THE APA IN THE ERA OF TAX REFORM

ABA SECTION OF TAXATION
MAY MEETING 2019
WASHINGTON, D.C.

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AGENDA

- Types of Administrative guidance
- Basics of administrative rulemaking
- Role of deference
- Validity of Regulations
APA was enacted to ensure that same safeguards that apply to administrative rulemaking and rule-enforcing as apply to our tripartite system of democratic government. Pat McCarran, Foreword to Comm. on the Judiciary, Administrative Procedure Act, Legislative History, 79th Congress, 1944-46, at iii (1946).

The process outlined in the APA with respect to rulemaking functions as a substitute for a legislative hearing and is designed to encourage public participation in agency rulemaking.
Is the action a rule or an adjudication/order?

- A “rule” is “the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency.” 5 U.S.C. § 551(4).

- An “order” is “the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing.” 5 U.S.C. § 551(5).


If it is a rule, is the action formal or informal?

- Formal rulemaking is subject to the notice-and-comment procedures outlined in 5 U.S.C. § 553.

- Informal rulemaking, which includes “interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice” is exempt from these procedures under 5 U.S.C. § 553(b)(3)(A).
APA PROCEDURAL REQUIREMENTS

- APA Requirements:
  - Notice and opportunity to comment. 5 U.S.C. § 553 (b) –(c).
  - Final rule must include a concise statement of basis and purpose. 5 U.S.C. § 553(c).
  - Not arbitrary and capricious, 5 U.S.C. § 706, for example:
    - Reliance on factors not intended by Congress.
    - Failure to consider an important aspect of the issue.
    - Failure of explanation (and post hoc rationalizations not foreshadowed in the regulatory process don’t count).
    - Manifestly contrary to statute (overlapping with Chevron analysis).
Regulations

- Proposed Regulations
  - Regulations are published in proposed form in a Notice of Proposed Rulemaking (5 USC § 553(b))
  - Includes description of the subjects and issues involved
  - Regulations are nonbinding in proposed form

- Final Regulations
  - After mandatory comment period, published as a Treasury Decision and legally binding
  - Includes a preamble with analysis and summary of comments

- Temporary Regulations
  - Can be legally binding immediately, without notice and comment, if there is “good cause” to do so
  - Expires after 3 years if not finalized
GUIDANCE TOOLBOX

- **Revenue Ruling**: Official interpretation by the IRS of the Internal Revenue Code, related statutes, tax treaties and regulations. It is the conclusion of the IRS on how the law is applied to a specific set of facts. Revenue rulings are published in the Internal Revenue Bulletin for the information of and guidance to taxpayers, IRS personnel and tax professionals.

- **Revenue Procedures**: Official statement of a procedure that affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code, related statutes, tax treaties and regulations and that should be a matter of public knowledge. Provides return filing or other instructions concerning IRS position. Published in Internal Revenue Bulletin and generally effective date published unless otherwise defined.

- **FAQs, Publications, Forms and Other IRS.gov material**
  - **Notices**: Public pronouncement by the IRS with immediate guidance involving substantive interpretations of the Code. For example, a notice can be used to communicate what regulations will say in cases where the regulations may not be published in immediate future.
  - **Announcements**: A public pronouncement that has immediate or short-term value. For example, to summarize the law or regulations without substantive interpretation; to state what the regulations will say when they’re certain to be published in the immediate future; notify taxpayers of existence of approaching deadline.
INTERNAL PROCESSES

- Regulation writers:
  - Treasury Office of Tax Policy lawyers – 30 to 40.
  - IRS Office of Chief Counsel lawyers – 400 to 600, organized by specialty area.
  - Resulting project teams are thus often 1-2 Treasury lawyers and 4-8 IRS lawyers.

