Under SB 401, absent a summons, the taxpayer has no reason to submit any information prior to the Policy Review Hearing. The Department must then within 90 days compile and analyze any new information, write its decision and issue the final assessment. This 90 days applies equally to a $250 and a $250,000,000 assessment.

Under SB 401, the State's ability to obtain and analyze taxpayer documentation doesn't really exist until the trial de novo. What Will Be the Ultimate Result? The results of moving the audit process out of the Department and into the court system are various, but speedy resolution of audit issues is not one of them. Indeed, under SB 401 the entire audit process will begin anew within the court. Since the Department will have been inhibited from properly developing issues, the whole process of obtaining and analyzing taxpayer information will start from scratch. And along with all the additional time needed will come the additional cost. All taxpayers will be affected--small as well as large. Cases will take longer to resolve, and the State will spend more on their resolutions.

But beyond the additional time and cost is the complete rearrangement of responsibilities necessitated by this legislation. In the process of fact gathering the Department of Revenue (under the Commissioner) is empowered by the legislature to develop and direct tax policy. Under SB 401 the administration of tax laws and regulations and the development and monitoring of tax law policy will have effectively been moved from the Department of Revenue into the court system. It is in the court that

issues will be developed and policy made. The Department will find itself unable to do the job it has been mandated to do.

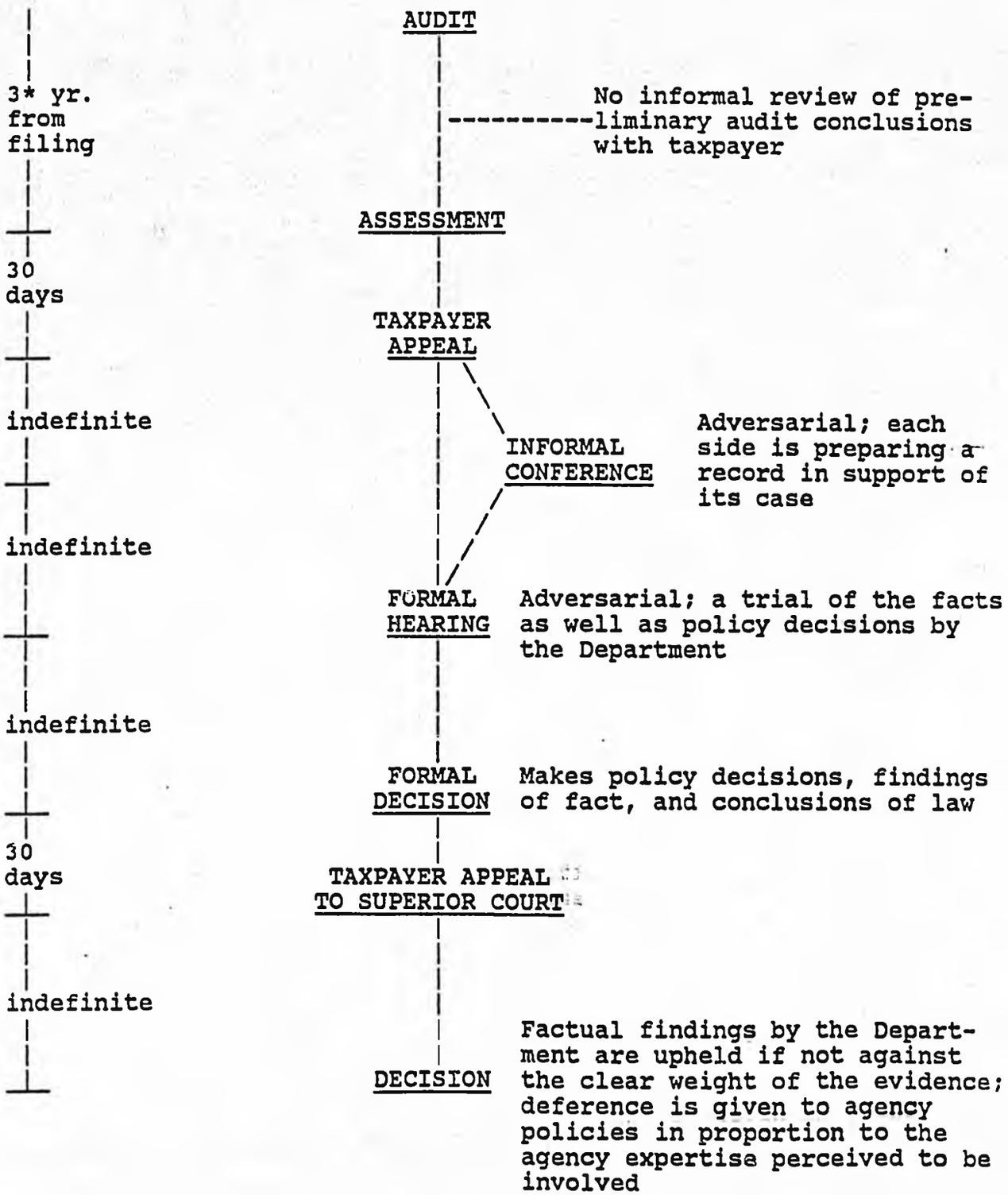
Transitional Rules

The Finance Committee Substitute does not solve the problem relating to old audit years. By allowing a trial de novo for current assessments, SB 401 allows the taxpayer to simply walk through the informal and formal hearing process and wait for the court to start the entire audit process anew. Further, since the application of Section 5 of the bill would apply to all audit years that have not been assessed as of its adoption, the limited time frames would effectively inhibit the Department from auditing any cases for which the statute of limitations will expire in less than the time needed to satisfy those specific timing requirements. Under the Finance Committee Substitute for SB 401 at least four years of production taxes will go unaudited.

Conclusion

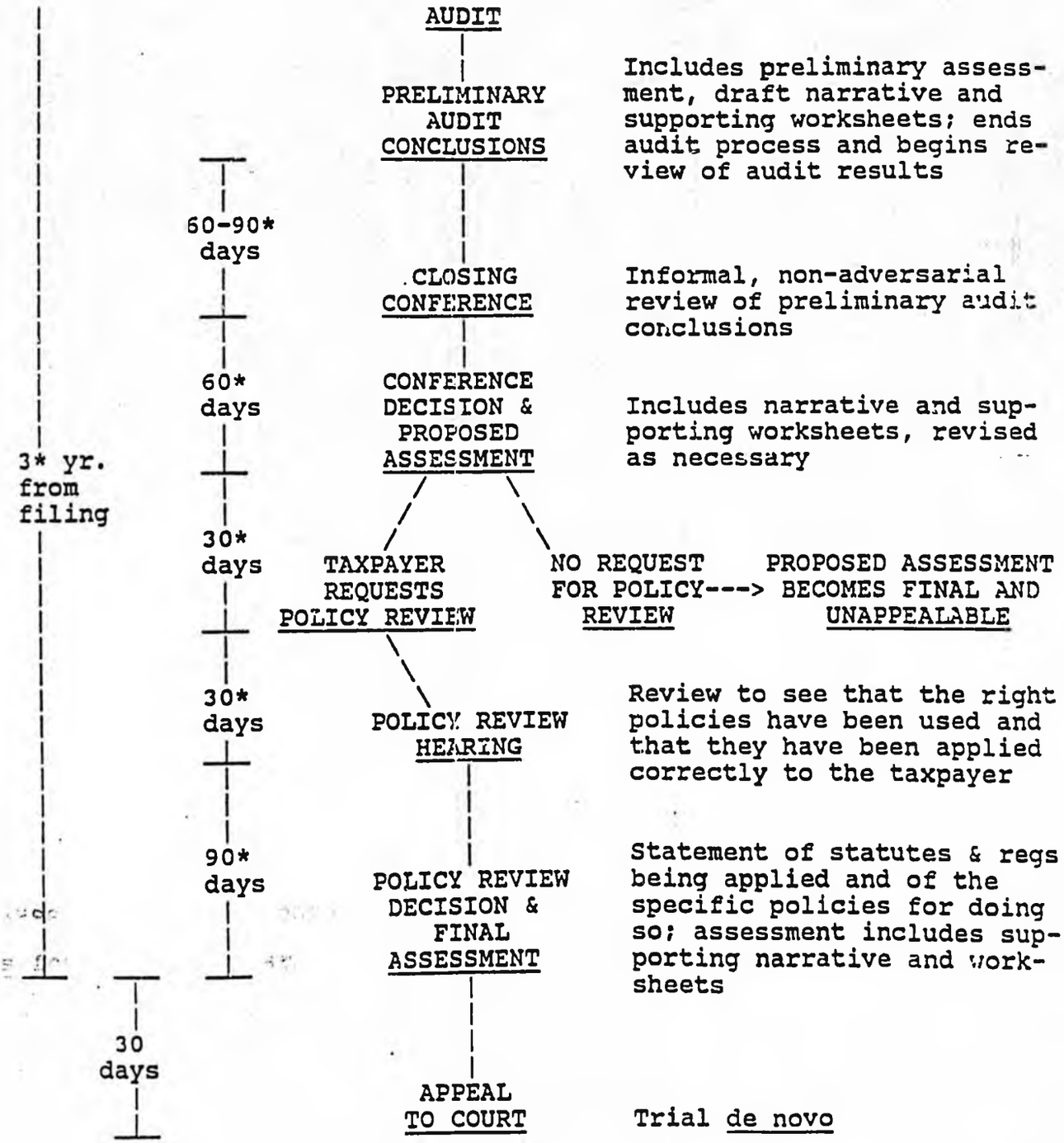
Senate Bill 401 removes from the Department of Revenue its legally mandated responsibility to develop and implement tax policy and in so doing creates a new audit process that will take longer and cost more than the system currently in place.

ALASKA'S PRESENT TAX APPEALS PROCESS



* Time may be extended by mutual agreement.

PROPOSED PROCEDURE



* Time may be extended by mutual agreement.

PRESENT STATUS OF THE "SEPARATE ACCOUNTING" INCOME TAX FOR THREE MAJOR TAXPAYERS

Separate accounting was in effect for only four tax years: 1978, 1979, 1980 and 1981.

Status for the 1978 Tax Year.

Taxpayer X. Informal conference has been held, but no formal hearing.

Taxpayer Y. No informal conference or formal hearing has been held, nor is one scheduled.

Taxpayer Z. Formal hearing has been scheduled for later in 1988.

Status for 1979 Tax Year

Taxpayer X. Audit still pending.

Taxpayer Y. No informal conference or formal hearing has been held, nor is one scheduled.

Taxpayer Z. Formal hearing has been scheduled for later in 1988.

Status for 1980 Tax Year

Taxpayer X. Audit still pending.

Taxpayer Y. No informal conference or formal hearing has been held, nor is one scheduled.

Taxpayer Z. Formal hearing has been scheduled for later in 1988.

Status for 1981 Tax Year

Taxpayer X. Audit still pending.

Taxpayer Y. Audit still pending.

Taxpayer Z. Formal hearing has been scheduled for later in 1988.

ONE TAXPAYER'S EXPERIENCE WITH THE PRESENT TAX APPEAL PROCEDURES

Tax Involved: Separate Accounting Income Tax (AS 43.21)

Tax Period Involved: 1978

Tax Billing Date: August 15, 1979

Normal Statute of Limitations Deadline: August 15, 1982

Experience:

Aug. 1979:	Assessment is issued.
Sep. 1979:	Assessment is amended.
Jul. 1980:	Second amendment is issued.
Sep. 1980:	Taxpayer protests and requests informal conference.
Feb. 1981:	Informal conference is held.
Apr. 1981:	Informal conference decision is issued, resolving all but one of the issues under protest.
May 1981:	Taxpayer requests formal hearing on one remaining issue.
Oct. 1983:	Without having acted on the taxpayer's request for a formal hearing, the Department issues a third amendment which raises additional claims for the first time.
Dec. 1983:	Taxpayer protests the third amendment and requests an informal conference.
Apr. 1984:	Second informal conference is held.
Jul. 1984:	Informal conference decision is issued.
Aug. 1984:	Taxpayer makes second request for a formal hearing.
Oct. 1986:	The Department holds a "prehearing conference" to discuss procedures and schedule for formal hearing.
Dec. 1986:	The Department issues a fourth amendment to the assessment, making additional claims for tax.
Today:	No formal hearing has been held, nor is one scheduled.

