

## SECOND DISCUSSION PAPER

### Proposed Regulation 1807, Process for Reviewing Local Tax Reallocation Inquiries

#### I. Issue

Should proposed Regulation 1807, *Process for Reviewing Local Tax Reallocation Inquiries*, be adopted?

#### II. Staff Recommendation

Staff proposes promulgating, in regulatory form, the process for appealing local tax reallocation decisions. These procedures have been in place for five years. They have been published in the Compliance Policy and Procedural Manual (CPPM) section 160.000 et. seq since 1996 and have been accepted and used successfully by inquiring jurisdictions and their consultants (IJC) as the proper appeals method.

Staff proposes to incorporate into the proposed regulation the following information, which was previously provided to cities and counties in special notices dated February 1996 and October 1998:

- Definitions for: Inquiring jurisdictions and their consultants (IJC), claim (inquiry) of incorrect or non-distribution of local tax, “date of knowledge” (DOK), and Board Management, in subdivision (a).
- The minimum factual data that is necessary to support the probability that local tax has been erroneously allocated and distributed in order to establish a DOK, in subdivision (a)(2).
- The process for submittals and acknowledgements of inquiries, in subdivision (b).
- The various levels of review for these inquiries, which include: review by the Board’s Allocation Group Supervisor, Refund Section Supervisor, Local Tax Appeals Auditor, Board Management and, under certain circumstances, the Board Members, in subdivision (c).
- The time limitations for each level of review, and information regarding how the DOK established by the original inquiry may remain intact, in subdivision (d).
- The appeal rights of jurisdictions that will lose revenue as the result of a reallocation. The jurisdictions that will lose revenue as the result of a reallocation may follow the same appeals procedure described in the regulation, in subdivision (e).
- A summary of RTC section 7209, *Limitation; Redistributions*, which establishes that redistributions shall not include amounts originally distributed earlier than two quarterly periods prior to the quarterly period in which the Board obtains knowledge of the improper distribution, in subdivision (f).
- The process for reviewing responses to local tax reallocation inquiries submitted under RTC section 6066.3, in subdivision (g).

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The proposed regulation does not include the provisions currently contained in the process regarding the internal procedures of the Board, how it actually processes the inquiries, what forms are used, etc. These provisions are not properly included in a regulation under the Government Code. However, the complete "Process for Reviewing Reallocation Inquiries" ("Process") which includes all the administrative procedures for this review, has been published in the Compliance Policy and Procedural Manual (CPPM) section 160.000 et. seq. These sections of the CPPM are presently being moved to the proposed CPPM 905.000 et. seq, and are being replaced with the latest version of the notice (1998). Proposed revisions to Chapter 9, *Miscellaneous*, of the CPPM is currently scheduled for approval by the Board at the November 28, 2001, Business Taxes Committee meeting.

#### III. Other Alternative(s) Considered

Mr. Dean Andal asked that staff evaluate the feasibility of the following changes to the process:

1. Move the review by the Local Tax Appeals Auditor, currently under the Sales and Use Tax Department, to the Appeals Section of the Legal Division, in subdivision (c)(3).
2. Make the granting of an appeal to the Board automatic rather than discretionary on the part of the Board, in subdivision (c)(5).

#### IV. Background

The California Sales and Use Tax Law imposes a sales tax upon retailers for the privilege of selling tangible personal property at retail in the State of California. The use tax is complementary (and mutually exclusive) to the sales tax and is imposed upon the consumer for the storage, use, or other consumption of tangible personal property in the State of California. Either the sales tax or the use tax applies to all retail sales of tangible personal property to consumers in California, unless specifically exempted by statute.

Starting in 1945, cities began levying sales and use tax separate from those imposed by the State of California. Under the locally imposed programs, retailers were required to file separate sales and use tax returns, sometimes at different rates of tax, for each city in which they were engaged in business. Cities adopted their own exemptions and conducted their own audits of retailers. Businesses that operated within cities that did not impose a local sales tax were viewed as having an unfair competitive advantage over those operating in cities imposing a tax. Counties were not allowed to impose local sales and use taxes.

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In response to these concerns, the Bradley-Burns Uniform Local Sales and Use (“Local”) Tax Law was enacted during the 1955 legislative session. Sections 7202 and 7203 of the Local Tax Law authorized counties to levy a one-percent sales and use tax that would be administered by the state. Under section 7202(g), the cities may levy a local tax at a rate of up to one percent to offset the county tax within their jurisdictions, thus maintaining the uniform rate. During the 1972 Legislative Session, the counties were allowed to raise their local tax rate to the current 1.25%. The extra one-quarter percent is dedicated to the counties to finance local transportation projects.

In 1956 the responsibilities for the Local Tax Program were initially assigned to Business Taxes Department (now Sales and Use Tax Department) staff in various sections. On July 1, 1960, the Local Tax Unit, (later renamed the Local Revenue Allocation Section) was formed to administer all aspects of the Local Tax program including requests for reallocation. Subsequently, the Local Revenue Allocation Section was transferred to the Special Taxes and Operations Division and then to the Administration Division. In December 1995, the responsibility of investigating requests for reallocations was transferred to the newly formed Allocation Group within the Refund section of the Sales and Use Tax Department.

