Judicial Deference to Tax Regulations: A Reconsideration in Light of *National Cable, Swallows Holding*, and Other Developments

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I. Introduction

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In a brief before the United States Supreme Court filed 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.[1] While this argument seems far-fetched, was rejected by the Court,[2] and has since been disavowed by the Justice Department,[3] that the government could make such an argument is a good indication of just how unclear the standards for determining the degree of deference to be accorded tax regulations have become in recent years.

Indeed, several developments over recent years have caused this observer, at least, to reconsider whether the standards long applied in determining the extent to which a tax regulation is to be accorded deference still correctly articulate the applicable standard.[4] These developments include:

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[1]Brief for Respondent in Opposition to Certiorari at 5-7, Knight v. Commissioner, 128 S. Ct. 782 (2008) (No. 06-1286), *reprinted at* 2007 Tax Notes Today 120-22, at 5 (June 21, 2007).

> The Internal Revenue Service (IRS) presently intends to issue a regulation resolving the question . . . . A regulation interpreting [the statutory provision at issue] would resolve the conflict among the courts of appeals without the need for this Court's intervention. . . . Under Chevron U.S.A. Inc. v. NRDC, 467 U.S. 837 (1984), a court would be required to defer to the agency's reasonable interpretation. In particular, if the IRS were to issue a regulation adopting the interpretation of [the statutory provision at issue] embraced by the court of appeals below, that regulation would be controlling even in [another court of appeals that had previously rejected the Service's interpretation]. As this Court has 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." National Cable & Telecoms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005) . . . . *[I]t is theoretically conceivable that a regulation adopting the view of the court of appeals below might not be accepted by the [courts of appeals that had previously accepted the Service's interpretation]. But that hypothetical possibility is not a reason to grant review in this case.*

Id. (emphasis added). The Treasury Department proposed the anticipated regulations some two months after this brief was filed, and a month after the Supreme Court agreed to decide the issue. Prop. Reg. § 1.67-4, 72 Fed. Reg. 41,243 (July 27, 2007); *see infra* note 2.

[2]Knight v. Commissioner, 127 S. Ct. 3005 (June 25, 2007) (No. 06-1286), *granting cert. to* William L. Rudkin Testamentary Trust v. Commissioner, 467 F.3d 149 (2d Cir. 2006).

[3]Brief for Respondent on the Merits at 13, Knight v. Commissioner, 128 S. Ct. 782 (2008) (No. 06-1286), *reprinted at* 2007 Tax Notes Today 215-28, at 13 (Nov. 6, 2007) ("Indeed, assuming that the standard set forth in the proposed Treasury regulation is adopted as a final regulation, that standard, being a reasonable interpretation of [the statutory provision at issue], would be upheld under the deferential review afforded to administrative interpretations of the Internal Revenue Code.").

1. The increasingly diverse ways in which Congress delegates regulation-writing authority to the Treasury Department, abandoning the traditional binary approach under which all delegations other than under the general authority delegated by Congress to the Treasury Department under section 7805(a)[5] were considered "legislative" in nature.[6]

2. The Supreme Court's opinions in the non-tax cases *United States v. Mead Corporation* (*Mead*)[7] in 2001 and *National Cable & Telecommunications Association v. Brand X Internet Services* (*National Cable*)[8] in 2005, which amplified its prior non-tax opinion in *Chevron U.S.A. Inc. v. National Resources Defense Council, Inc.* (*Chevron*),[9] and have been perceived as casting doubt on the continuing vitality of the standard enunciated in the tax context in *National Muffler Association v. United States* (*National Muffler*)[10] and on what had theretofore been viewed as fairly settled standards in this regard.[11]

3. The Treasury Department's apparent inclination, to a much greater degree than would have been imaginable previously, to take on the role of lawmaker in the absence of a specific Congressional mandate to do so.[12]

4. Two 2007 Court of Appeals decisions[13] rejecting taxpayers' challenges to the validity of regulations promulgated under the general authority delegated by Congress to the Treasury Department in section 7805(a), the validity of which had appeared to many to be questionable under the standards traditionally thought to be applicable.

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[4]For an excellent discussion of developments in this regard through 2003, see Irving Salem, Ellen P. Aprill, & Linda Galler, *ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 Tax Law. 717 (2004) [hereinafter *ABA Task Force Report*].

[5]Unless otherwise indicated, all "section" and "I.R.C. §" references herein are to the Internal Revenue Code of 1986, as amended (the Code), and all "Reg. §," "Temp. Reg. §," and "Prop. Reg. §" references herein are to final, temporary and proposed regulations, respectively.

[6]*See infra* text accompanying notes 24-27. Section 7805(a) provides that except where the Code expressly gives such authority to one who is not an officer or employee of the Treasury Department, "the [Treasury] Secretary shall prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." *See also* I.R.C. § 7701(a)(11)(B) (the term "Secretary" means the Secretary of the Treasury or his delegate).

[7]533 U.S. 218, 227-32 (2001).

[8]545 U.S. 967, 980-81 (2005).

[9]467 U.S. 837, 844, 865-66 (1984).

[10]440 U.S. 472, 484 (1979).

[11]*Compare* Swallows Holding v. Commissioner, 126 T.C. 96, 144-46 (2006), *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008), *with* 126 T.C. at 149 (Swift, J., dissenting), *and id.* at 170-72 (Holmes, J., dissenting).

[12]Examples include the subchapter K "anti-abuse" regulations promulgated in 1994 (Reg. § 1.701-2), the conduit-financing regulations promulgated in 1995 (Reg. §§ 1.881-3 and 1.1441-7(f)), the "check-the-box" regulations promulgated in 1996 (Reg. § 301.7701-1, *et seq.*) and the section 409A regulations promulgated in 2007 (Reg. § 1.409A-1, *et seq.*).

[13]McNamee v. Dep't of the Treasury, 488 F.3d 100 (2d Cir. 2007); Littriello v. United States, 484 F.3d 372 (6th Cir. 2007), *reh'g denied*, 2007 U.S. App. LEXIS 23640 (6th Cir. Sept. 25, 2007), *cert. denied*, 76 U.S.L.W. 3439 (Feb. 19, 2008).

5. A 2008 Court of Appeals decision[14] reversing the Tax Court's invalidation of a section 7805(a) regulation and casting further doubt on the continuing vitality of the *National Muffler* standard.

6. Recent United States Tax Court opinions regarding the validity of regulations issued pursuant to the authority of section 7805(a), one of which invalidated the regulation in question and in certain of which numerous individual judges wrote separate, widely divergent opinions stating their views regarding the impact of *Chevron*, *Mead* and *National Cable* on the validity of section 7805(a) regulations.[15]

This Article is one observer's attempt to make sense of these developments and to derive from the relevant Supreme Court opinions and other authorities a set of sensible and workable rules for determining the degree to which courts should accord deference to regulations promulgated under the various types of congressional delegations to the Treasury Department.[16] Part II of this Article examines the various ways in which Congress has articulated its delegations of regulation-writing authority to the Treasury Department, ren-

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[14]Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008), *rev'g* 126 T.C 96 (2006).

[15]*See* Lewis v. Commissioner, 128 T.C. 48 (2007) (unreviewed opinion upholding Reg. § 301.6330-1(e)(3), Q&A-E2); Estate of Gerson v. Commissioner, 127 T.C. 139 (2006) (upholding Reg. § 26.2601-1(b)(1)(i) by an 11-5 vote, with 9 of the 11 judges in the majority either concurring in result only or writing or joining separate concurring opinions), *aff'd*, 507 F.3d 435 (6th Cir. 2007), *petition for cert. filed*, No. 07-1064 (Feb. 7, 2008); *Swallows Holding*, 126 T.C. at 147-48 (invalidating Reg. § 1.882-4(a)(2) and (3)(i) by a 15-3 vote), *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008); *see also* Rowe v. Commissioner, 128 T.C. 13, 33-36 (2007) (Halpern, J., dissenting) (pointing out that the majority ruled in the taxpayer's favor in the face of a contrary and reasonable regulation (Reg. § 1.2-2(c)(1)) that, while apparently disavowed by the Service in rulings, had never been amended or revoked); *cf.* Estate of Roski v. Commissioner, 128 T.C. 113, 127-28 (2007) (giving "considerably less deference" to an administrative position of the Service that had changed "four times over the last 15 years").

[16]Among the several related and interesting issues that are beyond the scope of this discussion are: (1) what a court is to do when faced with an issue with respect to which Congress explicitly delegated regulation-writing authority to the Treasury Department but no such regulations have yet been issued (for an excellent discussion, see Phillip Gall, *Phantom Tax Regulations: The Curse of Spurned Delegations*, 56 Tax Law. 413 (2003); *see also* T.A.M. 2007-33-024 (Oct. 26, 2006)); (2) whether a particular delegation of regulation-writing authority (*e.g.*, in section 7701(l)) exceeds the constitutional limits on delegations of the Article I lawmaking power (*see* Whitman v. Am. Trucking Ass'n, Inc., 531 U.S. 457 (2001)); (3) the deference to be accorded to rulings and other less formal pronouncements by the Service (*see* PSB Holdings, Inc. v. Commissioner, 2007 T.C.R. (CCH) Dec. 57,159, 129 T.C.R. Dec. (RIA) ¶ 129.15 (129 T.C. No. 15); *ABA Task Force Report*, *supra* note 4, at 729-32 & 744-50; *cf.* Fed. Express Corp. v. Holowecki, slip op. at 8 (U.S. Feb. 27, 2008) (No. 06-1322) (EEOC "policy statements, embodied in its compliance manual and internal directives" given "a 'measure of respect' under the less deferential Skidmore standard")); (4) the status of so-called "temporary regulations" under the Administrative Procedure Act, 5 U.S.C. § 551, *et seq.* (2000) (the APA) (*see* 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); Michael Asimow, *Public Participation in the Adoption of Temporary Regulations*, 44 Tax

dering largely obsolete the traditional "legislative" vs. "interpretive" dichotomy, and addresses certain terminology issues in an attempt to cut through some of the sources of confusion in this area. This Article then takes a close look at the relevant Supreme Court cases (in Part III) as well as certain recent Tax Court and Court of Appeals cases (in Parts IV and V) in which the judges have attempted to apply the principles set out in the Supreme Court cases. Part VI concludes that, confusing semantics in the cases aside, the traditional distinction between the high level of deference accorded to tax regulations promulgated pursuant to an explicit delegation of authority to issue regulations dealing with a specific subject matter and the much lower level of deference given to regulations promulgated pursuant to the general grant of authority in section 7805(a) continues to articulate the applicable (and appropriate) standard, as far as it goes; suggests a framework for determining the level of deference that should be applied to regulations promulgated pursuant to the many types of congressional delegations of authority falling between these two categories; and discusses the application of these rules in a variety of circumstances, including so-called anti-abuse rules, regulations that represent a change in a longstanding regulatory policy, regulations that deviate from one or more prior judicial interpretations of the underlying statute, regulations that deviate from one or more prior judicial enunciations of a non-interpretive substantive tax principle, and regulations that do not interpret a word or phrase in the Code but rather provide non-interpretive administrative rules.

II. Delegations of Regulation-Writing Authority and Certain Terminology Issues

As a preliminary matter, given the extent to which many of the difficulties in this area can be attributed to semantics, this discussion turns first to certain points of terminology.

A. *Types of Delegations of Regulation-Writing Authority*

For many years, courts and commentators have placed all delegations by Congress of regulation-writing authority to the Treasury Department, and the resulting regulations, into two categories: Where a provision of the Code

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Law. 343 (1991); *ABA Task Force Report*, *supra* note 4, at 741-42); (5) the validity under the Constitution and the APA of a "re-delegation" by the Treasury Department to itself of regulation-writing authority delegated by Congress by issuing regulations providing that the Service will issue certain of the required rules in rulings or by other less formal means (*see, e.g.,* Reg. § 1.409A-1(b)(5)(iii)(D); Prop. Reg. § 1.707-7(h); *cf.* I.R.C. § 7701(a)(12)(A)(i); Gen. Mills, Inc. v. United States, 101 A.F.T.R.2d 2008-550, 2008-1 U.S.T.C. ¶ 50,141 (D. Minn. 2008) (revenue ruling held not to be a determination by the Secretary of the Treasury under section 404(k)(5)(A) absent evidence that the Secretary in fact delegated his authority thereunder to the Office of Chief Counsel)); and (6) the "invalidity" of regulations that are in conflict with an income tax convention to which the United States is a party as applied to taxpayers entitled to the benefits of such convention (*see, e.g.*, Nat'l Westminster Bank PLC v. United States, 512 F.3d 1347 (Fed. Cir. 2008)).

other than section 7805(a) specifically authorizes or requires the promulgation of regulations,[17] the resulting regulations are generally referred to as "legislative" regulations, and all other regulations are considered to have been generally authorized under section 7805(a) and are generally referred to as "interpretive" (or "interpretative") regulations.[18] The conventional wisdom in the tax area has long been that so-called legislative regulations are accorded such a high degree of deference that their validity is virtually a foregone conclusion,[19] whereas so-called interpretive regulations are entitled to a lower, but still largely insurmountable, level of deference.[20]

Commentators have pointed out that this terminology contributes to confusion, since the Administrative Procedure Act (the APA)[21] draws the line

[17]The Senate debate on the Revenue Act of 1921, which apparently included the first such specific delegations to the Treasury Department, provides an interesting (and, in retrospect, somewhat amusing) window into the original rationale for such specific delegations. Senator David Walsh of Massachusetts, responding to a question from Senator William King of Utah, justified this innovation as follows:

> In more than 20 places in the bill the commissioner is given flexible authority for the first time. That is a great departure from previous tax legislation [and] is the first departure in this country from the rule of defining accurately and in detail the tax law. In this bill in very many instances great power is given to the commissioner, as well as great discretion, in the interpretation of the law. . . . I think it is a very serious question whether we ought to make this departure. I wish to say to the Senator, however, that the language of the bill is so involved and the meaning in many places is so obscure and almost nonunderstandable that somebody ought to have discretion in administering its provisions.

61 Cong. Rec. 6576 (1921). Needless to say, however "involved," "obscure" and "nonunderstandable" the Revenue Act of 1921 might have seemed to Senators Walsh and King, it is a model of brevity, clarity, and simplicity compared with the handiwork of their successors over the last 87 years.

[18]*See, e.g.,* Tutor-Saliba Corp. v. Commissioner, 115 T.C. 1, 7 (2000) ("Regulations are either legislative or interpretive in character. . . . An interpretive regulation is issued under the general authority vested in the Secretary [of the Treasury] by section 7805, whereas a legislative regulation is issued pursuant to a specific congressional delegation to the Secretary."); *ABA Task Force Report*, *supra* note 4, at 728 ("In tax, legislative regulations are those promulgated pursuant to a specific grant of authority under some provision of the Internal Revenue Code. Interpretive regulations are those promulgated under the general grant of authority of section 7805(a) . . . .").

[19]For a rare example of an invalidation of a so-called legislative regulation, see *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), *reh'g en banc denied*, 2001 U.S. App. LEXIS 23207 (Fed. Cir. Oct. 3, 2001), *superseded in part by statute*, American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 844, 118 Stat. 1418, 1600; see also New York State Bar Association Tax Section, Report on Legislative Grants of Regulatory Authority (Nov. 3, 2006), *reprinted at* 2006 Tax Notes Today 215-22, at 16 n.39 (Nov. 7, 2006) [hereinafter *NYSBA Report*].

[20]*See, e.g.,* Rowan Companies, Inc. v. United States, 452 U.S. 247, 253 (1981).

between legislative and other regulations differently: The APA generally requires agencies to follow notice and comment procedures in the case of any rules or regulations that are intended to bind the public and have the force of law, but not for "interpretative rules, general statements of policy, or rules of agency organization, procedure or practice."[22] Thus, for purposes of the APA notice and comment requirements, all final regulations, whether promulgated pursuant to a specific congressional delegation or under section 7805(a), are arguably "legislative" or "substantive" regulations to which the APA notice and comment rules apply rather than "interpretative rules" to which they do not.[23] In addition, as will be seen, regulations promulgated under the general authority in section 7805(a) themselves fall into two categories—those that actually interpret a word or phrase used in the Code and those that set out other sorts of non-interpretive rules, which can be substantive or purely administrative in nature.

