



September 2016

REGULATORY GUIDANCE PROCESSES

Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance

Why GAO Did This Study

The public relies on IRS guidance to understand complex tax laws and meet their responsibilities. GAO was asked to examine IRS guidance and rulemaking processes. This report reviews (1) how IRS communicates its interpretation of tax laws to the public and decides what type of guidance to issue; (2) what relevant authorities apply and what policies and procedures IRS uses when issuing guidance; and (3) to what extent selected IRS guidance products followed relevant IRS policies and procedures for issuing guidance, conducted literature reviews, analyzed eight non-generalizable case files for compliance with relevant authorities, and interviewed agency officials and other subject matter experts.

What GAO Recommends

GAO is making six recommendations, including that IRS communicate more clearly the limitations of information not published in the IRB, and that IRS develop procedures to better document the type of guidance it plans to issue and the key decisions made during the evaluations. GAO also recommends that Treasury and OMB reevaluate their long-standing agreement to exempt some tax guidance and regulations from OMB oversight. IRS and Treasury agreed with all of GAO's recommendations, and OMB neither agreed nor disagreed.

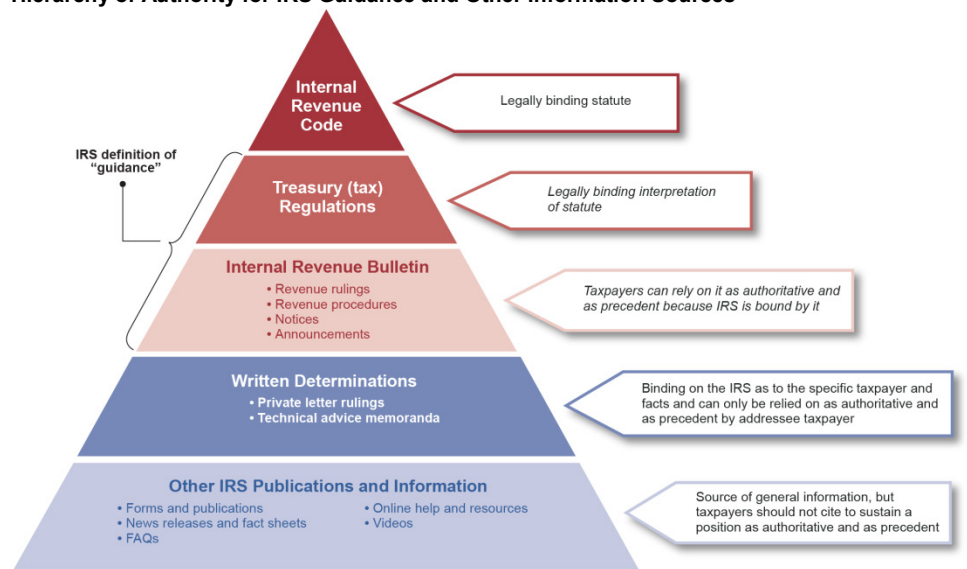
REGULATORY GUIDANCE PROCESSES

Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance

What GAO Found

The Internal Revenue Service (IRS) uses a variety of documents to communicate its interpretation of tax laws to the public, but only considers Internal Revenue Bulletin (IRB) guidance to be authoritative. IRS information published outside of the IRB can help taxpayers understand tax laws and make informed decisions, but does not always include information clarifying the limitations of its use. IRS has detailed procedures for identifying, prioritizing, and issuing new guidance. However, it lacks procedures for documenting the decision about what type of guidance to issue.

Hierarchy of Authority for IRS Guidance and Other Information Sources



Source: GAO analysis of IRS documents. | GAO-16-720

In a review of tax guidance, GAO found few instances in which the Office of Management and Budget (OMB) determined that a tax regulation was likely to have significant economic effects and would thus be subject to additional analysis. OMB's significance determinations largely result from initial assessments by the Department of Treasury (Treasury) and IRS that many administrative law or executive order requirements do not apply to most tax regulations and other guidance. Some tax regulations and other guidance are also exempt from further analysis and review under a 1983 agreement between OMB and Treasury, which was reaffirmed in 1993. This agreement has not been revisited in more than 20 years, and it is unclear whether this agreement is still relevant.

GAO also reviewed eight case files of non-regulatory IRS guidance documents published in 2015 and found that IRS did not consistently document required steps during key phases of the issuance process. Although these eight case files are non-generalizable, documenting key decisions may help IRS evaluate the risk of challenges to IRS assessments about whether tax guidance is significant enough to warrant additional OMB and congressional review.

Contents

Letter		1
	Background	2
	IRS Communicates Its Interpretation of Tax Laws through a Variety of Products	7
	IRS Procedures Do Not Include the Selection of a Type of Guidance	15
	IRS Guidance Is Routinely Exempt from the Analysis and Oversight Requirements of CRA and E.O. 12866	18
	IRS Did Not Always Clearly Document Required Steps for Developing Guidance in Selected Guidance Products	32
	Conclusions	34
	Recommendations for Executive Action	34
	Agency Comments and Our Evaluation	35
Appendix I	Objectives, Scope, and Methodology	38
Appendix II	Comments from the Department of the Treasury	42
Appendix III	Comments from the Internal Revenue Service	44
Appendix IV	GAO Contact and Staff Acknowledgements	46
Table		
	Table 1: Descriptions and Examples of IRS Guidance Types Published in the Internal Revenue Bulletin	10
Figures		
	Figure 1: Hierarchy of Authority for IRS Guidance and Other Information Sources	7
	Figure 2: Guidance Documents in the IRB and IRS Chief Counsel Hours Worked on Guidance	11

Abbreviations

APA	Administrative Procedure Act
BIN	Background Information Note
CCDM	Chief Counsel Directives Manual
CRA	Congressional Review Act
E.O.	Executive Order
FATCA	Foreign Account Tax Compliance Act
FAQs	Frequently Asked Questions
IRB	Internal Revenue Bulletin
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
NPRM	Notice of Proposed Rulemaking
OIRA	Office of Information and Regulatory Affairs
OMB	Office of Management and Budget
PGP	Priority Guidance Plan
PPACA	Patient Protection and Affordable Care Act
PRA	Paperwork Reduction Act
RFA	Regulatory Flexibility Act
SBA	Small Business Administration
TD	Treasury Decision

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



September 6, 2016

Congressional Requesters

The Internal Revenue Service (IRS), in collecting revenue owed to the government, is responsible for helping taxpayers understand the tax law and meet their tax responsibilities. To do so, IRS issues multiple types of guidance for taxpayers, such as notices and Frequently Asked Questions (FAQs).

You asked us to examine the extent to which IRS policies, procedures, and practices for issuing guidance conform to applicable statutory and related authorities. This report reviews 1) how IRS communicates its interpretation of tax laws to the public, and how it decides what type of guidance to issue, 2) what relevant authorities apply (including statutes, executive orders, and Office of Management and Budget (OMB) guidance), and what policies and procedures IRS uses, when issuing its guidance, and 3) to what extent selected IRS guidance products followed relevant authorities.

For the first two questions, we collected and analyzed documents that defined IRS guidance types, reviewed IRS's policies and procedures for issuing guidance, conducted literature reviews on IRS's issuance of guidance, and interviewed relevant officials at IRS, the Department of the Treasury (Treasury), the OMB Office of Information and Regulatory Affairs (OIRA), the National Taxpayer Advocate, and tax practitioner associations. To understand the variety and quantity of IRS guidance documents issued, we downloaded lists of all Internal Revenue Bulletin (IRB) documents published from 2002 to 2015.¹ To determine the topics for which guidance is issued, we reviewed the Highlights page for each IRB issue published from 2013 to 2015. To understand what authorities apply to IRS guidance, we reviewed language in IRS guidance documents issued from 2013 to 2015 that explained whether the guidance was subject to rulemaking requirements and additional

¹IRS, *Internal Revenue Bulletin*, "Numerical Finding List," <https://www.irs.gov/irb/>. The lists appear in issue numbers 26 and 52 of each year.

analyses.² We also searched a database of agency rules submitted to us under the Congressional Review Act (CRA) and a database of regulatory actions submitted to OMB. For our third question, we selected a non-generalizable sample of guidance documents published in 2015, and then reviewed IRS documentation associated with eight guidance projects (case files) to evaluate how the guidance process followed relevant authorities in these cases. We selected this sample to ensure representation of each of the four non-regulatory IRS guidance types—revenue rulings, revenue procedures, notices, and announcements—removing guidance covering administrative topics, such as rate adjustments, and any duplicate tax topics.³ We determined that the data we obtained through our reviews were sufficiently reliable for our purposes.

We conducted this performance audit from July 2015 to September 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

IRS's mission is to provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all. For more than 100 years, Treasury, in conjunction with IRS, has issued tax regulations and other guidance documents to help taxpayers comply with the tax code. Treasury and IRS are among the largest generators of federal agency regulations and they issue thousands of other forms of taxpayer guidance. The Internal Revenue Code (IRC) authorizes the Secretary of the Treasury to "prescribe all needful rules and regulations for the enforcement of" the code.⁴ IRS publishes tax regulations and other

²The preamble section of tax regulations contains explanatory information on IRS compliance with administrative laws and executive orders.

³See appendix I for information on how we selected our sample of guidance documents.

⁴26 U.S.C. § 7805(a). Tax regulations are also called Treasury regulations since they are promulgated by the Department of the Treasury in conjunction with the IRS.

guidance in the weekly IRB. Each annual volume of the IRB contains about 2,000 pages of regulations and other guidance documents.

In addition to the guidance published in the IRB, thousands of other documents that provide information to taxpayers are available on IRS's website.⁵ Some IRS guidance written by the IRS Office of Chief Counsel provides detailed and technical explanations of tax laws for professional return preparers as well as taxpayers. Other IRS sources of information that explain tax law in "plain language" include:

- forms, instructions, and publications for taxpayers to use in preparing their returns;
- news releases, fact sheets, and tax tips to the news media;
- online interactive tools in which taxpayers can receive answers after asking general or taxpayer-specific questions; and
- instructional audio and video presentations.

These various communication tools are intended to help taxpayers understand tax laws, improve voluntary compliance, and control IRS's administrative costs.

Statutes Relevant to the IRS Regulatory Process

IRS's policies and procedures for producing regulations and other guidance cite five legal authorities for IRS to follow when drafting and issuing regulations: the Administrative Procedure Act (APA), the Paperwork Reduction Act (PRA), the Regulatory Flexibility Act (RFA), the Congressional Review Act (CRA), and a section of the IRC.⁶

APA generally requires that agencies notify the public about, and solicit comments on, proposed regulations via a notice of proposed rulemaking

⁵We reported in 2013 that there were more than 110,000 web pages and downloadable documents available on www.irs.gov, and that 359 million downloads of IRS forms, publications, and instructions occurred in 2012. See GAO, *IRS Website: Long-Term Strategy Needed to Improve Interactive Services*, [GAO-13-435](#) (Washington, D.C.: Apr. 16, 2013).

⁶U.S. Code citations for these statutes are as follows: *APA*, 5 U.S.C. §§ 551-559; *PRA*, 44 U.S.C. §§ 3501-3520; *RFA*, 5 U.S.C. §§ 601-608; *CRA*, 5 U.S.C. §§ 801-808; and 26 U.S.C. § 7805.

(NPRM) in the Federal Register. PRA requires agencies to minimize the paperwork burden they impose on the public, and submit certain proposed information collections to OMB for approval. RFA generally requires agencies to consider the impact of their regulatory proposals on small businesses and other small entities, analyze effective alternatives that minimize small entity impacts, and make their analyses available for public comment. CRA requires agencies to submit each rule to Congress and to the Comptroller General before it can take effect. All agencies are also required to specify whether the rule is “major” under CRA; but OIRA is responsible for determining whether a rule is major based on certain criteria.⁷ We issue reports to Congress on major rules, summarizing and assessing the agency’s compliance with required procedural steps.⁸

OMB Oversight of Agency Regulatory Actions

Presidents have issued executive orders to centralize review of executive branch agency rulemaking within OMB, and to require executive branch agencies to prepare additional assessments and analyses of the potential costs and benefits of significant and economically significant rules.⁹ OIRA is the OMB organization responsible for the coordinated review of regulatory actions by executive agencies. Such coordinated review is

⁷CRA defines a “major” rule as one that OIRA determines has resulted in or is likely to result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, federal, state, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic and export markets.

