OFFICIAL OPINION NO. 87-41, Department of Revenue Audit Report

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Dear Auditor General:

Senator Gary W. Hanson, Chairman of the Government Operations and Audit Committee on your behalf, has requested my official opinion with respect to the Audit Report of the Department of Revenue for the Fiscal Year ended June 30, 1985.

Concerning this, he has set forth the following:

FACTS:

The Government Operations and Audit Committee has reviewed the above referenced audit report and is extremely concerned with the lack of support for adjusting taxes assessed as a result of tax audits. The committee is also concerned with the apparent inconsistent and retroactive application of tax laws. The committee requests your assessment of tax audit circumstances identified in the audit report and also requests a response to the following questions.

QUESTIONS:

1. Who has authority to adjust or write off taxes assessed as a result of tax audits?

2. Is the Department of Revenue required to document reasons for adjusting tax assessments resulting from tax audits?

3. If not specifically stated in law, can tax laws be applied retroactively?

BACKGROUND--Present State of the Law

A general discussion of the applicable laws is necessary before specifically addressing these questions.

The Department of Revenue is an executive agency of state government whose form and functions are provided in SDCL 1-47-3. The Secretary of the Department is appointed by the Governor, by and with the consent of the Senate, for a term of four years unless sooner removed by the Governor for cause. SDCL 10-1-2. Cf. SDCL 1-32-3.

Among the responsibilities of the Secretary of Revenue is the power to exercise general supervision over the administration of the assessment and tax laws of the State, SDCL 10-1-15. The Secretary is also given the power and the duty to construe the tax laws of the State to see that all taxes due the State, counties, municipalities, and other local subdivisions are collected. SDCL 10-1-40. From any decision of the Secretary of Revenue relating to compromise, adjustment or refund of taxes, any person aggrieved or interested, including any officer, department, board, commission, agency, institution or subdivision of the state may take an appeal to the circuit court. SDCL 10-1-41.

While by statute the Secretary of Revenue thus has broad powers, those powers have been characterized by our Supreme Court in the case of Berdahl v. Gillis, 81 S.D. 436, 136 N.W.2d 633 (1965). In that case the question revolved around a broadening of the sales tax by the Legislature in 1965, and a claim that the law was unconstitutional on its face for the reason that it unlawfully delegated legislative power to the Commissioner (Secretary) of Revenue.

The particular portion of the Act objected to was Section 1, which imposed the tax "... upon the gross receipts of any person engaging in the practice of any profession or of any business ... in which ... the service rendered is of a professional, technical or scientific nature and is paid for on a fee basis, or by a consideration in the nature of a retainer ..."

The Court interpreted what is now SDCL 10-1-40, and said at 136 N.W.2d 636:

In accordance with the general rule we have often held that the legislature may delegate to an administrative body or officer the duties of carrying out its enactments if it adopts a clearly declared legislative policy and lays down understandable standards to guide the

administrative action. Affiliated Distillers Brands Corporation v. Gillis, S.D. 1985, 130 N.W.2d 597.

The Petitioner had argued that there were not sufficient standards to distinguish gross receipts which are taxable from those which are exempt, and that the Commissioner in carrying out the Act would be legislating. This issue is similar to the questions raised by your opinion request regarding the Secretary's authority to adjust, write-off or otherwise interpret taxability versus exempt status in whole or in part of taxpayers' activities or business operations.

Our Court, after holding that there were sufficient guidelines in the Act to permit the Secretary to make a determination, stated at 136 N.W.2d 637:

Although the Commissioner may be required to make such determinations in the first instance, they must remain undecided until presented as an issue before the courts. (Citations omitted.)

The Commissioner's interpretation and construction of the terms of the statute are only an administrative guess at a judicial question. (Citations omitted.)

The Court held that when the Commissioner interprets the statutes he is not legislating. This unanimous decision of our Court sets the stage and will serve as a basis for my official opinion.

PRACTICAL EFFECT

The Secretary of Revenue has the duty and the authority to interpret the tax laws in performing his executive duties. An appeal may be taken from any final decision he makes within 30 days of that action. SDCL 1-26-31.

While such appeals are normally originated by a taxpayer against whom a Certificate of Assessment is filed (SDCL 10-59-4, my reading of the statutes convinces me that the purpose behind SDCL 1-26-17.1 and 1-26-30 is to permit any party interested in the ruling of the Secretary to appeal. This could include a person in similar circumstances who was treated in a different manner. It could include the Attorney General pursuant to SDCL 1-11-1(2) if in his judgment the welfare of the State demands such action. It may well include

yourself in the performance of your duties, as will be discussed more fully later in this opinion.

The obvious problem is that a taxpayer, other than the one who has been directly affected by the decision of the Secretary of Revenue, may not be aware of the lack of uniformity in the treatment accorded him. In point of fact, all tax returns and tax information is confidential. SDCL 10-1-28.1.

It would appear there is no practical system of checks and balances on the Department of Revenue except for the expected faithful performance of the officers and employees appointed thereto under the laws enacted by the Legislature.

The Legislature has, however, created the Department of Legislative Audit which is responsible for performing financial and compliance audits of all state officers, departments, agencies, etc. SDCL 4-11-2. In addition, the Governor may order a special audit, investigation or examination which, when made and appropriately filed with the Governor and Secretary of State, is subject to inspection in the office of the Secretary of State. SDCL 4-11-3.

