

Illinois's New Independent Tax Tribunal

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Introduction

With Public Act 97-1129 signed and effective on August 28, 2012, Illinois has established the Independent Tax Tribunal to largely replace the system of administrative hearings conducted by the Illinois Department of Revenue. Establishment of the tribunal dramatically changes Illinois tax administration. It will affect how taxpayers and practitioners approach tax planning, audits, and controversies.

Overview of the Tribunal

The tribunal will consist of up to four administrative law judges. Each ALJ must be an experienced tax attorney. The tribunal is independent of the department and will have offices in Chicago and Springfield. After July 1, 2013, all protests of assessments or denials of refund claims for taxes administered by the department (except property tax cases) involving more than \$15,000 will be heard by the tribunal. Taxpayers who use the tribunal will not be required to prepay the assessment. However, taxpayers do retain the right to use the existing process of paying an assessment under the Protest Monies Act (30 ILCS 230/1 et seq.) and having the case decided by a circuit court judge.

The tribunal will not hear all tax cases. It will not hear protests of property tax assessments, nor will it decide taxpayer claims to exempt status from local property tax or any tax administered by the department. For example, claims that a hospital should be exempt under the Property Tax Code or that a charity qualifies for a sales tax exemption will continue to be decided by the department's administrative hearings process. Finally, the department

will keep its jurisdiction over cases when the amount at issue is less than \$15,000.¹

The tribunal lacks the power to declare a statute invalid on its face as violating the state or federal constitutions. It may, however, decide that a statute is unconstitutional and invalid as applied to a specific taxpayer.

In terms of procedure, the tribunal will use the same rules of discovery and evidence applicable to trials in Illinois circuit courts, and its hearings and records will generally be open to the public. An ALJ will decide each case with a published written decision. An appeal from the tribunal's decision will go directly to the Illinois Appellate Court. Taxpayers can represent themselves before the tribunal or can use a licensed Illinois attorney.

The Existing Process for Deciding Illinois Tax Controversies

The establishment of the tribunal affects one of the two options that Illinois taxpayers have had for contesting a proposed assessment by the department. First, the taxpayer can pay the assessment under protest and file suit in the circuit court under the Protest Monies Act to obtain a court holding on the taxpayer's liability. The legislation creating the tribunal leaves that option in place. Second, taxpayers could file with the department a protest against the assessment, in which case the question would be decided in a hearing before an ALJ in the department's Office of Administrative Hearings (OAH). For denials of refund claims, the taxpayer's only option was to contest the denial by requesting a hearing in the OAH. The tribunal largely replaces the OAH hearing process. An understanding of the

¹The tribunal also lacks jurisdiction to decide insurance tax matters (premium and retaliatory tax), which are administered by the Illinois Department of Insurance, and franchise tax disputes, which are administered by the Illinois secretary of state.

current OAH process will put the changes made with the creation of the tribunal into perspective.

Cases in the OAH are conducted before ALJs. The ALJs are experienced tax attorneys employed by the department. The administrative hearings are conducted in the department's offices in Chicago and Springfield. The taxpayer need not pay an assessment to bring its protest before the OAH. The administrative hearings process closely parallels a civil trial. Both the taxpayer and the department can engage in discovery, with depositions, requests for document production, and interrogatories. All the evidence that the taxpayer wants to submit in support of its position must be submitted in the administrative hearing if the taxpayer intends to seek judicial review of an adverse decision.

Following the hearing, the ALJ makes a written recommendation to the director of revenue. The director can accept the recommendation or modify it in any way he wants. Senior department attorneys participate in the director's review. As a result, even if the ALJ recommends a finding in favor of the taxpayer, the taxpayer cannot prevail if the department's senior staff disagrees with the recommendation.

