NEW YORK STATE BAR ASSOCIATION

TAX SECTION

REPORT ON LEGISLATIVE GRANTS OF REGULATORY AUTHORITY

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New York State Bar Association Tax Section

Report on Legislative Grants of Regulatory Authority

This report[1] of the New York State Bar Association Tax Section addresses grants of authority given by Congress to the Treasury Department and the Internal Revenue Service (the "IRS") to promulgate regulations under the Internal Revenue Code of 1986, as amended (the "Code"), and proposes model language to be used in the Code to provide such grants so as to reach the results Congress intends. The goals of having standardized language for such grants are to make the process of drafting the Code simpler for Congress, to increase the likelihood that the Congressional intent in making the specific delegation is effectuated, to reduce the likelihood of litigation between taxpayers and the IRS as to whether any regulations are valid and as to what the law is when there have been no regulations issued, and to provide more certainty to taxpayers, the IRS and courts as to the meaning and application of the Code and any such regulations. The Tax Section undertook to prepare this report in part as a result of concerns expressed informally to the Tax Section by members of the staff of the Joint Committee on Taxation, and officials of the Treasury Department and the IRS Chief Counsel's office.

Part I of this Report discusses the purpose and phrasing of grants of regulatory authority in general; Part II discusses the issues that are perceived to have arisen as a

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[1] This report was prepared by the Committee on Tax Policy. The principal drafters of this report were David W. Mayo and Eric I. Lowenstein with substantial contributions by Diana L. Wollman. Helpful comments were received from Kimberly S. Blanchard, Andrew H. Braiterman, Patrick C. Gallagher, Stephen B. Land, David S. Miller, Michael L. Schler and Kirk Wallace.

result of variations in the wording of such grants; Part III discusses administrative law issues regarding grants of regulatory authority in the Code; Part IV provides some detailed examples of such grants; and Part V suggests model language to be used in making such grants.

I. Grants of Regulatory Authority

Grants of regulatory authority by Congress to the Treasury Department and the IRS permeate the Code. In addition to the general grant of regulatory authority contained in Section 7805(a),[2] which provides that "the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue," there are more than 550 individual provisions of the Code that provide grants of authority to promulgate regulations, *e.g.*, to effectuate the purposes of a particular Section,[3] to apply the provisions of a particular Section to particular transactions,[4] and to implement concepts that are expressed only in general terms.[5]

The specific grants of regulatory authority are phrased in a seemingly endless variety of ways, but a great number of them fall into one of a few broad categories. First, a Code provision may set out a particular rule that is self-operative and, included in that Code provision or a related Code provision, is a grant to the Treasury Department and the

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2 Unless otherwise indicated, all "Section" references are to the Code.

3 *E.g.*, Section 168(h)(8) ("The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.")

4 *E.g.*, Section 108(e)(4) (providing "to the extent provided in regulations prescribed by the Secretary" that cancellation of debt income rules will apply to acquisitions of debt instruments by parties related to the debtor); Section 305(c) (providing that "the Secretary shall prescribe regulations" extending deemed dividend rules to various situations).

5 *E.g.*, Section 1502 ("The Secretary shall prescribe such regulations as he may deem necessary" governing the filing of consolidated returns).

IRS to prescribe regulations in order to effectuate the purposes of the rule (so-called "how" regulations).[6] Generally, regulations of this type are intended to fill gaps or add detail in the operation of the provision; in the absence of regulations, such detail often would be provided by courts in the ordinary course of statutory construction.[7] The grants may be very general, such as grants to promulgate regulations to "carry out the purposes of this" section,[8] or may set forth varying degrees of detail as to the regulations being suggested, including, either in the statute or legislative history, lists of topics to be covered, such as a grant to promulgate "regulations as may be appropriate to carry out the purpose of this subsection, including regulations for applying this subsection to tiered partnerships."[9] Except for possibly different levels of judicial deference, discussed below, a general grant of authority in a particular Code provision may add little to the general grant already contained in Section 7805(a); a more detailed grant can highlight issues that Congress has identified while deferring the resolution of those issues to the administrative agency and, depending on the wording of the details, constraining the regulations to be issued.[10]

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6 *But cf. International Multifoods v. Commissioner*, 108 T.C. 579 (1997) (IRS argued unsuccessfully that Section 865(j)(1) was not self-executing).

7 Specific rules of statutory construction, including the use of and weight to be given to legislative history in the context of interpreting statutes that include specific grants of regulatory authority, are beyond the scope of this Report.

8 *E.g.*, Section 168(h)(8).

9 *E.g.*, Section 743(e)(7); *see also* Section 382(m) (providing a detailed list of topics to be covered by regulations).

10 *See, e.g.*, Section 163(i)(5) (providing that the "Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (e)(5)", which subsections relate to the disallowance of interest deductions arising from an "applicable high yield discount obligation," and describing the matters the regulations should address -- on the one hand, the modifications necessary so that the rules reflected in subsections (i) and (e)(5) can apply to particular cases, *e.g.*, varying rates of interest and put or call options, and, on the other hand, anti-avoidance transactions involving "the use of issuers other than C corporations, agreements to borrow amounts due under the debt instruments or other arrangements").

The second broad category is where the Code provides a grant of regulatory authority and simultaneously limits the applicability of the relevant rule (which is often not an entire Section) until regulations have been issued pursuant to the grant to implement the rule (so called "whether" or "when" regulations).[11] These grants often use some form of the phrase "to the extent provided in regulations."[12] Although not entirely clear, these provisions are generally not considered to be self-operative in the absence of regulations, although the position of the IRS and the courts has varied.[13] Often, the regulations are intended to and do provide substantial detail when the Code provision itself is a relatively short statement. In some cases, an otherwise self-operative Code provision will include a grant of authority to promulgate regulations to apply the provision in contexts where the Code provision is not self-operative.[14]

Other grants do not fit neatly into either of the categories described above. For example, some grants provide that a Code provision can be "turned off" in certain circumstances, using, for example "except to the extent provided in regulations."[15] Other

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[11] The "whether vs. how" formulation derives from *Estate of Newman v. Commissioner*, 106 T.C. 216 (1996).

[12] *E.g.*, Section 108(e)(4) ("to the extent provided in regulations prescribed by the Secretary").

[13] Section 108(e)(4) is a case in point. Commentators argued that Section 108(e)(4) was not self-operative, *see, e.g.*, New York State Bar Association Tax Section, *Acquisitions of Discount Debt by Related Parties Under the New Section 108(e)(4) Regulation, reprinted in* 52 Tax Notes 211, 222-23 (1991), although the IRS apparently took a different view in connection with the issuance of the regulations. T.D. 8460, 1993-1 C.B. 19, 22 (arguing that Section 108(e)(4) was effective on enactment). Further, the IRS litigated a case and successfully applied Section 108(e)(4) notwithstanding the lack of regulations, although the lack of regulations was not discussed by the court. *Traylor v. Commissioner*, 59 T.C.M. (CCH) 93 (1990) (applying Section 108(e)(4) in the absence of regulations). In other circumstances, however, the IRS has taken the position that Code provisions including "to the extent" grants of authority are not self-operative. *See, e.g, Alexander v. Commissioner*, 59 T.C.M. (CCH)121 (1990) (at risk rules). *See generally* Phillip Gall, *Phantom Tax Regulations: The Curse of Spurned Delegations*, 56 Tax Law. 413 (2003) (collecting cases and discussing circumstances in which courts have applied statutes in the absence of regulations).