⁸If applicable, agencies must submit to the Comptroller General a cost-benefit analysis of the rule, and information concerning the agency’s actions relevant to procedural rulemaking requirements set forth in certain statutes and executive orders. A searchable database of rules we received and reports we issued can be found at: <http://www.gao.gov/legal/congressional-review-act/overview>.

⁹Under Exec. Order No. 12866, October 4, 1993, a regulatory action is “significant” if it is likely to result in a rule that: (1) has an annual effect on the economy of \$100 million or more or adversely affects the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities; (2) creates a serious inconsistency or otherwise interferes with another agency’s actions taken or planned; (3) materially alters the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raises novel legal or policy issues. A rule that meets the first criteria is colloquially referred to as “economically significant” and further assessments of the rule’s costs and benefits are required.

necessary to ensure that, among other things, regulations are consistent with applicable laws, the President’s priorities, and the principles set forth in executive orders, and that decisions made by one agency do not conflict with the policies or actions taken or planned by another agency. Executive agencies provide OIRA with lists of planned regulatory actions when drafting rules, including assessments about whether the rules are significant under Executive Order (E.O.) 12866, to determine if additional OIRA review is required.¹⁰ If so, agencies provide the text of the draft regulation and any required analyses (including information on estimated costs and benefits) to OIRA before issuing the rule. OIRA staff review the rule and related documents and may request changes or additional analyses. OIRA can notify the agency that it has separately determined that a planned regulation is a significant regulatory action.¹¹ OIRA also has a responsibility under CRA for determining when rules issued by executive branch and independent regulatory agencies are major.

OMB Oversight of Agencies’ Non-Regulatory Guidance

OIRA is responsible for reviewing certain non-regulatory guidance issued by executive branch agencies.¹² OMB issued a bulletin in 2007 to establish policies and procedures for the development, issuance, and use of “significant” guidance documents by executive branch agencies.¹³ The bulletin’s definition of a significant guidance document is similar to the

¹⁰The President reaffirmed Exec. Order No. 12866 with Exec. Order No. 13563 in 2011. This order is supplemental to and reaffirms the principles, structures, and definitions governing contemporary regulatory review that were established in Exec. Order No. 12866.

¹¹Federal agencies work with OIRA to make the initial determination of whether their rules are significant (including economically significant) and subject to OIRA review, and whether their rules are major and subject to certain requirements. OIRA has the final authority in all rule designations.

¹²We recently reported on agency guidance practices in GAO, *Regulatory Guidance Processes: Selected Departments Could Strengthen Internal Control and Dissemination Practices*, [GAO-15-368](#) (Washington, D.C.: Apr. 16, 2015).

¹³OMB Bulletin No. 07-02, *Final Bulletin for Agency Good Guidance Practices*, (Jan. 18, 2007). The bulletin was republished in the Federal Register – 72 Fed. Reg. 3432 (Jan. 25, 2007).

definition of a significant regulatory action under E.O. 12866.¹⁴ The bulletin requires that agencies establish procedures to allow the public to view and comment on significant guidance documents after they are released and, for any economically significant guidance documents, also make a draft available for public comment and announce its availability in the Federal Register. Consistent with an OMB memorandum implementing the bulletin, OIRA has the opportunity to review some significant guidance documents prior to issuance.¹⁵ Guidance that is not significant (as defined by the OMB bulletin) is not subject to policies and procedures in the bulletin, and guidance procedures are left to agency discretion.

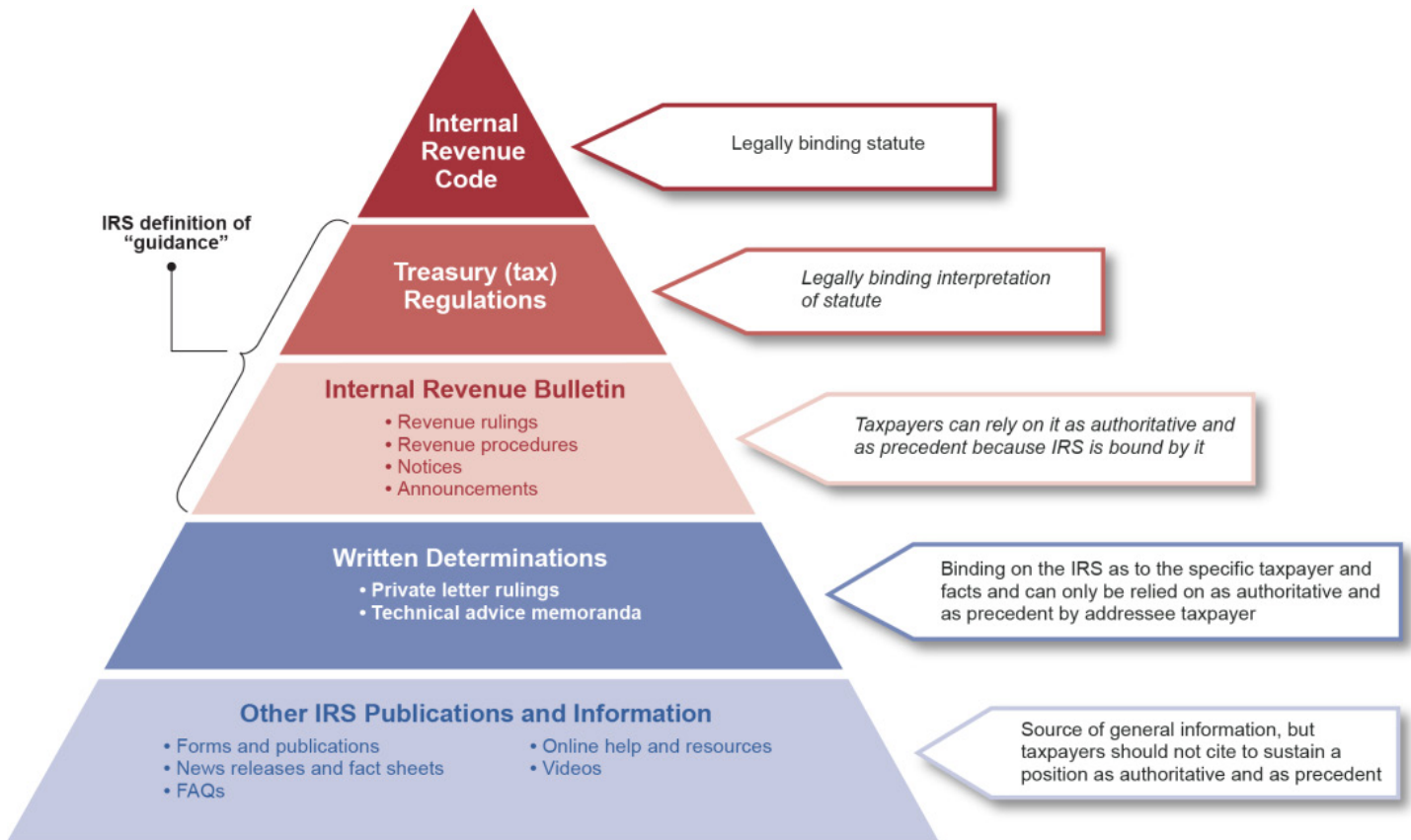
¹⁴A “significant guidance document” is a document disseminated to regulated entities or the general public that may reasonably be anticipated to (1) lead to an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs, or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, the President’s priorities, or the principles set forth in Exec. Order No. 12866, as further amended. A guidance document that meets the first criteria is colloquially referred to as “economically significant.” The bulletin’s definition of “guidance document” does not include: legal advisory opinions for internal executive branch use and not for release; briefs and other positions taken by agencies in investigations, pre-litigation, litigation, or other enforcement proceedings; speeches; editorials; media interviews; press materials; congressional correspondence; guidance documents that pertain to a military or foreign affairs function; grant solicitations; warning letters; case of investigatory letters responding to complaints involving fact-specific determinations; purely internal agency policies; guidance documents that pertain to the use, operation, or control of a government facility; internal guidance documents directed solely to other federal agencies; and any other category of significant guidance documents exempted by an agency head in consultation with the OIRA Administrator.

¹⁵OMB Memorandum No. M-07-13, *Implementation of Executive Order 13422 (amending Executive Order 12866) and the OMB Bulletin on Good Guidance Practices*, (Washington, D.C.: Apr. 25, 2007). In 2009, OMB issued a memorandum clarifying the current status of OMB review of agency actions; see OMB Memorandum No. M-09-13, *Guidance for Regulatory Review*, (Washington, D.C.: Mar. 4, 2009).

IRS Communicates Its Interpretation of Tax Laws through a Variety of Products

Although IRS issues thousands of publications in a variety of different forms to help taxpayers and their advisors understand the law, IRS has stated that only guidance published in the IRB contains the IRS’s authoritative interpretation of the law (see figure 1).

Figure 1: Hierarchy of Authority for IRS Guidance and Other Information Sources



Source: GAO analysis of IRS documents. | GAO-16-720

- Internal Revenue Code (IRC). Federal tax law begins with tax provisions enacted by Congress and codified in title 26 of the U.S. Code as the IRC. Consequently, the IRC is the most authoritative source of information for taxpayers. It is the codified collection of U.S. laws on income, estate and gift, employment, and excise taxes, plus administrative and procedural provisions.

-
- Treasury (tax) regulations provide Treasury’s and IRS’s official interpretation of tax laws. Regulations are the most authoritative source of published guidance, and they are binding on taxpayers and IRS since they have the force and effect of law. They are published both in the IRB and the Federal Register.
 - Other IRB guidance (revenue rulings, revenue procedures, notices, and announcements) do not have the same “force and effect” of Treasury regulations, but taxpayers can still rely on them as authoritative. For example, taxpayers can use IRB guidance to support a position knowing that IRS is bound by IRB guidance because IRS employees must follow it.
 - Written determinations are Chief Counsel letters to, or memorandums regarding, individual taxpayers; but IRS cautions that only the taxpayer addressed by the guidance can rely on it as precedent. Every year, the Chief Counsel issues thousands of private letter rulings to taxpayers or their advisors who request (for a fee) answers to technical questions about potential tax consequences of particular transactions.¹⁶ The Chief Counsel also issues technical advice memorandums to IRS offices that have technical or procedural questions about an individual taxpayer case. When written determinations are later published via the IRS website, they often contain disclaimers noting any legal limitations.¹⁷

Other IRS publications and information are described in the Internal Revenue Manual (IRM) as “a good source of general information.”¹⁸ However, the IRM states that these documents cannot be relied upon by taxpayers as authoritative or as precedent for their individual facts and circumstances since they are not binding on IRS. Tax practitioners and other tax law experts note that courts have ruled that taxpayers cannot rely on IRS documents published outside the IRB to support a position. The form that information in this category can take varies widely, and

¹⁶IRS procedures and user fees for obtaining a letter ruling are published annually at the beginning of each calendar year.

¹⁷The disclaimer reads, “written determinations may not be used or cited as precedent.” 26 U.S.C. § 6110 requires IRS to make public private letter rulings, technical advice memorandums, and other chief counsel advice after removing any taxpayer information.

¹⁸The IRM is a compendium of policies and procedures for IRS employees; it is available publicly at: <http://www.irs.gov/irm>.

includes IRS videos, online tools, forms and publications, and Frequently Asked Questions (FAQs).

IRS Considers Only IRB Documents to Be Authoritative Guidance

Guidance published in the IRB goes through a multi-step clearance process at both Treasury and IRS, involving review and approval by officials in a wide variety of Treasury and IRS offices. The weekly IRB is described as the “authoritative instrument” for publishing official IRS rulings and procedures and tax regulations.¹⁹ This distinction is important because, according to IRS officials, only guidance published in the IRB is binding on IRS and can be relied upon by taxpayers as authoritative. The five types of guidance published in the IRB are: regulations, revenue rulings, revenue procedures, notices, and announcements.²⁰ Tax regulations are also published in the Federal Register and codified in the Code of Federal Regulations like other federal agency regulations. Table 1 describes the types of IRS guidance published in the IRB.