The taxpayer may appeal to a circuit court an adverse decision issued by the director. In a sales tax case, the taxpayer must post a bond equal to the tax, penalty, and interest at stake in order to have the circuit court hear the case. Income tax cases do not require either payment of the tax or posting of a bond as a condition for circuit court review. The circuit court's review is based strictly on the evidence submitted at the administrative hearing. Except when the issue is a purely legal question, Illinois law provides that the circuit court should give a degree of deference to the department's administrative decision. In a close case, when the circuit court might have been inclined to rule in favor of the taxpayer if the circuit judge had been the first to hear the case, this deferential review requires the court to affirm the department's administrative decision unless the court concludes that the department's decision is "clearly erroneous."²

The Background for the Tribunal

The impetus for establishment of an independent tax tribunal in Illinois is no different from the thinking that has led a number of other states to create similar panels.³ There is a general perception that the department has an unavoidable conflict of

interest in administering a hearing system to decide protests of positions the department itself has taken. Many people believe that the department's ALJs, regardless of efforts to remain impartial, could not be independent of the department's influence. The ALJs share office space with the department's attorneys and senior administrators. There is a view that the ALJ's status as a department employee cannot help but color the ALJ's view of the facts and the law. Finally, even when an ALJ recommends a ruling in the taxpayer's favor, the director and his advisers have the final say in every case.

Taxpayers are dissatisfied with the expense involved in the administrative hearing system.

Also, taxpayers are dissatisfied with the expense involved in the administrative hearing system. The department's lawyers can take aggressive and costly discovery in OAH cases. The hearing before an OAH ALJ requires the same careful preparation as a circuit court trial. When the taxpayer appeals an adverse ruling to the circuit court, it incurs a new layer of expense. The circuit court judges' familiarity with tax law varies widely. Regardless of the particular judge's tax background, the taxpayer must do all it can to ensure that the circuit court judge fully understands the facts and the tax law governing the case. Finally, in cases other than income tax, the taxpayer must post a bond in the circuit court. As a result, a case that starts in the OAH can easily double the expense one could expect in dealing with a single-level administrative adjudication system.

Following a number of false starts, the movement toward an Illinois tribunal took off in the fall of 2011. Public Act 97-636 declared that after July 1, 2013, the department's ability to adjudicate tax controversies would terminate. The tribunal was to assume responsibility for hearing all protests of assessments issued by the department. Other than making these broad statements about the transfer of authority, the 2011 legislation left the details of the tribunal for later legislation.

Public Act 97-1129 establishes the detailed structure and jurisdiction of the tribunal. Two prominent taxpayer associations, the Illinois State Chamber of Commerce and the Taxpayers' Federation of Illinois, worked with the department and the General Assembly in drafting HB 5192. Gov. Pat Quinn (D) signed the bill on August 28. It took effect immediately.

²See, e.g., *City of Belvidere v. Ill. State Labor Relations Bd.*, 181 Ill. 2d 191, 692 N.E.2d 295 (1998); *Honeywell Int'l Inc. v. Dep't of Revenue of the State of Ill.*, No. 02 L 50519, slip op. at 3-4 (Cir. Ct. of Cook County, Ill. June 25, 2003).

³See generally W. Scott Wright, Jonathan A. Feldman, and Andrew D. Appleby, "Courting Independence: The Rise of (Footnote continued in next column.)

Effective State Tax Courts and Tribunals," *State Tax Notes*, Feb. 6, 2012, p. 475, *Doc 2012-1391*, or *2012 STT 24-2*.

How the Tribunal Will Work

The tribunal is based on the American Bar Association's Model State Administrative Tax Tribunal Act.⁴ The key concepts are that the tribunal will be completely independent of the department and that the tribunal's ALJs will be experienced tax litigators and substantive experts.

The tribunal is an independent executive agency, separate from the department's authority. It will establish its own offices in Chicago and Springfield that will be physically separate from the department's offices.

The ALJs will be appointed by the governor with the consent of the Senate. Each ALJ must have been licensed to practice law in Illinois for at least eight years and must have substantial experience with substantive state tax law and with state tax controversy practice. The ALJs' salaries are the same as the director's.⁵ The chief ALJ has complete control of the tribunal, including the assignment of cases to other ALJs.

The tribunal has jurisdiction over all cases involving state taxes administered by the department⁶ (except for cases involving assessments made under the Property Tax Code) if the amount at issue exceeds \$15,000.⁷ The tribunal cannot hear a case unless the department has issued a formal assessment or claim denial.⁸ The taxpayer can represent itself or can engage a licensed Illinois attorney.

⁴Model State Admin. Tax Tribunal Act (2006), available at http://apps.americanbar.org/tax/groups/salt/ABA1_OFFICIAL_MODEL_ACT_REPORT_AS_ADOPTED_8-7-06.pdf.

