The Importance of Tax Tribunals

by David Cay Johnston

Too many states lack tax tribunals, and some of those with tribunals create unnecessary barriers for taxpayers challenging audits and assessments.

Despite years of intense political rhetoric about taxpayer rights abuse by supposedly zealous tax enforcement, 18 states still have no tribunal in which experts trained in tax law can resolve disputes. Many of the 32 states with tribunals, plus the District of Columbia, have onerous rules that deter challenges to tax law enforcement.

This year, Georgia and Illinois launched administrative law tax tribunals to which taxpayers can take their disputes. Eight states considered legislation to create tax tribunals of varying powers and quality, according to the American Institute of Certified Public Accountants. All the bills died, some for technical reasons, others for lack of political will — a problem made worse by the tight budgets resulting from our being stuck in the economic doldrums almost six years after the Great Recession began in December 2007.

In California, Florida, Pennsylvania, Virginia, and 14 other states, taxpayers who want to challenge an audit or assessment must go to a court of general jurisdiction. That is risky for both taxpayers and the states. Judges unfamiliar with tax law, with its arcane and often counterintuitive rules, often try to avoid hearing tax cases or issue opinions not well grounded in tax law. The outcome can be bad law — very bad law.

Neither taxpayers nor tax enforcement agencies should have to risk a decision by a judge who lacks the qualifications to decide tax matters. The reasons we have specialty courts — bankruptcy, disability, landlord-tenant — apply even more to tax, which requires not just detailed factual knowledge, but deep and experienced conceptual understanding to produce wise rulings.

Earlier this year we saw a prime example of the reason tax controversies should be heard in specialized courts. A federal district court judge in Orange County, Calif., issued a cockamamie decision in a federal tax refund case.

Judge James V. Selna held that putting wrapped candy bars and bottles of wine in baskets constitutes manufacturing, qualifying for a federal tax break. By the standards and reasoning Selna applied, my Tax Notes column1 dissecting his ridiculous decision should qualify for the federal tax break for manufacturing. (That should be a joke, but it’s not.) Thankfully, his ruling has no precedential value.

The federal government has had a Tax Court, originally called the Board of Tax Appeals, since 1924, less than a decade after the individual federal income tax began and 15 years after the federal corporate income tax began. Taxpayers prevail more than the government before U.S. Tax Court judges.

That 18 states, as shown on the map, do not have specialized tax appeal courts, administrative or judicial, is bad public policy. It grants too much power to tax authorities and makes it too risky and costly to challenge audits, assessments, and other actions by the tax police in those states. Making appeals easier builds confidence in the tax system and, thus, in the legitimacy of our democratic institutions.

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But tax tribunals alone are not enough. They need rules that give taxpayers, especially those with small amounts at issue, a fair shot. In creating or modernizing tax tribunals, attention must be paid to their rules and procedures, including ease of access for taxpayers when the amount at issue is minute to the state but looms large for the taxpayer. Again, informal small claims procedures are vital.

As a general rule, no taxpayer should have to travel more than an hour each way to a hearing. Saturday courts may also be reasonable, given that for millions of Americans, taking time off work means losing income because they have no benefits like vacation or sick days. The law should not assume that everyone drives a car, either. Michigan, for example, has a 100-mile rule for property tax appeals, which seems at the far outer edge of fairness, especially given the paucity of public transit in that state.

With modern tools like Google Hangouts, tribunals can save money by having hearings over the Internet, but only for taxpayers who own computers that can use that technology. Because many taxpayers do not have computers or do not know how to use technology, video conferencing should be only an option for now.

Rules that give the state only one bite at the apple, especially in small claims matters, seem reasonable. A provision like that died in the Texas legislative session this year, along with a ban on any outside employment by the proposed three-member tribunal. Even the smallest states should have tax tribunals. If there are few cases, then the tribunals can operate on a part-time basis. Retired tax authorities could be recruited to serve in states with few disputes. Further, accountants and enrolled agents should be allowed to act as taxpayer representatives. Because those professionals may have prepared the tax returns at issue, they will know the details and therefore taxpayers will not need to pay a lawyer to study those details.

Transparency is also crucial to the fair administration of justice in tax disputes. That means published decisions, public access to court filings (done at the least expense, not with paper, but by posting dockets online), and extremely limited opportunities to invoke confidentiality. Disputes heard by taxpayer-financed panels should be done in the open. The proposed Texas tax tribunal would have conducted proceedings in secret. That is an open invitation to corruption, even with published opinions. Crime victims must testify in open court. In tax cases, taxpayers and tax law enforcement agents should, too.

