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STATE OF CALIFORNIA

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Executive Director

THE TAX APPEALS SYSTEM IN CALIFORNIA

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MAY 1979

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May 1979

Honorable Edmund G. Brown Jr.
Governor, State of California

Honorable James R. Mills
President pro Tempore, and to Members of the Senate

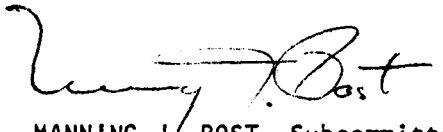
Honorable Leo T. McCarthy
Speaker, and to Members of the Assembly

This report is the product of the Commission's effort to determine the desirability of establishing an alternative tax appeals system and what form such a system, if warranted, should take. The Commission's study of this issue was prompted by Assembly Concurrent Resolution 143 of 1978 (Resolution Chapter 139) which requested the Commission to study the feasibility of establishing an independent "Department of Tax Appeals."

In conducting the study, the Commission reviewed present processes for appealing California's major taxes, examined past studies and testimony regarding the establishment of a new appellate system in California and surveyed the tax appeals practices of other states. In addition, State officials and representatives of various business and professional organizations with an interest in the appeals system were consulted and a public hearing was conducted to receive testimony on the issue.

Part I of this report provides an overview of the major taxes appealed and the system established to adjudicate the appeals. Part II consists of a summary of criticisms that have been leveled against the present tax appeals system and the Commission's general conclusions regarding these criticisms. Part III begins with the overall finding and recommendation that the present tax appeals system is inadequate and should be restructured. Following that is a discussion of possible alternative systems and major factors to be considered in selecting an alternative. In light of these considerations, Part III concludes with a listing of recommendations and suggestions.

The subject matter of this report is of direct concern to the taxpayers of California. Therefore, we urge the Legislature to take the actions necessary to establish an independent tax appeals entity.



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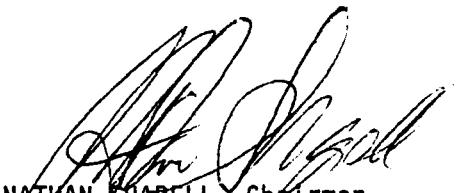

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*Mr. Harwin was appointed to this Commission on March 1, 1979 and, therefore, did not participate in either the preparation or review of this document.

SUMMARY

Most tax appeals are adjudicated by boards which are directly or closely connected with the agencies which administer the taxes and the members of most of these boards are not necessarily required to possess expertise in tax matters. These and other features of the State's tax appeals system leave it susceptible (in theory, if not in actuality) to the influences of untoward biases and incompetence. In addition, the appellate system is widely perceived to be lacking impartial and technically expert adjudicators.

As a means of eliminating weaknesses in the present structure of the appeals system and improving taxpayer confidence in the fairness of the appellate process, the Commission recommends that a new system be established for adjudicating taxpayer challenges to assigned tax liabilities.

The new system should incorporate these characteristics:

Impartiality. The appellate body should be completely independent of those agencies and officials responsible for collecting taxes or administering tax laws.

Expertise. Those hearing and deciding appeals should possess expertise in the legal and technical aspects of taxation.

Small Claims. The appellate process should include provisions for low-cost, less-formal adjudication of appeals involving relatively small disputed sums.

De Novo Hearings. The authority of the appellate body should not be limited with respect to its scope of review.

Timeliness. The appellate process should be handled more expeditiously than is currently possible in Superior Court.

Stature. The stature of the appellate body's decisions should be equal to that accorded Superior Court decisions and, so, should be appealable directly to the District Court of Appeals.

Ultimately, the structure and number of alternative appellate systems which could be designed is limited only by the imagination. Deciding upon the "best" design for a new system is largely a subjective policy matter properly assigned to the Legislature for final deliberation and action. However, four options seem most apparent to the Commission:

A. Consolidate appeals responsibilities under the Unemployment Insurance Appeals Board.

B. Consolidate appeals responsibilities under the Board of Equalization, but remove from the Board some or all of its tax-administering operations.

C. Create a new administrative entity to hear tax appeals.

D. Institute a tax court.

Additionally, the Commission offers these recommendations and suggestions:

1) Whatever new appellate system is established, it should not remove from the Unemployment Insurance Appeals Board the responsibility for adjudicating the payroll tax appeals the Board now handles.

2) An attempt should be made to secure the necessary constitutional amendment permitting property tax assessment appeals to be included within whatever new system is established.

3) Provided that there would be a sufficient volume of tax appeals to justify it, and provided that its costs of operation would not be unduly high, institution of a tax court would appear to be the most effective method for adjudicating tax appeals.

4) Should the Legislature determine that the net cost of operating a tax court is unacceptable, or if it proves impossible to include within a tax court's jurisdiction the adjudication of local property assessments, then the Commission suggests that the Legislature closely examine the possibility of consolidating appeals of state level taxes under the Unemployment Insurance Appeals Board.

THE TAX APPEALS SYSTEM IN CALIFORNIA

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THE TAX APPEALS SYSTEM IN CALIFORNIA

INTRODUCTION

It is an undisputed tenet that a taxpayer wishing to challenge the technical accuracy or legal correctness of an assigned tax liability should have ready access to a fair and impartial appellate process through which to pursue that challenge and seek rectitude. However, major aspects of California's present tax appeals system have long and often been criticized for being either unfair, biased or, for all practical purposes, inaccessible. These criticisms have been generated primarily by three conditions.

1) A major avenue for appealing most types of taxes involves a hearing before the members of the State Board of Equalization, who are either directly or closely connected with the administration of the tax liability being challenged and appealed to them. This situation creates the appearance, if not the reality, that appeals to the Board are not considered with impartiality and objectivity.

2) While recourse through the courts--beginning at the Superior Courts level--is widely available theoretically, in actuality the length and expense of litigation tends to preclude taxpayers with limited resources or small disputed amounts from pursuing legal appellate avenues.

3) Although California's tax laws are tremendously varied and complicated, major adjudicators of State tax appeals--members of the State and county boards of equalization, and Superior Court judges--are not required to have expertise in tax matters. Consequently, those authorized to adjudicate tax appeals may not adequately be qualified to fairly decide technically complex tax disputes.

This study was undertaken to determine the desirability of establishing an alternative tax appeals system and what form such a new system, if warranted, should take.

The various taxes levied under the laws of the State are administered by a number of different agencies including the Controller's Office, the Employment Development Department, the Board of Equalization, the Franchise Tax Board, the Department of Motor Vehicles, county assessors' offices, and others. A taxpayer wishing to contest an assigned tax liability must first attempt to satisfy his/her contention through reconciliation with the tax administering agency. If reconciliation cannot be achieved, the taxpayer may seek recourse through one of several appellate avenues as determined by the tax involved.

Relatively few assigned tax liabilities evoke taxpayer challenges. In addition, only a fraction of the number of challenges initiated by taxpayers necessitate review before a formally designated appeals body. Instead, the vast majority of challenges are reconciled through consultations between the taxpayer and the staff of the tax-administering agency.[1/]

For the purpose of this study, it is useful to group the most commonly appealed State and local taxes into six categories:

1) Business Taxes
2) Personal and Corporate Income Taxes
3) Property Tax Assessments--State
4) Unemployment Insurance, Disability Insurance and State Personal Income Withholding Taxes
5) Gift and Inheritance Taxes
6) Property Tax Assessments--Local

PART I: THE TAXES, ADMINISTERING AGENCIES AND APPELLATE BODIES

Business Taxes

Under the category of "business taxes" are included:

sales and use taxes (State, county, city and transit district portions)
alcoholic beverage tax
cigarette tax
motor vehicle license fuel tax (gasoline and jet fuel)
use fuel tax (diesel, LNG, LPG and CNG)
energy resources surcharge
emergency telephone users surcharge
insurance premiums tax

The Board of Equalization has complete or major responsibility for the administration of each of these taxes. In addition, the Board of Equalization (B of E) is the primary appellate body for taxpayer challenges to liabilities assigned under these taxes.

Composition and Functions of the Board of Equalization

The Board itself is comprised of four elected members and the State Controller who sits ex officio. The State is divided into four equalization districts and the voters of each district elect one Board member every four years at the time of the gubernatorial election. The present structure of the Board was established with the adoption of the State Constitution in 1879. Its Constitutionally designated functions include equalization of intercounty property assessment ratios, equalization of intracounty property assessments, assessment of the property of public utilities, assessment and collection of alcoholic beverage excise taxes, assessment of the tax on insurance companies and assessment of non-railroad-owned railroad cars. Other functions of the Board, including its appellate and business tax administration responsibilities, have been assigned to it over the years by the Legislature through statutes.

Formal actions of the Board may be classified in three broad categories; administrative, quasi-legislative, and quasi-judicial. As an administrative body, the Board develops capitalization rates, classifies unitary and nonunitary property of public utilities, and determines the values of the individual assessees.

In its quasi-legislative capacity, the Board promulgates rules and issues guidance directives. In property tax this includes all property tax rules and the assessors' handbooks. In business taxes, it issues regulations, the Business Taxes Law Guide, and Tax Tips pamphlets for various business enterprises and agencies.

Quasi-judicial functions of the Board include its appellate role in final actions of the Franchise Tax Board under the Personal Income Tax Law and the Senior Citizens Property Tax

Assistance Law. The Board hears petitions for redetermination of business tax matters; appeals of assessments made by county assessors on lands, water rights, and certain improvements on property owned by local government agencies but located outside their boundaries.[2/]

Business Tax Appeals Procedures

As with other taxes, persons protesting an assigned business tax liability must first attempt to reconcile their differences with the administers of the tax prior to seeking a hearing before an appellate body. In the case of business taxes, however, the tax-administering body and the appellate body are part of the same agency and are answerable to the same ultimate authority (i.e., the Board of Equalization itself). Nevertheless, these two levels in the process of challenging a business tax liability--i.e., attempted reconciliation prior to appeal, and filing for an appellate hearing--are distinguished from one another by the involvement of different decision-making personnel within the agency. Procedurally, the two levels are distinguished from one another by the issuance of a "notice of determination" resulting from an audit as explained below.

Since business taxes are self-assessed, disagreement over the correct amount of tax liability generally arises only as a result of an audit by B of E which concludes that a tax has been underpaid. Whenever an auditor concludes that a tax has been underpaid, the taxpayer is apprised of that fact and is afforded the opportunity to protest and attempt to reconcile any audit findings believed to be incorrect. This protest process may involve up to three steps of consultation with successively higher administrative authorities: 1) the auditor, 2) the auditor's field supervisor and 3) a local representative of the Board. If these B of E personnel are not persuaded that the taxpayer's protest is valid, then B of E will issue the taxpayer a "notice of determination" of the amount asserted to be underpaid. If, however, the taxpayer likewise remains unconvinced of the correctness of the B of E determination, he/she may further pursue relief by asking for a hearing before the Board. It is at this point that the appeal process is considered to begin.

To appeal a notice of determination, the taxpayer must file a "petition for redetermination" which identifies in writing the specific reasons why the B of E's determination of tax due is thought to be incorrect. Although a few of these petitions go directly to the Board itself for a hearing, the large majority are first given a preliminary hearing before a Board hearing officer.

Preliminary Hearing. The appointing authority of Board hearing officers is the Board itself, just as the Board is the appointing authority for auditors, legal counsel and other staff of B of E. These hearing officers are a part of the legal unit within the administration section of B of E.

The primary purpose of the preliminary hearing is "...to establish the facts in the case and the application thereto of the law and regulations." It is an informal affair at which the B of E auditor and the taxpayer present their respective positions. The taxpayer may be represented by legal or other counsel, but there is no requirement for such representation

and, if necessary, the hearing officer will assist the uninitiated taxpayer in understanding the legal and technical issues involved. Witnesses are permitted and testimony need not be delivered under oath. Proceedings of the hearing are not transcribed.

