IRS rulemaking should follow HHS model

By Susan Dudley, opinion contributor
April 11, 2018

Senior officials from the Office of Management and Budget and the Treasury Department will appear before a Senate subcommittee Thursday in what some have portrayed as a battle between two government titans. At issue is an obscure question of whether a Reagan-era agreement that exempted IRS regulations from OMB review should be retained.

OMB and its supporters argue that the IRS has abused the exemption, which was originally intended to apply only to technical rules interpreting discrete provisions of the tax code. Treasury counters that its regulations are different enough from other agencies’ that it deserves special treatment. Legislators have lined up on either side of the issue, and commentators are speculating whose side the White House will ultimately take in the dispute.

But, this need not be a win-lose issue — both arguments have merit and a compromise would provide a constructive path forward.

For almost 40 years, presidents of both parties have called on OMB to review significant regulations before they are published. OMB provides what President Obama called “a dispassionate and analytical second opinion” on draft regulations, both by coordinating

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interagency review and by ensuring that agencies have weighed the rule’s likely positive and negative consequences.

Treasury supporters do not deny the value of this review, but raise several concerns. First, they argue that IRS rules merely interpret the tax code legislated by Congress, so that any effects stem from the underlying law — but this argument could be made by virtually any agency implementing a statute enacted by Congress.

More legitimate concerns stem from the fact that subjecting IRS rules to OMB review would significantly delay regulations that taxpayers depend on to submit their returns — an especially urgent need in the wake of last year’s tax reform law. These concerns are based on three factors.

First, IRS would be responsible for developing regulatory impact analyses to satisfy OMB analytical requirements, and those would take significant time and staff resources.

Second, OMB can take three months or more to review a regulation, both before it is proposed and before it is finalized, potentially adding six months to the timeline for issuing a rule.

Third, OMB’s regulatory oversight office is small (fewer than 50 career staff), and it doesn’t have the expertise or capacity to review dozens of new IRS rules each year.

Let’s look at each of these concerns in turn.

Even the smallest IRS rule will likely have an effect of at least $100 million per year in tax revenue, thus triggering requirements for regulatory impact analysis.

For agencies like EPA and OSHA, these analyses can run into the hundreds or even thousands of pages, which is understandably an intimidating prospect for an agency like IRS that isn’t accustomed to such scrutiny. However, those agencies are not the right models.

Instead, the Centers for Medicare and Medicaid Services (CMS) issues regulations that are more akin to IRS rules because they largely transfer fiscal budget dollars, rather than imposing new costs on the private sector. The regulatory impact analyses CMS prepares are much more streamlined than EPA or OSHA’s, and they focus more on regulatory efficiency than benefit-cost analysis.

CMS payment rules might also provide reassurance that review times need not be as long as other agencies’ can be. Like the IRS, CMS faces annual deadlines for issuing its payment rules; without them, practitioners cannot get paid for services provided under Medicaid and Medicare.

To accommodate these deadlines, OMB works quickly with CMS to coordinate interagency review of time-sensitive rules. The agencies have developed practices, including working simultaneously with internal HHS review, to streamline the process and get rules issued on time.

Finally, it is true that OMB’s regulatory staff is small, and does not currently include experts in IRS regulations. To constructively review IRS rules, OMB will need to hire a few full-time
employees, but it would be incorrect to assume they would need to duplicate expertise found at the IRS. One strength of OMB review is that it provides a different perspective from that of the agencies — a cross-cutting expertise in regulatory impacts and statistical analysis that can lead to more well-reasoned regulations and better outcomes.

There is growing agreement that the nearly 40-year old exemption for IRS rules needs to be revisited. According to a 2016 Government Accountability Office report, since it was agreed to, “the tax code has increasingly been used by policymakers as a tool for accomplishing social and economic objectives by creating special tax credits, deductions, and exemptions to achieve certain policy goals.”

These types of regulations would benefit from the kind of review that OMB provides other executive branch agencies, but such review need not completely disrupt IRS practices. As it has with other agencies, OMB can work with the IRS to develop review procedures that benefit taxpayers and the public, while also respecting the nature and timing of IRS rules.