As a practical matter, only rarely will anyone but the parties attend. The principle of open access to court proceedings, even administrative court proceedings, should be sacrosanct. If a taxpayer is so concerned about confidentiality that she is unwilling to speak in open court, then she should pay the disputed tax as the cost of her desire for privacy in what is a quintessentially public matter if taken to a tribunal. The state should have zero expectation of confidentiality.

States should not discourage taxpayer challenges by driving up litigation costs, a point made by Peter Stathopoulos of Bennett Thrasher CPA, who helped draft the Georgia tax tribunal statute that took effect this year. “Before our tribunal kicked in on January 1, you had two choices,” Stathopoulos said. One was to go to an administrative hearing, whose findings the tax agency could ignore.

“You would go before a trial court of general jurisdiction, where in discovery the state would say ‘confidential taxpayer information’ to document requests and through depositions and interrogatories run up the legal bill on you in the name of thoroughness,” Stathopoulos said. The result was that unless at least $50,000 was at issue — and more likely three or four times that much — it was not worth the cost and risk to challenge the state, he said.

Discovery is extremely limited before the Georgia tax tribunal, which seems reasonable on the grounds of efficiency, but ultimately may harm taxpayers and prompt an overhaul of the new law.

Several states encourage informal hearings, with some even allowing them to be resolved by telephone conference. Others, such as Michigan, mix informality for some tax disputes with severe barriers for other taxpayers. Michigan resolves most tax disputes it hears through informal proceedings, but it also makes it not worth it for some taxpayers in distant parts of the state to protest an unfavorable audit. And its website has inconsistent, opaque, and confusing language, making it inherently unfriendly to ordinary taxpayers.

Michigan’s seven-member tax tribunal hears property disputes in the county where the real estate is located, but the tribunal website states that “small claims non-property tax matter hearings are held in Lansing at the Tribunal’s office.” Michigan law limits small claims to $20,000, adjusted for inflation ($22,263 this year). That amount is much too small, especially given how far taxpayers might have to travel across Michigan, the only state split into two separate landmasses.

A resident of Ironwood, in the Upper Peninsula, would have to drive almost 10 hours each way to resolve a claim adjudicated in suburban Lansing. The state capitals of Illinois, Minnesota, North Dakota, Wisconsin, and even Iowa are closer to Ironwood than Lansing is.

Another Web page indicates that non-property taxpayer controversies can be handled without going to the suburban Lansing office, but only the most diligent taxpayer who knows the Internet well would discover that. Such poorly written pages need rewriting yesterday.

Tax professionals in all states should work to ensure that even the smallest disputes are not barred from appeals to an independent body because of travel costs or burdens. A $100 dispute may be almost nothing to the state government, but it could be the difference between eating and going hungry for some taxpayers. Informal proceedings in which taxpayers can represent themselves help resolve that, as do forms that are simple and easy to fill out. Michigan’s forms offer a good example of simplicity.

Accountants, lawyers working for accounting firms, and enrolled agents all would have been allowed to represent taxpayers on appeal under legislation introduced in Oklahoma this year by Rep. Kay Floyd (D) and Sen. Brian Crain (R). SB 392 would have given taxpayers with unfavorable state audits:

The option to obtain review of [state tax auditors’] proposed determination by an independent administrative appeals function. An independent administrative appeals function means a program of holding conferences and negotiating settlements that is designed to resolve the vast majority of tax controversies without litigation on a basis that is fair and impartial to the state and the taxpayer and that enhances voluntary compliance and public confidence in the integrity and efficiency of the Tax Commission.

The bill emphasized informality, including allowing telephone appeals, but it died in the State Senate Appropriations Committee.

The proposed Alabama Tax Appeals Commission would have had powers over state taxes as well as over local taxes in the jurisdiction that agreed to have the commission settle disputes. The bill to establish the commission provided for judges to serve six-year terms. An advisory committee to nominate appeal commission judges would have included “one member appointed by the Alabama Society of Certified Public Accountants who shall be a representative of the taxpayers of the state but who shall not be a practicing attorney or employee or former employee of the Department of Revenue or municipal or county government.”

While that kind of language may be appealing to individuals to make sure the tribunal is not pro-state, it also excludes anyone who has ever worked for a state or local government. Indeed, as written, the language seems to prohibit someone who worked in another state even in a nontax role, such as a lifeguard. Tribunal members should be both competent and vetted for fairness. Blanket prohibitions on who can serve are poor policy.

What the Alabama bill, like many others, demonstrates is a desperate need for careful drafting. Bureaucratic and legalistic language is unfair and patronizing to ordinary citizens who are not steeped in the law or public administration.