STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of a Rule Governing the Practice of Attorneys, Accountants, Agents and Preparers Before the Department of Revenue (13 MCAR Section 1.6101)

STATEMENT OF NEED AND REASONABLENESS

This document has been prepared as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for and reasonableness of the proposed new rule. It is prepared pursuant to Minn. Stat. Section 15.0412, Subd. 4h, and 9 MCAR Section 2.104.

A Notice of Intent to Solicit Outside Opinion regarding the proposed rule was published in the State Register on January 29, 1979. The proposed rule was submitted for comment to those people and organizations that requested it, to the members of the Commissioner's Advisory Committee, and to various legislative staff persons. A meeting was held on May 20, 1981, at which time the rule was discussed with several interested people. Suggestions and comments that were received have been duly considered.

Authority to Adopt the Rule

Minn. Stat. Section 290.52 specifically grants the Commissioner of Revenue the authority to prescribe rules and regulations governing the recognition of agents, attorneys, or other persons representing claimants before the Commissioner.

Introductory Statement

The general purpose of this rule, pursuant to the statutory authority cited above, is to regulate the practice of attorneys, accountants,

agents and preparers (hereinafter referred to, as a group, either as "tax practitioners" or as "taxpayer representatives") before the Department of Revenue. Specifically, the rule is needed (1) to implement the authority which is granted to the Commissioner of Revenue to suspend or disbar tax practitioners, by providing a uniform procedure for such suspension or disbarment; (2) to provide ethical standards of behavior governing practice before the Department; (3) to set minimum standards of competency for those who practice; and (4) to define the nature and scope of practice before the Department of Revenue.

From a policy standpoint, it has been the experience of the Department of Revenue that certain tax practitioners have conducted themselves in an unprofessional manner regarding their dealings both with taxpayers and with the Department. The ultimate victims of such practitioners are their clients, and the promulgation of this rule will enable the Commissioner of Revenue to ensure taxpayers of receiving adequate representation in matters before the Commissioner. Furthermore, by requiring both competency and reputability from those who practice before the Department of Revenue, an efficient administration of tax cases involving Department employees and taxpayer representatives will be facilitated.

Many of the provisions in this rule are patterned after Treasury Department Circular No. 230-Regulations Governing the Practice of Attorneys, Certified Public Accountants, and Enrolled Agents Before the Internal Revenue Service (hereinafter referred to as the "I.R.S. regulations on practice"), and the I.R.S. Conference and Practice Requirements. The Internal Revenue Service has had regulations governing practice before it since 1966, and the Treasury Department deemed it necessary at that time to establish an office devoted entirely to such

matters, headed by a Director of Practice. Since the I.R.S. has both experience and expertise in administering this area, it is reasonable, whenever possible, to incorporate applicable federal provisions and procedures into this rule.

Statement of Need and Reasonableness

A. Since this proposed rule only affects those individuals who practice before the Department of Revenue, a definition of practice is obviously needed to determine under what circumstances the rule applies. The definition in this paragraph is adapted from the definition of practice found in Section 10.2(a) of the I.R.S. regulations on practice. The three exceptions to the definition, set forth in its third sentence, are mentioned to inform those who are affected by this rule that the Commissioner does not have the statutory authority to regulate these specific activities, of and by themselves. The Commissioner does have such authority, however, when these activities are coupled with the representation of a client at conferences, hearings and meetings. The last sentence of this paragraph is necessary for clarification and continuity.

B.1. This paragraph is needed to affirm the longstanding policy of the Department of Revenue, that no one can practice before the Department without first obtaining a written power of attorney from his client, and that whatever authority a taxpayer representative has in connection with a client's case stems from the power of attorney. The Internal Revenue Service also has the same policy, as expressed in Sections 601.502(c) and 601.504(a) of the I.R.S. Conference and Practice Requirements. The obvious

justification for requiring a power of attorney, is that pursuant to Minn. Stat. Section 290.61, the information contained in a taxpayer's return is private. Any Department of Revenue employee who discusses a taxpayer's case with a representative having no power of attorney risks violation of this statute, which constitutes a gross misdemeanor.

B.2. Since not all the taxes administered by the Commissioner of Revenue come within the purview of this rule, this paragraph is necessary to explain that the rule applies to those tax returns or tax forms arising under the income tax or property tax refund laws.

B.3. This paragraph is necessary to ensure that no privacy violations are committed, and that the power of attorney forms submitted to the Department of Revenue by the taxpayer representatives are accurate and complete.

B.4. This paragraph also ensures that no privacy violations are committed. If the Department employee does not recognize the taxpayer representative, it is reasonable to require some type of identification from him.