⁵The director is paid approximately \$140,000 per year. *State Journal Register*, available at <http://databases.sj-r.com/salaries/state-of-il/search/?name=hamer>. The chief ALJ will receive an additional \$15,000 payment. Public Act 97-1129, section 1-25(e), 97th Gen. Assemb. (Ill. 2012). An Illinois circuit court judge is paid approximately \$180,000 per year. State and Local Funding for the Illinois Courts, available at <http://www.state.il.us/court/General/Funding.asp>.

⁶The statute specifies that the tribunal will have jurisdiction over the following taxes: the Illinois Income Tax Act, the Use Tax Act, the Service Use Tax Act, the Service Occupation Tax Act, the Retailers' Occupation Tax Act, the Cigarette Tax Act, the Cigarette Use Tax Act, the Tobacco Products Tax Act of 1995, the Hotel Operators' Occupation Tax Act, the Motor Fuel Tax Law, the Automobile Renting Occupation and Use Tax Act, the Coin-Operated Amusement Device and Redemption Machine Tax Act, the Gas Revenue Tax Act, the Water Company Invested Capital Tax Act, the Telecommunications Excise Tax Act, the Telecommunications Infrastructure Maintenance Fee Act, the Public Utilities Revenue Act, the Electricity Excise Tax Law, the Aircraft Use Tax Law, the Watercraft Use Tax Law, the Gas Use Tax Law, and the Uniform Penalty and Interest Act.

⁷Cases involving less than \$15,000 will continue to be heard by the OAH.

⁸The Informal Conference Board will continue to be available to resolve audit issues. The Informal Conference Board's

(Footnote continued in next column.)

The tribunal cannot declare a statute unconstitutional on its face because the tribunal is part of the executive branch of the Illinois government; only the judicial branch can invalidate a legislative act. If a taxpayer wants to challenge the validity of a statute on its face, the taxpayer can use the tribunal to establish the facts relevant to the constitutional argument. The tribunal would necessarily decide the case in favor of the department, and the constitutional issue then would be presented to the Illinois appellate court, which has the power to invalidate a statute on its face. However, the tribunal may decide that a statute, as it is being applied to a particular taxpayer, is unconstitutionally applied.

It is important to note that the tried-and-true approach of paying a tax under protest and then suing in circuit court for a determination of the tax question remains available. This Protest Monies Act procedure offers an alternative remedy for taxpayers who do not want to go to the tribunal and are willing to prepay the contested liability in order to obtain a holding from the circuit court.

The tribunal will show no deference to the department in weighing the evidence and determining whether tax is due.

The tribunal will establish its own procedural rules. The taxpayer will begin the case by filing a petition with the tribunal within the time allowed for protesting the assessment or claim denial.⁹ There is a \$500 filing fee. The department, acting through the attorney general, must respond to each allegation in the taxpayer's petition. This new procedure will aid in sharpening issues and identifying the parties' legal theories at the start of the case.

The statute provides for discovery under the Illinois Supreme Court rules that govern practice in the circuit court. The statutes and rules governing evidence and privilege in the circuit courts also will apply to tribunal cases. Public Act 97-1129 states that proceedings before the tribunal "shall be tried *de novo*." The meaning of *de novo* is not entirely clear. *De novo* normally indicates that the matter is being tried anew and that the court is not bound by the evidence heard at the earlier proceeding. However, most tribunal cases will involve protests of the

work is completed before the department issues a formal assessment or claim denial and thus is not affected by the establishment of the tribunal.

⁹Public Act 97-1129 amends every tax statute over which the tribunal has jurisdiction to require that protests to assessments and claim denials issued under that statute will be heard by the tribunal after July 1, 2013.

department's assessments or denials of refund claims. The substantive tax statutes, such as the Income Tax and the Retailers' Occupation Tax acts, continue to provide that the department assessments and claim denials are "prima facie correct."¹⁰ That has meant that in OAH hearings and in circuit court Protest Monies Act cases, the department's determination is established simply by means of a certificate stating that the attached notice of assessment or claim denial is an accurate record of the audit finding. Beyond that, the department need not produce any evidence and the burden is then on the taxpayer to overcome the department's prima facie case. The most likely meaning of the provision that tribunal cases will be tried *de novo* is that the department will not have to prove what it did in the audit. The taxpayer's petition will assert that the assessment or claim denial is incorrect and the taxpayer will then assume the burden of proving that the audit result is wrong. The tribunal will, however, show no deference to the department in weighing the evidence and determining whether tax is due.