ATTACHMENT #1

COMMON SENSE FOR ALASKA, INC.

REVENUE TASK FORCE

February 1987

REPORT ON A REVIEW OF SELECTED DEPARTMENT OF REVENUE OPERATIONS

As many Alaskan businesses are currently doing, the Task Force has attempted to evaluate the Department's budget on the basis of cost-efficiency. The initial focus was on the audit function which employs a staff of approximately 80 and has the responsibility for compliance audits of the various tax programs. Given the history of taxation in the State, it was believed that the audit function had gone through the greatest amount of change over the past 5 to 10 years. The shift of the tax emphasis from individual to petroleum related activities necessitated a dramatic revision to the organization and the type of staff employed. At the outset, it may not have been clear that the petroleum related tax issues were ones that were not easily resolved. The Department was faced with the need to attract and train highly skilled personnel with expertise in a very complex and technical industry. The objective of both the taxpayer and the taxing authority is that of fair and equitable taxation, with prompt settlement in areas of dispute. This report deals primarily with clarification of these issues, and makes recommendations designed to expedite the audit/settlement functions.

Committee Members

Richard G. Carson, Chairman
Jan Bomhoff
B. Lynn Shaver
Mary Bettis
Mary Whitmore

It must be pointed out that our efforts were hampered by the lack of consistent operations and systems, through the period of our evaluation (1980-1985). During this time, systems, organizations and emphasis were modified. Without a detail knowledge of the Department's Budget and Expenditure activity one can not track the charges in spending activities. Accordingly, the Task Force focused on general trends that could be identified and evaluated.

As a general comment, one that could be made of government in general, the best way to develop a cost-effective budget is to "start over". The State uses what could be called an "incremental" budget which simply takes into account known changes (plus or minus) without reconsideration of the underlying cost base. This assumes that the cost base is appropriate. We believe that the Department of Revenue's current budget and structure has evolved out of many years of such incremental budgeting.

We have attempted to evaluate the Department's budget, as many Alaskan businesses are currently doing, on the basis of cost-efficiency. As mentioned earlier, this evaluation was complicated by the lack of reliable consistent data. Accordingly, there may be information that when made available will have an impact on our observations and comments.

Our initial focus was on the audit function which employs a staff of approximately 80 and has the responsibility for compliance audits of the various tax programs. Given the history of taxation in the State, it was believed that the audit function had gone through the greatest amount of change over the past 5 to 10 years.

The shift of the tax emphasis from individual to petroleum related activities necessitated a dramatic revision to the organization and the type of staff employed. The Department was faced with the need to attract and train highly skilled personnel with expertise in a very complex and technical industry. Given the complexity greater emphasis would be required to identify the issues and develop a plan to address these issues.

At the outset, it may not have been clear that the petroleum related tax issues were ones that were not easily resolved. In addition, it was not clear what kind of effort was needed to perform the audits.

Our efforts were concentrated on the audit function with the hope of developing recommendations to assist in making the audit process more effective and cost-efficient. The objective of both the taxpayer and the taxing authority is that of fair and equitable taxation. In the present economic environment, this should be done in a cost-efficient manner.

Additionally, the task force reviewed other aspects of DOR's activities with the goal of cost-efficient government in mind.

SUMMARY OF OBJECTIVES

OBJECTIVES

I. Make the Department of Revenue (DOR) audit function more effective and efficient.

II. Expedite settlement of the $1.5 billion reported outstanding assessments and implement procedures to facilitate prompt settlement of such assessments in future years.

III. Reduce the cost of the enforcement function.

IV. Reduce the administrative cost of distributing the Permanent Fund Dividends, and other similar programs.

p.5

Objective:

I. Make the Department of Revenue (DOR) audit function more effective and efficient.

Background:

The Department of Revenue is charged with the responsibility to collect and deposit all taxes rightfully due. The Audit function is required to determine tax compliance. The Department's stated goal is to "maintain a fair and equitable taxing system in the State" and to "achieve an acceptable level of oil and gas producer compliance...". To meet these goals and objectives the Department must establish clear policy and procedure for compliance auditing. Our review and discussion with professionals inside and out of the Department shows that neither exist.

This absence of clear policy and procedure results in auditors developing individual interpretations of tax policy and specific audit objectives which lead to significant tax disputes. At present, disputed taxes of $1.5 billion from as far back as 1978, are still unresolved. These efforts, which can consume years, are expended without consideration of the cost involved.

WE NEED AN AUDIT FUNCTION BUT WE NEED AN EFFECTIVE AND EFFICIENT ONE.

Recommendations:

1. Clarify audit policy/procedures so that DOR auditors and taxpayers have a better idea of the compliance requirements and expectations. Consideration should be given to the federal policy and procedure as a starting point, "piggybacking" where appropriate.

2. Develop an audit procedures and guidelines manual. Ensure that all auditors are knowledgeable of theses guidelines and the objectives of the audit process.

3. Establish a timeframe during which audits must be performed or discontinue the use of the statute of limitation waiver. At present, there is no incentive to perform prompt audits of returns. Returns for 1980-81 are currently under review.

4. Re-evaluate allocation of audit resources. Reconsider the need for the vast majority of nonpetroleum auditors. Consider consolidation of minor tax programs (ie. fish tax, gas tax, etc.) with other activities.

5. Develop a plan to resolve the major recurring tax issues outstanding. This plan should involve the cooperation of DOR and the Department of Law and the taxpayers.

6. Provide more specific guidance to auditors toward more realistic tax assessments. Institute accountability so that the auditor can be evaluated on the collection of taxes assessed, not merely the assessments levied.

Objective:

II. Expedite settlement of the reported $1.5 billion outstanding disputed tax assessments and implement procedures to facilitate prompt settlement of such assessments in future years.

Background:

The $1.5 billion of reported outstanding assessments arises from audits of returns as far back as 1978 including returns filed on the basis of tax law which has since been repealed. Based on our review, some believe that the $1.5 billion is fully collectible. We suspect and suggest that it is not.

Many issues have yet to be resolved on these open returns. Absent such resolution there is no way anyone can conclude that these assessments are realistic and valid. With the emphasis of the audit function being the generation of assessments, there is a strong possibility that these assessments are actually inflated.

Taxpayer disputes with tax assessments are currently heard in conference, formal, and appeal forums that are controlled by representatives of the Department of Revenue. As such, these forums may not be unbiased ones, denying the taxpayer "due process." In fact, our review showed that administrative hearings most often result in increased assessments. These circumstances reduce the taxpayers' incentive to settle.

In addition, with the absence of a time-frame within which these disputes must be settled, the State has had no real incentive to settle either.

Recommendations:

1. Establish a formal plan to resolve all outstanding assessments starting with those related to prior law.

2. Establish a timetable to resolve disputed assessments promptly. The result will be the availability of tax assessment monies at a much earlier date.

3. Consider the establishment of an independent/outside forum (Tax Court) within which the taxpayer can be heard, thereby truly providing "due process". Reference is made to federal tax hearing procedures.

4. Provide more specific guidance to auditors toward more realistic tax assessments. Institute accountability so that the auditor can be evaluated on the collection of taxes assessed not merely the assessments levied.

5. Establish an incentive to get the State and the taxpayer to settle disputed tax assessments on a prompt and equitable basis. Consideration should be given to financial incentive such as suspension of interest on unpaid assessments (State) or prepayment or graduated interest rates after a specified passage of time (taxpayer). Such incentives seem necessary to bring these matters to a much more prompt resolution.

Objective:

III. Reduce the cost of the enforcement function.

Background:

The Enforcement Division of Revenue Operations previously had the responsibility for collection of delinquent personal income taxes; its emphasis was shifted to review and follow-up on questionable Permanent Fund dividend applications. In light of the $10 million of delinquent individual income taxes (repealed in 1981) still outstanding, it is unclear whether there are clear guidelines for collection. It would appear these efforts are expended with relatively little return.

An Enforcement function is necessary but it must be based on determined need in light DOR's overall plan. The cost of maintaining this function should be evaluated against the benefits derived.

Recommendations:

1. Establish definitive collection procedures to be followed by the Enforcement Division. Establish procedures to determine uncollectible accounts that should be written off.

2. Re-evaluate the level of enforcement with respect to minor tax programs (ie. fish tax, gas tax, etc.). With the reallocation of audit efforts as discussed in Objective I, recommendation 4, the Enforcement may be discontinued.

3. Consideration should be given to privatization of the collection function. In light of the $25 million of delinquent and assigned taxes still outstanding, the current collection efforts appear ineffective.

Objective:

IV. Reduce the administrative cost of distributing the Permanent Fund Dividends.

Background:

The Permanent Fund Dividend Program Administration costs have increased to $3.3 million (FY 1985 revised) a year. The costs to process annual applications and payments are outside the Permanent Fund Trust Committee purview and are funded from the dividend pool. The majority of this work is performed by approximately 50 people from April to October. Their duties and responsibilities the rest of the year are unclear.

In addition to the Permanent Fund Dividend Program, there are several very similar programs such as occupational licensing, student loan program, etc.

Recommendations:

1. Inventory and critically evaluate the year-round responsibilities of personnel assigned to process the annual Permanent Fund distribution, both administrative and enforcement.

2. Inventory and re-evaluate the procedures used in administering the Dividend program to identify unnecessary paper handling and follow-up.

3. Contract out the Dividend distribution work to a local concern with the custodial and computer capabilities, such as a major bank. A private concern would have sufficient incentive to perform with even one-third of the costs being incurred by the State ($1 million).

4. Contract out the administration of fee assessment and collection for occupational licensing, the student loan program, and other similar programs.

5. For business licenses, consideration should be given to biennial renewal. This renewal could also be on a staggered basis resulting in lower administrative costs.

STATE OF NEW YORK

LEGISLATIVE COMMISSION ON THE MODERNIZATION
AND SIMPLIFICATION OF TAX ADMINISTRATION
AND THE TAX LAW

THE NEW YORK STATE TAX APPEALS SYSTEM

April 23, 1984

This document is a working paper prepared by the Staff of the Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law. The contents herein represent the preliminary analysis of the Staff and have not been approved or endorsed by the Commission.

3/23/88

In preparing this Report, the Staff has greatly benefited from discussions with Mark Friedlander, State Tax Commissioner, Paul Coburn, Secretary to the State Tax Commission, John Sollecito, Director of the Tax Appeals Bureau, and Thomas Lynch, former State Tax Commissioner.

In addition, the Staff greatly appreciates the thoughtful and perceptive comments provided by Paul Comeau, Esq., Sidney Glaser, Esq., Professor Michael J. McIntyre, Joseph Murphy, Esq., Professor Oliver Oldman, Arthur Rosen, Esq., Jack Wong, C.P.A.; and by Peter L. Faber, Esq., and Ralph O. Winger, Esq., members of the Commission's Policy Advisory Group.

The Staff also wishes to acknowledge the important contribution of the Legislative Drafting Research Fund of Columbia University Law School and its Director, Professor Frank P. Grad. The Legislative Drafting Research Fund was responsible for much of the background research for this Report and especially for the material contained in Appendix I.

Finally, Professor Richard Kay of the University of Connecticut Law School played a vital role in helping to formulate the Staff's treatment of certain key issues and is largely responsible for the work contained in Appendix II of this Report.

CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

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EXECUTIVE SUMMARY

The New York tax appeals system has been the subject of repeated criticisms, focusing on the inefficiency of the process, the quality of the decisions rendered, and, above all, the fundamental unfairness of the procedural framework used for the hearing and resolution of disputes. This Report describes the existing New York system in detail, evaluates the criticisms, and offers a range of policy options as alternatives to the current scheme.

