



Iowa Department of  
**REVENUE**

## **Study of the Tax Appeals System in Iowa**

### **Report to the Iowa General Assembly**

Issued January 8, 2014

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## Executive Summary

In recent years, the independence and fairness of state level tax appeals processes has gained national attention. The Iowa Department of Revenue (“Department”) recognizes that its own appeals process lacks independence because the Director of the Department has the authority to overturn a decision of the administrative law judge. This creates, at the very least, the appearance that the appeals process is biased against the taxpayer. The Department is also plagued by a large backlog of protests. During recent years the Department began taking steps within the scope of its authority to improve administration of the appeals process. However, true reform will require legislative change.

In 2013, following the Iowa Department of Revenue’s own recommendation, the 85th Iowa General Assembly enacted legislation<sup>1</sup> that required the Department to review the current tax appeals process and make recommendations for reform. In accordance with the requirements of the Act, the Department assembled an Advisory Panel that included stakeholders representing the public and certain state government agencies:

Cynthia Adams, Executive Director, Iowa Society of CPAs  
Bruce Baker, Attorney, Nyemaster Law Firm  
Dustin Blythe, President, Iowa Taxpayers Association  
Judy Chaplin, Director, Administration & Finance, Iowa Society of CPAs (Alternate)  
Nicole Crain, Vice President, Government Relations, Iowa Association of Business and Industry (Alternate)  
Richard A. Davidson, Partner, Lane & Waterman, LLP  
Jeffrey Farrell, Administrative Law Judge, Iowa Department of Inspections and Appeals  
Tom Jarrett, Vice President, Taxes, Deere & Company  
Kurt Konek, CPA, Konek, P.C.  
Carrie Johnson, Fiscal Policy Analyst, Iowa Department of Management  
Christopher Nuss, Chairperson, Iowa State Bar Association, Tax Section, Brown Winick Law Firm  
Mike Ralston, President, Iowa Association of Business and Industry  
Donald Stanley, Jr., Special Assistant Attorney General, Iowa Office of Attorney General  
Beverly Zylstra, Deputy Director, Iowa Department of Inspections and Appeals

In addition, the Department consulted with the current members of the State Board of Tax Review:

Jeff Elgin, Chair  
Michael Milligan  
Jill Sanchez  
Bryan Witherwax, Legal Counsel to the Board

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<sup>1</sup> 2013 Iowa Acts, 85th G.A. ch. 140, § 133.

Based on its review of the current system, and the input of the Advisory Panel and the State Board of Tax Review, the Department determined that the following changes should be made to Iowa's tax appeals process:

- Implement a small claims process to expedite cases of limited monetary value.
- Remove the Director stage of appeal to make the process wholly-independent.
- Eliminate the State Board of Tax Review to improve the efficiency of the appeals process.
- Enhance the tax law training and expertise requirements of the administrative law judges who hear tax matters to ensure decisions are firmly grounded in tax law and issued in a reasonable amount of time.

## **I. Introduction**

In recent years, the independence and fairness of state level tax appeals processes has gained national attention from the American Bar Association (“ABA”), the Council on State Taxation (“COST”), the American Institute of Certified Public Accountants (“AICPA”), as well as several states. Like other states that have explored improvements to their tax appeals processes, two key issues exist in Iowa’s administration of tax appeals. First, the State does not have a wholly-independent tax appeals board. Second, the time to resolve a dispute through the current appeals process is lengthy. The Iowa Department of Revenue (the “Department”) recognized these concerns and began taking steps within the scope of its authority to improve administration of the appeals process.

In 2013, following the Department’s own recommendation, the 85th Iowa General Assembly enacted legislation that required the Department to review the current tax appeals process and make recommendations for reforms. The Act provides:

[t]he department of revenue, in consultation with the department of management and other interested stakeholders, shall study the independence, effectiveness, and fairness of the state’s current administrative appeals processes for tax matters and shall make recommendations for changes, if necessary, and shall additionally study the desirability, practicality, and feasibility of replacing components of these processes with a new consolidated and independent administrative appeals board for tax matters within the executive branch to resolve disputes between the department of revenue and taxpayers. The department of revenue shall prepare and file a report detailing its findings and recommendations with the chairpersons and ranking members of the ways and means committees of the senate and the house of representatives and with the legislative services agency by January 8, 2014. This section of this Act shall not be construed to provide the department of revenue with the power or authority to eliminate or in any way modify the property assessment appeals board created pursuant to section 421.1A.<sup>2</sup>

To aid the Department in its review of the current system and its formulation of recommendations, the Department assembled a Tax Appeals Advisory Panel (the “Advisory Panel”) including the following group of stakeholders representing the public and certain state government agencies:

Cynthia Adams, Executive Director, Iowa Society of CPAs  
Bruce Baker, Attorney, Nyemaster Law Firm  
Dustin Blythe, President, Iowa Taxpayers Association  
Judy Chaplin, Director, Administration & Finance, Iowa Society of CPAs (Alternate)  
Nicole Crain, Vice President, Government Relations, Iowa Association of Business and Industry (Alternate)  
Richard A. Davidson, Partner, Lane & Waterman, LLP  
Jeffrey Farrell, Administrative Law Judge, Iowa Department of Inspections and Appeals  
Tom Jarrett, Vice President, Taxes, Deere & Company  
Kurt Konek, CPA, Konek, P.C.

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<sup>2</sup> 2013 Iowa Acts, 85th G.A. ch. 140, § 133.

Carrie Johnson, Fiscal Policy Analyst, Iowa Department of Management  
Christopher Nuss, Chairperson, Iowa State Bar Association, Tax Section, Brown  
Winick Law Firm  
Mike Ralston, President, Iowa Association of Business and Industry  
Donald Stanley, Jr., Special Assistant Attorney General, Iowa Office of Attorney  
General  
Beverly Zylstra, Deputy Director, Iowa Department of Inspections and Appeals

In addition, the Department consulted with the current members of the State Board of Tax Review:

Jeff Elgin, Chair  
Michael Milligan  
Jill Sanchez  
Bryan Witherwax, Legal Counsel to the Board

This report sets forth the Department's analysis of the independence, fairness, and efficacy of its current tax appeals process and makes recommendations for a more independent and effective system based on input from the Advisory Panel and the State Board of Tax Review, as well as recommendations from national experts.

## **II. Characteristics of an Effective and Fair Tax Appeals Process, National Trends**

The fairness of state tax appeals boards has gained national attention in recent years. This concern led the ABA to develop and adopt a Model State Administrative Tax Tribunal Act (the "Model Act"). During the process of reviewing Iowa's current tax appeals system, the Department reviewed procedures in other states as well as the Model Act for guidance on the characteristics of a fair and effective system. This research guided the Department's review of its current system as well as its recommendations for reform.

### **A. The Model Act**

In 2006, the ABA's House of Delegates officially endorsed and recommended the Model Act.<sup>3</sup> The Model Act was drafted by the State and Local Tax Committee of the ABA Section of Taxation to provide a statutory template for independent tax tribunals.<sup>4</sup> The goal of the Model Act is to guarantee that before paying the tax in dispute, every taxpayer who receives an assessment can obtain a hearing on the record before a judge that is a tax expert, in a forum independent of the tax collection agency.<sup>5</sup> Highlights of the Model Act are set forth in Appendix "A" to this Report.

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<sup>3</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT (2006).

<sup>4</sup> Garland Allen & Craig B. Fields, *The Model State Administrative Tax Tribunal Act: Fairness for All Taxpayers*, 10 STATE & LOCAL TAX LAW. 83, 83 (2005), available at <http://www.aicpa.org/advocacy/tax/statelocal/downloadabledocuments/taxlawyerart.pdf>.

<sup>5</sup> *Id.* at 84.

In addition to the ABA, other organizations, including COST and the AICPA, have evaluated state appeals processes. COST's position is that a state can only achieve a fair tax appeals system with a tax appeals board that operates independent of its tax collection agency.<sup>6</sup> The AICPA supports the Model Act.<sup>7</sup> Taking into account the current challenges of the tax appeals process, and the guidance of the Advisory Panel, the Department identified several characteristics of an effective and fair tax appeals system:

- The appeals board is separate and independent of the state tax collection agency;
- The appeals board consists of judges with substantial knowledge of and experience in tax law;
- The system does not require the taxpayer to pay the liability or post a bond in order to obtain a hearing;
- The decisions of the appeals board are appealable to state district court; and
- The process includes an informal stage where an effort is made to resolve matters prior to litigation, which recognizes the hazards of litigation to both parties.

#### B. State Tax Appeals Boards—National Overview

Around the country, states have adopted a variety of different appeals system models, with varying levels of independence. Only Illinois and Georgia have adopted the Model Act.<sup>8</sup> Twenty-five states have independent tax tribunals housed in their executive branches but not based on the Model Act.<sup>9</sup> Six states have tax courts housed in their judicial branches.<sup>10</sup> Overall, thirty-three states have tax appeals systems independent of their tax collection agencies. This suggests a national trend towards more independent appeals boards for tax matters.

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<sup>6</sup> Douglas L. Lindholm, Ferdinand S. Hogroian, & Fredrick J. Nicely, Council on State Taxation, *The Best and Worst of State Tax Administration COST Scorecard on Tax Appeals and Procedural Requirements* (Dec. 2013), available at <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=85976>.

<sup>7</sup> Am. Inst. of Certified Pub. Accountants, *State Tax Tribunals* (July 2012) available at <http://www.aicpa.org/Advocacy/Tax/StateLocal/DownloadableDocuments/AICPATaxTriPaper072012.pdf>.

<sup>8</sup> See Illinois Tax Tribunal Act, 2012 Ill. Legis. P.A. 97-2239 (West 2012) (codified as amended at 35 ILCS 1005/5-5); Act of Apr. 9, 2012, 2012 Ga. Laws 609 (codified as amended in scattered sections of Titles 48 and 50 of the Official Code of Georgia Annotated). Six states—Alabama, Colorado, Louisiana, Oklahoma, Tennessee, and Texas—considered but did not pass similar legislation in 2013. 2013 Ala. Senate Bill 223; 2013 Colo. House Bill 13-1140; 2013 La. House Bill 585; 2013 Okla. Senate Bill 382; 2013 Tenn. Senate Bill 0374; 2013 Tex. House Bill 2488.