- Process Inside OTP and IRS
  - Front end “joint briefing” of senior Tax Policy officials, IRS CC and DCC.
  - Mid-course check-ins for new issues or rethinking of initial choices.
  - “Green sheet” review by IRS stakeholders, including other Associate CC offices; IRS business units (especially LBI and Deputy Commissioner for business related guidance); and Taxpayer Advocate.
  - “Pink sheet” final circulation for signature by Deputy CC, Deputy Commissioner, and Assistant Secretary for Tax Policy (required signatures vary by kinds of guidance).
REGULATION REVIEWERS

- Senior lawyers in both organizations, including Assistant and Deputy Secretaries; IRS Chief Counsel, Deputy Chief Counsels, and Associate Chief Counsels.
- IRS Counsel office of Procedure and Administration, for procedural and Federal Register compliance.
- IRS operational reviewers, for example LBI and the Taxpayer Advocate.
- Cost-benefit reviewers in Treasury and OMB.
- Intergovernmental reviewers called in by OMB.
- Validity defense review (DOJ, OMB, Treasury GC).
- Treasury General Counsel; Office of the Secretary.
EFFECTIVE DATE CONSTRAINTS – IRC § 7805(B)

- § 7805(b) – Effective Date / Retroactivity
  - General Rule: No regulation shall apply retroactively before the earliest of: (1) Date such regulation was filed with the Federal Register; (2) Date a notice substantially describing the expected contents of such regulation was issued or (3) Date a proposed or temporary regulation to which the final regulation relates was filed with the Federal Register

- Exceptions: A regulation may apply retroactively:
  - when issued promptly (New statute exception for regulations finalized within 18 months of the date of enactment – e.g., June 22, 2019 for TJCA)
  - to prevent abuse
  - to correct a procedural defect in the issuance of any prior regulation
  - if it relates to internal Treasury policies, practices, or procedures
  - by authorization of Congress
  - at taxpayer’s election, if Secretary permits
Executive Order 12866, signed by President Clinton, originated with a similar Executive Order signed by President Reagan.

- General purposes are to require cost-benefit analysis of “significant regulatory actions” and OMB coordination of inter-agency reviews.
- EO 12866 is an internal executive branch set of protocols, -- no private right of action if there is a compliance failure.

- Tax regulations were exempt from Executive Order 12866 until 2018.
There is no OIRA review absent “significance.”

Three categories of “significance:”

- Serious inconsistency with other agency actions;
- Novel legal or policy issues; and
- Annual non-revenue economic effect of $100 million or more, measured against a no-action baseline (“economically significant”).

“Significant regulatory actions” require cost-benefit analysis and review by OMB’s Office of Information and Regulatory Affairs (OIRA).

OIRA makes decision regarding “significance.”

OIRA has veto power over publication of any significant regulatory action.
MOA provides 45 day and 10 day OIRA review periods; more of a good faith target than a requirement given OMB veto power.

Submission to OMB for review is visible on www.reginfo.gov.

OMB decisions relating to TCJA:
- 965 Proposed Rulemaking initially designated as not economically significant; however, the Notice of Proposed Rulemaking and Final Rule designed as economically significant.
- Bonus depreciation: OMB waived review and reserved on determination for final regulations.
- § 199A, § 163(j), § 59A, Foreign Tax Credit, Hybrid Dividend, Opportunity Zone and § 250 regulations designated as economically significant.
- GILTI, SALT, § 864(c)(8) not economically significant but still designated as significant for purposes of OMB review.

Performance difficult to monitor with precision but no significant delays to date.
GETTING INTO COURT

- IRC § 7421, Tax Anti-Injunction Act: with limited exceptions, no suit may be maintained “for the purpose of restraining the assessment or collection of any tax….”
  - With limited exceptions, IRC penalties are treated as taxes. IRC § 6671(a).
  - Generally, regulation challenges thus must be brought either in Tax Court or refund litigation.
  - Direct tension with general preference for pre-enforcement review of non-tax regulations.
- Florida Bankers Ass’n v. U.S. Dept. of the Treasury, 799 F.3d 1065 (2015): A trade association could not challenge the Federal regulation requiring reporting on nonresident aliens’ bank accounts. It is merely “nifty wordplay” to argue that it is only a regulatory challenge and not an attempt to restrain collection of the penalty/tax.
- CIC Services LLC v. IRS, 120 AFTR 2d 2017-6444 (E.D. Tenn. 2017)(currently on appeal to 6th Circuit): Captive insurance manager could not challenge Notice 2016-66, 2016-47 IRB 745, which requires microcaptive transactions and material advisors to file disclosures statements and subjects them to penalties under § 6707A for failure to do so. District Court dismissed the case based on the Anti-Injunction Act, which bars lawsuits seeking to restrain the government’s ability to assess and collect taxes.
A valid final regulation receives **deference** from courts.