Among the major findings of the Report are:

--The close organizational relationship between the State Tax Commission, which rules upon contested tax matters, and the Department of Taxation and Finance, which assesses and collects taxes, violates the doctrine of "separation of powers," fuels perceptions of possible unfairness, and creates the risk of actual bias in the adjudication of tax disputes.

--The President of the State Tax Commission is also the Commissioner of Taxation and Finance and in that role is directly responsible for the administration of that Department. The Department is always one of the parties in the contested tax matters upon which the Commission rules. The President of the Commission is thus required to sit in judgment of the very acts for which he and his subordinates are responsible.

--Other than undocumented reports, no factual evidence supports specific instances of bias in the current system. But arguments regarding the lack of independence of the Tax Commission and the resulting risk of unfairness ought not to turn on the presence or absence of such proof. The best method to assure fair determinations is to establish structures and procedures that are most likely to produce the desired results. Approaches that avoid the appearance of injustice do more than simply that; they also represent the best means of achieving the reality of justice.

--The institutional arrangements that create the risk of bias and perceptions of unfairness in the tax appeals system are not unusual in administrative agencies. Nonetheless, in the case of tax appeals, the arguments offered in favor of agency control of the adjudicatory process do not justify any departure from the fundamental principle that adjudicators ought to be

completely independent from the parties that argue before them.

--The tax appeals process could be made more efficient without undermining concerns for fairness if the Department were allowed to consider the hazards of litigation in negotiating settlements. This change should be considered regardless of what other reforms are undertaken.

--Under the current system, the Tax Commission does not hear live testimony; hearing officers are used instead. An appeals system in which the actual decisionmaker heard live cases could well enhance the fairness and efficiency of the tax appeals process.

--The President of the Tax Commission already has a full-time job in administering the Department of Taxation and Finance. It is unfair to impose upon him the additional full-time job of adjudicating tax disputes, although in an earlier era both roles might have been manageable.

--While the efficiency of the current system has improved in recent years, problems still remain.

--A variety of policy options exist as possible responses to existing problems. These might include statutory and procedural changes clarifying and narrowing the role of the State Tax Commission; removing the Commissioner of Taxation and Finance from the Tax Commission; removing the Commission's regulatory function; creating an independent tax tribunal; and creating a judicial tax court.

--The creation of an independent tax tribunal that would not be part of the judiciary would correct the fundamental weaknesses in the current system, allow for a rapid, inexpensive hearing process, and avoid some of the difficulties that might accompany an attempt to create a judicial tax court. The relative efficiency of such a tribunal compared to the current tax appeals system is difficult to assess, however.

--The creation of a judicial tax court has both advantages and disadvantages. Such a court would most clearly guarantee an independent decisionmaker and is likely to attract highly qualified individuals to sit as judges. The creation of a tax court, however, would entail a constitutional amendment.

INTRODUCTION

Taxpayers, tax lawyers,[1] and accountants have strongly attacked the existing procedures for contesting determinations of the New York State Department of Taxation and Finance. Critical comment has also come from other, disinterested quarters. A 1975 report by the Governor's Task Force on Court Reform concluded that "the power to adjudicate tax disputes now given the State Tax Commission should be withdrawn from it."[2] The 1979 Governor's Temporary Commission to Review the Sales & Use Tax Laws also recommended ". . . that serious consideration be given to creation of [an independent tax appeals board], particularly because it would establish a review group whose impartiality would at least be enhanced in the public view by its independence from the State Tax Commission."[3] Most recently, a 1984 report by the Office of the State Comptroller identified major deficiencies in the processing and resolution of tax controversies.[4] Criticisms have focused on a number of claimed defects, including the inefficiency of the appeals process, the quality of the decisions rendered and, above all, the unfairness of the procedural structure used for hearing and resolving disputes. This Report evaluates these complaints and explores alternatives to the present system.

Chapter I describes the existing New York tax appeals system in some detail. Chapter II surveys the tax appeals procedures of other jurisdictions and examines more closely those of selected states and of the federal government. Chapter III reviews and evaluates the complaints made against the New York system. Chapter IV sets forth a range of policy options which are alternatives to the current scheme.

I. THE NEW YORK STATE TAX APPEALS SYSTEM

The New York State Tax Commission is the head of the Division of Taxation of the New York State Department of Taxation and Finance (Department).[5] The President of the three-member Commission is also the Commissioner of Taxation and Finance--the chief executive officer of the Department of Taxation and Finance. The President serves at the pleasure of the Governor; the other two Commissioners serve for fixed terms of six years. The Commission is granted broad powers; in practice, however, most of these powers are executed by the Department.[6] All three members of the State Tax Commission review regulations, which are proposed by the Department.[7] The three-member Board is also the administrative body that rules upon contested tax matters. The Commission has promulgated Rules of Practice and Procedure governing proceedings before it.[8]

The Tax Appeals Bureau is the administrative adjudicatory arm of the State Tax Commission. The Bureau processes and reviews petitions for the redetermination of a tax deficiency or refund. A taxpayer generally has 90 days after a notice of deficiency[9] is mailed in which to file a petition for redetermination.[10]

Once a petition is filed, the review begins in most cases with an informal prehearing conference which is conducted by a Tax Appeals Bureau conferee.[11] Conferences are available at every district office of the Department and are scheduled at the taxpayer's convenience. Conferees are typically auditors and accountants with 10 to 15 years of experience with the Department. Their role in the conference proceeding is that of an arbiter; the Department is

represented at the conference by a member of the audit staff. In situations where taxpayers appear without professional representation, the conferee will insure that they have the opportunity to present their case.[12]

A dispute that is considered in conference may be resolved if the taxpayer and the Department can arrive at an agreement. The conferee can propose a settlement which, if accepted by the taxpayer, is binding on the Department.[13] The conferee acts with the delegated authority of the Commission in resolving cases. The Commission may revoke such authority as it sees fit, although it does so infrequently.

One constraint upon the conference settlement mechanism is that neither the Department nor the conferee may consider the hazards of litigation faced by the Department in considering a settlement. This policy is based upon the Commission's interpretation of the statutory law under which it operates.[14] The ramifications of this policy are discussed in detail in Chapter III, Section C, infra.

A taxpayer that is dissatisfied with the outcome of the conference may perfect a petition for a hearing. Small claims hearings are available for matters up to $10,000 of sales tax per year or up to $3,000 of income or unincorporated business tax per year, exclusive of all penalties and interest.[15] Formal hearings are available for New York State and local sales and income taxes in excess of the small claims limits. In addition, the formal hearings unit handles all other cases concerning state and local taxes under the purview of the State Tax Commission, including corporate

franchise tax; stock transfer tax; mortgage recording tax; truck mileage tax; cigarette tax; motor fuel tax; gift tax; and license revocations for cigarette vendors. The formal hearings unit also manages pre-decision warrants.[16]

Hearings are held in New York City and at various upstate locations. The travel schedule for the circuit-riding hearing officers is set 12 months in advance; a taxpayer's actual hearing date is set 60-90 days in advance. A transcript of the record is made in formal hearings. In small claims hearings, the proceedings are recorded on tape but usually are not transcribed.[17]

The hearing is conducted by a hearing officer, who is an employee of the Tax Appeals Bureau. Qualifications for hearing officers are established by the Commission. The Commission has initiated a four-year formal hearing officer trainee program for recent law school graduates.[18]

The hearing officer has the authority to administer oaths; to regulate the course of the hearing; to set the time and place for continuances and for filing legal documents; and to issue subpoenas, which are available upon the taxpayer's request, requiring the production of witnesses and documents.[19] Parties are encouraged to stipulate all relevant, unprivileged facts to the extent possible. During the hearing, parties may examine and cross-examine witnesses, introduce exhibits, rebut evidence, and impeach any witness. Section 306 of the New York State Administrative Procedure Act contains a provision that states "All evidence, including records and documents in the possession of the agency of which it desires to avail itself shall be offered and made a part of the rec-

on;

record. . . ." The hearing officer may clarify an ambiguous record by asking questions of the parties or witnesses.

The burden of proof generally rests upon the taxpayer. The Commission bears the burden, however, regarding whether the taxpayer is guilty of fraud with intent to evade tax; liable as the transferee of a taxpayer's property; or liable for any increase in a deficiency, where the increase is asserted for the first time after a petition for redetermination of deficiency was filed.[20]

After the proceedings, the hearing officer reviews the evidence and makes written findings of law and fact for the Commission. These recommendations are reviewed by the post-hearing review unit,[21] which reports its findings to the Director of the Tax Appeals Bureau. The Director can write a dissent if he disagrees with a hearing officer's recommendation, but may not alter the opinion. If the hearing officer wishes, he may write a justification in response to the Director's dissent. The opinion, dissent, and justification are forwarded to the Commission for its final decision. If the case was heard in a formal hearing, the entire record, including a stenographic transcript of the proceedings, is also sent to the Commission.[22]

In small claims cases, the Commission must render its final decision within 90 days of the submission of written arguments or the completion of the hearing. For formal hearings, the decision is due within 9 months after the submission of briefs or the completion of the hearing. The 9-month period may be extended to 12 months for good cause. If the Commission fails to render a timely

decision, the taxpayer may institute a mandamus proceeding under Article 78 of the New York Civil Practice Law and Rules.[23]

The full Commission reviews all recommendations for the quality of the writing and the soundness of the legal reasoning. The Commission also reviews the reasonableness and application of any regulations at issue (including those issued by the Commission itself). The Commission is assisted by an initial review performed by the Secretary to the Commission, who is appointed by vote of the Commission. If a Commissioner has a question concerning the facts of a case, he may examine the record or contact the Tax Appeals Bureau.[24] In the rare cases where a specific, procedural point is unclear, the Commission may contact the Department of Taxation and Finance.[25]

Commission decisions are provided immediately to both the taxpayer and the Department. Subsequently, the Department's Division of Taxpayer Services publishes and disseminates Commission decisions with an annotation stating whether or not the decision conforms with Departmental policy. An annotation indicating nonconformity with audit policy requires the express approval of the Commission, under a procedure outlined in a Departmental Executive Memorandum.[26] Such annotations are relatively rare. All other Commission decisions become official Departmental policy. Commission decisions are available to all persons on the State Tax Commission mailing list and are reproduced as headnotes, excerpts and occasionally in full by two privately published tax law services, Commerce Clearing House and Prentice Hall.[27]

The Department has no right to appeal an adverse decision of the Commission; only the taxpayer may do so. Review of the

Commission's decision is accomplished by bringing an Article 78 proceeding, the standard procedure in New York for contesting the determination of a State agency. This review is initiated in the Supreme Court of Albany County, from which it may be transferred to the Appellate Division Third Department in Albany.

Article 78 authorizes reversal of an agency decision if "affected by an error of law."[28] The standard of review used for factual determinations is much less clear. One section of the law[29] states that reversal of an agency decision will turn on "whether a determination was . . . arbitrary and capricious . . . ." but another section[30] provides for reversal unless "a determination made as a result of a hearing . . . is, on the entire record, supported by substantial evidence." Judicial decisions reviewing determinations of the State Tax Commission have not tracked the statutory standards. These decisions have ignored the "substantial evidence" rule and have applied instead a deferential but ill-defined standard of review.[31]

II. OTHER TAX ADJUDICATION SYSTEMS

The federal government and each of the 50 states have established mechanisms for the adjudication of tax disputes. These tax appeals systems fall into three broad categories. The first category consists of tax courts. Three states and the District of Columbia have full-fledged tax courts, which are established either as separate courts or as divisions of the lower courts of general jurisdiction. A second category consists of independent review agencies. These may occasionally be referred to as courts, as in the case of the United States Tax Court, but are in fact located in the legislative or executive branch rather than in the judicial branch of government. These independent agencies exist wholly outside of the tax department. A third large category of tax appeals systems, which includes that of New York, consists of internal review mechanisms. In these systems, the taxpayer's dispute is heard by the same agency that is responsible for the administration and collection of taxes.