¹⁹IRS also uses the IRB to announce its acquiescence or nonacquiescence in decisions of the U.S. Tax Courts. It also includes executive orders, tax conventions, legislation, court decisions, and other items IRS considers to be of interest to taxpayers.

²⁰By referring to regulations as guidance, and by treating certain non-regulatory guidance as binding, IRS practice differs from other federal agencies and OMB which generally makes a distinction between regulations and guidance, and views guidance as non-binding. For the remainder of this report, we use IRS’s definition (regulations plus the four other guidance types published in the IRB) when referring to IRS guidance. If necessary to distinguish between regulations and other guidance published in the IRB, we use the term “non-regulatory guidance” when referring to revenue rulings, revenue procedures, notices, and announcements. See [GAO-15-368](#) for more information on how federal agencies generally define guidance.

Table 1: Descriptions and Examples of IRS Guidance Types Published in the Internal Revenue Bulletin

Type	Description	Example
Regulation ^a	Treasury's and IRS's interpretation of how a particular Internal Revenue Code (IRC) section is to be applied. Final regulations carry the force and effect of the law. Proposed regulations convey the IRS's position on a topic.	T.D. 8784 (REG-122488-97) provided rules for substantiating certain business expenses.
Revenue Ruling	An official interpretation of the IRC, related statutes, tax treaties or regulations as applied to a specific set of facts.	Rev. Rul. 2006-56 provided guidance on the tax treatment of reimbursements to employees for certain travel-related expenses.
Revenue Procedure	An official statement of a procedure that affects the rights or duties of taxpayers or other members of the public under the IRC, related statutes, tax treaties and regulations.	Rev. Proc. 2010-51 specified how taxpayers can compute deductible automobile expenses by applying a mileage rate.
Notice	A public pronouncement that may contain guidance that involves substantive interpretations of the IRC or other provisions of law.	Notice 2016-1 announced a change to the mileage rate used to deduct certain automobile expenses.
Announcement	A public pronouncement that has only immediate or short-term value.	Announcement 2015-31 notified taxpayers of amendments to previously issued guidance.

Source: GAO analysis of IRS documents. | GAO-16-720

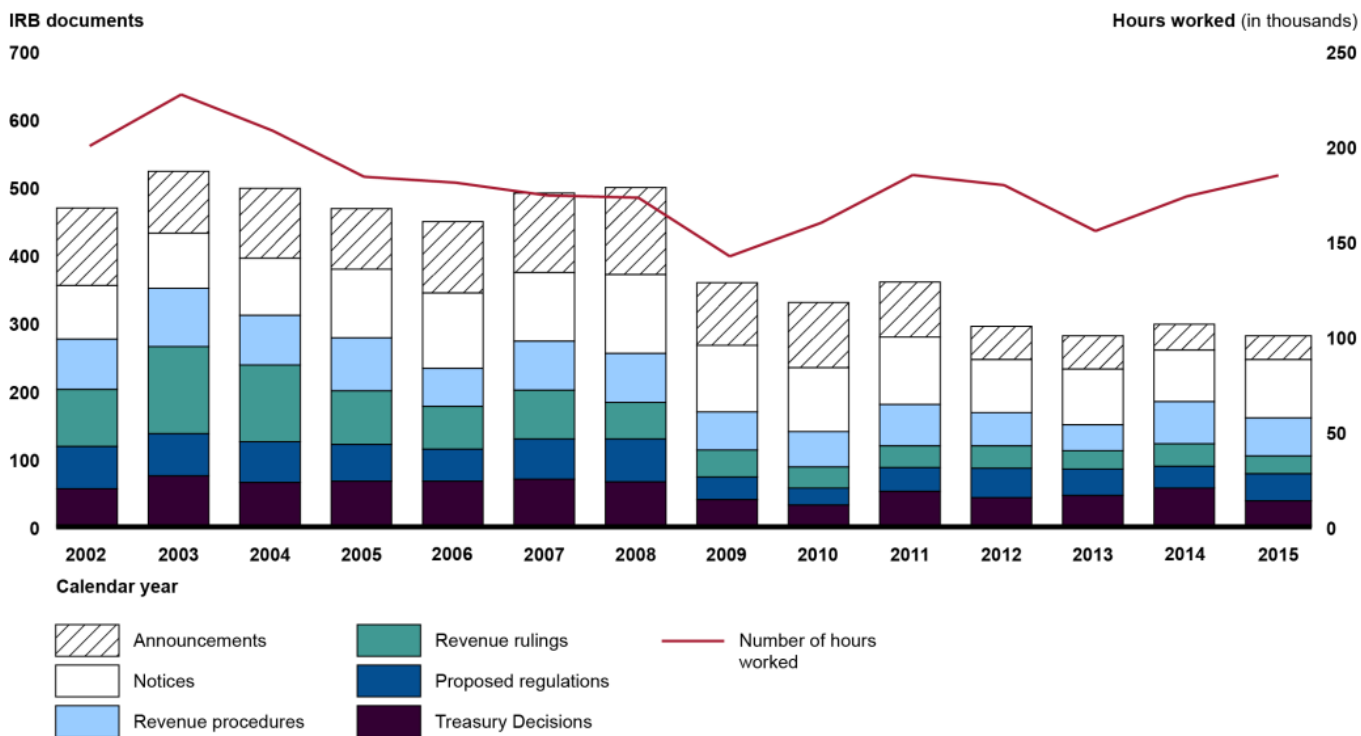
^aTemporary or final regulations called Treasury Decisions (TDs) take effect upon a specified date after they are published in the Federal Register. Proposed regulations do not take effect upon publication; rather they only become effective when issued as final regulations after Treasury and IRS have considered public comments on the proposed regulations.

From 2013 to 2015, the IRB (52 weekly issues) contained nearly 300 guidance documents per year, as shown in figure 2, that total about 2,000 pages. From 2002 to 2008, the number of IRB items published annually was higher (about 500 items), but starting in 2009 that number began to decline. IRS officials told us that, from 2002 to 2003, the then-Chief Counsel diverted resources away from litigation and toward the issuance of guidance, in particular revenue rulings, which contributed to the increasing counts of guidance documents during these years. Regarding the recent decline in the number of guidance documents issued, IRS officials said that hiring freezes have reduced the total number of chief counsel attorneys by 14 percent from 2011 to 2015.²¹ They also said that issuance of complicated regulations to implement the Patient Protection

²¹We previously reported that IRS staffing levels declined 13 percent between fiscal years 2011 and 2016. See GAO, *Internal Revenue Service: Preliminary Observations on the Fiscal Year 2017 Budget Request and 2016 Filing Season Performance*, [GAO-16-459R](#) (Washington, D.C.: Mar. 8, 2016).

and Affordable Care Act (PPACA) and the Foreign Account Tax Compliance Act (FATCA) has contributed to fewer overall guidance documents being issued in recent years.

Figure 2: Guidance Documents in the Internal Revenue Bulletin and IRS Chief Counsel Hours Worked on Guidance



Source: GAO analysis of Internal Revenue Bulletins (IRB); IRS data on chief counsel hours worked. | GAO-16-720

Note: IRS issues some Treasury Decisions (TDs) as temporary regulations that take effect upon or soon after publication, but simultaneously publishes them as proposed regulations and solicits public comments. Temporary regulations expire after 3 years during which time IRS can issue final regulations (TDs) after considering any public comments. The figure above thus includes some double-counting of regulations issued first as temporary TDs and proposed regulations, and then later as final TDs. The data on hours represent hours worked by Office of Chief Counsel attorneys on developing guidance documents.

Limitations of Non-IRB Guidance are Not Always Clearly Communicated

Even though IRS officials told us that only documents published in the IRB constitute guidance, and can be relied upon by taxpayers as authoritative and as precedent for their individual circumstances, limitations on the use of other IRS documents is not always clearly

communicated to taxpayers.²² IRS officials said that the agency distinguishes between official guidance published in the IRB and its thousands of other documents by explaining that information in the IRB can be relied upon as authoritative and that it is binding on IRS. Some taxpayers with relatively uncomplicated tax questions may only need to consult instructions or publications written in plain language for the general public. Other taxpayers with complicated returns or transactions may require more technical, but also more authoritative, guidance. For example, individual or corporate taxpayers (or their advisors) looking to structure a transaction in a certain way to reduce taxes and avoid potential penalties may seek the protection of “substantial authority” to support their position. Treasury regulations define “substantial authority” to include, among other sources, the IRC, tax regulations, and other guidance published in the IRB.²³ The IRM states that IRS is bound by this guidance published in the IRB (both regulations and non-regulatory guidance). Furthermore, even if subsequent case law would result in a ruling more favorable to IRS, the IRM states that IRS will not take positions in litigation contrary to published IRB guidance.²⁴

In our review of IRS guidance, we found that in recent years, IRS has issued information for taxpayers in the form of FAQs. This does not fall under IRS’s definition of official guidance and cannot be relied upon as precedent by taxpayers to support a position if it has not been published in the IRB. However, limitations on using this information are not always communicated clearly to taxpayers or their advisors. In our review of tax guidance issued from 2013 to 2015, we found a few examples of guidance published in the IRB that was written in the form of FAQs.²⁵ Such FAQs are authoritative because guidance published in the IRB is

²²IRS is not unique among federal agencies in limiting its definition of guidance to a subset of its publications. As we noted in [GAO-15-368](#), defining guidance can be difficult and other agencies told us that they do not consider many communication documents they publicly issue to be guidance.

²³26 CFR § 1.6662-4(d)(iii).

²⁴IRM 32.2.2.10 (Aug. 11, 2004).

²⁵See, for example, Notice 2014-21, *IRS Virtual Currency Guidance*, IRB 2014-16, Apr. 14, 2014, for FAQs about the tax treatment of virtual currencies. In 2013, we recommended that IRS provide information to taxpayers on tax reporting requirements for virtual currencies; see GAO, *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risk*, [GAO-13-516](#) (Washington, D.C.: May 15, 2013).

binding on IRS and can be relied upon by taxpayers as authoritative. For FAQs not published in the IRB, tax practitioners have noted that sometimes IRS has included a disclaimer noting that the FAQs do not constitute legal authority and may not be relied upon.²⁶ A third variety of FAQs, however, are published outside the IRB but without any disclaimer or explanatory language noting any limitations.

The National Taxpayer Advocate and tax practitioners said that some FAQs may not warrant additional clarifying language or publication in the IRB.²⁷ They cited, for example, FAQs published on the IRS website that disseminate administrative or procedural information to taxpayers needing information quickly, such as those who have lost financial records in a major disaster. The Taxpayer Advocate also noted that sometimes IRS's position on a tax issue is not yet fully formed, but IRS may need to publish answers quickly for taxpayers who are facing deadlines. FAQs published on the IRS website are an effective format for this purpose.

The Taxpayer Advocate and tax practitioners have raised concerns, however, about the authority and reliability of FAQs published outside the IRB that have contained more substantive guidance. In our interviews and in tax industry publications we reviewed, tax practitioners and other experts cited the example of FAQs that established an IRS voluntary disclosure program for taxpayers with previously undeclared offshore bank accounts.²⁸ The Taxpayer Advocate and some tax practitioners noted that IRS had previously launched a similar disclosure program by issuing a revenue procedure in the IRB. For the more recent and current

²⁶See, for example, IRS, "U.S. Withholding Agent Frequently Asked Questions," updated February 29, 2016, <https://www.irs.gov/businesses/international-businesses/u-s-withholding-agent-frequently-asked-question>, accessed April 12, 2016.

²⁷The National Taxpayer Advocate leads the Taxpayer Advocate Service which is an independent office inside IRS that helps taxpayers resolve problems and proposes changes to mitigate problems experienced by groups of taxpayers.

