Significant Changes In IRS Regulatory Process Ahead

By **Andrew Roberson and Timothy Shuman** (March 8, 2019, 2:42 PM EST)

Andrew Roberson

Timothy Shuman

In a previously unannounced development, the U.S. Department of the Treasury issued a policy statement on the tax regulatory process[1] on March 5, 2019, announcing significant changes related to regulations and subregulatory guidance. The policy statement addresses four areas, which are discussed below.

Commitment to Notice-and-Comment Rulemaking

Under the Administrative Procedure Act, agency rules can be either legislative or interpretive. Legislative rules are binding and carry the force of law while interpretive rules are intended only to advise the public of the agency's position on what the law means. The APA generally requires that legislative rules go through the notice-and-comment process before becoming effective.

The Internal Revenue Service's administrative position[2] is that most tax regulations are interpretive, despite the fact that courts have held that validly issued tax regulations are binding on taxpayers. The policy statement does not disavow this position; however, it states that "as a matter of sound regulatory policy, the Treasury Department and the IRS will continue to adhere to their longstanding practice of using the notice-and-comment process for interpretive tax rules published in the Code of Federal Regulations."

It is worth noting that this position applies only to regulations, not to interpretive tax rules such as subregulatory guidance that are published in the Internal Revenue Bulletin but not in the Code of Federal Regulations. Thus, the IRS will continue to issue subregulatory guidance without providing for notice-and-comment because such guidance is interpretive within the meaning of the APA.

Limited Use of Temporary Regulations

Over the years, the IRS has used interim-final rulemaking by issuing temporary regulations carrying the force of law without notice and comment while simultaneously issuing proposed regulations requesting comments. The practice is generally permissible under the APA so long as the IRS states in the temporary regulations that for good cause notice is impracticable, unnecessary or contrary to public interest and provides "a brief statement of reasons" in the regulations. However, in very few cases has the IRS invoked the good cause exception, instead arguing that I.R.C. Section 7805(e)[3] authorizes the issuance of immediately binding temporary regulations.

The policy statement, perhaps in response to recent litigation and the now-established view that administrative law principles apply equally to the tax law, states that the Treasury Department and the IRS commit to including a good cause statement when issuing any future temporary tax regulations. It remains to be seen how the IRS will interpret the good cause exception. The IRS has invoked the exception in the past, but in some instances its "statement of reasons" has been extremely limited and arguably short of what courts have required in general administrative law cases.

The policy statement also indicates that the IRS will continue to adhere to other limitations in the Code, including that temporary regulations must expire within three years of issuance and proposed regulations must be issued with any temporary regulations. However, the policy statement does not provide a position on the continuing applicability of temporary regulations issued before Nov. 20, 1998, the effective date of the three-year sunset provision. Although courts have not specifically addressed whether temporary regulations issued before this date can continue to remain binding, some courts have questioned how regulations can remain "temporary" several years after being promulgated.

Proper Scope of Subregulatory Guidance Documents

The IRS issues various forms of subregulatory guidance, including revenue rulings and procedures, notices and announcements. These forms of guidance, while published in the Internal Revenue Bulletin, do not carry the force of law and therefore are interpretive rules that are not subject to the APA's notice-and-comment requirements. However, courts have held that the IRS is bound by these forms of published guidance by essentially treating them as concessions by the IRS.

The policy statement reflects the logical view that subregulatory guidance should not be used to modify existing legislative rules or create new ones. Thus, as a matter of policy, the IRS will not seek Auer[4] or Chevron[5] deference for interpretations in such guidance.

