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IN FOCUS

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Reliance on Treasury Department and IRS Tax Guidance

The Treasury Department and Internal Revenue Service (IRS) use several forms of guidance to help taxpayers understand the Internal Revenue Code (IRC) and to inform taxpayers of Treasury and the IRS's position on particular tax issues. For the most part, this tax guidance can be split into three categories: (i) treasury regulations, (ii) sub-regulatory guidance published in the *Internal Revenue Bulletin* (IRB), and (iii) *unpublished* sub-regulatory guidance (i.e., sub-regulatory guidance not published in the *Federal Register* or the IRB). Former IRS Chief Counsel have remarked that the type of guidance issued reflects a balance between taxpayers' need for certainty and Treasury and the IRS's need for latitude in administering tax laws.

In a tax dispute with Treasury or the IRS, taxpayers can rely on treasury regulations and sub-regulatory guidance published in the IRB (such as revenue rulings, revenue procedures, notices, and announcements) to support their tax position, as long as the guidance is not contrary to or inconsistent with the law. Taxpayers are generally unable to rely on unpublished sub-regulatory guidance in tax disputes. Given that Treasury and the IRS often issue unpublished sub-regulatory guidance in response to time-sensitive issues, taxpayers may choose to exercise caution when the need for clarity and certainty is at its greatest, and might wait for Congress to potentially enact clarifying legislation or for courts to address the legal issue in litigation. That said, Treasury and the IRS sometimes may include a statement in their unpublished sub-regulatory guidance conveying that they will not take a position inconsistent with or contrary to the guidance.

This In Focus analyzes the ability of taxpayers to rely on valid treasury regulations and the more common types of sub-regulatory tax guidance.

Common Types of Treasury and IRS Tax Guidance

Treasury Regulations

Treasury regulations are the most significant type of tax guidance issued by Treasury and the IRS, and courts generally afford them the greatest deference. Treasury regulations can provide guidance on newly enacted legislation and tax issues that arise with respect to pre-existing laws. Taxpayers may rely on *final* and *temporary treasury regulations*, but may not rely on *proposed treasury regulations* unless they contain an express statement permitting reliance.

Generally, proposed treasury regulations are published in the *Federal Register* as a Notice of Proposed Rulemaking, which invites the public to review and comment on the proposed regulation. Treasury and the IRS may modify or withdraw a proposed treasury regulation based on the comments they receive. After considering the public's comments, the agencies may issue a final regulation and publish it in the *Federal Register* as a *treasury decision*.

Treasury and the IRS issue temporary treasury regulations when they conclude that the public requires immediate guidance before the publication of final treasury regulations. Temporary treasury regulations also are published in the *Federal Register* as treasury decisions. When Treasury and the IRS issue a temporary treasury regulation, they simultaneously issue a corresponding proposed treasury regulation. IRC Section 7805(e) mandates that temporary treasury regulations expire three years after issuance.

Pursuant to a memorandum of agreement between Treasury and the Office of Management and Budget (OMB) dated April 11, 2018, tax regulatory actions that are likely to result in any of three types of tax regulations are subject to another layer of review. These are (i) regulations that create serious inconsistencies or interfere with actions taken or planned by another agency; (ii) regulations that raise novel legal or policy issues; and (iii) regulations that have an annual nonrevenue effect on the economy of $100 million or more. Subject to listed exceptions, the OMB's Office of Information and Regulatory Affairs (OIRA) reviews these tax regulatory actions in accordance with Executive Order 12866. During the OIRA review process, OIRA may meet with business representatives, nongovernmental organizations, and the public to discuss these actions.

In litigation disputing the validity of a treasury regulation, Treasury and the IRS may argue that a court should show deference to their interpretation of a statute that they administer. Historically, courts distinguished tax regulations promulgated under specific statutory grants of authority from tax regulations promulgated under IRC Section 7805(a), which provides the Treasury Secretary with a general power to issue "all needful rules and regulations" to enforce the IRC. Courts showed greater deference to Treasury and the IRS when they promulgated tax regulations pursuant to a statute that expressly called for the agencies to create detailed rules to implement the statute or fill a particular gap. However, following the U.S. Supreme Court's decision in *Mayo Foundation for Medical Education and Research v. United States*, courts now apply the judicial deference framework established by the Supreme Court in *Chevron U.S.A. Inc., v. Natural Resources Defense Council* to evaluate whether a treasury regulation is valid, regardless of whether the agencies acted under a specific statutory grant of authority or IRC Section 7805(a).

Revenue Rulings

Revenue rulings are the IRS's official interpretation of tax laws, related statutes, tax treaties, and regulations as applied to a specific set of facts. They are published in the IRB. Taxpayers may rely on revenue rulings when the taxpayer's facts are substantially the same as the taxpayer's facts addressed in the revenue ruling. Revenue rulings foster uniformity and enable taxpayers to make informed decisions about their tax obligations.

