

## **EXECUTIVE BRIEF**

### **STATE BOARD OF EQUALIZATION**

**Fiscal Year 2009-10**

#### **Tax Refund Litigation**

##### **Background**

Under the general direction of the Legal Department's Chief Counsel, the Board's Litigation Division (LD) furnishes legal services to the elected Board, the Executive Director, and the staff of the Board of Equalization (BOE) with respect to the BOE's actions. In tax refund and related litigation, LD tax litigators are charged with defining, interpreting, applying, and advancing the Board's substantive tax positions and ensuring that such positions are fully, effectively, and persuasively communicated in court. LD tax litigators also locate, marshal, and organize the factual evidence and documentation relevant to the Board's defense that may be presented in court. These same LD litigators handle all discovery requests in these lawsuits and plan and organize the BOE's discovery plan vis-a-vis the plaintiffs. LD tax litigators additionally locate and prepare expert witnesses, which include economists, inside and outside accountants, appraisers and various regulatory experts, for trial.

##### **Request**

This proposal requests \$545,000 (\$306,000 General Fund, \$75,000 Special Funds and \$164,000 Reimbursement) in FY 2009-10 and \$450,000 (\$253,000 General Fund, \$62,000 Special Funds and \$135,000 Reimbursement) in FY 2010-11 and ongoing to establish 3.0 positions in the LD to provide the Division with the required resources necessary to effectively litigate the growing and increasingly substantial tax refund and related damage claims being made against the State.

##### **Current Need**

The LD has experienced a significant increase in both the volume of tax refund lawsuits filed and the significance and complexity of the tax issues being litigated in such lawsuits. In June of 2005, the average number of new cases filed and handled by the LD totaled 49. In June of 2008, the LD case load increased to 64, a workload increase of 31%. During this same time period, refunds and damages requested have increased threefold (3 times) to over \$140 million. As many of these cases take years to litigate, the number of cases held in each attorney's inventory is steadily increasing. As a result, the hours required to process the legal cases per lawsuit have surpassed current available resources. This has negatively impacted the tax litigation lawyers in the LD and their ability to provide the timely and superior legal representation to which LD aspires.

##### **Workload to be addressed**

This BCP request is based upon a need for two additional attorney and one additional support position to accomplish the following goals: (1) Address in excess of \$140 million potentially at risk due to tax refund and related damage claims filed against the State; (2) Provide adequate staff to defend costly litigation; (3) Provide the resources necessary to recruit and retain qualified staff with litigation experience and the motivation and willingness to aggressively engage in protracted litigation; (4) Significantly reduces the potential for judgments against the BOE and the State of California as a result of an omission or error of fact or law; (5) Mitigate the substantial potential financial risks and/or financial losses to the State's General Fund and Special Funded tax programs; and (6) Provide for a proactive approach to litigating tax refund and damage claims stemming from the various tax programs administered by the BOE.

## **EXECUTIVE BRIEF**

In summary, funding of this proposal will enable the LD to proactively address a growing and increasingly complex litigation caseload, and aggressively protect the financial interests of the General Fund and Special Program Funds that the BOE administers on behalf of the State of California.

Failure to adequately staff the LD will result in legal work products that are either untimely or below the highest standards of legal representation. At risk is in excess of \$140 million in tax refund and related damage claims against the State.

**STATE BOARD OF EQUALIZATION  
FISCAL YEAR 2009-10  
PROPOSAL No. XX**

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**TITLE OF PROPOSED CHANGE:**

**Tax Refund Litigation**

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**SUMMARY OF PROPOSED CHANGES:**

This proposal addresses the significant increase in both the volume of tax refund lawsuits filed and the significance and complexity of the tax issues being litigated in such lawsuits. Litigation Division (LD) tax litigators are charged with defining, interpreting, applying, and advancing the Board's substantive tax positions and ensuring that such positions are fully, effectively, and persuasively communicated in court. LD tax litigators also locate, marshal, and organize the factual evidence and documentation relevant to the Board's defense that may be presented in court. These same LD litigators handle all discovery requests in these lawsuits and plan and organize the Board of Equalization's (BOE) discovery plan vis-a-vis the plaintiffs. LD tax litigators additionally locate and prepare expert witnesses, which include economists, inside and outside accountants, appraisers and various regulatory experts, for trial.

