
***TAXPAYER OUTREACH STUDY:
PARTS 1 AND 3***

Vermont Department of Taxes
January 18, 2012

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1.0 BACKGROUND INFORMATION

Public input received by the Legislature in 2011 highlighted the opportunity for the Vermont Department of Taxes (VDT) to enhance its policies and operations to forge a stronger relationship with taxpayers. Accordingly, the Legislature included several provisions within the Miscellaneous Tax Bill requiring VDT to report back to the legislative committees of jurisdiction on taxpayer outreach. This report, focusing on recommendations to improve education and outreach to taxpayers and protocols VDT can adopt for tracking taxpayer inquiries and responses by the department of taxes to ensure that taxpayers receive correct information, is one of those required reports.

1.1 Statutory Mandate for Study

Section 36h of Act 45 of 2011 required the Vermont Department of Taxes to recommend to the House Committee on Ways & Means and the Senate Committee on Finance ways to improve its taxpayer outreach and information systems. The legislation prescribed the exploration of three specific issues, two of which are addressed in this study.¹ First, the Legislature mandated that VDT recommend “ways in which the department of taxes can improve its education outreach to taxpayers in specific industries or classes to ensure that taxpayers in those industries and classes are aware of their obligations under law and to ensure that the department of taxes is able to track and respond to industry or class-wide concerns.” Section Two of this report is submitted to fulfill the mandate described above.

Additionally, the Legislature required the Department to report on recommendations on the implementation of “protocols the department of taxes can adopt for tracking taxpayer inquiries and responses by the department of taxes to ensure that taxpayers receive correct information.” Section Three of this report is submitted to fulfill the mandate described above.

¹ The third issue prescribed for study in Section 36h of Act 45 of 2011 focused on the role and independence of VDT’s Hearing Officer. That report is submitted under separate cover.

1.2 Development of Recommendations

The Commissioner of Taxes used the legislative mandates described above as the impetus to review VDT's communication and education outreach efforts and policies. The Commissioner's Special Counsel led the review, examining the practices of other revenue agencies and discussing relevant VDT policies and actions with senior staff members. The review yielded a communications plan adopted by the Tax Commissioner and incorporated into the Department's overall strategic plan submitted to the Secretary of Administration. The review of VDT's communication and education outreach efforts and policies and the subsequent communications plan form the basis of the recommendations presented in this study.

The communications plan presented five strategic initiatives, each of which is underway at VDT. Each strategic initiative is designed to increase education and awareness of tax obligations and promote formal and informal outreach interactions between VDT and its stakeholders. These initiatives serve as the education and outreach recommendations required by law.

Additionally, the review of VDT's communication and education outreach efforts and policies led to a better understanding of how the Department tracks taxpayer inquiries and responds to taxpayers. Accordingly, the Commissioner has taken steps to strengthen these efforts.

1.3 Staffing Levels

The initial language found in Section 36h of Act 45 of 2011 stated that while the "department of taxes has increased its compliance efforts in recent years, it has not increased its taxpayer service and education capacity. To balance the needs of the state with the rights of taxpayers, the department of taxes should increase its taxpayer outreach and education

efforts.” Here, the Legislature provided valuable context regarding VDT’s operations and staffing.

State government executed a Reduction in Force (RIF) plan during the recent economic downturn. The previous Administration made a strategic choice to reduce other operational divisions at VDT rather than compliance staff. Additionally, the Legislature passed a specific mandates to hire 16 compliance staff in 2009 and 2010.² Overall, VDT has reduced staff from 187 employees to 169 employees since 2009 even though it added 16 compliance positions. The result was increased compliance activity coupled with diminished resources to assist taxpayers. This staffing disparity will continue in the near future as staffing levels remain mostly static; however, VDT views the strategic initiatives described in this report as a way to work more strategically in a resource constrained environment.

² See§. H.1 of Act 1 of the Special Session of 2009 and §§ 78 and 79 of Act 67 of 2010. The Legislature stated at that time that “there is a net gain to the state and to taxpaying Vermonters when the efforts of the tax department result in increased compliance” and reaffirmed its commitment to enhanced compliance actions.

2.0 Recommendations

The study includes five recommendations. Each represents a strategic initiative to be implemented by VDT. Each strategic initiative is listed below:

1. Increase Stakeholder Outreach Generally and by Industry Segment through Broader Stakeholder Outreach and Industry Tax Forums
2. Create the Vermont Taxpayer Advisory Board (VTAB)
3. Enhance Traditional and Social Media Outreach
4. Launch the Writing Project
5. Redesign and Modernize the Department's Web Site

The next sub sections describe the past practice of the outreach activity at VDT and the new strategic initiative.

2.1 Initiative 1: Redesign and Modernize the Department's Web Site

Past Practice

VDT maintains a web site where taxpayers may gather information, find news, conduct business, and contact department staff. The Department updates the web site regularly; however, VDT's review concluded that our web site is dated in comparison to sister state agencies and the web sites of other revenue agencies. Specifically, VDT's review determined that the web site needs a complete overhaul, focusing on providing a new design, organization, and content.

Strategic Initiative

The Department is committed to redesigning and modernizing the Department's web site. Technology is not a panacea; however, VDT believes that the web site can be the cornerstone of efforts to educate and reach taxpayers. Furthermore, VDT staff believes that a thoughtful redesign of web site content and incorporation of this information into our business protocols and practices may make the information given to taxpayers more uniform and consistent. The Department of Information and Innovation (DII) concurs with VDT's conclusion that the web

site requires replacement, and VDT will work with its strategic partners to implement this new and more powerful tool.

VDT considers the following points to be key in its web site redesign:

- Promotion of thoughtful web design principles, including a focus on design, content, organization, and user experience.
- Incorporation of web site into VDT business operations. For example, customer service staff would incorporate information found on the web site into their answers and explanations to taxpayers. Also, VDT would use customer service staff feedback regarding customer interactions to inform future web site development.
- Usage of focus group of tax professionals, the general public, and other stakeholders to inform the design of the site.
- Use the web site re-launch to strengthen other aspects of VDT's communications plan, including collaboration with VTAB, utilizing content improved by The Writing Project, and promotion of traditional and social media opportunities.

The web site redesign involves staff from every operational division and multiple agencies.

Accordingly, the process to create the web site is potentially slow; however, the potential benefits to taxpayers if implemented correctly are enormous.

2.2 Initiative 2: Increase Stakeholder Outreach Generally and by Industry Segment through Broader Stakeholder Outreach and Industry Tax Forums

Past Practice

The Department examined direct stakeholder outreach efforts. In the past, the Taxpayer Advocate coordinated stakeholder outreach efforts. Outreach and education activities focused on VDT's relationship with tax professionals. Specifically, VDT connected with tax

professionals through meetings, a department newsletter, publication of several informational guides, and organizing certain events, such as the annual tax school and informal meetings with the Commissioner. Also, VDT sent staff to tax related events. Events attended by VDT staff were organized typically by the tax professional community or by the Internal Revenue Service for tax practitioners. The scope of this outreach, though important, seemed too narrow. Accordingly, VDT has developed initiatives to broaden our outreach and education audience and provide targeted outreach to specific industries.

Strategic Initiative

Broaden the Outreach and Education Audience

The Department determined that VDT's strategic outreach must reach a broader audience than tax professionals. Accordingly, the Department identified the following actions to broaden its education and outreach audience and with them:

- Develop a master list of stakeholder groups. The list will assist the Department as it seeks to create education and outreach opportunities.
- Developed a master schedule of general stakeholder events where the Department ought to have a presence. These are the regular, annual, special, or large meetings of key stakeholder groups, including tax professionals, industry trade groups, and other major stakeholders.
 - Routinely develop written materials to be distributed at these events, focusing on broad initiatives, common issues encountered by taxpayers, and ways to connect with the Department to gain knowledge and resolve issues.
- Develop a master publication list of all publications published by our stakeholder groups. The list will help the department design and disseminate updates to stakeholder groups.

Overall, the steps described will broaden the audience of taxpayers receiving education and outreach information from VDT. Also, VDT will create more opportunities to listen and learn through informal interactions.

Industry Specific Tax Forums

The Department created industry specific tax forums to share subject matter expertise and hear taxpayer concerns outside of the compliance setting. Specifically, VDT intends to partner with industry groups and relevant government agencies to present common issues affecting that industry. The Tax Department tested this concept in November 2011 with the ski industry.

With the help of the Vermont Ski Areas Association and Sugarbush Resort, the Department held an industry specific tax forum attended by the relevant finance staff of the majority of ski areas in Vermont. The event focused on five topics:

- Common Meals and Rooms Tax Issues for the Ski Industry
- Common Sales and Use Tax Issues for the Ski Industry
- Common Audit Issues
- Emerging Tax Issues
- Question and Answer Session

The experience was constructive and helpful for both sides. Given this proof of concept, the Tax Department is considering similar forums for other industries, including manufacturing, agriculture, agritourism, retailers, and non-profit entities. Currently, the Department is exploring partnerships with these industries, relevant trade groups, and relevant government agencies to hold more forums in 2012.

2.3 Initiative 3: Creation of the Vermont Taxpayer Advisory Board (VTAB)

Past Practice

Other taxing jurisdictions, including the IRS, convene an advisory body comprised of some combination of tax professionals, business stakeholders, activists, scholars, and citizens to provide non-binding public input to management on important tax administration and policy matters. Currently, no such body exists at VDT. Informally, Department staff, including the Commissioner and Taxpayer Advocate, meets with leaders of the tax professional organizations and other business groups. Research and discussions with other states revealed the creation

of such a group as a positive force to provide perspective to the Department and to wrestle with issues that are important but not urgent. Accordingly, the Department seeks to create and convene the Vermont Tax Advisory Board (VTAB) in 2012.

Strategic Initiative

The Department believes that VTAB would serve three useful purposes. First, it would provide a public forum for communication between Vermont's Commissioner of Taxes and representatives of the public interested in Vermont tax administration and policy. Second, the board would provide ideas, input and perspective to the Commissioner, assisting her in identifying improvements in the administration of taxes. Third, the board would provide constructive observations regarding current or proposed policies.

The Board would be appointed by the Commissioner of Taxes through an application process. Applicants would be required to state their pertinent information, qualifications, and a statement of interest. The Commissioner would seek applications from tax practitioners and tax professionals and those with a broad background in tax policy, public policy, Vermont's business community, or consumer advocacy. The Board shall not include current members of the General Assembly.

The board will consist of nine or more members. The first board will have staggered terms. All subsequent appointments will be made for three year terms. The Commissioner of Taxes may make appointments to fill vacancies.

The board's agenda will be developed by the Commissioner of Taxes and staff and will include topics considered important but not urgent. Topics may be forwarded to the Commissioner in advance by members of the Board. Topics could include any areas and issues of broad interest to the members, but will not include specific taxpayer matters. For example, other jurisdictions include topics such as audit practices, federal tax developments impacting

their state, development and release of technical bulletins, responses to court decisions, modernization of the tax law, and the status of on-going projects and tax policy matters.

The creation of VTAB has been approved by the Commissioner of Taxes and Secretary of the Administration. Application materials will be available in mid-January and stakeholder groups notified of the opportunity to serve.

2.4 Initiative 4: Enhance Traditional and Social Media Outreach

Present Practice

The review of VDT outreach and education revealed only reactive engagement with the traditional media. VDT responded diligently to news requests but made no proactive effort to educate or reach taxpayers through the traditional media. Also, the review revealed a barely perceptible social media presence. VDT, like many state agencies, utilizes a Facebook page. A review of the site and analysis of its metrics demonstrated that little content was being posted and few if any people were visiting the VDT Facebook page. The Department can and will engage in traditional media outreach and reinvigorate our social media presence. Both initiatives are designed to disseminate broader messages to a wide group of taxpayers.

Strategic Initiative

Traditional Media Outreach

The Department believes that it can identify issues of broad concern to taxpayers that can be disseminated by current staff to enhance taxpayer education and outreach. For example, electronic filing of taxes is safe, secure, and saves taxpayers money by reducing printing and postage costs. While nearly 70 percent of personal income tax filers e-file, there is room for improvement yielding cost savings and other administrative efficiencies. The Department has identified this as an issue that can be easily explained and disseminated through print, radio, and television media. The Department intends to use e-filing as a proof

of concept for this activity and, if successful, the Department intends to identify a limited number of similar opportunities.

Social Media Outreach

The Department surveyed other revenue agencies and determined that the majority of jurisdictions use social media as a strategic communication tool. Accordingly, VDT re-launched its Facebook page and joined Twitter.

Social media is an efficient way to connect with a broad group of taxpayers on their own terms. Given the broad audience available through social media, the education and outreach content published by VDT can be categorized one of five ways:

- Encourage Best Practices
 - VDT will strive to raise awareness regarding best practices, such as e-filing, registration for VT BizFile, use of approved tax vendors, and other such best practices.
- Disseminate News
 - VDT will ensure that taxpayers preferring to receive news via social media rather than traditional media are informed.
- Customer Service
 - We will use social media as a two-way street, acknowledging and responding to taxpayer concerns.
- Brand Promotion
 - VDT can use social media to promote its brand. Examples include advertising job openings, touting operational successes, and being generally responsive to inquiries.
- Illuminating Quality Resources by Third Parties
 - Social media provides a platform to elevate resources from the IRS, other state revenue agencies, and our sister agencies in Vermont.

Our target audience is individual taxpayers, business taxpayers, tax professionals, the news media, other state agencies using social media, and the general public.

Recently, VDT analyzed the first 30 days of its new social media program against the previous 30 days. The analysis demonstrated the viability of these tools for disseminating general information in a timely manner to the general public. The Department evaluates social media metrics every fifteen days, and Twitter and Facebook usage is significant and rising.

2.5 Initiative 5: Undertake the Writing Project

Past Practice

At one time, VDT worked with the tax professional community to review and redraft correspondence. This practice ended, and the Tax Department reviews and redrafts correspondence on an ad hoc basis internally. While tax related correspondence can be technical by necessity, a review by VDT staff found that correspondence can and should be improved to ensure that VDT communications reflect a proper combination of readability, respect for the citizen, and effectiveness in achieving intended results.

Strategic Initiative

Based on similar projects in other jurisdictions, The Writing Project is a review and rewrite of all department system-generated and regular communications to citizens and businesses. Accordingly, the Department identified the following actions to be taken to complete The Writing Project:

- Create an inventory of correspondence by division and explanation of the correspondence's purpose, triggering event, frequency, audience, and volume.
- Solicit feedback from operational divisions regarding which correspondence requires the most urgent attention.