Based upon the arguments and evidence presented, the hearing officer issues a written statement of decision and recommendations to the Board. If the decision favors the taxpayer's position, and if, upon review by higher counsel within B of E, it does not conflict with established law or official Board positions, then the case is considered resolved. If the hearing officer's decision supports the auditors position, however, and if the taxpayer still disagrees, then the taxpayer may be afforded an oral hearing before the Board itself.3/

Board Hearing. "Hearings before the board... are not in the nature of trials or contests between adverse parties. They are meetings of the board at which the taxpayer presents orally to the board his arguments..."4/ Board hearings are considered informal and conformance to legal rules of evidence generally is not required. However, testimony may be required to be given under oath and witnesses may be cross-examined. A transcript of the hearing generally is not prepared unless requested in writing by the taxpayer, who will be charged for the cost of the transcription.

Prior to the hearing of a case, the Board is provided with a summary of the facts and issues involved as established in the preliminary hearing. They are also supplied with a copy of the hearing officer's recommendations.

The law does not require that Board members have a background of experience or training in tax matters, and the actual tax expertise of an individual Board member may be extensive or quite limited. "It is the duty of the staff of the board at hearings to assist the board in ascertaining the facts and determining the correct application of the law and the regulations to the facts."5/ However, staff assistance of this nature is only advisory and Board members are not required to conform their decisions to staff interpretations of the law or other matters at issue.

After hearing a case, the Board will issue a "notice of redetermination" indicating its decision. The redetermination may show agreement with the taxpayer by stating that no tax is due, or it may show partial or complete agreement with the original determination by requiring that some or all of that determination amount be paid.

The Board has no authority to reduce or excuse an actual tax liability. Therefore, a Board adjustment of a staff determination must be founded upon points of law and fact. However, Board decisions on business tax appeals are rarely put in the form of written formal opinions with identified supporting findings and conclusions.

Any tax which the Board has determined is due must be paid within thirty days of issuance of the notice of redetermination or penalties will begin to accrue. However, additional appellate steps are available after the tax has been paid.

Claim for Refund. After having paid a tax, a taxpayer may file a "claim for refund" on the basis that the liability paid was incorrectly assessed. The Board is not required to hear refund claims, but may elect to do so. Hearing procedures in these cases are the same as those for hearings on redetermination petitions.

The claim for refund is the last available step in the administrative appeals process. If the claim is denied however, the taxpayer may still pursue appellate remedy by filing a civil suit in the Superior Court of jurisdiction.

Court. A suit challenging an assigned tax liability may only be filed after the tax has been paid and after a formal claim for its refund has been denied. However, a taxpayer need not pass through all of the aforementioned administrative appeals steps before going to court. At any point the taxpayer may short-cut these steps by paying the disputed tax and filing a claim for refund with B of E. If the claim is denied, the courts then become available. Court proceedings are quite formal and representation by legal counsel is usually essential. The scope of the suit for refund and argumentation before the court are limited to the issues stated in the claim for refund submitted to B of E. Nevertheless, new evidence in support of a position may be introduced and the case is heard de novo.[6/] The presiding judge may or may not possess expertise in tax matters.

Caseload and Budget Figures

Only a small percentage of the audits which determine that a tax has been underpaid are appealed. In addition, the large majority of appeals are resolved at the preliminary hearing and are not brought before the Board itself.

In fiscal year 1977-78, B of E conducted 26,031 business tax audits. Of these, 17,067 indicated an underpayment and tax due. However, only 745 petitions for redetermination were filed that year. Of these, 561 were resolved at the hearing officer level and 184 were appealed before the Board itself.

The Board of Equalization has calculated that its 1977-78 expenditures of personnel and dollar resources for business tax appellate functions were as follows:

	1977-78 Actual	
Business Taxes	Personnel Years	Dollars
Board Review:		
Direct	2.3	$ 80,286
Indirect	2.1	78,723
Subtotal	4.4	159,009
Hearing Officer Review:		
Direct	12.6	413,209
Indirect	1.0	40,010
Subtotal	13.6	453,219
Total Business Taxes	18.0	$612,228

Personal and Corporate Income Taxes

Personal income taxes, the Senior Citizens Property Tax Assistance program and bank and corporation taxes are administered by the Franchise Tax Board (FTB). Since these taxes are self-assessed, protested assessments normally result only from FTB audits which determine that a tax has been underpaid. Taxpayers who are unable to resolve a disputed assessment with FTB officials may pursue administrative remedy by appealing their case before the Board of Equalization. The Board of Equalization may hear appeals regarding these FTB actions: denial of a protested assessment, denial of a petition for reassessment of a jeopardy assessment, denial of a claim for refund, denial of interest on refunds.

FTB and B of E

The Franchise Tax Board and the Board of Equalization have overlapping memberships with two of the three FTB members also sitting on B of E. The members of FTB are the chairperson of B of E, the State Controller and the Director of the State Department of Finance.

Appeals Procedures for FTB-Administered Taxes

B of E Hearing. Administrative appeal of FTB action is initiated by filing a written appeal with B of E which includes a statement of "...the facts involved and the points and authorities relied upon by the appellant."[7] Unlike appeals of business taxes, B of E does not conduct preliminary hearings of FTB appeals; all FTB appeals are scheduled to be heard directly by the Board of Equalization itself. Nevertheless, the large majority (see "Caseload and Budget Figures" below) of FTB appeals filed with B of E are "dismissed" (i.e., the taxpayer and FTB resolve their differences or the taxpayer otherwise withdraws) before they are actually heard by the Board of Equalization.

Hearings before the Board of Equalization are considered informal and strict rules of evidence are not applied. However, testimony must be given under oath and witnesses are subject to cross-examination. A transcript of the proceedings is not normally made unless requested by the appellant, who will be liable for the cost of the transcription. Decisions of the Board are issued as formal written opinions and orders determining the appeal.

Board of Equalization personnel are not involved in developing the case of either of the opposing parties (i.e., the taxpayer or FTB). However, B of E staff are responsible for summarizing for their board the undisputed facts and issues at hand, and the legal counsel of the Board of Equalization may question witnesses during the hearing.

Court. A taxpayer who is dissatisfied with a B of E decision may further appeal his/her case by filing suit in Superior Court. However, as a prerequisite to filing suite, the taxpayer must pay the disputed tax, file a claim for refund with FTB and have that claim denied. Once these steps have been completed, the taxpayer may initiate a civil suit against FTB for the refund. The scope of the suit brought before the court must be limited to the grounds set forth in the claim for refund submitted to FTB, but the case is otherwise heard de novo.

Appeal of an FTB action need not be first taken before B of E. The taxpayer may proceed directly to Superior Court with an appeal as long as the tax has been paid and a claim for its refund has been denied by FTB.

Unlike the taxpayer, FTB does not have appeal rights with respect to B of E decisions. A B of E decision contrary to FTB's position is final for FTB.

Caseload and Budget Figures

FTB Actions Appealed to B of E

Calendar Year	Total FTB Cases Decided by B of E	Number (%) Cases in which FTB Action Reversed or Modified by B of E	Reversals	Modifications[a/]	Reversals in part[b/]
1975	79	10 (13%)	2	8	0
1976	132	24 (18%)	11	10	3
1977	128	18 (14%)	10	3	5

a/ FTB was not reversed totally on any one issue. Its determinations of particular issue(s) were merely modified.

b/ FTB was reversed on one or more issues, but not on every issue.

During fiscal year 1977-78, 564 FTB appeals to B of E were disposed of. However, the Board of Equalization actually ruled on only 164 of these cases, while the other 400 were "dismissed" (see "Appeals Procedures..." above).

The Board of Equalization reports that its 1977-78 personnel and dollar resource expenditures for hearing FTB appeals were as follows:

	Staff Years	Dollars
Board Review:		
Direct	7.8	$251,216
Indirect	1.2	48,290
Subtotal	9.0	$299,506
Dismissals:		
Direct	2.5	67,674
Total	11.5	$367,180

Property Tax Assessments--State

The State is involved in five areas of property tax administration, all of which are the responsibility of the Board of Equalization. These property tax administrative functions include:

1) Equalizing Intercounty Assessments: establishing and ensuring the application of uniform assessment practices; computing the statewide and individual county assessment levels and bringing deviant counties into conformity with the statewide average.

2) Equalizing Intracounty Assessments: reviewing and, if necessary equalizing and adjusting the assessment of lands owned by a local government which lie outside that government's boundaries and which are subject to assessment by another local government.

3) Assessing Utilities: assessing the value of property owned by public utilities and certain interstate pipelines which are subject to local property taxation.

4) Applying the Private Car Tax: assessing and levying the State property tax on private railroad cars not owned by a railroad company (this is the only property tax levied by the State).

5) Administering the Felled Timber Tax: formulating regulations regarding, and collecting a percentage yield tax on felled timber (this is a local government property tax administered by the State; collections minus administration costs are apportioned back to the counties).

Appellate Procedures

Intercounty Equalization. The Board of Equalization's Division of Intercounty Equalization is responsible for ensuring statewide conformity of the assessment treatment of property taxpayers among the 58 counties. To do this, the Division periodically computes and compares the average assessment level of each county and the average statewide assessment level. These computations are based upon B of E appraisals of a sampling of properties on county property tax rolls. If these computations indicate that a county's assessment level--which is based upon the appraisals and assessments assigned by the county's assessor's office--is out of line with the statewide average, then B of E has the duty and authority to adjust the county's assessment level to bring it into conformity with the statewide average. Since local property tax revenues, as well as several State subventions to local governments, are based upon assessed value, an adjustment by B of E can significantly affect a county's revenue receipts. Counties, therefore, tend to be very sensitive to the sample appraisals made by B of E.

The appellants in intercounty equalization cases are normally county assessors. When a county assessor disagrees with an appraisal by B of E's Intercounty Equalization Division, and consultation with the Division staff fails to resolve the issue, the assessor may file an appeal with B of E's Office of Appraisal Appeals.

The function of the Office of Appraisal Appeals (OAA) is somewhat analogous to that of the preliminary hearing held in connection with business tax appeals (see above). Upon receipt of a county assessor's appeal, OAA--which is organizationally separate from the Intercounty Equalization Division, and is answerable directly to B of E's executive secretary--conducts its own inspection of the property involved and reviews the appraisals of both the county assessor and the Intercounty Equalization Division. OAA then prepares a report of initial findings and recommendations to the Board. If either the Intercounty Division staff or the county assessor disagree with this report, they may ask for a conference. At the conference, the opposing parties meet with OAA staff in an attempt to resolve their differences and present any new evidence in support of their respective positions. OAA then prepares a final report of findings and recommendations to the Board. If either party is still dissatisfied, they may request a hearing before the Board itself.

Hearings before the Board are informal. The State Revenue and Taxation Code requires that arguments presented at that time be considered together with the findings and recommendations of OAA in the Board's formulation of a decision and adjustment.[8/]

Intercounty assessment decisions by the Board are appealable to Superior Court. However, only appeals concerned with points of law are heard de novo by the court; appeals of valuation determinations are only reviewed on a "substantial evidence" basis.

Generally, a property tax appeal (be it at the state or local level) challenges either 1) an interpretation or application of the law or 2) the value assigned to the property. Because the authority and responsibility for equalizing property values is lodged with the State and county boards of equalization by the State Constitution, the courts have held that factual determinations of value by the boards should be accorded high deference.[9/] In conjunction with this position, the courts have limited their review of valuation appeals to a determination of whether or not--on the basis of the record of the hearing before the board--there is "substantial evidence" of the correctness of the board valuation. The court does not attempt to pass judgement specifically upon the accuracy of a board assessment determination. Instead, it reviews the case only to ascertain whether the board involved acted with conscious bias or employed arbitrary valuation methods. If there is no evidence that the board's decision was affected by unethical motives, gross incompetence or clearly erroneous evidence, then the court will not overrule.

