CENTRALIZED REVIEW OF TAX REGULATIONS

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ABSTRACT

Centralized oversight of agency policymaking and spending by the President's Office of Management and Budget is a hallmark of the modern administrative state. But tax regulations have almost never been subject to centralized review. Scholars and policymakers have provided various incomplete justifications for excepting tax policy from centralized review, including concerns about politicizing tax administration, resource constraints within OMB, and a perception that tax is somehow different from other types of regulatory policy in ways that matter for the desirability of centralized review.

This Article undertakes a holistic analysis of the advantages and disadvantages of centralized review of tax regulations, as well as the challenges arising from such review. I conclude that none of the reasons offered in the past for a default rule of no review is sufficient in light of the normative benefits of centralized review. The analysis here brings to the fore multiple functions of tax regulations: some rules are focused on shaping private behavior, whereas others focus on raising revenue or redistribution. I make the case that, as in other (non-tax) contexts, centralized review is a good fit for analyzing the portions of regulations that shape private behavior. For these tax rules, centralized review can facilitate productive coordination across agencies, increase political accountability, introduce analytical rigor through cost-benefit analysis, and potentially frustrate capture of the regulatory process by interest groups. As for rules that raise revenue and redistribute: the devil is in the details. This Article outlines the limitations of current centralized review conventions, and sketches some possible modifications that would make centralized review more beneficial for such rules.

The procedures and practices that shape tax regulations are particularly relevant at this moment. The major tax legislation Congress enacted at the end of 2017 included numerous broad delegations. Thus, Congress is relying on the executive branch to develop tax regulations that will reshape the tax system significantly. Recognizing the strengths and weaknesses of centralized review as applied to tax policy will help to establish consistent and productive oversight of the tax regulatory process.

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I. INTRODUCTION

When Congress enacted the Tax Cuts and Jobs Act in late 2017, reworking significant portions of the tax code, it did something unusual for tax legislation: it acted quickly. Whereas the legislative process that culminated in the major tax reform of 1986 reform played out over almost two years, the 2017 legislation was written and enacted in just four months.[1] Congress's haste puts special pressure on the Department of Treasury and the Internal Revenue Service to implement the new tax provisions. Often in the past, when it has worked more ponderously, Congress has enacted highly detailed tax legislation that has delegated very little policymaking authority to the executive branch. But the Tax Cuts and Jobs Act is different: Congress is relying on Treasury and the IRS to develop regulations and guidance without which the new law simply will not work—and Treasury and the IRS must deal with myriad issues that Congress did not have time to confront itself and thus delegated in broad strokes.[2] The pressure is on for the executive branch, as many of the new provisions are effective immediately for tax year 2018.

Usually when Congress delegates broad authority to an agency, it does so knowing that the President will have a substantial role in oversight,

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[1] The main part of legislative process leading to the 1986 bill took 21 months, beginning in early 1985 and extending through most of the year as legislating committees and subcommittees in each house held months of hearings and markups. A conference committee spent a month reconciling the bills from each house, and staff from each house and the Joint Committee on Taxation worked for another month after that to draft the conference committee report and the final legislation that Congress enacted. *See generally* JEFFREY H. BIRNBAUM & ALAN S. MURRAY, SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM (1988) (detailing the legislative process from start to finish).

[2] *See infra* note 108.

through the "centralized review" process overseen by the Office of Management and Budget (OMB).[3] But this established OMB oversight has, dating back to the Reagan administration, left out an essential piece of the Federal government's regulatory and fiscal policy apparatus: the tax system. Indeed, there has been practically *no* centralized review of tax policy in the past. Since 2011, just one tax regulation has been subject to plenary centralized review.[4] This, even as Treasury has produced hundreds of regulations, including many that appear to meet the usual requirements for centralized review as "significant" or "economically significant," meaning that they have significant policy implications or will have an annual effect on the economy of $100 million or more.[5] Meanwhile, thousands of regulations produced by other departments and agencies were subject to centralized review,[6] which Treasury avoids by regularly asserting that its tax regulations are exempt from such review,

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[3] *See* Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245, 2331–332 (2001); Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM L. REV. 1260 (2006); Leon E. Panetta, Memorandum for Heads of Executive Departments and Agencies, And Independent Regulatory Agencies, Guidance for Implementing E.O. 12866 (Oct. 12, 1993) (referring to OMB's oversight of regulatory actions as "centralized review").

[4] The regulation sought to limit the U.S. tax benefits of corporate inversion transactions. T.D. 9790, 2016-45 I.R.B. 1 (Nov. 7, 2016); *see infra* notes 116-103 and accompanying text. The Obama administration proposed the regulation only after years of urging Congress to enact legislation to accomplish the same thing; as explained *infra*, the Obama administration was exceedingly cautious in pushing this regulation, but nonetheless the White House-driven tax regulation broke with various decades-old norms against direct White House involvement in Treasury's tax regulations. Another set of tax-related rules was subject to centralized review during the Obama administration, but that regulation did not address any substantive tax law and was promulgated under statutory authority outside of the tax code. *See infra* note 96 and accompanying text.

[5] *See infra* notes 42–45 and accompanying text.

[6] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-16-720, REGULATORY GUIDANCE PROCESSES: TREASURY AND OMB NEED TO REEVALUATE LONG-STANDING EXEMPTIONS OF TAX REGULATIONS AND GUIDANCE 18 (Sept. 2016) [hereinafter GAO REPORT]. From 2011 to 2013, more than 350 regulations proposed across the executive branch were determined to be "economically significant" and were subject to centralized review as such; of those 350, just one was a tax-related regulation, and that one did not arise from the tax code. GAO REPORT, *supra*, at 18. OMB reviews in excess of 400 proposed and final regulations each year from other non-tax departments and agencies.

an assertion which OMB has accepted.[7] The issue has recently begun to gain attention in political circles, and pressure has increased, since the passage of the Tax Cuts and Jobs Act, for Treasury, the IRS and OMB to reconfigure their relationship.[8] This Article provides an overdue examination of the normative desirability of the current approach of exempting tax regulations from centralized review, and the alternative of imposing such review.

The blind spot that the typical presidential oversight has for tax policy leads to very different treatment by the executive branch of similar sorts of policy decisions, with the varied treatment oddly hinging on whether Congress has delegated authority to Treasury and the IRS or to another department or agency. For example, regulatory policy addressing health care is largely devised and implemented by the Department of Health and Human Services. Thus, when HHS recently conceived of a regulation to promote tobacco cessation incentives in health insurance policies, that regulation was subject to direct review by OMB including an OMB-run interagency coordination process.[9] OMB required that HHS assess of costs and benefits of the proposal and of alternative proposals in order to

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[7] *E.g.*, *infra* note 12 (example of the exemption claim). Under a longstanding agreement dating back to 1983, OMB generally does not review tax regulations. Memorandum of Agreement, Treasury and OMB Implementation of Executive Order 12291 (Apr. 29, 1983) [*hereinafter* Treasury-OMB Memorandum]; *see infra* notes 90-93 and accompanying text.

[8] *See* Exec. Order 13,789, 82 Fed. Reg. 19,317 (Apr. 21, 2017) (directing Treasury and OMB to reconsider the exemption for tax regulations); GAO REPORT, *supra* note 6; *infra* notes 103-111 and accompanying text; Nancy Cook & Aaron Lorenzo, *Tax law ignites White House power struggle*, POLITICO (Feb. 23, 2018), https://www.politico.com/story/2018/02/23/tax-law-white-house-power-struggle-364885; Naomi Jagoda, *Conservatives push for new check on IRS rules*, THE HILL (Mar. 6, 2018), http://thehill.com/regulation/finance/376852-conservatives-push-for-new-check-on-irs-rules; Marie Sapirie and Page Foster, *A Historical Perspective on OMB's Review of Tax Rules*, TAX NOTES TODAY (Mar. 26, 2018).

[9] Incentives for Nondiscriminatory Wellness Programs in Group Health Plans: Final Rule, 45 C.F.R. pts. 146 & 147 (2013). Technically this is a joint regulation issued under the Health Care Portability and Accountability Act of 1996 by HHS, DOL and Treasury together; Treasury claimed that its regulation (which duplicates the HHS and DOL regulations) was exempt from the requirements of Executive Order 12,866, but this exemption did not extend to HHS and DOL so the regulation went through those departments standard review process and was subject to centralized review.

maximize net benefits, introducing rigorous analytical requirements to HHS's decision making process.[10]

But HHS is not the only department that deals with smoking cessation programs—surprisingly enough, Treasury's tax regulations have also addressed smoking cessation incentives in employer health insurance policies.[11] In contrast to the HHS rule, when the Department of Treasury devised a *tax* regulation that dealt with tobacco cessation, that rule was not subject to OMB review of any sort. Rather, Treasury stated in the preamble to its proposed and final regulations that centralized review was not required, and no such review was carried out.[12] As a result, regulation-writers at the Department of Treasury were not subject to OMB oversight, and the proposed rule was not subject to any interagency review process, even as the Treasury personnel were addressing an issue that appeared to be far outside of the realm of Treasury expertise. The final regulation was not a product of any cost-benefit analysis nor explicit consideration of policy alternatives that OMB requires. That is, the final Treasury regulation was subject to less analytical rigor than the HHS regulation, but not for any stated or apparently deliberate reason.

These regulations on smoking cessation incentives—and the distinct, and in some instances counterintuitive treatment of tax regulations as compared to other regulations with similar policy objectives—are not an anomaly. Treasury produces reams of tax regulations and guidance documents prescribing how the tax system operates, and carrying out and affecting a wide variety of social and economic policies. These regulations establish policies related to raising revenue to fund federal government operations, and also to health, education, labor, the

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[10] *Id.* pt. III, tbl.1 (summarizing analysis of quantitative and qualitative costs and benefits).

[11] Minimum Essential Coverage; Shared Responsibility Payment for Individuals: Public Hearings, 79 Fed. Reg. 4302 (Jan. 27, 2014) (to be codified at 26 C.F.R. pt. 1); *see infra* Part IV.C.

[12] The preamble to the proposed regulation states: "It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12,866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to the proposed regulations." Shared Responsibility Payment for Not Maintaining Minimum Essential Coverage, 78 Fed. Reg. 7314 (Feb. 1, 2013) (to be codified at 26 C.F.R. pt. 1).

environment and other important policy areas, often shaping private behavior.

Why has centralized review and cost-benefit analysis almost never been invoked in the development of regulatory tax policies, even as recent administrations seem to be taking a more active role in tax regulation?[13] This Article charts, as a descriptive matter, how tax regulations are produced outside of the well-developed system of centralized review, and challenges several justifications for this omission that have been offered by scholars and policymakers. Especially among tax policymakers and tax scholars, there is a perception that tax regulations are different from other types of regulations in a way that makes centralized review either unnecessary or ineffective. Indeed, there are analytical challenges—for example, there are few empirical studies on the real-world behavioral effects of changes in tax policy, which hinders cost-benefit analysis.[14] And there are philosophical questions about how to account for taxes that are used to fund public goods like national defense—are these costs or benefits? OMB currently says that transfers are neither.[15] Some have suggested that the particular political sensitivities involved in tax policymaking warrant insulating tax regulations from White House influence, or, alternatively, should incentivize the White House to avoid engaging with tax regulations.[16] I argue that none of the proffered reasons for distinct treatment of tax regulations is sufficient to justify categorically foregoing centralized review of tax regulations in light of the normative justifications for centralized review.

So, should Treasury's tax-related regulatory actions be subject to centralized review? This Article carries out a holistic analysis of the advantages and disadvantages of centralized review of tax regulations, working through what might be gained from centralized review, and what problems might arise from it. I conclude that centralized review would have salutary effects on some tax regulations, but realizing any benefits depends on what the tax regulation is designed to accomplish.[17]

More specifically, centralized review is appropriate and would be beneficial in the development of tax regulations that affect private

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[13] *See infra* notes 103-111 and accompanying text.
[14] *See infra* Part V.A.2.
[15] *Id.*
[16] *See infra* Part V.A.1.
[17] *See infra* Part V.B.

behavior—what I call the private allocation function of tax regulations[18]—like the smoking cessation regulation discussed above. On the other hand, I argue that centralized review must be reshaped in order to be beneficial as applied to tax rules that primarily raise revenue or that produce differential effects between groups—what I call the public allocation function and the distributional function of tax regulations. There may well be a role for centralized review to augment existing Department of Treasury analysis and provide closer oversight for these rules, but the OMB's existing tools are not well-honed to the policy issues that often arise in these sorts of tax regulations—although these issues also arise in other contexts, and even supporters of centralized review have been critical of some of these limitations as to non-tax regulations. Finally, I argue that centralized review does not offer benefits for tax regulations that simply implement clear congressional directives—the implementing function. Thus, the current practice of abstaining from centralized review is, indeed, justified on normative grounds for a broad swath of tax regulations that are highly prescribed by Congress.[19]

Congress's recent inattention in enacting the Tax Cuts and Jobs Act means more opportunities for executive branch tax policy making—and the question of who will determine that policy and how is important. In popular debates, centralized review is associated with presidential control, which has spurred some critical reactions in the current political environment. But absent centralized review, there are very few formal protections to insulate tax regulation writing from political influence. Thus, I argue that centralized review can be beneficial especially when

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[18] *See infra* Part IV.A.

[19] *See* Clint Wallace, *Congressional Control of Tax Regulations*, 71 TAX L. REV. ___ (forthcoming 2018), which examines the institutions and practices in Congress that give rise to what I identify here as the implementing function, making the case that Congress is uniquely able to enact detailed and precise tax statutes that leave little if any policymaking discretion to Treasury. This includes making use of the expertise of the staff of the Joint Committee on Taxation, and producing voluminous "[s]pecific and illuminating legislative history." Comm'r v. Duberstein, 363 U.S. 278, 284 (1960). As such, in some instances, the substantive content of regulations is determined by Congress, leaving little policymaking discretion to the agency—*i.e.*, the "merits of the regulation" may be "strongly determined by statute." *E.g.*, Coates, *supra* note 31, at 5. This Article focuses on centralized review of regulations that result from broader delegations, leading to regulations that carry out the private allocation, public allocation and distributional functions.

there are acute concerns about politicizing tax administration, because centralized review fosters transparency and analytical rigor.

This Article proceeds as follows. Part II provides an overview of the mechanics and purposes of centralized review, including the roles of cost-benefit analysis and interagency review, and how that analysis and review is typically carried out. Part III describes the recent process Treasury uses to produce tax regulations, and scrutinizes the limited extent to which regulatory tax policy has typically been subject to centralized review. This Part then evaluates the various reasons offered by scholars and policymakers for this omission, concluding that none is convincing. Part IV introduces the four-part taxonomy of functions of tax regulations, which helps to reveal what centralized review can accomplish as applied to regulatory tax policy, and also its limitations. Part V explores the advantages and disadvantages of imposing centralized review on tax regulatory action, arguing that some tax regulations should be subject to centralized review, and identifying specific challenges that would arise in introducing centralized review and cost-benefit analysis to the various functions of tax regulations. Part VI concludes.

II. BACKGROUND: CENTRALIZED REVIEW OUTSIDE OF TAX

This Part provides an overview of the centralized review process and sets out the normative underpinnings of centralized review. Centralized review is generally—outside of the tax context—carried out in one of two ways. For regulatory activity, the OMB's Office of Information and Regulatory Affairs (OIRA) supervises agency policy development. Agencies are required to disclose to OIRA any planned regulatory and guidance actions; OIRA then helps ensure that those actions are consistent with Presidential priorities and are carefully considered—including quantifying the costs and benefits, among other forms of analysis.[20] For fiscal policy, personnel within OMB closely monitor each agency's ongoing spending, and shape budget priorities for future spending within

[20] *See* Exec. Order No. 12,866 § 6, 3 C.F.R. 638, 645 (1993-2000), *reprinted in* 5 U.S.C. § 601 (1994) (describing "centralized review" of agency regulations). Executive branch agencies are distinguished from independent regulatory agencies, which produce regulations that are not necessarily subject to centralized review. *See, e.g.*, Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599 (2010).

agencies as well as appropriations requests made to Congress.[21] In other words, Congress receives spending requests only once they have been filtered through OMB, and the use of agency funds that have been appropriated by Congress but without precise earmarking is subject to review—and influence—by OMB. Thus, OMB's role overseeing and managing both regulatory policy and fiscal policy on behalf of the President is expansive.

