

## **Tax Section Report on 2018 Budget Proposal to Consolidate Administrative Hearings**

Tax #1

March 16, 2017

This Report<sup>1</sup> expresses our concerns regarding aspects of Budget Bill S02006/A03006. If enacted in its present form, the Bill could impact New York State tax hearings. S02006/A03006 creates a new division of central administrative hearings located in the Executive Department, and gives the head of that division the power establish, consolidate, reorganize or abolish hearing functions within any civil department, including the Department of Taxation's Division of Tax Appeals, replacing those hearings with hearings conducted by the new division of central administrative hearings. The proposal covers all agencies other than the "department of law and the department of audit and control."

The current system for adjudicating tax disputes through administrative hearings conducted by the Division of Tax Appeals works well. Tax matters are resolved in an impartial manner by individuals who are knowledgeable regarding the complexities of the tax law.<sup>2</sup>

If this change is enacted for any agencies, we recommend that the exclusion applicable to the department of law and the department of audit and control be expanded also to exclude the Department of Taxation and Finance, especially its Division of Tax Appeals.

### **Summary of the 2018 Budget Proposal in Question**

The 2018 Fiscal Year New York State Executive Budget includes the addition of new Article 51 to the State's Executive Law.<sup>3</sup> The new article has only two sections: Sections 1010 and 1011. Section 1010 would

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<sup>1</sup> The principal author of this report was Paul Comeau. Helpful comments were provided by Peter Faber, Michael Farber, Karen Sowell, Arthur Rosen, Michael Schler, Irwin Slomka and Jack Trachtenberg. This report reflects solely the views of the Tax Section of the New York State Bar Association and not those of the New York State Bar Association Executive Committee or the House of Delegates.

<sup>2</sup> See 2015-16 Annual Report of the Tax Appeals Tribunal/Division of Tax Appeals (<https://www.dta.ny.gov/pdf/reports/2015%202016%20final%20annual%20report.pdf>) describing the mission, structure, operations and results of the Division of Tax Appeals for the 2015-16 fiscal year.

create within the Executive Department a new division of central administrative hearings, which would be called the “division.” The head of the division would be a chief administrative law judge appointed by and serving at the pleasure of the governor. Section 1011 states that:

notwithstanding any law to the contrary, the chief administrative law judge may establish, consolidate, reorganize or abolish any administrative hearing function within any civil department as he or she determines to be necessary for the efficient operation of the division, provided that any such actions must be approved by the director of the budget pursuant to a plan submitted to the director, and provided further that such authority shall not apply to the department of law or the department of audit and control.

The Statement in Support<sup>4</sup> refers to the ability of the new chief judge to reorganize and consolidate administrative hearing functions within executive agencies, but the legislation itself goes much farther, and includes the power to “establish, consolidate, reorganize, or abolish any administrative hearing function within any civil department as [the chief judge] determines to be necessary for the efficient operation of the division [subject to approval of the budget director].”

The Statement in Support also explains the rationale for this change, which reflects:

a national movement to consolidate State agency hearing processes, with over half the states participating in some form. Benefits of this consolidation [could] accrue. . . . An office independent of other agencies can result in a more impartial and efficient hearing process, a more skilled workforce, and possible cost savings in personnel management, administration, and other back office functions. ALJ’s will be more adaptable, receiving training in multiple areas of the law, providing flexibility in managing caseloads and addressing backlogs when needed. A corps of ALJs trained as adaptable generalists will have the opportunity to gain expertise in multiple areas, resulting in greater advancement opportunities.

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<sup>3</sup> See S02006/A03006, which “Amends Various Laws, generally. . . [e]nacts into law major components of legislation necessary to implement the education, labor and family assistance budget for the 2017-2018 state fiscal year; . . . [and] **establishes the division of central administrative hearings within the executive department; grants general powers thereto** (Part U).” (Emphasis added.) Part U would add new Article 51 to reshape administrative hearings in the State, and it would become effective 180 days after it becomes law. The proposal is not located in the tax portion of the Budget Bill, or in administrative sections. Rather, it is contained in the Education, Labor and Family Assistance Article VIII Legislation, which has 21 parts labeled “A” through “U.” Parts A through T deal with school performance, funding, new grants or programs, child abuse, public assistance, and housing for veterans, among other things. These are items one might expect in the Education, Labor and Family Assistance section of the Budget. Part U, the final section of the Bill, seems out of place, especially given its potential impact on nearly every State agency.

<sup>4</sup> See Summary of Provisions and Statement in Support, Budget Bill S02006/A03006 (the “Statement in Support”).

## **Background Regarding the Statutory Creation of the Division of Tax Appeals**

The New York Tax Law, the Executive Law, and the Civil Practice Law and Rules were amended in Program Bill #182 to create the Division of Tax Appeals as an independent unit within the Department of Taxation and Finance. The changes had been unanimously approved by both the Senate (S9389) and Assembly (A1415), were signed into law by then-Governor Mario Cuomo on July 17, 1986, and became effective on September 1, 1987.

