

ESSAY

Judicial Deference to Retroactive Interpretative Treasury Regulations

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INTRODUCTION

Can the Internal Revenue Service (“IRS”), by exercising its regulatory powers over the federal tax laws, reverse taxpayer-favorable court decisions? In a series of recent cases, most prominently *Intermountain Insurance Service of Vail, LLC v. Commissioner* (“*Intermountain II*”),¹ the IRS has argued that it can invalidate recently decided cases by issuing retroactive interpretative regulations and as-

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¹ *Intermountain Ins. Serv. of Vail, LLC v. Comm’r (Intermountain II)*, 134 T.C. 211 (2010), *rev’d*, No. 10-1204 (D.C. Cir. June 21, 2011). *Intermountain II* was the United States Tax Court’s supplemental decision to *Intermountain Insurance Service of Vail, LLC v. Commissioner (Intermountain I)*, No. 25868-06 (T.C. Sept. 1, 2009). In the interest of conciseness, this Essay refers to these cases as “the *Intermountain* cases,” which are part of the IRS’s ongoing so-called Son-of-BOSS tax shelter litigation. *Accord* *Salman Ranch Ltd. v. United States*, No. 09-9015 (10th Cir. May 31, 2011); *Grapevine Imports, Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir.), *reh’g en banc denied*, No. 2008-5090 (Fed. Cir. June 6, 2011); *Burks v. United States*, 633 F.3d 347 (5th Cir.), *reh’g en banc denied*, Nos. 09-11061, 09-60827 (5th Cir. Apr. 15, 2011); *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (4th Cir.), *reh’g en banc denied*, No. 09-2353 (4th Cir. Apr. 5, 2011); *Beard v. Comm’r*, 633 F.3d 616 (7th Cir.), *reh’g en banc denied*, No. 10-1553 (7th Cir. Apr. 8, 2011), *petition for cert. filed*, No. 10-1553 (U.S. June 27, 2011).

serting that these regulations warrant controlling deference under established administrative law principles.² The IRS's arguments have stirred controversy in the tax community,³ giving further credence to claims that the agency and the Treasury Department ("Treasury") are pushing the boundaries of their regulatory powers to an extent never before seen.⁴

The Commissioner of Internal Revenue cited two sources of law for this broad authority.⁵ The first is the agency's statutory prerogative under the Internal Revenue Code ("Code") to issue "all needful rules and regulations" to enforce the federal tax laws,⁶ including retro-

² See Respondent's Brief in Support of Motion to Vacate Order & Decision at 12–18, *Intermountain II*, 134 T.C. 211 (No. 2586-06) [hereinafter Commissioner's Tax Court Brief]. In tax law, "interpretative regulations" refer to rules issued pursuant to the Secretary of the Treasury's general authority to promulgate tax regulations under I.R.C. § 7805(a) (2006). See *infra* notes 63–65 and accompanying text. According to the IRS, interpretative regulations are not subject to the Administrative Procedure Act's ("APA") prepromulgation notice-and-comment provisions, 5 U.S.C. § 553 (2006), but have the force and effect of law, see *infra* notes 69–70 and accompanying text.

³ See, e.g., Alan Horowitz, *Son-of-BOSS Statute of Limitations Issue Inundates the Courts of Appeals*, TAX APP. BLOG (Nov. 30, 2010), <http://appellatetax.com/2010/11/30/son-of-boss-statute-of-limitations-issue-inundates-the-courts-of-appeals/> (describing the IRS's position as an "aggressive (one might say, desperate) effort to use the regulatory process to trump settled precedent"); Intermountain, *Interpretive Regulations, and Brand X*, TAXPROF BLOG, 3 (May 20, 2010), <http://taxprof.typepad.com/files/intermountain.pdf> (describing the IRS's litigating position as "highly controversial").

⁴ See Mark E. Berg, *Judicial Deference to Tax Regulations: A Reconsideration in Light of National Cable, Swallows Holding, and Other Developments*, 61 TAX LAW. 481, 483 (2008) (noting "[t]he Treasury Department's apparent inclination, to a much greater degree than would have been imaginable previously, to take on the role of lawmaker"); Kristin E. Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1543 (2006) ("[M]any in the tax community regard Treasury's authority over the Code absent strong judicial oversight with . . . misgiving."); see also Berg, *supra*, at 482 (noting that in a brief filed before the Supreme Court in 2007, "the Justice Department took the remarkable position that the Court should deny a taxpayer's petition for certiorari on the basis of a regulation that the Treasury Department had not yet promulgated or even proposed"); cf. Intermountain, *Interpretive Regulations, and Brand X*, *supra* note 3, at 4 ("It is worth remembering that, not just taxpayers, but the [IRS] too can commit tax abuse."). These views are not limited to scholars and practitioners; even federal judges have expressed criticism of and contempt for some of the IRS's practices. See, e.g., *Cohen v. United States*, 578 F.3d 1, 3 (D.C. Cir. 2009) (Brown, J.) (accusing the IRS of abusing its regulatory authority to overcollect on excise taxes and thereafter avoid judicial review of its actions), *reh'g en banc granted*, 599 F.3d 652 (D.C. Cir. 2010).

⁵ See, e.g., Commissioner's Tax Court Brief, *supra* note 2, at 12, 17–18.

⁶ I.R.C. § 7805(a). The full text of I.R.C. § 7805(a) reads: "[T]he Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." *Id.* Although Treasury officially promulgates I.R.C. § 7805(a) regulations, IRS attorneys play a central role in their development and drafting. See INTERNAL REVENUE SERV., U.S. DEP'T OF TREASURY, INTERNAL REVENUE MANUAL § 32.1.1.4.4 (2004) [hereinafter

active regulations.⁷ The second is the doctrine of administrative deference, most commonly associated with the United States Supreme Court's decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,⁸ and more recently articulated in *National Cable & Telecommunications Ass'n v. Brand X Internet Services* ("Brand X").⁹ *Brand X* established that a court must uphold a reasonable agency interpretation of an ambiguous statute even if a court has already issued a contrary interpretation.¹⁰

For decades, the scope of the IRS and Treasury's regulatory authority has been a highly controversial topic,¹¹ and the extent to which these entities are subject to general principles of administrative law is central to this debate.¹² Both government bodies, as well as many in the tax community, have long maintained that there is a sort of "tax exceptionalism" in administrative law,¹³ and the IRS's arguments in *Intermountain II* have sounded similar themes.¹⁴ Although the Com-

INTERNAL REVENUE MANUAL]. For this reason, and because the IRS plays the primary role in litigating tax cases, this Essay frequently refers to the IRS and Treasury interchangeably.

⁷ I.R.C. § 7805(b).

⁸ *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

⁹ See *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005).

¹⁰ *Id.* at 982.

¹¹ The IRS and Treasury's authority to issue retroactive tax regulations is among the most controversial of these subjects. See David W. Ball, *Retroactive Application of Treasury Rules and Regulations*, 17 N.M. L. REV. 139, 139 (1987) (describing the retroactivity provisions of I.R.C. § 7805(b) as "[p]erhaps one of the most unsettling areas of [tax] law" and "shocking" to those familiar with "notions of due process and fundamental fairness"); Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?*, 84 B.U. L. REV. 185 (2004); Allison H. Eaton, Comment, *Can the IRS Overrule the Supreme Court?*, 45 EMORY L.J. 987, 990 (1996) (evaluating conflicting interpretations of the Code by the IRS and the Supreme Court and considering "whether the IRS's regulatory powers are beyond judicial review"). The IRS has also been criticized for seeking to use this retroactivity power to reverse its court losses. See Brian Dooley, *IRS Tells Tax Court to Jump Off, Again*, INT'L TAX COUNSELORS BLOG (Dec. 20, 2010), <http://www.intltaxcounselors.com/blog/?p=6267> ("Starting in the mid 1990's the IRS started to issue regulations when they lost a major tax case. The IRS writes these regulation in the way that they wish the law was. . . . So, the IRS has decided that Congress is not above them, nor are the courts.").

¹² See generally 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 (2007) [hereinafter Hickman, *Coloring Outside the Lines*] (outlining Treasury's frequent and extensive noncompliance with the APA's rulemaking provisions); 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) [hereinafter Hickman, *A Problem of Remedy*] (same).

¹³ See Hickman, *supra* note 4, at 1541 (noting that the "perception of tax exceptionalism . . . intrudes upon much contemporary tax scholarship and jurisprudence"). See generally Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up to Be Tax Lawyers*, 13 VA. TAX REV. 517, 531 (1994) (discussing the tax exceptionalism view).

¹⁴ See Kristin Hickman, *Hickman: Goodbye National Muffler! Hello Administrative Law?*,

missioner lost 13–0 in the United States Tax Court,¹⁵ the IRS was not deterred.¹⁶ Acknowledging that “it would be a long haul,” the agency announced that it would continue to litigate until it gets “the right answer.”¹⁷ The question of judicial deference to retroactive interpretative Treasury regulations, or I.R.C. § 7805(b) regulations, is now part of the ongoing (and escalating) litigation in the circuit courts, and the IRS’s arguments are gaining traction.¹⁸

The caselaw on judicial deference to tax regulations, including retroactive regulations, has been described as “a muddle,”¹⁹ “markedly erratic,”²⁰ and “a quagmire.”²¹ Tax scholars and practitioners have not only noted a “continuing and widening confusion in the

TAXPROF BLOG (Jan. 11, 2001), http://taxprof.typepad.com/taxprof_blog/2011/01/hickman.html (“The government’s arguments in [the *Intermountain*] cases generally follow the . . . ‘tax is different’ theme . . .”).

¹⁵ *Intermountain II*, 134 T.C. 211, 225–26 (2010), *rev’d*, No. 10-1204 (D.C. Cir. June 21, 2011). The *Intermountain II* court did not reach the merits of the government’s argument; the majority instead held that the regulations, by their own terms, did not apply to the taxable years in question. *Id.* at 220.

¹⁶ Jeremiah Coder, *IRS Undeterred After Tax Court’s Intermountain Decision*, 127 TAX NOTES 729, 730 (2010).