Apart from their structural frameworks, tax appeals systems differ in a number of ways that can affect either or both the fairness and efficiency of the process. They vary with respect to the formality of the proceedings, the qualifications of those who hear cases, the mechanisms for prehearing settlement, and so forth. This Chapter describes the structures and procedures of the various appeals systems in general, and several in particular, in order to examine how the policy concerns that must be addressed in New York have been resolved elsewhere. Appendix I provides a survey of the

tax appeals procedures of the other 49 states and the District of Columbia.

A. Tax Courts

Three states--Oregon, Hawaii, New Jersey--and the District of Columbia have judicial tax courts. In 1978, New Jersey became the most recent state to establish a tax court[32] and can serve as a case study.

The New Jersey Tax Court is a full-fledged judicial court, hearing both state tax and local property tax cases. The Court replaced the State Division of Tax Appeals, a quasi-judicial body within the State Division of the Treasury.

The New Jersey Tax Court is an inferior court of limited jurisdiction. Its judges are appointed by the Governor and confirmed by the Senate. The enabling legislation provides for 6 to 12 judges; 8 have been appointed at present. Judges must have special expertise in tax law and must have been admitted to the New Jersey bar for at least 10 years. Terms are for 7 years with lifetime tenure upon reappointment. The Tax Court bench is intended to be bipartisan; by statute, appointments are to be made so that the two major political parties are represented in equal numbers.[33]

The judges of the Tax Court receive the same salary, pension rights, and other privileges of judges of the New Jersey Superior Court (the equivalent of the New York Supreme Court). The Chief Justice of the Superior Court may assign Superior Court judges to the Tax Court, and Tax Court judges are assigned to hear Superior Court cases from time to time.

The Tax Court is a court of record. Individual judges hear and determine all issues of fact and law de novo. The Court is empowered to grant legal and equitable relief and has jurisdiction to hear and decide federal and state constitutional questions that may arise. The Tax Court's rules of procedure incorporate the rules of the Superior Court wherever possible. Variation occurs only where required by the Tax Court enabling statute, other tax statutes, or by the special nature of tax cases and the desire of the Court to achieve speedy dispositions.[34] Only attorneys may practice before the court except in small claims matters.

Judges are not required to write formal opinions in each case and do so only in cases considered sufficiently significant or novel. In certain instances, judges will rule from the bench. In most other cases, decisions are disposed of in letter opinions. Formal opinions are reported in a bound volume of New Jersey Tax Court decisions.

The Presiding Judge attempts in two ways to assure substantial uniformity in the decisions that are rendered. First, at monthly meetings, the judges discuss issues and review opinions that have been prepared for publication. Second, the Presiding Judge can assign to a single judge a number of cases involving a particular issue. This judge's decisions can then provide future guidance to the others.[35] Ultimately, of course, appellate review may be necessary to resolve differences in particularly knotty issues.

The judges conduct pre-trial and settlement conferences, and a large majority of the cases that come before them are resolved prior to trial. During the year ending August 31, 1982, the Court

received 6,736 cases and disposed of 12,288.[36] Ninety-three percent of these cases were property tax cases. Eighty-nine percent of property tax cases and 83 percent of state tax cases were resolved prior to trial.

The Court maintains six permanent locations and travels circuit to hear cases in other locations. Each judge's courtroom staff is limited to a single clerk. Hearings are recorded on sound equipment, obviating the need for additional courtroom personnel. The Court has a small claims division for cases involving refunds or additional tax assessments of $2,000 or less, exclusive of interest and penalties. Small claims hearings are informal; the judge hears testimony and receives such evidence as is deemed necessary or desirable for a just determination. Tax Court decisions, including those of the small claims division, may be appealed to the Appellate Division of the Superior Court.

B. Independent Review Boards

1. Overview

Independent review boards are quasi-judicial agencies, which are attached organizationally to either the executive or legislative branches but are separate from the tax department. Generally, independent boards have jurisdiction to review all rulings related to major taxes, including property tax valuations. Almost invariably, members of the review board are appointed by the Governor, with Senate confirmation required in about one-half of the states. The number of members ranges from two to eleven, with three to five being most common. Most states have some criteria for choosing

members, such as political party affiliation, expertise in tax matters, and residency.

Procedures before review boards vary widely, with approximately one-third providing both formal and informal hearings, one-third only formal hearings, and one-third primarily informal hearings. Testimony is either tape-recorded or recorded by a stenographer. Strict rules of evidence rarely apply. Very few review boards have separate small claims proceedings.

Judicial review of the review board's decision is always available, but may be lodged in an inferior court, or, in some cases, in the state's highest court. Ordinarily, review is limited in scope; it may be limited to the record, to questions of law, or to the record and any evidence specially admitted for good cause.

Taxpayers generally begin an appeal in such a review agency by filing a petition and paying a fee ranging from $2 to $40. While they need not be represented by counsel, few taxpayers appear pro se for formal hearings. Taxpayers generally may be represented either by an attorney or an accountant.

2. The United States Tax Court

The United States Tax Court provides a principal forum for contested federal tax claims.[37] Despite its name, the Tax Court is not part of the federal judiciary but is a legislative court, subject to Congressional appropriation and oversight.[38] In many aspects, however, it resembles the federal district courts.

Tax court judges are appointed for 15-year terms. Salaries are identical to those of federal district court judges. The rules of practice are generally similar to those used for nonjury trials

in the federal district courts, including similar evidentiary rules. Facts are usually stipulated by the IRS and the taxpayer prior to trial. Streamlined procedures are available for hearing cases involving less than $5,000; under these procedures there are no formal rules of evidence, no formal opinion, and no right of appeal.

The Tax Court judges sit primarily in Washington, D.C. although each judge travels 15 to 20 weeks a year. Cases are heard in about 100 cities and judges sit in each city for about two weeks at a time. Until recently, opinions were forwarded to the Chief Judge for review. As of March 1, 1983, Tax Court judges are authorized to issue bench opinions, which are not subject to review. While it is too early to assess the impact of this new power, judges expect it to be used primarily to expedite decisions in small claims cases.[39]

Uniformity in decisionmaking is insured through conferences among the judges. A judge's decision becomes final 30 days after it is rendered unless the Chief Judge directs that it be reviewed in conference. Generally that is done only when there is a conflicting opinion, when a case raises a significant issue of law that has not yet been decided, or when a judge seeks to overturn an earlier decision of the court.

Attorneys must apply and be accepted to practice before the Court. All others, including certified public accountants, must pass an examination before they are allowed to practice.[40]

3. Wisconsin

The Wisconsin Tax Appeals Commission provides a final example of an independent review board.[41] The Commission consists of five

part-time members, appointed for six-year terms by the Governor with the advice and consent of the Senate. The Commission handles all state taxes. It also reviews the assessment of property taxes on manufacturing property; these assessments are done by the State Department of Revenue on behalf of local governments. A taxpayer first meets with one of 11 conferees within the Department of Revenue for an informal conference. Afterwards, the conferee sends a formal notice denying, granting, or offering a compromise. A dissatisfied taxpayer may then appeal to the independent Tax Appeals Commission. Generally, one commissioner presides at a hearing, with the commissioners traveling to designated central locations around the state. Commissioners may give oral opinions, but generally do so only in small claims cases that do not involve significant questions of law or fact. The Commission usually issues written opinions that are circulated among the five members and signed by all five members. The members meet approximately once a month to discuss cases and to help achieve uniformity of outcomes.[42]

Attorneys, accountants and taxpayers may practice before the Tax Appeals Commission. The evidentiary standard is strict, generally following the Wisconsin Circuit Court rules.

Taxpayers who seek judicial review take their cases to the Circuit Court, then to the Wisconsin Court of Appeals. Final judicial review rests with the Wisconsin Supreme Court.

C. Internal Review Mechanisms

The detailed description in Chapter I, supra, of New York's current procedures provides a representative example of an internal

review system. For a brief description of other similar systems, for example, the States of Connecticut, Florida, Illinois, and Virginia, see Appendix I.

III. CRITICISMS OF THE NEW YORK TAX APPEALS SYSTEM

Numerous features of the existing State tax appeals system have come under sharp criticism. The complaints have taken several forms, but most involve either the fairness or efficiency of the process. Both of these qualities are obviously desirable in any public agency that determines the legal rights and liabilities of citizens. This Chapter examines and evaluates these criticisms.

A. Lack of Independence

As an internal review mechanism, the Tax Appeals Bureau operates within the Department of Taxation and Finance, which also oversees the administration and collection of taxes. This institutional linkage provides the basis for what has, over the years, been a persistent assertion about the New York system--its lack of independence and consequent bias in favor of the Department. The 1975 Governor's Task Force on Court Reform also highlighted the perceived unfairness of the system.[43]

This perception of unfairness in the determination of contested cases stems from the commonly believed tendency of human beings to favor themselves or their associates, a tendency that underlies the ancient common law maxim that no person should sit in judgment of his or her own case. Our governmental arrangements have typically insisted on a separation of powers which specifically includes the independence of the judiciary. An adjudicator who, because of personal or institutional associations, is perceived as favoring one side or another will not be trusted to determine im-

partially the facts and law that should determine the outcome of a controversy. Because tax appeals in New York are decided by an agency that is organizationally related to one of the parties in the dispute, perceptions and fears of bias are frequently asserted by taxpayers or their representatives.

To be sure, the structure of the Department of Taxation and Finance described in Chapter I should allay some fears. The Tax Appeals Bureau is separately organized and operated from the rest of the Department. Other institutional links, however, maintain the risk of bias and fuel perceptions of possible unfairness.

First, the findings of fact and conclusions of law by the Tax Appeals Bureau are mere recommendations to the Commission; final authority rests with the Commission. The President of the Tax Commission is also the Commissioner of Taxation and Finance. He is directly charged with the administration of that Department, which is the revenue collection agent for the State. Because the Department of Taxation and Finance is always one of the parties in the contested matters upon which the Commission ultimately rules, the President is required to sit in judgment of the very acts for which he and his subordinates are responsible. Moreover, the perception exists that his performance as Commissioner of Taxation may be evaluated by the amount of revenue (or the increase in revenue) collected under his tenure. While this criterion is an improper basis upon which to measure his performance, nonetheless a fear is that it may exert subtle, perhaps subconscious pressure.

Second, the Commissioner of Taxation is directly involved in the promulgation of regulations.[44] As President of the Commission,

he is then asked to apply these rules neutrally in cases before him. This confusion and melding of legislative and adjudicative functions increase the risk that the strict application of pre-existing regulations will be subordinated to broader policy considerations. While these policy considerations are properly his concern when he acts as a legislator in promulgating rules, they ought not influence him as a judge.

The two other Commission members also serve multiple roles. They, too, not only sit in judgment of tax cases, but also are responsible for the promulgation of regulations. Additionally, they "perform such other duties in the department as the commissioner of taxation and finance may prescribe."[45]

Third, risks of bias are inherent in the existing structure even apart from the double role of the Commissioner-President. Although the Tax Appeals Bureau is separately organized, it remains a component of the Department. Such influences as common institutional identity, transfers of personnel between divisions, mere physical proximity, and budgetary links provide opportunities for the development of bias and an institutional mindset.[46]

The perception of bias is further underscored by current institutional procedures that attach the Commission's name, and not the Department's, to official actions that are actually taken by the Department. These actions include, among others, the issuance of advisory opinions and warrants.[47] In addition, hearings in Albany and Rochester are held at offices located within the Department of Taxation and Finance. In New York City, hearings are held at offices next to the Department's.[48] It is hardly surprising

that under these circumstances any distinction between the Tax Commission and the Department becomes blurred to a taxpayer.