[14] *E.g.*, Section 338(h)(10).

[15] *E.g.*, Section 367(b) (providing a rule and providing that regulations may cause the rule not to apply in order to prevent tax avoidance).

grants are made to vary the terms of the statute to carry out the purpose of the statute.[16] Presumably in the absence of regulations the provision applies as drafted and the potential alternatives are not operative until the regulations are issued.

In other cases it seems clear that the regulations are intended to be "how" regulations, but the wording of the grant creates a situation where technically the provision cannot be applied until the regulatory details are provided. An example of this is Section 706(d)(1), which provides that, subject to exceptions:

> if during any taxable year of the partnership there is a change in any partner's interest in the partnership, each partner's distributive share of any item of income, gain, loss, deduction, or credit of the partnership for such taxable year shall be determined by the use of any method prescribed by the Secretary by regulations which takes into account the varying interests of the partners in the partnership during such taxable year.

Section 706(d) appears to be intended to be self-operative, and the situation described in it - a change in any partner's interest in a partnership - is so common that Congress must have known that it would arise before the issuance of regulations. However, absent regulations there is no authorized method of applying the statute, because the statute provides that the only authorized methods are those provided for in regulations.

Within categories of grants, there can be significant variation in the wording employed by Congress. For the most part, this variation appears to be an accident of drafting rather than an intention to provide substantively different standards. For example, a grant may be drafted as either permissive (that is, "may promulgate") or mandatory (that is, "shall promulgate").[17] Another variation involves the relatively

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[16] *E.g.*, Section 1275(d) (providing that the Treasury Department and the IRS "may" promulgate regulations in circumstances where the tax treatment provided by the original issue discount rules does not carry out the purposes of those rules).

[17] *E.g.*, Section 902(c)(7) (drafted as permissive).

common use of the phrase "necessary and appropriate" or the term "appropriate," both of which appear to be intended to have the same meaning and to achieve the same result.[18] Finally, many grants appear to contain extra and arguably unnecessary words, such as Sections 367(a) and 367(b), which provide for the promulgation of regulations "by the Secretary."[19]

Finally, there are numerous grants the language of which makes it difficult to asertain whether the grant is intended to be a "how" or a "whether/when" regulation. For example, the phrase "under regulations prescribed by the Secretary" would seem to be quite similar to "to the extent" and thus mean the provision is not self-operative. Courts, however, have often held that statutory provisions that include the "under regulations" formulation are not dependent on the issuance of regulations.[20]

II. Problems Intended to be Addressed by Model Language

As noted above, inconsistent phrasing of grants of regulatory authority in cases where the grants are intended to achieve the same results has led to concerns by members of the staff of the Joint Committee on Taxation, and officials of the Treasury Department

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[18] *Compare, e.g.,* Section 167(e)(6) ("the Secretary shall prescribe such regulations as may be necessary and appropriate to carry out the purposes" of that Section) *with* Section 168(h)(8) ("the Secretary shall prescribe such regulations as may be necessary to carry out the purposes" of that Section). *Cf. Commissioner v. Heininger*, 320 U.S. 467, 471 (1943) (interpreting "necessary" in the predecessor of Section 162(a) as meaning "ordinary and helpful").

[19] Section 367(a)(3)(A); Section 367(b)(1); *compare* Section 367(a)(2) (omitting "by the Secretary").

[20] *See, e.g., Pittway Corp. v. U.S.*, 102 F.3d 932 (7th Cir. 1996) (holding that "under regulations prescribed by the Secretary, methane or butane shall be treated as a taxable chemical" in Section 4662(b)(1) could be applied in the absence of regulations because the plain meaning of what the statute intended is clear); *Francisco v. Commissioner*, 119 T.C. 317 (2002), *aff'd* 370 F.3d 1228 (D.C. Cir. 2004) (holding that "The determination as to whether income is described in paragraph (1) or (2) of subsection (a) [which provides a taxpayer favorable exclusion] shall be made under regulations prescribed by the Secretary" in Section 931(d)(2) was meant by Congress to permit the exclusion in (a) to apply whether or not regulations were issued). Another grant that includes this type of ambiguity appears in the last sentence of Section 871(h)(3), relating to the application of attribution rules to partnerships in the context of the portfolio debt exception. It provides "[u]nder regulations prescribed by the Secretary, rules similar to the rules of the preceding sentence shall be applied in determining the ownership of the capital or profits interest in a partnership for purposes of subparagraph (a)."

and the IRS Chief Counsel's office, which were expressed informally to the Tax Section. First, it is believed that inconsistent phrasing creates meaningful taxpayer uncertainty. In too many common situations, taxpayers do not know how to apply the provision of the Code that grants the regulatory authority in circumstances where regulations have not yet been promulgated and do not know whether to rely on case law interpreting such Code provisions before regulations are issued and whether such reliance is affected by subsequently issued regulations.[21] Courts have found that Code provisions containing grants of regulatory authority range from (i) being self-operative (*i.e.*, rules contained in such Code provision are operative without the issuance of regulations) and generally authorizing the issuance of regulations that provide details of how the rules contained in the corresponding Code provision should operate, (ii) not being self-operative, such that the rules contained in such Code provisions are not applicable until regulations are issued, (iii) requiring that regulations issued thereunder be consistent with case law decided before the grant was enacted or be consistent with administrative practice before the grant was enacted (*i.e.*, the statute reflects prior case law and administrative practice and, accordingly, regulations promulgated thereunder must be consistent therewith), and (iv) allowing or requiring regulations that vary from prior case law, statute or administrative practice.[22] Given the variety of possible meanings of each regulatory grant, the large number of regulatory grants and the inevitable delay between the date of

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[21] The question of whether and to what extent an administrative agency's discretion regarding the content of regulations should be influenced or restricted by how courts have interpreted the relevant statutory provision before the issuance of regulations has been hotly contested but is generally beyond the scope of this Report. *See National Cable & Telecommunications Assoc. v. Brand X Internet Services*, 125 S. Ct. 2688 (2005); *Swallows Holding Ltd. v. Commissioner*, 126 T.C. 86 (2006).

