

# THE TAX ADVISER

## State Independent Tax Tribunals: A Popular Alternative to Resolving Disputes

STATE & LOCAL TAXES

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The recent trend favoring the creation of independent tax tribunals as a means to resolve state tax issues prior to litigation is a significant development in the area of adjudicating state tax appeal controversies. The use of an impartial, independent forum outside the dominion and control of the state tax authority is often helpful in resolving state tax disputes in a more efficient, streamlined manner by judges possessing state tax expertise, without taxpayers having to prepay the disputed tax. This column examines the origins of the independent tax tribunal, surveys recent developments in this area, and assesses whether more states are likely to follow this trend.

### Background

Taxpayers (and their representatives) often find themselves frustrated in the late stages of an audit if it becomes clear to them that a material tax assessment, with associated interest and penalties, is inevitable. This is particularly true when the position the state tax authority is questioning is strong and the arguments the state tax authority is advancing are not. In those situations, taxpayers must consider their next move, which can vary from state to state. Often, once the assessment is issued, taxpayers may appeal the assessment to the administrative appeals unit within the state tax authority, at which point an informal or formal hearing may be held. In some cases, following the initial assessment, taxpayers can forgo the additional administrative appeal, pay the assessment, and then challenge the decision in court.

Both of these paths are fraught with problems. In the first instance, the administrative appeal is heard by a unit of the state tax authority that just issued the assessment. Typically, it is difficult for taxpayers to obtain relief when they are arguing their case in front of a decision-maker who is part of the same administrative entity as the one that issued the assessment. As for the second alternative, requiring taxpayers to pay the assessment before litigation may be unreasonable. The required payment may be significant, and the typically backlogged trial court, with judges who have no tax background and very little tax experience, means that the dispute may not be resolved in court for several years. That is especially true if the trial court decision is appealed. Compared with the choice of accepting an administrative decision that may merely reflect the position of a state tax authority or waiting a long time for a costly judicial response that may or may not vindicate the taxpayer, alternative methods of dispute resolution have become especially desirable in today's state tax environment.

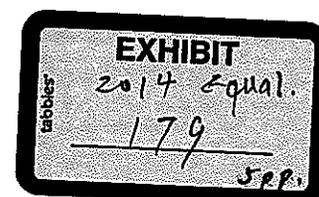
### The ABA Model Act

One of these alternatives is a quasi-judicial forum that is independent from the state tax authority. The 2006 American Bar Association (ABA) Model State Administrative Tax Tribunal Act (Model Act) provides legislative language that is intended to serve as a basis for legislation on this issue in various states. The Model Act was created as a means "[t]o increase public confidence in the fairness of the State tax system" and calls for the development of

an independent agency with tax expertise to resolve disputes between the [department of revenue] and taxpayers, prior to requiring the payment of the amounts in issue or the posting of a bond, but after the taxpayer has had a full opportunity to attempt settlement with the [department of revenue] based, among other things, on the hazards of litigation.<sup>1</sup>

The Model Act requires that the tax tribunal be separate and independent from the state tax authority,<sup>2</sup> and that the principal office of the tax tribunal be located in a building separate and apart from the state tax authority.<sup>3</sup> When hearings of the tax tribunal are held outside of the principal office, they must be held in a place separated from facilities regularly occupied by the state tax authority, again to ensure independence both in fact and in appearance.<sup>4</sup> However, the Model Act intends that the tax tribunal be placed in the executive branch of government, not the judicial branch.<sup>5</sup>

The tax tribunal's jurisdiction is laid out in the Model Act provisions. Generally, the tax tribunal is intended to be the sole authority for the hearing and determination of questions of law and fact



arising under the tax laws of the state (other than through judicial review).<sup>6</sup> The tax tribunal is allowed to decide constitutional questions, but it cannot declare a statute unconstitutional on its face.<sup>7</sup> Taxpayers can separate the constitutional and nonconstitutional issues in order to proceed with constitutional challenges in court.<sup>8</sup> In addition, the Model Act requires the state tax authority to provide an independent administrative appeals function following an assessment and prior to a hearing in the tax tribunal, to dispose of a majority of tax controversies before litigation.<sup>9</sup> The Model Act also provides for a small claims division of the tax tribunal, for controversies of \$25,000 or less.<sup>10</sup>

With respect to procedure, the Model Act provides that the parties should make every effort to conduct discovery informally and should stipulate all relevant and nonprivileged matters where possible.<sup>11</sup> Hearings at the tax tribunal are tried on a *de novo* basis, without a jury.<sup>12</sup> The tax tribunal takes evidence, conducts hearings, and issues final and interlocutory decisions.<sup>13</sup> Hearings are typically open to the public.<sup>14</sup> The tax tribunal is not bound by the civil court rules of evidence, although testimony may be given only on oath or affirmation.<sup>15</sup> Decisions are made in writing and must be rendered no later than six months after the last brief filed following the hearing (or six months after the hearing if no briefs are submitted).<sup>16</sup> The decision of the tax tribunal (other than the small claims division) can be appealed in the same manner as a decision of a general trial court.<sup>17</sup>