¹⁷ *Id.* (quoting Deborah Butler, IRS Associate Chief Counsel) (internal quotation marks omitted). Ms. Butler added: “And we mean it: We will see the right answer.” *Id.*

¹⁸ Just before this Essay went to press, the D.C. Circuit reversed the Tax Court’s judgment in *Intermountain II*, becoming the third straight circuit court to rule for the IRS. See *Intermountain Ins. Serv. of Vail, LLC v. Comm’r (Intermountain III)*, No. 10-1204, slip op. at 33 (D.C. Cir. June 21, 2011) (holding that the regulations defining omission of gross income warranted deference under *Chevron* and *Mayo Foundation*). As of this writing, therefore, the federal courts of appeals have ruled 4–2 in favor of the IRS. Compare *Burks v. United States*, 633 F.3d 347, 360 (5th Cir.) (holding that the statute unambiguously supports the taxpayers’ interpretation and refusing to decide the issue of *Chevron* deference), *reh’g en banc denied*, Nos. 09-11061, 09-60827 (5th Cir. Apr. 15, 2011), and *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (4th Cir.) (same), *reh’g en banc denied*, No. 09-2353 (4th Cir. Apr. 5, 2011), with *Salman Ranch Ltd. v. United States*, No. 09-9015 (10th Cir. May 31, 2011) (holding that the statute is ambiguous and deferring to the IRS’s regulations under the *Chevron* doctrine), *Grapevine Imports, Ltd. v. United States*, 636 F.3d 1368 (Fed. Cir.) (same), *reh’g en banc denied*, No. 2008-5090 (Fed. Cir. June 6, 2011), and *Beard v. Comm’r*, 633 F.3d 616, 623 (7th Cir.) (holding that the statute unambiguously supports the IRS’s interpretation), *reh’g en banc denied*, No. 10-1553 (7th Cir. Apr. 8, 2011), *petition for cert. filed*, No. 10-1553 (U.S. June 27, 2011). For background on this circuit split in the Son-of-BOSS cases, see Alan Horowitz, *Federal Circuit Adds to Intermountain Conflict by Deferring to New Regulations that Apply Six-Year Statute to Overstatements of Basis*, TAX APP. BLOG (Mar. 11, 2011), <http://appellatetax.com/2011/03/11/federal-circuit-adds-to-intermountain-conflict-by-deferring-to-new-regulations-that-apply-six-year-statute-to-overstatements-of-basis/>.

¹⁹ Berg, *supra* note 4, at 498.

²⁰ Hickman, *supra* note 4, at 1546; see also *id.* (“[T]he Court’s post-*Chevron* analysis of Treasury regulations . . . can be read to support almost any argument.”).

²¹ Toni Robinson, *Retroactivity: The Case for Better Regulation of Federal Tax Regulators*, 48 OHIO ST. L.J. 773, 775 (1987).

lower courts” over which standard applies,²² but have also disagreed themselves over which standard should apply.²³ The question is whether *Chevron* and its progeny govern judicial review of tax regulations or whether the Court’s earlier, tax-specific standard under *National Muffler Dealers Ass’n v. United States*²⁴ retains precedential force. The Supreme Court has had decades to address the debate,²⁵ but has only recently sought to bring any clarity to the issue, with its 2011 decision in *Mayo Foundation for Medical Education & Research v. United States*.²⁶

This Essay argues that the *Chevron* doctrine is not the appropriate standard for reviewing I.R.C. § 7805(b) regulations, and that the *National Muffler* test is the better alternative. *Chevron* and *Brand X* are premised on the idea that controlling deference should be accorded only to agency rules issued pursuant to congressional delegations of policymaking authority.²⁷ The IRS’s attempts to overturn

²² Brief of Tax Professor Carlton M. Smith as *Amicus Curiae* in Support of the Petitioners at 4–5, *Mayo Found. for Med. Educ. & Research*, 131 S. Ct. 704 (2011) (No. 09-837) [hereinafter Brief of Professor Smith]; see *id.* (“[M]uch ink has been spilled by commentators on this subject.”); Berg, *supra* note 4, at 492 (“[E]ven now, nearly 25 years after *Chevron*, the courts continue to wrestle with the question of . . . the standard to be applied to section 7805(a) regulations.”); Hickman, *supra* note 4, at 1538 (“[M]ore than twenty years after the Supreme Court decided *Chevron* . . . the question of judicial deference toward Treasury regulations remains stubbornly unresolved. The circuits are split and scholars are divided over whether *Chevron* deference or some other evaluative standard should apply to judicial review of Treasury regulations.”).

²³ See *infra* note 138 and accompanying text. As a result of this continued uncertainty, the ABA Section of Taxation’s Judicial Deference Task Force drafted a comprehensive report on the subject, in which it issued several recommendations for consistent treatment of various forms of tax regulations and guidance. See Irving Salem et al., *ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 TAX LAW. 717 (2004). The report did not, however, address retroactive regulations.

²⁴ *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472 (1979).

²⁵ See Hickman, *supra* note 4, at 1579 (noting that even though the Supreme Court has decided a substantial number of cases regarding judicial deference to interpretative Treasury regulations since *Chevron*, it has nevertheless been “woefully inconsistent in what, if any, deference doctrine it intends to apply”).

²⁶ *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 715–16 (2011) (employing the *Chevron* doctrine to uphold a Treasury regulation that denied medical students a tax exemption if they worked forty or more hours per week). Although some commentators believe that *Mayo Foundation* has conclusively established that all tax regulations, both prospective and retroactive, now receive *Chevron* deference, see, e.g., Hickman, *supra* note 14; Steve Johnson, *More Mayo: Johnson on the Demise of Tax Exceptionalism*, TAXPROF BLOG (Jan. 12, 2011), http://taxprof.typepad.com/taxprof_blog/2011/01/more-mayo.html, this Essay contends that there is sufficient flexibility in the caselaw for various levels of judicial deference based on the type of regulation and the context of its issuance, see *infra* notes 147–53 and accompanying text.

²⁷ See *infra* notes 154, 157–59, 179–80 and accompanying text.

court decisions through the agency rulemaking process do not warrant heightened deference because, as a reincorporation of its failed litigating position and an obstruction of the judicial decisionmaking process, they do not fall within the limited scope of the *Chevron* doctrine. This hybrid legislative-adjudicative agency action warrants a more nuanced and flexible judicial deference framework, not *Chevron*'s powerful, mandatory regime. The *National Muffler* test—a tax-specific, multifactor standard—would more appropriately balance the IRS's regulatory interests with the countervailing interests of both taxpayer-litigants and the judiciary in the validity and integrity of judicial decisions.

Part I of this Essay explores the *Intermountain* cases to provide context to the IRS's attempts to overturn cases by issuing retroactive interpretative Treasury regulations under I.R.C. § 7805(b). Part II gives a brief overview of the IRS and Treasury's regulatory authority over the Code, focusing on the government's ability to issue legally binding tax regulations, including those that apply retroactively. Part III briefly outlines the pre- and post-*Chevron* standards of administrative deference and describes how these standards have applied to (and created great confusion for) judicial review of tax regulations. Part IV then argues that the *Chevron* doctrine, particularly after *Brand X*, is both normatively and doctrinally the wrong standard for judicial review of I.R.C. § 7805(b) regulations, and that *National Muffler*'s context-based, multifactor analysis would better distinguish between legitimate and illegitimate exercises of the IRS's regulatory powers.

I. CURRENT LITIGATION: THE *INTERMOUNTAIN* CASES

The Tax Court's decision in *Intermountain II* has been described as a landmark decision for tax and administrative law.²⁸ The case is part of the IRS's high-profile, ongoing litigation over the Son-of-BOSS tax shelter.²⁹ This Part provides a brief overview of the *Intermountain I* and *Intermountain II* decisions.

²⁸ See Steve R. Johnson, *Intermountain and the Importance of Administrative Law in Tax Law*, 128 TAX NOTES 837, 837 (2010) (describing *Intermountain II* as “a must-read for tax academics and practitioners” and “among the richest decisions on the procedural and substantive validity of tax regulations”).

²⁹ See Horowitz, *supra* note 3. Son-of-BOSS is a variant of the “BOSS” (“bond and options sales strategy”) tax shelter. *Kligfield Holdings v. Comm’r*, 128 T.C. 192, 194 (2007). Son-of-BOSS transactions generally involve the disposition of assets heavily encumbered by liability in order to inflate the basis of partnership property, thereby producing an understatement of gross income. *Id.* “Gross income” refers to “[t]otal income from all sources before deductions, exemptions, or other tax reductions.” BLACK’S LAW DICTIONARY 831 (9th ed. 2009).

A. Intermountain I

In 1999, Intermountain Insurance Service of Vail, LLC (“Intermountain”) engaged in a series of transactions that culminated in the sale of nearly \$2 million in business assets.³⁰ Intermountain subsequently reported the sales price, along with an increased basis in the partnership assets,³¹ on its tax return filed September 15, 2000.³² On September 14, 2006, nearly six years after Intermountain submitted this return, the IRS issued a notice of final partnership administrative adjustment (“FPAA”) for Intermountain’s 1999 tax year.³³ In the FPAA, the IRS alleged that Intermountain had entered into a series of sham transactions in the sale of its assets and overstated its partnership basis by over \$2 million.³⁴ According to the Commissioner, Intermountain’s overstated basis produced an underreporting of gross income, and thus an illegal tax shelter.³⁵

Intermountain argued that the FPAA was untimely because the three-year statute of limitations for adjusting a partnership’s alleged tax deficiencies had lapsed.³⁶ In response, the IRS cited I.R.C. §§ 6501(e) and 6229, which permit a six-year statute of limitations for significant “omission[s] of gross income,”³⁷ claiming that Intermountain’s overstatement of basis constituted an omission of gross in-

³⁰ *Intermountain I*, No. 25868-06, slip op. at 2 (T.C. Sept. 1, 2009).

³¹ The term “basis” refers to “[t]he value assigned to a taxpayer’s investment in property and used primarily for computing gain or loss from a transfer of the property.” BLACK’S LAW DICTIONARY 171 (9th ed. 2009); *see also* I.R.C. § 1012 (2006).

³² *Intermountain I*, No. 25868-06, slip op. at 2.

³³ *Id.* at 3. An FPAA serves as notice to a partnership that the IRS is adjusting its assets or gross income for a given year to recalculate its tax liability. *See Clovis I v. Comm’r*, 88 T.C. 980, 982 (1987).

³⁴ *Intermountain I*, No. 25868-06, slip op. at 3.

³⁵ *See id.* Under § 61(a)(3) of the Code, gains from dealings in property—including, as here, the sale of partnership assets—are taxable as income and must be included in the taxpayer’s gross income. The amount of gain recognized from selling or otherwise disposing of property is defined as “the excess of the amount realized therefrom over the [taxpayer’s] adjusted basis [in the property]” I.R.C. § 1001(a). Thus, by overstating his basis, a taxpayer understates his gross income, thereby reducing his tax liability.

³⁶ *Intermountain I*, No. 25868-06, slip op. at 3.