With few exceptions, the exemptions and exclusions from the local sales and use taxes mirror those of the state sales and use tax. The one-and-one-quarter percent county tax applies uniformly throughout each county in the state, as each county levies this tax. The city taxes apply to sales within their jurisdictions, and offset the county taxes to maintain a uniform rate. The county gets the 0.25 percent tax over and above the one-percent tax on all sales within its borders. With respect to unincorporated areas of a county, the county retains the entire amount of the one-and-one-quarter percent local tax.

The Board administers the local tax pursuant to contracts with each city, county, city and county, and redevelopment agency in accordance with section 7202. Taxes collected by the Board are allocated on a quarterly basis, less the Board’s administrative costs imposed pursuant to section 7204.3. Limitations on redistributions made by the Board are in accordance with section 7209. Collection of information by cities and counties for seller’s permits is pursuant to section 6066.3.

For the purpose of the following discussion, the term “cities” includes: cities, counties, cities and counties, and redevelopment agencies unless otherwise specified. With the enactment of the Local Tax Law, cities were able to establish a source of revenue without the burden of establishing a system to administer the program. Existing cities were able to reduce the costs of administration for both their own city and the retailers located within their city. An additional benefit of the Local Tax Law was that the counties could impose a local sales and use tax. Retailers could file only one return to remit taxes to both the cities and the state. In addition, audits are now conducted for both tax programs by one agency.

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As the tax base was generally the same, it was easier for retailers to determine what was taxable and what was not for both the state and the cities. The local tax system also afforded merchants protection from untaxed competitors located in nearby cities. Cities supported the Local Tax Law for these reasons as well as the cost savings derived by the use of the administrative and audit resources of the state. All counties and cities in California participate in this program. In fiscal year 1999-2000, approximately \$4.1 billion in local tax revenues were returned to the state's 58 counties and 475 cities. In recent years, cities have become increasingly dependent upon local sales and use tax revenues to support their programs.

Because local taxes are locally enacted, the activities giving rise to local sales or use tax revenues must occur within the jurisdiction seeking to tax those activities. Under the local tax system, the Board has always had inherent power to ensure that local tax is allocated to the jurisdiction in which those activities occurred.

#### **Limitations on Redistributions**

Retailers in California are assigned a local tax area code based on the jurisdictions in which their activities occur. Occasionally, for a variety of reasons, the local tax is allocated erroneously to the incorrect jurisdiction. When the Local Tax Law was first enacted, there were no limitations on how far back the Board could reallocate the revenue that was initially allocated to the incorrect jurisdiction. However, after a period of time, when returns reporting local taxes were submitted, several significant local tax misallocations were discovered. In some cases the necessary reallocations could have caused severe financial harm to the cities that would lose the local tax previously allocated to them.

In response to this, the Legislature enacted, with the Board's support, section 7209 (Stats. 1959), with the specific intent of limiting the impact of reallocations on the cities.

On September 11, 1959, the Board's Business Taxes Department issued Business Taxes General Bulletin (BTGB) 59-12. BTGB 59-12 was issued seven days prior to the effective date of RTC section 7209 and presumably reflected the thinking that went into this law section. BTGB 59-12 states the general rule that the Board would "be considered to have knowledge of an improper distribution when an employee of the Board has such knowledge." When a taxpayer or other person writes to the Board "questioning the correctness of an allocation and setting forth facts which indicate the probability of an improper distribution, and such distribution is later found to be erroneous, the Board will be considered to have knowledge of the erroneous allocation when the letter is received..." When the facts indicating the probability of an erroneous distribution are already in the records of the Board, however, "the Board will not be considered to have knowledge of the erroneous allocation until an employee of the Board has examined the document and questioned the tax allocation."

BTGB 59-12 further points out that the actual distribution is usually three quarters prior to the quarter in which the Board obtains the required knowledge because returns filed in any given quarter report the previous quarter's tax information. As a result, the statutory two-quarter

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period is calculated back from the quarter reported in the returns, thus giving a three-quarter reallocation.

The term “date of knowledge” (DOK) appears in neither the statute nor BTGB 59-12. It is a term of art that has developed between the cities and the Board to discuss redistributions under RTC section 7209. The provisions of BTGB 59-12 are discussed in the Board’s Publication 28, “Tax Information for City and County Officials.”

As previously noted, section 7209 does not specify a process for administrative review of initial allocation decisions. Heretofore, appeal has been made directly to the Executive Director with the advice of the Chief Counsel, Assistant Chief Counsel for Business Taxes, and the Deputy Director of the Sales and Use Tax Department.

The rules set forth in BTGB 59-12 have been consistently applied to local tax allocation questions for forty-one years and have been agreed to by the cities. While their application in particular cases has been questioned, there appears to be no controversy regarding the rules themselves.

#### **Inquiries from IJCs**

One question that has arisen concerns written inquiries from IJC’s. There is an issue regarding the DOK when a taxpayer or other person writes to the Board “questioning the correctness of an allocation . . . and such distribution is later found to be erroneous.” The Board had consistently interpreted that phrase to mean that if an IJC wrote in with sufficient information to indicate the probability of an improper allocation, and the Board determined upon investigation that the questioned allocation was proper, any subsequent communication containing additional facts which caused the Board to change its position constitutes a new communication with a new DOK. Some IJCs contended it meant that if the information contained in the first communication was later found to support a reallocation, the date of receipt of the first communication supplies the DOK.

