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CALIFORNIA TAX COLLECTION: TIME FOR REFORM

Daniel L. Simmons*

California's present revenue administration structure is characterized by overlapping duplication, financial waste, and diffusion of activities and responsibilities. It is a hodgepodge of boards and elective and appointive officials and is not truly responsible to the Governor, the Legislature, or the people. Such adequacy of tax administration as we have in California is in spite of, rather than because of "organization."

- Subcomm. of the Assemb. Interim Comm. on Gov't Org.,
The Need for a Department of Revenue in California,
(Feb. 8, 1955).

The tax collection structure in California is a duplicative aggregation of competing agencies that have evolved from California's original dependence on property taxes as the base for state support. In addition, California's primitive tax adjudication framework leaves taxpayers without guidance with respect to interpretation of the State's tax provisions. Indeed, the resolution of tax disputes may depend more on the political vision of short-term elected officials and ex parte influence of campaign supporters than on findings of fact and application of the law to the facts. Further, application of the law is constrained by the complete absence of precedential guidance in the form of written opinions in past cases. Even in the face of powerful political interest in the status quo, it is time for California's government to take a hard look at reform.

The State of California often is compared to a large nation because of its geographic and economic prominence, and the size of its population. Like any nation, the people of

California require its government to maintain infrastructure, provide education, ensure social welfare, and create a legal and regulatory environment in which commercial and other interactions can occur with an expectation of reliability. The governmental structure requires revenue to operate. The revenue is derived from taxes. To be effective, the tax system must be fair and reasonably efficient to attract and not discourage business and investment, and to attract individual economic actors (whether they are workers or investors). Fairness requires a substantive tax regime that does not overly burden commercial transactions and a tax system whose collection practices do not discriminate between competing taxpayers in enforcing compliance with the tax law. The collection process should involve a tax administrative structure that is not unduly burdensome or confusing.

Tax planning requires reliable interpretative guidelines whether the taxpayer is trying to comply with the law, attempting to take advantage of intentionally provided tax subsidies, or trying to avoid taxes through statutory loopholes. Therefore, the tax structure should provide a taxpayer with reliability of result or, in other words, some level of certainty about the way in which the law will be applied. In addition, an open and fair dispute resolution mechanism is required to ensure taxpayer trust in the tax collection system. Every taxpayer is entitled to assurance that all taxpayers are required to meet their obligations under the law, and that no taxpayer is able to escape some or all of his tax burden because of undue influence with elected officials.

The California tax collection system, which has evolved out of historically obsolete mechanisms, fails these requirements. Administration of California's numerous taxes developed in the mid to late nineteenth century to manage a tax base almost entirely dependent on property taxes, which had to be equalized among numerous counties in order to apportion the burden of financing the State government. Although the number and incidence of various taxes has changed dramatically over the State's history, the primary structure of its principal tax collection agency has remained remarkably stagnant.

The collection of numerous taxes and the resolution of

disputes involving almost all of California's taxes is the responsibility of the four elected members of the State Board of Equalization plus the elected State Controller, who is an *ex officio* member of the Board. In spite of decades-long calls for reorganization, California retains its burdensome and confusing array of tax assessment and collection agencies. The obsolete dispute resolution mechanism that is part of this system is guaranteed to produce erratic results because the political make-up of the elected tax collection agency changes with each election cycle. In addition, the existence of a dispute resolution system that is dependent on officials elected for short terms is burdened by the appearance, if not the reality, of a tax structure dominated by political influence.

The first part of this article briefly explores the evolution of California's current tax administration, including periodic calls for the elimination of the Board of Equalization by legislative study groups and governmental commissions. Part II examines the California dispute resolution process with a comparison to procedures within the Internal Revenue Service and the U.S. Tax Court. Part III endorses numerous past recommendations for consolidation of tax collection agencies under the responsibility of the Governor and recommends the creation of a California Board of Tax Appeals to replace the Board of Equalization as the arbiter of tax disputes. These recommendations are supported on the basis of both good governmental policy grounds and by conformity with the United States tax administrative process. However, these recommendations are not supported by powerful politically entrenched interests. The pathway to reform, therefore, is torturous, or perhaps completely blocked.

I. A BRIEF LOOK AT THE EVOLUTION OF CALIFORNIA TAX COLLECTION

California's only source of revenue before adopting its first Constitution in 1849 was customs duties collected under a Federal tariff law of 1846, which had to be returned to the Federal government.¹ Early discussions of revenue sources

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for state government focused on taxation of property and on poll taxes, but Southern California delegates to the state's first constitutional convention were concerned that northern mining companies would use their political power to shift the property tax away from themselves and onto other regions.² The solution adopted to resolve the conflict was a provision that equal tax burdens be assessed by local elected officials.³ The Constitution of 1849 provided that:

Taxation shall be equal and uniform throughout the state. All property in this State shall be taxed in proportion to its value, to be ascertained as directed by law; but assessors and collectors of town, county, and State taxes shall be elected by the qualified electors of the district, county, or town in which the property taxed for State, county, or town purposes is situated.⁴

Notwithstanding the constitutional mandate for uniform taxation, the burden of property and poll taxes,⁵ which were the greatest sources of State revenue, was not evenly distributed. Grazing counties ended up with higher tax burdens than mining counties.⁶ The *San Francisco Daily Evening Bulletin* reported that in 1861 the commercial and agricultural counties with a voting population of 58,933 paid \$444,914 for the support of the State government, \$7.55 per capita, while the mining counties with a voting population of 60,797 paid only \$168,425, \$2.77 per capita.⁷ Since the state tax rates were applied to property assessed locally, the

1. See STEVEN P. ARENA, HISTORY: CALIFORNIA STATE BOARD OF EQUALIZATION; THE FIRST ONE HUNDRED YEARS 1879-1979, at 3, 6 (1980). For a discussion of early California taxation, see also MARVEL M. STOCKWELL, STUDIES IN CALIFORNIA STATE TAXATION 1910-1935, in 7 UNIV. OF CAL. AT L.A., PUBLICATIONS IN SOCIAL SCIENCES (G. McBride et al. eds., 1939).

2. See ARENA, *supra* note 1, at 4-5. In addition to the property tax, the legislature of 1850 enacted a poll tax, a military commutation tax, a foreign miner's license tax and a few additional taxes. See *id.* at 7.

3. See *id.* at 5.

4. CAL. CONST. of 1849, art. XI, § 13.

5. See ARENA, *supra* note 1, at 7.

6. See *id.* at 7-8.

7. ARENA, *supra* note 1, at 8 (quoting S.F. DAILY EVENING BULL., Jan. 14, 1862) (quotations omitted); see also DAVID R. DOERR, CALIFORNIA'S TAX MACHINE: A HISTORY OF TAXING AND SPENDING IN THE GOLDEN STATE 12 (Ronald Roach ed., 2000) (stating that Governor Peter Burnett reported to the Legislature that, by 1851, taxpayers in six ranching counties with a population of 6367 paid \$41,000 while twelve mining counties with a population of 119,917 paid only \$21,000).

elected local assessors had a powerful incentive to lower local assessments and thereby reduce the local property owners' share of state support.⁸ Local assessors attempted to reduce the tax burden of their constituents and transfer a portion of the state property taxation into other counties.⁹

The first legislative response to the unequal tax burdens imposed on county property taxpayers was the statutory creation of the State Board of Equalization, consisting of the State Controller and two members appointed by the Governor.¹⁰ The function of the Board was to equalize assessments among the various counties.¹¹ This legislation also attempted to define full cash value and draw definitional distinctions between real estate, personal property, and improvements.¹² However, in *Houghton et al. v. Austin*¹³ the California Supreme Court declared that the power vested in the State Board to raise and lower assessments violated the California Constitutional mandate that taxes be assessed by assessors and collectors elected in the county or jurisdiction in which the property was located.¹⁴

In order to eliminate this Constitutional infirmity, the State Board of Equalization was enshrined in the State Constitution of 1879.¹⁵ As originally structured, the Board consisted of one representative for each of the then-existing Congressional districts, plus the State Controller as an *ex-officio* member.¹⁶ Under current practice, the State Controller is represented on the Board by the Controller's deputy who acts for the Controller in all matters except in cases involving exercise of the Board's constitutional authority.¹⁷ The Constitution was amended in 1884 to provide for the present structure of four districts with equal

8. See ASSEMB. INTERIM COMM. ON GOV'T ORG., CALIFORNIA'S TAX ADMINISTRATION: THE NEED FOR A CENTRAL REVENUE DEPARTMENT 12 (1965).

9. See ARENA, *supra* note 1, at 8 (citing WILLIAM C. FANKHAUSER, A FINANCIAL HISTORY OF CALIFORNIA, in 3 UNIV. OF CAL., PUBLICATIONS IN ECONOMICS (1913)).

10. Act of Apr. 4, 1870, ch. CCCCLXXXIX, 1870 Cal. Stat. 714.

11. *Id.*

12. See ARENA, *supra* note 1, at 9-10.

13. 47 Cal. 646 (1874).

14. See *id.* at 650-51.

15. See CAL. CONST. of 1879, art. XIII, § 9.

16. See *id.*

17. See CAL. GOV'T CODE § 7.9(a) (Deering 2006).

population.¹⁸ Each member currently represents approximately eight million people, ranking California's Board of Equalization districts among the largest represented jurisdictions in the United States.

Under the 1879 Constitution, property was to be assessed locally.¹⁹ The 1879 Constitution charged the Board of Equalization with the duty to "equalize the valuation of the taxable property of the several counties in the State for the purpose of taxation."²⁰ This provision was interpreted to permit the State Board to equalize the assessment rolls of the various counties by adjusting the respective county assessment rolls, but did not permit the State Board to adjust individual assessments.²¹ Authority to adjust the assessments of individual taxpayers was restricted to the county boards of equalization.²² The State Board of Equalization also was charged with the responsibility of assessing the value of property owned by railroads that operated in more than one county, including the value of the railroad franchise,²³ roadbed, rails, and rolling stock, and apportioning the assessed value to the counties in proportion

18. See CAL. CONST. of 1879, art. XIII, § 9 (amended Nov. 4, 1884). CAL. CONST., art. XIII, § 17, now provides that, "The Board of Equalization consists of 5 voting members: [T]he Controller and 4 members elected for 4-year terms at gubernatorial elections. The state shall be divided into four Board of Equalization districts with the voters of each district electing one member. No member may serve more than 2 terms." *Id.*

19. See CAL. CONST. of 1879, art. XIII, § 10. The current provision is CAL. CONST. art. XIII, § 14. The 1879 Constitution also provided for the "levy and collection of annual poll tax of not less than two dollars on every male inhabitant of this State, over twenty-one and under sixty years of age, except paupers, idiots, insane persons and Indians not taxed. Said tax shall be paid into the State School Fund." CAL. CONST. of 1879, art. XIII, § 12.

20. CAL. CONST. of 1879, art. XIII, § 9. The current Constitution requires the Board to "measure county assessment levels annually and [to] bring those levels into conformity by adjusting entire secured local assessment roles." CAL. CONST. art. XIII, § 18. However, after the 1978 enactment of the Taxation Limitation Initiative (Proposition 13), the full cash value of real property is limited to its appraised value in 1975-1976, or the appraised value of the property when purchased, newly constructed, or a change in ownership has occurred after 1975, plus an annual inflation adjustment not to exceed two percent. See CAL. CONST. art. XIII, § 2.

21. See *Wells Fargo & Co. v. State Bd. of Equalization*, 56 Cal. 194, 198-99 (1880).

22. See CAL. CONST. of 1879, art. XIII, § 9.

23. The power of the State to assess a property tax on the value of a railroad franchise was upheld in *Cent. Pac. R.R. v. California*, 162 U.S. 91, 112 (1896), and *S. Pac. R.R. Co. v. California*, 162 U.S. 167 (1896).

to the number of miles of railway within the county.²⁴ Collecting the tax under this provision was a problem. The county tax collectors proved to be somewhat lax in actually collecting assessed taxes from the railroads.²⁵ In *People v. Sacramento County Board of Supervisors*²⁶ the California Supreme Court defeated an attempt by county supervisors to revise assessments of railroad property by the Board of Equalization.

The California legislature directed by statute in 1883 that the State Controller collect taxes assessed by the Board of Equalization.²⁷ This provision began a history of the separation of assessment of tax by the Board of Equalization and collection of taxes by an agency other than the Board, which continues to the present day.²⁸

In recognition of the inherent difficulties and unequal tax burdens that resulted from attempts to equalize property taxation among the counties, State Constitutional Amendment Number One, enacted by the voters in 1910, separated state revenue sources from the property tax collected by local governments.²⁹ Under this provision,

24. See CAL. CONST. of 1879, art. XIII, § 10. The power of the State Board of Equalization to assess railroad property under this provision was upheld by the California Supreme Court in *San Francisco and N. Pac. R.R. Co. v. State Bd. of Equalization*, 60 Cal. 12, 29 (1882).

25. See ARENA, *supra* note 1, at 15-16.

26. *People v. Sacramento County Bd. of Supervisors*, 59 Cal. 321 (1881).

27. See 1880 Cal. Stat. 31 (codified as amended at CAL. POL. CODE § 3670 (1883)); see also *San Mateo County v. Oullahan*, 69 Cal. 647 (1886) (upholding this scheme as applied to single out the railroads for different tax assessment and collection methodologies against an attack under the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution).

28. See ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 8, at 13. The inheritance tax, introduced in 1893, Stats. 1893, ch. 168, was to be collected by county treasurers who retained a percentage of the tax. In 1909 the State Controller was authorized to appoint a deputy to assist in the administration of the tax, and in 1915 the Controller was authorized to appoint an inheritance tax appraiser in each county. See *id.*

29. The separation of sources, known as the Plehn Plan, was recommended by a Commission on Revenue and Taxation created by the Legislature in 1905, including Governor George C. Pardee, Senators J. B. Curtin and M. L. Ward, Assemblymen H. S. G. McCartney and E. F. Treadwell, and UC Berkeley Professor Carl C. Plehn. See ARENA, *supra* note 1, at 18-19. The original constitutional amendment that resulted from the commission's recommendations failed to pass. See *id.* at 20. A subsequent commission, also including Professor Plehn, recommended revisions to the original proposal, which resulted in the successful 1910 constitutional initiative. See *id.*; see also STOCKWELL, *supra* note 1, at 16-18; DOERR, *supra* note 7 at 21, 25-26.

revenue from property taxes was reserved for local governments. The state was supported by revenue from a gross receipts tax on public service corporations such as railroads and utilities, a franchise tax on corporations based on the value of the corporate franchise,³⁰ a gross premiums tax on insurance companies, a capital stock tax on banks,³¹ and an inheritance tax.³² In addition, the State had been collecting a license fee from corporations since 1905.³³ Although the 1910 change was intended to establish tax rates for each class of taxpayer that approximated the general tax on property values, the rates continued to vary considerably between classes of taxpayers and between individual companies.³⁴ It fell to the Board of Equalization to advise the legislature on rates required to equalize these tax burdens; a somewhat revised equalization undertaking.³⁵

30. A corporate franchise generally was valued by ascertaining the total fair market value of outstanding securities and subtracting the value of tangible property of the corporation. See CAL. TAX COMM'N, SPECIAL REPORT OF THE CALIFORNIA TAX COMMISSION 29-30 (1928). Ultimately this system resulted in "an arbitrary tax, the amount of which [was] impossible to anticipate and accrue." See *id.* at 30. Valuation of the corporate franchise was undertaken by the Board of Equalization using various approaches. See STOCKWELL, *supra* note 1, at 128-30.

31. This tax was a personal property tax imposed on the owners of bank shares, but the tax was generally paid by the bank. See CAL. TAX COMM'N, *supra* note 30, at 19. The tax was in effect viewed as a tax on the bank, although such direct taxation of national banks was prohibited by Federal Law. See *id.*

32. See ARENA, *supra* note 1, at 21; see also ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 8, at 14. The inheritance tax was collected through a dual system. See STOCKWELL, *supra* note 1, at 60-62. Inheritance taxes were collected by County Treasurers, for a fee calculated as a percentage of the tax collected, subject to the jurisdiction of the Superior Court of the county in which the decedent's real property was situated. See *id.* at 61. Taxes were payable to the State Controller who also appointed appraisers for each county. See *id.* The State Controller's office included the Inheritance Tax Department. See *id.* at 61-62.

33. See Act of Mar. 20, 1905, ch. CCCLXXXVI, 1905 Cal. Stat. 493 (current version at CAL. POL. CODE § 416 (1905)). Fees for filing articles began at \$15 to \$500 for corporations with over \$1 million of capital stock plus \$50 for every \$500,000 of capital stock over \$1 million. *Id.* The annual license fee ranged from \$10 to \$250 depending on the value of capital stock. *Id.*

34. See ARENA, *supra* note 1, at 21-22.

35. See *id.* (quoting CAL. BD. OF EQUALIZATION, SPECIAL REPORT OF THE CALIFORNIA STATE BOARD OF EQUALIZATION ON THE RELATIVE BURDEN OF STATE AND LOCAL TAXATION IN 1912 (1913)). The Board advised that the property tax burden on public utilities was twenty to fifty percent lower than if they had paid property taxes at the average rate on locally assessed property.

The capital stock tax on banks initially imposed a tax of one percent on capital stock shares.³⁶ A 1924 amendment to the State Constitution empowered the Legislature to provide for the assessment and collection of tax on certain intangibles, including notes and shares of capital stock not otherwise exempt from taxation.³⁷ In 1925, the legislature first imposed a tax of seven percent of full cash value on intangibles,³⁸ but reduced the rate in 1927 to 1.45 percent of full cash value.³⁹ Both of these acts were declared invalid because the Legislature had failed to provide for apportionment of the tax revenue to counties and other local jurisdictions as required by the Constitutional provision.⁴⁰ In addition, the license fee on corporations, which had been repealed but reinstated in 1915, was declared invalid when applied to foreign corporations.⁴¹

Various motor vehicle taxes re-enacted and restructured in 1923⁴² were additionally assigned to the Board of Equalization for assessment, but assigned to the State Controller for collection. These included a registration fee for private motor vehicles, a motor vehicle license tax on commercial motor transportation that was based on gross receipts, and two cents per gallon tax on motor vehicle fuel.⁴³ The gross receipts tax on commercial carriers was revised, then repealed.⁴⁴ A subsequent gross receipts tax was imposed

See DOERR, supra note 7, at 25.

36. *See ARENA, supra note 1, at 27.*

37. *See CAL. CONST.* art. XIII, § 12 ½ (repealed 1933).

38. *See* 1925 Cal. Stat. 13, § 3 (codified at CAL. POL. CODE § 3627a (1925)).

39. *See* 1927 Cal. Stat. 399, § 2. (codified as amended at CAL. POL. CODE § 3627a (1927)). Banks were taxed by local government on real property. CAL. TAX COMM'N, *supra* note 30, 14. The state tax was imposed at a flat rate on the capital shares of stock where the base consisted of capital surplus plus undivided profits reduced by the assessed value of real property. *See id.*

40. *See Arnold v. Hopkins*, 203 Cal. 553, 566-67 (1928).

41. *See Perkins Mfg. v. Jordan*, 200 Cal. 667 (1927); *see also H.K. Mulford Co. v. Curry*, 163 Cal. 276, 282-84 (1912) (declaring the original 1905 tax invalid as applied to foreign corporations).