An appeal which involves a legal question is a matter for review by the court and is accorded a de novo hearing.

Intracounty Equalization. Some local governments own property which is located outside their boundaries and is subject to taxation by the local government within those jurisdiction it is situated. The law prescribes certain conditions under which the assessment and taxation of such property shall be determined. Responsibility for determination of the assessment belongs to the assessor's office of the jurisdiction in which the property is located.

If the government which owns the property believes that the property has been incorrectly assessed under the law, it may file with the Board of Equalization an application for review, equalization and adjustment of the assessment. Upon receipt of the application, legal staff of the Board arrange and conduct a prehearing conference with representatives of the appealing government and the pertinent assessor's office. The purpose of the conference is to clearly identify the facts and contended issues of the case.

Subsequently, the Board of Equalization itself conducts a formal hearing of the case and delivers a written decision including a statement of findings and conclusions, as well as an order. Appeal of a Board order may be pursued in court.

Intracounty appeals are rare (less than one per year on the average). However, they usually are highly involved and protracted cases which result in litigation.

Public Utilities Assessment Appeals

The Property Tax Department of the Board of Equalization--rather than county assessors--assesses the property of privately owned public utilities including telegraph and telephone companies, railroads, gas and electric companies, and intercounty pipelines, canals and aqueducts. These assessments are allocated among the local governments in which the property is located and form a part of those governments' property tax base.

Assessees who believe their property has been incorrectly valued, and who have been unable to reconcile their differences with the staff of B of E's Property Tax Department, may petition for a reassessment and an appellate hearing before the Board. At the discretion of the appellant, this hearing may be either an informal proceeding or a formal evidential hearing. The nature of the hearing determines the form of the decision; a formal written opinion will be rendered from an evidential hearing while an informal hearing will generally culminate in a less detailed notice of decision.

Appeal of a Board decision through the courts is available, but it must follow a somewhat indirect route. Before being able to file suit, the appellant must have paid the disputed tax liability, filed a claim for its refund with, and had the claim denied by, the taxing authority. The taxing authority, however, is the local government within whose jurisdiction the property is located (B of E only determines the property assessment value and does not apply the tax itself). Consequently, an appellant must pay the locally charged tax and have its refund denied by the relevant local government before being able to file suit to contend the B of E assessment.

Appeals of valuation decisions by the Board are not heard de novo by the court.

Private Car Tax. Railroad cars which are not owned or leased by a railroad company are subject to an ad valorem tax adjusted by the period of time which they are in the State during the year. The Board of Equalization determines the value of these "private cars" and calculates, levies and

collects the tax imposed upon them. (This is the only property tax levied for the purpose of generating State government revenue.)

Assessees may appeal B of E determinations of this tax by filing a petition for reassessment or, after payment of the tax, a claim for refund with the Board. The Board itself is required to hear the applicants of such petitions and claims. Hearing procedures before the Board are the same as for those of utility assessment appeals described above.

A Board determination may be appealed to the courts, but only after the disputed tax has been paid and the Board has denied a claim for its refund. Questions of valuation are not reviewed do novo by the court.

Timber Yield Tax. Felled timber is subject to a percentage yield tax, proceeds from which are ultimately distributed among timber tax revenue districts where the timber was harvested. Although it is applied to generate revenue for local entities, the tax is administered by B of E which audits the self-assessed returns of timber owners, oversees proper application of yield-calculating formulas and collects the remitted tax. Revenues, less administrative expenses, are apportioned back to local governments by the Controller.

This tax is appealable to the Board of Equalization upon the filing of a petition for redetermination or a claim for refund. Petitions are initially scheduled for a hearing before a hearing officer of B of E's legal division. The function of this hearing is to establish the facts pertinent to the appeal and identify the issues in contention. If the conclusions and recommendations fromulated by the hearing officer as a result of this hearing are not to the satisfaction of the appellant, the appellant may take his/her case to the Board itself.

Hearings before the Board are officially non-adversary in nature and informal. Technical rules of evidence are not applied and testimony need not be given under oath unless specifically ordered by the Board's chairman. The hearing is essentially a forum for the oral presentation of the appellant's arguments and responses to it from B of E staff.

Decisions are rendered by the Board in the form of a notice of redetermination or a notice indicating that the petition/claim has been either denied or granted. Written opinions are not normally issued. Appeal through the courts is available, but only after the tax has been paid and a claim for its refund has been denied by the Board. The scope of a court suit is limited to the issues identified in the claim for refund.

Caseload and Budget Figures

	OAA		
Caseload	1976-77	1977-78	1978-79
Appraisal appeals received	420	486	350
Appeals taken to conference	149	221	140
Appeals taken to Board	36	56	35
Expenditures	$286,770	$358,838	$359,672
Personnel Years	9.6	11.3	10.9

In addition to the 56 intercounty equalization appeals heard in 1977-78, the Board of Equalization itself also heard 31 other property tax-related appeals cases: one intracounty equalization, thirteen private car tax, seventeen utility assessment and no timber yield tax cases. The Board of Equalization reports that these hearings required expenditures of:

	Personnel Years	Dollars
Direct	2.3	$ 63,814
Indirect	1.2	47,259
Total	3.5	$111,073

Unemployment Insurance, Disability Insurance and State Personal Income Withholding Taxes

Three payroll deduction taxes are administered by the Employment Development Department (EDD), the unemployment insurance tax, the disability insurance tax and the withholding of State personal income taxes. These taxes generate the largest volume of contested State tax determinations which are ultimately appealed beyond the tax-administering agency. Appeals of EDD assessments are heard by the California Unemployment Insurance Appeals Board (UIAB).

Composition and Functions of the Unemployment Insurance Appeals Board.

Though organizationally housed within EDD, the UIAB has department status and is essentially independent of EDD administration. The Board itself consists of five members appointed by the governor for four-year terms and the Board is the sole appointing authority for the administrative law judges (ALJs) and support personnel which staff the UIAB.

The function of the UIAB is to decide on disputes concerning 1) eligibility for benefits claimed under the unemployment or disability insurance programs

and 2) the tax liability assigned by EDD under either of these programs or the provisions governing the withholding of State personal income tax.

UIAB Appeals Process

To bring an appeal of an EDD assessment before the UIAB, the taxpayer must first submit a written petition to the Board. The petition need not be formal, but it must state the specific grounds upon which it's based.

Appeals to the UIAB are first heard by an administrative law judge (ALJ) of the Board. An ALJ conducts an oral hearing at which the taxpayer and EDD present their respective positions. The hearing procedure is considered informal, but testimony is given under oath and a recording of the proceedings is made. The taxpayer is not required to be represented by legal counsel and the ALJ, who has expertise in the relevant tax area, stands ready to assist the uninitiated appellant in understanding the legal issues involved as well as the hearing procedures. Administrative law judge decisions are rendered in writing, but are not necessarily precedent setting.

Administrative law judge decisions may further be appealed by either the taxpayer or EDD to the five-member UIAB itself. With rare exceptions, the Board confines its consideration of the appeal to a review of the transcript, written arguments, exhibits and the decision arising from the ALJ hearing. Board decisions are set forth in writing, but are not precedent setting unless the Board specifically designates them as such. Either the taxpayer or EDD may further appeal a Board decision by filing a civil suit in the Superior Court of jurisdiction. However, taxpayers wishing to pursue this avenue of appeal must first pay the disputed tax, file a petition for refund and have it denied as a precondition for filing a suit for refund in court. The scope of the suit is limited to the issues presented in the claim for refund, but the court hears the case de novo.

Caseload and Budget Figures

The large majority of cases appealed to the UIAB are resolved at the ALJ hearing. In fiscal year 1977-78 administrative law judges issued decisions on 1,137 payroll tax appeals. The Board itself decided 175 appeals. The cost incurred by UIAB to produce these decisions has been estimated at $327,563.

Hearing appeals of payroll tax determinations constitutes a minor portion of the UIAB workload. The UIAB is also responsible for hearing appeals regarding eligibility for unemployment and disability insurance benefits (benefit eligibility is also administered by EDD). In 1977-78, for example, ALJs issued decisions on 91,551 benefit cases while the Board itself decided 9,892 cases.

Gift and Inheritance Taxes

Responsibility for overall administration and enforcement of inheritance and gift tax laws lies with the State Controller. Although the administrative procedures of the two taxes differ, their appellate avenues are similar in that disputes over assigned tax liability are initially referred to Superior Court for resolution.

Appellate Procedures

Inheritance Tax. The Controller appoints one or more persons in each county to be inheritance tax appraisers. For every probate proceeding the court must appoint an inheritance tax appraiser to undertake the responsibility of determining 1) the value of all property transferred by will or the laws of succession and 2) the tax liability carried with each of those transfers. (Inheritance recipients, rather than the estate of the deceased, are subject to this tax.) Upon completing these determinations, the appraiser reports them to the Controller and the court.

In fulfilling their responsibilities, inheritance tax appraisers are acting as independent officers of the court and not as employees of the Controller. However, the Controller does have the authority to rescind an individual's appointment as an inheritance tax appraiser.

If the executor of the estate, any of the inheritance beneficiaries or the Controller's Office disagree with the appraiser's report and determinations, any of them may file an objection with the court. In response to such a filing, the presiding judge will hear the objections and render a decision on the issue(s) in contention. Should the objecting party be dissatisfied with this decision, further appeal may be made through the District Court of Appeals.

Gift Tax. Donors of large gifts are subject to this tax and are required to file a return with the Controller's Office reporting their gift(s). The Controller, in turn, issues a notice of determination of the tax due and the donor has sixty days from the date of issuance in which to remit the tax. If the donor wishes to contest the liability assigned by the Controller, he/she may do so by filing suit in Superior Court. However, as a prerequisite to filing suit, the donor must first pay the tax within the prescribed sixty days.

Caseload and Expenditure Figures

Information regarding the number and cost of inheritance and gift tax appeals is not readily available.

Property Tax Assessments--Local

Local property value assessments are performed by county assessors' offices. Taxpayers who believe their county assessor has incorrectly valued their property may appeal to the county board of equalization or county assessment appeals board, one or the other of which exists in each county.

Composition and Function of County Boards of Equalization

The State Constitution provides that "The county boards of supervisors or one or more assessment appeals boards created by the county board of supervisors, shall constitute the county board of equalization... [T]he county board of equalization, under such rules of notice as the county board [of supervisors] may prescribe, shall equalize the value of individual

assessments."[10] Such equalization actions of the boards generally result from taxpayer appeals to the board of assessor's office determinations.

(When the county board of supervisors sits as the board of equalization, the equalizing body is generally referred to as the "county board of equalization." Where an assessment appeals board has been established to act as the board of equalization, the equalizing body is generally referred to as "the county assessment appeals board." Although technically different, the two terms refer to bodies with essentially identical functions and authority.)

A county board of supervisors may establish up to five assessment appeals boards consisting of three members each. At the discretion of the board of supervisors, appeals board members may either be appointed by a majority vote of the supervisors or selected by lot from among a roster of candidates nominated by the supervisors.

Appeals board members sit for three-year staggered terms. To be eligible for nomination to an appeals board, a candidate must have "...a minimum of five years' professional experience in this state as one of the following: certified public accountant or public accountant, licensed real estate broker, attorney, property appraiser accredited by a nationally recognized professional organization, or is a person who the nominating member of the board of supervisors has reason to believe is possessed of competent knowledge of property appraisal and taxation."[17]

Local Property Tax Assessment Appeals Procedure

A property owner may appeal an assessment by filing a petition with the appropriate county board of equalization/appeals. Hearings before the board are generally informal and representation by counsel is not required. However, knowingly and willfully making a false statement--either orally or in writing--regarding the basis of an application to reduce an assessment is a misdemeanor even if the statement was not made under oath. Both the appealing property owner and a representative of the assessor's office are required to appear at the hearings under most circumstances.