The focus here is on the policymaking side, and on regulations in particular.[22] OIRA is charged with overseeing all "regulatory actions" taken by any executive branch department or agency (but not independent agencies), and thus can review all variety of agency guidance, including sub-regulatory material such as policy statements that are not subject to notice and comment. Nonetheless, OMB's oversight of spending does not extend to raising revenue, and OMB's regulatory oversight most often does not apply to tax regulations.

Many scholars and policymakers view centralized review of proposed regulations—at least, non-tax regulations—as an essential element of the federal rulemaking process for executive branch agencies.[23] This centralized review often relies on cost-benefit analysis carried out by the rulemaking agency, whereby the agency undertakes a quantitative and qualitative analysis of the effects of a proposed rule, following OIRA guidelines on how this analysis should proceed.[24] OIRA also subjects draft

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[21] *See* OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRCULAR A-11, PREPARATION, SUBMISSION, AND EXECUTION OF THE BUDGET (July 2016); Eloise Pasachoff, *The President's Budget as a Source of Agency Policy Control*, 125 YALE L.J. 2182 (2016); 31 U.S.C. § 1101 *et seq.*

[22] While the tax system is certainly central to fiscal policy, this Article is limited to considering how tax regulations might fit into the existing OMB architecture for oversight of regulatory policy. Like other departments and agencies, Treasury and the IRS carry out congressional mandates through regulations, so distinct treatment of tax regulations by the OMB deserves scrutiny. Further consideration is necessary of OMB's tools for oversight of spending in order to determine if such tools are relevant to other aspects of the tax system and tax administration.

[23] Again, as executive branch agencies are distinguished from independent agencies that generally are not subject to OIRA oversight. *See supra* note 20; *infra* note 163 (describing the IRS's as place in the executive branch as featuring some hallmarks of agency independence).

[24] *See* OFFICE OF MGMT. & BUDGET, EXEC. OFF. OF THE PRESIDENT, CIRCULAR A-4: REGULATORY ANALYSIS (2003) [hereinafter CIRCULAR A-4]; OFFICE OF INFO. &

regulations to an interagency review process whereby experts in parts of the government that did not draft the regulation can weigh in on the substance and analysis of a regulation. Over the past 30-plus years, centralized review has been embraced by Republican and Democratic administrations alike, and cost-benefit analysis has proliferated in the development of a wide range of regulatory policies, including environmental regulation, public health regulation, and financial regulation, among other areas.[25]

There are many potential benefits of centralized review. The process is thought to foster political accountability for agency action by way of the President;[26] it can stave off overregulation;[27] and it can help prevent interest group capture.[28] Scholars also credit centralized review as a mechanism for interagency coordination that results in more effective and consistent regulatory policies.[29] Recently, scholars have recognized that

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REGULATORY AFFAIRS, REGULATORY IMPACT ANALYSIS: A PRIMER (2011), [hereinafter OIRA PRIMER].

[25] *See infra* Part II.

[26] Kagan, *supra* note 3, at 2331–332; Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 3–4 (1995); Joseph Cooper & William F. West, *Presidential Power and Republican Government: The Theory and Practice of OMB Review of Agency Rules*, 50 J. POL. 864, 882–83 (1988); Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1081 (1986).

[27] Bagley & Revesz, *supra* note 3; RICHARD L. REVESZ & MICHAEL A. LIVERMORE, RETHINKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH (2008).

[28] *See* Michael A. Livermore & Richard L. Revesz, *Regulatory Review, Capture, and Agency Inaction*, 101 GEO. L.J. 1337 (2013); Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. 167, 178 (Spec. Issue 1990); Richard L. Revesz, *Specialized Courts and the Administrative Lawmaking System*, 138 U. PA. L. REV. 1111, 1150 (1990) (noting that capture is less likely when an entity reviews a wide range of issues); Susan Webb Yackee, *Reconsidering Agency Capture During Regulatory Policymaking*, *in* PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 292 (David Moss & Daniel Carpenter eds., 2013).

[29] *E.g.*, Cass R. Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 HARV. L. REV. 1838, 1847–48 (2013); Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131,1184, 1209 (2012) ("Coordination tools can help agencies to manage overlapping agency functions or related jurisdictional assignments in ways that improve both cumulative expertise and the quality of the final agency decision); Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 31

the OMB's role in the budget process provides similar benefits in terms of aligning spending with presidential priorities.[30] Likewise, public finance scholars laud cost-benefit analysis as an indispensable tool for comparing alternative regulatory options.[31] This allows policymakers to maximize the extent to which the benefits of each regulation exceeds total costs (direct and indirect, private and social), with the goal of improving social welfare.[32] Early skepticism from public-interest-oriented scholars about reliance on centralized review and cost-benefit analysis—in particular because costs were perceived to be more readily quantifiable than benefits, potentially creating a bias against regulation—has largely given way to

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(2010); Julie E. Cohen, *The Regulatory State in the Information Age*, 17 THEORETICAL INQUIRIES IN LAW 369 (2016).

[30] *See* Pasachoff, *supra* note 21; Mila Sohoni, *On Dollars and Deference: Agencies, Spending, and Economic Rights*, 66 DUKE L.J. 1677, 1720–21 (2017).

[31] *E.g.*, John C. Coates IV, *Towards Better Cost-Benefit Analysis: An Essay on Regulatory Management*, 78 LAW & CONTEMP. PROBS. 1, 5 (2015) (cost-benefit analysis is "the best available overarching conceptual framework for organizing and communicating the pros and cons of a proposed regulation"); *accord* Ryan Bubb, Comment, *The OIRA Model for Institutionalizing CBA of Financial Regulation*, 78(3) LAW & CONTEMP. PROBS. 47, 47–48 (2015) (responding to Coates' declaration with "Amen to that.").

[32] *E.g.*, Jean Drèze & Nicholas Stern, *The Theory of Cost-Benefit Analysis*, *in* 2 HANDBOOK OF PUBLIC ECONOMICS 909 (Alan J. Auerbach & Martin Feldstein eds., 1987); John D. Graham, *Saving Lives Through Administrative Law and Economics*, 157 U. PA. L. REV. 395 (2008); Cass R. Sunstein, *The Most Knowledgeable Branch*, 164 U. PA. L. REV. 1607, 1638 (2016) ("The whole point of cost-benefit analysis is to provide information about the effects on social welfare."); MATTHEW D. ADLER & ERIC A. POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS (2006) (describing the "traditional" view of cost-benefit analysis, and describing theoretical challenges with measuring changes in welfare). Widespread use of cost-benefit analysis of proposed regulations across a broad range of policies (*i.e.*, across many different proposed regulations) helps to ensure that the "estimated social benefits of all rules exceed the estimated social costs." Richard J. Pierce, Jr., *The Regulatory Budget Debate*, 19 N.Y.U. J. LEGIS. & PUB. POL'Y 249, 250 (2016). The Trump administration has attempted to reframe the popular debate and use the term "regulatory budget" to focus solely on the estimated costs of regulations and disregarding anticipated benefits. *See* Glenn Kessler, *Fact Checker: The White House Claim that Obama-era Regulations Have Cost $890 Billion*, WASH. POST, Feb. 21, 2017; OFFICE OF MGMT. & BUDGET, OFFICE OF INFO. & REGULATORY AFFAIRS, 2016 DRAFT REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND AGENCY COMPLIANCE WITH THE UNFUNDED MANDATES REFORM ACT (2016) (showing the overall increases in estimated benefits and costs over a ten-year period).

debates about *how* to conduct centralized review and cost-benefit analysis,[33] not *whether* to do so.[34]

Centralized review, including in some cases cost-benefit analysis, is overseen by OIRA, within OMB.[35] OIRA has a broad mandate to oversee the development of rules, interpretations of law, policy determinations, and other guidance produced by executive branch departments and agencies. For each regulatory proposal, each agency is required to identify for OIRA "the problem that it intends to address [and] assess the significance of that problem."[36] The agency is instructed to "tailor its regulations to impose the least burden on society . . . consistent with obtaining the regulatory objectives."[37] OIRA, in turn, reviews each proposal (to varying degrees), and in some instances oversees an interagency review and coordination process.[38]

The wellspring of OIRA's authority is Executive Order 12,866.[39] It calls for centralized review of any "regulatory action," defined as any "substantive action" related to the eventual promulgation of a final rule, whether or not the action is published in the Federal Register, by executive

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[33] This is a heated debated in itself, and has made "centralized review" something of a moving target—its reach and form are continually shifting. *See* Sunstein, *supra* note 29.

[34] *But see* Rena Steinzor, *The Case for Abolishing Centralized White House Regulatory Review,* 1 MICH. J. ENVTL. & ADMIN. L. 209, 214-15 (2012); Frank Ackerman & Lisa Heinzerling, PRICELESS: ON KNOWING THE PRICE OF EVERYTHING AND THE VALUE OF NOTHING (2004); Thomas O. McGarity, REINVENTING RATIONALITY: THE ROLE OF REGULATORY ANALYSIS IN THE FEDERAL BUREAUCRACY (1991).

[35] The paragraphs that follow summarize the centralized review process carried out by OIRA. For a more detailed description that includes helpful commentary on the sorts of issues and considerations that OIRA regularly confronts during the process, and OIRA's internal mechanics during the course of the review, see Sunstein, *supra* note 29, at 1844–63.

[36] Exec. Order No. 12,866 § 1(b)(1), 3 C.F.R. at 639.

[37] *Id*. (OIRA is directed to provide "meaningful guidance and oversight so that each agency's regulatory actions are consistent with applicable law, [and] the President's priorities.").

[38] *Id*. at 638.

[39] Exec. Order No. 12,866, 3 C.F.R. 638 (Sep. 30, 1993), *reprinted in* 5 U.S.C. § 601 (2000); Exec. Order No. 13,563, 3 C.F.R. 215 (2011), *reprinted in* 5 U.S.C. § 601 (2006 & Supp. V. 2011). This followed and updated Exec. Order No. 12,866, 3 C.F.R. 638 (1993), *reprinted in* 5 U.S.C. § 601 (2000) and Exec. Order No. 12,291, 3 C.F.R. 127 (1981), *reprinted in* 5 U.S.C. § 601 (1996).

branch departments, agencies, and other parts of the federal government.[40] In practice, this allows OIRA to oversee all variety of agency guidance, including sub-regulatory material such as policy statements that are not subject to notice and comment.[41] Centralized review under Executive Order 12,866 does not apply to certain specified independent agencies and "agencies specifically exempted by the Administrator of OIRA."[42]

In accordance with the executive order, agencies must regularly disclose to OIRA any planned regulatory actions, and must designate any actions that it believes to be *significant* or *economically significant*.[43] A significant regulatory action includes any action that might be in conflict with action taken by another agency, any action that might "[m]aterially alter the budgetary impact of entitlements" or certain other government fiscal programs, or might "raise a novel legal or policy issue."[44] An economically significant regulatory action is an action that would have "an annual effect on the economy of $100 million or more," as well as any other regulation that is expected to "adversely affect in a material way" some aspect of "the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities."[45] The $100 million threshold includes amounts of any "transfer" payments.[46] If the agency fails to

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[40] *See* Exec. Order No. 12,866, § 3(b), *reprinted in* 5 U.S.C. § 601.

[41] *See infra* note 81.

[42] Exec. Order No. 12,866, § 6, 3 C.F.R. at 638, *reprinted in* 5 U.S.C. § 601.

[43] *Id.* § 6(a)(3)(A).

[44] *Id.* § 3(f)(4), 3 C.F.R. at 641.

[45] Exec. Order No. 12,866, § 3(f), 3 C.F.R. at 641. Previously, Executive Order 12,291 established a category of "major" rules that invoked the same $100 million threshold, applying to rules with an "annual effect on the economy of $100 million or more." Exec. Order No. 12,291, § 1(b), 3 C.F.R. at 127. Similarly, the Congressional Review Act defines "major" rules that can be revoked through the legislative process as rules that the OIRA administrator determines has had or will likely have an annual effect on the economy of $100 million or more, or will likely result in a "major" increase in prices for individuals or for particular groups, industries or regions, or will have "significant adverse effects on competition, employment, investment, productivity, [or] innovation[.]" 5 U.S.C. § 804(2).

[46] This point is not explicit in the Executive Order, but in recent years OIRA has reported that many "economically significant" regulations are categorized as such because of a transfer, in most cases a transfer from the government. *See, e.g.*, OIRA DRAFT 2016 REPORT 6 n.15, https://obamawhitehouse.archives.gov/sites/default/files/omb/%20assets/legislative_reports/draft_2016_cost_benefit_report_12_14_2016_2.pdf; Sunstein, *supra* note 29, at 1868-69 (describing OIRA practices

identify a regulation as significant or economically significant, OIRA can make the designation.[47] Any draft rule that is not designated as significant is not subject to OIRA review beyond the agency providing notification to OIRA that is has determined a planned action will not be significant.

For each significant regulatory action, the agency must provide OIRA with an advance draft of the proposed action as well as some analysis of the proposal.[48] The draft must be accompanied by a statement of need explaining why the action is necessary and how and why the action will achieve to desired results.[49] Additionally, the agency must explain how the proposal fulfills any statutory mandate, and how it addresses or is

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for providing oversight of transfer payments in excess of $100 million, which does not include cost-benefit analysis). This $100 million transfer standard is not currently applied to trigger OIRA review of tax regulations. *See infra* Part III.

[47] OIRA has 10 days to review the designation and can make a determination that a proposed rule *is* significant or request more information from the agency; otherwise, the rule is not subject to further OIRA review. Exec. Order No. 12,866 § 6(a)(3)(A), 3 C.F.R. at 638.

[48] Exec. Order No. 12,866 § 6(a)(3)(B)(i), *reprinted in* 5 U.S.C. § 601.

[49] *Id.* The statement of need explains the problem that the regulation is intended to address and lays out the authority for the agency to address it via regulation, as well as detailing "extent of discretion" Congress has granted to the agency. OIRA PRIMER, *supra* note 24, at 2. Executive Order 12,866 directs that a regulation should only be pursued if it is "required by law, are necessary to interpret the law, or are made necessary by compelling need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people." Exec. Order No. 12,866 § 1(a), 3 C.F.R. at 638. The statement can be as simple as a single sentence citing a statutory mandate, *e.g.*, OFFICE OF MGMT. & BUDGET, OFFICE OF INFO. & REGULATORY AFFAIRS, 76 Fed. Reg. 19,192, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201310&RIN=0910-AG57 (requiring nutrition labeling in chain restaurants as mandated by Section 4206 of the Patient Protection and Affordable Care Act), or can provide a comprehensive explanation of the role of the proposal in a broader regulatory or statutory scheme and how it connects to broader policy initiatives. *E.g.*, OFFICE OF MGMT. & BUDGET, OFFICE OF INFO. & REGULATORY AFFAIRS, 80 Fed. Reg. 64,964, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=2060-AS47 (providing a broad explanation of the EPA's notice of final rulemaking for model rules in greenhouse gas emission guidelines, as part of a President Obama's Climate Action Plan). OIRA suggests some categories of reasons for action, including market failures (for example, externalities or asymmetric information in the market) and "other social purposes" such as preventing discrimination, protecting privacy, and promoting "other democratic aspirations." CIRCULAR A-4, *supra* note 24, at 5.

consistent with the President's priorities.[50] And, the agency must identify "potential costs and benefits" of the action,[51] and "avoid[] undue interference" with non-Federal government bodies.[52]

For any *economically* significant action, the drafting agency must go a step further. In addition to the information and analysis required for significant actions, the agency must also undertake a "Regulatory Impact Analysis,"—*i.e.*, qualitative and/or quantitative cost-benefit analysis—and provide that analysis to OIRA.[53] The agency is directed to select the regulatory approach that will "maximize net benefits," and will "impose the least burden on society, consistent with obtaining regulatory objectives."[54] The purpose of the analysis is to "learn if the benefits of an action are likely to justify the costs [or to] discover which of the various alternatives would be the most cost-effective."[55] There are several audiences for this analysis: OIRA and the executive office of the President, other agencies, and the public—ideally all should be informed and given an opportunity to react to the analysis.[56]

The analysis should also include identification and analysis of alternatives to the agency's preferred regulatory approach.[57] For example, the agency might consider regulation at the state or local level, voluntary action, or not regulating at all.[58] The agency should also consider particular design alternatives, such as different default rules, different types of communication plans, or other alternative mechanisms that might affect the efficacy and impact of the regulation.[59] OIRA advises that agencies should use this requirement to "specify performance objectives" rather than locking into a specific action or "manner of compliance that

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[50] Exec. Order No. 12,866 § 6(a)(3)(B)(ii), *reprinted in* 5 U.S.C. § 601.

