



What Are The Odds? Tax Disputes and the Role of the State Office of Administrative Hearings (SOAH)

- Taxpayers unable to resolve tax liability issues with the Comptroller may appeal their case in an administrative hearing and are required to do so before they may file a challenge in court.
- Prior to 2007, administrative hearings on contested tax issues were conducted within the Comptroller's Office. In 2007, cases were moved to the State Office of Administrative Hearings (SOAH) to give taxpayers access to a more independent forum.
- A SOAH opinion is a "Proposal for Decision (PFD)" and is not binding on state agencies with hearings assigned to SOAH, including the Comptroller's Office. Agencies may modify or reverse the PFD. The Comptroller, however, has reversed less than one percent of SOAH PFDs.
- A review of the results of almost 3,000 SOAH hearings through December 1, 2020 revealed that taxpayers have prevailed in less than 5 percent of all cases. In contrast, the state has prevailed 85 percent of the time. Taxpayers, however, did get partial relief in 10 percent of the cases.

Resolving Tax Disputes

Anyone who has filled out a tax return understands the process is complex, and sometimes murky. Errors or misinterpretations often occur and disagreements between taxpayers and state tax agencies are common. Many disagreements can be resolved informally within the tax agency, others cannot. Texas taxpayers unable to resolve an issue directly with the Comptroller's Office may appeal their claim to the State Office of Administrative Hearings (SOAH) — a less formal and less costly option than going to court. Taxpayers that disagree with a final administrative ruling may then seek relief in district court, provided they have paid in

full the amount in dispute. Reversal of an unfavorable trial court decision may be pursued at the Court of Appeals and then even further to the ultimate arbiter, the Texas Supreme Court.

The process is not without controversy. For many years, administrative hearings of contested state tax issues were held within the Comptroller's Office. This created at least the appearance of bias against the taxpayer, since the agency presiding over the dispute was a party to it as well. In 2007, in-coming Comptroller Susan Combs transferred the hearings function to SOAH — a separate state agency established in 1992 for the sole purpose of conducting administrative

hearings for multiple state agencies. The transfer's purpose was to create a process in which taxpayers could have greater confidence that they had received an independent review of their claim.

Unfortunately, it's difficult to quantify "confidence" and "independence," since those terms are mostly in the eyes of the beholder. In this study, the TTARA Research Foundation simply reviewed the math of SOAH case dispositions. Available data revealed that taxpayers prevailed outright in 5% of decisions and the state prevailed outright 85% of the time. In another 10%, taxpayers were able to obtain some partial relief, such as waiver of penalty and/or interest.

Administrative hearings decisions at SOAH are not fully independent of the agency involved. Though the SOAH administrative law judges (ALJs) are not employees of the agency involved in the case, the contesting agency retains the ability to reverse an ALJ's decision (this is true of all SOAH decisions, not just those involving contested tax liability). Since 2007, the Comptroller has reversed all or part of just 24 opinions, less than 1 percent.

Despite the long odds of success, many taxpayers and practitioners contend that administrative hearings afford them, at a minimum, the opportunity to establish the facts involved and have a "dry run" of their arguments prior to filing their case in district court. Others see the process as an unnecessary and costly step in pursuing a case that is apt to be taken to court anyway, regardless of the administrative outcome.

The Appeal Process for Taxpayers

Taxpayers may find themselves in a disagreement with the Comptroller's Office with respect to many issues, even though they used their best judgement to determine whether tax liability applied in any given situation at issue.

State Assessment. Large taxpayers routinely are subject to audit, while small and medium-sized companies may be audited only occasionally. The agency has the right to examine the records of any person or entity doing business in the state.¹

Initially, the Comptroller will send the taxpayer a Notice of Audit and arrange a meeting to discuss parameters of the review. After researching and examining pertinent records and having various discussions with the taxpayer, the agency's auditor will identify instances in which it is believed that taxes were either under or over paid. If the taxpayer disagrees, a reconciliation conference may be scheduled with an audit manager or supervisor. The taxpayer also may request an Independent Audit Review be performed by an agency auditor previously not involved in the case.

Ultimately the agency finalizes its determination and issues a formal Notification of Audit Results. Amounts underpaid may be subject to a 10 percent penalty, as well as interest charged at a rate equal to prime plus one percent.

Refund Request. Additionally, taxpayers periodically may review their records in light of agency guidance, recent administrative rulings, or even court decisions, and determine that they have overpaid taxes and, thus, are due a refund. If so, the taxpayer must file a refund request identifying the periods and amounts involved and stating in detail each reason or ground for the claim. The Comptroller's Office will attempt to verify the claim, perhaps asking for additional records and documentation, before making a determination to accept or deny it.