C. Number 1. in this part is obviously needed to enforce this rule. Number 2. is based upon a similar provision, Section 10.3(f), in the I.R.S. regulations on practice, and is necessary to prevent conflicts of interest which might arise from the representation of a taxpayer by a Department employee. Number 3., disbarment or suspension from practice as an attorney or accountant, is based upon Section 10.51(g) of the I.R.S. regulations on practice. This provision is reasonable, because permitting a disbarred or suspended attorney or accountant to practice

before the Department of Revenue is tantamount to condoning the unauthorized practice of law or accountancy, contrary to the mandate of the appropriate state licensing authority which has disbarred or suspended the individual. Number 4., disbarment or suspension from practice before the I.R.S. is also reasonable, because (1) as stated above in the Introductory Statement, this rule is primarily based upon the I.R.S. regulations on practice, and (2) many of the issues involved in a taxpayer's state income tax return arise from federal tax law, and a tax practitioner who has been disbarred or suspended by the I.R.S. should not be allowed to argue federal tax issues before the Commissioner of Revenue. Finally, numbers 3. and 4. taken together are reasonable, because if the disbarred or suspended individual is reinstated as a lawyer or accountant, or is reinstated to practice before the I.R.S., such reinstatement automatically reinstates the individual's eligibility to practice before the Department of Revenue. Thus, duplication of the same administrative process by different agencies is avoided.

D.1. This paragraph is adapted from Section 10.20(a) of the I.R.S. regulations on practice. The ethical standard imposed by this paragraph is reasonable, because (1) a Department employee cannot properly audit or review a taxpayer's case without having all relevant records or information at hand, (2) the employee cannot abuse his authority, since his requests are limited to lawful requests for non-privileged, relevant information, and (3) the taxpayer representative is not prohibited from insisting upon a subpoena.

D.1. This paragraph is adapted from Section 10.22 of the I.R.S. regulations on practice. It is reasonable, because the phrase "due diligence" is not meant to encompass an occasional error by the practitioner, or a good faith difference of opinion with the Department of Revenue as to a particular tax issue. Rather, the failure to exercise due diligence means a course of repeated negligent conduct, thereby displaying a lack of the minimum care and conscientiousness one would normally expect from a tax practitioner in the course of his profession.

D.3. This paragraph is reasonable, because it does not require the tax practitioner to verify every statement made to him by a client regarding that client's tax case. Rather, it is only when the practitioner, based upon his tax knowledge and experience, believes his client's statements are in all likelihood false or inaccurate, that he is required to verify those statements.

D.4. This paragraph is based upon Section 10.23 of the I.R.S. regulations on practice. It it needed to prevent a tax practitioner from neglecting the cases he is handling with the Department of Revenue, and from taking on new cases when he is aware that his workload prevents him from concluding the new cases in a reasonable amount of time. A delay caused by circumstances beyond the practitioner's control is not an unreasonable delay.

E. This part is necessary to clarify what constitutes incompetent conduct. It is reasonable, because due warning must first be given by the Commissioner of Revenue, pursuant to G.3., before any type of conduct as a tax practitioner can be labelled as "incompetent." With regard to number 1., given the fact that

taxation is a specialized and complex area of the law and is constantly changing, it is clearly reasonable to expect any individual who practices before the Department to be familiar with the current income tax statutes, rules and forms. As further support for the reasonableness of number 1., the state licensing authorities for attorneys and certified public accountants have for some time required a minimum amount of continuing education credits from their licensed members, and the Internal Revenue Service requires a written tax examination to be taken by all applicants for enrollment to practice before the I.R.S. who are not attorneys or certified public accountants. With regard to number 2., the reasonableness of the due diligence requirement is discussed above in reference to D.2. Concerning the use of the common law standard of negligence, this standard can be applied to the failure to exercise due diligence by determining what a reasonable and prudent tax practitioner would have done (or not done) under the same or similar circumstances.

F. The first sentence of this paragraph is needed to enforce part D. of the rule. The second sentence is introductory.

F.1. This provision is taken from Section 10.51(a) of the I.R.S. regulations on practice. Its reasonableness can be divided into two parts. First, it is clearly reasonable to presume that an individual convicted of a state or federal tax crime is morally unfit to practice before the Department of Revenue. Second, since the professional relationship between a taxpayer representative and his client is founded, in large part, upon a mutual trust between the two, conviction of a crime involving

dishonesty or breach of trust also constitutes reasonable grounds for suspension or disbarment from practice.