Moreover, it has been many years since Congress has limited itself to these two ways of articulating its delegations of regulation-writing authority to the Treasury Department (that is, the general authority granted under section 7805(a) and specific authority to deal with particular enumerated matters granted under Code sections other than section 7805(a)). Rather, since the 1980s if not before then, Congress has been using various versions of a third delegation technique that grants both general authority to carry out the purposes of a particular provision or the provision itself, as well as specific authority to address certain enumerated matters. This third approach itself comes in several different varieties.

In most such cases, Congress authorizes the Treasury Department to promulgate regulations carrying out the purposes of a particular statutory provision, including regulations addressing one or more specified or enumerated matters. For example, Congress in 1984 enacted section 514(g), which provides that the Treasury Department "shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations to prevent the circumvention of any provision of this section through the use of segregated asset accounts." Similarly, a number of

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[21] 5 U.S.C. § 551, *et seq.* (2000) [hereinafter APA].

[22] APA § 553(b); *see ABA Task Force Report*, *supra* note 4, at 728 ("In the case of regulations, tax law has used a different basis [from APA § 553(b)] to distinguish between legislative and interpretive rules."); Swallows Holding v. Commissioner, 126 T.C. 96, 176 (2006) (Holmes, J., dissenting).

[23] *See, e.g.*, Hickman, *supra* note 16, at 1760-73; *but see* Jasper L. Cummings, Jr., *Treasury Violates the APA?*, 117 Tax Notes (TA) 263 (Oct. 15, 2007). Curiously, the Treasury Department generally follows notice and comment procedures in respect of the final regulations it promulgates pursuant to section 7805(a) while maintaining the position that such regulations are not subject to the notice and comment requirements prescribed by APA § 553(b), presumably on the ground that such regulations are "interpretative rules" for purposes of that provision. *See ABA Task Force Report*, *supra* note 4, at 728 & 738-41.

provisions enacted in 1986, including sections 382(m) and 884(g), direct the Treasury Department to "prescribe such regulations as may be necessary or appropriate to carry out the purposes of [the underlying provision or provisions]," including regulations addressing certain specified matters.[24]

In other cases, the delegation does not refer to the purpose of the underlying provision, but rather directs the Treasury Department to promulgate regulations carrying out the provisions themselves. For example, section 469(l), also enacted in 1986, directs the Treasury Department to "prescribe such regulations as may be necessary or appropriate to carry out the provisions of this section, including regulations" addressing certain enumerated matters, and section 7874(g), enacted in 2004, directs the Treasury Department to "provide such regulations as are necessary to carry out this section, including regulations" addressing certain enumerated matters.

In still another variation, the delegation includes the general "carry out the purposes" language but does not specify any particular matters that are to be covered in the regulations. For example, section 1298(f), enacted in 1986 as part of the so-called PFIC provisions,[25] provides that the Treasury Department "shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of [sections 1291-1298]."[26] In another variation of this variation, section 7701(e)(6), enacted in 1984, neither refers to the purposes of the underlying statute nor specifies any matters to be covered in regulations, providing that the Treasury Department "may prescribe such regulations as may be necessary or appropriate to carry out the *provisions* of

[24]*See also, e.g.,* I.R.C. §§ 163(j)(9) (enacted in 1989), 337(d) (enacted in 1986), 338(i) (enacted in its present form in 1984), 355(d)(9) (enacted in 1990), 355(e)(5) (enacted in 1997), 409A(e) (enacted in 2004), 743(e)(7) (enacted in 2004), 846(g) (enacted in 1986), 864(e)(7) (enacted in 1986), 864(g)(5) (enacted in 1989), 901(j)(4) (enacted in 1986), 1092(b) (enacted in 1984), 1256(g)(2)(B) (enacted in 1983), 1446(f) (enacted in 1988) and 7872(i) (enacted in 1984). Interestingly, certain of these delegations preface the list of specified matters to be addressed in the regulations with the word "including" while others instead use the words "including (but not limited to)." *Compare, e.g.,* I.R.C. § 469(l) ("including") *with* I.R.C. § 382(m) ("including (but not limited to)"), both of which were enacted as part of the same legislation in 1986. In this connection, it is interesting to note that section 7701(c), which provides that the word "including" shall not be deemed to be exclusive "when used in a definition contained in this title," does not literally apply when the word is used in a delegation provision rather than a definition.

[25]I.R.C. §§ 1291-1298, relating to "passive foreign investment companies."

[26]*See also, e.g.*, I.R.C. §§ 149(d)(7) (enacted in 1986), 168(h)(8) (enacted in 1984), 304(b)(5)(B) (enacted in 1997), and 411(a)(3)(D)(iii) (enacted in 1986). Section 1298(f) is particularly interesting because Congress at the same time also included within several of the provisions the purposes of which are to be carried out by regulations promulgated pursuant to section 1298(f) (including in section 1298 itself) specific delegations of authority to issue regulations regarding certain specified matters. *See, e.g.*, I.R.C. §§ 1291(b)(3), 1293(g)(2), 1298(a)(1)(B), 1298(b)(4)-(6), and 1298(d)(2)(A)-(B). Section 168(h)(8) is also interesting, since Congress in section 168(h)(6)(G) specifies two specific matters to be dealt with in the section 168(h)(8) regulations.

this subsection."[27]

The implications of these relatively recent varieties of delegation will be discussed below. For the moment, suffice it to say that these developments reinforce the view that in order to avoid confusion it is necessary to abandon the traditional terminology used in the tax area (*i.e.*, "legislative" and "interpretive" regulations). In their place, this Article adopts the following more descriptive terminology:

1. This Article uses the term "section 7805(a) regulations" to refer to regulations that are promulgated solely under the general authority granted in section 7805(a), whether or not such regulations actually interpret statutory language.

2. This Article refers to congressional delegations of regulation-writing authority to the Treasury Department in Code provisions other than section 7805(a), and the regulations promulgated thereunder, all of which have traditionally been referred to as "legislative regulations," as follows:

a. Grants of authority to prescribe regulations that deal with one or more specified matters are referred to as "specific delegations," and the regulations promulgated thereunder are referred to as "specific-authority regulations."[28]

b. Grants of authority to prescribe such regulations as may be necessary or appropriate to carry out the purposes of one or more statutory provisions, without specifying or enumerating the matters to be addressed in such regulations, are referred to as "purpose delegations," and the regulations promulgated thereunder are referred to as "purpose-authority regulations."[29]

c. Grants of authority to prescribe such regulations as may be necessary or appropriate to carry out one or more statutory provisions, without specifying or enumerating the matters to be addressed in such regulations, are referred to as "provision delegations," and the regulations promulgated thereunder are referred to as "provision-authority regulations."[30]

d. Delegations that combine aspects of purpose delegations or provision delegations and specific delegations (*e.g.*, providing authority to prescribe

[27]I.R.C. § 7701(e)(6) (emphasis added); *see also* I.R.C. § 453(j)(1) (enacted in 1981). Section 7701(e)(6) is also an example of a delegation to the Treasury Department of discretion to promulgate regulations, as contrasted with provisions requiring the promulgation of regulations. *See generally* Gall, *supra* note 16.

[28]Among the many examples of specific delegations are sections 163(f)(2)(C), 267(a)(3)(A) and (B)(ii), 305(c), 385(a) and (b), 863(b) (first sentence), 882(c)(1)(A), 1291(b)(3) and 1502. *Cf.* I.R.C. § 482 (delegating authority without mentioning regulations). *See generally* Edward J. Schnee & W. Eugene Seago, *Deference Issues in the Tax Law:* Mead *Clarifies the* Chevron *Rule – Or Does It?*, 96 J. Tax'n 366, 371 (2002) (counting 1,220 explicit delegations of regulation-writing authority in the Code, but presumably including in this total what this article defines as "purpose delegations", "provision delegations" and "mixed delegations").

[29]For examples, see *supra* notes 25 and 26 and accompanying text.

[30]For examples, see *supra* note 27 and accompanying text.

regulations necessary or appropriate to carry out the purposes of a particular Code provision, including regulations addressing certain enumerated points) are referred to as "mixed delegations" and are discussed separately below.

B. *Standards of Deference*

As will be seen, another source of confusion in this area results from the manner in which courts and commentators describe the varying degrees of deference[31] courts give to agency regulations, the terms of art including "*Chevron* deference,"[32] "the reasonableness test,"[33] "the *National Muffler* standard,"[34] and, particularly since the Supreme Court issued its opinion in *Mead* in 2001, "*Skidmore* deference."[35] Confusingly, however, these terms appear to be given different meanings in different situations. For example, when a regulation is described as meriting "*Chevron* deference," in some cases this means that the regulation is valid so long as it is not arbitrary, capricious or manifestly at odds with the statute, and in other cases it means that the regulation is valid only if it is reasonable.[36] In addition, the term "reasonable" is used by the courts in the context both of so-called "*Chevron* deference" and the *National Muffler* standard. As will been seen, the seeds for this confusion

[31]Even the word "deference" itself engenders difficulties. While courts sometimes speak as if deference were an all-or-nothing proposition, *i.e.*, as if a regulation entitled to deference must in all cases be upheld, the word is usually used in a comparative sense, with certain types of agency pronouncements being worthy of more deference than others. *Compare* Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 865 (1984) (agency interpretation is "entitled to deference") *with* Tutor-Saliba Corp. v. Commissioner, 115 T.C. 1, 7 (2000) ("An interpretive regulation, while entitled to deference, is not entitled to as much deference as is accorded a legislative regulation."); *see also ABA Task Force Report*, *supra* note 4, at 737-38 (using the term "controlling deference").

[32]*See, e.g.*, Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 127 S.Ct. 2518, 2523 (2007) ("deference under *Chevron*").

[33]*See, e.g.*, *ABA Task Force Report*, *supra* note 4, at 721, 740.

[34]*See, e.g.*, Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,390 (3d Cir. 2008).

[35]United States v. Mead Corp., 533 U.S. 218, 241 (2001).

[36]*Compare* Good Samaritan Hosp. v. Shalala, 508 U.S. 402 (1993) (arbitrary-and-capricious standard applied to non-tax regulation) *with* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 980 (2005) (non-tax regulation found worthy of *Chevron* deference upheld under a reasonableness standard); *see also* McNamee v. Dep't of the Treasury, 488 F.3d 100, 109 (2d Cir. 2007) (section 7805(a) regulations at issue are valid because they are not "arbitrary, capricious, or unreasonable"); Estate of Gerson v. Commissioner, 127 T.C. 139, 168 (2006) (Holmes, J., concurring) ("reasonableness is all that's required in step two of *Chevron*"); Swallows Holding v. Commissioner, 126 T.C. 96, 172-82 (2006) (Holmes, J., dissenting) (arguing that *Mead* has "clarified the law, by conflating the standard of 'reasonableness' with the standard of 'arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law'"); *ABA Task Force Report*, *supra* note 4, at 737-41 (recommending that "*Chevron* deference" be given to both legislative and section 7805(a) regulations, but nonetheless suggesting application of the arbitrary-and-capricious standard to legislative regulations

were planted in *Chevron* itself, and were fertilized by language in *Mead* and *National Cable*.

In an attempt to avoid confusion and to reflect the applicable case law more accurately, this Article refers to the various standards of deference as follows:

1. This Article refers to a standard under which a regulation would be upheld unless it is arbitrary, capricious or manifestly at odds with the statute (a standard often associated with *Chevron*) as the "arbitrary-and-capricious standard" or "arbitrary-and-capricious deference."

2. This Article refers to a standard that would uphold a regulation so long as it is "permissible" in the sense that it is not an unreasonable reading of the statute, even if it is not what the reviewing court would consider the best reading of the statute (a standard also associated with *Chevron*), as the "permissible-construction standard."

3. This Article refers to the standard set forth in *National Muffler*, *i.e.*, a standard that would uphold a regulation only if it is considered to be reasonable in light of numerous factors such as whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose, its contemporaneity with the underlying statute, the manner in which it evolved, the length of time it has been in effect, the reliance placed upon it, the consistency of the agency's position and the extent to which Congress subsequently scrutinized the regulation as the "*National Muffler* standard."

4. Finally, this Article refers to a standard that would give deference to a regulation only to the extent it is persuasive (a standard that is associated with *Skidmore*) as not being deference at all, because, as will be seen, such standard accords no more "deference" to an agency pronouncement than it does to the position set out in the agency's brief before the reviewing court.[37]

III. Deference in the Supreme Court

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and the reasonableness standard to section 7805(a) regulations); *NYSBA Report*, *supra* note 20, at 7-8 & n.39 (suggesting that courts have interpreted the reasonableness standard enunciated in *Chevron* to require that a regulation be upheld unless it is arbitrary, capricious or manifestly contrary to the statute); Cummings, *supra* note 23 at 264-65 (some section 7805(a) Regulations merit *Chevron* deference while others do not). Particularly noteworthy in this regard is *Swallows Holding v. Commissioner*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008), in which the court enunciated no fewer than three different *Chevron* standards. *See id.* at 83,391 ("[j]udicial deference to an agency's rule-making authority ends only when the agency's construction of its [sic] statute is unreasonable"); *id.* at 83,393 ("we will only defer to the Secretary's action if it is a permissible construction" of the statute) (citing Woodall v. Fed. Bureau of Prisons, 432 F.3d 235, 248 (3d Cir. 2005) (citing *Chevron*, 467 U.S. at 842-43)); *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,392 (a section 7805(a) regulation is to be upheld if it is "not 'unreasonable, arbitrary, capricious or contrary to the plain language of the Code'") (quoting Armstrong World Inds., Inc. v. Commissioner, 974 F.2d 422, 442 (3d Cir. 1992)).

[37] *See Mead*, 533 U.S. at 250 (Scalia, J., dissenting).

The basis for the traditional distinction drawn between the levels of deference to be accorded to section 7805(a) regulations and other tax regulations lies in a line of Supreme Court cases, including most recently *National Muffler*, *Chevron*, *Mead* and *National Cable*. But even now, nearly 25 years after *Chevron*, the courts continue to wrestle with the question of the effect, if any, of *Chevron* and *Mead* on the standard to be applied to section 7805(a) regulations.[38] In light of the continuing importance of these cases to the deference issue, and the widely divergent views judges and commentators have expressed regarding their teachings, it is illuminating to take a close look at these cases and their progeny.

A. National Muffler *(1979) and its Progeny*

In *National Muffler*, a trade association urged the Supreme Court to invalidate Regulation section 1.501(c)(6)-1, a section 7805(a) regulation pursuant to which the association was denied the tax exemption afforded to "business leagues" under section 501(c)(6).[39] The Court stated that where, as is the case with section 501(c)(6), a statutory term is "'so general . . . as to render an interpretive regulation appropriate'", such a regulation will be upheld if it is found to "'implement the congressional mandate in some reasonable manner.'"[40] According to the Court, "[t]he choice among reasonable interpretations is for the Commissioner, not the courts."[41]

The Court then set out the following test for determining the reasonableness, and thus the validity, of a section 7805(a) regulation under this standard:

> 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

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[38] *See infra* notes 89-200 and accompanying text; *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,390-91 (3d Cir. 2008); *Estate of Gerson*, 507 F.3d at 437-38; Lewis v. Commissioner, 128 T.C. 48, 53-61 (2007); *Estate of Gerson*, 127 T.C. at 153-54; *Swallows Holding*, 126 T.C. at 131; Cent. Pa. Sav. Ass'n v. Commissioner, 104 T.C. 384, 392 (1995). As will be seen, individual Tax Court judges have widely differing views on this point. *Compare Estate of Gerson*, 127 T.C. at 176-77 (Vasquez, J., dissenting) (arguing that *Mead* requires that section 7805(a) regulations be given only "*Skidmore* deference") *with Swallows Holding*, 126 T.C. at 176-82 (Holmes, J., dissenting) (arguing that after *Mead*, section 7805(a) regulations are entitled to full arbitrary-and-capricious deference).

[39] Nat'l Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472 (1979).

[40] *Id.* at 476-77 (quoting Helvering v. Reynolds, 306 U.S. 110, 114 (1939), United States v. Cartwright, 411 U.S. 546, 550 (1973) and United States v. Correll, 389 U.S. 299, 307 (1967)). In *Correll*, the Court noted that a court does not "sit as a committee of revision to perfect the administration of the tax laws." 389 U.S. at 306-07.

[41] *Nat'l Muffler*, 440 U.S. at 488.