[51] This assessment of costs and benefits is not necessarily quantified, and for these non-economically significant regulations the agency is not required to compare costs and benefits to potential alternative policy options, thus this mandate results in only rudimentary consideration of costs and benefits. *Id.*

[52] *Id.*

[53] *See* OIRA PRIMER, *supra* note 24, at 2.

[54] Exec. Order No. 13,563, § 3 C.F.R. 215 (2015), *reprinted in* 5 U.S.C. § 601 (2006 & Supp. V. 2011).

[55] CIRCULAR A-4, *supra* note 24, at 2.

[56] *See id.*

[57] *Id.*

[58] OIRA PRIMER, *supra* note 24, at 2.

[59] *Id.*

regulated entities must adopt."[60] That is, agency personnel should think creatively about what they are trying to accomplish and how to accomplish it. This analysis must include identification of various alternative regulatory approaches, as well as alternatives to regulation; and an evaluation of the costs and benefits of the proposal as well as the leading alternative approaches.

OIRA provides direction on the types of costs and benefits that agencies should take into account, and on the best methods for quantifying and monetizing these costs and benefits.[61] The basic analysis calls for agencies to define a baseline that identifies "what the world would be like absent" the proposed regulatory action.[62] Agencies are directed to "use the best reasonably obtainable scientific, technical, economic and other information to quantify the likely benefits and costs of each regulatory alternative."[63] OIRA provides direction on the types of costs and benefits agencies should take into account, for example "[p]rivate sector compliance costs," and "[g]ains or losses in consumers' or producers' surpluses."[64] Agencies are directed to distinguish between costs and benefits that can be monetized, quantified but not monetized, and that cannot be quantified, and to identify the timing of each category of costs and benefits.[65] And OIRA provides guidance on how agencies should quantify and monetize the effects of a rule, including relying on empirical studies of individual "willingness to pay" or "willingness to accept" a regulatory alternative, and discounting of future benefits and costs.[66]

OIRA's guidance also calls for agencies to "provide a separate description of distributional effects . . . so that decision makers can properly consider them *along with* the effects on economic efficiency."[67] That is, distributional analysis is not to be included as part of the cost-benefit analysis, but it is encouraged as an addendum to the proposed regulation. OIRA does provide that "[w]here distributive effects are thought to be important, the effects of various regulatory alternatives

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[60] *Id.* at 3.

[61] OIRA PRIMER, *supra* note 24 (listing nine steps for agencies to undertake in preparing a "regulatory impact analysis").

[62] *Id.* at 4.

[63] *Id.* at 9.

[64] *Id.* at 10.

[65] *Id.* at 7.

[66] *Id.* at 9, 11.

[67] *Id.* at 7.

should be described quantitatively to the extent possible, including the magnitude, likelihood, and severity of impacts on particular groups."[68] And it provides examples of some distributional effects that could be quantified, for example "[r]eductions in well-being for some consumers that are matched by increases for others."[69] But the directive to include distributional analysis is very often disregarded, and scholars and policymakers have lamented the scant attention paid to distribution in regulatory analysis.[70]

Once this information is in-hand, OIRA personnel generally have 90 days to conduct a review.[71] The review can result in OIRA accepting the regulatory action as-is, or returning the action to the drafting agency for "further consideration," in which case OIRA prepares a written explanation of particular issues the agency should address in a subsequent draft.[72] OIRA engages with the substance of the proposal to ensure that it is consistent with "the President's priorities."[73] This includes assessing whether the proposal conflicts with any policies or actions undertaken by another agency, which is accomplished through an interagency review process that OIRA convenes.[74] In that process, OIRA personnel seek to "identify and convey interagency views and seek reasonable consensus."[75] The Obama administration's addendum to Executive Order 12,866 emphasized the importance of interagency review.[76]

Agencies other than the drafting agency may have an interest in the regulatory action at issue or may have jurisdiction over some aspect of the issue.[77] Often, the nature of this interagency review is "highly technical," calling on experts from different departments and agencies to provide information that informs policy decisions made by other departments and agencies.[78] "OIRA may seek, for example, to ensure careful consideration

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[68] *Id.*

[69] *Id.* at 8.

[70] *See* Bagley & Revesz, *supra* note 3, at 1324–29 (arguing that analysis of distributional consequences should be central to regulatory policymaking).

[71] Exec. Order No. 12,866 § 6(b)(2), 3 C.F.R. at 646.

[72] *Id.* § 6(b)(3), 3 CF.R. at 646.

[73] *Id.* § 6(b), 3 C.F.R. at 646.

[74] Sunstein, *supra* note 29, at 1841; *see generally* Freeman & Rossi, *supra* note 29, at 1174–80.

[75] Sunstein, *supra* note 29, at 1841.

[76] Exec. Order No. 13,563, 3 C.F.R. § 215 (2011).

[77] Freeman & Rossi, *supra* note 29, at 1179.

[78] *Id.* at 1842.

of the views of the Department of Justice on a legal issue, or the views of the United States Trade Representative on an issue that involves international trade, or the views of the Department of Homeland Security and the National Security Council on an issue with national security implications, or the views of the Department of Energy on the effects of a rule on the energy supply. In such cases, career officials with technical expertise are frequently the central actors."[79] Additionally, the interagency review process has put particular emphasis on procedural issues: "OIRA also engages lawyers throughout the executive branch to help resolve questions of law, including questions of administrative procedure. As noted, OIRA considers itself a guardian of appropriate procedure, and much of its role is associated with that guardianship (including the promotion of public comments)."[80]

III. THE CURRENT PROCESS FOR TAX REGULATIONS

This Part describes the process for formulating tax regulations, which does not involve centralized review. It then introduces two illustrative regulations, one of which was already promulgated, and another of which will be promulgated in 2018 or 2019, and proposes a four-part taxonomy of the varied functions performed by tax regulations.

A. Overview: No Centralized Review

In some ways, the process for drafting tax regulations is similar to the process that OIRA oversees for regulations produced by other departments and agencies, as described in the prior section, except that there is almost never substantive OIRA review of draft tax regulations, and thus no cost-benefit analysis and no interagency process for most tax regulations.[81]

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[79] *Id.* at 1843.

[80] *Id.* at 1842–43.

[81] Centralized review could also apply to subregulatory guidance. In a 2007 bulletin, OMB established a threshold for centralized review of guidance documents similar to the economically significant designation used for regulations, but OMB and subsequent Treasury guidance exempt the IRS from the requirements in the bulletin. Treas. Directive 28-04 (July 10, 2015); GAO REPORT, *supra* note 6, at 28. Nonetheless it is clear that some subregulatory tax guidance documents the standards provided in the OMB bulletin, and so excluding these documents from centralized review raises similar issues to the exclusion of regulations that is the central focus here. For example, in 2016, the IRS issued a new "no-ruling" policy indicating that it

The regulation-drafting process is carried out by both IRS and Treasury personnel and is overseen by political appointees at both the IRS and Treasury—thus, the lines of authority are more blurred than in the more typical single-agency-head setup. Regulations are produced by the IRS Chief Counsel's office in coordination with Treasury's Office of Tax Policy. Some regulations are drafted solely by attorneys in the Chief Counsel's office and submitted for review by the attorneys in the Office of Tax Policy; for some regulations, the Office of Tax Policy is involved throughout the drafting process. Once drafted, regulations are subject to review and approval by the IRS Chief Counsel, the IRS Commissioner, the Assistant Secretary of Treasury for Tax Policy, and Treasury's General Counsel prior to publication in the Federal Register.[82]

There is a long-standing understanding among Treasury's tax policy personnel and the IRS Chief Counsel's office that, unlike regulations produced by other departments and agencies that *are* subject to centralized review, most tax regulations do not carry the force of law, and this position is congruous with the practice of not seeking OMB review.[83] There is a statutory justification for this position, but it does not hold up under scrutiny. Until 2011, there was wide agreement among Treasury attorneys, IRS personnel, and the tax practitioner community that "general authority" regulations were "interpretive" regulations. This category included all

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would no longer offer advance approval of certain spin-off transactions. Rev. Proc. 2016-1 (addressing the "active trade or business" requirement under section 355). The immediate (and predictable) effect of this guidance was that Yahoo's planned $10 billion spinoff of its Alibaba stock holdings was abandoned—this transaction alone would seem to exceed the $100 million threshold. *See supra* Part II (describing "economically significant" regulatory actions, which have an economic effect of $100 million or more, as subject to centralized review under the applicable Executive Orders).

[82] In order to be published in the federal register, proposed or final regulations must carry the signature of both the IRS Deputy Commissioner for Services and Enforcement and the Assistant Secretary of the Treasury for Tax Policy. INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL § 32.1.6.8. In contrast, subregulatory guidance is produced by the IRS Chief Counsel's office and approved by the IRS Chief Counsel. *See* INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL §§ 2.1.1.4.4, 32.1.1.4.5. The five Senate-confirmed posts with responsibility for tax administration and policy are: the Secretary of Treasury, the Assistant Secretary of Treasury for Tax Policy, the General Counsel of Treasury, the IRS Chief Counsel, and the Commissioner of the IRS, who serves a five-year term. 26 U.S.C. § 7803(a)(1).

[83] Kristin E. Hickman, *The Need for* Mead*: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537 (2006).

regulations promulgated under authority provided in Code section 7805(a), which provides general authority for Treasury to "prescribe all needful rules and regulations."[84] On the other hand, only a small handful of regulations issued under "specific" delegations from Congress—*i.e.*, express direction to issue regulations; these were understood to be the only potentially "legislative" regulations.[85]

Under non-tax precedent, an "interpretive" regulation does not carry the force of law and is not subject to the same stringent requirements for deference as "legislative" regulations, which do carry the force of law. However, while the distinction between interpretive and legislative is familiar outside of the tax context, the basis for making this distinction among tax regulations is not. Under *Mead*, whether regulations are interpretive or legislative is based on the content of the regulation and the nature of the delegation made by Congress.[86] But tax jurisprudence never made these sorts of distinctions until very recently—the Supreme Court's 2011 opinion in *Mayo Foundation*[87] made clear for the first time that the *Mead* framework applies to tax regulations, and the Tax Court has subsequently followed this lead.[88] Nonetheless, the Internal Revenue Manual, which prescribes the tax regulation drafting process, still directs that "most IRS/Treasury regulations merely implement a statute. The underlying statute provides adequate legal authority to impose or collect a tax, or issue a payment to a taxpayer. IRS/Treasury regulations provide a mechanism for the tax to be satisfied or collected, or payment to be issued to the taxpayer. The effect from a rule in most IRS/Treasury regulations is almost always a result of the underlying statute, rather than the regulation itself."[89]

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[84] 26 U.S.C. § 7805(a).

[85] *See* Mitchell Rogovin & Donald L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View from Within*, 2009 TAXES—THE TAX MAGAZINE 21, 23 (Aug. 2009) (the authors are former Chief Counsels of the Internal Revenue Service). Some scholars, however, have long pointed out that this reasoning is problematic. *See, e.g.*, Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727, 1762–63 (2007).

[86] United States v. Mead Corp., 533 U.S. 218 (2001).

[87] Mayo Found. for Med. Educ. & Research v. United States, 562 U.S. 44 (2011).

[88] Altera Corp. v. Comm'r, 145 T.C. 91 (2015).

[89] Internal Revenue Manual § 32.1.5.4.7.5.3 (Oct. 15, 2015), https://www.irs.gov/irm/part32/irm_32-001-005.

That understanding had only rarely been questioned until the past several years. A 1983 Memorandum of Agreement between Treasury and the OMB that suggests exactly this pragmatic justification prevailed at the dawn of the centralized review era.[90] The memorandum provides that under the predecessor to Executive Orders 12,866 and 13,563,[91] the "review procedures of the Executive order are waived with respect to all regulations [issued by the IRS and Treasury] except legislative regulations that are 'major' as defined in the Executive order."[92] Treasury and IRS officials seem to have combined this directive with their understanding that most tax regulations are "interpretive," to conclude that essentially no tax regulations are subject to centralized review, and OMB has rarely questioned Treasury's determinations.[93]

Senator Orin Hatch, the Chair of the Senate Finance Committee and a few other members of Congress, prompted the Government Accountability Office to examine the issue, and recommended that Treasury and OMB "reevaluate their long-standing agreement."[94] The GAO report highlighted the rarity of centralized review of tax regulations: From 2011 mid-way through 2016, just two of Treasury's tax-related regulations were determined to be significant or economically significant. (One of those two is discussed below;[95] the other is not at all a typical tax regulation, because it arose under statutory authority outside of the tax code and had nothing to do with substantive tax law.[96]) Those same

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[90] Treasury-OMB Memorandum, *supra* note 7. The MOU was made public for the first time in 2016.

[91] *See supra* note 39 and accompanying text.

[92] *Id.* at 1.

[93] The one recent exception to this is described *infra* note 96.

[94] GAO REPORT, *supra* note 6; *see* Letter from Orrin G. Hatch, Chairman, Senate Fin. Comm., to Jacob Lew, Treasury Secretary (Oct. 11, 2016) (following up after GAO released the 1983 memorandum).

[95] *See infra* Part III.B.

[96] GAO REPORT, *supra* note 6, at 18. Those two regulations were actually two takes at the same set of rules, which provided for the nationwide regulation of tax return preparers, covering any person who prepares any tax return or refund request. T.D. 9527, 2011-27 I.R.B. 7 (July 5, 2011). This regulation was not at all a typical Treasury-IRS tax regulation in that it did not arise from the tax code. *Id.*; *see* 31 U.S.C. § 330(a)(1). The rules required every preparer to pass a competency exam, register with and pay an annual fee to the IRS, complete continuing education each year. *Id.* It was designated as economically significant (initially in 2011 by OIRA; Treasury did not designate it as such) and subject to centralized review. But the rules were

regulations were the only ones issued solely by Treasury identified as "major" tax regulations for purposes of the Congressional Review Act.[97]

Yet, a high level review of titles and summaries shows that dozens of tax regulations from this period appear to be significant or economically significant, especially given OIRA's general standard of considering transfers as part of the economic effect for purposes of the $100 million threshold: over the last several years, dozens of tax regulations appear to meet that threshold, while just one was so designated.[98] Frequently Treasury's designations of not significant have defied logic: a recent regulation issued under the Affordable Care Act was designated as significant (but not economically significant) by the Department of Labor and the Department of Health and Human Services.[99] But when Treasury promulgated the regulation, it stated that "[n]otwithstanding the determinations of the Department of Labor and Department of Health and Human Services, for purposes of the Department of Treasury, it has been determined that this Treasury decision is not a significant regulatory action for purposes of Executive Order 12,866. Therefore, a regulatory assessment is not required."[100] The GAO found that from 2013 to 2015,

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ultimately struck down by the D.C. Circuit as exceeding Treasury's statutory authority. Loving v. Internal Revenue Service, 742 F.3d 1013 (D.C. Cir. 2014).

[97] GAO REPORT, *supra* note 6, at 19; 5 U.S.C. § 801(a)(1)(A); *see supra* note 45.

[98] For example, in 2016 and 2017 there were 15 proposed, finalized or temporary regulations that potentially could have triggered OIRA review as "economically significant," and just one—discussed below, *see infra* Part III.B—that was designated as such. These regulations addressed topics ranging from the exemption from the ACA's employer mandate for contraceptive coverage for private employers who object to such coverage based on their religious beliefs, T.D. 9827, 2017-44 I.R.B. 382 (Oct. 30, 2017), to withholding requirements for gambling winnings from bingo and slot machine games, T.D. 9807, 2017-5 I.R.B. 573 (Jan. 30, 2017), to reporting requirements for charitable contributions, a measure which was withdrawn but was expected to have a significant effect on claimed charitable deductions (though the total effect was undetermined—there was no quantitative analysis undertaken in connection with the rule). *Substantiation Requirements for Certain Contributions*, 2016-4 I.R.B. 294 (Jan. 25, 2016).

[99] *See generally* Treas. Reg. § 54.9815-2713T (as amended by T.D. 9541, 2011-39 I.R.B. 438); *see also* 29 C.F.R. § 2590.715.2713T(a)(i)(iv) (as amended by T.D. 9541, 2011-39 I.R.B. 438) (containing amending language by Treasure Decision 9541); 45 C.F.R. § 147.130(a)(i)(iv) (as amended by T.D. 9541, 2011-39 I.R.B. 438) (containing language identical to the language amended by the final tax regulation in Treasury Decision 9541).

[100] T.D. 9541, 2011-39 I.R.B. 438.

