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NEWS RULINGS VERDICTS

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California on the brink of fixing its broken tax system

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Gov. Jerry Brown and the California Legislature are set to enact sweeping changes to California's tax system. In response to widespread and long-standing criticisms of the 138-year-old State Board of Equalization, Assembly Bill 102 and Senate Bill 86 - the Taxpayer Transparency and Fairness Act of 2017 - will establish two new agencies to take over many of the board's functions. The new law will be effective July 1. However, most taxpayers will not enjoy the new system's benefits until Jan. 1, 2018. That interim period will allow the new agencies to get organized and issue regulations describing how taxpayers may take advantage of them.

The two bills recite some of the discontent with the present system: The board's "current practices support inappropriate interventions by board members in administrative and appeal-related activities, all of which have led to inconsistencies in operations, breakdowns in centralized processes and activities contrary to state law and budgetary and legislative directives"; "[t]he current operational environment has also led to numerous complaints concerning [board members'] and their staff's attempt to influence the audits, investigations and collection activities of the board's civil service employees"; "[t]he [board's] civil service employees, who seek to professionally perform their duties according to the law, are handicapped in their efforts to fairly apply the law through the undue influence of elected board members and [their] staff."

Of the two new agencies, for tax lawyers the more important of the two may be the new Office of Tax Appeals. It will consist of three administrative law judges who will sit as a panel to hear sales and use tax, special taxes and fees and income tax appeals. This will eliminate California's sorry distinction as the only state in the country which uses elected officials to resolve tax disputes between taxpayers and the state. The OTA, selected by the governor, will select the judges. For some observers that leaves open the possibility of political influence. However, the judges will be civil service employees, which should protect them from political pressure. The judges will hear cases at three locations: Sacramento, Fresno and Los Angeles. One of the biggest improvements over the existing system is that each decision of the three-judge panel will be followed, within 100 days, by a written opinion. For lawyers who try to advise clients about the law, that is an important, welcome development: we will be able to find, and cite, precedent.

For purposes of the new OTA, "appeal" includes any of the following: (i) a petition, including one for redetermination; reassessment; or reconsideration of successor liability; or for rehearing; (ii) administrative protest; (iii) claim, including for a refund; (iv) appeal from a Franchise Tax Board action; (v) application for an administrative hearing; and (vi) any other item that may be scheduled for a hearing, including requests for relief of taxes, fees, interest or penalties.

The new California Department of Tax and Fee Administration will take over most of the board's other duties. The governor will appoint the executive director, who will also require Senate confirmation. The governor will also appoint a deputy director and chief counsel.

With the transfer to the new DTFA of all but the board's constitutional functions, where does that leave the State Board of Equalization? It will only have the following duties: (i) review, equalization or adjustment of a property tax reassessment; (ii) measurement of county assessment levels and secured local assessment rolls for property tax purposes; (iii) the assessment of pipelines, flumes, canals, ditches and aqueducts lying within two or more counties, etc.; (iv) assessment of taxes on insurers; and (v) assessment and collection of excise taxes on the manufacture, etc., of alcoholic beverages. In other words, the new legislation will make the State Board of Equalization a mere shadow of its former self. And that is the motivation behind the new legislation.

Some legislators have suggested that the new rules are being rushed through to meet the deadline for the state budget for the next fiscal year. In response to that criticism, supporters have argued that the ideas manifested in the new legislation have been around for decades, and that recent criticism of the board demonstrates, once again, that the current system is broken.

As we suggested in our May 16 article titled "California Needs to Create a Court Devoted to Tax," most tax lawyers who struggle to represent clients in California will welcome the new system. The old system was sometimes unresponsive to taxpayers. That was not due to a lack of good faith by the Franchise Tax Board's excellent employees. That was due to the fact that California taxpayers, if they disagree with an FTB determination, must file a refund claim and, when it is rejected, must sue for a refund. That means that, structurally, the Franchise Tax Board has no incentive to settle. Why? Because taxpayers must sue for a refund, and the FTB is not worried about having refund cases clog the 1,500 superior courts. Contrast that with the federal tax system in which there are only 19 Tax Court judges for the entire U.S. and taxpayers can sue for a refund *without paying the tax*. Now, with one three-judge panel for all of California, the threat of clogging up one court, which must issue a written opinion within 100 days of hearing a case, should create pressure on the FTB to offer, and enter into, reasonable settlements taking into account the "hazards of litigation." That will make the state system fairer and more responsive to taxpayers.