Amounts the agency agrees were overpaid are refunded with interest, but at a substantially lower rate — equal to the rate of earnings of state treasury deposits (see *Losing Interest: Disparate Interest Rates Penalize Texas Taxpayers* by the TTARA Research Foundation at www.ttara.org, January 2021) — than the taxpayer has to pay if additional taxes are owed.

Contesting the Comptroller's Position. The taxpayer may object to the results of either an audit assessment or a refund denial within 60 days by filing a Request for Redetermination accompanied by a Statement of Grounds listing the items in disagreement and stating the facts and law in support of the taxpayer's position. Even though they may disagree with an audit

¹ Tax Code Section 111.004.

assessment, taxpayers commonly pay the amount in dispute to avoid the accrual of additional penalty and interest. Afterward, the taxpayer's challenge becomes a refund request.

In response, the Comptroller may ask for a preliminary conference or additional documentary evidence to support the claim. Unresolved cases are referred to a hearings attorney who issues a Position Letter explaining the agency's position. The taxpayer may respond with a Reply to the Position Letter that explains continuing disagreements. The taxpayer at that point may request a hearing at SOAH to resolve the dispute.

Administrative Hearing.² The Comptroller's hearings attorney will contact SOAH and notify the taxpayer of the time and date of a scheduled SOAH hearing.³ The hearing before SOAH may be conducted orally or by written submission as requested by the parties. Taxpayers may represent themselves or name a designated representative. Upon request and with the agreement of all parties, any person with a direct pecuniary interest in the case's resolution may be allowed to participate. Informal exchange of information is encouraged to narrow and define disputed issues and reach an agreed resolution before the case is docketed.⁴

The formal discovery process begins when SOAH acquires jurisdiction and is conducted pursuant to SOAH Rules of Procedure. The taxpayer must produce records and documentation to substantiate and verify claims related to the amount of tax, penalty, interest, or refund under review.

Generally, the taxpayer has the burden of proof by a preponderance of the evidence; however, if the

dispute involves an exemption, the taxpayer must meet the higher standard of clear and convincing evidence. In contrast, the Comptroller shows exclusion from an exemption by a preponderance of the evidence.⁵ Also, the Comptroller must prove fraud by clear and convincing evidence to impose the additional 50% fraud assessment or personal liability for fraudulent tax evasion.

At any time, the parties may execute a resolution agreement to adjust, compromise or settle any of the case's contested issues. A motion to dismiss also may be filed. After the record is closed, the SOAH ALJ issues a Proposal for Decision (PFD). The parties have 15 days to file exceptions and are notified of any resulting changes. SOAH then returns jurisdiction to the agency. After reviewing the case record, the PFD, and any exceptions and replies, the Comptroller issues a final decision that may accept, change, or overrule any of the PFD's findings.

Unless an extension of time has been granted, the taxpayer has 25 days to file a motion for rehearing to reconsider all or part of a final decision. The rehearing motion is a required prerequisite for subsequently filing a tax refund lawsuit in district court. The Comptroller may, but is not required to, grant or deny the rehearing motion; however, if action is not taken within 55 days, the motion is overruled by operation of law.

Taking the Case to Court. In the event the taxpayer disagrees with the Comptroller's final disposition of the case, they may opt to pursue their claim in court; however, amounts in dispute, including any applicable penalty and interest must be paid prior to filing (consequently, tax cases before the judiciary are refund claims). State tax cases must be filed in district court in Travis County, the county in which the Capitol is located, and must name the public official charged with collecting tax. As a result, the Comptroller is one of Texas' most sued government officials.

In state tax cases, just like in all other civil cases, either party — the Comptroller or the taxpayer —

² A taxpayer may bypass the administrative hearings process if pursuing a refund claim for payment made under protest, however, cases must be filed within 91 days after filing under protest, effectively limiting the claim period. For claims not involving payments made under protest, the statute of limitations is 4 years.

³ If the taxpayer is insolvent, in liquidation or out of business, or will be so if they must pay the amount in dispute, they may request an insolvency settlement with the Comptroller's Office. If the request is denied, a SOAH appeal may be pursued.

⁴ For this reason, the number of cases referred to SOAH is less than the actual number of decisions issued.

⁵ Christi Mondrik (Mondrik and Associates, Austin, Texas), *Burden of Proof in State Tax Cases: What Happens When the Legislature Changes It?* ABA Tax Times, Vol. 37, No.3 – Spring 2018.

may appeal district court decisions to the Court of Appeals (the 3rd Court of Appeals in Austin hears cases from Travis County), and then to the Supreme Court.

