Understanding Treasury Regulations

The U.S. Department of the Treasury, part of the executive branch of the U.S. government, is responsible for implementing tax laws. Treasury Regulations, also referred to as Federal Tax Regulations, are the Treasury Department's official interpretation of how a particular Internal Revenue Code (IRC) section is to be applied.

Overview of Treasury Regulations

The Internal Revenue Service (IRS), a bureau of the Treasury Department, is the nation's tax collection agency and is charged with enforcement of the IRC. The IRS, under the supervision of the Treasury Department, issues Treasury Regulations to provide guidance for new Internal Revenue Code provisions or other tax law provisions or to address issues that arise with respect to existing IRC sections. Treasury Regulations interpret the IRC, set forth the IRS’s position and give directions on complying with tax laws.

Authority of Regulations

Executive agencies, like the Treasury Department, get their authority to issue regulations from laws enacted by Congress. Typically, when Congress creates an agency, that agency is given general authority to regulate certain activity within the confines of that agency’s purpose.

While agencies do not enact or create actual law, they are empowered with creating rules to be followed in furtherance of a particular enacted legal provision and for the enforcement of the law. Consequently, although regulations are not technically laws, they carry significant authority, and generally must be adhered to by the public.

Federal Rulemaking Procedures

The Federal Administrative Procedure Act sets forth the procedures that the IRS and other federal agencies must follow to propose and establish regulations. Generally, regulations are first published as proposed regulations in the Federal Register. The public is invited to participate in the rulemaking process, and the IRS often holds public hearings on regulations it has proposed. Based on the rulemaking record and public input, a proposed regulation may be modified or withdrawn, or the agency may proceed with a final rule. Final regulations (and temporary regulations) are published via Treasury Decisions (TDs) in the Federal Register.
Official Publication

The Federal Register is the official publication for rules, proposed rules, and notices of federal agencies and organizations, and it is published every business day. Specifically, the Federal Register contains the following: Federal Agency Regulations, Proposed Rules and Public Notices, Executive Orders, Proclamations, and Other Presidential Documents. Regulations are published by date of issuance in the Federal Register.

After publication in the Federal Register, Regulations are organized by subject matter and codified in a separate publication called the Code of Federal Regulations (CFR). The purpose of the CFR is to present the official and complete text of federal agency regulations in one place. The CFR is divided into several Titles that represent broad areas subject to federal regulation. Income Tax Regulations are located in Title 26 of the CFR. Numbering of tax regulations in the CFR corresponds to the numbering of the IRC sections that the regulations interpret. (Although CFR sections correspond to IRC sections, paragraphs and other subdivisions do not correspond.)
Numbering System

Treasury regulations have a specific numbering system, as shown in the illustration below.

![Numbering System for Treasury Regulations](image)

The prefix before the decimal indicates the “Part” within the CFR. The part corresponds to a single program or function—for tax, this generally corresponds to tax type. The prefix "1" is for income tax regulations, "20" is for estate tax regulations, “25” is for gift tax regulations, “31” is for employment taxes, “40” is for excise taxes, “301” indicates procedure and administration, etc. The first group of numbers following the decimal indicates the IRC section that the regulation explains and interprets. The number after the dash indicates the regulation number or sequence (but does not correspond directly with IRC designations). For example, Treas. Reg. §1.167(a)-1 is the first regulation on IRC Section 167(a).

Levels of Treasury Regulations

Proposed Regulations

Proposed regulations are published in the Federal Register via a Notice of Proposed Rulemaking (NPRM). NPRMs are numbered sequentially and include an introduction (explanatory preamble). There is a public comment period (variable, commonly 30 to 60 days) during which interested parties can review the proposed regulations and submit written comments. During a comment period, the agency may hold a public hearing. These hearings and written comments allow interested parties and tax professionals the opportunity to comment on whether the proposed regulation adequately addresses the issue it seeks to explain and interpret or whether the regulation negatively impacts a certain group without legal authority, and provide an opportunity for the public to note that changes or clarifications are needed before the regulations become binding. It can take a considerable amount of time (months or years) before a proposed regulation is adopted as a final regulation.
Proposed regulations provide insight into how the IRS is interpreting the law and allow practitioners to have input in the rulemaking process. While proposed regulations can be useful in indicating the IRS’s position, they are generally not binding on the IRS or taxpayers. Taxpayers cannot rely on proposed regulations to support a tax position or for planning purposes, unless the IRS clearly states otherwise. Occasionally, the IRS needs to provide guidance on an issue quickly, as in the case of a recently enacted, complex new Internal Revenue Code provision. In this case, the IRS/Treasury will indicate in the NPRM for that provision that the proposed regulations can be relied upon by taxpayers. These types of proposed regulations are known as “reliance regulations.”

Temporary Regulations
Temporary regulations provide guidance until final regulations are adopted and have the same authority as final regulations. Temporary regulations may be issued before the normal public comment and review process when guidance is urgently needed (e.g., after major changes in the IRC or in the IRS’s interpretation). The Treasury Department issues a proposed regulation simultaneously as a temporary regulation because the rulemaking process requires that the agency issue regulations in proposed form. While the text of the temporary regulations and the proposed regulations are identical, there are in fact two distinct sets of regulations—one temporary and one proposed. The proposed regulations provide the regular public comment period. Temporary regulations are effective upon publication in the Federal Register and are valid for three years from issuance. (However, temporary regulations issued before November 20, 1988, are excluded from this three-year rule.) Temporary regulations are usually designated by a “T” at the end of the regulation number (e.g., Reg. §1.702-3T).

