REPORT #792

TAX SECTION

New York State Bar Association

Report on Proposed Amendments to the
Rules of Practice and Procedure of the
Division of Tax Appeals
May 26, 1994

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Ms. Roberta Mosely Nero
Secretary to the Tax Appeals Tribunal
Tax Appeals Tribunal
Riverfront Professional Tower
500 Federal Street
Troy, New York 12180-2893

Division of Tax Appeals
Rules of Practice and Procedure

Dear Ms. Nero:

Enclosed is a Report by the New York State Bar Association Tax Section commenting on the proposed regulations issued by the Division of Tax Appeals concerning its rules of practice and procedure.

The Report states that the Tribunal has clearly met the expectations of the private sector in providing a fair, independent, efficient and informal forum for the resolution of tax disputes. The Report expresses concern, however, that the costs and burdens of certain of the proposed rules will outweigh the benefits of the rules. In particular, the Report concludes that the rules will adversely affect the informal nature of the Tribunal, which is one of its key benefits to taxpayers.

The Report suggests that the Tribunal reconsider the proposals and work with the private sector and the Law Bureau (which has raised a number of concerns similar to ours) to devise different approaches towards new and improved rules. We would be most willing to be of assistance in this effort.

Very truly yours,

Michael L. Schler
Chair, Tax Section

Tax Report #792

NEW YORK STATE BAR ASSOCIATION

TAX SECTION

COMMITTEE ON NEW YORK STATE INCOME TAXES

Report on Proposed Amendments to the Rules of Practice and Procedure of the Division of Tax Appeals

May 26, 1994

This report[1] sets forth comments of the Committee on New York State Income Taxes of the New York State Bar Association Tax Section on recently proposed amendments to the rules governing practice and procedures in the Division of Tax Appeals (hereafter the "Tribunal").

In considering these proposed rules, we think it important to note what is currently provided in Regulation 3000.0(a):

> The rules of practice and procedure contained in this Part are intended to provide the public with a clear, uniform, rapid, inexpensive and just system of resolving controversies with the Division of Taxation of the New York State Department of Taxation and Finance. In this Part, the Tax Appeals Tribunal has set forth rules of practice and procedure to afford the public both due process of law and the legal tools necessary to facilitate the rapid resolution of controversies, while at the same time avoiding undue formality and complexity.

[1] The principal author of this report is Michel Pierre Cassier. Helpful comments were received from Janet Bernier, E. Parker Brown II, Paul R. Comeau, Christopher L. Doyle, Peter L. Faber, Damian M. Hovancik, Maria T. Jones, Arnold Y. Kapiloff, J. Brian Kopp, Daniel Lavin, Carolyn Joy Lee, Joseph Lipari, James A. Locke, John R. McQueen, Robert D. Plattner, Robert Plautz, Martha L. Salzman, Carlton M. Smith, Andrew Solomon, and Brian Spillane.

It has been our experience thus far that the Tribunal has fulfilled this function admirably, providing an adequate mechanism for resolving disputes while avoiding excessive formality or complexity.

We generally believe that the proposed new rules, by contrast, would introduce significant complexity and increase the level of formality. For the most part, we believe the proposed changes discussed below are not necessary. We appreciate that the Tribunal proposed these rules in response to problems and issues it perceived in the practice before it and in its procedures; however, from our perspective the changes proposed offer few advantages and pose several potential disadvantages.

From a policy standpoint, we believe that the formalization of current ad hoc procedures is in conflict with the Legislature's desire to create an informal administrative forum. Many (if not most) of the changes proposed are adopted from the federal Tax Court rules. The two forums are similar in terms of the subject matter of the hearings. However, it is our view that the New York Legislature, when it created the Tribunal, specifically chose not to emulate the federal model, but instead sought an informal structure that would deal with items such as discovery on a more ad hoc basis. It is our view that this is one of the Tribunal's strengths, not one of its weaknesses; and it seems likely that the proposed rules will significantly increase the costs and burdens to taxpayers and discourage some taxpayers from pursuing matters before this forum.

