

Tax Court Unwilling to Abandon Phantom Regulations

MARCH 28, 2017

In a recent decision, *15 West 17th Street, LLC v. Commissioner*, the Tax Court held that Section 170(f)(8)(D), which authorized, but did not command, the Secretary to promulgate regulations that would provide taxpayers an alternative method to substantiate their charitable contributions, was inoperative because the Secretary did not exercise his discretion to issue regulations under subparagraph (D).¹ The Tax Court concluded that the Secretary's authority to issue regulations was permissive, rather than mandatory, and because subparagraph (D) was not self-executing, it had no operative effect in the absence of the discretionary regulations. Judge Lauber's decision begs the question: Had this case involved a Code provision with a mandatory delegation of rulemaking authority, rather than a discretionary delegation, would the Tax Court have found it to be self-executing and would the Tax Court have crafted "phantom regulations" in order to apply that Code provision? Could it have done this in the wake of the Supreme Court's decision in *Mayo Foundation for Medical Education & Research v. United States*?²

Background

The term "phantom regulations" refers to regulations created by the courts, where the Secretary has failed to promulgate regulations in accordance with his authority to do so under certain Code provisions. Initially, this practice was limited to taxpayer-friendly statutes, where the lack of regulations would deprive the taxpayer of a congressionally intended benefit; however, it has since expanded.³

Since the Supreme Court's decision in *Mayo Foundation*, it has been argued that no Code section that calls for unissued regulations is self-executing and that the use of phantom regulations is inappropriate.⁴ In *Mayo Foundation*, the Supreme Court expressly stated that there was no reason "to carve out an approach to administrative review good for tax law only."⁵ This meant that courts should not apply a different set of rules to tax disputes than it applies to other types of cases. Accordingly, because phantom regulations are not used in other cases, a court cannot employ them in the tax law context.

One might be concerned with this conclusion, since Code sections and regulations are not always taxpayer-adverse. In many instances, Code sections reference regulations to be promulgated that are advantageous to the taxpayer. The Code section at issue in *15 West 17th Street, LLC v. Commissioner* is one such example.

15 West 17th Street, LLC v. Commissioner

On December 22, 2016, in *15 West 17th Street, LLC v. Commissioner*, the Tax Court held that a donor could not use a donee organization's amended return as a way to circumvent the substantiation requirements of the charitable contribution deduction, which require a contemporaneous writing acknowledgment ("CWA") at the time of the gift.⁶ The taxpayer argued that Section 170(f)(8)(D) nullified the CWA requirement of Section 170(f)(8)(A) so long as the donee organization included information regarding the contribution on its own return. The Commissioner took the position that subparagraph (D) was inoperative, making subparagraph (A) and the CWA the only allowable forms of substantiation, since subparagraph (D) only allowed this alternative form of substantiation "on such form and in accordance with such regulations as the Secretary may prescribe,"⁷ and since no such regulations had been promulgated.

Tax Court's Analysis

The Tax Court agreed with the Commissioner, concluding that Section 170(f)(8)(D) set forth a discretionary delegation of rulemaking authority, which meant that it was not self-executing in the absence of regulations.⁸ Without this subparagraph, the only allowable form of substantiation was a CWA under subparagraph (A). However, the Tax Court was not ready to dismiss the use of phantom regulations full stop. Acknowledging that courts have struggled with the proper way to interpret Code sections with absent regulations, the Tax Court explained that pursuant to the Administrative Procedure Act, a court's usual role is to review, not create, regulations.⁹ However, the court goes on to state that in instances where Congress has made it clear that a particular tax benefit or treatment should be available, there is legitimate concern when the Secretary prevents such an outcome by failing to issue regulations.¹⁰ This is known as "spurned delegations" and it is exactly the scenario which gave rise to the use of phantom regulations in the first place.¹¹ In its analysis, the Tax Court placed the Code sections which referenced Treasury regulations into two categories: those borne out of delegations of mandatory or permissive rulemaking authority.¹²

Mandatory delegations are those which require "the Secretary to issue regulations that achieve a particular result or apply a particular rule."¹³ Generally, this language comes in the following form: "the Secretary shall prescribe regulations." Most of the cases that deal with such mandatory delegations are taxpayer-friendly, *i.e.*, they involve Code sections providing a tax credit, deduction or other benefit.¹⁴ In these situations, the courts have found the Code sections to be self-executing in the absence of regulations in order to avoid the spurned delegations scenario described above.¹⁵ With respect to taxpayer-unfriendly provisions, the Tax Court explained the usual approach is to determine whether Congress directed the Secretary to determine "whether" a particular tax treatment should apply or "how" such treatment should be implemented.¹⁶ If the "whether" question was resolved by the statute alone, and such future regulations would merely address a means of "how" to implement the statute, then the statute was considered to be self-executing.¹⁷