- But, note – When an agency promulgates a rule that conflicts with the statute enacted by the legislature, even if procedurally valid, the rule must cede to the statute.

- Practical effect is similar to a statute.
- The modern regulation writing process is designed with validity in mind.

A valid final regulation:

- Can change prior administrative practice, including prior regulations.
- Can change the result of prior litigation (but not an interpretation previously adopted by the Supreme Court).
- Can be adopted in the midst of litigation.
- Can adopt rules of thumb for the purpose of avoiding costly case-by-case determinations.
ROLE OF DEFERENCE – TAX RULEMAKING

- Legislative Regulations – Regulations promulgated pursuant to specific authority grants in the Code

- Interpretive Regulations – Regulations promulgated under Treasury’s general rulemaking authority under section 7805

Although Treasury still delineates between legislative and interpretive regulations, see Treasury Policy Statement, March 5, 2019, there is no distinction in the level of deference applied by courts to both types of regulations. See Mayo Foundation for Medical Education and Research v. United States, 562 U.S. 44 (2011) (requiring Chevron deference for § 7805(a) regulations).
State Farm, 463 U.S. 28 (1983)—Reagan Transportation Department reversal of Carter administration automobile passive restraint guidance was arbitrary where there was no consideration or discussion of airbag technology. Auto industry post hoc arguments about airbags not relevant to analysis.

One aspect of a capitalization regulation was invalidated where there was no rationale offered for provision, and where the provision seemed inconsistent with the statute. Dominion Res., Inc. v. U.S., 681 F.3d 1313 (2012).

Changing a consolidated return rule from proposed to final was invalidated where the proposed regulation did not provide fair notice to the public of the possibility that the final regulation would take that form. American Standard, Inc. v. U.S., 602 F.2d 256 (1979).

A District Court invalidated the “serial inversion” Temporary Regulation because of the absence of notice and comment, but the IRS continues to argue that IRC 7805(e) overrides this APA requirement. Chamber of Commerce v. U.S., 2017 WL 4682050 (2017). The government was granted its request to dismiss appeal after the regulation was finalized.

The withdrawn 9th Circuit Altera opinion, 2018 WL 3542989, features a debate over whether the government’s arguments in support of the challenged IRC 482 regulation were adequately foreshadowed in the regulatory process or were post hoc justifications that the Court should disregard.
STANDARDS OF REVIEW

- **Skidmore v. Swift & Co.,** 323 U.S. 134 (1944)
  - Court determines level of deference to afford an agency interpretation based on “the thoroughness evident in [the agency’s] consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.”

  - Defers to an agency regulation that “carries the force of law” and is a permissible interpretation of the statute under a two-step analysis that asks (1) is the statutory language clear on its own? And (2) if the language is ambiguous, is the agency’s interpretation reasonable?

- **United States v. Mead Corp.,** 533 U.S. 218 (2001) (AKA Chevron Step zero)
  - Did Congress intend to delegate to IRS/Treasury? – “Administrative implementation of a particular statutory provision qualifies for Chevron deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.”

- **Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.,** 545 U.S. 967 (2005)
  - Prior judicial construction of a statute trumps an agency construction otherwise entitled to Chevron deference only if the prior court holds that its construction follows from the unambiguous terms of the statute and leaves no room for agency discretion.

- **Auer v. Robbins,** 519 U.S. 452 (1997)
  - Courts defer to an agency’s interpretation of its own ambiguous regulations unless they are plainly erroneous or inconsistent with the regulation.
“Line-drawing” regulations holding that the “student” exception from payroll taxation does not apply where the individual works 40 hours or more a week are valid, despite contrary results in litigation covering periods before regulations came into effect. *Mayo Foundation v. U.S.*, 131 S.Ct. 704 (2011).

