

Tax Trends

By Mark A. Luscombe

The Impact of *Mayo* on the IRS Regulatory Process

Since the Supreme Court does not take a lot of tax cases, we tend to take notice when they do. Even rarer is for the Chief Justice to write the opinion in a tax case. So *Mayo Foundation for Medical Education and Research*¹ deserves some attention for that reason alone.

The History Behind *Mayo*

The importance of the decision has little to do with the particular facts of *Mayo* unless you are a teaching hospital or a medical resident at a teaching hospital. The issue involved in *Mayo* was whether medical residents who spend much of their time seeing patients rather than in a classroom are primarily students exempt from FICA taxation or employees subject to FICA taxation. Historically, resident physicians had been treated as employees both by the IRS and by the Social Security Administration, even though the applicable regulations called for analyzing each situation on a case-by-case basis.

In 1998, the Eighth Circuit held in *Minnesota v. Apfel*² that the SSA could not categorically exclude resident physicians from student status. This decision resulted in a flood of claims to the IRS for student status for resident physicians. In response, the Treasury Department in 2004 adopted revised regulations that stated that any individual working 40 or more hours per week would be treated as not performing services that are merely incidental to and for the purpose of pursuing a course of study.

Mayo responded by filing suit asserting that the regulations were invalid. The district court sided with *Mayo*, citing the multiple-factor test for the



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validity of regulations under *National Muffler Dealers Assn., Inc.*,³ looking at how long after the statute was enacted the regulation was adopted, the length of time the regulation had been in effect, the reliance placed on the regulation, the consistency of the regulation's interpretation and the subsequent degree of scrutiny Congress has given the regulation since its adoption.

The appeals court reversed, siding with the IRS, relying on another Supreme Court case, *Chevron U.S.A. Inc. v Natural Resources Defense Council, Inc.*,⁴ applying a simpler two-step analysis: (1) whether Congress has directly addressed the issue in question, and, if not, (2) that agency rules should be preserved unless they are arbitrary or capricious in substance, or manifestly contrary to the statute. The Supreme Court in *Mayo* adopted the *Chevron* standard over the *National Muffler* standard and upheld the IRS regulation. The more important issue is what this means for IRS regulations going forward.

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The IRS Regulatory Process

There are several aspects of the Supreme Court ruling in *Mayo* that could impact IRS regulations:

1. The Court clearly adopted the *Chevron* standard that gives a lot of deference to agency regulations where the statute is silent on the issue and the regulation can be viewed as a reasonable interpretation of the statute.
2. The Supreme Court rejected the long-held view that legislative regulations are due more deference than interpretive regulations. Legislative regulations are regulations with respect to a statute where Congress has expressly in statutory language deferred to regulations to flesh out a particular statutory provision. Interpretive regulations flesh out statutory language without that express statutory authority. Now the same *Chevron* standard is to be applied to both sets of regulations.
3. The Supreme Court does not view Treasury regulations any differently than the regulations of any other federal agency. They all are subject to the same *Chevron* standard.
4. IRS regulations that are a reasonable interpretation of the statute must be upheld.

5. Drawing arbitrary lines to provide certainty in regulations can be a reasonable approach to regulation drafting.

The Impact of *Mayo*

The IRS has indicated that the *Mayo* decision should help the IRS issue more guidance faster. Rather than trying for a perfect set of regulations that addresses every possible issue, the IRS will focus on getting out a pretty good set of regulations faster. The IRS will no longer have to concern itself with the various authority issues surrounding the *National Muffler* analysis.

The IRS is expected to continue its current processes for internal regulatory review and publishing proposed regulations for comment. Congress seems to increasingly write statutory language that leaves a lot to interpretation. This trend will give more discretion to the IRS in interpreting such statutory language under the *Chevron* standard.

One current area of concern is the validity of the IRS's final and temporary regulations adopting a six-year statute of limitations in overstated basis cases. Although there is a split in the circuits, the IRS has been losing a majority of those cases. *Mayo* may encourage the IRS to fight on and try for a Supreme Court review of the matter.

A related issue not addressed in the *Mayo* decision but being discussed in some court cases is whether the requirements of the Administrative Procedures Act apply to IRS rulemaking. The Treasury has historically taken the position that APA requirements do not apply because IRS regulations are interpretive, but that might be another issue for the Supreme Court to consider in a subsequent case.

The Taxpayer Advocate has expressed concern that a combination of poorly drafted statutes and unfettered IRS discretion could give too much influence to lobbyists who have the access to try to influence the regulatory process. She encouraged Congress to try to be more careful and thorough in the drafting of tax laws. IRS representatives speaking on the subject have tried to provide assurances that the regulatory process will continue to give representation to all stakeholders on a particular issue.

Although the *Mayo* decision only dealt with IRS regulations, it also opens up questions as to how much

deference should be given to IRS revenue rulings, notices, and other forms of guidance that may or may not receive as much vetting as final regulations.

Tax practitioners may welcome more frequent guidance from the IRS. One of the concerns associated with the new Uncertain Tax Positions reporting requirements is the number of positions that are uncertain because taxpayers are awaiting IRS guidance on the issue. Frequently, there is less concern with what the rule is than that there is at least a rule. Still, tax practitioners are likely to find it more difficult to

challenge IRS regulations that they do not like under the *Mayo* and *Chevron* standard.

ENDNOTES

- ¹ *Mayo Foundation for Medical Education and Research*, SCt, 2011-1 USTC ¶50,143.
- ² *Minnesota v. Apfel*, 151 F3d 742 (8th Cir. Minn. 1998).
- ³ *National Muffler Dealers Assn., Inc.*, SCt, 79-1 USTC ¶9264, 440 US 472 (1979).
- ⁴ *Chevron U.S.A. Inc. v Natural Resources Defense Council, Inc.*, 467 US 837 (1984).

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