A final perceived bias grows out of the Department's inability to appeal from an adverse decision of the Commission, which makes some sense in the current structural scheme where the roles of "judge" and "prosecutor" are intertwined. The Department's inability to appeal reinforces taxpayers' perceptions that the Tax Commission is viewed as an arm of the Department, rather than being independent. If the Commission were truly independent, little reason would exist for denying the Department a right of appeal. Furthermore, although the Department's inability to appeal adverse decisions would superficially appear to favor taxpayers, exactly the opposite result is said to occur. Some persons assert that because the Department has no right of appeal, the Commission has a tendency to rule against taxpayers in close cases. This perceived source of bias, coupled with the limited review afforded by the courts, discussed infra, represents another area of taxpayer resentment.

To be sure, other than undocumented reports, no factual evidence supports specific instances of bias.[49] But the validity of the argument regarding the lack of independence of the Tax Commission and the resulting risk of unfairness ought not to turn on the presence or absence of such proof. Improper influences cannot be expected to manifest themselves in easily apparent or visible ways. Nor can the behavior of past and current Commissioners, hearing officers, and Tax Appeals Bureau Directors, no matter how impeccable, assure similar behavior by their successors. The best method--

indeed, the only method available to assure fair and sound determinations is to establish structures and procedures that are most likely to produce the desired results. Structures and procedures that avoid the appearance of injustice do more than simply that; they also represent the best means of achieving the reality of justice.[50]

Admittedly, the institutional arrangements that give rise to these problems regarding tax appeals are not unusual in administrative agencies, notwithstanding that such arrangements have been criticized since the creation of these agencies.[51] The New York tax appeals system follows the approaches of the State and the Federal Administrative Procedures Acts,[52] which require a separation within the agency of persons responsible for initiating, investigating, and prosecuting cases, from persons responsible for adjudicating them. Agency heads, however, retain final control of all aspects of the agencies' work, including administrative adjudication. This framework has been held to be consistent with the federal constitutional requirement of due process.[53]

Standing alone, however, the prevalence of this kind of administrative agency adjudication elsewhere cannot justify its retention in the context of New York tax appeals. Indeed, consideration of the reasons for the usual administrative arrangements and the inapplicability of those reasons in the context of the tax appeals system lead to exactly the opposite conclusion. This argument is developed in detail in Appendix II of this Report and is summarized as follows.

For the reasons stated earlier, the norm for all adjudication in our legal tradition includes an independent decisionmaker. In other words, the presumption is that no person should sit in judgment of him or herself. Departures from that norm require special justification. That justification has been found in the special need of some administrative agencies to maintain complete control over all aspects of administrative policymaking, including that policymaking which can emerge from administration adjudication. In this context, the most persuasive argument on behalf of a departure from the norm of an independent decisionmaker is that the separation of functions would unduly impair administrative responsibility and effectiveness.[54]

The validity of this argument, however, depends to a considerable degree on the nature of the functions of the particular administrative agency. The justification for deviating from the presumption in favor of the separation of powers is probably strongest in the case of an action-oriented administrative agency that was created to achieve broadly defined legislative goals,[55] such as discouraging unfair and deceptive practices, or "to insure the safe and sound conduct of the [banking] business . . . and . . . to maintain public confidence in such business and protect the public interest . . . ."[56] Under these circumstances, the agency's mission requires that new policy decisions be continuously made within the broad perimeters set forth by the governing legislation. If these policymaking powers cannot be effective if confined to executive decisions, adjudication should be under the control of the policymaker--the head of the agency.[57]

These arguments in favor of utilizing agency adjudication as a tool for policy implementation rely on important assumptions about the kind of policy which the agency should make and on the various tools it has available. As early as 1942, another State Commission[58] that looked at the issue of administrative adjudication throughout State government concluded that

> [this] argument is not applicable to the field of taxation. The administrative process in taxation is clearly separable from the adjudicative process; the former will have ended before the latter begins. Audit, assessment and related steps result in the controverted case, in a conclusion which is challenged by the taxpayers. Such controversies involve typical, justifiable issues of fact and law, and lend themselves peculiarly to adjudication of the ordinary type.[59]

As more fully developed in Appendix II, in the case of tax appeals the arguments offered in favor of agency control of the adjudicatory process do not justify any departure from the fundamental principle that adjudicators ought to be completely independent of and separated from the parties that argue before them. The values of fair and impartial adjudication outweigh any needs of the Department to the contrary and justify modifying existing administrative structures in order to create a more independent mechanism for deciding tax appeals.

Another factor in favor of an independent adjudicator involves the criteria by which a Commissioner of Taxation might be measured. The heads of other departments--motor vehicles, banking, health--are unlikely to have their performance measured by the outcome of any litigation they oversee. The Commissioner of Motor Vehicles, for example, is unlikely to be judged by the number of licenses that are revoked. By contrast, the Commissioner of Taxation

might be evaluated by the increase in revenue collected under his tenure, especially when a priority is rightfully placed on collecting taxes that already exist before entertaining the imposition of new ones. Accordingly, the Commissioner of Taxation may have a more personal stake in the outcome of litigation than is true in the case of his counterparts in other departments.

The sheer volume of contested tax matters is a further argument on behalf of the principle of an independent decisionmaker. Deviations from this principle are more tolerable when the number of affected individuals is small. Creating a separate and independent adjudicatory body may not become compelling until a certain minimum number of controversies can be predicted to occur from year-to-year. Creating an independent body will entail, at the least, transitional costs that may not be justified for other departments that do not experience the same level of litigation as does Taxation and Finance.

Finally, every citizen has an interest in the quality of the State's tax administration. In this respect, the tax system is more akin to the criminal justice system--part of the fabric that holds us together as a society--and is thus quantitatively and qualitatively different from other administrative agencies, which oversee more specialized areas of activity. Tax appeals demand a more exacting standard of impartiality and independence than that demanded of other agency adjudications, especially when voluntary compliance is the bedrock of the tax system.

The New Jersey and federal tax appeals systems, described in Chapter II, supra, originally resembled New York's internal review

mechanism in structure and were the subject of much of the same criticism now levelled against the New York system. Both were subsequently reformed after legislative investigations[60] in order to provide for a fully independent review of contested tax matters. New Jersey created a judicial tax court; the United States in 1924 created the U.S. Board of Tax Appeals, which eventually was transformed into the current legislative U.S. Tax Court.[61]

A brief history of the federal legislation is instructive because of the similarities with New York. The Tax Simplification Board, created by statute in 1921 to investigate the administration of the federal internal revenue laws, criticized the internal review mechanism then used for the adjudication of contested tax matters. It identified the lack of independence of the decision-making body from the revenue department as a fundamental weakness in the system. In its 1923 report, the Board stated:

> . . . it would never be possible to give to the taxpayer the fair and independent review to which he is of right entitled as long as the appellate tribunal is directly under, and its recommendations subject to the approval of, the officer whose duty it is to administer the law and collect the tax. As long as the appellate tribunal is part and parcel of the collecting machinery it can hardly maintain the attitude essential to a judicial tribunal.[62]

The parallels between New York's current situation and the federal situation at that time are noteworthy. A former Commissioner of Taxation and Finance, testifying in support of a New York tax court, stated in 1975 that "as a result of our present rate structure and the large number of taxpaying citizens on our rolls, New York has come to about the point which the Federal Government had reached in 1924"[63] (the year the U.S. Board of Tax Appeals was created).

Parallels in other states exist as well. In 1979, the Commission on California State Government Organization and Economy issued a report on the tax appeals system in California. Their report stated:

> Most tax appeals are adjudicated by boards which are directly or closely connected with the agencies which administer the taxes and the members of most of these boards are not necessarily required to possess expertise in tax matters. These and other features of the State's tax appeals system leave it susceptible (in theory, if not in actuality) to influences of untoward biases and incompetence. In addition, the appellate system is widely perceived to be lacking impartial and technically expert adjudicators.
>
> As a means of eliminating weaknesses in the present structure of the appeals system and improving taxpayer confidence in the fairness of the appellate process, the Commission recommends that a new system be established for adjudicating taxpayer challenges to assigned tax liabilities.
>
> The new system should incorporate these characteristics:
>
> Impartiality. The appellate body should be completely independent of those agencies and officials responsible for collecting taxes or administering tax laws.[84]

B. Inefficiency

Practicality requires that tax appeal procedures be measured not only against the principles of fairness, but also against the need for efficiency. Any realistic procedural framework must meet both these concerns.

Ideally, an efficient tax appeal system would be simple, rapid, and inexpensive. Such a system would resolve controversies within a reasonable period of time, minimize the use of time-consuming and costly formal procedures, and encourage the settlement of disputes. These attributes need not be inconsistent with fairness. For example, informal procedures may not only dispose of

simple cases more rapidly, but they can also reduce the need for professional representation, allowing taxpayers to pursue their rights even in cases where limited sums of money are at stake.

In other instances, however, fairness and efficiency may be in conflict. The desire to protect individual rights may result in procedures that are more complex and time-consuming than efficiency concerns would dictate. Conversely, efficiency considerations may suggest that significant deviations from the judicial model of adjudication with its often elaborate rules (juries, strict rules of evidence, etc.) are proper.

The New York tax appeals system has been criticized in the past for being inefficient. The following passage is from a 1974 report:

> There are extreme time delays throughout the conference and hearings process for all taxes, and the worst delays occur in the income tax area where cases which travel through the entire system remain unresolved for an average of over 10 years. The audit and protest follow-up process in the Income Tax Bureau takes an average of four years . . . . Once cases reach the formal hearing unit, they wait an average of three years before a hearing is held and it takes an additional 16 months--on average--before a determination is issued by the State Tax Commission.[65]

In 1975, the tax appeals system was revamped, partially in response to criticisms of inefficiency.[66] In recent years, such criticism has abated and some would argue that the system has achieved a reasonable measure of efficiency. In 1981, for example, the Commission closed 4,242[67] cases, while receiving 3,696 new matters. It reduced its case inventory by 8.4 percent--from 6,441 to 5,895.

Two recent studies of the Tax Appeals Bureau suggest, however, that serious problems of inefficiency persist. A recent report by the Office of the State Comptroller concluded that:[68]

> One of the goals of the tax appeals process is to provide a rapid resolution to taxpayer controversies with the Department. However, our review showed extensive delays occurring with the processing of protest through the pre-hearing conference and small claims and formal hearing processes . . . the resolution of the controversies showed that long periods of time elapse until tax matters are resolved: pre-hearing conferences require more than a year to close and Small Claims and Formal Hearings take more than five years to close.

The second study, a review of sales tax cases decided between June 1982 and April 1983, indicated that the average elapsed time between the notice of deficiency and hearing for these cases was 35 months and that the average elapsed time between hearing and decision was approximately 20 months[69]--a total of 55 months, close to five years.

The New York system does meet many of the criteria required for an efficient system. Most importantly, it begins with an informal conference mechanism that is designed to encourage the early, expeditious resolution of most disputes. It then provides increasingly formal procedures--hearings and Article 78 judicial review--to deal with disputes that cannot be otherwise resolved. Further, cases destined for hearing are sorted into formal and small claims hearings and less formal procedures are appropriately utilized in trying small claim matters. Nonetheless, several aspects of the current system may be inefficient and could be corrected, either in the course of other significant structural changes, or in some cases without any major changes in the basic framework at all.

All four of the topics discussed in Sections C, D, E and F, infra, bear on both the efficiency and the fairness of the tax appeals system. Sections C and D raise the most serious issues,

however, regarding the efficiency of the current system and that of alternative schemes.

C. Obstacles to Settlements

Settlements are essential to the efficient operation of a tax appeals system. A system that does not resolve a substantial majority of its disputes at an early stage is likely to be inordinately expensive, agonizingly slow, or both. Nor do settlements necessarily reduce the fairness of the system in any way; to the contrary, they may well enhance the uniformity with which taxpayers with legitimate legal claims are treated.[70] Expeditious settlements may also permit the State to collect revenues in disputed cases in a more timely fashion.