This proposal requests \$545,000 (\$306,000 General Fund, \$75,000 Special Funds and \$164,000 Reimbursement) in FY 2009-10 and \$450,000 (\$253,000 General Fund, \$62,000 Special Funds and \$135,000 Reimbursement) in FY 2010-11 and ongoing to establish 3.0 positions in the LD to provide the Division with the required resources necessary to effectively litigate the growing and increasingly substantial tax refund and related damage claims being made against the State.

## STATE BOARD OF EQUALIZATION

Fiscal Year 2009-10

## Tax Refund Litigation

## A. Nature of Request

This proposal requests \$545,000 (\$306,000 General Fund, \$75,000 Special Funds and \$164,000 Reimbursement) in FY 2009-10 and \$450,000 (\$253,000 General Fund, \$62,000 Special Funds and \$135,000 Reimbursement) in FY 2010-11 and ongoing to establish 3.0 positions in the Litigation Division (LD) to provide the Division with the required resources necessary to effectively litigate the growing and increasingly substantial tax refund and related damage claims being made against the State. The amounts at issue now exceed \$140 million. In fact, over the last three years, the tax and related damage lawsuits filed against the Board, including class actions, have risen from 49 to 64, an increase of 31 percent. During this same time period, due to economic conditions and trends, the amounts at issue in these lawsuits have risen from \$39 million to \$140 million, a 3.6 times increase in three years. This exceptionally high increase in claimed damages against the state reflects the fact that these tax refund lawsuits both are increasingly complex and are being aggressively litigated.

The following chart reflects the tax refunds and related damage claims at issue in the lawsuits filed against the Board

## Number of Lawsuits by Dollar Amount

Dollar Amounts	Number of Lawsuits
Less than \$1K:	0
More than \$1K to \$10K:	0
More than \$10K to \$100K:	4
More than \$100K to \$500K:	7
More than \$500K to \$1M:	6
More than \$1M:	17
Unstated:	30

Even the substantial amount at issue of \$140 million significantly understates the revenue risk to the state, however, as: (1) 30 of the lawsuits pending against the Board do not specify the damages requested; (2) the amount does not reflect the amounts of interest at stake or potential claims for attorneys fees in some lawsuits, including class actions; (3) the amount excludes a class action in which the tax refund amounts requested exceed \$200 million; (4) the amount excludes a property tax-related tort claim filed against the Board and the counties for an amount in excess of \$2 billion; and (5) in many cases, the actual amount at risk is significantly greater than the claimed damages. For example, in one tax refund lawsuit alone, the Board of Equalization (BOE) reported to the Department of Finance that \$500 million in State revenues were potentially at stake in the lawsuit. Finally, the above lawsuit data does not reflect two major tort class actions filed against the state in which Division tax litigators have been required to invest substantial time and resources.

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 Division requires the specified staffing augmentation.

The need for the requested two attorney positions that has arisen due to the additional lawsuit filings and the increase in lawsuit complexity is reflected in the following chart:

Current No. of Attorney Positions (including lead/supervising. attys)	4.0
Cases Completed Per Position per Attorney FY	3.0
Total Cases Completed Per Year	12.0
Total No. of Cases Received Each Year	20.0
Annual Growth in Lawsuit Backlog	8.0
Total Attorney Positions Needed for Current and Future Cases	2.0
Total Attorney Positions Requested	2.0

As illustrated above, funding of this proposal will enable the LD to proactively address a growing and increasingly complex litigation caseload, and aggressively protect the financial interests of the General Fund and Special Program Funds that the BOE administers on behalf of the State of California.

Failure to adequately staff the LD will result in legal work products that are either untimely or below the highest standards of legal representation. At risk is in excess of \$140 million in tax refund and related damage claims against the State.

