

New York State Bar Association

One Elk Street, Albany, New York 12207 • 518/463-3200



TAX SECTION

1995-1996 Executive Committee

CAROLYN JOY LEE
Chair
Worldwide Plaza
825 Eighth Ave.
New York, NY 10019
212/903-8761

RICHARD L. REINHOLD
First Vice-Chair
212/701-3672

RICHARD O. LOENGARD, JR.
Second Vice-Chair
212/859-8260

STEVEN C. TODRYS
Secretary
212/715-9331

COMMITTEE CHAIRS:

Bankruptcy
Joel Scharfstein
Linda Z. Swartz

Basin, Gains & Losses
Stephen B. Land
Robert H. Scarborough

CLE and Pro Bono
Darnan M. Hovancik
Deborah H. Schenk

Compliance, Practice & Procedure
Robert S. Fink
Arnold Y. Kaploff

Consolidated Returns
Ann-Elizabeth Purman
Dennis E. Ross

Corporations
Kathleen M. Bristol
Deborah L. Paul

Cost Recovery
Geoffrey R.S. Brown
Elliot Pisem

Estates and Trusts
Carlyn S. McCaffrey
Georgiana J. Slade

Financial Instruments
David P. Hanton
Bruce Kayle

Financial Intermediaries
Richard C. Blake
Thomas A. Humphreys

Foreign Activities of U.S. Taxpayers
Reuven S. Avi-Yonah
Philip R. West

Individuals
Victor F. Keen
Sherry S. Kraus

Multistate Tax Issues
Robert E. Brown
Paul R. Comeau

Net Operating Losses
Stuart J. Goldring
Robert A. Jacobs

New York City Taxes
Robert J. Levinson
Robert Plautz

New York State Franchise and Income Taxes
James A. Locke
Arthur R. Rosen

New York State Sales and Misc.
Hana T. Jones
Joanne M. Wilson

Nonqualified Employee Benefits
Stuart N. Aldern
Kenneth C. Edgar, Jr.

Partnerships
Andrew N. Berg
William B. Branman

Pass-Through Entities
Roger J. Baneman
Stephen L. Millman

Qualified Plans
Stephen T. Lindo
Loran T. Thompson

Real Property
Alan J. Tarr
Lary S. Wolf

Reorganizations
Patrick C. Gallagher
Mary Kate Wold

Tax Accounting
Erika W. Nijenhuis
Jodi J. Schwartz

Tax Exempt Bonds
Linda L. D'Onofrio
Patti T. Wu

Tax Exempt Entities
Michelle P. Scott
Jonathan A. Small

Tax Policy
David H. Brockway
Peter v.Z. Cobb

U.S. Activities of Foreign Taxpayers
Michael Hirschfeld
Charles M. Morgan, III

M. Bernard Airdinoff
Dickson G. Brown
E. Parker Brown, II

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE:
Scott F. Cristman
Harold R. Handler
Walter Hellerstein
Sherwin Kamin
Charles I. Kingson
Richard M. Leder
Yaron Z. Reich
Stanley I. Rubinfeld
David R. Sicular

Esta E. Stecher
Eugene L. Vogel
David E. Watts

October 2, 1995

The Honorable Bill Archer
Chairman, Committee on Ways and Means
House of Representatives
1236 Longworth House Office Building
Washington, D.C. 20515-6348

Re: Legislation Limiting
Retroactive Regulations

Dear Mr. Chairman:

The Revenue Reconciliation Act of 1995 includes a provision that would limit the retroactivity of any regulation relating to internal revenue laws (section 13351, amending Internal Revenue Code section 7805(b).) Presumably, this statutory proposal reflects Congressional concern that substantial delays between the enactment of statutory changes and the promulgation of regulations can work hardships on taxpayers, particularly where regulations apply an unexpected interpretation retroactively.

We certainly concur with the desire to encourage the prompt promulgation of regulations. We also are sympathetic to the concern that retroactive regulations can inflict hardships on taxpayers. As a practical matter, however, our experience has been that regulations that impose a new or changed interpretation generally are not applied retroactively to the disadvantage of the taxpayer. In our view, legislation of this sort is not needed, and we are concerned that certain collateral aspects of the proposal are in themselves likely to cause problems that become more severe than the current situation. We therefore believe that this is a proposal whose time has not come.

FORMER CHAIRS OF SECTION:

Howard O. Colgan, Jr.
Charles L. Kades
Samuel Brodsky
Thomas C. Plowden-Wardlaw
Edwin M. Jones
Hon. Hugh R. Jones
Peter Miller
John W. Fager

John E. Morrissey, Jr.
Charles E. Heming
Richard H. Appert
Ralph O. Winger
Hewitt A. Conway
Martin D. Ginsburg
Peter L. Faber
Hon. Renato Beghe

Alfred D. Youngwood
Gordon D. Henderson
David Sachs
J. Roger Mentz
Willard B. Taylor
Richard J. Hiegel
Dale S. Collinson
Richard G. Cohen

Donald Schapiro
Herbert L. Camp
William L. Burke
Arthur A. Feder
James M. Peaslee
John A. Corry
Peter C. Canelios
Michael L. Schler

Do the Public Good • Volunteer for Pro Bono

As an example of the undesirable collateral effects of the proposal, the proposal would only apply to regulations that relate to statutory amendments enacted on or after the date the proposal is enacted. Clearly, this is an entirely sensible effective date for the proposal. However, assuming that manpower constraints play some role in the delay of regulations, it seems likely that a side effect of this effective date will be to intensify the attention that is devoted to new legislation, while relegating existing statutory provisions, some of which have gone for years without regulatory guidance, to a less urgent priority. This kind of artificial pressure on the prioritizing of regulations projects seems undesirable.