³⁷ Section 6501(e)(1)(A) provides:

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

I.R.C. § 6501(e)(1)(A). Section 6229(c)(2) provides that “[i]f any partnership omits from gross income an amount properly includible therein [and such amount is described in § 6501(e)(1)(A)],” then the statute of limitations is six years, rather than three years. *Id.* § 6229(c)(2).

come.³⁸ Intermountain countered by arguing that only a direct understatement of gross income, and not an overstatement of basis, could be an “omission” for purposes of I.R.C. §§ 6501(e) and 6229.³⁹

The Tax Court rejected the IRS’s argument,⁴⁰ relying on the Supreme Court’s interpretation of a predecessor Code provision a half-century earlier in *Colony, Inc. v. Commissioner*.⁴¹ In *Colony*, the Supreme Court held—directly on point—that an overstatement of basis did not constitute an omission of gross income.⁴² Based on this Supreme Court and Tax Court precedent, the court held that the three-year limitations period applied, and ruled in favor of Intermountain.⁴³

B. Intermountain II

Intermountain I was decided on September 1, 2009.⁴⁴ On September 28, 2009, the IRS promulgated two temporary interpretative regulations stating that, for purposes of I.R.C. §§ 6501 and 6229, an understatement of basis constituted an “omission of gross income.”⁴⁵ In other words, the IRS issued agency rules that contained the interpretation of the Code previously rejected by the Tax Court. The Commissioner then filed motions to vacate and reconsider the *Intermountain I* decision, citing its newly issued regulations as an intervening change in the law.⁴⁶ In *Intermountain II*, an en banc Tax Court panel addressed the IRS’s motions to vacate and reconsider.⁴⁷

The Commissioner argued that the *Chevron* doctrine required judicial deference to its newly issued interpretations of I.R.C. §§ 6501 and 6229.⁴⁸ He then cited the agency’s I.R.C. § 7805(b) authority to issue retroactive regulations⁴⁹ and the Supreme Court’s decision in *Brand X* for the proposition that the regulations’ conflict with prior

³⁸ See *Intermountain I*, No. 25868-06, slip op. at 3 n.2.

³⁹ See *id.* at 3.

⁴⁰ See *id.* at 6–8.

⁴¹ *Colony, Inc. v. Comm’r*, 357 U.S. 28 (1958).

⁴² *Id.* at 37–38. The Tax Court also relied on its own decision applying *Colony* two years earlier, also concluding that an overstatement of basis was not an omission of gross income. See *Bakersfield Energy Partners, LP v. Comm’r*, 128 T.C. 207, 215 (2007) (“[T]he Supreme Court [in *Colony*] held that ‘omits’ means something ‘left out’ and not something put in and overstated.”), *aff’d*, 568 F.3d 767 (9th Cir. 2009).

⁴³ See *Intermountain I*, No. 25868-06, slip op. at 7–8.

⁴⁴ See *id.* at 1.

⁴⁵ See Temp. Treas. Reg. §§ 301.6229(c)(2)-1T(a), 301.6501(e)-1T(a) (2009).

⁴⁶ *Intermountain II*, 134 T.C. 211, 215 (2010), *rev’d*, No. 10-1204 (D.C. Cir. June 21, 2011).

⁴⁷ *Id.* at 212.

⁴⁸ Commissioner’s Tax Court Brief, *supra* note 2, at 27–33.

⁴⁹ *Id.* at 10–13.

judicial interpretations posed no barrier to this deference.⁵⁰ The essence of the IRS's argument was that because the agency is the "authoritative interpreter" of the Code and the prior court decisions were in conflict with its interpretation, *Brand X* required that the judiciary's construction yield to the agency's.⁵¹ In response, Intermountain called this an "unprecedented maneuver never seen in this or any other court," and argued that the government was seeking "to improperly utilize the Treasury's regulatory rule-making authority to . . . usurp [the] Court's judicial authority."⁵²

The Tax Court again ruled against the Commissioner, denying his motions to reconsider and vacate.⁵³ But the court did not rule on the substance of the Commissioner's argument regarding I.R.C. § 7805(b) regulations, and found it unnecessary to decide whether *Chevron* or *National Muffler* was the proper standard of judicial deference to tax regulations, whether prospective or retroactive.⁵⁴ The majority instead held that the regulations, by their own terms, did not apply to the taxable years in question, thereby avoiding the issue entirely.⁵⁵ Because the Tax Court did not directly address the merits of the Commissioner's argument, *Intermountain II* is likely just the beginning of the retroactivity battle.⁵⁶ As previously noted, the government was not deterred by its loss, and instead effectively promised that this issue would resurface.⁵⁷ In fact, in several recent cases, the IRS has been pushing aggressively for the circuit courts to adopt its view of the *Chevron* doctrine and I.R.C. § 7805(b) regulations.⁵⁸ The courts will therefore ultimately have to decide what level of judicial deference is

⁵⁰ *Id.* at 17–18 (citing *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982–83 (2005)). The retroactivity argument was not the IRS's primary argument. The Commissioner first claimed that the regulations were not retroactive, and then only in the alternative that they were. *See id.* at 7–13.

⁵¹ *Id.* at 17–18 (citing *Brand X*, 545 U.S. at 982–83).

⁵² Brief in Opposition to Respondent's Motions (1) to Vacate Order & Decision, & (2) for Reconsideration of Opinion at 1, *Intermountain II*, 134 T.C. 211 (2010) (footnotes omitted).

⁵³ *Intermountain II*, 134 T.C. at 225.

⁵⁴ *Id.* at 220.

⁵⁵ *Id.* Of the thirteen judges hearing *Intermountain II*, only two concurring judges spoke to the issue of *Chevron* deference. *See id.* at 231–38 (Halpern & Holmes, JJ., concurring in the result only) (acknowledging the "longrunning issue" about whether *Chevron*, *National Muffler*, or some other standard of deference applies).

⁵⁶ *See* Horowitz, *supra* note 3 (positing that *Intermountain II* "is just the first skirmish in what will be an extended battle" and noting that "[t]he Justice Department has asserted that there are currently 35–50 cases pending in the federal courts that raise the same issue, with approximately \$1 billion at stake").

⁵⁷ *See supra* notes 16–17 and accompanying text.

⁵⁸ *See* Horowitz, *supra* note 3; *see also supra* note 18 (providing an overview of the recent litigation in the courts of appeals).

warranted in reviewing I.R.C. § 7805(b) regulations, which requires an evaluation of the proper scope of the IRS and Treasury's regulatory authority over the Code.

II. THE SCOPE OF IRS AND TREASURY AUTHORITY: TREASURY REGULATIONS AND RETROACTIVITY

A. *Treasury Regulations*

The IRS and Treasury possess broad regulatory powers over the interpretation and enforcement of the Code. Due to the importance of collecting revenue for the government,⁵⁹ they have extensive power and discretion relative to other federal agencies.⁶⁰ In addition to their tax-collecting responsibilities, the IRS and Treasury are tasked with issuing regulations interpreting and enforcing the federal tax laws.⁶¹

The IRS and Treasury promulgate interpretations of the Code through several regulatory instruments, the most official and authoritative of which are Treasury regulations.⁶² Traditional administrative law doctrine distinguishes between agency regulations that have the force of law and bind the public (called “legislative rules”) and other agency pronouncements that do not create enforceable rights or obligations (such as “interpretative rules”).⁶³ In tax law, however, the terms “legislative rule” and “interpretative rule” carry different meanings. Legislative rules are those promulgated pursuant to a specific

⁵⁹ See *Bull v. United States*, 295 U.S. 247, 259 (1935) (“[T]axes are the life-blood of the government, and their prompt and certain availability an imperious need.”); see also *United States v. Hughes Props., Inc.*, 476 U.S. 593, 603 (1986) (“[T]he major responsibility of the Internal Revenue Service is to protect the public fisc.”).

⁶⁰ See *Bob Jones Univ. v. United States*, 461 U.S. 574, 596–97 (1983) (“[E]ver since the inception of the Tax Code, Congress has seen fit to vest in those administering the tax laws very broad authority to interpret those laws. . . . [A]nd this Court has long recognized the primary authority of the IRS and its predecessors in construing the Internal Revenue Code.”); see also *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249, 259 (4th Cir.) (Wilkinson, J., concurring) (stating that it “makes perfect sense” to afford highly deferential treatment to tax regulations “[g]iven the fact that government today is an enterprise of unprecedented complexity” and “judges [do not] harbor any desire to impair the mission of the IRS in a day of staggering budget deficits,” but likewise acknowledging that “it remains the case that agencies are not a law unto themselves”), *reh'g en banc denied*, No. 09-2353 (4th Cir. Apr. 5, 2011).

⁶¹ See INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.1.4.4; see also Hickman, *A Problem of Remedy*, *supra* note 12, at 1155–56.

⁶² See Kristin E. Hickman, *IRB Guidance: The No Man's Land of Tax Code Interpretation*, 2009 MICH. ST. L. REV. 239, 240; Hickman, *supra* note 4, at 1538. See generally Donald L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View from Within*, 46 DUQ. L. REV. 323, 324–26 (2008) (exploring the various means that the IRS and Treasury employ to inform the public of the tax laws).

⁶³ See RICHARD J. PIERCE, ADMINISTRATIVE LAW TREATISE § 6.4, at 432–33 (5th ed. 2010).

congressional delegation under a particular Code provision (otherwise known as “specific authority” regulations).⁶⁴ Interpretative rules, by contrast, are those promulgated under Congress’s general grant of authority under I.R.C. § 7805(a) to promulgate “all needful rules or regulations” relating to internal revenue (otherwise known as “general authority” regulations).⁶⁵ This Essay is concerned with interpretative regulations.

Although the Administrative Procedure Act (“APA”) provides the basic guidelines for most agency rulemaking,⁶⁶ the Code specifies its own procedures for issuing tax regulations.⁶⁷ I.R.C. § 7805(a) sets forth the IRS and Treasury’s extensive regulatory powers over the interpretation and enforcement of the federal tax laws, and the vast majority of Treasury regulations are issued as general authority regulations under this section.⁶⁸ The government has contended that both specific authority and general authority regulations create binding rules and obligations for the public, and the federal courts have generally treated both types of rules as having the force of law.⁶⁹ Therefore, for most purposes, failing to follow interpretative regulations can result in fines and other penalties, and taxpayers generally operate under the assumption that interpretative regulations are legally binding for purposes of assessing tax liability.⁷⁰

B. *Retroactivity*

A taxpayer’s liability for a given year is generally determined by the Code provisions and tax regulations in force during that year, notwithstanding subsequent amendments or changes to the law.⁷¹ Under I.R.C. § 7805(b), however, the Secretary of the Treasury is authorized to issue regulations that apply retroactively—i.e., to events or conduct that occurred in taxable years prior to the adoption of the rule.⁷²

⁶⁴ See Berg, *supra* note 4, at 485–86; Salem et al., *supra* note 23, at 728.

⁶⁵ See Berg, *supra* note 4, at 485–86; Salem et al., *supra* note 23, at 728.

⁶⁶ 5 U.S.C. §§ 553, 556–557 (2006).

⁶⁷ See Robinson, *supra* note 21, at 779.

⁶⁸ See Hickman, *supra* note 4, at 1544 (“Even where a specific authority grant supports a Treasury regulation, Treasury often will cite I.R.C. § 7805(a) as the primary or only authority behind the regulation in question.”).

⁶⁹ See Berg, *supra* note 4, at 487; Hickman, *supra* note 4, at 1618.

⁷⁰ Brief of Professor Kristin E. Hickman as *Amicus Curiae* in Support of Plaintiffs-Appellants on Rehearing *En Banc* at 7, *Cohen v. United States*, 578 F.3d 1 (D.C. Cir. 2009) (Nos. 08-5088, 08-5093, 09-5174).

⁷¹ See, e.g., *First Chold Corp. v. Comm’r*, 306 U.S. 117, 118 (1939); *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U.S. 110, 116 (1939).

⁷² I.R.C. § 7805(b) (2006).

