

WILLIAM C. STALEY
Business Planning

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CAN THE IRS DO THAT?

One role of the U.S. Department of the Treasury is to supervise the Internal Revenue Service. One role of the IRS is to interpret federal tax statutes. The IRS has broad discretion to interpret the Internal Revenue Code, but the Service's discretion has limits.

The Process of Providing Official Guidance. The tax community outside the IRS consists of tax lawyers, accountants, professors and journalists. When Congress enacts changes to the Internal Revenue Code and the President signs the bill (or lets it become law without his signature), members of the tax community examine the new law to find ambiguities. Generally, they find many.

Bar associations and accounting groups write to the Treasury and IRS and engage in discussions with the people there who will issue formal guidance. Some of this is lobbying by special interests. But a lot of it is an effort to make sense of complex, ambiguous statutes.

The IRS and Treasury generally issue **proposed regulations** after collecting comments informally. Generally, proposed regs can be re-lined upon, but taxpayers are not required to rely on them. This is because many things in proposed regulations are changed by the IRS and Treasury when the final regulations are issued.

In the **preamble** to the proposed regulations, the IRS and Treasury explain their reasoning on key issues and might also note why they took one approach as opposed to another possible approach.

When the proposed regulations are published, they are generally accompanied by a request for

comments from the public and a notice that a **hearing** will be held on a particular date. The comments are requested before the hearing. If the issue is not controversial, the hearing might be cancelled.

In the preamble to the **final regulations**, the IRS and Treasury often address every comment that they received on the proposed regulations. The preamble will also explain the changes in the final regulations from the proposed regulations.

When formulating regulations about substantive tax matters, Treasury and the IRS generally must comply with the federal **Administrative Procedures Act**. A regulation can be held by a court to be invalid if the agency issuing the regulation did not comply with the Act.

After a new tax law is enacted, Treasury and the IRS consider if there are issues so pressing that the IRS needs to issue a “**Notice**” letting taxpayers know where the IRS stands on an issue. Notices are vetted inside the IRS and Treasury, but they do not have the formal feedback loop of other administrative guidance, such as regulations. With the 2017 Tax Act, the IRS was somewhat reluctant to issue Notices, because there was a concern that a Notice might be issued and the Ser-

vice would move on to other issues, leaving the Notice as the only guidance.

When issues arise about how to apply the statute or the regulations to specific factual situations, the IRS can issue **Revenue Rulings**, on which taxpayers may rely.

For procedural issues not covered in the regulations, the IRS issues **Revenue Procedures**.

Notices, proposed regulations, final regulations, the preambles to each, revenue rulings and revenue procedures are all published in the **Federal Register** and are also published by private publishers for tax advisers.

It is possible to obtain a letter from the IRS about how the statute, regulations and revenue rulings apply to a specific transaction. This requires paying a user fee. The letter from the IRS is called a “**private letter ruling**.” These are published under the Freedom of Information Act, but other taxpayers are not entitled to rely on them.

If an IRS field office encounters in an audit a factual circumstance in which the field office is unsure how to apply tax law, the field office can request an interpretation from the IRS Chief Counsel

in the IRS National Office. The response is a “**technical advise memorandum**,” which is also published. Other taxpayers may not rely on these memos.

Private letter rulings and technical advice memoranda, as well as other IRS documents, are published by private companies and indexed for tax advisers.

Taxpayers who do not agree with IRS about the proposed disposition of tax audits can file a case in **Tax Court**, which is a specialized court. The taxpayer can also pay the tax, ask for a refund and, if it is not refunded by the IRS, file a case in a federal **District Court**. All of these cases may be appealed to a **Circuit Court of Appeals**. A decision of a Circuit Court can be appealed to the **U.S. Supreme Court**. The decisions in these cases are published by official and non-official publishers. Often they are available online soon after publication.

The “Four Corners of the Statute.” Of course, the first place to look to resolve an ambiguity in a law is the “four corners” of the law itself. If an issue can be resolved this way, using either the everyday meaning of the words or, if the law so indicates, the technical meaning

of the terms for income tax purposes.