The jurisdiction of county boards of equalization/assessment is limited to matters of property tax equalization; i.e., to determining correct property valuation. Property tax issues involving a disputed interpretation or application of the law are matters for decision by the courts and are directly appealable to Superior Court.

Final determinations by a county board of equalization/appeals "...shall be supported by the weight of evidence..."[12] However, written findings indicating the evidence and method of valuation upon which the board based its determination are rendered only upon request from the appellant. Hearings are recorded but a transcript is supplied only upon request. A fee is charged for producing either written findings of the board or a hearing transcript.

Hearing Officers

A county board of supervisors may appoint one or more assessment appeals hearing officers to make recommendations to the board of equalization/appeals regarding cases in which the property at issue is currently assessed

at less than $25,000 or is a family or cooperative dwelling of four units or less regardless of value. In addition, hearing officers may only hear cases in which the appellant has requested that the matter be heard before a hearing officer. Hearing officers must meet the same qualifications criteria specified for assessment appeals board members.

Hearing officers conduct informal hearings and report the proceedings together with their recommendations to the board of equalization/appeals. Without further testimony, the board then either accepts the recommendations as they stand or rejects them and schedules the case for a hearing before the board. Regardless of the hearing officer's recommendations or the board's disposition of those recommendations, the appellant is entitled to a hearing before the board itself if so desired.

Court. A county board of equalization/appeals decision may be appealed to Superior Court after the levied tax has been paid and a properly filed claim for its refund has been denied. However, court review of assessment matters is not de novo for the reason cited above (see page 10).

Caseload and Expenditure Figures

For fiscal year 1977-78, the State's 58 counties reported the filing of 26,419 assessment protests involving assessments on 42,722 parcels. County boards of equalization/appeal heard 23,109 protests. It is estimated that the counties expended $1,883,854 that year in performing their constitutionally assigned duty of hearing assessment appeals (see Appendix B).

PART II: CRITICISMS OF CURRENT APPELLATE STRUCTURES AND PROCESSES

A variety of criticisms have been leveled at various aspects of the tax appellate structures described in the previous section. Many of these criticisms have been articulated in written and oral testimony submitted to the Commission and in the course of discussions between the Commission staff and representatives of organizations whose members have had occasion to become involved in tax appeals.13/ In addition, earlier studies and inquiries dealing with tax administration have revealed discontentment with features of the appeals system.14/ The most commonly and strongly mentioned of these criticisms are enumerated below. (The following statements are simply expressions of the criticisms leveled and do not necessarily constitute conclusions or opinions of this Commission.)

1) By virtue of the fact that the Board of Equalization itself establishes policies governing the administration of various taxes, its role as an adjudicator of appeals which challenge those policies is inherently subject to bias. In fulfilling its tax-administering responsibilities, the Board of Equalization developes rules and regulations governing the methods of determining business and certain property tax liabilities under the provisions of the law. Establishing these rules and regulations necessarily involves adopting policy decisions on audit procedures and interpreting the law. The substance of many appeals cases involves an issue of procedure or a point of law and so may either implicitly or explicitly challenge a Board-adopted policy of interpretation of the law. Essentially, such cases question the wisdom of the Board's original decision on the issue in contention. The Board is not likely to be able to view these cases from an objective and open perspective.

2) The same B of E legal staff which is available to provide advice and counsel to B of E auditors, also counsels the Board itself when it sits as an appellate body. Consequently, in appeals cases which turn on a point of law, the tax-administering group (the B of E auditing staff) and the tax appellate group (the Board itself) draw their legal advice from the same source. This situation places the legal staff in the position of having to serve conflicting functions (i.e., supporting the agency stand <u>and</u> providing objective advice to the Board) and may thus impair its ability to impartially counsel the Board.

3) Members of the Board of Equalization itself are not required to have--and, historically, many members have not possessed--expertise in tax matters. As a result, the Board tends to be ill-equipped to fairly and independently decide technically or legally complex appeals. When such appeals arise, Board members lacking expertise are forced to issue a judgement which is based upon either a) recommendations from B of E staff who may be biased in their perspective, or b) a less-than-thorough understanding of an appreciation for the issue(s) involved.

4) Business tax preliminary hearings are not impartial because "captive" hearing officers conduct the proceedings and make recommendations to the Board. That is, the hearing officers are not independent of the tax-administering agency; they are hired by and are answerable to the same authority as the tax-administering staff. Although the hearing officers constitute a distinct and separate unit within B of E, and

although fairness and objectivity in their activities are promoted by the agency, the hearing officers are inherently susceptible to at least three influences which tend to militate against them being objective: a) they are employed by the tax-administering authority and so may be subject to its bias, b) they belong to the same organization as, and may personally know, those who administer the tax and so may be affected by a sense of organizational or personal loyalty, c) they are generally drawn from among the ranks of B of E auditors and lawyers and so may be predisposed to view the auditor's position and arguments sympathetically.

5) Because the Board of Equalization is not perceived as an impartial appellate body, some determinations are not appealed on the belief that appeal would be a fruitless pursuit. This is especially true of tax determinations which are substantially passed through to consumers. Consequently, consumers may be paying improperly levied taxes. This situation is most likely to occur in two areas, utility assessments and sales tax determinations.

   Property tax payments are generally considered by the Public Utilities Commission (PUC)--which regulates the rates which public utilities may charge their customers--to be a legitimate and unavoidable cost of business for utilities. Therefore, the PUC usually grants utility company requests for rate increases necessary to pay property tax liabilities. As a result, utilities generally have little incentive to pursue vigorously appeals of property valuations made by B of E, especially when the Board is perceived to be biased in its outlook. To the extent that a B of E valuation would be judged incorrect by some independent appellate body, utility company consumers are paying an incorrect amount of tax.

   Similarly, retailers are authorized by law to directly pass on to their customers the sales taxes which retailers are required to pay on their taxable sales. Therefore, a retailer who believes a commodity he/she sells is being improperly subjected to sales taxation may not be inclined to exert much effort to challenge that application of the sales tax. This disinclination may be overcome to some extent if the retailer is placed in a less profitable position by the fact that competing commodities are not subject to the sales tax and so are less costly to purchase. However, when determining whether pursuing appeal would be worthwhile, the retailer must weigh the effort and cost of appeal against the extent of the loss resulting from the competitive disadvantage. The relative perceived costs of pursuing appeal will tend to increase when appeal to the Board of Equalization is perceived as a largely futile effort to convince a biased body. Hence, a perceived bias in the Board could discourage an appeal which correctly argues that consumers are being improperly taxed.

6) The overlapping membership of FTB and B of E impairs the objectivity of B of E's adjudication of FTB appeals cases. As members of the body which establishes policies regarding the administration of personal and corporate income taxes, the Chairman of the Board of Equalization and the Controller are inherently prone to view from a biased perspective appeals which challenge those policies.

7) As a practical matter, pursuing a tax appeal by filing suit in Superior Court is not a viable option for many taxpayers. Utilization of the courts necessitate employing legal counsel. The expense of securing counsel, however, is beyond the resources of many taxpayers. Further, even for those taxpayers who can afford legal representation, the cost of counsel may outweigh any potential benefits resulting from an appeal if the disputed tax amount is relatively small.

8) Superior Court justices are not required to possess any special expertise in tax matters and so may not be qualified to fairly judge tax appeals which revolve around technically complex accounting methods.

9) The case backlong of the court system ensures that litigation of a tax appeal will involve a long period of time. During this period the taxpayer will not have access to the disputed tax amount which was paid as a prerequisite for filing suit in court. (However, interest is generally paid on payments ultimately refunded to the taxpayer.)

10) Members of county boards of equalization are not necessarily adequately qualified to sit in judgement of property valuation questions. Although the law sets out some minimum qualifications criteria for assessment appeals board members, it also authorizes nomination of a person to an assessment appeals board "...who the nominating member of the board of supervisors has reason to believe is possessed of competent knowledge of property appraisal and taxation." This loophole leaves open the possibility of appointments to assessment appeals boards being made based upon political considerations rather than technical qualifications. Furthermore, the board of supervisors sits as the Board of Equalization in more than half of the counties. Supervisors tend not to be experienced in property valuation and they are inherently susceptible to political influences which may bias their decisions.

11) Both the county assessor's office (the tax-administering body) and the county board of equalization (the tax appellate body) draw their legal advice from the same source, county counsel. Consequently, counsel's advice to the board may not be impartial.

12) Essentially, there is no appeal of a property valuation decision beyond the county board of equalization because the court does not afford a trial de novo to such decisions. The court's limited review of a board decision is not likely to reveal board biases or errors which are less than gross in character. This is especially distressing because the impartiality and expertise of the board may be questionable for the reasons cited above.

13) The decentralized character of local property tax appeals tends to lead to inconsistent decisions between counties with respect to the resolution of similar valuation matters. For taxpayers (especially corporations) with property in more than one county, this lack of uniformity tends to reduce the predictability of their tax liability. In addition, the inconsistencies may lead to unequal treatment between properties in different counties.

These criticisms generally infer that some or all of the members and hearing officers of the State and county boards of equalization are not impartial and/or lack adequate expertise. However, the Commission has not been presented with any evidence conclusively demonstrating that such is in fact the situation. The true level of fairness with which these bodies dispense their appellate responsibilities remains unmeasured here. Nevertheless, two important conclusions about the current tax appeals system are evident:

1) Several features of the appellate structure leave it susceptible (in theory, if not in actuality) to the influences of untoward biases and incompetence.

2) The appellate system in general is widely perceived to be lacking impartial and technically expert adjudicators.

PART III: FINDINGS AND RECOMMENDATIONS REGARDING A REDESIGN OF THE TAX APPEALS SYSTEM

On the basis of these conclusions from the current study of the tax appeals system, and on the basis of supporting conclusions and remarks expressed in past examinations of the system, the Commission recommends the establishment of a new system for considering taxpayer challenges to assigned tax liabilities. In spite of the fact that there is no concrete evidence of malfeasance or misfeasance on the part of present appeals adjudicators, the inherently conflictual structure of the current appeals system and the lack of taxpayer confidence in that system warrants its redesign.

As with the present system, under any new system taxpayers should initially attempt to reconcile disagreements over assigned liabilities by conferencing with officials of the relevant tax-administering agency. Experience clearly shows that most initial disagreements arise out of misunderstandings--on the part of auditors as well as taxpayers--regarding the requirements of the law or the facts of the situation.[15] Superseding attempted reconciliation at this administrative level by having disputed liabilities go directly to an appellate body would not only be inefficient, it would automatically establish and adversary relationship between the taxpayer and the tax agency and thus encourage hostile attitudes.

For those taxpayers who are unable to reconcile their differences with the tax-administering agency, the Commission urges the Legislature and the Governor to create an independent entity for hearing citizen appeals of disputed tax liabilities. To overcome the fundamental criticisms and weaknesses of the present appellate system, such an entity should incorporate these characteristics:

Impartiality. It should be completely independent of those agencies and officials responsible for collecting taxes or administering tax laws.

Expertise. Those hearing and deciding appeals should possess expertise in the legal and technical aspects of taxation.

Small Claims. The appellate process should include provisions for low-cost, less-formal adjudication of appeals involving relatively small disputed sums.

De Novo Hearings. The authority of the appellate entity should not be limited with respect to its depth of review; i.e., appeals should be heard de novo.

Timeliness. The appellate process should be handled more expeditiously than is currently possible in Superior Court.

In addition, the Commission recommends that the decisions of this appellate entity be appealable directly to the District Court of Appeals. This recommendation is based upon the Commission's concurrence with the position--strongly and commonly stated by those submitting testimony--that, whatever new appellate entity might be created, the stature of its decisions should be equal to that accorded Superior Court decisions.