Treasury issued 15 joint regulations that were *not* designated as significant or economically significant by Treasury, but were so designated by one or both of the other drafting agencies.[101]

For the single tax code regulation that was subject to centralized review,[102] President Obama went to significant lengths to peg the proposed regulation as the independent work of Treasury and the IRS, even as that seemed far-fetched.[103] When the Trump administration took over in early 2017, it immediately took a more heavy-handed approach to tax regulations in general, with OMB including tax regulations in its early anti-regulatory directives.[104] President Trump also used an executive order to direct the Secretary of Treasury to "review" all significant tax regulations issued in the final year of the Obama administration to determine if any "increased financial burdens" on taxpayers.[105] And, notably, President Trump directed the Secretary of Treasury and the Director of the OMB to "review and, if appropriate, reconsider" the exemption of tax regulations from centralized review.[106] But the most recent regulatory agenda for tax regulations, submitted to OIRA by

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[101] GAO REPORT, *supra* note 6, at 20.

[102] *See infra* Part III.B for further discussion of this rule.

[103] Remarks on Tax Code Reform and an Exchange with Reporters (Apr. 5, 2016) ("So I am very pleased that the Treasury Department has taken new action to prevent more corporations from taking advantage of one of the most insidious tax loopholes out there, and fleeing the country just to get out of paying their taxes. This got some attention in the business press yesterday, but I wanted to make sure that we highlighted the importance of Treasury's action and why it did what it did.").

[104] President Trump issued an Executive Order that called for two regulations to be revoked for every one new regulation finalized, and his Chief of Staff issued a directive to department heads that halts publication of new regulations and "guidance documents." Exec. Order 13,771, 82 Fed. Reg. 42,751 (2017); Reince Priebus, Memorandum for Heads of Executive Departments and Agencies, Regulatory Freeze Pending Review (Jan. 20, 2017). The IRS interpreted this to mean that it should cease publication of all but the most routine guidance (such as updating interest rates). Andrew Velarde & Emily L. Foster, *No Substantive IRS Guidance Coming for a While, Official Says*, TAX NOTES TODAY, Feb. 27, 2017.

[105] Exec. Order 13,789, § 2(a), 82 Fed. Reg. 19,317 (Apr. 21, 2017) (titled "Identifying and Reducing Tax Regulatory Burdens" and directing that "earlier determinations of whether a regulation is significant pursuant to Executive Order 12866 of September 30, 1993, as amended (Regulatory Planning and Review), shall not be controlling."), https://www.federalregister.gov/documents/2017/04/26/2017-08586/identifying-and-reducing-tax-regulatory-burdens.

[106] *Id.* at § 3(c).

Treasury, and released publicly in summer 2017, did not designate any tax regulations as "economically significant," consistent with past practices.[107]

With the passage of the Tax Cuts and Jobs Act at the end of 2017, focus on centralized review began to sharpen, particularly as policymakers and the tax community digested the unusually broad delegations to the executive branch that were included in the new legislation.[108] A conservative nonprofit issued a report criticizing the fact that tax regulations are not subject to centralized review.[109] Various congressional Republicans and conservative interest groups have begun to push the issue as well.[110] Treasury and OMB officials have recently suggested that OMB will be involved in formulating regulations under the Tax Cuts and Jobs Act, but have not indicated whether that means formal centralized review

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[107] Stephanie Cummings & Andrew Velarde, *2017 Regulatory Agenda Doesn't Deem Any Tax Regs Significant*, TAX NOTES TODAY, July 21, 2017.

[108] Congress made some very broad express delegations of authority in the 2017 Tax Cuts and Jobs Act. Examples include the pass-through provision, described *infra* Part IV.B, a provision that directs Treasury to determine who qualifies for a new special tax break on beer, and delegation of rules addressing how private equity partnerships can qualify for the long-term capital gains rate. Pub. L. 115-97, § 13802, 131 Stat. 2054 (Dec. 22, 2017), 26 U.S.C. § 5051(a)(1). Congress also left significant gaps that demand that Treasury exercise policymaking discretion. *See, e.g.*, Stephen E. Shay, Treasury Can Close a Potential Loophole in the Treatment of Deferred Foreign Income in the Tax Cuts and Jobs Act—Will It Act? (Dec. 26, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3093379 (describing how a new provision imposing a tax on the deemed repatriation of deferred foreign income is unclear as to how certain distributions from foreign are to be accounted for, creating the possibility that multinational corporations could use such distributions to reduce tax liability, potentially by billions of dollars for a corporate taxpayer like Apple).

[109] James Valvo, *Evading Oversight: The Origins and Implications of the IRS Claim That Its Rules Do Not Have an Economic Impact*, CAUSE OF ACTION INSTITUTE (Jan. 2018), https://causeofaction.org/evading-oversight-origins-implications-irs-claim-rules-not-economic-impact/; *see supra* note 8.

[110] Letter from Ron Johnson, Chairman, and James Lankford, Chairman, Subcommittee on Regulatory Affairs and Federal Management, to Neomi Rao, Administrator, Office of Information and Regulatory Affairs (Feb. 1, 2018); Letter from Ron Johnson, Chairman, and James Lankford, Chairman, Subcommittee on Regulatory Affairs and Federal Management, to David Kautter, Commissioner, Internal Revenue Service (Feb. 13, 2018); Press Release, Cause of Action Inst., 17 Groups Urge Trump Administration to End Unlawful IRS Practice of Dodging Oversight (Feb. 27, 2018).

or informal consultation.[111] While Republican lawmakers and the Trump administration officials closest to the White House seem to be pushing for centralized review, it is not clear what political ends centralized review would necessarily achieve.

B. One (Partial) Exception: The Earnings Stripping Rule

The only recent Treasury regulation that was designated as economically significant and subject to OIRA review was a highly politicized Obama administration rule to stem the tax benefits of corporate inversions. Inversions are tax-driven transactions that involve a U.S.-headquartered corporation merging with a foreign corporation, and causing the foreign corporation to become the parent of entire corporate structure. The 2016 regulation reduces the extent to which a foreign parent corporation can issue debt to its U.S. subsidiary.[112] Prior to the 2017 tax legislation, this sort of debt allowed the U.S. subsidiary to make deductible interest payments that reduce U.S. tax liability, and that often flow into low tax jurisdictions, thus reducing U.S. income, reducing the corporation's tax liability, and reducing revenue collected by corporate income tax.

President Obama urged Congress to act to address the problem of tax inversions repeatedly.[113] Only after Congress had stalled for nearly two years did Treasury draft and propose regulations.[114] Although the

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[111] Bernie Becker, *Politico's Morning Tax: What's happening, OMB*, POLITICO MORNING TAX (Feb. 22, 2018), https://www.politico.com/newsletters/morning-tax/2018/02/22/whats-happening-omb-113001 (describing the Treasury Deputy Assistant Secretary for Tax Policy and the Administrator of OIRA each expecting great OMB involvement than in the past); *see supra* note 8.

[112] *See* Treatment of Certain Interests in Corporations as Stock or Indebtedness, 81 Fed. Reg. 20,912 (proposed Apr. 4, 2016) (to be codified in 26 C.F.R. pt. 1), https://www.regulations.gov/document?D=IRS-2016-0014-0002.

[113] *See* David Jackson, *Obama: Congress should end 'tax inversions'*, USA TODAY (Aug. 6, 2014); TREASURY GREENBOOK FISCAL YEAR 2015 64-65 (March 2014) (proposing legislation to limit inversions); TREASURY GREENBOOK FISCAL YEAR 2016 37-38 (February 2015) (same); TREASURY GREENBOOK FISCAL YEAR 2017 27-28 (February 2016) (same).

[114] Despite failing to act legislatively, members of Congress were engaged in the rulemaking process, although the effects of this engagement are unclear. *See* Naomi Jagoda, *Treasury officials to meet with lawmakers on inversion rules*, THE HILL (June 29, 2016), http://goo.gl/hckFP7 (describing a meeting among presidential appointees

President did not issue a directive to Treasury to act, it appeared that the rules were prompted by President Obama's publicly expressed concerns.[115]

Perhaps because the policy was driven by the President personally—although we do not know that for certain—the rule was subject to centralized review as economically significant, but that review appeared rudimentary. Treasury did carry out cost-benefit analysis of the rule—an anomaly in the context of past practices.[116] But this analysis addressed only the anticipated revenue the rule would raise ($843 million over 10 years), and the anticipated costs to taxpayers of complying with the rules ($13 million over 10 years).[117] In accordance with Circular A-4, anticipated revenue was not accounted for as a cost to taxpayers.[118] The analysis also did not attempt to estimate any potential benefits flowing from government expenditure of this money.[119] Despite OIRA's general instruction that distributional considerations should be addressed qualitatively, Treasury provided no indication of the incidence of the $843 million in revenue, nor how it might affect distribution even in broad strokes. And, in spite of Circular A-4, the analysis involved no contemplation of potential behavioral effects of the proposed policy, let alone quantification of those effects. As such, the regulatory impact analysis bears little resemblance to the robust quantified analysis provided for under Circular A-4.[120]

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and staff from Treasury, staff of the JCT, and members of the House and Senate tax committees to discuss the proposed rule).

[115] The President's statements on Treasury's actions to combat inversions are conspicuously deferential, indicating that President Obama supports Treasury but has not initiated or directed Treasury's work. *See, e.g.*, Statement by the President (Sep. 22, 2014) ("[M]y administration will act wherever we can to protect the progress the American people have worked so hard to bring about. As part of this effort, Secretary Lew briefed me today on the first steps the Treasury Department is taking to discourage companies from taking advantage of corporate inversions . . . . I'm glad that Secretary Lew is exploring additional actions to help reverse this trend.").

[116] *See* Exec. Order No. 12,866, *supra* note 44.

[117] OFFICE OF MGMT. & BUDGET, REGULATORY IMPACT ANALYSIS OF PROPOSED EARNINGS STRIPPING REGULATIONS (Apr. 4, 2016), https://goo.gl/9Q8Wcc (click on Regulatory Impact Analysis) [hereinafter EARNINGS STRIPPING RIA].

[118] CIRCULAR A-4, *supra* note 24.

[119] *See infra* Part V.A.2.

[120] *See supra* note 24–27 and accompanying text.

Other aspects of centralized review were incomplete as well. For example, the statement of need submitted to OMB along with the draft regulation casts the proposal as a technical response to a technical problem.[121] But some alternative rationales were provided during the public relations effort surrounding the introduction of the proposed and final regulations. Both President Obama and Secretary of the Treasury Jacob Lew suggested that the policy was motivated by a desire to protect the fisc from lost revenue,[122] and underscored concerns about fairness because large multinational corporations were using inversion transactions and earnings stripping in a way that was perceived to allow them to avoid paying taxes that they *should* owe—maneuvers that were not available to wholly domestic corporations or to individuals.[123] The statement of need does not address these concerns directly, although it does include a citation to a 2007 Treasury report that estimated that earnings stripping cost the Treasury more than $700 million of revenue in 2002 and 2003.[124] By claiming to be motivated entirely by the revenue effect, the formal justification for the rule appears not entirely forthcoming.

This omission shapes the regulatory analysis that follows. The regulatory impact analysis does not specify what, if any, alternative policies Treasury considered. For example, one part of the rule applies only to corporations that have more than $50 million of outstanding related-party debt; another part applies only to corporations with more than $100 million of assets or $50 million of revenue.[125] Presumably, Treasury could have considered alternatives that made the rule apply either more broadly or more narrowly. And other parts of the rule could have

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[121] EARNINGS STRIPPING RIA, *supra* note 117.

[122] Remarks by Treasury Secretary Jacob J. Lew on a Press Conference Call Regarding Announcement of Earnings Stripping (Oct. 13, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0577.aspx ("Earnings stripping is…a contributing factor to the erosion of the U.S. corporate tax base.").

[123] Remarks by President Obama on the Economy (Apr. 5, 2016), https://obamawhitehouse.archives.gov/the-press-office/2016/04/05/remarks-president-economy-0 (discussing the proposed regulations and describing inversion transactions as allowing "big corporations" to "get out of paying their fair share of taxes here at home.").

[124] DEPARTMENT OF THE TREASURY, REPORT TO CONGRESS ON EARNINGS STRIPPING, TRANSFER PRICING AND U.S. INCOME TAX TREATIES 26 (Nov. 2007), https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Earnings-Stripping-Transfer-Pricing-2007.pdf.

[125] EARNINGS STRIPPING RIA, *supra* note 117, at 2.

been altered to create a menu of different options that would cover different types of debt arrangements in varying quantities and applying to different types of taxpayers. But it is unclear whether the rule as adopted was shaped in consideration of the revenue effects, fairness implications, or only based on more technical considerations, so it is not clear what sort of alternatives Treasury might have wanted to consider.

This incomplete version of centralized review of the anti-inversion rule was perhaps the first sign that centralized review was about to become a political football.

IV. THE VARIED FUNCTIONS OF TAX REGULATIONS

Each rule is described in further detail in the sections that follow, and is referenced in the next Part, which considers how centralized review might come to bear on each regulation.

A. A Four-Part Taxonomy

To explore the utility of centralized review in different tax regulatory contexts, the sections that follow make reference to the following taxonomy of four functions performed by tax regulations: (1) private allocation; (2) public allocation; (3) distribution; (4) implementation. Each is described below.

First, some tax regulations result in allocating private resources to different private uses through incentives, intentional and unintentional; this is the *private allocation* function. Second, some elements of regulatory tax policy involve allocating private resources to public uses by collecting tax revenue; I call this the *public allocation* function. Third, some tax policy redistributing resources among different groups, which is the *distributional* function. That is, tax regulations affect distribution when the regulations determine which taxpayers or which groups of taxpayers have how much of the total resources in society. Any time the government collects revenue, it has the potential to alter who gets how much of the total economic pie depending on who pays the tax and who benefits from government expenditures.[126]

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[126] The Gross Domestic Product was approximately $19 billion in 2016; the individual income base was approximately $10 billion (*i.e.*, individual gross income totaled $10 billion; taxable income was approximately $7 billion), and total federal tax collections were $3.3 billion.

These first three functions are an extension of the distinction drawn by the Musgraves between allocative fiscal policies and distributional fiscal policies.[127] As Shaviro summarizes, "[a]llocation affects the amount, use, and character of all assets in society, while distribution affects who has what."[128] Thus, Shaviro casts tax revenue that is deployed on public goods—for example, police protection—as serving an allocative function, because policymakers are allocating funds that would be spent or saved by individuals to an alternative use.[129]

The final function is the *implementing* function. Some tax regulations implement allocative and distributional decisions made by Congress, whereby Treasury is given very little policymaking discretion and simply follows directives to promulgate substantive rules prescribed by statute. The implementing function is consistent with the category of so-called interpretive rules that are familiar in other agency rulemaking contexts.[130]

These four functions of tax regulations are not mutually exclusive—any given regulation might have elements of each, and indeed the two examples that follow feature all four functions. For example, many tax provisions are allocative, in that they raise revenue for the government to spend (in ways that are different than how the funds would have been deployed if left in private hands). These same revenue-raising regulations may *also* be distributive, in that the manner in which the funds are raised and in which the benefits of government spending accrue alters the relative wealth or income of different groups of taxpayers. The purpose of this taxonomy is not definitively categorizing regulations that have multiple purposes; rather the point in the remainder of this Part is to illuminate that there are different analytical frameworks and expectations appropriate for different elements of tax regulations.

Recognizing the varied functions of tax regulations brings to the fore a key point of confusion regarding how best to develop and analyze tax regulations: some tax regulations are very much like other types of

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[127] *See* RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE (5th ed. 1989),

[128] Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX L. REV. 187, 188 (2004).

[129] *Id.*

[130] *See* notes 83-85 and accompanying text; Hickman, *supra* note 85, at 1764-65 (observing that "the courts have had little opportunity to apply contemporary administrative law principles for distinguishing legislative from interpretive rules in the tax context.").

regulatory activity currently overseen by OMB (albeit, with varying degrees of efficacy). At the same time, other tax regulations present issues that OMB disregards in its regulatory oversight, regardless of the source of the regulations (*i.e.*, some unreviewed tax regulation functions are not necessarily particular to the tax system).[131]

Consider two notable recent additions to the Internal Revenue Code that require regulations that exemplify each of the four functions—first, the 2017 tax cut legislation's deduction for certain "pass-through" income, and second the Affordable Care Act's soon-to-be effectively repealed individual mandate,[132] which lead to regulations addressing smoking cessation incentives connected to employer-provided health insurance.[133]

One effect of the new pass-through deduction rules will be *distributional*—it will affect distribution both between industries and within industries, with varying consequences (and varying degrees of regressivity) for different income levels in different industries. The differential tax rates that the provision will create—and the way that lines are drawn in regulations to distinguish "winners" who are permitted to take the deduction from "losers" who are not—will also have *private allocation* effects: the lower tax rates in particular industries may move investment and work effort from one industry to another. Further, while Congress has given Treasury significant policymaking discretion to decide who can benefit from the deduction, it has also established a core set of rules about how the deduction should operate—for example, above congressionally-mandated income levels, the deduction is limited for specified industries, the . These rules will require regulations to implement but nonetheless are largely predetermined. These regulations will be simply *implementing*, that is, the regulations will fit within policy decisions Congress has already made.