For example, we are concerned that under the proposed rules relating to Disclosure, pre-hearing discovery could become commonplace, with increased costs and litigation burdens to taxpayers. The Division of Taxation (hereafter the “Division”) is

in all instances represented by attorneys who are not only conversant in litigation tactics but also with the rules of procedure before the Tribunal. By contrast, taxpayers and their representatives often do not have this knowledge. Interrogatories, bills of particular, preclusion orders, and so forth may so overwhelm accountants and enrolled agents, not to mention pro se taxpayers, as to effectively make the Tribunal a court for lawyers only.

Further, in some instances, we read the proposals to operate towards inconsistent ends. For example, the rules for clarifying pleadings are expanded considerably, apparently giving them heightened importance in the hearing process, while at the same time the necessity for an Answer appears to have been effectively eliminated. In the same vein, pre-hearing memoranda are required by the new rules, while at the same time the rules for amending pleadings (i.e. raising new factual and legal arguments) by “implied consent” are liberalized to the point where almost any changes can be made at the hearing, thereby undercutting the purpose of the memoranda.

Finally, although the rules are intended to accelerate the case towards a hearing on a more structured basis -- an objective we commend -- we are concerned that in application the rules as proposed will have the opposite result. With a myriad of pre-hearing motions, discovery and so forth now formally available in every case, it seems likely that a substantial motion practice will develop and that cases will have motions outstanding or other matters unresolved when the hearing date is scheduled. The rules propose that the hearing will proceed regardless, but how, in practice, will this be implemented? The likely practical result is that hearings will be postponed until

the prehearing practice is complete, thus, delaying a hearing and defeating the intended purpose of the proposed changes.

While we understand that the Tribunal has proposed these rules in order to improve the system, our overall view is that these proposals will not achieve this goal and may in fact prove detrimental. We suggest that the Tribunal reconsider the nature of the issues, and work with the private sector and the Division (which has raised a number of substantive concerns similar to ours) to devise different approaches. We believe this to be particularly important because the concerns we have with the proposed rules in many cases go to the heart of the Tribunal's function and mission, and present questions not simply of litigation procedure, but rather of the very nature of the Tribunal as an informal forum.

The foregoing expresses in general terms our concerns about the proposed regulations. More specific comments are set forth below.

Section 4

Powers of Attorney and Notice of Appearance

While we have no objection to the requirement that a power of attorney be filed with the Tribunal, the simultaneous submission of a notice of appearance is duplicative. Perhaps the better rule would be to give the representative the option of submitting a power to the Tribunal or filing a notice of appearance.

Section 8

Purpose of Pleadings

We applaud the formal policy statement that pleadings are designed to provide “fair notice” to the parties. However, as discussed below, we believe this goal is not advanced by the new rules regarding Answers.

Failure to Answer and Failure to Specifically Deny or Admit Allegations Contained in Petition Currently, 20 NYCRR § 3000.4(a)(3) provides that when an allegation contained in a Petition is neither admitted nor denied in an Answer, it is “deemed admitted”. The proposed regulation 20 NYCRR § 3000.4(d)(1) provides that every allegation of fact neither admitted nor denied is “deemed denied”. If no Answer at all is served within 60 days, the Division is “deemed to have denied” every allegation of fact contained in the Petition. The effect of these rules is that no Answer is required. Should the Petitioner feel the need for an Answer where none is forthcoming, it may move for an order that all allegations (or specific allegations) contained in the Petition be “deemed admitted”. In practical terms, the Petitioner may move that an Answer actually be served. Finally, the proposal provides that even if no Answer is filed, the case is “deemed to be at issue” 60 days after the Petition is filed and will, thus, be ready for scheduling.

Under current rules, failure to answer can, under defined circumstances, result in a default order against the Division. The Tribunal has not yet heard a case where a late Answer has so prejudiced a taxpayer (or was sufficiently at odds with the tax appeals system) that a default against the Division

was deemed justified.[2] When such a case does arise, the Tribunal should have the authority to enforce a default against the Division. It is not helpful to the fair resolution of disputes to address scheduling problems by pushing a case forward when the Division has not responded, and to eliminate the Answer altogether is to penalize taxpayers for the Division's failure to follow existing rules. Furthermore, in terms of the perceived independence of the Tribunal, it is important that not only taxpayers but also the Division respect and abide by the basic and relatively straightforward requirements for joinder of issue. There are alternatives between defaulting a party and outright elimination of the Answer that could create an incentive for timely Answers. The rules could be revised to put the onus on the Division to provide “good cause” for its failure to Answer on time. Alternatively, if no timely Answer is served, all allegations in the petition could be deemed admitted.