Another major difference between the tribunal and the current practice for administrative hearings is that tribunal proceedings will be open to the public. The taxpayer may petition the tribunal to impose secrecy on part of the proceeding "for good cause." Also, the taxpayer may ask the tribunal to allow pleadings or evidence to be submitted under seal to prevent economic or other harm to the taxpayer. Tax returns and schedules will not be available for public inspection. However, once a tribunal decision is appealed to the Illinois Appellate Court, the rules of the appellate court and not the tribunal will govern the confidentiality of the evidence in the record.

The tribunal must decide a case within the later of 90 days after the end of the hearing or the completion of briefing. The tribunal's decision must be in writing and must explain the facts and the tribunal's conclusions of law. Its decisions will be indexed and published so that they are permanently available as the reports of the tax tribunal.

Both the department and the taxpayer may appeal a tribunal decision directly to the Illinois Appellate Court. The appellate court will hear the case based strictly on the evidence brought before the tribunal. Its review will not be under the normal rules of appellate practice. Instead, the review is governed by the Illinois Administrative Review Act

(735 ILCS 5/3-101 et seq.), which provides for judicial review of final administrative agency decisions.¹¹

Public Act 97-1129 took effect on August 28, 2012. The tribunal will not be able to assume jurisdiction of any case until July 1, 2013. However, the ALJs may be appointed at any time and may take the steps needed to have the tribunal ready to begin handling cases on July 1, 2013.

Public Act 97-1129 contains an important ambiguity regarding the transition of cases from the OAH to the tribunal. It is clear that protests on or after June 1, 2013, may be transferred to the tribunal when its jurisdiction begins on July 1. However, the statute is unclear on the important question of the transfer of protests filed between the August 28, 2012, effective date and June 1, 2013.

The relevant statute provides as follows:

Any administrative proceeding commenced prior to July 1, 2013, that would otherwise be subject to the jurisdiction of the Illinois Independent Tax Tribunal may be conducted according to the procedures set forth in this Act if the taxpayer so elects. Such an election shall be irrevocable and may be made on or after July 1, 2013, but no later than 30 days after the date on which the taxpayer's protest was filed.¹²

It is clear that a protest filed 30 days or less before the tribunal's July 1, 2013, start date can be transferred from the OAH to the tribunal if the taxpayer so elects in a timely fashion. What is unclear is whether a protest filed after the statute's August 28, 2012, effective date but before June 1, 2013, may be transferred. The text states "any administrative proceeding commenced prior to July 1, 2013," may be transferred. The provision that the taxpayer's election "may be made on or after July 1, 2013, but no later than 30 days after the date on which the taxpayer's protest was filed" is confusing. Two readings are possible:

- Does the statute mean that the election to transfer may *not* be made before July 1, 2013, that is, do the words actually mean that the

¹¹Under the Administrative Review Act, the scope of review is described as: all questions of law and fact presented by the entire record before the court. No new or additional evidence in support of or in opposition to any finding, order, determination or decision of the administrative agency shall be heard by the court. The findings and conclusions of the administrative agency on questions of fact shall be held to be prima facie true and correct.

735 ILCS 5/3-110.

¹²Public Act 97-1129, section 1-15(d), 97th Gen. Assemb. (Ill. 2012).

¹⁰See, e.g., 35 ILCS 5/904; *Id.* at 120/4; *Id.* at 120/6b.

election “shall be made on or after July 1, 2013”? If so, the election could be made only for protests filed on or after June 1, 2013, because a taxpayer who filed a protest before June 1, 2013, could not comply with the requirement that the election be made no later than 30 days after filing the protest.

- Does the statement that the election “may be made on or after July 1, 2013” mean that a taxpayer may elect to proceed in the tribunal after the tribunal becomes active on July 1, 2013, so long as it makes the election within 30 days after filing its protest? Under this reading, any taxpayer who files a protest after the statute’s August 28, 2012, effective date has 30 days to decide whether it wants to make the irrevocable election to have its case transferred to the tribunal. If so, the words “may be made on or after July 1, 2013” simply give taxpayers who must file a protest during the month of June 2013 the same 30-day period that taxpayers filing protests before that date have.