The Model Act contains broad rules on who can represent taxpayers at the tax tribunal:

Appearances in proceedings conducted by the Tax Tribunal may be by the taxpayer, by an attorney admitted to practice in this State (including an attorney who is a partner or member of, or is employed by, an accounting or other professional services firm), by an accountant licensed in this State, or by an enrolled agent authorized to practice before the Internal Revenue Service. The Tax Tribunal may allow any attorney or accountant authorized to practice or licensed in any other jurisdiction of the United States to appear and represent a taxpayer in proceedings before the Tax Tribunal for a particular matter. In addition, the Tax Tribunal may promulgate rules and regulations permitting a taxpayer to be represented by an officer, employee, partner or member.<sup>18</sup>

The broad provisions governing the representation of taxpayers parallel the practice within the IRS, the Tax Court, and before most state tax authorities in formal hearings.<sup>19</sup>

#### Status of Independent Tax Tribunals

While the Model Act has been developed as a template for states to follow when considering the creation of an independent tax tribunal, it is not surprising that states vary in their approaches, as they are wont to do in matters of state taxation. And a number of states already had in place one form of tax tribunal or another before the Model Act was finalized. As of June 2013, 31 states and the District of Columbia have adopted some form of independent state tax tribunal or court (either in the judicial or executive branch), in which there is at least some level of independence from the state tax authority, jurisdiction limited to tax matters, published precedents, and judges who are experienced in state tax matters, without the need for taxpayers to pay the assessment before the hearing.<sup>20</sup> The AICPA State & Local Tax Technical Resource Panel developed a summary matrix chart of the current status of state tax tribunals.<sup>21</sup>

In 2012 state legislative sessions, Georgia and Illinois enacted bills to establish independent state tax tribunals. The Georgia tax tribunal legislation, which followed many of the Model Act provisions, began operation on Jan. 1, 2013.<sup>22</sup> While CPAs are not allowed to represent taxpayers in the tax tribunal's main division, Georgia offers a small claims division for tax controversies that do not exceed a certain threshold in which CPAs can represent taxpayers.<sup>23</sup> The Georgia tax tribunal is operational, and the first judge has been appointed.<sup>24</sup>

The Illinois tax tribunal relied on many of the Model Act provisions, though one major departure from the Model Act restricts representation at tax tribunal proceedings to the taxpayer itself or to an attorney admitted to practice in Illinois.<sup>25</sup> The Illinois tax tribunal was scheduled to begin operation on July 1, 2013, but has been delayed to Jan. 1, 2014. So far in 2013, eight states have considered creating a state tax tribunal, though none have adopted them to date.<sup>26</sup> The authors expect this trend of state legislatures considering state tax tribunals to continue into 2014 and future years.

#### The Issue of CPA Representation

With the advent of a new form of dispute resolution that straddles the line between an administrative hearing and a court proceeding, the question of who can represent taxpayers in this forum is important. It is particularly important for taxpayers, who need to know their representation options if they decide to appeal an assessment to a tax tribunal. In addition to the types of representatives who may practice at a tax tribunal, a question has arisen over out-of-

state representatives. As described above, Section 16 of the Model Act provides that a tax tribunal may allow both out-of-state attorneys and accountants to appear and represent a taxpayer in proceedings before the tax tribunal in any matter. When adopting the Model Act, states have typically implemented the provision in a flexible manner, often allowing all out-of-state practitioners to practice in the tax tribunal as a matter of course, which benefits taxpayers who may feel more comfortable using the same representative in all multistate tax matters.

The AICPA has monitored this trend for several years and in 2012 released a [paper](#) to assist state CPA societies.<sup>27</sup> The Institute generally supports the creation of state tax tribunals and is working with state CPA societies on this issue. The AICPA believes that if a state is considering possible legislation on this issue, "Section 16. Representation" of the Model Act should be slightly revised to take into account state CPA mobility laws, which were far less prevalent when the act was adopted in 2006.

#### Other Organizations' Views on State Tax Tribunals

As the number of independent tax tribunals has proliferated in recent years, several state and national groups have publicly come out in favor of this concept. For example, before Georgia and Illinois adopted independent tax tribunals, the Georgia Chamber of Commerce<sup>28</sup> and the Illinois Chamber of Commerce<sup>29</sup> supported the creation of an independent tax tribunal for disposition of state tax disputes.

The Council on State Taxation (COST) supports tax appeal tribunals that are independent, have trained tax judges, and have no prepayment requirements:

Foremost in good tax administration is a fair and efficient tax appeals system. A state's ability to recognize the potential for error or bias in its tax determinations and to provide taxpayers access to an independent appeals tribunal is one of the most important indicators of the state's treatment of its tax customers. The American Bar Association's model legislation for independent tax tribunals should be considered by states that do not currently have an independent tax appeals process.<sup>30</sup>

The Tax Executives Institute (TEI) also supports independent state tax tribunals. As of February 2012, the TEI publicly stated its position of encouraging all states to establish prepayment, independent tax tribunals presided over by individuals possessing a strong knowledge of tax law. The TEI's view is that tribunals' decisions should be made public as a means to assist taxpayers with compliance. The TEI states the case for independence in no uncertain terms:

The most important attribute of a tax tribunal is its independence. An impartial process for resolving tax disputes is a hallmark of both equitable tax administration and a competitive business environment. This perception of fairness also contributes to better relationships between taxpayers and tax administrators as taxpayers would know that disagreements with state auditors will not necessarily need to be brought into the general state court system. Similarly, state tax administrators would be unlikely to make arbitrary assessments knowing they could be reviewed in an impartial forum.<sup>31</sup>

In addition, the American Legislative Exchange Council (ALEC) and the National Taxpayers Union (NTU) support the Model Act.

