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Legal Updates

California State Board of Equalization Adopts New Rules for Franchise Tax Board Tax Appeals

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by [Eric J. Coffill](#)

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Effective February 6, 2008, the California State Board of Equalization (“SBE”) has adopted new Rules for Tax Appeals (“RTA”), which are found in Title 18 of the California Code of Regulations, beginning at section 5000. The new RTAs are intended to establish a comprehensive set of procedural regulations that cover all of the SBE’s administrative review functions, including the SBE’s appellate review authority with respect to appeals from actions of the California Franchise Tax Board (“FTB”). Prior regulations existed, but the SBE desired a complete restructuring of the procedures applicable to the SBE’s appeal processes, and decided to undertake that process in a single project on the theory that the prior regulations were not well-suited to piecemeal amendment. The new RTAs are the result of a very thorough, two-year review, drafting and approval process that included more than 25 drafts, multiple interested party meetings, and 10 SBE Board meetings.^[1] Our compliments to the Board members and Board staff, and especially to Senior Tax Counsel Bradley Heller, who was instrumental in the project.

This article will focus exclusively on how the new RTAs impact basic aspects of appeals to the SBE from actions of the FTB. Chapter 4 of the RTAs provides rules applicable only to appeals from actions of the FTB. Chapter 5 provides rules for general Board hearing procedures. Where there is a conflict between Chapter 4 and Chapter 5, the provisions of Chapter 4 control. RTA 5410(b).

Filing the Appeal

There are very few statutory rules regarding the filing and prosecution of an SBE appeal from a decision by the FTB. California Revenue and Taxation Code section (“section”) 19045 states an FTB Notice of Action upon a protest (in either a corporate or personal income tax matter) becomes final 30 days from the date when it is mailed to the taxpayer, “unless within that 30-day period the taxpayer appeals in writing from the action of the Franchise Tax Board to the board,” i.e., to the SBE.^[2] Section 19046 states that two copies of the appeal and supporting documents must be sent to the SBE (and the SBE then provides one of those copies to the FTB). Regarding the appeal itself, section 19047 states simply and in full: “The board shall hear and determine the appeal and thereafter shall forthwith notify the taxpayer and the Franchise Tax Board of its determination and the reasons therefor.” Regarding FTB’s notice of action on a claim for refund (corporate or personal income tax), section 19324 provides that such action is final 90 days from the mailing of the notice unless within that 90-day period the taxpayer appeals in writing to the SBE.

Various publications, including FTB Publication 7277, “Personal Income Tax Notice of Action Information”; the FTB’s recent (i.e., 9/07) Publication 965, “Appeal/Protest/Appeals (The Process)”; and SBE Publication 81, “Franchise and Personal Income Tax Appeals,” all provide helpful, but informal, guidance on the appeals process. Like all California tax forms and informational booklets, the information found within these publications does not rise to the level of binding legal advice. Accordingly, in view of the nonbinding nature of the tax agencies’ publications and in view of the lack of a detailed and comprehensive statutory scheme on the subject, the RTAs take on a heightened significance regarding the mechanics of appealing from an adverse FTB decision. Such regulations are presumed valid (*Freeman v. Contra Costa County Water Dist.*, 18 Cal. App. 3d 404, 408 (1971)) and the SBE is also bound by its own regulations (see *Bonn v. Cal. State University, Chico*, 88 Cal. App. 3d 985, 990 (1979)).

RTA 5420 sets forth the appeal filing requirements. Consistent with sections 19045 and 19324, the appeal must be in writing, and RTA 5420 goes on to set forth what must be contained in the appeal:

1. The name of the appellant, or appellants, filing the appeal;
2. The social security number or taxpayer identification number, whichever is applicable, of each appellant filing the appeal;
3. The address and telephone number of each appellant and, if applicable, each appellant's authorized representative;
4. The amount involved, including tax, penalties, fees, and interest (whichever is applicable);
5. The year(s) involved;
6. A copy of the Franchise Tax Board's notice from which the appeal is made, unless the Franchise Tax Board has failed to act on a claim for refund or a request for interest abatement, in which case the appellant must provide a copy of the claim for refund or request for interest abatement;
7. The facts involved and the legal authorities upon which the appellant relies, including any relevant statutes, regulations, and judicial and administrative decisions;
8. Any portion of the amount at issue conceded by the appellant; and
9. The signature of each appellant who is filing the appeal, whether jointly or separately, or the signature of an authorized representative made on behalf of each appellant who is filing the appeal.^[3]