<sup>9</sup> To determine this number, data from the AICPA, *supra* note 8 was compared with data from Douglas L. Lindholm et al., *supra* note 5. Legislative changes as well as differing criteria led to differences in their evaluations.

<sup>10</sup> Arizona, Connecticut, Hawaii, Indiana, New Jersey and Oregon. AICPA, *Chart of States with and without State Tax Tribunals (as of 9/23/13)*, available at <http://www.google.com/url?sa=t&rct=j&q=aicpa+state+tax+tribunals&source=web&cd=1&ved=0CCwQFjAA&url=http%3A%2F%2Fwww.aicpa.org%2Finterestareas%2Ftax%2Fresources%2Fstateandlocal%2Ftoolsandaids%2Fdownloadabledocuments%2Fchart-of-states-with-and-without-state-tax-tribunals-3-8-13.doc&ei=fksSURC7D6qG2gWQjYF4&usg=AFQjCNFsJJsnekztghzDFtsrKAE09Yfaw&bvm=bv.50768961,d.b2I>.

### **III. A Brief History of Iowa's Tax Appeals Process**

The structure of Iowa's state tax collection agency and its appeals process has changed over time. Below is a brief summary of that evolution. Section IV of this report provides a critique of the current system.

#### **A. The State Tax Commission**

Prior to 1967, Iowa's state tax agency was the State Tax Commission (the "Commission").<sup>11</sup> Rather than being headed by a director, the Commission was composed of three members, appointed by the Governor with the consent of two-thirds of the Senate.<sup>12</sup> The members were salaried employees appointed to six-year terms.<sup>13</sup> The members were required to "possess knowledge of the subject of taxation and skill in matters pertaining thereto."<sup>14</sup> No more than two members could belong to the same political party.<sup>15</sup>

A taxpayer could "appeal to the commission for revision of the tax, interest, and/or penalties assessed against him at any time within ninety days from the date of the notice of assessment of such tax, additional tax interest, and/or penalties."<sup>16</sup> In response to the appeal, the Commission was required to grant a hearing to determine if the assessment was excessive or incorrect.<sup>17</sup> If the Commission determined the assessment was excessive or incorrect, the Commission would revise the assessment according to the law and facts.<sup>18</sup> The Commission notified the taxpayer of its findings, and refunded any excess tax paid with interest.<sup>19</sup>

If the taxpayer disagreed with the findings of the Commission, the taxpayer's immediate remedy was to appeal the decision to district court.<sup>20</sup> The district court heard the appeal in equity and had de novo review.<sup>21</sup> Either the Commission or the taxpayer could appeal the decision of the district court to the Iowa Supreme Court.<sup>22</sup>

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<sup>11</sup> IOWA CODE ch. 421(1966).

<sup>12</sup> IOWA CODE §§ 421.1, .2 (1966).

<sup>13</sup> *Id.* §§ 421.5, .8.

<sup>14</sup> *Id.* § 421.3.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* § 422.28. This applied to the income tax. *Id.* Similar provisions applied to the sales tax. *Id.* § 422.54.

<sup>17</sup> *Id.* § 422.28.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* § 422.29.

<sup>21</sup> *Id.* § 422.29(3).

<sup>22</sup> *Id.*



## B. The Department of Revenue and the State Board of Tax Review

In 1967, the legislature replaced the Commission with the Department of Revenue.<sup>23</sup> A new position, the Director, was created to head the agency in place of the three-member Commission.<sup>24</sup> The Director inherited the powers and duties of the Commission, including the right to review assessments.<sup>25</sup> A taxpayer now had to appeal an assessment to the Director.<sup>26</sup> As before, if the taxpayer disagreed with the determination of the Director, the taxpayer could appeal the decision to district court.<sup>27</sup> However, the legislature also created a new avenue of appeal beyond the Director: the State Board of Tax Review (the “Board”).<sup>28</sup>

The Board was created and headquartered at the offices of the Department.<sup>29</sup> The Board shared some characteristics with the former Commission. Like the Commission, the Board was comprised of three members, appointed by the Governor and confirmed by two-thirds of the Senate.<sup>30</sup> Also like the Commission, no more than two Board members could belong to the same political party.<sup>31</sup> However, the Board also differed from the Commission in several ways. First, Board members served staggered terms.<sup>32</sup> Second, Board members were not required to be tax experts.<sup>33</sup> Third, Board members were not salaried; they served as volunteers, and were required to meet at least six times per year.<sup>34</sup> It was the Board’s duty to review decisions of the Director.<sup>35</sup> This meant a dissatisfied taxpayer could now appeal a decision of the Director to either the Board or district court.<sup>36</sup> This applied to all assessments issued by the Director, which included centrally-assessed property.<sup>37</sup> The Board also had the authority to review a decision of the Director upon its own motion.<sup>38</sup> In addition to its role in the appeals process, the Board was required to approve or reject the rules and regulations proposed by the Director for approval or

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<sup>23</sup> 1967 Iowa Acts, 62st G.A. ch. 342 (codified at IOWA CODE ch. 421).

<sup>24</sup> *Id.* (codified at IOWA CODE § 421.2).

<sup>25</sup> 1967 Iowa Acts, 62st G.A. ch. 342 § 87 (codified at IOWA CODE § 422.28).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* § 88 (codified at IOWA CODE § 422.29).

<sup>28</sup> *Id.* § 1 (codified at IOWA CODE § 421.1).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* (empowering the Board to, “upon their own motion or upon appeal by any affected taxpayer, review the record evidence and the decisions of, and any orders or directive issued by, the director of revenue for the assessment and collection of taxes by the department or an order to reassess or to raise assessments to any local assessor and shall expeditiously affirm, modify, reverse or remand the same.”).

<sup>36</sup> *Id.*

<sup>37</sup> Centrally-assessed property is valued and assessed by the Department rather than the local assessors. *See, e.g.* IOWA CODE § 433.4. At the time of the valuation of the property, a hearing is held where the taxpayer has the right to appear. *See, e.g.*, IOWA CODE § 433.7. Such assessments are final decisions of the Director, appealable to the Board.

<sup>38</sup> 1967 Iowa Acts, 62nd GA ch. 342, § 1 (codified at IOWA CODE § 421.1).

rejection.<sup>39</sup> The Board's duties remained the same until the adoption of the Iowa Administrative Procedure Act ("IAPA").

### C. The Introduction of the Iowa Administrative Procedure Act

In 1974, the legislature enacted the IAPA. Prior to the IAPA, the Iowa Code provided little guidance regarding the functions of state agencies, and the few existing laws varied between agencies.<sup>40</sup> The IAPA mandated adequate publicity for certain state administrative functions; regulated state agency rulemaking procedures; set forth a hearing procedure for deciding individual cases; and established procedures for judicial review of agency action.<sup>41</sup> The IAPA mandated uniform minimum procedural requirements for all Iowa state agencies.<sup>42</sup> Agencies continued to maintain additional procedures in their own Code chapters.<sup>43</sup> The IAPA also strengthened oversight of agencies with the introduction of the Administrative Rules Review Committee (ARRC).<sup>44</sup> While a legislative review committee existed prior to the IAPA, the ARRC enhanced that committee's role and added a formal process for providing public notice of proposed rules.<sup>45</sup> With the ARRC now responsible for reviewing all administrative rules, the legislature eliminated the Board's duty to review rules of the Director.<sup>46</sup>

The IAPA also altered the appeals process for state agencies, including the Department,<sup>47</sup> by creating "contested case proceedings" and additional guidelines for judicial review. Under the IAPA, decisions of an agency could be appealed and heard by a hearing officer who was generally an employee of the agency.<sup>48</sup> If an agency did not need a full-time hearing officer, the agency could utilize a hearing officer from another agency.<sup>49</sup> Following a hearing, the hearing officer issued a decision.<sup>50</sup> If a hearing officer from another agency presided over the appeal, the hearing officer issued a "proposed decision."<sup>51</sup> A party or the agency could appeal the proposed decision, and the agency director would then issue the final decision of the agency.<sup>52</sup> If no one appealed the proposed decision, it automatically became the final decision.<sup>53</sup> If a hearing officer from

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<sup>39</sup> *Id.* See Appendix "B" for a complete list of the Board's original duties.

<sup>40</sup> Arthur Earl Bonfield, *The Iowa Administrative Procedure Act: Background, Construction, Applicability, Public Access to Agency Law, the Rulemaking Process*; 60 IOWA L. REV. 731, 731–32 (1975).

<sup>41</sup> *See id.*; *see also generally*, Iowa Code ch. 17A.

<sup>42</sup> Bonfield, 60 IOWA L. REV. at 732.

<sup>43</sup> *Id.* at 848.

<sup>44</sup> 1974 Iowa Acts, 65th G.A. ch. 1090, § 8 (codified at IOWA CODE § 17A.8).

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* § 140 (codified at IOWA CODE § 421.1).

<sup>47</sup> *Id.* § 142 (codified at IOWA CODE § 422.29).

<sup>48</sup> *See id.* §§ 11, 12 (codified at IOWA CODE § 17A.11, .12).

<sup>49</sup> *Id.* § 11 (codified at 17A.11(3)).

<sup>50</sup> *Id.* § 15 (codified at IOWA CODE § 17A.15).

<sup>51</sup> *Id.* § 15(2) (codified at IOWA CODE § 17A.15(2)).

<sup>52</sup> *Id.* § 15(3) (codified at IOWA CODE § 17A.15(3)).