Appellate System Alternatives

Some Options. Ultimately, the structure and number of alternative appellate systems which could be designed is limited only by the imagination. However, four options seem most apparent to the Commission:

A. Consolidate appeals responsibilities under the Unemployment Insurance Appeals Board.

B. Consolidate appeals responsibilities under the Board of Equalization, but remove from the Board some or all of its tax-administering operations.

C. Create a new administrative entity to hear tax appeals.

D. Institute a tax court.

A. Consolidation of appeals under the Unemployment Insurance Appeals Board. This option provides an existing administrative structure and system of appellate procedures for handling tax appeals. Methods for conducting hearings and tending to internal administrative matters are well established and the Board currently maintains eleven district offices throughout the State. Assuming that UIAB's operations are satsifactorily effective and efficient--something which the Commission has not attempted to evaluate--it appears that appeals consolidation under this entity could be accomplished largely by augmenting UIAB with the necessary administrative law judges (ones having expertise in the relevant tax areas) and support staff. However, the viability of this approach will be limited by the extent to which the Board members themselves could absorb whatever increased workload would accrue to them.

Although it appears to the Commission that UIAB is impartial and independent of any tax-administering agency, it might not be so perceived by the general public. The Board is, after all, an appendage of the Employment Development Department (a tax-administering agency) which in turn is a part of the executive branch of State government--the branch responsible for tax administration generally. As evidenced in testimony received by the Commission, it is important not only that a tax appeals system be fair and impartial, it must also be perceived to be fair and impartial by the taxpayer. Since the Commission did not specifically survey the attitudes of appellants in cases heard by the UIAB, the degree to which the Board is presently perceived to be objective is unknown.

The effectiveness of any administrative tax appeals body will to a major extent be dependent upon the confidence it can instill in the public in its objectivity. The more closely connected structurally to tax-administering agencies the appellate body is, the more difficult it will likely be to gain such confidence.

B. Consolidate appeals responsibilities under the Board of Equalization, but remove from the Board some or all of its tax-administering operations. This option was proposed by the Commission in its 1964 "letter report" on the establishment of a department of revenue (see Appendix C). Though it is considered here as a means of dealing with the tax appeals problem, the

removal of tax-administering functions from the Board of Equalization could be an important first step toward centralizing State revenue administration--a move which the Commission still believes to be a highly desirable economy measure.

Some of B of E's major tax-related functions (most notably intercounty equalization and utilities assessment) are constitutionally assigned and their transfer to another agency would require passage of a constitutional amendment. However, a great many of the appeals presently heard by the Board stem from taxes administered by the Board under the prescription of statute. Responsibility for the administration of these taxes could readily be transferred to another agency, thus substantially reducing the administrator-adjudicator conflict now inherent in the Board's dual role.

Two of the current criticisms of the Board as an appellate body would not necessarily be remedied under this option: a) Unless a department of revenue were created and the Franchise Tax Board abolished, two FTB members would still be sitting as B of E members; b) There would still be no requirement for expertise among the B of E members themselves.

C. Create a new administrative entity to hear tax appeals. Such a new entity could assume any of a variety of forms. Presumably, however, it would be designed as some sort of plural body (board, commission, tribunal, etc.) so as to avoid a concentration of adjudicatory power under a single agency head and thus the creation of an appellate czar. The members of this body could be required to possess relevant expertise and could probably best be insulated from political influences if they were appointed by the Governor for fixed overlapping terms with confirmation by the Senate. These members could either hear appeals directly or act as a review board over decisions rendered by administrative law judges or hearing officers. Being a new entity unbounded by precedent, it could tailor its procedures to meet the needs of providing equitable tax hearings in an economical fashion.

Whatever the structure of a new administrative appellate entity, it would by definition be a part of the executive branch of government and so could suffer some lack of credibility among taxpayers as a completely impartial appellate authority. However, if properly detached organizationally and politically from other segments of the executive, it seems probable that the public would view the entity as independent.

D. Institute a tax court. Many of those who testified before the Commission and voiced disfavor with present appellate structures indicated a preference for the replacement of those structures with a tax court. Such a court would be equal in stature to Superior Court, but would be of limited, specialized jurisdiction and would be manned by judges with expertise in tax matters.

The major advantages of a tax court over any administrative appellate body would be a greater sense of finality of its decisions with respect to questions of law, and a greater likelihood of taxpayer confidence in the detachment and fairness of appeal deliberations. Even though it may be vested with the authority to adjudicate points of law as well as fact, an administrative body's rulings on purely legal matters may tend to be viewed

by taxpayers (and their attorneys) as somewhat less definitive than a ruling by an arm of the judiciary. Although it cannot be said with certainty, it is suspected that a tax court ruling would be less likely to be appealed to a higher court than would an administrative body's ruling. By placing tax appeals within the purview of the judiciary, it is also expected that taxpayers would be more apt to feel their grievances would receive a full measure of due process.

Testimony received by the Commission suggested that a disadvantage to establishment of a tax court would be its relatively high cost. However, there is no evidence indicating that in fact this option would be unacceptably expensive to institute.

The Judicial Council--which is responsible for general administration of the State's court system--has traditionally opposed the creation of specialized courts (tax courts, divorce courts, etc.). This opposition has been based largely upon the arguments that specialization reduces administrative flexibility by limiting the transferability of judicial resources (i.e., judges and legal support staff), and that it tends to lead to jurisdictional conflicts.

Which Taxes?

It may not be prudent or feasible to place all tax disputes under the jurisdiction of a single appellate structure. Since the design of any new appellate structure can be significantly influenced by the nature and volume of cases which it must handle, some consideration should be given to the question of which taxes would be adjudicated under the structure. (An overview of pertinent tax characteristics is provided on page 40.) In regard to this question, three points in particular bear attention:

OVERVIEW OF TAX CHARACTERISTICS

TAXES	ADMINISTERED BY	APPEALED TO	APPEALS VOLUME 1977-78	SPECIAL COMMENTS
Business				
Sales & Use	B of E	B of E	Total Business Taxes: 163 (heard by the Board itself; preliminary hearings not included)	
Alcoholic beverage	B of E	B of E		Administrative function assigned by Constitution
Cigarette	B of E	B of E		
Fuel	B of E	B of E		
Electrical energy	B of E	B of E		
Insurance	B of E & Insurance Commissioner	B of E		Administrative function assigned by Constitution
Personal Income	FTB	B of E	Total FTB: 553 (400 of these dismissed before being heard)	
Corporate Income	FTB	B of E		
Payroll				
Unemployment Insurance	EDD	UIAB	Total Payroll: 1010 heard by ALJ's; 182 heard by Board*	Payroll tax appeals are frequently intertwined with unemployment/ disability benefit eligibility disputes
Disability Insurance	EDD	UIAB		
Withholding	EDD	UIAB		
Inheritance	Controller	Superior Court	Not Available	
Gift	Controller	Superior Court	Not Available	
State-assessed property				
Intracounty	B of E	B of E	1*	Appellate function assigned by Constitution
Intercounty	B of E	B of E	56*	Administrative function assigned by Constitution
Utilities	B of E	B of E	17*	Administrative function assigned by Constitution
Private Care	B of E	B of E	13*	Administrative function assigned by Constitution
Timber Yield	B of E	B of E	—[a]	
Locally-assessed Property	County Assessor	County Bd. of Equalization	23,109	Appellate function assigned by Constitution

*Calendar Year 1978

[a]The administration of this tax has been fully operative only a short time. The first appellate hearing on this tax was in November 1978; it is expected there will be two more by June 1979.

1) The number of locally assessed property tax appeals is so much greater than the number of other tax appeals that their inclusion (or exclusion) under a new appellate structure would substantially affect at least the physical (e.g., number and type of staff, geographical distribution of appellate offices, total costs) and possibly the functional (e.g., hearing procedures, type of adjudicator) characteristics of the structure.

2) Some tax administration and appeals functions are assigned to particular bodies by the State Constitution. Changing the assignment of these functions would require a constitutional amendment, an act which is generally considered to be difficult to achieve. Most notably, changing the current local property tax assessment appeals procedures would require a constitutional amendment.

3) No major criticism of the UIAB as an appellate structure was evidenced in this study. It appears essentially independent of the tax-administering agency of which it is a part and its ALJ's have relevant expertise. Also, tax appeals cases heard by UIAB are very often inextricably involved with benefit cases. Separating out its tax appellate functions for transfer to another body may only complicate those cases which involve both benefit and tax questions.

Costs.

Some have argued that considerations for equity and due process should override those of cost in designing a system for deliberating on taxpayer appeals. The Commission agrees that achieving equity is of fundamental and superior importance. However, costs should not be totally ignored, especially when it appears that there may be more than one acceptable alternative available. Any attempt at assessing the relative cost/benefit of the alternatives is dependent upon at least some knowledge of the expenses and savings which can be expected under each alternative.

Resource limitations have prevented the Commission from conducting an in-depth cost/savings study of the various alternatives. Nevertheless some data were collected which may assist the effort to gain perspective on basic cost dimensions and identify areas where additional expenditures or savings might accrue.

1) The State Board of Equalization

According to figures supplied by the Board of Equalization, if the Board had been relieved of its appellate functions it could have reduced its budget by the following amounts for the corresponding fiscal years:

	1976-77	1977-78	1978-79	
Cost	$478,897	$462,990	$482,551	(estimate)
Personnel years	16.6	14.9	14.9	

These amounts represent direct costs for Board appellate review. They do not include a) indirect costs which could not be readily deleted from B of E's budget if it were no longer responsible for hearing

appeals; b) costs for preliminary business tax hearings; c) the costs of operating the Office of Assessment Appeals (OAA). (In the Commission's view, preliminary business tax hearings and OAA should properly remain as review operations internal to B of E.)

2) County Property Assessment Appeals

The Commission wrote to the twenty-five counties currently operating assessment appeals boards and asked them to identify the savings that would have accrued to them in fiscal year 1977-78 if they had been relieved of their responsibility for hearing property tax assessment appeals. Twenty-one counties responded. These twenty-one accounted for 83% of the local property tax assessment protests filed statewide in 1977-78. Extrapolating the savings reported by these counties on the basis of their proportion of statewide assessment protests, it is estimated that the aggregate savings to all counties would have been $1,883,854 (see Appendix B).

(There is reason to believe that this figure somewhat underrepresents the actual savings that would have accrued. Many of the counties reported only their direct appeals board costs (i.e., compensation for board members and clerical support staff) and did not include services rendered by the county assessor's office and county counsel on behalf of the board. The degree to which the aforementioned figure is underrepresentative because of the omission of these costs is undetermined.)

3) The Unemployment Insurance Appeals Board

The Unemployment Insurance Appeals Board has calculated that its average 1977-78 cost for hearing tax appeals was $165 per hearing by the lower authority (administrative law judge level) and $653 per case reviewed by the higher authority (the Board itself). In 1977-78 the lower authority disposed of 1137 cases and the higher authority reviewed 175. On the basis of these figures it is estimated UIAB expended $327,563 on tax appeals cases in 1977-78. However, UIAB would probably not realize savings of this magnitude if relieved of its tax appellate duties, because the average cost figure used to infer this total expenditure amount includes overhead and other indirect expenses which could not practically be reduced. The extent to which such irreducible indirect costs are represented in the estimated total expenditure is unknown.

4) Superior Court

An undetermined savings would accrue as a result of reduced Superior Court caseload if the decisions of a newly created appellate body were appealable directly to the District Court of Appeals. In addition, inclusion of gift and inheritance tax matters under the jurisdiction of the appellate body would further reduce the caseload of Superior Court. The extent of such a caseload reduction would be dependent upon the scope of the tax matters placed under the jurisdiction of the new appellate body.