F.2. The need for and reasonableness of this provision are obvious. An individual who prepares or files a false return, whether his own return or that of his client's, is clearly unfit to practice before the Department of Revenue.

F.3. The need for and reasonableness of this provision are again obvious, for the same reasons given in support of F.2., above. It should be noted that neither F.3. nor F.4., discussed below, applies where the tax practitioner prepares a return and then submits it directly to the taxpayer, for it then becomes the responsibility of the taxpayer to file the return with the Department.

F.4. This provision is reasonable, because it is the responsibility of the tax practitioner to prepare an accurate return for the taxpayer. Once the practitioner becomes aware that a material error or omission was made on the original return, whether resulting in additional tax or a refund of tax, it is incumbent upon him, as a professional, to correct the error or omission by preparing or filing an amended return.

F.5. The need for this provision is obvious. It is also reasonable, because it only includes plans which are clearly illegal, or have been litigated in court and ruled to be illegal. Tax planning of questionable or unresolved legality is not prohibited by this rule.

F.6. The need for and reasonableness of this provision, which describes actions tantamount to perjury in a court of law, are obvious.

F.7. The need for and reasonableness of this provision are also obvious. The phrase "procuring the filing thereof" refers to a situation where the taxpayer representative is instrumental in bringing about the act, but does not directly commit the act itself.

F.8. This provision is adapted from Section 10.51(c) of the I.R.S. regulations on practice. It is a necessary and reasonable exercise of the Commissioner of Revenue's specific statutory authority to regulate false or misleading advertising by tax practitioners. Such authority is found in Minn. Stat. Section 290.52, which states in part as follows: "Such commissioner may . . . suspend and disbar from further practice before him, any such person, agent, or attorney . . . who shall with intent to defraud, in any manner wilfully and knowingly deceive, mislead, or threaten any claimant or prospective claimant, by words, circular, letter, or by advertisement." (Emphasis added.) Number a. is necessary to ensure continued compliance with the proposed rule following a disbarment or suspension from practice before the Department of Revenue. Number b. is reasonable, because it does not prohibit representations commonly referred to as "puffing"--that is, boasting about or slightly exaggerating one's expertise or ability as a tax return preparer. Number c. is reasonable, because such a guarantee constitutes a false assurance to the client that his claimed refund or tax credit will not be audited, reviewed or adjusted by the Department of Revenue. Number d. is reasonable, because it is directed at misrepresentations which have the effect of casting doubt upon the honesty and integrity of the Department of Revenue and its employees.

F.9. This provision is needed to explain that a tax practitioner cannot avoid responsibility under this rule for the preparation of a false return, when he is aware it is false, merely because its actual preparation was delegated by him to one of his employees or agents.

F.10. This provision is a duplication of Section 10.51(e) of the I.R.S. regulations on practice, and its need and reasonableness are obvious.

F.11. This paragraph is based upon Section 10.31 of the I.R.S. regulations on practice, and upon Section 6695(f) of the Internal Revenue Code. The Code provision prescribes a $500 civil penalty for each instance in which an income tax return preparer endorses or negotiates a client's refund check. F.11. is reasonable, because it does not prohibit the tax practitioner from endorsing or negotiating a client's refund check when the practitioner is a proper holder in due course of the check. Neither does it prohibit the practitioner from having the Department of Revenue mail a client's refund check to him, when the client, by means of a duly executed power of attorney, has authorized the practitioner to receive the check. However, a power of attorney cannot authorize a tax practitioner to endorse or negotiate a client's refund check. Since this procedure has been attempted in the past, this clause is needed to prohibit such improper use of the power of attorney form.

F.12. This provision is similar to Rule 302 of the Code of Professional Conduct governing accountants, found in 4 MCAR Section 6.150, and is needed and reasonable for several reasons. First, by charging a client a fee based upon a percentage of the cli-

ent's anticipated tax refund, the tax practitioner is confronted with an undue incentive to overstate the amount of his client's refund, contrary to the proper application and interpretation of the income tax laws. Second, there is no justifiable relationship between the amount of work which the tax practitioner performs for his client, and the amount of the client's tax refund. The amount of a refund is governed entirely by the income tax laws. Third, especially in regard to property tax refunds, which are often sizeable for those taxpayers with smaller incomes, contingent fees offer a tax practitioner the opportunity to charge more than his competitors for the same amount of work, because the poorer taxpayers may not have the funds to pay normal cash fees. Finally, the Department of Revenue has been contacted a number of times by taxpayers who have entered into contingent fee arrangements regarding their anticipated property tax refunds, complaining that they have been overcharged by the tax practitioner. This clause will enable the Department to take disciplinary action against a practitioner in response to such complaints.