On the other hand, delegations of permissive rulemaking authority include no such mandate.¹⁸ They usually take the form "the Secretary may prescribe regulations" or "under such regulations as the Secretary may prescribe"; however, they come in many other verbal forms, including "in such manner, in such form and within such time as the Secretary may by regulations prescribe" or "to the extent provided in regulations prescribed by the Secretary."¹⁹ In these cases, the courts generally have been unwilling to find these Code sections self-executing in the absence of regulations.

In a concurring opinion, Judge Holmes leaves the door open for the Tax Court to consider the appropriateness of phantom regulations, citing *Mayo Foundation* and highlighting that this case is another example of tax laws "wandering away from general principles of administrative law" and explaining that "this body of tax law [is] apparently blissful disregard for the APA."²⁰

There have also been a few circuit court opinions that have been unwilling to cross the boundary into the legislative arena. In *Hillman v. Commissioner*,²¹ the Fourth Circuit reversed the Tax Court's determination that a statute was self-executing in the absence of regulations, concluding that the inequity created by the lack of regulations was one that "only the Congress or the Secretary (as the holder of the delegated authority from Congress) has the authority

to ameliorate.”²² More recently, in *Summa Holdings v. Commissioner*, the Sixth Circuit reversed a Tax Court determination that a taxpayer’s combined use of DISC and Roth IRA Code provisions circumvented the contribution limits for high earners, stating, “[i]f Congress sees DISC-Roth IRA transactions of this sort as unwise or as creating an improper loophole, it should fix the problem.”²³

Conclusion

In the wake of *15 West*, a question remains as to whether any Code section which references unissued regulations can be self-executing. Based on the Tax Court’s exhaustive analysis in this opinion, it would seem the majority of the Tax Court believe that there can be such self-executing provisions and that crafting phantom regulations is permissible, at least for those provisions categorized as mandatory delegations of rulemaking authority. However, some, including Judge Holmes, feel that after *Mayo Foundation*, the crafting of such phantom regulations is inappropriate.

1 147 T.C. No. 19 (2016).

2 131 S. Ct. 704 (2011).

3 Gall, *Phantom Regulations: The Curse of Spurned Delegations*, 56 Tax Law. 413, 414 (2002).

4 Grewal, *Mixing Management Fee Waivers with Mayo*, 16 Fla. Tax. Rev. 1, 3 (2014) (“Mayo suggests that phantom tax regulations have evaporated. That is, in line with general administrative law authorities, tax statutes that call for regulations necessarily lack effect until regulations are issue.”).

5 131 S. Ct. at 713.

6 *15 West 17th Street LLC v. Comm’r*, 147 T.C. No. 19 (2016).

7 Section 170(f)(8)(D).

8 *15 West 17th Street, LLC*, 147 T.C. No. 19 at 18 (2016).

9 *Id.* at 10.

10 *Id.*

11 See Phillip Gall, *Phantom Tax Regulations: The Curse of the Spurned Delegations*, 56 Tax Law. 413 (2003); see also Amandeep Grewal, *Substance over Form? Phantom Regulations and the Internal Revenue Code*, 7 Houston Bus. & Tax. J. 42 (2006).

12 *Id.* at 10.

13 Gall, *supra* at 415.

14 Grewal, *supra* at 46.

15 See *Occidental Petroleum Corp. v. Comm’r*, 82 T.C. 819, 829 (1984) (“the failure to promulgate the required regulations can hardly render the new provisions . . . inoperative.”); *First Chicago Corp. v. Comm’r*, 88 T.C. 663, 676 (1987) (the Secretary has “failed to carry out the mandate imposed upon him by the Congress’ . . . [making the Court obligated] to act in his place.”); *Estate of Maddox*, 93 T.C. 228, 233 (1989) (Congress “directed (not merely authorized) the Secretary to prescribe regulations.”).

16 *15 West 17th Street, LLC*, 147 T.C. No. 19 at 11 (2016).

17 *Id.* at 11-12.

18 *Id.* at 13.

19 *Id.* at 13-14.

20 *Id.* at 18-19.

21 *Hillman v. Comm’r*, 263 F.3d 338 (4th Cir. 2001).

22 *Id.* at 343.

23 *Summa Holdings, Inc. v. Comm’r*, 848 F.3d 779 (6th Cir. 2017).

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