> placed upon it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute.[42]

Over three dissents, the Court in *National Muffler* upheld the regulation, stating that it "merits serious deference" because the Treasury Department's reading of the statute, while "perhaps . . . not the only possible one, . . . does bear a fair relationship to the language of the statute, . . . reflects the views of those who sought its enactment, . . . matches the purpose they articulated [and has] stood for 50 years".[43]

In the years between *National Muffler* and *Chevron*, the Supreme Court elaborated on this test in tax cases, drawing a sharp distinction between section 7805(a) regulations and other tax regulations. For example, in *Rowan Companies, Inc. v. United States*,[44] the Court in 1981 invalidated Regulation sections 31.3121(a)-1(f) and 31.3306(b)-1(f), stating that section 7805(a) regulations interpreting a statutory term are entitled to "less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision" because in the case of such a section 7805(a) regulation, the Court "can measure the Commissioner's interpretation against a specific provision in the Code," whereas with a specific-authority regulation, "our primary inquiry is whether the interpretation or method is within the delegation of authority."[45] The next year, in *United States v. Vogel Fertilizer Co.*,[46] the Court, citing *National Muffler* and *Rowan Companies*, invalidated Regulation section 1.1563-1(a)(3), a section 7805(a) regulation, stating that a regulation that "purports to do no more than add a clarifying gloss on a term . . . that has already been defined with considerable specificity by Congress" (in that case, the term "brother-sister controlled group" under section 1563(a)(2)) is entitled not only to less deference than a specific-authority regulation, but also to less deference than a regulation interpreting an extremely general term in the Code, such as the regulation at issue in *National Muffler*.[47]

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[42] *Id.* at 477 (citing Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501 (1948); Helvering v. Winmill, 305 U.S. 79, 83 (1938)).

[43] *Nat'l Muffler*, 440 U.S. at 484. In dissent, Justice Stewart, joined by Justices Rehnquist and Stevens, argued that the regulation was not worthy of deference because the Treasury Department's initial interpretation of the statute was "exactly the opposite of the one now urged." *Id.* at 489 (Stewart, J., dissenting). In response, the majority expressed its reluctance "to adopt the rigid view that an agency may not alter its interpretation in light of administrative experience," and held the regulation valid on the basis of the factors quoted above. *Id.* at 485.

[44] 452 U.S. 247 (1981) (6-3 decision).

[45] *Id.* at 253 (citing *National Muffler*, 440 U.S. at 477; Commissioner v. Portland Cement Co., 450 U.S. 156 (1981)).

[46] 455 U.S. 16 (1982) (7-2 decision).

B. Chevron *(1984)*

In *Chevron*, environmental groups challenged regulations that had been promulgated by the Environmental Protection Agency (the EPA) to implement a provision of the Clean Air Act Amendments of 1977[48] requiring certain states to establish a permit program regulating "new or modified major stationary sources" of air pollution.[49] In the regulations, the agency allowed states to adopt a plant-wide definition of the term "stationary source," rather than a definition that views each pollution-emitting device within a plant separately.[50]

Reversing the D.C. Circuit, the Supreme Court upheld the regulations, stating that the lower court "misconceived the nature of its role in reviewing the regulations at issue."[51] In its opinion, the Court enunciated several principles, which it referred to as "well-settled."[52] Because much of today's confusion in this area can be traced back to language the Court used in *Chevron*, key aspects of the Court's opinion are quoted and considered below.

First, the Court enunciated what has by now become the familiar two-step *Chevron* analysis:[53]

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.[9] If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, *the question for the court is whether the agency's answer is based on a permissible construction of the statute*.[11]
>
> [9]The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent. If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.

[47]*Id.* at 24 ("'The Commissioner's authority is consequently more circumscribed than would be the case if Congress had used a term 'so general . . . as to render an interpretive regulation appropriate.'").

[48]Pub. L. No. 95-95, 91 Stat. 685 (1977).

[49]Chevron U.S.A., Inc. v. Nat'l Res. Def. Council, 467 U.S. 837, 840 (1984) (quoting Clean Air Amendments Act of 1977 § 172(b)(6), 91 Stat. 747, now codified at 42 U.S.C. § 7502(c)(5) (2000)).

[50]40 C.F.R. § 51.18(j)(1)(i)-(ii) (1983), 46 Fed. Reg. 50,766, 50,771 (Oct. 14, 1981).

[51]*Chevron*, 467 U.S. at 845.

[52]*Id.*

[53]*Id.* at 842-43 (footnotes in original; citations and certain footnotes omitted) (emphasis added).

> [11]The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.

The Court then set out the following standard for reviewing the regulation:

> "The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." If Congress has explicitly left a gap for the agency to fill, there is *an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation*. Such legislative regulations are given controlling weight *unless they are arbitrary, capricious, or manifestly contrary to the statute*. Sometimes the *legislative delegation to an agency on a particular question is implicit rather than explicit*. In such a case, a court may not substitute its own construction of a statutory provision for a *reasonable interpretation* made by the administrator of an agency.[54]

Thus, although *Chevron* is often remembered exclusively for the arbitrary-and-capricious standard of deference applicable to so-called legislative regulations, the Court actually described both an arbitrary-and-capricious standard and a permissible-construction standard, and considered one or the other applicable depending on whether the agency action in question was taken pursuant to an "explicit" or "implicit" delegation of authority by Congress.[55]

The environmental groups argued that the regulations in question in *Chevron* were entitled to less deference because the EPA's interpretation of the term "source" had changed over time, an argument the Court disposed of as follows:

> The fact that the agency has from time to time changed its interpretation of the term "source" does not, as respondents argue, lead us to conclude that no deference should be accorded the agency's interpretation of the statute. An initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis.[56]

The Court concluded that the EPA regulation was "entitled to deference," citing the following reasons:

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[54]*Id.* at 843-44 (quoting Morton v. Ruiz, 415 U.S. 199, 231 (1974)) (citations and footnotes omitted) (emphasis added). Although the Court in *Chevron*, somewhat remarkably, did not mention the APA, it should be noted that the APA requires a reviewing court to "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." APA § 706(2)(A).

[55]The Court apparently viewed the Congressional delegation at issue in *Chevron* to be implicit, since it stated that the question before the lower court "was not whether in its view the [EPA's plant-wide definition of the term "stationary source"] is 'inappropriate' in the general context of a program designed to improve air quality, but whether the Administrator's view that it is appropriate in the context of this particular program is a *reasonable* one." 467 U.S. at 845 (emphasis added).

[56]*Id.* at 863-64.

> [T]he regulatory scheme is technical and complex, the agency considered the matter in a detailed and reasoned fashion, and the decision involves reconciling conflicting policies. . . . Perhaps [Congress] consciously desired the Administrator to strike the balance at this level, thinking that those with great expertise and charged with responsibility for administering the provision would be in a better position to do so; perhaps it simply did not consider the question at this level; and perhaps Congress was unable to forge a coalition on either side of the question, and those on each side decided to take their chances with the scheme devised by the agency. For judicial purposes, it matters not which of these things occurred.[57]

C. Mead *(2001)*

In *Mead*, a Customs Service ruling letter classified Mead Corporation's "day planners," which it had previously classified as duty free, as bound diaries subject to tariff.[58] The Federal Circuit held that the ruling letter was not entitled to *Chevron* deference, or indeed any deference at all. The Court agreed to hear the case "in order to consider the limits of *Chevron* deference owed to administrative practice in applying a statute."[59] Agreeing with the Federal Circuit that the ruling letter was not entitled to the level of deference described in *Chevron*, the Court nonetheless vacated and remanded for further proceedings to determine the extent to which the ruling letter is entitled to some measure of respect under the standard that had been set out by the Court in *Skidmore v. Swift & Co.* (*Skidmore*).[60]

The Court first noted *Chevron*'s holding that regulations promulgated pursuant to "'an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation'" are entitled to deference under the arbitrary-and-capricious standard.[61] The Court then noted that even where they do not "enjoy any express delegation of authority on a particular question, agencies charged with applying a particular statute necessarily make all sorts of interpretive choices."[62] According to the Court, even where these agency choices do not "bind judges to follow them," those that are "'well-reasoned'" have traditionally been accorded a degree of deference that varies with the circumstances, with courts looking to "the degree of the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position."[63]

The Court next pointed out that in between these two categories, *Chevron* "identified a category of interpretive choices distinguished by an additional

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[57] *Id.* at 865.

[58] United States v. Mead, 533 U.S. 218, 225 (2001).

[59] *Id.* at 226; *see Mead,* 530 U.S. 1202 (2000) (granting certiorari).

[60] 323 U.S. 134 (1944).

[61] *Mead*, 533 U.S. at 227 (quoting Chevron U.S.A., Inc. v. Nat'l Res. Def. Council, 467 U.S. 837, 843-44 (1984)).

[62] *Mead*, 533 U.S. at 227.

[63] *Id.* at 227-28 (quoting Bragdon v. Abbott, 524 U.S. 624, 642 (1988) and citing *Skidmore*, 323 U.S. at 139-40) (footnotes omitted); *cf.* Nat'l Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472, 477 (1979).

reason for judicial deference":

> This Court in *Chevron* recognized that . . . "[s]ometimes the legislative delegation to an agency on a particular question is implicit." Congress, that is, may not have expressly delegated authority or responsibility to implement a particular provision or fill a particular gap. Yet it can still be apparent from the agency's *generally conferred authority* and other statutory circumstances that Congress would expect the agency to be able to speak with the force of law when it addresses ambiguity in the statute or fills a space in the enacted law, even one about which "Congress did not actually have an intent" as to a particular result. When circumstances implying such an expectation exist, a reviewing court has no business rejecting an agency's exercise of its *generally conferred authority* to resolve a particular statutory ambiguity simply because the agency's chosen resolution seems unwise, but is obliged to accept the agency's position if Congress has not previously spoken to the point at issue and the agency's interpretation is *reasonable*.[64]

Having thus confirmed that what the Court referred to as "*Chevron* deference" actually consists of two different levels of deference—an arbitrary-and-capricious standard for regulations promulgated pursuant to "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation," and a permissible-construction standard for regulations promulgated pursuant to an "implicit" delegation that "generally conferred authority,"—the Court held

> that administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.[65]

The Court considered it "a very good indicator of delegation meriting *Chevron* treatment" when Congress provides for "a relatively formal administrative procedure" in respect of agency action, such as the notice and comment procedures provided in the APA for, *e.g.*, certain types of regulations.[66]

The Court concluded that the ruling letter in question was not entitled even to the second-tier (permissible-construction) level of "*Chevron* deference" because the Customs Service's practice in issuing such rulings is "far removed not only from notice and comment practice, but from any other circumstances reasonably suggesting that Congress ever thought of classification rulings as deserving the [*Chevron*] deference claimed for them here."[67] However, while the Customs Service ruling letter was found to be unworthy of the kind of deference described in *Chevron*, the Court held that "*Chevron*

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[64] *Mead*, 533 U.S. at 229 (quoting *Chevron*, 467 U.S. at 844-45) (citations omitted) (emphasis added).

[65] *Mead*, 533 U.S. at 226-27.

[66] *Id.* at 229-30; *see* APA § 553(b).

[67] *Mead*, 533 U.S. at 231; *see also id.* at 230 (citing Christensen v. Harris County, 529 U.S. 576, 596-97 (2000) (Breyer, J., dissenting)) for the proposition that *Chevron* is inapplicable "where it is in doubt that Congress actually intended to delegate particular interpretive authority to an agency").

did nothing to eliminate *Skidmore*'s holding that an agency's interpretation may merit some deference whatever its form," and suggested that the ruling letter "may therefore at least seek a respect proportional to its 'power to persuade,'" and "may surely claim the merit of its writer's thoroughness, logic, and expertness, its fit with prior interpretations, and any other sources of weight."[68]

D. *Tax Cases in the Supreme Court Since* Chevron *and* Mead

Interestingly, although the lower courts' discussions of the validity of section 7805(a) regulations generally center around *Chevron* and, more recently, *Mead*, the Supreme Court in post-*Chevron* tax cases involving the validity of section 7805(a) regulations has tended to ignore *Chevron* and *Mead*, leaving the lower courts in a muddle on this point.[69] Post-*Chevron* tax cases not even mentioning *Chevron* include *Cottage Savings Association v. Commissioner* in 1991,[70] in which the Court upheld Regulation section 1.1001-1 under the *National Muffler* standard; *United States v. Cleveland Indians Baseball Co.* in 2001,[71] in which the Court upheld Regulation sections 31.3111-3 and -2(c) and 31.3301-2 and -3(b) citing both *Cottage Savings* and *National Muffler* and pointing to such *National Muffler* factors as contemporaneity and the consistency of the Treasury Department's interpretation over time[72]; and *Boeing Co. v. United States* in 2003,[73] a post-*Mead* case in which the Court upheld Regulation section 1.861-8(e)(3) citing *Cottage Savings* (which stands

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[68]*Mead*, 533 U.S. at 235 (quoting Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944)).

[69]*See* Wolpaw v. Commissioner, 47 F.3d 787, 790 (6th Cir. 1995) ("The degree to which courts are bound by agency interpretations of law has been like quicksand. The standard seems to have been constantly shifting, steadily sinking, and, from the perspective of the intermediate appellate courts, frustrating."); Cent. Pa. Sav. Ass'n v. Commissioner, 104 T.C. 384, 391 (1995) ("*Chevron* has had a checkered career in the tax arena."). For surveys of the varying standards of deference applied by the courts of appeals to section 7805(a) regulations after *Chevron*, *see* Swallows Holding v. Commissioner, 126 T.C. 96, 180-81 (2006) (Holmes, J., dissenting); *ABA Task Force Report*, *supra* note 4, at 763-76. For more recent examples of the confusion in the courts of appeals, see *Swallows Holding v. Commissioner*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008) (No. 06-3388), *McNamee v. Department of the Treasury*, 488 F.3d 100 (2d Cir. 2007), *Littriello v. United States*, 484 F.3d 372 (6th Cir. 2007), *reh'g denied*, 2007 U.S. App. LEXIS 23640 (6th Cir. Sept. 25, 2007), *cert. denied*, 76 U.S.L.W. 3439 (2008), discussed *infra* at text accompanying notes 121-138, 178-200.

[70]499 U.S. 554, 560-61 (1991) ("Because Congress has delegated to the Commissioner the power to promulgate 'all needful rules and regulations for enforcement of [the Code],' we must defer to his regulatory interpretations of the Code so long as they are reasonable, see *National Muffler* . . . .").

[71]532 U.S. 200, 218-19 (2001).

[72]*Id.* at 220 ("We do not resist according such deference in reviewing an agency's steady interpretation of its own 61-year-old regulation implementing a 62-year-old statute. 'Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law.' *Cottage Savings* . . . ."). For the contrary view of the *Cleveland Indians* case expressed by the Third Circuit in *Swallows Holding*, see *infra* note 125 and accompanying text.

for the proposition that the applicable standard is the *National Muffler* standard), without mentioning *Chevron* or *Mead*.[74]

E. National Cable *(2005)*

In *National Cable*, the Federal Communications Commission (the FCC) had ruled[75] that broadband cable modem service is not a "telecommunications service" within the meaning of the Communications Act of 1934, as amended (the FCC Act),[76] and as a result is not subject to mandatory common carrier regulation under the FCC Act.[77] The Ninth Circuit overturned the FCC's interpretation of the statute,[78] basing its decision on the stare decisis effect of *AT&T Corporation v. Portland*,[79] in which the Ninth Circuit in 2000 had held cable modem service to be a "telecommunications service" within the meaning of the FCC Act.

In a 6-3 decision, the Supreme Court reversed, largely on the basis of *Chevron*. The Court paraphrased *Chevron* as follows: "If a statute is ambiguous, and if the implementing agency's construction is reasonable, *Chevron* requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation."[80] Noting that the FCC Act empowers the FCC to "prescribe such rules and regulations as may be necessary in the public interest to carry out [its] provisions,"[81] the Court determined that:

> [t]hese provisions give the [FCC] the authority to promulgate binding legal rules; the [FCC] issued the order under review in the exercise of that authority; and no one questions that the order is within the [FCC]'s jurisdiction. Hence, as we have in the past, we apply the *Chevron* framework to the [FCC]'s interpretation of the [FCC] Act.[82]

In response to the argument that *Chevron* does not apply in light of the FCC's own prior decisions to the contrary, the Court stated:

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[73]537 U.S. 437 (2003).

