

**Morrison & Foerster LLP
1290 Avenue of the Americas
New York, New York 10104
(212) 468-8193**

**Law Office of Garland Allen
2722 Washington Avenue
Santa Monica, California 90403
(310) 260-1288**

May 27, 2009

Via E-Mail

The Honorable Members,
California Commission on the 21st Century Economy
915 L Street, 8th Floor
Sacramento, California 95814

Re: California Should Abolish "Pay-to-Play" and
Create an Independent Tax Tribunal or Court

Dear Commissioners:

At Commissioner Richard Pomp's invitation, the principal authors of the American Bar Association's *Model State Administrative Tax Tribunal Act* submit this letter to urge you to include reform of California's present system for adjudicating tax controversies in your Final Report.

Summary

In 1992, distinguished UCLA Law School Professor Michael Asimow, an expert on California administrative law, observed: "[T]o put it charitably, California's present arrangement for adjudicating tax cases is a patchwork that can only be understood as a series of historical accidents; to put it less charitably, the system is a mess." Things have not improved in the last 17 years, and California still finds itself among a steadily decreasing minority of states that place responsibility for collecting taxes and adjudicating tax disputes in the hands of the same agency.

Taxpayers have two basic concerns when it comes to the adjudication of their tax disputes: they want (1) the ability to contest alleged deficiencies without the heavy burden of prepaying the tax, a requirement commonly referred to as "pay-to-play," and (2) due process in the form of a fair, impartial, tax-expert forum for adjudicating their state tax disputes.

The Honorable Members
California Commission on the 21st Century Economy
May 27, 2009
Page Two

The time has come for California to get rid of “pay to play”—the requirement that in order to go to court, the taxpayer must pay the tax liabilities in issue. It is also time for California to create a fair tax adjudication forum—a tax tribunal or court that is both independent of the state’s tax collecting agencies and staffed with real tax expertise, to handle the often complicated tax issues that now face individuals and businesses across the state.

As California tax controversy expert Robert R. Rubin of Sacramento colorfully summed up in his March 10 testimony before the Commission: “Well, if you recommend a new tax structure and keep the old dispute system, it would be like putting a Prius engine into a Ford Pinto. It wouldn't make any sense at all.”

Who We Are

The undersigned are co-authors of the American Bar Association’s *Model State Administrative Tax Tribunal Act*. Developed over a period of 4 years by the ABA Section of Taxation’s State and Local Tax Committee, the Model Act was the product of input from leading state and local tax litigators, state and local tax accountants and accounting firms, state tax department officials, state tax judges, taxpayer organizations, organizations of taxing officials, and academics. After thorough review by the ABA Section of Taxation, the ABA’s House of Delegates adopted and recommended the *Model Act* to the states at its August, 2006, meeting.

Under the *Model Act*, every taxpayer who receives a state tax assessment has the right, prior to paying the disputed tax, to obtain a hearing of record (“of record” meaning that the taxpayer creates at that hearing the fact and legal record that will be reviewed by the courts if the case is not resolved at the tribunal level) before a judge who has tax expertise and who is completely independent from the revenue department. While the *Model Act* provides a legislative template for accomplishing these goals as well as improving the state dispute resolution process generally, the Report accompanying the model legislation explains that the ABA’s main purpose is to encourage states to assure state and local taxpayers the availability of a hearing of record before a tax expert body that is completely separate from the tax collectors and to eliminate “pay-to-play.” A copy of the *Model Act* and Report as adopted by the ABA is attached.

The undersigned brought to the task of drafting the *Model Act* years of personal experience in the resolution and litigation of tax disputes before numerous state and local revenue departments, independent administrative tax tribunals and courts, and regular state and federal courts.

Craig Fields is a partner in the New York office of the national law firm of Morrison & Foerster LLP. Over the last 20 years, Craig has litigated hundreds of tax disputes on behalf of individual and business taxpayers before state and local administrative and judicial bodies across

the United States. Craig also writes and speaks extensively on state litigation procedures and other state and local tax topics. His articles have appeared in *The Journal of State Taxation*, *The Journal of Multistate Taxation and Incentives*, *Tax Management's Multistate Tax Report*, *State Tax Notes*, Research Institute of America's *State and Local Taxes Weekly*, the Council on State Taxation's (COST's) *State Tax Report*, *Interstate Tax Report*, and the ABA's *State and Local Tax Lawyer*. Among other venues, Craig has lectured at New York University's Institute on State and Local Taxation, Georgetown University Law Center's Advanced State and Local Tax Institute, Vanderbilt University Law School's Paul J. Hartman State and Local Tax Forum, the Tax Executives' Institute, Practising Law Institute, Tulane Tax Institute, and COST's tax schools.

Garland Allen conducts a legal practice focused on state and local taxation in Santa Monica, California. Before that, Gar spent 28 years representing and advising corporate and individual taxpayers, as leader of the state and local tax practice at the Chicago law firm of Hopkins & Sutter (now part of Foley & Lardner), as partner-in-charge of Coopers & Lybrand's Midwest multistate tax practice, and as Chicago Market Leader and head of Midwest Dispute Resolution in the state and local tax practice of PricewaterhouseCoopers LLP. Gar is also co-author of the American Bar Association's *Model S Corporation Income Tax Act*, adopted by the ABA in 1989, endorsed by the Multistate Tax Commission and the American Institute of Certified Public Accountants, and enacted to date by North Carolina, Alabama, Colorado, Mississippi and Hawaii.