[22] These issues do not arise solely (or primarily) from inconsistent drafting; in many cases the prompt promulgation of proposed regulations and the prompt finalization of proposed regulations would eliminate them.

enactment and the date final regulations are issued, taxpayer uncertainty as to the law is a significant and growing problem.[23]

A related problem is the not insignificant amount of litigation over these issues. In addition to litigation regarding whether a particular regulation exceeds the scope of the grant of authority (that is, the validity of existing regulations), in many cases the taxpayer or the IRS will argue that a Code provision that contains a regulatory grant is not operative in the absence of regulations or, conversely, that the Code provision applies even though there are no regulations extending it to the taxpayer's specific situation. The court is then required to determine what Congress intended and whether the court achieves this in each case is subject to disagreement. Although standardized language will not solve all problems regarding the validity of regulations, it should be useful in reducing disputes regarding whether particular provisions are self-operative or not in the absence of regulations.

These uncertainties as to the meaning of regulatory grants also produce the possibility of whipsaw for the Treasury Department and the IRS. Taxpayers that benefit from a regulation will rely upon it, while others who are disadvantaged will challenge its validity. A taxpayer who would benefit from a Code provision not being self-operative will, in the absence of regulations, take the view that the provision is not self-operative, while other taxpayers who would like the provision to apply to them will take the position that the provision is self-operative.

The Tax Section undertook to prepare this Report because the Tax Section

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[23] This uncertainty has both direct consequences (taxpayers do not know how to prepare returns where the provision may be applicable) and indirect or ancillary consequences (for example, taxpayers may perceive the system to be unfair and full of catch-22s or so unclear that compliance is impossible, or may be encouraged to take aggressive positions because they can argue that any interpretation was possible given the variations seen in the courts with respect to other provisions).

believes that eliminating or at least reducing these problems would improve significantly the fairness and effectiveness of tax administration and assist in ensuring that Congressional intent is furthered to the greatest possible extent.

III. General Overview of Treasury Regulations

A. In General

Administrative law issues relating to regulations in general, and to Treasury regulations in particular, have been the subject of a number of recent judicial decisions.[24] Numerous commentators have addressed these cases, along with the question of the appropriate deference to be paid by courts to regulations, and the power of administrative agencies to promulgate regulations that may be viewed as contrary to prior judicial decisions.[25] Most of the issues raised by these cases, as well as the issue of the appropriate degree of deference to be afforded to Treasury regulations generally, are beyond the scope of this Report. Nonetheless, in this section of the Report we set out a brief description of the background and some of the issues relating to the level of deference given to Treasury regulations.

Although we are not addressing the appropriate degree of deference to be applied to any specific regulation, the issue of deference is relevant to this Report in two respects. First, in at least some cases a Treasury regulation issued pursuant to a specific grant of

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[24] *E.g., National Cable & Telecommunications Assoc. v. Brand X Internet Services*, 125 S. Ct. 2688 (2005); *Swallows Holding Ltd. v. Commissioner*, 126 T.C. 86 (2006). For discussion, see Lee Sheppard, *Tax Court Flunks the Brand X Test*, 110 Tax Notes 585 (2006).

[25] There is a substantial body of literature addressing deference to Treasury regulations. *See, e.g.*, ABA Section of Taxation, *Report of the Task Force on Judicial Deference, reprinted* at 57 Tax Law. 717 (2004) (the "ABA Report"); Steve R. Johnson, *Swallows as it Might Have Been: Regulations Revising Case Law*, 112 Tax Notes 773 (2006); Irving Salem, *Deference and the American Jobs Creation Act of 2004*, 108 Tax Notes 1055 (2005); Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?,* 84 B.U.L. Rev. 185 (2004); Edward J. Schnee and W. Eugene Seago, "Deference Issues in the Tax Law: Mead Clarifies the Chevron Rule -- Or Does It?," 96 J. Tax'n 366, 371 (2002); Ellen P. Aprill, *Muffled Chevron: Judicial Review of Tax Regulations*, 3 Fla. Tax Rev. 51 (1996).

authority may be given more deference by a reviewing court than a regulation issued pursuant to the general grant of Section 7805(a) and Congress should be aware of this higher degree of deference when including a grant in a particular provision (whether or not it is using the language we propose below) as opposed to being silent and relying upon Section 7805(a). Second, the precise wording of the specific grant may affect the degree of deference accorded to the resulting regulations (or to a decision by the Treasury Department and the IRS not to issue any regulations thereunder). We have tried to explain below which of our proposed formulations we believe would result in more deference and which would result in less deference.

B. Legislative versus Interpretative Regulations

Tax practitioners generally characterize Treasury regulations as either legislative or interpretative regulations. To a tax practitioner, the term "legislative regulations" refers to regulations promulgated pursuant to a specific grant of authority by Congress to the Treasury Department that is expressly set forth in a Section or subsection of the Code. Legislative regulations are often viewed as having the force and effect of law, because they entail an exercise of power delegated by Congress to the Treasury Department for a specific purpose.[26] In contrast to legislative regulations, the term "interpretative regulations" (at least as the term is used by tax practitioners) refers to Treasury regulations issued under the general grant of authority set forth in Section 7805(a). Interpretative regulations "purport only to interpret, explain, and apply the rules prescribed by Congress, rather than to fill gaps deliberately left open by Congress; and this limited function seems to leave more room for judicial review to determine whether

[26] *See, e.g., Allstate Ins. Co. v. United States*, 329 F.2d 346, 349 (7th Cir. 1964) (legislative regulations have "force and effect of law, so long as they were reasonably adapted . . . to the administration and enforcement of the act and did not contravene some statutory provision").

the agency's interpretation is a distortion of the legislation."[27] Even though there are, as noted above, more than 550 different Code provisions that expressly grant regulatory authority, Section 7805 interpretive regulations are far more numerous than legislative Treasury regulations.

The Administrative Procedure Act of 1946, as amended (the "APA"), which generally governs the rulemaking activities of administrative agencies, uses these terms in a somewhat different manner. The APA requires all governmental agencies to give a notice of "proposed rule making" in the *Federal Register* and permit "interested persons" to participate in the agency's rule-making process by being allowed to submit comments on the regulations being proposed.[28] In general, the notice-and-comment procedure applies only to "legislative regulations" (as defined in the APA), and does not apply to "interpretative rules."[29] A regulation is treated as a legislative regulation for purposes of the APA if it constitutes a "rule", which the APA defines as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency . . . ."[30]

Even though regulations promulgated under Section 7805 would seem to fit within this definition of a "rule," the Treasury Department and the IRS take the position

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27 Boris I. Bittker, Martin J. McMahon, Jr. & Lawrence A. Zelenak, *Federal Income Taxation of Individuals*, ¶ 46.04[2] (3rd ed. 2002).

28 Administrative Procedure Act of 1946, 5 U.S.C. Sections 553(b), 553(c), 553(e). The applicability of these concepts to tax regulations has been acknowledged by the Treasury Department. Treasury Regulation Sections 601.601(d) & 601.702(a). For a discussion of the APA and its interaction with Treasury regulations, *see* Bittker, McMahon, &. Zelenak, *supra* n. 27, at ¶ 46.04[1]; Aprill, *supra* n. 25, at 55-56; Michael Asimow, *Public Participation in the Adoption of Temporary Tax Regulations*, 44 Tax Law. 343 (1990).