In an effort to resolve this issue and to create a formalized appeals process, staff, in conjunction with both of the major consultant firms and several individual jurisdictions developed a formalized process for reviewing reallocation inquiries. The Board adopted in February of 1996 the “Process for Reviewing Reallocation Inquiries” (the “Process”). In June 1996 a special notice regarding the Process was sent to all local tax jurisdictions. The Process provides for an appeal from the initial decision and timelines within which the Board and the cities had to perform various actions. If the timelines are maintained, the DOK supplied by the original city request remains open. There are several levels of appeals, and the Board Members may ultimately hear an appeal if three members agree to hear the appeal. Several cities requested automatic appeal to the Board, but the Board Members rejected that in favor of discretionary appeal. It was determined at the time that the Process would not be put into a regulation until the details of the process were established. In October of 1998, the Process was amended to substitute a hearing before a hearing auditor instead of an appeal to the Headquarters Operations

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Manager. The hearing auditor prepares a Decision and Recommendation explaining the reasons for his or her decision.

The Process incorporates two important concepts from BTGB 59-12. First, the inquiry from the IJC must contain “sufficient facts to indicate the probability of a misallocation.” Second, if the inquiry meets this standard, the DOK is the date on which the inquiry is received, not the date the inquiry is sent. If it does not meet this standard, the inquiry is returned to the city and no DOK is established.

#### **Application of Tax**

Revenue and Taxation Code (RTC) section 7209, Limitations redistributions, provides that:

The board may redistribute tax, penalty and interest distributed to a county or city other than the county or city entitled thereto but such redistribution shall not be made as to amounts originally distributed earlier than two quarterly periods prior to the quarterly period in which the board obtains knowledge of the improper distribution.

In practice, three quarters are subject to reallocation as the Board is processing the previous quarter’s return during the current tax quarter. The law does not provide for notification to either the gaining or losing jurisdiction nor does it provide any procedures for appeal of the decisions made by the Board to make a redistribution of local tax revenues. (Similarly, BTGB 59-12 did not provide for an appeal from the initial reallocation decision.)

In 1999 sections 6066.3 and 6066.4 (added by Stats. 1999, Ch. 908, (AB 990) in effect January 1, 2001) were added to the RTC (see Exhibit 2).

The provisions of RTC sections 6066.3 and 6066.4 authorize cities and counties to collect information from persons seeking to engage in the business of selling tangible personal property and to transmit that information to the board. AB 990 requires the board to issue permits to applicants within specified time periods. AB 990 also authorizes cities and counties to require each person desiring to engage in business in that jurisdiction for the purposes of selling tangible personal property to provide his or her seller’s permit account number, if any. The AB 990 procedure, as it applies to reallocation inquiries under the statute, was established to run in addition to, and not replace, the provisions of the Process concerning submitting inquiries. The Process does not address initial allocation inquiries made under AB 990. Only appeals from an AB 990 allocation determination are to be handled under the Process. The proposed regulation incorporates the application of the Process for reviewing local tax reallocation determinations made under AB 990 in addition to review of inquiries made under the Process itself.

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Proposed Regulation 1807, *Process for Reviewing Local Tax Reallocation Inquiries*, is intended to implement, interpret, and make specific those provisions of RTC sections 7209 and 7223.

The Business Taxes Committee is scheduled to discuss this issue at its meeting on February 5, 2002.

#### V. Discussion

Staff met with interested parties on October 18, 2001, to discuss the initial draft of the proposed Regulation 1807, *Process for Reviewing Local Tax Reallocation Inquiries*. Interested parties expressed concerns about several provisions in the initial draft:

- The possibility of conflicts between the provisions of AB 990 (RTC sections 6066.3 and 6066.4) and the proposed Regulation 1807 regarding the definition of IJC (in subdivision (a)(1)).
- The factual information required under subdivision (a)(2) Claim (inquiry) of incorrect distribution of Local Tax.
- The submittal and acknowledgment of inquiries (in subdivision (b)).
- The review by Local Tax Appeals Auditor (in subdivision (c)(3)).
- The review by Board Management (in subdivision (c)(4)).
- The review by Board Members (in subdivision (c)(5)).
- The application of section 6066.3 inquiries (in subdivision (g)).

Staff requested that interested parties provide written comments addressing their concerns and provide suggested regulatory language prior to the second interested parties meeting. To date, staff has received comments on the proposed regulation from Mr. Paul Steinberg from Board Member Dean Andal's office regarding the review by the Local Tax Appeals Auditor, review by Board Management, and the review by Board Members.

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#### Discussion of Conflicts between IJC's and RTC sections 6066.3 and 6066.4

Under Regulation 1807, the term "Inquiring Jurisdictions and their Consultants (IJC)" is defined as:

Any city, county, city and county, or transactions and use tax district of this state which has adopted a sales or transactions and use tax ordinance and which has entered into a contract with the State Board of Equalization to perform all functions incidental to the administration or operation of the sales or transactions and use tax ordinance of the city, county, city and county, or transactions and use tax district of this state. IJC also includes any consultant that has entered into an agreement with the city, county, city and county, or transactions and use tax district, and has a current resolution filed with the Board which authorizes one (or more) of its officials, employees, or other designated person to examine the appropriate sales, transactions, and use tax records of the Board.

Under the interpretation and implementation of the provisions of RTC sections 6066.3 and 6066.4, the State Board of Equalization, the California State Association of Counties, and the League of California Cities entered into a Memorandum of Understanding ("MOU"). For the purpose of this MOU the terms "Local" and "Locals" are defined to include "cities," "counties," and "cities and counties." The provisions of RTC sections 6066.3 and 6066.4 make no reference to "consultants."