- Perform preliminary review of correspondence by division.
- Consider the creation of a three year review cycle for initial and ongoing review of all correspondence
- Create a regular review process which incorporates participation by the Vermont Taxpayer Advisory Board
- Create a regular process for vetting new correspondence within VDT

VDT engaged in this process on a small scale for the report on the hearing officer required by Section 36h (2) of the Act of 2011. This work validated the need for, and viability of, this strategic initiative.

3.0 TRACKING AND RESPONDING TO TAXPAYER INQUIRIES

The Legislature required VDT to recommend the implementation of “protocols the department of taxes can adopt for tracking taxpayer inquiries and responses by the department of taxes to ensure that taxpayers receive correct information.” Accordingly, the Commissioner of Taxes set forth a review of the intake of taxpayer inquiries, tracking of inquiries, and quality control of responses. This section of the report describes business practice changes and enhancements designed to improve the tracking of taxpayer inquiries and quality and consistency of those responses. The first sub-section (3.1) of this segment of the report focuses on the tracking of inquiries, and the second sub-section (3.2) focuses on quality assurance. The final sub-section focuses on synergies between the strategic initiatives described in section two of the report and the goal of better understanding of taxpayer issues and the tracking and consistent quality of VDT responses.

3.1 Tracking Taxpayer Inquiries

VDT proposed a comprehensive analysis of its written response procedures. Specifically, VDT made a proposal to the Vermont Public Manager (VPM) Program to review our current written communications procedures and identify ways to improve quality, avoid duplication, and streamline our internal processes. The VPM program accepted VDT’s proposal; however, the VPM program was suspended after their facility in Waterbury was damaged by Tropical Storm Irene. The VPM program has not been re-activated as of the writing of this report. While VDT will seek additional ways to evaluate written communications systemically, VDT’s own review of the intake of taxpayer inquiries led to several enhancements throughout the organization, including the streamlining of public email intake, implementation of call counts, the introduction of a regular policy meeting with senior policy staff, and telecommunications improvements that add all customer facing divisions to our call center phone system.

Streamlining Public Email Intake

VDT's review found gaps in the monitoring of folders associated with public email addresses. The Department eliminated redundant or unused public emails from VDT's web site. Also, VDT used testing to ensure that all emails sent to a public email address were being monitored and responded to in a timely manner.

Call Counts

The Taxpayer Services Division, the primary customer service division within VDT, now engages in periodic counting of calls to monitor volume, content, or both. Call counts help VDT understand taxpayer needs and provide improved service by adjusting phone coverage. Based on this success of this effort, the Compliance Division (Audit and Collections) is developing tools to track the number of taxpayers that call reporting a VDT error and the type of error so that we may identify and improve technical issues with our billing and collection systems.

Policy Meeting

The Commissioner instituted a weekly meeting of senior policy personnel. Previously, VDT policy meeting were ad hoc, being held as the need arose. A report on policy issues raised by taxpayers is raised at this meeting so that policy staff can understand prominent and timely taxpayer issues and ensure that a consistent interpretation and communication of a reply occurs. Issues raised at the policy meeting are transmitted to operational staff via the Deputy Commissioner and Special Counsel as part of the weekly operations meeting. The regularization of this meeting is designed to reduce the risk of inconsistent policy answers being disseminated by staff.

Call Center Improvements

The Taxpayer Services Division and Collections Unit utilize a phone system typical for a call center environment. This Automatic Call Distributor (ACD) technology ensures that taxpayers reach the proper business unit in the shortest possible time. Recently, VDT purchased the licenses and hardware necessary to place the rest of our customer facing employees on the ACD system. This enhancement may help better track taxpayer inquiries by reducing wait time and misdirected calls, thereby reducing taxpayer frustration and ensuring that VDT is aware of more taxpayer issues.

3.2 Quality Assurance

Despite the loss of the VPM program, VDT has taken several notable steps to ensure quality assurance in its responses to taxpayers. Specifically, VDT is moving toward recording of customer service phone calls, standardization of correspondence, quality control checks of e-mail, and circulation of field audit findings.

Call Recording

VDT has committed to the recording of customer service calls for the purposes of training and quality assurance. Additional monitoring and training through recorded and monitored calls should improve the quality and consistency of VDT answers given to taxpayers. Also, this tool will provide VDT staff with a way to resolve some taxpayer disputes more effectively.

VDT partnered with the Department of Information and Innovation (DII) to better understand the recording of calls, which is done on a limited basis by some other state agencies utilizing a call center environment. After this review, VDT has purchased the technology and hardware necessary to begin recording at least some customer phone calls during 2012.

However, VDT must work with DII and the IRS to develop protocols around a more comprehensive recording strategy.

Standardization of Correspondence

A review of VDT responses to taxpayers revealed some freestanding written correspondence by employees to taxpayers. The quality of this correspondence varied. Accordingly, VDT is developing more standardized templates. For example, VDT is working toward uniform e-mail standards that would include minimum information required, a uniform and professional look, and a uniform disclosure statement.

Quality Control Checks

Supervisors in our Taxpayer Services Division now ask for a random sampling of correspondence from employees to ensure that quality and consistency of correspondence. Based on the success of this process, VDT is considering implementing this in other taxpayer facing divisions.

Circulation of Field Audit Findings

In the past, the Director of Compliance circulated summaries of field audits to senior staff. VDT revived this practice. The summary includes the relevant issues encountered by the audit staff while working with taxpayers. The summaries provide senior staff with a timely illustration of how policy is being interpreted by compliance staff in the field, illuminating emerging or repetitive issues and ensuring consistent application of the law.

3.3 Synergies

VDT believes that the two sections of this study, focusing on recommendations to improve education and outreach to taxpayers and protocols VDT can adopt for tracking taxpayer inquiries and responses by the department of taxes to ensure that taxpayers receive correct information, create a welcome synergy. Increased outreach, creating opportunities for formal and informal interaction with a broader group of taxpayers, should provide VDT with the opportunity to understand taxpayer issues in a timely basis and be more nimble in our response.

REPORT TO THE
GENERAL ASSEMBLY
SENATE COMMITTEE ON FINANCE
HOUSE COMMITTEE ON WAYS AND MEANS

A Study of Taxpayer Outreach and Information Systems:

PART 2. Taxpayer Appeals

Submitted January 17, 2012

by

The Vermont Department of Taxes

Mary N. Peterson, Commissioner of Taxes

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SUMMARY OF REPORT

The General Assembly requested that the Department study taxpayer outreach and information systems, and in that study to look at how to improve the Department's system of taxpayer administrative appeals, including a review of the feasibility of creating an independent tax appeals entity. Part 1 of the Department's report covers taxpayer outreach and information systems generally; this is Part 2 of the report, and covers taxpayer appeals.

This report describes (1) the Department's current appeals process, (2) the history and purpose of administrative hearings, (3) other states' tax appeal processes, (4) how the Department is improving its appeals system, and (5) a review of a proposal to the General Assembly from several Vermont tax attorneys to replace the Department's commissioner-level appeal with an independent tax court in the Executive Branch and to replace the Department's settlement function with an independent, optional settlement conference.

Section I Department Appeals and Settlement Procedure

On average, the Department issues about 15,000 notices of tax liability each year. Most of these assessments are resolved when the taxpayer pays the tax or files the missing return, or the taxpayer and Department settle, or the Department withdraws the assessment. Out of the entire 15,000 cases, an average of 16 cases each year remain unresolved at all levels in the Department, and proceed to an appeal hearing before the hearing officer.

Section II

History and Role of the Administrative Hearing

Administrative agencies are given the authority to provide a hearing to citizens who contest an agency action. The hearing is the commissioner's opportunity to see all the facts and law related to the case, for a last chance to change the agency's action before the parties go to court.

The U.S. Supreme Court and the Vermont Supreme Court have both held that agency hearings provide due process, and that there is no bias inherent in the fact that the hearing officer is an agency employee.

The fact that the hearing officer is not independent of the agency does not mean that the hearing officer does not act impartially. The National Association of Hearing Officials has formalized a national code of ethics for administrative hearing officers which provides, “Regardless of the hearing official’s employment relationship with a party agency, the hearing official should exercise independence of action and judgment.”

Although the factual record is determined at the agency level, the reviewing court has the power to require the agency to reopen the record for more evidence on any issue.

Section III Taxpayer Appeals in Other States

35 states require a department administrative appeal before the taxpayer may proceed to a court or other outside appeal entity. 7 states provide a department administrative appeal, but the taxpayer has the option to pay the tax (or post a bond) and go directly to a Judicial Branch court (6 states) or a tax court (Oregon). 2 states have a department appeal, but the taxpayer may opt to appeal directly to a tax court without paying the tax first. 6 states have no department appeal; the taxpayer appeals directly to an independent administrative appeals body, and then to court.

Section IV Improving the Department’s System of Taxpayer Administrative Appeals

The Department met with groups of tax attorneys, tax preparers and Certified Public Accountants to hear their concerns and suggestions and then took steps to address these issues.

Department personnel met with the Directors of the Compliance Division and Taxpayer Services Division and together they are creating a new, expedited process for the steps from audit to appeal, with new ways to communicate that process to taxpayers.

The Department rewrote the regulations pertaining to taxpayer appeals, and reviewed and is revising taxpayer correspondence related to audit, assessment and appeals. The Department is

designing new training programs for Compliance and Taxpayer Services personnel, including training on taxpayer communication, settlement negotiations and complex or frequent tax issues. The Department is also redesigning its Web site and will be including new sections for tax alerts and options for the public to sign up for automatic notices of new tax information.

Section V Proposal for Tax Court and Settlement Office

The proposal is to give taxpayers the option of negotiating settlement through an independent settlement office, to eliminate the Department tax appeal process, and to have all taxpayer appeals heard by an independent Executive Branch tax court. Based on the proposal, it is estimated that the tax court might docket several hundred cases per year and would start with two judges. Costs might be in the range of \$500,000 to \$600,000 per year, minus savings of about \$60,000 from current personnel at the Department.

The goal of the proposal is a good one: “to increase public confidence in the fairness of the tax system.” Other states have found that creating an independent tax court did not necessarily improve the public perception, however. For example, the Council on State Taxation, a nonprofit, corporate tax lobbying group representing 600 multistate corporations (“COST”), is a major proponent of creating independent tax courts and tribunals, but COST notes that in two states that have created tax tribunals:

California and New Jersey, while offering independent review, each suffer from a perception that their appeals process is reluctant to overturn revenue department decisions. The fix may be more than statutory.

It is a rational and common perception that if the Commissioner, or even a tax court, finds in favor of the Department often, then the adjudicator is biased against the taxpayer. However, by the time a case has been scheduled for an appeal hearing, the taxpayers have had several layers

of review at the Department and opportunities to make their case. Taxpayers are able to resolve their differences with the Department in 99.9 percent of all assessments; only about 16 cases per year, out of 15,000 cases, go to hearing and determination. At that point, if the Department loses the case, it means that many Department personnel at all levels got the issue wrong.

SUMMARY OF STUDY TOPICS

TAXPAYER APPEALS

In the course of the portion of the study related to taxpayer appeals, the Department interviewed groups of tax practitioners to hear their concerns and suggestions for the Department, and undertook research on the history of administrative appeals and how other states handle tax appeals. With regard to an independent tax appeals entity, the Department focused on a proposal by several Vermont tax attorneys to replace the Department's commissioner-level administrative appeal with an independent Tax Court in the Executive Branch and to replace the Department's settlement function with an independent, optional settlement conference.

This report consists of five sections, each on a different topic related to the study of taxpayer appeals. The following is a quick summary of the topics:

1. Current appeal and settlement procedures and statistics within the Department are the starting point for the study. **Section I. Department Appeals and Settlement Procedure**

2. The main reason cited for dissatisfaction with the Department's tax appeals system is a perception that a hearing officer employed by the Department is unable to make an impartial determination; the study looked at the purpose of the hearing, the issue of bias as viewed by courts, practitioners and academics, and statistics on resolution of Department appeals.

a. The purpose of the administrative hearing is to provide the commissioner with a record of the full facts and law, for a final chance to review the department's action before deciding to affirm the action or reverse it. Can this system of review be impartial? **Section II. History and Role of the Administrative Hearing**

b. External review of a tax department's action is available in all states through judicial review, by appeal to the lower courts and the Supreme Court. Do the courts view the administrative hearing process as impartial or fair? **Section II. History and Role of the Administrative Hearing**

c. Some of the current perceptions about Department appeals may be due to a lack of outreach by the Department. For example, taxpayers are not always aware that the hearing officer is prohibited by law from discussing their case with the Department attorneys, auditors, or other employees directly involved in the hearing unless the taxpayer is also present. In addition, the statistics on how often the Department prevails at the hearing level can look skewed, but in the context of all levels of review within the Department, the statistics may look somewhat different. **Section I. Department Appeals and Settlement Procedure; Section IV. Improving the Department's System of Taxpayer Administrative Appeals**

d. Some administrative law commentators note that a hearing officer may be impartial, even if not independent of the agency. The National Association of Hearing Officials (NAHO) Code of Ethics requires:

“Regardless of the hearing official's employment relationship with a party agency, the hearing official should exercise independence of action and judgment to protect the due process rights of parties and to achieve the most legally correct result in a case, maintaining decisional independence from agency management and programs.” **Section II. History and Role of the Administrative Hearing; Appendix B. NAHO Code of Ethics**

e. What is the best way to eliminate the perception of bias? The Department sought input from various groups of tax practitioners and is taking action to correct the problems they identified which affect the public's perception of the appeals process. **Section IV. Improving the Department's System of Taxpayer Administrative Appeals.** The Department looked at how the role of the

administrative appeal itself may contribute to the perception, and whether creation of an independent appeals tribunal could change the perception. The Department found that public perception of bias persists in some states even after creation of an independent appeals tribunal. **Section II. History and Role of the Administrative Hearing; Section V.5. Monetary Costs of Tax Court and Settlement Office**

3. Other states use a variety of tax appeals systems, from internal to external hearing offices, tribunals and courts. **Section III. Taxpayer Appeals in Other States**

4. Study participants were asked what they see as specific problems in the current tax appeals system. These are described in Section IV, along with possible resolutions for these problems and other steps the Department is taking to improve the appeals process. **Section IV. Improving the Department's System of Taxpayer Administrative Appeals**

5. Annual costs for the proposed tax court and settlement office were estimated, and nonmonetary considerations researched. **Section V. Proposal for Tax Court and Settlement Office**

Section I

Department Appeals and Settlement Procedure

Current Department Procedures for Audit, Settlement and Administrative Appeals
Audit and Appeal Statistics

INTRODUCTION: ANNUAL STATISTICS¹ IN A NUTSHELL

- A. How many tax assessments and adjustments-to-returns are issued each year?
200,000 returns examined²

12,000 audit assessments issued
+ 3,000 adjustment notices issued
15,000 cases opened in which taxpayers receive notice of some
change to their tax liability

- B. Of the 15,000 cases opened, how many request an appeal?