<sup>53</sup> *Id.* § 15(2) (codified at IOWA CODE § 17A.15(2)).

the agency presided over the appeal, the hearing officer issued the final decision of the agency.<sup>54</sup>

The appellant could seek judicial review of the final decision in district court, however, the scope of review changed with the passage of the IAPA.<sup>55</sup> Under the IAPA, a court could no longer review the facts of a contested case de novo, nor could a court consider any new evidence related to the facts of a contested case.<sup>56</sup> The IAPA also laid out specific grounds and limitations for overturning final agency action.<sup>57</sup>

In 1988, the term “hearing officer” was replaced with “administrative law judge” (“ALJ”) in the IAPA, but these ALJs remained officers of each state agency.<sup>58</sup> In 1998, the legislature created the Administrative Hearings Division (“AHD”) of the Department of Inspections and Appeals (“DIA”), and transferred the ALJs of each agency to the AHD to create the more independent system Iowa has today.<sup>59</sup> At that time, all decisions of the ALJ became proposed decisions for adoption or review by the director of the applicable agency.<sup>60</sup>

Regardless of the many changes to the appeals process, the Iowa Code consistently protected taxpayers’ right to appeal an income tax assessment in sections 422.28 and 422.29, and rights to appeal a sales tax assessment in sections 422.54 and 422.55.<sup>61</sup> However, in 1994, the legislature adopted the Tax Procedures and Practices Act.<sup>62</sup> This Act did not eliminate the taxpayers’ right to appeal an income tax or sales tax assessment, rather it imposed additional obligations on the Department regarding the substantive and procedural rights of the taxpayer.<sup>63</sup>

#### D. Changes in the State Board of Tax Review’s Duties and Powers

As the contested case proceeding evolved through the IAPA and amendments thereto, the Board remained an avenue of appeal for the taxpayer, as it does today.<sup>64</sup> The Board retained its authority to review decisions of the Director, which meant after the

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<sup>54</sup> *Id.* § 15(1) (codified at IOWA CODE § 17A.15(1)).

<sup>55</sup> *Id.* § 19 (codified at IOWA CODE § 17A.19).

<sup>56</sup> *Id.* § 19(7) (codified at IOWA CODE § 17A.19(7)).

<sup>57</sup> *Id.* § 19(8) (codified at IOWA CODE § 17A.19(8)).

<sup>58</sup> 1988 Iowa Acts, 72nd G.A. ch. 1109, § 4 (codified at IOWA CODE § 17A.11).

<sup>59</sup> 1998 Iowa Acts, 77th G.A. ch. 1202 § 3 (codified at IOWA CODE § 10A.801); *id.* at § 15 (codified at IOWA CODE § 17A.11).

<sup>60</sup> *Id.* § 17 (codified at IOWA CODE § 17A.15(3)).

<sup>61</sup> Compare IOWA CODE §§ 422.28, .29 (1966), with IOWA CODE §§ 422.28, .29 (2013) (income tax); compare IOWA CODE §§ 422.54, .55 (1966), with IOWA CODE § 422.54, .55 (2003), and IOWA CODE §§ 423.37, .38 (2013) (sales tax).

<sup>62</sup> 1994 Iowa Acts, 75th G.A. ch. 1133, § 1 (codified at IOWA CODE § 421.60).

<sup>63</sup> *Id.*; see also H.F. 2419, 75th G.A. (Iowa 1994) (“These duties require informing the taxpayer of the taxpayer’s rights, the obligations of the department with respect to notice of tax owed, denial of claim, or reduction in refunds and the reasons for such, and the taxpayer’s right to appeal and the time period when the appeal must be filed. The bill also provides for awarding of costs and damages to a taxpayer as a result of a position taken by the department which is not substantially justified.”).

<sup>64</sup> See IOWA CODE § 421.1(5) (2013).

Director reviewed or adopted the proposed decision of the ALJ; the taxpayer could appeal that decision to the Board instead of district court.<sup>65</sup> The Board also retained its authority to review central assessments.<sup>66</sup> A 1980 Act explicitly codified the taxpayer's right to appeal assessments of centrally-assessed property to the Board.<sup>67</sup> This Act also permitted the taxpayer to seek judicial review of Board decisions on such property pursuant to the IAPA.<sup>68</sup> To date, the Board remains the court of original jurisdiction for centrally-assessed property.<sup>69</sup> However, the Board can transfer the case to the AHD of DIA.<sup>70</sup> If the hearing is delegated to the AHD, the ALJ hears the case and issues a proposed decision.<sup>71</sup> That decision becomes the final decision of the Board unless a party files a motion to vacate or an appeal.<sup>72</sup> If the Board presides over the reception of evidence at the hearing, its decision is the final decision.<sup>73</sup> A party may appeal a decision of the Board to district court.<sup>74</sup> The Director does not hear centrally-assessed property tax appeals.

In 1988, the Board was given the authority to review identifications of taxable property and classification of property, in addition to its existing authority to review centrally-assessed property tax assessments.<sup>75</sup> In 1994, the legislature codified additional rules related to the Board's review of property tax assessments.<sup>76</sup>

Today, the Board retains its power of review for all tax types.<sup>77</sup> However, a 2004 amendment limited the significance of that review by permitting the Department to seek judicial review of a decision by the Board in accordance with the IAPA.<sup>78</sup> Previously, only the taxpayer could appeal a decision of the Board.<sup>79</sup> According to the Advisory Panel, giving the Department the right to appeal the Board's decision, was intended to indicate that the Board was an independent body rather than a branch of the Department. However, members of the Advisory Panel indicated that the introduction of the

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<sup>65</sup> *See id.*

<sup>66</sup> *See id.*

<sup>67</sup> 1980 Iowa Acts, 68th G.A. ch. 1142, § 3 (codified at IOWA CODE §429.2) ("Notwithstanding the provisions of chapter seventeen A (17A) of the Code, the taxpayer shall have thirty days from the date of postmark of the notice of assessment to appeal the assessment to the state board of tax review. Thereafter, the proceedings before the state board of tax review shall conform to section four hundred twenty-one point one (421.1), subsection four (4) and chapter seventeen A (17A) of the Code."). Previously, the Board had this authority under its general power to review decisions of the Director.

<sup>68</sup> *Id.* § 4 (codified at IOWA CODE § 429.3) ("Judicial review of the action of the state board of tax review may be sought by the taxpayer in accordance with the terms of chapter seventeen A (17A) of the Code.").

<sup>69</sup> IOWA CODE §429.2(1) (2013).

<sup>70</sup> IOWA ADMIN. CODE r. 701—2.31(2013).

<sup>71</sup> *Id.* r. 701—2.50(2).

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* r. 701—2.50(1).

<sup>74</sup> *Id.* r. 701—2.54.

<sup>75</sup> 1988 Iowa Acts, 72nd G.A. ch. 1251, §1 (codified at IOWA CODE § 421.1(4)).

<sup>76</sup> 1994 Iowa Acts, 75th G.A. ch. 1133, § 9 (codified at IOWA CODE § 429.2).

<sup>77</sup> *See* IOWA CODE § 421.1(5) (2013).

<sup>78</sup> 2004 Iowa Acts, 80th G.A. ch. 1073, § 3 (codified at IOWA CODE § 421.1(4)), now codified at Iowa Code § 421.1(5)(c); *see also* IOWA ADMIN. CODE r. 701—2.16 (2013).

<sup>79</sup> IOWA ADMIN. CODE r. 701—2.16.

Department's right to appeal Board decisions reduced the value of appeals to the Board. Once the Department gained the ability to seek judicial review of Board decisions to district court, taxpayers used the Board less frequently because the Board's decisions were no longer dispositive. Regardless of intent, the 2004 legislation has had the effect of lessening the utilization of the Board.

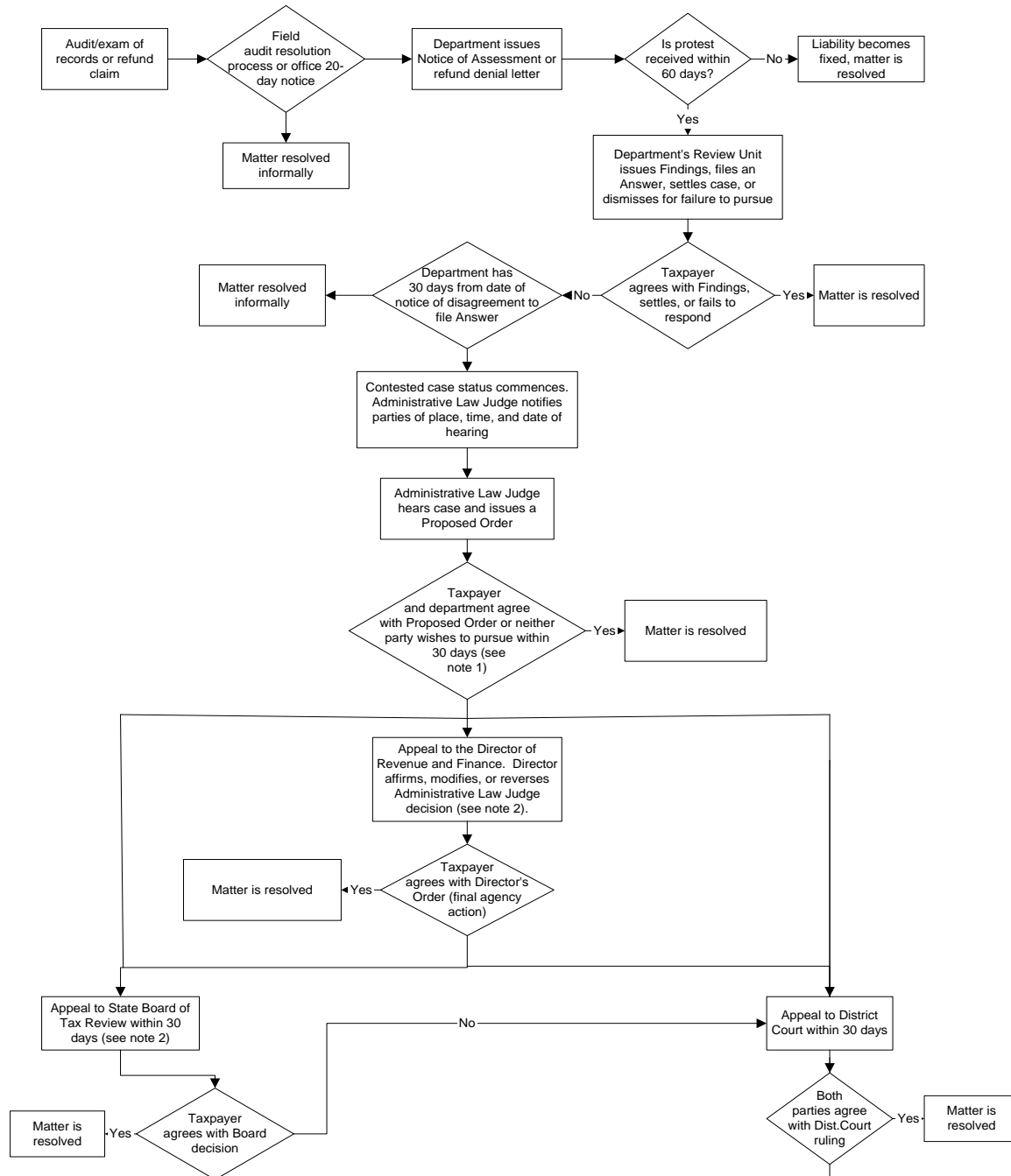
Department statistics over the past ten years indicate that the Board has had little impact in the appeals process in recent years. The Board rarely overturns the decision of the Director or the ALJ. The Department approximates that the Board only hears a small minority of appeals of the Director's decisions. Since 2003, the Board has only heard eleven non-property tax cases. The Board disagreed with the ALJ or the Director, or both, in only four cases. In the other seven cases, the ALJ, the Director, and the Board all reached the same conclusion.