42. California began collecting vehicle registration fees in 1905. *See STOCKWELL, supra note 1, at 88.* The initial tax was a flat fee, but evolved into a variable levy based on horsepower. *See id.* at 89-90. The vehicle registration fee was paid into a "motor vehicle fund" thus beginning California's long history of setting aside tax revenue into specific funds with limited purpose. *See id.*

43. Act of May 30, 1923, ch. 266, 267, 1923 Cal. Stat. 517, 571; Act of June 13, 1923, ch. 341, 1923 Cal. Stat. 706; *see ASSEMB. INTERIM COMM. ON GOV'T ORG.*, *supra* note 8, at 14; *see also ARENA, supra note 1, at 24-25.*

44. Common carriers were removed from the license tax in 1926 by adoption

in 1933 on the operators of a motor vehicle carrying persons or freight for hire.⁴⁵ Most passenger carriers were treated as public utilities so this tax applied only to trucking firms that carried goods for others.⁴⁶ The tax was administered by the Board of Equalization, which issued licenses and verified returns, and was collected by the Controller.⁴⁷ These motor vehicle fuel taxes continue to be administered by the Board of Equalization.⁴⁸

Even with the motor vehicle taxes, the loss of revenue from the truncated bank and corporation taxes placed the State in financial jeopardy. The contemporary structure of California's income tax system began to evolve as the result of a study commissioned by the Legislature in 1927 to review the California revenue situation. In 1928, the first report of the California Tax Commission (the Martin Commission) recommended taxation of banks and corporations on the basis of net income.⁴⁹ The recommendation was implemented by constitutional amendment approved by the voters in 1928, which authorized the Legislature to tax corporations and banks by any method not prohibited by the Constitution, and which provided that the tax would be based on net income unless otherwise provided by the Legislature.⁵⁰ The tax was implemented with the Bank and Corporation Act of 1929.⁵¹

The State Controller attempted to have administration of the new bank and corporation income tax assigned to the Controller's office, while members of the Board of Equalization lobbied to have responsibility for administration of the tax assigned to the Board.⁵² The legislative

of Section 15, Article XIII, of the California Constitution and reclassified as public utilities subject to the public utilities gross receipts tax. See ARENA, *supra* note 1, at 25. The tax, which thereafter applied only to contract carriers, was repealed in 1928. See *id.*

45. See ARENA, *supra* note 1, at 50.

46. See *id.* at 50-51.

47. See *id.* at 51.

48. See CAL. REV. & TAX. CODE §§ 7301 et. seq. (Deering 2006). The Board also administers a similar tax on jet fuel. See also CAL. REV. & TAX. CODE § 7370 et. seq. (Deering 2006).

49. See CAL. TAX COMM'N, *supra* note 30, at 18-19.

50. See CAL. CONST. art. XIII, § 16 (Nov. 6, 1928) (current version at CAL. CONST. art. XIII, § 27).

51. See Bank and Corporation Act of 1929, ch. 13, 1929 Cal. Stat. 19.

52. See DOERR, *supra* note 7, at 30.

compromise influences income tax administration to this day. Administration of the corporate franchise tax was assigned to the Franchise Tax Commissioner, who was to be appointed by a special committee consisting of the Controller, the Director of Finance, and the Chair of the Board of Equalization.⁵³ Appeals from assessment of the tax were to be made to the Board of Equalization.⁵⁴ The same pattern was followed in the enactment of the Personal Income Tax Act of 1935,⁵⁵ administration was assigned to the Franchise Tax Commissioner, and the Board of Equalization was designated to hear appeals.⁵⁶ The 1937 enactment of a supplemental corporate income tax applicable to corporations engaged

53. See ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 8, at 15; see also ARENA, *supra* note 1, at 30.

54. See ARENA, *supra* note 1, at 30.

55. See Personal Income Tax Act of 1935, ch. 329, 1935 Cal. Stat. 1090-91. The personal income tax was authorized by Constitutional Amendment 30 (approved by the voters June 27, 1933), which added Article XIII, section 15, of the California Constitution to provide in part that,

The Legislature shall provide for the raising of revenue by any form of taxation not prohibited by this Constitution in amounts sufficient to meet the expenditures of this State not otherwise provided for and in amounts sufficient to apportion, and shall apportion, to each county or city and county of this State, an amount equal to the entire amount required to be raised by each such county or city and county respectively

Act of May 6, 1933, ch. 63, 1933 Cal. Stat. 3072, 3076.

In addition to authorizing the Legislature to enact forms of taxes as it determined, Constitutional Amendment 30, the so-called Riley-Stewart Plan named after State Controller Ray L. Riley and Board of Equalization member Fred E. Stewart, terminated the separation of sources concept, returned public utilities to local tax rolls (although public utility property is still assessed by the Board of Equalization), transferred public school expenditures to the State from the counties thereby reducing the tax burden on real property, imposed a spending limitation on counties and school districts of not more than five percent of the preceding year's expenditures, imposed a biennial spending limit on the State not to exceed more than five percent of the expenditures in the preceding biennium, and prohibited raising more than twenty-five percent of state funds with an ad valorem property tax. See CAL. CONST. art. XIII, § 22; see also ARENA, *supra* note 1, at 38-39; see ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 8, at 15-16; STOCKWELL, *supra* note 1, at 163-200. The Riley-Stewart plan worsened the state deficit by reducing state revenue from the utility tax and adding education costs without increased state revenue. See DOERR, *supra* note 7, at 34.

56. Attempts to assign administration of the personal income tax to the Board of Equalization were defeated in the Assembly. See STOCKWELL, *supra* note 1, at 250. Reportedly it was argued that while the Board members are elected, the Franchise Tax Commissioner is appointed by the Governor and therefore subject to political control. See *id.*

solely in interstate commerce also provided for administration by the Franchise Tax Commissioner.⁵⁷

The transformation of the position of Franchise Tax Commissioner into the existing Franchise Tax Board is one of the unusual stories that seems to characterize California political history. Charles L. McColgan, a former State Assembly member from San Francisco, was appointed in 1931 as the third Franchise Tax Commissioner.⁵⁸ The 1934 constitutional amendment creating the civil service protected most State employees, with exemptions for persons appointed by the Governor and elected officials, among others. This did not include the Franchise Tax Commissioner who was appointed not by the Governor, but by the Controller, the Governor's Finance Director and the chair of the Board of Equalization.⁵⁹ The Franchise Tax Commissioner thus became subject to civil service protection and could not be removed under the 1929 act that created the position. "The Franchise Tax Commissioner became the only civil service employee not responsible to anyone for his conduct or professional actions."⁶⁰ Apparently, Commissioner McColgan took full advantage of this autonomy. A 1948 legislative investigation of the San Francisco office of the Franchise Tax Commissioner⁶¹ "revealed a picture of gross inefficiency and maladministration"⁶² including a "widespread practice of employees . . . soliciting and performing outside employment which is incompatible with their duties as state employees."⁶³ As a consequence, the Legislature abolished the position of

57. See SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., THE NEED FOR A DEPARTMENT OF REVENUE IN CALIFORNIA 57 (1955). The Legislature rejected an attempt to assign administration of the personal income tax to the Board of Equalization. See ARENA, *supra* note 1, at 54.

58. See ARENA, *supra* note 1, at 30.

59. See CAL. CONST. art. XXIV, § 4 (1934) (current version at CAL. CONST. art. VII, § 4).

60. SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 57, at 57.

61. ASSEMB. INTERIM COMM. ON GOVERNMENTAL EFFICIENCY AND ECON., PARTIAL REPORT ON THE SAN FRANCISCO OFFICE OF THE FRANCHISE TAX COMMISSIONER (1949).

62. SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 57, at 57.

63. ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 8, at 17 (quoting ASSEMB. INTERIM COMM. ON GOVERNMENTAL EFFICIENCY AND ECON., *supra* note 61, at 19).

Franchise Tax Commissioner and restructured the position into the Franchise Tax Board consisting of the State Controller, the Director of Finance (an appointed member of the Governor's staff), and the Chair of the Board of Equalization, the same group of officials originally designated as the appointment authority for the Franchise Tax Commissioner.⁶⁴ The Franchise Tax Board succeeded to all of the duties of the Franchise Tax Commissioner.⁶⁵ The Franchise Tax Board currently appoints an executive officer, subject to the consent of two-thirds of the State Senate, who is subject to removal by a two-thirds vote of the Board.⁶⁶

The 1929 final report of the Martin Commission contained far-reaching recommendations in addition to the income based franchise tax.⁶⁷ The Commission described the existing tax system as "fundamentally faulty"⁶⁸ and recommended a tax structure consisting of the property tax dedicated to local government, a business tax on net income from business carried on in California to support State government, and a personal income tax to be divided between state and local government.⁶⁹ Significantly, the Martin Commission recommended abolition of the Board of

64. See Act of July 25, 1949, ch. 1188, 1949 Cal. Stat. 2108.

65. See CAL. GOV'T CODE § 15700 (Deering 2006). The Franchise Tax Board is housed in the California Consumer Services Agency. See *id.* § 12804. Currently, the Franchise Tax Board is responsible for the administration of the personal income taxes, the corporation tax, and the so-called "taxpayers' bill of rights." See CAL. REV. AND TAX. CODE § 19501 (Deering 2006).

66. See CAL. GOV'T CODE § 15701 (Deering 2006). The original legislation required a two-thirds vote of the State Senate to remove the executive officer, thereby providing security of employment almost as great as the civil service protection enjoyed by Commissioner McColgan. Act of July 25, 1949, ch. 1188, § 2, 1949 Cal. Stat. 2108. The removal provision was required to induce the first incumbent, John J. Campbell, to accept the executive director position. When the removal provision was repealed in 1979 (1979 Cal. Stat. ch. 1203 § 1), the then executive director, Martin Huff, resigned from the position. See DOERR, *supra* note 7, at 48, 169-70, 440. Doerr suggests that one of the reasons the legislature was willing to revise the removal language was concern that Mr. Huff was preparing to tax the legislative per diem allowance. See *id.* at 170.

67. See CAL. TAX COMM'N, FINAL REPORT OF THE CALIFORNIA TAX COMMISSION 1 (1929).

68. *Id.* at 1.

69. See *id.* at xxi; see also SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 57, at 57. The personal income tax was first recommended in 1917 as a substitute for the property tax by the Tax Commission of that date. See REPORT OF THE STATE TAX COMMISSION, 110 (1917).

Equalization and its replacement by a tax commission consisting of three members appointed by the Governor.⁷⁰ This was the first of multiple attempts to eliminate the Board of Equalization.⁷¹ The report of the Martin Commission contains guidance that should be inscribed on the desk of every California legislator:

“Students of government find one of the fundamental faults in American government to be the willingness to write upon the statute books laws which theoretically call for a high degree of equity without the willingness to provide the necessary machinery for carrying these laws into effect.”⁷²

Notwithstanding the recommendations of the Martin Commission and its loss of authority over collection of the corporate franchise tax, the role of the Board of Equalization was strengthened with enactment of the retail sales tax in 1933.⁷³ Administration of the new sales tax was assigned to the Board. The Board of Equalization was also designated to hear sales tax appeals from the decisions of its own administrators. At the end of prohibition in 1933, a State Constitutional Amendment delegated to the Board of Equalization the power to license and collect taxes with respect to the sale of alcoholic beverages.⁷⁴ Licensing and regulation of alcoholic beverages was transferred by constitutional amendment in 1954 to the Department of

70. CAL. TAX COMM'N, *supra* note 67, at xxiv, 131. The report states: “The Commission considers this recommendation fundamental and desires to condition its other recommendations for changes in the tax system upon its acceptance.” *Id.* at xxiv.

71. Efforts to abolish the Board occurred no less than forty times after this 1929 attempt. See ARENA, *supra* note 1, at 33.

72. CAL. TAX COMM'N, *supra* note 67, at 116. The report also states, “It is of course trite to observe that a law is no better than its administration. If the standards of the community would countenance the apportionment of the burdens of government by the rough and crude methods of primitive countries, there would be no problem here. The complications arise because the people insist upon fairness in taxation. Administration, indeed, is an important limiting factor upon progress.” *Id.*

73. See 1933 Cal. Stat. ch. 1020, p. 2609. The sales tax, like the personal income tax enacted in 1935, was authorized by Constitutional Amendment 30, adding Article 30, section 15, of the California Constitution, enacted by vote of the people in 1933. See CAL. CONST. art. XIII, § 15; *supra* note 55. The sales tax and income tax acts were drafted in significant part by Roger Traynor who later became Chief Justice of the California Supreme Court. See DOERR, *supra* note 7, at 37.

74. See CAL. CONST., art. XX, § 22 (amended 1934).

Alcoholic Beverage Control, but assessment and collection of excise taxes on alcoholic beverages remains with the Board of Equalization.⁷⁵ In 1937, the Legislature enacted a diesel fuel tax (use fuel) administered by the Board of Equalization as a supplement to the gasoline tax.⁷⁶ A private car tax was enacted that same year, which replaced the state assessed, but locally collected, property tax on privately owned railroad cars, also administered by the Board of Equalization.⁷⁷ Administration of the gift tax, enacted in 1939,⁷⁸ was assigned to the Controller to accompany the inheritance tax enacted in 1893 that had been administered by the Controller since 1911.⁷⁹ In a significant change in tax administration, the Bradley-Burns Uniform Local Sales and Use Tax Law⁸⁰ authorized the State Board of Equalization to administer and collect sales and use taxes imposed by cities and counties.⁸¹ A cigarette tax administered by the Board of Equalization was enacted in 1959,⁸² and the Board was assigned administration of a television subscription tax enacted in 1963,⁸³ which was repealed by initiative in 1964.⁸⁴ Also, the Board of Equalization was given constitutional responsibility for administration of the net income tax on insurance companies.⁸⁵ Employment payroll taxes and disability insurance are administered by the Employment Development Department. The most recent annual report of the Board of Equalization lists thirty-three taxes and fees administered by the Board.⁸⁶

As was the case with the 1929 Martin Commission

75. See CAL. CONST., art. XX, § 22 (amended 1954).

76. See Use Fuel Tax Act of 1937, ch. 352, 1937 Cal. Stat. 763-70.

77. See Act of Aug. 27, 1937, ch. 283, 1937 Cal. Stat. 621-27.

78. See Gift Tax Act of 1939, ch. 652, 1939 Cal. Stat. 2079.

79. See Act of Mar. 23, 1893, ch. CLXVIII, 1893 Cal. Stat. 193; Act of Apr. 7, 1911, ch. 395, 1911 Cal. Stat. 713. California inheritance and gift taxes were repealed in 1982. Proposition 6, ch. 1535, § 16, 1982 Cal. Stat. 5988.

80. Bradley-Burns Uniform Local Sales and Use Tax Law of 1955, ch. 1311, 1955 Cal. Stat. 2381.

81. See *id.*

82. See Cigarette Tax Law of 1959, ch. 1040, 1959 Cal. Stat. 3061.

83. See Act of July 24, 1963, ch. 5, 1963 Cal. Stat. 5016.

84. Free Television Act of 1964, 1964 Cal. Stat. A-132, § 8.

85. See CAL. CONST. art. XIII, § 28.

86. See CAL. STATE BD. OF EQUALIZATION, 2004-2005 ANNUAL REPORT, TAXES AND FEES ADMINISTERED BY THE BOARD OF EQUALIZATION 2004-2005, at 6 (2006), <http://www.boe.ca.gov/annual/pdf/2005/1-profile05.pdf>.

report, the confusing nature of California tax administration was recognized in a 1955 legislative report that concluded:

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.⁸⁷

The 1955 report went on to say:

Historically, insofar as the committee has been able to determine, every comprehensive report on the subject that has been made by objective, unbiased persons who were not part of California's existing revenue administration structure (and whose own positions would therefore not be affected) has endorsed consolidation of the State's major revenue agencies in some form or other. The committee knows of no comprehensive, independent study that has defended the existing organization—or lack of it.⁸⁸

Ten years later, a 1965 legislative study recommended that "a Department of Revenue be established with responsibility for the statutory state tax collection functions presently exercised by the State Controller, the Board of Equalization and the Franchise Tax Board."⁸⁹ The study noted that, "For more than 35 years legislative committees and special commissions have consistently recommended unification of revenue collection. This consensus has been supported by each of our present state officials with tax administration responsibilities."⁹⁰ The study recommended that "the Department of Revenue be administered by a Director of Revenue appointed by the Governor with Senate confirmation and removable by the Legislature for cause."⁹¹ The study also recommended that the Board of Equalization

87. SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 57, at 9.

88. *Id.* at 25; *see also id.* at 37 (providing a list of recommendations for a consolidated revenue administration predating the 1955 report).

89. ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 8, at 43.

90. *Id.* at 9-10.

91. *Id.* at 43.

be designated as the board of tax appeals.⁹²

The multiplicity of taxes in California administered by different agencies led the 1965 Legislative study committee to comment:

The distribution of tax collection responsibility among several agencies presents a complicated picture to the taxpayer. An individual taxpayer is faced with the confusing situation of having to deal with as many as four separate agencies in the payment of his state taxes and in some instances having to deal with more than one agency in the payment of a single tax.⁹³

The Committee added:

A taxpayer engaged in a small business, for example, pays his sales tax to the Board of Equalization, his corporation income tax to the Franchise Tax Board, his unemployment and disability insurance taxes to the Department of Employment, his registration fees for commercial vehicles to the Department of Motor Vehicles and so on. [¶] To add to this complexity, several taxes are jointly administered by more than one agency. The Insurance Commissioner and the Board of Equalization have joint responsibilities in the assessment of the gross premiums tax on insurance companies and the tax is then collected by the State Controller.⁹⁴

In his testimony to the Committee, A. Alan Post, the State's highly respected Legislative Analyst at that time, stated:

I would make the case that it would be beneficial to the public to be able to go to one tax agency, and to know that you could get your tax business done there, rather than having the present complex decision of knowing whether to go, with respect to one tax to the Controller, another to the Board of Equalization, and then to another agency, and so forth. This is just bad business from the standpoint of the public and the public's time is wasted by the present system and there's no doubt about it.⁹⁵

The 1965 study also concluded that the California revenue structure fails to focus authority and responsibility in the

92. *See id.*

93. *See* ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 8, at 10.

94. *Id.* at 36.

95. *Id.*

Governor.

“Under the California Constitution, the Governor is responsible for the enforcement of all laws. The present structure for revenue administration, violates the principle of concentrating administration of the executive branch under the chief executive. In addition to having several tax agencies, the responsibility for administration is shared by various elective and appointive officials.”⁹⁶

Mr. Post, the Legislative Analyst, testified on this point that:

I contend that this is a dangerous way to organize, because as in the case of liquor administration, as in the case of other scandals in other states, the real problems come about primarily in those cases where nobody was responsible because everybody appeared to be responsible.⁹⁷

The California property tax revolt of 1978, with the voters' enactment of Proposition 13, minimized the Board of Equalization's historic role with respect to equalizing ad valorem real property taxes among the counties.⁹⁸ Proposition 13 provides that property tax on real property shall not exceed one percent of full cash value.⁹⁹ “Full cash value” is limited to the assessed value shown on the 1975-76 property tax assessment, but property may be reassessed to the appraised value of the property when purchased or newly constructed.¹⁰⁰ Full cash value is allowed to reflect an inflation adjustment not to exceed two percent for any given year, may be decreased to reflect declines in the consumer price index or comparable indices, and may be decreased to reflect declines in value from various causes.¹⁰¹ Restrictions on real property assessment, limiting value to acquisition value, eliminate the need for equalization of values among the counties. The original constitutional function of the Board to equalize assessment rolls across the counties has been rendered obsolete.

While studies and commissions have regularly

96. *Id.* at 37.