There is a lack of available information regarding the volume of Superior Court tax cases. There are also no figures readily available regarding typical or average per case costs for adjudicating such matters in Superior Court. (This information could certainly be developed with sufficient investigation and analysis, but that level of undertaking was not within the resources of this study effort.)

The costs of setting up and operating a new appellate system can be determined only after policy decisions have been made regarding the structural and functional framework of the new system. Decisions regarding such matters as the taxes to be included within the system's pruview and the type of adjudicator to be employed will affect cost determinants such as caseload and compensation levels.

However, from the information above, at least one cost perspective may be established regarding a new system. If the system were to include appeals of business taxes, personal and corporate income taxes, and State and local property tax assessments, if decisions under the system were appealable to the District Court of Appeals, and if the bodies currently hearing these tax appeals were to be relieved of that function, then expenditures for a new system could run a minimum of $2,346,844 (in 1977-78 dollars) without exceeding present combined State and local appellate costs. This figure is composed of the 1977-78 appellate cost estimates of the State Board of Equalization and the county boards of equalization/appeals. The figure is definitely conservative since it does not include 1) some amount of county assessor and county counsel costs (see above) or 2) Superior Court costs.

Other States.

The Commission conducted a limited review of other states' tax appeals, but this review revealed no pronounced trends or obvious "models" to guide the establishment of a new system in California. Appellate structures and practices among the states vary considerably ranging from states which maintain tax courts possessing full judicial status to states which provide only informal review by the tax-administering agency.16/ It is interesting to note, however, that in the last twenty years no less than a dozen states have reevaluated their methods of adjudicating tax appeals and reacted by establishing new appellate systems.

Selecting an Alternative

Deciding upon the "best" design for a new system of adjudicating tax appeals is largely a subjective policy matter properly assigned to the Legislature for final deliberation and action. Some presently unknown--and perhaps undeterminable--factors (e.g., the specific costs and taxpayer acceptance of alternative systems) may weigh in that decision. Given these unknowns, the Commission cannot conclusively recommend an alternative that would in fact prove most efficient and effective. Nevertheless, the Commission does offer the following recommendations and suggestions in addition to its aforementioned primary recommendation that a new appellate system be established incorporating specified characteristics (see page 22).

1) Whatever new appellate system is established, it should not remove from the Unemployment Insurance Appeals Board the responsibility for adjudicating the payroll tax appeals the Board now handles. These appeals are so often closely connected with unemployment insurance benefit appeals that their separation from the Board would probably only tend to promote confusion and inefficiency at no obvious gain to justice.

2) An attempt should be made to secure the necessary constitutional amendment permitting property tax assessment appeals to be included within whatever new system is established. Property assessment protests comprise by far the largest number of taxpayer appeals. The State's voters should be afforded an opportunity to decide whether or not the present assessment appeals structure should remain as designated in the State Constitution.

3) Provided that there would be a sufficient volume of tax appeals to justify it, and provided that its costs of operation would not be unduly high, institution of a tax court would appear to be the most effective method for adjudicating tax appeals. Being a part of the judiciary, a tax court would probably be the alternative most likely to provide both the fact and the perception of impartiality and equity.

Without depreciating the general argument against specialized courts, the Commission notes three points in support of a specialized tax court:

a) With the volume of cases to be handled by a court system having jurisdiction over local property assessment appeals as well as virtually all major State taxes (payroll taxes excluded), the internal resources of a tax court would probably be sufficient to be self-sustaining; i.e., any limitations that might exist with respect to the transferability of resources between a tax court and the rest of the judicial system would probably not create any significant administrative difficulties.

b) Tax law generally is complex and intricate. Not uncommonly, the complexity of the statutes is compounded by technical issues regarding proper accounting methodology. While there is no reason to believe that these complexities are beyond the grasp of the average justice, a judge who is unfamiliar with tax issues would likely require more time to study a technically complex case and may be less sensitive to any subtle but legally significant technical nuances of a case than would a colleague with expertise in tax matters. Therefore, for a judicial system handling any significant volume of tax cases, it would seem that establishment of a specialized tax court would contribute to more effective and efficient judicial administration.

c) The federal government operates a tax court which appears to function quite effectively without producing any significant administrative problems.

The position in favor of a tax court is contingent upon "sufficient caseload" and "reasonable cost," both of which are inexact and largely subjective qualifiers. Without attempting to specifically define "sufficient caseload," the Commission believes that a tax court would be justified from a workload standpoint if it were assigned to handle the property assessment appeals currently adjudicated by county boards of equalization/appeals. However, if a tax court were only to handle appeals of state level taxes--and if the volume of those appeals did not increase substantially over recent historical levels--its existence as a specialized judicial entity could not be justified on the basis of appeals volume.

With regard to cost, "reasonableness" is a highly comparative term which becomes even less precise when applied to efforts aimed at attaining such immeasurables as "justice" and "public confidence." Determination of the level at which the costs of operating a tax court exceed any benefits to be derived from it is a matter best left to the representative deliberations of the Legislature or the electorate directly.

4) Should the Legislature determine that the net cost of operating a tax court is unacceptable, or if it proves impossible to include within a tax court's jurisdiction the adjudication of local property assessments, then the Commission suggests that the Legislature closely examine the possibility of consolidating appeals of state level taxes under the Unemployment Insurance Appeals Board. Unless further analysis shows the Board's operations to be unsatisfactory, consolidation would appear to be a relatively inexpensive way of acceptably achieving the ends sought by the creation of an independent tax appeals entity. Also, should the Legislature find consolidation under UIAB to be a viable option, consideration should be given to further enhancing the Board's independence by making it organizationally separate from the Employment Development Department and any other agency responsible for tax administration.

FOOTNOTES

1/ For example, from fiscal 1976-77 through 1978-79 only about 7% of the protested business tax determinations received by the Board of Equalization were appealed to the Board itself after consultations at the staff level. Similarly, between 1976 and 1978 staff-taxpayer consultations resolved about 94% of the personal and corporate income tax protests filed with the Franchise Tax Board.

2/ California State Board of Equalization. Annual Report 1976-77, pp. 11-12

3/ In order for a taxpayer to be assured of an oral hearing before the Board, a request for such a hearing must be specifically stated in the petition for redetermination. If not included in the petition, the Board is not required to grant a request for an oral hearing.

4/ California State Administrative Code. Title 18, Chapter 2, Section 5054

5/ Ibid.

6/ Literally, "de novo" means anew or again. A de novo hearing is one in which the court hears and considers the arguments of the parties involved and rules on the substance of the arguments. A hearing is not de novo when the court strictly limits its review to the record of the foregoing hearing and rules only on whether the adjudicating authority in that hearing acted properly in issuing its decision. That is, the substance of the arguments is considered and evaluated only to the extent necessary to determine whether or not the ruling authority's decision was reasonable, objective and legally correct.

7/ California State Administrative Code. Title 18, Chapter 2, Section 5024

8/ California Revenue and Taxation Code. Division 1, Part 3, Section 1816.2

9/ Domenghini v. San Luis Obisbo County, 40 Cal. App. 3d 689.
Hunt-Wesson Foods, Inc. v. Alameda County, 41 Cal. App. 3d 163.
Madonna v. San Luis Obisbo County, 39 Cal. App. 3d 57.
Quinn v. Aero Services, Inc., 172 F 2d 157.
Westlake Farms, Inc. v. Kings County, 39 Cal. App. 3d 179.

10/ California State Constitution, Article XIII, Section 16

11/ California Revenue and Taxation Code. Division 1, Section 1624

12/ Ibid. Section 1611.5

13/ In conducting this study, the Commission met with the Chairman of the State Board of Equalization, the State Controller, the Executive Officer and the Chief Counsel of the Franchise Tax Board, and the Chief and Senior Administrative Law Judges of the California Unemployment Insurance Appeals Board. The Commission also held a public hearing on February 13, 1979 to receive testimony on this issue. Oral or written testimony was submitted to the Commission by the following organizations:

Amfac
California State Bar Association-Section on Taxation
California Chamber of Commerce
California Farm Bureau Federation
California Judicial Council
California Society of Certified Public Accountants
California Taxpayers' Association
Ernst and Ernst
Foremost - McKesson
Getty Oil
Office of Administrative Hearings (State Dept. of General Services)
Pacific Gas and Electric Company
Southern Pacific Railroad

14/ The issues surrounding the State's present tax appellate structure are not new. Since 1939 at least 29 bills and constitutional amendments have been introduced in the Legislature for the purpose of creating an independent tax appeals body. In addition, establishment of an alternate appellate system has been recommended in the reports of several studies including two published by the Assembly Interim Committee on Government Organization ("The Need for a Department of Revenue in California," 1955 and "California's Tax Administration," 1965) and one published by this Commission ("Proposed Organization of Revenue Administration in California," 1964). In spite of these recommendations and proposals, no effort to create an independent tax appeals body has yet been successful. This lack of success appears in large part to be a result of the fact that such efforts were usually tied to a simultaneous and very politically sensitive move to reorganize and consolidate tax administration in the State, a movement which has never been realized.

15/ See footnote 1.

16/ For an overview of other states' tax appeals systems, refer to "State Tax Review Agencies: Organizations and Practices," research report No. 79, published in December, 1978 by the Federation of Tax Administrators, 444 North Capitol Street, N.W., Washington, D.C. 20001

APPENDIX A

MAJOR TAXES AND LICENSE FEES COLLECTED BY THE STATE OF CALIFORNIA

MAJOR TAXES AND LICENSE FEES COLLECTED BY THE STATE OF CALIFORNIA

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
SALES AND USE TAX State Local Governments Total	 $5,030,438,159 $1,404,100,724 $6,434,538,883	Gross receipts from all retail transactions not specifically exempt by law and involving the sale or use of tangible personal property are subject to a percentage tax. Sellers pay this tax and, under the authority of the law, reimburse themselves by charging the purchaser the amount of the tax. The tax consists of a State portion (4.75%), a city and county portion (1%), a county transportation portion (0.25%) and, in some areas, a special transportation district portion (0.25%).	R&T: Div. 2, Parts 1.5, 1.6	The tax is self-assessed and retailers are required to file returns on either a quarterly or a monthly basis in most instances. B of E is responsible for auditing returns and collecting the State and local shares of the tax except in the case of a vehicle sale between non-dealer parties. For those transactions, DMV collects the tax from the purchaser at the time the vehicle is registered. Local government portions of the sales and use taxes collected by B of E are apportioned back to the local governments based upon the place of transaction.	B of E

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
PERSONAL INCOME TAX	$4,667,887,272	Personal income, after adjustment for authorized exemptions, deductions and credits, is subject to taxation. The tax rate varies with the amount of adjusted taxable income and is based upon a generally progressive tax scale ranging from 1% to 11%.	R&T: Div.2, Part 10	Persons with filing obligations and tax liabilities are required to self-assess this tax annually and submit returns to FTB. FTB is responsible for overall administration of this tax process including collecting returns, refunding payments, auditing returns and ensuring compliance with tax laws. A significant feature of this tax is its required regular withholding of a portion of income during the course of the year. In effect, this is a requirement of current payment on expected year-end tax liability. Most taxpayers have an amount withheld each year which exceeds their year-end liability and, upon filing a return, receive a refund from the State for the amount over withheld. Under contract with FTB, EDD is responsible for ensuring proper withholding.	B of E
BANK AND CORPORATIONS FRANCHISE INCOME TAX	$2,082,207,624	For-profit corporations and banks are subject to a 9% tax on their net taxable income with a minimum tax of $200. In addition, banks, savings and loans and other financial institutions are subject to an additional tax of up to 4% of net income in lieu of local property taxes, from which they are exempted by the Constitution.	R&T: Div.2 Part 11	FTB is responsible for the administration of this tax. Tax liability is self-assessed and is based upon net income for the previous year. FTB audits a selected sampling of returns to ensure compliance and monitor accuracy.	B of E

