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Retroactive Treasury Regulations?

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With the upcoming change in Administrations along with Republican control of both the Senate and House of Representatives, there have been questions about whether retroactive changes may be made to current tax rules and regulations, including the withdrawal or cancellation of current regulations.

The Courts have established that Federal agency rules are presumptively prospective unless Congress has explicitly given the agency retroactive authority. Congress, in Internal Revenue Code §7805(b), addresses the issue of the retroactivity of Treasury Regulations and changes thereto. Generally, if a taxpayer s tax year ends before a regulation is released, any regulatory changes will not apply to the taxpayer for the preceding tax years. IRC §7805(b) specifies three dates after which the regulation shall apply. The effective date that is used is either the date the regulation is filed with the Federal Register, the date of issuance of any preceding temporary or proposed regulation to which a final regulation relates, or the date of a published Notice which substantially explains the expected contents of any temporary, proposed or final regulation.

However, IRC §7805(b) provides exceptions as follows:

- The presumption of prospective application may be overridden by Congressional authorization. In other words, Congress can give the Treasury Secretary authorization to designate a retroactive effective date for any regulation. §7805(b)(6)
- The Secretary may provide that any regulation may take effect retroactively to prevent abuse, or to correct a procedural defect in any prior published regulation. 7805(b)(3) and §7805(b)(4)
- Regulations that only apply to internal agency policies, practices, or procedures may be retroactive. 7805(b)(5)

In addition, the Treasury Secretary may prescribe that any ruling (including a judicial decision or administrative determination) relating to internal revenue laws shall be applied without retroactive effect. In Treasury Regulation §301.7805-1, that authority has been delegated to the Commissioner of Internal Revenue.

The U.S. Constitution prohibits at least some retroactive actions of the government in the form of the prohibition of a bill of attainder and the prohibition of ex-post facto laws.[1] Therefore, Congress may not pass legislation with retroactive effect if it makes an act already legally committed illegal, increases penalties for an infraction after it has been committed, changes the rules of evidence to make conviction easier, or finds a person guilty of a crime without a trial. These same constitutional protections also apply generally to agency actions.

A leading case on this topic is *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), in which the Supreme Court ruled that the Department of Health and Human Services could not claw back Medicare reimbursement payments previously made to hospitals by adopting retroactive rules, without explicit congressional authorization. Since 1988, courts have applied the *Bowen* ruling with somewhat mixed results. The courts generally focus on any notice provided by the agency as to the rules the agency applied retroactively. If the agency gave some type of notice through agency publications, proposed regulations, or other pronouncement,

the court is less likely to prohibit the retroactive effect of the regulation or rule.

It will be very difficult for the incoming Administration to cause the Department of Treasury to issue and implement Treasury Regulations with retroactive effect, unless Treasury or the Internal Revenue Service has already issued a Notice to taxpayers indicating that a change in the law, or interpretation of the law, will be forthcoming. The level of specificity of the Notice will impact whether a court would find the taxpayer had sufficient notification of the change in rules. For example, if a taxpayer takes advantage of a statutory tax credit that the taxpayer has claimed due to reliance on a Treasury Regulation s interpretation of eligibility, the IRS would have a difficult time if it implemented, retroactively, a change in eligibility. In particular, under the authority of the *Bowen* case, if that retroactive change resulted in a balance due for the taxpayer of funds previously paid out or credited to the taxpayer, it is doubtful the retroactive application of the new regulation would be upheld.

Thus, it is not impossible for the Treasury Secretary to issue, or cause the IRS to issue, regulations or rules with retroactive effect. However, any such retroactive regulation or rule could be challenged on constitutional grounds, depending upon the facts of the situation. The U.S. Constitution and the courts interpreting the U.S. Constitution favor prospective agency action so that U.S. taxpayers and citizens have notice and certainty regarding the rules governing their financial and personal affairs.

[1] *Ex post facto* laws are expressly forbidden by the United States Constitution in Article 1, Section 9, Clause 3 (with respect to federal laws) and Article 1, Section 10 (with respect to state laws).