The traditional rationale for the IRS's authority to issue retroactive regulations is grounded in the declaratory theory of jurisprudence.⁷³ Under this theory, by issuing interpretative regulations that apply to earlier taxable years, the IRS is declaring what a particular Code provision has always meant, rather than creating new legal obligations.⁷⁴ In other words, retroactive Treasury regulations are designed to bring clarity to or correct past mistaken interpretations of the current tax laws.⁷⁵

The government has a compelling interest in ensuring the proper collection of internal revenue, and the retroactivity provisions provide a necessary degree of flexibility for the IRS and Treasury to oversee and administer the Code.⁷⁶ Not only can the retroactivity power correct vague or inconsistent provisions of the Code, but “[r]etroactivity can also prevent taxpayers from taking advantage of newly discovered mistakes and ambiguities in the tax law”—such as the Son-of-BOSS tax shelter—and therefore serves as an important antifraud mechanism.⁷⁷

For most of the twentieth century, the Code granted the Secretary of the Treasury near-pleinary authority to issue retroactive regulations.⁷⁸ In fact, all Treasury regulations were presumed to have retroactive effect unless otherwise specified.⁷⁹ In 1996, however, this provision was amended, and the presumption of retroactive application was replaced with a presumption of only prospective application.⁸⁰ Congress also enumerated several exceptions permitting retroactive application of Treasury regulations.⁸¹ Under the new I.R.C. § 7805(b), the IRS can issue retroactively applicable regula-

⁷³ See Ball, *supra* note 11, at 142.

⁷⁴ See *id.* (“According to [this] theory, judges do not *make* the law, instead they *find* the law and declare it to the litigants. The newly found law is applied retroactively because it is deemed to be the correct law.” (footnote omitted)).

⁷⁵ See *id.*

⁷⁶ See *id.* at 152 (“Retroactivity gives the Commissioner discretion to amend regulations in reaction to newly discovered mistakes, internal policy changes and external changes in ways of doing business.”).

⁷⁷ *Id.*

⁷⁸ See *id.* at 142 (“The courts have historically accorded extraordinary deference to the discretion of the Commissioner under Section 7805(b).”).

⁷⁹ The Code previously stated that “[t]he Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.” I.R.C. § 7805(b) (1994) (amended 1996); see also Ball, *supra* note 11, at 139 n.1.

⁸⁰ See Taxpayer Bill of Rights 2, Pub. L. No. 104-168, sec. 1101(a), § 7805(b), 110 Stat. 1452, 1468–69 (1996).

⁸¹ See I.R.C. § 7805(b)(1)–(7) (2006). For instance, “any regulation” may be applied ret-

tions, but these regulations must fall within one of the specified categories, and they can only be applied to taxable years that did not expire before the notice of proposed rulemaking is published in the *Federal Register* or the date “on which any notice substantially describing the expected contents of any temporary, proposed, or final regulation is issued to the public.”⁸²

Although it appears that the 1996 amendment greatly restricted the government’s ability to issue retroactively applicable regulations, two factors have permitted the IRS and Treasury to retain broad retroactive authority. First, the amendments creating the new I.R.C. § 7805(b) only apply “with respect to regulations which relate to statutory provisions enacted on or after” July 30, 1996.⁸³ Therefore, if the IRS issues a retroactive regulation interpreting a provision of the Code that existed prior to the date of the amendment—and most of the present tax laws likely come from (or antedate) the “Internal Revenue Code of 1986,” the last major revision of the federal tax code⁸⁴—it retains its pre-1996, near-plenary authority to apply the rules retroactively. Second, for provisions enacted after 1996, the IRS frequently cites the exception for the “prevention of abuse” of the federal tax laws,⁸⁵ which can be interpreted broadly to permit retroactive application to a great number of taxpayer practices.⁸⁶ For these two reasons, the IRS and Treasury continue to possess a great deal of power to promulgate retroactive regulations. It is important to note, however, that although the IRS warrants a certain level of authority to interpret and clarify the federal tax laws, and therefore a certain degree of deference to its constructions, this regulatory power must always be exercised within congressionally delegated parameters.⁸⁷

III. ADMINISTRATIVE DEFERENCE AND TREASURY REGULATIONS

Judicial review of agency regulations is primarily governed by the framework outlined by the Supreme Court in *Chevron*.⁸⁸ Before

roactively in order to “prevent abuse,” *id.* § 7805(b)(3), or “to correct a procedural defect in the issuance of any prior regulation,” *id.* § 7805(b)(4).

⁸² *Id.* § 7805(b)(1).

⁸³ See Taxpayer Bill of Rights 2, sec. 1101(b), § 7805(b).

⁸⁴ Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085.

⁸⁵ I.R.C. § 7805(b)(3).

⁸⁶ Cf. Berg, *supra* note 4, at 538 & n.258 (noting that I.R.C. § 7805(b)(3) permits Treasury to issue regulations retroactively to prevent general abuse of the system).

⁸⁷ See *infra* notes 156–58 and accompanying text.

⁸⁸ John F. Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the Chevron Era*, 64 GEO. WASH. L. REV. 35, 39 (1995).

Chevron, it was clear that *National Muffler*'s tax-specific test applied to judicial review of interpretative Treasury regulations.⁸⁹ After *Chevron*, deference jurisprudence in the tax context became substantially complicated.⁹⁰ Although the Supreme Court recently endorsed the *Chevron* standard for interpretative Treasury regulations in *Mayo Foundation*, the case did not address the question of judicial deference to I.R.C. § 7805(b) regulations.⁹¹

A. *The National Muffler Standard*

In *National Muffler*,⁹² the Supreme Court addressed the question whether the petitioner, a trade association for muffler dealers, was a “business league” entitled to a tax exemption under I.R.C. § 501(c)(6).⁹³ The IRS rejected National Muffler's exemption application because, pursuant to its regulations, a business league did not include an association whose membership was confined to franchisees of a single corporation.⁹⁴ The Court deferred to the regulations, citing the agency's congressional mandate to interpret the Code and its policymaking expertise.⁹⁵

In its opinion, the Supreme Court established a multifactor test for judicial deference to interpretative tax regulations based on overall “reasonableness.”⁹⁶ It offered several guidelines that it considered useful for determining the ultimate reasonableness of an agency's construction:

In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. *If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed upon it, the*

⁸⁹ See Berg, *supra* note 4, at 483 (describing *National Muffler* as the “fairly settled standard[]” for pre-*Chevron* caselaw).

⁹⁰ See *infra* notes 127–40 and accompanying text.

⁹¹ See *infra* notes 141–52 and accompanying text.

⁹² Nat'l Muffler Dealers Ass'n v. United States, 440 U.S. 472 (1979).

⁹³ *Id.* at 472.

⁹⁴ *Id.* at 474–75.

⁹⁵ *Id.* at 476–77.

⁹⁶ *Id.* (noting that a regulation will be upheld if it is found to “implement the congressional mandate in some reasonable manner” (internal quotation marks omitted)).

*consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute.*⁹⁷

The *National Muffler* test therefore relies upon an objective, case-by-case assessment of a number of factors, based on an ultimate determination of the reasonableness of the agency interpretation.⁹⁸ In fact, *National Muffler* has been described as providing the “fullest statement of [the Supreme Court’s] reasonableness test” for tax regulations.⁹⁹

In the years following *National Muffler* and before *Chevron*, the Supreme Court developed a substantial body of caselaw under *National Muffler*.¹⁰⁰ For instance, the Court applied the test more stringently for interpretative rules than legislative rules, and regulations interpreting statutory terms that had been given “considerable specificity by Congress” were entitled to less deference than regulations interpreting “extremely general term[s]” in the Code.¹⁰¹ In other words, the Court largely embraced *National Muffler* for tax cases, and it determined whether deference was appropriate under the standard based on contextual considerations and a case-by-case evaluation of the IRS’s proper interpretive role.

⁹⁷ *Id.* at 477 (emphasis added) (citations omitted).

⁹⁸ The *National Muffler* standard is similar to the pre-*Chevron* test established in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). In *Skidmore*, the Supreme Court provided a test for courts to use in assessing the level of respect to be given agency interpretations. *Id.* at 139–40. In *United States v. Mead Corp.*, 533 U.S. 218 (2001), the Court established that agency rules not entitled to *Chevron* deference may still be entitled to a degree of respect under *Skidmore*, in accordance with the various factors that lend the agency interpretation credibility and “persuasiveness.” *Id.* at 228. Acknowledging the similarities between *Skidmore* and *National Muffler*, this Essay endorses the *National Muffler* standard for several reasons. First, *National Muffler* has a higher precedential value for tax-specific cases due to the established body of caselaw that has developed regarding judicial deference to interpretative Treasury regulations, including the scope of the IRS’s authority to issue I.R.C. § 7805(b) regulations. See *infra* notes 211–12. Second, the specific factors for consideration in the *National Muffler* test are distinctly on point for retroactivity cases, and will therefore better distinguish between proper and improper uses of the IRS’s rulemaking authority. See *infra* notes 201–05 and accompanying text. Finally, the federal courts and tax scholars have consistently treated *National Muffler*, not *Skidmore*, as the primary doctrinal alternative to *Chevron* for judicial deference to tax regulations. See Berg, *supra* note 4, at 483; see also Hickman, *supra* note 4, at 1540.

⁹⁹ Salem et al., *supra* note 23, at 721.

¹⁰⁰ See Berg, *supra* note 4, at 493.

¹⁰¹ *Id.*

B. *The Chevron Doctrine*

1. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*

Five years after *National Muffler*, the Supreme Court decided *Chevron*, a watershed case in administrative law, in which it declared that federal agencies, not courts, are the primary interpreters of the statutes that they administer.¹⁰² If Congress explicitly or implicitly delegates rulemaking authority to an agency, the judiciary must respect Congress's delegation and the agency's construction of its organic statute.¹⁰³

The Court established a two-step test for applying this general rule.¹⁰⁴ Under *Chevron*'s first step, the court must determine whether Congress "has directly spoken to the precise question at issue."¹⁰⁵ If congressional intent is unambiguous, then there is no room for agency interpretation.¹⁰⁶ Conversely, "if the statute is silent or ambiguous with respect to the specific issue," then, under *Chevron*'s second step, the court must determine "whether the agency's answer is based on a permissible construction of the statute."¹⁰⁷ An agency's "reasonable interpretation" will be upheld unless it is "arbitrary, capricious, or manifestly contrary to the statute."¹⁰⁸ *Chevron* therefore established a regime of powerful judicial deference to administrative rules.¹⁰⁹

2. *National Cable and Telecommunications Ass'n v. Brand X Internet Services*

The Supreme Court's 2005 decision in *Brand X* significantly "amplified" *Chevron*'s already-powerful standard of judicial deference.¹¹⁰

¹⁰² See *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984); see also Hickman, *supra* note 4, at 1548 ("The more revolutionary but less often recognized aspect of *Chevron* is its call for *strong, mandatory deference* . . . where Congress . . . delegates rulemaking authority through the combination of statutory ambiguity and administrative responsibility." (emphasis added)).