The need for an Answer, which serves two valuable functions, is evident. First, and foremost, the Answer provides notice to the taxpayer of the Division's position. Although the filing of an Answer does provide a convenient time to begin scheduling hearings, its role is more significant and its existence is required in order to provide a fair hearing to the taxpayer.

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[2] Cf., Matter of Macbet Realty Corp (May 19, 1990) (“A systematic disregard of the time limitation for filing answers...would interfere with our responsibility to provide “the public with a just system of resolving controversies...”).

Second, at a purely practical level, the Answer is the first opportunity for an attorney at the Division to review the case. Presumably, the attorney charged with preparing the Answer reviews the file, learns the facts of the case and makes critical decisions about whether to concede issues or develop them. With no need to prepare an Answer, these decisions can be deferred almost indefinitely. When the Division does not have an attorney familiar with the case, the most dramatic side effect is that settlement negotiations are frustrated. Prior to the Answer's submission, settlement discussions are very difficult to entertain because the taxpayer has not been notified whom to contact and the Division's attorneys have frequently not yet evaluated the case.

As noted below, stipulations of facts are to be encouraged. However, a “deemed denied” rule puts more pressure on the stipulation process by assuming that all facts are at issue merely because the Division has not responded to assertions made in the petition.

Also, the interaction of the “deemed denied”/”deemed at issue” rule with the newly created discovery rules and pleading rules is unworkable. The rule for requests for disclosure provides that such requests must be made within 90-days following the “deemed denied”/”deemed at issue” date. This period overlaps with the period during which the taxpayer can request an Answer. The practical effect is that the taxpayer must choose between notice of the Division's position or discovery. We doubt this was intended. Although the rules permit it, we also doubt that the Tribunal meant to permit the Division to commence discovery during the pendency of a request for an Answer.

The same mechanical problems are true for motion practice. For example, the period for summary determination motions overlaps with the period during which an Answer can be requested. An Answer would be necessary to establish that there are no factual issues. Again these conflicts in scheduling the progression of the case seem unintended.

To make the rules for amplifying pleadings -- bills of particulars, more definite statements, demands for Answers -- meaningful and workable, joinder of issue should not take place until this pleading phase of the case is complete. Unless and until that time, motions and discovery are counterproductive. A rule that tolled the “joinder of issue” until such time as all motions relating to pleadings were finalized would resolve the problem.

Amended Pleadings -- Conforming to Evidence at Hearing

Under the proposed rule, legal and factual issues raised at hearing and “tried by express or implied consent” of the parties, even though not contained in the pleadings, are treated as if part of the pleadings. A formal motion to conform the pleadings to the proof, however, will no longer be necessary -- “failure to amend [the pleadings by motion] does not affect the result of the trial of these issues”. In addition to deeming pleadings to be amended to raise new issues tried “by consent”, the proposed rules also provide that evidence relating to issues not raised in the pleadings shall be freely admitted unless the objecting party can establish “prejudice” by the lack of notice.

Experience has shown that motions to conform pleadings to the evidence are valuable tools that should remain in place. A formal motion to conform should be required if for no other reason than to avoid situations where a new legal theory is raised for the first time subsequent to the hearing as having been tried by “implication”. Because taxpayers bear the burden of proof, before the record is closed the Division should be required to make clear the issues for which the taxpayer must satisfy the burden. To permit new arguments to be introduced post-hearing on the suggestion that they were tried by “implication” puts the taxpayer in the position of being required trying to meet a burden of proof on a legal theory which it may not have understood was at issue before the record was closed.

We have some concern about the overall philosophy behind this proposed rule. It seems unfair for the Administrative Law Judge or the Tribunal to decide a case on issues not raised by the parties where an opportunity to brief new legal issues or introduce additional facts relevant to the new issue is not provided.