2,500 appeals are requested, out of the 15,000 cases opened
(the taxpayer has 60 days after assessment to request an appeal)

- C. Of the 2,500 appeals requested, how many are not resolved in the Division and continue on to be docketed for an appeal hearing?

102 cases per year, on average, remain unresolved by Compliance or Taxpayer Services, and are sent to Legal Division to be docketed for an appeal hearing

- D. Of 15,000 cases opened, how many are resolved without docketing for an appeal hearing?
14,898 cases are settled or otherwise resolved³ within the Compliance Division or the Taxpayer Services division without referring the case to the Legal Division to be docketed for an appeal hearing

¹ The annual numbers in this section are rounded approximations, based on the average of actual annual totals for 2008, 2009, 2010 and 2011. Actual annual totals and more detailed statistics are shown in Subsection 4, below.

² These numbers do not include the returns that are reviewed by computer for arithmetic error or omitted information, etc. These are returns which are examined by Department personnel, and include personal income tax returns, renter rebate and property tax adjustment, homestead declarations, sales and use tax, meals and rooms tax, withholding tax, corporate and business, estate and trust returns and others.

³ Cases are resolved when

- (a) taxpayer does not dispute the adjustment or assessment and pays the tax; or
- (b) taxpayer supplies the missing information or files the missing returns, and taxpayer pays the assessment; or
- (c) Department withdraws the assessment; or
- (d) taxpayer and Department settle the assessment.
- (e) for miscellaneous other reasons the assessment is withdrawn or the taxpayer withdraws the protest.

E. How many docketed cases are resolved before a hearing?

- 102 cases docketed for hearing in the Legal Division
- 69 cases settled or resolved within the Legal Division before the hearing⁴
- 33 cases continue on to be scheduled for a Commissioner's hearing

- 17 of the 33 cases scheduled for a hearing: the taxpayer fails to attend the hearing, with no explanation (taxpayer loses the appeal by default)

16 Subtracting the 17 "no show" defaults from the 33 docketed cases leaves an average 16 cases per year which go to hearing, followed by the Commissioner issuing a Determination

F. So, on average, what percentage of the 15,000 cases each year are unresolved and actually go to hearing and Determination?

16 cases go to hearing on average each year; this means that only 1/10 % of all cases remain unresolved and go to hearing and Determination

G. Who wins the 16 cases⁵ that go to Commissioner's hearings each year?

- 79.7 % of Determinations are for the Department
- 9.4 % of Determinations are for the Taxpayer
- 10.9 % of Determinations are partially for the Taxpayer

H. New York State has created an independent Division of Tax Appeals, where independent Administrative Law Judges hear the taxpayer appeals and write the determinations. Who wins the appeals⁶ that go to hearing before these independent ALJs each year?

- 71.0 % of New York ALJ Determinations are for the Department
- 14.9 % of New York ALJ Determinations are for the Taxpayer
- 14.1 % of New York ALJ Determinations are partially for the Taxpayer

⁴ See footnote 3 for reasons cases are resolved. See more detailed discussion in Subsections 2, 4 and 5, below.

⁵ The number of audits, settlements and appeals can vary greatly each year, and since so few cases go to hearing, an average of statistics over a four-year period 2008-2011 is used.

⁶ Average statistics for the four years 2008-2011; www.NYSDTA.org.

1. TAXPAYER OUTREACH AND INFORMATION SYSTEMS

One of the most important jobs of the Tax Department is to publish information and educate taxpayers so that compliance with the tax laws is made easier. With better information and education, there will be fewer taxpayer mistakes and less need for enforcement in the first place. The Legislature identified taxpayer outreach and information systems as the focus of this study, to improve tax administration. The Department is taking many steps to improve its performance in these areas:

The Department is meeting with various groups of tax practitioners to hear their concerns and suggestions and then taking action to correct and implement. The Department is also reviewing all correspondence to taxpayers, to ensure that it is simple and informative. We will also be reviewing all tax forms and instructions in greater detail than has historically been done, and will be rewriting the forms and instructions for greater clarity. As a result of our meetings with various groups of tax practitioners and ongoing outreach with the public, we are reviewing our audit procedures and creating a more predictable process for review with taxpayers, and creating new training programs for our compliance and taxpayer services staff. We are redesigning the Department's computer information systems, and creating new ways to provide information on our Web site and through computer social media, to keep information flowing to taxpayers and practitioners. Detail on these efforts is contained in Part I of this report.

2. DEPARTMENT AUDIT AND SETTLEMENT PROCEDURE

When the Compliance Division and Taxpayer Services Division review returns, they may find errors which require an adjustment to the amount of tax owed or may find items on the return which require further investigation. In other cases, Compliance may audit the taxpayer's return after receiving information from the IRS or another source that shows income was received by a person who did not declare that income or did not file a Vermont return. If any of these audit and review functions indicate that additional tax is owed, the Department issues an assessment notice to the taxpayer.

In many clear-cut cases, the taxpayer will pay the assessment. In other cases, the taxpayer may have informal conversations with the auditor, examiner or other personnel, as more information is gathered and the issues are discussed. The taxpayer may also request a more formal conference with a supervisor or director. Many cases are resolved during these discussions with the taxpayer.

Once an assessment is made, the law provides that the taxpayer has 60 days to appeal the assessment. Many taxpayers request an appeal even if discussions with Compliance or Taxpayer Services are ongoing, because they want to keep their options open. Once a taxpayer requests an appeal, the case is entered into the appeals database for tracking. Discussions may continue, but if the taxpayer and Division are unable to resolve or settle all the issues through these discussions, the taxpayer's appeal is then forwarded to the Legal Division to be docketed for hearing.

3. COMMISSIONER'S APPEAL

When a formal appeal is docketed, the General Counsel decides whether to assign a Department attorney or a Compliance Division or Taxpayer Services Division staff member to represent the Department. The choice of Department representative will depend on what issues are in dispute. The Department representative will talk with the taxpayer before the hearing to focus the issues and to see if there is any further possibility for settlement, and to discuss the evidence to be presented at the hearing. About 65 percent of docketed appeals are resolved before the hearing.

Some taxpayers who request a hearing simply fail to attend the hearing, with no notice to the Department that the taxpayer will not attend the hearing. Unexplained failure to attend a hearing results in loss of the case by default. 33 percent to 50 percent of scheduled appeals are lost by the taxpayer's unexplained failure to attend the hearing.

At the hearing, the proceedings are recorded. The taxpayer may attend alone (pro se), or may bring a Vermont accountant, CPA or attorney to represent her, and may bring witnesses. At the hearing, the hearing officer explains the hearing procedure to the taxpayer and the taxpayer's representative, unless the representative has attended an administrative appeal before. Hearings are informal, and court rules of procedure do not apply.

Each side is permitted to present their case and to offer witnesses and exhibits as evidence. Each side may question the witnesses of the other side and may object to any evidence offered. Evidence is rarely excluded, as long as the evidence is relevant, not redundant, and not privileged. At the end of the hearing, the record is closed; no more evidence may be submitted by either side. If the case is appealed, the reviewing court may not consider evidence which was not presented at the administrative hearing; but the court may choose to send the case back and require the Department to take any further evidence the court deems necessary.

The hearing officer is legally barred from discussing the case with the Department attorney, auditor or any other Department employee who is directly involved in the hearing, unless the taxpayer is also present at that discussion.

After the hearing is concluded, the officer writes a legal opinion for the Commissioner to review. The Commissioner reviews the opinion and the record and decides whether to uphold the Department or find for the taxpayer. If the Commissioner upholds the Department's action, the taxpayer may appeal to Superior Court to dispute the Department's action. If the Department loses, it may not appeal to Superior Court.

4. AUDIT AND APPEAL STATISTICS 2008 THROUGH 2011

The number of audits, settlements, appeals and other administrative actions varies somewhat from year to year. In order to present more meaningful statistics, the following statistics are from a multi-year period, 2008 through 2011:

A. AUDIT AND TAXPAYER SERVICES
DIVISION STATISTICS

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Returns examined ⁷ :	196,219	206,653	182,204	213,422
Assessment notices issued:	11,508	10,612	10,378	15,812
Adjustment notices issued:	4,203	3,136	2,645	2,607
Appeals requested by taxpayer:	3,070	2,892	2,305	1,966
% of assessments and adjustments appealed:	19.5%	21.0%	17.7%	10.7%
Unresolved appeals forwarded to Legal Division and docketed for hearing:	124	111	91	80
% of assessments and adjustments unresolved by Compliance Division or Taxpayer Services Division:	0.008 or 0.8%	0.008 or 0.8%	0.007 or 0.7%	0.004 or 0.4%
Division resolution rate:	99.2%	99.2%	99.3%	99.6%

⁷ These numbers do not include the returns that are reviewed by computer for arithmetic error or omitted information, etc. These are returns which are examined by Department personnel, and include personal income tax returns, renter rebate and property tax adjustment, homestead declarations, sales and use tax, meals and rooms tax, withholding tax, corporate and business, estate and trust returns and others.

B. DEPARTMENT LEGAL DIVISION STATISTICS

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Docketed appeals opened:	124	111	91	80
Docketed appeals closed:	110	95	105	101
<u>Reason closed</u>				
Department Withdrew Assessment	6	9	8	9
Taxpayer Filed Returns	18	15	11	5
Taxpayer Withdrew Appeal	29	21	21	10
Parties Settled	26	26	24	37
No-Show Default Determination	19	8	28	19
Combined two related appeals				1
Commissioner's determination issued; no further appeals	8	13	11 ⁸	17
Commissioner's determination issued; court appeals ended	4	3	2	3

C. WHO WINS AT THE COMMISSIONER'S HEARINGS?

<u>Determination found for:</u>				
Determination for Department ⁹	14	12	12	13
Determination for Taxpayer	0	4	0	2
Determination partially for Taxpayer	0	0	0	7 ¹⁰

⁸ There were only 12 determinations in 2010; the two determinations shown on this line were issued to the same taxpayer, once in the original determination, and again after remand.

⁹ Does not include determinations for the Department due to taxpayer's unexplained failure to attend hearing ("no show" default). Defaults were as follows: 2008, 19; 2009, 8; 2010, 28; 2011, 19.

¹⁰ Modified the deficiency, reduced the tax or audit period, or waived the penalty or interest. Two of these seven determinations concerned "household income" and netting of business losses and the Commissioner abated interest and penalties on all of these assessments, regardless of whether the assessment was appealed.

D. SUPERIOR COURT TAX APPEAL STATISTICS

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Court affirmed the Commissioner's decision	6	6		1
Court granted Dept's motion to dismiss taxpayer's appeal		1	1	2
Court affirmed in part, reversed in part			1	
Court reversed the Commissioner's decision	0	0	0	0
Court remanded to Commissioner for further action			1	2

E. SUPREME COURT TAX APPEAL STATISTICS

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Court affirmed the Commissioner's decision	3	1	1	
Court reversed the Commissioner's decision ¹¹			1	
Court remanded to Commissioner for further action			1	

¹¹ During this multi-year period, the Supreme Court also reversed one PVR decision. The statistics shown in the report, however, pertain only to Commissioner's appeals, not PVR appeals.

5. SETTLEMENT

About 80 to 90 percent of all audit assessments and adjustments are resolved each year without the taxpayer requesting an appeal. Many audit assessments are resolved by the taxpayer filing the missing returns or the missing information and paying the tax, or agreeing to pay the tax because it was the result of a taxpayer error which the taxpayer does not dispute. Many other assessments are settled by the taxpayer and the Department through discussions and the informal conference procedure within the Compliance Division or Taxpayer Services Division.

In the other 10 to 20 percent of assessment cases, the taxpayer requests an appeal, meaning 2,000 to 3,000 taxpayers request appeals. Even these requested appeals are mostly resolved within the Compliance or Taxpayer Services Divisions for the reasons just described. On average, only about 102 requested appeals each year remain unresolved and are sent on to the Legal Division to be docketed for hearing.

Of these 102 docketed appeals, about 67 percent are resolved before the hearing, for the reasons shown in Table 4.B., above. Only about 33 cases per year are actually scheduled for a hearing. In about half of these hearings, the taxpayer fails to attend, with no explanation, and therefore loses the appeal by default. So, on average, only about 16 cases per year actually result in a hearing and a Commissioner's determination. 16 cases represents about one-tenth of one percent, or 0.001 of all assessments and adjustments which are not resolved by the taxpayer and the Department.

If "settlement" means voluntary resolution of a case through party discussions, without the need for a hearing, then 99.9 percent of all assessment are "settled" by the parties each year.

"Settlement" in a more technical sense, however, usually means a case in which each of the parties accedes partially to the other side. An objection was raised during this study that taxpayer appeals to the Commissioner are not settled often enough. Litigation can be expensive, and going through an entire court proceeding presents various risks to both parties. These risks, or "hazards of litigation", include the unpredictable things that can go wrong in a trial, including losing the case. The hours of attorney time required to prepare for and present a court case are costly, too, and the parties are usually better off to take "half a loaf" and settle, each giving up something in order to avoid the greater costs and the unpredictability of a trial. The Department statistics show that of the appeals which are docketed for a Commissioner's hearing, about 28 percent are "settled" in this more technical sense, 49 percent are resolved by the taxpayer acquiescing in some form, and 8 percent are resolved by the Department withdrawing its assessment. About 15 percent actually proceed to hearing and determination.

It is important to note that settlement in the administrative law setting involves different considerations from settlement in private litigation. In a private law suit, settlement discussions involve only the individual interests of the two parties. On the other hand, in a tax appeal, the Department must take broader concerns into consideration in deciding whether to settle a case. First, the Department is charged by the Legislature with enforcing the tax laws. If the Department feels that a law requires it to take the position it did, it cannot settle only to save the time or expense of litigation. In addition, while the Department must consider the hazards of

litigation, it must also consider the equities of how settling the case might affect all the other taxpayers who have complied with this law. The Department must also consider how settling might affect the Department's ability to enforce that particular law against other taxpayers in future. Even "losing" at court may not be a detriment to the Department in the same way it would be to a private litigant: whether the Department wins or loses, the Department will be receiving clarification from the Judicial Branch as to how that law should be applied. In fact, in some cases the Department may be seeking judicial clarification on how broadly or narrowly the law should be read. In addition, the Department is charged with protecting the State Fisc through its enforcement of the tax laws. The Department must consider that one consequence of its action in settling an assessment or a disputed refund, credit or other benefit, will be to create a cost to all other taxpayers. The very few cases that reach the hearing stage at the Department are typically complex cases of major legal importance, which magnifies these considerations. For all of these reasons, settlement concerns in administrative law cases are different from settlement concerns of private litigants.

