

TAX

NEW BURDENS FOR THE IRS



In 2018, tax regulation writers at the Internal Revenue Service and the Department of the Treasury face a perfect storm of demands to produce new regulations, fewer resources, and judicial and executive scrutiny of their regulation-writing procedures. Their response

will influence the tax law and practice for years to come. In the short term, taxpayers may see the IRS and Treasury rely more on informal guidance, such as rulings, notices, press releases, and FAQs on IRS.gov. Longer term, expect an increase in tax controversies and litigation challenging that informal guidance and the manner through which the guidance is adopted.

Congress's enactment of the Tax Cuts and Jobs Act of 2017 means that the IRS and Treasury have to quickly produce a slew of new regulations. The TCJA is the most significant overhaul of the tax code in a generation. It makes fundamental changes to the taxation of corporations and pass-through entities and creates new international taxes as well as different classes of taxpayers and income that are taxed differently. It is up to the IRS and Treasury to implement those changes. In November, Treasury estimated that the then-proposed bill included 80 delegations of regulation-writing authority.

At the same time, the IRS is facing a budgetary and manpower crisis that will severely hamper its ability to staff these projects. The IRS budget fell 10 percent from 2010 to 2017, and its staff fell 20 percent from 2012 to 2016.

Meanwhile, the IRS and Treasury regulations are facing increased scrutiny by the courts and the White House—particularly with respect to their adherence to the procedures that apply to agencies like the IRS when promulgating regulations. “The IRS has been pulled sort of kicking and screaming into the modern law related to issuing regulations,” says [David Blair](#), a partner at Crowell & Moring and chair of the firm’s [Tax Group](#).

THE RULES OF REGULATION

■ **The Administrative Procedure Act**, signed in 1946 by President Harry S. Truman, established rules by which U.S. agencies propose and establish new regulations. The APA generally requires that an agency file a notice about a proposed regulation in the Federal Register and then solicit public comments. An extensive body of case law applying the APA clarifies that an agency must engage in “reasoned decision-making” in the notice-and-comment process, including addressing points raised in the public comments.

■ **Executive Order 12866**, issued in 1993 by President Bill Clinton, established additional executive branch procedures requiring cost-benefit analysis by the Office of Management and Budget Office of Information and Regulatory Affairs of “significant regulatory actions,” defined broadly by the anticipated effect of the regulation on the economy.

For many years, the IRS took the position that tax regulations were not subject to the Administrative Procedure Act. More recently, however, a series of cases, including the Tax Court’s decision in *Altera v. Commissioner*, made it clear that the IRS and Treasury are subject to the APA no differently than other agencies, have to follow notice-and-comment procedures, and must engage in reasoned decision making.

The IRS also took the position that almost all Treasury regulations were not “significant regulatory actions” that required OIRA cost-benefit analysis under EO 12866, in part on the theory that the tax statutes alone create economic burdens and the tax regulations merely interpret those statutes.



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“Taxpayers may be able to challenge tax regulations, at least in a class of cases, ahead of time, without incurring the tax in question.” —*David Fischer*

TRUMP WEIGHS IN

In 2017, the Trump administration issued an executive order that pointedly told the IRS to reconsider its views on whether Treasury regulations constitute significant regulatory actions.

Executive Order 13789 directed Treasury and the IRS to identify “significant tax regulations” issued since January 2016 that impose undue financial burden, add undue complexity, or exceed IRS statutory authority. It also told them to “reconsider the scope and implementation of existing exemption for certain tax regulations from the review process.”

That prompted Treasury and the IRS to reconsider 105 IRS regulations issued since January 1, 2016. The result? “To no one’s surprise, they found that more tax regulations imposed ‘significant’ regulatory burdens than previously thought,” says [David Fischer](#), a tax controversy and tax litigation partner at Crowell & Moring.

UNINTENDED CONSEQUENCES

The IRS and Treasury now recognize that in many cases they are required to follow the reasoned decision-making standard of the APA and conform to the OIRA procedures, including cost-benefit analysis, before adopting tax regulations. The new procedures, and the increased scrutiny of the IRS and Treasury’s regulation-writing process by the courts and the administration, when coupled with the 2017 tax reform and recent IRS budget cuts, may have negative effects on the development of tax guidance and ultimately lead to more tax controversy and litigation. The IRS is ill-equipped to take on additional regulation-writing responsibilities and, at the same time, improve its notice-and-comment rulemaking process to meet the standards imposed by the APA and EOs 12866 and 13789.

There are two questions, says Blair. How will the IRS get all that work done, and what kind of regulations will it issue? “They don’t have the resources to write a whole bunch of new regulations,” he says. So there is going to be a significant amount of time between when the law is written and when the IRS issues new regulations.

During that period, Blair says, the IRS may rely on informal guidance in the form of notices and press releases. In recent interviews, Treasury officials have conceded as much. “That is the more troubling piece,” Blair says, because informal guid-

ance doesn’t go through the notice-and-comment process, “yet as a practical matter, IRS field agents and appeals officers tend to follow IRS informal guidance.”

Fischer adds that we will see challenges to informal guidance under the APA. “Whether challenges to IRS guidance for failure to satisfy the APA will be successful is yet to be seen,” he says. In the meantime, he notes, it is easier for extreme positions to make it into informal guidance.

A CRACK IN THE IRS’S ARMOR

The IRS and Treasury already face tough adjustments as they adhere to federal rules for issuing new regulations. A recent court ruling could make things worse.

A U.S. District Court in Texas sided with the U.S. Chamber of Commerce when it sued the IRS on behalf of its members, charging that the agency scuttled a merger between Irish and U.S. drug makers because of the potential tax burden from the agency’s “anti-inversion” regulations.

The Chamber of Commerce decision represents a possible major change to the process of challenging tax regulations because the taxpayer succeeded in challenging a tax regulation before paying any taxes under the regulation, says Crowell & Moring’s David Fischer. “Taxpayers have tried preemptory challenges to tax regulations many times, with no success,” he says.

The Chamber of Commerce argued that IRS anti-inversion rules “chilled and killed the merger,” says Fischer. They argued on behalf of the drug companies, “We were hurt even though we don’t owe tax yet.”

Other federal agencies often face such preemptory challenges to regulations, but the IRS has consistently won in court, he says. The Internal Revenue Code includes an anti-injunction act and a declaratory judgment act providing that taxpayers may not sue to restrain assessment or collection of tax. These acts protect the IRS’s ability to collect taxes necessary to operate the government. This time the court ruled the acts didn’t apply.

“This doesn’t happen in the tax area,” Fischer says. “It may be that there is now a crack in the armor. Taxpayers may be able to challenge tax regulations, at least in a class of cases, without incurring the tax in question.” The federal government is appealing.