MULTISTATE AND FEDERAL

Tax Litigation Returns to Normal Despite Pandemic

by Andrea Muse

The COVID-19 pandemic, which shut offices and turned kitchen tables into workspaces, did not spare tax administration, resulting in fewer court filings, delayed deadlines, and suspended audits across both state and federal systems.

But in most cases, the effects were mitigated or minimized by the rapid and widespread embrace of remote work facilitated by technology such as videoconferencing, and commonsense moves such as extending deadlines, spurred in part by the realization that tax controversies involve revenue.

An examination by Tax Notes found that federal and state appellate court filings decreased and that individuals who might otherwise have been involved in litigation were unwilling to participate during the pandemic. The pandemic affected almost every aspect of the judiciary, with court staff and attorneys having to learn new skills to work remotely and the suspension of most jury trials.

But after surveying numerous state tax courts and departments of revenue, Tax Notes found that the agencies reduced operations at the outset of the pandemic but resumed them quickly, in some cases pivoting to remote work to move cases along.

Charles Capouet of Eversheds Sutherland (US) LLP told Tax Notes his firm saw little change in the number of significant tax decisions handed down during the pandemic. Eversheds Sutherland has released its SALT Scoreboard quarterly since 2016, using a litigation tracker spreadsheet to note each quarter’s significant taxpayer wins and losses.

“Throughout the scoreboard’s history, case numbers have remained fairly consistent each year, hovering at approximately 220 significant cases, including — on average — throughout 2020 and 2021,” Capouet said. “However, the dates of decision releases can fluctuate and be uneven on occasion, resulting in slightly more decisions released in one year than the next.”
State Tax Courts

Those findings are consistent with data from state tax courts, with most of the surveyed courts reporting that the decline in the number of cases disposed since the pandemic began hasn’t been significant.

Minnesota Tax Court Chief Judge Jane Bowman told Tax Notes that while she didn’t have specific numbers, she doesn’t believe fewer cases were disposed of in 2022.

Noting that the court stayed many of the immediate deadlines at the beginning of the pandemic and then converted most of its hearings to remote, Bowman said she believes the court “successfully figured out how to move cases along, whether in person or remote, despite the ongoing pandemic.”

And although the New York State Division of Tax Appeals extended briefing deadlines to the extent permitted by law and adjourned hearings during the pandemic, filing deadlines were not extended. The number of petitions for an administrative law judge hearing in fiscal 2021 was 334, down from the 448 filed in fiscal 2020, but petitions increased to 496 for fiscal 2022, and the number of disposed cases showed a similar pattern.

According to its annual report for fiscal 2021, the New Jersey Tax Court saw fewer filing dispositions for fiscal 2020 compared with fiscal 2019 and 2021, although dispositions decreased in both fiscal 2020 and fiscal 2021. Cases were tolled and deadlines were extended for several months, with the court transitioning to remote proceedings and expanding electronic filing.

Oregon Tax Court Administrator Rocco Lieuallen, speaking generally about the court’s magistrate division, said the tax court remained open throughout the pandemic but conducted most of its hearings remotely. He noted that while there was no blanket tolling of deadlines in existing cases, the court allowed set-overs in specific cases to accommodate COVID-19 concerns and extended filing deadlines for appeals.

Lieuallen said the court has seen no substantial change in the time for disposition, noting that the number of new appeals in 2020 and 2021 slightly increased from 2019.

“Looking ahead, the court anticipates a continued increase in workload due to adoption of a new state tax (corporate activity tax), and to address that, the legislature has funded a new position,” Lieuallen added.

Myriam Bouaziz, chief deputy director of the California Office of Tax Appeals, said the office has seen a steady increase in cases since February 2021, adding that the state Franchise Tax Board began including the office’s appeal form with its appealable notices in January 2021, which made the process easier. But data she provided show slightly fewer cases opened in calendar year 2020 (1,322) compared with 2019 (1,444).

The South Carolina Administrative Law Court also saw a similar number of tax cases filed in fiscal 2020 and fiscal 2021, followed by a slight decrease in fiscal 2022, according to Jana Cox Shealy, clerk of court.

Jack Hearn, clerk of the Maryland Tax Court, said the court postponed hearings from March to August 1, 2020, but did not toll filing deadlines. Hearn said the pandemic affected the number of appeals filed in fiscal 2020 but that the court’s efficiency for that year wasn’t seriously affected.