Section II

History and Role of the Administrative Hearing

1. The Rise of Statutory Law and Creation of the APA

Until the mid-nineteenth century, the American legal system was primarily a common law system. In that common law system, courts made most of the laws, as they had for hundreds of years in the English common law system, case by case. Case law developed out of disputes between two parties, one case at a time, and the pace of change was intentionally slow. After the middle of the nineteenth century, however, there began a pronounced increase in legislated (statutory) law.

The number of statutes began to increase with the advent of the Industrial Age and rapid growth in population, as American society became more complex and interdependent. Before the middle of the nineteenth century, legal concerns usually arose out of personal and local issues, and very few laws affected citizens on a national level. After the middle of the century, however, issues of national concern began to emerge. During the Civil War, for example, the national government needed uniformity in railroad track gauge and train schedules, so that troops could be moved predictably; troops did not have time to disembark at a state border to change to another train because the track gauge was narrower in the next state. New dangers from automated forms of transportation, factory machinery, and mass-produced food meant that the legal focus was shifting from local, state concerns, to national concerns, national laws, and a new era of regulatory law. With the Industrial Age came the creation of big business and the responding development of Federal anti-trust laws and labor laws. Publication of “The Jungle” in 1906 led to greater Federal regulation of food production. Reaction to the Great Depression brought laws to provide for

retirement security and to govern financial markets. By the end of the 1930's, Congress had created numerous Federal agencies to administer the numerous regulatory laws. Beginning in the 1950's and 1960's, state legislation and regulation began to grow, as well, and today, the regulatory complexity of the Federal government is mirrored by growth in administrative law to some extent in every state. American law had moved from a primarily common law basis to a primarily statutory basis. The number of court cases today which do not involve any statutory issues is approximately zero.

To administer the day-to-day detail of these laws, Congress gave agencies the authority to create administrative rules and the authority to provide an agency hearing to citizens who contest an agency action. In 1946 Congress adopted the Federal Administrative Procedure Act, to establish uniformity in how the various agencies would exercise their rule-making and hearing authority. Most states have also adopted a state version of an Administrative Procedure Act.

If the citizen is unable to resolve his issues at lower levels of the agency, the administrative hearing is his opportunity to put all the facts and law on the record for review by the agency head. The hearing also allows the agency head a fully-informed review of the agency action and a chance to alter that action if appropriate. If appealed to the courts, the Judicial Branch then reviews the administrative decision to ensure that the agency has acted reasonably, and not arbitrarily or capriciously, in its administration of the law.

2. Difference Between a Hearing Officer/Administrative Law Judge and a Judge in a Court of Law

“Hearing officer” and “administrative law judge” (ALJ) are two different names to describe the same position - an Executive Branch employee who hears contested cases in an

administrative agency and writes determinations of those cases. The use of the word “judge” in “administrative law judge” can create confusion, because the word “judge” may seem to imply that the person should be isolated from the agency in the same way that a judge in a court of law is isolated. However:

[A]dministrative judges and Article III [judiciary branch] judges perform fundamentally different roles in [our government]. Article III judges have authority to overrule the actions of the two elected branches. No such power inheres in the presiding officers at administrative hearings. So Article III judges perform a role in society which demands an independence that administrative judges do not and cannot have: they make decisions which can override the actions of the other two political branches.

James E. Moliterno, *The Administrative Judiciary's Independence Myth*, 41 Wake Forest L. Rev. 1191, 1231-1233 (2006). So the notion of separation of powers requires that the Judicial Branch be independent of the other branches of government, and allows it to override the other branches' actions. The administrative hearing and the hearing officer are not independent of the agency; they are an in-depth “quality control” step by the agency itself to ensure that it is administering the law correctly. The hearing provides the Commissioner with an impartial assessment of the case at the highest level in the agency, so the commissioner may review the agency's action with all of the fully-analyzed facts and legal arguments from both sides. If the commissioner affirms the agency's action, the taxpayer may then appeal to the Judicial Branch, which will review the commissioner's decision. The agency itself may not appeal from the commissioner's decision.

In his article, Professor Moliterno notes that independence is not necessary to provide impartiality in the hearing process: a hearing officer is not necessarily independent of the agency, but must adjudicate in an impartial manner. As noted, the agency hearing does not serve the same purpose as a law suit in a court of law: the agency hearing allows the taxpayer who is unable to resolve his issues at lower levels of the agency to take his case to the highest

level in the agency - the commissioner. The National Association of Hearing Officials has formalized a national code of ethics for administrative hearing officers, which includes the following:

Section III: Impartiality

Hearing officials should always strive to assure all persons involved that the proceedings will be conducted and decided impartially. "All persons involved" includes the appealing or petitioning parties and their representatives, the agency, agency staff or representatives, witnesses, interpreters, intervenors, observers, and any other person who appears before the hearing official, whether in person, in writing, or by electronic means.

Hearing officials should act in such a way that no one could reasonably believe that any person or agency could improperly influence them in the performance of their duties.

Hearing officials should not conduct or participate in deciding the outcome of any proceeding in which their impartiality might be reasonably questioned. However, the hearing official should not withdraw from a proceeding if the hearing officials' impartiality is challenged solely on the basis that the hearing officials are employed by an agency appearing in the proceeding. . . .

Section IV: Independence

The administrative hearing process requires re-examination and reappraisal of determinations made by an administrative agency. Regardless of the hearing official's employment relationship with a party agency, the hearing official should exercise independence of action and judgment to protect the due process rights of parties and to achieve the most legally correct result in a case, maintaining decisional independence from agency management and programs. . . .

National Association of Hearing Officials, Code of Ethics, Sections III, IV. *See* full text of code of ethics in Appendix B.

3. Is There Bias or Lack of Fairness in the Administrative Hearing Process?

The U.S. Supreme Court and the Vermont Supreme Court have each ruled that there is nothing inherent in the administrative judge's position as an employee within the agency that reduces his or her ability to judge impartially; agency hearings provide due process, and in

addition, there is no bias inherent in the fact that the hearing officer or ALJ is an agency employee. Town of Victory v. State of Vermont, 177 Vt. 383 (2004). The mere structure of the administrative hearing and administrative judge system does not of itself create the potential for bias. Schweiker v. McClure, 456 U.S. 188, 195 (1982).

In fact, the Vermont Supreme Court has ruled that the same employee who signed the Department letter notifying the taxpayer of the tax assessment may also serve as the hearing officer in that case, “without losing their judicial balance.” Rock v. Department of Taxes, 170 Vt. 1 (1999). In Rock, the Court said,

[The appellant must show] actual or potential bias.... Absent such bias, it is well settled that a hearing officer may both initiate and then adjudicate a case without violating due process because agency directors can act on the recommendation of investigators without losing their judicial balance.

Id. at 12 (citing Department of Taxes v. Tri-State Indus. Laundries, 138 Vt. 292 (1980)). In Tri-State Laundries, the Court was even more pointed in its endorsement of the agency hearing as a fair and unbiased forum:

The taxpayer argues, however, that it could not receive a fair hearing because the tax department's attorney and many of its witnesses were associates of the hearing officer, and the hearing officer was the official who had in fact directed the initiation of proceedings against the taxpayer in the first place. Although due process imposes some limits on multiplicity of functions by individuals in the course of contested cases, it does not similarly limit multiplicity of functions by the agency in toto. The fact that one individual within the agency is a witness, another is a prosecutor, and a third is a judge, presents no more conflict than the fact that a state police officer can testify for a state's attorney before a state judge. K. Davis, *Administrative Law Text*, supra, s 13.01-.02. Furthermore, the fact that the hearing officer ordered the initiation of the prosecution is generally considered insufficient to require disqualification, because “agency heads probably can pass upon recommendations of investigators to prosecute a case without losing their judicial balance.” K. Davis, *Administrative Law Text*, supra, s 13.04 at 260. *We conclude, therefore, that the taxpayer had an adequate opportunity to present its case in a fair hearing.*

Id. at 296 [emphasis added].

4. “Exhaustion of Administrative Remedies” Principle

It is a commonly-accepted principle of law that courts in the Judicial Branch will not accept a case on appeal from an administrative agency unless the parties have first taken all steps available to resolve the dispute at the agency level, including any available appeal to the commissioner. This doctrine is known as the “exhaustion of administrative remedies.” This principle ensures that administrative cases are resolved quickly and economically for the citizen and for the courts:

The exhaustion rule serves a legitimate state interest in requiring parties to exhaust administrative remedies before proceeding to court, thereby preventing an overworked court from considering issues and remedies that were available through administrative channels. It also encourages the use of more economical and less formal means of resolving disputes and is credited with promoting accuracy, efficiency, agency autonomy, and judicial economy.

2 Am. Jur. 2d Administrative Law § 474 [citations omitted]. The U.S. Supreme Court describes the exhaustion principle in similar terms:

Exhaustion of administrative remedies serves two main purposes: first, it protects administrative agency authority, in that it gives an agency an opportunity to correct its own mistakes with respect to the programs it administers before it is haled into federal court, and it discourages disregard of the agency's procedures, and, second, it promotes efficiency, in that claims generally can be resolved much more quickly and economically in proceedings before an agency than in litigation in federal court.

Id. (quoting Woodford v. Ngo, 126 S. Ct. 2378, 165 L. Ed. 2d 368 (U.S. 2006)).

Exhaustion of remedies is required by statute in Vermont’s Administrative Procedure Act. 3 V.S.A. § 815(a).

5. Is the Taxpayer Disadvantaged by Having the Factual Record Determined at the Agency Hearing?

As noted above, administrative hearings provide an informal and inexpensive means for a citizen to take issue with an agency action, in a far less intimidating atmosphere than in a

courtroom, where a citizen would be unlikely to feel comfortable appearing on his or her own behalf, without an attorney: The taxpayer does not need to know the rules of court procedure or rules of evidence that apply in court. “One of the purposes of administrative remedies is to enable parties to resolve their disputes in a less cumbersome and less expensive manner than is normally encountered at a trial in court.” 2 AmJur 2d. Administrative Law, § 4 *Advantage of Administrative Process*, (2010).

Administrative hearings allow the agency, which has the technical expertise and experience, to develop the factual record “according to the more informal procedures” allowed in an agency hearing, and to provide “the courts the benefit of the specialized expertise of the Commissioner.” Stone v. Errecart, 165 Vt. 1, 5 (1992). Evidence is rarely excluded in an administrative hearing, so long as it is relevant to the case. Even if it is excluded, the taxpayer may ask the Superior Court to require the commissioner to reopen the case to take more evidence into the record if it was erroneously excluded. This right of the taxpayer is codified in Vermont’s Administrative Procedure Act. 3 V.S.A. § 815(b).

One test of whether the taxpayer is disadvantaged by having the factual record determined at the agency level is whether the taxpayer wins more often when the record is determined by an independent entity. A comparison of the determinations¹² for the taxpayer by the independent administrative law judges of the New York Division of Tax Appeals, as measured against the determinations for the taxpayer by the Vermont Department of Taxes hearing officer, shows a similar rate of opinions for the taxpayer and partially for the taxpayer in both forums.

¹² See Section I, Introduction, G, H.

6. What Issues Might Be Raised if the Commissioner's Hearing is Moved Outside the Department to an Executive Branch Tax Court?

As noted in Section III of this report, other states use a variety of models for the hearing function. Some are completely integrated into the agency, while others are integrated but physically separated, and some are completely independent entities. Many of the states which have created outside entities to hear taxpayer appeals have also retained their department hearings, simply adding the outside entity as an additional layer of review or as a substitute for the lower-court level of review. The proposal which is addressed in section V of this study is a proposal to eliminate the hearing function from the Department. While replacing the commissioner's hearing with an executive branch tax court might remove the perception of bias, it would also create changes in the tax appeal process. Such a proposal should be accompanied by a discussion of how those changes would affect the citizen, the Department, and the implementation of administrative policy.¹³ Some of these issues may have been addressed by Vermont's Department of Labor and Agency of Human Services, both of which have independent appeal entities and may be able to provide insight into the history and functioning of these appeals processes. The Labor Department does not use an independent entity for its tax appeals, however.¹⁴

Implementation of policy plays a role when the hearing is within the agency, because the hearing officer's determination is presented to the commissioner for approval. That is, the determination is the commissioner's determination. If the hearing function is independent of the

¹³ Many of these issues are described in Section V of this report.

¹⁴ While labor law appeals are handled by the independent Labor Relations Board, the Labor Department has a mandatory in-house administrative appeal system for appeals related to the unemployment insurance tax. The tax hearing officers ("referees") are department employees. A decision of the hearing officer/referee may be appealed to the Employment Security Board, which is chaired by the Commissioner of Labor. From the Board, further appeal is to the Supreme Court. 21 V.S.A. §§ 1330 - 1332, 1337a.

agency, the determination is not presented to the commissioner, and she has no administrative or policy input into the result at that point. The commissioner's review ensures that a determination is consistent with agency policy. This policy consistency is one of the reasons the Administrative Procedure Act specifically allows the hearing officer to confer with other employees in the agency (though the Act forbids the hearing officer to confer with any employee directly involved in the hearing, unless the taxpayer is also present at the discussion):

3 V.S.A. § 813. Ex parte consultations

Unless required for the disposition of ex parte matters authorized by law, members or employees of any agency assigned to render a decision or to make findings of fact and conclusions of law in a contested case shall not communicate, directly or indirectly, in connection with any issue of fact, with any person or party, nor, in connection with any issue of law, with any party or his or her representative, except upon notice and opportunity for all parties to participate.

An agency member:

- (1) *May communicate with other members or employees of the agency;* and
- (2) *May have the aid and advice of one or more personal assistants.*

3 V.S.A. § 813 [emphasis added]. The appropriateness of the hearing officer communicating with other members of the agency has been articulated several times by the Vermont Supreme Court, as noted above, when it ruled that the agency hearing process affords due process, with no inherent bias or lack of impartiality.

As noted, the agency hearing provides an informal opportunity for the citizen to have her case heard by the agency at the highest level. Removing this "last look" hearing from the agency takes away the citizen's opportunity to say "I want to talk to your boss" about an unresolved issue. Forcing the citizen to appeal to an outside tax court before this point means replacing that informal, inexpensive hearing with a new layer of formal court review.

