

## Newfound Settlement Authority at the Pennsylvania Board of Appeals: Having the Option is Great, but Not Always a Great Option

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Without any statutory action, the Pennsylvania Department of Revenue's Board of Appeals has decided it has the authority to compromise tax appeals, effective immediately. See *Miscellaneous Tax Bulletin* 2011-02, issued November 16, 2011. This change is sure to shake up the Pennsylvania appeals process, but how much is yet to be seen.

Previously in Pennsylvania, a challenge to a tax assessment or refund claim could not be compromised<sup>1</sup> until an appeal had been filed in Commonwealth Court. There, the taxpayer or its representative were able to negotiate a settlement with a deputy attorney general. However, before filing an appeal in Commonwealth Court, a taxpayer typically had to first go through two administrative boards - the Board of Appeals and the Board of Finance and Revenue. Both the Board of Appeals and the Board of Finance and Revenue have historically applied Pennsylvania law, as interpreted by the Department of Revenue, and decided cases on an "all-or-nothing" basis. Both the Board of Appeals and the Board of Finance and Revenue have historically taken the position that they lacked the authority to compromise cases. Unlike other states,<sup>2</sup> and unlike the federal government<sup>3</sup>, Pennsylvania has not provided any administrative agency with statutory authorization to compromise a tax matter out of court.

However, in the wake of *Miscellaneous Tax Bulletin* 2011-02, the compromise of cases at the Board of Appeals is now a possibility. Now, when an appeal is filed at the Board of Appeals, the taxpayer or its representative may simultaneously, or shortly thereafter, submit a Request for Compromise on a form designated by the Department.<sup>4</sup> This form is used to state the taxpayer's proposed compromise offer and the reasons for requesting the compromise. But, "[a] compromise will only be considered when it illustrates doubt regarding liability or promotes effective tax administration."<sup>5</sup>

Only attorneys or taxpayers acting without representation are permitted to raise or argue legal issues before the Board under the Board's own regulations. Presumably this means that a request for compromise based on doubt regarding liability that arises because of a legal issue can only be submitted by a taxpayer or an attorney representing the taxpayer.

Following a taxpayer's submission of the Request for Compromise form, an informal conference will be held with a Board of Appeals hearing officer, and possibly a Department of Revenue representative. If both parties are able to reach a tentative settlement, that settlement will then be submitted for approval.<sup>6</sup> The extensiveness of this approval process varies widely based on the amount at issue.<sup>7</sup> In any case, if a compromise is reached, and approval is received, within the one-year window the Board of Appeals is allotted to dispose of cases,<sup>8</sup> then the appeal is resolved on the basis of the compromise.<sup>9</sup>

Cases that have been resolved through a compromise at the Board of Appeals cannot be reopened. Specifically, by agreeing to compromise an issue at the Board of Appeals, a taxpayer waives its right to: (1) appeal the compromise order, (2) claim any refund of money paid pursuant to the compromise order, and (3) file any petition or appeal that raises the same issues for the tax period(s) and liability(ies) addressed in the compromise order.<sup>10</sup> As a consequence, taxpayers must be certain they have accurately quantified the value of an issue before offering to compromise the issue before the Board. Quantifying an issue requires understanding the potential settlement value of the issue, if the issue were to be appealed to Commonwealth Court. Taxpayers should consult with advisors who have experience litigating similar issues to make sure they understand the settlement value of an issue before submitting a request for compromise.

This new process has been dubbed "more efficient" and "more taxpayer-friendly" by Department of Revenue Secretary Dan Meuser.<sup>11</sup> While the new compromise process is likely to achieve Secretary Meuser's goals in small-dollar cases that have straightforward fact patterns and do not require multiple approvals, it is unclear that it will achieve any additional efficiency for taxpayers dealing with complex issues or with large dollars at stake.

For example, in large-dollar cases, settlement negotiations at the Board of Appeals may be futile because of the one-year window in which the Board must issue its decision. Settlement of large-dollar cases requires numerous levels of approval -up to six in some circumstances.<sup>12</sup> If the necessary approvals are not received within the one-year timeframe, the appeal will likely be denied by the Board, and the taxpayer will then have to return to the standard appeals process.

In addition, taxpayers should consider the impact that a request for compromise at the Board of Appeals could have on their leverage for settling an issue if their appeal ultimately reaches Commonwealth Court. Once at Commonwealth Court, a taxpayer that has made a request for compromise at the Board of Appeals that was not accepted is likely to find that it is not opening settlement negotiations with a clean slate. Instead, any compromise proposed by the taxpayer for an issue at the Board of Appeals is likely to be viewed by the Office of Attorney General as placing a ceiling on any relief to be negotiated on the issue at Commonwealth Court, even for tax periods different from the one covered by the compromise request. This will be troublesome if the taxpayer has built time-value-of-money or other considerations into the proposal at the Board of Appeals since these considerations may be moot by the time the appeal reaches Commonwealth Court. For this reason, taxpayers should not sell themselves short in a request for compromise, especially when dealing with an issue that is expected to be a recurring one.

Further, for large, complex cases, there are often too many "moving parts" to consider in the short window of time available to taxpayers to submit a compromise proposal to the Board of Appeals. This is especially true for reassessment appeals, which must be filed at the Board of Appeals within 90 days of the date of a notice of assessment.<sup>13</sup> Because the Request for Compromise form must be filed with the Board of Appeals petition or shortly thereafter, taxpayers will generally have less than three months to fully develop their position and formulate a settlement offer. In the rush to meet this deadline, the taxpayer may propose, or even accept, a compromise that does not accurately reflect the facts and circumstances. When the facts are complex and the dollars are big, taxpayers may be wise to take the time to fully develop the issues and relevant facts and circumstances, and not rush to meet the Board of Appeals' deadlines to propose and finalize a settlement.

