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TAX LETTER

TAX LAWS AND TAX REGULATIONS

There are laws and there are regulations. Laws are passed by Congress and signed by the President. Regulations are promulgated and set up by Government Agencies charged with the responsibility of administer the Laws. The differences are specifically clear between the Federal income tax laws and the associated tax regulations. The set of Internal Revenue Codes (IRC) are the tax laws passed by Congress and signed into law by the Presidents. Certainly, they have the power of law. However, the Income Tax Regulations are promulgated by the Department of Treasury and/or the Internal Revenue Services (IRS) which are Federal Agencies responsible for the administration of the IRC. Sometimes they have the power of law and sometimes they are nothing more than an interpretation of the law by the Department of Treasury and/or by the IRS. For any regulations, if they are interpretations of the IRC, they do not necessarily have the power of law.

How can we differentiate the tax regulations between those having the power of law and those don't ? The answer lies in one or more legal foundations. The most significant one is that Congress provided certain specific provision(s) that the Department of Treasury and/or the IRS are responsible to promulgate regulations for those particular Sections of the Code, or for the purposes of fully implementing the spirit of the law and/or legislative intent. If this is the case, the regulations so adopted are part of the IRC having power of the law. If it is not so, in general, those regulations will be regarded as "interpretative" and not part of the law.

Taxpayers could, under certain appropriate situation and condition, deviate from an "interpretative" regulation provided that the Taxpayer discloses the deviation and/or departure from the regulation using Form 8275R. Form 8275R is a formal method to disclose and inform the IRS of such departure. In most cases the IRS will treat tax returns with a Form 8275R "Disclosure Statement" with special scrutiny and usual denial of the departure. Under such circumstance, the Taxpayer will receive certain notice of tax deficiency from the IRS. For the Taxpayer to disagree with the IRS and to object to the tax deficiency, the Taxpayer most likely has to appeal his case to Court.

In a 1979 case, " National Muffler Dealers Association v. U.S." the US Supreme Court outlined a 6-factor test to determine whether the departure from regulation is valid or not. The factors examined by the US Supreme Court are: (i) the substantial contemporaneous promulgation test, (ii) the evolution of the regulation, (iii) length of time the regulation

was in effect, (iv) the reliance placed on it by appropriate authorities and the public at large, (v) the consistency of its interpretation, and (vi) how much scrutiny was given by

Congress when subsequent related Code section(s) were enacted. These were the set of guidelines used by all parties concerned until 1984.

In 1984, a 2-step test was established by the US Supreme Court. This 2-step test was the result of a case “Chevron USA v. Natural Resources Defense Council”, and asked two basic questions. (i) Is the language of a particular Section of the Code **ambiguous** ? If NO, the standard acceptable meaning of the language of the Code should be followed. (ii) If the language of a specific Section of the Code is **ambiguous**, then, is the specific regulation in question an acceptable and reasonable interpretation of the Code? If the answer is YES, the regulation should be followed. Thereafter, most of the lower Courts regarded the 1984 ruling as an addition to and not as a replacement of the earlier 6-factor test. Depend upon the sets of facts and circumstances, they could work in tandem or parallel to each other.