Requests for More Definite Statement; Bill of Particulars

It is widely understood that pleadings from both parties have been less than satisfactory in providing notice of the parties' positions. To the extent that the new rules are designed to force parties to give adequate notice, there is no objection. However, we are concerned that the problem stems in substantial part from the inexperience of some representatives and question whether these sorts of additional requests will ultimately achieve an increased level of clarity. Also, there is concern that these tools will become heavily and routinely used by the

Division in a manner that could overwhelm and intimidate taxpayers (particularly those represented by accountants and appearing pro se). Again, while we recognize that these kinds of procedures apply in federal Tax Court, we do not believe that the Tax Court is the model the Tribunal should be following. In addition, as we discuss below in connection with discovery, consideration should be given to modifying the current rules on bills of particulars to prevent their overuse by allowing their use only when good cause is shown.

Finally, at a mechanical level, these pleading amplifiers are taking place within the same time period during which motion practice and discovery are supposed to be taking place. It is recommended that if these devices are retained, there be established an identifiable period during which motions and requests seeking clarification of pleadings be completed, and more importantly, that discovery and motion practice be held in abeyance until the pleading phase of the hearing is complete.

Section 9

General Procedural Rules

The proposed rules appear to leave the old rules in place, although they now provide a specific time period during which an order must be issued. Such a rule should prove useful in avoiding open-ended motions. However, it is not clear how the 90-day/6-month time periods would interact. If a motion to dismiss is made, is it subject to the 90-day rule or the 6-month rule? If granted, it would finally determine the case (subject to the 6-month rule). If denied, it would not finally determine the case subject to the 90-day rule). May the parties assume that if an

order is not issued on the 90th day that the motion to dismiss has been granted?

Section 10

Disclosure

These proposed changes would permit expanded forms of discovery and effectively endorse their widespread use. The new provisions generally allow for the routine use of interrogatories, requests to admit, discovery and inspection, and so forth. These tools could be used routinely and extensively by the Division and, in practice, could result in Tribunal litigation becoming considerably more expensive for taxpayers who would be faced with the cost of complying with discovery motions and requests.

Some of our members believe that discovery in some form is reasonable in light of the fact that the Tribunal is the forum in which facts relevant to the case are tried, and the use of discovery is appropriate to the function of the hearing. Most of those commenting on the proposed rules believe, however, that the informal rules currently in effect are adequate and that given the potential burden of compliance with the proposed changes, the changes are not necessary. Moreover, discovery should be unnecessary for the Division. The Division has already conducted an audit (with full subpoena powers) to its own satisfaction in advance of issuing the assessment being protested. The presumption of correctness which attaches to that audit presupposes that the audit was complete and thorough. It is feared that the Division would use the discovery power as a tool

to, in effect, perform a “second audit”. It is also feared that “boiler plate” discovery tools would be widely used by the Division and that could overwhelm and overburden taxpayers.[3] Finally, compliance with discovery requests, preclusion orders and so forth is a practice for which accountants and pro se taxpayers are frequently not well equipped and to which they should not be subjected.

Further, discovery often will provide no corresponding benefit for taxpayers. The Division usually cooperates in providing documents informally when requested. To the extent cooperation is not forthcoming, the taxpayer can obtain most items through a Freedom of Information Law application. On balance therefore, we have concluded that the current system of flexible and informal discovery is adequate and should be retained.

Section 11

Ex Parte Communications

Although we expect that all parties have conducted themselves in a manner consistent with this rule, the appearance of impartiality will be enhanced if this rule is adopted formally. However, for this mile to have any meaningful effect, some form of sanction should be put in place for the failure to comply.

[3] For example, the Audit Division's residency audit questionnaire, or its corporate nexus questionnaire, could reemerge as “interrogatories”.

Recusal

The rules governing recusal motions are essentially unchanged, with the exception that the requirement that a motion to recuse an Administrative Law Judge be made at least 15 days before the hearing has been eliminated to reflect the fact that litigants are not informed of the identity of their Administrative Law Judge prior to the hearing date. As before, however, it is unclear how such motions may be made and when. More importantly, it is unclear whether a party must first conduct the hearing before the motion will be reviewed. Some additional clarity is needed. For this rule to be meaningful, we believe the Tribunal should provide notice of the Administrative Law Judge's identity in advance of the hearing date.

Sections 12 and 13

Stipulations of Fact

As proposed, stipulations would be mandatory. Currently, stipulating facts is elective and only at the taxpayer's discretion. While we appreciate the desire to cause stipulations to be made as often as possible, and stipulations are to be encouraged, forcing stipulations where neither party is inclined to do so in effect starts the “factual dispute” prematurely. Active and early involvement by the judge assigned to the case would prove helpful in the stipulation process. In addition, assigning an Administrative Law Judge at the outset would also help to eliminate some of the timing problems with motions (such as those for recusal) and might encourage the parties to conduct their pre-hearing preparations on an informal and cooperative basis.