²⁸The Offshore Voluntary Disclosure Program was first established in 2009 via FAQs published on the IRS website. IRS extended and modified the program in 2011, 2012, and 2014 by publishing more FAQs on its website. IRS has reported that, as of October 2015, more than 54,000 taxpayers have participated in the program, and that it has collected \$8 billion in taxes, interest, and penalties. We reported on the results of the 2009 program in GAO, *Offshore Tax Evasion: IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion*, GAO-13-318 (Washington, D.C. Mar. 27, 2013).

programs, they recommended that IRS replace the series of FAQs issued on the IRS website with more authoritative and reliable guidance in the IRB. Some tax practitioners and experts have also recommended that IRS include disclaimers on information to taxpayers published outside the IRB noting any legal limitations. They stated that some IRS publications and, as we noted above some FAQs, already contain disclaimer-like language.

Tax practitioners and the Taxpayer Advocate told us that publishing the offshore program FAQs via the IRS website has also made it difficult to keep track of updates to the FAQs. If the FAQs had been published in the IRB, it would be easier for practitioners to track those changes. IRS officials said that while they received some negative feedback following the 2009 FAQs, subsequent feedback about the 2011 and 2012 FAQs has been more positive. They stated that providing the offshore program terms and instructions as FAQs allowed IRS more flexibility to incorporate input from stakeholders than would have been available through the Chief Counsel publication process. This flexibility includes being able to quickly respond to practitioner concerns and trends with program submissions. According to IRS, the formal guidance process would not allow for such flexibility.

Clarity about the authoritativeness of certain IRS publications, such as some FAQs involving more substantive guidance, could be improved by either noting any limitations or publishing those FAQs in the IRB. Additional explanatory language would help taxpayers understand what type of IRS information is considered authoritative and reliable as precedent for a taxpayer's individual facts and circumstances. The first article in the IRS's Taxpayer Bill of Rights—"The Right to Be Informed"—states that taxpayers have the right to know what they need to do to comply with tax laws.²⁹ The article further states that taxpayers are entitled to clear explanations of the laws and IRS procedures in all forms, instructions, publications, notices, and correspondence. Just as taxpayers have the right to clear explanations in IRS instructions and publications, taxpayers should be alerted to any limitations that could make some IRS information less authoritative than others. Other federal agencies sometimes include disclaimers in their guidance to note that the

²⁹IRS, *Publication 1: Your Rights as a Taxpayer*, December 2014.

documents have no legally binding effect on regulated parties or the agencies. OMB's 2007 bulletin on good guidance practices also recommends that agencies' guidance include disclaimers noting the legal effect of the guidance.

Failing to note any limitations associated with particular guidance could lead to misinterpretation of non-authoritative information sources from IRS. If taxpayers make decisions after using particular guidance that is non-authoritative, those taxpayers' confidence in IRS and the tax system could be undermined. As we have noted in prior reports, taxpayers' perceptions that IRS is fairly and uniformly administering the tax system helps further overall voluntary compliance and lowers IRS's administrative costs.³⁰ Furthermore, as IRS notes in its current Strategic Plan, if taxpayers receive unclear guidance or doubt its reliability, they are more likely either to contact IRS for clarification or make mistakes, thereby adding to IRS's workload and administrative costs.³¹

IRS Procedures Do Not Include the Selection of a Type of Guidance

IRS policies and procedures for producing guidance can be found in a section of the IRM known as the Chief Counsel Directives Manual (CCDM). IRS has detailed policies and procedures for identifying guidance projects, designating guidance projects as priorities, and for issuing guidance. For example, IRS and Treasury follow procedures contained in the CCDM and an annual IRB notice to identify guidance projects. This process includes obtaining recommendations from internal sources including Treasury and IRS personnel, as well as from external sources including tax practitioner organizations and taxpayers. IRS also has detailed policies and procedures to determine when to add a guidance topic to each year's Priority Guidance Plan (PGP) and

³⁰See, for example, GAO, *IRS Return Selection: Wage and Investment Division Should Define Audit Objectives and Refine Other Internal Controls*, [GAO-16-102](#) (Washington, D.C.: Dec. 17, 2015); and *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, [GAO-16-103](#) (Washington, D.C.: Dec. 16, 2015).

³¹IRS, *Strategic Plan FY2014-17*, Publication 3744 (Rev. 6-2014).

IRS Criteria for Guidance Projects

- Does the guidance resolve significant issues relevant to many taxpayers?
- Does the guidance promote sound tax administration?
- Can the guidance be drafted in a manner that will enable taxpayers to easily understand and apply?
- Does the guidance involve regulations that are outmoded, ineffective, insufficient, or excessively burdensome, and that should be modified, streamlined, expanded, or repealed?
- Can IRS administer the recommended guidance on a uniform basis?
- Does the guidance reduce controversy or lessen the burden on taxpayers or IRS?

Source: GAO summary of Internal Revenue Manual sections 32.1.1.4.3 and 32.2.2.6.4 "Publication Criteria." | GAO-16-720

designate it as a priority for the year.³² Projects are recommended for the PGP if they meet at least one of six criteria (see sidebar).³³ In addition to these criteria, the CCDM instructs IRS and Treasury officials to consider priorities for the PGP based on whether the guidance is required by statute, affects a large number of taxpayers, and whether the Chief Counsel has resources available to complete the project within a particular year.

Two sections of the CCDM, the Chief Counsel Regulation Handbook and the Chief Counsel Publication Handbook, include more than 150 pages of detailed procedures and instructions for IRS to follow when drafting and publishing guidance.³⁴ These policies and procedures cover the entire life cycle of a regulation or non-regulatory guidance document, including: how to identify and open a guidance project; how to comply with relevant administrative laws and executive orders that govern regulatory and guidance processes; how to draft guidance and coordinate reviews with other IRS and Treasury offices, or other agencies; and how to process public comments and finalize guidance for publication.

Written procedures are a basic component of internal controls.³⁵

Documented policies and procedures such as those in the CCDM help ensure a consistent approach to and effective management of guidance initiation, development, and review. However, IRS does not have documented procedures for selecting the type of guidance product to

³²The PGP is an annual list of topics that are priorities for allocating resources in the 12-month period from July 1st to June 30th. In recent years, the PGP has consisted of about 300 guidance projects that Treasury and IRS identified as guidance priorities. On average about 30 percent of these projects are completed by the end of the plan year. Treasury and IRS update the plan quarterly with information about which projects were completed, suspended, or withdrawn without publication. New projects can also be added in the quarterly updates to reflect new priorities that arise during the plan year. About 40 new products were added to PGP lists in this way in recent years, and nearly all of these additional projects were completed within the relevant plan year.

³³The criteria are also listed in the annual notice requesting public comments on projects for the upcoming PGP; see Notice 2016-26, *Public Comment Invited on Recommendations for 2016–2017 Priority Guidance Plan*, IRB 2016-14, Apr. 4, 2016.

³⁴See CCDM Chief Counsel Regulation Handbook (IRM pt. 32, ch. 1) and Chief Counsel Publication Handbook (IRM pt. 32, ch. 2) available at <http://www.irs.gov/irm>.

³⁵GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014).

issue, other than definitions of guidance types in the CCDM. IRS officials told us that they refer to these definitions when selecting a guidance type.³⁶ The definitions alone do not constitute policies and procedures, or factors to consider, when deciding whether to issue guidance as a revenue ruling, revenue procedure, notice, or announcement.

Treasury and IRS officials told us that it may not be practical or feasible to develop clear-cut procedures for selecting guidance types because determining the appropriate type is not always a straightforward process. They also said sometimes the most appropriate type of guidance may not be known at the start of a project, and the choice of guidance type may change as the project develops. However, IRS officials told us that the CCDM could be revised to include a list of factors to consider when selecting a guidance type. Consistent with internal control standards, documentation of this decision-making process would help IRS evaluate decisions about guidance type during the drafting and approval process.

According to internal control standards, agencies should use techniques and processes to identify and manage risk. Agencies face multiple risks when issuing guidance, including the risks of challenges to an agency's regulatory authority. For example, the IRS faced challenges to a notice discontinuing an excise tax for telephone charges and creating a refund process for taxes erroneously collected. Court cases were filed that argued that the notice should be reviewed as a substantive rule under the Administrative Procedure Act (APA).³⁷ Internal control components, such as written procedures for selecting among guidance types, can help agencies evaluate the level of risks associated with issuing potential guidance. Procedures that identify factors to consider and criteria for selecting among different guidance types, and that require documentation of the decision, could encourage consideration of alternatives to mitigate risks, while retaining flexibility for IRS.

³⁶The definitions are contained in IRM 32.2.2.3.

³⁷In a 2009 appellate court opinion, *Cohen v. United States (Cohen I)*, 578 F.3d 1, 12 (D.C. Cir. 2009), a three-judge panel of the D.C. Circuit found the notice (Notice 2006-50) bound IRS and altered the legal rights and obligations of taxpayers, and therefore was a substantive rule under the APA. The *Cohen I* opinion was vacated in part when the IRS asked for an en banc hearing, *Cohen v. United States*, 599 F.3d 652 (D.C. Cir. 2010) (en banc), and the subsequent en banc opinion adopted the determination from *Cohen I* that the notice binds IRS. See *Cohen v. United States*, 650 F.3d 717, 735 (D.C. Cir. 2011).

IRS Guidance Is Routinely Exempt from the Analysis and Oversight Requirements of CRA and E.O. 12866

Rule Designations

Few tax regulations are deemed significant by the Office of Information and Regulatory Affairs (OIRA) and subject to additional rulemaking requirements and analysis under E.O. 12866.³⁸ Between 2013 and 2015, only 1 of more than 200 tax regulations issued was determined to be significant.³⁹ This rule was determined not to be economically significant. By contrast, we previously reported that, over a 2-year period from 2011 to 2013, OIRA determined that more than 350 executive branch agency rules were significant, and about 20 percent of these were also economically significant, under E.O. 12866.⁴⁰ When we asked OIRA to identify any tax regulations that were deemed economically significant, they identified one tax regulation issued in 2011 governing paid preparers.⁴¹ During the course of our review, one additional economically

³⁸A regulatory action is “significant” under Exec .Order No. 12866 if it is likely to result in a rule that: (1) has an annual effect on the economy of \$100 million or more or adversely affects the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities; (2) creates a serious inconsistency or otherwise interferes with another agency’s actions taken or planned; (3) materially alters the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raises novel legal or policy issues. A rule that meets the first criteria is colloquially referred to as “economically significant” and further assessments of the rule’s costs and benefits are required.

³⁹See T.D. 9668, *Regulations Governing Practice Before the Internal Revenue Service*, IRB 2014-27, June 30, 2014.

⁴⁰July 1, 2011 to June 30, 2013. GAO, *Federal Rulemaking: Agencies Included Key Elements of Cost-Benefit Analysis, but Explanations of Regulations’ Significance Could Be More Transparent*, [GAO-14-714](#) (Washington, D.C.: Sept. 11, 2014).

⁴¹See T.D. 9527, *Regulations Governing Practice Before the Internal Revenue Service*, IRB 2011-27, July 5, 2011.

significant proposed regulation was issued in April 2016 regarding corporate earnings stripping.⁴² We did not independently review the recommendations made by IRS and the determinations made by OIRA on whether or not any rule was significant.

Similarly, few tax regulations are deemed by OIRA to be major under CRA.⁴³ For major rules, the effective date is delayed for 60 calendar days after they are submitted to Congress or after they are published in the Federal Register, whichever date is later.⁴⁴ The 60-day delay in the effective date gives Congress more time to review major rules before they go into effect. The major rule designation also triggers the requirement that GAO write a report describing the procedural steps the agency took in promulgating the rule. Between 2013 and 2015, no tax regulations promulgated solely by Treasury and IRS were major under CRA.⁴⁵ In contrast, we previously reported that, over a two-year period from 2011 to 2013, OIRA determined that more than 100 rules were major under CRA.⁴⁶ When we asked OIRA to identify any tax regulations that were ever deemed major under CRA, they identified the same 2011 regulation governing paid preparers that was also economically significant under E.O. 12866. The economically significant regulation on corporate earnings stripping that was issued in April 2016 is not a final regulation and therefore has not been submitted to Congress under CRA. However,

⁴²See REG-108060-15, “*Notice of Proposed Rulemaking: Treatment of Certain Interests in Corporations as Stock or Indebtedness*,” IRB 2016-17, Apr. 25, 2016.

