

**DEPARTMENT OF TAXATION
2003 Fiscal Impact Statement**

1. **Patron** Louderback
3. **Committee** Passed House and Senate
4. **Title** State Taxes; Circuit Court Appeals

2. **Bill Number** HB 2538
House of Origin:
 Introduced
 Substitute
 Engrossed
- Second House:**
 In Committee
 Substitute
 Enrolled

5. Summary/Purpose:

This bill would eliminate the current requirement that a taxpayer must pay an assessment of state taxes in order to appeal the assessment to the circuit court. However, the Tax Commissioner would be authorized to petition the court to require the taxpayer to pay the assessment. If the Department shows to the satisfaction of the court that it is likely to prevail on the merits of the case, the application is interposed for an improper purpose or is otherwise frivolous, the taxpayer would be required to pay the assessment, post a bond or offer a letter of credit before proceeding with the appeal. The bill also clarifies that the Tax Commissioner may collect the tax if collection is jeopardized by delay.

Under current law, a taxpayer cannot appeal an assessment to the circuit court unless the assessment is paid or a bond is posted within 90 days of the assessment.

The effective date of this bill is not specified.

6. **Fiscal Impact Estimates are:** Not available. (See Line 8.)
7. **Budget amendment necessary:** None.
8. **Fiscal implications:**

As this bill would allow additional appeals of income tax assessments without the requirement that the taxes be paid before the appeal, this bill would have a negative effect on General Fund revenues to the extent that these appeals are successful or delay the collection of proper assessments. Additional litigation would also result in increased litigation expenses to the Commonwealth.

9. Specific agency or political subdivisions affected:

Department of Taxation
Office of the Attorney General

10. Technical amendment necessary: None.

11. Other comments:

The Commonwealth's Current Tax Appeals Process

Under current law, a taxpayer assessed with a tax administered by TAX, has two options for appealing the assessment. By statute, the taxpayer is allowed to appeal an assessment to the Tax Commissioner within 90 days from the date of such assessment. The taxpayer is required to submit a letter to the Tax Commissioner setting forth the grounds upon which the assessment is being appealed and is not required to pay the assessment before the appeal.

As a practical matter, TAX does not require an appeal to be submitted within 90 days, instead allowing an appeal to be filed at any point within the three-year statute of limitations for pursuing a judicial remedy. This has been a long-standing procedure to avoid forcing taxpayers to utilize the more expensive judicial process and to reduce the amount of litigation in Virginia.

The Virginia administrative appeals process is nonevidentiary. As a result, taxpayers can and do represent themselves *pro se* before the Tax Commissioner in appealing an assessment. In addition, TAX streamlined its audit resolution process a number of years ago to give taxpayers quicker access to an appeal to the Commissioner. Virginia no longer subjects audits to an "audit review" function such as is found in many revenue agencies, but instead treats contested audits as appeals. This allows taxpayers to receive a single response to an assessment issue reviewed at the highest level of TAX.

The second option available to taxpayers is to apply to the circuit court for correction of erroneous or improper assessments of tax. This appeal must be filed within three years from the date of the assessment. In addition, the assessment must have been paid or a bond must have been posted within 90 days of the assessment. Taxpayers may also use this option for an appeal of a determination of the Tax Commissioner. Such an appeal must be filed within one year from the date of the determination. For any appeal to the circuit court, the department is named as the defendant and the burden of showing that the assessment is erroneous is on the taxpayer.

Using this current appeals process, the Commonwealth has seen a very low incidence of tax litigation. This is primarily attributable to the department's ability to effectively resolve the majority of issues on an administrative basis. Current law gives the Tax Commissioner broad authority on many tax issues which allows for necessary adjustments and compromises on complicated issues.

Proposal

This bill would eliminate the current requirement that a taxpayer must pay an assessment of state taxes in order to appeal the assessment to the circuit court. However, the Tax Commissioner would be authorized to petition the court to require the taxpayer to pay the

assessment before proceeding with the appeal. The court would grant the Department's motion if the Department shows to the satisfaction of the court any of the following:

- The Department is likely to prevail on the merits of the case;
- The application is not well grounded in fact;
- The application is not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law;
- The application is interposed for an improper purpose, such as to harass, to cause unnecessary delay in the collection of the revenue, or to create needless cost to the Commonwealth from the litigation; or
- The application is otherwise frivolous.

In lieu of paying the tax, the taxpayer would be able to post a bond or offer an irrevocable letter of credit within 60 days of the court's ruling. The letter of credit would need to be in the amount of the assessment increased by twice the interest rate for tax underpayments in effect at the time the application is filed.

Other Considerations

In considering the elimination of the payment requirement, the following issues are relevant:

- The requirement to prepay has been in the Code of Virginia since 1980. [*Report of Practices and Procedures in the Collection and Administration of State Taxes Study Committee*, House Document No. 30, 1980.] Previously, it was the long-standing practice of the Tax Department to insist upon collecting the tax prior to litigation and the circuit courts acceded to the Department's requirement for prepayment of the tax. *Id.*
- The 2001 Governor's Commission on Government Finance Reform for the 21st Century (Bliley Commission) did not recommend that the requirement to pay first before going to circuit court be changed (recommended an independent tribunal such as a Board of Tax Appeals or a Tax Court with no prepayment requirement, but did not address payment requirements at the circuit court level).
- Delay decreases the likelihood of collection; delay can be used to forestall collection action to prevent ultimate payment.
- Interest earned by the taxpayer on the refund if the tax assessment is determined to be erroneous is generous in today's market.
- When going to court, the majority rule among the states is "pay first:"¹

¹ Federation of Tax Administrators study, *State Tax Appeal Systems*, Appendix Q (August 1994).

- 28 jurisdictions, 27 States and D.C., require payment first before going to court;
- 23 States do not require payment before going to court;
- Among contiguous states, NC, SC, WV require payment, but MD, TN and KY do not.

cc : Secretary of Finance

Date: 02/21/03 JEM

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