

**PROPOSAL FOR HEARING TAX APPEALS
BY INDEPENDENT HEARING OFFICER
IN AN OFFICE OF TAX APPEALS**

Virginia Department of Taxation
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VIRGINIA DEPARTMENT OF TAXATION PROPOSAL TO CREATE AN INDEPENDENT HEARING OFFICER FOR TAX APPEALS

Background: The Governor's Commission on Government Finance Reform for the 21st Century (" the Bliley Commission"), Recommendation No. 12 (Dec. 17, 2001), made one suggestion and one set of recommendations concerning tax appeals. First, it suggested that the timing of a requirement for posting a bond (in lieu of paying the assessment) prior to litigating an assessment in the circuit courts of the Commonwealth be changed to avoid the "Catch 22" where the time period (90 days) may expire before a review by the Tax Commissioner is completed and the result announced. Second, it specifically recommended the introduction of a tax tribunal, wholly independent of the Tax Department, to which judges trained as tax lawyers would be appointed to hear complex tax issues in income and corporate tax cases. Such a tribunal would be dedicated solely to hearing tax cases and the taxpayer would not be required to prepay an assessment before seeking a hearing. The Commission recommended against the addition of another administrative layer in the current system of appeals.

It is clear from these suggestions and recommendations that the Bliley Commission did not address and did not recommend that there be any change to the current requirement for taxpayers to pay the tax first prior to challenging the assessment in the circuit court. It appears that the contention that appeals should be permitted to the circuit court without payment originates from other quarters. For the reasons in Appendix A, the Tax Department opposes any change in the law that would permit an application for correction of an erroneous assessment to be filed in the circuit court without first paying the tax or posting a bond, as the law now requires.

The elimination of the "Catch 22" regarding the posting of a bond can be addressed with a simple change to Va. Code § 58.1-1825 to start counting the 90-day period for the posting of a bond from (1) the date of the assessment, (2) the date of the Tax Commissioner's final determination (Va. Code § 58.1-1822) on an application for correction of an erroneous assessment filed pursuant to Va. Code § 58.1-1821, or (3) the date of the decision of the independent hearing officer (if such a process is established), whichever is later.

The thrust of the second Bliley Commission recommendation is for the creation of an independent hearing tribunal that would not require prepayment of the assessment. Given the current fiscal limitations and the recent inability of proposals for an independent tax tribunal to attract widespread General Assembly support, there appears to be no current interest in supporting the creation of an independent tax tribunal as contemplated by the Bliley Commission. In order to fairly meet the thrust of the Bliley Commission without inordinate cost, the Department of Taxation proposes the creation of a limited

right of appeal to an independent hearing officer located in an Office of Tax Appeals within the Department. A description of the salient features follows.

Qualifications, Selection and Location of Hearing Officer: Consistent with the Bliley Commission recommendation, the Hearing Officer will be an attorney equipped with training or experience as a tax lawyer. Consistent with the qualifications of hearing officers authorized to hear cases under the Virginia Administrative Process Act, the Hearing Officer will be an active member in good standing of the Virginia State Bar, will have practiced law for at least five years and will have completed an appropriate course of instruction or training for hearing officers. The Hearing Officer will be selected by the Tax Commissioner to serve for renewable terms of four years and may be employed on either a full-time or part-time basis, depending upon caseload. The Hearing Officer will be located in the Office of Tax Appeals (to be created, if approved) in the Tax Department.

Limited Right of Appeal to Hearing Officer: Consistent with the Bliley Commission recommendation's focus on complex cases, appeals to the Hearing Officer will be limited to assessments of \$30,000 or more, not including penalty or interest, of corporate or individual income tax, as well as sales and use tax. Based upon cases filed with the Tax Department over the past two years, we expect about 75 cases annually that would meet this threshold. Appeals of assessments less than \$30,000, all offers in compromise and all protective claims will continue to be handled by the current Tax Department Appeals and Rulings section. The Tax Commissioner would be granted authority to set the filing threshold at an appropriate level based upon experience, caseload and other relevant factors.

Subject matter authority of the Hearing Officer would be limited to three state taxes: sales and use; corporate income; and individual income. There would be no appeal to the Hearing Officer of any local tax. The Hearing Officer would not have jurisdiction to decide constitutional issues.