#### Conclusion

It is clear that the independent tax tribunal is a forum that will continue to grow in importance as taxpayers and state tax authorities grapple with methods to resolve disputes in an impartial venue, without reaching the option of last resort—litigation. The overall success of the independent tax tribunal process in each state will ultimately be judged by the states' ability to properly staff these forums with capable and experienced arbiters who truly are unbiased and can make decisions without unduly lengthening the process. Taxpayers need to be confident that the independent tax tribunal will properly protect their interests; affording them an unfettered choice of representation is an important component of this aim. State tax authorities should try to keep an open mind on the value of an independent tax tribunal as well. While the complexity of state and local tax laws guarantees that taxpayers and state tax authorities always will have something to dispute, the independent tax tribunal can make such controversies a little less painful on both sides and in the long run promote tax compliance and a pro-business reputation for the state.

#### Footnotes

<sup>1</sup> ABA Model Act, §1; see also Allen and Fields, "The Model State Administrative Tax Tribunal Act: Fairness for all Taxpayers," 10 *The State and Local Tax Lawyer* 83 (2005).

<sup>2</sup> ABA Model Act, §2(b).

<sup>3</sup> ABA Model Act, §5(c).

<sup>4</sup> *Id.*

<sup>5</sup> ABA Model Act, §2(a).

<sup>6</sup> ABA Model Act, §7(a).

<sup>7</sup> ABA Model Act, §7(e).

<sup>8</sup> *Id.*

<sup>9</sup> ABA Model Act, §8(b).

<sup>10</sup> ABA Model Act, §14.

<sup>11</sup> ABA Model Act, §11.

<sup>12</sup> ABA Model Act, §12(a).

<sup>13</sup> ABA Model Act, §12(b).

<sup>14</sup> ABA Model Act, §12(c).

<sup>15</sup> ABA Model Act, §§12(d) and (e).

<sup>16</sup> ABA Model Act, §§13(a) and (b).

<sup>17</sup> ABA Model Act, §15(a).

<sup>18</sup> ABA Model Act, §16(a).

<sup>19</sup> See Report of ABA Model Act, Explanation of Section 16.

<sup>20</sup> In addition to the District of Columbia, the 25 states with executive branch tribunals are: Alaska, Delaware, Georgia, Idaho, Illinois (in 2014), Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, New York, North Carolina, Ohio, South Carolina, Washington, West Virginia, Wisconsin, and Wyoming. The six states with judicial branch tribunals are: Arizona, Connecticut, Hawaii, Indiana, New Jersey, and Oregon.

<sup>21</sup> It should be noted that four jurisdictions (District of Columbia, Mississippi, Texas, and Wyoming) allow CPAs (in-state and out-of-state) full rights to represent taxpayers in all tax matters before an independent tax forum with no additional steps required. Ten states (Alaska, Arizona, Delaware, Georgia, Iowa, Michigan, New York, South Carolina, Washington, and West Virginia) allow CPAs (with limitations or additional steps required) to represent taxpayers in some fashion in a truly independent tax forum in some tax matters.

<sup>22</sup> Ga. Act 609 (H.B. 100), Laws 2012.

<sup>23</sup> *Id.*

<sup>24</sup> See Georgia Department of Revenue website, [gataxtribunal.georgia.gov](http://gataxtribunal.georgia.gov).

<sup>25</sup> Ill. H.B. 5192, §1-80.

<sup>26</sup> The eight states that considered, but failed, to adopt legislation in 2013 to date are Alabama (H.B. 264, S.B. 223); Colorado (H.B. 13-1140); Iowa (H.B. 1446 and H.S.B. 228); Kansas (H.B. 2413) (would have established current tax tribunal as an independent agency); Louisiana (H.B. 585 and H.B. 515) (would have created tax court in place of current executive branch tribunal); Oklahoma (S.B. 392); Tennessee (S.B. 734, H.B. 961); and Texas (H.B. 2488).

<sup>27</sup> For more information on the AICPA position and resources on the issue, see the AICPA [State Tax Tribunals](#) webpage. CPAs who want to become involved in this issue in their state should contact their state CPA society.

<sup>28</sup> See [Georgia Chamber of Commerce website](#).

<sup>29</sup> See [Illinois Chamber of Commerce website](#).

<sup>30</sup> Council on State Taxation, *Independent Tax Appeals Tribunals*.

<sup>31</sup> Tax Executives Institute, *Policy Statement on Independent State Tax Tribunals*.

**EditorNotes**

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