Along the same lines, the central purpose of the smoking-cessation regulations under the individual mandate provisions is a *private allocation*

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[131] *See infra* Part IV.

[132] The individual mandate was effectively repealed as part of the Tax Cuts and Jobs Act, but curiously Congress's approach to repeal was simply to reduce the penalty for failure to meet the insurance requirement to $0 (from around $700 or more per person), starting in 2019. That means that the regulations remain fully in force for 2018, and after that the requirements will remain on the books, as will the regulations implementing the requirement and facilitating the process for exemptions from the mandate.

[133] *See supra* notes 8-12 and accompanying text.

function: the individual mandate generally promotes private spending on health coverage that meets specific requirements, thus diverting spending on other forms of consumption or on non-conforming health coverage. The smoking cessation regulation addresses a particular type of health insurance incentive that is directly focused on shaping private behavior—it determines whether certain individuals are subject to a penalty (essentially an excise tax[134]) for failure to maintain acceptable coverage. The excise tax serves a *public allocation* function: it raises revenue that is used to fund general government operations. And the rule is tied to income level, which gives it a *distributional* effect as well. However, there is not a clear *implementing* function in this rule: the executive branch was essetnailly working from a clean slate because there was no indication that Congress directly contemplated the rule.

B. Example 1: The Pass-Through Deduction

The Tax Cuts and Jobs Act provides, in a new section 199A that is added to the Internal Revenue Code, that certain income from businesses that are taxed as passthroughs—meaning that the income of the business appears on the tax return of the individual owner or owners—will be eligible for a special 20 percent deduction.[135] In some respects, Congress acted in typical fashion, consistent with how it has produced tax legislation in the past: it created an exceedingly complicated statutory scheme that limits the amount of the deduction based on how much a pass-through business spends on a combination of payroll expenses and capital investments. The deduction is capped at either 50 percent of W-2 wage expenses, or 25 percent of W-2 wage expenses plus 2.5 percent of the original cost of "qualified property."[136]

But Congress left various critically important issues in section 199A for the executive branch to sort out on its own, with essentially no direction or limits on the regulation-writers' policymaking discretion. Perhaps most problematic, section 199A establishes differential rates as between distinct types of services, but does not establish which services qualify for the low rate and which do not. The deduction is expressly disallowed for high-

[134] *See* Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519 (2012).

[135] H.R. 1 (2017) § 11011(a), 26 U.S.C. § 199A; H.R. Rep. No. 115-__, at 20-40 (2017) (Conf. Rep.).

[136] 26 U.S.C. § 199A(b)(2)(B).

earning lawyers and doctors, and expressly *not* disallowed for engineers and architects.[137] At the same time, the qualifying services cannot include "any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees."[138] Treasury's regulations must specify which specific service businesses qualify for the deduction—do architecture firms built on the reputation of employees qualify or not? Should they be treated differently than general contracting businesses built on the reputation of employees? What about firms providing support services to reputation-based firms? For example, if office support for a reputation-based service is a qualifying business, can a reputation-based service spin-off its support functions into a separate entity and receive a partial deduction?

A regulation addressing services that are built on the reputation and skill of employees will call upon each of the four functions, private allocation, public allocation, distribution and implementation. The private allocation function arises because allowing the deduction for one type of service but not for others will result in certain service sectors being seven percent more profitable than others.[139] This may influence private allocation, increasing investment in industries that are more profitable qualify for the special deduction. The regulations also have distributional implications as between industries, regions, and income levels (because some reputation-based services are generally higher income than others, for example). There are also significant public allocation effects, as a more inclusive rule could substantially reduce government revenue as compared to a more limited rule. Finally, Congress left some standard sorts of implementation gap-filling regarding the limitations to the deduction that are included in the statute to be dealt with in regulations—

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[137] 26 U.S.C. § 199A(d)(2)(A) *citing* 26 U.S.C. § 1202(e)(3)(A) (defining specified services by reference to a list that includes lawyers, doctors, engineers, and architects, but section 199A(d)(2) directs that the engineers and architects should be omitted from the list).

[138] 26 U.S.C. § 1202(e)(3)(A).

[139] At the 37 percent top marginal tax rate, married joint filers making over $600,000, or single filers making $300,000, the 20 percent deduction increases after tax income by 7.4 percent. The increase is lower in lower tax brackets (7 percent in the 35 percent bracket, which ranges from $400,000 to $600,000 for married joint filers in 2018).

for example, the definition of "qualified property"[140] leaves open some questions as to what property might be included—relatively straightforward gap-filling which leaves Treasury without significant discretion.[141]

These many issues create significant challenges for regulation-writers, which are magnified because of Congress's haste in formulating section 199A. Congress did not address any of the questions regarding how to delineate service industries or how to define "reputation" for these purposes—and, in fact, gave literally no hint as to how the questions should be resolved.[142] There is little additional explanation of the meaning or purpose of the provisions from the Joint Committee on Taxation, and there are not any clear underlying purposes to the provisions that might offer some semblance of consistency as to who should and who should not be able to take advantage of the deduction. The end result is that Treasury *must* act—through regulations and other forms of guidance—to clarify how the rules should work, who is permitted to take the deduction, and who is not so permitted. But these regulations will necessarily involve significant policy decisions based on little guidance from Congress, policy decisions that affect distribution between owners and workers, between industries, within industries, and between current and future taxpayers.

C. Example 2: The Smoking Cessation Rule

This section describes a tax regulation issued as part of Treasury's efforts to implement the Affordable Care Act's "individual mandate."[143] The individual mandate is intended to prompt individuals to acquire health insurance coverage that meets particular specifications. It is implemented

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[140] The new provision in section 199A incorporates a somewhat vague, though longstanding, definition from 26 U.S.C. § 167.

[141] Critics of the legislative have pointed out that based on the statutory language alone, there are some absurd possible inclusions in "qualified property." David Kamin et al., *The Games They Will Play: An Update on the Conference Committee Tax Bill* 14-15 (Dec. 22, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3089423. But frankly the confines of Treasury's task here is essentially a technocratic task, and certainly Treasury will issue regulations to flesh out this definition.

[142] *See* Kamin et al., *supra* note 141, at 11-12; *[Additional cite forthcoming -- to be published shortly, citation not yet permitted]*

[143] Minimum Essential Coverage; Shared Responsibility Payment for Individuals: Public Hearings, 79 Fed. Reg. 4302 (Jan. 27, 2014) (to be codified at 26 C.F.R. pt. 1).

through a detailed statutory and regulatory scheme, and the focus here is on one particular regulatory provision: a rule establishing tobacco-related "wellness program incentives."[144] The Affordable Care Act and prior legislation allows employer-provided health insurance plans to include monetary incentives for certain healthy behavior, such as regularly exercising or abstaining from tobacco use. For example, a health insurance plan might have a total annual cost of $6,000 per covered individual, of which $4,500 is paid by the employer, and $1,500 is paid for by the employee. Under the wellness program incentive rules, a plan could include a $500 discount off the employee portion if the employee joins a gym and regularly makes use of it, and an additional $1,000 discount for abstaining from smoking or seeking help to stop smoking. With these incentives in place, any regular gym-goers who are also non-smokers would end up paying $0 for the coverage, and while smokers who did not workout at a gym would pay the full $1,500.[145]

Section 5000A requires that individuals have health insurance, but provides an exemption such that the penalty is *not* imposed if a person did not have sufficient income to be able to afford the plan made available to the person through her employer.[146] (In 2019, the penalty amount will be $0, effectively repealing the individual mandate absent further action by Congress.[147]) Congress provided that a plan is unaffordable for purposes

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[144] Treas. Reg. § 1.5000A-3(e)(3)(ii)(F). I have not attempted to estimate whether the tobacco-cessation rule might trigger the $100 million threshold under Executive Order 12,866. If 150,000 people were subject to the penalty because of the rule, it would have resulted in approximately $100 million of penalty revenue for the government, although those revenues are transfers and so could potentially trigger centralized review as economically significant on that basis alone. *See supra* note 46 and accompanying text. It seems almost certain the entire set of proposed rules under 26 U.S.C. § 5000A would have done so—for example, another piece of the rule provided that a person is deemed to have coverage for the entire month for purposes of determining penalty liability if they have coverage for a single day during the month. Treas. Reg. § 1.5000A-2. If this rule affected penalty payments or insurance coverage decisions for just a fraction of the 28.5 million uninsured people, it would surely amount to over $100 million.

[145] *See, e.g.*, Treas. Reg. § 54.9802-1(f)(5)(ii) (describing, in examples 2 and 3, the operation of incentives for tobacco cessation programs as part of wellness programs as permitted under the Public Health Service Act as amended by the Affordable Care Act).

[146] 26 U.S.C. § 5000A(e)(1) ("Individuals who cannot afford coverage").

[147] The provision is not actually being excised from the tax code and the regulation will apparently remain on the books. *See supra* note 132.

of the individual mandate if the employee's required contribution is more than 8% of the employee's household income.[148] Congress defined household income, and delegated to Treasury the task of determining exactly how to calculate the required contribution.

The regulation is performing is classic gap-filling: although Congress did not expressly direct Treasury and the IRS to issue regulations to deal with this particular issue within Code section 5000A, it is unenforceable and impossible to administer consistently without fleshing out numerous details, including how to calculate the "required contribution" amount, including the question of how to account for incentives provided in wellness programs when calculating affordability.

The final regulation that Treasury produced provides that the 8% calculation will not count tobacco cessation benefits as actual costs to the employee.[149] That is, the employee cannot account for failure to qualify for the tobacco cessation benefit as part of the cost of the insurance. Thus, in calculating affordability, the example plan described above would automatically be treated as costing an individual employee $500 out of pocket (i.e., the $1,500 sticker price, minus the $1,000 tobacco wellness benefit, regardless of whether the employee qualifies for that benefit). However, the plan only truly costs $500 for employees who actually qualify for the smoking cessation benefit. As a result, an employee who had household income of $7,000 per month would not qualify for an affordability exemption because the deemed $500 employee contribution is 7.1% of household income. But if the employee were not eligible for the smoking cessation benefit (that is, the employee is a smoker and does not participate in an anti-smoking program), then the *actual* employee cost could be as much as $1,500 per month, which is 21.4% of household income. Nonetheless, even with $1,500 of out of pocket costs per month, the regulation provides that the employee would not qualify for exemption from the penalty because only the $500 part of the cost of the insurance (deemed the "unearned" benefit in the language of the regulation) counts for purposes of calculating the exemption.

The preamble to the final regulation as published (without centralized review) explains that the rationale for the ultimately adopted rule was connected to the ACA's healthcare goals: the rule is justified as "consistent

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[148] 26 U.S.C. § 5000A(c)(4)(B) (defining household income by reference to other provisions of the Tax Code).

[149] Treas. Reg. § 1.5000A-3(e)(3)(ii)(F); T.D. 9705 (Nov. 26, 2014).

with policies related to tobacco use reflected in the Affordable Care Act, such as allowing issuers to charge higher premiums based on tobacco use."[150] Treating all employees as qualifying for the smoking cessation program regardless of the reality extends the individual mandate penalty to a group of low-income people who would otherwise be exempt from it. In so doing, it *potentially* creates incentives for those low-income people to accept and pay for health insurance, and then further to participate in the smoking cessation program offered under their plan; otherwise, they will be subject to the penalty or take on health insurance that may be truly unaffordable. But on the other hand, it may result in the affected population paying the penalty, as the insurance (without the smoking cessation benefit) may cost more than the penalty, so they feel they have no choice. There was no public discussion of these alternative manifestations of the rule before it was finalized.

The smoking cessation rule invokes three distinct functions of the rule: how much revenue will be raised (public allocation), how strong the incentive affects will be for certain low-income people (private allocation), and which low-income people are or are not covered by the rule (distribution).

When this provision was proposed, it was not subjected to centralized review by OIRA, and Treasury did not undertake regulatory impact analysis, nor did it develop a statement of "need" for the proposed action, nor explore possible alternatives. But what if the rule had gone through centralized review as an economically significant rule? That possibility is considered further in Parts IV and V.

V. CONSIDERING CENTRALIZED REVIEW

Why is it that tax regulations are not subject to centralized review and cost-benefit analysis? The omission of tax policy from OMB review is surprising, because the tax system is an essential element of each of the two components of the federal bureaucracy that the OMB oversees: tax policy is an important tool for implementing regulatory policy, and raising revenue is central to the fiscal system. Although the fact of no centralized review has occasionally been acknowledged by scholars[151] and it has been

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[150] T.D. 9705 (Nov. 26, 2014).

[151] *E.g.*, Cass R. Sunstein, *Financial Regulation and Cost-Benefit Analysis*, 124 YALE L.J. F. 263, 268 n.25 (2015) ("There is a longstanding exemption, based on

questioned recently in the political sphere,[152] the normative foundation for this omission has not received close scrutiny.

This Part explores the potential advantages and disadvantages of imposing centralized review on tax regulations, by reference to forthcoming rules address the new pass-through deduction,[153] and recently finalized smoking cessation rule, each described below.[154]

A. Advantages, Disadvantages, and Challenges

1. Politicization vs. Political Accountability

The conventional explanation for why tax regulations are most often produced in a manner that is foreign to standard administrative procedures relates to politicization. This term invokes negative connotations that make it distinct from normative goal of political accountability, but as discussed below, politicization and political accountability are very much connected.

Politicization of tax administration has long been a concern, and various institutional arrangements and norms developed over the course of the twentieth century that were intended to keep politics out of tax administration. In the early decades of the income tax, the system was administered and taxes were collected by regional "Collectors of Internal Revenue," positions that were patronage appointments made by the President.[155] In the 1920s, congressional investigators asserted that tax administrators had too much autonomy and that the Bureau of Internal Revenue should de-politicize tax collection by "promulgat[ing] and publish[ing] the principles and practices to be followed in determining tax

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practice rather than the text of any relevant Executive Order, for rules from the Internal Revenue Service."); Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 FORDHAM L. REV. 961, 1016 n.320 ("The IRS does not typically engage in the cost-benefit analysis required of some other agencies under Executive Order 12,866, typically taking the position that the rulemaking is not a "significant regulatory action," meaning, among other things, that it will not have an annual economic effect of $100 million or more.").

[152] *See supra* Part III.A.

[153] *See infra* Part IV.B.

[154] *See infra* Part IV.C.

[155] *See* Thorndike, *supra* note 156, at 756.

liability."[156] But nonetheless, the patronage system persisted until the 1950s when series of corruption scandals among the Collectors resulted in purging of hundreds of government employees involved in tax collection.[157] After the scandal broke, organizational reforms limited Treasury's role in IRS affairs, creating a "generally independent structure."[158] At the same time, the congressional committee investigating the scandals determined that greater transparency in tax administration, and specifically greater reliance on onstensibly apolitical published guidance interpreting the tax laws, would be an important reform of tax administration.[159] This gave rise to the modern day system of tax regulations and a variety of regularly published guidance.[160]

Politicization of tax administration once again gained public attention when Richard Nixon's attempts to use the IRS for political ends was exposed during impeachment proceedings. Nixon sought to direct audits of his political enemies, and sought information from their tax returns.[161] As a direct result, in the Tax Reform Act of 1976 Congress imposed strict limits on the availability of tax returns and the disclosure of tax return information to prevent the White House from directing IRS activities for untoward purposes.[162]

The combination of investigations and institutional reforms in the 1920s and 1950s and significant privacy protections enacted in the 1970s

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[156] *See* Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 751 (2001) (citing S. REP. NO. 69-27, at 229 (1926)); George K. Yin, *James Couzens, Andrew Mellon, the "Greatest Tax Suit in the History of the World," and Creation of the Joint Committee on Taxation and Its Staff*, 66 TAX L. REV. 787, 842–48 (2013).

[157] *Id.* at 757–59.