During the interested parties meeting, concerns were raised regarding whether the definition of IJC under the proposed regulation would be in conflict with the provisions of RTC sections 6066.3 and 6066.4. It is important to note that it was the desire of local governments and the intent of the California Municipal Business Tax Association in sponsoring AB 990, to form a partnership with the Board in identifying and reporting unregistered and misallocating sellers. It was their belief that a successful program would empower cities and counties with another tool in sales/use tax compliance, and use of this system would reduce the need for local government to hire outside services, thus minimizing costs and maximizing revenues for local government.

Section 6066.3 authorizes cities, counties, or cities and counties to collect information from persons seeking to engage in the business of selling tangible personal property and to transmit that information to the Board. The provisions of RTC sections 6066.3 and 6066.4 are not applicable to consultants. However, the provisions of proposed Regulation 1807 are applicable to all city, county, city and county, transactions and use tax district, as well as to consultants.

The information submitted to the Board under provisions of section 6066.3 will primarily serve three purposes: (1) As a preliminary application for a sellers permit; (2) As notification to the Board by the cities, counties, or cities and counties of a person desiring to engage in business of selling tangible personal property in that jurisdiction; and (3) As a notice for purposes of redistribution under Section 7209.

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The procedures set forth under RTC section 6066.3 for submitting information to the Board concerning redistribution under Section 7209 are in addition to the procedures being promulgated under the proposed Regulation 1807. If inquiries regarding suspected improper distribution of local tax are received under the procedures set forth in RTC section 6066.3, the terms and procedures set forth in subdivision (c)(2) through (c)(5) of Regulation 1807 shall apply to the appeals. Specifically, if the district office (which takes the place of the review by the Allocation Group Supervisor, in subdivision (c)(1)) receiving and or examining the inquiry from a “Local” determines that a misallocation has not occurred and recommends that a request for reallocation be denied, the “Local” that filed the inquiry will be notified of the recommendation and will be allowed 30 days from the date of mailing of the notice of denial to contact the Allocation Group Supervisor to discuss the denial, set forth in subdivision (c)(2).

Staff, in order to differentiate between the provisions of RTC 6066.3 and the proposed regulation, has added language to the definition of IJC to specify that *except for submittals under Revenue and Taxation Code Section 6066.3*, IJC also includes any consultant that has entered into an agreement with the city, county, city and county, or transactions and use tax district, and has a current resolution filed with the Board which authorizes one (or more) of its officials, employees, or other designated person to examine the appropriate sales, transactions, and use tax records of the Board.

#### Discussion of Claim (Inquiry) of Incorrect or Non Distribution of Local Tax

Concerns were raised as to whether the factual information required in subdivision (a)(2) of the proposed regulation would be in conflict with the provisions of RTC section 6066.3. However, during the meeting staff explained that, in order to establish a date of knowledge, the factual information required in subdivision (a)(2) of the proposed regulation is the minimum factual data that must be provided under the provisions of the proposed regulation. However, additional information may be required to assist in determining that a misallocation has or has not occurred.

Under the provisions of RTC 6066.3 there is additional factual information requested that is not requested under the proposed Regulation 1807. As stated earlier, allocation inquiries under AB 990 are separate from allocation inquiries under subdivision (c)(1). AB 990 inquiries that do not contain the elements required by the procedures developed under AB 990 will be rejected. Any DOK will be established under those procedures rather than under the proposed regulation.

Moreover, questions were asked regarding conflicting language in subdivision (a)(2)(B) in conjunction with the title of subdivision (a)(2). It was not clear how there could be incorrect distributions of local tax when a permit was not required. To clarify this language staff and interested parties agreed to change the title of this section to include claims of incorrect *or non-distributions* of local tax; and subdivision (a)(2)(B) was also changed from “Taxpayer’s permit number or reason why a permit is not required” to “Taxpayer’s permit number *or a notation stating ‘No Permit Number’.*”

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Concerns were also raised as to whether the regulation should specify a format, such as USPS, for the complete business address of the taxpayer that is requested under subdivision (a)(2)(C). Section 6066.3 specifies that “The board shall, after consulting with the League of California Cities and the California State Association of Counties, adopt standardized data addressing and naming conventions that are compatible with local jurisdictions conventions for new registrants and, to the extent possible, for current accounts.” Such requirement does not exist under RTC section 7209. Staff believes that incorporating this requirement into the proposed regulation would be in conflict with the Administrative Procedure Act (APA) and would likely not be approved by the Office of Administrative Law (OAL).

#### **Discussion of Submittal and Acknowledgment of Inquiries**

Interested parties inquired as to the possibility of providing the submittal and acknowledgement via e-mail over the Internet. Currently for inquiries under section 6066.3 there are provisions being established where inquiries may be submitted via e-mail.

Staff believes that although submittal and acknowledgements could potentially be provided via e-mail over the Internet, this method of providing information is currently not sufficiently secure in order to protect the privacy of taxpayer information. There are also questions of compatibility of both hardware and software between the Board and the cities. However, although it is conceivable that, once encryption policies or software has been put in place, submittal and acknowledgements could be provided via e-mail over the Internet, it is not necessary to state this in the proposed regulation. The regulation already specifies that every inquiry of local tax allocation must be submitted in writing (which does not preclude inquiries via e-mail). Methods by which submittals and acknowledgements could be made relate to internal procedures, and thus are not appropriate for a regulation under the APA. All inquiries are to be sent directly to the Allocation Group in the Refund Section of the Board’s Sales and Use Tax Department, which acknowledges inquiries after they are received.

