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INSIGHT: Treasury Issues Policy Statement that May Be the Death Knell for 'Auer' Deference in Tax Cases and Zombie Notices



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On March 5, 2019, the Treasury Department released a “Policy Statement on the Tax Regulatory Process.” The policy statement announces changes to the processes used for issuing and applying various types of guidance used by the Treasury Department and the Internal Revenue Service.

Tax litigators will appreciate that the IRS will no longer seek *Auer* deference in the U.S. Tax Court for interpretations set forth in its subregulatory guidance. Tax practitioners also will be pleased that the policy statement addresses their concerns that tax law guidance too often is announced through informal means without an opportunity for the tax law community’s participation through notice and comment. But practitioners may also be concerned whether these new policies will allow Treasury and the IRS to address urgent questions and provide clarity about tax issues in a timely fashion.

THE FINAL NAIL IN THE AUER DEFERENCE COFFIN?

[The policy statement](#) has serious implications for the use of judicial deference in tax litigation. Treasury states that the IRS will not seek judicial deference under *Auer v. Robbins* or *Chevron U.S.A. v. Natural Resources Defense Council* to its statutory or regulatory interpretations set forth only in subregulatory guidance and will not argue that subregulatory guidance has the force and effect of law. Examples of subregulatory

guidance issued by the IRS include revenue rulings, revenue procedures, notices, and announcements.

Auer and its progeny provide that courts should defer to an agency’s interpretation of its own regulations unless the agency’s interpretation is “plainly erroneous or inconsistent with the regulation,” “conflicts with a prior interpretation,” “does not reflect the agency’s fair and considered judgment on the matter in question,” or “appears. . . [to be] nothing more than a convenient litigating position.” See *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 155 (2012) (internal quotations and citations omitted); see also *Auer*, 519 U.S. at 461-63; *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). The Supreme Court also has admonished against using *Auer* deference where the agency’s interpretation results in an unfair surprise by failing to provide a “fair warning of the conduct a regulation prohibits or requires.” *Christopher*, 567 U.S. at 156-57 (citations omitted). *Chevron* deference provides that, when a statute is ambiguous, courts must defer to the agency’s reasonable interpretation of that statute. *Chevron*, 467 U.S. at 844-45.

The policy statement may effectively eliminate *Auer* deference in Federal tax cases, certainly in Tax Court cases and possibly in refund forum and appellate cases. Under the policy statement, the IRS will no longer seek *Auer* deference in Tax Court cases for its subregulatory guidance. The policy statement does not address matters handled by the Department of Justice Tax Division, either in refund cases or on appeal, in the circuit courts of appeals, district courts, and bankruptcy courts. However, the DOJ may find it very difficult, if not impossible, to argue persuasively that courts should defer under *Auer* to interpretations set forth in the IRS’s sub-

regulatory guidance, when the IRS has announced that such judicial deference is inappropriate and that it accordingly will no longer seek deference regarding the very same guidance in the Tax Court.

Although the policy statement also indicates that the IRS will not seek *Chevron* deference in the Tax Court for its subregulatory guidance, it does not address whether the IRS will seek *Chevron* deference for Treasury regulations that have gone through the formal notice-and-comment process. For now, it is safe to assume that the IRS will continue to argue for *Chevron* deference in cases involving agency interpretations adopted through formal rulemaking. Though the policy statement does not address *Skidmore* or *Mead* deference, it seems likely that both the IRS and DOJ will continue to argue for such judicial deference in some cases involving the IRS's subregulatory guidance. *Skidmore* and *Mead* deference provide that courts should assess the merits of an agency's analysis of the statute when determining the best available construction because the agency has access to "specialized experience and broader investigations and information." *United States v. Mead Corp.*, 533 U.S. 218, 234 (2001) (quoting *Skidmore v. Swift*, 323 U.S. 134, 139 (1944) (internal quotation marks omitted)).

The Treasury Department's new policy regarding *Auer* deference is issued in the context of growing criticism of such judicial deference, both inside and outside of the tax world. On March 27, 2019, the Supreme Court will hear arguments in *Kisor v. Wilkie*, a case dealing with the Department of Veterans Affairs' interpretation of one of its regulations. See 869 F.3d 1360 (Fed. Cir. 2017), *petition for cert. granted*, 139 S.Ct. 657 (Dec. 10, 2018) (No. 18-15). In *Kisor*, the petitioner is arguing that, because of *Auer* deference, agencies deliberately issue vague regulations with the expectation that the agency can then later interpret those regulations to its advantage. Accordingly, in *Kisor*, the Supreme Court may eliminate *Auer* deference entirely or place additional restrictions on its use by the lower courts.