⁴³CRA defines a “major” rule as one that OIRA determines has resulted in or is likely to result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers, individual industries, federal, state, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or the ability of U.S.-based enterprises to compete with foreign-based enterprises in domestic and export markets.

⁴⁴In contrast, the effective dates of “non-major” rules are determined by the Administrative Procedure Act (APA), which generally requires that the effective date be at least 30 calendar days after the rule is published in the Federal Register.

⁴⁵We did not independently review the recommendations made by IRS and the determinations made by OIRA as to whether or not any rule was major under CRA.

⁴⁶[GAO-14-714](#).

as of June 2016, it was listed as a major rule under CRA on OIRA's Spring 2016 Unified Agenda of Regulatory and Deregulatory Actions.⁴⁷

Between 2013 and 2015, we found 15 examples in which agencies jointly issued rules with Treasury and IRS and those other agencies stated in their sections of the rules' preambles, that for their purposes, the rules were significant or economically significant. Treasury and IRS, however, stated in their section of the preambles, that for their purposes, the rules were neither significant nor economically significant. All of the rules were jointly issued with the Department of Health and Human Services and the Department of Labor, and all but one were related to implementation of the Patient Protection and Affordable Care Act (PPACA).

IRS procedures for drafting regulations contain instructions on notifying OIRA about planned regulatory actions, and alerting OIRA to any rules that are significant or economically significant under E.O. 12866, or major under CRA, at two key points during the early phases of the drafting process. First, on initial submissions to OMB, IRS must provide a title and abstract summary of the planned regulation, as well as other key pieces of information, such as whether a planned regulation will be significant (including economically significant). Second, executive branch agencies must prepare a memorandum for OIRA that includes an explanation of the significance of the regulation. The CCDM instructs IRS guidance drafting teams to prepare this memorandum "as early in the drafting process as possible," but not later than 2 months before the planned publication.

OIRA staff told us that for all agencies, including IRS, they generally request that agencies propose to OIRA a designation of a rule as significant or not significant under E.O. 12866, or major under CRA. If necessary, OIRA may request additional information than what is contained in the summary information submitted to OIRA, such as copies of the rule text. For example, in 2010, Treasury and IRS proposed to OIRA that draft regulations mandating training and certification for paid

⁴⁷The semiannual Unified Agenda (available at <http://www.reginfo.gov>) lists regulatory activities under development throughout the federal government, primarily proposed or final rules to be issued within the next 12 months.

Notice and Comment
Procedures

tax preparers were not economically significant.⁴⁸ However, OIRA determined during its E.O 12866 review process (which, consistent with the E.O, included discussion with external parties) that these regulations were both economically significant and major.⁴⁹

Treasury and IRS policies and procedures state that the notice and comment procedures under the Administrative Procedure Act (APA) do not apply to most tax regulations because tax regulations are almost always “interpretative” (as opposed to “legislative”).⁵⁰ However, according to Treasury and IRS officials, IRS provides for notice and comment on nearly every regulation.⁵¹ Treasury and IRS officials told us that, to make a determination of whether a rule is interpretative or legislative, they consider each rule on its unique facts and circumstances using the factors listed in the CCDM. These determinations include IRS and Treasury decisions that the regulations are interpretative because the underlying Tax Code being implemented by the regulation contains the necessary legal authority for the action taken, and any effect of the regulation flows directly from the code.

The CCDM instructs the IRS drafting team to use a preamble section before the text of each regulation to describe IRS’s compliance with statutory and executive branch mandates governing the regulatory process. Consequently, the preamble sections of tax regulations

⁴⁸See REG-138637-07, *Notice of Proposed Rulemaking: Regulations Governing Practice Before the Internal Revenue Service*, IRB 2010-44, Nov. 1, 2010. The final regulation is T.D. 9527, *Regulations Governing Practice Before the Internal Revenue Service*, IRB 2011-27, July 5, 2011.

⁴⁹The OIRA website (<http://www.reginfo.gov>) includes a searchable database of meetings held with external stakeholders concerning Exec. Order No. 12866 reviews of agency regulations.

⁵⁰As characterized by APA, interpretative rules are rules issued by an agency to clarify or explain existing laws or regulations. In contrast to a legislative rule, an interpretative rule does not attempt to create new duties or obligations or modify an existing duty or obligation. APA includes several exceptions to notice and comment rulemaking requirements including one for interpretative rules.

⁵¹IRS officials provided one recent example of the IRS not providing notice and comment. In that 2016 example, the regulations were issued to quickly address a legislative technical correction and to minimize any confusion caused by the effect of the correction on the existing final regulations. See T.D. 9722, *Modification of Treatment of Certain Health Organizations*, IRB 2016-28, July 11, 2016.

generally include a one-sentence statement that APA notice and comment requirements are not applicable.⁵² Between 2013 and 2015, we found that nearly 90 percent of the proposed, temporary, and final regulations issued during this period included this statement. Although IRS and Treasury have determined that the notice and comment requirements frequently do not apply, Treasury and IRS officials told us they follow notice and comment requirements for nearly all proposed and final tax regulations. Our analysis of tax regulations issued between 2013 and 2015 confirmed this. An IRC provision also requires IRS to solicit public comments whenever it issues temporary regulations.⁵³ The practice of asking for public comment after issuing a rule is known as post-promulgation notice and comment. As we reported in 2012, agencies may solicit comments at the same time as publishing a temporary or final rule, but then the public does not have an opportunity to comment before the rule goes into effect.⁵⁴

Impact on Small Entities

We found that Treasury and IRS rarely perform a regulatory flexibility analysis assessing a regulation's impact on small businesses and other small entities as generally required by the Regulatory Flexibility Act (RFA). In our review of over 200 tax regulations issued from 2013 to 2015, only two regulations' preambles included a regulatory flexibility analysis. In about half of the regulations issued, Treasury and IRS stated in the regulations' preambles that RFA's requirements for a regulatory impact analysis did not apply because the regulation does not impose a

⁵² In 2015, the U.S. Tax Court invalidated tax regulations regarding cost-sharing agreements among related companies on the basis that the regulations were procedurally deficient under APA because IRS failed to consider empirical data before the agency. Although not directly at issue in the case, the Tax Court decision stated that the regulation at issue was legislative rather than interpretative. See *Altera Corp. vs. Commissioner*, 145 T.C. No. 3 (2015). In February 2016, IRS appealed the Tax Court's decision to the Ninth Circuit, and the matter was still pending as of June 2016.

⁵³ See 26 U.S.C. §7805(e), which requires that any temporary regulations must also be published as a notice of proposed rulemaking (NPRM), thereby providing the public an opportunity to comment on the rule, and that any temporary regulations will sunset after 3 years.

⁵⁴ In 2012, we reported that agencies did not publish an NPRM soliciting public comment for about 35 percent of major rules and 44 percent of nonmajor rules published from 2003 to 2010. For major rules that had been issued without an NPRM, we found that agencies often solicited public comments upon publication of the final rule. See GAO, *Federal Rulemaking: Agencies Could Take Additional Steps to Respond to Public Comments*, [GAO-13-21](#) (Washington, D.C.: Dec. 20, 2012).

collection of information requirement on small entities.⁵⁵ For the other half of regulations in our review that did not include a regulatory flexibility analysis, the preamble text stated that the regulation will not have a significant economic impact on a substantial number of small entities. The CCDM states that a statute or other legal authority may have an impact on small entities, but a regulatory flexibility analysis is not required if the effect flows directly from the underlying statute or authority, not the regulation implementing it.

We found a few examples of rules where Treasury and IRS stated that they received public comments disagreeing with their determination that RFA did not apply and therefore a regulatory flexibility analysis was not required. In one example, an association of accountants disagreed with a determination that a proposed rule would not have a significant economic impact on a substantial number of small entities.⁵⁶ In the final regulation's preamble, Treasury and IRS addressed those comments by stating that any economic impact was principally the result of the underlying statute, not the regulation.⁵⁷ In another example, Treasury and IRS acknowledged that the Small Business Administration (SBA) disagreed with their determination that the rule did not impose a collection of information requirement on small entities.⁵⁸ Under an IRC provision, IRS is required to solicit comments from the SBA on a proposed or temporary rule's impact on small businesses, and consider those comments before issuing a final rule.⁵⁹

⁵⁵ Congress amended the RFA in 1996 to make it applicable to interpretative rules involving internal revenue laws, but only to the extent that those tax regulations imposed a collection of information requirement on small entities.

⁵⁶ Institute of Management Accountants, letter addressed to the IRS, "Re: Proposed Regulations under Section 9015 of the Patient Protection and Affordable Care Act," Mar. 5, 2013, available via <http://www.regulations.gov>. The letter also disagreed with the determination that the regulatory action was not economically significant under Exec. Order No. 12866.

⁵⁷ See T.D. 9645, *Rules Relating to Additional Medicare Tax*, IRB 2013-51, Dec. 16, 2013.

⁵⁸ See T.D. 9655, *Shared Responsibility for Employers Regarding Health Coverage*, IRB 2014-9, Feb. 24, 2014.

⁵⁹ See 26 U.S.C. § 7805(f).

Source and Measures of Economic Impact

IRS and Treasury officials told us that they rarely recommend to OIRA that tax regulations are major under CRA or economically significant under E.O. 12866 because of their view that any economic impact of a tax regulation generally comes from the underlying statute, and not the regulation. According to IRS and Treasury officials (and as explained in the CCDM), most of the economic impact is rooted in the tax code and therefore beyond Treasury or IRS's discretion to control. In guidance to agencies for preparing regulatory impact analyses, OMB states that using a pre-statute baseline would be appropriate for a review of existing regulations or one that simply restates statutory requirements that are self-implementing.⁶⁰ The OMB guidance also states that when more than one baseline is reasonable and the choice of baseline will significantly affect estimated benefits and costs, agencies should consider measuring benefits and costs against alternative baselines.

Some tax practitioners and stakeholder organizations have raised questions about Treasury and IRS statements in tax regulation preambles that the rules were determined not to be significant or economically significant under E.O. 12866. In 2009, a group of taxpayers petitioned the U.S. Tax Court that IRS violated E.O. 12866 because it failed to identify a regulation as significant; but the court ruled that the petitioners did not have the right to challenge IRS compliance with the executive order.⁶¹ Other experts and stakeholders have noted that statements in tax regulation preambles often provide limited explanations as to why or how IRS determined a rule's significance.⁶² Most of the tax regulations issued from 2013 to 2015 included only one or two sentences in the preambles stating that the rule was determined not to be a significant regulatory action (as defined by E.O. 12866), and therefore a regulatory assessment was not required. In 2015, the U.S. Chamber of Commerce questioned why the preamble of a tax regulation implementing part of PPACA did not

⁶⁰OMB Circular No. A-4, *Regulatory Analysis* (Sept. 17, 2003); see also, *Regulatory Impact Analysis: Frequently Asked Questions (FAQs)*, (Feb. 7, 2011).

⁶¹*BLAK Invs. v. Commissioner*, 133 T.C. 431 (2009).

⁶²See, for example, Jeremiah Coder, "Why Treasury Tax Regulations Are Rarely 'Significant,'" *Tax Notes Today*, 2012 TNT 161-1, Aug. 14, 2012. See also letter from Clea Mitchell, Reed D. Rubinstein, Eric Wang and Barnaby Zall addressed to OIRA Administrator, "Re: Need for Proper Rulemaking Processes and Analyses in Upcoming IRS Proposal," Dec. 19, 2014, published at <http://www.campaignfreedom.org>.

Long-standing Agreement between Treasury and OMB

include an economic analysis as required by E.O. 12866. In a letter to IRS, the chamber further noted that Treasury and IRS had specifically stated in the regulation's preamble that certain regulations were exempt from the requirements of E.O. 12866.⁶³ In our review of tax regulations issued from 2013 to 2015, we found that about 10 percent included statements in the preambles explaining that certain IRS regulations are "exempt" from the requirements of E.O. 12866.