[158] REPORT OF THE NATIONAL COMMISSION ON RESTRUCTURING THE INTERNAL REVENUE SERVICE, A VISION FOR A NEW IRS 12 (June 25, 1997) [hereinafter A VISION FOR A NEW IRS].

[159] Thorndike, *supra* note 156, at 759 (citing SUBCOMM. ON ADMINISTRATION OF THE INTERNAL REVENUE LAWS, 82ND CONG. REPORT OF INTERNAL REVENUE INVESTIGATION 30 (Subcomm. Print 1952)).

[160] *Id.*

[161] Joshua D. Blank, *In Defense of Individual Tax Privacy*, 61 EMORY L.J. 265, 279 (2011) (summarizing the Nixon administration's attempts to use the IRS and taxpayer information for political purposes); David J. Herzig, *Justice for All: Reimagining the Internal Revenue Service*, 33 Va. Tax Rev. 1, 25-26 (2013).

[162] *Id.* at 279–80; JOINT COMMITTEE ON TAXATION, CONFERENCE COMPARISON ON H.R. 10562—TAX REFORM ACT OF 1976, JCS-26-76, at 55–59 (Aug. 24.1976).

created an environment in which tax administration has—for the last four decades or so—been treated with particular sensitivity by Presidents and political appointees in the Executive Office of the President. In the late 1990s, Congress remained notably focused on ensuring that the IRS remained "insulated from political interference."[163]

Today, the structure of the tax policymaking apparatus and presidential appointment power for the key roles mixes the hallmarks of agency independence and presidential control. The Commissioner of the IRS is removable by the President at-will, as are IRS Chief Counsel and the Assistant Secretary of the Treasury for Tax Policy.[164] The Chief Counsel plays an important role within the IRS that includes overseeing litigation, providing legal advice and interpretations of tax law to the Commissioner, to IRS field staff, and to taxpayers, and drafting regulations and legislative proposals.[165] But as part of congressional attempts to separate administration from policymaking (and from politicization), the Chief Counsel generally reports to the Commissioner, but is directed by Congress to report exclusively to the General Counsel for the Department of Treasury on matters related to tax policy.[166] The Commissioner is removable by the President, and the Commissioner has statutory authority to recommend the removal of the Chief Counsel to the President.[167] In short, the lines of authority from the President are blurred. Treasury has attempted to "retain[] its rightful place as the developer of tax policy for the executive branch" while deliberately staying "removed from tax administration."[168]

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[163] A VISION FOR A NEW IRS, *supra* note 158, at 12. A report issued in the late 1990s by a congressionally appointed commission proposed various reforms to the IRS, including a five-year term for the IRS Commissioner. *See id.* Congress adopted this proposal, continuing the trend of insulating tax administration from the White House. 26 U.S.C. § 7803(a)(1).

[164] *Id.*; *see* Christopher M. Davis & Michael Green, Cong. RESEARCH SERV., RL30959, PRESIDENTIAL APPOINTEE POSITIONS REQUIRING SENATE CONFIRMATION AND COMMITTEES HANDLING NOMINATIONS 27 (2017).

[165] *See* INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL § 1.1.6.1 (2015).

[166] 26 U.S.C. § 7803(b)(3) (for tax litigation issues and "legal advice or interpretation of the tax law not relating solely to tax policy," the Chief Counsel reports to both the Commissioner and the General Counsel).

[167] 26 U.S.C. § 7803(a)(2).

[168] A VISION FOR A NEW IRS, *supra* note 158, at 12.

From the Nixon White House until 2016,[169] norms developed and remained intact across administrations and without regard to party that limit White House engagement with tax administration more broadly. For example, the National Economic Council, within the Executive Office of the President, often takes the lead in prompting and crafting regulatory initiatives that are top presidential priorities.[170] But the NEC has avoided engaging with tax regulations in this manner.[171] Instead, tax regulations are produced solely within the Department of Treasury (except in instances when tax regulations are jointly issued by Treasury and another agency or department). The IRS procedures for producing tax regulations specify that the drafting team at the IRS and Treasury should not disclose the draft rule or information about the proposed outside of the Treasury Department until it is published as a proposed rule for public comment.[172] The procedures provide an exception for "routine coordination necessary with other government agencies (e.g., Department of Labor and Pension Benefit Guaranty Corporation on pension regulations)," which suggests that the procedure allows for intra-government sharing only with jointly issued regulations.[173]

Towards the end of the Obama administration, OIRA staff expressed that sensitivity about politicizing tax administration extends to centralized review, with administrations not wanting to appear to be involved in regulatory tax policymaking.[174] And former Treasury and IRS officials have claimed that submitting tax regulations for OIRA review would inevitably politicize the rulemaking process in way that would be harmful for the substance of tax regulations, although the specific concern here

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[169] *See supra* notes 103-111 and accompanying text.

[170] Since the Clinton administration, the NEC has been charged with coordinating economic policy.

[171] This was relayed to this author orally by a former NEC official.

[172] *See* INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL § 32.1.1.5 (under the header "Confidentiality," generally disallowing dissemination of draft regulations outside of the Department of Treasury prior to publication in the Federal Register).

[173] *Id.*

[174] *See* GAO REPORT, *supra* note 6, at 26 (current OIRA staff expressed that abstaining from centralized review tax regulations was intended "to insulate the Executive Office of the President from the charge that it might use OMB's review of IRS [sic] for political purposes.").

with regard to tax regulations is not exactly clear.[175] In contrast, over the last 40 years, oversight of the other areas of the administrative state by political appointees in or near the White House has notably increased, and a move that has been justified normatively by scholars and policymakers.[176]

The optimistic justification for politicization is that having political personnel involved in policy decisions establishes political accountability. The basic claim to political accountability in the executive branch is that Presidential imprimatur creates a "link" between the electorate and the policy decisions that emerge from the executive branch.[177] Proponents of centralized review argue that it can strengthen this link by inserting OMB political personnel who are close to the White House—physically and also in terms of familiarity and commitment to the President's policy goals—into the regulation-drafting process.[178]

In addition to establishing processes to ensure that policies reflect the priorities of the elected president, political accountability in the regulatory process is fostered by transparency. Transparency includes making clear the tradeoffs inherent in policy decisions.[179] This is especially lacking currently in tax regulations: with no publicly available revenue estimates, it is most often totally unclear how a particular tax regulation will affect the fiscal position of the U.S. government.[180] For example, with the

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[175] Jeremiah Coder, *News Analysis: Why Treasury Tax Regulations Are Rarely 'Significant'*, TAX NOTES TODAY, Aug. 14, 2012 ("[O]ne 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.").

[176] *See, e.g.*, Jerry L. Mashaw et al., ADMINISTRATIVE LAW: THE AMERICAN PUBLIC LAW SYSTEM CASES AND MATERIALS 326–28 (7th ed. 2014) (providing a concise overview of the development of White House regulatory oversight from the Nixon administration through the Obama administration, with emphasis on establishing presidential control).

[177] Kagan, *supra* note 3, at 2331–332; Mark Seidenfeld, *The Role of Politics in a Deliberative Model of the Administrative State*, 81 GEO. WASH. L. REV. 1397, 1411-12 (2013).

[178] *E.g.* Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State,* 62 U. CHI. L. REV. 1, 3-4 (1995); Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1081 (1986).

[179] *See generally*, Mark Seidenfeld, *The Irrelevance of Politics for Arbitrary and Capricious Review*, 90 WASH. U. L. REV. 141, 149 (2012).

[180] *See infra* Part V.A.2.

forthcoming pass-through regulations, no discussion of the merits of a proposed rule could be complete without considering the public allocation function of the rule. It is critically important to consider the revenue implications of alternative versions of the regulation, and what varying amounts of revenue raised means for government spending or borrowing in the future. The need for a broad perspective on the implications of any given policy is a longstanding justification for centralized review.[181] It seems particularly important in the tax regulation context, especially as to the public allocation function.

Political accountability may be an antidote to a significant concern with tax regulations, one that cuts across the public allocation function, private allocation function, and distributional function: capture of the regulatory process. Agency "capture" describes the concern than an agency can be controlled or unduly influenced by the interests it is intended to regulate, at the expense of the public interest.[182] In the tax regulation context, capture can consiste of seeking to shape regulations to avoid increased tax liability or increased private costs. This could be accomplished by blocking a regulation that would increase tax liability, as discussed below, or by shaping a regulation to carve out an industry or set of taxpayers who would otherwise face increased tax liability. Whatever the particular manifestation, capture in the tax contexts looks very similar to capture in other contexts: well-organized interest groups can take advantage of superior information (for example, technical understanding of the subject matter that regulations are focused on) and procedural protections built into the regulatory process to shape outcomes, often at the expense of the diffuse and unorganized public.[183]

The extent to which the tax regulatory process is susceptible to capture is subject to debate. Because the tax system affects essentially every person and every industry in the country, Treasury and the IRS are not prone to the sort of single-industry-focused pressures that arise with more

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[181] Recommendation 88-9: Presidential Review of Agency Rulemaking, *in* ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, at 42 (1988) ("An effective mechanism is needed to coordinate agency decisions with the judgments of officials having a broader perspective, such as the President and Congress.").

[182] *See generally* Steven P. Croley, REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT 19-25 (2008); PREVENTING REGULATORY CAPTURE (Daniel Carpenter & David A. Moss, eds., 2013)

[183] *Accord* Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321, 1326 (2010).

narrowly focused regulators.[184] On the other hand, the participants in the notice and comment process for tax regulations are highly skewed towards organized interests, with very few public interest participants.[185] And tax regulation writing is largely a "closed process" with little transparency (even when Treasury uses notice and comment), which makes it highly susceptible to capture which may not be outwardly apparent.[186] The potential for capture may skew tax regulation to favor taxpayers with greater resources, affecting the distributional function, and in so doing may affect both the public and private allocative functions of particular regulations.

Political accountability is not just a sword that can combat malignant influences in the regulatory process. Rather, the prospect of political accountability may actually keep Presidents (and their closest political appointees) *away from* the tax policymaking process. From this view, perhaps tax regulations have not been subject to centralized review is simply because presidential administrations prefer to stay separated from the unpopular work of raising revenue. Centralized review is credited with facilitating presidential "ownership" of regulatory policy and marking resultant policy with presidential approval. But when policies are unpopular, as is the case with at least some tax regulations that raise revenue, presidents do not want this sort of ownership and appearance of approval. A similar theory has been offered for why presidents have not imposed centralized review of financial regulations.[187] Recent

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[184] *Cf.* Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L. J. 1165, 1178 (1993) (describing tax committees in Congress having "numerous and diverse constituencies" as compared to the "fewer and more homogeneous pressures" of more specialized committees).

[185] Wallace, *supra* note 19.

[186] Zelinsky, *supra* note 184, at 1173 ("relatively closed processes, less visible to some groups or to the general public than to other groups, are more easily captured by the interests that can readily monitor those processes and therefore intelligently punish and reward such processes' decisionmakers.").

[187] Sunstein, *supra* note 151, at 269–70 (Considering presidential oversight in financial regulations, many of which are promulgated by independent agencies and thus are exempt from OIRA oversight: "some Presidents might be cautious about subjecting financial regulation to the OIRA process, because that step would force the Executive Office of the President, and the President personally, to "own" the decisions of financial regulators. If, for example, the SEC were subject to the OIRA process, the President would be blamed for its decisions, which might be an unwelcome

administrations have rarely used presidential directives and public actions to proactively support revenue-raising regulations in any manner, let alone through centralized review.[188] Presidential avoidance of tax administration is poignantly illustrated by the fact that President Kennedy was the last and only President ever to visit the IRS in person.[189]

Are tax regulations in the tax administration domain, whereby we should be concerned about politicization for the reasons that have arisen repeatedly over the past century? Or are tax regulations firmly policymaking that really *should* be politicized so as to make the President accountable for policy decisions? The pass-through rules show that tax regulations can be both. Consider a regulation defining "reputation or skill" (and therefore determining which services businesses qualify for the pass-through deduction) creates huge opportunities for political favoritism not grounded in any defensible policy rationale. Perhaps reality television stars should be exempt—i.e., should qualify for the deduction—because the genre has friends in high places? But on the other hand, it does not offend any of the politicization concerns if reality television stars (and every other potentially reputation-based service) lobby the White House in addition to Treasury and IRS officials. And perhaps it is better for the White House to make the final decision and to be known to be the decision maker. Transparency in this context virtues which could prevent capture and special rules, or could at least allow voters to account for capture. The earnings stripping regulation exhibits the absurdity of trying to

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complication. It might be better, from the standpoint of the President himself, to be able to maintain a degree of distance from financial regulators' decisions. Such distance could serve as a kind of 'enabling constraint' in which the President's authority is, in an important respect, increased if and because the decisions of financial regulators cannot be directly attributed to him. Of course, there is a countervailing point, which is that without the OIRA process or some surrogate for it, the President cannot control such decisions, even if he believes them to be misdirected or wrong.").

[188] *See* Daniel J. Hemel, *The President's Power to Tax*, 102 CORNELL L. REV. 633 (2017). The Obama-era earnings stripping regulation is the single significant counter-example. *See supra* Part III.B. Even the Clinton administration, reputed for liberal use of presidential memorandum directing agencies to take particular actions, *see* Kagan, *supra* note 3, made no such tax-related directives. *See* THE AMERICAN PRESIDENCY PROJECT, PAPERS OF BILL CLINTON, http://goo.gl/7k9u23 (last visited Feb. 23, 2018);

[189] President Kennedy visited the IRS in April of 1961 at the invitation of IRS Commissioner Mortimer Caplin. Colby Itkowitz, *This 100-year-old Public Servant Is from a Time When Americans Still Believed in Government*, WASH. POST, July 8, 2016.

depoliticize inherently political tax policy: centralized review conducted for that regulation was hindered because the administration obfuscated the purposes, shrouding private allocation, public allocation and distributional goals in technical tax policy implementing sort of language. In short, the line drawing between services seems inherently political and appropriate for political accountable decision makers.

2. *Quantitative Analysis*

This Section considers how qualitative and quantitative analysis that is or could be part of the centralized review process might work as applied to tax regulations. As a part of the fiscal policy apparatus, tax rules are monitored and shaped primarily through the federal budget. OIRA's annual report on the costs and benefits of federal regulations has, in recent years, included a very brief statement distinguishing that certain regulations are analyzed by budget impact rather than costs and benefits: "Budgetary transfer rules are rules that primarily cause income transfers usually from taxpayers to program beneficiaries. Agencies typically do not estimate possible resulting distortionary effects on the economy."[190]

Thus, analysis of transfers—tax or otherwise—is generally relegated to budget tables. The budget is a measure of the government's "fiscal position," employed in the legislative process as a tool for making "tradeoffs between different uses of resources."[191] But the practice of analyzing tax policy strictly through budgetary tools belies ambiguity

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[190] OIRA DRAFT 2016 REPORT 6 n.15, https://obamawhitehouse.archives.gov/sites/default/files/omb/%20assets/legislative_reports/draft_2016_cost_benefit_report_12_14_2016_2.pdf. And later: "for budgetary transfer rules, benefits and costs are generally not estimated because agencies typically estimate budgetary impacts instead." *Id.* at 63 n.134. This language echoes similar language in reports from previous years. *See* OIRA REPORTS TO CONGRESS, https://obamawhitehouse.archives.gov/omb/inforeg_regpol_reports_congress/ (last visited Feb. 23, 2018).

[191] David Kamin, *Risky Returns: Accounting for Risk in the Federal Budget*, 88 IND. L.J. 723, 727 (2013). The many rules and practices related to enacting taxing and spending policies within budget constraints, as well as measuring budget effects of legislation, all contribute to the basic purpose of reflecting the government's fiscal position and requiring tradeoffs between on-budget expenditures. In arguing that the federal budget should *not* account for certain risks that have no fiscal effect, Kamin comments, "policymaking should, to the extent possible, take into account the full costs and benefits of policies; that is how resource allocation should be done. . . . However, budgeting is a different exercise than cost-benefit analysis." *Id.* at 728.

about whether tax policy is distinct from other types of regulatory policy. Dan Shaviro illustrated this point: "one might think of minimum wage laws either as workplace regulation, involving the organization of a mandatory cartel among low-wage workers, or as equivalent to an off-budget tax on the employers of such workers accompanied by an off-budget transfer to those same workers."[192] Of course, a minimum wage could also be accomplished by way of an *on*-budget tax on employers and transfer back to workers, managed by the government and reflected in in the federal budget. Shaviro concludes that the "rationale for distinguishing between the fiscal system and everything else the government does is simply ease of measurement."[193]

Therein lies an enormous challenge for centralized review of tax regulations, and for analysis of tax policy more generally: revenue estimates are challenging enough to produce, but nonetheless provide incomplete information about the effects of tax policy. While the budget analysis facilitates some tradeoffs in policymaking—the public allocation element, *i.e.*, what level of resources are available for public spending—it does not attempt to manage or to engage directly with the "social costs" of such tradeoffs, nor with the benefits of policy alternatives.[194] This means that analyzing tax policy strictly through budget effects leaves out important considerations in tax policymaking—private allocation effects and distribution.[195] Although distributional analysis sometimes

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[192] Shaviro, *supra* note 128, at 190.

