IRS Draft Regs: OIRA Review Offers Fresh Opportunity

Tax

After decades of not doing so, the IRS is sending its draft regulations to the White House for centralized policy review—as nearly every other federal agency does. This is meaningful at a time when the IRS must issue voluminous guidance to clarify provisions of the Tax Cuts and Jobs Act of 2017.

Crowell & Moring partner David Blair, chair of the firm's Tax Group and a former trial attorney in the Department of Justice's Tax Division, sees this as a mixed picture for those seeking to influence tax policy. "There's concern that giving OIRA greater authority will extend the IRS rulemaking process and possibly politicize it to a greater extent," he says. "On the other hand, it also offers interested parties a new opportunity to make their voices heard."

How We Got Here

For many years, the IRS avoided review by the Office of Information and Regulatory Affairs (OIRA) of its proposed regulations under a 1983 agreement between the Department of the Treasury and the White House's Office of Management and Budget. In addition, the IRS often considered its draft regulations largely exempt from the Administrative Procedure Act's notice and comment requirements because the APA grants an exception if the rule or regulation is deemed "interpretative"—a designation the IRS historically applied to its draft regulations.

Courts have long affirmed the applicability of the APA to tax regulations. J. Bradford Anwyll, a senior counsel in Crowell & Moring's Tax Group, cites three cases as most significant.

In *Mayo Foundation for Medical Education and Research v. United States* (2011), the Supreme Court clarified that the APA applies to the IRS in the same manner as other agencies.

Motor Vehicles Manufacturers Association v. State Farm Mutual Automobile Insurance Co. (1983) was a milestone, though it didn't address tax issues. In *State Farm*, the Court articulated the meaning of "arbitrary and capricious" agency decision making under the APA, establishing that "the agency must examine the relevant data and articulate a rational connection between the facts found and the choice made."

Altera Corp. v. Commissioner is ongoing and focuses on Treasury's compliance with the APA's notice and comment requirements, including *State Farm*'s reasoned decision-making standard. In the original *Altera* decision in 2015, the U.S. Tax Court unanimously held invalid a 2003 Treasury regulation mandating that controlled entities entering into qualified cost-sharing arrangements share stock-based compensation costs. The court concluded that Treasury hadn't followed the APA's notice and comment requirements or met the reasoned decision-making standard. The government appealed to the 9th Circuit, which overturned the decision last June. Altera filed a petition for a rehearing *en banc*, which the 9th Circuit denied in November.

Altera reportedly plans to seek *certiorari*, and should the Supreme Court take the case, Anwyll says, "the odds of victory aren't great—but it wouldn't be the first time the Court defied expectations. A decision in favor of Altera would likely compel Treasury and the IRS to tighten their APA compliance, which could lengthen the tax rulemaking process."

Finally, No More Exemption

Treasury and the IRS are also feeling pressure from the White House to comply with policy review and other procedural requirements under the APA and the Congressional Review Act. After years of criticism and defeat in the courts, this pressure appears to have moved the IRS's position. As part of its quest for regulatory reduction, the White House in April 2017 released

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Executive Order 13789, which directed Treasury to identify for elimination or revision "significant tax regulations" issued starting in 2016, and essentially forced the IRS to drop its insistence on exclusion from rulemaking review. It instructed Treasury to consult with OIRA in identifying significant tax regulations. It also ordered Treasury to work with OMB to reconsider the exemption of certain tax regulations from the OIRA review process set forth in EO 12866 (1993).

The IRS exemption ended in April 2018 with an agreement between Treasury and OMB that superseded the original 1983 agreement. According to the new agreement, tax regulations are generally subject to OIRA review within 45 days of submission; Treasury and OIRA may designate certain tax regulatory actions related to TCJA for expedited review; Treasury may not publish any tax regulatory action in the Federal Register unless OIRA has concluded its review; and Treasury is required to submit quarterly notices of planned tax regulatory actions.

The Jury's Still Out

After more than a year, how much has the agreement improved the efficiency of the rulemaking process? Not very much. For starters, OIRA is fairly small and has recently suffered departures from its tax review staff. And unlike Treasury, OIRA doesn't have deep expertise in tax matters—which means it needs more time and outside assistance to grapple with the complexities of tax regulations.

There's hard evidence that OIRA review is making the TCJA guidance process take longer. According to an analysis by *Tax Notes*, OIRA had taken an average of 43 days to review TCJA projects as of midyear 2019, more than double the average in 2018. Although no TCJA projects in 2018 exceeded the 45-day review limit, at least 10 did in 2019; several took at least 100 days.

Blair thinks it's too soon to reach any conclusions. "Government processes are notorious for being slow, but sometimes the issue is that the process is new and simply needs time to become more efficient," he says.

How to Be Heard

Comments on regulations to the IRS and Treasury offer the best avenue for input on substantive and procedural issues presented as draft regulations. OIRA involvement may offer organizations a second opportunity to be heard on tax rules that affect them. Blair and Anwyll recommend a proactive approach that includes these steps:

- Read the quarterly list of planned tax regulatory actions prepared by the IRS Office of Chief Counsel. The list states what the actions are, as well as who is working on them.
- Take advantage of the notice and comment process by submitting comments or questions to the IRS and Treasury. "This helps to build a paper trail for potential legal action," says Anwyll, "because under the APA, the proposed rule could be invalidated if the IRS fails to respond to significant comments."
- Meet in person, as necessary, with tax rule writers at the IRS and Treasury, as well as with OIRA reviewers to reinforce written comments.

By the Numbers

For decades, the IRS claimed that its rules and regulations were largely exempt from both policy review by OIRA and various rulemaking procedures mandated by the Administrative Procedure Act and the Congressional Review Act. According to Crowell & Moring's J. Bradford Anwyll, IRS actions frequently reflected this stance.

- A 2007 University of Minnesota study of 232 IRS regulation projects quantified the extent of the IRS's unwillingness to comply with the APA. Among its conclusions: Few of the regulations met the "interpretative" qualification for exemption under the APA; 80 percent of the time the IRS claimed that the APA didn't apply; and the IRS followed notice and comment procedures just 60 percent of the time.
- In 2016, the Government Accountability Office published a report showing that between 2013 and 2015, no tax regulations promulgated solely by Treasury and the IRS were classified as "major" under the CRA, which would have exposed them to stricter scrutiny.