

## California Governor Signs Legislation Creating New Office of Tax Appeals and New Department of Tax and Fee Administration

### Overview

On June 27, 2017, the California Governor signed Assembly Bill ("AB") 102, known as "The Taxpayer Transparency and Fairness Act of 2017."<sup>1</sup> Generally, AB 102 reduces the functions of the Board of Equalization ("BOE") to the core responsibilities granted to it under the California Constitution and creates two new tax agencies - the Office of Tax Appeals ("OTA") and the California Department of Tax and Fee Administration ("CDTFA") - which would take over many of the responsibilities previously handled by the BOE. The CDTFA will administer certain taxes and fees that were once administered by the BOE, including the sales and use tax and business and excise taxes.<sup>2</sup> The OTA will take over the appeals function from the BOE members and hear appeals of taxes and fees administered by the CDTFA and appeals of Franchise Tax Board ("FTB") determinations relating to the income and franchise tax. California will now have five state tax agencies - the FTB, BOE, CDTFA, OTA, and the Employment Development Department.

This Tax Alert provides some background on the BOE's historical function and summarizes the more notable changes made under AB 102.

### Background on the historical function of the BOE

The California Constitution provides for the establishment of the five member Board of Equalization, consisting of the Controller and four members who individually represent four distinct geographic districts in California and are elected by California voters for four-year terms.<sup>3</sup> Under the California Constitution, the BOE was granted various duties, powers, and responsibilities which included: (1) review, equalization and adjustment of property tax assessments, (2) measurement of county assessment levels or adjustment of secured assessment rolls, (3) assessment of pipelines, flumes, canals, ditches and aqueducts lying within two or more counties, (4) assessment of property owned or used by regulated railway, telegraph, and telephone companies, car companies operating on railways in the state, and companies transmitting or selling gas or electricity, (5) assessment of taxes on insurers, and (6) assessment and collection of excise taxes on manufacture, importation or sales of alcoholic beverages.<sup>4</sup>

Over the years, California statutes had expanded the BOE's duties, powers, and responsibilities to include the administration of various taxes and fees, including sales and use taxes and business and excise taxes, as well as administrative appeals relating to the assessment and collection of those taxes and fees and the California personal income tax and corporation franchise and income tax.<sup>5</sup> The BOE also administers the motor vehicle fuel tax and is required until July 1, 2019 to annually modify the motor vehicle fuel tax rate in accordance with California law.<sup>6</sup>

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<sup>1</sup> See "Governor Brown Signs 2017-2018 State Budget," Latest News, Office of Governor Edmund G. Brown Jr., available [here](#); A.B. 102, 2017-2018 Reg. Sess. (Cal. 2017), available [here](#). On June 15, 2017, the California Legislature passed AB 102. Based on a review of the BOE's current practices and operational environment, the California Legislature determined that it was "in the best interest of the taxpayers, their businesses, and the state to have members of the [BOE] refocus the board's efforts toward its core constitutional responsibilities." *Id.* at 7. The California Legislature passed AB 102 to, among other reasons, ensure "a tax administration and appeals process that is fair, transparent, consistent, equitable, and impartial" as "[o]ne of the most fundamental aspects of a good tax system is a fair and efficient appeals process" and "to restore the public's trust in the system and provide a work environment that is free from undue influence." *Id.* at 5-6.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 2.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 2-3.

<sup>6</sup> *Id.* at 3.

### Summary of the more notable changes made under AB 102

AB 102 creates the OTA and the CDTFA, both of which will be headquartered in Sacramento, California.<sup>7</sup> For each of those agencies, the Governor will appoint a Director (subject to senate confirmation) as well as a Chief Deputy Director and a Chief Counsel, all of whom will manage and supervise their respective agencies.<sup>8</sup> The CDFTA and the OTA may also adopt regulations as necessary or appropriate to carry out its duties, powers, and responsibilities and maintain emergency regulations until January 1, 2019.<sup>9</sup>