[193] *Id.* David Bradford and Shaviro illustrated this point most absurdly, imagining the possibility of replacing all weapons procurement spending carried out by the Department of Defense with a tax credit for weapons production, offered to the same manufacturers for the same amounts as would have been paid directly. *Id.* (citing David Bradford, *Reforming Budgetary Language*, *in* FISCAL FINANCE AND PUBLIC POLICY IN THE NEW CENTURY 93–116 (Sijbren Cnossen & Hans-Werner Sinn eds., 2003)).

[194] Kamin, *supra* note 191, at 737 (arguing that the federal budget should not be used for such purposes).

[195] This critique may also apply to spending, but congressional appropriations are enacted annually and generally subject to significant scrutiny. This does raise an oddity in tax policymaking that has been recognized only partially in the literature: tax expenditures are widely viewed as not receiving sufficient oversight, but nonetheless when tax expenditures are shaped by Treasury through regulations, these regulations are not subject to centralized review or cost-benefit analysis. Scholars have widely criticized the distinction between fiscal functions and other functions as too blurred to justify treating tax policy differently than other types of policy, focusing

accompanies revenue estimates, this analysis is generally limited. And none of these tools are regularly applied to the tax regulatory process and made available for public consumption during that process.

Centralized review often includes cost-benefit analysis, which has the potential to illuminate a diversity of trade-offs across the varied functions of tax regulations. Further, proponents and critics of centralized review have explored the possibility of integrating distributional analysis into that review. This section considers each—cost-benefit analysis and distributional analysis—in turn, as applied to tax regulations.

a. Cost-Benefit Analysis

For economically significant regulations, OIRA instructs that the drafting agency must evaluate the costs and benefits of the proposal and the leading alternative approaches, and thus the agency must determine which options should be treated as the top alternatives. This analysis is very much focused on the effects of various alternative rules on private behavior, *i.e.*, the private allocation function. If this approach were applied to consider alternatives with regard to how to treat smoking cessation programs, the possibilities might have included: (1) the rule as proposed, counting such programs as "earned" while counting other wellness incentives as unearned; (2) counting other wellness incentives as earned but counting smoking cessation programs as "unearned"; (3) counting all wellness incentives as earned; (4) counting all wellness incentives as unearned; (5) establishing some process to allow calculations to reflect the wellness incentives that a taxpayer actually qualified for, thus actually establishing whether a taxpayer's costs exceed the congressionally-mandated affordability threshold; or (6) Treasury could have considered whether there was some alternative regulatory or non-regulatory approach to further the goal of discouraging tobacco use, as encouraged by OIRA guidance—for example, could some other anti-tobacco intervention be packaged with the communications related to compliance with the individual mandate?[196]

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on the legislative process for so-called tax expenditures. *See, e.g.*, Edward D. Kleinbard, *The Congress Within the Congress: How Tax Expenditures Distort our Budget and Our Political Processes*, 36 OHIO N.U. L. REV. 1 (2010).

[196] *See supra* notes 58–60 (OIRA suggests considering different forms of communication, different default rules, and various other outside-the-box alternatives to the proposed regulation). Given the broader health care policy context, Treasury

To carry out cost-benefit analysis of the proposal and alternatives, Treasury would first identify a baseline against which to measure costs and benefits. One approach—although there are alternatives—would be to assume a world in which there was cost-free perfect measurement of each employee's actual cost of healthcare coverage. Then alternative proposals could be compared based on (1) how closely they could be expected to replicate perfect measurement; and (2) administrative and compliance costs.

Next, Treasury would outline the anticipated costs and benefits of each alternative. These might include: compliance costs for taxpayers and their employers calculating whether coverage is affordable; enforcement and error costs for the IRS confirming whether taxpayer's have accurately determined that they are exempt from the individual mandate penalty; changes in behavior including whether deeming coverage affordable changes healthcare plan consumption, uptake of smoking cessation programs resulting from including or not including the benefit in the affordability calculation, and whether and how the smoking cessation programs affect smoking behavior. Additional consideration might be given to collection of the individual mandate penalty.[197]

With potential costs and benefits identified, Treasury would attempt to quantify and then monetize each consequence of each alternative regulation. This would require Treasury to determine the number of taxpayers whose behavior would potentially be affected by the regulation. This would not include taxpayers for whom health care coverage was expected to easily fall below the 8% affordability threshold whether or not wellness incentives are included (presumably higher income taxpayers), nor taxpayers whose coverage would not be affordable regardless of whether marginal incentives were included (presumably more low-income taxpayers or taxpayers with especially high employer healthcare costs). From the remaining universe of potentially affected taxpayers, Treasury would then estimate the number who might have a wellness incentive and/or smoking cessation incentive available, and then the number who

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might have ruled out option (2) as running counter to Congress's desired policy to discourage smoking (by, instead, undermining the incentive effect of smoking cessation programs. Similarly, option (3) would seem to undermine the congressional goal of affordability by making plans appear to be less expensive than they actually are for many employees. That would have left the regulation as adopted, along with alternatives (4), (5) and (6).

[197] *See infra* Part IV.C.

were actually smokers. This would provide an idea of the universes of taxpayers who: (a) could be affected in any way by how wellness program incentives are included in the affordability calculation; and (b) might have a smoking cessation benefit available, but might not actually receive available smoking cessation incentives, and thus would be affected by a rule that treated the benefit as earned.

The analysis would then turn to quantifying the behavioral effects of the alternative rules—would one rule actually encourage greater participation in smoking cessation programs, and what would be the anticipated effects of such participation? What would be the compliance costs of alternative rules, and how would compliance costs affect behavior? What alternative anti-smoking intervention might Treasury carry out in connection with administering the individual mandate, and would that be more effective (in terms of costs and/or behavior)? Policymakers have devoted significant attention to quantifying behavioral responses and tradeoffs applicable in other areas of regulatory policy.[198] But this quantification is lacking with tax policy: tax scholars and economists working on optimal income taxation are grappling with these issues,[199] and the behavioral tradeoffs in response to tax remain subject to significant academic debates.[200]

Tax rules present particularly vexing analytical challenges for economists.[201] Raising revenue generally distorts behavior in undesired ways, and greater taxation generally results in exponentially greater

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[198] *See id.* (suggesting that existing "revealed-preference studies" are a useful source of information for quantifying the tradeoffs involved in regulatory alternatives).

[199] *See* JOEL SLEMROD & CHRISTIAN GILLITZER, TAX SYSTEMS 182–83 (2014) (summarizing the empirical challenges involved in measuring behavioral effects of different tax instruments and evaluating behavioral responses along multiple margins, *e.g.*, work/leisure, avoidance, evasion, career choice, and so on); Alex Raskolnikov, *Accepting the Limits of Tax Law and Economics*, 98 CORNELL L. REV. 523, 583 (2013) (summarizing some recent progress in empirical work on behavioral responses to taxation, and emphasizing the need for more of this research).

[200] SLEMROD & GILLITZER, *supra* note 199, at 79.

[201] Raskolnikov, *supra* note199, at 533–34 (detailing the particular challenges that tax law raises for economic analysis, describing "immense complexity, uncertainty, and value dependence" in theoretical tax models, and emphasizing, under the header "Why What's Good for Environmental Law Isn't Good for Tax," the challenge of inherent inefficiency in (most) taxation, and the further complication of responses including substitution, evasion, and avoidance).

distortionary costs causing changes in behavior that "move the market away from competitive equilibrium, thereby reducing social efficiency."[202] For the individual income tax, the basic distortion is of the work-leisure tradeoff (or the consumption-leisure tradeoff): an income tax will reduce work effort, because additional work will yield less dollars for consumption.[203] There are alternative possibilities for how this distortion manifests: the substitution effect entails workers facing an income tax opting for less work and more leisure, while the income effect anticipates that less money for consumption will cause workers to opt for more work and less leisure. This work/leisure tradeoff encompasses a wide range of potential behaviors in the real world: it might distort "intensity of work, quantity of income-tax-deductible consumption (e.g., charitable giving), career choice, form and timing of compensation, tax avoidance, and tax evasion."[204] The relevant point of analysis for modeling behavioral responses is the taxpayers' marginal tax rates, which vary widely.[205] Among individuals, marginal rates vary based on family status, location (e.g., state and local income tax), type of income, and so on. For the corporate income tax, the basic distortions are of returns to labor (*i.e.*, employee compensation), capital (*i.e.*, investor returns), or in prices.[206] Among business entities, marginal rates vary across lines of business, types of business investments, and location of investments, among other factors.[207]

Problematically, none of these responses are well understood in the real world.[208] Prior work on designing tax instruments has required making significant assumptions as to these key questions of behavioral responses.[209] To take one example, scholars continue to rely on a study from 1985 that found between $0.17 and $0.56 of deadweight loss for each

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[202] JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 589 (4th ed. 2013).

[203] *Id.* at 623–31.

[204] SLEMROD & GILLITZER, *supra* note 199, at 182.

[205] *See id.* And, actually, the best, although even more challenging, data point is probably each individual's *perceived* marginal tax rate.

[206] GRUBER, *supra* note 202, at 715–16.

[207] SLEMROD & GILLITZER, *supra* note 199, at 182.

[208] *See* Raskolnikov, *supra* note 199.

[209] *See, e.g.*, Lily L. Batchelder et al., *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 27 n.16 (2006) (arguing that tax incentives should be designed assuming "underlying price elasticities and behavior do not vary systematically across the income distribution" in the absence of evidence to the contrary).

marginal dollar of revenue raised.[210] The study concluded that "a public project must produce marginal benefits of more than $1.17 per dollar of cost if it is to be welfare improving."[211] But this is an enormous range, and the study relied on significant assumptions that ought to be tested before moving to the real world. This is just one example, but it is a key piece of information for tax policy analysis—the uncertainty and lack of data would impair effective cost-benefit analysis.

Thus, the size and even the direction of some tax-induced distortions remains unclear, and even if empirical work provides greater insights on taxpayer elasticities the analysis remains complex and dynamic.[212] Policymakers have developed various methods for addressing some of these issues for purposes of revenue estimates.[213] But revenue estimate models are far less complex than models that attempt to integrate efficiency costs: revenue estimates involve determining the extent to which taxpayers will engage in the taxed behavior; whether those who are not taxed are able to do so through illegal evasion or legal avoidance does not matter to revenue estimators, nor does the cost of evasion or avoidance activities. But to estimate the social costs more broadly for purposes of cost-benefit analysis, and to model behavioral responses accurately, much more information is necessary about the types of responses and costs of responses.

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[210] Charles L. Ballard et al., *General Equilibrium Computations of the Marginal Welfare Costs of Taxes in the United States*, 75 AM. ECON. REV. 128, 128 (1985). *See* Zachary Liscow, Note, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478, 2482 (2014) (describing the Ballard et al. study as "[t]he most cited economics article estimating the efficiency costs of taxation . . . ."); Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905, 1925 n.85 (1987); Brian Galle, *Carrots, Sticks, and Salience*, 67 TAX L. REV. 53, 72 n.102 (2013); Gary S. Becker & Casey B. Mulligan, *Deadweight Costs and the Size of Government*, 46 J.L. & ECON. 293, 317-18, 329 n.86 (2003).

[211] Ballard et al., *supra* note 210.

[212] SLEMROD & GILLITZER, *supra* note 199, at 88–91.

[213] The Department of Treasury, the Joint Committee on Taxation, and various think tanks have developed microsimulation models based on actual tax returns that capture behavioral responses at least as to tax return positions. *See, e.g.*, The Tax Policy Center Microsimulation Model, https://www.urban.org/research/data-methods/data-analysis/quantitative-data-analysis/microsimulation/tax-policy-center-microsimulation-model.

Cost-benefit analysis thus offers alluring possibilities for analyzing the private allocative function of tax regulations: a set of proven (in some contexts) analytical methods could provide quantified and qualitative insights on private allocative effects of tax regulations. But cost-benefit analysis is not plug-and-play, so realizing benefits from cost-benefit analysis will in many instances further empirical research to quantify and monetize how tax policies affects behavior. This research may have been started in other contexts, and can build on the tools used for revenue estimates, but this leaves significant work to be done before cost-benefit analysis can play a reliable role in developing tax regulations.

b. Introducing Distributional Analysis?

Because distributional effects are so central to tax policy, it makes sense to consider those effects in regulatory tax policy. In other policymaking and scholarly contexts aside from tax, disregarding distribution is justified the belief that it is appropriate to rely exclusively on the tax system to deal with redistribution—most notably, Louis Kaplow and Steven Shavell advocate that policymakers could avoid dealing with the distributive effects of non-tax policies *because* any such effects should be corrected through the income tax.[214] But that justification does not hold true for tax policy analysis and the distributional function of tax regulations.

Treasury's Office of Tax Analysis regularly provides distributional analysis of existing law and of legislative proposals.[215] And distributional analysis of proposed tax laws is generally carried out by economists and attorneys staffed by the Joint Committee on Taxation as a regular feature of the tax legislative process.[216] The baseline used for analysis of

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[214] Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994); Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 993 n.64 (2001) ("[T]here may be no need separately to identify the redistributive effects of legal rules, especially of particular rules, because general data on the distribution of income and measures of the standard of living will tend to capture the aggregate of distributive effects from all sources.").

[215] U.S. DEP'T OF TREASURY, OFFICE OF TAX ANALYSIS, TREASURY'S DISTRIBUTION METHODOLOGY AND RESULTS (Nov. 12, 2015).

[216] JOINT COMM. ON TAXATION, METHODOLOGY AND ISSUES IN MEASURING CHANGES IN THE DISTRIBUTION OF TAX BURDENS (June 14, 1993). The same microsimulation models that are used—in government and by think tanks—for

legislative proposals, like the baseline for revenue estimates used in the legislative process, is existing law. Distributional effects are then predicted in income bands, perhaps by decile or perhaps using nominal ranges (*e.g.*, less than $10,000, $10,000-$20,000 and so on).[217] While existing methods of distributional analysis should continue to be refined, these methods nonetheless have much to offer to regulatory tax policy and to regulatory policy analysis more broadly.

Nonetheless, the distributional function is challenging to analyze—for tax regulations and otherwise. The standard analytical framework established by OIRA and applied to non-tax regulations expressly sets aside distributional effects of regulatory action to be described independently of cost-benefit analysis, which has led agencies to ignore distributional effects.[218] Scholars have been skeptical of this blind spot in regulatory analysis. OIRA is seen as "disclaim[ing] any responsibility for developing protocols that agencies could use to determine the distributional impacts of a particular regulation," which "sends a clear message that consideration of distributional consequences is a peripheral concern at best. Regulatory agencies have gotten that message and, in general, pay little attention to distribution."[219] Further, OIRA directs agencies to disregard transfer payments in analysis of the effects of regulations—distributional and otherwise.[220] For example, OIRA's guidance to agencies includes a stylized example of a Pigouvian tax, specifying that "taxes paid [to the government, by a firm] are a transfer and have no effect on the net benefits of the regulation."[221]

Still, some scholars have argued that distributional analysis has an important role to play in the regulatory process outside of tax.[222] Steve Croley's volume defending the administrative state and regulatory processes as generally up to the task of producing "socially beneficial regulation" is instructive on the challenges involved in confronting

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revenue estimates can produce distributional estimates, setting aside social costs. *See supra* note 213.

[217] *Id.* at 17.

[218] *See supra* notes 67-70 and accompanying text.

[219] Bagley & Revesz, *supra* note 3, at 1326–27.

[220] OIRA PRIMER, *supra* note 24, at 8.

[221] *Id.*

[222] Bagley & Revesz, *supra* note 3, at 1324–29.

distributional issues.[223] He notes that from a "purely distributive point of view, reallocation of social resources may be desirable even if a regulatory initiative's benefits are outweighed by its costs."[224] The desirability of alternative distributional outcomes, he argues, hinges on establishing a desired distribution against which the expected distributional outcomes of competing policy alternatives can be measured.[225] Even if policymakers could agree on the baseline, the argument goes, there are measurement problems: how can you determine what distribution is desirable and whether it has been achieved?[226] Other scholars argue that distributional analysis is unfeasible.[227] But simplified analysis—using existing law as a baseline for example—could be useful in regulatory tax policy even if it is not a panacea. Further, if we were to treat the tax system as *the* tool for redistribution, it is all the more important that analysis of tax regulations include consideration of distributional effects.

