

## Giving Washington Taxpayers Their Day in Tax Court

by Michelle DeLappe



Michelle DeLappe

Michelle DeLappe is an owner at the Seattle office of Garvey Schubert Barer. She can be reached at [mdelappe@gsblaw.com](mailto:mdelappe@gsblaw.com).

In the inaugural edition of Skookum Tax News, DeLappe discusses efforts to establish a judicial branch tax court in Washington. She addresses concerns that a judicial branch court could be too intimidating or complicated for taxpayers and notes the need for judicial independence where taxes are concerned.

Washington's 2016 legislative session just started on January 11. Although this is a 60-day short session, it will feature an important legislative effort that merits national attention: a proposal to create a fairer and more streamlined system for resolving tax disputes by forming a tax court in the judicial branch. Taxpayers — both those who already pay tax in Washington and those who may find themselves caught in the wide net cast by the state's aggressive nexus laws<sup>1</sup> — should take special note of this effort. Fair and efficient treatment in Washington's tax system depends on it.

### What Kind of Tax Appeals System?

A confidence-inspiring tax appeals system is one that provides review by a fair and expert forum before payment of taxes and access to a body of reliable decisions that contributes to certainty and predictability in tax payment and collection. The American Bar Association has developed a model act focused on four pillars of a fair system: (1) eliminating pay-to-play, (2) making the record before a tax tribunal and subject to a reasonable standard for review, (3) ensuring the independence of the tax tribunal from the tax agency, and (4) requiring expertise in tax law for tax tribunal judges.<sup>2</sup> Those four pillars set a minimum threshold for fairness. Achieving those goals

<sup>1</sup> See, e.g., *Avnet v. Dep't of Revenue*, 348 P.3d 1273 (Wash. Ct. App. 2015) (disallowing dissociation of specific transactions with no direct nexus with the state); Wash. Rev. Code section 82.04.067 (defining Washington's economic nexus standard).

<sup>2</sup> Craig B. Fields and Richard C. Call, "Independent Tax Tribunals: Model Act and Recent Developments With Tax Appeals Systems,"

(Footnote continued in next column.)

marks clear progress for states whose systems lack those attributes. But it takes more than those four pillars to achieve a fair and efficient tax appeals system.

In 2012 the Washington State Bar Association (WSBA) Section of Taxation's State and Local Tax Committee began to take a hard look at Washington's tax appeals system. Attorneys with many years of experience on both the government and taxpayer sides contributed valuable insights on what Washington's tax appeals system should strive for and where it falls short. Those insights boil down to four additional attributes for a fair and efficient tax appeals system: (1) streamlining the overall system to reduce the cost and delay in reaching a final resolution not subject to further appeal; (2) providing a publicly accessible body of expert decisions that have precedential weight; (3) for states like Washington that elect judges, ensuring fair voter representation in the election of the judges that create state tax jurisprudence; and (4) for states like Washington that span a large territory, allowing cases to be heard in various parts of the state for taxpayer convenience.

### Where Does Washington's Tax Appeals System Fall Short?

Washington taxpayers have no prepayment forum to dispute excise taxes aside from the Department of Revenue's own internal appeals process. For any appeal beyond that internal process, a taxpayer must pay the tax and navigate a Byzantine appeals process. Property tax appellants face yet another maze of options. In the end, the parties may have to endure four or five administrative and judicial levels before the dispute finally reaches a resolution not subject to further appeal.

And that doesn't count when the Board of Tax Appeals (BTA) and courts play ping-pong with each other over a taxpayer's case. Multiple remands and petitions for review can develop into a seemingly endless loop. One recent case traveled to superior court on judicial review three times. After reversing the BTA twice, each time with a remand ordering the BTA to try again, the court decided in 2015 that the BTA's third decision on a tax appeal dating from

Bloomberg BNA Tax Management Weekly State Tax Report, Perspective, May 23, 2014; Garland Allen and Fields, "The Model State Administrative Tax Tribunal Act: Fairness for All Taxpayers," 10 *State and Local Tax Lawyer* 83, 84-85 (2005).