Final Regulations
A Treasury Decision (TD) is the document issued by the IRS that formally issues the text of a final (or temporary) regulation. TDs are drafted by the IRS and must be approved by the Secretary of the Treasury. They are numbered sequentially and include an introduction (explanatory preamble). TDs are effective for the period covered by the law section they interpret, unless they specifically provide otherwise. TDs are documents in and of themselves and are considered IRS Rulings. The regulations contained within the Treasury Decision are ultimately published in the Code of Federal Regulations and have a higher authoritative value.

Final regulations interpret an IRC section and provide guidance to tax professionals for tax compliance and planning purposes. However, a subsequent change to the IRC can reduce or eliminate the need to comply with a final regulation.
Levels of Treasury Regulations

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<th>Level</th>
<th>Description</th>
<th>Issuance</th>
<th>Weight of Authority</th>
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<tr>
<td>Proposed</td>
<td>Provide insight into how IRS is interpreting the law; allow practitioners to have input in the rulemaking process.</td>
<td>Published in Federal Register via a Notice of Proposed Rulemaking.</td>
<td>Cannot rely on proposed regulations to support tax position or for planning purposes, unless IRS clearly states otherwise.</td>
</tr>
<tr>
<td>Temporary</td>
<td>Provide guidance until final regulations are adopted. Valid for no more than 3 years from date issued, generally.</td>
<td>Published via a Treasury Decision.</td>
<td>Same authority as final regulations.</td>
</tr>
<tr>
<td>Final</td>
<td>Interpret an IRC section and provide guidance for tax compliance and planning purposes.</td>
<td>Published via a Treasury Decision.</td>
<td>Highest authority issued by Treasury Department.</td>
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Types of Tax Regulations

There are three types of tax regulations—legislative, interpretive and procedural. Details on each type of regulation are discussed below.

**Legislative Regulations**

The Internal Revenue Code authorizes the IRS to provide operational rules for specific IRC provisions. Generally, legislative regulations carry the same weight of authority as the law itself. The regulation will typically refer to its statutory authority.

**Interpretative Regulations**

Interpretive regulations help to explain the IRS’s position on various IRC sections. Interpretative regulations are issued under the IRS’s general authority to interpret the language of the IRC, but they are not specifically authorized by the law. They are subject to challenge if they do not
reflect Congressional intent. Nevertheless, interpretive regulations often carry substantial weight of authority.

Reproduced below is an excerpt from the IRS Internal Revenue Manual that provides guidance on how to determine if a rule is interpretative or legislative.

32.1.1.2.8 (09.23.2011)
How to Determine If a Rule Is Interpretative or Legislative

1. Whether a regulation is promulgated under a specific grant of authority in the Internal Revenue Code does not govern whether the regulation is interpretative or legislative.

2. If Congress simply provided an end result, without any guidance as to how to achieve the desired goal, then regulations promulgated to achieve that goal are considered to be legislative.

3. If Congress provided specific rules and merely left gaps for the Secretary to fill, regulations filling those gaps are considered interpretative.

4. If the regulation repeats law subsumed in the underlying legislation, then the regulation is considered interpretative.

Procedural Regulations

Procedural regulations address procedural rather than interpretative matters, such as how to go about filing returns and making elections. Generally, procedural regulations relating to particular IRC Sections are considered to be binding. However, the procedural regulations set forth in 26 CFR Part 601, known as the Statement of Procedural Rules, are considered to be directive and not mandatory. The Statement of Procedural Rules provides guidelines for conducting the internal affairs of the IRS. They are issued by the IRS Commissioner without the signature of the Treasury Secretary. Nevertheless, the procedural rules are published in the Federal Register and have the status of regulations. Therefore, such rules have higher weight of authority than other IRS pronouncements that are not published in the Federal Register.

Any of these three types of regulations can be amended. The process for amending regulations is the same as for issuing new regulations; they must be issued in proposed format with a public comment period. It is important that tax professionals are aware that amendments to a regulation may be pending.

Weight of Authority

The Internal Revenue Code provides the foundation of all federal tax authority and is the ultimate authority when researching federal tax law issues. Treasury Regulations interpret IRC sections. The regulations provide greater detail and often include helpful examples.

The Treasury Department and IRS recognize a hierarchy of authorities. Final and temporary regulations are the highest administrative authority issued by the Treasury Department and rank above all IRS rulings. Final and temporary regulations must be followed by the IRS. Although proposed regulations can be useful in indicating the IRS’s position, neither the IRS nor
the courts are bound by proposed regulations unless the Treasury Department specifically notes that they can be relied upon.

Generally, final and temporary regulations have the full force and effect of law, unless they conflict with the IRC. When challenged, federal regulations are usually upheld. Normally, the longer a regulation remains on the books without substantial changes, the greater the weight accorded to it by the courts. If a taxpayer challenges the validity of a regulation and loses the challenge, a 20% penalty is imposed on the portion of any underpayment of tax that is due to negligence or disregard of rules or regulations (see IRC §6662).