## IV. Iowa's Current Appeals Process

The following chart provides a general outline of the Department's current tax appeals procedure:

Oct 2009

### AUDIT APPEAL PROCEDURES



NOTE - This is intended as a general overview. For details, refer to Chapter 7 of the rules.  
 1. Department must appeal to Director; taxpayer may appeal to District Court, the Director, or the State Board of Tax Review. However, if the taxpayer chooses to bypass the Director and appeal directly to District Court or the State Board of Tax Review, the appeal must be filed on or between the 31st and 60th days following the issuance of the order of the Administrative Law Judge.  
 2. Department cannot appeal decisions from the Director.

In addition to reviewing the evolution of the appeals process, the Department, in consultation with the Advisory Panel and the current members of the Board, analyzed the efficacy of the current process. To illustrate the comparative strengths and weaknesses of Iowa's current appeals process regarding fairness, efficacy, and independence, the following sections of this report compare Iowa's current process to the recommendations of the ABA and COST. As described below, Iowa's current appeals process contains some of the features that the ABA and COST consider essential to an independent system; however, some key characteristics are absent.

#### A. "Pay to Play"

One of the principles of the Model Act is that taxpayers should have the right to a hearing without first being required to pay the tax liability or post a bond.<sup>80</sup> COST also recommends against a "pay to play" system.<sup>81</sup> Requiring a taxpayer to pay a filing fee for filing the protest is not considered a "pay to play" system; COST considers a system unfair "pay to play" only when the taxpayer must specifically pay the tax due or a bond based on the tax due before receiving access to the appeals process.<sup>82</sup>

Iowa's current appeals procedure does not require taxpayers to pay the disputed tax amount prior to appealing a Notice of Assessment.<sup>83</sup> In fact, currently Iowa does not even require a filing fee for filing a protest at the administrative level. This allows taxpayers access to an administrative hearing, without the burden of paying the disputed tax.

#### B. The Informal Stage

Another key feature of the Model Act is that the process should include an informal stage that affords both the tax collection agency and the taxpayer the opportunity to resolve the matter without the need for a contested case hearing.<sup>84</sup> This principle is important because it recognizes the potential costs associated with litigation, which may deter a taxpayer from contesting an assessment or refund denial that the taxpayer believes was unlawful.<sup>85</sup>

Iowa's system provides an initial informal stage in the tax appeals process.<sup>86</sup> The IAPA explicitly encourages settling a case at the informal stage.<sup>87</sup> After a taxpayer files a protest, the Department's Review Unit gathers additional information from the Field Audit and Examinations Sections of the Department, and possibly the taxpayer or third parties, to determine the merits of the taxpayer's claim and the correct amount of tax or refund due.<sup>88</sup>

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<sup>80</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 7(d).

<sup>81</sup> Douglas L. Lindholm et al., *supra* note 5 at 6–7.

<sup>82</sup> *Id.*; See also Garland Allen & Craig B. Fields, *supra* note 3, at 84–85.

<sup>83</sup> See IOWA CODE § 422.28 (2013).

<sup>84</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 8.

<sup>85</sup> Garland Allen & Craig B. Fields, *supra* note 3 at 87.

<sup>86</sup> IOWA ADMIN. CODE r. 701–7.11 (2013).

<sup>87</sup> IOWA CODE § 17A.10(1) (2013).

<sup>88</sup> IOWA ADMIN. CODE. r. 701–7.11(1)"a"–"b" (2013).

During this stage, the Review Unit has the authority to concede any items contained in the protest which it finds the Department should not pursue and to reach a settlement agreement.<sup>89</sup> The vast majority of protests are resolved informally. Of the 648 protests resolved between January 1, 2012 and November 30, 2013, 600 were resolved at the informal stage.

Although the informal stage of the Iowa system allows taxpayers and the Department an opportunity to avoid the hazards of litigation, depending on the complexity of the case, this review may still be very lengthy. For example, as of November 30, 2013, fifteen sales/use tax protests filed in 2009 or prior remain at the informal stage of review. The taxpayer or the Department may impose a time limit on the informal stage by choosing to waive informal proceedings.<sup>90</sup> Otherwise, the informal review has no time limit and this stage can take substantial time.<sup>91</sup> Over the past three years, the Department has taken steps to streamline the informal process and remove bottlenecks where legally permissible, but, as indicated by the number of 2009 protests still on the docket, these efforts have had limited success.

### C. An Independent Appeals Board

The principle that the tax appeals board must be a body that is independent of the tax collection agency is perhaps the most important principle of the Model Act.<sup>92</sup> Without an independent appeals board, the system appears biased towards the Department, even if the decision makers consciously strive for objectivity.<sup>93</sup> The current Iowa tax appeals process is not wholly-independent because the Director of the Department is a decision maker at one level of the appellate process.

The informal stage is the first opportunity for the Director to participate in the protest by dismissing the protest under certain circumstances. The Director may dismiss the protest if the protest was not timely filed or if the protester fails to pursue the protest.<sup>94</sup> Grounds for a dismissal based on a failure to pursue include the failure to present evidence or information requested by the Review Unit during the informal stage.<sup>95</sup> A protest may also be dismissed by the Director if the protest is not in the format required by the Department rules.<sup>96</sup> If the Department files a motion to dismiss, the taxpayer has twenty

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<sup>89</sup> *Id.* r. 701—7.11(1)“b”.

<sup>90</sup> *Id.* r. 701—7.12(6) (“[I]f a taxpayer makes a written demand for a contested case proceeding, as authorized by rule 701—7.14(17A), after a period of six months from the filing of a proper protest, the department shall file its answer within 30 days after receipt of the demand.”).

<sup>91</sup> *See id.* r. 701—7.11.

<sup>92</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 1 (“By establishing an independent tax tribunal within the executive branch of government, this Act provides taxpayers with a means of resolving controversies that insures both the appearance and the reality of due process and fundamental fairness.”).

<sup>93</sup> Douglas L. Lindholm et al., *supra* note 5 at 6.

<sup>94</sup> IOWA ADMIN. CODE r. 701—7.11(2)“a” (2013).

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*



days to file a motion to resist.<sup>97</sup> If the taxpayer does not resist, the Director must enter an order to dismiss.<sup>98</sup> If the protest is dismissed, the taxpayer may file an application for reinstatement of the protest for good cause within thirty days.<sup>99</sup> While the Director's role at this stage is not to reach a legal conclusion on the merits of the protest, permitting the Director to decide procedural issues compromises the independence of the process somewhat. However, such decisions may be reviewed independently by an ALJ from the AHD at the taxpayer's request.<sup>100</sup>

The Director's authority becomes more significant once a matter moves to contested case proceedings. If the matter cannot be resolved informally, the Department must file an answer to the protest with its Hearing Section, which begins the contested case proceedings.<sup>101</sup> At this point, the Department's Hearing Section transfers the case to the AHD to be set for a hearing before an ALJ.<sup>102</sup> Alternatively—though rarely utilized in practice—the Director has the authority to retain a case rather than refer it to the AHD.<sup>103</sup> If this procedure is utilized, the taxpayer does not get the benefit of the initial independent review.

The AHD has some features that promote independent decisionmaking. First, it is part of DIA, which is an independent agency within the executive branch.<sup>104</sup> Second, the AHD hears disputes between Iowans and state agencies, including but not limited to disputes between taxpayers and the Department.<sup>105</sup> Third, the AHD offices are located in a building separate from the offices of the Department.<sup>106</sup> Despite these independent characteristics, the treatment of the ALJ's decision undermines the ALJ's independent authority. The ALJ issues a "proposed decision" after presiding over a contested case hearing.<sup>107</sup> The "proposed decision" then becomes the final decision of the Department without further proceedings unless the taxpayer or the Department files an appeal within thirty days.<sup>108</sup> Under this system, the "proposed decision" may never become the final decision of the Department. While the "proposed decision" concept provides deference to the Department's subject matter expertise, it also undermines the value of an independent hearing by an ALJ.

Either the taxpayer or the Department can appeal the ALJ's decision to the Director. On appeal, the Director "has all the power which [he or she] would have in initially making

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<sup>97</sup> *Id.* r. 701—7.11(2)"b".

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* r. 701—7.11(2)"a".

<sup>100</sup> *Id.* r. 701—7.11(2)"b"—"c". The AHD is discussed at greater length below.

<sup>101</sup> *Id.* r. 701—7.12, .14.

<sup>102</sup> *See id.* r. 701—7.14 (2013).

<sup>103</sup> IOWA CODE § 17A.11(1)(a) (2013); IOWA ADMIN CODE r. 701—7.17(1)–(2) (2013).

<sup>104</sup> *See* IOWA CODE ch. 10A (2013).

<sup>105</sup> *See id.*; *see also generally* Iowa Admin. Code ch. 701—7 (2013).

<sup>106</sup> *See* IOWA CODE § 10A.801(3)(a) (2013) ("[A]n administrative law judge ... shall be located in an office that is separated from the offices of the agencies for which that person acts as a presiding officer.").

<sup>107</sup> IOWA CODE § 17A.15(2) (2013).