[74]*Cf.* Atlantic Mutual Ins. Co. v. Commissioner, 523 U.S. 382, 387-89 (1998) (citing *Chevron* only for the step-one proposition (which was the law long before *Chevron*) that courts and agencies must give effect to the unambiguously expressed intent of Congress, finding the statute in question to be ambiguous, and upholding regulation section 1.846-3(c)(3) as "a reasonable accommodation"); United States v. Boyle, 469 U.S. 241, 245-47 (1985) (mentioning *Chevron* in a footnote in a case not turning on the validity of a regulation); *see generally ABA Task Force Report*, *supra* note 4, at 761-63.

[75]*In re* Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, 17 F.C.C.R. 4798, 4802 (2002).

[76]47 U.S.C. § 153(46) (2000).

[77]Nat'l Cable and Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 987 (2005).

[78]Brand X Internet Servs. v. Fed. Commc'ns Comm'n, 345 F.3d 1120, 1137 (9th Cir. 2003).

[79]AT&T Corp. v. Portland, 216 F.3d 871, 880 (9th Cir. 2000).

[80]*Nat'l Cable*, 545 U.S. at 980 (citing *Chevron*, 467 U.S. at 843-44 and n.11).

[81]47 U.S.C. § 201(b) (2000); *cf.* I.R.C. § 7805(a).

[82]*Nat'l Cable*, 545 U.S. at 980-81 (citing, *inter alia*, United States v. Mead Corp., 533 U.S. 218, 231-34 (2001)) (citations omitted).

> Agency inconsistency is not a basis for declining to analyze the agency's interpretation under the *Chevron* framework. *Unexplained* inconsistency is, at most, a reason for holding an interpretation to be an arbitrary and capricious change from agency practice under the Administrative Procedure Act. For if the agency *adequately explains* the reasons for a reversal of policy, change is not invalidating, since the whole point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agency. An initial agency interpretation is not instantly carved in stone. On the contrary, the agency must consider varying interpretations and the wisdom of its policy on a continuing basis, for example, in response to changed factual circumstances, or a change in administrations. That is no doubt why in *Chevron* itself, this Court deferred to an agency interpretation that was a recent reversal of agency policy.[83]

The Court then reversed the Ninth Circuit's ruling that its prior holding in *Portland* foreclosed the FCC's contrary interpretation of the FCC Act:

> 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. This principle follows from *Chevron* itself. *Chevron* established a "presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows." Yet allowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute, as the Court of Appeals assumed it could, would allow a court's interpretation to override an agency's. *Chevron*'s premise is that it is for agencies, not courts, to fill statutory gaps. The better rule is to hold judicial interpretations contained in precedents to the same demanding *Chevron* step one standard that applies if the court is reviewing the agency's construction on a blank slate: Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction.[84]

Determining that the Ninth Circuit in *Portland* had not held that the FCC

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[83] *Nat'l Cable*, 545 U.S. at 981-82 (quoting *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 742 (1996), and *Chevron*, 467 U.S. at 863-64) (emphasis added) (citations and internal quotation marks omitted)); *see also Nat'l Cable* 545 U.S. at 1001 n.4 ("Any inconsistency [in treatment between cable modem service and DSL service] bears on whether the [FCC] has given a *reasoned explanation* for its current position, not on whether its interpretation is consistent with the statute." [emphasis added]). For a well-publicized example of the confusion the "reasoned explanation" language has engendered in the lower courts, compare *Fox Television Stations, Inc. v. FCC*, 489 F.3d 444, 456-57 (2d Cir. 2007), *petition for cert. filed*, No. 07-582 (Nov. 1, 2007) (invalidating the FCC's change of policy regarding "fleeting obscenities" during broadcasts, a 2-1 majority noted that *Chevron* permits an agency to revise its rules, but when it does so it "must explain why the original reasons for adopting the rule or policy are no longer dispositive," and "such a flip-flop must be accompanied by a reasoned explanation of why the new rule effectuates the statute as well as or better than the old rule") with *Fox Television* at 470 (Leval, J., dissenting) (stating that the agency need only provide a "reasoned analysis" supporting the change, and finding that the FCC met the test).

Act unambiguously treats cable modem service as a telecommunications service, the Court held that the *Chevron* standard applied to the FCC's ruling.[85] Applying the two-step *Chevron* analysis, the Court found (at step 1) that the FCC Act was sufficiently ambiguous to give the FCC "the discretion to fill the consequent statutory gap,"[86] and held that the FCC's interpretation of the FCC Act "was 'a *reasonable* policy choice for the [FCC] to make' at Chevron's second step."[87] In nontax cases arising after *National Cable*, the Court has continued to apply the permissible-construction standard in determining the validity of nonlegislative regulations.[88]

Against this background, set out below is a discussion of recent cases in the Tax Court and Courts of Appeals in which the judges attempted, with

[84]*Nat'l Cable*, 545 U.S. at 982-83 (citations omitted; quoting *Smiley*, 517 U.S. at 740-41). While somewhat beyond the scope of this discussion, it should be noted that this holding of *National Cable* seems difficult to square with footnote 9 in *Chevron*, quoted above, which declares that the judiciary, employing "traditional tools of statutory construction," is the "final authority on issues of statutory construction," and with a series of post-*Chevron* cases holding that where the Court has interpreted the statute, a later agency interpretation is to be given no deference. *See Nat'l Cable*, 545 U.S. at 1016 n.11 (Scalia, J., dissenting); Neal v. United States, 516 U.S. 284, 295 (1996) ("Once we have determined a statute's meaning, we adhere to our ruling under the doctrine of *stare decisis*, and we assess an agency's later interpretation of the statute against that settled law."); Lechmere, Inc. v. NLRB, 502 U.S. 527, 536 (1992); Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116 (1990); *see generally* Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?*, 84 B.U. L. Rev. 185, 202-07 (2004) (referring to *Neal*, *Lechmere* and *Maislin Industries* as establishing an "incorporation rule" whereby a prior judicial construction is considered to have been incorporated into the statute for purposes of determining how much leeway an agency has in interpreting the statute). Interestingly, Justice Thomas, the author of the majority opinion in *National Cable*, seems to have come around to this view to some extent. *See* Global Crossing Telecomms., Inc. v. Metrophones Telecomms., Inc., 127 S. Ct. 1513, 1533 (2007) (Thomas, J., dissenting) ("[A] court may not, in the name of deference, abdicate its responsibility to interpret a statute. Under *Chevron*, an agency is due no deference until the court analyzes the statute and determines that Congress did not speak directly to the issue under consideration."). As discussed below, the Tax Court in *Swallows Holding* noted that the FCC itself was not a party to the *Portland* litigation, and suggested that *National Cable* has less force where, as tends to be the case in tax litigation, the agency was a party to the prior litigation.

[85]*Nat'l Cable*, 45 U.S. at 984-85. In a concurring opinion, Justice Stevens rather slyly noted that were it the Supreme Court, rather than a Court of Appeals, that had previously construed the statute, the result might be different, since "a decision by this Court . . . would presumably remove any pre-existing ambiguity." *Id.* at 1003 (Stevens, J., concurring).

[86]*Id.* at 986-97.

[87]*Id.* at 997 (quoting *Chevron*, 467 U.S. at 845) (emphasis added). The Court took at least three additional opportunities in its opinion in *National Cable* to use the word "reasonable," making it abundantly clear that it was applying a reasonableness standard, rather than arbitrary-and-capricious deference, at *Chevron* step two. *See id.* at 986 ("we defer at step two to the agency's interpretation so long as the construction is 'a reasonable policy choice for the agency to make'"); *id.* at 998 (finding the FCC's "understanding of the nature of cable modem service" to be "reasonable"); *id.* at 1000 ("We therefore conclude that the [FCC]'s construction was reasonable.").

varying degrees of clarity and success, to sift through the Supreme Court's opinions in *National Muffler*, *Chevron*, *Mead* and *National Cable* to arrive at a standard to apply in assessing the validity of section 7805(a) regulations.

IV. Deference Standard(s) in the Tax Court

A. *In General*

The Tax Court is an Article I court of national jurisdiction in federal tax matters, the decisions of which are appealable to twelve different courts of appeals.[89] As a matter of judicial efficiency, the Tax Court considers itself bound in a particular case to follow the rulings of the court of appeals to which that case is appealable, but not those of the other courts of appeals.[90] As a result, the Tax Court sometimes renders decisions that are not only reversed by the court of appeals to which the particular case is appealable, but with which one or more other courts of appeals disagree in other cases; in certain cases, after sticking to its guns for a time, the Tax Court ultimately overrules its prior decision in light of the disagreement registered by the courts of appeals.[91]

Since the time of *Chevron*, the Tax Court as well as the courts of appeals have been wrestling with the question of *Chevron*'s effect (if any) on the *National Muffler* standard. In *Central Pennsylvania Savings Association and Subsidiaries v. Commissioner*, after noting that the Tax Court had previously been criticized by a court of appeals for ignoring *Chevron*,[92] the court stated that it is "inclined to the view that the impact of the traditional, *i.e.*, *National Muffler* standard, has not been changed by *Chevron*, but has merely been restated in a practical two-part test with possibly subtle distinctions as to the role of legislative history and the degree of deference to be accorded to a regulation."[93] In other cases, the Tax Court harmonized *Chevron* and *National Muffler* by applying the latter case's "reasonableness" standard, rather than a permissible-construction standard, in step two of the *Chevron* analysis.[94] In

[88] *See, e.g.,* Long Island Care At Home, Ltd. v. Coke, 127 S. Ct. 2339, 2345-46, 2350-51 (2007); *Global Crossing*, 127 S. Ct. at 1516, 1522.

[89] I.R.C. §§ 7441, 7482.

[90] Golsen v. Commissioner, 54 T.C. 742, 757 (1970), *aff'd on other grounds*, 445 F.2d 985 (10th Cir. 1971).

[91] For an example of this phenomenon in the context of the validity of section 7805(a) regulations, see *Redlark v. Commissioner*, 106 T.C. 31 (1996) (invalidating, in an 11-7 decision, Temp. Reg. § 1.163-9T(b)(2)(i)(A)), *rev'd*, 141 F.3d 936 (9th Cir. 1998). In light of disagreement with *Redlark* expressed by five Courts of Appeals in *Kikalos v. Commissioner*, 190 F.3d 791 (7th Cir. 1999), *McDonnell v. United States*, 180 F.3d 721 (6th Cir. 1999), *Allen v. United States*, 173 F.3d 533 (4th Cir. 1999), *Commissioner v. Redlark*, 141 F.3d 936 (9th Cir. 1998) and *Miller v. United States*, 65 F.3d 687 (8th Cir. 1995), the Tax Court overruled *Redlark* in *Robinson v. Commissioner*, 119 T.C. 44 (2002) (11-5 decision).

[92] 104 T.C. 384, 391 n.7 (1995) (Tannenwald, J.) (citing Peoples Fed. Sav. & Loan Ass'n v. Commissioner, 948 F.2d 289, 299-300 (6th Cir. 1991)).

still other cases, the Tax Court declined to "parse the semantics of the two tests to discern any substantive difference between them," stating that the result would be the same under either standard.[95]

Two recent cases have exposed deep divisions in the Tax Court, as the judges struggle to come to terms with *Chevron*, as amplified by *Mead* and *National Cable*. These cases—*Swallows Holding, Ltd. v. Commissioner*[96] and *Estate of Gerson v. Commissioner*[97]—are discussed below in some detail.

B. Swallows Holding *(2006)*

1. *Background*. In *Swallows Holding*, a foreign corporation challenged the validity of Regulation section 1.882-4(a)(3)(i), which the parties agreed is a section 7805(a) regulation.[98] Section 882(c)(2), the underlying Code provision, allows deductions and credits to a foreign corporation for a taxable year only if it files "a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the Secretary may deem necessary for the calculation of such deductions and credits." Substantially similar provisions have been in the Code since 1928. At issue in *Swallows Holding* was a regulation, promulgated in 1990, which imposes a fixed deadline for filing a tax return in order to avoid losing deductions and credits under section 882(c)(2). Under this regulation, in order for a foreign corporation's tax return to qualify under section 882(c)(2), it is required to have been filed within 18 months after the due date of such return (or, if no return was filed for the immediately preceding year and the current year is not the first taxable year of the corporation, by the earlier of 18 months after the due date or the date the Service notifies the corporation it is not entitled to deductions or credits by reason of section 882(c)(2)).[99]

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[93]*Cent. Pa. Sav.*, 104 T.C. at 392; *see also* Ga. Fed. Bank v. Commissioner, 98 T.C. 105, 107-10 (1992) (describing *Chevron* step-two principles as including such *National Muffler* factors as the contemporaneity, consistency and longevity of the agency's interpretation and the agency's reaction to public comments), *vacated and remanded per agreement of the parties in an unpublished decision*, No. 92-9111 (11th Cir. July 12, 1994).

[94]*See, e.g.*, Robinson v. Commissioner, 119 T.C. 44, 68 (2002) (citing United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 (1982)).

[95]Swallows Holding v. Commissioner, 126 T.C. 96, 131 (2006); *see, e.g.,* Lewis v. Commissioner, 128 T.C. 48, 54 (2007); Estate of Gerson v. Commissioner, 127 T.C. 139, 153-54 (2006), *aff'd*, 507 F.3d 435 (6th Cir. 2007), *petition for cert. filed*, No. 07-1064 (Feb. 7, 2008); *see also* Mayo Found. for Med. Educ. & Research v. United States, 503 F. Supp. 2d 1164, 1171 (D. Minn. 2007) (stating in the course of invalidating Reg. § 31.3121(b)(10)-2(c) and -2(d)(3)(iii) that "[t]here is no indication that the standard in *National Muffler* was changed by *Chevron*. Regardless, the Court reaches the same conclusion under either standard.").

[96]126 T.C. 96 (2006), *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008) (No. 06-3388).

[97]127 T.C. 139 (2006), *aff'd*, 507 F.3d 435 (6th Cir. 2007).

[98]126 T.C. at 98-99, 129.

By the time this regulation was promulgated in 1990, the predecessor to the Tax Court and the Fourth Circuit, to which all cases involving non-U.S. corporations were appealable prior to 1954,[100] had for roughly 50 years interpreted section 882(c)(2) and its predecessors as imposing no fixed deadline for the filing of a return to avoid the loss of deductions and credits, so long as the Service had not prepared a return for the taxpayer for the year in question prior to the taxpayer's filing of the late return.[101] Perhaps for this reason, the regulations that were in effect prior to 1990 did not purport to impose a fixed deadline for filing returns to avoid the loss of deductions.[102]

2. *The Tax Court's opinions*. The Tax Court began by stating the following regarding the applicable standard of review:[103]

> When this Court reviews an interpretative Federal tax regulation, we generally apply the analysis set forth by the Supreme Court in *Natl. Muffler* . . ., [u]nder . . . which . . . an interpretative regulation is valid if it implements a congressional mandate in a reasonable manner.[16] We must defer to a Federal tax regulation that is reasonable under this standard.
>
> [16]Legislative regulations, by contrast, are upheld "unless arbitrary, capricious, or manifestly contrary to the statute." Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844, (1984).

The court proceeded to recite the *National Muffler* standard quoted above, to quote the "permissible construction" language from *Chevron*, to reiterate its view that the *National Muffler* standard survived *Chevron* and to conclude as follows regarding the applicable standard: "Here, we conclude likewise that we need not parse the semantics of the two tests to discern any substantive difference between them. While we apply a *Natl. Muffler* analysis, our result under a *Chevron* analysis would be the same."[104]

In a 15-3 decision, the Tax Court invalidated the regulation, citing the following reasons:

a. First, the court, agreeing with the prior cases, held that the statute is unambiguous and not susceptible of the interpretation set out in the regula-

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[99]Reg. § 1.882-4(a)(3)(i).

[100]*See Swallows Holding*, 126 T.C. at 105, 106 n.9, 112 n.11.

[101]*See* Anglo-Am. Direct Tea Trading Co. v. Commissioner, 38 B.T.A. 711 (1938) (the word "manner" in the predecessor to section 882(c)(2) does not include an element of time); Ardbern Co. v. Commissioner, 120 F.2d 424 (4th Cir. 1941) (returns lodged with revenue agent, but not properly filed, prior to issuance of notice of deficiency are sufficient); Blenheim v. Commissioner, 125 F.2d 906 (4th Cir. 1942) (filing of a personal holding company return not sufficient where revenue agent had made repeated requests for an income tax return prior to issuing notice of deficiency); Taylor Sec., Inc. v. Commissioner, 40 B.T.A. 696 (1939) (returns filed after notice of deficiency issued not sufficient); Georday Enters., Ltd. v. Commissioner, 126 F.2d 384 (4th Cir. 1942).