Cases involving constitutional issues should also be of particular concern to taxpayers considering a compromise at the Board of Appeals. Such issues are quite different from the statutory and regulatory issues that the Board is used to handling. In fact, in the past, when taxpayers have raised constitutional issues in their Board of Appeals petitions, the Board has routinely concluded that: "the Board of Appeals does not have the authority to address the constitutionality of the law." If the Board did not, or does not, have the authority to address such constitutional issues, and has not addressed such issues in the past, it will be hard-pressed to fully understand these constitutional issues when addressing a request for compromise. Accordingly, taxpayers seeking to compromise constitutional issues are not likely to find the Board of Appeals very accommodating. In contrast, Pennsylvania's Office of Attorney General is familiar with state tax constitutional issues, and is more likely to give the constitutional issues raised by a taxpayer fair consideration in settlement negotiations.

In this regard, consider the experiences in other states that have actually authorized administrative agencies to compromise tax cases. For example, California's Franchise Tax Board (the equivalent of Pennsylvania's Department of Revenue) has an administrative "settlement bureau" that reviews settlement proposals. The FTB is currently being sued for not handling those negotiations in good faith.<sup>14</sup> The taxpayer that is suing the FTB alleges that, over a one-year period, the FTB never settled a case in a manner that granted more than 50 percent relief to a taxpayer, and that corporate taxpayers "conceded more than two-thirds of the amount in dispute in approximately 72% of the settlements" with the settlement bureau. The taxpayer says that it "is improbable that normal analysis of the hazards of litigation would produce such results." Thus, if Pennsylvania's Board of Appeals follows the lead of FTB's settlement bureau, the settlements may not fully reflect the value of the case.

Finally, there is concern that the Board of Appeals will now expect all taxpayers to make compromise offers, even for items that have historically been resolved by the Board in taxpayers' favor without any compromise. Traditionally, errors and other situations in which the taxpayer was clearly in the right were corrected at the Board of Appeals, meaning the taxpayer was able to obtain 100 percent relief in such situations. However, now that the Board has the authority to compromise issues, there is a risk that the Board may use this newfound power to pressure taxpayers into compromising items where the taxpayer is clearly in the right for less than full relief.

It is yet to be seen how *Miscellaneous Tax Bulletin* 2011-02 will actually operate in practice. Although the introduction of the option to settle at the Board of Appeals is good news for all taxpayers, all taxpayers may not want to exercise this option in all circumstances. This is especially true for appeals involving multiple, complex issues and appeals with significant amounts at issue, as well as for appeals involving constitutional issues.

If you have questions about the new compromise process at the Pennsylvania Board of Appeals, or any other Pennsylvania tax matter, please contact the authors of this article, or the Reed Smith lawyer with whom you usually work. For more information on Reed Smith's Pennsylvania tax practice, visit [www.reedsmith.com/patax](http://www.reedsmith.com/patax).

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1. By "compromise," we mean any negotiated resolution of a tax matter, not just a resolution of a matter with risks of collection.
2. For example, both California and New Jersey have specific statutory authority allowing the administrative agency to compromise a tax matter. See Cal. Rev. & Tax Code § 19443 and N.J.S.A. 54:53-1.
3. I.R.C. § 7121.
4. Pennsylvania Department of Revenue, Board of Appeals Request for Compromise form DBA-10 - (11-11); Pennsylvania Department of Revenue News Release: Revenue Department Board of Appeals Accepting Requests for Compromise (November 16, 2011).
5. *Miscellaneous Tax Bulletin 2011-02* (November 16, 2011).
6. *Miscellaneous Tax Bulletin 2011-02* (November 16, 2011); Pennsylvania Department of Revenue News Release: Revenue Department Board of Appeals Accepting Requests for Compromise (November 16, 2011).
7. *Miscellaneous Tax Bulletin 2011-02* (November 16, 2011) ("Any compromise granting relief of less than \$10,000 shall require approval of one Board member; any compromise granting relief of \$10,000-\$99,999 shall require approval of two Board members; and any compromise granting relief of \$100,000 or more shall require approval of three Board members. In addition, the Department's Office of Chief Counsel must review and approve all compromises. Compromises that reduce tax liability by less than \$50,000 must be approved by a Deputy Chief Counsel. Compromises that reduce the tax liability by \$50,000 or more must be approved by the Chief Counsel and a designee for the Secretary of Revenue (currently the Deputy Secretary for Tax Policy). The Department of the Auditor General will continue to play an independent role in approving proposed decisions and orders of the Board of Appeals on corporate tax cases, including proposed compromise orders").
8. Under Pa. Stat. Ann. § 9703(d) the Board of Appeals must issue a decision within six months after receipt of a petition. However, this time period may be extended for an additional six-month period upon agreement of the parties.
9. Pennsylvania Department of Revenue, Board of Appeals Request for Compromise form DBA-10 - (11-11)
10. *Id.*
11. Pennsylvania Department of Revenue News Release: Revenue Department Board of Appeals Accepting Requests for Compromise (November 16, 2011).
12. A corporate tax case that grants relief of \$100,000 or more would require the approval of three Board members, the Chief Counsel, a designee for the Secretary of Revenue, and potentially, the Department of the Auditor General. *Miscellaneous Tax Bulletin 2011-02* (November 16, 2011)
13. Pa. Stat. Ann. § 9702(a).
14. *Bunzl Distribution USA, Inc. v. FTB*, Superior Court of San Francisco, No. CGC-10-506344.

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