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
UNEMPLOYMENT INSURANCE CONTRIBUTION	$1,652,053,296	To lessen the economic dislocation of involuntary unemployment, this tax is levied to provide a system of income maintenance based upon insurance principles. Employers pay a percentage tax on the first $6,000 of taxable wages paid to each employee during the year. The basic rate is 2.7%, but the actual rate applied to an individual employer may vary from 0.0% to 3.9% depending upon specified circumstances. Revenues finance benefit payments to eligible unemployed persons.	UI: Div.1, Part 1	This is essentially a federal program administered by the State. The tax is self-assessed and employers are required to file quarterly returns with EDD, which is responsible for overall administration of the tax. EDD's responsibilities include auditing returns, registering employers and determining benefit payments.	UIAB
DISABILITY INSURANCE CONTRIBUTION	$ 588,972,301	This tax funds a State program designed to provide limited compensation for wages lost as a result of a non-occupational illness or injury. Employees pay this tax at the rate of 1% of the first $11,400 of wages received for the calendar year. With the major exceptions of government employees and the self-employed, most employees in the State are required to contribute to the Disability Insurance program unless they have opted to participate in a voluntary plan which provides benefits at least comparable to those under the State program. Revenue from this tax provides eligible persons with benefit payments of $30-$146 per week depending upon the claimant's wages during a prescribed base period.	UI: Div.1, Part 1	Although this tax is paid by the employee, employers are responsible for deducting the proper amount from their employees' wages and reporting and paying these deductions to EDD. EDD is responsible for overall administration of the tax including the auditing of employer reports, the maintenance of employee accounts and the determination of benefit payments.	UIAB

TAX	REVENUE[1] 1977-78	DESCRIPTION [2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
MOTOR VEHICLE LICENSE FEES		This is an annual fee charged against each vehicle. It is imposed "in-lieu" of any State or local property taxes and is equal to 2% of the vehicle's "market value" as calculated by DMV.	R&T: Div.2 Part 5	DMV collects this fee as part of the vehicle registration process.	B of C
Motor vehicle license fees	$494,323,312				
Trail coach fees	39,831,392				
Total	$534,154,704				
MOTOR VEHICLE REGISTRATION FEE	$223,830,958	Motor vehicles and trailers are required to be registered annually. An $11 fee is charged at the time of registration.	Veh: Div.3 Chapter 6	This fee is collected by DMV as a condition of vehicle registration.	B of C
WEIGHT FEES	$128,785,984	Commercial motor vehicles and trailers are subject to an annual fee determined on the basis of the number of axles and unladen weight of the vehicle.	Veh: Div 3 Chapter 6	DMV collects this fee as a part of the vehicle registration process.	B of C

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
FUEL TAXES Motor Vehicle Fuel License Use Fuel Tax Total, Motor Vehicle and Use	 $785,139,561 66,105,330 $851,244,891	There are two categories of fuel taxes: 1) the motor vehicle fuel license tax, which is imposed for the privilege of distributing fuel, and 2) the use fuel tax, which is imposed for the privilege of using fuel. The motor vehicle fuel license tax group consists of a 7¢ per gallon tax on various forms of gasoline (e.g. automobile gas, aviation gas, naphtha, etc.) and a 2¢ per gallon tax on jet fuel. Use fuel taxes include a 7¢ per gallon tax on diesel fuel, a 6¢ per gallon tax on liquified petroleum gas (LPG) and liquified natural gas (LNG), and a charge of 7¢ per 100 cubic feet of compressed natural gas (CNG). These taxes apply to fuel used to propel a motor vehicle on public roadways, a non-commerical aircraft or a vessel. Taxpayers not using these fuels for these purposes may apply for a refund of taxes paid. Revenues from these taxes are used largely for the construction and maintenance of highways and public transit systems, and for services to vehicle owners (e.g. vehicle registration, traffic regulation, etc.)	Const: Article XIX R&T: Div.2 Parts 2,3	These taxes are self-assessed and regular returns must be filed. In the case of the fuel license tax, payments are due from the initial distributor. Use taxes are due from the final vendor who collects them from the user. B of E is responsible for auditing returns and ensuring compliance. The Controller's Office is responsible for collecting deficiency payments and refunding taxes paid by those using fuels for exempted purposes.	B of E

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
CIGARETTE TAX		A tax of 10¢ per pack is levied on cigarettes sold or consumed in the State. Thirty percent of the revenue is disbursed to cities and counties and 70% goes to the State General Fund.	R&T: Div.2, Part 13	B of E collects this tax directly from the distributor through the sale of tax stamps and meter impressions which must be affixed to each package of cigarettes. The Controller apportions 30% of the revenue proportionately to cities and counties through formulas based upon local sales tax revenue and population.	B of E
State portion (7¢ per pack)	$191,853,954				
Local portion (3¢ per pack)	82,962,212				
Total	$274,816,166				
ALCOHOLIC BEVERAGE CONTROL TAX		Taxes are levied against all alcoholic beverages manufactured, imported or distributed to retailers in California. The tax rate varies with the type of beverage: $4 per gallon on distilled spirits of more than 100 proof; $2 per gallon on distilled spirits of 100 proof or less; 4¢ per gallon on beer; 2¢ per gallon on sweet wine (more than 14% alcohol); 1¢ per gallon on dry wine (14% alcohol or less); 30¢ per gallon on sparkling wine.	Const: Article XX R&T: Div.2 Part 14	B of E collects this tax directly from licensed alcoholic beverage distributors who self-assess the tax. Auditing returns and general administration of the tax are B of E responsibilities.	B of E
Distilled spirits	$109,088,200				
Beer & Wine	22,971,917				
Total	$132,060,117				

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
INHERITANCE TAX	$351,694,724	Generally, except for spouses receiving community property, recipients of property through the conditions of a will or the laws of succession are subject to this tax. After allowing for applicable deductions and exemptions, the beneficiary is subject to graduated rates based upon both the net amount of the inheritance and the recipient's familial relationship to the decedent.	R&T: Div 2, Part 8	Although the Controller has overall responsibility for the administration of inheritance tax law, actual determination and collection functions are largely performed by other parties. The Controller appoints one or more inheritance tax appraisers to each county. Upon initiation of a probate proceeding, the superior court of jurisdiction appoints an appraiser to the probate case. Among the appraiser's duties are inventorying and appraising the estate's assets and determining each beneficiary's tax liability in light of the conditions of succession and applicable exclusions, exemptions and deductions. The appraiser submits a report of determined tax liability to the court and to the Controller. Payment of the tax is made to the county treasurer who then transfers the payment to the State Treasurer.	If either the beneficiary or the Controller object to the tax liability assigned by the inheritance appraiser, they may file to have their objections decided by the court presiding over the probate proceedings.

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
GIFT TAX	$ 13,396,811	Levied primarily against the donor, this tax applies to the transfer of property by gift. Essentially, the tax is only imposed upon gifts to an individual which, after allowing for specified deductions and exemptions, total $25,000 or more in any one year. The amount of tax is determined by the net value of the gift(s) and the familial relationship between the donor and the recipient.	R&T: Div.2 Part 9	Administration of this tax is the responsibility of the State Controller. Donors are required to file a gift tax return with the Controller, who examines its accuracy and determines whether an adjustment of the reported tax liability is required. Gift taxes are paid directly to the State Treasurer.	Taxpayer-Controller disputes regarding gift tax liability are resolved through the courts
HORSE RACING PARI-MUTUAL LICENSE FEES	$111,590,954	A tax with rates ranging between 2.50% and 7.45% is collected on the total amount wagered at horse racing meets.	R&T: Div.2 Part 12	This tax is administered by the California Horse Racing Board, which is responsible for regulating pari-mutual horse racing.	California Horse Racing Board
INSURANCE GROSS PREMIUMS TAX	$387,559,798	In lieu of all other taxes except license fees and real property taxes, insurance companies, with some limited exemptions, pay a tax on their annual gross premiums received for insurance policies. In most instances the tax rate is 2.35% of gross premiums. A 5% rate is levied on the underwriting profits on gross premiums for ocean marine insurance and a 0.5% rate is levied on premiums from annuities.	Const: Art. XIII Section 28 R&T: Div. 2 Part 7	The Department of Insurance regulates insurers and determines the amount of insurance tax for which they are liable B of E actually renders the assessment and the Controller collects the taxes.	B of E

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
ENERGY RESOURCES SURCHARGE	$17,660,401	This is paid by all consumers of electrical energy and is used solely to fund the State Energy Resources Conservation and Development Commission. The surcharge rate is measured in tenths of a mill (1 mill=1/10 of 1¢) per kilowatt-hour of energy consumed. Based upon projected kilowatt-hour consumption for that year, the rate is recalculated annually so that it will generate the amount of revenue approved by the Budget Act for the operation of the Commission. However, the rate is prohibited by law from exceeding two-tenths of a mill (0.02¢) per kilowatt-hour.	R&T: Div.2 Part 19	Electrical utilities in the State collect the surcharge as a part of their customer billing process and remit the revenues to B of E quarterly. B of E is responsible for determining the necessary surcharge rate.	B of E
PRIVATE CAR TAX	$ 8,277,118	This is a property tax levied by the State on the assessed value of railroad cars neither owned nor leased by a railroad company, but which are used to generate revenue for their owners. Such owners include firms which lease their cars to shippers and companies which maintain their own railroad cars to ship the products they produce. This is the only State property tax. The rate used for this tax is the average statewide local property tax rate from the preceding year.	R&T: Div.2 Part 6	B of E determines private car assessment values, calculates the tax rate, and presents and collects the tax liability due.	B of E

TAX	REVENUE[1] 1977-78	DESCRIPTION[2]	AUTHORITY	ADMINISTRATION	APPEALS BODY[3]
TIMBER YIELD TAX	$28,854,659[4]	Effective April 1, 1977, this tax replaced an ad valorem tax on standing timber. This tax consists of a percentage levy on the yield of felled timber. The percentage varies and is determined by a statutory formula based upon the average property tax rate of the county involved. This is a local government property tax which is administered by the State.	R&T: Div. 2, Part 18.5	B of E is responsible for the administration of this tax in consultation with the Timber Advisory Committee which consists of five timber-county assessors and one representative each from B of E, the State Board of Forestry, small scale timber owners and large scale timber owners. B of E's duties include developing regulations governing the methods of calculating timber yield, registering taxpayers, processing harvest data and auditing the returns which timber owners are required to file quarterly. Collections from this tax less administrative costs incurred by B of E are apportioned back to the counties by the State Controller according to past ad valorem tax experience and harvest data.	B of E

1/ Revenue amounts from the "Annual Report of the State Controller, 1977-78 Fiscal Year"

2/ The tax rates cited here were in effect as of January 1, 1979.

3/ Taxpayers must first attempt to resolve disputed tax liabilities with the agency which administers the tax. Having exhausted this avenue of appeal without satisfaction, taxpayers may then appeal to the agencies listed in this column. With the exception that Inheritance and Gift Tax appeals are initially handled by the courts, these agencies constitute the formal and final administrative appellate body. Taxpayers dissatisfied with these bodies' rulings may seek remedy through the courts.

