well as administer income taxes and is currently in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. The tax appeals systems for each of these states are different from one another and also different from California's tax appeal system as follows:

Florida taxpayers may challenge adverse determinations of the Department of Revenue (DOR) either to the:

- Circuit Court, which conducts a de novo trial, and the decisions of which can be appealed by either party to the appellate court of Florida; or
- Division of Administrative Hearings (DOAH), which conducts a de novo hearing, but has the authority to issue only proposed orders. The final order is written by DOR. Hence, only the taxpayer may appeal adverse decisions to the appellate court of Florida. However, either party may appeal adverse appellate court decisions to the Florida Supreme Court.

Illinois taxpayers may challenge adverse determinations of the DOR in Circuit Court by:

- Paying the tax under protest and bringing an action, which is conducted as a de novo trial; or
- Requesting the court to review the Department's final determination, which is limited to the record. Either party may appeal adverse decisions to the appellate court of Illinois.

Massachusetts taxpayers may challenge adverse determinations of the DOR by appealing to the Appellate Tax Board, which conducts a de novo hearing. Either party may appeal adverse decisions to the appellate court of Massachusetts.

Michigan taxpayers may challenge the determination of the Commissioner of Revenue by filing a petition with the Michigan Tax Tribunal or by filing a claim for refund with the Michigan Court of Claims. These forums conduct de novo proceedings. Either party may appeal adverse decisions to the appellate court of Michigan.

Minnesota taxpayers may challenge the DOR's determination in Minnesota Tax Court or file a refund suit in District Court. Both of these courts conduct de novo trials. Either party may appeal an adverse determination of the Tax Court to the Minnesota Supreme Court. Adverse determinations of the District Court are appealed to the appellate courts of Minnesota.

New York taxpayers may challenge determinations of the Department of Taxation and Finance by filing a petition with the Division of Tax Appeals, which provides a de novo hearing by an administrative law judge. Either party may challenge an adverse decision to the Tax Appeals Tribunal, which conducts a de novo hearing based on prior evidentiary record. Only taxpayers can appeal adverse Tribunal decisions to the appellate court of New York.

FISCAL IMPACT

Departmental Costs

The departmental costs for appeals from FTB actions being adjudicated by the CTC instead of the BOE are estimated to be minor and would be accommodated within FTB's existing departmental budget. Assuming that fewer than 10 additional actions (FTB appealing adverse CTC decisions to the Court of Appeal) might be brought each year under the authority of this bill, the additional workload costs are unknown but expected to be similar to the current costs associated with de novo trials in Superior Court.

This bill could result in an increase in the workload of the Office of the Attorney General from representing the FTB before the Court of Appeal.

ECONOMIC IMPACT

Revenue Estimate

The potential revenue effects of this bill are unknown. It is speculative whether decisions of the proposed tax court would be any different than that of the BOE.

ARGUMENTS/POLICY CONCERNS

1. Unlike current law, this bill would allow "pre-payment access" to the CTC and the Court of Appeal. "Pre-payment access" means that the taxpayer may appeal the FTB's action prior to being required to pay the tax. Current law allows pre-payment access to the BOE but requires payment of the tax if the BOE sustains FTB's action on a protest of a proposed assessment. Thus, under current California law, in order to litigate the issue in court, the taxpayer may proceed only after having paid the tax. Under the federal Tax Court system, for the taxpayer to appeal an adverse decision to the federal appellate court, a bond (up to double the amount of the deficiency at issue) must be posted. As a preferable policy, the author may wish to consider requiring payment of the tax prior to an appeal to the Court of Appeals or paralleling the federal Tax Court practice more closely by requiring a bond to stay assessment and collection pending appeal of a CTC decision.
2. The bill would provide that if the taxpayer receives an adverse CTC decision, the taxpayer may proceed in court only through an appeal of that decision to the Court of Appeal. That is, a suit for refund may not be filed in superior court. However, it does not appear that the bill prevents a taxpayer that receives an adverse CTC decision on a protest of a proposed assessment from paying the tax, filing a claim for refund, and then appealing the FTB's denial of that claim for refund to the CTC. The author may wish to consider making the first CTC decision binding regarding any subsequent CTC action.
3. The bill would limit the CTC proceedings to the grounds raised in the claim, which is the current standard for lawsuits and generally for BOE; however, CTC appeal proceedings are not specifically limited to the grounds raised in the protest. The author may wish to consider limiting the CTC proceedings for both appeals and claims to the grounds raised in the protest or claim.

LEGISLATIVE STAFF CONTACT

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