97. *Id.*

98. For a history of Proposition 13, see DOERR, *supra* note 7, at 130.

99. CAL. CONST. art. XIII A, § 1(a).

100. CAL. CONST. art. XIII A, § 2(a).

101. CAL. CONST. art. XIII A, § 2(b).

recommended consolidation of tax collection functions in a single agency, as was the case with the 1929 enactment of the Bank and Corporation tax, which created the position of Franchise Tax Commissioner,¹⁰² jockeying for authority under various tax collection agencies has derailed reform. In 1994, the California Legislature enacted legislation that would have abolished the Franchise Tax Board and transferred its responsibilities to the Board of Equalization.¹⁰³ The proposed legislation would have assigned all taxpayer administrative appeals to the staff of the Board of Equalization. The Board itself would have had authority to adjudicate taxpayer appeals. In vetoing this legislation, Governor Pete Wilson said:

AB 15 would centralize all state tax policy, implementation, and administration outside the executive branch of government. This makes no sense. Ultimately, the Governor is held accountable for the operations of state government, including the tax system, and should be. [¶] In contrast, most other state revenue departments are administered by a director appointed by the Governor, and confirmed by the state Senate.¹⁰⁴

The Governor's veto message also noted the "conflict of interest inherent in the structure proposed in Assembly Bill 15, in which the Board of Equalization serves as both administrator of the tax system, as well as the appellate body for taxpayer appeals."¹⁰⁵

Again in 1996, following the direction of Governor Wilson's veto message, the Constitutional Revision Commission, appointed by the Governor, recommended "abolishing the board of Equalization and the Franchise Tax Board and combining their regulatory and executive functions and those of other major revenue agencies into a new Department of Revenue."¹⁰⁶ The Commission added that "a

102. See *supra* text accompanying note 52.

103. Assemb. B. 15, 1993-1994 Reg. Sess. (Cal. 2006). The bill was enrolled on September 6, 1994 and later vetoed by the Governor on September 30, 1994. *Id.*

104. Governor's Veto Message to the California Assembly Regarding Assembly Bill No. 15 (Sept. 30, 1994), available at http://www.leginfo.ca.gov/pub/93-94/bill/asm/ab_0001-0050/ab_15_vt_940930.

105. *Id.*

106. CAL. CONST. REVISION COMM'N, FINAL REPORT AND RECOMMENDATIONS TO THE GOVERNOR AND THE LEGISLATURE 20 (1996).

state tax appeals body should be established, appointed by the governor and subject to senate confirmation.”¹⁰⁷

The value of consolidating administration of various taxes into a single agency was most recently recognized in the report of the Governor’s California Performance Review that states:

California’s tax collection system is currently divided between four different agencies: Board of Equalization, Franchise Tax Board, Department of Motor Vehicles, and the Employment Development Department collects employment taxes. It is important to streamline tax collection in order to facilitate financing for needed services to maintain the trust of taxpayers. In its comprehensive review, CPR found three main obstacles to efficient tax collection in the state:

- California’s tax system is duplicative.
- California’s tax system is inefficient.
- California’s tax system is confusing for taxpayers.

To address these problems, California’s revenue agencies will be consolidated into one California Tax Commission. This Commission will integrate revenue collection activities independent of the budget and fiscal agencies. By consolidating revenue agencies, the California Tax Commission will eliminate duplicative functions and responsibilities, be open and accountable to the people, maintain a high level of efficiency, and maintain and promote customer service, providing a one-stop-shop where any taxpayer can resolve tax issues.¹⁰⁸

In 2004, the Governor’s Performance Review Commission introduced its 126 recommendations by stating that the recommendations collectively will “[c]reate a clear line of authority to the Governor.”¹⁰⁹ While its final report is somewhat ambiguous on this point, the Commission seems to suggest that its recommended California Tax Commission will consist of the State Controller and the elected members

107. *Id.*

108. CAL. PERFORMANCE REVIEW COMM’N, CALIFORNIA PERFORMANCE REVIEW – THE PUBLIC PERSPECTIVE, THE REPORT OF THE CALIFORNIA PERFORMANCE REVIEW COMMISSION 440-41(2004).

109. *Id.* at 5.

of the State Board of Equalization.¹¹⁰ This approach, however, ignored both the Commission's own professed desire to create clear lines of administrative authority to the Governor, and the earlier wisdom of previous studies of the issue calling for a consolidated tax agency for which the Governor is held responsible.

As noted in the 1965 Legislative study:

The product of 115 years of taxation in California is an administrative structure that has developed to meet specific fiscal crises. While there are historical reasons for the present assignment of tax collection responsibilities among several agencies, there is little over-all administrative rationale to the current structure.¹¹¹

The California Performance Review Commission is correct in its observation that the California tax system is duplicative, inefficient, and confusing to taxpayers.¹¹² Again, as indicated in the 1965 study, "there is no central agency with responsibilities for tax collection. There is no single administrator who can be held responsible by the Governor, the Legislature, or the people for the administration of the revenue laws."¹¹³

The California Legislative Analyst stated in her Analysis of the 1993-94 state budget bill:

A long-standing recommendation of the Legislative Analyst's Office has been to integrate the existing tax administration functions of the Franchise Tax Board (FTB) and the Board of Equalization (BOE) into a new Department of Revenue In our view, this proposal represents a real opportunity to achieve improved services and long-run savings despite the potential for increased costs in the short-run.¹¹⁴

110. The staff report states, "The Board of Equalization should be retained, while other tax collection programs should be consolidated under the California Tax Commission. The members of the Board of Equalization should serve as ex officio members of the California Tax Commission, with the State Controller serving as the Commission's initial chairperson." CAL. PERFORMANCE REVIEW, FORM FOLLOWS FUNCTION: A FRAMEWORK TO IMPROVE THE PERFORMANCE AND PRODUCTIVITY OF CALIFORNIA STATE GOVERNMENT 78 (2004), available at http://cpr.ca.gov/report/cprprt/frmfunc/pdf/Vol_2_FormFolFunct.pdf.

111. ASSEMB. INTERIM COMM. ON GOV'T ORG. *supra* note 8, at 17.

112. See CAL. PERFORMANCE REVIEW, *supra* note 108 at 440-41.

113. ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 8, at 31.

114. LEGIS. ANALYST'S OFFICE, REPORT TO JOINT LEGISLATIVE BUDGET COMMITTEE, ANALYSIS OF 1993-1994 BUDGET BILL, 1992-1993 Reg. Sess., at H-

The Legislative Analyst's Office reached a slightly different conclusion in a 2005 report that examined potential savings from a limited consolidation of the payment and documentation functions of the Board of Equalization, Franchise Tax Board, and the Employment Development Department.¹¹⁵ The report's findings were summarized as follows:

Consolidation of the tax agencies' payment and documentation processing activities could in the medium to long term generate some annual cost savings and interest earnings through elimination of duplicative functions and increased efficiencies. The state, however, would have to incur significant net costs in the short term to achieve these savings. In addition, such benefits are likely to be less than benefits from increasing electronic processing. We therefore recommend that low priority be given to consolidation of payment and document processing functions in favor of steps to increase electronic processing.¹¹⁶

The report also states that "the aggressive pursuit of electronic technologies" would advance the overall consolidation of tax agency functions with a combined web-based approach to filing returns and remitting tax payments through electronic fund transfer.¹¹⁷

The most recent legislative attempt at consolidation of the tax agencies involved a reprise of the vetoed 1994 legislation¹¹⁸ to consolidate the Franchise Tax Board and the Employment Development Department into the State Board of Equalization. Assembly Bill 2016, introduced in 2006,¹¹⁹ was sponsored by Board of Equalization member Bill Leonard and was rejected by the legislature. Staff analysis for the California Assembly Committee on Appropriations described opposition to the legislation as follows:

Opponents note that the BOE is the only elected tax commission in the United States. The other states and the

14 (Cal. 1993).

115. See LEGIS. ANALYST'S OFFICE, TAX AGENCY CONSOLIDATION: REMITTANCE AND RETURN PROCESSING 1 (Cal. 2005). The report was prepared in response to legislative direction. See 2003 Cal. Legis. Serv. 3473 (West).

116. *Id.* at 1.

117. See *id.* at 23-26.

118. See Assemb. B. 15, 1993-1994 Reg. Sess. (Cal. 2006).

119. Assemb. B. 2016, 2005-2006 Reg. Sess. (Cal. 2006).

federal government have subsumed tax administration under the executive branch as an essential governmental function. An independently elected tax board is not responsible for the impact of its tax administration decisions on the government's ability to provide services, and may be more vulnerable to political pressures to decide tax disputes in the favor of the taxpayer. Additionally, the California Tax Reform Association raises the concern about the separation of powers under the consolidated BOE proposed in this bill, since the administrative and adjudicatory processes for resolving tax disputes would rest with the same agency – the BOE.¹²⁰

Notwithstanding California's long history of recommendations for consolidation, the administration of revenue collection in California is not likely to change. The Board of Equalization is an institution of elected political officials. Even before the imposition of term limits on California legislators, the Board of Equalization provided an additional opportunity for higher political office.¹²¹ Now, legislators unable to run for their former seats view its elected positions as an opportunity and a potential jumping off point for higher statewide office. Thus, attempts to consolidate tax administration in an agency directly responsible to the Governor, which also contemplates elimination of the elected Board of Equalization, are probably doomed to failure. Conversely, as noted in the opposition to Assembly Bill 2016,¹²² consolidation of the Franchise Tax Board into the elected Board of Equalization is likely to fail because it removes responsibility for tax collection from the executive branch of the California government. In addition, proponents of effective revenue law enforcement will oppose any reduction in the effectiveness of the Franchise Tax Board by putting that agency within the control of the elected politicians of the Board of Equalization. Nonetheless, some

120. ASSEMB. COMM. ON APPROPRIATIONS, ANALYSIS OF ASSEMBLY BILL 2016, 2005-06 Reg. Sess. (Cal. 2006). Note, however, that currently the executive director of the Franchise Tax Board also is not responsible to the Governor.

121. In 2006, former Board Member John Chaing successfully ran for State Controller. Former Board Member Claude Parish ran unsuccessfully for State Treasurer.

122. Assemb. B. 2016.

improvement in California Tax administration might be achieved by providing an independent review mechanism of Board actions. Under the current system, not only does the Board of Equalization administer a wide array of taxes, it is the appellate body of first resort with respect to appeals from taxes it administers and taxes administered by the Franchise Tax Board.

II. THE CALIFORNIA TAX APPEALS PROCESS

In general, the individual income tax and the corporate franchise tax are assessed by the Franchise Tax Board. Assessments are appealable to the Board of Equalization prior to payment of the tax. Sales and use tax issues are also appealable to the Board of Equalization, the agency responsible for assessing the tax. Once a Board of Equalization decision becomes final, the taxpayer's only resort is to pay the tax, file an administrative claim for refund through the Franchise Tax Board and/or the Board of Equalization, then file a refund suit against the State of California in the Superior Court.

1. *Review Procedures at the Franchise Tax Board*

As under the Federal system, California income tax is self-assessed with payment due on the statutory due date for filing a return.¹²³ The Franchise Tax Board is directed by statute to examine the return and conduct an audit as soon as practicable.¹²⁴ The Franchise Tax Board generally has four years from the date of the filing of a return to issue a Notice of Proposed Assessment of delinquent taxes due.¹²⁵ A

123. See CAL. REV. & TAX. CODE § 19001 (Deering 2006). Calendar year individuals are required to file by April 15th following the close of the calendar year. See *id.* Fiscal year taxpayers are required to file returns by the fifteenth day of the fourth month following the close of the fiscal year. See *id.* § 18566. Partnership and Limited Liability Company returns are due on the fifteenth day of the fourth month following the close of the tax year. See *id.* § 18633.

124. See CAL. REV. & TAX. CODE § 19032 (Deering 2006). The Franchise Tax Board audit procedure is described in Franchise Tax Board Regulation § 19032. See 2003 Cal. Legis. Serv. 350 (West). Franchise Tax Board Regulation § 19032(a)(2) states that the taxpayer may reasonably expect the Board to complete its audit within two years of the date a return is filed unless the audit is delayed by fraud or taxpayer delay. See *id.*

125. See CAL. REV. & TAX. CODE § 19057(a) (Deering 2006). The statute of limitations is extended to six years if the taxpayer fails to include items compromising 25 percent or more of gross income. See *id.* § 19058(a). The

taxpayer who intends to dispute the Franchise Tax Board's proposed assessment must file a Protest Letter with the Franchise Tax Board within sixty days of the date of mailing of the Notice of Proposed Assessment.¹²⁶ On the timely filing of a taxpayer's protest, the Franchise Tax Board is required to reconsider the assessment and grant the taxpayer an oral hearing if requested.¹²⁷ If the taxpayer fails to file a timely protest letter, the Franchise Tax Board assessment becomes final and is not thereafter appealable to the Board of Equalization.¹²⁸

Taxes paid with a return or paid under a final determination of the Franchise Tax Board are subject to a claim for refund against the state. A claim for refund first must be filed with the Franchise Tax Board¹²⁹ by the later of four years from the due date for the return or one year from the date of payment.¹³⁰ A claim for refund may also be filed with the Franchise Tax Board within two years of a determination by the Commissioner of Internal Revenue that results in an adjustment that affects California tax liability.¹³¹ The Franchise Tax Board's action on a claim for refund becomes final ninety days from the date of mailing of the Franchise Tax Board's notice of action on the claim unless

statute of limitations is eight years in the case of an abusive tax shelter transaction. *See id.* § 19755. The Notice of Proposed Assessment must state the reasons for the assessment, explain the computations involved, and advise the taxpayer of the filing date for a protest of the assessment. *See id.* § 19034.

126. *See* CAL. REV. & TAX. CODE § 19041(a) (Deering 2006). A protest letter will be considered timely if it is filed on or before the last day specified in the Notice of Proposed Assessment as required under section 19034 of the California Revenue and Tax Code. *See id.* § 19041(b). Amounts that are assessed by the Franchise Tax Board attributable to mathematical errors are not treated as deficiency assessments subject to protest or appeal by the taxpayer. *See id.* § 19051. The same applies to taxpayer overstatement of amounts withheld or estimated payments. *See id.* § 19054.

127. *See* CAL. REV. & TAX. CODE § 19044(a) (Deering 2006). Proposed section 19044(c) of the California Franchise Tax Board Regulation, http://www.ftb.ca.gov/law/regs/19044_032700.PDF, provides that the taxpayer is entitled to request a hearing at an office of the Franchise Tax Board that is convenient to the taxpayer, and such requests are to be granted when possible. *Id.* Hearings may be conducted by telephone or video conferencing if the taxpayer consents. *Id.*

128. *See* CAL. REV. & TAX. CODE § 19042 (Deering 2006).

129. *See id.* § 19382.

130. *See id.* § 19306.

131. *See id.* § 19311.

the taxpayer files an appeal with the Board of Equalization.¹³² If the Franchise Tax Board fails to issue a notice of action within six months of the date the taxpayer's claim for refund is filed, the taxpayer may treat the refund claim as denied and appeal to the Board of Equalization¹³³ or file suit for refund in the Superior Court.¹³⁴ Although the taxpayer must file the claim for refund with the Franchise Tax Board,¹³⁵ appeal to the Board of Equalization is not a prerequisite to filing a suit for refund in the Superior Court. A suit for refund in the Superior Court must be filed by the later of four years from the due date for the tax return, one year from the date on which the tax was paid, ninety days after notice of action by the Franchise Tax Board on a claim for refund, or ninety days from a determination by the Board of Equalization on a taxpayer's appeal from an action by the Franchise Tax Board on a claim for refund.¹³⁶

2. *Appeal to the Board of Equalization*

Appeal to the Board of Equalization is the only avenue available to the taxpayer to contest a determination of a tax deficiency by the Franchise Tax Board in advance of payment of the tax. An appeal from the Franchise Tax Board's notice of action on a protest must be filed with the Board of Equalization within thirty days of the date on which the Franchise Tax Board mails its notice of action upon the protest, or an alternative date specified in the notice of proposed action by the Franchise Tax Board as the last date on which to file an appeal.¹³⁷

The Board of Equalization is required to "hear and determine the appeal,"¹³⁸ and to notify the taxpayer and the Franchise Tax Board "of its determination and the reasons therefore."¹³⁹ The Board of Equalization Rules of Practice prescribe the form of the appeal,¹⁴⁰ a briefing schedule,¹⁴¹ and

132. *See id.* § 19324(a).

133. *See id.* § 19331.

134. *See* CAL. REV. & TAX. CODE § 19385 (Deering 2006).

135. *See id.* § 19382.

136. *See id.* § 19384.

137. *See id.* § 19045.

138. *Id.* § 19047.

139. *Id.*

140. *See* CAL. CODE REGS. tit. 18, § 5012 (2007).

141. *See id.* § 5075.1.

rules for the conduct of the hearing.¹⁴² At the outset of the hearing, a Board of Equalization staff member summarizes the issues in a case, followed by the presentation of the taxpayer, then the Franchise Tax Board.¹⁴³ The taxpayer may be represented at a hearing by “any person of the taxpayer’s choosing.”¹⁴⁴ Potential representatives are, therefore, not limited to attorneys, accountants, or any sort of recognized tax agent, and may indeed include persons such as a political lobbyist or representative of a political action committee if the taxpayer believes that sort of representation will aid the taxpayer’s case. The parties are allowed to present witnesses, who may be called upon to testify under oath at the discretion of the Board of Equalization chair or on the request of a party.¹⁴⁵ Each party’s witnesses are subject to cross-examination by the other party,¹⁴⁶ and may also be subject to cross-examination by Board of Equalization staff on recognition by the chair of the Board.¹⁴⁷ Board of Equalization staff may also be permitted to explain the staff’s view of arguments and the value of evidence presented.¹⁴⁸ The Rules of Practice provide for the acceptance of any evidence of the sort “on which responsible persons are accustomed to rely in the conduct of serious affairs.”¹⁴⁹ The Rules indicate that the Board will be liberal in allowing the presentation of evidence, but that objections to evidence will be considered in assigning “weight” to the evidence.¹⁵⁰ The rules add that the Board may “refuse to allow the presentation of evidence that it considers irrelevant, untrustworthy or unduly repetitious.”¹⁵¹ At the conclusion of a hearing, the Board may decide the matter or take the

142. *See id.* § 5079.

143. *See id.* § 5079(b).

144. *Id.* § 5073(a). The Board or Board Staff may require the taxpayer to grant a power of attorney to the taxpayer’s representative on a form provided by the Board. *See id.* § 5073(c).

145. *See* CAL. CODE REGS., tit. 18 § 5079(c)(1) (2007).

146. *See id.*

147. *See id.* § 5079(c)(2).

148. *See id.*

149. *Id.* § 5079(d). Hearsay evidence is specifically permitted. *See id.*

150. *See id.*

151. CAL. CODE REGS. tit. 18, § 5079(d) (2007). Exhibits are accepted into evidence on the motion of a party. *See id.* § 5079(e). If a party or a Board Member objects to the submission, the matter is discussed and determined by a vote of the Board. *See id.*

matter under consideration for decision at a later meeting.¹⁵² The Rules of Practice provide for written notification of the Board's decision, but, with the exception of requests in property tax cases, there is no requirement of written findings.¹⁵³ Formal written opinions are drafted only at the Board's direction¹⁵⁴ and are rare. The Board publishes its opinions electronically and publishes general business tax opinions in the *Business Taxes Law Guide*.¹⁵⁵ Opinions also are available in electronic legal databases and are maintained by some commercial publishers.¹⁵⁶

The procedure is different for the business taxes that are administered by the Board.¹⁵⁷ Tax assessments are reviewable on the filing of a petition for redetermination to the Board.¹⁵⁸ Refund claims related to business taxes are subject to the same procedure.¹⁵⁹ The petition is first considered at an appeals conference conducted by an appeals attorney or appeals auditor who is a Board employee, but independent of the assessing department.¹⁶⁰ The taxpayer is

152. *See id.* § 5081(a).

153. *See id.* § 5081.2.

154. *See id.* § 5182.1(a).

155. Formal and Memorandum opinions are listed by year on the Board of Education website at <http://www.boe.ca.gov/legal/legalopcont.htm>. Memorandum opinions involving business tax issues, other than income and franchise taxes, are published by the Board of Equalization in the *Business Taxes Law Guide*, which is updated annually.