This uncertainty surrounding the fate of protests filed between the statute’s August 28, 2012, effective date and June 1, 2013, has significant repercussions. If protests filed before June 1, 2013, may be transferred to the tribunal, it is unlikely that the OAH would have much incentive to move a case along if the taxpayer has filed an election to transfer to the tribunal. Why would the department spend time and money on a matter that it will not decide? But if protests filed before June 1, 2013, cannot be transferred to the tribunal, taxpayers could linger for years in the OAH. That would be the result if the Illinois General Assembly were to reduce the department’s funding for the OAH in recognition of the tribunal’s new role. If that cut led to a reduction in the number of ALJs or attorneys handling administrative cases, a backlog would develop.

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Moreover, appeals from cases that the OAH does retain and decide could be impeded. The Circuit Court of Cook County, where the bulk of appeals from OAH decisions have been heard over the years, has maintained a panel of circuit court judges who specialize in tax cases. Because appeals from the tribunal will go directly to the appellate court and bypass the circuit court, it may be that the Cook County Circuit Court administrators will no longer want to devote judges to tax matters. If so, the judicial review of the remaining OAH cases could be heard by judges with no tax background.

Finally, a taxpayer who files an election to have its case transferred to the tribunal before July 1, 2013, would encounter a huge risk if the tribunal decided that it would take jurisdiction of those cases. The risk is that the department could appeal an adverse tribunal ruling to the appellate court. If the department convinced the appellate court that the tribunal did not have jurisdiction and that the tribunal’s decision was therefore void, the taxpayer would be in dire straits. Its only recourse would be to attempt to have the case remanded to the OAH, where it might well have to re-litigate the entire case.

It is critical that the selected ALJs be impartial and talented.

The legislative history of Public Act 97-1129 does not provide much guidance. The bill as originally drafted provided that any taxpayer could elect to transfer its case to the tribunal if the OAH had not made a final decision by July 1, 2013. A later draft of the bill would have kept any case that had been docketed in the OAH before July 1, 2013, in the OAH for final disposition. The final text of Public Act 97-1129 appears to be a compromise between the two prior drafts that leaves the transition question undecided. We hope that during its fall veto session the Illinois General Assembly will be able to clarify the question.

Observations and Conclusion

Illinois taxpayers have a huge amount at stake in the coming months. The governor’s selection and the Senate’s confirmation of the tribunal’s ALJs will make or break the tribunal. The governor and Senate’s unfettered hand in selecting the persons who will play a major role in shaping Illinois tax law is unparalleled in the state’s history. Although the existing OAH ALJs are appointed by the director, who is himself appointed by the governor, there has never been a sense that political connections have played a role in the selection of ALJs. With the governor and the Senate having a direct hand in selecting the tribunal’s ALJs, there is an obvious risk of those ALJs being selected with an eye towards their sympathies with Illinois’s growing financial disaster. The first drafts of Public Act 97-1129 proposed a selection process that would have given the private sector a significant role.¹³ However, the General Assembly ultimately insisted on

¹³For example, the judge of the Indiana Tax Court is selected by the governor from a list of candidates proposed by the Judicial Nominating Commission. That commission is composed of elected officials and private practitioners. Ind. Const. art. 7, section 9; Ind. Code sections 33-27-2-1 and 2.

giving the governor and the Senate complete control over the appointment process. It is critical that the selected ALJs be impartial and talented.

The establishment of the tribunal will affect the development of Illinois case law. The OAH has been publishing its decisions for a number of years. Those decisions represent the director's ruling on a particular set of facts. There is no requirement that the director retain consistency from one case to the next. In fact, ALJ decisions rarely cite other administrative decisions as precedent. Circuit court decisions, which result from taxpayer appeals from adverse rulings by the OAH or from Protest Monies Act suits filed directly in the circuit court, are not reported unless one of the parties contacts one of the professional reporting services. Further, circuit court decisions have little precedential value. The bulk of

judicial authority in Illinois thus consists of decisions of the Illinois appellate and supreme courts.

The tribunal will publish and index the official reports of the tax tribunal. Those decisions will form an important additional source of precedent, and over time, the tribunal may reduce the number of cases appealed to the appellate and supreme courts. If the tribunal fulfills its mission of providing an independent and technically expert forum for deciding tax controversies, it is likely that the appellate court will be more deferential to tribunal decisions than it has been to circuit court tax decisions. The tribunal will eventually produce a body of case law that could be more significant than the existing body of appellate decisions. That additional clarity would be a step toward improving the predictability of outcomes for Illinois taxpayers. ☆