The administrative consistency which is provided by agency determinations, along with an agency hearing process which is professional and impartial, creates a public trust and confidence in the agency's administration of the tax laws. As Professor Moliterno notes (commenting about creating a separate, central panel of Federal ALJs), the more the hearing officer is separated from the agency, the greater the erosion of public confidence and trust in the executive branch:

Insofar as [central panels of ALJs] further the rupture of the administrative judiciary from the executive branch, they are an undesirable development in the law. . . . If they were meant to be independent of the executive branch, Congress would have established administrative courts in the judicial branch. . . . To call for the ALJ to aspire to judicial independence offers real potential for the loss of public trust and confidence in the administrative adjudicative process because the public would no longer be able to rely on administrative judge fidelity to agency goals and policies. [T]his role of furthering agency policies defines the essential quality of administrative judges' work that makes them indispensable to the administration of justice.

James E. Moliterno, *The Administrative Judiciary's Independence Myth*, 41 Wake Forest L. Rev. 1191, 1231-1233 (2006).

Section III

Taxpayer Appeals in Other States

1. INTRODUCTION

States use a variety of entities for taxpayer appeals of agency actions.

In 35 states, the taxpayer appeal begins with an administrative appeal within the tax department or tax agency that must be taken before the taxpayer may appeal to an outside entity.¹⁵ This “in-department appeal” may be a formal or informal review of the agency action, but results in an agency determination. In these states, review by the independent appeal entity occurs after the administrative appeal in the tax department; the independent entity is either an added layer of review or replaces the trial court level of review.

7 states have an in-department administrative appeal, but the taxpayer may opt to pay the tax (or post a bond) and proceed directly to a Judicial Branch court (6 states) or a tax court (Oregon) for appeal. These states are Illinois, Michigan, Oregon, Tennessee, Texas, Virginia and Washington.

2 states have an in-department administrative appeal, but the taxpayer may opt to appeal directly to a Tax Appeals court. These states are Hawaii and Kansas.

6 states and the District of Columbia have no in-department appeal; the taxpayer appeals directly to an independent administrative appeals entity, and then to court. These states are Maine (beginning July 2012), Missouri, Montana, New York, West Virginia and Wyoming.

The Federation of Tax Administrators (FTA) and the Council on State Taxation (COST) have each published a list of the types of appeal entities available in all the states and the District of Columbia, and this information is combined in the table shown below in Subsection 3.¹⁶

The FTA and COST lists did not indicate whether each state also has an in-department administrative appeal and if so, whether it must be taken before proceeding to an outside entity. Information on in-department administrative appeals was obtained from Bureau of National Affairs, Multistate Portfolio 1700-2nd, “State Tax Appeal Systems”; Research Institute of America’s “Checkpoint” data service; and by direct communication with several states. States with an in-department administrative appeal which must be taken before appealing to an outside

¹⁵ See also “Exhaustion of Administrative Remedies” in Section II.4. of this report.

¹⁶ This information comes mainly from “The Best and Worst of State Tax Administration” by Council on State Taxation, February 2010; and “State Tax Appeal Systems” by Federation of Tax Administrators Research Report 144, August, 1994. Both reports list New Hampshire as using an independent board for tax appeals, but the New Hampshire Department confirms that their independent board is for property tax appeals, and that all other tax appeals are by the hearing office within the tax department.

entity are indicated by an asterisk in the tables in Subsections 3 and 5 below. The resulting table shows that most states which have created an independent tax appeal entity have retained an in-department administrative appeal.

2. RECENT PROPOSALS IN THREE OTHER STATES

Alabama, Maine and Mississippi state legislatures have recently considered creating taxpayer appeal entities outside their tax departments. These states were contacted to discuss the details of actions taken, and the proposals for each state are discussed in Subsection 4, below.

3. LISTING OF STATES' TAX APPEAL ENTITIES

States which have an in-department administrative appeal process which must be used before proceeding to the outside entity are indicated by an asterisk¹⁷ on the following list of Tax Appeal Entities.

TAX APPEAL ENTITIES

Judicial Branch courts (5 states)

Arizona*
Hawaii
Indiana*
New Jersey*
Oregon

Local court tax division (1 state + DC)

Connecticut*
District of Columbia

Executive Branch tax courts (2 states)

Maryland*
Minnesota*

Tax tribunals (2 states)

Michigan
New York

¹⁷ This information was obtained from Bureau of National Affairs, Multistate Portfolio 1700-2nd, "State Tax Appeal Systems"; Research Institute of America's "Checkpoint" data service; and conversations with various state tax departments.

Tax boards¹⁸ (15 states)

California* (personal income, corporate franchise tax)
California* (property tax, sales and use tax, misc. taxes)
Delaware*
Iowa*
Kansas
Kentucky*
Louisiana*
Massachusetts*
Missouri
Montana
North Carolina*
Ohio*
Pennsylvania*
Washington
Wisconsin*
Wyoming

Tax commissions¹⁹ (5 states)

Idaho*
Nevada*
Oklahoma*
South Carolina*
Utah*

Tax departments (20 states)

Alabama*
Alaska*
Arkansas*
Colorado*
Florida*
Georgia*
Illinois
Maine**
Mississippi*
Nebraska*
New Hampshire*
New Mexico*
North Dakota*
Rhode Island*
South Dakota*

¹⁸ In some states the tax or revenue department is called a “board”; in other states the board is a separate entity from the tax department.

¹⁹ In some states the tax or revenue department is called a “commission”; in other states the commission is a separate entity from the tax department.

Tennessee
Texas
Vermont*
Virginia
West Virginia

*An asterisk indicates a state which requires an in-department administrative appeal by the taxpayer before the taxpayer may proceed to an independent entity for an outside appellate review.

**Maine currently requires an in-department appeal before proceeding to an outside appellate entity; but Maine is in the process of implementing 2011 legislation to move the department's appeal division out of the department by July 2012. *See* discussion below at Subsection 4.

4. THREE STATES WITH RECENT LEGISLATIVE PROPOSALS TO CREATE OUTSIDE APPEAL ENTITIES

Alabama

Alabama's proposal is still pending in the legislature, and would not eliminate the commissioner's appeal within the Department.

Alabama has a required administrative appeal. After the administrative appeal, the taxpayer has a choice of appeal to the Circuit Court or to the Department's administrative law judge. The ALJ is appointed by the commissioner.

A legislative proposal is pending in the Alabama legislature which would retain the mandatory administrative appeal, but move the ALJ out of the Department. If that were adopted, the taxpayer would have a choice of appeal from the department determination to either an executive branch ALJ or to the judicial branch Circuit Court.

Maine

Maine is in the process of implementing new legislation to eliminate the commissioner's appeal within the Department and move the appeals division outside the department.

Maine's current commissioner's appeal is an informal conference with no record of the proceedings, followed by a written determination. The determination is then appealable de novo to the judicial branch trial court.

Maine last year passed legislation to move the appeals function (and its four hearing officers) out of the department to a separate office in July, 2012. The legislation may be amended this session, before the July, 2012, effective date.

Mississippi

Mississippi has implemented legislation which retained the commissioner's appeal within the Department, but added a new layer of review by an independent Board of Tax Appeals, before the taxpayer goes to the judicial branch courts for further appeal.

Until 2009 Mississippi handled taxpayer appeals within its Tax Commission (the "commission" was Mississippi's tax department). In 2009, it split the commission into a Department of Revenue and an independent Board of Tax Appeals. The Department of Revenue still hears taxpayer appeals through its in-house "Review Board". The department appeal is mandatory - the taxpayer must exhaust this administrative remedy before going to the new outside Board of Tax Appeals. If the taxpayer fails to attend the Department hearing, the matter is considered involuntarily withdrawn and cannot be further appealed.

The new Board of Tax Appeals is not in place of, but in addition to, the Department appeal. There is no record made of the appeal to the Department or of the appeal to the Board of Tax Appeals. From the Board of Tax Appeals, the taxpayer may appeal to the Judicial Branch courts, de novo.

5. ALPHABETICAL LISTING OF ALL 50 STATES PLUS THE DISTRICT OF COLUMBIA²⁰

* = State has a required department administrative tax appeal process.

N = State has no personal income tax.

Div = State has a tax on dividend income.

Alabama*

Required department admin appeal; then choice of appeal to Dept ALJ or circuit court; pending legislation to move ALJ out of department

Alaska*N

Required department admin appeal; then to Office of Tax Appeals or to Superior Court (must pay tax before Superior Court appeal)

Arizona*

Required department admin appeal, with determination appealable to either the department director or Arizona Board of Tax Appeals or Tax Court

Arkansas*

Required department admin appeal; then to Circuit Court

²⁰Information in this subsection was obtained from Bureau of National Affairs, Multistate Portfolio 1700-2nd, "State Tax Appeal Systems"; from Research Institute of America's "Checkpoint" data service; and from conversations with various state tax departments.

California*

Required department admin appeal; then to State Board of Equalization, then to Superior Court

Colorado*

Required department admin appeal; then to district court

Connecticut*

Required department admin appeal; then to “Tax Session” division of Superior Court

Delaware*

Required department admin appeal; then to Tax Appeals Board, then to Superior Court

District of Columbia

Taxpayer has choice of appeal to independent Office of Administrative Hearings or D.C. Superior Court (must pay tax before appeal to Superior Court)

Florida*N

Required department admin appeal; then to circuit court

Georgia*

Required department admin appeal; optional further appeal to Commissioner; then to Superior Court

Hawaii

Taxpayer has choice of appeal within the department, or directly to Tax Appeal Court

Idaho*

Required department admin appeal; then to Board of Tax Appeals (if \leq \$25,000 including penalties + interest) or to district court

Illinois

Taxpayer has choice of appeal within the department, or pay the tax in full and appeal directly to circuit court; commissioner’s determination is appealable to circuit court

Indiana*

Required department admin appeal; then to Tax Court

Iowa*

Required department admin appeal to department’s ALJ; then to department director or Tax Review Board; then to district court

Kansas

Taxpayer has choice of appeal to department director or directly to Court of Tax Appeals

Kentucky*

Required department admin appeal; then to Board of Tax Appeals, then to circuit court

Louisiana*

Required department admin appeal; then to Board of Tax Appeals or pay the tax and appeal to district court

Maine

Currently has required department admin appeal; then to superior court; but recent legislation will move the department's administrative appeals outside the department to become an independent appeals office as of July 2012

Maryland*

Required department admin appeal; then to tax court; then to circuit court

Massachusetts*

Required department admin appeal; then to appellate tax board; then to appeals court

Michigan

Taxpayer has choice of appeal within the department or, pay the tax and go directly to court of claims; commissioner's determination is appealable to Tax Tribunal, or pay the tax and appeal to court of claims

Minnesota*

Required department admin appeal; then to tax court; then to Supreme Court

Mississippi*

Required department admin appeal; then to Board of Tax Appeals; then to chancery court

Missouri

Taxpayer appeal is to independent Administrative Hearing Commission; then to court of appeals; or taxpayer may pay the tax and appeal directly to circuit court; then to supreme court

Montana

Taxpayer appeal is to independent Office of Dispute Resolution; then to district court, then to supreme court

Nebraska*

Required department admin appeal; then to district court, then to court of appeals, then to supreme court

Nevada*N

Required department admin appeal; then to Nevada Tax Commission; then to district, then to supreme court

New Hampshire* N Div

Required department admin appeal; then to superior court, then to supreme court

New Jersey*

Required department admin appeal; then to tax court; then to superior court; then to supreme court

New Mexico*

Required department admin appeal; then to court of appeals, then to supreme court

New York

Taxpayer appeal is to independent Division of Tax Appeals (DTA) appeals unit for hearing by ALJ, then to DTA appeals tribunal; taxpayer (but not tax department) may then appeal to supreme court, then to court of appeals.

North Carolina*

Required department admin appeal; then to independent Tax Review Board; then to superior court, then to court of appeals, then to supreme court

North Dakota*

Required department admin appeal; then to district court, then to supreme court

Ohio*

Required department admin appeal; then to Board of Tax Appeals; then to court of appeals, then to supreme court

Oklahoma*

Required department admin appeal; then to Tax Commission; then to supreme court

Oregon

Taxpayer has a choice of appeal within the department, or pay the tax and appeal directly to tax court; then to supreme court

Pennsylvania*

Required department admin appeal (appeal is to the Board of Appeals, but this is a division within the tax department); then to Board of Finance and Revenue; then to commonwealth court, then to supreme court

Rhode Island*

Required department admin appeal; then to district court, then to supreme court

South Carolina*

Required department admin appeal; then to circuit court, then to court of appeals, then to supreme court

South Dakota*N

Required department admin appeal (hearing is by an independent Office of Hearing Examiners, but Secretary of Revenue reviews the ALJ opinion and either adopts it or issues Secretary's own determination); then to circuit court, then to supreme court. If Secretary affirms the ALJ opinion, taxpayer must pay the tax before proceeding to court.

Tennessee N Div

Taxpayer has a choice of appeal within the department, or pay the tax and appeal directly to chancery court; then to supreme court

Texas N

Taxpayer has a choice of appeal within the department, or pay the tax and appeal directly to district court; then to court of appeals, then to supreme court

Utah*

Required department admin appeal; then pay tax, penalty and interest and may appeal to district court, then to supreme court

Vermont*

Required department admin appeal; then to superior court, then to supreme court

Virginia

Taxpayer has a choice of appeal within the department, or pay the tax and appeal directly to district court; then to supreme court

Washington N

Taxpayer has a choice of appeal within the department, or pay the tax and appeal directly to superior court; then to court of appeals, then to supreme court

West Virginia

Taxpayer appeal is to independent Office of Tax Appeals; then tax must pay the tax to appeal to circuit court; then to supreme court

Wisconsin*

Required department admin appeal; then to Tax Appeals Commission; then to circuit court, then to court of appeals, then to supreme court

Wyoming N

Sales and use taxes are appealed directly to State Board of Equalization; then to district court, then to supreme court (Wyoming only has the following major taxes: sales and use, liquor, mineral, property)

Section IV

Improving the Department's System of Taxpayer Administrative Appeals

INTRODUCTION

One of the legislative directives to the Department was to study “how to improve its system of taxpayer administrative appeals”.

To determine how to improve the appeals system, the Department set up meetings with representative groups of tax attorneys, tax preparers and Certified Public Accountants to discuss any issues they might have with the appeals process and with taxpayer service in general. In addition, Department personnel met with the Director of the Compliance Division and the Director of the Taxpayer Services Division, to discuss all the steps from audit to settlement or appeal, to determine how to expedite that process and how to communicate the process to taxpayers.

