
Minnesota Department of Revenue Study

STUDY ON DISSEMINATION OF ADMINISTRATIVE DETERMINATIONS

January 7, 1991

Appeals and Legal Services Division
Minnesota Department of Revenue

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FEB 19 1991

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MINNESOTA DEPARTMENT OF REVENUE

LEGISLATIVE STUDY

DISSEMINATION OF ADMINISTRATIVE DETERMINATIONS

I. The Department's Goals.

As the agency charged with the administration of Minnesota tax law, the Department's goals are to correctly interpret Minnesota tax law and to make those interpretations readily accessible to the public. When these goals are achieved, taxpayers will have a better understanding of their rights and responsibilities, which in turn will result in greater voluntary compliance with Minnesota tax law. Our objectives to meet these goals are to identify and resolve issues in a timely fashion, to simplify and increase the number of our messages regarding those issues, and to provide access to our determinations in all cases not involving protected information.

II. Discussions With Taxpayer Representatives.

In conducting this study, Department representatives discussed taxpayer concerns with members of the Bar and the accounting profession. These discussions resulted in the conclusion that taxpayer concerns coincide with the Department's objectives of simplifying and increasing the volume of messages to the public regarding tax law, and of providing access to those messages. Moreover, the Department and taxpayer representatives agree that the main focus of efforts should be the production and dissemination of information with broad applicability.

III. Current System of Communicating Information to the Public.

A. Types of Communication.

The Department of Revenue currently employs various means of communicating with the public regarding technical, legal and policy statements or decisions.

Informal oral advice and advisory letters are given in response to specific inquiries from taxpayers and non-Revenue government personnel regarding how Revenue will apply the law to a specific fact situation.

Revenue also communicates to the general public on issues that have broad applicability. This is done both informally through newsletters and other publications, and formally through the promulgation of rules pursuant to the Administrative Procedures Act.

Further, Department personnel often make presentations regarding Minnesota tax law to professional and trade associations.

B. Problems Identified With the Current System.

Communications come from various divisions within the Department. Depending on the nature of a taxpayer's question or the tax type at issue, that question could be referred to and answered by any number of divisions of Revenue. Newsletters and other policy statements originate in different divisions of Revenue, as well. This system leaves open the possibility of inconsistent information coming from Revenue.

None of the communications are binding on the Department. Although it rarely occurs, the Department can change its policy and apply it retroactively, or an auditor may not follow the policy set out in Department communications. However, if a taxpayer receives incorrect written advice from a Department employee in response to a specific written request from that taxpayer, and a penalty is the direct result of that advice, the penalty must be waived, although the taxpayer must still pay the tax and interest. (The written advice must have been reasonably relied on by the taxpayer and not the result of failure by the taxpayer to provide adequate or accurate information.)

In most tax areas, it is difficult for taxpayers to find out about prior determinations made by the Department. Written opinions to specific taxpayers are not disseminated to the general public and there is no central index or formal filing system. Moreover, there is a need for more newsletters and other publications for most tax types.

To the extent that the written communications describe Department policy, they may be in conflict with the Minnesota Administrative Procedures Act. Under the APA, a rule is every "agency statement of general applicability and future effect." If the communication meets that definition, the Department must go through the formal rulemaking process before it can issue that policy statement. Because the formal rulemaking process involves the expenditure of significant amounts of time, the Department is often unable to promulgate rules quickly enough to resolve issues which affect an immediate tax year, and thus the liability of taxpayers which must be established in that year.

IV. Possible Methods of Improving Communication.

A. Improvement of Current System.

To deal with the issue of volume, the Department could issue newsletters and other publications more frequently. The development of a centralized review process would address the issue of consistency.

A system of compilation and indexing could be established to improve accessibility. Finally, to address the APA, an exception for newsletters and other publications could be requested. Such an exemption would also add some formality to the system, which would permit the consideration of creating some binding authority in these releases.