How SOAH Became Involved in Tax Hearings

Prior to 2007, administrative appeals of contested tax cases were heard internally by hearings attorneys in the Comptroller's Office. Concerns were raised about an agency essentially passing judgment on its own findings by administering hearings to contest them:

- Could an agency truly be impartial overseeing cases in which it was a party, and
- Was it appropriate for the Comptroller to oversee cases involving taxpayers and practitioners that may also be political contributors?

Lawmakers in 2003, in a provision entitled "Integrity and Disclosure in the State Tax System," enacted legislation directing the State Auditor to review and report on all the Comptroller's "tax refunds, credits, payments, warrants, offsets, checks, and settlements for the preceding six years."⁶ One of the recommendations to the Legislature in the audit report issued in September 2005,⁷ was:

Enacting legislation to transfer the authority to conduct tax dispute hearings from the Comptroller's Office to the State Office of Administrative Hearings or another independent entity. Currently, disputed tax cases are assigned to an administrative law judge appointed by the Comptroller of Public Accounts. While we found no evidence of preferential treatment, this arrangement could present the appearance that hearings are not processed in an objective and impartial manner and that independence could be impaired. To maintain the technical knowledge and efficiency

⁶ House Bill 7, Section 23, 78th Texas Legislature, 3rd Called Session.

⁷ Texas State Auditor's Office, John Keel, CPA, State Auditor, *A Review of Tax Settlements at the Office of the Comptroller of Public Accounts*, September 2005, Report No. 06-002.

of current operations, the administrative law judges, their support staff, and their equipment should be transferred to the State Office of Administrative Hearings to continue their duties. The Comptroller's Office should provide technical tax expertise as appropriate.

Then-Comptroller Carole Keeton Strayhorn responded:

The Comptroller does not agree with the recommendation to move the hearings process to the State Office of Administrative Hearings. This recommendation has been considered by the Legislature several times in the past. It has been rejected in each case because it is costly to the taxpayers and does not improve the overall effectiveness of state tax administration.

Awaiting the Auditor's report, no action regarding the issue was taken during the 79th Legislative Session that adjourned at the end of May 2005. In a new development, however, Comptroller Strayhorn chose not to run for reelection in 2006, opting instead to run for Governor against incumbent Rick Perry.

Then-Commissioner of Agriculture Susan Combs won election as Comptroller, succeeding Strayhorn. During her campaign, she vowed that when elected she would transfer the Comptroller's Hearings Division to SOAH, as recommended by the State Auditor. One of her first official acts of office on January 9, 2007 was execution of a memorandum of agreement by which SOAH assumed those duties with costs reimbursed by the Comptroller. The Comptroller's law judges were transferred to form SOAH's new Tax Division. The arrangement subsequently was formalized in state law by the 80th Texas Legislature that convened on January 11.⁸

Tax hearings basically became subject to the same processes and procedures, e.g., pleadings, discovery, briefing, arguments, etc., applicable to the other state agency administrative hearings assigned to SOAH. The new law included:

⁸ Senate Bill 242, 80th Texas Legislature, Regular Session, codified as §111.00455, Tax Code, and Subchapter D, Chapter 2003, Government Code.

- Creation of a SOAH Tax Division to conduct hearings relating to contested cases involving the collection, receipt, administration, and enforcement of taxes and fees.
- Establishment of qualifications of master administrative law judge II (ALJ) who had to have been licensed to practice law for at least seven years with substantial tax case experience.
- Requiring ALJs to issue a proposal for decision (PFD) that includes findings of fact and conclusions of law as well as the legal reasoning and other analysis considered by the judge.
- Prohibiting the Comptroller from attempting to influence a PFD.
- Allowing the Comptroller, however, to change a finding of fact or conclusion of law or vacate or modify an order, but only if the Comptroller determined and stated in writing the specific reason and legal basis that the ALJ:
 - Had not properly applied or interpreted applicable law, rules, policies, or prior decisions.
 - Made a finding of fact unsupported by a preponderance of the evidence; or
 - Relied on an incorrect prior decision.⁹

In 2014, the Sunset Commission reviewed SOAH's tax division, recommending that hearings should continue at SOAH, rather than being returned to the Comptroller's Office, but that certain changes be made. The report¹⁰ noted that certain requirements tended to "perpetuate the perception of the comptroller having undue influence over these cases" recommending a few changes. The report praises the quality of decisions, noting the Comptroller overturned so few of them; however the Commission does not evaluate the appropriateness of decision reversals by state agencies, nor does it evaluate win-loss ratios — key elements in complainants' perception of the ability to receive an independent decision. The

⁹ The Administrative Procedures Act in Government Code §2001.2001(e) provides general authority for a state agency to vacate or modify an order issued by a SOAH ALJ.