2007 was correct. Not everyone has the patience or resources to seek justice in this kind of system. Even if the system technically provides due process, the lack of a prepayment forum in excise tax cases and the procedural inefficiencies can effectively deny taxpayers their day in court.

Numerous other deficiencies plague Washington's system. First, regarding who decides the cases, no case in the judicial branch is assured a judge with tax expertise, and no case in the administrative agencies is assured a decision-maker with legal or tax expertise. Over the course of that system's history, a small minority of BTA members have possessed both legal and tax expertise. But a system of gubernatorial appointments has resulted too often in selections driven by political considerations.

And for cases that go to court in Olympia, they are heard by judges in Thurston County who are elected by only a small portion of the state's voters. Appeals from the Thurston County Superior Court typically go to Division II of the court of appeals, whose judges are elected only by the voters in that third of the state.

A related problem is the state's geography. Most tax cases are heard in Olympia, a relatively small city with no commercial passenger service at its airport. Parties from other parts of the state may have to drive hundreds of miles to appear in person at a hearing, and in winter, mountain pass closures can make the trip difficult.<sup>3</sup>

For taxes that depend on voluntary compliance, such as Washington's business and occupation tax, the dearth of clear, precedential decisions poses a challenge for businesses. The department publishes some of its internal determinations — ones it deems of precedential value — but as decisions written by the agency imposing the tax, they are not the last word on uncertain areas in tax law. As the next level up, the BTA has been diligent about publishing all its decisions and making them easily accessible, but its decisions lack precedential value. Even superior court decisions are not published and cannot be cited as authority. The court of appeals issues both published and unpublished decisions. Unpublished appellate decisions cannot be cited — if a dispute arises, one must pretend they do not even exist. In the end, Washington's courts issue very few published tax decisions, and none decided by judges with any specialized tax expertise. Correcting that is key for predictability and tax fairness.

Washington overall flunks on nearly all eight attributes listed above. At least in the BTA, the state has a forum dedicated to taxes that is not part of the DOR. Even so, in considering the independence attribute, one should strive for a tax court free of any perceived or real influence that could be exerted by the executive branch by establishing it in the judicial branch. Washington could do much better on all eight attributes of a fair and efficient system.

<sup>3</sup>Washington Department of Transportation Mileage Charts, available at <http://www.wsdot.wa.gov/Publications/HighwayMap/Mileage/Olympia.htm>.

## There's Nothing Wrong With Coveting Your Neighbor's Tax Court

In contrast to Washington's unsatisfactory system, its neighbor to the south is celebrating the 55th anniversary of its successful judicial branch tax court. Since its creation in 1961, the Oregon Tax Court has served as a model for the rest of the nation. In drafting what eventually became a model act, the ABA task force drew substantially on Oregon's experience.<sup>4</sup> Two other jurisdictions formed judicial branch tax courts in 1968: Hawaii and the District of Columbia.<sup>5</sup> Ten years later, New Jersey created its own tax court in the judicial branch.<sup>6</sup> Indiana created one in 1985,<sup>7</sup> and Arizona in 1988.<sup>8</sup> In all, six states and the District have a judicial branch tax court.<sup>9</sup>

Shortly after Oregon formed its tax court, Washington seriously considered creating one too. In 1965 a governor-appointed tax advisory council reviewed, among other things, "the procedures for review and appeal of tax determinations."<sup>10</sup> The council recommended that the Legislature create both the BTA and a tax court in the judicial branch.<sup>11</sup> One of the advantages the council expressed was having judges who would be "specialists in tax law."<sup>12</sup> It recommended that the tax court provide an option for informal proceedings and "sit in locations convenient for the taxpayers."<sup>13</sup> The BTA, formed in 1967, was all that came out of the recommendations.

