

**Add Part 10.1 (commencing with Section 15706) to Division 3 of Title 2 of the Government Code to specify that the Board and the Franchise Tax Board (FTB) shall have the burden of proof in any court or administrative tax proceeding, with respect to a factual issue related to ascertaining the tax liability of a taxpayer that has established that it is a cooperating taxpayer, as defined.**

**Source: Honorable Bill Leonard**

### **Existing Law**

Under existing law, as a general rule, in civil cases involving the potential loss of money or property, the burden of proof is on the party in control of the facts. California law generally provides that taxpayers, like plaintiffs in other civil actions, have the burden of proving that the government's action was incorrect and establishing the merits of their claims by a preponderance of the evidence. The burden of proof is placed on the taxpayer since that is the party who has control of the records and documents.

*Under Federal law*, the Internal Revenue Service Restructuring and Reform Act of 1998, as added by Public Law 105-206, added Section 7491 to the Internal Revenue Code to place the burden of proof on the Internal Revenue Service (IRS) in any *court proceeding* involving a factual issue if the taxpayer introduced credible evidence with respect to the factual issue relevant to ascertaining the taxpayer's tax liability. Under this provision, the burden of proof shifts to the IRS if the taxpayer:

- (1) Complies with all the substantiation requirements of the Code,
- (2) Maintains all the records required by the Code,
- (3) Cooperates with the IRS' reasonable requests for witnesses, information, documents, meetings, and interviews, and
- (4) Meets the net worth requirements (the burden of proof shift does *not* apply to partnerships, corporations, or trusts whose net worth is more than \$7 million; no net worth limitation is applicable to individuals).

### **This Proposal**

This proposal would add a provision to the Government Code to provide that the Board and the FTB shall have the burden of proof in any court or administrative tax proceeding, with respect to a factual issue related to ascertaining the tax liability of a taxpayer that has established that it is a cooperating taxpayer.

The proposal would define a "cooperating taxpayer," as one that has both complied with all statutory, regulatory, or case law substantiation requirements to substantiate any item on a return or claim filed with the Board or the FTB; has maintained all records required by law or regulation, and has provided those records to the state agency, upon a reasonable request; and has provided credible evidence with respect to any factual issue relevant to ascertaining the tax liability.

The proposal would also provide that, unless provided otherwise, the burden of proof upon the Board and FTB for purposes of this part shall be a preponderance of the evidence, and that these proposed provisions would not apply to an adjustment proposed and made to a taxpayer's federal income tax return by the federal government, nor to specified appeals under the personal income tax and corporation tax laws.

The current placement of the general burden of proof on the taxpayers creates a perception of guilt until proven innocent. A better balance, as provided by this proposal, would place the burden of proof on the government to show an increase in liability if the taxpayer complied with the procedural and recordkeeping requirements of the tax laws. That is, if the taxpayer is generally law-abiding, it would be the government's responsibility to show that the taxpayer's determination of liability was not correct.

This shift would not impose an unreasonable obstruction to the State in determining the correct tax liability. Instead, good auditing practices would ordinarily be required to produce sufficient evidence to sustain the burden of proof regardless of the shift.

Taxpayers would still be required to maintain adequate records and comply with the law. Many Board-audited taxpayers have lost their contested audits largely because they failed to keep "adequate records." The Board in many cases is required to determine these taxpayers' taxable sales through other techniques, such as mark-up audits. In such situations, under this proposal, the burden of proof would still rest with the taxpayer.

Under this proposal, California's standard of the burden of proof on the tax agencies would be consistent with Federal law. This proposal would simply put California in conformity with the IRS, as the taxpayer's hearing before the Board Members is the state tax equivalent of a federal proceeding in tax court.