Another potentially unfortunate effect of the proposal stems from the "abuse" exception of proposed section 7805(b)(3). Under the proposal, "[t]he Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse." Again, this seems an entirely reasonable and necessary exception to the general rule proscribing retroactivity. Any anti-retroactivity rule clearly needs an "abuse" exception. While needed, however, the "abuse" exception creates other problems. An abuse exception will likely put pressure on regulation writers to characterize transactions as "abusive." We are concerned about encouraging this. It is often difficult to identify abuse, the abusiveness of given interpretations may vary from situation to situation, and overuse of the "abuse" label undermines respect for the tax system generally. Thus the "abuse" exception, while necessary, also engenders its own troublesome dynamics.

We also believe that the grants of powers to taxpayers in proposed section 7805(b)(7) and to the Secretary in proposed section 7805(b)(8) are overbroad and unwise. As we understand section 7805(b)(7), it would permit similarly situated taxpayers, as well as taxpayers on opposite sides of a transaction, to apply different rules depending on their individual tax situations. For example, suppose that after an exchange occurs a new regulation is issued expanding the parameters of a tax-free exchange. The acquiror may not be subject to such subsequently issued regulation, and thus may treat the earlier transaction

as taxable (entitling it to increased basis), while the transferor can elect retroactive application of the new regulation and treat the same transaction as tax free to it. This kind of gamesmanship is not good for the tax system. On the other side of the coin, section 7805(b)(8) gives the Secretary broad power to deny a judicial decision retroactive effect. Why should the Secretary be given the power to deny taxpayers the retroactive application of judicial decisions that confirm the correctness of taxpayers' interpretations of the law? Since tax decisions often are favorable to some taxpayers and unfavorable to others, there seems no practical way to circumscribe the Secretary's exercise of this power to avoid unjustifiable negative impacts on taxpayers (except by applying something like the proposed section 7805(b)(7) election, which as noted, raises other problems). Again, we do not believe that the evil of retroactive regulation is sufficiently serious to justify these proposed changes in tax administration.

As a final comment, we are very concerned about the proposal's treatment of administrative announcements. Proposed section 7805(b)(1) generally limits the retroactivity of any regulation to the earliest of (A) the date on which the regulation is filed with the Federal Register; (B) the date on which proposed or temporary regulations are filed; or (C) "the date on which any notice substantially describing the expected contents of any temporary, proposed or final regulation is issued to the public." In our view, notices and similar administrative announcements should be used only sparingly. They may sometimes serve a legitimate function by alerting taxpayers to specific narrow issues of immediate concern. They do not, however, entail the same depth of consideration as temporary or proposed regulations, they do not invoke the same kinds of public commentary, and they do not have any particular lifespan. Furthermore, since notices lack the detail of a regulation, questions -- and probably litigation -- will arise as to whether a notice "substantially described" the eventual regulations, and whether regulatory details not spelled out in a notice, and provisions (significant or minor) that change between the notice and the regulations, have retroactive effect.

October 2, 1995
Page -4-

If section 7805(b) is amended as proposed one would expect that many new tax amendments will be responded to in relatively short order by the issuance of a notice that purports to outline upcoming regulations. Over the long run, this new pressure to issue notices is not a constructive development. Again, if an anti-retroactivity rule is enacted it seems necessary to have some kind of exception along these lines (although the law could at least require that regulations be promulgated within a short time after the notice is issued). On balance, however, we do not believe that the current problem of unfairly retroactive regulations is sufficiently severe to warrant legislative encouragement of the generally undesirable practice of regulation-by-notice.

As the Tax Section has said on many occasions, we strongly favor the issuance of tax regulations, and believe they are very important to taxpayers' efforts to comply with the tax laws. We endorse the view, no doubt motivating this proposal, that regulations should be issued promptly, and we are frustrated when there are long delays, and therefore uncertainties, between the enactment of tax laws and the promulgation of regulations. In our experience, however, the retroactive application of regulations has not been a major problem to date. Given this, and the problems engendered by the proposed cure, we do not support the proposed amendment to section 7805(b).

Very truly yours,



Carolyn Joy Lee
Chair

cc: The Honorable Sam M. Gibbons
House of Representatives
Committee on Ways and Means
2204 Rayburn House Office Building
Washington, D.C. 20515

October 2, 1995
Page -5-

The Honorable William V. Roth, Jr.
Chairman, Committee on Finance
United States Senate
104 Hart Senate Office Building
Washington, D.C. 20510

The Honorable Daniel P. Moynihan
United States Senate
Committee on Finance
464 Russell Senate Office Building
Washington, D.C. 20510

Hon. Leslie B. Samuels
Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3120 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20200

Hon. Margaret M. Richardson
Commissioner
Internal Revenue Service
Room 3000
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Mr. Kenneth J. Kies
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, D.C. 20220