The RTAs "encourage" filing the appeal by electronic means ("e.g., facsimile, e-mail, etc."), and also provide rules for filing by mail or by hand delivery. RTA 5421. RTA 5423(b), "Accepting the Appeal," provides that if the SBE's Chief of Board Proceedings or the Chief Counsel determines that the SBE has jurisdiction to hear the appeal and that the appeal is timely, "or that there is a genuine, material issue relating to jurisdiction or timeliness," the Chief of Board Proceedings must accept the appeal. Note that acceptance is not based on the completeness of the appeal under the requirements of RTA 5420. RTA 5424 addresses "Perfecting an Appeal," and provides that the briefing and resolution of an appeal cannot begin until the appeal is perfected, and an appeal is "perfected" if it contains "substantially all" of the information requested by RTA 5420. RTA 5424 goes on to provide that if an appeal is accepted and not perfected, the SBE will notify the appellant of the need to perfect the appeal and will provide the taxpayer 90 days from the date of the SBE's notice for that purpose. In addition, RTA 5424(b)(1) states the Chief of Board Proceedings may extend the deadline for perfecting an appeal "upon a showing of extreme hardship or upon written agreement by the parties."

Filing the Briefs

RTA 5430 sets forth the basic rules for briefing the appeal. All briefs filed in the SBE appeal are subject to a 30-page limitation – double-spaced, 8.5" by 11" pages, at least 10 point font. Briefs that do not comply with the requirements may be returned to the filing party for corrections. RTA 5430 (e). The 30-page limitation excludes any table of contents, table of authorities and exhibits. RTA 5430(e). Indeed, there are no limitations under the RTAs on the length, size, or number of exhibits. Based on the SBE's admonition in *Appeal of Sierra Production Service, Inc.*, 90-SBE-010 (Sept. 12, 1990), "that a taxpayer who appeals to this board should always submit to us each item of evidence that will support its case, even though that evidence has already been submitted to (and rejected by) the Franchise Tax Board," a taxpayer always should err on the side of providing more, not less, evidence and documentation in the form of exhibits. See also *Appeal of Merry Mary Fabrics*, 93-SBE-007 (Apr. 22, 1993) on same point. Finally, RTA 5430(e) provides the Chief of Board Proceedings may grant an exception to these page requirements upon written request "that establishes why an exception is necessary."

The "perfected appeal" is the taxpayer's opening brief. RTA 5431(b)(1). Once the taxpayer's opening brief has been filed, the FTB has 90 days to file its opening brief. RTA 5431(b)(2). The taxpayer then may file a reply brief no later than 30 days after the FTB's opening brief, which is limited to "points of disagreement with the Respondent's Opening Brief." RTA 5431(c)(1). Then, upon request and with permission, the FTB may file a reply brief, which may only address "points of disagreement with the Appellant's Reply Brief." RTA 5431(c)(2). If the FTB is permitted to file a reply brief, the taxpayer may then file a supplemental brief as well. RTA 5431(c)(3). Finally, additional briefing may be requested by SBE staff, by individual SBE Board members, or by the SBE Board. RTA 5435. In a change from the prior rules, all time limits for filing a brief may be extended, and deferrals of briefing may be granted for "reasonable cause." RTAs 5430(c) & 5522.8(b).^[4]

The SBE has long permitted non-parties to file briefs in FTB appeal cases in support of a party, and that practice continues under the new RTAs. RTA 5430(g) provides that briefs may be filed by non-parties, i.e., *amicus curiae* briefs, subject to any applicable conditions regarding briefing in general.

Any individual or entity may file a Non-Party Brief, whether unsolicited or upon the request of the Appeals Division. No individual or entity may file more than one Non-Party Brief, unless the Appeals Division specifically allows otherwise. Unless the Appeals Division specifically allows otherwise, all Non-Party Briefs must be filed prior to the conclusion of briefing by the parties under RTA 5431. Parties may file briefs in response to a Non-Party brief, as specified. RTA 5430(g).

The Oral Hearing

Every taxpayer in an appeal from an FTB action has a right to an oral hearing. RTA 5440; see also RTA 5522.[5] An oral hearing must be requested no later than 30 days after the conclusion of briefing, but an untimely request may be accepted. RTA 5440(a). Upon the scheduling and noticing of an oral hearing, the SBE Appeals Division staff will prepare a Hearing Summary, which is intended to assist the Board in its consideration and decision of the appeal. RTA 5444(a). A copy of the Hearing Summary is provided to all parties. RTA 5444(b). Multiple matters may be consolidated for hearing or decision if the facts and issues are similar and no substantial right of any party will be prejudiced. RTA 5522.4(a).

A new provision in the RTAs allows Appeals Division staff to meet with parties to an appeal from actions of the FTB prior to the oral hearing. Under RTA 5443, any party may now request a Pre-Hearing Conference, as specified, the purpose of which is to obtain additional facts and evidence, obtain stipulations of fact, and narrow questions of law, in order to facilitate a more efficient and productive oral hearing.

