

**CALIFORNIA LAWYERS ASSOCIATION TAXATION SECTION
2025 SACRAMENTO DELEGATION TOPIC SUBMISSION**

**REMOVING THE COST OF RECONSIDERATION:
A PROPOSAL FOR STATUTORY AND/OR ADMINISTRATIVE CHANGES TO
ALLOW TAXPAYERS TO DISPUTE THE MERITS OF THE UNDERLYING TAX
LIABILITIES WITH THE FRANCHISE TAX BOARD POST-ASSESSMENT AND PRE-
PAYMENT.**

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Passthrough Entities Committee**

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EXECUTIVE SUMMARY

Currently, the California Franchise Tax Board (“FTB”) does not provide a mechanism for taxpayers to dispute the merits of an assessed tax liability once a Notice of Proposed Assessment becomes final and before full payment. This forces taxpayers into a “pay to play” situation, requiring full payment before pursuing a refund claim, even when the liability itself is disputed.

This paper proposes statutory and/or administrative changes establishing a formal Offer in Compromise Doubt as to Liability and/or Audit Reconsideration procedures at the FTB which would allow post-assessment and pre-payment challenges to the underlying tax liabilities.

DISCUSSION

I. PROPOSAL AND BACKGROUND

This paper proposes the following statutory and/or administrative changes establishing two procedures at the FTB: (1) Offer in Compromise Doubt as to Liability, and (2) Audit Reconsideration. These procedures would allow taxpayers to challenge the tax assessments after the assessment becomes final but prior to full payment is required.

Under current FTB practice, taxpayers are limited to two opportunities to challenge the underlying merits of their tax liability: (1) pre-assessment, by filing a protest in response to a Notice of Proposed Assessment (“NPA”), or (2) post-payment, by paying the liability in full and then filing a claim for refund. If a taxpayer fails to timely protest for whatever reason, the only path to challenging the assessment requires a full payment of the tax.

This “pay to play” requirement creates a significant barrier for many taxpayers. For example, for a taxpayer who missed the deadline to timely protest, whether due to a practitioner error or lack of awareness, the only path now left to challenge the liability would be to full pay. A taxpayer who cannot afford to pay the disputed assessment now must either accept the liability as correct (even if its not) or endure years of collection activity.

By contrast, the Internal Revenue Service (“IRS”) provides post-assessment, and pre-payment alternative mechanisms for taxpayers to challenge such liabilities. Through the Offer in Compromise – Doubt as to Liability under I.R.C. § 7122(a), the IRS considers that a doubt as to the liability exists where there is a genuine dispute as to the existence or amount of the tax debt. This allows taxpayers to dispute on the fact as to whether they owe the assessment amount without even having to consider making a payment.

Additionally, the IRS Audit Reconsideration provides taxpayers with an opportunity to provide new information that was not previously considered by the IRS to support their

position to potentially reduce or eliminate the tax liability. Neither of these procedures are payment contingent, and more significantly, do not require a full payment prior to challenging the assessment.

Our proposal aims to bring the FTB into alignment with the procedures at the federal level providing California taxpayers with such opportunities to challenge assessments without first requiring a full payment to ensure fairness.

II. CURRENT LAW AND PRACTICE

Cal. Rev. & Tax Code ("R&TC") § 19433 authorizes the FTB to compromise tax liabilities if acceptance of the compromise is in the best interest of the state and the taxpayer establishes: (1) the amount offered is the most that can be expected from the taxpayer's present assets or income, and (2) the taxpayer lacks reasonable prospects of acquiring increased income or assets to satisfy a greater amount. This statute effectively permits only Offers in Compromise based on Doubt as to Collectability and not Doubt as to Liability.

R&TC §19442 provides legislative intent that the FTB "pursue settlements as authorized under this section with respect to civil tax matters in dispute that are the subject of protests, appeals, or refund claims, consistent with a reasonable evaluation of the costs and risks associated with litigation of these matters." This settlement authority, however, is currently interpreted to apply only to disputes already in the protest, appeal, or refund claim process.

R&TC §19032 mandates that "the Franchise Tax Board shall examine [returns] and shall determine the correct amount of the tax." This provision establishes the FTB's duty to ascertain the correct tax liability.