Several bills on this issue were considered in the past when the "Internal Revenue Service Restructuring and Reform Act" was pending before Congress. Since enactment of that Act, three additional bills have been introduced on this issue as well. The next page lists the previous measures:

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Year	Legislation	Proposal	Final Status
2008	AB 2727, La Malfa	In part, similar to this proposal (this bill had another change to the Evidence Code).	Held in Assembly Revenue and Taxation Committee
2007	AB 1600, La Malfa	In part, similar to this proposal (this bill had another change to the Evidence Code).	Never heard in committee
2005	SB 633, Dutton	In part, similar to this proposal (this bill had another change to the Evidence Code).	Never heard in committee
1998	AB 1488, Pringle	As amended 1/16/98, among other things, would have shifted the burden of proof from the taxpayer to FTB when ascertaining income tax liability in any court proceeding.	Held in Assembly Appropriations Committee
1998	AB 1631, Sweeney, et al.	As amended 4/15/98, declared legislative intent to shift burden of proof to conform with federal law	Held in Assembly Appropriations Committee
1998	AB 1633, Ortiz, et al.	As amended 4/14/98, stated legislative intent to conform state law to federal law relative to the shifting of the burden of proof in connection with taxes paid by California income tax taxpayers	Held in Assembly Appropriations Committee
1998	SB 1166, Hurtt	As amended 1/5/98, would have provided that the FTB shall have the burden of proof in any court proceeding	Failed passage in the Senate Revenue and Taxation Committee
1998	SB 1425, Hurtt & Kopp	As amended 4/14/98, would have made findings and declarations that California should conform to the IRS Restructuring and Reform Act, which may include provisions that would shift the burden of proof in court proceedings from the taxpayer to the taxing agency	Failed passage in the Assembly Revenue and Taxation Committee
1998	SB 1478, Rainey, et al.	As amended 3/19/98, provided that the Board, FTB, and EDD, and any state agency that collects taxes shall have the burden of proof in any court or administrative tax proceeding with respect to any factual issue relevant to ascertaining the tax liability of a taxpayer, but only if certain requirements are met.	Died in the Senate Revenue and Taxation Committee

*Part 10.1 (commencing with Section 15706) is added to Division 3 of Title 2 of the Government Code, to read:*

PART 10.1. BURDEN OF PROOF

15706. (a) The State Board of Equalization and Franchise Tax Board shall have the burden of proof in any court or administrative tax proceeding, with respect to a factual issue related to ascertaining the tax liability of a taxpayer that has established that it is a cooperating taxpayer.

(b) For purposes of this section:

(1) "Administrative tax proceeding" means either of the following:

(A) For disputes concerning taxes or fees collected by the State Board of Equalization, the oral hearing before the members of the State Board of Equalization.

(B) For disputes concerning taxes collected by the Franchise Tax Board, the oral hearing before the members of the State Board of Equalization.

(2) "Cooperating taxpayer" means a taxpayer that satisfies all of the following requirements:

(A) Has complied with all relevant statutory, regulatory, or case law substantiation requirements to substantiate any item on a return or claim filed with the State Board of Equalization or the Franchise Tax Board.

(B) Has maintained all records as required by the Revenue and Taxation Code, or any regulations issued by the State Board of Equalization or the Franchise Tax Board, and, upon a reasonable request by the state agency, has provided those records to the state agency.

(C) Has provided credible evidence to the State Board of Equalization or the Franchise Tax Board with respect to any factual issue relevant to ascertaining the tax liability of the taxpayer.

(3) "Tax liability" means any tax or fee assessed or determined by the State Board of Equalization or the Franchise Tax Board, including any interest accrued or penalties levied in association with the tax or fee.

(c) Unless provided otherwise, the burden of proof-for purposes of this part shall be a preponderance of the evidence.

(d) This section does not apply to either of the following:

(1) An adjustment proposed and made to a taxpayer's federal income tax return by the federal government.

(2) An appeal filed under Section 19045 or 19324 of the Revenue and Taxation Code that is subject to the provisions of Section 21024 of the Revenue and Taxation Code.

(e) Nothing in this section shall subject a taxpayer to unreasonable search or access to records in violation of the United States Constitution, the California Constitution, or any other law.

(f) This section shall apply only to court and administrative tax proceedings involving assessments or notices of determination issued on or after the date on which this act becomes operative.