Prior to the 1986 legislation, the Department of Taxation and Finance had a Division of Taxation headed by the Tax Commissioner. The Tax Appeals Bureau, which handled disputes between the Division of Taxation and taxpayers, was located in the Division of Taxation, and held hearings via hearing officers, who then reported their factual findings and recommended their conclusions of law to the three-member State Tax Commission, which was also headed by the Tax Commissioner. The Commission could accept the findings and conclusions or could modify or even reverse them before issuing a decision. Commission decisions could be appealed by taxpayers to the Third Department, Appellate Division, via an Article 78 proceeding.

The Governor's Memorandum in Support of the 1986 Program Bill noted various problems that justified a change, including "a persistent perception that this system was inherently unfair because the same administrative body charged with assessing, collecting and enforcing the taxes also administered the "adjudication of controversies arising from this administration." Further, when the Division of Taxation attempted to resolve disputes, it had limited settlement authority.

In various letters<sup>5</sup> and Reports,<sup>6</sup> the Tax Section and the President of the New York State Bar Association identified issues in the prior structure. A July 1985 letter from the Tax Section concluded that "(1) [there should be a] separation of the tax collection and adjudication functions; (2) final decisions [in tax proceedings should be rendered] by those who hear the evidence; (3) [there should be] appointment of experts as adjudicators; and (4)

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<sup>5</sup> See, e.g., April 4, 1985 letter from Henry Miller, then-President of the New York State Bar Association, to Governor Mario Cuomo and Legislative Leaders, outlining areas of concern; see also Letters from 1987 Tax Section Chair Donald Schapiro to Governor Mario Cuomo, Legislative Leaders, and others dated June 16, 1987, providing copies of Tax Section Report #565.

<sup>6</sup> See, e.g., NYSBA Report Dated July 12, 1983 and reprinted as The Need for an Independent New York Tax Tribunal, 2 Journal of State Taxation 259 (1983); NYSBA Report #565 Dated June 9, 1987: Report on Tax Tribunal Legislation and Proposed Regulations.

[the law should grant] settlement authority to the Department of Taxation and Finance.”<sup>7</sup> Others in private practice and in the Government also noted similar needs and goals.<sup>8</sup> These issues were addressed in the Governor’s 1986 Budget Bill, and the Tax Section of the New York State Bar Association “strongly urge[d] the Governor to approve this legislation.”<sup>9</sup>

The 1986 legislation<sup>10</sup> made a distinction between the New York State Tax Commissioner, responsible for the Division of Taxation, and the newly-created Division of Tax Appeals, responsible for administrative hearings, and headed by an independent three-member Tax Appeals Tribunal. The three Tribunal members are also called “Commissioners”, but they only have responsibility within the Division of Tax Appeals. Under the 1986 legislation, the three Division of Tax Appeals Commissioners, appointed by the Governor and confirmed by the Senate, are required to have knowledge and skill in matters pertaining to taxation; they serve for nine year terms. This helps to assure both expertise and independence. The New York State Tax Commissioner, also appointed by the Governor and subject to Senate confirmation, runs the Division of Taxation, but has no authority or power regarding the budget, operations or administration of the Division of Tax Appeals. This provision, which separates the budgets and operations of the two Divisions, assures that the Division of Taxation and the Division of Tax Appeals are each independent of the other.

The 1986 Budget legislation also established and defined the role of Bureau of Conciliation and Mediation Services, which was given the power to conduct Conciliation Conferences, similar to pre-trial mediation but with greater settlement authority. These Conferences and Conferees were left in the Division of Taxation, and are ultimately subject to Division of Taxation review and control.

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<sup>7</sup> July 15, 1985 Letter from 1985 Tax Section Chair Richard Cohen to Evan Davis, Chief Counsel to the Governor.

<sup>8</sup> A July 9, 1986 letter from Tax Commissioner Roderick G.W. Chu to Governor Mario Cuomo reviewed each element of the proposed legislation and “recommend[ed] executive approval.” *See also* State of New York Executive Chamber Memorandum of Approval (Chapter 282, Approval #19), dated July 17, 1986; Pomp, Plattner and Kay, “Fairness and Function in the New York State Tax Appeals System: Proposals for Reform”, 49 Albany Law Review 352 (1985), based upon a Report prepared for the New York Legislative Commission on the Modernization and Simplification of Tax Administration.

<sup>9</sup> July 15, 1985 Letter from 1985 Tax Section Chair Richard Cohen to Evan Davis, Chief Counsel to the Governor.

<sup>10</sup> Chapter 282 of the Laws of 1986, effective September 1, 1987.

As noted above, Conciliation Conferees have greater settlement authority, which addressed the concern regarding the Division of Taxation's limited settlement authority under the prior law. Administrative hearings, formerly conducted by hearing officers who were employed by the Division of Taxation, have been removed from the Division of Taxation and are conducted by Administrative Law Judges who are employed by the Division of Tax Appeals, and who have independent authority to decide cases that is not subject to review or interference by the Division of Taxation.