<sup>108</sup> *Id.* § 17A.15(3); IOWA ADMIN. CODE r. 701—7.17(8)"d" (2013).

the final decision.”<sup>109</sup> “The agency may reverse or modify any finding of fact if a preponderance of the evidence will support a determination to reverse or modify such a finding, or may reverse or modify any conclusion of law that the agency finds to be in error.”<sup>110</sup> The Director may overturn the conclusions of law made by the ALJ if they are “in error,” which is a low standard of review that minimizes the value of the hearing before the independent ALJ.<sup>111</sup> The Director may not discuss the specific details of tax appeals with other interested Department employees.<sup>112</sup> However, the Director’s role as leader of the Department, while deciding whether the Department acted in error, creates at least the appearance of a system biased toward the Department.

The Board provides the taxpayer with another opportunity for independent review. The Board has several duties, including conducting hearings and hearing appeals.<sup>113</sup> If the ALJ rules against the taxpayer, the taxpayer may bypass the Director and appeal to the Board.<sup>114</sup> Also, if the Director rules against the taxpayer, the Board may review the decision “[u]pon its own motion or upon appeal by any affected taxpayer.”<sup>115</sup> The Board is a Governor-appointed board of volunteers.<sup>116</sup> It has some characteristics of autonomy, but it also has ties to the Department. The Department, for example, provides office space for the Board’s hearings, supplies administrative services to the Board, and pays all expenses of the Board.<sup>117</sup>

Overall, the Board and the AHD provide the taxpayer with opportunities for independent review; however the Director’s role in the process creates, at a minimum, the appearance of a less-than-independent process. The Director’s ability to overrule the ALJ under a low standard of review further lessens the value of that independent review. On the other hand, the taxpayer’s right to appeal the decision of the Director to an independent body enhances the independence of the process somewhat.

#### D. Judges with Specialized Expertise

Another principle of the Model Act is that those deciding the cases must have substantial tax expertise.<sup>118</sup> This provision recognizes the complexity and ever-changing nature of tax law.<sup>119</sup> Judges that are tax experts should produce decisions firmly grounded in tax law, which will develop a sound body of precedent and improve the public’s perception of the fairness of the system.<sup>120</sup> A judge with tax expertise should also reach

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<sup>109</sup> IOWA CODE § 17A.15(3) (2013).

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* § 17A.17; IOWA ADMIN. CODE r. 701—7.22 (2013).

<sup>113</sup> IOWA CODE § 421.1(4)(d), .1(5) (2013).

<sup>114</sup> *Id.* § 421.1(5)(a).

<sup>115</sup> *Id.* § 421.1(5).

<sup>116</sup> IOWA ADMIN. CODE r. 701—1.1 (2013).

<sup>117</sup> *See id.*

<sup>118</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 4(a).

<sup>119</sup> Douglas L. Lindholm et al., *supra* note 5 at 6.

<sup>120</sup> Garland Allen & Craig B. Fields, *supra* note 3 at 87–88.

decisions more quickly than a judge who must learn a substantial body of law to formulate a decision.

Although the ALJs who hear tax matters develop expertise over time, tax knowledge is not a prerequisite under Iowa law.<sup>121</sup> The AHD merely must “facilitate, insofar as practicable, specialization by its administrative law judges so that particular judges may become expert in presiding over cases in particular agencies.”<sup>122</sup> Additionally:

An agency may, by rule, identify particular classes of its contested cases for which the administrative law judge who acts as presiding officer shall have specified technical expertness. After the adoption of such a rule, the division may assign administrative law judges to preside over those identified particular classes of contested cases only if the administrative law judge possesses the technical expertness specified by agency rule....<sup>123</sup>

However, the Department has no such requirements.<sup>124</sup>

The Board is also not required to have tax expertise.<sup>125</sup> The three board members are only required to be registered Iowa voters, and they cannot hold any other elective or appointive office.<sup>126</sup>

The fact that neither the ALJs nor the Board members are required to be tax experts increases the likelihood that their decisions may not be firmly grounded in tax law and also lengthens the time it takes the arbiter to reach a decision.

#### E. Decisions Appealable to State District Court

The Model Act also contemplates that decisions should be appealable to the state district court.<sup>127</sup> Iowa already offers such judicial review.<sup>128</sup> If the ALJ rules in favor of the Department, the taxpayer may appeal to the Director or the Board and from there to district court.<sup>129</sup> The Taxpayer may also bypass the Director and the Board and appeal directly to district court.<sup>130</sup> The Department cannot appeal the Director’s decision, but can appeal an unfavorable decision by the Board to district court.<sup>131</sup> From district court, either party can appeal to the Iowa Supreme Court.<sup>132</sup>

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<sup>121</sup> See IOWA CODE § 10A.801(3)(b) (2013).

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> See generally, IOWA ADMIN. CODE ch. 701—7 (2013).

<sup>125</sup> IOWA CODE § 421.1 (2013).

<sup>126</sup> *Id.*

<sup>127</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 15(a).

<sup>128</sup> IOWA CODE § 17A.19 (2013).

<sup>129</sup> See generally, IOWA ADMIN. CODE ch. 701—7 (2013).

<sup>130</sup> See *id.*

<sup>131</sup> *Id.* § 421.1(5)(c).

<sup>132</sup> See *id.* ch. 625A.

## F. The Burden of Proof and the Scope of Judicial Review

The Model Act generally places the burden of proof upon the taxpayer, except in cases of fraud and certain other circumstances.<sup>133</sup> The Act establishes the standard of proof for the taxpayer as “preponderance of the evidence.”<sup>134</sup>

Like the Model Act, Iowa generally assigns the burden of proof to the taxpayer,<sup>135</sup> and the evidentiary standard is “preponderance of the evidence.”<sup>136</sup> Iowa also assigns the burden of proof to the Department in specific circumstances.<sup>137</sup> For example, the Department must prove fraud by “clear and convincing evidence.”<sup>138</sup> The Department must carry the burden of proof in certain other circumstances as well.<sup>139</sup>

The IAPA sets forth the scope of judicial review.<sup>140</sup> In many cases, the scope is deferential to the agency.<sup>141</sup> The deferential scope of review reflects the substantial authority the legislature grants agencies to interpret the laws they must administer.<sup>142</sup> The legislature has granted the Department “the power and authority to prescribe all rules not inconsistent with the provisions of [chapter 422], necessary and advisable for its detailed administration and to effectuate its purposes.”<sup>143</sup> The Director also has the power to interpret the Code to determine a taxpayer’s liability.<sup>144</sup> The Iowa Supreme Court has recognized the Department’s discretion to interpret the chapters it governs.<sup>145</sup> In matters where the legislature has clearly vested in the Department the authority to interpret the statutory language, the court may only reverse the Department’s interpretation of the law if it is “irrational, illogical, or wholly unjustifiable.”<sup>146</sup> In matters where the legislature has not clearly vested authority to interpret in the Department, the court must reverse the Department’s decision if the Department committed “an erroneous interpretation of a provision of law.”<sup>147</sup>

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<sup>133</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 12(g).

<sup>134</sup> *Id.*

<sup>135</sup> IOWA CODE § 421.60(6)(c) (2013).

<sup>136</sup> *Arora v. Board of Medical Examiners*, 564 N.W.2d 4, 6 (Iowa 1997)(citing *Eaves v. Board of Medical Examiners*, 467 N.W.2d 234, 237 (Iowa 1991)).

<sup>137</sup> IOWA CODE § 421.60(6) (2013).

<sup>138</sup> *Id.* § 421.60(6)(a).

<sup>139</sup> *Id.* § 421.60(6)(b) (generally placing the burden of proof on the Department “where the assessment was not made within six years after the return became due”).

<sup>140</sup> *See id.* § 17A.19(10) (2013).

<sup>141</sup> *See id.*

<sup>142</sup> *See Renda v. Iowa Civil Rights Comm’n*, 784 N.W.2d 8, 10–14 (Iowa 2010).

<sup>143</sup> IOWA CODE § 422.68(1). Chapter 422 governs income tax, however this section is made applicable to the sales tax by cross reference in Iowa Code section 423.42.

<sup>144</sup> *Sherwin-Williams Co. v. Iowa Dep’t of Revenue*, 789 N.W.2d 417, 423 (Iowa 2010) (citing IOWA CODE § 422.70).

<sup>145</sup> *See, e.g., Ranniger v. Iowa Dep’t of Revenue & Fin.*, 746 N.W.2d 267, 268 (Iowa 2008); *City of Sioux City v. Iowa Dep’t of Revenue & Fin.*, 666 N.W.2d 587, 590 (Iowa 2003).

<sup>146</sup> IOWA CODE § 17A.19(10)(l) (2013).

<sup>147</sup> *Id.* § 17A.19(10)(c).

## G. The Length of the Process

Although the Model Act provides no specific time limits for a fair and independent process, it does address some issues related to lengthiness by including an informal stage and a small claims procedure. The Department uses an informal stage, but currently Iowa does not have a separate process for small claims.

Some aspects of the appeals process are inherently lengthy. The Department often must conduct an intense factual investigation in order to apply complex and detailed tax laws. Over the years, the Department has modernized a number of processes to lessen the work needed to complete an audit. This has resulted in a greater volume of audits and a corresponding increase in the number of appeals. While the Department and the taxpayer spend fewer hours working on each audit, the end result has been a backlog of inactive protests and a longer length of time to resolve protests.

Some aspects of the current Iowa appeals process aim to address its length, but these options have advantages and disadvantages for the taxpayer. The taxpayer may negotiate an informal resolution with the Department, which aims at limiting the cost and length of the appeals process. However, many tax issues are fact-intensive, and the parties may need to spend significant time gathering facts at the informal stage. Furthermore, the parties may still require litigation to settle issues after the informal process. In the alternative, the taxpayer may force a case into formal litigation by waiving the informal stage, which requires the Department to file an answer within six months.<sup>148</sup> Yet, depending on the circumstances of the case, the litigation process will likely be more costly and time-consuming than simply resolving the matter informally. When a matter enters litigation, the taxpayer can expedite the case by bypassing the Director and the Board to appeal the decision of the ALJ directly to state district court. However, judicial review can be even more expensive and onerous than the administrative process.