156. *See, e.g.*, LexisNexis Electronic Database and California Tax Reporter (Commerce Clearing House).

157. As listed in the Board's rules of practice, these include the Alcoholic Beverage Tax, California Tire Fee, Childhood Lead Poisoning Prevention Fee, Cigarette and Tobacco Products Tax, Diesel Fuel Tax, Emergency Telephone Users Surcharge, Hazardous Substances Tax, Insurance Tax, Integrated Waste Management Fee, Marine Invasive Species Fee Collection Law, Motor Vehicle Fuel Tax, Natural Gas Surcharge, Occupational Lead Poisoning Prevention Fee, Oil Spill Response, Prevention and Administration Fees, Sales and Use Tax, Timber Yield Tax, Underground Storage Tank Maintenance Fee, and the Use Fuel Tax. *See* tit. 18, § 5020(b).

158. *See, e.g.*, CAL. REV. & TAX. CODE § 6561 (discussing sales tax redeterminations) (Deering 2006). A petition for redetermination must be filed within 30 days of the issuance of a determination that additional tax is due. *See id.* A description of the appeals process for sales and use taxes and other business taxes is provided in the Board of Equalization's publication, *Appeals Procedures – Sales and Use Taxes and Special Taxes*. *See* State Bd. of Equalization, *Appeals Procedures, Sales and Use Taxes and Special Taxes*, Publ'n 17 (July 2004).

159. *See* tit. 18, § 5022.

160. *See id.* § 5023(a).

permitted to waive appearance at the appeals conference, which is thus voluntary, in which case the conference holder may conduct the conference with the department alone.¹⁶¹ The process concludes with the issuance of a decision and recommendation by the conference holder.¹⁶² Adverse decisions are then appealable to the Board of Equalization.¹⁶³ In all matters other than appeals from actions of the Franchise Tax Board, the Rules of Practice provide that “hearings 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 the taxpayer’s arguments for a reduction or cancellation of a tax liability”¹⁶⁴ Nonetheless, the taxpayer and the assessing department may offer witnesses at the hearing who may be required to testify under oath and be subject to cross-examination.¹⁶⁵

The Chief of Board Proceedings is empowered to “allocate the hearing time for each party, including response time, and reserve time for questions by the Board.”¹⁶⁶ A typical monthly Board meeting, which usually encompasses one or two days, will include discussion of legislative and regulatory proposals, decisions in multiple cases on consent calendars, and hearings in ten to fifteen (or more) cases.¹⁶⁷ Thus, although the Board maintains rules that suggest an extensive hearing process in cases involving Franchise Tax Board determinations, extensive deliberations in complex cases are the exception rather than the rule.¹⁶⁸

Consideration of a case pending before the Board of

161. *See id.* § 5023(c).

162. *See id.* § 5023(e).

163. *Id.* § 5071(a).

164. *Id.* § 5078(b).

165. *See* tit. 18, § 5079(c).

166. *Id.* § 5077.

167. Agendas of the Board of Equalization can be found on the Web at <http://www.boe.ca.gov/meetings/pubmeet04.htm>.

168. *See* Michael Asimow, *Toward a New California Administrative Procedure Act: Adjudication Fundamentals*, 39 UCLA L. REV. 1067, 1107 (1992). Professor Asimow states, “Similarly, the Board of Equalization hears income and franchise tax cases en banc without any prior hearing officer decision. Some attribute this inefficient procedure to the fact that the Board is elected and wishes to demonstrate its responsiveness to the voters by hearing every case regardless of importance. The result is a clogged agenda, rushed proceedings, and a perception among tax professionals that the decisions are made by staff rather than Board members.” (Footnotes omitted.) *Id.*

Equalization is not limited to the formal hearing process. As elected politicians with a need to serve their constituents, members of the Board are available for *ex parte* discussions with litigants.¹⁶⁹ As a practical matter, most of the factual and legal analysis of an appeal is undertaken by staff. Prior to the end of the members' terms in January 2006, only one member of the Board had any professional experience as a tax expert prior to becoming a member of the Board of Equalization.¹⁷⁰ That individual has since been elected as the State Controller and, as a consequence, currently serves *ex officio* as a member of the Board of Equalization and the Franchise Tax Board.

Decisions of the Board of Equalization require a majority vote of a quorum of the Board.¹⁷¹ Three members of the Board constitute a quorum.¹⁷² Thus, a decision may be rendered with the support of only two of the five members of the Board of Equalization.

A majority of only two Board members recently decided cases that ultimately involved the loss of millions of dollars of tax liability to the State. In matters regarding LSI Logic Corporation and Cypress Semiconductor Corporation,¹⁷³ by a vote of two to one, the Board determined that a California manufacturer's tax credit entitled the taxpayers to tax credits refundable against both franchise taxes and sales taxes of \$3,895,018 and \$926,635, respectively.¹⁷⁴ One member of the

169. This issue was raised by proponents of Assembly Bill No. 2472 (2003-2004 Reg. Sess.) to create a California tax court. *See infra* text accompanying note 268. It was also a point of concern raised by Assembly members at legislative hearings. *See* ASSEMB. COMM. ON REVENUE AND TAXATION, ANALYSIS OF ASSEMBLY BILL 2427, 2003-2004 Reg. Sess., at 10 (2004).

170. Board member John Chiang. Mr. Chiang has a law degree from the Georgetown University Law Center. He began his career as a Tax Law Specialist with the Internal Revenue Service and served as an attorney with the Office of the State Controller. State Controller John Chiang—Biography, <http://www.sco.ca.gov/eo/controller/about/bio.shtml> (last visited Oct. 6, 2007).

171. CAL. CODE REGS., tit. 18, § 5181(b) (2007).

172. *See id.* § 5072.

173. LSI Logic Corporation, 142330; Cypress Semiconductor Corporation, 173287, 2003 Minutes of the State Board of Equalization, 2003 Minutes of the State Board of Equalization, Aug. 6, 2003, at 287, available at <http://www.boe.ca.gov/meetings/pubmins/080603Min.pdf>.

174. *See id.*; *see also* CAL. REV. & TAX. CODE § 6902.2 (Deering 2006). The statute provided that in lieu of claiming a credit against net income tax under section 17053.49 or against sales tax under section 23649 for sales taxes paid on certain manufacturing equipment, the taxpayer may "file a claim for refund

Board was disqualified from participating because the member owned stock in one of the parties.¹⁷⁵ The State Controller was disqualified because of a campaign contribution from Hewlett-Packard, which had the same issue pending before the Board.¹⁷⁶ There is no formal opinion in the case to disclose the Board's reasoning. Of the three members deciding the case, one member was reported in the press as stating that granting the refunds was important "to encourage companies to invest in California,"¹⁷⁷ a legitimate policy goal, but not an appropriate factor in applying the law to a specific case. Another member was reported as complaining about the "tally of givebacks . . . that day,"¹⁷⁸ which is also not a ground for deciding individual cases. In addition, the President Pro Tempore of the California Senate attempted to affect the decision with a letter claiming that, "misreading of this statute in favor of LSI Logic would result in revenue losses in the hundreds of millions of dollars, as other taxpayers would attempt to use the same inappropriate interpretation to yield a sales tax refund on top of fully utilized research credits."¹⁷⁹

The State Legislature responded to the *LSI Logic* and *Cypress Semiconductor* holdings with an amendment to the

equal to the credit amount that would otherwise be allowed pursuant to those sections." *See id.* The provision added that any claim "shall be for an amount not in excess of the amount of the credit that could have been used to offset personal income or bank or corporation tax liability." *See id.* The claims before the Board asked for refunds in excess of income tax liability. *See* 2003 Minutes of the State Board of Equalization, *supra* note 173, at 287.

175. *See* CAL. GOV'T CODE § 15626(c) (Deering 2006) (prohibiting participation under the Conflict of Interest Act). Board member John Chiang announced that he owned stock in LSI Logic. *See* Nancy Vogel, *Tax Panel Vote is Costly*, L.A. TIMES, Aug. 11, 2003, at B1.

176. Controller Steve Westly is reported to have accepted a \$10,000 contribution from Hewlett-Packard. *See* Vogel, *supra* note 175. Sections 15626(b) and (c) of the California Government Code require that any member of the Board who has received contributions of \$250 or more from a party or a party's agent in the preceding twelve months disclose the contribution and not participate in nor influence the decision. *See* CAL. GOV'T CODE § 15626(b), (c) (Deering 2006). The Board staff is required to inquire into contributions by parties and their agents and report on the record. *See id.* § 15626(h)(6). Where the Deputy State Controller participates in lieu of the Controller, she is required to disclose contributions to the Controller and disqualify herself from the proceeding. *See id.* § 15626(g).

177. Vogel, *supra* note 175.

178. *Id.*

179. *Id.*

manufacturer's tax credit that indicated that the credit is not refundable except to the extent of taxes paid and that the revision is merely a declaration of existing law.¹⁸⁰ Nonetheless, in December 2004, the Board awarded another \$5 million of refunds to three companies.¹⁸¹ Notwithstanding his Hewlett-Packard campaign contribution, Controller Westly voted in favor of the refunds on this occasion and is reported as saying that he received fourteen letters from Democrats and Republicans in the State Assembly urging support for the refunds.¹⁸² Additional rationale for the decision was expressed by Board Member Bill Leonard who is quoted as saying that under the original law (as interpreted

180. California Senate Bill 1064 was amended by section 6902.2 of the California Revenue and Tax Code to provide that the amount of the refund "shall be for an amount not in excess of the amount of the credit that could have been used to . . . reduce the 'net tax' as defined in Section 17039, or the 'tax,' as defined in Section 23036. Any credit carried over pursuant to Section 17053.49 or Section 23649 may not be refunded under this section until the credit carried over could be applied to reduce the 'net tax' (as defined in Section 17039) or the 'tax' (as defined in Section 23036), as applicable. Under no circumstances may any claim for refund exceed the 'net tax,' as defined by Section 17039, or the 'tax,' as defined by Section 23036, after the allowance of any credits authorized by Section 17039 or 23036." See 2003 Cal. Legis. Serv. 3682 (West) (amended CAL. REV. & TAX. CODE § 6902.2 (Deering 2006)). Section 2 of the Income and Corporation Appeals and Credits Act provides that amendments made by section 1 of the act "are declaratory of existing law, but are effective for any claims for refund filed with the State Board of Equalization on or after August 7, 2003." 2003 Cal. Legis. Serv. 3683 (West).

181. Conexant Systems, 1965556, received a refund of \$4.1 million; Grundfos U.S. Holding, 209694, received a refund of \$624,450; and Lightwave Electronics, 223053, received a refund of \$163,185. See 2004 Minutes of the Board of Equalization, Dec. 15, 2004, at 377-78, 391, available at <http://www.boe.ca.gov/meetings/pubmins/121504M.pdf>.

182. See Jim Wasserman, *Firms that Paid no State Taxes Set to Get \$82 Million in Refunds*, RIVERSIDE PRESS-ENTERPRISE, Dec. 28, 2004, available at <http://www.consumerwatchdog.org/nw/?postId=4065&pageTitle=Firms+that+paid+no+state+taxes+set+to+get+%2482+million+in+refunds>. Note that the restraint on participating only applies to campaign contributions received in the twelve-month period preceding the decision. See CAL. GOV'T CODE § 15626(b) (Deering 2006). Michael Asimow recognized that, "This provision obviously places a premium on making the contribution more than 12 months before the matter comes on for decision." and describes the 12-month rule as a "huge loophole" that "permits a member who has received a contribution requiring disqualification to return the contribution and then participate in the decision. . . . Anecdotal evidence available to the author suggests this loophole is frequently employed; the returned contribution can then be recontributed when the member stands for reelection." Michael Asimow, *The Influence of the Federal Administrative Procedure Act on California's New Administrative Procedure Act*, 32 TULSA L.J. 297, 306 n.48 (1996).

by the Board) companies were allowed credits against both income and sales taxes and that companies understood that “I should never lose one because I’ve taken advantage of the other.”¹⁸³ Mr. Leonard added that the law “was designed to give a tax break for a public purpose.”¹⁸⁴ In January 2005, the Board followed these refunds with further grants totaling \$80.9 million to eighteen claimants including Intel and Hewlett-Packard.¹⁸⁵ As for the legal reasoning in these cases, the press reported that the Board majority interpreted the legislative revisions to the manufacturers’ investment credit “to justify the refunds. Others thought the intent was to allow the tax board to continue hearing the companies’ cases but not automatically grant refunds.”¹⁸⁶ This writer, and the taxpayers of California, must rely on press accounts of the Board’s reasoning because the Board rarely publishes a formal opinion in its tax cases, even where the case is controversial, involves significant legal questions, or involves large amounts of tax.¹⁸⁷

183. Wasserman, *supra* note 182.

184. *Id.*

185. See 2005 Minutes of the State Board of Equalization, Jan. 25, 2005, at 21-23, available at <http://www.boe.ca.gov/meetings/pubmins/102505M.pdf>.

186. Kate Folmar, *State’s Big Tax Refunds Attacked*, SAN JOSE MERCURY NEWS, Jan. 26, 2005.

187. The Board published a total of one opinion in 2004, three opinions in 2005, and five opinions in 2006. Board of Equalization formal opinions can be found through the Board’s web site at <http://www.boe.ca.gov/legal/legalopcont.htm> (last visited Feb. 28, 2007). The only indication of the Board’s reasoning in the manufacturers’ credit cases comes from the self-published remarks of Board Member Leonard who wrote:

The other twist in the law is that the taxpayer could choose to take this credit as a refund of their income taxes or a refund of their sales taxes. Hundreds of companies have chosen to take this credit from their income taxes without controversy. However, the government auditors have resisted allowing taxpayers to take this credit against their sales taxes. This is the substance of the so-called “give away.” All these companies paid their sales taxes. California, unlike many states, charges full sales taxes on manufacturing equipment, which means that to locate machinery in California you have to pay an average of 8% OVER the purchase price in sales taxes. The credit law would have given a 6% refund so the taxpayer never comes out ahead when compared to other states. [¶] The Board of Equalization voted to honor the credits against the sales taxes paid for these companies that have chosen to expand their businesses in California despite all of our anti-business laws and regulations. My premise is that taxpayers should pay every penny they owe to the government, but I will help them to make sure that they never pay one penny more than that.

The immediate past chair of the Board, who was reported to have delayed the decisions until she left the Board to assume her position as a State Senator after the November 2004 elections, was quoted as describing the manufacturers' credit refunds as "indefensible" and a "wholesale and unforgivable tax giveaway."¹⁸⁸ However, she was less concerned about tax refunds when the case of one of her constituents was involved. On its first hearing, the Board voted 4-0 to deny a sales tax appeal of Century Theatres involving \$590,984 of sales tax on the sale of popcorn.¹⁸⁹ The case was re-heard by the Board as a claim for refund on October 19, 2004.¹⁹⁰ The Board approved the refund by a vote of 2-1, with Board Members Midgden and Mandell (acting for the State Controller) voting for the refund.¹⁹¹ Century Theatres is headquartered in the State Senate district in which Board Chair Migden was running for office.¹⁹² The formal opinion in *Century Theatres* was adopted on November 4, 2004, two days after the November 2004 elections, with a vote of 4-1 to grant the refund.¹⁹³ Sacramento Bee columnist Dan Walters asserted that, "The chairwoman of the board, Carole Migden, clearly had a change of attitude after some private meetings with Century executives" ¹⁹⁴ Mr. Walters also states that the decision "underscores how

BILL LEONARD, THE LEONARD LETTER, Jan. 3, 2005, <http://www.boe.ca.gov/leonard/blletters/pdf/010305letter.pdf>.

188. Folmar, *supra* note 186.

189. See 2004 Minutes of the State Board of Equalization, Feb. 18, 2004, at 31, available at <http://www.boe.ca.gov/meetings/pubmins/021804Min.pdf>. The staff position was supported by Board Members Midgden, Chiang, Leonard, and Mandell. See *id.* Board Member Parrish abstained. See *id.*

190. See 2004 Minutes of the State Board of Equalization, Oct. 19, 2004, at 306, 329, available at <http://www.boe.ca.gov/meetings/pubmins/101904M.pdf>.

191. See *id.* at 329. Board Member Chiang voted against the refund. See *id.* Board Members Leonard and Parrish abstained. See *id.*

192. Century Theatres, Inc. corporate headquarters is located at 150 Pelican Way, San Rafael, CA 94901, which is in the State Senate district represented by Senator Migden.

193. 2004 Minutes of the State Board of Equalization, Oct. 19, 2004, at 329, available at <http://www.boe.ca.gov/meetings/pubmins/101904M.pdf>. Board Member Chiang voted against the refund. See *id.* Board Members Leonard and Parrish abstained. See *id.*

194. Dan Walters, *Tax Panel's Change of Heart Pops Up and Helps Theaters*, SACRAMENTO BEE, Dec. 8, 2004, available at <http://dwb.sacbee.com/content/politics/columns/walters/story/11695656p-12584486c.html>.

arbitrary state tax laws have become.”¹⁹⁵ Sales tax regulations impose sales tax on the sale of hot prepared food, which is described as “those products, items, or components which have been prepared for sale in a heated condition and which are sold at any temperature which is higher than the air temperature of the room or place where they are sold.”¹⁹⁶ The Board’s opinion describes Century Theatre’s production of popcorn as follows:

Claimant’s process for making popcorn starts with a popper. Kernels are placed in a suspended kettle where the kernels are heated until they pop. Under the kettle is a bin that holds the popcorn once it has popped. Next to the popper machine is a machine called a “cornditioner.” The cornditioner includes a storage bin that stores popped popcorn until claimant’s employee scoops the popcorn into a bag. Under the storage bin, the cornditioner also includes a heating element and motor that blows air over the heating element causing heated air to be blown up through the popcorn while it sits in the cornditioner.¹⁹⁷

The opinion concludes that “claimant’s cooking process has not resulted in the sale of a hot prepared food product within the meaning of the regulation.”¹⁹⁸ The Board majority accepted the taxpayer’s argument that the popcorn is served at room temperature and is, therefore, not hot food.

Interpretation of the tax law also can vary by election result. In *Costco Wholesale Membership Co.*,¹⁹⁹ the Board initially determined by a vote of 3-1 that the entire Costco organization was subject to sales tax on sale of memberships because membership fees purchased through its virtual store, www.Costco.com, created a two-tier membership structure for all Costco stores.²⁰⁰ Two members of the three-person

195. *Id.*

196. CAL. CODE REGS. tit. 18, § 1603(e)(1) (2007).

197. CAL. BD. OF EQUALIZATION, IN THE MATTER OF THE CLAIM FOR REFUND UNDER THE SALES AND USE TAX LAW OF CENTURY THEATRES, INC. 1 (Nov. 4, 2004) (mem.).

198. *Id.* at 3.

199. *Costco Wholesale Membership Co.*, 132058, 2002 Minutes of the State Board of Equalization, Nov. 12, 2002, at 440, 2002 Minutes of the State Board of Equalization, Nov. 12, 2002, at 438, available at <http://www.boe.ca.gov/meetings/pdf/111202.pdf>.