Taxpayers who receive a proposed tax assessment or who have been denied a refund can go directly to the Division of Tax Appeals, or can choose the less formal Conciliation Conference channel, and if they are not satisfied after a Conciliation Conference, they can proceed to the Division of Tax Appeals. Division of Tax Appeals cases include pretrial conferences and Administrative Law Judge ("ALJ") hearings, resulting in a final written published decision. This assures that the person who presides over the hearing and receives the evidence will make the factual and legal decisions in the case. ALJ decisions are appealable by either the taxpayer or the Division of Taxation to the three-member Tax Appeals Tribunal. Tribunal decisions are final unless appealed by the taxpayer in an Article 78 proceeding.

#### **Reasons to Retain the Current Division of Tax Appeals Structure**

The 1986 legislation was the result of many years of deliberations, and addressed concerns raised by taxpayers, practitioners, the Division of Taxation, the legislature, the judiciary and the State Budget office. It reflected nationwide trends to separate state tax adjudicatory functions from their administrative functions. Some states chose separate tax courts, while others chose separate adjudicatory divisions. New York chose the latter.

Over the 30 years that the Division of Tax Appeals has been in operation, we have found that the structure created in 1986 has worked quite well in New York, with knowledgeable, professional, independent Administrative Law Judges and Tribunal members rendering high quality decisions in a timely and impartial manner, and subject to an effective appeals process. Unlike some other administrative agencies, where there may be inadequate separation, the Division of Tax Appeals runs in an independent and even-handed manner.

The stated goals and benefits of the proposed legislation do not seem applicable or necessary in the tax area. As noted earlier in this letter, the Budget proposal refers to a nationwide trend to consolidate hearings functions in a single administrative hearings unit. To our knowledge, only five states have done this for tax hearings. Thirty-six states have a dedicated tax hearings unit while another eight either have a state tax court or

use the judicial courts to resolve tax disputes. Some of the tax hearing units are within the state's division of taxation and are not independent, but nationwide, more than half of the tax hearing units are independent. This suggests that for state tax cases, the trend has been towards independent, dedicated state tax hearing units.<sup>11</sup>

The 2017-2018 Budget proposal has several stated objectives: it could provide “a more impartial and efficient hearing process, a more skilled workforce, and possible cost savings in personnel management, administration, and other back office functions.” There may be a need for this in some agencies, but we believe that the Division of Tax Appeals already achieves these goals, including cost savings. Finally, the Budget proposal describes the advantages of “a corps of ALJs trained as adaptable generalists [who] will have the opportunity to gain expertise in multiple areas [of the law].” We do not see this as an advantage in the tax area. New York's tax law is very complex. The New York State Department of Taxation and Finance website lists approximately 28 different types of taxes that are administered by the state, affecting individuals, businesses, estates, and others. Certainty and clarity in tax rulings are essential for the smooth administration of and compliance with the tax law, and the Division of Tax Appeals, with its seasoned professionals, is an essential, respected part of that process.

Among those who have studied tax systems,<sup>12</sup> there is a consensus that the best adjudicatory systems for state and local taxes are independent “tax courts” or divisions of tax appeals. Members should be appointed for a set term and should not be subject to removal from office without cause. They should not work for the state's division of taxation and they should be selected based on tax experience and expertise. The last point may be the most important, given the complexities in the field. These goals are met by the current Division of Tax Appeals.

#### **Exception for the Department of Taxation, Especially the Division of Tax Appeals**

The current hearings process within the Department of Taxation and Finance works quite well, and we do not believe that the hearings process would be improved if the functions were transferred to a new division of central administrative hearings.

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<sup>11</sup> See Lindholm, Hogroian and Nicely, “COST Scorecard on Tax Appeals & Procedural Requirements” (December 2016), which notes at page 7 that, “[t]oday well over half the states provide an independent appeals process specifically dedicated to hearing tax cases.” See also the American Bar Association's Administrative Tax Tribunal Act.

<sup>12</sup> Pomp, Plattner and Kay, “Fairness and Function in the New York State Tax Appeals System: Proposals for Reform”, cited above in footnote 6. See also Comeau and Rosen, “The Need for an Independent New York Tax Tribunal,” 2 Journal of State Taxation 259 (1983).

This Report addresses Budget Bill S02006/A03006. We note that Assembly A02041 is also before the State Legislature and it calls for the creation of an office of administrative hearings, but identifies agencies and activities which are exempt, unless the agency chooses to use the process. The list of excluded agencies includes the Division of Tax Appeals.

If the consolidation of administrative hearings occurs, legislatively or otherwise, we ask you to exclude the Department of Taxation and Finance, especially its statutorily created and highly effective Division of Tax Appeals, from that consolidation.

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