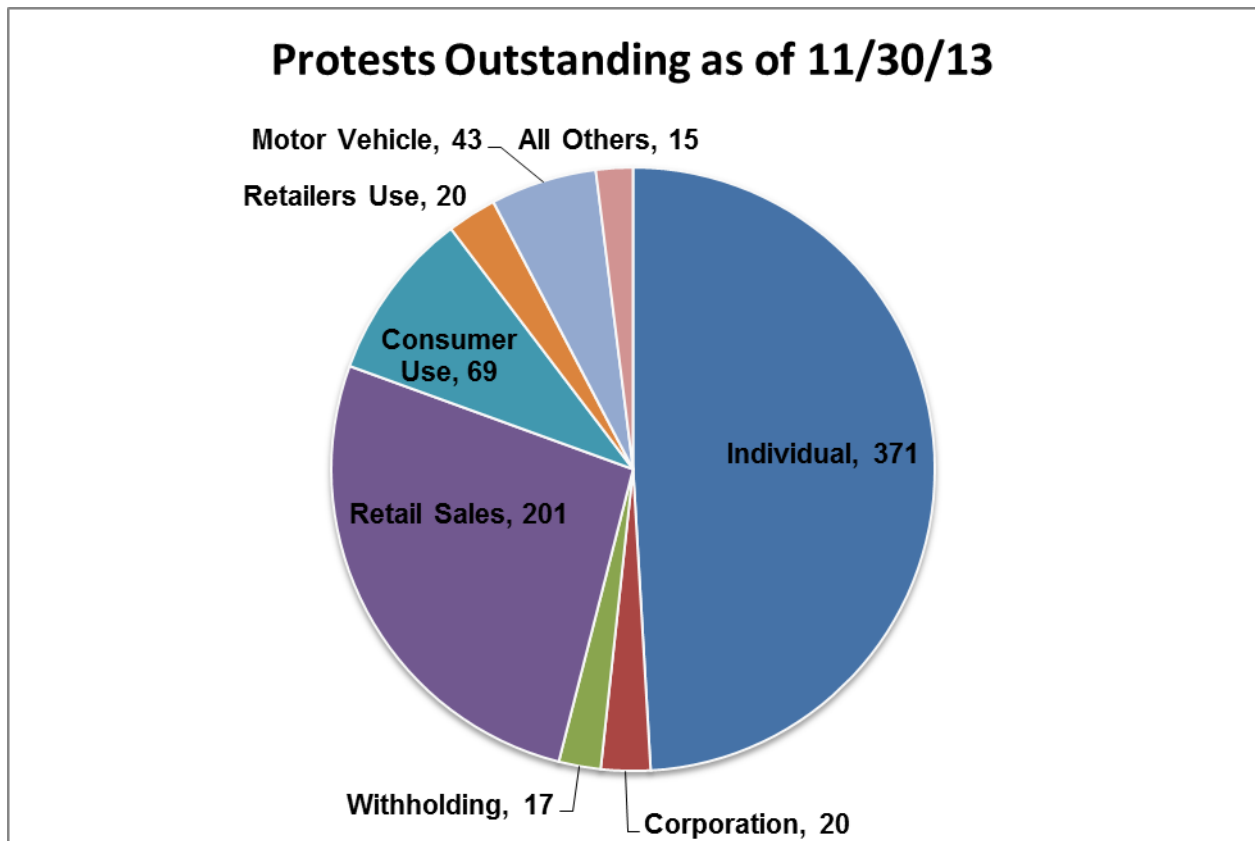
The Department has recently adjusted the appeals process to shorten the review time without the need for amendments to statutes or administrative rules. The Department held two “LEAN” events to study the existing process, which helped the Department eliminate redundancies and implement automated procedures where possible. The Department also improved coordination between the Audit Services Section of its Policy and Communications Division (which houses the Review Unit) and its Compliance Division to ensure consistency and to help prevent issues from becoming protests. Recently, the Department has authorized overtime for work exclusively on protests, enabling staff to work during off-peak hours with fewer distractions. The Audit Services Section has also received research assistance from senior Taxpayer Service Specialists to assist with initial protest review and has held meetings to review all protests with similar issues in one group effort. These adjustments have helped to reduce the protest backlog, but more substantial changes are needed.

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<sup>148</sup> IOWA ADMIN. CODE r. 701—7.12(6) (2013).

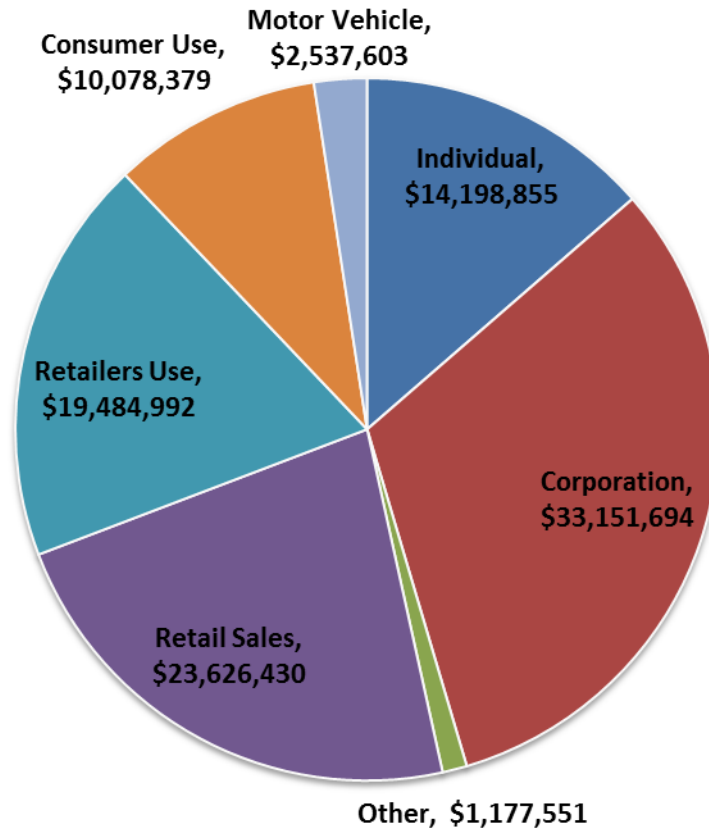
## V. Statistical Analysis of the Iowa Department of Revenue's Current Appeals Process

The following charts summarize the number of protests by subject matter, the age of the protests currently under review, and provide data related to the dollar amounts involved in protests by various categories. For purposes of this analysis, dollar values are the amounts assessed by the Department.

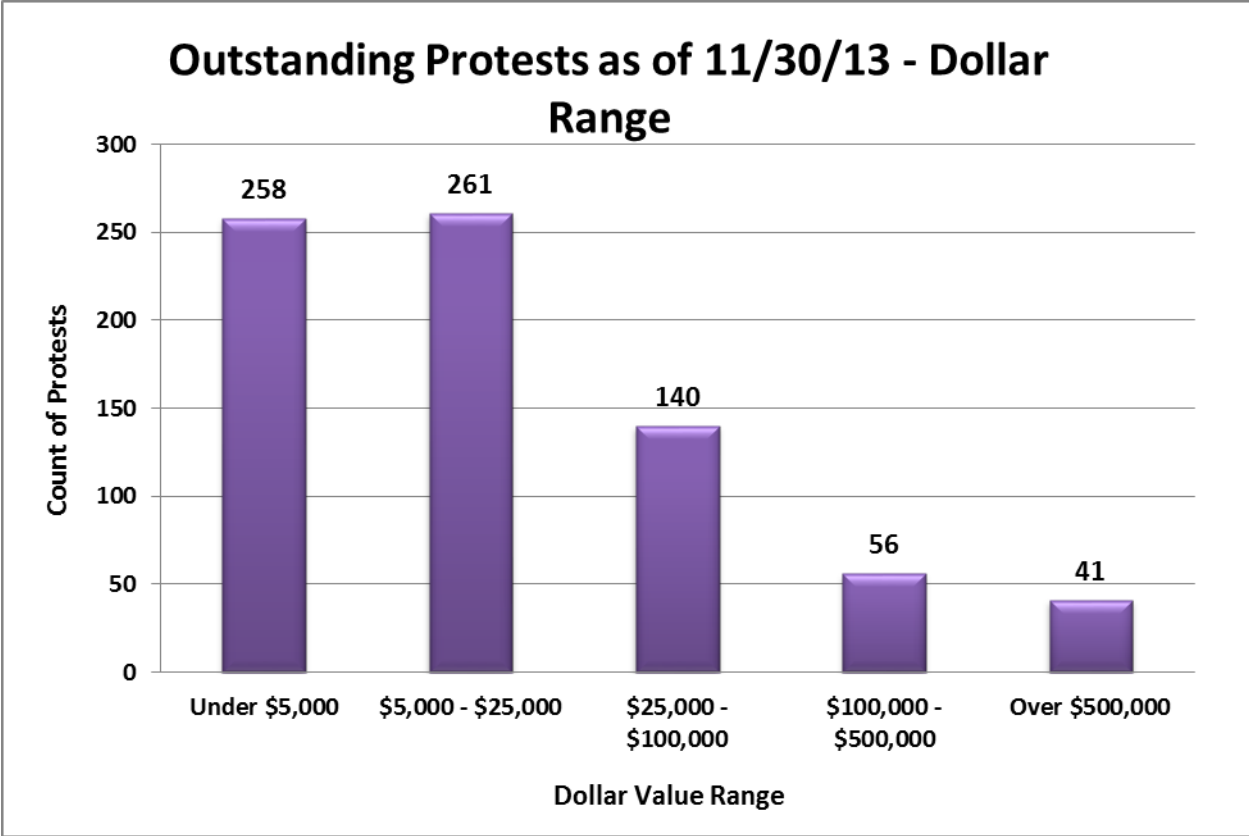


- As of November 30, 2013, there were 756 protests, at various stages of the appeals process.
- Ninety-three percent of the protests are either individual income or sales/use tax.
- Of the 333 sales/use tax protests, 193 relate to field audits, 59 relate to denied refund claims, and 81 relate to desk audits of sales tax (which often are recaptures of refunds previously issued).
- Of the 371 individual income tax protests, 113 relate to non-filers (primarily nonresidents with Iowa source income) and 93 relate to the capital gain deduction. All other issues account for less than twenty protests each.