California's Current Tax Dispute Resolution System

Currently, California taxes are administered and collected by various administrative agencies, including the Franchise Tax Board ("FTB"), the State Board of Equalization ("SBE"), and the Employment Development Department ("EDD"). In general, the FTB administers corporate franchise taxes and income taxes, while the SBE administers sales and use taxes, state-assessed property taxes, and a myriad of other "special" taxes (*e.g.*, cigarette taxes, environmental taxes, fuel taxes, and insurance taxes). The EDD primarily administers employment taxes. The SBE (two of whose five members sit on the 3-member FTB) also hears taxpayer appeals of decisions rendered by the FTB on disputes over the taxes it administers.

In general, an aggrieved taxpayer who seeks to appeal a final decision of one of these revenue collection agencies must first pay the tax, and then file a suit for refund in the Superior Court. In other words, unlike federal taxpayers and taxpayers in most other states, California taxpayers must pay their tax before having their "day in court" before a tribunal other than the tax collection agency. This is true regardless of the size or propriety of the proposed liability.

The Honorable Members
California Commission on the 21st Century Economy
May 27, 2009
Page Four

Knowledgeable Commentators Agree That California's Dispute Resolution System Is Broken and Needs Reform

In 2003 the bipartisan California Commission on Tax Policy in the New Economy, established by Governor Davis to review all state tax issues in light of California's changing economy, unanimously endorsed the creation of an independent California tax court modeled on the U.S. Tax Court. The very first reason cited by the Commission was the lack of a sufficient prepayment procedure to contest assessments. The Commission noted that most taxpayers could not afford to "pay-to-play" and thus are "stuck with whatever the SBE or its staff decides." Even the former director of the Multistate Tax Commission, Gene Corrigan, called California's "pay-to-play" system "simply unfair."

In its 2007 survey of state tax appeals and procedural requirements, the Council on State Taxation (COST), a nonprofit trade association of 600 multistate corporations engaged in interstate and international business, ranked California among the 5 least fair states, noting California's pay-to-play rule and lack of an independent non-judicial forum for the adjudication of tax controversies. This was COST's third attempt to objectively analyze state treatment of significant procedural issues that reflect whether states provide fair, efficient, and customer-focused tax administration. All three surveys have placed California's system at the bottom of the rankings.

Distinguished University of California, Davis Law School Professor Daniel Simmons, who in 1978 was Chair of the California Commission on Government Reform ("Post Commission") that examined conforming California's tax code to the Internal Revenue Code, supports the creation of an independent tax tribunal or court. In a comprehensive history and critique of California's tax administration and appeals procedures published in the 2008 edition of the *Santa Clara Law Review*, Professor Simmons recounts more than 40 years of California legislative studies and board and special commission reports that have recommended pulling out the adjudicatory functions of the SBE and putting them into a separate tax court or tribunal.

CFO Magazine's 2009 survey of corporate tax officials asked, "What is your overall impression of the tax environment in this state?" Collectively, these executives ranked California dead last among the states—50th out of 50—on the basis of a "very unfair and unpredictable" tax environment. This has been the pattern over a number of years of such surveys.

In an April, 2009, *State Tax Notes* article, California tax attorney and commentator William Hays Weissman explained why creating an impartial tax adjudication system with tax-trained judges and ending pay to play would meet at least three Commission goals set out in Governor Schwarzenegger's Executive Order S-03-09, dated March 27, 2009:

First, [these reforms] will likely improve California's ability to compete with other states for jobs and investments, because business will likely perceive California as having a more reasonable tax dispute resolution process.

Second, an impartial tax adjudication system reflects sound tax policy and adds more predictability and ease of compliance to tax administration. . . .

Third, there is no question that an impartial adjudication process is both fair and equitable to all parties, even the government. . . .

Taxpayers of all stripes and sizes support the notion of a fair, impartial prepayment forum for contesting taxes. When a tax collection agency also adjudicates the tax, the appearance of a lack of independence is imparted to taxpayers, who view the agency as both the prosecutor and the judge. And where taxes are collected by means of a voluntary self-assessment system—like most of California's—the perception of unfairness risks driving taxpayers, especially individuals and small businesses, to abandon or manipulate that system to the detriment of all.

Neighboring States Have Established Prepayment, Independent, Tax-Expert Forums

Oregon, Washington, Hawaii, and Alaska have all created a tax tribunal or court independent of the revenue department to resolve state tax disputes.

With one exception, all states that have created an independent tax adjudication forum allow taxpayers to access the independent forum without prepaying the tax in dispute.

Conclusion

As stated in the ABA Report accompanying the *Model State Administrative Tax Tribunal Act*:

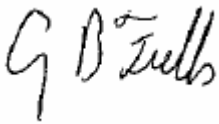
Basic fairness demands that a taxpayer be allowed to make his case against an assertion of tax liability before an independent adjudicatory body with tax expertise. And, except in unusual situations, a taxpayer challenging a tax determination should not be required to pay the amount in dispute, or post a bond, as a condition to receiving an initial hearing before an unbiased, adjudicatory body.

We urge the Commission to recommend these important reforms to the Governor and People of the State of California. While both are important, eliminating pay-to-play as a condition to going

The Honorable Members
California Commission on the 21st Century Economy
May 27, 2009
Page Six

to the Superior Court would be relatively simple and by itself would make a significant contribution to the fairness of California's broken dispute resolution system.

Respectfully submitted,

A handwritten signature in black ink that reads "Craig B. Fields". The signature is written in a cursive style with a large initial "C".

Craig B. Fields

A handwritten signature in black ink that reads "Garland Allen". The signature is written in a cursive style.

Garland Allen

Enclosure: American Bar Association *Model State Administrative Tax Tribunal Act*