With the information gained from these meetings, the Department rewrote the regulations pertaining to taxpayer appeals, and created new letters to be sent to taxpayers at the time they docket their appeal and when they receive notice of the scheduled appeal. The proposed new regulations are shown in Appendix C, and the new taxpayer letters are in Appendix D. In addition, the Department is creating a prescribed process for the steps between audit and appeal. The Department is also reviewing correspondence to taxpayers related to audit and assessment, and is revising these for greater simplicity and clarity. The Department is designing new training programs for Compliance and Taxpayer Services personnel including training on taxpayer communication, settlement negotiations and complex or frequent tax issues. Finally, the Department is redesigning its Web site and will be including new sections for tax alerts and options for the public to sign up for automatic notices of new tax information.

Major issues raised in the meetings with the tax attorneys, preparers and CPAs which relate to appeals are summarized in the “Issues” section below. Following each issue is a summary of the specific action taken by the Department to address that issue.

Taxpayer outreach issues unrelated to appeals were also raised in these meetings, and these are discussed in Part 1 of this report.

ISSUES RELATED TO CURRENT APPEALS SYSTEM RAISED DURING THE STUDY AND DEPARTMENT ACTIONS TAKEN

1. Comment: The Department needs to make its audit and assessment notices clearer. Also, more quality control before the assessment notice is issued could eliminate a lot of appeals.

ACTION TAKEN: *The Department has simplified and clarified its audit and assessment notices, and created a uniform template for the notices, which requires the Department staff to clearly state the issues to be resolved. The Department is also reviewing its taxpayer correspondence, in a Department-wide project to improve communication with taxpayers and tax preparers.*

Quality control will be increased by new mandatory periodic training of audit personnel by the Chief Counsel and Division Directors on how to articulate and focus the audit issues in communications with taxpayers. The Department will also be researching possible options for additional compliance training from national tax associations and from the IRS.

2. Comment: The Department should create an audit division appeal, giving a second look before the taxpayer requests a Commissioner's appeal.

ACTION TAKEN: *The Department does in fact have such a process. In response to comments received during this study, the process has been reviewed, revised and made more uniform.*

In addition, the Department is updating its internal procedures with regard to informal conferences, and creating a simple written statement of the process, to be mailed to every taxpayer with an assessment.

3. Comment: Everything doesn't need to go to the mat; the Department should settle cases more often and consider the hazards of litigation.

ACTION TAKEN: *The Department has created a checklist of considerations when reviewing or offering a settlement proposal. There are actually very few cases in which the taxpayer and the Department do not voluntarily resolve the issues. From about 15,000 assessments each year, only about 102 remain unresolved and are actually docketed for an appeal hearing. Of those 102, only about 16, on average, are cases in which the parties do not eventually resolve all the issues. Those 16 proceed to a hearing and Commissioner's determination. This means that the Department rate of case resolution for all assessments is 99.9 percent.*

Of the 102 or so appeals which are docketed for a Commissioner's hearing each year, about 25 - 30 percent settle, and another 40 - 45 percent are otherwise resolved (taxpayer withdraws, Department withdraws, taxpayer defaults, etc.). The overall resolution rate for docketed appeals, including settlement, is nearly 70 percent. Only about a third of docketed appeals - or about 33 appeals per year - remain unresolved. In about half of these 33,

the taxpayer defaults, and the remaining 16 or so proceed to hearing and determination. Details of how these cases are resolved and detailed statistics are contained in Section I of this report. Settlement considerations in administrative law are somewhat different from settlement considerations in private litigation. See Section I.5.

4. Comment: You should bifurcate the process for smaller assessment amounts.

ACTION TAKEN: *More information is needed on why this is requested and what the problem is that needs to be addressed before creating a separate process based on dollar amounts at issue. The Department does take into account the assessment amount at issue, but settlement is not usually driven by how small or large the amount is; it is more often driven by the nature of the legal issues and policy consequences.*

5. Comment: Tax Examiners' reports should spell out their tax positions in detail; not just cite a statute, but explain the position.

ACTION TAKEN: *See response to item #1, above.*

6. Comment: The Department should not change its arguments and issues during the progress of the case without warning to the taxpayer. Sometimes new issues are legitimate to raise, but the taxpayer needs to know up front when the issues arise.

ACTION TAKEN: *The Department does try to identify for the taxpayer all legal issues involved in an assessment or appeal, and in turn, taxpayers and their counsel usually try to keep the Department informed of all the legal issues in the case, as well. As a case develops, however, unforeseen issues can arise. Even in the face of unexpected developments, though, the Department and taxpayer's counsel usually apprise each other.*

It is rare that an issue arises for the first time at the hearing, though there have been a few times when either taxpayers have raised defenses at the hearing which they had not raised before, or the Department has raised new bases for assessment or refund denial. The cause for this is usually that the party could not have known of the issue at an earlier date, or perhaps just did not think of it until almost too late in the process.

Late-arising issues without forewarning do occasionally happen, whether in administrative hearings or in court proceedings, but late-arising issues used intentionally for "trial by ambush", while legal, should be avoided, and the Department agrees that this approach to tax litigation is undesirable. Having received this comment during the course of this study, the Department will emphasize its efforts to keep taxpayers and their counsel informed of new issues as soon as they arise.

7. Comment: Some cases require policy input from the Commissioner. How can she provide policy input if the case is under appeal, or even may become under appeal, given the ex parte rule?

ACTION TAKEN: *In discussions with the Attorney General's Office, the Department learned that this issue comes up in all departments. The Commissioner may discuss the case with the taxpayer, as long as the Department representative is also present. 3 V.S.A. § 813.*

It is also of interest to note that the Commissioner's ability to move a case toward settlement may be lessened if the hearings are moved out of the Department: With the hearing inside the Department, the Commissioner has the ability to see the proposed determination, after the full hearing and full legal briefing by both sides, and have input into whether to go forward with that determination. The Commissioner may ask for a status conference, to ask the two sides to negotiate a settlement. On the other hand, if the hearing is by an independent tax court, the Commissioner never gets to see the fully briefed case before it goes to court, and loses the ability to have policy input at that stage.

8. Comment: Several tax preparers and CPA's mentioned that the Commissioner's appeal process was unfair, because the Hearing Officer discusses the case with the Department's attorney and auditor assigned to the appeal.

ACTION TAKEN: *These preparers and CPA's were surprised to learn that Vermont law forbids the hearing officer from discussing the taxpayer's case with any Department staff who are directly involved in that hearing, including Department attorneys, auditors, compliance personnel or others, unless the taxpayer is also present at the discussion.*

To assure taxpayers that the hearing officer will not discuss their case with the Department auditor, attorney or others, the Department has added an explanation of this law to the letters it sends to taxpayers when their appeals are docketed for hearing. (See Appendix D)

9. Comment: The Department should publish its proposed regulations and technical bulletins for comment by the tax bar.

ACTION TAKEN: *The Department does publish its proposed regulations for comment. Regulations have the force of law, and for this reason they must be adopted through a prescribed process which includes several requirements similar to the requirements for adoption of statutes by the legislature. Part of this process requires publication of the proposed regulation and a period for public comment, followed by legislative review of the regulation.*

Technical bulletins, however, do not have the force of law. They are one of many ways in which the Department notifies the public of its various policy decisions in the daily administration of the tax laws. Through technical bulletins, instruction booklets, taxpayer alerts,

press releases and other publications, the Department provides information for the public on specific topics of tax administration. The Commissioner has made it a top priority to increase Department endeavors to solicit public comments and suggestions on topics of tax policy and administration, including issues which may be addressed in upcoming technical bulletins. As a part of the Commissioner's actions to increase public awareness and public input, she continues to meet personally with various groups of taxpayers and practitioners, both to seek their comments and to provide them with information about developing tax policy. Through these efforts and also through Web site re-design and other technology, the Department is working to increase the flow of information from, and to, the Department.

Section V

Proposal for Tax Court and Settlement Office

1. INTRODUCTION

The legislative directive for this study asked that the Department look at ways to improve its system of taxpayer administrative appeals, and include in the study a review of the feasibility of creating an appeals officer or body independent of the Department of Taxes. This section of the report looks at the issues raised by a proposal to the General Assembly from several Vermont tax attorneys to replace the Department's commissioner-level appeal with an independent tax court in the Executive Branch and to replace the Department's settlement function with an independent, optional settlement conference. Following a discussion of the issues in Subsections 1 through 4 is an estimate of costs in Subsection 5, based on the details of the proposal.

Quick summary of the tax court proposal

The proposal is to replace the in-department commissioner-level appeal with an independent tax court in the Executive Branch. The tax court would function like a Superior Court, but would only hear tax appeals. From the tax court, appeal would be to the Superior Court and then to the Supreme Court.

The tax court would incorporate court rules for procedure, including service of process on the parties, pleadings and discovery, and would charge a \$250 filing fee. Either party could appeal from the tax court to the Superior Court and Supreme Court.

The tax court would have its own budget and appropriation to maintain offices and hearing rooms in a building separate from the Tax Department and in other locations in the state, maintain its own library and office equipment, publish its opinions in an official court reporter, and hire tax court hearing judges and support personnel.

Independent settlement office

The proposal would also replace the in-department settlement function with an optional independent settlement conference.

It is not specified in the proposal at what point the taxpayer would stop negotiations with the Department and proceed to the independent settlement office. The proposal provides that the

Department would promulgate a regulation to define when the Department's action becomes "final".

Currently, when an assessment is made, the taxpayer has 60 days to file an appeal (*see* Section I for details), and about 2,000 to 3,000 taxpayers a year request an appeal. More than 95 percent of these requested appeals are resolved by the taxpayers and the Compliance or Taxpayer Services Division; the 102 or so cases that remain unresolved proceed to the Legal Division to be docketed for a hearing. It would need to be defined at what point the taxpayer would stop negotiating with Compliance or Taxpayer Services and move to the independent settlement office; this is the "final" stage that the Department would need to define in a regulation.

One possibility would be to set a time limit. If, for example, the taxpayer and Compliance Division had not resolved the case within 60 days, the taxpayer could choose to move to a settlement conference. A time limit would be somewhat arbitrary, since a more complex corporate case might take several months to negotiate, while a homeowner rebate case might only take a week or two. If, on the other hand, all settlement should be handled by an independent entity, then taxpayers should have the option to go directly to the settlement office as soon as the appeal has been requested, and the Department's action would be "final" at that point.

Once the Department's action is final, the taxpayer would choose whether to go to the independent settlement conference or go directly to the tax court. Under the proposed system, taxpayers might feel that they needed an attorney or representative for the independent settlement conference, because the conference would consist of the taxpayer and the Department presenting their case to an outside office unfamiliar with the facts and issues. Rather than go through the expense and time required for two proceedings (settlement conference and tax court trial), many of these 2,000 to 3,000 taxpayers might opt to go directly to the tax court trial. It is estimated that the tax court might docket several hundred cases per year and so is projected, for this cost estimate, to start with two judges²¹. The number of judges could be increased if the annual case load demanded it.

2. TAXPAYER COSTS

a. Cost of unfairness

The sponsors of the proposal have said that the cost of creating a tax court is less than the cost to taxpayers of the current system, which they believe imposes costs on taxpayers in the form of erroneous assessments being unfairly upheld by the Commissioner's determinations.

To evaluate this statement, it is necessary to determine whether there is unfairness in the current administrative hearing system. One fact to note in this regard is that the percentage of Tax Department hearings in which the Department prevails in Vermont is similar to the

²¹ For comparison, New York's independent Division of Tax Appeals employs 10 full-time administrative law judges; they docket about 450 cases per year, and hold about 100 hearings per year. The Vermont Department currently docket about 102 appeals per year, and holds about 16 hearings, on average.

percentage of cases in which the independent New York Tax Appeals Tribunal finds for the New York Department of Revenue. *See* Section I. Introduction. The issue of unfairness is discussed in Subsection V.4. (below) Tax Court as a Remedy to Appearance of Unfairness; and also in Section I. Audit and Appeal Statistics; and in Section II. History and Role of the Administrative Hearing.

Even if the current system is not unfair, another important question is whether there is a public *perception* that it is unfair. If public perception is the issue, then the question is, what is the best way to address that perception.

b. Taxpayer cost of eliminating the commissioner's appeal and creating a tax court.

If the administrative hearing is eliminated and replaced with a court proceeding in a tax court, there will be both monetary and nonmonetary costs to the taxpayer. Monetary costs would be the \$250 court fee and the likely cost of hiring an attorney, since many taxpayers may feel reluctant to try to navigate a tax court trial without an attorney. Taxpayers who opt for a settlement conference might also feel the need for an attorney or other professional representative at the conference.

Nonmonetary costs would include the increased time needed for the more complex and formal court proceeding. One of the more significant costs would be the proposed use of "discovery", the court procedure which allows each party to compel the other side to produce requested documents and other evidence. Discovery is rarely, if ever, used in Commissioner's appeals: the Department may informally request documentary evidence from taxpayers, but does not compel taxpayers to produce that evidence. The Department and the taxpayer customarily have provided each other before the hearing with the documents they intend to introduce into evidence at the hearing, without using court procedures and formalities of discovery.

3. ADMINISTRATIVE AND POLICY CONSIDERATIONS

a. Abatement authority and tax administration

Under the current taxpayer appeal system, once the Commissioner hears both sides of the case, she may find for the Department or for the taxpayer; but she may also decide to find partially for the taxpayer (*See* Subsection I.4. Audit and Appeal Statistics), by reducing the penalties or reducing a portion of the assessment or other relief. The Commissioner has the authority to do this under her general administrative powers in Title 32; and this authority enables the Commissioner to shape and apply Department policy, as well. It is not clear whether a tax court would have the authority to make such concessions, unless the Legislature granted it some type of abatement authority. If the tax court had abatement authority, would it then be sharing the policy-making role with the Commissioner? If so, how would this affect administration of the tax laws?