None of these statutes explicitly prohibit the FTB from considering post-assessment, pre-payment challenges to the underlying correctness of a liability. However, in the authors' experience, FTB representatives generally refuse such requests, citing lack of explicit statutory authority. As there lacks official legal authority explicitly barring such procedures, there exists an issue of compliance; taxpayers should and must be able to rely on taxing agencies to furnish correct information. Our proposed solution clarifies the FTB's position and will instill confidence in taxpayers, resulting in cooperation and prompt settlements.

III. PROBLEMS ADDRESSED

A. Mandating Full Payment as the Sole Relief Post- Final Assessment is Inconsistent with Legislative Intent

Where settlement should be pursued when considering reasonable evaluation of litigation costs and risks, the current practice effectively acts contrary to this intent since it requires taxpayers to bring a refund claim only upon full payment of the contested liability amount. Because taxpayers would not have had a chance to provide arguments and documentation to correct the amount of liability at the outset, they will be more litigious

than otherwise, prolonging negotiation and unnecessarily depleting judicial and administrative resources.

B. Current Pay in Full Requirement Exposes Taxpayers to Financial and Personal Vulnerabilities

Despite taxes being the crucial bedrock of our society and government programs, the reality of paying taxes can be quite burdensome to most individuals. Taxpayers may struggle to come up with the required funds in order to be compliant with the current practice. As a result, they may engage in actions that could have detrimental impacts not just on their financial prospects but also their personal livelihood and wellbeing.

Some taxpayers may take a turn for the worst and fall prey to loan sharks and predatory lenders, entering into arrangements that could have life-threatening consequences. Desperate to challenge an assessment, taxpayers without sufficient liquid assets may resort to high-interest loans or other predatory financial products.

Requiring payment in full may impact not just livelihood but also the ability to be tax compliant going forward. A taxpayer who must liquidate all available funds to pay a disputed assessment may then lack the resources to pay current taxes, creating a cycle of non-compliance, leaving clients with no choice.

Others may be forced to liquidate long-term investments and pay additional taxes due to the creation of a taxable event from the liquidation itself. For example, liquidating retirement accounts or selling appreciated assets to pay a disputed assessment may trigger additional tax liability, compounding the financial harm.

Some taxpayers may have to reduce consumption of groceries and other goods which are fundamental to their health and survival. When faced with the choice between paying a disputed tax assessment and providing for their family's basic needs, taxpayers should not be forced into such an untenable position.

C. Taxpayers Should Not be Denied Relief where Current Laws do not Explicitly Prohibit

The federal Taxpayer Bill of Rights which California has explicitly adopted through its 1997 Taxpayers' Rights Conformity Legislation establishes that taxpayers have "the right to pay only the amount of tax legally due."

The federal Taxpayer Bill of Rights also guarantees the "right to challenge the IRS's position and be heard" and the "right to a fair and just tax system" that considers "facts and circumstances that might affect their underlying liabilities." California taxpayers deserve no less. Yet under the current FTB practice, taxpayers are denied the right to be heard on the merits of their liability unless they first pay in full even when they have compelling evidence that the assessment is incorrect.

Upon review of R&TC §§ 19032, 19433, and 19442, the relevant statutes do not explicitly allow or bar the FTB from considering challenges to underlying liabilities post-assessment. Taxpayers should not be denied relief since none of the statutes explicitly bar the FTB from considering challenges to the underlying liabilities post-assessment. However, in the authors' experience, practitioners are categorically told that the FTB cannot consider post-assessment, pre-payment challenges to underlying liabilities.

As there lacks official legal authority explicitly prohibiting such procedures, there exists an issue of clarity and compliance. Taxpayers should and must be able to rely on taxing agencies to furnish correct information and apply consistent standards. The current ambiguity where statutes do not prohibit post-assessment reconsideration, yet the FTB categorically refuses it creates uncertainty and undermines confidence in the tax system.

Our proposed solution clarifies the FTB's position and authority, whether through statutory amendment or administrative policy. This clarification will instill confidence in taxpayers, hopefully resulting in greater cooperation and prompt settlements, consistent with the legislative intent expressed in R&TC § 19442.