200. See *id.* at 440; see R. Ayoob & Christopher J. Matarese, Univ. of S. Cal. 2004 Tax Inst., *Current Developments in State and Local Taxation*, at 5 (unpublished course materials Jan. 26, 2004). It is noteworthy, again, that the

majority were replaced on the Board in the November 2002 elections (Messers Andal and Klehs were barred by term-limits from an additional term). In a subsequent claim for refund, the newly elected Board members, Carole Migden and Bill Leonard, joined Board Members Chiang and Mandell (acting for Controller Westly) to grant a refund of sales taxes collected on the Costco membership sales by concluding that the two-tier membership pricing rules should be applied on a store-by-store basis instead of on the basis of the company as a whole.²⁰¹

When a taxpayer prevails in cases such as the manufacturers excise credit cases, the sales tax on popcorn decision, or the Costco membership fees, there is no avenue to protect the interest of the State or its other taxpayers. The Franchise Tax Board does not have an avenue of appeal for Board decisions. In the sales and use taxes arenas, the Board itself is not going to pursue an appeal of its own decisions. Clearly, the prevailing taxpayer is not going to object to a favorable ruling on its own appeal. Thus, the general taxpaying public, which is required to shoulder the burden of lost revenue from arbitrary Board decisions, has no way to protect its interests. Indeed, because the Board rarely publishes formal decisions in these cases, the general public rarely has a mechanism to judge the actions of the Board.

3. *Beyond the Board of Equalization*

In the event of an adverse decision from the Board of Equalization in cases involving personal income or the corporate franchise tax, the taxpayer must first file a claim for refund with the Franchise Tax Board, pay the tax, then file a suit for refund in the Superior Court.²⁰² As is the case

holdings of the Board of Equalization are generally only discoverable through secondary sources, and sometimes only through obscure sources. Section 1584, title 18, of the California Code of Regulations provides that membership fees are part of gross receipts subject to sales tax when either the fee exceeds a nominal amount or the retailer sells goods at a lower price to persons who have paid the fee. *See* tit. 18, §1584. The regulation was amended in 2004 to add that the fees are part of the gross receipts of the person selling tangible personal property and that it is immaterial that the person selling the membership is not the person who sells tangible personal property to the member. *See id.*

201. *See* 2002 Minutes of the State Board of Equalization, *supra* note 199.

202. *See* CAL. REV. & TAX. CODE § 19382 (Deering 2006). As noted in the text accompanying note 130, the taxpayer has one year from the date of payment to

with decisions by the Board of Equalization, although the Superior Courts will make findings of fact and write memoranda of their decisions, the material is rarely published and is generally not available to provide a body of interpretation of the California income tax provisions. Decisions of the Superior Courts are appealable to the California District Courts of Appeal, and from there to the California Supreme Court, which has discretionary jurisdiction.

A taxpayer who obtains an adverse decision from the Board of Equalization with respect to a petition for redetermination of business taxes administered by the Board must also pay the tax and file an action for a refund, beginning with a claim for refund before the Board of Equalization.²⁰³ Although filing a claim for refund within the required six-month period following an adverse decision²⁰⁴ or a petition for redetermination may seem redundant, as *Costco Wholesale, Co.*²⁰⁵ and *Century Theatres, Inc.*²⁰⁶ demonstrate, the Board of Equalization is not above changing its view of the same case, particularly if an election intervenes. Once the claim for refund is denied, the taxpayer may proceed with a suit for refund in the Superior Court.²⁰⁷

4. *The Almost Parallel Federal Review Procedure*²⁰⁸

Federal tax returns are initially examined at an

file the claim for refund (or four years from the date the return was due, whichever is later). *See id.* § 19306. The suit for refund must be filed within ninety days after notice from the Franchise Tax Board on the claim for refund. *See id.* § 19384. If the Franchise Tax Board fails to act on the claim for refund within six-months, the taxpayer may then file the suit for refund in the Superior Court. *See id.* § 19385. Alternatively, before filing suit, the taxpayer may return to the Board of Equalization with an appeal from the Franchise Tax Board's denial of a claim for refund. *See id.* § 19324, 19384. The taxpayer has ninety days from the receipt of the Franchise Tax Board's notice of action to file an appeal with the Board of Equalization. *See id.* § 19384. The taxpayer then has ninety days from the date that the Board of Equalization's determination is final to pursue an action for refund in the Superior Court. *See id.*

203. *See e.g.*, § 6932 (applicable to sale and use tax determinations).

204. *See* § 6902.

205. *See* 2002 Minutes of the State Board of Equalization *supra* note 199.

206. *See* 2004 Minutes of the State Board of Equalization, *supra* note 193.

207. *See, e.g.*, § 6932 (applicable to sale and use tax determinations).

208. This description of federal procedure is largely drawn from PAUL MCDANIEL, MARTIN MCMAHON, DANIEL SIMMONS & ALICE ABREU, *FEDERAL INCOME TAXATION* 24-34 (4th ed. 2004).

administrative level within the Internal Revenue Service at Regional Service Centers for mathematical errors and through the District Directors' offices in the form of correspondence audits (including examination of discrepancies between information reporting and filed returns) and more detailed "field audits." On failure to reach an agreement with respect to taxes due, the District Director will issue a so-called "thirty day letter"²⁰⁹ that gives the taxpayer thirty days in which to either (1) file a formal protest that moves the case to the Internal Revenue Service Appellate Division,²¹⁰ (2) request a Statutory Notice of Deficiency²¹¹ (a ninety-day letter) that allows the taxpayer to proceed to the Tax Court, or (3) pay the tax.²¹² The appeals conference is an informal meeting with the Appeals Office where the taxpayer can present additional information, including witnesses, although additional evidence must also be presented in the form of an affidavit.²¹³ The Appeals Officer has authority to settle a case on the merits and may consider the hazards of litigation, but not the nuisance value of the case.²¹⁴ If no settlement is reached, the Internal Revenue Service issues a Statutory Notice of Deficiency,²¹⁵ the ninety-day letter, in which case the taxpayer has ninety days in which to pay the tax or file a petition to the Tax Court for review of the deficiency. There is a single process through one administrative agency.

The Tax Court provides a vehicle for petitioning to set aside the tax agency determinations in advance of payment of the tax. The United States Tax Court, known as the Board of Tax Appeals until 1942, is a quasi-judicial body created under the legislative authority of Article I of the United States Constitution, rather than the judicial authority of Article III of the Constitution. Tax Court judges are appointed by the President for fifteen-year terms²¹⁶ and are often reappointed to office at the end of their term. Generally, Tax Court judges

209. I.R.C. § 7522(b)(3).

210. See Treas. Reg. § 601.106(b).

211. I.R.C. § 6212.

212. I.R.C. § 6213(a).

213. Treas. Reg. § 601.106(c).

214. Treas. Reg. § 601.106(f)(2).

215. I.R.C. § 6212.

216. See I. R. C. § 7443 (2000).

are lawyers with significant tax experience from private practice or government service. Trials in the Tax Court are conducted by a single judge who issues findings of fact and an opinion deciding the case. Decisions by a single judge may be reviewed by the entire court as determined by the Chief Judge. Decisions are issued either as published decisions, which are officially published by the Tax Court, or memorandum decisions that are not published by the court and have less precedential value. Memorandum decisions generally involve factual issues, or are decisions that involve only previously decided legal issues. Decisions of the Tax Court are appealable to the United States Circuit Court of Appeals for the circuit in which the taxpayer resides.²¹⁷ The Tax Court has a small claims procedure involving deficiencies of \$50,000 or less that provides an independent review to a taxpayer with informal rules that do not require the expense of a full scale trial. The taxpayer usually is not represented by an attorney. Small claims cases are decided with a summary opinion rather than formal findings of fact and opinion, and are not appealable.

In lieu of the Tax Court procedure, the taxpayer may pay the deficiency and file a claim for refund.²¹⁸ After a refund claim is denied by the Internal Revenue Service, or the Service fails to act on the claim within six-months, the taxpayer may file a suit for refund in either the United States District Court for the district in which the taxpayer resides,²¹⁹ or a suit for refund with the Court of Federal Claims. Decisions by the District Court are appealable to the Circuit Court of Appeals.²²⁰ Decisions by the Circuit Courts of Appeals, or by the Court of Federal Claims may be heard by the United States Supreme Court under a writ of certiorari.

5. *So What's Wrong with the California Picture?*

a. The Elected Tax Tribunal

California State Assembly Member Lois Wolk made the

217. I.R.C. § 7482(b)(1)(A). In the case of a corporation the appropriate Circuit is the Circuit in which the corporation has its principal place of business. I.R.C. § 7482(b)(1)(B).

218. I.R.C. § 6511.

219. 28 U.S.C. §1402(a)(1).

220. 28 U.S.C. §§ 1291, 1294.

following statement in testimony before the California Performance Review Commission:

The members of the Board [of Equalization] are politicians who campaign for election every four years. They need to raise millions of dollars in campaign contributions. Unfortunately, significant campaign contributions have come from entities who appear before the Board, such as the accounting firm Price Waterhouse Coopers, who circumvent conflict of interest rules by making contributions through their own PACs. Frankly, it's disgusting and an insult to honest taxpayers who have to carry more than their fair share because others are better connected or because decisions were made based on politics and not tax law.²²¹

Assembly Member Wolk is not the first to recognize the problem. The 1929 Martin Commission said:

This great preponderance of appointed tax officials seems to bear out the conclusion that neither elected nor ex officio tax officials are desirable. Elected members are subject to political pressure; ex officio members are ordinarily occupied with other duties; and neither elected nor ex officio members are apt to be chosen primarily for their fitness for the task.²²²

The Martin Commission report adds that, "The necessity for highly specialized knowledge and the value of accumulated experience in this work make a fairly long term of office desirable— both to attract the able person and to profit from his experience."²²³

The problem of an elected tax collector is self-evident. Board members "tend to view themselves more as politicians with responsibility to their constituents than as adjudicators or rulemakers."²²⁴ The campaign slogan for an elected tax collector might be, "Elect me and I will not collect taxes from you (even if those taxes are due under the law)."²²⁵ Former

221. Transcript of California Performance Review Commission, Government Reorganization Meeting (Sept. 27, 2004) (statement of Assemb. Member Lois Wolk).

222. CAL. TAX COMM'N, *supra* note 67, at 117 (footnote omitted).

223. *Id.* at 120.

224. Asimow, *supra* note 182, at 306.

225. Daniel L. Simmons, Letter to the Cal. Comm'n on Tax Policy for the New Econ., Sept. 23, 2003, *reprinted in* CAL. COMM'N ON TAX POLICY IN THE NEW ECON., FINAL REPORT 77, app. D (2003).

Board Member Claude Parrish came very close to this advocacy where he listed as an accomplishment of his tenure on the Board the fact that, "He has shown his responsiveness to taxpayers by instituting an open door policy and is responsible for increasing the percentage of relief received by California taxpayers before the Board of Equalization."²²⁶ Indeed, Mr. Parrish claims credit for demanding an immediate vote on the hearing of taxpayer cases as he asserted that, "The result of this practice is that more taxpayers have received a favorable outcome. In 1999, thirty-nine percent of taxpayers were granted relief; however in 2000, that percentage jumped to forty-one percent."²²⁷ While Mr. Parrish might be commended for attempting to streamline and improve tax dispute resolution, ideally the goal of the decision-maker should be to fairly apply the law to the facts of a particular case, rather than increasing the percentage of taxpayer victories on appeal. In addition, while reducing taxes collected by the State is an appropriate position for an elected policy maker, there is an inherent conflict between the executive function of the Board of Equalization, which is to supervise the collection of numerous taxes (and its concurrent role in developing tax policy and making recommendations to the Legislature) and its role as a quasi-judicial body in the determination of tax appeals.

b. Separation of Powers

Government in the United States is typically divided between executive, legislative, and judicial functions. All three of these activities come together in the Board of Equalization, which administers tax collection, proposes legislation, adopts regulations (the latter being both a legislative and executive function), and determines cases on appeal from determinations in the course of its executive tax collector role. The 1955 interim legislative report reflected on this amalgamation of authorities as follows:

226. See Full Biography for Claude Parrish, Nov. 7, 2006 Election, Candidate for Treasurer, http://www.smartvoter.org/2006/11/07/ca/state/vote/parrish_c/bio.html (last visited Apr. 7, 2007).

227. *Id.* Perhaps the trend towards snap judgment immediately following the taxpayer's presentation is one of the reasons that formal written opinions in Board action is so rare.

The Board of Equalization is in the questionable position of hearing appeals from its own administrative policies and actions. This practice is contrary to the usual Anglo-American philosophy of justice in which the taxpayer has the privilege of appealing to some impartial agency outside the sphere of influence of those whose decisions are being appealed.²²⁸

With respect to hearing appeals from determinations made by staff within departments of the Board of Equalization, the interim committee report states:

It is perfectly evident that this situation exists, that it is directly contrary to the best thought in judicial procedures, and that it is unfair to the aggrieved taxpayers of the State as a whole. In such a position, the board must and does rely heavily upon staff recommendations—recommendations which, of course, come from the same staff whose findings are being appealed This condition is dangerous, particularly in complicated disputes, both because the elective system does not necessarily provide incumbents with any tax background and because the many duties otherwise saddled upon the board preclude time for ample study of pending cases.²²⁹

A decade later similar findings led another interim legislative study to recommend: "One of the essentials of good tax administration is an adequate appeals process. The committee concludes that the tax appeals procedure should be established independently from the administrative functions of tax collection to insure a clear separation of authority."²³⁰

A. Alan Post, the Legislative Analyst at the time, is quoted in the 1965 report as testifying:

228. SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 57, at 18.

229. *Id.* at 19. In *Union Pac. Railroad Co. v. State Bd. of Equalization*, a case involving property tax assessment methods of certain railroad property, the court indicated that dual representation by a Board of Equalization staff attorney, who represented staff at reassessment hearings and who directly advised the Board by preparing proposed findings through *ex parte* communications not available to the taxpayers, established a procedure that "is fundamentally unfair, and should not be employed in any hearings on remand." *Union Pac. R.R. Co. v. State Bd. of Equalization*, 282 Cal. Rptr. 745, 755-56 (Cal. Ct. App. 1991).

230. See ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 8, at 10.

[W]e had recommended, and we would still recommend as a model form of organization, that the tax appeals board be one which would be appointed by the Governor. I am prepared, however, to say that . . . it would seem to me that there would be no harm whatsoever done to have the present Board of Equalization reconstituted as a Board of Tax Appeals and a Board of Equalization.²³¹

The 1965 interim study committee concluded that, “the tax appeals procedure should be established independently from the administrative functions of tax collection to insure a clear separation of authority easily understood by every taxpayer.”²³² The committee’s overall recommendation was the creation of a department of revenue to take over all tax collection responsibilities leaving the Board of Equalization as the designated board of tax appeals.²³³ This solution, while separating the executive and juridical functions, would leave resolution of tax disputes in the hands of short-term elected officials.

The problems inherent in the amalgamated tax structure are exacerbated by the elective nature of the Board of Equalization. On the one hand, the job of the tax collection agency is to protect the State’s revenue by collecting taxes that are due under the laws enacted by the legislature and signed by the Governor. An individual could campaign for the Board of Equalization on a position that big corporations and other big business, along with wealthy individuals, don’t pay enough taxes. Another individual may campaign for the Board on the premise that taxes are bad for the California economy because they stifle investment.²³⁴ As elected

231. *Id.* at 40.

232. *Id.*

233. *See id.* at 10.

234. For example, Board Member Leonard states on his Board of Equalization web site:

His service in the State Legislature has established Bill Leonard as an advocate for fiscal responsibility, families, and quality public education. He is also known for his efforts to improve the job and business climate in the Golden State by lowering taxes, reducing unnecessary regulation and providing incentives for job creation and business expansion.

Board of Equalization, Bill Leonard – Biography, <http://www.boe.ca.gov/leonard/info/blbio.htm> (last visited Nov. 11, 2007). In a subsequent iteration, Mr. Leonard states that, “[During his twenty-four years of service in the State Legislature] he became well known as a fighter for low taxes, quality schools and a better business climate He has fought for

officials, the members of the Board of Equalization have a legitimate policy role in the structure of the tax system that may be influenced by these varying positions. The overall position of the Board of Equalization can and does vary with each election cycle as the philosophy of the majority changes with new membership. That result is appropriate for the Board in its executive and policy functions. However, when these varying and changeable political views are brought to the judicial function of deciding individual cases, the result is an inconsistent jurisprudence that provides neither guidance nor certainty to taxpayers planning transactions for the future. In addition, the application of the elected member's political philosophy to the decision of individual cases may lead to results that are unfair either to the taxpayer or to the State of California, and thereby unfair to all of the state's taxpayers.²³⁵

c. The Absence of Interpretative Guidance

As noted above, the Board of Equalization's monthly meeting agenda is filled with so many items that there is no time for serious deliberation of any one case. Indeed, the Board's tripartite role as executive, rule maker, and arbitrator of disputes, leaves it with insufficient time to adequately steward any of the functions.²³⁶ This is apparent in the paucity of formal decisions in tax cases. The absence of formal decision leaves the Board free to arbitrarily decide individual cases as the whim of the majority may choose. As

justice for taxpayers, advocated for taxpayer rights, and public accountability." *Id.* These sentiments are similar to Mr. Leonard's reported comments as the reason for his vote in the *LSI Logic* refund case. See *supra* note 183 and accompanying text.

235. See Simmons, *supra* note 225.

236. The 1955 interim study complained that:

Adequate tax research is not and cannot be conducted within California's present scattered tax administration structure. There is no centralized tax research staff in California's tax administration structure from which the Legislature and the Governor may obtain comprehensive information as a basis for major tax policies. The need for such research is particularly evident this year in view of the proposals both for new taxes and for a comprehensive study next year of our entire tax structure.

SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 57, at 15.

the opposite results in *Century Theatres, Inc.*²³⁷ demonstrate, even with the same membership, the Board's conclusions, in the same case, under the same regulations, may vary from appeal to claim for refund. The absence of formal opinions also creates uncertainty for taxpayers. The potentially arbitrary nature of decision making, unrestrained by the guiding light of precedent, and operating in the shadow of unpublished reasoning, prevents taxpayer reliance on past decisions. Reliance is impossible in the absence of Board opinions explaining the Board's interpretation of the law.

The uncertainty in the application of California's tax law is harmful to California's business environment in ways not fully appreciated by pro-business advocates of taxpayer relief. Business decisions to invest require an analysis of the after-tax return of the investment. After-tax return is a combination of before-tax returns, application of the relevant tax law, and the time value of money.²³⁸ Uncertainty regarding the application of the tax law adds an element of risk that undermines the investor's ability to calculate its after-tax return from an investment. This, in turn, will cause the investor to demand a higher return, which may translate into higher prices or lower investment.

d. Ex Parte Communications

The committee-meeting nature and informality of the procedures before the Board of Equalization permit procedures and access to board members by individual parties to tax disputes that lead to decisions based on information not developed in open meeting and unequal access to the tax determination process. The problem with *ex parte* communication is summarized by Professor Asimow as follows:

The rationale for a prohibition on *ex parte* contact is familiar to all lawyers: it is deeply offensive in an adversary system that any litigant should have an opportunity to influence the decision-maker outside the

237. See discussion *supra* note 189.

238. MYRON S. SCHOLES, MARK A. WOLFSON, MERLE ERICKSON, EDWARD L. MAYDEW & TERRY SHEVLIN, *TAXES AND BUSINESS STRATEGY 1-2* (2d ed. 2002); see also MCDANIEL ET AL., *supra* note 208, at 244. On the other hand, hope springs eternal that a taxpayer might beat the system and avoid tax liability thereby increasing after-tax return.

presence of opposing parties. The parties may spend weeks or months conducting a detailed adjudicatory hearing and an administrative judge may prepare a painstakingly detailed proposed decision. Yet all this can be set at naught by a few well-chosen words whispered into the ear of an agency head or the agency head's adviser. Ex parte contacts frustrate judicial review since the decisive facts and arguments may not be in the record or the decision. Finally, ex parte contacts contribute to an attitude of cynicism in the minds of the public that adjudicatory decisions are based more on politics and undue influence than on law and discretion exercised in the public interest.²³⁹

Professor Asimow also indicates that, "Ex parte contacts between taxpayers and the Board are said to be commonplace, because Board members view such contacts as a legitimate constituent service."²⁴⁰ One commentator knowledgeable in the workings of state government wrote:

Ex parte contact involves communication between a board member and a taxpayer (or someone representing a taxpayer) regarding an appeal before the board, without the opportunity for all parties to participate in the conversation. Retired staff involved in appeals before the board cite numerous cases where they believe ex parte communication was responsible for board decisions contrary to prior decisions of the board or inconsistent with prior case law, statute or regulation.²⁴¹

The report adds:

[E]x parte communication sometimes puts staff at a disadvantage because information is shared with board members that is not shared with staff prior to the board hearing. This makes it difficult for staff to respond to undocumented assertions made "on the fly" at the hearing. Combined with the fact that the [Franchise Tax Board]

239. See Asimow, *supra* note 168, at 1127.

240. Asimow, *supra* note 182, at 306.

241. B. Timothy Gage, California's Tax Administration Can be Improved With or Without Consolidation of the State's Tax Agencies, at 4 (2005) (unpublished report prepared on behalf of SEIU Local 1000 & SEIU California Council)(on file with author). The report also notes that, "In many of these cases the board's decision was also contrary to the summary prepared by staff, which recommended against the taxpayer." *Id.* at 20. Mr. Gage was the Director of Finance under Governor Gray Davis and, therefore, a member of the Franchise Tax Board. See *id.* at About the Author and Sponsor Organizations.

does not have power to compel taxpayers to respond to requests for information, ex parte communication creates an uneven playing field.²⁴²

A footnote to this last statement indicates that:

In one instance, a taxpayer made assertions at the board hearing that could not be contested by the FTB staff because information requested from the taxpayer had not been provided. Despite the information not being provided, the board ruled for the taxpayer. The taxpayer reportedly had an ex parte contact prior to the hearing.²⁴³

A fundamental principle of fair hearing and due process is the concept that findings be based on the evidence in the record of the adjudicative proceeding. That requires that "all of the factual inputs that decision-makers consider be drawn from the record produced at the hearing."²⁴⁴ Ex parte communication between taxpayers and Board members that influences the decision in tax disputes deprives the taxpaying public with assurance that the tax system is operated fairly.