Oral hearings (as well as briefing) may be postponed or deferred under specified circumstances. There are three deferral provisions. First, RTA 5522.8(b)(1) provides the Chief Counsel of Board Proceedings may grant a deferral or postponement of the due date of any brief or a hearing for a period of 90 days or less in his or her “sole discretion” or for a period of more than 90 days with the consent of the Chief Counsel in certain specific circumstances. Those circumstances include: (1) an unavoidable scheduling conflict; (2) when all parties desire a deferral or postponement; and (3) any other facts or circumstances determined by the Chief of Board Proceedings and the Chief Counsel to constitute “reasonable cause.” RTA 5522.8(b)(1).[6] Second, RTA 5522.8(b)(3) provides the Chief Counsel may, in his or her discretion, grant a deferral or postponement for a determined period of time if the Chief Counsel determines that (1) related civil or criminal litigation is pending in state or federal court, the outcome of which is likely to have a bearing on the matter being deferred or postponed; or (2) unrelated civil or criminal litigation pending in federal or state court contains issues similar to those claimed by parties to a matter and that the outcome of the unrelated litigation is likely to have a bearing on the matter being deferred or postponed. Third, as a “catch all” provision, RTA 5522.8(b)(5) provides the Chief Counsel “may, with the consent of the Board Chair, grant a deferral or postponement for any reason.”

Taxpayers may represent themselves at the oral hearing or may be represented by authorized persons including, but not limited to, attorneys and accountants. RTA 5523. Evidence and exhibits may be presented (RTA 5523.6) and witnesses may testify (RTA 5523.7) at the hearing. In terms of evidentiary standards and admissibility, RTA 5523.6(a) provides in pertinent part: “*Any relevant evidence, including affidavits, declarations under penalty of perjury, and hearsay evidence, may be presented to the Board at a hearing*” (emphasis added).[7] The RTAs also state “the burden of proof is upon the taxpayer as to all issues of fact” [with the exception of the issue of fraud]. RTA 5541.

RTA 5523.5(c) provides the Chief of Board Proceedings will generally allocate a total of 35 minutes per hearing and will inform the parties of the time allocation. RTA 5523.5 did not change the SBE’s prior hearing rules regarding time allocation. Under the prior rules (and presumably under the new rules as well), a party scheduled for a hearing would receive a form letter from the SBE stating that 35 minutes have been reserved for the hearing, with the following time allocation: (1) 10 minutes for the taxpayer to present its case; (2) 10 minutes for the FTB to present its case; (3) 5 minutes for the taxpayer for rebuttal; and (4) 10 minutes allotted for Board Members to ask questions of both parties. Accordingly, a taxpayer is typically allocated only 15 minutes for oral presentation of its entire case. However, RTA 5523.5 gives the Board Chair discretion to grant a party additional time to complete its presentation during the hearing.

The regulations also contain a provision by which parties may seek additional time. RTA 5523.5(d) provides a request for additional time must be submitted to the Board Proceedings Division in writing no less than 15 days prior to the hearing and state the reason(s) why additional time is needed. The Chief of Board Proceedings must submit requests for additional time to the Board Chair for approval. The Board Chair may grant a party whatever additional time the Board Chair “determines the party needs to present a *complex matter*.” (Emphasis added.) Unfortunately, no guidance is

offered in the RTAs regarding what constitutes a “complex matter.”

As is evident from the brevity of the oral hearings themselves, appeals to the SBE are designed under the RTAs to be decided principally on the documentation before the SBE, e.g., briefs and exhibits, as opposed to what happens and what is presented at the oral hearing itself. Accordingly, an SBE hearing should not be thought of as the equivalent of a court trial or even a typical administrative hearing before an administrative law judge, where the record is made and the case is largely presented through live testimony and the admission of exhibits. One cannot plan to make one’s case on appeal with the SBE by the use of witnesses or any time-consuming exhibits, which makes the briefing in the case absolutely essential.