#### **Discussion of the Review Process**

Interested parties and staff were in agreement regarding review by the Allocation Group Supervisor and review by the Refund Section Supervisor (subdivision (c)(1) and (c)(2)). Mr. Paul Steinberg from Board Member Dean Andal’s office expressed some concerns regarding review by the Local Tax Appeal Auditor (subdivision (c)(3)) and review by the Board Members (subdivision (c)(5)). Specifically, Mr. Steinberg asked staff to explore the possibilities of :

1. Moving the review by the Local Tax Appeals Auditor, currently under the Sales and Use Tax Department, to the Appeals Section of the Legal Division.

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2. Granting a hearing by the Board Members automatically upon appeal rather than at the discretion of the Board, thereby streamlining the process, which now requires a Board Member to request a decision by the Board to hear the matter prior to the actual hearing. A request to hear a matter must be approved by a majority vote of the Board Members.

As to Mr. Steinberg's first concern, in 1996, prior to the existence of the review by the Local Tax Appeals Auditor, the IJC's could ask for review of a denial, and the review would be done by the Audit Refund Section Supervisor and the Audit Program Manager (now called the Headquarters Operations Manager). In October of 1998, in part due to a large backlog of these types of cases, the Process was amended to substitute a hearing before a hearing auditor instead of an appeal to the Headquarters Operations Manager. The Local Tax Appeals Auditor, who is independent from the Refund Section and the Allocation Section's review, prepares a Decision and Recommendation explaining the reasons for his or her decision. If the IJC does not agree with the hearing auditor's decision, the IJC can ask for review by Board Management.

The appeals process, as far as Petitions for Redetermination are concerned, is based on statute (RTC sections 6561, 6561.5, and 6562). The local tax reallocation appeals are not statutory in nature, but are granted (using the procedures established in the process for reviewing local tax reallocation inquiries) under the Board's inherent authority to ensure the allocation of local tax is correct. Under the current appeals process, the Appeals Section does not become involved in the petition process until after all the review processes at the Sales and Use Tax Department level are exhausted.

Consequently, if the review by Local Tax Appeals Auditor were to be moved to the Appeals Section, in the Legal Division, the review by Board Management (which is in part at the Sales and Use Tax Department level) would have to take place prior to the review by the Local Tax Appeals Auditor in the Appeals Section of the Legal Division. If the review by the Board Management takes place before the review by the Local Tax Appeals Auditor, the Local Tax Appeals Auditor would have authority to override decisions made by the Executive Director, Chief Counsel, Assistant Chief Counsel for Business Taxes, and the Deputy Director of the Sales and Use Tax Department. Thus, the review by Board Management would most likely have to be eliminated.

In creating these procedures, the intent was to continue the process that was already in existence. The Executive Director, as the individual who signs the "Agreements for State Administration of Local Sales and Use Tax," and as a member of Board Management (which reviews these local tax appeals), should have the last word before the Board Members may consider the appeals cases.

Mr. Steinberg mentioned that similar issues regarding appeals of Timber Taxes were recently moved from the Property Taxes Department to the Appeals Section. Per consultation with the Appeals Section, it was confirmed that Timber Tax appeals are handled through the Appeals Section. However, the Appeals Section indicated that since this change was introduced, no Timber Tax cases have been appealed.

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However, on average, seven to more than fourteen local tax reallocation appeals cases per month reach the level of the Local Tax Appeals Auditor, and approximately 90% of these cases are forwarded to the next level, Board Management review. Therefore, moving the review from the Sales and Use Tax Department to the Appeals Section could create a backlog of these types of cases in the Appeals Section.

It is important to note that the procedures were developed through close collaboration between Board staff, both of the major consultant firms and several individual jurisdictions, all of whom agreed to the levels of review, with Board Management being the last level of review prior to involvement by the Board Members. At the time the Process was approved, the Board Members expressed their intention that all possible levels of staff review be completed before they would review the case.

A potential advantage of moving the Local Tax Appeals Auditor position to the Legal Division's Appeals Section is that it may increase the objectivity and impartiality of the review by the Local Tax Appeals Auditor. Further, although the present review by the Local Tax Appeals Auditor is considered to be independent and separate from the Refund Section's and the Allocation Section's review, moving the Local Tax Appeals Auditor to the Appeals Section would increase the *perception* of the position's independence, fairness and impartiality.

As to Mr. Steinberg's second concern, currently, if the IJC disagrees with the Board Management finding, the IJC may file a request for review with a Member of the Board. However, whether the Board Members hear the case or not it is at their discretion. An oral hearing by the Board for local tax reallocation appeals is not automatic as it is under RTC section 6562 for sales and use tax appeals. If a Board Member wishes to do so, he or she may request that the Board hear the matter. A request to hear the matter must be approved by a majority vote of the Board Members. If a Board Member does not make a request to the full Board within 90 days of the Board Management's notification of decision, the matter will be considered closed. The Board Members rejected a similar request for automatic review when the Process was initially developed in 1996. At the time, they expressed their concern that if automatic review by the Board was made available, cities would do minimum work at the staff level in order to push all local tax allocation appeals to the Board Members, and such appeals would consume an inordinate amount of their time. Staff believes that the two steps cannot be collapsed without essentially granting automatic appeal to the Board.