B. Use of Emergency Rulemaking Procedures.

The Department could seek emergency rulemaking power under the APA to be used in addition to its existing power to promulgate rules. This power would enable the Department to use an expedited process to make policy determinations which are binding on the Department and the taxpayers. The emergency rule would be effective for one year (including one extension of time). At that time, if the Department sought to enforce that policy, it would have to promulgate a permanent rule or seek the inclusion of the policy in a new statute. The Department would have to obtain emergency rulemaking authority for each statute specifically. The authority expires six months from the effective date of the statute which granted the authority.

C. Possible New Rulings System.

This study contemplated the systems of communication currently being used by the IRS and by other states.

1. The IRS System.

The IRS has a comprehensive system of dissemination of formal determinations. Basically, the IRS system has four major types of formal releases relevant to this discussion. First, there are various forms of releases which announce policy or interpretation of law and have broad applicability. Second, there are a number of releases which deal with specific fact situations. Third, the IRS issues its internal communications regarding policy decisions. Fourth is the issuance of informational releases. The following are the various forms of dissemination currently utilized by the IRS:

a. Regulations - The Internal Revenue Code authorizes the IRS to prescribe regulations for the enforcement of the Code. Legislative regulations are issued in accordance with the requirements of the federal APA. To the extent they are not inconsistent with the law, the regulations are said to have the force and effect of law. Legislative regulations apply prospectively only. Interpretative regulations (those that merely explain the meaning of a statute) need not be promulgated as rules under the federal APA. They do not have the force and effect of law, but are binding on the IRS. They apply retroactively to the effective date of the applicable law provision, unless the regulation itself provides otherwise.

b. Revenue Rulings - Revenue rulings are issued by the National Office and are official interpretations published for information and guidance. Since they are "interpretive," the IRS can issue them without complying with the notice and hearing requirements of the federal APA. They do not have the force and effect of Regulations, but a taxpayer may normally rely on them. They are limited in scope by their stated pivotal facts. They are retroactive in effect. A revocation or modification of any ruling applies to all open years unless the IRS limits the retroactive effect. The new ruling ordinarily will not be applied retroactively to the extent they have adverse tax consequences.

c. Private Letter Rulings - A private letter ruling is a written statement issued by the National Office to a specific taxpayer, upon request, who wants to know the IRS's view on the applicability of the law to a specific transaction. The taxpayer must disclose all relevant facts, including copies of all documents germane to the transaction. Issuance of the letters is discretionary with the IRS. The IRS charges the taxpayer a user fee, payable in advance. If the IRS proposes to rule adversely to the taxpayer, the taxpayer is entitled to one conference at which the IRS representative explains its tentative decision. If the taxpayer withdraws the request, the IRS may still give its opinion to the district director where the taxpayer's return will be filed. A private letter ruling is binding on the IRS only as to the requesting taxpayer and only as to the specific fact situation as submitted. The private letter rulings are published after confidential information is deleted.

d. Determination Letters - A taxpayer can request a local IRS district director to give the taxpayer the IRS's view on the applicability of the law and regulations to the taxpayer's particular completed transaction. The letter applies the principles and precedents previously announced by the National Office to a specific set of facts. It has the same binding effect as a private letter ruling. The taxpayer is charged a user fee for the letter. Determination letters are open to public inspection.

e. Technical Advice Memoranda - These memoranda are issued by the National Office, in response to technical or procedural questions, to provide guidance on the application of laws, regulations, and precedents to a specific case. They are issued in connection with the audit or examination of a return or of a claim for a refund or credit, or in the appeals process. Either the IRS or the taxpayer may initiate the request. They have the same binding effect as a private letter ruling if the advice is favorable to the taxpayer. The appeals office is not bound by technical advice unfavorable to the taxpayer and may settle a case despite contrary technical advice. Technical advice memoranda are open to public inspection.

f. Technical Memoranda - Technical memoranda are issued to summarize and explain newly published IRS regulations.