**B. Background/History**

Under the general direction of the Chief Counsel, the LD furnishes legal services to the elected Board, the Executive Director, and the staff of the BOE with respect to the BOE’s actions. Through its Tax Litigation Section, the LD advises and represents the BOE in tax and fee litigation. LD also represents the BOE in administrative proceedings involving employment, labor, and civil rights laws. The LD additionally represents the BOE in tax-related bankruptcy, collection, and special collection procedure matters. Finally, the LD also represents the Board on several government tort actions.

In tax refund and related litigation, while Department of Justice litigators typically act as lead counsel, LD tax litigators are charged with defining, interpreting, applying, and advancing the Board’s substantive tax positions and ensuring that such positions are fully, effectively, and persuasively communicated in court. LD tax litigators also locate, marshal, and organize the factual evidence and documentation relevant to the Board’s defense that may be presented in court. These same LD litigators handle all discovery requests in these lawsuits and plan and organize the BOE’s discovery plan vis-a-vis the plaintiffs. LD tax

litigators additionally locate and prepare expert witnesses, which include economists, inside and outside accountants, appraisers and various regulatory experts, for trial.

As indicated above, the LD has experienced a significant increase in both the volume of tax refund lawsuits filed and the significance and complexity of the tax issues being litigated in such lawsuits. In June of 2005, the average number of new cases filed and handled by the LD totaled 49. In June of 2008, the LD case load increased to 64, a workload increase of 31%. As many of these cases take years to litigate, the number of cases held in each attorney's inventory is steadily increasing. As a result, the hours required to process the legal cases per lawsuit have surpassed current available resources. This has negatively impacted the tax litigation lawyers in the LD and their ability to provide the timely and superior legal representation to which LD aspires.

Denial of this proposal will further exacerbate the problem and increase the financial risks to the BOE, the General Fund and Special Funded programs.

### **C. State Level Considerations**

The BOE is charged by the State Constitution and the State Legislature with administering the state's sales and use tax, fuel, alcohol, and tobacco taxes as well as collecting fees to fund numerous specific state programs. More than one million California businesses are registered with the BOE to engage in retail sales in the state. BOE also has substantial property tax responsibilities, including assessing state-assessed property taxes and ensuring fair and consistent local property tax assessment practices and procedures. In addition, BOE serves as the highest administrative appeals body for franchise and income taxes. (Cal Const. art. 13, section 19; Rev & Tax Code, sections 6001-7176, 17001-18180, and 18401-19802.)

Successful administration of these taxes results in the collection of 34% of the State's annual revenue. LD's Tax Litigation Sections' role is to protect these revenues for the State by providing quality legal representation to the Board in court litigation. As indicated above, LD tax litigators are charged with defining, interpreting, applying, and advancing the Board's substantive tax positions and ensuring that such positions are fully, effectively, and persuasively communicated in court. LD tax litigators also locate, marshal, and organize the factual evidence relevant to the Board's defense that may be presented in court. LD tax litigators additionally handle discovery matters and locate and prepare expert witnesses, which include economists, inside and outside accountants, appraisers and various regulatory experts, for trial.

This proposal advances the following BOE goals as set forth in the Strategic Plan:

Goal 2: Improve the Efficiency of BOE's Tax and Fee Programs

Goal 3: Improve the BOE's Organizational Efficiency

Goal 5: Foster a Skilled, Motivated, and Diverse Workforce

**D. Justification/Analysis of All Feasible Alternatives**

The LD has a need for an augmentation of staffing due to increased workload and difficulty of existing workload. The following are three alternatives in order to meet the needs of the LD:

**Alternative 1 – Establish 3.0 positions and related resources to augment the LD.**

This alternative requests a budget augmentation of \$545,000 to fund 3.0 permanent positions in the LD. These positions (1.0 Tax Counsel III, 1.0 Tax Counsel IV, and 1.0 Associate Governmental Program Analyst) mitigate financial risk and/or financial loss to the State's General Fund and Special Funded Programs administered by the Board. Exhibit I on pages 8-9 describe in detail the workload for the requested positions.

