

## Hold the Mayo: Even More Deference to Internal Revenue Service Regulations

By Robert W. Wood

It isn't often that the U.S. Supreme Court hears a tax case. Most lawyers are not interested in tax law, even when the Supreme Court interprets it. Moreover, when the Court does take on tax law, many observers are tempted to look at the narrow holding of the case and see whether it directly affects them and their clients. If you have read reports of the Court's decision in Mayo Foundation for Medical Education and Research, 178 L. Ed. 2d 588, you may be tempted to happily move on to the rest of your more important reading.

The Supreme Court's opinion in Mayo Foundation involved a seemingly narrow and even arcane question. Were stipends paid to Mayo's medical residents subject to Federal Insurance Contributions Act (Social Security) tax? That may sound like a big yawn for most of us. Yet the bigger and broader issue the case decided may end up affecting all taxpayers and tax advisers.

The reason is the way the Supreme Court focused on the nature of treasury regulations and their effect. Most tax law is not actually in the Internal Revenue Code itself, but rather in the treasury regulations. These regulations are where the Internal Revenue Service puts meat on the bare bones of the tax law. From that perspective, anyone dealing with the IRS and treasury regulations on any topic should pay attention to Mayo Foundation.



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The question whether FICA tax applied to stipends to medical residents turned on the validity of regulations amended by the IRS in 2004. Those amended regulations provided that an employee can be treated as a student only if the services he provides are incidental to the course of study.

The IRS set out a test to determine what qualified as incidental. In addition, the IRS required the educational aspect of the relationship to predominate over the service aspect. Furthermore anyone working 40 or more hours a week is presumed to be performing services that are not incidental to his course of study.

The larger question was whether these regulations should be held as valid, even though they quite clearly go significantly outside the bounds of the Internal Revenue Code itself. Despite our current era of divisiveness, the Supreme Court unanimously said yes in Mayo Foundation. That underscores just how big a victory this case is for the IRS and U.S. Department of the Treasury.

In 2007, a District Court had held a portion of these regulations invalid, noting that they were only interpretive regulations. 503 F. Supp. 2d 1164 (2007). Many of us thought that "interpretive regulations" were quite different from so-called legislative regulations. The latter gave the IRS and Department of the Treasury an express grant of authority to cover a particular topic. That implies more latitude for legislative regulations and less for mere IRS interpretations.

But the 8th U.S. Circuit Court of Appeals reversed the District Court and said these FICA regulations were valid, teeing up the question for the Supreme Court. 568 F.3d 675 (8th Cir. 2009). In what can only be called a sweeping opinion, the Supreme Court held that these regulations represented

a reasonable construction of the underlying code section. Significantly, the Supreme Court underscored the test of deference set forth in Chevron U.S.A Inc v. Natural Res. Def. Council Inc., 467 U.S. 837 (1984).

In Chevron, the Court had ruled that an interpretive regulation (in the environmental arena) is valid if it implements a congressional mandate in a reasonable manner, and if it "harmonizes with the plain language of the statute, its origin, and its purpose." Does that sound broad, permissive, even laissez faire? It sure does.

The Court in Mayo Foundation even admitted that some of its prior opinions had stated that regulations promulgated by the IRS pursuant to a general grant of authority were entitled to less deference. But the arguably wide-open Chevron standard now applies with full force in the context of tax law. The IRS is very happy with this decision, and will probably be emboldened by it. Challenging an IRS regulation is never easy. The difficulties a taxpayer faces in arguing that a treasury regulation should be struck down are quite significant. Yet it has been done successfully numerous times. I've even done it myself. Yet in the wake of the Supreme Court's latest enormous victory for the IRS in Mayo Foundation, it will now be even harder still.

*This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*

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