Under the current sales and use tax appeals process, after the appeals conference, if the petitioner has also requested an oral hearing, the Board automatically grants the oral hearing. However, local tax reallocation appeals are not mentioned in RTC section 7209, and under the current Process for local tax appeals, the hearings by the Board are discretionary and not automatic. Mr. Steinberg indicated that in the past few years this hearing process has been eliminated with respect to welfare exemption claims and fee reimbursement claims. The main reason the process has been eliminated is because of the duplication of work that is involved for all parties by having in effect two hearings instead of one. In examining the Hearing Procedures Guidelines of

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the Board, Rules of Practice, Article 6, Property Tax Welfare Exemption Claim Review Procedure, Article 7, General Board Hearing Procedure, and Article 9, Taxpayer Bill of Rights Reimbursement Claims, it is apparent that several amendments have been made to these Articles which now provide for the hearing process mentioned by Mr. Steinberg. In general, these issues do not receive the extensive review at various staff levels, as do local tax reallocation appeals. As a result, all possible work by staff of both the cities and the Board should have already been done, and the actual appeal to the Board Member should consist of no more than a short document outlining the issues. That minor procedure, if needed, could be specified in an update to Publication 28, "Tax Information for City and County Officials." As noted above, however, the Process currently provides for two steps at the specific instruction of the Board Members. If they conclude that the concerns they had in 1996 are no longer existent, they may, of course, alter the procedure.

During the October 18, 2001 interested parties meeting, Mr. Al Koch, General Counsel for Municipal Resource Consultants, MBIA MuniServices Company, raised concerns regarding the review by Board Members, specifically in regard to the following provision in subdivision (c)(5): "If the Board Member does not agree to make a request to the full Board within 90 days of the date the Board Management's decision was mailed, the matter will be considered closed." This requirement is new with the proposed regulation. The interested parties appeared to agree that some time limit was necessary, but some interested parties did not believe that 90 days was sufficient time for the IJC to do the staff work needed to file a request for review with a Member of the Board. Mr. Koch stated his belief that 12 months would be a more appropriate time period to complete this process.

However, by the time these types of cases arrive at this level of review, all of the work should have been essentially completed. The 90-day period provides a closure to this process, and it allows the Board to complete any necessary fund transfer of the local tax that was originally misallocated. It is the Board's obligation to transmit these moneys to the proper local jurisdictions as promptly as feasible. Therefore, staff believes 90 days is sufficient time for this level of review.

#### **Discussion of Application to Section 6066.3 Inquiries**

Concerns were raised as to whether the procedures developed under section 6066.3 should be incorporated in whole or in part into this proposed regulation. Under the direction of RTC section 6066.3, the State Board of Equalization, the California State Association of Counties, and the League of California Cities established procedures to implement the provisions of that section and RTC section 6066.4. These procedures were intended to run separately from those established under section 7209. In addition, if these procedures were incorporated in the proposed regulation, the Memorandum of Understanding (MOU) would have to be reviewed by Office of Administrative Law (OAL) for conformance with the Administrative Procedure Act (APA), which procedure was not contemplated by the Legislature when it enacted AB 990.

## SECOND DISCUSSION PAPER

### Proposed Regulation 1807, Process for Reviewing Local Tax Reallocation Inquiries

Therefore, staff does not believe that the MOU should be incorporated in whole or in part into this proposed regulation. Thus, in order to remove any possible conflict with the APA, staff has removed any mention of the MOU in the proposed regulation in subdivision (g) as follows:

(g) APPLICATION TO SECTION 6066.3 INQUIRIES

~~(1) The terms and procedures set forth herein shall also apply to appeals from reallocation determinations made under the procedures set forth in the Memorandum of Understanding executed by the Board, the California League of Cities, and the California State Association of Counties pursuant to Revenue and Taxation Code section 6066.3.~~

~~(2)(1) The procedures set forth herein for submitting information to the Board concerning improper distributions are in addition to, but separate and apart from, any procedures established under the authority of Revenue and Taxation Code section 6066.3 for making inquiries regarding improper distributions. ~~procedures.~~ If inquiries regarding suspected improper distribution of local tax are received both under the procedures set forth herein and section 6066.3, duplicate submissions will not be processed. The date of the earliest date requested submission shall be controlling as to whether the request is to be handled under the provisions of this regulation or section 6066.3, and the date of knowledge shall be established under the controlling procedure.~~

~~(2) The terms and procedures set forth in subdivision (c)(2) through (c)(5) of this regulation shall also apply to appeals from reallocation determinations made under Revenue and Taxation Code section 6066.3.~~

#### VI. Summary

Regulation 1807, *Process for Reviewing Local Tax Reallocation Inquiries*, will clarify and further publicize the appeals process currently in place. Staff welcomes any comments, suggestions, and input from interested parties regarding proposed Regulation 1807.

Prepared by the Program Planning Division, Sales and Use Tax Department

Current as of 11/16/2001

**Regulation 1807. Process for Reviewing Local Tax Reallocation Inquiries.**

Reference: Sections 7209, 7223, Revenue and Taxation Code.

**(a) DEFINITIONS:**

For inquiries under Revenue and Taxation Code section 6066.3, see subdivision (g) of this regulation.