The value of procedures that facilitate settlements is predicated on the notion that not all tax disputes are, from the perspective of the State, equally worthy of full litigation. Certain disputes are neither essential to the tax department's litigation policy nor capable of clarifying the law in any meaningful way. Litigation of these cases may be time-consuming and expensive without having any sufficiently redeeming attributes.[71]

A tax department gains little from this type of litigation other than protecting the revenue at stake in the individual dispute. The value of the State's interest prior to litigation is no greater than the amount of the assessment discounted by the probability of prevailing should the dispute be litigated, less any costs that would be incurred. The value of the taxpayer's interest should be evaluated similarly. In this light, it is sensible for the system to be satisfied with a result that generally conformed

with the parties' valuation of their interests, which would take into account the hazards of litigation (that is, the probability of prevailing in court). Settlements achieved in this manner may well produce more uniformity among taxpayers than would the attempt to decide such cases entirely for one side or the other. The ability to settle cases based on a realistic appraisal of the litigation hazards faced by both a tax department and a taxpayer facilitates bilateral agreements at the administrative level, greatly enhancing the efficiency of the appeals process while preserving its general fairness.[72]

The power to settle cases on the basis of hazards of litigation is sometimes criticized as being susceptible to undue influence or unprincipled decisionmaking, although similar fears can also be raised about the conference mechanism. The experience of the IRS, however, which exercises precisely this power, indicates that appropriate procedural safeguards can be incorporated to prevent abuse. First, the IRS places authority for approving settlements within a small group of relatively high-level staff, who have no direct contact with the taxpayer and who review all proposed settlements based on only the paper record. Second, settlements actually approved are subject to further review in order to gauge the overall quality of the actions taken. This post-review may occur within the IRS District office or within the Regional or National offices.

The New York Department of Taxation and Finance has interpreted State law as prohibiting the agency from entering into settlements based on hazards of litigation.[73] In effect, the Department asks a taxpayer to pay voluntarily 100 percent of an assessment

notwithstanding that the taxpayer has a realistic chance of prevailing in litigation. A well-represented taxpayer will not be likely to make such a concession. The administrative process cannot efficiently dispose of these kinds of disputes if the Department cannot offer a realistic compromise prior to litigation based on an evaluation of its probability of success.[74]

As a matter of practice, cases involving factual disputes may sometimes be resolved in a manner that approaches a compromise based on hazards of litigation. In these cases, the Department will offer a resolution of factual issues that reflects the merits of each side's case. Legal issues, however, are never the subject of compromise.

At present, over 70 percent of disputes are resolved at the conference stage. In addition to those cases which involve factual disputes that are truly compromised, cases may also be resolved because of new factual material presented by the taxpayer, better communication of the law by the Department to the taxpayer, the disposal of cases in which auditors failed to follow established Departmental policy, or the fear by the taxpayer that an appeal to the Commission would not receive fair consideration because of perceived bias. In cases where only legal issues are in controversy, cases may be assigned for a hearing without a conference. The settlement process could be substantially improved if the Department were allowed to consider the hazards of litigation in negotiating settlements where legal issues in addition to factual issues are disputed.

Some taxpayers assert that another obstacle to settlement stems from what they perceive to be the lack of an independent Tax Commission. In the absence of such an independent forum, these taxpayers argue that the Tax Department may not be compelled to examine each dispute with the necessary degree of objectivity and impartiality to reach fair settlements. If, however, the Department were faced with the prospect of a full hearing before an independent agency, it would be more likely to take a detached look at a case, weigh its chances for success in that forum, and, if given the authority, offer the taxpayer a settlement based on a calculation of its relative chance to prevail.[75]

If the conference mechanism fails to resolve a matter, it is unlikely that it will be resolved before or during the hearing. Approximately 25 percent of cases that are not resolved in conference are disposed of prior to hearing. This figure, however, includes cancellations and withdrawals, as well as settlements.[76] This experience differs greatly from that of certain other jurisdictions, where a majority of cases which have not been settled at the conference level (or its equivalent) are settled before or during the hearing stage (or its equivalent).[77] The inability of the Department to be able to offer a settlement based on the hazards of litigation no doubt contributes to this difference.

Additionally, the use of hearing officers in New York decreases the opportunity for reaching a settlement. Once a case is scheduled for hearing in New York, a strong likelihood exists that it will, in fact, be tried. The system does not really afford another fertile opportunity for settlement at the hearing stage.

Hearing officers do not schedule pretrial or settlement conferences and do not view the attempted resolution of cases prior to hearing as their major role. Evidence from other jurisdictions, however, indicates that additional settlement efforts at the hearing stage produce significant results.[78] Finally, hearing officers, even if interested in achieving prehearing settlements, may lack the stature or leverage necessary to persuade the parties to consider compromise.

D. The Use of Hearing Officers

In the New Jersey Tax Court, the U.S. Tax Court, the Wisconsin Tax Appeals Commission, as well as in some other states, individual judges or board members actually hear cases. In New York, hearing officers take testimony and write recommended findings of fact and conclusions of law; these are forwarded to the Commission which alone has the statutory power to render a decision.

In the abstract, it would seem clearly preferable to have the final decisionmaker actually hear as well as rule on cases. First, from both a theoretical and practical viewpoint, it is better for a decisionmaker to see and hear live testimony rather than merely review a record (or a tape recording) and the recommendations of a third party who did see and hear the testimony. Second, "taxpayer confidence" is likely to be increased because litigants would confront the decisionmaker directly. Taxpayers are thus more likely to come away with the sense that they have had their "day in court." Finally, because judges or commissioners are likely to be highly-skilled, experienced, and well-paid tax experts, the quality of

decisionmaking should be better than in the case of even well-trained hearing officers.

The hearing officer format, on the other hand, does facilitate uniformity in the decisionmaking process. Because the New York State Tax Commission as a whole ultimately rules on every case, it speaks with a single voice. In other jurisdictions, individual judges may rule differently under similar fact patterns, until some higher court ultimately resolves an issue one way or another. As was discussed in Chapter II, supra, most jurisdictions have mechanisms to minimize the possible lack of uniformity.

The use of hearing officers has been defended on efficiency grounds. Their use does reduce the number of highly paid personnel in the system, but other aspects of the system are costly. In New York, a case is heard by a hearing officer, who must write up recommended findings of fact and conclusions of law in every case. This recommended decision is then reviewed by the formal (or small claims) supervising hearing officer, the post-hearing review unit[79] and, in some cases, by the Director of the Tax Appeals Bureau. The Director may write a dissent to accompany the hearing officer's recommendation to the Commission. These are then reviewed by the Secretary to the Commission and next by the Commissioners themselves, who may also need to consult the record. The hearing officer's opinion may then be sent back for redrafting.[80]

Under other formats, a single judge can hear a case and rule on it. A formal written opinion may or may not be required in all instances. The presiding judge can require the Court (Board) to sit en banc for cases of unusual importance. Additionally, he can

establish a system to review all opinions or just those which deal with novel or complex cases. Both New Jersey and the U.S. Tax Court use tools of this kind to achieve uniformity and to categorize and sort cases according to their significance. In New Jersey, for example, decisions in only a small percentage of cases are accompanied by full-blown written opinions; in other cases, letter opinions are deemed sufficient.

Questions have been raised regarding the ability of a reasonable number of judges (board members) to handle the Commission's current caseload efficiently if they were to hear individually each case. Currently, the Tax Appeals Bureau has five attorneys conducting formal hearings, three small claims hearing officers, and seven individuals in its post-hearing review unit. There is no apparent reason why an independent board consisting of five members that heard cases individually and which used other staff to hear and decide small claims cases could not handle the Commission's current case load.

Further, as discussed above, the use of judges rather than hearing officers may also significantly improve the probabilities for settlement at the hearing stage. In New Jersey, over 80 percent of state tax cases are settled after filing with the Court but prior to hearing. The New Jersey Tax Court judges take an active role in the settlement of cases and their stature and leverage no doubt facilitate the negotiations. Overall, a system that relied on individual judges to hear cases could well enhance both the efficiency and fairness of the tax appeals process.

E. Unclear Standards of Judicial Review

The actual standard of review of decisions of the Tax Commission employed by the Appellate Division is a matter of some confusion. Article 78 authorizes reversal of an agency decision if "affected by an error of law."[81] Thus, apart from the ordinary and reasonable deference a court should give to the interpretation of a statute or rule by the administering agency, all questions of law are open to review with no presumption in favor of the Commission's decision.[82]

With regard to questions of fact, New York courts seem to have sometimes abstained from reversing Commission conclusions unless "arbitrary and capricious."[83] This standard of review, however, seems to be at odds with the statutory scheme. The requirement that an agency decision be arbitrary and capricious before it may be judicially reversed is based on subsection (3) of the New York Civil Practice Law Section 7803. Conventional usage in administrative law employs the term "arbitrary and capricious" as a standard for the propriety of a decision committed to an agency's discretion.[84] In those cases, an arbitrary and capricious exercise of discretion is itself illegal and cause for reversal. But the kinds of determinations in most of the cases at issue here, those applying the law to facts developed on an administrative record, are typically judged under the substantial evidence test embodied in Subsection (4) of Section 7803. This subsection permits reversal unless "a determination made as a result of a hearing . . . is, on the entire record, supported by substantial evidence." Because all of the determinations of the Commission are decisions on a record,

they are evidently covered by that subsection. Therefore, a decision that is not "arbitrary and capricious," but one unsupported by substantial evidence on the whole record, is still subject to reversal. Nevertheless, judicial decisions reviewing determinations of the State Tax Commission have failed to maintain this distinction. Instead, the courts have developed a vague, but deferential standard of review.[85]

The "substantial evidence" test, when properly followed, is the correct standard of review, particularly if the decision being reviewed is that of an independent tax tribunal. A court should accord considerable deference to the factual findings of such a body. In addition to the advantages an administrative tribunal has in its first-hand observation of the presentation of evidence, the decisionmakers have the added benefit of their experience and expertise in considering questions of taxation. Moreover, the courts have no special competency in the area of taxation that justifies a more liberal standard of review than that ordinarily used to review administrative agencies. Therefore, while some statutory clarification might be in order to assure its faithful application, the "substantial evidence test" seems appropriate.

F. Absence of Accessible Precedents

A final aspect of the current system is its failure to provide taxpayers with a coherent and conveniently accessible body of decisions and opinions. A body of well-indexed cases helps assure predictability, uniformity, and fairness in the decisionmaking process and helps assure taxpayers of a principled and unbiased hearing.

It may also improve the efficiency of the system over time by serving to reduce the number of cases filed.

All Commission decisions are now published and distributed by the Department's Taxpayer Services Division to persons requesting them. The State has been unable, however, to obtain full publication of opinions by private publishing companies. If these companies are unwilling to publish Commission opinions in full, the State might consider publishing a volume of its own decisions that it would sell at cost.

IV. OPTIONS FOR CHANGE

Chapter III identified and analyzed a number of weaknesses in the existing system for resolving tax disputes. This Chapter sets forth seven policy options that represent possible responses to these problems. These options are not intended to be exhaustive. Clearly, the existing structure could be modified in countless ways. The options presented, however, generally focus on basic thematic issues and serve to identify various stages along a continuum of possible changes. The options are presented in the order of the magnitude of the structural changes that would be required in existing procedures, and range from preserving the status quo to the creation of a judicial tax court.

A. Option One - Preserve the Status Quo

The first option would be to preserve the status quo. As stated, there is little, if any, evidence of actual rather than perceived bias in the current system. While there have been isolated incidents cited by the tax bar and others that purport to show actual bias in the decisionmaking process,[86] it is clear that no one has been willing or able to identify any pattern of ongoing or systematic bias. Moreover, over recent years, the efficiency of the system has improved.

This option, however, would be unresponsive to taxpayers' fears of bias attributable to the absence of an independent forum. In effect, Option One would state that the present system ought to remain unchanged because there is no hard evidence that it produces unfair results despite its structure. In addition, Option

One would fail to address the increased efficiency that would likely result from granting the Department the clear authority to settle cases based on hazards of litigation.