Recently, several tax practitioners began to explore whether Washington's constitution would allow a tax court in the judicial branch. That analysis resulted in the current proposal to form a statewide tax division in the court of appeals (the tax court of appeals). The proposal would also phase out the "pay to play" requirement for excise taxes.

The proposal closely follows the Oregon Tax Court. It would replace the BTA with a statewide court offering both informal and formal proceedings. The informal proceedings would allow non-lawyers to appear before judge-appointed

<sup>4</sup>Carlisle B. Roberts, "An Introduction to the Oregon Tax Court," 9 *Willamette L.J.* 193, n.19 (1973).

<sup>5</sup>*Id.* at 202. The Hawaii court website explains, the "Tax Appeal Court hears appeals regarding real property taxation directly from assessments or from the Boards of Review. It is a court of record and decides all questions of fact and law, including constitutional questions involving real property taxation, without intervention of a jury," available at <http://bit.ly/1ZzSCt8>.

<sup>6</sup>James H. Peters, "Present at the Creation: The SALT Committee's Role in the Formation of the New Jersey Tax Court," 68 *Tax Lawyer* 591 (2014-2015).

<sup>7</sup>King, J.B., "Some Very Significant Developments in Indiana Taxation," 20 *Ind. L. Rev.* 361 (1987).

<sup>8</sup>See <http://1.usa.gov/1OvbVBP>.

<sup>9</sup>That includes Connecticut, which has a tax and administrative appeals session at the superior court level.

<sup>10</sup>Report of the Tax Advisory Council of the State of Washington (1966), at 71.

<sup>11</sup>*Id.* at 74.

<sup>12</sup>*Id.*

<sup>13</sup>*Id.*

commissioners. Large or complex cases could bypass the commissioners and go directly to the main department to be heard by one of three judges. At the taxpayer's option, excise tax cases could start at the DOR or go straight to the tax court of appeals as long as the department has taken some action (issued an assessment, denied a refund or ruling request, etc.). Property tax appeals would still start at the county board of equalization, with appeal to the tax court of appeals. As with the Oregon Tax Court's two divisions, appeals from the commissioners' department would go to the main department of the tax court of appeals.

In the 2015 legislative session, the tax court proposal passed the Senate with broad bipartisan support (33 to 16).<sup>14</sup> The Tax Council of the WSBA Taxation Section voted to support the bill as exhibiting key attributes that promote due process and fundamental fairness in tax administration. The Association of Washington Business (AWB) gave the bill its full support. The Council On State Taxation wrote that the bill's enactment would raise Washington's grade in the COST Scorecard on Tax Appeals and Procedural Requirements from a C to an A-. The department did not oppose the bill. But the bill got bogged down in the House Judiciary Committee, in part because of active opposition by the court of appeals. In the fray of last-minute budget negotiations, the session closed without further progress on the bill.

The bill's primary sponsor, Sen. John Braun (R), is showing admirable persistence by giving the House another chance in 2016. But Rep. Laurie Jinkins (D), chair of the House Judiciary Committee, has told AWB that she sees the creation of a specialized tax court in the judicial branch as an "extreme" measure to be avoided. She favors refining the current executive branch process instead. For several reasons, refining a process that remains in the executive branch misses the mark.

#### The Current Situation Is Not as Normal as It Seems

Assigning purely judicial functions to an agency in the executive branch is a fairly recent phenomenon. Congress's creation in 1890 of the Board of General Appraisers, later to become the Customs Court, appears to be the only instance of such a body being created until Congress created a similar agency for tax appeals in 1924.<sup>15</sup> Over the years the disadvantages of assigning that judicial function to the executive branch became obvious. Congress tried to ameliorate those problems by changing the board of tax appeals' name to the tax court and calling its members judges in 1942. After several decades of efforts to place it in the federal judiciary, Congress finally elevated it to a legislative court in 1969.<sup>16</sup>

As recently as the 1960s, the tax court's place in the executive branch was viewed as "anomalous" and "peculiar."<sup>17</sup>