Some tax regulations are exempt from OIRA review otherwise required under E.O. 12866 based on a long-standing agreement between Treasury and OMB.⁶⁴ The agreement was entered into by both agencies in 1983, after the President signed E.O. 12291 (the precursor to E.O. 12866). The 1983 agreement exempts regulations issued by IRS and two other bureaus that were then part of Treasury (the Bureau of Alcohol, Tobacco and Firearms, and the U.S. Customs Service) from further analysis and review unless their regulations were legislative and major under E.O. 12291.⁶⁵ The agreement also exempts from OMB review other documents issued by the three Treasury bureaus, specifically, "revenue rulings, revenue procedures, Customs decisions, legal determinations, and other similar ruling documents."

The effect of this agreement has been that few tax regulations (only those that are both legislative and significant) and none of the other types of tax guidance are subject to OMB review. As we described earlier, IRS generally concludes that tax rules are neither legislative nor significant. Treasury is still required under the agreement to notify OMB of any major rules as defined in E.O. 12291 for which review has been waived, and any nonmajor regulation or other guidance that "reasonably could be expected to have a significant economic impact." The agreement states that OMB reserves the right to review the economic impact of any

⁶³U.S. Chamber of Commerce, letter to IRS regarding REG-143800-14 (Supplemental Notice of Proposed Rulemaking on Minimum Value of Eligible Employer-Sponsored Health Plans), Nov. 2, 2015. Available via <http://www.regulations.gov>.

⁶⁴OMB, Internal Memorandum, *Memorandum of Agreement, Treasury and OMB Implementation of Executive Order 12291*, (Apr. 29, 1983).

⁶⁵The 1983 agreement refers to major rules as the term was defined in Exec. Order No. 12291. When Exec. Order No. 12886 revoked Exec. Order No. 12291, the term "significant regulatory action" was introduced.

regulation or other guidance under terms of the executive order, if available. Treasury and IRS officials told us that they comply with this requirement by providing a memorandum to OMB for every regulatory action. The memorandum provides a plain-language description of the regulation and describes its significance to OMB.

Current OIRA staff that we interviewed told us that they did not know the original reasons for the 1983 agreement. OIRA staff cited a 2003 statement given by the then-OIRA Administrator before the House of Representatives Committee on Government Reform. He said that OMB had not, as a routine matter, reviewed IRS interpretative regulations since the administration of President Carter.⁶⁶ He said that one historic rationale for the agreement was to insulate the Executive Office of the President from the charge that it might use OMB's review of IRS for political purposes. In addition, he said that historically OMB had lacked staff expertise on tax policy.

According to IRS officials and OIRA staff, as of June 2016, the 1983 agreement was last revisited in 1993 after the President signed E.O. 12866 which revoked E.O. 12991 and any exemptions. Treasury and OMB officials then exchanged letters confirming their understanding that E.O. 12866 did not apply to Treasury regulatory actions that were previously not subject to review under E.O. 12291 and the 1983 agreement. In 2011, when the President reaffirmed E.O. 12866 with E.O. 13563, OMB and Treasury officials did not revisit the agreement. The original intent behind the agreement, and whether that intent remains valid, are not known. OIRA staff told us that it would be reasonable to conclude that Treasury and OMB had continued to abide by the agreement without a specific reaffirmation because no change in circumstances had occurred since 1993 that would have necessitated another reaffirmation. The importance of increasing the transparency of the rulemaking process is a common theme throughout our body of work on federal regulation.⁶⁷ Federal standards for internal controls state that

⁶⁶John D. Graham, Administrator, OIRA, testimony before the House of Representatives Committee on Government Reform, July 22, 2003.

⁶⁷GAO, *Federal Rulemaking: Opportunities Remain for the OMB to Improve the Transparency of Rulemaking Processes*, [GAO-16-505T](#) (Washington, D.C.: Mar. 15, 2016).

effective information and communication is vital for an entity to run and control its operations. Agency management should ensure there are adequate means of communications with external stakeholders that can significantly affect the agency achieving its goals.⁶⁸ OMB has also stressed the need for transparency in agency decisions.⁶⁹

Changes in the nature of tax regulations being issued since Treasury and OMB signed the 1983 agreement are another reason why the agreement warrants reconsideration. Over the past three decades, the tax code has increasingly been used by policymakers as a tool for accomplishing social and economic objectives by creating special tax credits, deductions, and exemptions to achieve certain policy goals. These credits, deductions, and exemptions are known as “tax expenditures” because they represent revenue losses. In our body of work on tax expenditures, we have reported that they have major budgetary effects and deserve greater scrutiny.⁷⁰ We have recommended that OMB periodically review how well specific tax expenditures work to achieve their goals and how their benefits and costs compare to those of other programs with similar goals. Since 1983, when OMB agreed to exempt some tax regulations from centralized review, the number of tax expenditures has increased substantially.⁷¹ Because Treasury and IRS are responsible for issuing regulations necessary to implement this growing number of tax expenditures, many tax regulations today are related to social and economic objectives rather than traditional tax collection or administration

⁶⁸GAO-14-704G.

⁶⁹OMB Memorandum No. M-10-06, *Open Government Directive*, (Washington, D.C.: Dec. 8, 2009).

⁷⁰GAO, *Tax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight*, GAO-16-622, (Washington, D.C.: July 7, 2016); and key issues webpage: http://www.gao.gov/key_issues/tax_expenditures/issue_summary.

⁷¹The Joint Committee on Taxation (JCT) identified 109 tax expenditures in fiscal year 1983 and 243 in fiscal year 2015 (for 31 of those in 2015 JCT was unable to quantify the revenue losses). See JCT, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019*, JCX-141R-15 (Washington, D.C.: Dec. 7, 2015); and JCT, *Estimates of Federal Tax Expenditures for Fiscal Years 1983-1988*, JCS-4-83 (Washington, D.C.: Mar. 7, 1983). OMB listed 96 tax expenditures in the President’s budget for fiscal year 1983 and 169 in the budget for fiscal year 2017. See OMB, “Tax Expenditures,” *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2017*, (Washington, D.C.: Feb. 9, 2016); and OMB, “Tax Expenditures,” *Special Analysis G, The Budget of the United States Government, 1983*, (Washington, D.C.: February 1982).

issues.⁷² However, tax regulations, including an increasing number implementing tax expenditures, are routinely exempt from E.O. 12866 and CRA analysis and oversight requirements due to Treasury's and IRS's views on applicability of these requirements and the exemptions in OMB's longstanding agreement with Treasury.

Non-Regulatory IRS Guidance Is Exempt from OMB Review

OMB's 2007 bulletin on agency good guidance practices and an accompanying memorandum establish executive branch policies and procedures for agencies to follow when they develop and issue significant guidance documents.⁷³ The bulletin and memorandum also encourage agencies to ensure that significant guidance documents receive appropriate review and are consistent with other agency actions. In the OMB bulletin, the term guidance would normally apply to IRS non-regulatory guidance documents such as revenue rulings, revenue procedures, notices, and announcements. However, OMB's bulletin excludes tax guidance documents from the definition of economically significant guidance. When Treasury issued procedures in 2007 to comply with OMB's bulletin, it adopted OMB's position.⁷⁴

The effect of the exemption in OMB's bulletin is similar to that of the 1983 agreement between OMB and Treasury in that non-regulatory tax

⁷²We found that more than 20 percent of tax regulations issued from 2013 to 2015 (Treasury Decisions and proposed regulations) were related to the implementation of PPACA. According to one recent study, about one third of tax regulations issued from 2008 to 2012 were related to implementation of social welfare and regulatory matters. See Kristin E. Hickman, "Administering the Tax System We Have," *Duke Law Journal*, vol. 63:1717 (2014).

⁷³A "significant guidance document," as defined in the OMB 2007 bulletin, is a document disseminated to regulated entities or the general public that may reasonably be anticipated to (1) lead to an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs, or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in Exec. Order No. 12866, as further amended. A guidance document that meets the first criteria is colloquially referred to as "economically significant."

⁷⁴Department of the Treasury, *Treasury Directive: 28-04*, § 6(i) (rev. Jul. 2015).

guidance is exempted from centralized review and additional analysis. The agreement between Treasury and OMB exempting certain Treasury bureaus' regulations also exempted other agency documents from centralized review.⁷⁵ Treasury is still responsible under the 1983 agreement for notifying OMB if any of these other documents could reasonably be expected to have a significant economic impact, and OMB reserves the right to review them. In a 2009 investigation of the process used to issue one IRS notice, the counsel to the Treasury Inspector General reported that Treasury and OMB's use of the 1983 agreement to exempt the notice from OIRA review did not appear improper.⁷⁶ However, he stated that the agreement itself "may warrant further inquiry and consideration," because it appears to allow Treasury to unilaterally determine whether some tax guidance could be considered a rule under CRA. As we have noted in decisions on the applicability of CRA to agency guidance, the definition of a rule under CRA is very broad and can include non-regulatory guidance.⁷⁷ However, our opinions have not addressed the question of whether guidance that met the definition of a rule for CRA purposes was in turn major or nonmajor. CRA, as we noted above, also entrusts the determination of what is a major rule to OIRA.

The CCDM explains how IRS Chief Counsel drafting teams are to notify us and Congress when publishing final regulations as well as non-regulatory guidance. The instructions state that revenue rulings and revenue procedures are generally subject to CRA, and must be submitted

⁷⁵Specifically, revenue rulings, revenue procedures, legal determinations, and "other similar ruling documents" issued by IRS and two other bureaus that were then part of Treasury (the U.S. Customs Service, and the Bureau of Alcohol, Tobacco and Firearms) were exempted from OMB review.

⁷⁶In 2008, Senator Charles E. Grassley (then ranking member of the Committee on Finance) requested that the Treasury Inspector General investigate issuance of Notice 2008-83 that removed existing limits on the use of tax losses that could be taken by a company when it acquired a bank. The guidance was issued on September 30, 2008 at the time when two major bank takeovers were occurring, leading policymakers to question whether the notice favored certain banks, and whether it was issued in accordance with CRA. In 2009, Congress inserted a provision in the American Recovery and Reinvestment Act, Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009) repealing Notice 2008-83 for corporate takeovers occurring after Jan. 16, 2009.

⁷⁷See [GAO-B-323772](#), at 4, Sept. 4, 2012.

for congressional review before they can become effective.⁷⁸ For notices and announcements, the CCDM states that these types of guidance are generally not subject to congressional review under CRA, but a final determination is made on a case-by-case basis. There are no documented procedures, however, for how this determination is to be made.⁷⁹

The CCDM also lacks detailed procedures to help drafting teams assess whether any revenue rulings, revenue procedures, notices, and announcements should be considered a rule for purposes of the CRA and in turn deemed major. Similar to instructions regarding regulations, the congressional notification instructions for other guidance simply state that “almost all” IRS guidance is not major because any economic effects result from the underlying statute. In the event a drafting team was to conclude that a non-regulatory guidance product met CRA’s definition of a rule and in turn a major rule, there are no procedures in the CCDM for notifying or coordinating with OIRA. IRS and Treasury officials told us that if a piece of non-regulatory guidance was thought to be significant or major, it would be issued as a regulation. In our review of guidance issued from 2013 to 2015, we found no examples of IRS non-regulatory guidance being reported to us as meeting the definition of a rule under CRA and in turn major, nor could we find any examples in our database covering the period from 1996, when CRA was enacted, through June 2016.

Although the OMB bulletin and Treasury’s 2015 directive exempt IRS non-regulatory guidance from OIRA review, IRS generally applies the recommended practices for agency guidance in the OMB bulletin. IRS officials said that when drafting all guidance (both regulations and other guidance), they take into consideration OMB’s good guidance principles such as transparency, interagency coordination, and public input.

⁷⁸The CCDM states that as a “matter of administrative convenience” all revenue rulings and revenue procedures will be treated as rules that must be reported to us and Congress. However, the CCDM also states that certain ministerial revenue rulings and revenue procedures are exempt from the congressional review provisions.

