The Authority of Regulations

For many years, taxpayers and the government have disagreed over the level of deference that courts should give to regulations. In other words, how much authoritative weight should courts give to the rules that Treasury writes? The Supreme Court’s 2011 decision in Mayo Foundation seems to have clarified this issue.11

Mayo involved a long-running controversy between the IRS and the medical community over whether medical residents are “students” and therefore exempt from employment taxes. After losing a number of cases on this issue, Treasury revoked a 50 year old regulation favorable to Mayo and the students and replaced it with one saying that anyone who works more than 40 hours a week cannot qualify for the student exemption. The primary concern of the case was the authoritative value that should be given the new regulation and whether it was valid at all. According to the Mayo court, all regulations should be analyzed using the standards developed in Chevron, a non-tax case.12

The Chevron approach involves a two step inquiry. The first step asks whether Congress has directly addressed the precise question at issue. If Congress has made its intent clear, then the regulation must give effect to Congress’ stated intent. If Congressional intent is not clear, the second inquiry is whether the regulation is a reasonable construction of the statute. In Mayo, the Court concluded that the statute that Congress had written to address the issue (the definition of a student) was unclear. so it turned to the second Chevron inquiry: was the regulation a reasonable interpretation of the ambiguous statute. The Court believed it was reasonable and held against the taxpayer.

The effects of Mayo appear to be far reaching. Most importantly, courts now must apply the two-part test of Chevron in evaluating regulations. Moreover, the Mayo court made it clear that the authority of a regulation did not depend on whether the regulation was issued at the specific direction of Congress or under the general rulemaking authority granted to the Treasury Department. Whether a regulation is legislative or interpretive now appears irrelevant. Finally, the court indicated that the history of a regulation, such as whether it represents a reversal of Treasury policy or whether it was issued because the government was losing cases, is not a consideration in determining whether the regulation is valid. According to some, the immediate effect of Mayo will cause challenges to regulations to ignore history and whether the regulation is legislative or interpretive and center on substance.