*Office of Tax Appeals.* Within the OTA, there will be tax appeals panels that each consist of three administrative law judges (“ALJs”) designated by the OTA’s Director.<sup>10</sup> Each ALJ must be an active member of the State Bar of California for at least the preceding five years, possess the knowledge and experience with regard to the administration and operation of the tax and fee laws of the United States and California, and subscribe to the Code of Judicial Ethics adopted by the California Supreme Court.<sup>11</sup> Beginning January 1, 2018, the BOE is prohibited from conducting any appeals and that function is transferred solely to the OTA.<sup>12</sup> As of that date, the OTA will have the duties, powers, and responsibilities of the BOE necessary or appropriate to conduct appeals hearings,<sup>13</sup> and the tax appeals panels will conduct all appeals, including hearings related to the following:

- i. Petitions, including, but not limited to, petitions for redetermination, reassessment, reconsideration of successor liability, or rehearing.
- ii. Administrative protest.
- iii. Claim, including a claim for refund.
- iv. Appeal from an action of the Franchise Tax Board.
- v. Application, including, but not limited to, applications for an administrative hearing.
- vi. Any other item that may be scheduled for a hearing including, but not limited to, requests for relief of taxes, fees, interest or penalties.<sup>14</sup>

A taxpayer may be represented on an appeal by any individual who is at least 18 years old, including, but not limited to, an attorney, appraiser, accountant, bookkeeper, employee, business associate, or other person. Within 100 days after the date upon which a tax appeals panel’s decision becomes final, the OTA is required to publish a written opinion.<sup>15</sup> The taxpayer may appeal the decision of the tax appeals panel to the superior court in accordance with the law that imposes the tax or fee.<sup>16</sup>

*California Department of Tax and Fee Administration.* The CDTFA will be under the control of the Director, who will be solely responsible for selecting individuals for career executive positions and other non-civil service managers for the CDTFA.<sup>17</sup> The duties, powers, and responsibilities of the CDTFA will include all those vested in the BOE, except for those specified in the California Constitution.<sup>18</sup> In addition, the CDTFA Director, Chief Counsel, and any other person

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<sup>7</sup> *Id.* at 8, 18.

<sup>8</sup> *Id.* at 9, 17.

<sup>9</sup> *Id.* at 11, 19. AB 102 also requires the OTA to adopt regulations by January 1, 2018. *Id.* at 19. AB 102 further provides that, for purposes of these emergency regulations, the CDTFA and the OTA are “exempted from the requirement that it describe facts showing the need for immediate action and from review of the emergency regulations by the Office of Administrative Law.” *Id.* at 11, 19.

<sup>10</sup> *Id.* at 17.

<sup>11</sup> *Id.* at 17-18. With respect to the requirement to subscribe to the Code of Judicial Ethics, AB 102 requires that any regulations adopted to carry out the purposes of this requirement must be consistent with: (1) the procedures established by the Commission on Judicial Performance for regulating activities of state judges, (2) the gift, honoraria, and travel restrictions on legislators contained in the Political Reform Act of 1974, and (3) the Model State Administrative Tax Tribunal Act dated August 2006 adopted by the American Bar Association. *Id.* at 19-20.

<sup>12</sup> *Id.* at 18.

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

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 19.

<sup>16</sup> *Id.* Generally, California state tax agencies do not have similar rights to appeal administrative decisions to the California superior court.

<sup>17</sup> *Id.* at 9.

<sup>18</sup> *Id.* at 9-10. AB 102 also provides that “[a]ll laws prescribing the duties, powers, and responsibilities of the [BOE] to which the department succeeds, together with all lawful rules and regulations established under those laws, are expressly continued in force, including, but not limited to, existing processes and remedies available to a taxpayer or feepayer such as settlement options and appeals processes.” *Id.* at 9. In addition, all current employees of the BOE engaged in functions transferred to the CDTFA will be transferred to the CDTFA and will retain their current status, position and rights. *Id.* at 10.