[102]Reg. § 1.882-4 (1957).

[103]*Swallows Holding*, 126 T.C. at 129-30 (footnote in original; certain citations and footnotes omitted).

[104]*Id.* at 130-31 (citing *Cent. Pa. Sav.*, 104 T.C. at 390-92).

tion in question: "[T]he plain meaning of the word 'manner,' as used in the relevant text, does not include an element of time."[105]

b. The court went on to rule that deference would be

> especially unwarranted where, as here, the Secretary's construction of the relevant text does not fill in a gap left open by the statute as to a timeliness requirement but simply adopts respondent's unsuccessful litigating position, with total disregard to firmly established judicial precedent, and adds an impermissible restriction to the statute. The functional reasons for deference to agencies, *i.e.*, the agencies' expertise and experience, do not carry the same force when interpreting the word "manner" for purposes of the relevant text. The judiciary has enough expertise and experience to ascertain congressional intent with respect to that word, and any deference that is owed to the Secretary does not mean that the judiciary as a matter of course should simply ratify an unauthorized assumption by the Secretary of major policy decisions made by Congress . . . .[106]

c. Applying the *National Muffler* standard, the court pointed out that the regulation in question (1) was hardly a contemporaneous interpretation, having been issued 62 years after the relevant language was enacted, and after the courts had "repeatedly and consistently" held that the statute did not include a fixed filing deadline; (2) had been in effect for only three years as of the first year in issue; and (3) was issued after multiple re-enactments of the statute, none of which changed the judiciary's prior construction of the relevant language.[107] Significantly, the court also pointed out that the regulation represents a departure from the interpretation set forth in the Treasury Department's prior regulations on the subject, stating the following in this connection:

> Of course, the mere fact that the Secretary has changed his interpretation of a statutory term does not necessarily mean that the latter interpretation in invalid. Courts should accord considerably less deference, however, to an agency's statutory interpretation that conflicts with the agency's previous interpretation of the same statute.[108]

d. As an additional reason not to defer to the agency's interpretation, the court assumed that Congress was mindful of the prior judicial interpretations when it re-enacted the predecessor to section 882(c)(2) without relevant change in each of 1939, 1954, 1966 and 1986.[109]

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[105] *Swallows Holding*, 126 T.C. at 132.

[106] *Id.* at 135-36 (citations and footnotes omitted).

[107] *Id.* at 136-37.

[108] *Id.* at 137-38 & n.24 (citations omitted) (citing *Chevron*, 467 U.S. at 863-64, Pauley v. BethEnergy Mines, Inc., 501 U.S. 680, 698 (1991), and INS v. Cardoza-Fonseca, 480 U.S. 421, 446 n.30 (1987)). Perhaps in recognition of its inability to refute this proposition, the Department of Justice, in its brief on appeal to the Third Circuit in *Swallows Holding*, conflated the *consistency* of the agency's interpretation over time with its *contemporaneity* with the underlying statute:

e. Finally, the court acknowledged that the Supreme Court in *National Cable* had recently discussed the issue of deference to an agency interpretation that differs from a prior judicial construction, and pointed out that "[g]iven that the Supreme Court has historically reviewed Federal tax regulations primarily under the reasonableness test of [*National Muffler*], the question arises whether [*National Cable*], which neither cited *Natl. Muffler* nor involved a Federal tax regulation, applies to Federal tax regulations."[110] The court, however, declined to decide that issue, finding *National Cable* distinguishable on the following five grounds: (1) unlike the FCC's extensive analysis in *National Cable*, the Treasury Department's stated rationale for the regulation in question in *Swallows Holding* was "at best perfunctory"; (2) unlike in *National Cable*, the regulation in question purports to reverse "long-settled law" and indeed changed the Treasury Department's own longstanding interpretation; (3) unlike in *National Cable*, where the prior judicial construction arose in a case between two private litigants, the Treasury Department was the losing party in the prior litigation at issue in *Swallows Holding*; (4) the judicial interpretation in question in *National Cable* was only five years old, as contrasted with the 50-year-old judicial interpretations at issue in *Swallows Holding*; and (5) unlike the prior judicial interpretation at issue in *National Cable*, those in *Swallows Holding* held that the statute in question unambiguously precluded the agency's interpretation.[111]

The three dissenting Tax Court judges[112] criticized the majority's attempt to distinguish *National Cable*,[113] and pointed out that it is unusual to apply the legislative reenactment doctrine (1) in the absence of some indication, of which there is none here, that Congress was at least aware of the prior judicial construction, and (2) in the context of holding that a statute requires an

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Although the Supreme Court in *National Muffler* cited consistency of a regulation over time as a factor warranting upholding the validity of the regulation therein, more recent decisions of the Supreme Court place little or no weight on this factor. *See, e.g., Smiley v. Citibank*, 517 U.S. 735 (1996), in which the Supreme Court held that a 100-year delay in issuing a regulation "makes no difference" in determining whether the regulation is entitled to deference, and that "neither antiquity nor contemporaneity with the statute is a condition of validity." 517 U.S. at 740.

Brief for Respondent, Swallows Holding v. Commissioner, No. 06-03388 (3d Cir. Oct. 18, 2006), *reprinted at* 2006 Tax Notes Today 211-8, at 19 n.4 (Nov. 1, 2006).

[109] *Swallows Holding*, 126 T.C. at 139-43.

[110] *Id.* at 143-44. *Cf.* Morrissey v. Commissioner, 296 U.S. 344, 354-55 (1935) (Treasury Department's authority to issue regulations cannot "be deemed to be so restricted that the regulations, once issued, could not later be clarified or enlarged so as to . . . conform to judicial decision").

[111] *Id.* at 144-47.

[112] *See id.* at 148-57 (Swift, J., dissenting); *id.* at 157-62 (Halpern, J., dissenting); *id.* at 162-82 (Holmes, J., dissenting).

agency to adopt (rather than precludes) a particular interpretation. The dissenters also took issue with the majority's characterization of the prior cases as not imposing a deadline on the filing of the return, arguing that these cases held that there was a "terminal date" (that is, the date the Service issued a notice of deficiency) after which filing a return would not preserve the taxpayer's deductions.

More significantly for purposes of this discussion, Judge Holmes in his dissenting opinion engaged in a lengthy discussion of the effect of *Chevron* and *Mead* on the standard of review of section 7805(a) regulations. In Judge Holmes' view, the searching review of regulations called for under the *National Muffler* standard, which he refers to as "a top-to-bottom review" and "'hard look' deference,"[114] differs from the permissible-construction standard (referred to by Judge Holmes as the reasonableness standard) prescribed under step two of *Chevron*, the main difference being the great weight *National Muffler* gives to the consistency of the agency's position over time.[115] Judge Holmes expounded on this point as follows:

> I think the problem lies in a very subtle distinction between *National Muffler* and *Chevron*—"reasonableness" using the *National Muffler* factors is taken to mean "is the Secretary construing the statute reasonably?," while under *Chevron* it means "is the Secretary behaving unreasonably by violating the statute in the course of exercising his delegated authority to set policy?" Both cases look to reasonableness, but in different ways. . . . The fact is that the Secretary routinely makes tax law more certain by using his regulatory authority under section 7805(a) to dredge safe harbors and stake well-defined boundaries. . . . [These regulations] (or at least most of them) survive *Chevron* review because they are "permissible constructions" in the sense that they don't violate the Code, not in the sense that they interpret the Code in the same way a judge using normal canons of statutory interpretation would. If each of these detailed regulations had to survive scrutiny by matching it up against general statutory language and asking "where did this come from?," instead of "does the Code prohibit it?" today's Opinion would ignite a thoroughgoing revolution in tax law.[116]

Judge Holmes also asserted that the *National Muffler* standard "simply doesn't reflect the contemporary understanding of administrative law that regula-

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[113]Interestingly, one of these criticisms is Judge Holmes' observation that after *National Cable*, such *National Muffler* factors as the degree to which the agency gave the matter careful consideration are no longer relevant to the "reasonableness" determination. *See Swallows Holding*, 126 T.C. at 171-72 (Holmes, J., dissenting). *But see* Long Island Care at Home, Ltd. v. Coke, 127 S. Ct. 2339, 2350-51 (2007) (a post-*National Cable* case in which the Supreme Court held that the relevant factors under *Chevron* step two include whether "the agency focuses fully and directly upon the issue"); *Chevron*, 467 U.S. at 865 (observing that "the agency considered the matter in a detailed and reasoned fashion").

[114]*See Swallows Holding*, 126 T.C. at 172, 174 (Holmes, J., dissenting).

[115]*See id.* at 173-74 (Holmes, J., dissenting).

tions are a way to make policy choices, not just a way to interpret ambiguous statutory phrases."[117] Finally, Judge Holmes expressed the view that the *National Muffler* standard did not survive *Chevron* and *Mead*, which in Judge Holmes' view accord deference under the arbitrary-and-capricious standard to all tax regulations, including section 7805(a) regulations, that are issued with notice and comment.[118] Regarding this last (and most remarkable) point, Judge Halpern (and possibly Judge Swift) declined to go along with Judge Holmes,[119] and it would appear that Judge Holmes himself has since pulled back from this position.[120]

3. *The Third Circuit's opinion*. On appeal, the Third Circuit reversed the Tax Court, upholding the regulation in question.[121] Most significantly for purposes of this discussion, the Third Circuit stated that the "crucial issue" before it was "whether the Tax Court erred in applying *National Muffler* rather than *Chevron*" in determining the validity of a section 7805(a) regulation.[122] Disagreeing with the Tax Court's conclusion that the result would be the same under either standard, the Third Circuit pointed out that the factors comprising what it referred to as the "six-factor balancing test" under the *National Muffler* standard "are not mandatory or dispositive inquiries under *Chevron*," concluding that the two standards will in many cases reach different results.[123]

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[116] *Id.* at 175 (Holmes, J., dissenting). In this connection, Judge Holmes noted that the Tax Court "has met with limited success in finding regulations unreasonable after the extensive review of the sort we do today," citing *Robinson*'s overruling of *Redlark* (*see supra* note 91) and *Pacific First Federal Savings Bank v. Commissioner*, 94 T.C. 101 (1990), *rev'd*, 961 F.2d 800 (9th Cir. 1992), *overruled*, *Central Pennsylvania Savings Ass'n v. Commissioner*, 104 T.C. 384 (1995), as two examples of capitulations by the Tax Court in light of disagreement registered by numerous courts of appeals. 126 T.C. at 163 n.2 (Holmes, J., dissenting).

[117] *See Swallows Holding*, 126 T.C. at 174 (Holmes, J., dissenting).

[118] *See id.* at 179 (Holmes, J., dissenting) ("After *Mead*, I don't think it possible to draw distinctions between the deference owed tax regulations issued under section 7805(a) and those issued under more specific authority."); *see generally id.* at 176-82 (Holmes, J., dissenting). Not surprisingly, the Justice Department, in its brief on appeal before the Third Circuit in *Swallows Holding*, cites Judge Holmes' dissent in *Swallows Holding* with approval. However, rather than arguing that section 7805(a) regulations should be accorded deference under the arbitrary-and-capricious standard, the government's brief states, in a footnote, only that there is "considerable force" to Judge Holmes' view in this regard. *See* Brief for Respondent, Swallows Holding v. Commissioner, No. 06-03388 (3d Cir. Oct. 18, 2006), *reprinted at* 2006 Tax Notes Today 211-8, at 20 n.5 (Nov. 1, 2006).

[119] *See Swallows Holding*, 126 T.C. at 161 n.5 (Halpern, J., dissenting). Puzzlingly, Judge Swift joined both Judge Halpern's and Judge Holmes' dissenting opinions.

[120] *See* Estate of Gerson v. Commissioner, 127 T.C. 139, 166 (Holmes, J., concurring) ("The issue before the court is simply this—is the [section 7805(a)] regulation a reasonable interpretation of the statute? I concur with the result that the majority reaches and with their analysis of the disputed regulation's validity under *National Muffler*.").

[121] 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008).

[122] *Id.* at 83,390.

On the key question of the continuing vitality of the *National Muffler* standard, the court acknowledged that the Supreme Court in *National Muffler* had indeed described the deference due to section 7805(a) regulations in terms of multiple factors such as the contemporaneity, age and consistency of the regulation's interpretation of the statute over time, intervening contrary judicial constructions and legislative reenactments.[124] The court, however, went on to indicate that in its view, the Supreme Court has since repudiated the *National Muffler* standard:[125]

> More recently, however, in *United States v. Cleveland Indians Baseball Co.*, the Court remarked that "we defer to the Commissioner's regulations so long as they 'implement the congressional mandate in some reasonable manner.'"[8]
>
> [8]The Court in *Cleveland Indians*, in fact, went on to quote *National Muffler*, not for the factors listed by the Tax Court in this case for determining deference, but for the overall concept that "Congress has delegated to the [Commissioner], not to the courts, the task of prescribing all needful rules and regulations for the enforcement ~~of the Inter~~nal Revenue Code."

On the basis of *Cleveland Indians*, as well as a Third Circuit decision issued nine years *before* the Supreme Court decided *Cleveland Indians*, the Third Circuit essentially held that *Chevron* has replaced *National Muffler* as the standard to be applied in determining the validity of section 7805(a) regulations.[126]

However, a careful reading of *Cleveland Indians* in its entirety does not support the Third Circuit's view. Far from repudiating *National Muffler*, the Supreme Court in *Cleveland Indians* went on from the passage quoted by the Third Circuit to decide the case on the basis of the contemporaneity and consistency of the Treasury Department's interpretation over time and legislative reenactments, which of course are key *National Muffler* factors, without so much as a single mention of *Chevron*. The words used by the Court in *Cleveland Indians* are instructive:

> Echoing the language in [the underlying Code provisions], these regulations have

[123]*Id*. at 83,390-91 & n.6.

[124]*Id*. at 83,391.

[125]*Id*. at 83,391 & n.8 (footnote in original; citations omitted).

[126]*Id*. at 38,391-92 (citing Armstrong World Indus., Inc. v. Commissioner, 974 F.2d 422, 442 (3d Cir. 1992)). In this connection, the Third Circuit asserted that while the Second Circuit in *McNamee v. Department of the Treasury*, 488 F.3d 100 (2d Cir. 2007), discussed below, cited *National Muffler*, it did not actually apply the *National Muffler* standard, but rather "placed the inquiry within the purview of *Chevron*, *Mead* and [*National Cable*, and] simply used *National Muffler* to explain that an agency's interpretation of an ambiguous provision must be reasonable, a proposition that is not at odds with *Chevron*'s core teachings." *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,391 n.6. This of course begs one of the core questions raised in this article and in Judge Holmes' dissenting opinion in *Swallows Holding*, that is, whether the "reasonableness" standard prescribed by *Chevron* and its progeny is different from, and superseded, the "reasonableness" standard prescribed earlier by *National Muffler*. *See Swallows Holding*, 126 T.C. at 173-75 (Holmes, J., dissenting).

> continued unchanged in their basic substance since 1940. *Cf. National Muffler*, 440 U.S., at 477 ("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.") Because [the Service's longstanding] interpretation [of the regulations] is reasonable, it attracts substantial judicial deference. We do not resist according such deference in reviewing an agency's steady interpretation of its own 61-year-old regulation implementing a 62-year-old statute. "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law."[127]

The above-quoted language raises serious doubts regarding the basis for the Third Circuit's central conclusion in *Swallows Holding* that the *National Muffler* standard no longer applies to section 7805(a) regulations. Indeed, as noted above, the Supreme Court in its tax cases decided since *Chevron* and *Mead* has declined to apply or even mention *Chevron*, and has instead continued to apply the *National Muffler* standard.[128]

Having disposed of *National Muffler*, the Third Circuit next addressed the question of whether the *Chevron* standard is applicable to section 7805(a) regulations such as the Regulation at issue, suggesting that the only alternative to *Chevron* would be the *Skidmore* standard. Noting that the taxpayer argued that section 7805(a) regulations "as a class, do not merit *Chevron* deference,"[129] the Third Circuit cited *Mead* for the proposition that the *Chevron* standard is applicable "in situations where 'Congress would expect the agency to be able to speak with the *force of law*,"[130] and concluded that "[t]here is no *per se* rule that relegates interpretive rules to the realm of *Skidmore*."[131] The court went on to observe that the application by the Treasury Department of notice and comment procedures to the section 7805(a) regulation in question "is indicative of agency action that carries the force of law," and that such regulation "is entitled to *Chevron* deference if it survives *Chevron*'s two prong inquiry."[132]

Turning to the standard to be applied under *Chevron*, the court first addressed the step-one question whether the underlying statutory text is ambiguous. As an initial matter, the court rejected the Tax Court's argument

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[127] *Cleveland Indians*, 532 U.S. at 219-20 (certain citations omitted) (quoting Cottage Sav. Ass'n v. Commissioner, 499 U.S. 554, 561 (1991) (citing United States v. Correll, 389 U.S. 299, 305-06 (1967))).