¹⁰³ *Chevron*, 467 U.S. at 844 (stating that if Congress delegates interpretive power to an agency, "a court *may not* substitute its own construction of a statutory provision for a reasonable interpretation made by the . . . agency" (emphasis added)).

¹⁰⁴ *Id.* at 842.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 842–43.

¹⁰⁷ *Id.* at 843.

¹⁰⁸ *Id.* at 844; see also Berg, *supra* note 4, at 491 (describing *Chevron*'s arbitrary and capricious standard).

¹⁰⁹ See Coverdale, *supra* note 88, at 44–46; Laurence H. Silberman, *Chevron—the Intersection of Law & Policy*, 58 GEO. WASH. L. REV. 821, 822–23 (1990).

¹¹⁰ Berg, *supra* note 4, at 483.

As the Court's most recent articulation of the *Chevron* doctrine, and because the facts and holding of the case are analogous to the use of retroactive tax regulations,¹¹¹ it is perhaps the most authoritative statement of how the current *Chevron* doctrine would play out in an evaluation of I.R.C. § 7805(b) regulations.

In *Brand X*, the Court reviewed a decision by the Ninth Circuit holding broadband cable service to be properly classified as a "telecommunications service" under the Communications Act of 1934.¹¹² Before the Ninth Circuit decision, the Federal Communications Commission ("FCC") had issued a contrary interpretation of the 1934 Act (i.e., that broadband cable service was not a telecommunications service).¹¹³ The Ninth Circuit instead relied on contrary circuit precedent, *AT&T Corp. v. City of Portland*,¹¹⁴ which held that this service was a telecommunications service,¹¹⁵ thereby rejecting the FCC's opposite determination.¹¹⁶

The Supreme Court reversed.¹¹⁷ It held: "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference *only if* the prior court decision holds that its construction follows from the *unambiguous* terms of the statute *and thus leaves no room for agency discretion.*"¹¹⁸ As a result, notwithstanding circuit precedent, the Ninth Circuit was bound by the FCC's contrary interpretation: "*Chevron's* premise is that it is for agencies, not courts, to fill statutory gaps."¹¹⁹ Furthermore, the Court stated that courts must review agency constructions "on a blank slate," i.e., by ignoring both their own judicial precedents¹²⁰ as well as any prior inconsistent interpretations by the agency itself.¹²¹

Brand X is a powerful statement of agency primacy.¹²² The case strengthened *Chevron* in three critical ways. First, it underscored that

111 See *infra* note 162 and accompanying text.

112 See *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 979, 987 (2005); see also *Brand X Internet Servs. v. FCC*, 345 F.3d 1120, 1136 (9th Cir. 2003).

113 See *Brand X*, 545 U.S. at 979, 987; *Brand X*, 345 F.3d at 1136.

114 *AT&T Corp. v. City of Portland*, 216 F.3d 871 (9th Cir. 2000).

115 *Id.* at 880.

116 *Brand X*, 545 U.S. at 980, 987.

117 *Id.* at 1003.

118 *Id.* at 982 (emphases added).

119 *Id.*

120 *Id.* ("[A]llowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute . . . would allow a court's interpretation to override an agency's.").

121 *Id.* at 981.

122 Cf. *Hickman*, *supra* note 4, at 1590 ("*Chevron* represents a certain pro-agency bias in judicial review . . .").

Chevron, where applicable, calls for both powerful and mandatory deference.¹²³ Second, it set forth a highly text-specific, “four-corners” approach to evaluating agency regulations; the court may not consider the surrounding context or other outside factors regarding the agency’s promulgation of the rule in determining whether it is a “reasonable,” and thus permissible, construction.¹²⁴ Third, and perhaps most important, it established a framework of statutory interpretation that, on principle, eschews judicial precedent in favor of agency prerogative.¹²⁵ If the doctrinal requisites are met, a later interpretation by an agency controls over an earlier interpretation by a court.¹²⁶

C. Judicial and Scholarly Uncertainty

In the decades since *National Muffler* and *Chevron* were decided, the proper standard of judicial deference for interpretative Treasury regulations has remained “stubbornly unresolved.”¹²⁷ The lower federal courts have been in “a state of confusion”¹²⁸ over whether *Chevron* or *National Muffler* applies.¹²⁹ In the Tax Court, confusion has reigned.¹³⁰ The courts have stated at various points that *National Muffler* is the correct standard,¹³¹ that there is no substantive difference between the *National Muffler* and *Chevron* tests,¹³² and that both *Na-*

¹²³ *Brand X*, 545 U.S. at 982–83.

¹²⁴ *Id.* at 986.

¹²⁵ *Id.* at 982; see also Jonathan Masur, *Judicial Deference and the Credibility of Agency Commitments*, 60 VAND. L. REV. 1021, 1024 (2007) (noting that “the Supreme Court [in *Brand X*] held for the first time that *Chevron* deference effectively ‘trumped’ stare decisis”).

¹²⁶ *Brand X*, 545 U.S. at 982.

¹²⁷ See Hickman, *supra* note 4, at 1538.

¹²⁸ Brief of Professor Smith, *supra* note 22, at 4.

¹²⁹ See Berg, *supra* note 4, at 490 (noting that “*Chevron* deference,” “the *National Muffler* standard,” and other common terms of art “[c]onfusingly . . . appear to be given different meanings in different situations”); see also *id.* at 490 n.31 (“Even the word ‘deference’ itself engenders difficulties. While courts sometimes speak as if deference were an all-or-nothing proposition . . . , the word is usually used in a comparative sense, with certain types of agency pronouncements being worthy of more deference than others.”); see also Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Respondent at 16–20, Mayo Found. for Med. Educ. & Research v. United States, 131 S. Ct. 704 (2011) (No. 09-837) [hereinafter Brief of Professor Hickman].

¹³⁰ See Berg, *supra* note 4, at 502 (noting that the Tax Court and the circuit courts have “wrestl[ed] with the question of *Chevron*’s effect (if any) on the *National Muffler* standard”).

¹³¹ See, e.g., Mayo Found. for Med. Educ. & Research v. United States, 503 F. Supp. 2d 1164, 1171 (D. Minn. 2007) (“There is no indication that the standard in *National Muffler* was changed by *Chevron*.”), *rev’d*, 568 F.3d 675 (8th Cir. 2009), *aff’d*, 131 S. Ct. 704 (2011); Swallows Holding, Ltd. v. Comm’r, 126 T.C. 96, 131 (2006) (stating that the Tax Court “generally” applies *National Muffler* to review interpretative Treasury regulations), *vacated and remanded*, 515 F.3d 162 (3d Cir. 2008).

¹³² See, e.g., Estate of Gerson v. Comm’r, 127 T.C. 139, 153–54 (2006), *aff’d*, 507 F.3d 435 (6th Cir. 2007).

tional Muffler and *Chevron* govern because *Chevron* simply restates the *National Muffler* analysis.¹³³ The circuit courts are also split on this issue.¹³⁴ For example, in the Third and Sixth Circuits, *Chevron* is the rule,¹³⁵ whereas in the Eighth Circuit, *National Muffler* applies.¹³⁶ Scholars and practitioners have similarly disagreed both on which standard actually governs judicial review of interpretative Treasury regulations,¹³⁷ as well as on which standard is better; some have argued that *Chevron* deference is the more appropriate standard, whereas others have argued that *National Muffler* should apply for judicial review of interpretative tax regulations.¹³⁸

The confusion among courts, scholars, and practitioners is most likely attributable to the Supreme Court's longtime failure to address the relationship between *Chevron* and *National Muffler* and to articulate which standard governs.¹³⁹ In fact, since 1984, the Court has routinely cited both *Chevron* and *National Muffler* in reviewing interpretative tax regulations.¹⁴⁰ It has only recently sought to bring coherence and consistency to this area of doctrinal uncertainty, with its 2011 decision in *Mayo Foundation*.¹⁴¹

Mayo Foundation involved judicial review of Treasury regulations interpreting the Federal Insurance Contributions Act ("FICA"), the federal statute that requires full-time employees to pay taxes on

¹³³ Cent. Pa. Sav. Ass'n & Subsidiaries v. Comm'r, 104 T.C. 384, 392 (1995) (stating that *Chevron* merely incorporates the *National Muffler* factors into a "practical two-part test").

¹³⁴ Hickman, *supra* note 4, at 1538.

¹³⁵ See, e.g., *Estate of Gerson*, 507 F.3d at 438; *Swallows Holding, Ltd.*, 515 F.3d at 164.

¹³⁶ See, e.g., *St. Jude Med., Inc. v. Comm'r*, 34 F.3d 1394, 1400 (8th Cir. 1994).

¹³⁷ See Berg, *supra* note 4, at 523 (arguing that "rather than working a sea change in the traditional standards of deference," *Chevron* actually created two separate standards: arbitrary and capricious deference for explicit congressional delegations, and permissible-construction, or reasonableness, for implicit and general congressional delegations); Hickman, *supra* note 4, at 1542 (arguing that *Chevron* governs).

¹³⁸ Compare Brief of Professor Smith, *supra* note 22, at 6 (arguing for the application of *National Muffler*), and Berg, *supra* note 4, at 545–46 (same), with Brief of Professor Hickman, *supra* note 129, at 22–28 (arguing for the application of *Chevron*).

¹³⁹ See Hickman, *supra* note 4, at 1559 ("The disagreements among the lower courts are perhaps to be expected when one considers . . . the Supreme Court's confusing signals on the issue."). Professor Hickman also describes the Court's caselaw as "all over the map" and a "jurisprudential mess." *Id.* In the end, "[t]he best interpretation of the Court's post-*Chevron* citation of both *Chevron* and *National Muffler* is that the Court simply has not decided what standard to apply in reviewing Treasury regulations." *Id.* at 1584.

¹⁴⁰ Compare *Atl. Mut. Ins. Co. v. Comm'r*, 523 U.S. 382, 387 (1998) (citing *Chevron*), and *United States v. Boyle*, 469 U.S. 241, 246 n.4 (1985) (same), with *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001) (citing *National Muffler*), and *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 561 (1990) (same).

¹⁴¹ *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704 (2011).

wages.¹⁴² Since 1951, Treasury had recognized a student exclusion, which relieved students from the tax burden if they were enrolled in a course of study.¹⁴³ In 2004, however, Treasury issued new interpretative regulations that eliminated the student exclusion.¹⁴⁴ The Mayo Foundation, on behalf of a group of medical residents now categorized as full-time employees under FICA, challenged the regulations as an impermissible construction of the statute.¹⁴⁵

Chief Justice Roberts, writing for a unanimous Court, acknowledged the disagreement between the parties over the proper standard for judicial deference, and acknowledged the Court's unclear and inconsistent treatment of *National Muffler* and *Chevron* in the past.¹⁴⁶ The Chief Justice then stated that the *Chevron* doctrine is the proper standard for judicial deference to Treasury regulations.¹⁴⁷ He wrote, "The principles underlying our decision in *Chevron* apply with full force in the tax context."¹⁴⁸ Despite this broad pronouncement, a closer reading of *Mayo Foundation* reveals that there is substantial flexibility in its application.