## External Multistate Tax Alert

who has obtained knowledge about a business during an inspection of the taxpayer's records shall not make confidential taxpayer information public (subject to certain exceptions), unless the Governor directs otherwise.<sup>19</sup>

*Implications for the Board of Equalization.* As of July 1, 2017, the BOE would only continue to carry out those duties and responsibilities granted to it under the California Constitution (as discussed above) and adjust the motor vehicle fuel tax rate for fiscal year 2018-2019.<sup>20</sup> The BOE would no longer retain its statutory functions, including the collection and administration of the sales and use tax and the business and special taxes, as well as hear tax appeals for those taxes and the income and franchise taxes.<sup>21</sup> Also, as of July 1, 2017, AB 102 restricts the activities of BOE members as follows:

- "Ex parte" communications with BOE members on issues being appealed are generally prohibited.<sup>22</sup>
- BOE members shall have no authority to appoint, remove, discipline, assign, reassign, promote, demote, or issue orders to any employee of the BOE, including, but not limited to, the career executive assignment positions and other non-civil service managers.<sup>23</sup>
- BOE members shall not interfere with or influence the process of the BOE or the CDTFA's legislative analyses, revenue analyses, or any other form of technical assistance requested by the Governor or the Legislature.<sup>24</sup>
- BOE members shall not represent a person in appeals before one year after the expiration of the member's BOE term or one year after separation from the BOE.<sup>25</sup> This restriction also applies to a BOE member's staff.<sup>26</sup>
- BOE members are prohibited from investigating the administration, enforcement, and operation of tax administration within the district from which the BOE member was elected.<sup>27</sup>

## Considerations

Given the differences in operative dates governing provisions in AB 102 that relate to the various functions of the BOE members, CDTFA, and OTA, additional guidance will be required. For example, as of July 1, 2017, the BOE is only allowed to continue to have the duties, power, and responsibilities granted to it under the California Constitution and to adjust the motor vehicle fuel tax rate for fiscal year 2018-2019. Therefore, the BOE is not permitted to hear appeals as of that date. However, AB 102 also provides that, beginning January 1, 2018, the OTA will take over the appeals function and, as of that date, the BOE is prohibited from conducting appeals. This raises the question of how California will handle appeals that are scheduled to be heard between July 1, 2017 and January 1, 2018 as well as matters that were initially heard by the five BOE members but are subsequently deferred for further proceedings into 2018 because the hearing was continued or it involved a petition for rehearing or other appeals proceeding.

Although the Assembly Committee on Budget has issued a letter, dated June 15, 2017, indicating that taxpayer appeals that are set for hearing at the BOE on or before December 31, 2017 will still be heard and decided by BOE members<sup>28</sup>, until there is further legislation clarifying these and other potential ambiguities in AB 102, it is uncertain exactly how these issues will be addressed. Taxpayers who have appeals that are or may be scheduled for hearing before the BOE during this period, or have other matters currently before the FTB or BOE, should consult their tax advisers to discuss their available options.

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<sup>19</sup> *Id.* at 12-13. AB 102 also make a violation of these taxpayer privacy provisions a misdemeanor that is punishable by a fine not to exceed \$1,000 or by imprisonment not to exceed six months, or both, at the court's discretion. *Id.* at 13.

<sup>20</sup> *Id.* at 14.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 16. Specifically, AB 102 provides that "[e]x parte communications shall be restricted as provided in Article 7...of Chapter 4.5 of Part 1." *Id.* at 16. Article 7 of Chapter 4.5 of Part 1 contains the California Government Code ("CGC") provisions which govern ex parte communications. See Cal. Gov. Code §§ 11430.10-11430.80. Generally, ex parte communications with the presiding officer without notice and opportunity for all parties to participate in the communications is prohibited, but these CGC provisions provide some very limited circumstances under which such communications could be permitted. *Id.*

<sup>23</sup> *Id.* at 15. AB 102 appears to allow the BOE members to appoint an executive director for the BOE, though no other BOE employees. AB 102 provides that "[t]he [BOE] shall retain the authority to appoint an executive director." *Id.* at 15. AB 102 then provides that "[a] board member shall have no authority to appoint, remove, discipline, assign, reassign, promote, demote, or issue orders to any employee of the [BOE], including, but not limited to, the career executive assignment positions and other noncivil service managers" and that "[t]he executive director shall be solely responsible for selecting persons for career executive assignment positions and other noncivil services managers for the [BOE]." *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 15-16, 19.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 17.

<sup>28</sup> Letter from Phil Ting, Chair, Assembly Budget Committee, to E. Dotson Wilson, Chief Clerk, Assembly State Capitol, (June 15, 2017) (on file with California State Assembly, Assembly Daily Journal, June 15, 2017, 2229), available [here](#).

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