B. Option Two - Statutory and Cosmetic Changes

Even if the State decides not to alter the structure of the appeals process, certain statutory and operating changes could be made to eliminate some characteristics of the current system which needlessly underscore taxpayers' perceptions of bias.

This process should begin with changes in the tax law to allocate appropriately responsibilities between the Commission and the Department. The current statutory framework makes the Commission both the tax assessor and collector--roles it no longer plays in any meaningful way. The Commission should give up all vestiges of these responsibilities and the statute should be amended accordingly. The Commission would issue regulations and decide contested tax matters--and nothing else. The Commission's name would be removed from advisory opinions and warrants. Another improvement in this same direction would be to hold hearings at offices not associated with the Department of Taxation and Finance. In addition, the Tax Commission, rather than the Department's Division of Taxpayer Services, should disseminate and publish all decisions. While these changes would not address more fundamental problems, they would mitigate at least some of the confusion over the roles of the Tax Commission which reinforces taxpayers' fears of unfairness in the appeals process.

C. Option Three - Settlement Authority Based on Hazards of Litigation

Even if all other features of the existing system remain unchanged, the State should consider granting the Department the clear authority to settle cases based on the hazards of litigation. Procedural safeguards similar to those used by the IRS would be required to prevent against abuse of discretion. This change is not mutually exclusive with the other options outlined in this Chapter and should therefore be considered regardless of whatever other changes might be made in the existing structure or procedures.

* * * *

The following proposals discuss changes that would eliminate the combination of functions now imposed on the Commissioner of Taxation and Finance, who is also the President of the Tax Commission. A wide range of proposals are available to achieve this result. The simplest of these alternatives--Option Four--would be to remove the Commissioner of Taxation from the Commission. The most sweeping change--Option Seven--would be to create a full-fledged judicial tax court. Options Five and Six present alternatives that would fall within these two cases.

D. Option Four - Remove the Commissioner of Taxation and Finance from the Tax Commission

The least disruptive change to the existing system would be to remove the Commissioner of Taxation and Finance from the Tax Commission and to replace him with a third person.

This proposal has a number of advantages. First, this change would remove some of the actual and perceived risks of bias in the adjudicatory process.

Second, the changes required would be relatively few and easy to implement and the increased cost would be small--the additional salary for a new Commissioner.

Third, it may well be that very different sets of skills are required to run a large revenue collection agency from those needed to rule on contested tax matters. There is no particular reason why an excellent Commissioner of Taxation and Finance should necessarily make an excellent "judge," or vice versa, and it may be unfair to impose both sets of responsibilities on the same person.

Fourth, this proposal would remove a significant and time-consuming burden from the Commissioner of Taxation, who must review transcripts and decide contested cases in addition to his other considerable administrative duties. Administering the Department of Taxation and Finance is obviously a full-time commitment and so is the adjudication of tax disputes. In an earlier age of less litigation and simpler tax laws, the Commissioner of Taxation might have been expected both to administer the Department and to rule on cases; today, however, these duties impose a heavy burden on the same person, no matter how hardworking or talented the Commissioner may be. Perhaps because of this concern the Tax Commission uses a procedure under which the other two members review all cases before they are sent to the Commissioner of Taxation and Finance. If these two agree, and they take pains to do so,[87] the Commissioner of Taxation does not have to spend time in a thorough review of the case; the temptation is to accede to the decision reached by the other Commissioners. The result could be that a taxpayer's case will receive full consideration by only two Commissioners. To the

extent that one of these persons might be a tax expert while the other is not, a taxpayer's case may receive a complete and thorough review by only one Commissioner.

Under Option Four, the Commission would maintain its rulemaking as well as its adjudicatory function. While this would perpetuate the present mix of judicial and legislative functions, there is an argument that the benefits of this overlap outweigh the drawbacks. The Commissioners, who would not be responsible for the collection of revenue, would review potential regulations from a "neutral" or even "pro-taxpayer" perspective. The Commission could thus insure additional outside input into the regulatory process and perhaps temper the occasional "overzealousness" of the Department.[88]

The greatest drawback of Option Four is that it would fail to achieve a complete separation of the Commission from the rest of the Department and would continue the mix of rulemaking and adjudicatory functions. The Commissioners, for example, might be asked to judge the validity of regulations that they had promulgated. Additionally, the Tax Commission and the Department of Taxation and Finance would remain two components of a single organization. Many of the subtle opportunities for the development of bias and an institutional mindset would continue. A taxpayer pursuing a claim through the administrative process might still perceive that the same entity is both a party in the dispute as well as the judge that will hear and rule upon the contested matter.

E. Option Five - Remove the Regulatory Functions from the Commission

A variation of Option Four would be both to replace the Commissioner of Taxation and Finance with a third-party and to remove the Commission from the regulatory process. This option would, by taking away the rulemaking role from the Commission, respond better than Option Four to concerns regarding violations of the doctrine of separation of powers. Under this proposal, tax regulations would be the sole responsibility of the Commissioner of Taxation, with a continuation of the present opportunities for public input into the process.

One variation of Option Five might require the State Tax Commission to have its own budget separate from that of the Department of Taxation and Finance. An independent budget would remove another possible source of control or leverage over the Commission and would achieve a further separation of the adjudicatory body from the rest of the Department. A more complete separation would be accomplished if the Commission were to be housed in a separate physical structure from the Department, a change that would entail additional expense.

These variations of Option Five constitute almost a complete separation of the Commission from the Department. Nonetheless, a weakness in Option Five is that taxpayers might still perceive the revamped Commission as a continuation of the past without fully appreciating the extent of change. Once at this stage along the continuum of possible changes, it may be sensible to take the next step and restructure the entire adjudicatory process rather than to make patchwork changes. Our tax system asks a good deal of its

taxpayers. For one, it relies heavily upon voluntary compliance. Such compliance requires a certain shared sense that the system "works"--which among other things means that it operates--and is perceived to operate--fairly. The tax appeals system can further this sense by providing a forum for disputes that is perceived to be unquestionably independent and impartial. Additionally, a restructuring of the process--Options Six and Seven--could involve other significant improvements, such as the replacement of hearing officers by "judges."

F. Option Six - An Independent Tribunal

At the core of this option is the creation of an independent tribunal located not in the judiciary, but rather in the legislative or executive branch. This independent forum would thus resemble the U.S. Tax Court or the Wisconsin Tax Appeals Commission in character. See Chapter II(B), supra. As a natural consequence of this proposal, the State Tax Commission would be abolished. The Department of Taxation and Finance would continue to be headed by a Commissioner, appointed by the Governor and serving at his pleasure. The Department, through the Commissioner, would continue to be responsible for the promulgation of regulations.

Once this basic structural framework has been postulated, a host of other issues remain to be decided. As discussed in Chapter II(B), supra, independent review boards can differ from one another in a variety of ways, including the formality of the proceedings, the qualifications of those who hear cases, the standards for appellate review, and so forth.

Some of these issues are discussed below. The creation of an independent tribunal does not necessarily require some, or all, of the additional changes that are discussed, but does provide an opportunity to address or re-think these issues.

1. Tribunal Membership, Appointment, Tenure, Etc.

The independent tribunal might consist of from five to seven individuals, appointed by the Governor with the advice and consent of the Senate. The exact number would obviously depend on the tribunal's expected workload. Each member of the tribunal should be required to be an attorney who has practiced law for at least ten years, and who possesses special expertise in tax matters. Organizations representing lawyers and accountants might be required to certify a candidate's expertise or at the least, to have the opportunity to provide some comment and evaluation.

Appointments would be for a term of years, say six years. In order to increase the prestige and status of the tribunal, the salaries and other benefits of its members should be equivalent to those received by judges of the New York State Supreme Court.

2. Tribunal Procedures

The tribunal would have a presiding member, designated by the Governor, who would bear primary responsibility for its administration. The tribunal would hear all case de novo, with full opportunity for the examination and cross-examination of witnesses. Ordinarily, the members of the tribunal would hear cases individually and would not rely on hearing officers. The presiding judge, however, could schedule cases of particular importance to be heard en

banc. Additionally, the presiding judge could require a case that was heard by one of the judges to be reviewed on the record by the tribunal as a whole. Tribunal members should conduct prehearing and settlement conferences to maximize the resolution of cases prior to hearing.

Tribunal members should not be required to render formal written opinions in all cases. Instead, formal opinions might be issued only in cases of some importance. In other cases, letter opinions would suffice. The presiding tribunal member could have the power to review formal opinions and the members might meet relatively often to discuss issues of mutual concern. Tribunal members would maintain both permanent locations and ride circuit as well, using available court room space to house them. Proceedings would be recorded on tape; stenographers would not be used. Tribunal members could then travel with only a single clerk to hear cases.

The presiding member would have the authority to appoint members of the bar with experience in tax matters to hear and rule on small claims cases. The taxpayer would have the right to choose the small claims forum if the dispute were within established jurisdictional limits. The rules and proceedings for small claims should be simple and designed to expedite cases; otherwise, a taxpayer would have no incentive to choose this forum. The choice of the small claims forum would constitute a waiver of the right to judicial appeal, but there could be an appeal to the tribunal in egregious cases.

The rules of practice and evidence would be adopted by the tribunal itself. The rules should provide the safeguards embodied in the State's Administrative Procedures Act, but they need not be as complex as the CPLR. The rules should be designed to encourage the simple, inexpensive, and rapid disposition of cases, while preserving fundamental requirements of fairness. Accountants as well as lawyers should be allowed to represent clients before the tribunal.

3. The Continuation of an Administrative Forum Within the Tax Department

It is essential that a forum for settlement continues to exist within the Department of Taxation and Finance itself, and the current conference format is well-designed to accomplish this end. The conference proceeding is a valuable tool of efficient management for the Department and a simple and inexpensive forum for taxpayers to air grievances, resolve certain factual issues, and reach settlements. Aggrieved taxpayers would first pursue their claims at conference. If a resolution could not be reached, the taxpayer would then file a petition with the independent tribunal.

One argument raised against an independent tribunal is that it would be less efficient than the current system. Because the Department would no longer be responsible for managing the hearing process, it would have no stake, as it does now, in seeing that a large percentage of cases were resolved in conference. The Department, with no interest in settlement, might force too many taxpayers to pursue their claims to the independent tribunal, overloading the system.

This argument, however, improperly characterizes the Department's interest in resolving disputes prior to hearing. Faced with the prospect of defending its position before an independent tribunal, with the manpower required, the Department should in fact have a real interest in disposing of cases at the conference level. The experiences of the federal government and other jurisdictions with independent tribunals indicate that revenue departments do in fact resolve a majority of cases through their internal, informal conference mechanisms. Nonetheless, if the Department does not, for whatever reason, facilitate the resolution of cases at the conference level, the independent tribunal will face an increased workload that could hamper its efficiency, a situation that might necessitate other changes to encourage more settlements. For example, the Department could be made liable for a certain percentage of a successful taxpayer's costs of litigation.

4. Right to Appeal

As noted earlier, the Department has no right to appeal an adverse decision, which makes some sense under the current system where the judge (the Commission) and the prosecutor (the Department) are components of a single agency. If a new independent tribunal were created, no compelling reason would exist to deny the Department the right to appeal decisions of the tribunal to the courts.

The inability to appeal an adverse decision is cited by the Department as a benefit of the current system which would be lost to taxpayers. There is some feeling among tax lawyers and accountants, however, that the Commission rules against taxpayers in

close cases for the very reason that the Department has no right of appeal. The relatively narrow scope of judicial review of Commission decisions might also encourage this practice because a case is unlikely to be overturned on appeal. Whatever the reality, characterizing the argument in this manner obfuscates a more fundamental point. It is preferable to afford both sides the right to appeal from a system that is structurally designed to increase the likelihood of fair and unbiased results, whether actual or perceived, rather than to speculate at who gains from the ramifications of the present system.