Among other things, they state the issues involved, identify controversial legal or policy questions, discuss the reasons for the approach taken by the individuals drafting the regulations, and provide other background information. Use of Technical Memoranda has decreased because now new regulations include explanations.

g. Information Letters - These letters are advisory, nonbinding statements issued by either the National Office or by a district director that merely call attention to a well-established interpretation or principle of tax law without applying it to any specific set of facts. Such a letter may be issued in response to a taxpayer's request for general information, where a taxpayer's request for a determination letter or ruling fails to meet all applicable requirements, or where the IRS thinks that the general information may help the taxpayer.

h. Revenue Procedures - These determinations are official statements of practice and procedure which affect rights or duties of taxpayers, or which, because of their nature, should be a matter of public knowledge. They are binding on IRS personnel and taxpayers can rely on them to the same extent as a revenue ruling. They are published in the Internal Revenue Bulletin.

i. Notices and Announcements - With these, the IRS provides procedural or substantive guidance which is needed quickly (i.e., advanced text of revenue rulings). They are published in the Internal Revenue Bulletin. They are binding on the IRS and can be relied on by taxpayers to the same extent as revenue procedures.

j. Procedural Rules - Procedural rules provide the broad framework for the internal operation and procedures of the IRS in its administration of the Internal Revenue laws. They are contained in the Code of Federal Regulations.

k. Opinion Letters - An opinion letter is issued to a specific taxpayer by the National Office as to the acceptability of the proposed form of a master or prototype pension, profit-sharing, or stock bonus plan and any related trust or custodial account under Code Sections 401 and 501(a). The requesting taxpayer may rely on a favorable opinion letter with respect to the form, but not necessarily the substance, of the proposed master or prototype plan. They are advisory and nonbinding.

l. Actions on Decisions - These are legal memoranda that are prepared by the IRS when it loses on an issue in a litigated tax case. They are issued whether or not formal recommendation is made to the Department of Justice as to whether certain court decisions adverse to the commissioner should be appealed. They are internal memos not intended for public use.

m. Chief Counsel Orders and Notices - Prepared by the Chief Counsel, they provide insight into the inner workings of the IRS. They are procedural and have no legal effect.

n. General Counsel Memoranda - The IRS discloses its General Counsel's internal memoranda although they are not prepared for public use. They are generally an extensive analysis of a particularly significant legal issue. The IRS takes the position that taxpayers cannot rely on them.

o. News Releases - News releases simply announce items of general interest. They do not provide an interpretation of tax laws so they cannot be relied upon.

p. Informal Advice - IRS personnel may still issue informal oral and written advice to specific taxpayers. This advice is not binding on the IRS and can later be repudiated.

2. Other States' Systems.

Many other states have adopted a formal system. The systems adopted usually consist of one or more types of releases used by the IRS. States with formal systems continue to give informal advice in addition to their private letter rulings.

California has the most extensive system of all the states. The state issues Legal Rulings (like revenue rulings), Chief Counsel Rulings (like private letter rulings), Opinion Letters (like determination letters), FTB Notices (like IRS notices or revenue procedures), News Releases (informal, nontechnical, explanatory bulletins) and Information Letters (nonbinding advisory opinions). Their State Board of Equalization publishes an index which consists of summaries of the rulings. Thus, California has adopted three of the IRS categories, i.e., broad rulings, taxpayer-specific rulings, and informational releases.

Michigan has opted for a system of broad rulings and taxpayer-specific rulings, including Revenue Administrative Bulletins (like revenue rulings), Letter Rulings (like private letter rulings), Acquiescences and Nonacquiescences (like IRS method), and Technical Advice Letters (informal documents which are technical assistance, are not published, and can be relied upon by the requesting taxpayer only).

Several other states issue private letter rulings as the only administrative determinations binding on the state (except APA rules). Indiana, New York, Wisconsin and South Carolina issue private letter rulings using a system similar to the IRS.

Ohio's private letter rulings differ from the IRS' in that a specific expiration date for the effectiveness of the letter can be

written into it and, in any event, none of the letters are effective beyond one year after their issuance date. In Mississippi, letters are only effective for three years. The one and three year periods of effectiveness are caps. Every state with private letter rulings (and the IRS) has included in its statute or rule a provision that any change in the applicable law automatically modifies or revokes the private letter ruling previously issued. Arkansas has such a provision along with a three year effectiveness period. Its Revenue Division personally notifies taxpayers with current private letter rulings of administrative changes in policy but holds them to have constructive notice of changes in the law.