The policy regarding not arguing for Chevron deference is not surprising given that the IRS has abandoned efforts in recent years to apply Chevron to subregulatory guidance after failing to gain traction with the courts. The abandonment of reliance on Auer deference is somewhat surprising given that the IRS has gained some traction — mostly outside the Tax Court — in arguing for such deference to guidance, even when the guidance is not published in the Internal Revenue Bulletin. However, this is a welcome development for taxpayers and may reflect the government-as-a-whole's concern over the continued viability of Auer as expressed in the pending U.S. Supreme Court case of Kisor v. Wilkie.[6]

The policy statement does not address the Treasury's and the IRS' view on Skidmore[7] deference for subregulatory guidance. Thus, the IRS may continue to argue that guidance published in the Internal Revenue Bulletin that interprets the Internal Revenue Code should be granted deference commensurate with such guidance's "power to persuade."[8]

Limit on Notices Announcing Intent to Propose Regulations

In the past, the IRS has published notices in the Internal Revenue Bulletin announcing an intent to issue proposed regulations, often using the publication of the notice as setting the date on which the eventual regulations will be effective. Such notices often describe the scope and content of the intended proposed regulations and invite comments. This practice has sometimes resulted in a chilling effect for taxpayers with regard to certain transactions — most notably in recent years, the IRS has issued notices involving "inversion" transactions and related issues (although in some instances the guidance announced in these notices has been reflected in final regulations). The practice of issuing notices can create confusion and uncertainty for taxpayers, particularly as notices remain on the books years after issuance.

The policy statement acknowledges this problem and states "each future Notice of intent to issue proposed regulations" will state that if no proposed regulations or other guidance is released within 18 months after the date the notice is published, taxpayers may continue to

rely on the notice and the IRS will not assert a position adverse to taxpayers based in whole or in part on the notice.

Unanswered questions here include whether this policy will be applied to existing notices and whether the IRS will continue the practice of using the issuance of a notice as fixing the effective date of final regulations — once ultimately promulgated. Given that the intent behind the policy is to avoid confusion and uncertainty, the policy should be applied to both existing and future notices.

Conclusion

The policy statement is a welcome development for taxpayers and appears to reflect a shift in thinking at the Treasury Department and the IRS to bring existing practices more in line with general administrative law principles. The policy statement appears consistent with other recent actions by the current administration on the scope and volume of administrative guidance. However, the policy statement specifically states that it "is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States, its departments, agencies, or entities, its officers, employees, or agents, or any other person." Thus, it is unclear to what extent taxpayers can force the IRS to follow the policy statement.[9]

Andrew R. Roberson and Timothy S. Shuman are partners at McDermott Will & Emery LLP.

McDermott Will & Emery LLP is a regular contributor to Tax Authority Law360.

[1] Department of the Treasury, "Policy Statement on the Tax Regulatory Process," (Mar. 5, 2019) (available at https://home.treasury.gov/system/files/131/Policy-Statement-on-the-Tax-Regulatory-Process-3-4-19.pdf).

[2] See Internal Revenue Manual, 32.1.1 (available at https://www.irs.gov/irm/part32/irm_32-001-001#idm139647502564816).

[3] I.R.C. Section 7805(e)

[4] Auer v. Robbins, 519 U.S. 452 (1997).

[5] Chevron U.S.A., Inc. v. Natural Resources Defense Council Inc., 467 U.S. 837 (1984).

[6] S.Ct. Dkt. No. 18-15. For prior coverage of Kisor, see Roberson & Shuman, "Deference Principles: Tax Litigation's Next Battleground," Law360 (January 7, 2019) (available at https://www.law360.com/articles/1115939/deference-principles-tax-litigation-s-next-battleground) and Roberson & Shuman, "Government Files Its Brief in Auer Deference Case," Tax Controversy 360 (February 27, 2019) (available at).

[7] Skidmore v. Swift & Co., 323 U.S. 134 (1944).

[8] An overview of deference principles can be found in Roberson & Shuman, "Deference Principles: Tax Litigation's Next Battleground," supra note 5.

[9] This same limiting language can be found in executive orders issued by the president of the United States, and courts have generally rejected attempts to rely on such orders containing this language. See, e.g., Defenders of Wildlife v. Perciaspe, 714 F.3d 1317, 1324 n.6 (D.C. Cir. 2017). However, the statements in the policy statement can be analogized to the IRS' statements in CC-2003-014, which instruct IRS employees not to take positions contrary to IRS published guidance.