



Federal Tax ADVISORY ■

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Regulations in Trouble

Problems are mounting for the Treasury's business of issuing tax regulations. One lawyer in a prominent law firm is personally suing the Treasury for failing to provide within two months of his Freedom of Information Act request 24 enumerated categories of documents from more than 30 years ago. He wants to know about the prior effort to write regulations for Section 385.

Another high-profile case (*Altera*) is pending in the circuit court on appeal by the government from a stunning unanimous, reviewed loss in the Tax Court. The Tax Court opinion put up several hurdles for regulations to climb, which many old regulations could never meet, and even current regulations can meet only if the Treasury substantially changes its methods of adopting regulations.

Legal problems are exacerbated by practical problems. An attorney who recently left the government said that the pending Section 385 regulations have sucked all the air out of the room; the effort to push them out before the end of the current administration is keeping government attorneys from completing lower profile regulation projects.

The practical problems are made worse by the loss of personnel in almost all branches of the IRS and Chief Counsel, and the narrow funnel through which all regulations must pass at Treasury. Basically one person in Treasury must sign off on all regulations and is expected to actually know something about each one. As usual, that one person has some assistants for subject-matter areas (foreign, financial, partnership, corporate), but the ranks are very thin.

So is this good or bad for taxpayers? It is bad. Even though all guidance projects do not turn out the way all interested taxpayers might like, fewer tax audits turn out the way they might like. IRS agents who are not constrained by published guidance have a broad ability to assert any plausible interpretation of the Code.

But when guidance is promulgated, the biggest challenge for the government in the future will be explaining it. The courts have begun to apply a theory whose seeds were planted in some U.S. Supreme Court opinions decades ago that if the contemporaneous justification for a regulation does not make sense to the court, then the regulation is invalid because it is arbitrary or capricious.

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Pushed to its extreme, this doctrine can lead to the invalidation of regulations that have an obvious justification that was not explained in a preamble. If you look back at Treasury decisions from the 1980s and before, you see that hardly any of them explained themselves. Even today, the explanations may not be written in as defensive a manner as the courts now tend to require.

The point here for taxpayers and taxpayer groups is to become more involved in the regulation writing process and make your voices heard and recorded. A negative view that is not well addressed in a regulation preamble can be a ground for invalidating the regulation.

Far fewer hearings on proposed regulations are held today than in years past. It may be due to the desire of commenters to appear only on paper and not in person; also the government personnel in attendance at hearings have become much more close-mouthed. Nevertheless, hearings are probably the best way to record negative views.

In sum, attacking regulations may be a growth industry in tax, and interested taxpayers should prepare accordingly.

For additional information, call [Jack Cummings](#) at 919.862.2302.

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