The Decision

The Board issues three types of decisions, but there are no time requirements in the RTAs for the Board to issue its decision in a case. First, there is the “Summary Decision,” which consists of findings of fact and conclusions of law that form the basis of the Board’s decision. RTA 5451. The RTAs provide that Summary Decisions may not be cited as precedent in any appeal or other proceeding before the SBE, a position consistent with SBE decisional law. RTA 5451(d); see *Appeal of Fowlks*, 88-SBE-023-A (Oct. 31, 1989).^[8] Second, there is the “Formal Opinion,” which is “intended to set precedent” and generally may be cited as precedent. RTA 5452(a) & (f). Unlike the prior Board rules, the RTAs now provide a list of non-exclusive factors as to when a Formal Opinion would be appropriate, such as to establish a new rule of law, modify or repeal an existing rule, resolve conflicts in the law, or make a significant contribution to the law. RTA 5452(e).^[9] Finally, there is the “Letter Decision,” which is adopted by the Board when it decides an appeal without adopting a Summary Decision or a Formal Opinion and which is also non-precedential. RTA 5450. Once an opinion is issued, a party may file within 30 days a petition for hearing. RTA 5561 & 5562.

Ex Parte Communications with Board Members

Finally, one of the most controversial provisions of the new RTAs is the ability for taxpayers^[10] to communicate directly with Board members regarding a pending appeal case. RTA 5523.8, entitled “Communications with Board Members,” states in full:

The Board Members shall remain accessible to their constituents, their subordinates, other government agencies, *and taxpayers at all times* in order to execute their constitutional and statutory duties. Therefore, such persons and their authorized representatives, including members of the State Bar, may contact Board Members and a Board Member’s Staff at any time, *including while a matter involving such persons is awaiting an oral hearing before the Board.*

(Emphasis added). The review and approval of RTA 5523.8 was one of the major reasons why the SBE’s regulation project took two years of hearings and drafting. The SBE’s Final Statement of Reasons/Non-Controlling Summary of the new regulations states, “The purpose of this section is to codify and provide notice of the Board’s *longstanding policy* permitting constituents and their representatives, other agencies’ staff, and Board staff to contact the Board members at any time.” *Id.* at 54 (emphasis added). However, no comparable written provision was found in the SBE’s previous hearing regulations, and some practitioners, especially California Bar members, saw potential ethical concerns over *ex parte* communications with Board members while a matter was pending before them. Any such concerns are now resolved as a result of the language in new RTA 5523.8 specifically referring to and permitting such communications by “members of the State Bar.” In drafting regulation 5523.8, the SBE considered and rejected two alternatives. First, it rejected an alternative provided by the FTB which would have prohibited Board members from communicating with any party to an appeal from actions of the FTB while such appeal was pending without offering the other party an opportunity to participate in the communication, required summaries of any such communications to be provided to parties that did not participate, and required copies of any written communications to be distributed to all the parties. Second, the SBE rejected an alternative offered by the California Tax Reform Association which would have had the practical effect of prohibiting virtually all non-governmental communications between Board members and persons who have pending appeals before the Board. See SBE’s Final Statement of Reasons/Non-Controlling Summary at 54.

Footnotes:

[1] Indeed, the author’s copy of the rule-making materials for the RTAs occupies over three linear

feet of shelving.

[2] Section 19045 also requires an FTB Notice of Action to include the date determined by the FTB as the last day on which the taxpayer may file an SBE appeal.

[3] RTA 5523.1 sets forth rules for powers of attorney.

[4] Former SBE Regulation 5075(g) provided that “a reasonable extension of time for the filing of briefs may be granted by the Chief of Board Proceedings, *upon a showing of extreme hardship*” (emphasis added).

[5] In the absence of an oral hearing, i.e., where the taxpayer waived the right to a hearing, the case will be submitted for decision based on the written record. RTA 5441.

[6] Another circumstance under RTA 5522.8(b)(1)(D) is when the Chief of Board Proceedings has been informed by the FTB that the matter is being reviewed for possible settlement consideration. See FTB Notice 2007-2, “Settlement of Administrative Civil Tax Matters in Dispute” (June 27, 2007).

[7] The RTAs do not offer a definition of relevancy, but presumably the definition found in California Evidence Code section 210 would apply: “‘Relevant evidence’ means evidence, including evidence relevant to the credibility of a witness or hearsay declarant, having any tendency in reason to prove or disprove any disputed fact that is of consequence to the determination of the action.”

[8] Nevertheless, Summary Decisions are instructive on the Board’s thinking on a given issue at a given time.

[9] One can hope new RTA 5452(e) and its criteria for publishing precedential, citable appeals will act to increase the number of published decisions in appeals from actions by the FTB. Historically, the number of published decisions has been dropping. For example, there were 156 published decisions in 1985, 16 published decisions in 1995, and just 2 published decisions in 2005. The trend reversed somewhat for 2006, in which there were 4 published decisions. See California State Board of Equalization, Franchise and Income Tax Formal Legal Opinions, <http://www.boe.ca.gov/legal/legalopcont.htm> (last visited Apr. 23, 2008).

[10] Note that new RTA 5523.8 also permits FTB staff to be in direct *ex parte* contact with Board members regarding a pending appeal.