[128] *See supra* notes 63-68 and accompanying text.

[129] Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,392 (3d Cir. 2008).

[130] *Id*. at 83,391 (quoting *Mead*, 533 U.S. at 229).

[131] *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,392.

that under *National Cable*, the prior judicial interpretations of section 882(c)(2) and its predecessors in *Anglo-American Direct Tea Trading* and its progeny trump the agency's later interpretation and render the statute unambiguous, noting that the prior cases relied on by the Tax Court did not "unambiguously foreclose[] the agency's interpretation."[133] The court then determined that the statutory language in question ("in the manner prescribed in subtitle F") is ambiguous regarding whether the word "manner" when used without the word "time" includes a temporal element, which determination the court based largely on the basis of a perceived disagreement among the very prior cases to which the Tax Court pointed, a dictionary definition of the word "manner" and certain other Code provisions not using the word "time" under which the Treasury Department has promulgated what the court referred to as "valid regulations that include temporal components."[134]

Finally, under step two of *Chevron*, the Third Circuit held that the regulation in issue is valid. Stating that under *Chevron*, "[j]udicial deference to the agency's rule-making authority ends only when the agency's construction of its [*sic*] statute is unreasonable,"[135] and that "deference is 'even more appropriate in cases' that involve a '"complex and highly technical regulatory program"'" such as the Code,[136] the court found the 18-month rule under the regulations, which the court noted gives a foreign corporation 23-1/2 months after the end of the year to file its return without losing deductions under section 882(c)(2), not to be unreasonable.[137] The court also noted that

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[132] *Id.* at 83,392 & nn. 9-10. In addition to *Mead*, 533 U.S. at 227 & 229-30, the court cited for this proposition certain non-tax cases in the Third Circuit (Mercy Catholic Med. Ctr. v. Thompson, 380 F.3d 142 (3d Cir. 2004); George Harms Const. Co. v. Chao, 371 F.3d 156 (3d Cir. 2004); Cleary v. Waldman, 167 F.3d 801 (3d Cir. 1999); Elizabeth Blackwell Health Ctr. for Women v. Knoll, 61 F.3d 170 (3d Cir. 1995)), and tax cases in other circuits (McNamee v. Department of the Treasury, 488 F.3d 100 (2d Cir. 2007); Hospital Corp. of America v. Commissioner, 348 F.3d 136 (6th Cir. 2003); Bankers Life & Cas. Co. v. United States, 142 F.3d 973 (7th Cir. 1998); United States v. Cook, 494 F.2d 573 (5th Cir. 1974)). Interestingly, the court does not mention that although the Treasury Department generally follows the APA notice and comment procedures in respect of section 7805(a) regulations, when doing so it asserts that such regulations are not subject to such APA procedures, presumably on the ground that section 7805(a) regulations are merely "interpretative rules" for APA purposes. *See supra* note 23.

[133] *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,392 & n.11 (quoting *National Cable*, 545 U.S. at 982-83). *See supra* note 101 and accompanying text.

[134] *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,393 (citing Anglo-American Direct Tea Trading Co. v. Commissioner, 38 B.T.A. 711, 714 (1938); Espinosa v. Commissioner, 107 T.C. 146, 156 (1996); WEBSTER'S DICTIONARY 724 (9th Ed. 1986); Reg. §§ 1.179-5(a) and 1.826-1(a)(3)(i)). Remarkably, the court does not cite any judicial or other authority for its assertion that the cited regulations are valid.

[135] *Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,391. Elsewhere in its opinion, the Third Circuit also stated that under *Chevron*, section 7805(a) regulations are to be upheld so long as they are "not 'unreasonable, arbitrary, capricious, or contrary to the plain language of the Code.'" *Id.* at 83,388 (quoting *Armstrong World Indus.*, 974 F.2d at 442).

the "drawing [of] this temporal line is a task properly within the powers and expertise of the [Service]," and that it was a reasonable exercise of the Treasury Department's authority to choose an 18-month rule in balancing "its desire for compliance with the federal tax laws and a foreign corporation's desire to obtain valuable tax deductions."[138]

C. Estate of Gerson *(2006)*

1. *Background*. The Tax Court was once again faced with the issues raised in *National Cable* and *Swallows Holding* in *Estate of Gerson*, a case involving a section 7805(a) regulation in the context of the generation-skipping transfer (GST) tax.[139] This time, the court found the regulation valid in an 11-5 decision.[140] In *Estate of Gerson*, the decedent's husband in 1973 had created an irrevocable trust and granted the decedent a general power of appointment over a portion of the trust corpus. No additions were made to the corpus of this trust after September 25, 1985. The decedent died in 2000, and in her will exercised her general power of appointment in favor of a trust for the benefit of her grandchildren and more remote descendents. The Service determined that the transfer from the decedent's estate directly to her grandchildren was subject to the GST tax.

While normally this sort of generation-skipping transfer would be subject to the GST tax, the taxpayer claimed an exemption under a transitional rule enacted by Congress in 1986, which provides that the GST tax does not apply to

> any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added) . . .[141]

The taxpayer argued that since the trust in question had become irrevocable in 1973 and no corpus had been added to the trust after September 25, 1985, and since the transfer by the decedent was pursuant to a power of appointment granted under that trust, the Transitional Rule exempts the transfer from

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[136]*Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,393 (quoting Robert Wood Johnson Univ. Hosp. v. Thompson, 297 F.3d 273, 282 (3d Cir. 2002) (quoting Thomas Jefferson Univ. v. Shalala, 512 U.S. 504, 512 (1994))).

[137]*Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,393.

[138]*Id.* at 83,393.

[139]I.R.C. §§ 2601-2664.

[140]Two fewer Tax Court judges voted in *Swallows Holding* than in *Estate of Gerson* because (1) between the two cases, Judge Gerber, who had joined the majority opinion in *Swallows Holding*, retired and was recalled by the Chief Judge to serve as a senior (and therefore nonvoting) judge pursuant to section 7447(c) (*see* Swallows Holding v. Commissioner, 126 T.C. 96, 148 (2006)), and (2) Judge Foley, who had concurred in the result in *Swallows Holding*, did not participate in the consideration of *Estate of Gerson*.

[141]Tax Reform Act of 1986, Pub. L. 99-514, § 1433(b)(2)(A), 100 Stat. 2085, 2731 (the Transitional Rule). This rule is amusingly referred to in the *Estate of Gerson* opinions as a "grandfather rule."

the GST tax. According to the taxpayer, Regulation section 26.2601-1(b)(1)(i),[142] which provides to the contrary, is invalid.

As was the case in *Swallows Holding*, there was significant judicial and regulatory activity preceding the promulgation of the regulation in question:

a. Temporary regulations issued in 1988 did not address the question raised in *Estate of Gerson*, but did provide that for purposes of determining whether a transfer is "made out of corpus added to the trust after September 25, 1985," and therefore not covered by the Transitional Rule:

> where any portion of a trust remains in the trust after the release, exercise, or lapse of a power of appointment over that portion of the trust, . . . the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed will be treated as an addition to the trust.[143]

b. In 1994, in *Peterson Marital Trust v. Commissioner*,[144] the Tax Court considered the validity of the 1988 temporary regulation. In *Peterson Marital Trust*, the decedent's husband had died in 1974, leaving a will that created a trust and gave the decedent a testamentary general power of appointment over its corpus. Under the husband's will, if such power was not exercised, the corpus was to be set aside for the husband's grandchildren. The decedent died in 1987 without having exercised her power of appointment, and the trust property accordingly passed to the grandchildren. Citing the temporary regulation referred to above, which treats the lapse of the power of appointment as a constructive addition of corpus to the trust, the Service argued that this constructive addition caused the transfer not to qualify for exemption under the Transitional Rule. The taxpayer argued that the temporary regulation is invalid. The Tax Court found the temporary regulation valid, largely on the ground that the Transitional Rule was designed to protect the reliance interests of trust settlors who had irrevocably transferred money to a trust, which interests were not implicated where a holder of a power of appointment such as the decedent could have avoided the tax by exercising her power of appointment in favor of someone other than her grandchildren.[145] The Second Circuit affirmed, on essentially the same grounds.[146]

c. A regulation issued in 1995 in respect of the Transitional Rule did little more than to quote the Transitional Rule, and did not address the question in

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[142]Regulation section 26.2601-1(b)(1)(i) provides

> [The Transitional Rule] does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under [the estate or gift tax]. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985.

[143]Temp. Reg. § 26.2601-1(b)(1)(v)(A) (1988).

[144]102 T.C. 790 (1994), *aff'd*, 78 F.3d 795 (2d Cir. 1996).

Estate of Gerson.[147]

d. In 1999, the Eighth Circuit, in *Simpson v. United States*,[148] held that a transfer to grandchildren pursuant to the exercise of a general power of appointment was eligible for the Transitional Rule. The facts in *Simpson* were nearly identical to those in *Estate of Gerson*, save that *Simpson* arose prior to the promulgation of the regulation at issue in *Estate of Gerson*. The Eighth Circuit, reversing the District Court, based its ruling in *Simpson* on the plain meaning of the words "transfer under a trust which was irrevocable on September 25, 1985" in the Transitional Rule, reasoning that a transfer pursuant to a power of appointment that was created by a trust that was irrevocable on September 25, 1985 is itself a transfer under such a trust and therefore is covered by the Transitional Rule.[149] The Eighth Circuit distinguished *Peterson Marital Trust* as a case concerning a lapse, rather than an exercise, of a power of appointment, and noted that unlike in *Peterson Marital Trust*, the Service's interpretation had not been embodied in a regulation.

e. Less than four months after losing the *Simpson* case, the Treasury Department proposed the regulation that was ultimately adopted as the final regulation that the taxpayer challenged in *Estate of Gerson*.[150]

f. In 2002, in *Bachler v. United States*,[151] another nearly identical case arising prior to the effective date of the regulation, the Ninth Circuit, also reversing a District Court, followed the Eighth Circuit and held the Transitional Rule to be applicable to a post-1985 transfer pursuant to a power of appointment that was created under a pre-1985 trust.

2. *The Tax Court's opinions*. Against this background, the Tax Court in *Estate of Gerson* began its analysis by citing *Chevron* and *Vogel Fertilizer* for the proposition that "[a]lthough entitled to considerable weight, interpretative tax regulations are accorded less deference than legislative regulations issued under a specific grant of authority."[152] The court then stated that in reviewing a section 7805(a) regulation, "we generally apply the analysis set forth by the Supreme Court in *Natl. Muffler*," and proceeded to state that the result in this case would be the same whether the *National Muffler* or *Chevron* standard applied.[153] The court also held that in light of the "conflicting judicial constructions" in the Eighth and Ninth Circuits on one hand and the

[145]*Peterson Marital Trust*, 102 T.C. at 799-801.

[146]*Peterson Marital Trust*, 78 F.3d at 801-02.

[147]Reg. § 26.2601-1(b)(1)(i) (1995).

[148]183 F.3d 812 (8th Cir. 1999), *rev'g* 17 F. Supp. 2d 972 (W.D. Mo. 1998).

[149]183 F.3d at 814-15.

[150]Prop. Reg. § 26.2601-1(b)(1)(i), 64 Fed. Reg. 62,997 (Nov. 18, 1999), *finalized in* T.D. 8912, 2001-1 C.B. 452. The Service also "nonacquiesced" in the Eighth Circuit's decision in *Simpson*. Simpson v. United States, 183 F.3d 812 (8th Cir. 1999), *nonacq.*, 2000-1 C.B. xvi.

[151]281 F.3d 1078 (9th Cir. 2002), *rev'g* 126 F. Supp. 2d 1279 (N.D. Cal. 2000).

[152]Estate of Gerson v. Commissioner, 127 T.C. 139, 153 (2006).

Second Circuit and the Tax Court on the other, the Eighth Circuit's ruling on the plain meaning of the Transitional Rule does not "trump" the Treasury Department's interpretation under *National Cable*.[154] Determining that Congress had not directly spoken to the issue in the case, the court examined the legislative history of the Transitional Rule, and found the Regulation to be in harmony with the legislative purpose of providing similar treatment for generation-skipping transfers having similar economic effect and with Congress' intention to protect the reliance interests of settlors making irrevocable transfers under pre-existing rules.[155]

The five concurring and dissenting opinions in *Estate of Gerson*, to which a total of 13 of the 16 judges voting in the case subscribed, offer an intriguing look into the judges' views on the deference issue. In his concurring opinion, Judge Swift, joined by Judges Wells and Holmes, criticized the dissenters' suggestion (and that of the majority in *Swallows Holding*) that the Treasury Department had inappropriately issued regulations that bootstrapped its unsuccessful litigating positions, and pointed out that while the Service had indeed recently lost in the Eighth Circuit in *Simpson* by the time it promulgated the Regulation in question, its interpretation of the Transitional Rule had been adopted by four other courts—the Tax Court and Second Circuit (in *Peterson Marital Trust*) and two district courts (in *Simpson* and *Bachler*).[156] Judge Swift then posed the following intriguing and difficult questions:

> With the responsibility for tax administration and with the authority and responsibility under section 7805(a) to provide rules and regulations relating to our Federal tax laws, what are the Secretary and [the Commissioner] supposed to do? When the Federal courts disagree as to the proper interpretation of tax law, is the regulatory authority placed on hold? Must the public and the tax administrator await an ultimate resolution of the issue by the courts? What if the Federal courts remain in conflict, without an ultimate resolution of an issue? Is the tax law, in such a situation, to be interpreted differently in different judicial districts? Are taxpayers to be treated differently?[157]

Judge Thornton, joined by Judges Cohen, Swift, Wells, Marvel, Goeke, Kroupa and Holmes, also concurred, finding the meaning of the Transitional Rule to be "sufficiently plain as to erase any doubt as to the validity of the dis-

[153] *Id.* at 153, 154.

[154] *Id.* at 152-53.

[155] *Id.* at 154-57.

[156] *Id.* at 160-61 (Swift, J., concurring). At first blush, it does not seem entirely accurate to include the two courts deciding *Peterson Marital Trust* on this list, since that case involved a lapse of a power of appointment rather than its exercise. However, as Judge Swift pointed out, since *Peterson Marital Trust* involved a *lapse* of a power of appointment after the transition date and *Simpson* and *Bachler* involved *exercises* of powers of appointment after such date, rather than being distinguishable from *Peterson Marital Trust*, the *Simpson* and *Bachler* cases logically should have been considered as following *a fortiori* from the Service's victories in *Peterson Marital Trust*. *Id.* at 159-61 (Swift, J., concurring).