The growth of the administrative state since then has been explosive as the executive branch (both federal and state) has continued to expand in its legislative and judicial functions. Some now call administrative agencies the "fourth branch of government." One result of that expansion is a diminishment of judicial authority, as "a citizen is 10 times more likely to be tried by an agency than by an actual court," with a corresponding risk to due process protections.<sup>18</sup>

Despite this, Jinkins sees assigning judicial functions to the judicial branch as an extreme measure. That is especially surprising given that the original recommendation that culminated in the formation of the BTA envisioned that agency as only part of the solution, with the other part being a judicial branch tax court. As Oregon's success proves, the judicial branch tax court alone suffices. The history of the U.S. Tax Court also shows that moving the tax appeals function out of the executive branch is not an extreme measure — it is a reasonable measure that can be carried out smoothly.

#### A Judicial Branch Tax Court Is Important

Much of the discussion about independent tax tribunals blurs the distinctions between those in the executive branch and those in the judicial branch. But the difference is significant. Judicial status confers numerous advantages on a tax court. The ABA's model act recommends a judicial branch tax court, noting:

A specialized judicial branch court would have advantages over the executive branch tribunal contemplated by the Model Act, *i.e.*, a judicial court would have greater institutional independence and the power to invalidate facially unconstitutional tax statutes. Accordingly a state considering reform of its tax appeals system should explore the alternative of accomplishing the Model Act's goals by establishing a specialized tax court in the judicial branch.<sup>19</sup>

Judge Martha B. Wentworth of the Indiana Tax Court recently elaborated on several benefits of a judicial branch tax court, saying:

The Indiana Tax Court is one of six judicial branch tax courts. This is the gold standard of independence. Not only is a judicial tax court free of any perceived or real influence by the administrative agency it reviews, but it is also free of any perceived or real influence that could be exerted by the executive branch. This influence can rear its head when least expected when

<sup>14</sup>Washington State Legislature SB 5449 (2015), available at <http://app.leg.wa.gov/billinfo/summary.aspx?bill=5449&year=2015>.

<sup>15</sup>Harold Dubroff, "The United States Tax Court: An Historical Analysis," 41 *Alb. L. Rev.* 1, 6 (1976-1977).

<sup>16</sup>*Id.* The U.S. Tax Court is now an Article I court (that is, a legislative court); as such, it does not exercise the full judicial powers of an Article III court (that is, a constitutional court). *See, e.g.*, Leandra

(Footnote continued in next column.)

Lederman, "Equity and the Article I Court: Is the Tax Court's Exercise of Equitable Powers Constitutional?" 5 *Fla. Tax Rev.* 357 (2001-2002).

<sup>17</sup>Dubroff, *supra* note 15, at 27.

<sup>18</sup>Jonathan Turley, "The Rise of the Fourth Branch of Government," *The Washington Post*, May 24, 2013.

<sup>19</sup>American Bar Association, "Model State Administrative Tax Tribunal Act Report," Aug. 2006, at p. 15.

dealing with budgetary recommendations, salary considerations of judicial staff — if not the judge herself — and other insidious ways. One important function of the judicial branch is to review executive branch actions; therefore, a quasi-judicial tax tribunal cannot exercise the same degree of independent review as a judicial branch tax court cloaked by the constitutional precept of separation of powers.<sup>20</sup>

The arguments raised in favor of a judicial branch tax court in Washington echo the observations made during the efforts to accord judicial status to the U.S. Tax Court. For example, on attracting qualified judges, proponents of judicial status observed that it would increase the prestige of the court and “make recruiting top caliber people for judgeships easier.”<sup>21</sup> Similarly, the value of specialized tax judges over generalists is clear: Judges hearing cases in disparate fields cannot be expected to be experts in each, and most tax experts are unwilling to serve as judges in courts where they would be required to hear unrelated cases, much less “make the financial sacrifice frequently attendant on leaving the private sector for government service.”<sup>22</sup>

By creating a prestigious, specialized forum, Washington would take a giant step toward attracting top-caliber experts to the adjudication of tax disputes. The key is to make it a judicial court and give the decision-maker the title, salary, tenure, and other trappings of a judge. Oregon’s history of excellent judges, elected statewide to its tax court, shows that imposing tax expertise qualifications on judicial candidates is not necessary to attract top talent to the position. Importantly for a budget-strapped state like Washington, the increased prestige is a cost-effective way to attract top tax experts to government service.