Policy-making is also an issue raised by the proposed settlement conference. Since the settlement officer would be independent of the Department, how would the settlement officer

make policy decisions on when and how to settle? What impact would it have on the Commissioner's ability to administer the tax laws if a settlement officer were making these policy decisions independently of the Department? Currently, 2,000 to 3,000 taxpayers per year request an appeal of an assessment; most of these requests are made because the taxpayer has 60 days to request an appeal or lose the appeal right. Under the current system, most of these requested appeals are resolved and only about 16 per year result in a Commissioner's hearing. The proposed system would remove 2,000 to 3,000 cases from the Department to the settlement office or tax court (or both) each year.

b. Additional Department personnel

With an independent tax court, the Department would also have the right to an appeal from the tax court to the superior court. Attorneys would become involved much sooner in a case, since the case would be removed from the Department as soon as the taxpayer requests an appeal. Attorney preparation time for a formal court trial would be quite a bit greater than preparation time for an informal Department hearing. In addition, the use of discovery would require attorney time to request and pursue discovery from the taxpayer, and to respond to taxpayer requests for discovery from the Department.²² Finally, the Department would likely want to be represented in many of the cases before the independent settlement office, and this would also require attorney preparation time. If the Department "loses" at the settlement conference, would it have the right to appeal from there to the tax court? If so, this would also increase attorney staffing needs. Depending on how many conferences and appeals might result under the new system, the Department would need at least one additional trial/appellate attorney. Since attorneys under the current system become involved in about 102 appeals per year, and under the proposed system they could become involved in 2,000 to 3,000 settlement conferences and tax trials per year, the need for more Department attorneys could be greater than one additional attorney.

c. Public confidence in the Tax Department

An important consideration may be that the creation of a tax court to replace the Commissioner's appeals could be viewed as a statement that the current system of administrative hearings is unfair or cannot be improved. Such a signal could erode public confidence in the tax system. *See also* discussion in Subsection II.6. History and Role of the Administrative Hearing.

²² Some additional costs would also be incurred if hearings were held at a location outside the building where the Tax Department is located. Currently, the hearing officer and the hearing room are located on the First Floor of the Department building, while the attorneys and the General Counsel are located on the Fourth Floor. If tax court hearings were held in a different location, the Department would incur additional costs. The Department attorneys would need to travel to the hearing location, which will mean mileage costs and loss of productive employee time. A significant percentage of taxpayers simply do not show up for their hearings, and in these cases, the time and mileage costs for Department attorney travel to and from the hearing site would still be incurred. The taxpayer could be instructed to meet the Department attorney at the Department and then travel to the hearing site, so that the attorney does not make the trip if the taxpayer does not show up. In addition, taxpayers sometimes meet with the Department attorney just before the hearing and reach a settlement; so this might also require the taxpayer to travel first to the Department, or for the attorney to travel to the hearing site even for cases that settle. This seems somewhat awkward and also adds to the travel time for the taxpayer, who would now need to allow more time, to travel to the Department, and then on to the hearing location.

4. TAX COURT AS A REMEDY TO THE APPEARANCE OF UNFAIRNESS

The goal of the tax court proposal is a good one: “to increase public confidence in the fairness of the tax system.” While creating a tax court is feasible, it is not clear such a step would accomplish this goal. Some states have found that creating an independent tax court did not improve the public perception. For example, the Council on State Taxation, a nonprofit, corporate, tax lobbying group representing 600 multistate corporations (“COST”), is a major proponent of creating independent tax courts and tribunals, but COST notes that in two states that have created tax tribunals:

California and New Jersey, while offering independent review, each suffer from a perception that their appeals process is reluctant to overturn revenue department decisions. The fix may be more than statutory.

From The Best and Worst of State Tax Administration, Lindholm and Nicely, Council on State Taxation, 2007, p. 3. Thus, independence from the revenue department may be insufficient to create the perception of a fair system, since a tax court may still be perceived as unfair if it finds in favor of the revenue department position too often. Improvements to the appeals process itself and more outreach by the Department in educating the public about the process might provide the “more than statutory fix” that is needed.

It is a rational and common perception to think that if the Commissioner, or even a tax court, finds in favor of the Department often, then the adjudicator is biased against the taxpayer. Putting the Commissioner’s appeal into context, however, may change the perception. By the time a case has been scheduled for an appeal hearing, the taxpayer has had several layers of review at the Department and opportunities to make their case. Taxpayers are able to resolve their differences with the Department in 99.9 percent of all assessments; only about 16 cases per year, out of 15,000 cases, go to hearing and determination. At that point, if the Department loses the case, it means that many Department personnel at all levels got the issue wrong. The statistics reported in Subsection I.4. also show that over a four-year period from 2008 through 2011, the Superior Courts agreed with the Commissioner’s determination in all cases, and the Supreme Court reversed only one Commissioner’s determination.

5. MONETARY COSTS OF A TAX COURT AND A SETTLEMENT OFFICE

The following are rough estimates of possible costs based on the details of the proposal. These costs are for staffing and furnishing offices of two Administrative Law Judges and one tax court docket clerk Level A, plus one remote tax court office and hearing room; and one settlement officer and one settlement office docket clerk. Also included is one additional Tax Department appeals attorney, but with no added costs for office furniture, computer, etc. for that position. All amounts are annual costs, unless indicated as one-time “initial” costs. Costs for furniture and equipment do not include amortized annual costs after the initial year. This section is merely to give some idea of what costs might be involved.

a. Personnel

2 Tax court judges (ALJs) [Proposal is to use Superior Court judge’s salary: \$122,865 + 30% benefits]	\$319,449
Tax court Docket Clerk/ administrative assistant [Court Clerk Level A + 30% benefits]	\$ 34,151
Settlement officer [AAG/GC I 30% benefits]	104,000
Settlement office clerk/admin ass’t [+ 30% benefits]	34,151
Department appeals attorney [AAG Level II + 30% benefits]	54,000
Savings from current personnel ²³	(57,000)

TOTAL \$488,751

²³The Department hearing officer spends approximately 55% of time on hearings and determinations; the Department docket clerk spends approximately 20% of time on appeals-related duties. These functions would be eliminated under the tax court proposal, with a total savings for both positions of \$57,000.

b. Office space

2 offices for judges = \$5600
2 offices, each 200 sq ft
@ \$14/sq ft

office for court clerk 150 sq ft “ “ = \$2100

library and file room 150 sq ft “ “ = \$2100

hearing room 240 sq ft “ “ = \$3360

(“Montpelier and elsewhere”):

remote hearing room 240 sq ft “ ” = \$3360

remote court office 150 sq ft “ “ = \$2100

office for settlement officer 150 sq ft = \$2100

office for settlement clerk 150 sq ft = \$2100

library and file room 150 sq ft “ “ = \$2100

conference room 240 sq ft “ “ = \$3360

TOTAL \$ 28,280

c. Equipment

furniture (desk, chair, 2-drawer file)	\$950 per office x 6 initially	initial cost \$ 5,700
telephone	\$250 per telephone, initial + \$120/yr/phone x 6 = \$720	initial cost \$ 1,500
computer	\$1000 per computer, initial x 6	initial cost \$ 6,000
software licenses; computer security, tech support contract	\$1000 x 6, initial	initial cost \$ 6,000
recording devices	\$85.00 each x 2, initial	initial cost \$ 170
printer/copier/fax	\$4500 x 3, initial	initial cost \$13,500
equipment maintenance contracts	\$1000/yr x 2 (court + settlement office)	
office supplies incl paper	\$300 ? /yr x 6 = \$1,800	

TOTAL INITIAL \$32,870

TOTAL ANNUAL \$ 4,520

d. Library and publications

for court, remote, and settlement offices?

Maybe settlement office could share the
Tax Dept library?

Westlaw	\$375/yr x 3	\$ 1,125	
VSA	\$ 15/yr x 3; (\$150 initial year cost x 3)	45	plus \$450 initial cost
BNA	\$3350 Federal 1460 States /yr x 2 ?	9,620	
CCH Federal tax materials	\$12,000/yr x 2 ?	24,000	
Hellerstein	\$800/yr x 2	1,600	
Journals and periodicals ?	x 2	400?	

TOTAL ANNUAL \$36,790 [Or, maybe \$19,000, if the settlement
office can share the Department's library.]

e. Transcripts of hearings appealed to superior court \$ 21,600
(based on \$3 per page, 60 pages per hour,
4 hours; est. 30 Superior Court appeals per year)

f. Creation of published report of redacted decisions \$ negligible
(based on conversations with Labor Board;
the Labor Board self-publishes a hard copy of
opinions every two years and sells each copy for
\$25 to cover the cost; the opinions are also
published online with no access charge)

APPENDIX A
2011 LEGISLATIVE DIRECTIVE TO THE DEPARTMENT OF TAXES

Section 36h from No. 45 of the Acts of 2011 (H.436), “An act relating to tax changes, including income taxes, property taxes, economic development credits, health care-related tax provisions, and miscellaneous tax provisions”, provides as follows:

Sec. 36h. TAXPAYER OUTREACH AND INFORMATION SYSTEMS

As the department of taxes has increased its compliance efforts in recent years, it has not increased its taxpayer service and education capacity. To balance the needs of the state with the rights of taxpayers, the department of taxes should increase its taxpayer outreach and education efforts. By January 18, 2012, the department of taxes shall make recommendations to the senate committee on finance and the house committee on ways and means on:

(1) ways in which the department of taxes can improve its education outreach to taxpayers in specific industries or classes to ensure that taxpayers in those industries and classes are aware of their obligations under law and to ensure that the department of taxes is able to track and respond to industry- or class-wide concerns;

(2) how to improve its system of taxpayer administrative appeals that includes a review of the feasibility of creating an appeals officer or body independent of the department of taxes; and

(3) protocols the department of taxes can adopt for tracking taxpayer inquiries and responses by the department of taxes to ensure that taxpayers receive correct information.

APPENDIX B

National Association of Hearing Officials Model Code of Ethics

SECTION I - SCOPE

SECTION II - COMPETENCE

SECTION III - IMPARTIALITY

SECTION IV - INDEPENDENCE

SECTION V - EX PARTE COMMUNICATION

SECTION VI - DIGNITY AND DECORUM OF THE FORUM

SECTION VII - PROFESSIONAL CONDUCT

SECTION VIII - PERSONAL CONDUCT

SECTION IX - CONFIDENTIALITY

SECTION X - COMPLIANCE WITH ETHICAL RULES

The National Association of Hearing Officials (NAHO) has adopted the following Model Code of Ethics.

Section I: Scope

This Code of Ethics is a guide to ethical behavior for hearing officials. Hearing officials include persons who conduct or review administrative hearings or who supervise hearing officials. NAHO had adopted this model code in recognition of the importance of the integrity of hearing officials. It is intended to supplement but not overrule, any existing statutes, codes, policies or regulations setting out ethical requirements for hearing officials and public employees in a particular agency or jurisdiction.

Section II: Competence

Hearing officials should know the substantive and procedural law, including the principles of due process, to be applied in the hearings over which they preside, and should understand the principles of its application and interpretation. Hearing officials should be skilled in conducting

hearings efficiently and fairly. Hearing officials should be skilled in discerning the facts of the cases presented to them. Hearing officials should be clear and fair-minded in their application of the law to the facts of each case, and should communicate their decisions completely and clearly.

Hearing officials should regularly participate in continuing education to improve their competence and to stay current in their knowledge of the law.

Section III: Impartiality

Hearing officials should always strive to assure all persons involved that the proceedings will be conducted and decided impartially. "All persons involved" includes the appealing or petitioning parties and their representatives, the agency, agency staff or representatives, witnesses, interpreters, intervenors, observers, and any other person who appears before the hearing official, whether in person, in writing, or by electronic means.

Hearing officials should act in such a way that no one could reasonably believe that any person or agency could improperly influence them in the performance of their duties.

Hearing officials should not conduct or participate in deciding the outcome of any proceeding in which their impartiality might be reasonably questioned. Personal knowledge of the facts in a case is an appropriate ground for disqualification of the hearing official. Hearing officials should promptly disclose to the parties any prior personal knowledge of or involvement in the matter. Hearing officials should always withdraw from any proceeding in which their impartiality becomes compromised for any reason. However, the hearing official should not withdraw from a proceeding if the hearing officials' impartiality is challenged solely on the basis that the hearing officials are employed by an agency appearing in the proceeding.

The parties may agree to allow the hearing official to preside after full disclosure has been made.

Hearing officials should preside without bias or prejudice and without discrimination on any prohibited basis against any person involved in the proceeding, and should control the proceedings to prevent such discriminatory behavior by any other person involved.

Section IV: Independence

The administrative hearing process requires re-examination and reappraisal of determinations made by an administrative agency. Regardless of the hearing official's employment relationship with a party agency, the hearing official should exercise independence of action and judgment to protect the due process rights of parties and to achieve the most legally correct result in a case, maintaining decisional independence from agency management and programs. Supervisors may provide consultation to hearing officials, except as prohibited by law, but may not alter the hearing officials' decisions or substitute their judgment for that of the hearing officials.

Section V: Ex Parte Communication

Hearing officials should have a strong working knowledge of their jurisdiction's definitions and restrictions on ex parte contact. Generally, "ex parte" refers to communication between a hearing official and fewer than all parties to an administrative hearing.

Hearing officials should not receive information from any party without sharing that information with all parties.

If hearing officials are authorized to consult with an expert, the nature of the consultation and the substance of the expert's advice must be disclosed to all parties. Hearing officials should also give all parties an opportunity to respond.

Section VI: Dignity and Decorum of the Forum

Hearing officials should promote the dignity and decorum of the administrative hearing process and tribunal. Hearing officials should exercise their lawful authority in any proceeding to ensure that all persons involved conduct themselves with the proper decorum.

Section VII: Professional Conduct

Hearing officials should:

- always act in a manner that promotes public confidence in the integrity, impartiality and efficiency of the hearing process;
 - maintain high standards of professional conduct and encourage other hearing officials to do the same;
 - be temperate and dignified;
 - be courteous to all in the performance of their duties;
 - follow procedural formalities, making exceptions only in the interest of fairness; and
- punctually fulfill their professional commitments.

Section VIII: Personal Conduct

Hearing officials should refrain from all illegal or ethically reprehensible conduct.

Hearing officials should not accept any gifts or favors from parties to any proceeding before them.

Hearing officials should not engage in activities which may bring their own personal or professional interests into conflict with the performance of their official duties.

Hearing officials should not give the impression that any party is in a special position to personally influence them, nor should they permit anyone, including friends and relatives, to convey such an impression to others.

Hearing officials should treat all participants with equal courtesy and dignity and require the same treatment of the hearing officials by participants. For example, before, during and after a hearing, hearing officials should restrict their contacts regarding the matter such as social conversation, with agency staff or representatives, and should address agency participants as they would address any other hearing participant, using last names and courtesy or professional titles. During the hearing process, hearing officials should politely discourage all participants from referring to a hearing official on a first name or casual basis.

Section IX: Confidentiality

Hearing officials should not disclose confidential or private information obtained by reason of official position or authority except as required by law.