29 5 U.S.C. Sections 553(b)(A), 553(b)(B).

30 5 U.S.C. Section 551(4).

that such regulations are "interpretative regulations" for purposes of the APA and, accordingly, are not required to comply with the notice-and-comment procedure that is applicable to APA-defined legislative regulations.[31] Nevertheless, the Treasury Department and the IRS generally choose to follow this notice-and-comment procedure, but, in so doing, state that "Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) [(*i.e.* the notice-and-comment requirement)] does not apply to these regulations."[32]

C. Judicial Deference

Determining the degree of deference that courts should afford administrative guidance is the subject of uncertainty and has been heavily litigated for many years and will likely continue to be heavily litigated in the future.[33] In the context of Treasury regulations, this has been particularly true of regulations promulgated under the general authority of Section 7805(a). Judicial deference to administrative guidance has recently attracted significant attention because of the Supreme Court's decision in *Brand X* and the Tax Court's decision in *Swallows Holding*.[34] This section of the Report is intended to provide a short summary of the case law relating to judicial deference.

In *Brand X*, the Supreme Court addressed whether to uphold a decision by the

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31 The confusion over whether Section 7805(a) regulations are legislative or interpretive was discussed by the Seventh Circuit in *Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 978-79 (7th Cir. 1998). The possible different meanings of the terms are discussed in the ABA report on judicial deference. *See* ABA Report, *supra* n. 25, at 728-735.

32 *See, e.g.*, T.D. 9225, 2005-42 I.R.B. 716 (Oct. 17, 2005); *see also* Michael I. Saltzman, *IRS Practice and Procedure* ¶ 3.02[2], [3][b] (rev. 2d ed. 2002).

33 For a general discussion, see ABA Report, *supra* n. 25, at 719-722, 750-759.

34 *See, e.g.*, Sheppard, *supra* n. 24; W. Eugene Seago & Edward J. Schnee, *The Tax Court Salvages a Foreign Corporation's Deductions in Swallows Holding,* 33 J. Corp. Tax'n 20 (2006); Richard M. Lipton, *A Divided Tax Court Rejects a Regulation -- and Struggles With Administrative Law -- in Swallows Holding*, 104 J. Tax'n 260 (2006); Irving Salem, *Supreme Court Should Clarify Its Deference Standard*, 112 Tax Notes 1063 (2006); Johnson, *supra* n. 25; Steve R. Johnson, *Swallows Holding as It Is: The Distortion of National Muffler*, 2006 TNT 142-37 (July 24, 2006).

Federal Communications Commission (the "FCC") regarding the interpretation of the phrase "telecommunications services" for purposes of the Federal Communications Act.[35] The FCC had ruled that cable companies that sell broadband internet service do not provide "telecommunications service" for purposes of the Communications Act, and, as a result, such companies are exempt from the so-called mandatory common-carrier rules. Prior to the FCC's ruling, the issue had been addressed by the courts, which had held that the cable companies did provide "telecommunications service" as that term was used in the Communications Act. The Supreme Court upheld the FCC's ruling and concluded that this issue of deference should be analyzed under the framework established in *Chevron v. Natural Resources Defense Council.*[36] The Supreme Court held that an administrative construction of a statute entitled to *Chevron* deference can contradict a court's prior interpretation of that same statute as long as the court did not previously rule that the statute is unambiguous and that there was no room for agency interpretation.

The *Chevron* framework is twofold. First, if the agency rule covers a matter that Congress has directly addressed (the statute is unambiguous), the rule will be upheld only if the court finds that the rule conforms to Congress's intent.[37] Second, if the agency rule covers a matter that Congress has not directly addressed, then the court must uphold the rule if the court finds that it is a reasonable construction of the statute.[38] Pursuant to this second principle, the court may not find a rule to be invalid merely because the court determines that it would have promulgated a different rule (even if the court's rule would

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35 Title II of the Communications Act of 1934, 48 Stat. 1064, as amended, 47 U.S.C. § 151 *et seq.*

36 467 U.S. 837 (1984).

37 *Id.* at 842.

38 *Id.* at 843.

have been a better rule in its view). Thus, so long as the agency construed the statute reasonably, the agency's rule must be upheld. [39]

It is well accepted that *Chevron* deference is the highest degree of deference available. At the other end of the spectrum is what is referred to as *Skidmore* deference, based upon a 1944 Supreme Court case[40] and its progeny and pursuant to which the reviewing court has the flexibility of choosing a rule that it determines is better than the rule or regulation adopted by the administrative agency, even if the rule or regulation adopted by the administrative agency was reasonable. Numerous articles discuss the interplay of *Chevron* and *Skidmore* and how cases decided after *Chevron* influence the analysis.[41]

In *Swallows Holding*, the Tax Court, in a reviewed opinion, considered the validity of regulations issued under Section 882(c)(2), which states that a tax return must be filed in the "manner" prescribed by statute and regulations in order for the taxpayer to be entitled to certain substantive tax benefits. The regulations at issue denied tax benefits if the tax return was not filed timely under the regulations; the taxpayer in the case had

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[39] Subsequent cases have interpreted *Chevron* to mean that under the second principle a rule must be upheld unless "arbitrary, capricious, or manifestly contrary to the statute." *Schuler Industries, Inc. v. United States*, 109 F.3d 753, 755 (quoting *Chevron*, 467 U.S. at 844). A number of Treasury regulations have been held to be invalid under *Chevron*. *E.g.*, *Rite Aid Corp.* v. *United States*, 255 F.3d 1357, 1359 (Fed. Cir. 2001) (held that regulations promulgated under Section 1502 are legislative regulations and the duplicated loss factor set forth in Treasury Regulation Sections 1.1502-20(c) and 1.1502-32 are "manifestly contrary to [Section 1502]"); *Union Carbide Corp. v. United States*, 612 F.2d 558 (Ct. Cl. 1979) (holding that the last sentence of Treasury Regulation Section 1.1502-25(c), which excludes corporations with net operating losses from both the numerator and denominator of the fraction on computing consolidated taxable income attributable to Western Hemisphere trade corporations, is a legislative regulation and is invalid as its applies to the consolidated section 922 deduction); *Phillips Petroleum Co. & Subsids. v. Commissioner*, 97 T.C. 30 (1991), *aff'd*, 70 F.3d 1282 (10th Cir. 1992) (Tax Court held, in part, that since (i) Treasury Regulation Section 1.863-1(b) is a legislative regulation promulgated under Section 863(a), (ii) the grant of regulatory authority in Section 863(a) is limited by Section 863(b), and (iii) such regulation and Section 863(b) conflict, Treasury Regulation 1.863-1(b) is invalid).