First, the Supreme Court reiterated that the basis for *Chevron* deference is the congressional delegation of gap-filling authority over complex questions of statutory interpretation to administrative agencies.¹⁴⁹ This implies that for cases where these rationales are not present, heightened deference is not warranted. Second, the Court stated that it has "not thus far distinguished between *National Muffler* and *Chevron*,"¹⁵⁰ which suggests that *National Muffler* has survived *Mayo Foundation* and still applies in certain, albeit perhaps limited, situations. Finally, the Court explicitly considered the possibility that some scenario may warrant the *National Muffler* test rather than *Chevron*:

Aside from our past citation of *National Muffler*, Mayo has not advanced any justification for applying a less deferential

¹⁴² *Id.* at 708, 709–10.

¹⁴³ *Id.* at 709.

¹⁴⁴ *Id.* at 710.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 712 ("Since deciding *Chevron*, we have cited both *National Muffler* and *Chevron* in our review of Treasury Department regulations.").

¹⁴⁷ *Id.* at 713.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* The Court also recognized the IRS and Treasury's important interests over the interpretation of the Code. *See id.* ("[I]n an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems." (quoting *Bob Jones Univ. v. United States*, 461 U.S. 574, 596 (1983) (alteration in original) (internal quotation marks omitted))).

¹⁵⁰ *Id.* at 712.

standard of review to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only.¹⁵¹

Given this built-in reservation, and because the Court has yet to decide a case regarding the use of retroactive tax regulations to overturn court decisions, there is room to argue that *National Muffler* should apply to retroactivity cases. Furthermore, “[t]he courts should be open to deviating from legal norms where circumstances justify departure.”¹⁵²

For these reasons, the proper standard of judicial deference to I.R.C. § 7805(b) regulations has not been conclusively resolved by *Mayo Foundation*. In any event, even if the case established a broad principle that the *Chevron* doctrine generally applies to judicial review of interpretative Treasury regulations, there are still compelling reasons for abandoning the *Chevron* doctrine for judicial review of I.R.C. § 7805(b) regulations.

IV. JUDICIAL DEFERENCE TO I.R.C. § 7805(B) REGULATIONS

The courts should reject the IRS’s latest reincarnation of the tax exceptionalism argument and refuse to apply the *Chevron* doctrine to review I.R.C. § 7805(b) regulations. The primary rationales for *Chevron* deference, congressional delegation and agency expertise, do not counsel in favor of heightened deference when the IRS issues a retroactive regulation to invalidate a court decision. *Chevron*’s premise is that courts should defer to agency interpretations of ambiguous statutes because the agency, using its institutional expertise, is exercising congressionally delegated authority to administer a particular statutory scheme.¹⁵³ As a reincorporation of its failed litigating position and an impermissible interference with the judiciary’s decisionmaking prerogatives, the IRS’s use of retroactive regulations to overturn court decisions has no basis in either of these rationales. Furthermore, after *Brand X*, *Chevron*’s regime of mandatory deference would fail to distinguish between legitimate and illegitimate exercises of the IRS’s reg-

¹⁵¹ *Id.* at 713.

¹⁵² Hickman, *supra* note 4, at 1540–41; *see also id.* at 1541 (noting that for tax deference issues, “[d]eviation should be premised only on clear justification,” and that “such justification should be context-specific”).

¹⁵³ *See Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984) (emphasizing “legislative delegation”); *Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 980–81 (2005) (same); *see also Hickman, supra* note 4, at 1539 (emphasizing congressional delegation and the institutional advantages of government agencies).

ulatory authority because it's highly text-specific, four-corners approach to determining "reasonable" agency interpretations would not take into account the context and circumstances surrounding the IRS's issuance of the I.R.C. § 7805(b) regulations.

The *National Muffler* test is a better standard, both normatively and doctrinally, for balancing the IRS's congressionally delegated prerogative to interpret and enforce the federal tax laws—a task that requires wide interpretive latitude¹⁵⁴—against the powerful interests of both taxpayer-litigants and the judiciary in the integrity and finality of court decisions. However, this Essay does not suggest that *National Muffler* is manifestly suited for reviewing I.R.C. § 7805(b) regulations, or that *Chevron* is wholly ill suited for this task. After all, it is possible that some I.R.C. § 7805(b) regulations designed to invalidate court decisions would not survive the heightened deference afforded by *Chevron*.¹⁵⁵ This Essay simply seeks to shed light on a complex and relatively unexamined area of the law, where both judicial prerogative and agency preeminence are regarded as foundational principles. In light of the uniquely complicated questions presented by this issue, *National Muffler* presents the best, most principled, and most workable test for balancing the competing values at play in retroactivity cases.

A. *Treasury's Retroactive Regulations Are Not Entitled to Chevron Deference*

The *Chevron* doctrine "only appl[ies] where a court affirmatively finds that Congress implicitly delegated primary interpretive power" and the agency exercised this regulatory power within the scope of the delegation.¹⁵⁶ Congressional delegation "reflect[s] a presumptive evaluation that independent and executive branch agencies, rather than the courts, should be responsible for the policy choices inherent in statutory interpretation."¹⁵⁷ In other words, *Chevron* requires both

¹⁵⁴ See *supra* notes 59–61, 76–77 and accompanying text.

¹⁵⁵ Under the *Chevron* doctrine, even a regulation that passes the two-step test may still be set aside if it is found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A) (2006). Under this abuse of discretion standard, however, the courts' records are hit-or-miss with respect to overturning retroactive tax regulations, even where they produce significant hardship for individual taxpayer-litigants. See Robinson, *supra* note 21, at 775 n.18 (citing several cases for the proposition that, regardless of the taxpayer's hardship and the factor of ongoing litigation, the courts' decisions to uphold or overturn an I.R.C. § 7805(b) regulation under the abuse of discretion standard often turn on whether or not the court is "sympathetic to the plight of [the] taxpayer").

¹⁵⁶ Hickman, *supra* note 4, at 1553.

¹⁵⁷ See *id.* at 1539.

that Congress expressly or implicitly delegated interpretive authority to an agency and that this delegation is the power to set policy. Therefore, although *Chevron* deference is ubiquitous—and, where applied, powerful—“*Chevron*’s scope is limited.”¹⁵⁸

1. Congressional Delegation

The IRS’s issuance of I.R.C. § 7805(b) regulations to influence ongoing litigation, or to outright reverse judicial decisions already handed down, has no basis in the congressional-delegation rationale for *Chevron* deference. The retroactive application of administrative rules has long produced concerns over the proper delegation of legislative power.¹⁵⁹ Nonetheless, in *Intermountain II*, the IRS asserted near-plenary authority to overturn court decisions by issuing retroactive regulations.¹⁶⁰ The Commissioner cited *Brand X* for the proposition that courts must respect reasonable agency interpretations of ambiguous statutes even in the face of a prior contrary judicial interpretation.¹⁶¹ On the surface, *Brand X* and *Intermountain II* look very similar: in each case, the court reviewed the validity of a later-promulgated agency rule and determined whether the regulation warranted controlling deference despite the existence of inconsistent caselaw.¹⁶² A closer examination of the *Brand X* opinion, however, reveals more differences than similarities.

In *Brand X*, the Supreme Court stated that the executive branch cannot interfere with the legitimate decisionmaking responsibilities of courts, expressly rejecting the idea that its holding would make “judicial decisions subject to reversal by executive officers.”¹⁶³ In response to the dissent’s accusation that the majority’s opinion left open this possibility, the majority simply stated, “It does not.”¹⁶⁴ This statement

¹⁵⁸ *Id.* at 1553.

¹⁵⁹ See Robinson, *supra* note 21, at 778 n.32 (noting that there are constitutional concerns about “whether substantive rulemaking may be exercised retroactively”).

¹⁶⁰ See Commissioner’s Tax Court Brief, *supra* note 2, at 14–18.

¹⁶¹ See *id.* at 17–18 (citing Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs., 545 U.S. 967, 982–83 (2005)).

¹⁶² Compare *Brand X*, 545 U.S. at 982, with *Intermountain II*, 134 T.C. at 211–15, 220–25 (2010), *rev’d*, No. 10-1204 (D.C. Cir. June 21, 2011).

¹⁶³ *Brand X*, 545 U.S. at 983 (quoting *id.* at 1016 (Scalia, J., dissenting)).

¹⁶⁴ *Id.* The Court further stated that “[i]n all other respects, the court’s prior ruling remains binding law. . . . The precedent has not been ‘reversed’ by the agency.” *Id.* It is also worth noting that although *Brand X* endorses agency preeminence where prior contrary caselaw exists, *id.* at 982–83, the opinion does not address retroactive application of agency rules to ongoing or decided cases, particularly those in which the agency in question was itself a litigant. Because the IRS is an active litigant in revenue-collection cases, its reading of a statute is almost always linked to its own interests in prevailing in court or reversing unfavorable judgments, which

underlines the principle that *Chevron* deference is restricted to clear congressional delegations of policy judgments better suited for agency resolution than judicial decisionmaking,¹⁶⁵ and there is no such delegation where the agency's actions are best described as interfering with the courts' decisionmaking processes.

The principle that Congress possesses constitutionally delegable power over legislative decisions regarding public matters¹⁶⁶ is accompanied by the rule that the judiciary has the power to decide individual cases and controversies.¹⁶⁷ The *Chevron* doctrine therefore reflects an understanding of and respect for the appropriate decision-making capabilities and prerogatives of the constituent branches of government—policy decisions, through congressional delegation, are reserved for executive branch agencies, whereas interpretations of the law in individual cases are reserved for the judiciary.¹⁶⁸ Because *Chevron* is limited to instances where agencies properly exercise congressionally delegated power, the line between congressional and judicial authority blurs where agencies inject this policymaking ability into actively litigated cases.

If the IRS were permitted to reverse previously decided cases by issuing new interpretative regulations, this regulatory authority would exceed the lawmaking power exercised by Congress.¹⁶⁹ When Congress passes a law, the statute usually applies only prospectively, not retroactively, and therefore does not overturn or invalidate previously decided cases.¹⁷⁰ To permit the IRS to reverse judgments by issuing

greatly blunts the persuasive power of its argument that its interpretations deserve heightened deference.

¹⁶⁵ See, e.g., *id.* at 980 (“In *Chevron*, this Court held that ambiguities in statutes . . . are delegations of authority to the agency to fill the statutory gap in reasonable fashion. Filling these gaps . . . involves difficult policy choices that agencies are better equipped to make than courts.”); Hickman, *supra* note 4, at 1549 (noting that *Chevron* “sounds themes of congressional delegation, agency technical expertise, and democratic accountability” (citing *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843–44, 865 (1984))).

¹⁶⁶ See Hickman, *supra* note 4, at 1548–49 (noting that policymaking is “the job of administering agencies, not the courts, to make”).

¹⁶⁷ See U.S. CONST. art. III, §§ 1–2.