**Pros:**

- Addresses in excess of \$140 million potentially at risk due to tax refund and related damage claims filed against the State.
- Provides adequate staff to defend costly litigation.
- Provides the resources necessary to recruit and retain qualified staff with litigation experience and the motivation and willingness to aggressively engage in protracted litigation.
- Significantly reduces the potential for judgments against the BOE and the State of California as a result of an omission or error of fact or law.
- Mitigates financial risks and/or financial losses to the State's General Fund and Special Funded tax programs.
- Provides for a proactive approach to litigating tax refund and damage claims stemming from the various tax programs administered by the BOE.

**Cons:**

- Requires expenditures of \$545,000 to fund 3.0 new positions.

**Alternative 2 – Continue with the existing staff allocation in the LD.**

This alternative proposes to leave staffing at its current level in the LD. This carries financial risks for the BOE, the State and Special Fund stake holders, as workload has significantly outpaced existing resources.

**Pros:**

- No additional funding required.
- No fiscal impact to General Fund or Special Funded Tax Programs.

**Cons:**

- Fails to address the \$140 million plus at risk in tax refund and related damage claims.
- Fails to recognize the existing shortfall in staffing necessary to meet current and projected future litigation demands.
- May result in significant revenue loss to the State's General Fund, as well as Special Funded programs.
- Long-term effects of understaffing may result in loss of the requisite litigation and tax expertise.

**Alternative 3 – Redirect 3.0 positions and related resources from other legal programs to augment LD.**

This alternative will augment the LD without a budget augmentation by redirecting legal staff with specific areas of tax expertise to the LD. This alternative will have a negative impact to existing programs and services to taxpayers where the positions are being redirected from.

**Pros:**

- No additional funding needed.
- No fiscal impact to General Fund or Special Funded Tax Programs.
- Utilizes current tax program expertise.

**Cons:**

- Redirection of attorneys from other legal divisions within the Board will negatively impact current services being provided to taxpayers and Board program staff.
- While redirection of staff might provide tax expertise related to specific tax programs, these staff often lack the litigation experience, interest in litigation, and aggressive litigation mindset and motivation required to successfully capitalize on their tax program knowledge in a litigation context.
- The redirection of staff does not provide trained litigation attorneys with the required experience, expertise, mindset, and motivation necessary to successfully litigate in a potentially hostile or emotionally charged litigation environment, nor with the skills and abilities required to meet the stringent time requirements often entailed in preparing for trial and other court-related proceedings. Such non-litigation attorneys also typically lack training and insight into how to translate and transform BOE legal positions into effective and admissible courtroom evidence.

**E. Facility/Capital Outlay Considerations**

BOE is currently completing a “restacking plan” for BOE’s Headquarter building. This plan will allow BOE to address current optimum occupancy issues, align program functions/activities, identify additional offsite lease space, and for growth.

**F. Outcomes and Accountability**

Data collected from litigation savings will be captured for revenue estimation and reporting.

LD keeps detailed records of each lawsuit filed against the Board, the attorney or attorneys assigned to each such lawsuit, the damages or refunds sought, and the ultimate outcome of each such lawsuit. Therefore, LD records will be available on a long-term basis with respect to the number of lawsuits filed against the Board, the number of lawsuits handled by each LD attorney, the amounts of money at issue, and LD’s success rate in defending the state in these lawsuits. This data will provide full accountability with respect to the positions sought.

## G. Timetable

### Litigation Division

January 2009 to June 2009	July 2009 +
	<ul style="list-style-type: none"> <li>• Hire new personnel July 1, 2009.</li> <li>• Train new personnel.</li> </ul>
<ul style="list-style-type: none"> <li>• Advertise new positions and conduct hiring interviews.</li> </ul>	<ul style="list-style-type: none"> <li>• Monitor and measure production of new hires.</li> </ul>

## H. Recommendation

**Alternative 1 is recommended.** This alternative would authorize funding for 3.0 full-time permanent positions and related resources to address staffing deficiencies in the LD. By providing the resources as identified in Alternative 1, LD will be able to hire and train the experienced litigators and support staff that are needed to monitor and aggressively defend the growing refund and damage claims being made against the State, which now total over \$140 million.