## Protest Dollars at Issue as of 11/30/13

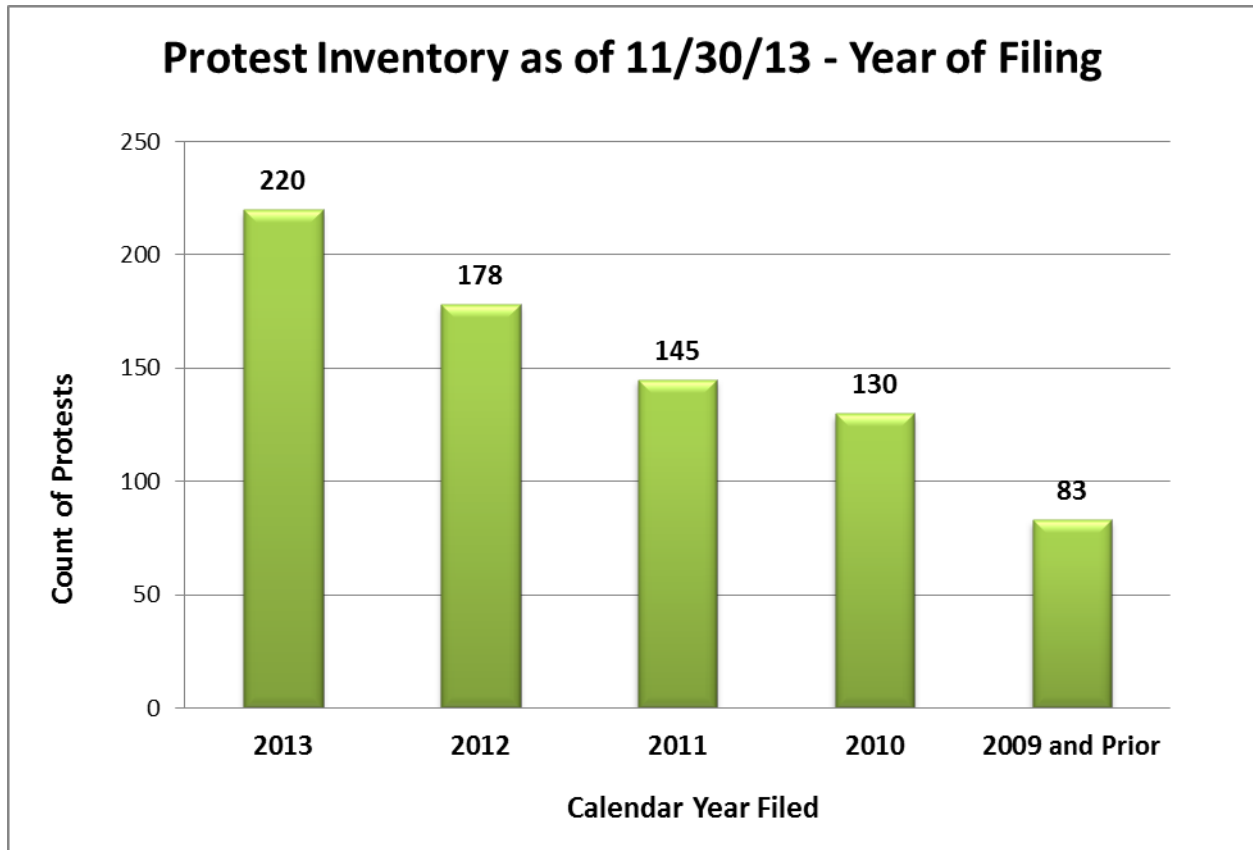


- Only twenty protests involve corporation income tax, but this tax type involves the highest dollar amounts, and some of the most complex issues.



- Of the 371 individual income tax protests, 140 involved less than \$5,000 and 161 involved between \$5,000 and \$25,000. Only 70 involved more than \$25,000, of which 54 involved between \$25,000 and \$100,000.
- Of the 333 sales/use tax protests, 125 involved less than \$5,000, 73 involved between \$5,000 and \$25,000, 69 involved between \$25,000 and \$100,000, 40 involved between \$100,000 and \$500,000, and 26 involved more than \$500,000.





- Of the 756 protests, 220 were filed in 2013, 178 were filed in 2012, 145 were filed in 2011, 130 were filed in 2010, and 83 were filed in 2009 or earlier.

*Detailed Statistics Related to Protests Filed in 2009 or Prior*

- As of December 2, 2013, there are 83 protests that were filed in 2009 or prior.
- Of these 83, 64 are individual income tax protests, 16 are sales/use tax protests, and 3 are corporation income tax protests.
- Of the 64 individual income cases, 36 involve one group of taxpayers for which an administrative law judge hearing was held earlier this year. Four of the protests were presented in that hearing. The remaining thirty-two will be decided based on the outcome of that hearing.
- Twelve individual income cases involve the capital gain deduction. Only one of those cases is in litigation.
- Of the sales/use tax protests, only one case is currently in litigation.
- The corporation income tax cases involve nexus issues. None of the corporation income tax cases are in litigation at this time.
- The total value of the three corporation income tax protests from 2009 and before is \$2,495,028.
- The total value of the 16 sales/use tax protests from 2009 and before is \$6,709,117.
- The total value of the 64 individual income tax protests is \$1,381,736.

### *Assessments v. Refunds*

- Of the 756 protests, 576 relate to assessments and 180 relate to refund claims.
- Assessment dollars in protest total \$69,970,697 and refund dollars in protest total \$34,284,807.
- Of the 333 sales/use tax protests, 130 are related to refund claims and 203 are related to assessments.
- Of the 16 sales/use tax protests filed in 2009 or prior, 9 are related to assessments and 7 are related to refunds. Assessment dollars in protest total \$3,297,015. Refund dollars in protest total \$3,403,620.

### *Protest Resolution*

- Over the last few years, the average time to resolve a protest has been eighteen months. This does not vary much between the various tax types.
- Of the 648 protests resolved from January 1, 2012 through November 30, 2013, 600 were resolved through the informal process. Of that 600, the taxpayer ultimately prevailed in 208, the Department prevailed in 168, 219 were settled or had mixed results, and 5 were dismissed because they were not filed in the proper format.
- Of the 648 protests resolved from January 1, 2012 through November 30, 2013, 41 went to contested case proceedings and 7 advanced to judicial review in district court and beyond. Of that 41 that went to contested case, the Department prevailed in 32 cases, 5 were settled or had mixed results, and the taxpayer prevailed in 4. Of the 7 cases that advanced to judicial review, the Department prevailed in all 7.

## **VI. Recommendations**

Based on its review of the current system, and also upon the input of the Advisory Panel and the Board, the Department recommends the following changes to Iowa's tax appeals process:

- Implement a small claims process;
- Remove the Director stage of appeal;
- Eliminate the State Board of Tax Review; and
- Enhance the training and expertise requirements of the ALJs who hear tax matters.

An explanation of each recommendation is provided below.

### A. Implement a Small Claims Process

The Department recommends creating a small claims process. The ABA also recommends a small claims process in the Model Act.<sup>149</sup> A small claims process could quickly and efficiently adjudicate a large number of protests involving lower dollar amounts. A small claims process also provides an attractive forum for the many protesters with lower dollar protests who insist on an independent hearing rather than settling matters informally.

Department statistics show approximately two-thirds of all protests involve amounts in dispute of \$25,000 or less, and one-third of all protests involve amounts in dispute of \$5,000 or less. Pro se taxpayers brought sixty-three percent of the cases certified to the AHD for contested case proceedings between 2008 and 2013.<sup>150</sup> Many of these pro se taxpayers reject negotiations through the informal process because they prefer an independent arbiter. Implementing a small claims procedure would encourage the parties to move a case to hearing more quickly when the parties clearly cannot reach an informal resolution. The informal process can take months and even years. Creating a small claims system that expedites the time to hearing could significantly reduce the Department's protest docket.

Although most aspects of the small claims process could be implemented by rule under the Department's existing authority, the Department seeks clear legislative authority to develop a small claims process. The Department is currently working with the Legislative Services Agency "LSA" to draft statutory language. Through the rulemaking process, the Department will work with stakeholders to develop the parameters of the small claims process.

### B. Remove the Director Level of Appeal

The Department recommends removing the Director from the contested case appeals process. Both the Advisory Panel and the Department agree the Director's authority to review the decisions of the ALJ undermines the value of an independent hearing and creates, at the very least, the appearance of bias towards the Department. An independent tax appeals process is also a central feature of the Model Act.<sup>151</sup>

Taxpayers already have the right to bypass the Director. Members of the Panel were of the opinion that the Director stage of appeal provides little value. The Department utilizes the option of appeal to the Director on occasion when an unfavorable decision is received from the ALJ; however, generally taxpayers appeal any decision that the Director reverses in the Department's favor.

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<sup>149</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 14.

<sup>150</sup> The AHD provided this information, which is accurate as of August 8, 2013.

<sup>151</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 2.

Eliminating the Director's role in the appeals process will reduce the perceived bias of the system. It will also allow the Director to take an active role in the Department's review of protests. Allowing the Director to provide input on pending cases will ensure the Department only pursues cases when the Director supports the staff's interpretation of the relevant laws. Additionally, this recommendation would shave months off the appeals process for an individual case. Currently, the taxpayer must appeal a decision from the ALJ to the Director within thirty days.<sup>152</sup> However, Iowa law places no deadline for the Director to set a hearing.<sup>153</sup> After the hearing, the Director need only issue an opinion within a "reasonable amount of time."<sup>154</sup> Typically, this process takes several months.

The Director should retain the authority to dismiss protests at the informal stage for failure to pursue and failure to file the protest in the proper format. This authority does not compromise the independence of review of the merits of the case. Shifting this role to the ALJ would place additional burdens on the AHD and delay the resolution of appeals, which would defeat the goals of reform. Additionally, taxpayers would retain the right to appeal Orders to Dismiss to the AHD which provides an independent review of the Director's decision.

This recommendation would require a legislative amendment. The Department is currently working with the LSA to draft language.

### C. Eliminate the State Board of Tax Review

The Department recommends eliminating the Board. The role of the Board has diminished since the adoption of the IAPA in 1974. Initially, one of its primary roles was the review of administrative rules.<sup>155</sup> The ARRC has since inherited the duty to review administrative rules.<sup>156</sup> Members of the Advisory Panel also indicated the value of the Board further diminished in 2004 when the Department gained the right to appeal decisions of the Board to district court. Additionally, Iowa law does not require Board members to have tax expertise.<sup>157</sup> The Board may overturn a decision of the Director despite a potential lack of tax expertise, which raises concerns about the quality and value of its review. Finally, taxpayers rarely use the Board, and the Board almost never changes the outcome of a case.