F.13. This provision is based upon Section 10.51(f) of the I.R.S. regulations on practice, and is needed to ensure that the honest enforcement of the income tax laws by the Department of Revenue will not be disrupted or interfered with in any way.

F.14. This provision is adapted from Section 10.51(i) of the I.R.S. regulations on practice, and its need and reasonableness are obvious. The Commissioner cannot condone any conduct which impugns the honesty or integrity of the Department of Revenue or any of its employees.

F.15. This provision is based upon Section 10.51(h) of the I.R.S. regulations on practice. An example of the conduct proscribed by this clause is maintaining a partnership for the practice of law, accountancy, or other related professional service, with a person who is under disbarment or suspension from practice before the Department of Revenue. This example is taken from the text of the cited I.R.S. provision. F.15. is reasonable, because (1) it cannot be invoked by the Commissioner unless an individual has actual knowledge that a person with whom he is practicing has been disbarred or suspended, and (2) it prevents a disbarred or suspended individual from being afforded an undue opportunity to continue practicing before the Department, in direct violation of this rule.

F.16. This provision is needed for clarification, cross-reference, and continuity.

G.1. This paragraph, for purposes of introduction, clarification and continuity, summarizes the relevant portions of Minn. Stat. Section 290.52, giving the Commissioner statutory authority to disbar or suspend attorneys, accountants, agents or preparers from practicing before the Department of Revenue.

G.2. This paragraph is based upon Section 10.52 of the I.R.S. regulations on practice. It is needed for transition into the remainder of the rule, which deals with the actual procedure for disbarring or suspending an individual from practicing before the Department of Revenue.

G.3. This paragraph is reasonable on its face. Constitutional due process of law does not require any type of warning before legal action is commenced, so G.3. goes beyond due process of law in an attempt to be fair to the tax practitioner.

G.4. This paragraph is obviously needed to implement the Commissioner of Revenue's statutory authority to disbar or suspend a tax practitioner. It is reasonable, because the practitioner is guaranteed due process of law by means of a hearing in accordance with the Administrative Procedure Act, and the rules issued thererunder.

G.5. This paragraph is based upon Section 10.55(b) of the I.R.S. regulations on practice. G.5. is necessary, because it provides a means for disciplining a tax practitioner who admits to violating this rule and who waives his right to a hearing.

G.6. This paragraph is needed to provide the Commissioner of Revenue with a uniform guideline for disciplining a tax practitioner who has either voluntarily consented to suspension, or who, pursuant to hearing, has been found to violate the rule. By providing such a guideline, the Commissioner is prevented from making an arbitrary or capricious determination as to disciplinary action. The penalties provided in this paragraph are fair and reasonable, because a practitioner is not disbarred until his third proceeding in which disciplinable misconduct has been found or admitted to, and extenuating circumstances are considered in determining the severity of disciplinary action.

G.7. This paragraph is based upon Section 10.73 of the I.R.S. regulations on practice. The need and reasonableness of the first two sentences are obvious. The third sentence is needed to clarify the point, which is implicit throughout the rule, that this rule is intended to regulate individuals and not business entities by whom they may be employed.

G.8. This paragraph is needed to provide a suspended or disbarred taxpayer representative with the opportunity to petition for reinstatement to practice before the Department of Revenue. The Internal Revenue Service also has a provision for petitioning for reinstatement, which is Section 10.75 of the I.R.S. regulations on practice. The effort to be fair and reasonable to the practitioner becomes apparent when G.8. is compared to the more restrictive I.R.S. provision. Under Section 10.75, only those individuals who have been disbarred by the I.R.S. can petition for reinstatement, and a petition may not be made until five years have expired after disbarment. Individuals who have been suspended by the I.R.S. have no right to petition for reinstatement. In contrast, the only conditions to petitioning for reinstatement under G.8. are first, a material change must have occurred in the practitioner's circumstances, and second, oral or written support for the petition from responsible third parties is required. These conditions are necessary to prevent excessive or unjustified use of the petition process, which could occur if unsubstantiated petitions were allowed to be filed.

Repealer It is necessary and reasonable to repeal Income Tax Rule 2054(4) because (1) Rule 2052(4) and the proposed new rule both deal with the same subject matter, so the existing rule must be repealed to eliminate any conflicts with the proposed rule, and (2) the existing rule is inadequate in effecting the Commissioner of Revenue's statutory authority to regulate the practice of attorneys, accountants, agents and preparers before the Department of Revenue.