

**REPORT #717**

**TAX SECTION**

**New York State Bar Association**

Letter on Section 5803

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April 20, 1992

The Honorable Dan Rostenkowski  
Chair, House Ways & Means Committee  
House of Representatives  
Rayburn 2111  
Washington, DC 20515

The Honorable Lloyd Bentsen  
Chair, Senate Finance Committee  
United States Senate  
Hart 703  
Washington, DC 20510 Dear Sirs:

Dear Sirs:

Section 5803 of H.R. 4210 as passed by Congress last month generally provides that any temporary or proposed regulation shall apply only prospectively from the date it was published in the Federal Register. Although H.R. 4210 was vetoed and did not become law, we are concerned that a similar provision might be included in tax legislation that might be enacted at some future date. We strongly oppose enactment of such a rule because any wide-sweeping prohibition of this sort in many instances will impair, rather than facilitate, the proper administration of the tax law.<sup>1</sup>

<sup>1</sup> We plan subsequently to submit comments with respect to certain other provisions contained in the "Taxpayer Bill of Rights" provisions of H.R. 4210, including specifically the provision in section 5704 that would impose personal liability on Internal Revenue Service employees in certain cases.

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I.R.C. Section 7805(b) currently provides that the Secretary may prescribe the extent, if any, to which any ruling or regulation shall be applied without retroactive effect. Section 5803 would amend section 7805(b) to provide that any temporary or proposed regulation must apply prospectively from the date of its publication in the Federal Register. Under the proposal retroactivity is permitted only (i) to prevent abuse of the statute to which the regulation relates, (ii) to correct a procedural defect in the issuance of any prior regulation and (iii) where the secretary provides "for any taxpayer to elect to apply any temporary or proposed regulation retroactively from the date of publication of such regulation in the Federal Register." Further, the prospective applicability mandated by the amendment may be superseded by Congressional action authorizing the Secretary to prescribe the effective date with respect to a statutory provision.

Read literally, section 5803 would preclude the adoption of a regulation with an effective date subsequent to the date of its publication in the Federal Register. This point should be clarified since there frequently are situations in which, in order to provide taxpayers time to adapt to new regulatory provisions, regulations provide for prospective effective dates.

We further note that section 5803 would apply to any temporary or proposed regulation published before February 20, 1992 and published as a final regulation after that date. This means that many proposed regulations that presently are outstanding and that would be effective prior to the date of their publication will no longer be effective for that period notwithstanding reliance therein by both taxpayers and the Service<sup>2</sup>. Thus, a statute that is intended to discourage retroactivity will in fact apply retroactively. This effective date provision should be modified.

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<sup>2</sup> Under Treas. Reg. § 1.6662-4(d)(3)(iii) proposed regulations constitute substantial authority for purposes of the accuracy related penalty provisions of IRC § 6662(d)(2)(B)(i).

Our major objection to section 5803, however, is to its substantive provisions. The premise behind Section 5803 seems to be that current law has allowed the Service to administer the tax law inequitably or inappropriately. No support for that premise has been aired or evaluated. We know of no crisis or emergency situation that, without testing that premise, warrants a complete reversal of the rule contained in Section 7805(b), which has remained in the Code substantially unchanged since 1934. To the contrary, three years ago, the Planning Committee of the American Bar Association Section of Taxation published a report that concluded that although some deficiencies existed, "7805(b) actions have been taken, by and large, intelligently"<sup>3</sup> and that "in the main, the Treasury and Service have attempted to administer section 7805(b) reasonably."<sup>4</sup> This has been our experience as well.

While proposed Section 5803 is a rule to which the system over time could perhaps adjust, there are likely to be significant costs in the adjustment process. One can reasonably anticipate litigation as to its scope and application. This is particularly likely in the case of interpretative regulations, where the Service and taxpayers would dispute whether a particular assessment is based on a valid statute or an invalid retroactive application of the regulations interpreting the statute. Moreover, even where prospective treatment is clear, the status of issues covered by the regulations for taxable years occurring before their publication would remain uncertain.

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<sup>3</sup> American Bar Association, Section of Taxation Planning Committee, Report on Exercise by the Treasury Department and the Internal Revenue Service of the Authority Granted by Internal Revenue Code Section 7805(b) to Prescribe the Extent to which Tax Rulings and Regulations Shall be Applied without Retroactive Effect, 42 Tax Lawyer 621 (1989).

<sup>4</sup> Id. at 664. The Tax Section recently has commenced a study which is likely to focus principally on the Service's approach to retroactive application of "legislative" regulations. We anticipate that the study will offer a proposal for the appropriate retroactive application of such regulations.

Accordingly, both the Service and taxpayers would be free to assert positions on audit -- and in the courts -- most favorable to them.

The possibility of regulations being issued retroactively is one of the significant constraints on taxpayers taking the most aggressive possible positions with respect to newly enacted legislation (or long-standing legislation for which there are no regulations governing the interpretative issue in question). If this threat were materially reduced and taxpayers were free to challenge all regulations as being improperly issued with retroactive effect, we fear that there would be an explosion of aggressive reporting positions and aggressively structured transactions which would produce significant revenue losses and administrative difficulties. This problem is of even greater concern given the recent legislative tendency to cede broad interpretative authority under many complex revenue statutes to the Secretary.

We recognize that, under either section 5803(b)(4) or otherwise, Congress can specifically direct that regulations can be applied retroactively to the date of a statute's enactment. On the other hand, under current law Congress also can provide that the regulation interpreting any Code amendment is to be applied prospectively only. For that reason, Section 5803 is unnecessary.

We therefore strongly recommend that section 7805(b) not be amended without careful study and input from all interested parties, including the Treasury Department, the Internal Revenue Service, taxpayers and their representatives. We will be happy to participate in that effort.

Very truly yours,

John A. Corry  
Chair

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