⁷⁹The CCDM does state that notices or announcements relating to technical corrections, personnel matters, and proposed rules generally are not subject to CRA review.

To ensure public input when developing non-regulatory guidance, IRS has documented processes for soliciting suggestions from tax practitioner organizations as well as taxpayers. Tax practitioner organizations we interviewed said that IRS officials routinely share their plans for non-regulatory guidance at tax forums, conferences, and conventions. IRS and Treasury have also established policies and practices to help coordinate with other departments and agencies that have a stake in the implementation of tax guidance. The CCDM contains an entire section of policies and procedures for coordinating the drafting and clearing of guidance with other agencies.

IRS routinely provides opportunities for the public to comment on non-regulatory guidance documents that address topics that are likely to be covered by future regulations. Between 2013 and 2015, IRS issued several notices in the IRB announcing that it was considering or beginning to draft regulations. Some of these notices related to topics that were complex and likely to generate substantial public comments such as implementation of the Patient Protection and Affordable Care Act (PPACA) and the Foreign Account Tax Compliance Act (FATCA). By soliciting comments before drafting proposed regulations, IRS and Treasury gathered public input earlier than the usual practice of obtaining comments when proposed or temporary regulations are issued.

While these notices solicited public input early on many issues related to potential or future regulations, IRS and Treasury did not specifically solicit input as to whether the future regulations were likely to be significant under E.O. 12866 or major under CRA, and if so, how any economic effects might be measured. Obtaining information from taxpayer groups or industries about likely economic or other significant effects could help inform preliminary decisions about regulations' anticipated impacts, which could be included in memos or other information IRS submits to OIRA. One option is for IRS to simultaneously solicit this additional information during the public comment period that is already in place, and within those timeframes. In our review of tax regulations issued from 2013 to 2015, we found two examples in which Treasury and IRS specifically solicited comments on their determination that proposed regulations would not have a significant economic impact on small entities. Using notices to solicit public comments on likely economic or other significant effects could help inform IRS's initial assessment, and OIRA's final determination, about whether a rule is significant or economically significant under E.O. 12866 or major under CRA.

IRS Did Not Always Clearly Document Required Steps for Developing Guidance in Selected Guidance Products

We found that required steps in IRS's guidance process, as outlined in the CCDM, were not always documented in the sample of eight guidance products that we reviewed.⁸⁰ Thus, it was difficult to determine whether policies and procedures were followed. Our sample included two guidance products issued in 2015 from each of the four non-regulatory guidance types (revenue rulings, revenue procedures, notices, and announcements). Each of the eight products we selected concerned a different tax issue. As recommended by federal internal control standards, clear and complete documentation of key decisions would help management ensure that drafting teams follow all required steps before issuing final guidance.⁸¹

The key phases were not fully documented in four of the eight IRS guidance case files that we reviewed. For example, four of the eight case files we reviewed were missing a Background Information Note (BIN). This internal document provides a record of clearance at each stage, pertinent background information, the identification of risks, and any significant issues raised during coordination and circulation. In the case files that were missing BINs, we found some documentation of information typically contained in the BIN elsewhere in the case files, such as approvals and clearance prior to publication. IRS also told us that they use a case management information system to track approvals of guidance projects.

Of the four case files that included BINs, only one had a complete BIN. In instances of missing or incomplete BINs, it was not possible to verify that all steps listed as required by the CCDM were followed from the case file alone. For example, some case files contained copies of emails noting that various IRS or Treasury officials had approved moving draft guidance to the next stage, or clearing the guidance for final publication. However, the checklist of required approvals on the BIN was incomplete, making it

⁸⁰For non-regulatory guidance, the CCDM contains procedures that cover six key phases for developing guidance products: identification of the issue, drafting, coordination and associate chief counsel approvals, agency circulation, formal clearance, and publication. For each key phase, the CCDM contains required steps, including obtaining necessary approvals and clearances prior to publication. The CCDM also contains recommended steps, such as preparing an "issues memorandum" to document opposing positions and alternative ways to address the tax issues.

⁸¹[GAO-14-704G](#).

difficult to determine whether required approvals were received. Complete documentation of approvals at various stages is an internal control activity that can help drafting teams, managers, and reviewers track and monitor guidance projects.

The eight case files that we reviewed also did not consistently document discussions of whether the final guidance should be reported to us and Congress as a rule, and whether the guidance could be considered major under CRA. The CCDM says that all revenue rulings and revenue procedures will be treated as rules that must be reported to GAO and Congress.⁸² However, one of the two revenue procedures that we reviewed was not submitted for CRA review.⁸³ IRS told us that the failure to notify us and Congress was an oversight due to the revenue procedure being managed by personnel not familiar with IRS's usual requirements. Unlike for revenue procedures and revenue rulings, the CCDM states that generally notices and announcements are not required to be submitted for CRA review, but sometimes should be, on a case-by-case basis. For one of the two notices we reviewed, IRS decided to notify us and Congress.

The CCDM requires documentation of public comments, if any. Three of the eight case files that we reviewed contained evidence that public comments were obtained. One case file contained public comments estimating sizeable economic impacts from potential guidance being drafted. Considering public comments on potential economic effects when assessing whether non-regulatory guidance should be considered a rule under CRA and in turn major could help promote IRS compliance with CRA. More complete documentation of how IRS considers the potential effects of guidance, including consideration of public comments about any economic effects, could help IRS evaluate the risk of challenges to its assessments about whether guidance could be considered major.

⁸²IRM 32.2.8.2

⁸³There was also no record that we received this revenue procedure (Rev. Proc. 2015-5) in our online database of CRA submissions (<http://www.gao.gov/legal/congressional-review-act/overview>).

Conclusions

Treasury and IRS produce large numbers of regulations and guidance documents for the public every year. IRS uses a variety of documents to communicate its interpretation of tax laws to the public, but only considers guidance published in the IRB to be authoritative. However, IRS does not always clearly identify the extent to which certain documents published outside the IRB can be considered authoritative for use by the public. While IRS does have detailed procedures for identifying, prioritizing, and issuing new guidance, it lacks documented procedures for deciding what type of guidance to issue. Policies and procedures that identify factors to consider when deciding among different guidance types could help IRS ensure that the selected form of guidance reflects what is known about the binding nature of various types of guidance.

Our analysis indicates that IRS has inconsistently documented required steps during key phases of the guidance issuance process. Although results from our analysis are not generalizable, complete documentation of key decisions could help IRS better track and monitor guidance projects.

Our review of IRS guidance issued from 2013 to 2015 also found that very few tax regulations were (1) determined to be significant regulatory actions under E.O. 12866, (2) determined to have significant economic impacts on small businesses under RFA, or (3) considered major rules under CRA. These determinations reflect Treasury's and IRS's position that any impacts associated with tax regulations or other guidance result from the underlying statute rather than the regulations or guidance implementing it. Some tax regulations and other guidance are also exempt from the requirements of E.O. 12866 under a long-standing agreement between OMB and Treasury. This long-standing agreement, however, has not been reevaluated since 1993 to ensure that it still reflects current requirements for reviewing regulations and guidance as well as the current environment for tax regulations and guidance (including an increased use of the tax code to accomplish economic and social objectives through the use of tax expenditures).

Recommendations for Executive Action

We recommend that the Commissioner of Internal Revenue take the following four actions:

1. Communicate more clearly the limitations of information not published in the IRB to taxpayers. Such action could include adding clarifying language to some pieces of information not published in the IRB, like FAQs, and amending policies and procedures, such as the IRM, to

clarify when IRS information should contain a statement regarding its legal authority and whether the item can be used or cited as precedent.

2. Amend current policies and procedures for drafting guidance to include factors to consider when deciding what type of guidance to issue and procedures for documenting those decisions internally.
3. Develop policies and procedures to help guidance-drafting teams assess whether non-regulatory guidance should be considered a rule for purposes of the CRA and in turn major, and document those assessments internally.
4. Take action to ensure that required steps are consistently documented during key phases of the non-regulatory guidance process, as defined in the CCDM.

We recommend that the Director of the Office of Management and Budget and the Secretary of the Treasury take the following two actions:

1. Examine the relevance of the long-standing agreement that exempts certain IRS regulations from executive order requirements and OIRA oversight; and if relevant, make publicly available any reaffirmation of the agreement and the reasons for it.
2. Develop a process to ensure that OIRA has the information necessary to determine whether IRS rules are major under CRA and significant under E.O.12866. Consideration should be given on ways to solicit public comments on the potential effects of proposed regulations and non-regulatory guidance, including measures of economic impacts, and on how to document internally the consideration of significant comments by both IRS and OIRA.

Agency Comments and Our Evaluation

We provided a draft of this report to the Commissioner of Internal Revenue, the Secretary of the Treasury, and the Director of the Office of Management and Budget for comment. IRS officials met with us during their review in order to discuss the type of actions IRS could take to satisfy our first recommendation. Based on these discussions, we revised that recommendation to clarify the kinds of actions that IRS could take and sent the revised recommendation to the three agencies reviewing the draft report.

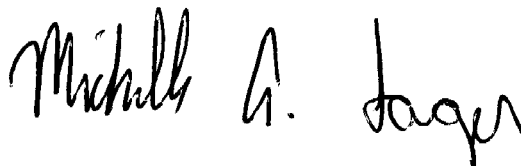
We received written comments from Treasury and IRS, which are reproduced in appendices II and III. Both Treasury and IRS agreed with our recommendations and identified steps that they will take to implement

them. OMB staff provided oral comments and neither agreed nor disagreed with our recommendations.

All three agencies also provided technical comments that were incorporated as appropriate.

We are sending copies of this report to the Secretary of the Treasury, the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. We are also sending copies of this report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions or wish to discuss the material in this report further, please contact me at (202) 512-6806. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

A handwritten signature in black ink that reads "Michelle A. Sager". The signature is written in a cursive, flowing style.

Michelle A. Sager
Director
Strategic Issues

List of Requesters

The Honorable Orrin G. Hatch
Chairman
Committee on Finance
United States Senate

The Honorable Ron Johnson
Chairman
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable James Lankford
Chairman
The Honorable Heidi Heitkamp
Ranking Member
Subcommittee on Regulatory Affairs and Federal Management
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Jason Chaffetz
Chairman
Committee on Oversight and Government Reform
House of Representatives

The Honorable Mark Meadows
Chairman
The Honorable Gerald E. Connolly
Ranking Member
Subcommittee on Government Operations
Committee on Oversight and Government Reform
House of Representatives

The Honorable Jim Jordan
Chairman
The Honorable Matt Cartwright
Ranking Member
Subcommittee on Health Care, Benefits, and Administrative Rules
Committee on Oversight and Government Reform
House of Representatives

Appendix I: Objectives, Scope, and Methodology

This report addresses 1) how the Internal Revenue Service (IRS) communicates its interpretation of tax laws to the public, and how it decides what type of guidance to issue; 2) what relevant authorities apply (including statutes, executive orders, and Office of Management and Budget (OMB) guidance), and what policies and procedures IRS uses, when issuing its guidance; and 3) to what extent selected IRS guidance products followed relevant authorities.

Guidance Definitions and Type

We collected and analyzed documents on IRS's website that defined guidance types, and reviewed IRS policies and procedures for issuing guidance in the IRS Chief Counsel Directives Manual (CCDM). We also interviewed relevant officials at IRS, the National Taxpayer Advocate, and two tax practitioner associations. We conducted a literature search of relevant articles and studies from the tax practitioner community that described how IRS communicates its tax law interpretations. To identify these articles, we conducted searches of various databases, such as ProQuest, PolicyFile, HeinOnline, Lexis, JSTOR, and EconLit. We identified 22 articles that were relevant to our report objectives, and we interviewed the author of 6 of those articles.