The informality of Board hearings, ex parte contacts, coupled with the absence of written opinions that are precedent for future actions, creates an ad hoc decision making environment that is prone to political pressure. The decisions of an elected tax agency are as likely to be based on political expediency and the personal beliefs of the elected members as they are based on application of law to facts found on the basis of evidence.

III. RESTRUCTURE CALIFORNIA TAX COLLECTION

1. *Consolidate California Tax Collection*

The large collection of studies of California's tax administration provides both a consistent call for restructuring California's tax collection administration and substantial guidance regarding the form that reform should follow. The failure of all attempts to consolidate California's tax collection agencies into a single entity, however, confirms the political power of the vested interests in the elected Board of Equalization. To repeat the language of the 1955 Assembly

242. *Id.* at 20.

243. *Id.* at 20, n.7.

244. Asimow, *supra* note 168, at 1126.

Interim Committee on Government Organization:

[E]very comprehensive report on the subject that has been made by objective, unbiased persons who were not part of California's existing revenue administration structure (and whose own positions would therefore not be affected) has endorsed consolidation of the State's major revenue agencies in some form or another. The committee knows of no comprehensive, independent study that has defended the existing organization—or lack of it.²⁴⁵

There are two themes that consistently appear in every legislative and special commission study of the California tax collection process. First, that confusing, overlapping, and duplicative tax collection functions should be consolidated into a single revenue agency.²⁴⁶ Second, enforcement of the revenue laws is an executive function for which the Governor should be held accountable subject to legislative oversight.²⁴⁷ That means that the head of the revenue agency should be appointed by the Governor subject to both confirmation and removal by action of the legislature. As a corollary, the concept of an elected tax collector is recognized as an inherently bad idea.²⁴⁸ The earliest reviews of the California tax collection enterprise called for the abolition of the Board of Equalization.²⁴⁹ Finally, although not as clearly reflected in the legislative and commission studies, there is a fairly consistent national recognition that the California Franchise Tax Board is a highly effective (if not overly aggressive) tax collection agency. This last point should provide guidance regarding the direction that any restructuring should take.

The clearest of the cumulative list of recommendations regarding California tax collection is that collection should be consolidated into a single agency.²⁵⁰ The reasons for consolidation are detailed in the most recent study of the issue, the California Performance Review,²⁵¹ which cites the existence of multiple agencies performing identical functions in duplicative space, the absence of coordinated information

245. *Supra* note 88.

246. SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG, *supra* note 57, quoted at the beginning of this article.

247. *See supra* text at note 91.

248. *See supra* text accompanying notes 221-22.

249. *See CAL. TAX COMM'N, supra* note 67, at xxiv.

250. *See supra* note 88.

251. CAL. PERFORMANCE REVIEW COMM'N, *supra* note 108.

regarding particular taxpayers, and the confusion and duplicative reporting requirements imposed on taxpayers who are required to respond to the demands of multiple agencies.²⁵² Although the Legislative Analyst concluded that some duplication may be eliminated by consolidated electronic filing,²⁵³ the creation of an electronic filing system itself requires coordination, which to-date has not been achievable across multiple agencies. While the Legislative Analyst concluded that the potential short-term costs of consolidation pose a constraint on the activity, the Analyst's assessment of a limited consolidation of payment and documentation functions did not consider the potential long term saving for individual taxpayers and California business enterprise that could be achieved through coordinated reporting through a single agency.

Taking the recommendations of the California Performance Review,²⁵⁴ but treading further into the province of the State Board of Equalization where the Performance Review Commission feared to go,²⁵⁵ California taxes and tax-like fees should be collected by a single revenue department. This includes sales and use taxes, state-assessed property taxes, the insurance company tax,²⁵⁶ the variety of fees and excise taxes collected by the Board of Equalization, the individual income tax and the corporate franchise tax collected by the Franchise Tax Board, vehicle license fees collected by the Department of Motor Vehicles, and employment taxes collected by the Employment Development Department.

The difficult question is not whether consolidation of tax collection is warranted. The real issue, the overriding political issue that dates back to the adoption of the corporate

252. See *id.* at 440-41.

253. See LEGIS. ANALYST'S OFFICE, *supra* note 115.

254. CAL. PERFORMANCE REVIEW COMM'N, *supra* note 108.

255. See *supra* text accompanying note 110. However, almost every other committee or commission to examine the matter has called for elimination of the Board of Equalization. See *supra* text beginning at note 61.

256. Of all of these taxes, only removal of authority over insurance company taxation would require an amendment of the California constitution. The remainder of these taxes is assigned to the Board of Equalization by statute. The gross premiums tax on insurance companies is assessed jointly by the Insurance Commissioner and the Board of Equalization and is collected by the State Controller. See *supra* note 85.

franchise tax,²⁵⁷ is who is to be in charge. The consistent answer by almost all of the studies that recognize tax collection as an executive function is to house the tax collection agency with the Governor.²⁵⁸ Thus, following the 1965 recommendation of the Assembly Interim Committee on Government Organization,²⁵⁹ a Department of Revenue should be directed by an individual appointed by the Governor with Senate confirmation, and removable for cause by the Legislature. While not explicit in the report, such a director should serve at the will of the Governor to whom he or she is responsible.

California, however, is a place where numerous executive functions that may be charged to gubernatorial appointees are performed by elected officials. Thus, Californians elect the Attorney General, the Secretary of State, the State Controller, and the State Treasurer. Recognizing the diffusion of executive authority in state government, a second best solution might encompass appointing the director of a revenue agency by a "Tax Commission" consisting of the Governor, the Controller, and the State Treasurer.²⁶⁰

Finally, the organizational structure of a department of revenue should begin with the existing structure of the Franchise Tax Board under its director and management. Collection functions spread across the agencies can be folded into the department of revenue as divisions reflecting each of the separate tax areas. Thus, the department would contain divisions responsible for individual income tax, the corporate franchise tax, sales and use taxes, various excise taxes, employment taxes, insurance taxes (if included through constitutional revision), etc. A single division for collection and data management could cut across these divisions to coordinate reporting for individual taxpayers through combined accounts. This last consolidation is the most significant efficiency for taxpayers. Importantly,

257. See *supra* text accompanying and following note 52.

258. See *supra* note 87.

259. See ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 8, at 43, discussed in the text accompanying note 89.

260. This solution in part mirrors the existing Franchise Tax Board where the Governor is represented by the Governor's Finance Chief. The other members are the State Controller and the Chair of the Board of Equalization. See CAL. PERFORMANCE REVIEW COMM'N, *supra* note 108, for another recommendation.

consolidation would enhance compliance and enforcement through consolidated data management.²⁶¹

2. *Reform the Tax Adjudication Process*

The process for adjudication of tax disputes in California is a horror story.²⁶² A restructuring of the California tax dispute resolution structure would be a major step forward towards making the California tax environment friendlier to residents and investors. Indeed, reformation of the dispute resolution mechanism may be a more important reform than consolidating the tax agencies. Currently, there is no consistent body of interpretative law on which taxpayers may rely in planning their affairs. Compounding the absence of written guidance is the fact that interpretations change as the make-up of the elected dispute resolution body changes.

261. This last issue is a magnet for opposition to consolidation by tax avoiders who might hide some activities from some but not all of the existing disparate tax agencies.

262. See e.g., Professor Asimow's article, which describes the California tax adjudication process as follows:

SBE's system of adjudication is primitive. For example, the 5-member Board hears every income tax case en banc. It has a rudimentary system of hearing officers who hear business tax cases; however, it has staunchly rejected classification of these hearing officers as ALJs [administrative law judge] (apparently because reclassification would give them a pay increase). *Ex parte* contact between taxpayers and Board members is said to be commonplace, because Board members view such contacts as a legitimate constituent service. Additionally, Board members decide cases of persons who have contributed to their campaigns, and separation of functions is largely ignored. The SBE believes in a true institutional method: its advocates engage in off-record discussions with both hearing officers and Board members about specific cases. (Footnotes omitted.)

Asimow, *supra* note 182, at 306-07.

In another article, Professor Asimow states:

To put it charitably, California's present arrangement for adjudicating tax cases is a patchwork that can be understood only as a series of historic accidents; to put it less charitably, the system is a mess. Under that system, the Franchise Tax Board and State Board of Equalization have overlapping membership, SBE has adjudicatory power both over the income and franchise taxes imposed by FTB and over the business taxes imposed by itself, SBE members are elected and must solicit campaign contributions, and judicial review of SBE decisions is available only after a taxpayer pays the tax and sues for a refund. The initial hearing in franchise tax cases is before the SBE, en banc; the initial hearing in business tax cases is before a hearing officer whose powers and responsibilities are presently in sharp dispute.

Asimow, *supra* note 168, at 1165, n.334.

Consistency of result and some assurance that equally placed taxpayers and investors are receiving equal treatment with regularly disclosed analytical resolution of tax disputes would add a significant dose of credibility to California tax collection.

The 2003 report of the California Commission on Tax Policy in the New Economy recommended that “California . . . establish a state administrative body to operate like the U.S. tax court. This body would resolve all tax disputes, including personal income tax, corporate income tax, sales and use tax, property taxes, payroll taxes, and excise taxes”²⁶³ Appeals from final administrative tax assessments would be heard by a board of tax appeals before the taxpayer would be required to pay the assessment.²⁶⁴ Appeals from decision of the board of tax appeals would be directed to the California Courts of Appeal.²⁶⁵ Decisions could be appealed by both the taxpayer and the tax collection agency.²⁶⁶ The Commission described its proposal as follows:

The overriding theme of the proposal is conformity with federal procedures. Also, the creation of a state tax body should shorten the dispute-resolution process by reducing the number of steps needed to resolve a case. The system would not be duplicate; one level of administrative appeal and the hearing before the Board of Equalization could be eliminated. In addition, this proposal would reduce the need for staff at the Board of Equalization to find facts and draft decisions proposed for Board adoption. Some of the staff might be shifted to the tax body. Overall, an administrative tax body would create efficiencies in the decision making process that could result in cost savings to the State.²⁶⁷

The recommendations of the Commission were incorporated into a 2004 legislative proposal by California Assembly Member Lois Wolk.²⁶⁸ Similar legislative proposals

263. CAL. COMM’N ON TAX POLICY IN THE NEW ECON., *supra* note 225, at 4. The recommendation was based on an appearance before the Commission by the author and a letter dated September 23, 2003, *supra* note 225. The letter is reproduced as an appendix to the report and a copy is in the author’s files.

264. CAL. COMM’N ON TAX POLICY IN THE NEW ECON., *supra* note 225, at 35.

265. *See id.*

266. *See id.*

267. *See id.* at 34.

268. *See* Assemb. B. 2472, 2003-2004 Reg. Sess. (Cal. 2004), as introduced

for a Board of Tax Appeals were introduced in 1994 by Senator Quinton Kopp and Assembly Member Willie Brown.²⁶⁹

The creation of an independent administrative tax tribunal would not necessarily affect the alternate route for review by payment of the tax, filing a claim for refund, followed by a suit for refund in the Superior Court. Thus, as in the Federal system, the creation of an administrative tax tribunal for California could leave taxpayers with the option of pursuing a refund claim through a judicial tribunal.

The Commission provided an example of an administrative court with five administrative law judges.²⁷⁰ The proposal for an administrative court is similar to the United States Tax Court, which is not a judicial court.²⁷¹ The recommendation for an administrative law court, rather than a judicial court, is based on opposition from California judges to fragmentation of the court system by the creation of specialty courts.²⁷² In addition, the State and Local Tax

Feb. 19, 2004. After receiving do pass recommendations from the Judiciary Committee and the Revenue and Taxation Committee, the bill was referred by the Rules Committee to the Appropriations Committee where it was held in suspense until the end of the session and never acted upon by the Assembly. See Assembly Bill History, Assemb. B. 2472, 2003-2004 Reg. Sess. (Cal. 2004). The author worked with Assembly Member Wolk and her staff in drafting this legislation.

269. See S.B. 87, 1992-1993 Reg. Sess. (Cal. 1993); Assemb. B. 3820, 1993-1994 Reg. Sess. (Cal. 1994).

270. See CAL. COMM'N ON TAX POLICY IN THE NEW ECON., *supra* note 225, at 34.

271. See *id.* at 34; see also text accompanying note 216. California assembly bill number 2472 would have referred to the tax tribunal as the California Tax Court. See Assemb. B. 2472, 2003-2004 Reg. Sess. (Cal. 2004). Even the use of the term "court" generated opposition from representatives of the Judicial Council of California.

272. See Letter from William C. Vickrey, Admin. Dir. of the Courts, Judicial Council of Cal., to the Cal. Comm'n on Tax Policy in the New Econ. (Nov. 6, 2003) (on file with author). The Judicial Council opposition did not apply to the creation of an administrative tribunal. See also Garland Allen & Craig B. Fields, *The Model State Administrative Tax Tribunal Act: Fairness for all Taxpayers*, in 10 THE STATE & LOCAL TAX LAWYER 83, 88-89 (2005) (noting that the model act drafted by the State and Local Tax Committee of the American Bar Association, Section of Taxation, would create a tax tribunal in the executive branch of state government because of the practical difficulties encountered with respect to attempts to establish a specialized judicial tribunal). Some critics of the proposal for an independent tribunal complain that the tax tribunal would not be a judicial court capable of resolving constitutional issues. See Wm. Gregory Turner, General Counsel and

Committee of the Tax Section of the American Bar Association asserts that formation of tax tribunals within the executive branch of state government has been effective.²⁷³ Only six states have established judicial branch tax tribunals, while executive branch tax tribunals exist in twenty-four states.²⁷⁴

Consideration of the objections to creation of a specialized tax tribunal in the course of hearings on Assembly Member Wolk's proposed tax court legislation helps to strengthen the argument in favor of the tax tribunal.

a. Appellate Review

The California Commission on Tax Policy recommended that decisions of the tax tribunal be reviewed by the Courts of Appeal.²⁷⁵ Assembly Bill 2472 would have provided for appellate review by the Court of Appeal for the appellate

Legislative Dir., Cal. Taxpayers' Ass'n. (Cal-Tax), Letter to Assemb. Member Lois Wolk in Opposition to A.B. 2472, at 2 (Apr. 5, 2004) (on file with author) [hereinafter Turner Letter]. *But see infra*, text accompanying note 321. Establishment of a specialized court is opposed by a group called Consumer Attorneys of California. *See* Bruce Brusavich, President Consumer Attorneys of Cal., Letter to William Rosendahl, Chairman, Cal. Comm'n on Tax Policy in the New Econ. (Nov. 12, 2003) (on file with author). In ballot arguments California Chief Justice Phil Gibson is quoted as opposing adoption of California Assembly Constitutional Amendment number 39 (1946) (Proposition 5), which would have created a three-judge tax appeals court with appellate jurisdiction to hear appeals from superior courts and tax agencies on the grounds that, "there is no need for the so-called tax court, either as an appellate court or as a substitute for the superior court; the adoption of the amendment would result in a sheer waste of manpower and money, and serve only to complicate our judicial system and confuse and inconvenience litigants and attorneys." Hastings Law Library, University of California Hastings, California Propositions Data Base, <http://traynor.uchastings.edu/cgi-bin/starfinder/10909/calprop.txt>. This proposition was rejected by the voters, Yes: 586,412 (28.7%); No: 1,458,568 (71.3%). *Id.*

273. *See* Allen & Fields, *supra* note 272, at 89.

274. *See id.* Allen and Fields indicate that judicial tax tribunals have been established in Arizona, Connecticut, Hawaii, Indiana, New Jersey, and Oregon. Allen and Fields add:

The track record of executive branch tax tribunals over the last 35 years is impressive, demonstrating that such forums can efficiently achieve the Model Act's principal goals. Tribunals in states such as Maryland, Massachusetts, Michigan and New York have operated successfully for many years and have earned a reputation for fairness and for tax expertise.

Id.

275. *See* CAL. COMM'N ON TAX POLICY IN THE NEW ECON., *supra* note 225, at 35.

judicial district in which the proceeding originally arose.²⁷⁶ The legislation would have directed the appellate court to apply a substantial evidence test under which the appellate court would apply its independent judgment to findings of fact only if the findings of the tax tribunal were not supported by substantial evidence on the record considered as a whole, and to apply its independent judgment as to questions of law and fact.²⁷⁷

There appears to be little question that the legislature has authority to provide for primary appellate review of administrative decisions by the Court of Appeals. However, questions of the scope of permissible judicial appellate review of the decisions of an administrative tax tribunal have been central to the discussion of legislative proposals. An examination of the evolution of the view of the California Supreme Court regarding appellate review of administrative action makes it clear that legislation directing review of the decisions of an administrative tax tribunal by the appellate courts is permissible.

In *Standard Oil Co. v. State Board of Equalization*,²⁷⁸ the California Supreme Court held that, notwithstanding a statutory provision²⁷⁹ providing for review of decisions of the State Board of Equalization under sections of the California Code of Civil Procedure governing writs of certiorari, or writs of review, the courts had no jurisdiction to issue the writ to review a decision of the Board of Equalization.²⁸⁰ The Court reasoned that the writ of review would lie only to review the exercise of a judicial function²⁸¹ and that the State legislature did not have the power to confer judicial power on a state-

276. See Assemb. B. 2472, § 33, 2003-2004 Reg. Sess. (Cal. 2004), (adding CAL. REV. & TAX. CODE § 25182(a)).

277. See *id.* (adding CAL. REV. & TAX. CODE § 25182(b)(1) and (2)).

278. *Standard Oil Co. v. State Bd. of Equalization*, 6 Cal. 2d 557 (1936).