Revenue rulings do not carry the same level of authority as treasury regulations. Taxpayers can rely on a revenue ruling published in the IRB, but later sub-regulatory guidance can render a revenue ruling moot. Treasury has stated it will not take positions inconsistent with a revenue ruling published in the IRB when the revenue ruling is in effect. Courts have not come to a consensus on what, if any, deference they should afford to the IRS's interpretation in a revenue ruling, but they usually apply the framework set forth in the U.S. Supreme Court's opinion in *Skidmore v. Swift & Company*, under which a court gives the IRS's interpretation weight that is consistent with the strength of the agency's persuasiveness.

Revenue Procedures

The IRS announces administrative practices and procedures through revenue procedures published in the IRB. While a revenue ruling informs the public of Treasury and the IRS's position on the application of a law, treaty provision, or regulation to a specific set of facts, a revenue procedure may provide return filing or other instruction concerning that position. Revenue procedures cover diverse topics, such as the adoption of accounting methods, the computation of certain expenses, the methods of electronic filing, and the types of transactions that Treasury and the IRS are scrutinizing. Taxpayers may rely on revenue procedures when their facts are substantially the same as those described in the revenue procedure.

Like revenue rulings, revenue procedures do not have the same level of authority as treasury regulations. Taxpayers can rely on a revenue procedure published in the IRB, but later sub-regulatory guidance can render a revenue ruling moot. Treasury has stated it will not take positions inconsistent with a revenue procedure published in the IRB when the revenue procedure is in effect. *Some* courts have applied *Skidmore* deference when reviewing the IRS's interpretation in a revenue procedure, but again there is no consensus on the proper standard of deference, if any.

Announcements and Notices

The IRS makes public pronouncements through announcements and notices when time is of the essence. Announcements have immediate or short-term value. They can summarize laws and regulations without making substantive interpretations, explain regulations that are imminent, and notify taxpayers of approaching deadlines. Notices may contain substantive interpretations of the IRC or other laws. Treasury and the IRS have used notices to inform taxpayers of the types of transactions that they are scrutinizing. Treasury and the IRS *may* publish announcements and notices in the IRB. Generally, taxpayers can rely on announcements and notices published in the IRB, but later sub-regulatory guidance can render a notice or announcement moot.

Treasury has stated it will not take positions inconsistent with an announcement or a notice published in the IRB when the announcement or notice is in effect. In determining the validity of the IRS's action in an announcement or notice, it is unclear if courts will afford Treasury and the IRS any deference.

Administrative Procedure Act Challenges to the Validity of Treasury and IRS Tax Guidance

Section 553 of the Administrative Procedure Act (APA) generally requires federal agencies to follow notice-and-comment rulemaking procedures before issuing, amending, or repealing *legislative rules* (i.e., rules that carry the force of law). The APA does not require federal agencies to apply these same procedures to *interpretive rules*. The IRS contends, in Internal Revenue Manual 32.1.1.2.6, that most treasury regulations are interpretive rules, because the tax statute that the treasury regulation implements "contains the necessary legal authority for the action taken and any effect of the regulation flows directly from that statute."

Contemporary case law suggests that some of the tax guidance that the IRS designates as interpretive rules are, in fact, legislative rules subject to APA notice-and-comment rulemaking procedures. In *Chamber of Commerce of United States v. Internal Revenue Service*, a district court determined that a temporary treasury regulation was not an interpretive rule because it was substantive. The temporary treasury regulation adjusted the computation for determining whether a corporation should be treated as a surrogate foreign corporation. The court held that the adjustments were "not mere interpretations of the statute, but substantive modifications to the application of the statute." The court relied on the U.S. Supreme Court's decision in *Chrysler Corporation v. Brown*, which describes legislative rules as substantive rules "affecting individual rights and obligations."

Another district court case, *Bullock v. IRS*, suggests a court could invalidate *any* type of tax guidance if the court finds the guidance constitutes a legislative rule and Treasury and the IRS have failed to adhere to APA notice-and-comment rulemaking procedures. The district court found that a revenue procedure was a legislative rule because it effectively amended a prior legislative rule—a treasury regulation promulgated after a public notice-and-comment period. In response to the decision in *Bullock*, the IRS published Notice 2019-47 in the IRB, which provides penalty relief for taxpayers who relied on the revenue procedure invalidated by the district court.

The application of APA notice-and-comment rulemaking procedures to Treasury and IRS tax guidance is a quickly developing area of law. Treasury and IRS tax guidance may also face procedural challenges to their validity under the Paperwork Reduction Act, the Regulatory Flexibility Act, and the Congressional Review Act.

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