In ACA litigation over whether the Federal health exchange could grant tax credits, the Supreme Court disregarded IRS regulations because Congress did not intend to delegate that kind of decision to the IRS ("step zero"). *King v. Burwell*, 135 S.Ct. 2480 (2015).

An IRS regulation treating stock option compensation as “money remuneration” was invalid under both steps one and two of Chevron. *Wisconsin Central Ltd. v. U.S.*, 138 S.Ct. 2067 (2018).

On March 5, 2019, the Department of Treasury issued a statement on the tax regulatory process reaffirming its commitment to notice and comment rulemaking and limited use of temporary regulations.

Statement does not abandon the historical interpretive vs. legislative rule dichotomy (notwithstanding Mayo, which finds the distinction between legislative and interpretive regulations “archaic”).

“In deciding whether to issue regulations or subregulatory guidance, the Treasury Department and the IRS must consider the content and nature of the interpretation or position being announced.”

Absent exceptional circumstances, Treasury will use notice and comment procedures for rules that modify or create legislative rules for questions not already addressed in regulations.

Treasury will limit its use of notices of intent to issue proposed regulations – its failure to issue proposed regulations in a timely manner “can cause confusion or uncertainty for taxpayers.” Treasury will now include a statement in notices that if the IRS fails to issue the proposed regulations or other guidance within 18 months of publishing the notice, the IRS “will not assert a position adverse to the taxpayer based in whole or in part on the notice.”


Treasury and IRS will use temporary regulations less frequently; when issued, the preamble will include a good cause explanation.
## GUIDANCE EXAMPLE: § 965

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<th>TCJA Enacted</th>
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### 2017 TAX RETURN DUE

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VALIDITY OF SUBREGULATORY GUIDANCE

- **Kisor v. Wilkie, Sup. Ct. Dkt. No. 18-15:**
  - Whether the Supreme Court should overrule *Auer v. Robbins* and *Bowles v. Seminole Rock & Sand Co.*, which direct courts to defer to an agency's reasonable interpretation of its own ambiguous regulation.

- **CIC Services LLC v. IRS, Dkt. No. 18-5019 (6th Cir. 2018):**
  - CIC Services contends that Notice 2016-66, 2016-47 IRB 745, which requires taxpayers who enter into microcaptive transactions and their material advisers to file disclosure statements with the IRS, is a legislative rule that was issued without notice and comment in violation of the APA. Section 6707A imposes penalties for failing to comply with the reporting requirements,
  - District Court dismissed the case based on the Anti-Injunction Act, which bars lawsuits seeking to restrain the government's ability to assess and collect taxes.

- **Bullock v. IRS, Dkt. No. 18-00103 (D. Mont. 2018):**
  - Montana Gov. Steve Bullock challenges the validity of a Revenue Procedure that said exempt organizations other than section 501(c)(3) entities and section 527 political groups will no longer be required to make specific disclosures because it was issued without notice and comment.
IRS issued a total of 100 notices last year – a steep jump from the 76 notices issued in 2017 and 81 notices in 2016.

The number of Revenue Rulings issued increased slightly from 25 in 2017 to 32 in 2018. Overall, the pace of revenue rulings declined over the previous decade, from a high of 54 in 2008 to 32 in 2018. However, in the early 2000s there was a significant spike in revenue rulings, with more than 100 issued in several consecutive years.

Notice – Guidance Under Sections 164 and 170(c): first example of subregulatory IRS guidance to be submitted for OMB review. Could signal effort to discourage subregulatory guidance.
IMPLICATIONS FOR TCJA

- Treasury and the IRS are focused on APA compliance;
- Will Treasury follow notice and comment procedures for all regulations, notwithstanding its continued distinction between legislative (specific authority) regulations and interpretive (section 7805) regulations?
- Potential challenges for Treasury/IRS to issue regulations where the legislative history is thin and statute is vague (e.g., Opportunity Zone guidance);
- Challenges to recently issued regulations may be prohibited by AIA until IRS assessment;
- Treasury’s reluctance to use subregulatory guidance impacts taxpayers’ ability to make informed decisions on tax returns;
- Taxpayers must take tax return positions in an uncertain/changing legal environment.