Consistent with the Bliley Commission recommendation to not add another layer to the appeals process, the taxpayer would have the option of choosing which of the administrative appeal remedies it would pursue, either the Tax Commissioner or the Hearing Officer, but the taxpayer could not utilize both remedies. Once one of the administrative remedies is elected, the other is excluded.

Stay of Collection Action During Appeal: While an appeal is before the Hearing Officer, the Department of Taxation will refrain from collecting the tax unless the Tax Commissioner determines the collection of the tax to be in jeopardy. The Tax Commissioner's determination that the collection of the tax is in jeopardy may be challenged by the taxpayer before the Hearing Officer if a proper appeal has been filed with the Hearing Officer.

Taxpayer Representatives: Taxpayers may appear *pro se* before the Hearing Officer or be represented by an attorney licensed to practice law in Virginia, a Certified Public Account licensed to practice in Virginia, or an IRS-certificated Enrolled Agent with an office in Virginia.

Hearing Officer's Decision: The Hearing Officer shall render a decision within 90 days of the conclusion of the hearing (consistent with the Va. APA for hearing officer decisions). The decision shall be reduced to writing and state the facts and law supporting the result. The decision shall take effect 14 days after the date of the decision unless within that time period either the taxpayer or the Tax Commissioner files a notice of intent to appeal the decision.

Relief Granted: The Hearing Officer may grant the same relief currently authorized the Tax Commissioner in Va. Code § 58.1-1822. The Hearing officer may order that the assessment be corrected. If the assessment exceeds the proper amount, the Hearing Officer may order that the applicant be exonerated from the payment of so much as is erroneously or improperly charged, if not already paid into the Treasury, and, if paid, that it be refunded to the taxpayer. If the assessment is less than the proper amount, the Hearing Officer may order that the assessment be corrected and that the taxpayer pay the proper amount of taxes.

Appeal of the Hearing Officer's Decision: The Tax Commissioner has no right of review of the decision and may neither direct nor otherwise interfere with the Hearing Officer's rendering of a decision. Neither may the Tax Commissioner alter the Hearing Officer's decision after it is rendered.

Both the taxpayer and the Tax Commissioner may appeal the Hearing Officer's decision to the circuit court, *de novo*, within one year of the date of the decision. In lieu of an appeal, the Tax Commissioner may, within 45 days of the Hearing Officer's decision, publish a notice of nonacquiescence signaling that the Tax Department, notwithstanding its determination not to appeal the case, does not agree with the holding and will not follow the decision in disposing of cases involving other taxpayers. Absent a published notice of nonacquiescence, the Tax Department will follow the decision in the cases of other taxpayers with the same facts. Hearing Officer decisions will not have retroactive effect for any pending case unless the assessment has been paid and a protective claim has been filed.

Within 30 days of the date of the decision, the Hearing Officer may, in his or her sole discretion, entertain a request for reconsideration filed either by the taxpayer or the Tax Department upon a showing or allegation of (1) new facts not discoverable by the party prior to or during the hearing, (2) legal arguments presented by the party but not considered by the Hearing Officer in the decision, (3) controlling legal authority decided after the Hearing Officer's decision, or (4) a

misapplication of facts or law by the hearing officer. The Hearing Officer must act on the request for reconsideration within 30 days but such period of reconsideration will not extend any other periods of limitations unless the Hearing Officer changes the original decision in some respect.

Exhaustion of Remedies: Once an appeal to the Hearing Officer is initiated by any filing, the taxpayer must exhaust that remedy before appealing the matter to the circuit court, unless the appeal is abandoned at least 21 days prior to the date set for the hearing. If the appeal to the hearing officer is abandoned less than 21 days prior to the date set for the hearing, the taxpayer forfeits the right of appeal to the circuit court.

Statute of Limitations Generally: Currently, Va. Code § 58.1-1821 requires that the application for correction of an erroneous assessment be filed with the Tax Commissioner within 90 days of the assessment. In practice, that 90-day period has not been enforced. Henceforth, the statute of limitations would be enlarged to 120 days but the statute will be enforced unless the Department of Taxation has failed to give the taxpayer notice of the time period with the assessment, and the same 120-day time period will apply to the limited right of appeal to the Hearing Officer. An additional reason for extending the period to 120 days is to allow for an audit "clean-up" process whereby there will be an opportunity to resolve simpler issues before the appeal process begins.