The Board stage of the appeals process can take several months. The taxpayer has thirty days to appeal a decision of the Director to the Board.<sup>158</sup> Following the filing of that appeal, the Board determines a briefing and argument schedule for the matter.<sup>159</sup> The Board must give the Department and the taxpayer at least fifteen days' notice of the

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<sup>152</sup> IOWA ADMIN. CODE r. 701—7.17(8)"d" (2013).

<sup>153</sup> See generally *id.* r. 701—7.17.

<sup>154</sup> *Id.* r. 701—7.17(8)"h".

<sup>155</sup> IOWA CODE § 421.1 (1967).

<sup>156</sup> *Id.* § 17A.8.

<sup>157</sup> See IOWA CODE § 421.1 (2013).

<sup>158</sup> IOWA ADMIN. CODE r. 701—2.2(1) (2013).

<sup>159</sup> *Id.* r. 701—2.2(3).

hearing date.<sup>160</sup> Once the case is submitted, the Board has sixty days to issue a decision.<sup>161</sup> Some decisions take even longer. Combined, eliminating the Director and the Board from the appeals process would reduce the appeals timeframe by a year or more in some cases.

The Board is currently the hearing body of original jurisdiction for centrally-assessed property tax appeals. In nearly every case, the Board currently transfers these hearings to the AHD. If the legislature eliminates the Board, the AHD must become the hearing body of original jurisdiction for these appeals.

The public could view the elimination of the Director and Board level reviews as a repeal of taxpayer rights. Currently, taxpayers have three levels of formal administrative review—AHD, Director, and Board. Under the proposed structure, the AHD level of appeal would be retained to ensure that the taxpayer has one avenue of appeal prior to district court. Based on statistics, it appears that eliminating the Director and Board reviews would have little impact on the outcome of cases and could expedite the resolution process.

This recommendation requires a legislative amendment. The Department is currently working with the LSA to draft language.

#### D. Enhance the Training of the Administrative Law Judges

The Department recommends substantial training in tax law for the ALJs assigned to Department cases. ALJs could receive tax training through seminars, continuing legal education, and similar forums. The Department also recommends the AHD take steps to identify and select candidates with tax expertise to fill administrative law judgeships as they open.

The Model Act recommends every judge possess “substantial knowledge of the tax law and substantial experience making the record in a tax case suitable for judicial review.”<sup>162</sup> The Department recognizes the value of the Model Act’s recommendation, but it may be unachievable within the existing DIA, AHD system. DIA’s current model is cost effective. During fiscal years 2012 and 2013, the Department spent \$41,309.48 and \$39,814.66 respectively on all DIA services, including sales tax permit revocation hearings.<sup>163</sup> Creating a judicial body devoted to tax appeals would add considerable expense to the system. Additionally, the size of the Department’s caseload may not justify devoting an ALJ solely to tax appeals. The Department’s recommendation, though less stringent than the Model Act, would substantially improve the current system.

The Department and DIA have agreed to enhance the training of ALJs. Therefore, implementing this recommendation does not require a legislative change at this time.

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<sup>160</sup> IOWA CODE § 421.1(5) (2013).

<sup>161</sup> *Id.*

<sup>162</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 4(a).

<sup>163</sup> Sales tax revocation hearings are beyond the scope of this report.

Some members of the Advisory Panel believe the Department's recommendation is insufficient. Those members think the goals of reform require an ALJ with a background in tax law. According to those members, an ALJ needs years of specialization in tax law, and not just enhanced training, to become an expert in the field. Those members recommend DIA maintain at least a part-time ALJ with substantial experience and expertise in tax law.

## **VII. Conclusion**

The tax appeals study illuminated a number of improvements that are likely to make the appeals process more efficient and independent for Iowa's taxpayers. Some of the improvements will be made through the rulemaking process under the Department's existing authority. For those changes that require statutory changes, the Department is in the process of drafting legislation with the LSA.

While implementing any one of the recommendations described above would substantially improve the current system, all of the recommendations are necessary to establish a more efficient, more independent tax appeals process. The Department's study demonstrates that Iowa's current system is inefficient and publicly-viewed as biased towards the Department. Iowa's system also lags behind the national trend of adopting more independent procedures. Adopting the Department's recommendations would improve the efficiency of the Department, allowing it to better allocate its resources and to improve customer service to taxpayers.

## APPENDIX “A”

The following are highlights of the American Bar Association Model Act:

- A taxpayer does not have to pay or post a bond for an asserted tax liability in order to obtain a hearing and decision from the tribunal.<sup>164</sup>
- The tax tribunal has exclusive jurisdiction in all cases involving “questions of law and fact arising under the tax laws of this State,” unless otherwise provided by law.<sup>165</sup>
- The tribunal shall be separate from and independent of the authority of the director of and the department of revenue.<sup>166</sup>
- Every judge must have “substantial knowledge of the tax law and substantial experience making the record in a tax case suitable for judicial review.”<sup>167</sup>
- The tax collection agency must offer an informal review and opportunity to settle based on the hazards of litigation.<sup>168</sup>
- Parties must accomplish discovery by informal means before using formal discovery methods and must stipulate the relevant facts as much as possible.<sup>169</sup>
- The taxpayer bears “the burden of persuasion by a preponderance of the evidence in the record, except that the [department of revenue] shall have the burden of persuasion in the case of an assertion of fraud and in other cases provided by law.”<sup>170</sup>
- Taxpayer may pay the tax at issue in order to stop the further accrual of interest or penalties without “mooting” the proceeding.<sup>171</sup>
- Decisions must be written<sup>172</sup> and published.<sup>173</sup>
- A small claims division must give taxpayers the option of proceeding through that division in matters involving \$25,000 or less.<sup>174</sup> The decision may not be appealed, may not be considered precedent, and is not required to be published.<sup>175</sup>
- The tax tribunal must be located in the executive branch.<sup>176</sup>
- A taxpayer may be represented before the tribunal “by the taxpayer, by an attorney admitted to practice in this state...by an accountant licensed in this

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<sup>164</sup> MODEL STATE ADMIN. TAX TRIBUNAL ACT § 7(c).

<sup>165</sup> *Id.* § 7(a)–(b).

<sup>166</sup> *Id.* § 2(b).

<sup>167</sup> *Id.* § 4(a).

<sup>168</sup> *Id.* § 8.

<sup>169</sup> *Id.* § 11.

<sup>170</sup> *Id.* § 12(g).

<sup>171</sup> *Id.* § 7(d).

<sup>172</sup> *Id.* § 13(a).

<sup>173</sup> *Id.* § 17.

<sup>174</sup> *Id.* § 14(c).

<sup>175</sup> *Id.* § 14(h).

<sup>176</sup> *See id.* § 2(a)–(b).

State...or by an enrolled agent authorized to practice before the Internal Revenue Service.”<sup>177</sup> Attorneys and accountants licensed by other states may appear *pro hac vice*.<sup>178</sup>

- The State, as well as the taxpayer is allowed to appeal the decision of the tribunal to district court.<sup>179</sup>

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<sup>177</sup> *Id.* § 16(a).

<sup>178</sup> *Id.* The AICPA recommendation uses the following language: “Appearances in proceedings conducted by the Tax Tribunal may be by the taxpayer, by an attorney admitted to practice in this State..., by a *certified public accountant licensed or authorized to practice in this State under the State’s accountancy laws...*” AICPA, *State Tax Tribunals* (June 20, 2012), <http://www.aicpa.org/Advocacy/Tax/StateLocal/Pages/StateTaxTribunals.aspx> (emphasis added).

<sup>179</sup> *Id.* § 15(a).



## APPENDIX “B”

*State Board of Tax Review’s duties as described originally in Iowa Code section 421.1 (1967), numbered paragraphs 1-6.*

1. Determine and adopt such policies as are authorized by law and are necessary for the more efficient operation of any phase of tax review.

2. Perform such duties prescribed by law as it may find necessary for the improvement of the state system of taxation in carrying out the purposes and objectives of the tax laws.

3. Review for approval or rejection all rules and regulations for the collection of taxes by the department and revision of tax forms proposed by the director of revenue.

4. Employ, pursuant to the Iowa merit system, adequate clerical help to keep such records as are necessary to set forth clearly all actions and proceedings of the state board.

5. Advise and counsel with the director of revenue concerning the tax laws and the regulations adopted pursuant thereto; and, upon their own motion or upon appeal by any affected taxpayer, review the record evidence and the decisions of, and any orders or directive issued by, the director of revenue for the assessment and collection of taxes by the department or an order to reassess or to raise assessments to any local assessor and shall expeditiously affirm, modify, reverse or remand the same. In order for any appeal to the board to be valid, written notice thereof must be given to the department within thirty (30) days of the rendering of the decision, order or directive from which such an appeal is taken. The director shall thereafter cause to be certified to the board the record, documents, reports, audits and all other information pertinent to the decision, order or directive from which such appeal is taken.

The affected taxpayer and the department shall be given at least fifteen (15) days written notice by the board of the date the appeal shall be heard and both parties may be present at such hearing if they desire. The board shall adopt and promulgate, pursuant to chapter seventeen A (17A) of the Code, rules and regulations for the conduct of appeals by the board. The record and all documents, reports, audits and all other information certified to the board by the director, and hearings held by the board pursuant to the appeal and the decision of the board thereon shall be open to the public notwithstanding the provisions of sections four hundred twenty-two point sixty-five (422.65), subsection one (1), and four hundred twenty-two point twenty (422.20) of the Code; except that the board upon the application of the affected taxpayer may order the record and all documents, reports, audits, and all other information certified to it by the director, or so much thereof as it deems necessary, held confidential, if the public disclosure of the same would reveal trade secrets or any other confidential information that would give the affected taxpayer’s competitor a competitive advantage. Any deliberation of the board in reaching a decision on any appeal shall be confidential.

6. Adopt a long-range program for the state system of tax reform based upon special studies, surveys, research, and recommendations submitted by or proposed under the direction of the director of revenue.

The state board shall constitute a continuing research commission as to tax matters in the state and cause to be prepared and submitted to each regular session of the general

assembly a report containing such recommendations as to revisions, amendments, and new provisions of the law as the state board has decided should be submitted to the legislature for its consideration.