IV. MERITS OF PROPOSAL

Establishing Doubt as to Liability and Audit Reconsideration procedures would provide meaningful access to challenge assessments regardless of a taxpayer's ability to pay. This aligns with fundamental fairness principles embodied in both the federal and California Taxpayer Bills of Rights and ensures that taxpayers are liable only for taxes they actually owe. Taxpayers could provide documentation and explanations essential to accurate determination without first being required to pay disputed amounts. This implements the right to "challenge the [agency's] position and be heard" and supports "a fair and just tax system" that considers all relevant facts and circumstances.

Allowing the FTB to consider substantive challenges promotes efficiency for both taxpayers and the agency. Rather than both parties expending resources on collection and resistance to collection, disputes could be resolved on their merits. If the FTB determines that an assessment was correct, collection can proceed with greater confidence and legitimacy. If the assessment was incorrect, it can be corrected before significant collection resources are wasted and before taxpayers suffer unnecessary financial hardship.

This approach also reduces unnecessary litigation. Taxpayers with legitimate disputes would have an administrative remedy, reducing the number of refund claims and lawsuits. This conserves judicial and administrative resources while providing faster resolution for taxpayers.

R&TC § 19032 requires the FTB to "determine the correct amount of the tax." Post-assessment reconsideration procedures would support this mandate by providing a mechanism to correct assessments when new information demonstrates they were

incorrect. The FTB's duty is not merely to issue assessments, but to determine the correct amount of tax.

Adopting procedures similar to those used successfully by the IRS would harmonize California practice with federal practice, reducing confusion amongst taxpayers and promoting consistency in taxpayer treatment. California has historically looked to federal tax administration for guidance.

The IRS has operated Doubt as to Liability and Audit Reconsideration procedures for decades without significant abuse or systemic problems. These procedures have proven their value in resolving disputes.

All administrative systems involve some level of error. The current FTB system provides no practical remedy for correcting assessment errors once the protest deadline passes unless the taxpayer can afford to pay the disputed amount in full. Establishing reconsideration procedures would serve as an important safeguard against systemic errors and unforeseeable mistakes.

Moreover, a system that provides meaningful opportunities to correct errors is more legitimate and trustworthy. Taxpayers are more likely to view the system as fair and to comply voluntarily when they know that genuine errors can be corrected through reasonable procedures. Conversely, a system that provides no remedy for errors or makes that remedy contingent on ability to pay breeds resentment and can further undermine voluntary compliance.

V. FEASIBILITY

A statutory change would be burdensome, but not practically impossible. A statutory change allowing post-assessment and pre-payment procedures to challenge underlying liabilities will not require any existing statute to be repealed or contradicted. Instead, a statutory change will provide clarity and/or explicit authority.

An administrative change would not be burdensome since the FTB is not statutorily barred from providing post-assessment and pre-payment procedures but will need to take an agency-level position that it is within its authority to do so.

VI. CONCLUSION

California taxpayers are currently subject to a “pay to play” system that denies meaningful opportunities to challenge erroneous tax assessments unless they can afford to pay disputed amounts in full. This structure creates inequitable results and places vulnerable taxpayers at risk of severe financial hardship and even undermines public confidence in the fairness of the tax system.

The practice is inconsistent with the intent expressed in R&TC § 19442, which directs the FTB to pursue settlements based on a reasonable evaluation of litigation costs and risks.

Forcing all post-assessment disputes into the costly refund claim process runs contrary to this intent and unnecessarily strains judicial and administrative resources.

Creating Offer in Compromise Doubt as to Liability and Audit Reconsideration procedures in California would bring state practice into alignment with federal models that have operated effectively. These procedures improve administrative efficiency, reinforce the FTB's duty to determine the correct tax, and advance the principles embodied in taxpayer bills of rights.

Adopting these reforms serves the interests of both taxpayers and the FTB. Liabilities would be deemed accurate before significant collection resources are deployed, reducing wasted effort and improving voluntary compliance. The Legislature and the FTB can implement these changes either through statutory amendment or administrative action.

Taxpayers should only be required to pay the correct amount of tax. The current system denies them a fair chance to prove when an assessment is wrong, unless they can afford to pay first. This is fundamentally unjust and inconsistent with the values California has committed to uphold.

The FTB should adopt these recommendations and extend to California taxpayers the same opportunities to challenge erroneous assessments that federal taxpayers have long enjoyed.

The comments contained in this paper are the individual views of the author(s) who prepared them, and do not represent the position of the California Lawyers Association or of the Taxation Section.