## I. Fiscal Detail

“See attached Fiscal Detail”

## Tax Refund Litigation – Workload Summary

Exhibit I  
(Page 1 of 2)

## 1.0 Tax Counsel IV (Legal Counsel)

The Tax Counsel IV within the Legal Affairs Division will litigate the most complicated and significant business and property tax litigation cases involving the most complex tax law issues and litigation tactics. This position will serve as the highest-level tax counsel to the Board and the Attorney General's office and will act as lead and instruct, review and direct the work of other Tax Counsel positions.

Classification	Time Measure Activity	Time Measure		On-going Activities	
		M = Measure H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
<b>Legal Counsel IV</b>					
	Research and analyze statutes, rules, and appellate decisions for application to assigned cases.	H	100	8	800
	Prepare and present documents and briefs with courts for hearings and trials related to assigned cases.	H	50	8	400
	Interview, prepare, and coordinate testimony and statements from various public and private parties related to assigned cases.	H	30	8	240
	Review and provide input to the cases assigned to other Tax Counsels	H	10	50	500
	Total legal hours				1940
	Total legal positions requested (1800 hours per position)				1.08

## 1.0 Tax Counsel III (Legal Counsel)

The Tax Counsel III within the Legal Affairs Division is the journey level tax litigation position. This position will be assigned court litigation cases involving all program areas within the Board. The position holder will prepare/ review all court filings, pleadings, briefs, discovery issues and other documents needed to litigate assigned cases. Other duties typically include helping to develop litigation strategy, discovery plans and witness preparation. The incumbent will work closely with the Chief Counsel, the Assistant Chief Counsel, Deputy Attorney General staff and the Tax Counsel IV.

Classification	Time Measure Activity	Time Measure		On-going Activities	
		M = Measure H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
<b>Legal Counsel III</b>					
	Research and analyze statutes, rules, and appellate decisions for application to assigned cases.	H	100	11	1100
	Prepare and present documents and briefs with courts for hearings and trials related to assigned cases.	H	50	11	550
	Interview, prepare, and coordinate testimony and statements from various public and private parties related to assigned cases.	H	30	11	330
	Total legal hours				1980
	Total legal positions requested (1800 hours/position)				1.1

## Tax Refund Litigation – Workload Summary

Exhibit I  
(Page 2 of 2)**1.0 Associate Government Program Assistant (AGPA)**

The AGPA within the Legal Affairs Division will provide support services to Tax Counsel positions. The AGPA will perform research in the area of litigation timelines and procedures; analyze and interpret laws and procedures; process newly filed summons, complaints and subpoenas; design, create and maintain databases to track case status and due dates, budget deadlines, contracts and other information; prepare various litigation-related reports; and liaison with the Department of Justice.

Classification	Time Measure Activity	Time Measure		On-going Activities	
		M = Measure H = Hours	Time Per Occurrence	Occurrences Per Year	Total Hours
<b>AGPA</b>					
	Perform specified research and analysis re timelines and procedures	H	20	52	1040
	Create and maintain case management files and databases	H	8	52	416
	Process subpoenas, summons and complaints for all cases	H	8	52	416
	Prepare monthly and summary case reports	H	10	12	120
	Total legal hours				1992
	Total AGPA positions requested (1800 hours per position)				1.1

STATE OF CALIFORNIA  
BUDGET CHANGE PROPOSAL--FISCAL DETAIL  
STATE OPERATIONS  
FISCAL YEAR 2009-10  
(Dollars in Thousands)

**Title of Proposed Change:** Tax Refund Litigation

**Program/Element/Component:** All Programs

	PERSONNEL YEARS			CY	BY	BY + 1
	CY	BY	BY + 1			
<b>TOTAL SALARIES AND WAGES</b> <i>_a/</i>		3.0	3.0		\$272	\$272
Salary Savings		-2	-2		-14	-14
<b>NET TOTAL SALARIES AND WAGES</b>		2.8	2.8		258	258
Staff Benefits <i>_a/</i>					95	95
Distributed Administration <i>_b/</i>					40	33
<b>TOTAL PERSONAL SERVICES</b>		2.8	2.8		\$393	\$386
<b>OPERATING EXPENSE AND EQUIPMENT</b>						
General Expense					\$32	\$10
Distributed Administration					10	8
Printing						
Communications					3	3
Postage						
Travel--In-State					6	6
Travel--Out-of -State						
Training					2	2
Facilities Operations					97	34
Consulting & Professional Services: Interdepartmental						
Consulting & Professional Services: External						
Department of Technology Services						
Data Processing					2	1
Equipment						
Other Items of Expense: (Specify Below)						

*\_a/* See page 12 of 13 for itemized staff benefits and classification detail.