How might distributional analysis of the pass-through regulation and the smoking cessation rule be carried out? Using existing tools—the standard microsimulation models used to analyze tax legislation—policymakers can get some sense of the relative effects on income based solely on different tax rates. But there are significant limitations: although the IRS collects data on industries from corporate taxpayers and partnership filers, it has not used previously this data for cross-sector distributional comparisons of individual taxpayers.[228] Nonetheless, the existing models could be useful for the smoking cessation rule, in conjunction with other data that revealed income characteristics of the

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[223] STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT 253 (2008).

[224] *Id.*

[225] *Id.* (describing the need for a "normative distributive baseline").

[226] *See* Cass R. Sunstein, *The Limits of Quantification*, 102 CALIF. L. REV. 1369 (2014). Executive Order 13,563 recognizes that some benefits and burdens are "difficult or impossible to quantify, including equity, human dignity, fairness and distributive impacts."

[227] *See id.* at 1325 n.391, 1326-27; David A. Weisbach, *Distributionally-Weighted Cost Benefit Analysis: Welfare Economics Meets Organizational Design*, 7 J. LEGAL ANALYSIS 151 (2015).

[228] *See* Internal Revenue Service, Statistics of Income: Corporation Data by Sector, https://www.irs.gov/statistics/soi-tax-stats-corporation-data-by-sector-or-industry; Internal Revenue Service, Partnership Statistics by Sector or Industry, https://www.irs.gov/statistics/soi-tax-stats-partnership-statistics-by-sector-or-industry.

affected population, thus illuminating the effects of alternative versions of regulations carrying out the pass-through rules.

Tax regulatory policy often demands some form of distributional analysis. That raises a variety of thorny issues that have been recognized in other areas of regulatory policy in the past, there are some analytical tools available—based on revenue estimate models—that could be helpful to inform the tax regulatory process.

3. Ossification vs. Interagency Deliberation

A common concern regarding centralized review in general and centralized review of tax regulations specifically is ossification.[229] There are several manifestations of ossification: when each proposed rule requires more time and energy, it leads to delays in commencing regulatory projects, delays in completing projects, failure to take up projects, failure to review and amend existing regulations, and, in attempts to make up for these delays and failures, redirecting agency resources to regulation-writing instead of other priorities.[230] This concern is pointed the tax context, where there is a longstanding backlog of regulations to-be-proposed, and where there is wide recognition of the need for more guidance and faster in order to facilitate tax compliance.[231]

The regulatory impact analysis prepared by the drafting agency is provided to OIRA and fed into an interagency review process.[232] Cass Sunstein, the recent former head of OIRA, portrayed OIRA as a "conveyer and a convener," acting as the central hub in the interagency review process as its primary and most important function.[233] Scholars have commended interagency review as a means of applying appropriate expertise to policy challenges, eliciting useful information from within the

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[229] Richard J. Pierce, Jr., *Which Institution Should Determine Whether an Agency's Explanation of a Tax Decision is Adequate?: A Response to Steve Johnson*, 64 DUKE L.J. ONLINE 1, 3–5 (2014). Following the enactment of the Tax Cuts and Jobs Act, several news organizations reported on a developing "turf war" between Treasury and OMB as to the extent to which OMB review is appropriate. A common reaction from tax practitioners and policy analysts has been concern about delays (ossification). *See, e.g.*, Jagoda, *supra* note 8 (quoting on tax practitioner asking, "Why would you slow the process down?").

[230] *Id.*

[231] Coder, *supra* note 175.

[232] *See supra* notes 74-80 (describing the interagency review process).

[233] Sunstein, *supra* note 29, at 1848.

government, and coordinating agency functions that might otherwise coincide or conflict.[234] Additionally, the interagency process allows an administration to coordinate policies across departments and agencies.[235]

The interagency process—if properly staffed—could have been enormously valuable for the smoking cessation regulation. OIRA would have circulated the proposed regulation and accompanying analysis to other relevant agencies, including perhaps the Department of Health and Human Services, the Department of Labor, and the Food and Drug Administration. Each might weigh in with suggestions on the rule or refinements on the analysis. Most obviously, experts in these other agencies have greater experience and familiarity than Treasury with empirical studies on anti-smoking interventions. Invoking empirical work could have informed qualitative or quantitative cost-benefit analysis of the proposed rule, allowing Treasury to use its own expertise in estimating costs of compliance with the anticipated benefits of the rule (if any), including the potentiality that the rule would have unexpected affects such as reducing access to healthcare. In an ideal version of interagency review, the shared information might inform an alternative plan to realize some further benefits in smoking cessation programs with lower costs.

Would centralized review on its own nonetheless cause unacceptable ossification, particularly if quantified cost-benefit analysis of tax regulations is challenging? This is not simply a question of slow verses fast—there are potential benefits flowing from the slower process. Ryan Bubb has credited the "creative tension" between that staff and OIRA for producing "more and better information and analysis for regulatory decisionmaking.[236] Would a similar dynamic emerge in tax policymaking? What to do in the short- to medium-term when we expect that data will continue to be lacking?

One challenge is that OIRA does not have any tax expertise, and overseeing tax regulations would require hiring new staff or redirecting

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[234] Jody Freeman & Jim Rossi, *Agency Coordination in Shared Regulatory Space*, 125 HARV. L. REV. 1131,1184 (2012). Freeman and Rossi's assessment is that the President (and by extension OIRA) is "uniquely positioned and motivated to manage the problems of shared regulatory space and that coordination tools afford him the chance to put his stamp on policy." *Id.* at 1209.

[235] *See, e.g.*, Rachel E. Barkow, *Insulating Agencies: Avoiding Capture through Institutional Design*, 89 TEX. L. REV. 15, 31 (2010).

[236] Bubb, *supra* note 31, at 51 (citing Ryan Bubb & Patrick Warren, *Optimal Agency Bias and Regulatory Review*, 43 J. LEGAL STUD. 95, 128 (2014)).

existing staff to take responsibility for tax.[237] This concern has historic valence as well—the 1983 memorandum was motivated in part by a desire on the part of OIRA personnel to avoid being overwhelmed by tax regulations, which no one was particularly interested in dealing with.[238] In such a small office (OIRA has just 50 full-time staff[239]), the sheer volume of tax regulations presents a significant burden that would detract from oversight of regulations in other important policy areas. In contrast, the IRS Chief Counsel's office has some 600 attorneys.

Absent OIRA review, tax administration has generally been shielded from one of the primary culprits of ossification that arises in other contexts. Pre-enforcement judicial review of proposed rules can make the regulatory process move very slowly. But, in accordance with the Tax Anti-Injunction Act[240] and the Declaratory Judgment Act[241] pre-enforcement review of tax regulations is off limits.[242] Some scholars have pressed the argument that courts should accept that pre-enforcement

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[237] *See* GAO REPORT, *supra* note 6, at 26 ("[Current OIRA staff] said that historically OMB had lacked staff expertise in tax policy."). Recent news reports have indicated that, following the enactment of the Tax Cuts and Jobs Act, OIRA has sought to hire tax experts. Cheryl Bolen & Allyson Versprille, *OMB Hires Tax Experts as It Negotiates Rules Review With Treasury*, BLOOMBERG DAILY TAX REPORT (Mar. 30, 2018), https://www.bna.com/omb-hires-tax-n57982090700/.

[238] This was relayed to this author orally by a former OIRA official, and echoes the concerns of current staff as reported to the GAO, *id.*, and as relayed to this author in informal conversations. *See also*, Coder, *supra* note 175 ("historically OMB had lacked staff expertise on tax policy").

[239] *Frequently Asked Questions*, OFFICE OF MGMT. & BUDGET, OFFICE OF INFO. & REGULATORY AFFAIRS, https://www.reginfo.gov/public/jsp/Utilities/faq.jsp (last visited Mar. 3, 2017).

[240] 26 U.S.C. § 7421(a) ("no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.")

[241] 28 U.S.C. § 2201(a) (providing declaratory relief except expressly disallowing such relief "with respect to federal taxes").

[242] *See* Kristin E. Hickman, *A Problem of Remedy: Responding to Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 76 GEO. WASH. L. REV. 1153 (2008) (questioning limitations on pre-enforcement judicial review of tax regulations). A few recent cases have suggested that this protection may be weakening. Direct Mktg. Association v. Brohl, 135 S. Ct. 1124 (2015) (addressing the Tax Injunction Act, 28 U.S.C. § 1341, which applies to state tax provisions, and interpreting the provision more narrowly than courts have interpreted the Tax Anti-Injunction Act).

review of tax regulations should be permitted under the Tax Anti-Injunction Act.[243] Others have suggested that judicial review and centralized review should be complementary.[244] Under that analysis, increased OIRA review is justified in part *because* parties have less access to judicial review. Conveniently, this either/or approach would obviate some of the concerns regarding ossification: while tax rulemaking may be slowed down marginally by centralized review, it remains (for now) insulated from expansive pre-enforcement judicial review.

B. Assessing the Competing Considerations

This section evaluates the competing considerations regarding imposing centralized review implicated by the four different functions of tax regulations.

First, I conclude that centralized review is appropriate and would often be beneficial in the development of tax regulations that have a private allocation function. Private allocation is the core purpose of the smoking cessation regulation, and a likely side effect of the pass-through deduction regulation. The trade-offs involved in centralized review of these and other tax regulations are familiar outside of the tax context: the potential benefits of political accountability, interagency review, and analytical rigor must be balanced against the cost of a more plodding rulemaking process and the potential for counterproductive politicization.

OIRA's current standard of making "economically significant" regulations subject to the most intensive centralized review makes as much sense with the private allocation function of tax regulations as for non-tax regulations.[245] Applying the economically significant trigger to tax

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[243] Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 VA. L. REV. 1683 (2017).

[244] Catherine M. Sharkey, *State Farm "With Teeth": Heightened Judicial Review in the Absence of Executive Oversight*, 89 N.Y.U. L. Rev. 1589 (2014) (proposing more lenient judicial review for rules that have been subjected to greater executive oversight, including through OIRA review and cost-benefit analysis, and less deference for rules that are not).

[245] This is not to endorse or disclaim the "economically significant" standard. Exec. Order No. 12,866, § 3(f), 3 C.F.R. at 641. There is an ongoing debate about the wisdom of that standard, and I see no reason to exclude tax regulations with a private allocation function from that broader discussion. *See, e.g.*, Nina A. Mendelson & Jonathan B. Wiener, *Responding to Agency Avoidance of OIRA*, 37 HARV. J.L. & PUB. POL'Y 447 (2014).

regulations means that the process will only come to bear on a portion of proposed regulations. For these regulations, adding interagency review to the process for developing tax regulations offers significant promise as tax regulations often touch on areas outside of Treasury's and the IRS's expertise. Further, requiring Treasury to conduct cost-benefit analysis, and allowing that analysis to be subject to public scrutiny will illuminate a currently shrouded process. The result could be a more responsive rulemaking apparatus, a better-informed public (and thus less opportunity for capture behind closed doors), or simply transparency and clarity that the President is ultimately responsible for tax rules.[246]

Interagency review and cost-benefit analysis are each particularly well suited to benefit and inform tax regulations that have a private allocation function. Subjecting the pass-through rules to scrutiny from the Department of Commerce and the Small Business Administration could indeed be expected to produce better rules. This is especially promising given that in the past many tax regulations have been subject to little scrutiny, even through the notice and comment process[247]—that is, tax regulations are often produced without significant, publicly-minded input. Similarly, there are significant potential benefits to subjecting the private allocation function of the smoking cessation rule to cost-benefit analysis. The methods and conventions for analysis that are currently suggested by OIRA would have informed Treasury as to the potential behavioral response aspects of that rule.[248]

Nonetheless, there are limitations to the utility of cost-benefit analysis—anticipating the private allocation effects of the pass-through rule may involve quantification that is not feasible based on current data, as discussed below. Further, one significant potential downside to centralized review of the private allocation function is that welcoming a more complicated and more politicized tax regulatory process will create more footholds for well-organized interest groups to get what they want, and will delay rules that need to be publicized quickly. It is reasonable to question whether this will create additional problems, but there is no

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[246] Again, the extent to which this political accountability benefit—attributing decisions of the bureaucracy to the President—is meaningful in the real world is subject to debate.

[247] *See* Wallace, *supra* note 20 (tallying participants in the notice and comment process for tax regulations and finding almost no commenters for most proposed regulations).

[248] *See supra* notes 62-66 and accompanying text.

reason to think that this concern should be any more pronounced than it is with other types of regulation where, of course, centralized review is mandated.

Second, centralized review could be beneficial but also should be refined as applied to tax rules that have a public allocation function. The beneficial element is the prospect of interagency review, and the introduction of quantified analysis to the tax regulatory process. This quantified analysis could start with OMB requiring revenue estimates, similar to the current practice with non-tax transfers.[249] Treasury is well equipped to provide this analysis, and in fact in some instances makes such revenue estimates internally (*i.e.*, produces revenue estimates that are not released to the public, but that inform policymaking, both legislative proposals and regulatory policy). Mandating revenue estimates as part of the centralized review process would ensure that revenue could not be disregarded at the whim of individual personnel inside Treasury. Deeper qualitative and quantified analysis of the public allocation function requires grappling with the very challenging (perhaps metaphysical) question of how to account for government spending as a cost or benefit.

Perversely, transparency could be a detriment for the public allocation function in some respects: why would any President want to "own" tax increases carried out through regulations?[250] Indeed, it seems possible that revenue estimates could become a poison pill that prevents proposed tax regulations from moving forward. Despite these hypothetical downsides, the normative benefits of well-analyzed proposed tax policies, and well-informed regulation drafting is too alluring, especially when the tools already exist to make effect revenue estimates, and the procedures already exist to subject those revenue estimates to interagency scrutiny, which could help improve the substance of proposed regulations. Thus, centralized review for provisions that raise revenue—the public allocation function—can be beneficial, although the methods of analysis can be honed beyond simple revenue estimates.

Third, centralized review is not currently well-suited to offer benefits with regard to the distributional function. Distributional effects are the Achilles heel of existing quantified regulatory analysis, and the problem is all the more pronounced with tax regulations, particularly because of the

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[249] *See supra* note 46 and accompanying text.

[250] Of course, President Obama did exactly this with the earnings stripping regulation. *See* supra Part III.B.

widely shared expectation that tax rules ought to account for distribution. Because the distributional function is critically important in tax regulations, future refinement of methods for distributional analysis and procedures for considering distribution in the regulatory policy making process should be priorities. The need for workable distributional analysis is not unique to tax regulations; this blind spot in centralized review deserves further attention regardless of one's position on centralized review of tax regulations.

Finally, as in other contexts, centralized review of the interpretive regulations—the implementing function—serves little purpose. Thus, the current practice of abstaining from centralized review is, indeed, justified on normative grounds for a broad swath of tax regulations that are highly prescribed by Congress.[251] Although Treasury and the IRS have drawn too large a circle around the implementing function in the past, using it to effectuate a blanket exemption from centralized review, this history should not give rise to an overcorrection. Many tax regulations that have very large effects on revenue—and thus might trigger centralized review as economically significant based on the transfer amount alone, if not treated as exempt from such review—are, in fact, carrying out precise directives from Congress that involve little if any policymaking discretion at the regulation-writing stage. The extent to which these sorts of narrow delegations continue to predominate is an open question—it depends on whether Congress's quick policy development and legislative drafting as seen with the Tax Cuts and Jobs Act proves to be an aberration or the new normal.

VI. CONCLUSION

The procedures and practices that shape tax regulations are particularly relevant now as both the Obama and Trump administrations have taken extraordinary steps to change federal tax policy unilaterally through administrative actions. The earnings stripping regulation discussed here represented a sharp break from past practices—even as President Obama avoided directing Treasury to act, he made clear that he supported the action. The Trump administration now appears poised to take a much more active role in directing regulatory tax policy via the Office of Management and Budget than has any prior administration.

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[251] *See supra* note 19.

Recognizing the strengths and weaknesses of centralized review as applied to tax policy—and particularly as applied to different sorts of regulatory tax policy described in the four-part taxonomy developed here—will help to establish consistent and productive oversight of the tax regulatory process.