If the taxpayer misses the 120-day statute of limitations for an appeal to the Tax Commissioner or the Hearing Officer without first paying the tax assessed, the taxpayer may avail itself of either of these administrative remedies at any time prior to the expiration of a 270-day statute of limitations from the date of the assessment so long as the tax is paid first.

Procedure: The Tax Department will adopt regulations setting forth the procedure for appeals to the Hearing Officer that will be generally consistent with but not subject to the Va. Administrative Process Act.

Filing fee: Every appeal filed with the Hearing Officer must be accompanied by a nonrefundable filing fee of \$500. Any payment of the filing fee that is dishonored will result in the appeal being deemed not filed. No filing fee will be required for pursuing the current administrative appeal process under Va. Code 58.1-1821.

Confidentiality: The appeal to the Hearing Officer will be subject to the secrecy provisions of Va. Code § 58.1-3, just as appeals to the Tax Commissioner are governed now. The decision of the Hearing Officer will be published in the same manner as are the decisions of the Tax Commissioner on administrative appeals.

Cost: Given the level of complexity anticipated, the expected 75 cases each year may require a full-time hearing officer, but it is possible the caseload could be managed on a part-time basis. Assuming outside hearing officers were used for the limited purpose of determining an estimate of costs, 75 cases would cost about \$187,500 to process, including the costs of the hearing officer and his or her administrative support (\$2,500 per case). The estimated cost to perform this service in house would be:

Hearing Officer	\$90,000	
Paralegal	35,000	
Benefits for both positions @ 25%	31,250	
Subtotal	\$156,250	
CLE, Bar Dues (\$480, \$250)	730	
Office Equipment (computers, etc., one time expense)	\$15,000	
Legal research tools (TAX furnished)	0	
Office supplies	1,500	
Grand Total 1 st Yr.	\$173,480	-37,500 = \$135,980
Subsequent Years	\$158,480 (plus annual increases)	

The Tax Department is unable to bear this additional cost and an appropriation for these amounts would be requested. The appropriation would be offset, in part, by the estimated \$37,500 filing fees collected annually.

Effective Date: The Tax Department is currently heavily involved in converting its legacy computer system to a modern, state-of-the-art system effective in October 2003. Because of the preoccupation with this and other issues relating to the current fiscal crisis and to enable the Department to enact regulations, it is proposed that the effective date for these changes would be July 1, 2004.

Other Issues: The Tax Department has given considerable thought to this proposal but other issues no doubt will emerge that must be addressed. The Department welcomes suggestions for improvement and constructive criticism of the proposal. Public comment may identify the need for additional changes.

Penalties and interest would still be due

APPENDIX A

REASONS FOR CONTINUING "PAY TO PLAY" IN CIRCUIT COURT

1. The requirement to prepay has been in the Code of Virginia since 1980. [Report of Practices and Procedures in the Collection and Administration of State Taxes Study Committee, House Document No. 30, 1980.] Previously, it was the long-standing practice of the Tax Department to insist upon collecting the tax prior to litigation and the circuit courts acceded to the Department's requirement for prepayment of the tax. *Id.*
2. The Bliley Commission did not recommend that the requirement to pay first before going to circuit court be changed (recommended an independent tribunal such as a Board of Tax Appeals or a Tax Court with no prepayment requirement, but did not address payment requirements at the circuit court level).
3. Delay decreases the likelihood of collection; delay can be used to forestall collection action to prevent ultimate payment.
4. Interest earned by the taxpayer on the refund if the tax assessment is determined to be erroneous is generous in today's market.
5. When going to court, the majority rule among the states is "pay first:"¹
 - a. 28 jurisdictions, 27 States and D.C., require payment first before going to court;
 - b. 23 States do not require payment before going to court;
 - c. Among contiguous states, NC, SC, WV require payment, but MD, TN and KY do not.

¹ Federation of Tax Administrators study, *State Tax Appeal Systems*, Appendix Q (August 1994).