Although the pandemic caused delays in scheduling and processing for fiscal 2021, Hearn said, “the difference in the filing versus closed numbers can be attributed also to the fact that the lower-level agencies were back to issuing their decisions toward the latter part of the fiscal year, so the [court’s] processing could not be completed by fiscal year-end.”

Alabama Tax Tribunal Department Manager Ann Rittenour said the tribunal was closed to the public briefly but never ceased operations during the pandemic. Rittenour said that although filings deadlines remained in effect, extensions of deadlines set by a tax tribunal judge would be considered upon written request. Both the number of cases docketed and the number of decisions rendered for calendar year 2020 dropped from 2019, going from 1,279 docketed cases and 1,212 rendered decisions to 959 cases and 730 decisions. Those numbers increased in 2021 to 1,322 cases docketed and 820 decisions rendered.

Indiana Tax Court Judge Martha Blood Wentworth noted that her court is both a trial court and an appellate court, which can skew its
statistics, but said the Indiana Department of Revenue has a settlement initiative that has significantly reduced the number of cases.

U.S. Tax Court

Statistics for the U.S. Tax Court show a similar return to the status quo through the use of remote proceedings. In its fiscal 2022 budget justification submitted to Congress in April 2021, the court said it canceled 81 trial sessions throughout the country but that its “implementation of remote proceedings avoided the accrual of significant backlog.” It also deployed a new electronic filing system, shifted to mandatory telework, and conducted remote trials during the pandemic. But there was a large decrease in the number of cases filed, with roughly 24,000 cases filed in fiscal 2019 and 17,000 filed in fiscal 2020, according to the court.

The court noted that the IRS did not issue notices of deficiency or similar actions and didn’t start new audits during the pandemic unless the statute of limitations was an issue, and that the agency also suspended new automatic liens and levies as well as passport certifications for seriously delinquent taxpayers.

In its fiscal 2023 budget justification submitted to Congress in February, the court said the IRS significantly increased the number of notices it issued in fiscal 2021. More than 35,000 petitions were filed that year, the court said, noting that between 23,000 and 26,000 petitions are typically filed in a 12-month period. The court closed roughly 20,000 cases in both fiscal 2020 and fiscal 2021.

Litigation as a Whole

According to the Administrative Office of the United States Courts’ federal caseload statistics report for March 31, 2020, to March 31, 2021, U.S. appellate court filings decreased by 8 percent. Civil filings in U.S. district courts during the same period increased by 39 percent, but the report attributed the increase to personal injury cases that increased in response to multidistrict litigation filed in one district court, noting that otherwise civil filings would have decreased by 4 percent.

State court caseload data published by the Court Statistics Project, a joint project of the National Center for State Courts and the Conference of State Court Administrators, showed an overall 17 percent decrease in the number of incoming appellate cases for 2020 in the 45 states that reported publishable data. The project also showed decreases in civil filings at the state trial court level in 2020 for the states that reported caseload data.

Departments of Revenue

Like the IRS, the revenue departments surveyed by Tax Notes reduced audits at the outset of the pandemic, with some focusing instead on training and voluntary compliance.

Charlie Moore, communications director of the New Mexico Taxation and Revenue Department, said the department “did suspend some of our most serious compliance activities for a time near the beginning of the pandemic” and that it has been “actively trying to promote voluntary compliance through a variety of means from the beginning of this administration.”

South Carolina Department of Revenue spokeswoman Bonnie Swingle said the DOR reduced the number of audits it initiated in the beginning of the pandemic but has been working at its normal pace since August 2020, adding that it has seen an increase in appeals over the past year but could not determine whether that is related to the pandemic.

Maryland Comptroller’s Office spokesman Alan Brody said the office was precluded from conducting audits during the period of the executive order issued by Gov. Larry Hogan (R), which was in effect from March 2020 through August 16, 2021. There was a significant dropoff in appeals in fiscal 2021 — 1,930, compared with 5,151 in fiscal 2020 — but 4,627 were filed in fiscal 2022, according to Brody.