Section 16

Hearing Memorandum

This section proposes a new requirement that appears to be fashioned after the hearing memorandum required in federal Tax Court. The hearing memorandum must be submitted no later than 10 days before the hearing and must contain the following: (1) a list of witnesses and summary of expected testimony; (2) a list of all exhibits to be introduced; (3) a brief statement of the issues; (4) a statement of applicable legal authorities; and (5) copies of any stipulations that have been executed. Failure to identify a witness or exhibit will result in the party being precluded from introducing the testimony or exhibit unless “good cause” is shown for the omission in the hearing memorandum.

Presumably the requirement of a pre-hearing memorandum is suggested as a means to improve the efficiency and organization of the hearing. This can be useful. It should be recognized, however, that these memoranda will involve additional costs and burdens to taxpayers. This will be particularly troubling if the memoranda develop into briefs, a possibility suggested by the requirement that the parties recite the issues and the legal authorities relied upon. If pre-hearing submissions are to be required, they should be no more than lists, and the rules should state this clearly.

The proposed rules should also be modified to better reflect the realities of litigation experience. As a practical matter, taxpayers rarely have their cases fully in place ten days before hearing. Witnesses (particularly corporate witnesses) are often substituted at the last minute. While the main legal authorities may be known prior to hearing, others will

undoubtedly surface before the hearing date or as the brief is being prepared. Accordingly, while we agree that pre-hearing memoranda will help to define the issues and organize the proof, the memoranda should not be used to circumscribe the hearing. Any rule prescribing pre-hearing memoranda should permit general descriptions of the anticipated witnesses and evidence (e.g. “an employee of X corp.” or “documents evidencing the taxpayer's whereabouts”) and should not limit the lines of legal authority to which a litigant can refer or the evidence that can be introduced. The purpose of encouraging taxpayers to be prepared and ready for trial should not overwhelm the primary function of the hearing, which is to elicit the facts and provide a fair and efficient forum for resolving tax disputes.

Finally, the requirement of a pre-hearing memorandum appears to conflict with other changes, in particular the apparent absence of a requirement for an Answer, and the liberalized rules for amending pleadings at hearing.

Pre-Hearing Conferences

Many of the problems the proposed rules are intended to address might be better solved by the early assignment of the Administrative Law Judge and the use of pre-hearing conferences. These conferences can provide a forum for identifying and distilling the issues, facilitating stipulations and apprising each side and the Administrative Law Judge of anticipated witnesses and documentary evidence. Furthermore, pre-hearing conferences often will promote settlement.

To date, the Tribunal has not deployed its Administrative Law Judges to conduct pre-hearing conferences, but we believe the Tribunal should experiment with such conferences. Obviously it would be optimal to conduct such conferences face-to-face, and we again lament the failure of the Tribunal to provide hearings state-wide. However, even if the parties are not brought together physically, we believe there are considerable benefits to be obtained from conducting pre-hearing teleconferences.

Conclusion

We believe that the Tribunal has clearly met the expectations of the private sector in providing a fair, independent, efficient and informal forum for the resolution of tax disputes. We are concerned that the proposed rules will erode some of that important role. We recognize that the proposed rules are an attempt to rationalize and make uniform the disposition of various procedural issues that heretofore have been resolved on an ad hoc basis, and certainly that concern is worthy of consideration. On balance, however, we are of the view that the costs and burdens of the particular changes described above outweigh their merits, and impair the essential benefits of the Tribunal.

If, after due deliberation, the Tribunal nonetheless concludes that it is in the interests of justice to adopt the full panoply of formal and complex pre-hearing devices proposed, at a minimum it is necessary to clarify the interaction of the various time limitations that are to be established.

We also suggest that consideration be given to expanding the jurisdictional limits of small claims hearings, which are a less formal, less costly means of affording taxpayers their day in court. Current dollar limitations for small claims hearings could be entirely eliminated, for example, thereby making this forum available to all taxpayers who are willing to give up their appeal rights in exchange for greater informality.