(1) INQUIRING JURISDICTIONS AND THEIR CONSULTANTS (IJC). “Inquiring Jurisdictions and their Consultants (IJC)” means any city, county, city and county, or transactions and use tax district of this state which has adopted a sales or transactions and use tax ordinance and which has entered into a contract with the Board to perform all functions incidental to the administration or operation of the sales or transactions and use tax ordinance of the city, county, city and county, or transactions and use tax district of this state. Except for submittals under Revenue and Taxation Code section 6066.3, IJC also includes any consultant that has entered into an agreement with the city, county, city and county, or transactions and use tax district, and has a current resolution filed with the Board which authorizes one (or more) of its officials, employees, or other designated person to examine the appropriate sales, transactions, and use tax records of the Board.

(2) CLAIM (INQUIRY) OF INCORRECT OR NON DISTRIBUTION OF LOCAL TAX. Except for submittals under Revenue and Taxation Code section 6066.3, “claim or inquiry” means a written request from an IJC for investigation of suspected improper distribution of local tax. The inquiry must contain sufficient factual data to support the probability that local tax has been erroneously allocated and distributed. Sufficient factual data must include at a minimum all of the following for each business location being questioned:

- A. Taxpayer name, including owner name and d.b.a. (doing business as) designation.
- B. Taxpayer’s permit number or a notation stating “No Permit Number.”
- C. Complete business address of the taxpayer.
- D. Complete description of taxpayer’s business activity or activities.
- E. Specific reasons and evidence why the taxpayer's allocation is questioned. In cases where it is submitted that the location of the sale is an unregistered location, evidence that the unregistered location is a selling location and that it is a place of business as defined by Regulation 1802 must be submitted. In cases that involve shipments from an out-of-state location and claims that the tax is sales tax and not use tax, evidence must be submitted that there was participation by an in-state office of the out-of-state retailer and that title to the goods passed in this state.
- F. Name, title, and phone number of the contact person.
- G. The tax reporting periods involved.

(3) DATE OF KNOWLEDGE. “Date of knowledge” shall be the date the inquiry of suspected improper distribution of local tax that contains the facts required by subdivision (a)(2) of this regulation is received by the Board, unless an earlier date is operationally documented by the Board. If the IJC is not able to obtain the above minimum factual data, but provides a letter with the inquiry, indicating what the IJC has done to obtain the minimum factual data required by subdivision (a)(2) of this regulation, the Board can use the date this inquiry is received as the date of knowledge.

(4) BOARD MANAGEMENT. “Board Management” consists of the Executive Director, Chief Counsel, Assistant Chief Counsel for Business Taxes, and the Deputy Director of the Sales and Use Tax Department.

### **(b) INQUIRIES**

(1) SUBMITTING INQUIRIES. Every inquiry of local tax allocation must be submitted in writing and shall include the information set forth in subdivision (a)(2) of this regulation. Except for submittals under Revenue and Taxation Code section 6066.3, all inquiries are to be sent directly to the Allocation Group in the Refund Section of the Board’s Sales and Use Tax Department.

(2) ACKNOWLEDGEMENT OF INQUIRY. The Allocation Group will acknowledge inquiries after they are received. Acknowledgement of receipt does not mean that the inquiry qualifies to establish a date of knowledge under subdivision (a)(2) of this regulation. The Allocation Group will review the inquiry and if the inquiry does not qualify to establish the date of knowledge the IJC will be notified.

### **(c) REVIEW PROCESS**

(1) REVIEW BY ALLOCATION GROUP SUPERVISOR. The Allocation Group will investigate all accepted inquiries. If the Allocation Group determines that a misallocation has not occurred and recommends that a request for reallocation be denied, the IJC will be notified of the recommendation and allowed 30 days from the date of mailing of the notice of denial to contact the Allocation Group Supervisor to discuss the denial. If the IJC contacts the Allocation Group Supervisor, the IJC must state the specific facts on which its disagreement is based, and submit all additional information in its possession that supports its position at this time.

(2) REVIEW BY REFUND SECTION SUPERVISOR. Subsequent to the submission of additional information by the IJC, if the Allocation Group Supervisor upholds the denial, the IJC will be advised in writing of the decision and that it has 30 days from the date of mailing of the decision to file a “petition for reallocation” with the Refund Section Supervisor. The petition for reallocation must state the specific reasons of disagreement with the Allocation Group Supervisor’s findings. If a petition for reallocation is filed by the IJC, the Refund Section Supervisor will review the request for reallocation and determine if any additional staff investigation is warranted prior to

determining whether a reallocation adjustment should not be granted. If no basis for reallocation is found, the petition will be forwarded to the Local Tax Appeals Auditor.

(3) REVIEW BY LOCAL TAX APPEALS AUDITOR. A conference between the Local Tax Appeals Auditor and the IJC will be scheduled. The IJC may, however, at its option, provide a written brief instead of attending the conference. If a conference is held, the Local Tax Appeals Auditor will consider oral arguments, as well as review material previously presented by both the IJC and the Sales and Use Tax Department. The Local Tax Appeals Auditor will prepare a written Decision and Recommendation (D&R) detailing the facts and law involved and the conclusions reached.