Yating Campbell of the California Department of Tax and Fee Administration Office of Public Affairs said there was no decrease in the number of tax litigation cases during the pandemic but that there was a 13 percent decrease in audits and 12 percent decrease in petitions filed. Lockdown orders made audit coordination more difficult, and the department was sensitive to struggling businesses whose operations were affected by the pandemic, according to Campbell.
Angela Jones, a media liaison with the California FTB, said the board paused new audits between April and July of 2020, which allowed it to better assess its workload, adjust to taxpayers’ situations, and learn effective virtual tools. She said the number of protests filed since the beginning of the pandemic was comparable to prior years.

Robin Maxey, public information officer with the Oregon Department of Revenue, said the department similarly paused audit activities for a short time early in the pandemic and began focusing on training opportunities, then temporarily shifted to using virtual methods to meet with taxpayers.

While the Oregon DOR completed more than 6,600 audits in 2018 and 2019 with more than 1,100 appeals, it completed 5,412 audits in 2020 and 2021 with 598 appeals. But Maxey cautioned that the numbers can’t be directly compared, noting that personal income tax audits — which represent more than 86 percent of the audits conducted — were down 35 percent for 2020 and 2021. He pointed out that “corporate audits can take one to two years to complete, [and many] of the audits that posted after the pandemic started were well underway before the pandemic hit.”

Maxey noted that audits in some smaller programs increased, mostly from the addition of new programs during the period.

Ryan Brown, a spokesman with the Minnesota Department of Revenue, said the department replaced most of its in-person/on-site audits with virtual audits over the past two years, which he said presented challenges for auditors, but that the number of completed audits has remained similar to prior years. The DOR also places an emphasis on taxpayer education and voluntary compliance, he said.

Brown said the number of sales and use tax audits dropped from 2,588 in 2019 to 1,671 in 2020 and to 1,414 in 2021, attributing the decrease to the pandemic’s impact on businesses required to collect the sales and use tax. “With some mandated shutdowns, as well as the pandemic itself negatively impacting these businesses, [the DOR] adjusted some of our compliance efforts and instead offered relief” like grace periods and the waiver of penalties and interest, he said.

Practitioner Insights

Jeff Friedman of Eversheds Sutherland said he wouldn’t anticipate the pandemic having too much of an effect on tax litigation yet, given the statutes of limitations for assessing taxes and the speed of tax litigation, which can take years. But he said he has noticed an effect on legislation, noting that it was a very quiet year for tax legislation at the state level.

Marilyn Harbur, senior assistant attorney general at the Oregon Department of Justice, said she saw little effect from the pandemic on the state tax court. She noted that Oregon tolled its filing deadlines for litigation, which may have resulted in case filings remaining about the same as in prior years. She said the court moved to virtual proceedings early on, which made it much easier to schedule conferences and oral arguments with taxpayers and lawyers based outside Oregon.

Harbur added that significant cases in tax can be cyclical anyway and that the economy can affect appeals. Appeals in some industries may have increased depending on how the industry was affected by the pandemic, she said. The effects of loss on income tax from the pandemic likely won’t show up for three or four years, she said, noting that returns would have been filed in 2021 and likely would not have been subject to audit yet.

Jay Adams of Jones Walker LLP said there was an early slowdown, but noted that one fundamental difference between tax and other litigation is that tax controversies are generally heard before a state tax tribunal or a judge rather than a jury. He said most courts had to set off jury trials early in the pandemic but tax cases could move along. He added that tax controversies also involve revenue, which can give both the government and the taxpayer an interest in moving the case along.

Adams said the pandemic seemed to hasten a transition to remote audits, which he called the “new normal,” but noted that the Louisiana Board of Tax Appeals has transitioned back to in-person hearings. He said there are benefits and drawbacks to the increased use of remote audits — for example, it could be harder for taxpayers and auditors to develop relationships and for auditors to gain an in-depth understanding of a
taxpayer’s business, but that remote audits can be more efficient.

But Friedman noted that in general, it may take longer for cases to be completed because of the ongoing loss of senior auditors at departments of revenue. He said corporate tax audits in particular can be complicated and that a lack of experienced auditors, and supervisors to sign off, can substantially prolong an audit, and in turn the amount of time before litigation can be filed. That’s worrisome, he said, because taxpayers generally have the burden of proof, and as time progresses, the likelihood that evidence will be lost grows. And a lack of resources can affect how long it takes for a case to be disposed of at the court level, he added.

Paul Jones contributed to this article.