



## Federal Tax ADVISORY ■

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### Questioning Old Regulations

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Old regulations got a boost recently as *SIH Partners v. Commissioner*, 923 F.3d 296 (3d Cir. 2019), upheld an old Section 956 regulation against attack. The circuit had to work fairly hard because like most old regulations there was little to no Treasury explanation contemporaneous with the time of adoption. But courts cannot be expected to work so hard at helping out Treasury in this time of heightened skepticism about the authority of tax regulations.

Therefore, taxpayers who may not even feel slighted by a regulation might take a second look at it and wonder how Treasury found the authority to adopt it. The first step in that analysis will be trying to figure out whether the regulation is interpretive or legislative. If it is interpretive, then the Treasury's interpretation will receive little deference in a court dispute. If it is legislative, it will receive more deference, but will have to run the gauntlet of proper adoption and of being within the zone of reasonableness and properly explained in a timely manner.

An interesting example of a questionable regulation is Reg. Section 1.951-1(e). It has long had a strange rule for finding the pro rata share of Subpart F income to be allocated to a holder of preferred stock and to the holders of the common stock. Since 1965, the regulation has directed that a distribution of all the current-year earnings and profits be hypothesized. Assume that produced a distribution of \$40 out of \$100 on the preferred as a class.

Now suppose the Subpart F income is \$50. The regulation applies the 40% share of the total current earnings to the Subpart F income and finds the pro rata share of the preferred to be \$20.

What is odd about it is that even though an actual distribution of \$50 would have allocated \$10 to the common and \$40 to the preferred, the method of the regulation reduces the share of the preferred from \$40 to \$20.

That method is not suggested by Section 951 and was never explained in a Treasury decision. Some common shareholder who is allocated more than it would have actually received on a distribution of the Subpart F income amount might complain that the regulation's allocation method is (1) not interpretive and that (2) the statute can be interpreted otherwise, but (3) if not, as a legislative regulation it is arbitrary and capricious.

Alston & Bird's tax group regularly addresses the propriety of Treasury regulations and how to attack them in the filing, planning, and litigation contexts.

For more information, please contact [Jack Cummings](#) at 919.862.2302.

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