Two states (Iowa and South Dakota) issue Declaratory Rulings pursuant to their APA. Declaratory Rulings are similar to contested case proceedings. They don't normally conduct a hearing if they have enough facts from correspondence from the taxpayer.

New York, Indiana, and Mississippi issue Information Letters, which are nonbinding, advisory opinions, in addition to issuing binding rulings.

The drafting and review of the formal rulings is done differently in each state but there are some similar procedures. In some states, the rulings are drafted by the staff of Taxpayer Information or by people who work in the area of the tax type involved. In other states, attorneys draft the rulings, either exclusively or in addition to their duties drafting informal letters. The rulings are always reviewed by one or more attorneys. Typically, there is review by an attorney with expertise in the tax area and then review by either a committee or the chief counsel.

Many states could not determine the cost of their formal ruling system because their systems have been in place for a number of years, and the duties are allocated throughout their various revenue divisions. Therefore, they do not recall what the start-up of their program required. Other states, however, with more recent start-up of a program, could point to new employees' salaries as part of the cost. Michigan hired an attorney and a paralegal just to administer the system. The Wisconsin Department of Revenue hired one new employee who administers the private letter rulings in addition to performing other, unrelated duties.

V. Considerations Necessary in Implementing a Rulings System.

A. Administrative Procedures Act.

The APA would preclude DOR from issuing rulings with general applicability and future effect without utilizing APA rulemaking procedures. Private letter rulings are, arguably, not "of general

applicability" since they are only binding as to the requesting taxpayer, and are therefore probably not impacted by the APA. Revenue rulings, however, are "rules" within the meaning of the APA. The taxpayers' concern is that APA rulemaking can be a long process, leaving them without guidance on transactions occurring during the process.

B. **Cost.**

At the minimum, a coordinator for a formal rulings system would be needed. In addition, in order to disseminate the rulings, costs would be incurred for their publication in newsletters and/or in a computer research system. Department personnel would need to commit time for drafting and review of rulings, and, if a system of private letter rulings is implemented, for conferences with taxpayers regarding rulings.

C. **Allocation of Resources.**

A decision must be made regarding the allocation of resources between private advice given by the Department and broad based decision making.

D. **Facts.**

In issuing private letter rulings, the IRS and many states have had to deal with taxpayers' "fact shopping"--writing in for an opinion several times until they discover the proper shading or changing of facts to get a favorable tax ruling.

E. **Reliance.**

The issue is whether Department determinations bind the Department, the taxpayer, or both.

F. **Appealability.**

The question is whether determinations issued by the Department may be appealed when a ruling is made. The other choice is to require that taxpayers use the appeal process currently available when a final order has been issued.

G. **Precedential Value.**

With respect to rulings with broad applicability, there are two issues. The first issue is whether the ruling will be applied retroactively. The second issue is whether revocation or modification operates retroactively, or prospectively only. Regarding rulings specific to a taxpayer's particular set of facts, the question is whether the Department's decision may be relied on by other taxpayers.

VI. **Tax Types Which Could Be Included in a Rulings System.**

CPAs and the Tax Section of the Bar both expressed interest in the inclusion of Income, Corporate Franchise, Sales, Withholding, and Special Taxes.

The CPAs and the Tax Section of the Bar expressed no interest in the inclusion of property tax. The Real Property section of the Bar opposes inclusion of property tax in a formal rulings system because it is locally administered. The Association of Minnesota Counties and the Local Government Services Division of the Department of Revenue both oppose formal, binding rulings in property tax.

VII. **Recommendations.**

A. **Summary.**

A rulings system should be implemented incorporating two of the types of releases used by the IRS. Revenue rulings would announce audit policy or interpretations of tax law. Tax information bulletins, like the IRS informational releases, would summarize and report developments with respect to tax law, including revenue rulings. In order to implement this system, an exception to the Administrative Procedures Act is both necessary and reasonable.