REDUCED RELIANCE ON SUBREGULATORY GUIDANCE

For many years, practitioners have expressed concern regarding the IRS's extensive use of subregulatory guidance. The IRS's need to issue guidance to tax practitioners and taxpayers is particularly significant today in light of the Tax Cuts and Jobs Act and other recent tax law changes. To address issues quickly, the Treasury Department and the IRS often use subregulatory or other informal guidance. Historically, the IRS considered Treasury regulations and guidance published in the Internal Revenue Bulletin, such as revenue rulings, revenue procedures, notices and announcements, to be authoritative. See Government Accountability Office, "Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance," GAO-16-720 (Sep. 6, 2016).

The Treasury Department's policy statement addresses the criticism of the IRS's extensive reliance on subregulatory guidance. The policy statement emphasizes that the notice-and-comment process is the preferred method for agency rulemaking because it allows the public to engage with the government and point out issues of which the government is unaware. Treasury

states it will use the notice-and-comment process for both legislative and interpretive rules going forward. With respect to the use of informal guidance, such as notices of intent to propose regulations, subregulatory guidance, and temporary regulations, the policy statement addresses a number of regulatory practices that have been of concern to many practitioners.

Death of "Zombie Notices"

With respect to notices announcing the intent to propose regulations, the policy statement acknowledges that, when such notices are published and regulations are not proposed in a timely manner, taxpayers may become confused or uncertain regarding the issues addressed in the notices. Tax practitioners sometimes call this type of notice a "zombie notice" because the Treasury Department releases a notice announcing that a proposed regulation is forthcoming but then never actually issues the regulation.

To address this concern, the policy statement indicates that:

"[T]he Treasury Department and the IRS will include a statement in each future notice of intent to issue proposed regulations stating 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 but, until additional guidance is issued, the Treasury Department and the IRS will not assert a position adverse to the taxpayer based in whole or in part on the notice."

The policy statement thus provides much needed clarification that the IRS cannot use a notice of intent to propose regulations affirmatively against a taxpayer after 18 months have elapsed since the issuance of the notice. However, it is unclear from the statement whether the IRS will treat a notice of intent as authoritative or subject to *Skidmore* deference within that 18-month period. The Treasury Department also did not take the further step of having such notices of intent expire after a certain amount of time if no proposed regulations or other guidance is released, as Congress required for temporary regulations. See [tax code Section 7805\(e\)](#).

Less Reliance on Subregulatory Guidance

The policy statement also sets forth a series of factors to be considered when Treasury and the IRS are deciding whether guidance should be issued as a regulation that goes through the notice-and-comment process or as subregulatory guidance. The policy statement provides that the Treasury Department and the IRS, in making such a determination, will weigh various factors listed in the policy statement. The factors to be considered include the intended effect on taxpayers' rights or duties, the need for public comments, the form and content of prior positions, the significance of the issues, the statutory framework, and whether the interpretation or position is of short-term or long-term value. If the guidance modifies existing legislative rules or creates new legislative rules on matters addressed in existing regulations, the more formal notice-and-comment process will be used, aside from in "exceptional circumstances" (which are not explained in the policy statement). Subregulatory guidance, in contrast, will be used if the in-

terpretation applies to a limited set of facts, a statutorily prescribed form of relief, a statement of agency procedure or practice, a public announcement of intent to issue proposed legislative rules, or an announcement with only immediate or short-term value.

'Good Cause' for Temporary Regulations

The policy statement also announces a new standard for the issuance of temporary regulations. Historically, the Treasury Department and the IRS have issued temporary tax regulations as interim final rules that become effective immediately without notice and comment. Under the Administrative Procedure Act, such interim final rules must include a statement explaining the basis for finding that the agency has "good cause" to issue the rule. The policy statement indicates that, although the Treasury Department has not included such statements in the past as part of its temporary regulations, it will do so going forward. The policy statement notes, however, that Treasury will continue to use temporary regulations when "necessary and appropriate to stop abusive practices or to immediately resolve an injurious inconsistency between existing regulations and a new statute or judicial decision."

The policy statement reiterates the existing requirement that temporary regulations expire within three years of issuance. See Section 7805(e). The statement also sets forth that proposed Treasury regulations must be issued simultaneously with any temporary regulations to allow the public to participate in a notice-and-comment process prior to the implementation of final regulations.

Effects of the Policy Statement

Although the Treasury Department's announcement that it will seek to use more formal guidance and move away from reliance on subregulatory guidance and

Auer deference is admirable, the policy statement makes it clear that these policies do not create any rights or benefits, substantive or procedural, that can be enforced against the U.S. Of course, taxpayers already have the ability to challenge the IRS's reliance on regulations, and subregulatory guidance, under the standards developed by the courts under the Administrative Procedures Act. Only time will tell if the Treasury Department and the IRS will in fact rely increasingly on more formal notice-and-comment rulemaking or, if the pressure of budget constraints and the need to issue guidance quickly, will continue to drive Treasury and the IRS to use subregulatory guidance to announce important tax law policies and interpretations.

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