

Fiscal Year 2009-2010

TITLE OF PROPOSAL

Tax Litigation Defense

DIVISION PRIORITY NUMBER

PROGRAM IMPACTED

Legal and Board Proceedings

SUMMARY OF REQUEST (including impact if request denied)

This proposal requests approximately \$1.8 million and 15.0 positions in fiscal year (FY) 2009-10 to be divided among the Legal Affairs Division (LAD) (3.0 positions: 1.0 Tax Counsel III (TC III), 1.0 Tax Counsel IV (TC IV), and 1.0 Associate Governmental Program Analyst (AGPA)), the Board Proceedings Division (BPD) (6.0 positions: 1.0 AGPA, 1.0 Staff Service Analyst (SSA), 2.0 Management Services Technician (MST), and 2.0 Office Technicians (OT), and the Appeals Division (6.0 positions: 1.0 Tax Counsel (TC), 2.0 TC III, 2.0 Business Taxes Specialist II (BST II), and 1.0 Legal Secretary). These positions will enable the LAD both to more effectively defend and protect the State against increasingly substantial claimed litigation refunds and damages and better manage an increased tax litigation workload (which, as to one current tax refund case alone, there is an estimated \$500 million potential impact to the State); and for the BPD and Appeals Divisions to accelerate the collection of revenue by increasing their capacities to process their increased workloads. The positions requested for the Appeals Division (which BPD supports) are expected to accelerate collection of \$27.6 million in additional BOE revenue annually. Denial of the request will jeopardize the effective management of tax refund litigation, increasing the risk of adverse rulings in those matters, and delay the processing of appeals and the generation of revenue at issue in those appeals, which is contrary to the BOE's strategic plan, Goal 1(c) and Goal 2(e).

BACKGROUND/HISTORY

Revenue Protection in Court Litigation: There have been steady increases of money at risk in pending tax refund lawsuits against the BOE. Between FY 2005-06 and the current FY, the number of litigation cases has increased over 26%. Furthermore, the aggregate amount of refunds and damages demanded has increased 200%.¹ The additional positions for the LAD are necessary to ensure that the increased claimed refund and damage amounts at risk are adequately protected. Finally, the actual amount at risk is actually significantly greater than the claimed damages. For example, for one case alone in which damages demanded are \$32 million, the actual potential fiscal impact of the issues being litigated is approximately \$500 million, as reported to the Department of Finance (DOF). In providing litigation assistance to the Attorney General, the role of the LAD attorneys has substantially increased resulting in an increase in the number of hours required per lawsuit to effectively defend the State against revenue loss in such litigation. (continued on next page)

STATE LEVEL CONSIDERATIONS (including impact to other departments)

There has been a 200% increase in the monetary amounts at risk in Board litigation, which litigation the LAD attorneys are charged with aggressively opposing and defending. The positions requested for the Appeals Division and the BPD are necessary to process the increased volume of tax appeals and are expected to accelerate \$27.6 million in additional State revenue annually.

JUSTIFICATION (including link to Strategic Plan)

If denied, this request will: (1) result in increased exposure in litigation as to which over \$500 million in refunds and damages are at issue; (2) delay the collection of revenue each year potentially totaling \$27.6 million; and (3) will result in large potential litigation losses to the State. (continued on next page)

COSTS AND BENEFITS (BUDGET YEAR ONLY – FISCAL YEAR 2009-10)

New funding Continuation Redirection

COST	REVENUE (if applicable)
\$ 1,800,000	\$27,600,000
POSITIONS (if applicable)	COST SAVINGS (if applicable)
15.0	\$ 0

PREPARED AND APPROVED

PREPARED BY

Amy Kelly

DIVISION CHIEF APPROVAL

AUTHOR'S TELEPHONE NUMBER

323-2029

DATE

June 11, 2008

ACTION

Concept Approved Request Denied

EXECUTIVE DIRECTOR (signature)



REQUEST FOR CONCEPTUAL APPROVAL (Continued)

Fiscal Year 2009-10

BACKGROUND/HISTORY

In addition, as a result of recent economic conditions and trends, there has been not only a significant increase in the volume of tax refund lawsuits filed against the BOE and in the damages claimed in such litigation, but there also has been: (1) an increase in the significance and complexity of the tax issues being litigated; (2) a substantial expansion in the potential fiscal impact of such tax issues to the State; and (3) a consequential rise in the resources that must be dedicated by the LAD to these lawsuits in protecting the State against loss of revenues.

Given the magnitude of the monetary amounts at issue, and the size and influence of the plaintiff companies and their law firms, and the critical importance of the tax policy issues at stake, the plaintiffs are litigating these increasingly common "big ticket" lawsuits very seriously and thoroughly. In order to devote the substantial time and resources needed to aggressively defend the State against such lawsuits, the LAD needs two additional experienced TCs, one at the TC III level and one at the TC IV level.

¹The following are the specifics for these statistics:

Fiscal Year End	Total Cases Filed	Total Damages Claimed
June 2005	49	\$ 39,432,829
June 2006	61	73,343,060
June 2007	64	79,010,949
June 2008	62	118,488,040

Revenue Generation in Administrative Litigation: New Appeals Division workload has resulted in additional disputed estimated tax amounts of \$55.9 million that may be finalized and collected in potential State tax revenues. There has been a substantial growth in the workload for the Board Proceedings and Appeals Divisions during the current fiscal year (FY) (8% for the Business Tax Section, 23% for the Franchise Income Tax Section, and 15% for the Property Tax Section) and greater growth is likely during the 2008-09 FY. In addition, more complex issues and increased demands on the attorneys and auditors have translated to more time and effort per appeal and lower manageable caseloads. Finally, there has been an increase in Board Hearing Summaries of 31% from FY 2005-06 to date. Available Sales & Use Tax Department (SUTD) statistics show that the BOE retains approximately 44.5% of the tax, interest, and penalties at issue in each appeal. Furthermore, funding of these additional positions should eliminate the need for BPD overtime costs (2,105.5 hours) and accelerate the conclusion of an additional 100 business tax appeals per year, with an aggregate potential revenue amount of approximately \$16.8 million.

For Franchise Income Tax appeals, for FY 2006-07 to 2007-08, the caseload has increased 23% from 1723 appeals to 2127 appeals. There has been a corresponding increase in the number of complex appeals involving issues of first impression in the areas of abusive tax shelters, unitary law, and enterprise zone appeals. The TC and TC III positions would accelerate the collection of an additional 120 appeals per year, totaling potentially \$10.8 million in revenue.

JUSTIFICATION *(including link to Strategic Plan)*

The LAD is defending the State against tax refund litigation with potentially large losses to the State; losing one current \$32 million case would potentially result in losses of \$500 million or more in other tax refund litigation on the same issue. The Legal Department needs increased positions to adequately staff the LAD's increased workload and involvement in tax refund lawsuits.

The Appeals Division and BPD are actively involved in resolving tax disputes so that final tax amounts can be collected. Delays in collection put collection at risk, further reducing overall collection success for the State.

This request conforms to the BOE's Strategic Plan, Goal 1(c) (Tax Gap Implementation Plan) and Goal 2(e) (Improve Efficiency in Processing Appeals and Bankruptcy Cases).