Neither a private letter rulings system nor the IRS system of formally issuing internal communications regarding policy decisions is recommended. However, a system of revenue rulings will result in the compilation and centralization of all public information, providing easier access than currently exists to internal communications which may be made public.

B. **Rulings System.**

1. **Types of Rulings.**

The consensus of taxpayer representatives and the Department is that Departmental resources should be committed to resolving issues with the broadest impact and applicability, providing for the most effective allocation of resources. The Department's objectives are to identify and resolve these issues in a timely fashion, to simplify and increase the volume of our messages to taxpayers, and to provide access to our determinations.

A system of revenue rulings, combined with tax information bulletins, will meet each of these objectives and needs. Revenue rulings would present the Department's view of the correct meaning of a statute or other provision of law as precedent, informing taxpayers of policy positions the Department will take regarding particular tax

laws. Tax information bulletins would provide summaries of tax law, including statutes and revenue rulings.

2. APA Exception.

Any system the Department administers involving rulings which will have general applicability and future effect currently must adhere to the APA rulemaking requirements because there are no applicable statutory exceptions. Moreover, while Minnesota courts recognize two nonstatutory exceptions to the APA, neither of those exceptions apply.

The first exception recognized by the courts is for interpretations which are consistent with the plain meaning of the statute or rule. This exception is not met by merely showing that the interpretation is supported by the purpose of the law or rule. The interpretation must either be a restatement or must be consistent with and required by the language of the statute or rule, where any other interpretation would fail to give effect to that language. This exception does not apply because the interpretations contemplated by this study will go beyond the plain meaning to explain the requirements set out in the statute or rule.

The second exception recognized by the courts is for long-standing interpretations of an ambiguous rule. The courts give judicial deference to an agency's interpretation of its own rule where the rule is ambiguous and the interpretation is long-standing. This exception does not apply because the rulings will contain new pronouncements of Department policy rather than long-standing interpretations. Thus, a system of revenue rulings and tax information bulletins requires a statutory exception to the APA.

Taxpayer representatives and the Department agree that information, including policy decisions and statutory interpretations often needs to be made and disseminated quickly. For example, taxing statutes often become effective soon after enactment. At the effective date, taxpayers are liable for the tax imposed pursuant to the statute. Because of the time required for promulgation of an APA rule, taxpayers are left in the dark regarding the Department's interpretation and audit position well beyond the time when they become responsible for compliance. Therefore, an exception to the APA is necessary to enable the Department to provide the guidance needed by taxpayers.

An exception necessary for implementation of a system of rulings would apply only to interpretive rulings which merely explain the meaning of a statute, and such rulings would bind only the Department. Rulings involving other than mere interpretation of law would continue to be promulgated as APA rules. This includes rulemaking which is legislative in nature. For example, legislative

rules often confer rights and obligations by effectively filling in the requirements of a statute, as opposed to explaining it. Because the necessary exception will apply only to interpretive rulemaking, and will bind only the Department, the policies which support the APA will not be impaired.

APA procedures are designed to strike a balance between administrative ease (efficiency, economy, and convenience) and the public's right to be involved in governmental decision making. This right to be involved in governmental decision making assures that citizens will not be encumbered by laws enacted without their input.

Legislative rulemaking requires the APA level of public input because such rules often confer rights and obligations. Legislative rules usually provide the substance of a statute which may only set out the policy to be implemented. Because such rules encumber the public apart from the statute itself, the APA requires that public input be obtained. For situations which require expedited legislative rulemaking, the emergency rulemaking process is available.

On the other hand, interpretive rulemaking confers no rights or obligations, but merely explains the requirements set out in the statute itself. Statutes which are complete in and of themselves have already been subject to public input at the legislative hearings held when the statute was enacted.

Furthermore, because interpretive rulings are binding only on the Department, the taxpayer is not encumbered to the extent which results from an APA rule which has the force and effect of law. Taxpayers retain the ability to challenge the Department in court to the same extent available when a decision is made at the audit level. Interpretive rulings merely inform taxpayers about the Department's position.

3. **Tax Types Included.**

The tax types included in the rulings system should be all tax types except property tax.