Hearing officials should never seek to use such confidential information to further their personal interests.

Hearing officials should follow their agency's rules or policies regarding media contacts. In any permitted contact with the media, hearing officials should limit the sharing of information to that which does not identify individuals and should never discuss the merits of any specific case. Hearing officials should avoid ex parte communications about a case with anyone (including family, friends and agency staff and associates) unless authorized by statute or agency regulations. However, hearing officials may in confidence discuss cases with other hearing officials.

Section X: Compliance with Ethical Rules

Hearing officials must comply with all applicable statutes, administrative rules, codes of conduct, policies, and ordinances regarding ethics in their jurisdiction, and work to ensure that persons involved in the proceedings also comply. Hearing officials have a duty to report ethical violations.

APPENDIX C

Proposed Administrative Hearing Regulations

Organization and Rules of Procedure

Rule 1. Organization and Operation

(a) Organization.

The Department of Taxes is established by 3 V.S.A. § 212. 32 V.S.A. § 3101 provides that the Department shall be administered by a Commissioner of Taxes, who is appointed biennially by the Governor with the advice and consent of the Senate.

3 V.S.A. § 253 provides that the Commissioner may appoint a Deputy, with approval of the Governor, who shall perform such duties as the Commissioner shall direct.

There is a Director of Property Valuation and Review who shall assist assessing officials, conduct the equalization study of municipalities' education grand lists, set education tax rates and assist the Commissioner in administration of various property related programs and taxes.

The Commissioner shall organize the Department into such divisions as in the Commissioner's judgment promote the fair and efficient administration of taxes within the Commissioner's jurisdiction.

(b) Location and Assistance to the Public.

The main office of the Department of Taxes is located at 133 State Street, Montpelier, immediately west of the State House. The telephone number is (802) 828-2505. The hours of work are 8:00 a.m. to 4:30 p.m., Monday through Friday. Persons having business with the Department or requesting assistance may write or call the Department or may come to the main office during working hours.

(c) Tax Department Forms.

The Department utilizes a wide variety of forms in the administration of the tax laws. The forms are changed frequently to reflect changes in law and for administrative reasons. Forms are available on the Department's website, www.state.vt.us/tax and at the main office of the Tax Department. Commonly used forms, such as income tax returns, are also available at Post Offices and Town Offices across Vermont. In most cases, Department forms must be used to accomplish the transaction in question, such as when reporting income, transferring property or

claiming exemption from sales tax. Many tax forms may be completed and filed electronically and in some cases, electronic filing is required.

(d) Tax Department Guidance.

The Department issues formal regulations interpreting the tax laws and establishing procedures. From time to time it issues technical bulletins and other notices which are a less formal way of providing information to taxpayers. Instructions also accompany tax forms.

Rule 2. Definitions

The definitions set forth in 3 V.S.A. § 801 are hereby adopted and made applicable to these Rules.

Rule 3. Formal and Informal Proceedings

The following types of proceedings will be treated as formal proceedings that are governed by the provisions of Chapter 25 of Title 3, the Vermont Administrative Procedure Act:

- (a) Proceedings wherein a determination by the Commissioner of Taxes is required by statute to be made after an opportunity for hearing. These proceedings are referred to as appeals.
- (b) Rule-making proceedings under the Vermont Administrative Procedures Act.
- (c) Requests for declaratory rulings.

All other petitions, applications, submissions, requests, charges, etc. will be treated as informal proceedings.

Rule 4. Appeals

(a) Right to Appeal. A taxpayer or claimant (hereinafter in this rule references to taxpayer includes claimant) may appeal to the Commissioner any action of the Department for which appeal is provided by law including assessment, denial in part or whole of a refund claim, denial or reduction of a property tax adjustment or renter rebate, suspension or revocation of a license or certificate, requirement of a bond and notice of development or discontinuance, by filing a written notice of appeal as provided by Rule 6(a) herein within the time allowed by statute for appeal. The notice of appeal should advise the Department of the reason for the appeal.

(b) Prehearing Meeting. Prior to hearing, the taxpayer may elect to meet informally with the Department's representative. The purpose of such a meeting is to resolve or narrow the issues in dispute to the extent consistent with law. In evaluating any settlement proposal or resolution of the appeal, the Department shall consider evidence and arguments that support the taxpayer's position, hazards of litigation, factors affecting collectability of an assessment, equity among

taxpayers and the requirements of law. A taxpayer is not required to meet prior to the hearing. At the taxpayer's option, the prehearing meeting may be conducted by telephone.

(c) Right to a Hearing. A taxpayer who appeals as provided above has the right to a hearing before the Commissioner or at the Commissioner's discretion, the Commissioner's designated hearing officer (hereinafter in this rule references to Commissioner includes the Commissioner's designated hearing officer).

(d) Commissioner's Hearing. If the Department and taxpayer (referred to herein as the "parties") are unable to resolve all issues, the matter will be docketed for hearing before the Commissioner. The hearing is the parties' opportunity to present evidence to the Commissioner in support of their respective positions. The admissibility of evidence will be determined pursuant to 3 V.S.A. § 810(1)-(4) which is attached hereto as Appendix A. Notice of hearing shall be mailed to the taxpayer at the last address provided by the taxpayer to the Department no less than three weeks before the date of the hearing unless the parties agree to a shorter notice period. The parties and witnesses shall be present at the hearing except as follows:

(1) the facts may be presented to the Commissioner by written stipulation of the parties at any time prior to the hearing.

(2) upon the Commissioner's grant of a taxpayer's motion supported by good cause, a hearing may be conducted over the telephone.

The testimony of a witness on direct examination may be offered in written form, either by having it read into the record or by offering it for incorporation in the record without reading, provided that a copy of the testimony shall be supplied to the opposing party no less than two weeks in advance of the hearing at which testimony will be offered. Written testimony shall be subject to the same rules of admissibility and cross-examination as oral testimony at the hearing.

At the end of the hearing the Commissioner's record is closed and the findings of fact made by the Commissioner shall be based exclusively on the evidence and matters officially noticed as required by the Vermont Administrative Procedure Act.

(e) Continuance of Hearing. A hearing will be continued only by leave of the Commissioner which may be granted upon motion showing just cause, such as, but not limited to:

(1) complexity of legal or factual issues;

(2) newly discovered evidence which by due diligence could not have been discovered in time for the hearing;

(3) illness;

(4) a scheduling conflict;

(5) stipulation of the parties.

(f) Post Hearing Filings. Following the hearing and within the time prescribed by the Commissioner, the parties may file proposed findings of fact and/or memoranda of law. The Commissioner may request the parties to file proposed findings of fact and /or memoranda of law. The time for filing may be extended only upon motion granted by the Commissioner.

(g) Transcript. Hearings shall be recorded by the Commissioner and shall be transcribed on the request of any party to a pending appeal and upon payment by the requesting party of the reasonable costs thereof.

Rule 5. Appearances in Appeals

(a) A party to an appeal before the Commissioner may appear for himself or herself or in the case of a corporation, partnership, trust, municipality or other entity created by law, through its duly authorized agent, or the party may be represented by either an attorney or a certified public accountant, if such representative is currently licensed to practice in the State of Vermont. The name of the attorney or certified public accountant or person who has signed the appeal letter or a subsequent notice of appearance will be entered in the Department's records.

(b) All notice given to or by a party's representative of record shall be considered in all respects as notice to or from the party until such time as the represented party notifies the Department that the representative of record is no longer authorized as the party's representative.

(c) An attorney or certified public accountant not residing or not licensed to practice in the State of Vermont may appear for a party if he or she is associated with a resident and licensed attorney or certified public accountant who has entered his or her appearance for the same party.

Rule 6. Filing and Service of Documents in Formal Proceedings

(a) Notices of appeal, requests for formal ruling under 3 V.S.A. § 802 and requests for rulemaking under 3 V.S.A. §831(c) shall be signed by the taxpayer or the taxpayer's representative and mailed or delivered to the Vermont Department of Taxes, 133 State Street, Montpelier, VT 05602-1401. Other methods of transmission do not constitute filing. Filing with the Department shall be deemed to occur when a mailed document is marked as received by the Department and when a document is delivered to the Department in person.

(b) Every document filed by a party subsequent to the initial notice or request in a formal proceeding shall be served upon the attorney of record if there is one and if not, upon the other party. Service upon an attorney or upon a party shall be made by delivering a copy to him or her or by mailing it to him or her at the last known address. Delivery of a copy means handing it to his or her representative or to the party, or leaving it at his office with the person in charge thereof or, if the office is closed or the person to be served has no office, leaving it at his dwelling house or usual place or abode with some person of suitable age and discretion then residing therein. Service by mail shall mean first-class mail, in a sealed and properly stamped

envelope. Service by mail is deemed complete upon posting the mail in a proper United States Post Office receptacle.

Rule 7. Requests for Rule-Making and Declaratory Rulings

(a) The Department shall initiate rulemaking to adopt as rule an existing practice or procedure when so requested by 25 or more persons or by the Legislative Committee on Administrative Rules.

(b) Upon request of a taxpayer, the Department will issue a declaratory ruling as to the applicability of any statutory provision or of any rule or practice of the Department. Declaratory rulings may be obtained only for actual, not hypothetical or possible, fact situations. If the applicability of a Vermont statute depends upon the how federal law applies to the facts, the Department may require the taxpayer to have obtained a letter ruling from the Internal Revenue Service prior to obtaining a declaratory ruling on the application of Vermont law. A written ruling will be made within sixty days of receipt of the facts involved and the point of interpretation as to which the ruling is requested, unless additional time is required due to the complexity of the request. If additional time is needed, the requester shall be notified within the original sixty days of the date by which the ruling is expected to be issued.

Rule 8. Licenses and Certificates

An application for a license or certificate shall be submitted on a completed official application form. The Commissioner may consider any credible information in the application or exhibits filed therewith or otherwise available to the Department in determining whether to impose a bond requirement with respect to the applicant or a related business. If a bond is required, that requirement may be appealed as provided in Rule 4 herein.

Rule 9. Enlargement of Rules

The Department may take a proceeding partially or entirely out of these rules when the law so permits and, in its opinion, the interest of the public so requires.

Appendix A. Rules of Evidence, Official Notice

- (1) Irrelevant, immaterial, or unduly repetitious evidence shall be excluded. The rules of evidence as applied in civil cases in the county courts of this state shall be followed. When necessary to ascertain facts not reasonably susceptible of proof under those rules, evidence not admissible thereunder may be admitted (except where precluded by statute) if it is of a type commonly relied upon by reasonable prudent men in the conduct of their affairs. Agencies shall give effect to the rules of privilege recognized by law. Objections to evidentiary offers may be made and shall be noted in the record. Subject to these requirements, when a hearing will be expedited and the

interests of the parties will not be prejudiced substantially, any part of the evidence may be received in written form.

- (2) Documentary evidence may be received in the form of copies or excerpts, if the original is not readily available. Upon request, parties shall be given an opportunity to compare the copy with the original.
- (3) A party may conduct cross-examinations required for a full and true disclosure of the facts.
- (4) Notice may be taken of judicially cognizable facts. In addition, notice may be taken of generally recognized technical or scientific facts within the agency's specialized knowledge. Parties shall be notified either before or during the hearing, or by reference in preliminary reports or otherwise, of the material noticed, including any staff memoranda or data, and they shall be afforded an opportunity to contest the material so noticed. The agency's experience, technical competence, and specialized knowledge may be utilized in the evaluation of the evidence.

APPENDIX D

REVISED DEPARTMENT LETTERS TO TAXPAYERS WHO REQUEST AN APPEAL

YOUR TAX APPEAL
Docket # [pre-printed]

Your request for an appeal has been referred to the Commissioner's Office and docketed for hearing. Please refer to the docket number shown above in any correspondence with the Department.

Please complete the following statement, sign it, and return it to the Docket Clerk.
I DISAGREE WITH THE DEPARTMENT IN THIS CASE FOR THE FOLLOWING REASONS:

Signature of Taxpayer _____ Date _____

Taxpayer's daytime telephone number
and/or email address: _____

Fax this sheet to: (802) 828-5282 OR **Mail to:** R. Sicely, Docket Clerk
Vermont Dept of Taxes
Montpelier, VT 05633-1401

NOTE: The hearing officer who hears your case is prohibited by law from discussing your case, before or after the hearing, with you, your representative, and the Department attorney, auditor or anyone else in the Department directly involved in your appeal, unless all parties participate in that discussion. 32 V.S. A. § 813.

Account Number # []
Tax Account Period [mm/dd/yyyy]
Docket # []

TAXPAYER NAME
TAXPAYER ADDRESS *If address is incorrect, please make changes on this form.*
ADDRESS
ADDRESS

[TP address,
etc.]

A hearing has been scheduled on this appeal as follows:

[date, time, place]

The hearing may be rescheduled only by permission of the Commissioner.

NOTE: The hearing officer who hears your case is prohibited by law from discussing your case, before or after the hearing, with you, your representative, and the Department attorney, auditor or anyone else in the Department directly involved in your appeal, unless all parties participate in that discussion. 32 V.S.A. § 813.

Pre-Hearing Meeting

Please call the Department representative, [], at [tel #] to discuss whether there are facts or issues of law which you can agree on before the hearing. You may also exchange information about the evidence and witnesses which you and the Department plan to present at the hearing.

At the Hearing

The hearing is a legal proceeding and will be recorded. Witnesses will be sworn in by the hearing officer. Rules of evidence in accordance with 3 V.S.A. § 810 will apply to the hearing.

You and the Department representative will each have the opportunity to present evidence in support of your position in the case and to call witnesses if you wish. You and the Department representative will also have the opportunity to question the evidence and witnesses presented by the other side.

At the end of the hearing, the record is closed; no more evidence may be presented after the hearing.

If you request a transcript of the hearing, you must complete the attached Transcript Order Form before the hearing and pay for the transcript.

After the Hearing

The parties may submit memoranda after the hearing, or the hearing officer may require the parties to submit memoranda. Due dates for memoranda will be set by the hearing officer and these dates may be extended only with permission of the hearing officer.

The Commissioner will issue a written determination in the case. If the determination is adverse to you, you may appeal the determination to the Superior Court. The Superior Court will decide

the appeal based on the record of the facts established and the legal arguments presented in the Department hearing. No further evidence is admitted at the Superior Court. Therefore, the Commissioner strongly urges to you be prepared to present all your evidence in support of your position at the Department hearing.

If you wish to consult the Department regulations regarding hearings, you may call me or the Office of the Secretary of State. If you have any questions, please let me know.

Sincerely,

Rheannon Sicely
Clerk of the Department