A judicial branch tax court is the only way to create a body of reliable, consistent, and quality tax decisions with precedential value. No improvements to an executive branch agency can ever remedy the lack of that reliable guidance for taxpayers and tax authorities.

In explaining the reason for the Oregon Tax Court’s existence, one of its early judges observed, “[t]hroughout history, taxation has been a subject of particular sensitivity.”<sup>23</sup> In the United States, from the American Revolution to the present, taxation has proved a particularly delicate matter in the relationship between the governed and the government. Given the pervasiveness of tax and the sensitivity of the subject, it is worth treating tax cases with special care by providing for their resolution by the fairest and most efficient means possible.

<sup>20</sup>Bruce Ely et al., “The Advantages of Independent Tax Tribunals,” *State Tax Notes*, July 20, 2015, p. 275.

<sup>21</sup>Dubroff, *supra* note 15, at 42.

<sup>22</sup>*Id.* at 38 (discussing a proposal to incorporate the tax court into a larger administrative court that would adjudicate disputes dealing with labor and trade matters).

<sup>23</sup>Roberts, *supra* note 4, at 199.

## Dispelling Misconceptions

During the 2015 legislative session, several misconceptions about the proposal bubbled to the surface. The lobbyist for the Washington Association of County Officials misstated that the bill would change the burden of proof in property tax appeals to a mere preponderance of the evidence, which is untrue. That lobbyist and others voiced concerns about the formality of proceedings as though assigning the function to the judicial branch would intimidate small taxpayers. In fact, the bill provides for a commissioners department with directions to create informal rules. And the bill specifically permits non-lawyers to represent taxpayers in those proceedings, contrary to a concern raised by the American Institute of Certified Public Accountants. The Washington Society of Certified Public Accountants, which has the same goal, supports the proposal.

Those opposed to elevating the status of the U.S. Tax Court raised similar fears: that procedures would become too formalistic, that the court would dispose of cases less rapidly, and that non-attorneys could no longer practice before the court without committing the unauthorized practice of law.<sup>24</sup> Both the U.S. Tax Court and the Oregon Tax Court show that court proceedings can be user-friendly for taxpayers large and small, whether representing themselves, accompanied by an accountant or consultant, or represented by a lawyer. In addition to simplifying procedures, courts can provide guidance like the Oregon Tax Court’s Appeal Handbook, recognized recently at the last state tax judges conference as an example of how to help litigants navigate the judicial system and access justice.

For its part, the Washington Court of Appeals expressed concern about having a trial function at the intermediate appellate level. The constitutional language establishing Washington’s court of appeals is very broad, however. And Washington would not be the only state to allow an intermediate appellate court to conduct evidentiary hearings in tax cases.<sup>25</sup> Though innovative, it is not unheard of. And no proposal should be discarded merely for being innovative if it accomplishes important goals, as the Washington tax court proposal does.

## Conclusion

There is no reason taxpayers in Washington should settle for less than the gold standard by creating a judicial branch tax court that ensures fairness and efficiency. Oregon achieved that standard in 1961. Why not Washington in 2016? ☆

<sup>24</sup>Dubroff, *supra* note 15, at 32.

<sup>25</sup>*See, e.g.*, Pa. R.A.P. 1571 and 1542; *see also CONRAIL v. Commonwealth*, 670 A.2d 722, 724 n.2 (Pa. Commw. Ct. 1996) (“Although we review the determinations of the [Board of Finance and Revenue] in our appellate jurisdiction, in such a proceeding we essentially function as a trial court under Pa. R.A.P. 1571”).