[157] *Id.* at 161 (Swift, J., concurring).

puted regulations."[158] In another concurring opinion, Judge Holmes, joined by Judge Swift, agreed with the majority's analysis of the regulation under *National Muffler*,[159] noted that the Sixth Circuit, to which *Estate of Gerson* is appealable and whose rulings thus control the case under the Tax Court's *Golsen* rule,[160] "has expressly adopted *Chevron* deference for tax regulations, like the one here, that are issued under section 7805's general authority,"[161] and concluded that the regulation meets the permissible-construction test under step two of *Chevron*.[162]

In dissent, Judge Laro, who was the author of the majority opinion in *Swallows Holding*, agreed with the Eighth and Ninth Circuits that the Transitional Rule unambiguously applies to the transfer at issue in *Estate of Gerson*, and concluded that therefore the Treasury Department's "interpretation of that language is not entitled to any greater respect simply because [the Treasury Department] has bootstrapped [its] interpretation by causing it to be prescribed in a regulation," particularly "where, as here, [the Treasury Department]'s interpretation was previously rejected by a judicial tribunal in favor of the plain reading application of that section."[163] Judge Laro also noted that *National Cable* does not require the court to hold that the regulation trumps the prior judicial construction by the Eighth Circuit since such construction "follows from the unambiguous terms of the statute."[164]

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[158] *Id.* at 166 (Thornton, J., concurring). Judge Thornton also noted that because the courts of appeals in *Simpson* and *Bachler* did not address the validity of the regulation in issue in *Estate of Gerson*, and because the Tax Court is not bound under *Golsen* to follow these Eighth and Ninth Circuit decisions in *Estate of Gerson*, which is appealable to the Sixth Circuit, *National Cable* does not compel the Tax Court to find the regulation invalid. *Id.* at 166 n.5 (Thornton, J., concurring). Judge Thornton's reference to the Tax Court's *Golsen* rule in this context is reminiscent of Justice Stevens' concurring opinion in *National Cable*, 545 U.S. at 1003 (Stevens, J., concurring), in which he noted that the result might have been different in that case had the prior judicial construction been by the Supreme Court rather than a court of appeals, as well as Justice Scalia's dissent in *National Cable*, 545 U.S. at 1019 (Scalia, J., dissenting) ("*Whatever* the *stare decisis* effect of [the Ninth Circuit's prior construction] in the Ninth Circuit, it surely does not govern this Court's decision.") (emphasis in original). *See also* Estate of Gerson v. Commissioner, 507 F.3d 435, 440 n.2 (6th Cir. 2007) ("The full significance of [National Cable] remains unclear . . ., but we are surely not bound by the Eighth and Ninth Circuits."), *petition for cert. filed*, No. 07-1064 (Feb. 7, 2008).

[159] 127 T.C. at 166 (Holmes, J., concurring). *But see Swallows Holding*, 126 T.C. at 176-82 (Holmes, J., concurring).

[160] *See* Golsen v. Commissioner, 54 T.C. 742 (1970), *aff'd on other grounds*, 445 F.2d 985 (10th Cir. 1971).

[161] 127 T.C. at 166-67 n.3 (Holmes, J., concurring) (citing Hosp. Corp. of Am. v. Commissioner, 348 F.3d 136, 140-41 (6th Cir. 2003); Peoples Fed. Sav. & Loan Assn. v. Commissioner, 948 F.2d 289, 299-300 (6th Cir. 1991)).

[162] *Id.* at 166-68 (Holmes, J., concurring).

[163] 127 T.C. at 169-70 & n.1 (Laro, J., dissenting). Judge Laro accused the majority of straining to find an ambiguity in an unambiguous statute, and argued that a term is not "ambiguous simply because it is not defined by Congress." *Id.* at 169-72 & n.2. Applying the "rule of the last antecedent," Judge Laro would have construed the statutory phrase "any generation-

This dissenting opinion was joined by Judges Colvin, Vasquez, Gale, and Wherry.

Finally, Judge Vasquez, writing only for himself, took the view that *Mead* "changed the landscape regarding the deference courts should give to interpretive regulations,"[165] such that, in his view, the *Skidmore* standard, rather than the *National Muffler* standard, now applies to section 7805(a) regulations:

> The Internal Revenue Code contains numerous specific delegations of authority from Congress to the Secretary or the Commissioner to issue rules or regulations that have the force and effect of law. These sections – that provide for issuing legislative regulations – would be superfluous if section 7805 were a delegation of authority from Congress to make rules or regulations carrying the force of law. It is a fundamental rule of statutory construction to give effect to all of the language of the statute. It is a well-accepted rule of statutory construction that the various sections of the Code should be construed so that one section will explain and support and not defeat or destroy another section. Accordingly, I believe that section 7805 is not a delegation of authority by Congress to make rules or regulations carrying the force of law. . . . The first question in the *Mead* analysis is whether Congress delegated authority to the agency to make rules or regulations carrying the force and effect of law. . . . By promulgating a regulation pursuant to section 7805, the regulation was not issued pursuant to a delegation of authority by Congress to make rules or regulations carrying the force and effect of law. Accordingly, pursuant to *Mead*, interpretive regulations are not entitled to *Chevron* deference; instead, they are entitled to *Skidmore* deference.[166]

3. *The Sixth Circuit's opinion*. On appeal, the Sixth Circuit affirmed the Tax Court's decision.[167] Echoing Judge Holmes' concurring opinion, the Sixth Circuit began by noting that it "has faithfully applied *Chevron* deference [to section 7805(a) regulations] since abandoning the less deferential *National Muffler* standard" in the cases cited by Judge Holmes.[168] In this connection, the court disagreed with Judge Vasquez' contention that *Mead* requires that the *Skidmore* standard be applied to section 7805(a) regulations, noting that the Service subjects section 7805(a) regulations to notice and comment procedures and the applicability of penalties to taxpayers who violate the provisions of section 7805(a) regulations.[169]

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skipping transfer under a trust which was irrevocable on September 25, 1985" such that the words "which was irrevocable on September 25, 1985" modify the word "trust" rather than the word "transfer". *Id.* at 172-73 (citing 2A Singer, Sutherland Statutory Construction §47:33 (6th ed. 2000)). While this approach is unassailable as a matter of statutory construction, it does not explain how the exercise of a power of appointment created under a trust is itself a transfer under the trust.

[164]127 T.C. at 169 n.1 (Laro, J., dissenting) (citations omitted).

[165]*Id.* at 177 (Vasquez, J., dissenting).

[166]127 T.C. at 176-77 (Vasquez, J., dissenting) (citations omitted); *see also* Robinson v. Commissioner, 119 T.C. at 118-21 (Vasquez, J., dissenting).

[167]Estate of Gerson v. Commissioner, 507 F.3d 435 (6th Cir. 2007).

[168]*Id.* at 438; *see supra* note 161.

Applying *Chevron*, the Sixth Circuit agreed with the Tax Court that the phrase "transfer under a trust" in the Transitional Rule is ambiguous, since its meaning could be either that asserted by the taxpayer (the "trust instrument is the root" of the power to make the transfer) or that asserted by the Service (the transfer itself must be described in and undertaken pursuant to the trust instrument).[170] The court enunciated the question under *Chevron* step two as "whether the Commissioner reasonably construed the statute," and answered this question in the affirmative in light of the principle that a general power of appointment is treated as the equivalent of outright ownership and the type of reliance interest that other statutory exceptions to the GST tax protect.[171] In the words of the Sixth Circuit, determining the extent to which a taxpayer must have relied on the previous nonexistence of the GST tax "is precisely the type of decision entrusted to agency discretion."[172]

V. The "Check-the-Box" Regulations: A Case Study in the Courts of Appeal

It is clear from the two cases discussed above that the various judges on the Tax Court have widely divergent views on the meaning of the Supreme Court's various pronouncements regarding deference to agency determinations, with Judges Holmes and Vasquez, in particular, standing at opposite ends of the spectrum regarding the effect of *Chevron*, *Mead*, and *National Cable* on the standard to be applied to section 7805(a) regulations. While the differences of opinion among the courts of appeals are perhaps not as pronounced, these courts are also coming to differing conclusions as to the effect of *Chevron*, *Mead*, and *National Cable* in the tax arena.[173] Discussed below are two recent examples, both arising in the context of the validity of the so-called check-the-box regulations.

The Code draws a sharp distinction between corporations and other entities, imposing an entity-level tax under section 11 on corporations but not on other entities. Section 7701(a)(3) provides that the term "corporation" "includes associations," but does not define the latter term. In *Morrissey v. Commissioner*,[174] the Supreme Court in 1935 filled this gap by defining "associations" in terms of an entity's corporate characteristics, such as associates, continuity of life, centralization of management, transferability of interests, and limited liability, and the Treasury Department later issued Regulations adopting and fleshing out the *Morrissey* standards.[175]

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[169] *Id.* (citing *Long Island Care*, 127 S. Ct. at 2350-51).
[170] *Estate of Gerson*, 507 F.3d at 439-41.
[171] *Id.* at 441-42 (citing *Tataranowicz v. Sullivan*, 959 F.2d 268, 277 (D.C. Cir. 1992)).
[172] 507 F.3d at 441.
[173] *See, e.g.*, E.I. DuPont de Nemours & Co. v. Commissioner, 41 F.3d 130, 135-36 (3d Cir. 1994) (questioning whether *Chevron* applies at all to section 7805(a) regulations).
[174] 296 U.S. 344 (1935).

In December of 1996, the Treasury Department revolutionized and greatly simplified the rules regarding entity classification by promulgating regulations establishing a largely elective system, commonly known as the check-the-box rules.[176] Under these rules, United States corporations and certain enumerated non-United States entities are treated as corporations, and all other entities, including partnerships and limited liability companies (LLCs), are entitled to elect to be treated either as a corporation or as a partnership (or, in the case of an entity having a single member, a disregarded entity), with a series of default rules for situations where no election one way or the other is made. When these regulations were proposed, along with the overwhelmingly favorable reaction from tax practitioners, some concern was expressed regarding the validity of these regulations in light of the Supreme Court's interpretation of the statute in *Morrissey*; however, the elective, taxpayer-favorable nature of the regulations caused many practitioners to view the regulations as a "revenue concession" that would be unlikely ever to be challenged.[177]

Sure enough, however, not one but two taxpayers (so far) have found themselves to have been sufficiently adversely affected by the check-the-box regulations to challenge their validity. In both cases, the courts have upheld the regulations as a valid exercise of the Treasury Department's authority under section 7805(a).

The facts in the two cases—*Littriello v. United States*[178] and *McNamee v. Department of the Treasury*[179]—are roughly identical: Each taxpayer was the sole owner of an LLC that had failed to pay federal employment taxes for quarters falling after the effective date of the check-the-box regulations but prior to the effective date of later proposed regulations, discussed below,

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[175]Reg. § 301.7701-1, *et seq. (*1960); *see also* United States v. Kintner, 216 F.2d 418 (9th Cir. 1954).

[176]Reg. § 301.7701-1, *et seq.* (1997); *see* Notice 95-14, 1995-1 C.B. 29 (announcing that the Service was considering replacement of the then-existing entity classification rules with an elective system).

[177]*See, e.g.,* Mark E. Berg, *Checking the Box: New Proposed Regulations Would Simplify Entity Classification and Afford Planning Opportunities*, 8 J. Corp. Tax'n 195, 205-06 (1997); *see also* Dover Corp. v. Commissioner, 122 T.C. 324, 330-31 n.7 (2004) (noting that not only commentators but also the Joint Committee on Taxation had questioned the validity of the check-the-box regulations). For an interesting discussion of the validity of the check-the-box regulations prior to the decisions in *McNamee* and *Littriello*, and prior to the Supreme Court's decision in *National Cable*, see Polsky, *supra* note 84, at 226, *cited in* Littriello v. United States, 96 A.F.T.R.2d 5764 (W.D. Ky. 2005), *denying motion for reconsideration of* 2005-1 U.S.T.C. ¶ 50,385 (W.D. Ky. 2005), *aff'd*, 484 F.3d 372 (6th Cir. 2007), *reh'g denied*, 2007 U.S. App. LEXIS 23640 (6th Cir. Sept. 25, 2007), *cert. denied*, 76 U.S.L.W. 3439 (2008).

[178]Littriello v. United States, 484 F.3d 372 (6th Cir. 2007), *reh'g denied*, 2007 U.S. App. LEXIS 23640 (6th Cir. Sept. 25, 2007), *cert. denied*, 76 U.S.L.W. 3439 (2008).

[179]McNamee v. Dep't of the Treasury, 488 F.3d 100 (2d Cir. 2007), *aff'g* 96 A.F.T.R.2d 6746 (D. Conn. 2005).

which would limit the application of the check-the-box regulations in the employment tax context. Since the LLC had not elected to be treated as a corporation, its default treatment under the check-the-box regulations was as a disregarded entity, that is, a sole proprietorship. In each case, the Service assessed the unpaid employment taxes on the taxpayer individually, on the basis that the LLC is disregarded and treated as a sole proprietorship under the check-the-box regulations.[180] The District Court in each case granted the Service's motion for summary judgment, and the taxpayer appealed.[181]

In *Littriello*, the taxpayer appears[182] to have argued that no deference is due the check-the-box regulations because they stray from both the Code's unambiguous definition of the terms "corporation" and "partnership" and the Supreme Court's unambiguous tests in *Morrissey*. The Sixth Circuit rejected this argument, stating that *Chevron* requires deference to the regulations "as long as they are reasonable," and permits an agency to revise its interpretation of a statute "to meet changing circumstances."[183] Significantly, the court noted that the Supreme Court in *Morrissey* "observed that the Code's definition of a corporation was less than adequate and that, as a result, the IRS had the authority to supply rules of implementation that could later be changed to meet new situations,"[184] and that *National Cable* would require a different result only if the Court in *Morrissey* had held that its construction of section

[180]The District Court's opinion in *Littriello* indicates that the unpaid federal employment taxes in that case were "withholding and FICA taxes." *Littriello*, 2005-1 U.S.T.C. at 88,059. The Second Circuit in *McNamee* indicates that the unpaid taxes in that case included both employment taxes the LLC had withheld from its employees and the employer-share taxes imposed on the company itself under sections 3111 and 3301. *McNamee*, 488 F.3d at 103. In both cases, to the extent the deficiencies related to the LLC's failure to pay over income, FICA and Medicare taxes withheld from its employees, rather than its failure to pay its own employer-share taxes, it is not clear why the Service did not assess the tax on the taxpayers in their individual capacities under section 6672(a), the so-called 100% penalty on responsible persons (*see* I.R.C. § 6671(b)), in which case the issue regarding the validity of the check-the-box regulations would not have arisen. Indeed, the taxpayer in *Littriello* argued that the Service's failure to proceed under section 6672, which the taxpayer suggested was the Service's "sole statutory recourse," precluded the Service from proceeding against the taxpayer under any other theory, an argument the District Court rejected. *Littriello*, 2005-1 U.S.T.C. at 88,061. In addition, it should be noted that in *McNamee*, the Second Circuit pointed out that the LLC was liquidated while the case was before the Service's Appeals Office. *McNamee*, 488 F.3d at 104. As a result, even had the taxpayer in *McNamee* prevailed on the issue of the validity of the check-the-box regulations, the Service presumably could have asserted transferee liability against the taxpayer individually. *See* I.R.C. §6901, *et seq.*

[181]Littriello v. United States, 2005-1 U.S.T.C. ¶ 50,385, 95 A.F.T.R.2d 2581 (W.D. Ky. 2005), *motion for reconsideration denied*, 96 A.F.T.R.2d 5764 (W.D. Ky. 2005), *aff'd*, 484 F.3d 372 (6th Cir. 2007), reh'g *denied*, 2007 U.S. App. LEXIS 23640 (6th Cir. Sept. 25, 2007), *cert. denied*, 76 U.S.L.W. 3439 (2008); McNamee v. Dep't of the Treasury, 96 A.F.T.R.2d 6746 (D. Conn. 2005), *aff'd*, 488 F.3d 100 (2d Cir. 2007).

[182]The Sixth Circuit noted that the taxpayer's argument in this regard "is not a model of clarity." *Littriello*, 484 F.3d at 377.

[183]*Id.*

7701(a)(3) follows from the unambiguous terms of the statute.[185] Concluding that section 7701(a)(3) is ambiguous as applied to what it called "hybrid business entities" such as LLCs, the Sixth Circuit held the check-the-box regulations to be "eminently reasonable" and thus a valid exercise of the Treasury Department's authority to fill the statutory gap.[186] Neither the District Court nor the Sixth Circuit mentioned the words "arbitrary" or "capricious" in their opinions in *Littriello*.

After also disposing of the taxpayer's argument that the Treasury Department must recognize for tax purposes the separate existence of the LLC for state law liability purposes, the Sixth Circuit noted that in October 2005, after the District Court had issued its opinion, the Treasury Department issued proposed regulations that would treat entities that are disregarded for federal income tax purposes as separate entities for employment tax purposes.[187] The taxpayer argued that although the proposed regulations were not in effect (or even proposed to become effective) during the periods in question, they "should be taken as reflecting current Treasury Department policy and applied to [the taxpayer's] case."[188] The Sixth Circuit rejected this argument as well, holding that even when an agency issues a proposed regulation that would change the Treasury Department's interpretation of a statute, the agency "does not lose its entitlement to *Chevron* deference," since "the further development of permissible alternatives is part of the administering agency's function under *Chevron*."[189] Interestingly, the Sixth Circuit noted in this connection that the proposed regulations had not yet been finalized as of the date of its opinion, leaving open the possibility that had the proposed regulations been finalized, the court might have determined that the prior regulations, the new regulations, or both could be vulnerable on the basis that the agency has been inconsistent.[190]

In *McNamee*, the taxpayer made essentially the same arguments as were

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[184] *Id.* at 377-78 (citing *Morrissey*, 296 U.S. at 354-55); *see Morrissey*, 296 U.S. at 354-55 ("As the statute merely provided that the term 'corporation' should include 'associations,' without further definition, the Treasury Department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction. Nor can this authority be deemed to be so restricted that the regulations, once issued, could not later be clarified or enlarged so as to meet administrative exigencies or conform to judicial decision.").