279. Retail Sales Act, ch. 1020, § 33, 1933 Cal. Stat. 2599, 2611.

280. See *Standard Oil Co.*, *supra* note 278, at 565. A thorough discussion of the *Standard Oil* decision and judicial review of administrative action can be found in Michael Asimow, *The Scope of Judicial Review of Decisions of California Administrative Agencies*, 42 UCLA L. REV. 1157 (1995). Professor Asimow notes that the *Standard Oil* decision “set off a torrent of academic criticism and ridicule” and cites numerous articles and judicial opinions questioning the judgment. See *id.* at 1165 n.20; see also Ralph N. Kleps, *Certiorarified Mandamus*, 12 STAN. L. REV. 554 (1960).

281. *Standard Oil Co.*, *supra* note 278, at 565, citing CAL. CIV. PROC. CODE § 1068 (Deering, 2006).

wide administrative agency.²⁸² Subsequently, in *Drummey v. State Board of Funeral Directors and Embalmers*,²⁸³ the Court held that "in the absence of a proper statutory method of review, mandate is the only possible remedy available to those aggrieved by administrative rulings of the nature here involved."²⁸⁴ The Court in *Drummey* also held that the reviewing court must exercise its independent judgment on the facts, but that the courts "can and should be assisted by the findings of the [administrative agency]."²⁸⁵ The Court suggested that in reviewing a determination of a quasi-judicial agency the court "must weigh the evidence, and exercise its independent judgment on the law, if the complaining party is to be accorded his constitutional rights under the state and federal Constitutions."²⁸⁶

In 1946, the California legislature reacted to *Standard Oil* and *Drummey* with the enactment of California Code of Civil Procedure section 1094.5, which provides for administrative mandamus to review decisions of administrative agencies in which a hearing is required.²⁸⁷ The scope of the inquiry includes questions whether the agency has proceeded without, or in excess of its jurisdiction, whether there was a fair trial, and whether there was an abuse of discretion.²⁸⁸ The statute does not clearly specify the standard of review. Section 1094.5(c) provides:

Where it is claimed that the findings are not supported by the evidence, in cases in which the court is authorized by law to exercise its independent judgment on the evidence, abuse of discretion is established if the court determines that the findings are not supported by the weight of the evidence. In all other cases, abuse of discretion is established if the court determines that the findings are not supported by substantial evidence in the light of the

282. See *Standard Oil Co. v. State Bd. of Equalization*, 6 Cal. 2d at 559. Section 1 of Article VI of the California Constitution vests the judicial power in the courts. See CAL. CONST. art. VI, § 1.

283. *Drummey v. State Bd. of Funeral Dirs. & Embalmers*, 13 Cal. 2d 75 (1939).

284. *Id.* at 82. The case involved an action to set aside an administrative license suspension. See *id.* at 78-79.

285. *Id.* at 85.

286. *Id.* at 84.

287. See Act of June 15, 1945, ch. 868, § 1, 1945 Cal. Stat. 1636.

288. See CAL. CIV. PROC. CODE § 1094.5(b) (Deering 2006).

whole record.²⁸⁹

The California Supreme Court addressed the scope of review question in *Bixby v. Pierno*,²⁹⁰ holding that under Code of Civil Procedure section 1094.5 the courts could apply the substantial evidence test to review a decision of the Commissioner of Corporations' approving a corporate reorganization plan.²⁹¹ The Court observed that the separation of powers doctrine embodied in Article III of the State Constitution establishes a system of checks and balances under which the judicial power empowers the courts to protect fundamental rights.²⁹² In the words of the majority opinion of Justice Tobriner:

By carefully scrutinizing administrative decisions which substantially affect vested, fundamental rights, the courts of California have undertaken to protect such rights, and particularly the right to practice one's trade or profession, from untoward intrusions by the massive apparatus of government. If the decision of an administrative agency will substantially affect such a right, the trial court not only examines the administrative record for errors of law but also exercises its independent judgment upon the evidence disclosed in a limited trial de novo.²⁹³

As to the application of the standard of review under section 1094.5, Justice Tobriner added:

The courts must decide on a case-by-case basis whether an administrative decision or class of decisions substantially affects fundamental vested rights and thus requires independent judgment review. As we shall explain, the courts in this case-by-case analysis consider the nature of the right of the individual: whether it is a fundamental and basic one, which will suffer substantial interference by the action of the administrative agency, and, if it is such a fundamental right, whether it is possessed by, and vested in, the individual or merely sought by him. In the latter case, since the administrative agency must engage in the delicate task of determining whether the individual qualifies for the sought right, the courts have deferred to the administrative expertise of the agency. If, however,

289. *Id.*

290. *Bixby v. Pierno*, 4 Cal. 3d 130 (1971).

291. *See id.* at 134.

292. *See id.* at 141.

293. *See id.* at 142-43.

the right has been acquired by the individual, and if the right is fundamental, the courts have held the loss of it is sufficiently vital to the individual to compel a full and independent review. The abrogation of the right is too important to the individual to relegate it to exclusive administrative extinction.²⁹⁴

Justice Burke added in a concurring opinion that:

[I]t is apparent that practical necessity precludes continued reliance upon a strict separatist theory of government. The rapid technological growth and economic expansion which resulted in the creation and proliferation of administrative agencies likewise has placed ever-increasing burdens upon the judiciary. Only the most compelling reasons should lead us to perpetuate the uneconomic duplication of effort inherent in an independent judgment review. Likewise, there is no justification whatsoever for permitting the courts to ignore or overrule the administrative decisions of statewide agencies whose experience and expertise best qualify them, and not the courts, to make those decisions. From the foregoing discussion, it seems clear that the separation of powers doctrine does not afford a firm basis for sustaining the independent judgment rule. Therefore, I would conclude that the provisions of the California Constitution do not forbid the administrative exercise of such quasi-judicial functions as making factual determinations which are binding upon the courts if supported by substantial evidence.²⁹⁵

The Court took a step towards Justice Burke's position in *Tex-Cal Land Management, Inc. v. Agricultural Labor Relations Board*²⁹⁶ where the Court accepted a legislative mandate for appellate court review of a quasi-judicial administrative finding applying the substantial evidence test.²⁹⁷ The majority opinion commented on Justice Burke's

294. *Id.* at 144 (citations omitted).

295. *Id.* at 156 (Burke, J., concurring) (footnotes omitted).

296. *Tax-Cal Land Mgmt., Inc. v. Agric. Labor Relations Bd.*, 24 Cal. 3d 335 (1979).

297. The holding was repeated in *Frink v. Prod.*, where the Court described its opinion in *Tex-Cal Land Management, Inc.* by saying:

Pointing out that none of the earlier cases had invalidated a statute providing that administrative findings were conclusive if supported by substantial evidence, the court in *Tex-Cal* held that 'the Legislature may accord finality to the findings of a statewide agency that are supported by

opinion in *Bixby v. Pierno* describing the opinion as calling for a uniform application of the substantial evidence test and adding:

The majority opinion expressed two reasons for rejecting the dissent. First it pointed out that section 1094.5 was intended to leave to courts the establishment of standards for deciding which cases require independent judgment and which substantial evidence review. ("In view of this judicial history, the court would now assert a doubtful prerogative if it were to rule that no cases at all require an independent judgment review, and that the Legislature created an empty category in section 1094.5.") Second, the majority opinion urged that independent judgment review be retained because it may help cure due process violations at the administrative level.

Those two reasons for rejecting the dissent imply that a statute might pass constitutional muster if it were to (1) provide for judicial review of fact findings only by the standard whether they are supported by substantial evidence in the light of the whole record, and (2) guarantee administrative due process.²⁹⁸

Importantly, the Court, in *Tex-Cal Land Management, Inc.*, adopted Justice Burke's view of the scope of the constitutional mandate. The Court indicated that language in its earlier cases "that described constitutional limitations on legislative power was unnecessary to the holdings, which could as well have been grounded in judicially fashioned rules of procedure or in interpretation of section 1094.5."²⁹⁹ The Court also pointed out that, "none of the cases that commenced in 1936 with *Standard Oil* . . . and continued through *Bixby* . . . , as well as later cases, invalidated any legislative command that findings be conclusive if supported by substantial evidence."³⁰⁰ The Court confirmed the

substantial evidence on the record considered as a whole and are made under safeguards equivalent to those provided by the [Agricultural Labor Relations Act] for unfair labor practice proceedings, whether or not the California Constitution provides for that agency's exercising "judicial power." *Frink v. Prod*, 31 Cal. 3d 166, 173 (1982).

298. *Id.* at 344. The majority opinion in *Tex-Cal Land Management, Inc.* mistakenly refers to Justice Burke's concurrence in *Bixby v. Pierno* as a dissent. The majority's page citation to Justice Burke's opinion is a clear reference to his concurring opinion.

299. *Id.* at 345.

300. *Id.* (citations omitted). Professor Asimow thus asserts that, "As a result

legislative mandate in the California Agricultural Labor Relations Act for direct judicial review of orders of the Labor Relations Board by the Court of Appeal applying the substantial evidence test.³⁰¹ The Court in *Tex-Cal Land Management, Inc.* specifically states that “a mandate proceeding initiated in an appellate court is a constitutionally permitted vehicle for reviewing an administrative determination.”³⁰² The Court described its ruling as follows:

We therefore hold that the Legislature may accord finality to the findings of a statewide agency that are supported by substantial evidence on the record considered as a whole and are made under safeguards equivalent to those provided by the ALRA for unfair labor practice proceedings, whether or not the California Constitution provides for that agency’s exercising “judicial power.” Our holding does not, of course, affect review of administrative findings where the Legislature has left the choice of standard to the courts (e.g., as in § 1094.5).³⁰³

of *Tex-Cal*, the way is open for the courts or the legislature to design a modern instrument for judicial review of adjudicatory action and to either abolish the independent judgment test or shrink the circle of cases to which it applies.” Asimow, *supra*, note 168, at 1170.

301. Section 1160.8 of the California Labor Code provided in part that:

Any person aggrieved by the final order of the board granting or denying in whole or in part the relief sought may obtain a review of such order in the court of appeal having jurisdiction over the county wherein the unfair labor practice in question was alleged to have been engaged in, or wherein such person resides or transacts business, by filing in such court a written petition requesting that the order of the board be modified or set aside The findings of the board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall in like manner be conclusive.

302. *Tax-Cal Land Mgmt., Inc. v. Agric. Labor Relations Bd.*, 24 Cal. 3d 335, 350 (1979). The court also prevaricated regarding the application of its holding in *Standard Oil v. Board of Equalization* with respect to availability of the writ of review stating simply:

Is the writ of review available only as to orders made in the exercise of “judicial power?” . . . We need not decide that question here, for if the writ of review is unavailable, the functions assigned a Court of Appeal by section 1160.8 are within its original jurisdiction over a proceeding “for extraordinary relief in the nature of mandamus.”

Id.

303. *Tex-Cal Land Mgmt., Inc.*, 24 Cal.3d at 346. As to the requisite standards of due process, the court points to safeguards in the National Labor Relations Act (29 U.S.C. §§ 160(e) and (f)). The court states:

The ALRA incorporates procedural safeguards of the NLRA including the separation of prosecutorial from adjudicatory functions (§ 1149; cf. 29 U.S.C. § 153(d)), notice, written pleadings, evidentiary hearings (§

Tex-Cal Land Management, Inc. thus explains that the legislature may provide for appellate review of the actions of a quasi-judicial administrative tribunal by *mandamus* applying the substantial evidence test. *Tex-Cal Land Management, Inc.* and *Bixby v. Pierno* also indicate that the administrative proceeding must be structured with safeguards to provide a fair hearing based on principles of adequate due process. The structure of a tax court provided by the proposed model tax court legislation of the American Bar Association, Section of Taxation, State and Local Tax Committee, fulfills these requirements.³⁰⁴ Indeed, the proposed model act contemplates an adjudicatory procedure that contains more safeguards than the current review process of the Board of Equalization. The summary explanation of the proposed model act states:

Basic fairness demands that a taxpayer be allowed to make his case against an assertion of tax liability before an independent adjudicatory body with tax expertise. And, except in unusual situations, a taxpayer challenging a tax determination should not be required to pay the amount in dispute, or post a bond, as a condition to receiving an initial hearing before an unbiased, adjudicatory body.³⁰⁵

The basic procedural safeguards proposed by the draft model act are consistent with the recommendation of the California Commission on Tax Policy in the New Economy³⁰⁶ and Assembly Member Wolk's 2004 proposed legislation.³⁰⁷ Principal features of the administrative tax tribunal proposed by the model act include the following:

- The tax tribunal would be separate and independent

1160.2; cf. 29 U.S.C. § 160(b)), and a requirement that orders be accompanied by findings based on the preponderance of the reported evidence (§ 1160.3; cf. 29 U.S.C. § 160 (c)). To make full use of the board's expertise and to minimize delay from judicial review, both the ALRA and the NLRA provide for direct review of board orders by appellate courts and require that findings be conclusive if supported by substantial evidence on the record as a whole. (§ 1160.8; cf. 29 U.S.C. §§ 160(e), 160(f).)

Id.

304. See MODEL STATE ADMIN. TAX TRIBUNAL ACT (Proposed Draft Jan. 18, 2005).

305. *Id.* at 2.

306. See CAL. COMM'N ON TAX POLICY IN THE NEW ECON., *supra* note 225.

307. See Assemb. B. 2472, 2003-2004 Reg. Sess. (Cal. 2004), *supra* note 268.

- from the agencies responsible for collecting the tax,³⁰⁸
- Judges would be appointed by the Governor with the consent of the Senate for a specified term of years,³⁰⁹
 - Judges will be required to have “substantial knowledge of the tax law and substantial experience making the record in a tax case suitable for judicial review,”³¹⁰
 - Judges will be expected to devote full-time to the duties of the tax tribunal and shall not be permitted to engage in other employment,³¹¹
 - Subject to separate provisions for filing a claim for refund, the tax tribunal would have jurisdiction for hearing and determination of questions of law and fact under the tax laws regulating payment of taxes or assessments over which the tax tribunal is given jurisdiction,³¹²
 - A taxpayer would commence a proceeding before the tax tribunal within ninety days following receipt of a notice of assessment from the revenue agency, with provisions for an answer filed by the revenue agency and further reply briefs from the taxpayer,³¹³
 - The tribunal would encourage informal discovery and stipulations to agreed facts, but the tribunal would also provide procedures for parties to obtain discovery through production of books and records, written interrogatories, and depositions,³¹⁴
 - Tax cases would be heard in a trial *de novo* in a public session with rules of evidence that permit relevant evidence, including hearsay, “if it is probative of a

308. See MODEL STATE ADMIN. TAX TRIBUNAL ACT § 2(b).

309. See *id.* § 3(b).

310. See *id.* § 4(a).

311. See *id.* § 4(c). Members of the California State Board of Equalization are prohibited from receiving compensation from a lobbyist or lobbying firm or from a person who has within the past 12 months been under contract with the agency. See CAL. CONST. art. V, § 14(a). Board members are also prohibited from accepting any honorarium. See CAL. CONST. art. V, § 14(b). Section 15603 of the California Government Code requires members of the Board to devote full-time to the duties of the office. See CAL. GOV'T CODE § 15603 (Deering 2006).

312. See MODEL STATE ADMIN. TAX TRIBUNAL ACT § 7(a).

313. See *id.* § 9(a)-(c).

314. See *id.* §§ 11(a)-(c).

material fact in controversy,³¹⁵

- The taxpayer would have the burden of persuasion by a preponderance of the evidence except in cases of fraud or other cases where the burden is shifted by law to the revenue agency,³¹⁶
- The tax tribunal would be required to render a decision in writing with a concise statement of the facts found and the applicable law within six-months after submission of the matter for decision,³¹⁷
- Decisions of the tax tribunal would be enforced in the same manner as a judgment of the Superior Court,³¹⁸ and
- The Tax Tribunal's interpretation of a taxing statute subject to contest in one case shall be followed by the Tax Tribunal in subsequent cases involving the same statute, and its application of a statute to the facts of one case shall be followed by the Tax Tribunal in subsequent cases involving similar facts, unless the Tax Tribunal's interpretation or application conflicts with that of an appellate court or the Tax Tribunal provides satisfactory reasons for reversing prior precedent.³¹⁹

In contrast, the administrative hearings before the Board of Equalization do not provide for decisions by persons independent of the tax collecting agency, the decision makers are elected public servants with short and limited terms, the decision makers are not required, and indeed generally do not have any experience with the tax law, nor are the members of the Board of Equalization necessarily skilled in the creation of a record suitable for judicial review. With the rare exception of an occasional written opinion, the only record of

315. *See id.* §§ 12 (a)-(d). The Model Act would expressly provide that the tax tribunal would not be bound by rules of evidence applicable in civil cases. The Act would also permit the tax tribunal to exclude evidence that is irrelevant and unduly repetitious. *See id.* § 12(d).

316. *See id.* § 12(g).

317. *See* MODEL STATE ADMIN. TAX TRIBUNAL ACT § 13(a), (b) (Proposed Draft Jan. 18, 2005).

318. *See id.* § 13(e).

319. *Id.* § 13(f). This, of course, would be a major improvement over the decision making of the Board of Equalization, which rarely publishes decisions, and which, therefore, has no precedential value for future reference.

Board decisions provided for either judicial or public review are brief notations in Board minutes. Furthermore, the judicial review process, available only as a refund claim following full payment of the tax, does not provide a hearing before a judge with expertise in tax matters. The Board of Equalization is not required, and often does not render a written decision, and, especially in the absence of written decisions analyzing the law and facts of a case, the Board does not apply its interpretation in one case to subsequent decisions. Cases reviewed by the Superior Courts are not much different in that at the trial-court level decisions on claims for refund generally are not available as guidance for future litigants. In terms of the quest for adequate safeguards and due process addressed by the Court in *Bixby v. Pierno*,³²⁰ the creation of an independent administrative tribunal to resolve tax disputes would provide a vast improvement over the current situation.

b. Review of Constitutional Questions

Critics of proposals to create an independent tax tribunal argue that such an administrative tribunal would lack jurisdiction to resolve disputes involving constitutional questions.³²¹ The California Constitution provides that no administrative agency may declare a statute unenforceable or refuse to enforce a statute on the basis of it being unconstitutional unless an appellate court has made a determination that the statute is unconstitutional.³²² The proposed ABA Model State Administrative Tax Tribunal Act addresses the issue by providing that the tax tribunal shall decide questions regarding the constitutionality of statutes and regulations, but shall not have the power to declare a statute unconstitutional on its face.³²³ The model act proposes that a taxpayer with a constitutional claim may commence a declaratory action in the trial court and file a petition with the tax tribunal with respect to the remainder of the matter, which is stayed pending resolution of the

320. *Bixby v. Pierno*, 4 Cal. 3d 130 (1971).

321. See Turner Letter, *supra* note 272, at 2.

322. CAL. CONST. art. III, § 3.5 (Deering 2006).

323. See MODEL STATE ADMIN. TAX TRIBUNAL ACT §7(e) (Proposed Draft Jan. 18, 2005).

constitutional claim.³²⁴ As an alternative, the model act would permit the taxpayer to pursue a petition with the tax tribunal with respect to all issues other than the constitutional challenge and to preserve the constitutional challenge for presentation to the appellate court,³²⁵ or to bifurcate the matter by pursuing a declaratory action in the state courts regarding the constitutional issue and, at the same time, proceeding with the remaining issues in the tax tribunal.³²⁶

The procedure contemplated in the model act provides taxpayers with an expedient process to pursue constitutional claims through the judiciary in state tax matters that is more efficient than the existing structure. Under the current structure, the taxpayer must first pay the tax in order to raise a constitutional claim in the Superior Court in the course of a claim for refund.³²⁷ In addition, in order to raise constitutional issues, either the taxpayer must forego any administrative review by paying the tax and proceeding with a claim for refund, or the taxpayer must pursue the matter to completion through a Board of Equalization hearing (where the constitutional question may be raised but not decided), then pay the tax and file a refund action.

c. *Small Tax Cases*

Opponents of an independent California tax tribunal also argue that a tribunal modeled on the United States Tax Court would complicate access for *pro se* taxpayers in small claims matters.³²⁸ A provision for a small claims procedure is

324. See *id.* § 7(e)(1). In *Delta Dental Plan v. Mendoza*, 139 F.3d 1289, 1396 (9th Cir. 1998), the court notes that Section 3.5, article III, of the California Constitution does not prevent a party from raising an issue before the administrative agency in order to preserve the issue for review in the State courts. See also *S. Pac. Transp. Co. v. Pub. Utilities Comm'n*, 716 F.2d 1285, 1291 (9th Cir. 1983).