¹⁶⁸ See *Bankers Trust N.Y. Corp. v. United States*, 225 F.3d 1368, 1376 (Fed. Cir. 2000) (“The *Chevron* doctrine, properly understood, does not change this basic application of Separation of Powers doctrine.”); see also *Chi. & S. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948) (“Judgments within the powers vested in courts by the Judiciary Article of the Constitution may not lawfully be revised, overturned or refused faith and credit by another Department of Government.”).

¹⁶⁹ See Alan Horowitz, *Tenth Circuit Sides with Government on Intermountain Issue*, TAX APP. BLOG (May 31, 2011), <http://appellatetax.com/2011/05/31/tenth-circuit-sides-with-government-on-intermountain-issue/>.

¹⁷⁰ See *id.*

I.R.C. § 7805(b) regulations would “potentially give[] regulatory agencies more power than even Congress to change the law.”¹⁷¹ Because the IRS’s use of I.R.C. § 7805(b) regulations transcends the boundaries of congressional lawmaking, and because an agency possesses no more power than that which is delegated from Congress, it follows that the agency is exercising its regulatory powers outside the scope of *Chevron*’s congressional-delegation rationale.

The IRS’s manifest purpose in the *Intermountain* cases is to introduce policy interpretations post hoc into actively litigated issues to upset court decisions. The courts should regard this type of agency action as a simple reincorporation of its unsuccessful litigating position. The caselaw on judicial deference does not permit the use of regulatory powers to interfere with ongoing litigation or to upset decided cases.¹⁷² “[A]n obvious attempt to bootstrap the government’s litigating position” is not a permissible exercise of policymaking authority,¹⁷³ and therefore “[d]eference to what appears to be nothing more than an agency’s convenient litigating position would be entirely inappropriate.”¹⁷⁴ The caselaw on I.R.C. § 7805(b) regulations already provides this distinction and rejects the use of the IRS’s rulemaking power to control ongoing litigation: “[T]he Commissioner may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations.”¹⁷⁵ In other words, there is and must be a distinction between exercising regulatory powers to interpret and administer statutes based on general or specific congressional delegations to set policy or clarify the law and exercising regulatory powers to influence or manipulate judicial decisionmaking. The IRS’s use of retroactive regulations to overturn taxpayer-favorable decisions falls squarely in the latter category.

Furthermore, by asserting an undue degree of influence over a particular, individualized case, the IRS’s actions more closely resemble judicial, rather than legislative, decisionmaking. Although the IRS does not overstep its congressionally delegated powers simply by issuing I.R.C. § 7805(b) regulations, it does overstep its congressionally

¹⁷¹ *Id.*

¹⁷² See *supra* notes 163–68 and accompanying text.

¹⁷³ *Sala v. United States*, 552 F. Supp. 2d 1167, 1203 (D. Colo. 2008), *rev’d*, 613 F.3d 1249 (10th Cir. 2010).

¹⁷⁴ *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213 (1988).

¹⁷⁵ *Chock Full O’ Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971).

delegated powers by obstructing or misappropriating the judiciary's prerogative to decide individual cases and controversies. The judicial power is vested in the courts,¹⁷⁶ and the principle that Congress and executive branch agencies are not permitted to intrude upon this power is both well established and forcefully protected:

[The judicial power cannot be] controuled by the legislature, [or] by an officer in the executive department. Such revision and controul [is] deemed radically inconsistent with the independence of that judicial power which is vested in the courts; and consequently, with that important principle which is so strictly observed by the Constitution of the United States.¹⁷⁷

Ultimately, the *Chevron* doctrine, as applied in this context, allows the IRS to reincorporate its failed litigating position and arrogate the judiciary's role to decide individual cases. Such executive branch interference with the judicial function does not fall within the proper scope of the congressional-delegation rationale.

2. Institutional Expertise

The second traditional rationale for *Chevron* deference is that agencies are not only congressionally authorized to interpret and enforce complex statutory regimes but also better suited than courts to do so because they have certain institutional advantages.¹⁷⁸ Although this rationale is powerful, it “only appl[ies] where a court affirmatively finds that Congress implicitly delegated primary interpretive power” and the agency exercised that power.¹⁷⁹

The institutional-expertise rationale does not justify *Chevron* deference to I.R.C. § 7805(b) regulations for the same reasons as the congressional-delegation rationale. As previously noted, the use of retroactive regulations to resurrect failed litigating positions is not an acceptable exercise of congressionally delegated power, and an agency can only exercise policymaking authority to the extent that Congress has delegated this authority.¹⁸⁰ The IRS possesses congressionally delegated gap-filling and policymaking authority, as well as the power to issue “all needful rules and regulations” for the enforcement of the

¹⁷⁶ U.S. CONST. art. III, §§ 1–2.

¹⁷⁷ *Hayburn's Case*, 2 U.S. (2 Dall.) 409, 411–12 n. (1792).

¹⁷⁸ *See, e.g.*, *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 980 (2005); Hickman, *supra* note 4, at 1539 (noting that agencies are “better positioned” than courts to interpret complex statutory regimes because they are more democratically accountable, more responsive to policy trends, and possess more expertise).

¹⁷⁹ Hickman, *supra* note 4, at 1553.

¹⁸⁰ *See, e.g.*, *Brand X*, 545 U.S. at 980, 982.

Code,¹⁸¹ but in the end, the judiciary remains “the primary interpreter of the law.”¹⁸²

At the same time, however, the institutional-expertise rationale presents a compelling justification for a certain level of deference to retroactive interpretative Treasury regulations that are not issued simply to reverse an unfavorable judgment, given that Congress has properly delegated general rulemaking authority to IRS and the Treasury under I.R.C. § 7805(a) and § 7805(b).¹⁸³ To a degree, therefore, the courts must respect the IRS’s duty and prerogative to administer and enforce the laws under its jurisdiction. This, in turn, requires a degree of judicial deference to its statutory interpretations,¹⁸⁴ even in cases where the agency seeks to assert its interpretive preeminence through retroactive application of its regulations.

Although issuing I.R.C. § 7805(b) regulations involves aspects of policymaking, such that the decision reflects the interpretive expertise of the agency, there are aspects of adjudicative decisionmaking when the IRS seeks to overturn previously litigated cases. In other words, the hybrid legislative-adjudicative character of issuing retroactive tax regulations and applying them to ongoing litigation cuts both ways: the agency is exercising its regulatory authority to interpret and administer the Code as it applies to all taxpayers—an act that warrants heightened deference—but the agency is also disrupting and displacing the judicial decisionmaking process and overturning a court decision for an individual litigant—an act that does not warrant heightened deference. For the reasons outlined above, consideration of the agency’s institutional advantage in interpreting the substance of the statute must be weighed against the compelling and countervailing prerogative of the judiciary.¹⁸⁵ This requires a realistic, context-spe-

¹⁸¹ I.R.C. § 7805(a) (2006).

¹⁸² Hickman, *supra* note 4, at 1564 (citing *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803)).

¹⁸³ See *supra* notes 59–61 and accompanying text.

¹⁸⁴ Cf. Hickman, *supra* note 4, at 1570 (“[C]omplexity and expertise likely explain the courts’ propensity to give general authority Treasury regulations as a class slightly more deference than similar rules issued by other agencies.”).

¹⁸⁵ In a recent case, the Fourth Circuit, while not endorsing the *National Muffler* standard, suggested that employing *Chevron* deference to I.R.C. § 7805(b) regulations would permit an impermissible intrusion upon the judicial role. See *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249, 260 (4th Cir.) (“*Chevron*, *Brand X*, and more recently, *Mayo Foundation* rightly leave agencies with a large and beneficial role, but they do not leave courts with no role where the very language of the law is palpably at stake. There is a balance to be struck here, and courts still must play a part in determining where ‘here’ is. The disruption of that balance in this case seems clear and evident.”), *reh’g en banc denied*, No. 09-2353 (4th Cir. Apr. 5, 2011).

cific judicial deference standard for determining the ultimate reasonableness of I.R.C. § 7805(b) regulations.

3. *Controlling Deference to “Reasonable” Agency Interpretations*

Both *Chevron* and *National Muffler* require agency interpretations to be “reasonable,”¹⁸⁶ but each test evaluates what is reasonable on different terms. After *Brand X*, a reasonable agency interpretation under the *Chevron* doctrine is determined almost exclusively by a textual analysis of the agency’s construction.¹⁸⁷ The doctrine’s requirement that regulations be evaluated under a “blank slate” means that an agency’s purpose in promulgating its interpretation is not the touchstone of the analysis; to determine the reasonableness of the agency’s reading, courts disregard the context and circumstances and focus solely on the text.¹⁸⁸

For instance, the IRS’s interpretations of I.R.C. §§ 6501 and 6229 in *Intermountain II* may have been the “best” interpretations of the meaning of “omission of gross income,” in the sense that they most accurately reflect the language and congressional intent of the Code. If so, the strict, four-corners analysis required by *Brand X* would likely result in a summary decision upholding the IRS’s interpretation as reasonable—notwithstanding the context in which the regulations were issued.¹⁸⁹ Under *Chevron* and *Brand X*, therefore, if a statute’s meaning is not completely unambiguous and the agency’s interpretation is reasonable on its face, judicial deference to the agency’s construction is mandatory.¹⁹⁰ This highly deferential scheme is consistent with the *Chevron* doctrine’s emphasis on agency supremacy.¹⁹¹ Because agency primacy is in direct conflict with the principle of judicial review,¹⁹² the use of controlling deference to agency interpretations

¹⁸⁶ Compare *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984), with *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 477 (1979).

¹⁸⁷ See *supra* notes 118–21 and accompanying text (emphasizing a text-specific, four-corners approach to the regulation, and disregarding external factors, such as the surrounding circumstances and the intention of the agency).

¹⁸⁸ See *Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 982 (2005).

¹⁸⁹ In fact, in its brief before the D.C. Circuit, the government specifically argued that its interpretations should warrant *Chevron* deference based on a facial reading of the statute. See Brief for the Appellant at 43, *Intermountain III*, No. 10-1204 (D.C. Cir. June 21, 2011) (“*Brand X* . . . clarified that the *Chevron* step-one analysis focuses on the statute’s text . . .”).

¹⁹⁰ See *Chevron*, 467 U.S. at 844; *Brand X*, 545 U.S. at 980–81.

¹⁹¹ See *Brand X*, 545 U.S. at 982.

¹⁹² Cf. Hickman, *supra* note 4, at 1590 (noting that the principle of agency primacy “makes many people uncomfortable absent robust judicial review”).

should be cautiously exercised in retroactivity cases, where the delicate balance between agency and judicial decisionmaking is unsettled.¹⁹³

National Muffler, by contrast, requires agencies to “implement the congressional mandate *in some reasonable manner*.”¹⁹⁴ This linguistic distinction is important. Unlike *Chevron*, the test does not require a court to uphold an agency interpretation if, *on its face*, the statutory language reasonably supports the agency’s proffered construction. Rather, the language “in some reasonable manner” calls for a more holistic evaluation of the context in which the regulation was promulgated, thereby providing a more flexible framework for analyzing regulations on a case-by-case basis. *National Muffler*’s reasonableness inquiry is therefore slightly more expansive because it involves an analysis of both the substance of the interpretation as well as the surrounding context. This test is better suited for evaluating I.R.C. § 7805(b) regulations designed to overturn prior court decisions because it takes into account the circumstances behind their issuance.