*\_b/* Represents Distributed Administration costs resulting from this BCP. The Distributed Administration costs for existing BOE programs will reflect a corresponding decrease which will be addressed in the Planning Estimate process.

		<u>BCP No.</u>	
	<u>CY</u>	<u>BY</u>	<u>BY + 1</u>
<b>TOTAL OPERATING EXPENSE AND EQUIPMENT</b>		\$152	\$64
<b>TOTAL EXPENDITURES (State Operations)</b>		\$545	\$450

**Source of Funds**

General Fund	(0001)	\$306	\$253
Special Funds:			
Breast Cancer Fund	(0004)	1	
State Emergency Telephone	(0022)	1	1
Motor Vehicle Fuel Account	(0061)	28	26
Occupational Lead Prevention Fund	(0070)	1	1
Childhood Lead Poisoning Prev. Fund	(0080)	1	
Cig. and Tobacco Prod. Surtax Fund	(0230)	9	9
Oil Spill Prevention and Admin. Fund	(0320)	1	
Integrated Waste Management	(0387)	1	
Underground Storage Tank Fund	(0439)	4	4
Energy Resources Programs Account	(0465)	1	
CA. Children and Families First Trust Fund	(0623)	16	14
Federal Trust Fund	(0890)		
Timber Tax Fund	(0965)	3	2
Gas Consumption Surcharge Fund	(3015)	1	
Water Rights Fund	(3058)	1	
Elec. Waste Recovery and Recycling Acct.	(3065)	6	5
Cig. and Tobacco Prod. Compliance Fund	(3067)		
Federal Funds			
Other Funds			
Reimbursements	(0995)	\$164	\$135
Net Total Augmentation (Source of Funds)		\$545	\$450

**DETAIL OF STAFF BENEFITS  
AND PERSONAL SERVICES**

Staff Benefits Detail:	CY	BY	BY + 1
	<i>(Whole Dollars)</i>		
OASDI		\$19,737	\$19,737
Health Insurance		30,673	30,673
Retirement		43,852	43,852
Workers' Compensation		105	105
Industrial Disability Leave		184	184
Non-Industrial Disability Leave		133	133
Unemployment Insurance		39	39
Other		680	680
<b>TOTAL</b>		<b>\$95,403</b>	<b>\$95,403</b>

Classification	Positions			Salary Range	Amount		
	CY	BY	BY + 1		CY	BY	BY + 1
Legal Department							
Legal Affairs Division							
AGPA		1.0	1.0	\$58,200		\$58,200	\$58,200
Tax Counsel III		1.0	1.0	101,628		101,628	101,628
Tax Counsel IV		1.0	1.0	112,272		112,272	112,272
Blanket Funds:							
Overtime (Various)							
Temporary Help							
<b>TOTAL SALARIES AND WAGES</b>		<b>3.0</b>	<b>3.0</b>			<b>\$272,100</b>	<b>\$272,100</b>

\_a/ The salary is the mid-step of the salary range for the stated classification.

**SUPPLEMENTAL INFORMATION**

Dollars in Thousands

	<u>Current Year</u>	<u>Budget Year</u>	<u>Budget Year + One</u>
<b>Proposed Equipment:</b>			
N/A	_____	_____	_____
Total	=====	=====	=====
<b>Proposed Contracts:</b>			
N/A	_____	_____	_____
Total	=====	=====	=====
<b>One-Time Costs:</b>			
General Expense		\$27	\$4
Communications		1	
Facilities Operations		63	
Data Processing		2	1
Total	=====	\$93	\$5
<b>Future Savings:</b>			
N/A	_____	_____	_____
Total	=====	=====	=====
<b>Full-Year Cost Adjustments:</b>			
N/A	_____	_____	_____
Total	=====	=====	=====