[40] *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

[41] See generally the articles cited *supra* nn. 25 & 34.

filed the return, but had filed it late. The Tax Court held that these regulations were invalid because the word "manner," as used in Section 882(c)(2), does not include an element of time.

In reaching its conclusion, the Tax Court determined that, because the regulations were issued under Section 7805(a), the appropriate standard of review was the *National Muffler*[42] standard rather than the *Chevron* standard.[43] The *National Muffler* standard is often used in reviewing the validity of regulations promulgated pursuant to Section 7805.[44] In *National Muffler*, the Supreme Court had to determine the validity of a regulation promulgated under Section 7805, which interpreted a phrase in Section 501(c)(6), where such phrase had no commonly understood meaning outside of federal income tax law. In upholding the Treasury regulation at issue, the Supreme Court articulated the following guiding principles to determine a regulation's reasonableness and, thus, whether such regulation should be upheld:

> In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute. See *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); *Helvering v. Winmill*, 305 U.S. 79, 83 (1938).[45]

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42 *National Muffler Dealers Association v. United States*, 440 U.S. 472 (1979).

43 There was significant disagreement among the members of the court and the majority's decision stated that had *Chevron* been applied the result would have been the same.

44 *See Walton v. Commissioner*, 115 T.C. 589, 597 (2002).

45 440 U.S. at 477.

The circuit courts that have decided the issue are split as to whether the standard of review set out in *National Muffler* is used in reviewing regulations issued pursuant to the grant of authority in Section 7805 or whether the *Chevron* standard is used.[46]

The standard of review set out in *National Muffler* is generally considered to be less deferential than the *Chevron* standard,[47] although the degree to which that is the case is not clear, nor is the practical effect of applying *National Muffler* rather than *Chevron* in an particular case.[48] Nonetheless, it seems safe to say that if Congress wishes to ensure that a set of regulations is given the greatest amount of deference by a reviewing court, it should enact a specific delegation of authority for the regulation, thus ensuring review under the *Chevron* standard.

IV. Examples of Existing Grants of Regulatory Authority in the Code

This section of the Report sets out in more detail examples of grants of regulatory authority that are included in the Code.

A. Examples of Grants of Regulatory Authority in Self-Operative Code Provisions

One example of a grant of regulatory authority in a self-operative Code provision is set forth in Section 338, which, in general, provides rules regarding the circumstances in which a stock acquisition may be treated for federal income tax purposes as an asset acquisition if an election is made in the manner prescribed by the Secretary. Section 338(i), which is the provision containing the grant of regulatory authority, reads as

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[46] *Compare, e.g., Snowa v. Commissioner*, 123 F.3d 190, 197 (4th Cir. 1997) *and United States v. Tucker*, 217 F.3d 960, 965 (8th Cir. 2000) (both *National Muffler*) *with, e.g., Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 983 (7th Cir. 1998) (*Chevron*). The Federal Circuit has adopted *National Muffler*. *Schuler Indus. v. United States,* 109 F.3d 753, 755 (Fed. Cir 1997). *See generally Swallows Holdings*, 126 T.C. at 176-182 (Holmes, J., dissenting) (collecting cases).

[47] *See, e.g., Rowan Cos. v. Commissioner*, 452 U.S. 247, 253 (1981).

[48] *See* Johnson, *supra* n. 25, at 780-81 (arguing that substantial deference is paid to regulations issued pursuant to Section 7805).

follows:

> The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purpose of this Section, including – (1) regulations to ensure that the purpose of this Section to require consistency of treatment of stock and asset sales and purchases may not be circumvented through the use of any provision of law or regulations and (2) regulations providing for the coordination of the provisions of this Section with the provision of this title relating to foreign corporations and their shareholders.

Thus, the grant includes both a general grant of authority to promulgate necessary rules, as well as specific directions as to the needed rules – stock and asset consistency and the application to foreign corporations.[49] A substantial body of regulations have been issued under this grant of regulatory authority, including stock and asset consistency rules[50] and rules relating to foreign targets,[51] as well as rules relating to a host of other issues.[52]

Another example of this type of regulatory grant is contained in Section 902, which, in general, provides rules permitting a domestic corporation to claim a deemed paid credit in respect of certain taxes of a foreign corporation where certain ownership requirements are met. The regulatory grants are set forth in Sections 902(c)(7) and (c)(8) and read as follows:

> (c)(7) Stock owned, directly or indirectly, by or for a partnership shall be considered as being owned proportionately by its partners. Stock considered to be owned by a person by reason of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person. The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including rules to account for special partnership allocations of dividends, credits, and other incidents of ownership of stock in determining proportionate ownership.
>
> (c)(8) The Secretary shall provide such regulations as may be necessary or

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[49] Section 338 also includes non-self-operative provisions, in particular Section 338(h)(10) which is to apply "under regulations prescribed by the Secretary . . . ." Section 338(h)(10)(A).

[50] Treas. Reg. § 1.338-8.

[51] Treas. Reg. § 1.338-9.

[52] Treas. Reg. §§ 1.338-1 through -7.

> appropriate to carry out the provisions of this Section and Section 960, including provisions which provide for the separate application of this Section and Section 960 to reflect the separate application of Section 904 to separate types of income and loss.

The statutory provisions relating to the Section 902 deemed paid credit are self-operative, but their operation involves substantial complexity that requires regulatory elaboration. It is unclear, however, what significance, if any, was intended by phrasing the grants of authority in different ways, in particular the use of the phrase "[t]he Secretary *may* prescribe such regulations as may be *necessary* . . . ." in Section 902(c)(7) as compared to "[t]he Secretary *shall* provide such regulations as may be *necessary or appropriate* . . . ." in Section 902(c)(8). The legislative history does not provide any insight regarding the purpose of the different wording. The difference may well be a mere accident of drafting: The predecessor of Section 902(c)(8) (which was originally numbered Section 902(c)(7)) was enacted in 1986, whereas the current version of Section 902(c)(7) was enacted in 2004.[53]

B. Examples of Grants of Regulatory Authority in Code Provisions That Are Not Self-Operative

An example of the second approach to grants of regulatory authority -- *i.e.*, grants relating to Code provisions that are not self-operative -- is the regulatory grant contained in Section 197. In general, Section 197 provides for 15-year amortization of purchased goodwill and certain other intangibles, referred to in the Code as "Section 197 intangibles." Section 197(e) excludes certain intangibles from the definition of Section 197 intangibles. One of those exclusions is in Section 197(e)(4)(D), which provides the

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[53] Section 902(c)(7) was added to Section 902 by the American Jobs Creation Act of 2004. Pub. L. No. 108-357, sec. 405(a). Section 902(c)(8) was included in Section 902 (as Section 902(c)(7)) when the deemed paid credit provisions in Section 902 were enacted as part of the Tax Reform Act of 1986. Pub. L. No. 99-514, sec. 1202(a).

following grant of regulatory authority:

> (D) To the extent provided in regulations, any right under a contract (or granted by a governmental unit or an agency or instrumentality thereof) [is not a Section 197 intangible] if such right
>
> (i) has a fixed duration of less than 15 years, or
>
> (ii) is fixed as to amount and, without regard to this Section, would be recoverable under a method similar to the unit-of-production method.