(4) REVIEW BY BOARD MANAGEMENT. If the D&R's recommendation is to deny the petition, the IJC will have 30 days from the date of mailing of the D&R to file a written request for review of the denial with Board Management. The request must state the specific reasons of disagreement with the denial and submit any additional information in the IJC's possession that supports its position. Board Management will only consider the petition and will not meet with the IJC. The IJC will be notified of the Board Management's decision. If a written request for review of the denial is not filed with Board Management within the 30-day period, the D&R becomes final at the expiration of that period.

(5) REVIEW BY BOARD MEMBERS. If Board Management upholds a finding that no improper distribution has occurred, the IJC may file a request for review with a Member of the Board, stating the specific reason of disagreement with Board management findings. If a Board Member wishes to do so, he or she may request that the Board hear the matter. A request to hear the matter must be approved by a majority vote of the Board Members. If the Board Member does not agree to make a request to the full Board within 90 days of the Board Management's decision was mailed, the matter will be considered closed. If the date the Board decides to hear the mater, it will be scheduled for hearing on the appropriate Board Calendar. All interested local jurisdictions that would have appeals rights under this regulation will be notified of the scheduling of the Board hearing.

#### **(d) TIME LIMITATIONS**

(1) An IJC will be limited to one 30-day extension of the time limit established for each level of review through Board Management level.

(2) If action is not taken beyond acknowledgement on any inquiry for a period of six months at any level of review, the IJC may request advancement to the next level of review. For the purpose of these procedures, "action" means taking the steps necessary to resolve the inquiry.

(3) By following the time limits set forth in subdivisions (c) and (d), any date of knowledge established by the original inquiry will remain open even if additional supporting information is provided prior to closure. If the time limits or any extensions

are not met, or if closure has occurred, any additional supporting documentation submitted will establish a new date of knowledge as of the date of receipt of the new information.

**(e) APPEAL RIGHTS OF JURISDICTIONS THAT WILL LOSE REVENUE AS THE RESULT OF A REALLOCATION**

(1) If at any time during this review process the Board's investigation determines that a misallocation has occurred, any jurisdiction that will lose 5% of its average quarterly allocation (12 month historical period) or \$50,000, whichever is less, will be informed of the decision and be allowed 30 days from the date of mailing the notice, to contact the Allocation Group to discuss the proposed reallocation. The losing jurisdiction may follow the same appeals procedure as described in subdivisions (c) and (d) of this regulation. The reallocation will be postponed until the period for the losing jurisdiction to request a hearing with the Allocation Group has expired.

(2) If the losing jurisdiction contacts the Allocation Group and subsequently petitions the proposed reallocation, the postponement will be extended pending the final outcome of the petition.

**(f) LIMITATION PERIOD FOR REDISTRIBUTIONS**

Redistributions shall not include amounts originally distributed earlier than two quarterly periods prior to the quarterly period in which the Board obtains knowledge of the improper distribution.

**(g) APPLICATION TO SECTION 6066.3 INQUIRIES**

(1) The procedures set forth herein for submitting information to the Board concerning improper distributions are in addition to, but separate and apart from, any procedures established under the authority of Revenue and Taxation Code section 6066.3 for making inquiries regarding improper distributions. If inquiries regarding suspected improper distribution of local tax are received both under the procedures set forth herein and section 6066.3, duplicate submissions will not be processed. The date of the earliest submission shall be controlling as to whether the request is to be handled under the provisions of this regulation or section 6066.3, and the date of knowledge shall be established under the controlling procedure.

(2) The terms and procedures set forth in subdivision (c)(2) through (c)(5) of this regulation shall also apply to appeals from reallocation determinations made under Revenue and Taxation Code section 6066.3.

**6066.3. Collection of information by cities and counties for seller's permits.**

(a) A city, county, or city and county may collect information from persons desiring to engage in business in that jurisdiction for the purposes of selling tangible personal property under this part and shall transmit that information to the board. The information shall be provided to the board in a format to be determined by the board after consulting with the League of California Cities and the California State Association of Counties.

(b) The information submitted to the board under subdivision (a) shall serve as all of the following:

(1) The preliminary application for a seller's permit. (2) Notification to the board by the city, county, or city and county of a person desiring to engage in the business of selling of tangible personal property in that jurisdiction. (3) Notice to the board for purposes of redistribution under Section 7209.

(c) The board shall issue a determination regarding issuance of a seller's permit and receipt of notification for purposes of paragraphs (2) and (3) of subdivision (b). The board shall provide a copy of that determination and receipt of notification to the city, county, or city and county from which the board has received information under subdivision (a). The board shall make its determination as follows:

(1) For persons for whom a determination can be made based on the information submitted, the determination shall be issued within 30 days of receipt of the information.

(2) For persons for whom additional information is required before a determination can be made, the determination shall be issued within 120 days of receipt of the information.

(d) The board shall, after consulting with the League of California Cities and the California State Association of Counties, adopt standardized data addressing and naming conventions that are compatible with local jurisdiction conventions for new registrants and, to the extent possible, for current accounts.

(e) A city, county, or city and county may not charge applicants a fee for collecting and transmitting information pursuant to this section.

(f) This section shall remain in effect only until January 1, 2004, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2004, deletes or extends that date.

**6066.4. Providing of seller's permit to cities and counties.** (a) A city, county, or city and county may require each person desiring to engage in business in that jurisdiction for the purposes of selling tangible personal property to provide his or her seller's permit account number, if any.

(b) This section shall remain in effect only until January 1, 2004, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2004, deletes or extends that date.