325. See MODEL STATE ADMIN. TAX TRIBUNAL ACT § 7(e)(2).

326. See *id.* § 7(e)(3).

327. See CAL. CONST. art. III, § 32; see CAL. REV. & TAX. CODE § 6931 (Deering 2006) (barring any action to enjoin collection of tax).

328. See Turner Letter, *supra* note 272, at 3. Several opponents to this legislation repeat the silly statement that, "One need look no further than the U.S. Tax Court's rules of procedure, some 200 plus pages long, compared with 32 pages of the BOE's Rules of Practice to understand the significant jump in complexity that will result from a U.S. Tax Court style administrative adjudication." *Id.*; see also *e.g.*, Letter from Marc A. Aprea, Aprea and Co. Gov't

a necessary part of the creation of an independent tax tribunal. Simplified access to an independent tribunal for small claims litigants is important to the perception of fairness for all taxpayers. In addition, small cases deserve the opportunity for an independent hearing by knowledgeable tax professionals.

At the election of the taxpayer, the small case procedure in the United States Tax Court is available for matters with less than \$50,000 in dispute.³²⁹ A small tax case is initiated by the taxpayer with a simplified form of petition that is provided by the Tax Court rules.³³⁰ The rules do not require further pleadings.³³¹ Trials of small tax cases are to be conducted "as informally as possible consistent with orderly procedure, and any evidence deemed by the Court to have probative value shall be admissible."³³² Decisions in small tax cases are not appealable.³³³

The proposed ABA Model State Administrative Tax Tribunal Act contains provisions for a small claims division of the tax tribunal to hear cases at the election of the taxpayer in which the net amount of tax is less than \$25,000.³³⁴ As under the United States Tax Court rules, hearings proposed

Relations Firm, on behalf of PriceWaterhouseCoopers, LLP to Ellen M. Corbett, Chairwoman, Assemb. Comm. on the Judiciary, at 3 (Apr. 7, 2004) (on file with author). What these commentators omit is the fact that the U.S. Tax Court rules regarding small claims procedures are simple and very short, comprising less than three pages. See U.S. TAX COURT RULES OF PROCEDURE, tit. XVII, Small Tax Cases, R. 170-175. Also, since the U.S. Tax Court rules regarding regular cases contemplate a full hearing in which both sides fully present a case, including briefs, witnesses and evidence, the rules are more extensive than the procedures before the Board of Equalization, which are informal and not adjudicative in their nature. Section 33 of Assembly Bill number 2472 originally contained a provision permitting the California Tax Court to establish a streamlined hearing process for tax matters in excess of \$10,000, but this provision was removed by amendment. See Assemb. B. 2472 § 33, 2003-2004 Reg. Sess. (Cal. 2004).

329. See I. R. C. § 7463(a)(1); U.S. TAX COURT RULES OF PROCEDURE, R.170, 171(b).

330. See U.S. TAX COURT RULES OF PROCEDURE, R. 173(a), app. 1, Form 2.

331. See *id.* R. 173(b) and (c). An answer is required only with respect to issues where the Commissioner of Internal Revenue bears the burden of proof, or where the Court otherwise directs. A reply is required only if the Court directs.

332. *Id.* R. 174(b).

333. See I. R. C. § 7463(b) (2000).

334. MODEL STATE ADMIN. TAX TRIBUNAL ACT § 14(a) and (c) (Proposed Draft Jan. 18, 2005).

for the small claims division are to be “informal, and the judge may receive such evidence as the judge deems appropriate for determination of the case.”³³⁵ Decisions of the small claims division would not be appealable, nor considered as precedent in other cases.³³⁶ The informal dispute resolution procedure for small taxpayers allows access to an independent decision maker in small cases. A small case procedure can easily, and should be, incorporated into the creation of an independent tax tribunal for California tax matters.

d. Admission to Practice Before the Tax Tribunal

The Rules of Practice of the Board of Equalization allow taxpayers to be represented “at all levels of review by any person of the taxpayer’s choosing, including, but not limited to, an attorney, appraiser, accountant, bookkeeper, employee or business associate.”³³⁷ Accountants have raised concerns about potential restrictions on practice before an administrative tax tribunal that would not automatically permit certified public accounts to represent taxpayers before the tribunal.³³⁸ Admission to practice before the United

335. *Id.* § 14(g).

336. *See id.* § 14(h).

337. CAL. CODE REGS. tit. 18, § 5073(a) (2005).

338. *See* Letter from Bruce C. Allen, Dir. Gov’t Relations, Cal. Soc’y Certified Pub. Accountants, to Assemb. Member Lois Wolk (Feb. 17, 2004). Mr. Aprea wrote:

Under existing law, taxpayers may choose to have their accountant assist them before the Board of Equalization (BOE). It is the taxpayer’s accountant that best understands the individual of business and their tax returns. [¶] Only when a taxpayer appeals a decision by the BOE to the Superior Court, does existing law proscribe and limit who may provide the taxpayer assistance before the Superior Court. Over 95% of all cases are decided by the BOE. Less than 5% are appealed to the Superior Court.

Aprea, Letter in Opposition to A.B. 2472 on behalf of Price Waterhouse Coopers, LLP, *supra* note 328. Following this logic, accountants should be permitted to appear in the Superior Court in tax matters. Another commentator on A.B. 2472 counters this argument:

Further, PriceWaterhouse Coopers appears to be opposing the bill from the standpoint that they are concerned that their representatives may not be able to practice in front of the Tax Court. Nonetheless PWC manage to fashion legal arguments concerning constitutionality of the California Tax Court. [¶] Although I have no problem in allowing accountants to practice in front of the California Tax Court, it is apparent that PWC is an accounting firm wanting to practice law

States Tax Court requires the applicant to establish good moral character and the “requisite qualifications to provide competent representation before the Court.”³³⁹ Attorneys are required to file a certificate with the Tax Court showing that the attorney is admitted in good standing to the bar of the Supreme Court of the United States or the highest court of a state or the District of Columbia.³⁴⁰ Non-attorneys are required to pass an examination administered by the Tax Court to establish that the applicant is qualified to provide qualified representation before the Tax Court.³⁴¹ In addition, an applicant for admission by examination must be sponsored by at least three persons who are admitted to practice before the Tax Court who provide the Court with letters of recommendation submitted after the applicant has passed the Court’s written examination.³⁴² The proposed ABA Model State Administrative Tax Tribunal Act would provide for appearance before the tax tribunal by the taxpayer, an attorney admitted to practice in the state, including attorneys who are members of an accounting firm or professional services firm, an accountant licensed in the state, or by an enrolled agent authorized to practice before the Internal Revenue Service.³⁴³ The recent California tax court proposal would have restricted practice before a California Tax Court to attorneys, a participant in an accredited law school tax clinic, and persons licensed to practice before the Internal Revenue Service (e.g. enrolled agents) provided that the person has satisfied requirements for admission specified in rules of practice before the State Tax Court or the person is admitted to practice before the United States Tax Court.³⁴⁴

without passing the Bar. [¶] Further, their concerns about the cost of the bill makes me wonder about the millions of dollars of tax shelters that PWC created for their clients without being concerned about the effect on state tax revenues.

Letter from Phillip L. Jelsma, Luce Forward, Hamilton & Scripps, LLP, to Assemb. Member Lois Wolk (May 17, 2004) (on file with author).

339. U.S. TAX COURT RULES OF PROCEDURE, tit. XVII, Small Tax Cases, R. 200(a)(1).

340. *Id.* R. 200(a)(2).

341. *Id.* R. 200(a)(3).

342. *Id.* R. 200(c).

343. MODEL STATE ADMIN. TAX TRIBUNAL ACT § 16(a) (Proposed Draft Jan. 18, 2005).

344. *See* Assemb. B. 2472 § 33, 2003-2004 Reg. Sess. (Cal. 2004) (adding CAL. REV. & TAX. CODE §25167(a)).

The principal drafters of the Model Act explain the decision to broaden the scope of permissible representatives to the tax tribunal as follows:

The Model Act rule is based on several realities. In many cases, a non-attorney tax professional, such as an accountant with years of experience in tax dispute resolution, is competent to present a tax case effectively. Moreover, experienced tax attorneys and litigators are today commonly employed as members or employees of accounting or other professional service firms. Finally, many taxpayers prefer to have their regular tax professionals represent them in the first hearing before an independent forum, rather than absorb the time and expense of hiring and educating legal counsel.³⁴⁵

If a California tax tribunal is established as an administrative tribunal, accepting representation by professionals experienced with tax issues, including accountants, would provide taxpayers with flexibility to employ the professional that the taxpayer believes would best represent him or her. Whether applied to attorneys or other professionals, the tax tribunal should be permitted to adopt its own rules of practice, qualifications for admission to practice, and authority to regulate and discipline practitioners appearing before it.

3. *What About the Board of Equalization?*

Opponents of an independent tax tribunal cite duplication and cost as reasons for rejecting the proposal.³⁴⁶ The obvious answer to the question of duplication and cost, as suggested by most of the studies and commissions that have examined the issue, is consolidation of tax collection into a single executive agency and elimination of the Board of Equalization. The latter step would require repeal of the State Constitutional provisions that create the Board of Equalization³⁴⁷ and empower it to equalize local assessment rolls,³⁴⁸ assess certain public utility property,³⁴⁹ assess the

345. See Allen & Fields, *supra* note 272, at 90.

346. See, e.g., Aprea, Letter in Opposition to A.B. 2472 on behalf of PriceWaterhouseCoopers, *supra* note 328, at 6-7.

347. See CAL. CONST. art. III, § 17.

348. See CAL. CONST. art. III, § 18. As noted above, this function is obsolete because of the limitation of Article XIII of the California Constitution. See

taxes on insurance companies,³⁵⁰ and assess and collect excise taxes on alcoholic beverages.³⁵¹ Some additional Constitutional references to the Board would require revision.³⁵² Unfortunately, however, any attempt at constitutional revision would complicate efforts to achieve either consolidation of tax collection or creation of an independent tax tribunal. Other than equalization of property taxes, assessment of certain property, collection of excise taxes on alcoholic beverages, and collection of the insurance tax, consolidation can be achieved by statute. Likewise, creation of an independent tax tribunal for dispute resolution is purely a statutory matter, although including the authority of a tax tribunal in the State Constitution with provisions of judicial review would end questions about the jurisdiction of the tribunal.

There is a potential role for the Board of Equalization to continue as the forum for administrative appeals. The proposed ABA Model State Administrative Tax Tribunal Act calls for an opportunity for a determination of tax liability by an independent administrative appeals function, which is defined as “a program of holding conferences and negotiating settlements that is designed to resolve the vast majority of

supra text accompanying note 99 on property taxation in California to one percent of assessed value, which is the purchase price of real property adjusted for inflation by no more than two percent per year.

349. Section 19, article 3, of the California Constitution provides in part that:

The Board shall annually assess (1) pipelines, flumes, canals, ditches, and aqueducts lying within 2 or more counties and (2) property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity. This property shall be subject to taxation to the same extent and in the same manner as other property.

CAL. CONST. art. III, § 19.

350. See CAL. CONST. art. XIII, § 28(h).

351. See CAL. CONST. art. XX, § 22.

352. These include CAL. CONST. art. II, § 14 (recall petitions), art. III, § 8(l) (salaries of Board members set by the Citizens Compensation Commission), art. IV, § 18(b) (impeachment), art. V, § 5(b) (vacancies filled by the Governor), art. V, § 14(f) (limitation on compensation from lobbyists), art. VII, § 10(a) (defamatory campaign statements), art. XIII, § 3(j) (participation by a Board member in the identification of immature trees for property tax exemption), art. XIII, § 11(g) (assessment of property owned by a local government outside of its boundaries), art. XVI, § 10 (excluding federal aid-to-aged programs from the maximum expenditure base for local government independent of authorization by the Board of Equalization), and art. XXI, § 1 (reapportionment).

tax controversies without litigation on a basis that is fair and impartial to the State and the taxpayer"³⁵³ With the creation of an independent tax tribunal, the Board of Equalization might itself fulfill this requirement. The Board could be structured to function much as it does today by conducting hearings on appeals for tax assessments. Alternatively the Board could be restructured to supervise an appeals office, with appeals officers handling cases, similar to the Appeals Division of the Internal Revenue Service.³⁵⁴ The latter approach would provide a review by experienced tax professionals who are independent of the tax collection agency, but remove the direct decision making from elected officials. The elected Board members would protect the public interest through oversight of the appeals decision and review of the quality of decision-making.

There are two potential arguments against continuation of an administrative appeals function in the Board of Equalization. First, it would involve continuation of a duplicative administrative structure. Second, there would be no appeal from taxpayer favorable rulings, as is the case today. The elected Board of Equalization would remain in a position to thwart legislatively enacted tax policy on the basis of the independent policy views of the Board members.

Finally, the Board of Equalization could continue in its role as policy advisor and research agency for California tax policy, an important function in providing guidance to the Governor and the Legislature.

IV. CONCLUSION

California's tax collection administration is burdened with an administrative structure that dates to the early history of California taxation when state government relied primarily upon a share of property taxes assessed by local elected officials. The elected Board of Equalization was enshrined in the State Constitution to equalize county property tax assessments as an attempt to fairly allocate the burden of supporting the state government. As sources of revenue were expanded to encompass different tax bases, the

353. MODEL STATE ADMIN. TAX TRIBUNAL ACT § 8(a) (Proposed Draft Jan. 18, 2005).

354. See *supra* text accompanying note 208.

administrative structure grew with the addition of new tax collection agencies, in part because of political struggles over which agency would have authority to assess and collect taxes. The result, as stated in the opening quotation of this article, is an “administration structure [that] is characterized by overlapping duplications, financial waste, and diffusion of activities and responsibilities. It is a hodgepodge of boards and elective and appointive officials and is not truly responsible to the governor, the Legislature, or the people.”³⁵⁵

As part of the many compromises regarding tax collection authority, principal responsibility for dispute resolution has fallen to the State Board of Equalization. The elected members of the Board of Equalization are often political figures who either are former members of the state legislature affected by term limits, or political figures with aspiration for higher office. They are not individuals selected on the basis of experience with tax matters or with the process of adjudication. Indeed, one suspects that the voters electing the Board members have little or no idea of the purpose and function of the Board of Equalization. The Board places little emphasis on creating a base of written decisions upon which taxpayers may rely in interpreting California tax statutes. Indeed, there is no basis for consistency in decision making by the Board in the absence of written interpretations with precedential value. Application of the rule of law in tax matters may vary with frequent and periodic changes of membership through the electoral process. Results are impacted by withdrawal of members because of political contributions and financial conflicts of interest. The informal nature of hearings before the Board, while welcomed by large companies and practitioners with regular access to Board members through *ex parte* contacts,³⁵⁶

355. SUBCOMM. OF THE ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 57, at 9; ASSEMB. INTERIM COMM. ON GOV'T ORG., *supra* note 8, at 29.

356. *See, e.g.*, Letter from Joseph A. Vinateieri, Bewley, Lassleben & Miller, LLP, to Judy Chu, Chair Assemb. Appropriations Comm. (May 14, 2004); Letter from N. Douglas Martin, Vice-President and Counsel, Gov't & Indus. Affairs, Fireman's Fund, to Assemb. Member Lois Wolk (Apr. 7, 2004); Letter from D. Michael Foulkes, Manager State and Local Gov't Affairs, Apple Computer, to Assemb. Member Lois Wolk (Apr. 6, 2004) (on file with author). At the time the letter was written, Apple had an appeal pending before the Board that involved a substantial liability. *See* Appeal of Apple Computer, Inc., 2006-SBE-002, Case No. 152016 (Nov. 20, 2006). Another commentator on A.B. 2472 wrote:

does not lead to the appearance of competent decision making involving the finding of fact based on evidence and the consistent application of law to the facts so found.

Investors, business owners, and individuals deserve the opportunity to plan their financial affairs with the benefit of consistent and equitable guidance regarding application of the state's tax laws. All citizens and residents of California deserve assurance that the tax statutes enacted by the legislature are fairly applied and that no taxpayer is provided special treatment because of access to the members of the Board of Equalization. Taxpayers and residents, particularly business interests, should not be faced with California's confusing multiplicity of tax collection agencies.

For decades, virtually every legislative study, board and commission to examine the issue independent of the special interests embedded in the existing administrative structure has recommended consolidation of California's tax collection activity into a single administrative agency responsible to the Governor. Most reviews also have recommended the creation of an independent tribunal for the resolution of tax disputes. Both steps would represent a significant improvement in California tax policy. However, there are powerful interests vested in the current structure.³⁵⁷ Full consolidation would

I am concerned that certain special interests have opposed this bill. For example, Apple Computer, a public company with hundreds of millions of dollars and the ability to hire the finest counsel and consultants available seeks to deny the general public the same access to Superior Court it enjoys. It is both prejudicial and short sighted to oppose this bill. Although it is no problem for Apple Computer to write a seven-figure check, the average Californian does not enjoy the same luxury.

Jelsma, *supra* note 338.

357. Professor Asimow describes the Board of Equalization's lobbying campaign to exclude Board decisions from the California Administrative Procedure Act Bill of Rights provisions as follows:

Thus, the Bill of Rights provisions relating to separation of functions, pecuniary bias, and ex parte contact would have fundamentally changed the way the SBE functions. After a few initial submissions, the SBE remained silent during Commission deliberations. But once S.B. 523 reached the legislature, the SBE conducted an all-out lobbying campaign to win exclusion from the Act. Several Board members were former legislators; they contacted the present legislators with their concerns. The California Taxpayers Association ("CTA"), which represents the largest corporate taxpayers, lobbied vigorously to exclude SBE, even though the reforms in the Bill were primarily pro-taxpayer. But CTA persuaded the Republican caucus that the bill was

require constitutional amendments. Persuading California voters to eliminate elective positions would be a difficult task. Even fixes that can be accomplished with statutory change are difficult because of political interest in retaining elective offices for termed-out politicians and future office seekers. Members of the legislature are unlikely to eliminate positions that offer further political career opportunity. There is little constituency for complex reform on the basis of good government.

California's tax administration is not broken. It is, however, a patchwork quilt of administrative agencies that confronts taxpayers with a bewildering array of different offices for each of the many taxes in place in California. There is no independent dispute resolution process except for the time-consuming and expensive recourse to the Superior Courts in a claim for refund. Even there, the courts create little interpretive guidance regarding application of the statutory and regulatory provisions of the tax law. The pathway to reform has been extensively studied and the trail is marked. The only thing missing is the political will to embark on change.

"unfriendly to taxpayers." These largest taxpayers, evidently, wanted to maintain their backdoor access to decision-makers and their ability to influence decisions through making strategic campaign contributions.

In a dramatic confrontation before the Assembly Consumer Protection, Governmental Efficiency, and Economic Development Committee, the SBE won exclusion from the bill on a 7-6 party line vote. All Republicans voted for exclusion, following the recommendation of their caucus; all Democrats voted to keep SBE in the bill. To the author of this article, this Committee decision was the biggest single disappointment of the entire process.

Asimow, *supra* note 182, at 307.