¹⁰ Sunset Advisory Commission, Staff Report with Final Results, *State of Administrative Hearings*, July 2015

84th Legislature in 2015 adopted a number of changes stemming from the report, including eliminating tax as a separate division within the agency, reducing the required amount of a qualified judge's tax experience, giving SOAH greater control over the assignment of tax judges, and eliminating a sunset date for the tax hearings process separate from that of SOAH itself.

SOAH Hearing Results

After redaction to remove any taxpayer identification, final decisions that include the PFD, any changes made to it and the Comptroller's order disposing of the case are posted on the Comptroller's State Tax Automated Research (STAR) System. TTARA identified 2,875 hearings decisions that have been posted on STAR since the task of conducting appeals was transferred to SOAH. The following table catalogues those decisions based on whether the taxpayer or the Comptroller prevailed, if partial relief was granted to the taxpayer and when the Comptroller entirely or partially reversed a PFD's recommended taxpayer relief. As shown in Figure 1, the Comptroller prevailed in the vast majority of cases.

Taxpayers were able to negate assessments or obtain refunds in a mere 5% of cases. In another 10%, taxpayers were granted partial relief ranging from minimal to more substantial. The Comptroller either reversed all or part of a PFD's taxpayer-favorable rulings in only 24 cases. In stark contrast to the fate of taxpayers, the Comptroller's position was upheld 85% of the time.

One or more of the following types of relief was involved in the 295 cases in which taxpayers were given partial relief: audit items or refunds (181); penalty (48); interest (30); additional 50% fraud penalty (55); or assignment of personal liability (19).

The Arizona Experience

Arizona recently reviewed its administrative hearings process on tax cases. Like Texas, Arizona tax cases were required to pursue an administrative hearing in that state's Office of Administrative Hearings, with the regulating agency issuing the final order, prior to being able to file in district court.

Figure 1. Results of Contested Tax Cases Heard by SOAH

Year	Total	Comptroller Position Upheld	Taxpayer Prevailed	Partial Taxpayer Relief	Comptroller Negated PFD Granted Relief
2007	37	20	2	14	0
2008	176	152	5	19	0
2009	250	214	9	27	0
2010	229	209	9	11	0
2011	298	258	10	30	0
2012	178	147	11	20	0
2013	208	182	10	16	2
2014	240	201	8	31	1
2015	204	153	19	32	1
2016	163	135	10	18	1
2017	343	274	18	51	14
2018	251	211	20	20	2
2019	158	147	6	5	2
2020	140*	134	5	1	1
Total	2,875	2,437	142	295	24
	100.0%	84.8%	4.9%	10.3%	0.8%

*1/1 to 12/1

Note: SOAH does not publish a compendium of tax decisions. The above statistics were compiled by individually reviewing the decisions published on the State Tax Automated Research (STAR) System maintained by the Comptroller of Public Accounts. Though intended to be a comprehensive list, certain cases may have been omitted because they were not published, or the search function employed did not proffer complete results.

Taxpayers noted that the process overwhelmingly found in favor of the state, with taxpayers' winning percentage over the previous three years at only 4 percent.¹¹ Taxpayers and their representatives argued the mandatory administrative hearings prior to being able to file in court was unnecessary and costly. To streamline the process, in 2018 Arizona lawmakers of their 53rd Legislature passed SB 1385, which allowed taxpayers the option of filing their case directly in district court after meeting with a designated appeals officer of the Department of Revenue. In this manner, more complex cases most likely to end up in court regardless of the administrative outcome, could save time and expense by avoiding an administrative process in which the odds of success were low.

¹¹ A review of cases over the previous three years by the Arizona Tax Research Association found that taxpayers won in 2 of 50 cases, with 7 cases offering partial relief to the taxpayer.

Conclusions

The administrative hearings process may be a simpler, less costly option for taxpayers to seek resolution of a dispute with the state; however, it is an executive branch function, and is not a truly independent review of the issues involved. The data reveals that the process commonly affirms the state's position. A truly independent review of the issues involved is not available to the taxpayer until the case is filed with the judicial branch. For taxpayers committed to pursuing such an independent review, an administrative hearing may be an unnecessary cost. Arizona's streamlined process of providing more direct access to the court at the option of the taxpayer may provide taxpayers with a more efficient mechanism for resolving tax cases.