Relevant Authorities, Policies, and Procedures

To determine what authorities apply, and what policies and procedures IRS uses when issuing guidance, we interviewed IRS officials and reviewed relevant sections of the CCDM. We obtained and reviewed a 1983 Memorandum of Agreement between the Department of Treasury (Treasury) and OMB regarding implementation of Executive Order (E.O.) 12291, as well as an exchange of letters between Treasury and Office of Information and Regulatory Affairs (OIRA) officials in 1993 regarding implementation of E.O. 12866. We reviewed relevant executive branch documents that establish policies and procedures for centralized review of agency guidance documents, and a Treasury directive implementing those policies. We reviewed a 2009 memorandum from the Treasury Inspector General's office that summarized an investigation of one IRS notice issued in 2008.¹

¹Department of the Treasury, Office of Inspector General, "Memorandum: Inquiry Regarding IRS Notice 2008-83," Sept. 3, 2009.

To determine how frequently relevant authorities did or did not apply to recently issued tax guidance, we first identified all tax guidance documents issued from 2013 to 2015 using semi-annual cumulative lists of Internal Revenue Bulletin (IRB) documents.² We reviewed explanatory text in the preambles for all 253 tax regulations issued from 2013 to 2015 to understand how frequently tax regulations are not subject to additional reviews or analyses.³ In these preamble sections, Treasury and IRS describe what authorities apply or do not apply to a particular regulation, and whether the regulation was subject to additional centralized reviews. We then searched an online database of agency regulatory actions reviewed by OIRA to identify any tax guidance determined to be significant or economically significant under E.O. 12866.⁴ We also searched an online database of agency rules submitted to the Comptroller General to determine what tax guidance, if any, was determined to be major under the Congressional Review Act (CRA).⁵ We determined that the data from the IRB and the CRA database were reliable for the purposes of our review.

Sample Selection

To determine what topics were addressed by recent tax guidance, we reviewed summaries from the Highlights page of each IRB issued from 2013 to 2015. We used these summaries to classify each of the 860 guidance documents issued during this period by topic. Our classifications were based on a plain reading of the Highlights page summary of the guidance document. To determine whether our

²IRS, *Internal Revenue Bulletin*, "Numerical Finding List," <https://www.irs.gov/irb/>. The lists appear in issue numbers 26 and 52 of each year.

³Our count of 253 tax regulations issued from 2013 to 2015 includes 112 proposed tax regulations and 141 final or temporary Treasury Decisions (TDs); however, 33 of the temporary TDs were also issued simultaneously as proposed regulations. IRS issues some TDs as temporary regulations that go into effect upon or soon after publication, but simultaneously publishes them as proposed regulations and solicits public comments. Temporary regulations expire after 3 years during which time IRS can issue final regulations (TDs) after considering any public comments.

⁴OMB, Office of Information and Regulatory Affairs, *Regulatory Review*, "Search of Regulatory Review," <http://www.reginfo.gov/public/do/eoAdvancedSearchMain>, accessed July 2016.

⁵GAO, *Congressional Review Act*, <http://www.gao.gov/legal/congressional-review-act/overview>, accessed June 2016.

classifications were valid, we cross-checked them against IRS lists of guidance on particular subjects.⁶ We also validated our classifications by reviewing annual year-in-review articles published by a tax practitioner trade publication that summarized guidance published for particular topics. In doing so, we removed from our population about half of the non-regulatory guidance items that involved routine administrative matters such as:

- guidance related to the administration of private letter rulings;
- guidance documents that list tax exempt organizations whose status has been revoked or is currently being appealed;
- announcements of disciplinary actions IRS's Office of Professional Responsibility has taken against paid tax preparers; and
- monthly, quarterly, and other periodic updates to interest rates and other values that taxpayers use to perform calculations when preparing tax returns.⁷

To determine to what extent selected non-regulatory, non-routine/administrative guidance products followed relevant authorities, we selected a non-generalizable sample of guidance documents published in 2015. We selected eight guidance documents, chosen so that no two selected were about the same tax issue. We selected two from each of the four non-regulatory guidance types published in the IRB (revenue rulings, revenue procedures, notices, and announcements). We reviewed IRS documentation associated with each guidance project (case files) to evaluate how the guidance process followed relevant authorities. Criteria for our evaluation included elements from executive orders and OMB bulletins on agency guidance processes, and relevant internal controls.

⁶See for example: IRS, "FATCA – Regulations and Other Guidance," <https://www.irs.gov/businesses/corporations/fatca-regulations-and-other-guidance>, accessed January 6, 2016; and IRS, "Affordable Care Act Legal Guidance and Other Resources," <https://www.irs.gov/affordable-care-act/affordable-care-act-of-2010-news-releases-multimedia-and-legal-guidance>, accessed January 6, 2016.

⁷Some of these rates are referred to as Applicable Federal Rates and are published both in the IRB and via another IRS website; see <https://apps.irs.gov/app/picklist/list/federalRates.html>.

Because we used a non-generalizable sample to select the guidance documents, our findings cannot be used to make inferences beyond our sample of eight guidance projects. However, we determined that the selection of these guidance projects was appropriate for our design and objectives, and that the selection would generate valid and reliable evidence to support our work. We used a standard data collection instrument to review each case file to ensure we consistently captured information about the process followed and actions taken to issue the selected guidance documents. To ensure reliability, two analysts separately conducted this analysis, and a third analyst compared and reconciled any inconsistencies. We then analyzed the results of this data collection effort to identify main themes and develop summary findings, and traced and verified all information. We determined that the data we obtained through our reviews were sufficiently reliable for our purposes.

Appendix II: Comments from the Department of the Treasury



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

August 18, 2016

Michelle A. Sager
Director, Strategic Issues
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Sager:

We appreciate the opportunity to review the Government Accountability Office's draft report regarding the Internal Revenue Service's guidance and rulemaking processes (GAO-16-720).

The draft report contains two recommendations directed to the Director of the Office of Management and Budget (OMB) and the Secretary of the Treasury. Both recommendations concern OMB review of tax regulations and guidance.

OMB designates and reviews "significant regulatory actions" as that term is defined in section 3(f) of Executive Order 12866. These include rules with an annual economic impact greater than \$100 million, rules that raise novel legal and policy issues, rules that interfere with the actions of other agencies, and rules that materially impact the budgets of certain agency programs. For any rule that is subject to E.O. 12866 review and reaches the \$100 million threshold, which is commonly known as "economically significant" regulatory action, Treasury analyzes the costs and benefits of the proposed rule and its alternatives, consistent with OMB Circular A-4. For rules that do not reach the economic threshold, but that are subject to E.O. 12866 review, Treasury adheres to the principles set forth in Executive Orders 12866 and 13563.

The draft report's first recommendation is to "[e]xamine the relevance of the long-standing agreement that exempts certain IRS regulations from executive order requirements and OIRA oversight; and if relevant, make publicly available any reaffirmation of the agreement and the reasons for it."

As the draft report notes, Treasury and OMB have a long-standing agreement regarding OMB review of tax regulations. This agreement has been in place for decades and has governed Treasury's interactions with OMB regarding tax guidance across multiple administrations. Under that agreement, only IRS legislative rules that constitute "significant regulatory actions" are subject to E.O. 12866 review. In recent years, no change in circumstances has occurred that would warrant changes to or a reaffirmation of the agreement.

Treasury and OMB recognize the importance of ensuring appropriate OMB review of significant regulatory actions, including tax regulations. To that end, Treasury and OMB are examining the relevance of the long-standing agreement discussed in the draft report.

2

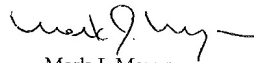
The second recommendation is to “[d]evelop a process to ensure that [OMB’s Office of Information and Regulatory Affairs] has the information necessary to determine whether IRS rules are major under [the Congressional Review Act] and significant under E.O. 12866. Consideration should be given on ways to solicit public comments on the potential effects of proposed regulations and non-regulatory guidance, including measures of economic impacts, and on how to document internally the consideration of significant comments by both IRS and OIRA.”

Treasury and IRS have an existing process to notify OIRA by memorandum of every regulatory action early in the regulatory development process. Those memoranda include a plain-language description of the regulatory action and a description of Treasury and IRS’s recommendation regarding the rule’s significance. In addition, Treasury and OIRA engage in a frequent dialogue regarding rules that are potentially significant and/or major and that may warrant OIRA attention.

We will consider additional ways to improve the quality and efficacy of our notification process. In addition, we will consider seeking public comment on the economic or other impact of certain proposed rules during our standard notice-and-comment process, in cases where the impact of the proposed rule may be significant. Treasury and IRS will continue to take into account any public comments on a proposed rule’s impact in the same way that we carefully consider and respond to all public comments.

Treasury values your feedback on these important issues relating to the regulatory process for tax guidance, and we are committed to working with OMB to ensure appropriate review of the anticipated impacts of significant regulatory actions. Thank you again for the opportunity to review and comment on the draft report.

Sincerely,



Mark J. Mazur
Assistant Secretary (Tax Policy)

Appendix III: Comments from the Internal Revenue Service



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

August 11, 2016

Michelle A. Sager
Director, Strategic Issues
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Sager:

Thank you for the opportunity to comment on the draft report titled *Regulatory Guidance Processes: IRS and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance*, (GAO-16-720). We appreciate the time your GAO team spent reviewing our guidance process and the cooperative nature of this engagement.

Both taxpayers and tax professionals rely on IRS and Treasury to provide relevant guidance. We strive to propose and finalize tax regulations shortly after enactment of major tax legislation or identification of serious problems in the tax system. We are committed to continuously improving our guidance process.

We agree with your recommendations directed at the IRS and believe they will make our guidance more useful to the public. We will reflect on improvements we can make to our internal processes while balancing the need for enough flexibility to allow the agency to provide timely guidance in response to changing circumstances.

We will consider ways to communicate the limitations on information we provide to the public, including whether to amend our policies and procedures to clarify when information not published in the IRB should contain a statement regarding its authority and whether the item can be used or cited as precedent. We appreciate the acknowledgment in your report that IRS has detailed procedures for identifying, prioritizing, and issuing new guidance, and agree with your recommendations directed at improving the drafting process by including factors for determining the type of guidance to issue, taking into account whether non-regulatory guidance should be considered major under the Congressional Review Act.

We also agree with your recommendation that IRS ensure required steps are consistently documented during key phases of the non-regulatory guidance process.

2

As you know, the internal control for guidance is our CASEMIS tracking system, and we will verify the effectiveness of this control in light of your recommendation.

We appreciate the insights provided in the draft report. If you have any questions, please contact Drita Tonuzi, Associate Chief Counsel, Procedure & Administration, at (202)-317-3400.

Sincerely,



William J. Wilkins
Chief Counsel
Internal Revenue Service

Appendix IV: GAO Contact and Staff Acknowledgements

Contact

Michelle A. Sager at (202) 512-6806 or sagerm@gao.gov.

Staff Acknowledgements

In addition to the contact named above, Tara Carter (Assistant Director), Mark Kehoe (Analyst in Charge), Ben Emmel, Andrea Levine, and Ifunanya Nwokedi made contributions to the report. Tim Bober, Robert J. Cramer, Sarah Gilliland, Shirley A. Jones, Heather Krause, Jessica K. Lucas-Judy, James R. McTigue, Jr., Edward Nannenhorn, Robert Robinson, Stewart W. Small, and Cynthia Saunders also provided key assistance.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's website (<http://www.gao.gov>). Each weekday afternoon, GAO posts on its website newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to <http://www.gao.gov> and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's website, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

Connect with GAO

Connect with GAO on [Facebook](#), [Flickr](#), [Twitter](#), and [YouTube](#).
Subscribe to our [RSS Feeds](#) or [E-mail Updates](#). Listen to our [Podcasts](#).
Visit GAO on the web at www.gao.gov.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Website: <http://www.gao.gov/fraudnet/fraudnet.htm>

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Katherine Siggerud, Managing Director, siggerudk@gao.gov, (202) 512-4400,
U.S. Government Accountability Office, 441 G Street NW, Room 7125,
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

Strategic Planning and External Liaison

James-Christian Blockwood, Managing Director, spel@gao.gov, (202) 512-4707
U.S. Government Accountability Office, 441 G Street NW, Room 7814,
Washington, DC 20548



Please Print on Recycled Paper.