Property tax should be excluded from a rulings system because the tax is county-administered. The Department provides only advice and direction to local government units. In addition, the Commissioner of Revenue has only general supervision over the administration of property taxes and, thus, lacks authority to prescribe the administration of local taxes. Although the Department has the power to promulgate rules under the APA for the administration of property taxes, rulemaking is less intrusive on the counties' authority than revenue rulings. In APA rulemaking, the counties have the opportunity to be heard, unlike when the Department makes unilateral

policy determinations. Counties can continue to seek advisory opinions from the Department but retain ultimate authority. There has been no interest in the inclusion of property tax and, in fact, there has been opposition to its inclusion by the Real Property Section of the Bar, the Association of Minnesota Counties and the Local Government Services Division of the Department of Revenue.

4. Structure.

Regarding the actual structure of a system of rulings, it is necessary to consider the legal effect of the rulings, the method of implementing and maintaining the system, and the cost.

a. Legal Effect.

The legal effect of rulings at the federal level and in other states should be the model for Minnesota's rulings. Thus, since they are interpretive of existing law, rulings issued by the Department would be retroactive to the effective date of the statute unless otherwise stated in the ruling.

(1) Reliance.

Taxpayers could rely on revenue rulings because they would bind the Department until revoked or modified. A ruling could be expressly revoked or modified by the Department. An express act by the Department would generally operate only prospectively. A change in law made subsequent to the issuance of the revenue ruling, whether by statute, court decision, or promulgation of an administrative rule or new revenue ruling, would modify or revoke a revenue ruling to the extent that the change in law affects the ruling. Whether such a change would operate retroactively would depend on the nature of the law change.

Tax information bulletins would not be binding on the Department. However, since they should, for the most part, contain only summaries and explanations, this should not burden the taxpayer. References will be provided to applicable law in order that the taxpayer may review the appropriate provision.

(2) Appealability.

Revenue rulings are not appealable decisions. As always, taxpayers would be free to appeal orders when the revenue ruling was applied to their circumstances. Because a revenue ruling does not have the force and effect of law, binding only the Department, the courts would not be required to give deference to the ruling. Similarly, tax information bulletins are not appealable.

b. Implementation and Maintenance.

The second element of structure, the method of implementation and maintenance, requires a centralized information bank. The functions of identifying issues, assigning the analyzing and drafting of rulings, and collection, publication and dissemination of rulings must be performed at one location.

Centralization will maximize efficiency and address the issue of consistency. Further, it will enhance accessibility.

c. Cost.

Cost is the final element of structure. If the system is to work effectively, a coordinator is necessary to perform the centralized functions. Further, costs will be incurred in publication of rulings and tax information bulletins, as well as in dissemination.

C. Private Letter Rulings.

Taxpayer representatives and the Department agree that a system for the issuance of private letter rulings should not be implemented.

Although the consensus was for rulings of broad applicability, there was some interest expressed in private letter rulings by the CPAs, the Bar, and the Taxpayers Association. The Bar expressed some interest in private advice regarding "unusual or extraordinary tax issues." There is, however, the recognized difficulty of balancing the interests of all taxpayers.

All eventually agreed that the Department should allocate its limited resources to issues of broad applicability rather than to specific taxpayers' requests for an analysis of the law as it applies to a particular set of circumstances. Moreover, if the Department's resources were expanded, its focus should remain on issues of broad applicability so that those resources benefit the greatest number of taxpayers. It is inequitable to spread the cost of private advice to specific taxpayers among all other taxpayers.

Further, the system of revenue rulings and tax information bulletins outlined above, combined with the current system of responding to individual taxpayers, will provide a mechanism for responding to "unusual or extraordinary tax issues." If the issue has broad application, the taxpayer will be able to request a revenue ruling. Otherwise, the Department will continue to respond informally to specific fact situations presented by individual taxpayers as time permits.

D. **Internal Communications.**

The final type of release issued by the IRS is the release of internal communications regarding the formation of policy decisions. Although a formal system of issuing these communications is not recommended, many of these communications are public information. Implementation of a rulings system will result in the compilation and centralization of this informal communication, providing for easier assessability.