4/ "Annual Report of the State Board of Equalization, 1977-78"

Abbreviations

B of C: Board of Control
B of E: Board of Equalization
Const: California State Constitution
DMV: Department of Motor Vehicles
EDD: Employment Development Department
FTB: Franchise Tax Board
R&T: Revenue and Taxation Code
UI: Unemployment Insurance Code
UIAB: Unemployment Insurance Appeals Board
Veh: Vehicle Code

APPENDIX B

County Assessment Appeals Boards
Fiscal Year 1977-1978

County	Workload (protests filed)	Cost
Alameda	2,583	$478,000
Butte	108	2,658
Contra Costa	730	34,161
Glenn	21	943
Kern	1,083	19,655
Los Angeles	8,258	550,119
Marin	469	29,691
Merced	233	6,449
Monterey	638	9,560
Orange	1,333	83,485
Riverside	432	8,949
Sacramento	613	60,000
San Bernardino	508	6,294
San Diego	1,495	122,752
San Francisco	2,122	99,664
San Luis Obisbo	229	6,223
San Mateo	696	29,059
Santa Cruz	119	5,100
Siskiyou	44	2,579
Sonoma	233	6,645
Stanislaus	85	1,613
Totals, surveyed counties	22,022	$1,563,599
Percent of all counties	83%	---
Total Estimated Cost For All Counties ($1,563,599 ÷ 0.83)		$1,883,854

APPENDIX C

STATE OF CALIFORNIA

EDMUND G. BROWN, Governor

COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY
1209 EIGHTH ST., SACRAMENTO

Chairman
HAROLD FURST
Berkeley

Vice Chairman
MILTON MARKS
Assemblyman, San Francisco

JOHN T. KNOX
Assemblyman, Richmond

DON B. LEIFFER
San Diego

GEORGE MILLER, JR.
Senator, Martinez

MANNING J. POST
Beverly Hills

RICHARD E. SHERWOOD
Los Angeles

ROY SORENSON
San Francisco

VERNON L. STURGEON
Senator, Paso Robles

DAIR TANDY
Oroville

FRANK D. TELLWRIGHT
Carmel

L. H. HALCOMB, JR.
Executive Secretary

December 28, 1964

Honorable Edmund G. Brown
Governor, State of California

Honorable Hugh M. Burns
President pro Tempore, and to Members of the Senate

Honorable Jesse M. Unruh
Speaker, and to Members of the Assembly

Gentlemen:

In recognition of the importance of tax administration to the state government and to the individual taxpayer, the Commission on California State Government Organization and Economy in the spring of this year initiated a comprehensive review of the current organizational status of the State's principal revenue collection agencies. Subsequently in a letter to the Commission in June, Governor Brown stated that, although there had been several major studies of state revenue administration in the past, he believed the time appropriate to consider again the possibility of consolidating all or most revenue collection activities within a single department. Accordingly, the Commission added this important organizational consideration to its study agenda. This letter summarizes the findings and recommendations of that study.

The issue of consolidation of revenue administration in the California State Government is not new; the matter has a long history of continued study. These many studies have been remarkedly consistent in their emphasis on the desirability of consolidating revenue administration in one organizational unit responsible to the State's Chief Executive--the Governor.

One of the first study groups to recommend a tax agency responsible to the Governor was the California Tax Commission authorized by the Legislature in 1927. Since that study, there have been at least 15 separate studies by outside agencies or legislative committees that have recommended some consolidation of the major taxing agencies as a sound organizational objective. In 1955 a subcommittee of the Assembly Interim Committee on Government Organization concluded that:

"California's revenue administration structure should be organized to provide a reasonably efficient, economical, understandable, and responsible vehicle for administering our tax laws. This can be accomplished best by placing the administration of major state taxes in a Department of Revenue headed by a Director appointed by the Governor, confirmed by the State Senate, removable by the Legislature for cause, and, therefore, responsible to the Governor and the Legislature, and through them, to all of the people."

This recommendation was repeated in substantially the same form in 1959 by the Governor's Committee on Organization of State Government and it has been reiterated by the Legislative Analyst in nearly every budget analysis report since 1943.

Current testimony before this Commission, as well as independent staff study, has substantiated the validity of the findings of those many past studies. It is clear that further documentation of the conclusive evidence on record would be repetitious--the logic of a Department of Revenue for California has been very well established. In addition, both the State Controller and the Chairman of the Board of Equalization stated their belief at the Commission hearing on this subject on August 20, 1964 that the unification of revenue collection activities would result in economies and other benefits to the State Government as well as to the individual taxpayer. Clearly, the time has come to set aside those considerations that have blocked constructive action in the past.

The Commission now proposes the establishment of a strong Department of Revenue with a Director appointed by and responsible to the Governor for state tax administration. Thus, the Legislature and in turn the people would be able to focus responsibility for the administration of the major revenue collection activities of the state government (see chart).

The August 19, 1964 proposal to the Commission, prepared by the Department of Finance, has been reviewed as one alternative organizational arrangement of revenue collection activities. The members of the Commission concur unanimously with the goal of consolidating most tax collection functions in one agency and for the provision of an independent tax appeals body. The suggested structural arrangement, however, does not provide an effective answer to one of the major shortcomings of the present unconsolidated revenue agency--that of diffused responsibility for revenue administration. The proposal of the Department of Finance would perpetuate the combination of boards and elective and appointive officials as responsible for the State's revenue collection program. Such a combination has been indicted as inefficient and irresponsive to taxpayers' needs by every previous study.

In the opinion of this Commission, revenue <u>collection</u> is a ministerial act for which responsibility can and should be clearly and definitely established in the executive branch of the state government. Line authority and responsibility for this function, therefore, should be placed with a Director appointed by the Governor who as the executive head of state government is finally responsible under the Constitution for the enforcement of all laws.

The Department of Revenue as proposed by this Commission would succeed to all activities of the Franchise Tax Board and to all non-constitutionally assigned tax collection functions of the State Controller and the Board of Equalization. The revenue collection responsibility of the Department of Motor Vehicles, the Department of Employment, and the Horse Racing Board would remain unaltered. The Board of Equalization responsibility for insurance company tax assessment, alcoholic beverage tax administration, equalization determinations, public utility valuation determinations and assessment standards would also remain unchanged. The proposed organizational arrangement and functional assignment, which in basic concept is neither new nor unusual, is illustrated by the attached chart.

The Commission proposal, which can be implemented without constitutional revision, also calls for the statutory assignment of the tax appeals function to the State Board of Equalization. In this way an independent board of constitutional officers, responsible to the electorate, would serve in the important capacity of hearing appeals related to taxes collected by the proposed Department of Revenue.

We make no recommendations as to the internal structure of the new department. The Director, subject to appropriate legislative approval, should be free to work out the internal details of integration of responsibility and geographic distribution to meet the requirements of effective administration. Commission recommendations relating to inheritance tax administration, however, are contained in a separate communication of this date.

The use of qualified personnel employed on a full-time basis in accordance with Article XXIV of the State Constitution in such matters as the administration of functionally integrated systems of tax appraisals, audits and collections through consolidated field offices and shared housekeeping and staff services will do much toward the effective implementation of a uniform tax collection policy. This Commission is convinced that taxpayer convenience as well as economy and increased efficiency can result from the establishment of Department of Revenue as proposed when organized and operated in accordance with modern revenue management principles.

Respectfully,

Harold Furst

Harold Furst, Chairman
Assemblyman Milton Marks, Vice Chairman *
Assemblyman John T. Knox
Don B. Leiffer
State Senator George Miller, Jr.
Manning J. Post
Richard E. Sherwood
Roy Sorenson
State Senator Vernon L. Sturgeon
Dair Tandy
Frank D. Tellwright

* See statement of Assemblyman Milton Marks attached.

STATE OF CALIFORNIA EDMUND G. BROWN, Governor

COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY
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FRANK D. TELLWRIGHT
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L. H. HALCOMB, JR.
Executive Secretary

December 28, 1964

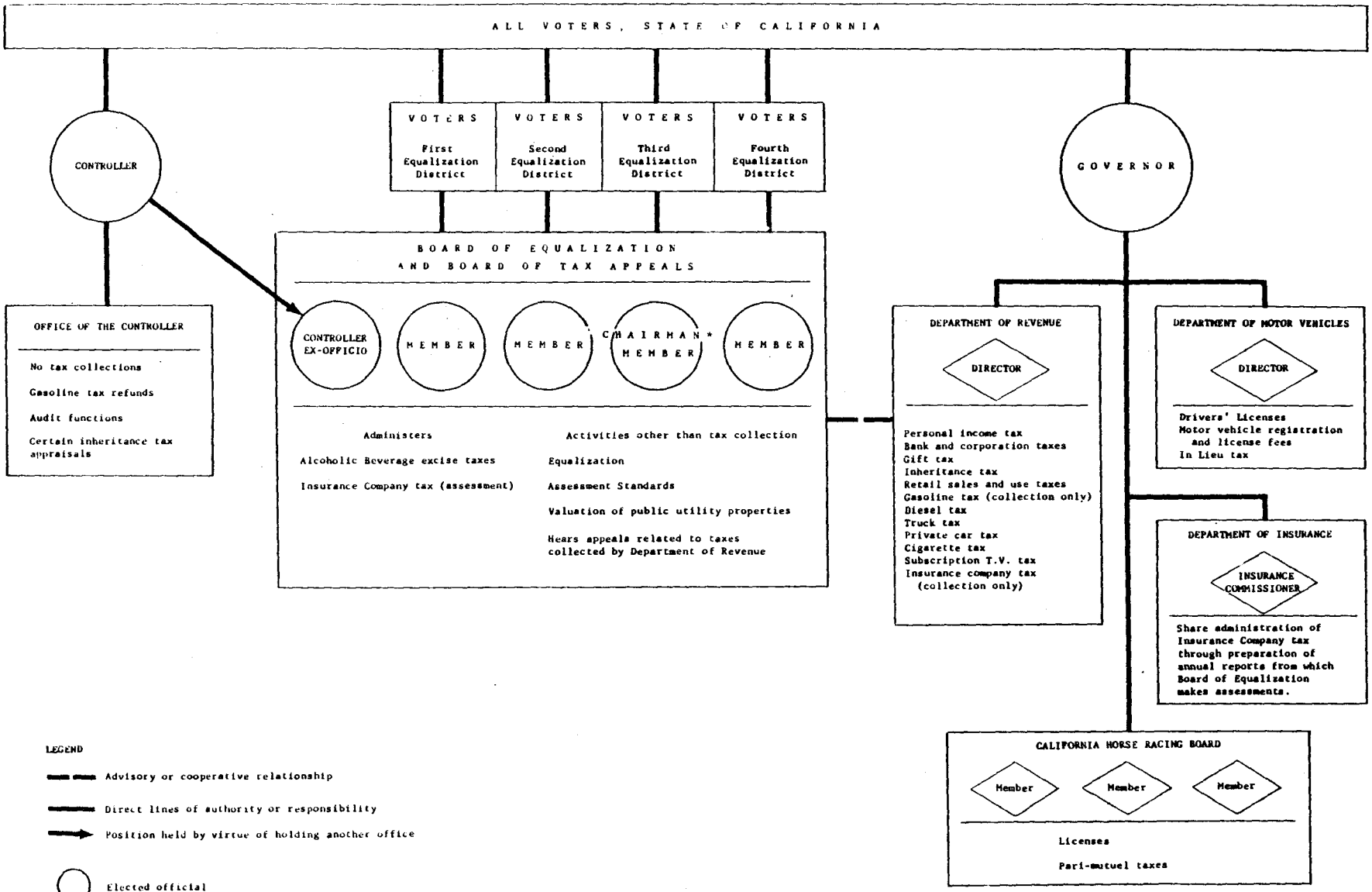
STATEMENT OF ASSEMBLYMAN MILTON MARKS

I have long favored the concept of a consolidation of the revenue collecting agencies of the State of California and have introduced legislation to carry out this purpose. This legislation and alternative proposals relating to this subject are being studied by the Assembly Interim Committee on Government Organization of which I am the Chairman. While I have participated in the discussions of this Commission and support its endorsement of the principle of revenue consolidation, I feel it appropriate to await the January report of our Assembly Committee which might differ in certain particulars, and I am therefore not signing this report at this time.

/s/ Assemblyman Milton Marks, Chairman
Interim Committee on Government
Organization

ORGANIZATION FOR
REVENUE ADMINISTRATION IN CALIFORNIA

AS PROPOSED BY
COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY



* Chairman rotates annually among members.

December, 1964