B. The National Muffler Standard Is More Appropriate in the Absence of Express Congressional Delegation

This Essay proposes that courts evaluate I.R.C. § 7805(b) regulations under the *National Muffler* test. The IRS’s use of retroactive interpretative Treasury regulations to reintroduce a failed litigating position and claim deferential treatment does not fall within the bounds of congressionally delegated policymaking authority, but is instead an impermissible intrusion upon the judicial decisionmaking function. *National Muffler*’s multifactor, tax-specific, context-based analysis can better distinguish between proper and improper exercises of the IRS’s regulatory authority with respect to retroactive tax regulations. This test can therefore more appropriately balance the agency’s prerogative to enforce the federal tax laws with the rights of both taxpayer-litigants and the courts in the integrity of judicial decisions.

A retroactivity-specific reasonableness test for evaluating agency regulations already has a jurisprudential pedigree.¹⁹⁵ For instance, in

¹⁹³ See *supra* note 185 and accompanying text.

¹⁹⁴ *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 476–77 (1979) (emphasis added) (citation omitted).

¹⁹⁵ See Robinson, *supra* note 21, at 778 (stating that the standard for granting a retroactive regulation the force of law is “whether the retroactivity is reasonable”).

Chock Full O' Nuts Corp. v. United States,¹⁹⁶ the Second Circuit stated that “[w]hile retroactivity in tax regulations is . . . presumptively permissible, it is *in each case* for the court to determine whether *under all the circumstances* retroactive application would be warranted.”¹⁹⁷ This long-established standard for evaluating retroactive regulations, including interpretative Treasury regulations, is analogous to the reasonableness analysis provided by *National Muffler*.¹⁹⁸

As previously noted, the IRS and Treasury require a high degree of autonomy in interpreting and enforcing the internal revenue laws, including the authority to issue retroactive regulations.¹⁹⁹ However, a retroactively applied tax regulation such as in *Intermountain II* does not just correct or clarify the tax laws for all taxpayers; it also invalidates judicial decisions for individual taxpayers who have already prevailed against the IRS in court. It may be appropriate for the government’s interpretation to apply to all other taxpayers, but when the IRS reopens and reverses a particular case for an individual litigant, “retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles.”²⁰⁰

1. Context-Based Analysis

National Muffler presents a context-specific, multifactor test for evaluating tax regulations.²⁰¹ The statement, “[i]f the regulation dates from a later period, the manner in which it evolved merits inquiry,” permits a case-by-case analysis of the context and purpose behind the issuance of an I.R.C. § 7805(b) regulation.²⁰² The “[o]ther relevant considerations”²⁰³ outlined in the opinion also provide a clear and appropriately tailored framework for distinguishing permissible versus impermissible retroactive regulations. As noted above, the three primary considerations are (1) the length of time the regulation has been in effect, (2) the parties’ reliance on this interpretation, and (3) the consistency of the agency’s interpretation over time.²⁰⁴ Each of these factors would likely serve to assist a reviewing court in distinguishing

¹⁹⁶ *Chock Full O' Nuts Corp. v. United States*, 453 F.2d 300 (2d Cir. 1971).

¹⁹⁷ *Id.* at 302–03 (emphases added).

¹⁹⁸ *See supra* notes 92–101 and accompanying text.

¹⁹⁹ *See supra* notes 59–60, 76–77 and accompanying text.

²⁰⁰ *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947).

²⁰¹ *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979).

²⁰² *Id.*

²⁰³ *See supra* text accompanying note 97.

²⁰⁴ *See supra* notes 96–98 and accompanying text.

between proper and improper exercises of the IRS's retroactivity powers—in other words, determining when the IRS is legitimately seeking to exercise its retroactivity power and when it is simply trying to overturn cases by administrative fiat.

Although the court must consider these factors, none are dispositive of the question, and all are merely proxies for determining the ultimate reasonableness of the regulation. These factors are also useful for distinguishing between exercises of the IRS's authority to prevent tax-fraud or tax-evasion schemes, or to make certain technical corrections that do not present unduly harsh results, from efforts to overturn judicial decisions.²⁰⁵ Therefore, one of the principal virtues of the *National Muffler* approach is that there is no strict formula, such as *Chevron's*, that requires a court to defer to a particular statutory interpretation if certain criteria are met; these factors merely serve as useful guidance.

2. *Length of Time and Consistency*

The length-of-time factor in the *National Muffler* test presents a strong basis for distinguishing between the IRS's attempts to overturn cases and the IRS's attempts to issue corrective interpretations of the Code to prevent or mitigate abuse or fraud. If the IRS issues a regulation subsequent to a related court loss, such as in *Intermountain II*, this can serve as compelling evidence for the court in determining whether the agency is merely seeking to reopen and overturn a particular judgment. By contrast, if the IRS issues the regulation much earlier, or other factors point to an alternative, legitimate rationale, this would serve as evidence that the agency is properly exercising its retroactivity authority. If the newly issued regulation were largely consistent with prior regulatory interpretations by the IRS or Treasury, this would be further evidence that the agency is not abusing its power. If conflicting factors are present, the courts have the flexibility to weigh the harm of applying the rule retroactively against the public interest in upholding the prior judicial construction.

3. *Reliance*

If the IRS were to issue retroactively applicable regulations under I.R.C. § 7805(b), this would greatly undermine the justifiable reliance

²⁰⁵ This Essay does not purport to provide a comprehensive list or framework for determining which exercises of retroactivity power are legitimate and which are not, because the *National Muffler* test itself is designed to permit courts to weigh these considerations on a case-by-case basis.

of the taxpayers, as well as the legal community itself, on the court's previous decision interpreting the Code. If the IRS invalidates, post hoc, a judicial decision, it severely disrupts the taxpayer's reliance on the state of the law regarding its tax liability. "In the interest of fairness, trust and confidence in the tax system, a taxpayer ought to be able to rely on a reasonable interpretation of a statute until such time as regulations are issued."²⁰⁶

The use of an I.R.C. § 7805(b) regulation to override the judicial power is also inapposite to the values of the civil litigation system, given its emphasis on the finality of court decisions. The doctrine of collateral estoppel holds that issues previously decided by courts are conclusive as to the same party in subsequent suits.²⁰⁷ The shared interest of the courts and litigants in leaving decided issues undisturbed is also supported by the "law of the case" doctrine. The law of the case doctrine holds that "when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case."²⁰⁸ The doctrine "expresses the practice of courts generally to refuse to reopen what has been decided."²⁰⁹ The judiciary itself has an interest—indeed, a constitutional prerogative²¹⁰—in having its decisions protected from displacement by regulatory fiat. If the IRS issues a retroactive regulation and files motions to vacate and reconsider a recently decided case based on compulsory deference principles, this essentially forces the court to reopen what has been decided, thereby ignoring the principles of finality that underlie the civil litigation system.

Additionally, it is likely that the IRS's substantially unbridled authority to issue retroactive regulations under I.R.C. § 7805(b) would tend to produce unfair or unduly harsh results. Although the IRS's interpretations have generally been accorded high deference, the courts have nonetheless created certain exceptions for retroactive Treasury regulations. For example, the courts have been reluctant to uphold I.R.C. § 7805(b) regulations when doing so would cause substantial hardship to taxpayers or treat similarly situated taxpayers differently.²¹¹ The caselaw does not provide a clear test, but the basic

²⁰⁶ Ball, *supra* note 11, at 153.

²⁰⁷ *Montana v. United States*, 440 U.S. 147, 153 (1979).

²⁰⁸ *Arizona v. California*, 460 U.S. 605, 618 (1983).

²⁰⁹ *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 817 (1988) (internal quotation marks omitted).

²¹⁰ *See Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177 (1803) ("It is emphatically the province and duty of the judicial department to say what the law is.").

²¹¹ *See* Ball, *supra* note 11, at 143–44.

principle appears to be that I.R.C. § 7805(b) regulations will not receive heightened deference when this would produce a significantly unjust or inequitable result.²¹² If the IRS were accorded the retroactivity power it asserted in the *Intermountain* cases, this would create an unjustifiably one-sided tax litigation system, in which the agency could reverse taxpayer-favorable judgments simply because administrative law principles suggest that agencies are in a superior position to courts with respect to statutory construction.

As applied to retroactivity cases, therefore, the *Chevron* doctrine is in opposition to the reliance interests of the courts and litigants, established procedural doctrine, and fundamental principles of fairness. In order to produce the best and most equitable result, the proper standard of judicial deference for reviewing I.R.C. § 7805(b) regulations should take into account each of these considerations before granting heightened deference to the agency's rule.

CONCLUSION

The standard for judicial deference to retroactive interpretative Treasury regulations is currently an unresolved question,²¹³ but sooner or later the federal courts (or the Supreme Court) will have to provide an answer.²¹⁴ Although the Commissioner's arguments were unsuccessful in the Tax Court,²¹⁵ the IRS's recent successes in the federal courts of appeals²¹⁶ and the Supreme Court's recent endorsement of the *Chevron* doctrine²¹⁷ could mean that all tax regulations, both prospective and retroactive, will be granted heightened deference.

The courts should not adopt the *Mayo Foundation* rule wholesale by applying the *Chevron* doctrine to I.R.C. § 7805(b) regulations. The complex issues raised by the *Intermountain* cases—including the interests and prerogatives of federal agencies, taxpayer-litigants, and the judiciary, as well as the appropriate balance of legislative and adjudicative decisionmaking authority in our system of separated powers—require a less deferential, more nuanced approach than that provided

²¹² See *id.* at 144.

²¹³ See *supra* notes 56–58 and accompanying text.

²¹⁴ See *supra* note 18 and accompanying text.

²¹⁵ See *supra* note 15 and accompanying text.

²¹⁶ *Intermountain III*, No. 10-1204, slip op. at 33 (D.C. Cir. June 21, 2011); *Salman Ranch Ltd. v. United States*, No. 09-9015, slip op. at 29 (10th Cir. May 31, 2011); *Grapevine Imports, Ltd. v. United States*, 636 F.3d 1368, 1384 (Fed. Cir.), *reh'g en banc denied*, No. 2008-5090 (Fed. Cir. June 6, 2011); *Beard v. Comm'r*, 633 F.3d 616, 623 (7th Cir.), *reh'g en banc denied*, No. 10-1553 (7th Cir. Apr. 8, 2011), *petition for cert. filed*, No. 10-1553 (U.S. June 27, 2011).

²¹⁷ See *supra* notes 146–48 and accompanying text.

by *Chevron* and *Brand X*. *National Muffler's* tax-specific, multifactor test circumvents the dangers of a highly deferential regime of controlling deference; provides a context-based, case-by-case analysis for evaluating proper versus improper exercises of rulemaking authority; and provides the optimal level of respect for the institutional prerogatives of both agencies and the judiciary. For these reasons, the *National Muffler* test is the best framework for reviewing I.R.C. § 7805(b) regulations.