Under Option Six, the standard of appellate review, which perhaps needs statutory clarification, would be the current "substantial evidence" rule. For a full discussion of this issue, see Chapter III(E), supra.

5. Publication of Tax Appeals Decisions

The decision and opinions of the tax tribunal should be regularly published in full, in an easily accessible form, and suitably indexed. A tax tribunal that issued formal opinions in only selected, noteworthy cases might influence a private publisher to publish a volume of New York tax cases. If not, the State should do so and sell the publication at cost.

* * * *

Option Six would completely satisfy the requirements for a fully independent and impartial decisionmaking body. Moreover, the use of individual judges to hear cases would be an improvement over the current structure. Some of the additional features outlined could also enhance the overall quality and fairness of the system.

Whether Option Six would improve the efficiency of the current system is difficult to assess. The grant to the Department of full settlement authority along with the active participation of judges in the settlement process and the full publication of a coherent and accessible body of precedent should promote the goal of efficiency. In addition, as noted above, the Comptroller has recently criticized the overall efficiency of the current system. It seems clear that the existing system cannot be defended on efficiency grounds. Nonetheless, considerations of efficiency should not be allowed to divert attention from the more fundamental issue of fairness.

G. Option Seven - A Judicial Tax Court

The most far-reaching reform would be the establishment of a New York Tax Court. Such a court would be entirely separate from the Tax Department and would be located in the judicial branch of the government. This option would achieve in the most unambiguous and resolute fashion an independent and impartial forum for hearing tax disputes. A judicial tax court would avoid the charge that might be made against an independent tax tribunal--because such a tribunal would be located within either the legislative or executive branch of the government, it might still be viewed as sensitive to revenue raising considerations.

A tax court would be likely to bring other advantages, although many of these could be achieved under Option Six as well. The position of a judge, with the prestige that it implies, would be likely to attract highly talented and experienced individuals, promoting the quality of the entire process. A tax court would

likely operate so that judges would actually hear testimony rather than relying on hearing officers. The potential benefits of such a system over current New York practice have been addressed in Chapter III(D), supra. Additionally, a tax court would be more likely to develop a body of published precedents, which encourages fairness and efficiency. Finally, because the court would be within the judicial system, its operations would be subject to the scrutiny of the State Office of Court Administration. An office would therefore exist which was specifically charged with the task of reviewing the efficiency and effectiveness of the court's operations.

A tax court proposal poses some significant problems, however. Foremost is that its creation would entail a revision of the Judiciary Article of the State Constitution.[89] The adoption of a constitutional amendment and implementing legislation would be a cumbersome and lengthy process.

Moreover, a proposal for a full judicial court would also raise concerns regarding the wisdom of adding one more specialized court to the New York court system. Advocates of broad court reform generally view these specialized courts with disfavor. Further, there is opposition in some quarters to the use of full judicial courts to resolve disputes where less formal, less expensive, and less time-consuming forums are suitable alternatives.

These concerns are not easy to assess. Almost certainly, however, the pressure to adopt the rather complex CPLR or rules modeled on the CPLR would be substantial if a new tribunal were proposed in the form of a judicial court. For similar reasons, client representation by accountants, now common, might well be prohibited

in a tax court. For example, the New Jersey Tax Court allows accountants to represent clients only in its small claims division, where relatively small sums are involved.[90]

Because of these drawbacks the tax court alternative probably has less to recommend it than do other approaches. The experience of the U.S. Tax Court would seem to indicate that a court which is not part of the judiciary can nonetheless achieve both the perception and reality of a fully independent forum. In light of this experience, the disadvantages in pursuing a judicial court arguably outweigh the possible benefits that such a court might offer over and above a tribunal of the kind outlined in Option 6. Compared with a judicial tax court, the changes discussed under Option Six would correct the fundamental weaknesses in the current system, provide for decisionmakers who actually hear live testimony, and allow for a rapid, inexpensive hearing process, while avoiding the disruption and difficult ancilliary issues[91] that would be likely to arise in the creation of a judicial tax court.

H. Costs of Implementation

The additional costs, if any, imposed by each of the various options above are difficult to quantify accurately. An accurate estimate cannot be made until the details of a particular option are formulated with specificity, especially in the case of Options 6 and 7. Some generalizations are possible, however.

Options 2 and 3 would involve trivial costs to implement. Option 4 would involve the cost of an additional commissioner's salary, currently $51,200. Option 5 would probably not impose any costs over those imposed by Option 4.

Options 6 and 7 would also result in additional costs. Compared with the existing structure, certain economies of scale will be unavailable under Options 6 and 7. For example, expenses for services such as mailroom, personnel processing, secretarial support, library and housing--now incurred by the Department--would be borne by a new independent tribunal. While the Department would save some of these costs, it savings would likely be less than the costs incurred by the new tribunal.

It should be noted, however, that the State Tax Commission's appropriation for the 1984-1985 fiscal year is $2.56 million. While not all of these funds can be attributed solely to the Commission's adjudication function, certainly some of the existing appropriation could be re-allocated to an independent tribunal and would not represent "new money." Moreover, a new, independent body would almost certainly charge a filing fee. The revenues from these fees would help offset the tribunal's costs. Furthermore, if a new independent tribunal settled cases faster, and perhaps was more efficient generally, State revenues would be enhanced. Finally, increased revenue might result if the Department were given the right to appeal. These potential sources of revenue, however, would be offset to some extent if taxpayers were encouraged to litigate issues that they now concede. Additional costs might also result if the Department, because it would no longer be responsible for managing the hearing process, had less incentive to settle cases and thereby forced more taxpayers to pursue their claims than at present.

V. SUMMARY AND CONCLUSION

The current system of tax appeals fails to satisfy certain fundamental principles concerning the independence of decision-makers. This failure to comply fully with the precept of "separation of powers" fuels taxpayer perceptions of possible unfairness and creates inherent risks of actual bias in the adjudication of tax disputes.

This Report has not attempted to document any specific instances of actual bias. The validity of the argument regarding the lack of independence of the Tax Commission and the resulting risk of unfairness ought not to turn on the presence of such proof. The best method to assure fair determinations is to establish procedures that are most likely to produce the desired results. Such procedures not only improve perceptions of fairness; they are the best means of achieving actual fairness.

Other administrative agencies are marked by the same institutional arrangement that has been criticized in the case of tax appeals. Nonetheless, the arguments offered in favor of the Department's involvement in the adjudicatory process are outweighed by other principles and policy concerns.

The efficiency of competing systems is difficult to assess. The current system can be criticized on efficiency grounds; other systems, however, will not necessarily prove more efficient. The central issue, however, is one of fairness and taxpayers' perceptions of fairness; attention should not be inappropriately diverted from that issue.

A range of possible options exists to address the problems that characterize the current system. These options vary from relatively minor and cosmetic changes to more fundamental reforms of the procedural framework to meet fully the concern for a completely independent forum for the adjudication of tax disputes.

NOTES

1. The Tax Section of the New York State Bar has been the most vocal critic of the New York tax appeals system; this criticism dates back many years. See e.g., New York State Bar Association, Tax Section, Special Report on a New York Tax Court Proposal (March 11, 1975), and Statement of Martin D. Ginsburg, Chairman of the Tax Section, New York State Bar Association, before the Select Tax Force on Court Reorganization on Senate Bill 6760 and Assembly Bill 7802, November 20, 1975. More recently, see Comeau & Rosen, The Need for an Independent Tax Tribunal, 2 J. of State Tax. 259 (1983).

2. The Integration and Unification of the New York State Trial Courts: A Report by the Governor's Task Force on Court Reform 2 (1975). The Committee was chaired by Cyrus Vance. Among its distinguished members was the then Secretary of State, Mario M. Cuomo.

   In 1975, changes were made in the procedures for adjudicating tax disputes (see footnote 66 infra) but as discussed in Chapter III(A), infra, taxpayers still perceive the resulting system as unfair. Taxpayer perceptions of unfairness were one of the points noted in the Task Force's Report. See id. at 10.

3. Final Report of the Governor's Temporary Commission to Review the Sales and Use Tax Laws, p. 77 (1979).

4. Office of the State Comptroller, Report 84-S-104, Department of Taxation and Finance, Tax Appeals Bureau.

5. Among the various powers and duties of the Commission set forth in §171 of the Tax Law are the following:

   First. Make such reasonable rules and regulations, not inconsistent with law, as may be necessary for the exercise of its powers and the performance of its duties under this chapter.

   Second. Assess, determine, revise, readjust and impose the corporation taxes under articles nine and nine-a of this chapter, and on and after July first, nineteen hundred and twenty-one, have the power and perform the duties of the state comptroller in the collection of such taxes and the crediting of such taxes erroneously paid, as jurisdiction thereof is vested in such commission by section one hundred and seventy-six of this chapter.

   Third. On and after July first, nineteen hundred and twenty-one, have the powers and perform the duties of the state comptroller in relation to the assessment, determination and collection of the tax on transfers of property, as jurisdiction thereof is vested in such commission by section one hundred and seventy-six of this chapter.

   Fourth. On and after July first, nineteen hundred and twenty-one, have the powers and perform the duties of the state comptroller in the collection of the tax on transfers of stock under article twelve of this chapter, as jurisdiction thereof is vested in such commission by section one hundred and seventy-six of this chapter.

   Fifth. On and after July first, nineteen hundred and twenty-one, have the power and perform the duties of the state comptroller in the assessment, determination, review, readjustment and collection of taxes upon and with respect to personal

income, as jurisdiction thereof is vested in such commission by section one hundred and seventy-six of this chapter.

Sixth. Administer, supervise and enforce the tax on mortgages as provided in article eleven of this chapter.

Eleventh. Compile and publish statistics relating to state and local taxation.

Twelfth. Make investigations of the general system of state taxation from time to time.

Thirteenth. Inquire into the provisions of the laws of other states and jurisdictions; to confer with tax commissioners of other states regarding the most effectual and equitable methods of taxation, and particularly regarding the best methods of avoiding conflicts and duplication of taxation, and to recommend to the legislature such measures as will bring about uniformity of methods, harmony and cooperation between the different states and jurisdictions in matters of taxation.

Fifteenth. Have authority to compromise any taxes or warrant or judgment for taxes imposed by this chapter, and the penalties and interest in connection therewith, if the tax debtor has been discharged in bankruptcy, or is shown by proofs submitted to be insolvent, but the amount payable in compromise shall in no event be less than the amount, if any, recoverable through legal proceedings, and provided that here the amount owing for taxes, penalties and interest or the warrant or judgment is more than twenty-five thousand dollars, such compromise shall be effective only when approved by a justice of the supreme court.

Sixteenth. Have authority to compromise any taxes or any warrant or judgment for taxes imposed by this chapter and the penalites and interest in connection therewith of a tax debtor which is a domestic railroad corporation, or its trustee or trustees in bankruptcy, (1) in connection with its qualification as a railroad redevelopment corporation or the acquisition of its facilities by a railroad redevelopment corporation or (2) if said domestic railroad corporation is principally engaged in the transportation of passengers and at the time of said compromise it is the debtor in a reorganization proceeding pursuant to the United States bankruptcy act and said compromise is approved by the bankruptcy court.

Seventeenth. Have authority to release any real property or chattels real from the lien of any warrant for unpaid taxes upon such conditions as it may exact, if it finds that the interests of the state will not thereby be jeopardized. Such release may be recorded in the office of any recording officer in which such warrant has been filed.

Eighteenth. Have authority to enter into a written agreement with any person, relating to the liability of such person (or of the person for whom he acts) in respect of any tax or fee imposed by the tax law or by a law enacted pursuant to the authority of the tax law or article two-e of the general city law, which agreement shall be final and conclusive, and except upon a showing of fraud, malfeasance, or misrepresentation of a material fact: (a) the case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of this state, and (b) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, cancellation, abatement, refund or credit made in accordance therewith, shall not be annulled, modified, set aside or disregarded. As used in this paragraph the term "person" includes an individual, trust, estate, partnership and corporation.