Legislative History. Treasury is usually very involved with Congress when changes to tax laws are considered. Each chamber of Congress has a tax-writing committee. These committees prepare reports on tax bills that explain the current law, the reason for the proposed change, and how the proposed change would work. Tax bills are supposed to originate in the House, so generally the **House Ways and Means Committee** generally writes the first report on a tax bill. The members of the Committee are members of the House of Representatives, chaired by a member of the majority party.

The **Joint Committee on Taxation** (the “**JCT**”) has a professional staff who are not members of Congress. The JCT provides estimates of the effect of a particular provision on the fisc. The JCT also prepares summaries of pending tax bills. After a bill becomes law, the JCT will prepare a “general explanation” of the law (called the “**Blue Book**”) that collects the legislative history in one place.

The **Senate Finance Committee** generally reviews tax bills that originate in the House. The Committee members are Senators

and the chair of the Committee is appointed by the majority party.

If the House and Senate pass different versions of a tax bill (the usual situation), then each chamber appoints members of a **Conference Committee**. The Conference Committee is composed of members of the House and Senate (Usually members of the House Ways and Means Committee and the Senate Finance Committee). They negotiate a final bill and prepare a **Conference Committee Report**. For each provision of the final law, that report lists the current law, the reason for a change, the House version or the proposal, the Senate version of the proposal, and the Conference Committee version. Each chamber votes the Conference bill up or down, with no amendments permitted.

The **U.S. Government Printing Office** publishes these Committee reports. They are republished by many private publishers and are generally available online.

The Ways and Means, Finance and JCT sometimes publish **press releases** about the bill or particular parts of it. The President, his staff or individual members of the Committees also sometimes comment or issue press releases.

The tax press reports these, and they are indexed and available for later reference.

The Committee reports, the Blue Book, the statements of members of Congress are all referred to as the “**legislative history**” of the bill. When the Treasury and the IRS write regulations and other guidance, they make judgments about how much to rely on the four corners of the statute and how much to rely on the legislative history and, if so, which legislative history.

Judicial Deference to Treasury and the IRS. The extent to which Treasury and the IRS are allowed to rely on legislative history is a matter of active political debate. Courts are generally inclined to defer to the expertise of the IRS. Recently courts have been more willing to substitute their own understanding of the Internal Revenue Code for the position of the Service, and to make their own assessments of the weight to be accorded to various items of legislative history.

In 1944 the U.S. Supreme Court announced the standard of what is now called “**Skidmore deference**”: the weight that a court should give to the agency’s position in a case depends on how thoroughly the agency considered the issue, whether the agency’s reasoning was

valid, whether the agency's position is consistent with the agency's earlier positions on the issue.

In 1984 the Supreme Court announced the standard of what is now called "**Chevron deference**": If a statute is ambiguous, a court should defer to the agency's position unless that position is arbitrary, capricious, or manifestly contrary to the statute.

Generally, Chevron deference applies when Congress gives the IRS the power to make regulations with the force of law. These are called "**legislative regulations.**" An example is Section 337(d) of the Internal Revenue Code, which provides, in part "The [IRS] shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986."

Tax Planning. From a planning perspective, it generally makes sense to treat the guidance provided in regulations and revenue rulings as settled law. It seldom makes

sense to take an intentional position that can be resolved in the taxpayer's favor only if the taxpayer takes the IRS to court and wins, possibly after appealing to the Circuit Court of Appeal and the Supreme Court.

California. The **Franchise Tax Board** in California publishes regulations and issues the guidance about the income tax provisions of the California Revenue and Taxation Code. California has its own Administrative Procedures Act. It is sometime possible to obtain private rulings from the FTB. California laws have detailed legislative history, much of which is available online.

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I regularly help clients determine how a tax rule will apply to a particular situation or transaction. I have obtained several private letter rulings, and have advised clients on how tax statutes, regulations and revenue rulings will apply to them and their transactions.

Bill Staley
818-936-3490
www.staleylaw.com

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