The question then arises: "Does the term 'compliance audit' encompass a review of the policy decisions of an executive officer?" In my view it does. It would be somewhat absurd to hold that the Auditor General can examine the expenditures of appropriated and non-appropriated funds, but not review the processes by which such funds are initially obtained, i.e., the levying of taxes, fees, etc.

This position is strengthened by SDCL 4-11-14, which authorizes recovery by legal process of fees or public funds which have been misappropriated based on the filed report of the Auditor General. That action may be instituted in the proper court, within 60 days from the receipt of the report where malfeasance, misfeasance or neglect of duty has been disclosed. It is made the obligation of the Governor and this office, to see that this recovery takes place, and SDCL 4-11-16 gives the Attorney General the power to institute and prosecute such action to final determination. The institution of such proceedings to recover funds or to determine the rights of the parties is not a bar to any criminal actions or prosecutions which may be applicable.

I also call your attention to the provisions of SDCL 2-6-2, concerning the Government Operations and Audit Committee. By law, this Committee may examine not only records,

vouchers and expenditures, but it may also examine the "general management of each department ..." SDCL 2-6-4. This may be accomplished with the assistance of the Department of Legislative Audit.

Thus the Auditor General may under SDCL ch. 4-11 conduct reviews. The Government Operations and Audit Committee may examine and the Executive Board of the Legislative Research Council is empowered to act on behalf of the Legislature in directing the activity of the Auditor General. SDCL 4-2-8. The process is therefore not completely without a balance, however cumbersome it may appear to be. It must be remembered that there is a general presumption that public officers have properly discharged the duties of their office, and have faithfully performed those matters with which they are charged. 63A Am.Jur.2d § 622.

This should in no way be taken as a suggestion or innuendo on my part that the Secretary of Revenue has done otherwise than the law requires. I felt this discussion was necessary preliminary to a response to your questions.

IN RE QUESTION NO. 1:

The Secretary of Revenue, or the Director of the Audit Division of the Department of Revenue may adjust audit amounts consistent with their understanding of the laws of this State; subject to review by the Auditor General and the courts.

IN RE QUESTION NO. 2:

The Department of Revenue is not required to reduce its thought processes to specific findings except as provided in SDCL ch. 1-26 in contested cases. The Secretary of Revenue should support his interpretations of the tax laws with logic and consistency, since clearly erroneous or arbitrary and capricious decisions would not stand judicial scrutiny.

IN RE QUESTION NO. 3:

The general rule in South Dakota is that statutes are presumed to have prospective application and may be construed as retroactive only when such intention plainly appears. SDCL 2-14-21. Johnson v. Kusel, 298 N.W.2d 91 (S.D. 1980).

The retroactive application of a statute must be considered in terms of the due process framework for determining its validity. Our Supreme Court noted in the case of State ex rel. VanEmmerik v. Janklow, 304 N.W.2d 700 (S.D. 1981) at 705:

No precise guidelines exist that state with certainty when a particular retroactive tax law can be upheld. In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation ...

The audit report you have placed on file does not detail any cases in which a retroactive effect was given to statutes. I understand this is because of your feeling that SDCL 10-1-28.1 makes return information in your hands confidential. Although SDCL 10-1-28.4(5) permits the release of returns and return information to you in your official capacity as Auditor General under certain circumstances where for example you are exercising your functions in the area of civil law enforcement. Because the scope of the present opinion request does not extend to the confidentiality question, I decline to give an opinion on that subject.

As a general proposition of retroactivity, I can say that from a legislative standpoint, merely because a statute has some retroactive application, does not mean the statute has taken effect before its effective date. In the normal instance the charge is usually that there is some retroactive application. The rule in South Dakota is that such application will only be applied when a clear intention of such operation is plainly indicated. Johnson v. Kusel, 298 N.W.2d 91, 92 (S.D. 1980); Homestake Mining Co. v. Johnson, 374 N.W.2d 357, 363 (S.D. 1985). Our Court in Homestake said that if, in light of the nature of the tax and the circumstances to which it is applied, its application is not harsh or oppressive, retroactive application will not be unconstitutional. Obviously in contested cases it will be the taxpayer who is challenging the retroactive application of the law. Where the administrator has given such application to a statute in the taxpayer's favor, there would be no challenge by him. I can only speculate from the information you have given me that following a clarifying amendment to the South Dakota Codified Laws, the then Secretary of Revenue determined that his prior interpretation of the section in question was not correct and changed it nunc pro tunc.

When that sort of administrative action takes place, it is my opinion such interpretation must continue to be, as stated in Berdahl, an "administrative guess at a judicial

question." In my view, however, the administrator is entitled, within the bounds of statutory construction, to place his own interpretation on the law and if this results in a greater or lesser tax liability, any person interested or aggrieved by that action has a right of appeal, as well as other processes described above.

The opinion request also asks me to give my assessment of tax audit circumstances identified in the audit report. Unfortunately, the tax audit section of the report is so general I am unable to give an assessment beyond the specific answers I have made above. I would like to suggest that where you may be concerned about malfeasance, misfeasance or neglect of duty on the part of a public official, your audit report details your findings and conclusions on that subject, and then I could give a meaningful assessment, and carry out my legal duties under SDCL 4-11-16.

Respectfully submitted,

Roger A. Tellinghuisen
Attorney General