Thus, Treasury Regulation Section 1.197-2(c)(13), issued pursuant to this grant of regulatory authority, permits the cost of certain contracts to be amortized over a period that is shorter than 15 years.

A second example is Section 453(k), which provides an exception to the general rule of installment sale treatment set forth in Section 453(a) in cases of revolving credit plans and regularly traded stock or securities. This provision states:

> In the case of—
>
> (1) any disposition of personal property under a revolving credit plan, or
>
> (2) any installment obligation arising out of a sale of—
>
> (A) stock or securities which are traded on an established securities market, or
>
> (B) to the extent provided in regulations, property (other than stock or securities) of a kind regularly traded on an established market, subsection (a) shall not apply, and, for purposes of this title, all payments to be received shall be treated as received in the year of disposition. The Secretary may provide for the application of this subsection in whole or in part for transactions in which the rules of this subsection otherwise would be avoided through the use of related parties, pass-thru entities, or intermediaries.

The exception described at the beginning of Section 453(k)(2)(B), relating to publicly traded property other than stock, does not apply until regulations have been issued. Moreover, this paragraph provides the Secretary with the authority to issue regulations in

the future to address abuse situations.

C. Other Grants

The Code also contains other types of grants of regulatory authority. One type is a grant that provides for regulations that "turn off" a Code provision in particular circumstances, either as provided in the relevant Code provision or as to be provided in regulations. An example of this type of grant is that contained in Section 367(a)(2). In general, Section 367(a)(1) disqualifies an outbound transfer of property in from tax-free treatment under other provisions of the Code. Section 367(a)(2) contains an exception for certain transfers of stock or securities of a foreign corporation except to the extent provided in regulations. The grant of regulatory authority provides:

> Except to the extent provided in regulations, paragraph (1) shall not apply to the transfer of stock or securities of a foreign corporation which is a party to the exchange or a party to the reorganization.

Thus, absent regulations, outbound stock transfers would be treated as tax-free if they would qualify as tax-free if the transferee were domestic. A substantial body of regulations has been issued pursuant to this grant of authority.[54]

A second type is a broad grant to promulgate regulations that may be contrary to the statute in order to carry out its purposes in certain circumstances. Section 1275(d) provides such a grant, using the following language:

> The Secretary may prescribe regulations providing that where, by reason of [certain terms] the tax treatment under this subpart . . . does not carry out the purposes of this subpart . . . , such treatment shall be modified to the extent appropriate to carry out the purpose of this subpart . . . .

Section 1502, in granting authority to promulgate the consolidated return regulations,

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[54] *See* Treas. Reg. § 1.367(a)-3.

provides to similar effect that "the Secretary may prescribe rules that are different from the provisions of chapter 1 that would apply if [the affiliated] corporations filed separate returns."[55] One of the consolidated return regulations provides that a number of generally applicable Code provisions do not apply to members of an affiliated group filing a consolidated return.[56]

V. Suggested Language for Grants of Authority to Promulgate Treasury Regulations

We believe it would be good practice to use standard formulations for grants of regulatory authority. In the first instance, we believe that this practice would ease the burden of drafting Code provisions, because once the type of grant has been determined, the words to accomplish the grant would be standard. Further, we believe that the use of standard formulations of such grants would provide certainty in the application of the Code and thereby better foster Congressional intent in making specific delegations by eliminating any questions relating to the distinctions discussed above among various formulations of grants, many of which do not appear intended to be substantively different. We suggest below language intended to provide for the common delegations discussed above, which we believe would be appropriate for the situations discussed above, and discuss as well the use of specific grants of regulatory authority to overturn prior case law. Finally, we recommend that Section 7805 be amended to add a subsection that would set out the intent of the various forms of delegation so that when a particular form is used in the Code its intended meaning will be clear. We have attached model language for such an amendment in an Appendix to this Report.

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[55] Section 1502.

[56] Treas. Reg. § 1.1502-80.

A. Self Operative Code Provisions

When Congress wishes to defer to the expertise of the Treasury Department and the IRS to provide additional details as to how a particular Code provision should operate, but where the provision is intended to be self-operative even in the absence of regulations, we suggest that the relevant Code provision state:

> "The Secretary shall prescribe such regulations as he determines are appropriate to carry out the purpose of this [insert the appropriate label of the relevant Code provision, *e.g.*, Section, subsection, etc.]"

This formulation would, we believe, provide the broadest discretion to the Treasury and the IRS and result in the greatest degree of judicial reference to any regulations that are ultimately issued. Because it is intended to be self-operative, the balance of the statute should be drafted with sufficient clarity and detail that taxpayers and the IRS can apply it, and courts can interpret it, with reasonable certainty in the absence of regulations.

We recommend that the word "appropriate," rather than other formulations that are used throughout the Code, such as the phrases "necessary and appropriate," "necessary or appropriate" or simply "necessary," should be used in this formulation. In our view, the meaning of the term "necessary," at least as part of a phrase, is unclear in this context. Broadly read, it may add nothing. Narrowly read, it may be thought to limit the scope of the grant. Thus, the use of "appropriate" alone may provide a broader grant of regulatory authority and, thus, reduce the possibility that a regulation would be deemed to be beyond the scope of the grant.[57]

As discussed above, grants of regulatory authority often include details of the subject matter to be covered by the regulations, constraints on the substantive terms of

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[57] As discussed above, *supra* n. 39, regulations issued pursuant to a specific grant of authority may be declared invalid if found to be beyond the scope of the grant.

the provisions to be included in the regulations, or both. If Congress determines to include such detail or constraints, simply adding a clause beginning "including regulations" followed by an appropriate description of the subject matter would suffice.[58] We recommend avoiding the formulation "under regulations to be prescribed" because we believe there is significant uncertainty as to whether provisions including that phrase are intended to be, or would be interpreted by the courts as, self-operative.

In a similar vein, Congress may identify cases in which a statute, written in terms of a one situation, should apply to a different situation. Congress may also intend that the statute be self-operative even in the second situation, while recognizing that the details of the statute's application in that case may differ from the details of application to the first situation, or may otherwise require amplification. An example of this type of case is where a statute that was drafted to apply to corporations would be made applicable to partnerships as well.[59] In these cases, we suggest that the relevant Code provision state:

> "[insert the appropriate label of the relevant Code provision, *e.g.*, Section, subsection, etc.] shall apply to [insert description of identified situation] and the Secretary shall prescribe regulations determining the manner in which it shall so apply."

