

**Baker
McKenzie.**

Handling a State Tax Controversy

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Agenda

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AUDIT & PRE-ASSESSMENT

2

ASSESSMENT & ADMINISTRATIVE APPEALS

3

COURT & SETTLEMENT/COMPROMISE PROCESS

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Audit & Pre-Assessment

The Audit

- Initial meeting with auditor
 - Expectations, rules and timing
 - Audit plan
 - Sampling methodology
- IDRs
 - Requests and responses should be kept in a log
 - Requests should be in writing
- Scope of IDRs
 - Hold firm on overly broad requests
 - Requests must be reasonably relevant
 - Not unduly burdensome/costly

Communication is Essential

- Learn the auditor's chain of command
- Does the auditor expect waivers?
 - Waivers are a two-way street
- Are there issues that the auditor can resolve with additional information?
- Speaking with the auditor's supervisors may be effective in certain circumstances
 - Particularly on issues that the auditor is not permitted to resolve on their own

The Audit

- Privileged Documents
 - Attorney client privilege
 - Communications between attorney and client/taxpayer
 - Applies if documents not shared with third parties
 - Attorney work product
 - Documents prepared in anticipation of litigation
- Privilege Logs
 - Redactions
- State information sharing agreements

After the Audit

- Many states provide taxpayers post-audit/pre-assessment protest/conference rights
- Just because these rights exist, doesn't mean that they should be exercised in all instances
- The respective pros/cons associated with exercising these pre-assessment rights vary dramatically from state-to-state

Considerations for Evaluation of Pre-Assessment Protest/Review

- Who is conducting protest/review?
- What requirements are necessary to participate in protest/review? e.g. waiver of statute of limitations
- What is nature of audit dispute? e.g. factual or legal
- What is likelihood of "success"?
- Is there risk for additional assessment? Things can always get worse...
- How long?
- How much will it cost?

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Assessment & Administrative Appeals

So You've Been Assessed

- If a taxpayer and the auditor cannot resolve all of the issues in an audit, the result is typically an assessment.
- However, an assessment is not the end of the road. It can be appealed and potentially overturned.
- Where and how to appeal an assessment can vary widely from state-to-state.
- Consider the path to resolution and ultimate goals prior to deciding how to proceed.

First Stop, Administrative Appeals

- Before taking an assessment to court, most states invite (read: require) taxpayers to first appeal it through administrative channels.
- In some states, the matter is appealed to an arbiter within the tax collector's department (e.g., Florida, Oklahoma). In others, it is appealed to a tribunal independent of the tax collector (e.g., Illinois, New York, West Virginia). Sometimes it is appealed to a tribunal that appears to be independent, but in fact, is not (e.g., Texas, Washington).

What to do in Administrative Appeals

- Fully understand all available options for protest/appeal
- Fully understand all relevant dates, documents, and procedures necessary to perfect protest/appeal
- Understand the import/impact of the document filed – does it define/limit the arguments throughout?
- Understand where the "factual record" is created
- Understand the players involved – trier of fact, decision-maker (not always one in the same) and counsel
- Define "success" upfront

What NOT to do in Administrative Appeals

- Do not assume the state is providing you notice of all available protest/appeal options
- Do not assume that appeals procedures in each state are the same
- Do not forget who bears the burden of proof
- Do not assume the proceeding is confidential
- Do not get discouraged if the assessment is not reversed
- Do not equate your "best" case with "most expensive" case

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Court & Settlement/ Compromise Process

Tax Tribunals

- A number of states have adopted independent tax tribunals over the years:
 - California (2017, effective July 1, 2017)
 - New Mexico (2015, effective July 1, 2015)
 - Alabama (2014, effective 10/1/2014)
 - Pennsylvania (2013, effective 4/1/2014)
 - Illinois (2012, effective 7/1/2013)
 - Georgia (2012, effective 7/1/12)
 - Maine (2012, effective 7/1/12)
- Others considering them or have recently considered them (e.g., Texas and Washington)

Tax Tribunals

- Why do states like them?
 - Removes the "appearance" of bias
 - Improves their COST Scorecard
- Why do taxpayers like them?
 - Independence from tax collector
 - Requires (or creates) an arbiter with experience in tax matters
 - Decision published, providing guidance
 - May provide speedier resolution
 - May avoid a further appeal to Court

Tax Tribunals

- Some downsides:
 - Loss of confidentiality
 - Public hearing
 - Published decision—rules for redaction
 - May be more costly
 - Creating a "record"
 - Discovery

Tax Tribunals: Variations

	Illinois	Alabama	Pennsylvania
Tribunal Composition	Chief ALJ + up to 3 more	1—3 Full time	3—2 Gov appt w/ confirmation
Term	5 yr (Chief)	6 yr (Gov appt)	6 yr (Gov appt)
State tax expertise required?	Yes	Yes	10 yrs PA tax; Atty or CPA
Full-time members?	Yes (Gov appt)	Yes (Gov appt)	Yes (Gov appt)
Tax agency role	Adversary	Adversary	Adversary
Attorneys	Attorneys	Anyone	Anyone
Compromises?	Permitted	Permitted	Permitted
Evidentiary rules	Formal	Flexible	Informal
Record created?	Yes	On Agreement	No
Dec. published?	Yes-Edited	Yes	Yes-edited
Pay-to-play?	No	No	No

Court

- The next step after an administrative proceeding is generally court. The court may hear the matter de novo or it may sit as an appellate court.
- Appeal to a court may require a taxpayer to "pay to play."
- Some states allow taxpayers to bypass the administrative process and go directly to court (e.g., Florida, Illinois (upon payment of assessment under protest)).

Settlement/Compromise Process

- Suitability
 - Uncertainty: Issue; facts; arbitrator biased/expertise
 - Cost to litigate may exceed benefit
 - Speed of resolution
 - Government motivated (close to year-end; budget shortfall)
 - Opportunity to negotiate
 - Confidentiality maintained
 - Doesn't forsake appeal; not binding on other years
- Stage when available varies widely by state
- Usually not influenced by elected officials
- Define winning in advance



Questions

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