

Surprising Nuances To California Tax Disputes

By Robert W. Wood

If you live in California, have investments in California, or do business here, you have to interact with California's tax system. It is hard to escape the Golden State's fisc. There are income taxes, franchise taxes, sales and use taxes, property taxes and excise taxes.

There are many nexus issues, surprising withholding taxes, and tough residency rules. And the procedural oddities are not obvious. California's taxes are high, and its tax system is complex.

Rather than adopt federal tax law wholesale, California's legislators pick and choose. Even administratively, our state tax authorities adopt some rules but not others. And California's tax agencies and tax dispute resolution system is quite unusual.

If you have an IRS dispute, you can fight it administratively with the auditor and the IRS Appeals Office. If necessary, you can then go to U.S. Tax Court, where you can contest the tax before paying. Alternatively, you could proceed to the U.S. Court of Federal Claims, or the U.S. district court (if you are willing to pay the tax first).

Many states have a state tax court, but California does not. It has a State Board of Equalization (SBE). It is a five-member administrative body — the only elected tax commission in the U.S. — that functions much like a court. If you are unable to resolve an income or franchise tax dispute with the Franchise Tax Board (FTB) — and that happens a lot — you can appeal it to the SBE.

The SBE will hear your side of the case, and the counterarguments from the FTB. The SBE will rule on the law, but it also has equitable powers. In fact, it is not uncommon for the SBE to bend the rules a little bit, if they are persuaded that the taxpayer is honest, forthright, and sympathetic.

Of course, you can't count on that. In many ways, the deck is stacked against you as a California taxpayer, so ever little bit helps. Notably, the SBE doesn't just hear income tax appeals. It also hears sales and use tax, and even property tax appeals.

If you are unable to resolve an income tax case, property taxes, a sales or use tax matter, or even an excise tax matter, you can appeal it to the SBE. The SBE is where the action is in California. Even the nomenclature can be puzzling.

Confusingly, in addition to the five-member SBE (the ruling body) there's also a large agency called the SBE that administers sales and use taxes. If you can't resolve your sales or use tax dispute administratively with the SBE (the agency), you can appeal to the SBE (the five-member body). It is confusing.

Property taxes, on the other hand, are administered by local county tax collectors. If you can't resolve your property tax dispute with the local authorities, though, it too can eventually end up at the SBE. You might say that all roads lead to the SBE.

And make no mistake, California's five member SBE has a very tough job. They are elected, and they have a constituency. They try to resolve and administer California's tax laws, and most of them are not tax professionals. They are not judges, so it is okay to talk to them *ex parte*, to lobby them, you might say.

In fact, it is common for California tax professionals to seek out the individual members of the SBE in advance of a hearing. You can give them a private advance screening (so to speak) of what your client's case is about, and why you think you should prevail. Much like lobbyists trying to count on legislator votes on a bill facing an upcoming vote, you can try to persuade them.

You may (or may not) be able to garner a commitment that your client's position is meritorious. But information, as they say, is power. If the member is going to vote against you, you are at least better off knowing in advance. You might find that the particular tax

case in question is going to go down party lines (say Republicans voting for the taxpayer and Democrats voting for the state).

You might get clear signals (or outright) statements that an individual SBE member that he or she cannot — or will not — vote for your client. Sometimes a “no” vote in this circumstance can have its own kind of empowerment. Indeed, where this happens, one of the most unique features of California's tax system kicks in: money.

You may donate to that SBE member, and both you and the member will then need to disclose that. Any contribution of \$250 or more must be disclosed. Your contribution will disqualify that member from considering your case.

However, the SBE member will not be disqualified if he returns the contribution within 30 days from the time he knows, or has reason to know, of the contribution and the proceeding pending before the SBE. With a five-member board, if you identify two members who will vote against your client and make contributions to them, they will likely be disqualified.

Your board is now three members. If you garner two positive votes out of the three remaining, you have won. You do the math. Non-Californians may find this untoward. It is certainly different, and not for the untutored. But until they change the rules, that is our system.

Another feature of California tax law that is quite important is what happens after an SBE dispute. The SBE is a unique forum. Perhaps particularly because of its powers to do equity as well as apply the statutes, it can sometimes offer unexpectedly good results.

On the other hand, if the taxpayer is a large company that might be seen as skirting California's tax system and taking the Golden State's resources, you may feel decidedly discriminated against by the SBE. Whatever the case, the SBE is an important venue for tax problem resolution in California.

It is a forum that should most certainly not be taken lightly. This is true for what it is, and for what can happen to a California tax case *after* the SBE. If you win before the SBE, that decision is binding on the FTB. The FTB can submit a petition for rehearing within 30 days of the date of the decision. However, the FTB cannot appeal or go on to another body or court.

That can be frustrating to the FTB tax lawyers, who may feel they are correct on the law but may nevertheless lose. If they lose, they cannot appeal. If the taxpayer loses at the SBE, the taxpayer can bring suit in California Superior Court, the primary trial level courts in California, for a *de novo* trial of the tax dispute.

This one-way appeal right, something only the taxpayer has, is a nice taxpayer protection. If you do sue in Superior Court, you will have a regular judge, not a tax specialist. Most federal tax disputes are heard in U.S. Tax Court, where you'll have a judge with special tax training. Superior Court also offers you the chance for a jury trial.

But if you are a California taxpayer or represent one, what you want is to win before the SBE. Until California changes the law, that means you're done.



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