This type of drafting would be appropriate if the intent is that the statute be entirely self-operative as to both situations -- regulations being needed merely to provide details as to the rule's application to the second situation. We note that care must be taken that the rules in the statute that would be applicable to the second situation be sufficiently clear that the provision fairly can be self-operative, in order to avoid substantive concerns such

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[58] We use "including," rather than "including, without limitation," in keeping with the Code's rule of construction that the word including, when used in definitions, shall not be deemed to exclude other things otherwise within the meaning of the term defined. Section 7701(c).

[59] *See, e.g.*, Section 871(h)(3)(C) (application of attribution rules to partnerships).

as the potential for non-compliance and whipsaw of the government.

Both of our model formulations include the requirement that the Secretary "determine" that the regulations are appropriate before promulgating them, even though many existing grants are written as either permissive or mandatory. We believe that Congress should acknowledge that the Secretary could reasonably determine (especially in the case of general delegations of authority) that no regulations are appropriate in a particular circumstance, and therefore draft none.[60] This is appropriate, in our view, because if Congress intends to defer to agency expertise, it should be willing to permit the agency to determine that regulations are not necessary for sound tax administration or, if appropriate in the agency's view in light of other priorities, not use its resources to draft a particular set of regulations. This is particularly the case in a dynamic economy where market forces and the non-tax regulatory climate may reduce the need for regulations in a particular area before they are issued.[61] In any event, it is not clear what enforcement mechanism exists that can be used on a regular basis to force the Secretary to draft a particular set of regulations.

B. Non-Self Operative Code Provisions

When Congress desires that a particular Code provision not be operative until the Treasury Department and the IRS promulgate regulations, we suggest that the relevant Code provision state:

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60 We do not believe any announcement of such determination is necessary. The IRS publishes an annual "business plan" alerting the public as to the regulatory projects it has under consideration. Any announcement of a determination would have to reserve the ability to change the determination if circumstances warranted, so the announcement would be of little practical significance other than as a notice that a regulation project was not on the business plan.

61 Also, in the case of a self-operative Code provision, gaps and ambiguities in a statute can be filled administratively by means other than regulations, for example, published rulings or revenue procedures, or judicially.

"to the extent provided in regulations and only upon the issuance of such regulations . . . ."

This provision uses the often-used "to the extent" formulation, which we believe is intended to provide that the particular provision not be self-operative. In order to clarify this intent and seek to avoid so-called "phantom regulations,"[62] at least in the case of non-self-operative provisions, we suggest the insertion of the phrase "only upon the issuance of such regulations." We believe that the rules expressed in the particular Code provision in which such grant is embedded will not apply until Treasury regulations are issued.

Non-self-operative Code provisions provide a challenge to tax administration: a taxpayer that perceives the provision as favorable to it in a particular situation may seek to apply it in the absence of regulations.[63] The model language is intended to make clear that non-self-operative provisions are not intended to apply in the absence of regulations, but it is possible that taxpayers would still take that position and that such position would be sustained. Thus, we believe that it is particularly important that Congress use this formulation only in areas where it wishes to leave to the Treasury and the IRS the determination of whether a provision should apply, and may wish to consider whether the existence of any particular grant of authority creates an incentive for taxpayers to apply such provisions in the absence of regulations. In situations in which the contemplated rule is reasonably clear from the statute and the legislative history, Congress may wish to avoid the use of grants of regulatory authority that are not self-operative, because the

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62 *See* Gall, *supra* n. 12. "Phantom regulations" are "written" by courts faced with a Code provision mandating that Treasury regulations be promulgated to address a particular tax issue and such regulations have not been promulgated.

63 *See, e.g., Occidental Petroleum Corp. v. Commissioner,* 82 T.C. 819 (1984) (the Tax Court did not permit the absence of Treasury regulations under Section 58(h) to deprive the taxpayer of the benefit provided by Section 58(h)). *See also First Chicago Corp. v. Commissioner*, 88 T.C. 663 (1987), *aff'd*, 842 F.2d 180 (7th Cir. 1988) (same). For a discussion of this case and other cases involving spurned delegations, *see* Gall, *supra* n. 12.

clarity of the underlying rule will make it more likely that taxpayers will assert that the rule should apply in the absence of regulations. Moreover, the clarity of the underlying rule calls into question the need for a grant that is not self-operative. In such situations, the use of the self-operative grant formulation may be preferable.

C. Other Grants

1. Grants to "Turn Off" Code Provisions

We believe that grants of authority to "turn off" Code provisions also lend themselves to standardized language. In those cases, we suggest that the provision state:

"except to the extent provided in regulations, ..."

Any detail or constraints (for example, limiting the authority to issue regulations to situations in which they are necessary in order to prevent the avoidance of tax) could be added in the text immediately following the grant. We think it should be sufficiently clear from the context whether the substantive provision is intended to be self-operative.

2. Grants to Supercede Code Provisions

Unlike the other grants that we have discussed, we do not believe that grants to supercede or change Code provisions in order to effectuate the intent of such Code provisions lend themselves to standardized language. We believe such grants must be tailored to the particular circumstances, and therefore do not suggest model language for them.

D. Overturning Case Law

Either the self-operative or non-self-operative version of our suggested language could be used where Congress intends a particular case or line of cases to be overturned or reconsidered by Treasury regulations authorized to be issued pursuant to a specific

grant of regulatory authority. In such circumstances, the grant should include a description of the situation intended to be addressed by the regulations. We believe it would be helpful if the legislative history were to indicate the name of the case or line of cases that Congress intends to overturn (or reconsider). Clearly expressing the legislative intent in this manner would deflate, at least to some degree, the argument that Treasury regulations cannot, or should not be able to, overturn court decisions.[64] Although not directly on point, this approach has been used in situations in which a statute has been enacted for the purpose of overturning a case or a series of cases.[65]

E. Anti-Abuse Regulations

One additional concern with specific grants of regulatory authority involving anti-abuse regulations bears discussion. In recent years, Congress has increasingly enacted specific grants of authority that include authority to issue anti-abuse regulations.[66] In our view, such grants can be useful because, in most cases, the existence of a specific anti-abuse rule places taxpayers on notice to expect regulations addressing abuse of the rule in question. In addition, such grants may serve as an incentive to the Treasury and the IRS

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[64] We believe this argument has less weight in a situation where Congress mandates the regulation after the case intended to be overturned is decided than when the regulation is issued under a more general grant of authority to issue regulations, as was the case in, for example, in *Swallows Holding*. *See Swallows Holding Ltd. v. Commissioner*, 126 T.C. 86 (2006). *But see also* Gregg D. Polsky, *Can Treasury Overule the Supreme Court,* 84 B.V.L. Rev. 185 (2005) (arguing that the check-the-box regulations should be invalid because they contradict the Supreme Court's decision in *Morrissey v. Commissioner*, 296 U.S. 344 (1935), which interpreted the term "association" as used in the 1935 version of Section 7701(a)(3)).

[65] For example, the Tax Court's decision in *Ganter v. Commissioner*, 91 T.C. 773 (1988), holding that the wash sale rules did not apply to options, was overturned by an amendment to Section 1091(a) in 1988. Pub. L. 100-647, sec. 5075(a). The Conference Report describing current law referred to the *Gantner* case. H. Rep. 100-1104 131, *reprinted in* 1988-3 C.B. 473, 621. Similarly, Congress overturned a series of cases dealing with income from treaty-protected fishing rights of Native Americans, including *Estate of Peterson v. Commissioner*, 90 T.C. 249 (1988), in 1988 when it enacted Section 7873. Pub. L. 100-647, sec. 3401(a). The legislative history to Section 7873 referred to several Tax Court cases to the contrary, but not by name. H. Rep. 100-647, *supra* at 77, 1988-3 C.B. at 567.

[66] *See, e.g.*, Section 332(d)(4); Section 732(f)(8); Section 954(c)(6).

to issue anti-abuse regulations promptly. At the same time, a number of anti-abuse regulations have been promulgated by Treasury and the IRS under the general grant of authority in Section 7805(a).[67] The specific grants of regulatory authority to issue anti-abuse regulations may create an unwanted negative inference as to whether Treasury and the IRS have authority to promulgate anti-abuse regulations issued under Section 7805. To avoid such an inference, we believe it would be appropriate for Congress to amend Section 7805(a) to provide Treasury and the IRS with general authority to issue regulations to prevent the abuse of the purposes of the Code.

As described above, the IRS takes the position that the notice-and-comment requirements of the APA do not apply to regulations issued under the authority of Section 7805(a), but nonetheless follows those procedures in issuing such regulations.[68] In light of the broad and general nature of most anti-abuse regulations, as well as the potentially draconian consequences of applying such regulations, we believe that the notice-and-comment procedure is particularly important in promulgating such regulations. We encourage the IRS to continue to follow those procedures when promulgating anti-abuse regulations under the authority of Section 7805(a).

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[67] *See, e.g.*, Treas. Reg. § 1.701-2.

[68] The validity of that position is beyond the scope of this Report.

Appendix

As described in the Report, this Appendix sets forth proposed language for an amendment to Section 7805, which would codify the intent underlying the model grants of regulatory authority proposed in the Report. Before stating the suggested amendment to Section 7805, immediately below is a summary of the model grants of regulatory authority proposed in the Report:

- Self-Operative Code Provisions. The following is suggested when Congress wishes to defer to the Treasury Department and the IRS to provide additional details as to how a particular Code provision should operate, but where the particular Code provision with respect to which this grant relates is intended to be self-operative in the absence of such regulations:

  > "The Secretary shall prescribe such regulations as he determines are appropriate to carry out the purposes of this [insert the appropriate label of the relevant Code provision, *e.g.*, Section, subsection, etc.]"

  If Congress wishes to include details of the subject matter to be covered by the regulations or constraints on the substantive terms of the provisions to be included in the regulations, we suggested that the grant state:

  > "The Secretary shall prescribe such regulations as he determines are appropriate to carry out the purposes of this [insert the appropriate label of the relevant Code provision, *e.g.*, Section, subsection, etc.], including regulations [insert appropriate description of the subject matter]."

- Self-Operative Code Provisions Adapting Concepts. The following is suggested when Congress wishes to identify a situation in which a statute, written in terms of another situation, should apply, and intend that the statute be self-operative and apply to it, but recognizes that the details of its application to that situation may

differ from the details of the application to the first situation, or otherwise require amplification.

> "[insert the appropriate label of the relevant Code provision, *e.g.*, Section, subsection, etc.] shall apply to [insert description of identified situation] and the Secretary shall prescribe regulations determining the manner in which it shall so apply."

- Code Provisions That Are Not Self-Operative. The following is suggested when Congress desires that a particular Code provision not be operative until the Treasury Department and the IRS promulgate regulations:

> "to the extent provided in regulations and only upon the issuance of such regulations . . ."

- Code Provisions "Turned Off" By Issuance of Regulations. The following is suggested when Congress desires to grant authority for the issuance of regulations that "turn off" Code provisions:

> "except to the extent provided in regulations . . ."

The following suggested amendment to Section 7805 would be inserted immediately after Section 7805(f):

> (g) INTENDED PURPOSE OF CERTAIN LANGUAGE TO BE USED IN GRANTING REGULATORY AUTHORITY. –
>
> (1) IN GENERAL. This subsection sets forth certain phrases (each, a "grant") used in delegating authority to the Secretary to promulgate regulations and provides a description of the purpose of each such delegation.
>
> (2) SELF-OPERATIVE PROVISIONS.
>
> (A) DESCRIPTION OF INTENDED PURPOSE. Where either of the grants set forth in clauses (2)(B)(i) or (2)(B)(ii) of this subsection appear in this title, such grants indicate that the Secretary has been delegated the authority to promulgate regulations to provide guidance regarding the particular provision of this title to which such grant relates and that such provision is intended to be operative despite the absence of such regulations.

(B) PHRASE OF GRANT –

(i) "The Secretary shall prescribe such regulations as he determines are appropriate to carry out the purposes of this [Code provision]."

(ii) "The Secretary shall prescribe such regulations as he determines are appropriate to carry out the purposes of this [Code provision], including regulations [insert appropriate description of the subject matter]."

(3) SELF-OPERATIVE PROVISIONS ADAPTING CONCEPTS.

(A) DESCRIPTION OF INTENDED PURPOSE. Where the grant set forth in clause (3)(B) of this subsection appears in this title, such grant indicates that the Secretary has been delegated the authority to promulgate regulations to apply the rule of a provision of this title to an identified situation or circumstance and that such regulations shall provide any appropriate amplification or modification of the rule that are appropriate. The provision to which this grant relates shall, unless otherwise indicated in such provision, be operative before the issuance of such regulations.

(B) PHRASE OF GRANT -- "The Secretary shall prescribe such regulations as are appropriate to apply [Code provision] to [insert description of identified situation]."

(4) PROVISIONS THAT ARE NOT SELF-OPERATIVE.

(A) DESCRIPTION OF INTENDED PURPOSE. Where the grant set forth in clause (4)(B) appears in this title, such grant indicates that the applicable section or provision of this title shall not be operative until the Secretary has promulgated regulations pursuant thereto.

(B) PHRASE OF GRANT -- "To the extent provided in regulations and only upon the issuance of such regulations"

(5) PROVISIONS "TURNED OFF" BY ISSUANCE OF REGULATIONS.

(A) DESCRIPTION OF INTENDED PURPOSE. Where the grant set forth in clause (5)(B) appears in this title, such grant indicates that the Secretary has been delegated the authority to promulgate regulations setting forth situations to which a provision of this title shall not apply and that such exceptions shall not apply until such regulations are effective.

(B) PHRASE OF GRANT. "Except to the extent provided in regulations"

(6) EFFECTIVE DATE. This subsection shall be applicable with respect to grants set forth in provisions of this title that are effective after _____.