[185] *Littriello*, 484 F.3d at 377-78 (citing *Chevron*, 467 U.S. at 863-64, *Morrissey*, 296 U.S. at 354-55, and *National Cable*, 545 U.S. at 982).

[186] *Littriello*, 484 F.3d at 378.

[187] Prop. Reg. § 301.7701-2(c)(2)(iv)(A), 70 Fed. Reg. 60,475 (2005).

[188] *Littriello*, 484 F.3d at 379.

[189] *Id.* (citing CFTC v. Schor, 478 U.S. 833, 845 (1986) ("It goes without saying that a proposed regulation does not represent an agency's considered interpretation of its statute and that an agency is entitled to consider alternative interpretations before settling on the view it considers most sound.")); *cf.* Boeing Co. v. United States, 537 U.S. 437, 453 n.13 ("[W]e find these proposed regulations to be of little consequence given that they were nothing more than mere proposals.").

made in *Littriello*.[191] Regarding the standard of review, the Second Circuit confusingly quoted both the passage from *Chevron* applying the arbitrary-and-capricious standard to legislative regulations promulgated pursuant to express delegations of authority, and the passage from *Mead* applying "*Chevron* deference" to regulations promulgated pursuant to general delegations of authority.[192] The court then characterized section 7805(a) as an "express[] delegat[ion of] authority to the Secretary of the Treasury to adopt regulations to fill in gaps in the Code"[193] and, citing *National Muffler*, stated that it is required to "'defer to [the Treasury Department's] regulatory interpretations of the Code so long as they are reasonable.'"[194] In short, the Second Circuit appears to have fallen prey to the semantic problems, discussed above, that have plagued courts and commentators in this area since the time of *Chevron*, using the term "*Chevron* deference" to refer to two very different standards, blurring the distinction between express and general delegations of authority and referring to *Chevron* and *National Muffler* as if the standards under those cases were identical. Having set forth the standard of review in this confusing manner, the Second Circuit held that in light of the emergence of LLCs and the Code's silence on their classification in the ten years since the check-the-box regulations became effective, the court could not "conclude that the above Treasury Regulations, providing a flexible response to a novel business form, are *arbitrary, capricious or unreasonable*."[195]

The Second Circuit next addressed the taxpayer's argument that the Treasury Department's issuance of the proposed Regulations in 2005 "means that the current regulations are 'wrong,'" stating that this argument is "wide of the mark."[196] In this connection, the Second Circuit cited *Littriello* and also noted that the Supreme Court in *National Cable* held that "'if the agency adequately explains the reasons for a reversal of policy, change is not invalidating.'"[197] The court then quoted the Treasury Department's explanation of the reason for the proposed regulations set out in their "preamble,"[198] and concluded that "[t]he proposed changes, which have not been adopted as of

[190] *Littriello*, 484 F.3d at 379 n.3. These proposed regulations were subsequently finalized in August 2007. T.D. 9356, 2007-39 I.R.B. 675.

[191] McNamee v. Dep't of Treasury, 488 F.3d 100, 104-05 (2007).

[192] *Id.* at 105-06 (quoting Chevron, U.S.A. Inc. v. Natural Res. Def. Council, 467 U.S. 837, 842-43 (1984) and United States v. Mead, 533 U.S. 218, 226-27 (2001)).

[193] *McNamee*, 488 F.3d at 105.

[194] *Id.* at 106 (quoting Cottage Sav. Ass'n v. Commissioner, 499 U.S. 544, 560-61 (1991), which in turn cited National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 476-77 (1979)).

[195] *McNamee*, 488 F.3d at 109 (emphasis added); *see also id.* ("The IRS check-the-box regulations, allowing the single-owner LLC to make the choice, are therefore eminently reasonable.").

[196] *Id.* (quoting the taxpayer's brief).

the filing of this opinion, provide no basis for finding the existing regulations unreasonable."[199] Disposing of the taxpayer's state law argument on similar grounds as did the Sixth Circuit in *Littriello*, the Second Circuit concluded as follows:

> McNamee could have had the benefit of limited personal liability [for tax] if he had simply elected to have his LLC treated as a corporation; he chose not to do so and thereby avoided having the LLC taxed as a separate entity. We know of no provision, policy, or principle that required the federal government to allow him both to escape personal liability for the taxes owed by his sole proprietorship and to have the proprietorship escape taxation as a separate entity.[200]

VI. Toward an Appropriate Deference Standard

A. Chevron, Mead, *and* National Cable—*Reviewing the Bidding*

As noted, tax advisors have long thought about the validity of tax regulations as strictly a binary question: Regulations explicitly authorized in a provision of the Code other than section 7805(a) are deemed "legislative regulations" that are virtually immune from challenge, being invalid only if arbitrary, capricious, or manifestly at odds with the statute, and all other tax regulations are considered section 7805(a) regulations, which are valid only if they meet the more demanding *National Muffler* standard. From this traditional perspective, much of the Supreme Court's language in *Chevron*, *Mead*, and *National Cable* has a familiar ring.

In Chevron, rather than working a sea change in the traditional standards of deference, the Court actually embraced the two different standards, applying arbitrary-and-capricious deference to regulations promulgated pursuant to an explicit delegation of authority by Congress to an agency to interpret a specific provision in the statute, and a lower level of deference, variously expressed in terms of whether the regulation effects a "permissible construction" or is "reasonable," to regulations promulgated pursuant to an "implicit" delegation.[201] *Mead*, rather than clouding this distinction, embraced and even clarified it, explaining that there are three distinct levels of "deference": (1) the arbitrary-and-capricious standard, which applies where Congress "*expressly delegated authority* or responsibility to implement a *particular provision* or fill a *particular gap*;"[202] (2) a permissible-construction standard, which applies where it is "apparent from the agency's *generally conferred authority* and other

[197] *Id.* (quoting Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 981 (2005)).

[198] *McNamee*, 488 F.3d at 110 (citing 70 Fed. Reg. 60475, 60476 (2005)).

[199] *McNamee*, 488 F.3d at 110. *See supra* text accompanying note 190 regarding the possibility this language leaves open for a different result once the proposed regulations are finalized.

[200] *McNamee*, 488 F.3d at 111.

[201] Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 843-44 (1984).

statutory circumstances that Congress would *expect the agency to be able to speak with the force of law* when it addresses ambiguity in the statute or fills a space in the enacted law;"[203] and (3) the much lower, nondeferential *Skidmore* standard, which applies to agency action not falling within either of the first two categories.[204] And while the focus of *National Cable* was on the interplay between judicial and agency constructions of a statute and changes over time in the agency's interpretations, the Court in *National Cable* once again made it clear that notwithstanding its use of the term "*Chevron* deference," regulations promulgated under a general delegation of authority quite similar to section 7805(a)[205] are entitled to less deference than that afforded under the arbitrary-and-capricious standard.[206]

To be sure, the Court in *Mead* placed a great deal of emphasis on the wide variety of ways in which Congress delegates rulemaking authority and agencies invoke such authority,[207] leading some commentators to conclude that *Mead* requires that a different standard of deference be worked out for each agency.[208] And bearing out Justice Scalia's warning in dissent that the Court "will be sorting out the consequences of the *Mead* doctrine, which has today replaced the *Chevron* doctrine, for years to come,"[209] there is an extraordinary amount of disagreement regarding the effect of *Chevron* and *Mead* on the standard of deference to be applied to section 7805(a) regulations, with some suggesting that because the Treasury Department generally follows the APA notice and comment procedures for section 7805(a) regulations and such regulations appear to be intended to have the force of law, *Mead raised* the level of deference to be accorded to section 7805(a) regulations to full

[202]United States v. Mead Corp., 533 U.S. 218, 229 (2001) (emphasis added); *see also id.* at 227 (applying the arbitrary-and-capricious standard where the agency "enjoy[s] an[ ] express delegation of authority on a particular question").

[203]*Id.* at 229 (emphasis added).

[204]*Id.* at 234-39.

[205]*Compare* 47 U.S.C. § 201(b) (the delegation at issue in *National Cable*, which grants the FCC authority to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions" of the FCC Act) *with* I.R.C. § 7805(a) (granting the Treasury Department authority to "prescribe all needful rules and regulations for the enforcement" of the Code).

[206]Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 980 (2005). One important question left unanswered by these cases is when, if ever, one would reach a result under the aribtrary-and-capricious standard that differs from the result under the permissible-construction or "reasonableness" standard described in *Chevron*, *Mead* and *National Cable*. After all, an agency determination having a basis in reason is both reasonable and not arbitrary or capricious, and thus will pass both tests, and a determination having no basis in reason will fail both tests.

[207]*Mead*, 533 U.S. at 236-37.

[208]*See, e.g.,* ABA Task Force Report, *supra* note 4, at 718, 720-21.

[209]*Mead*, 533 U.S. at 239 (Scalia, J., dissenting) (citation omitted).

arbitrary-and-capricious deference,[210] while others suggest that the cases can all be harmonized by treating the *National Muffler* standard as the *Chevron* step-two permissible-construction test in the tax context,[211] and still others suggest that since, in the Treasury Department's view at least, the APA notice and comment procedures do not apply to section 7805(a) regulations, *Mead lowered* the level of deference to be accorded to section 7805(a) regulations to the *Skidmore* standard.[212]

However, a close reading of these cases, cutting through the inconsistent terminology, makes it clear that *Mead* did nothing to disturb, and actually reinforced, the pre-*Mead* distinction between (1) regulations that the Court in *Mead* described as promulgated pursuant to "'an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation,'" in which Congress "intended to delegate particular interpretative authority" in a particular case,[213] and (2) other regulations promulgated pursuant to "generally conferred authority" and to which the APA notice and comment procedures are applied.[214] And while the Court in *Mead* and *National Cable* used the term "*Chevron* deference" to refer to the deference to be accorded to both types of regulations, the language used by the Court in *Chevron*, *Mead*, and *National Cable* makes it clear that something less than arbitrary-and-capricious deference is to be accorded to regulations issued under generally conferred authority. Since *Chevron*, *Mead*, and *National Cable* did not involve tax regulations, these cases leave open the questions of where in this framework tax regulations issued under the various types of congressional delegations fit, and particularly whether the *National Muffler* standard survived these cases.

B. *Application to Tax Regulations*

1. *The Degree of Deference to be Accorded to the Different Types of*

[210] *See* Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,391-92 (3d Cir. 2008) (No. 06-3388); Swallows Holding v. Commissioner, 126 T.C. 96, 172-82 (2006) (Holmes, J., dissenting).

[211] *See* Robinson v. Commissioner, 119 T.C. 44, 68 (citing United States v. Vogel Fertilizer, 455 U.S. 16, 24 (1982)); ABA Task Force Report, *supra* note 4, at 738 ("The Task Force recommends that interpretive regulations also be afforded *Chevron* deference, but articulates the test for reasonableness under *National Muffler*.").

[212] *See* Estate of Gerson v. Commissioner, 127 T.C. 139, 176-77 (2006) (Vasquez, J., dissenting); *see also* Administrative Procedure Act, 5 U.S.C. § 553(b) (2007); ABA Task Force Report, *supra* note 4, at 728-29.

[213] *Mead*, 533 U.S. at 227, 229-30 (quoting Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 843-44 (1984)).

[214] *Mead*, 533 U.S. at 229.

Regulations

The foregoing discussion indicates that the available deference standards include (1) full arbitrary-and-capricious deference at one end of the spectrum, (2) the nondeferential *Skidmore* standard at the other, and, falling somewhere between these two extremes, (3) the permissible-construction or "reasonableness" standard described in *Chevron* and (4) the *National Muffler* standard. As a preliminary matter, it should be noted that the practical differences among the various standards of deference can be significant. For example, while the *Skidmore* standard described in *Mead* seems somewhat similar to the *National Muffler* standard, with both standards focusing on factors such as the consistency of the agency's position,[215] the standards differ in at least one material respect: the *Skidmore* standard gives great weight to the agency pronouncement's "'power to persuade,'"[216] a subjective standard that gives judges great latitude to determine the persuasive force of the agency's pronouncement, whereas the *National Muffler* standard turns instead on more apparently objective factors such as the contemporaneity and consistency of the agency's construction with the underlying statute and its consistency over time.[217] Moreover, the *National Muffler* standard accords less deference to an agency position that has changed over time than does a higher standard such as the arbitrary-and-capricious standard, which recognizes to a greater degree that agencies are expected to "consider varying interpretations and the wisdom of its policy on a continuing basis."[218] Less clear is whether and to what extent there is a difference between the *National Muffler* standard and the permissible-construction standard described in *Chevron* and its progeny, although the Supreme Court in a 2007 nontax case unanimously described the latter standard in a manner strikingly similar to the *National Muffler* formulation.[219]

Perhaps the most important principle enunciated in these cases is that the degree of deference to be accorded to an agency's pronouncement depends on the nature of the congressional delegation of authority pursuant to which

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[215] *Compare* Nat'l Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472, 477 (1979), *with* Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944) *and Mead*, 533 U.S. at 228; *see also* Fed. Express Corp. v. Holowecki, slip op. at 8 (U.S. Feb. 27, 2008) (No. 06-1322) ("Under *Skidmore*, we consider whether the agency has applied its position with consistency.").

[216] *Mead*, 533 U.S. at 235 (quoting *Skidmore*, 323 U.S. at 140).

[217] *See Nat'l Muffler*, 440 U.S. at 477; *see also Mead*, 533 U.S. at 241 (Scalia, J., dissenting) ("The Court has largely replaced *Chevron*, in other words, with that test most beloved by a court unwilling to be held to rules (and most feared by litigants who want to know what to expect): th'ol' 'totality of the circumstances' test.").

[218] *Compare Nat'l Muffler*, 440 U.S. at 477, *with* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 981-82 (2005), *and Chevron*, 467 U.S. at 863-64; *see generally* Swallows Holding v. Commissioner, 126 T.C. 96, 173-75 (2006) (Holmes, J., dissenting).

[219] *See* Long Island Care At Home Ltd. v. Coke, 127 S. Ct. 2339, 2350-51 (2007) ("[T]he ultimate question is whether *Congress* would have intended, and expected, courts to treat an agency's rule, regulation, application of a statute, or other agency action as within, or outside, its delegation to the agency of 'gap-filling' authority. Where an agency rule sets forth important

the pronouncement was issued, and what the language used in the delegation tells us about Congress' delegative intent, that is, its intention as delegator regarding the level of deference to be given the resulting regulations.[220] In the tax area, Congress appears to have gone out of its way to draw a clear distinction in the Code between, for example, the dozens of explicit delegations by Congress of authority to the Treasury Department to interpret or administer particular Code provisions, referred to in this Article as specific delegations,[221] and the authority it more generally conferred in section 7805(a). From this demonstration by Congress that it knows how to authorize specific-authority regulations when it wishes to do so, one may conclude the following regarding the level of deference due to regulations issued pursuant to the different types of congressional delegations:

a. *Specific-Authority Regulations*. Specific delegations seem clearly to be the types of delegations described in *Chevron* as "express delegation[s] of authority to the agency to elucidate a specific provision of the statute by regulation," and in *Mead* as "express delegation[s] of authority on a particular question."[222] As a result, and particularly since Congress has taken such pains in the tax context to distinguish these delegations from the more general delegation in section 7805(a), it seems clear that the proper standard of deference for specific-authority regulations is the arbitrary-and-capricious standard that has been traditionally applied to such regulations.

b. *Section 7805(a) Regulations*. As noted above, while there is a great deal of confusion among the lower courts and commentators regarding the standard to be applied in determining the validity of section 7805(a) regulations, the Tax Court cases discussed above indicate that, with a few notable exceptions,[223] the judges on the Tax Court believe that the *National Muffler* standard survived *Chevron* and *Mead* and is to be applied to section 7805(a) regulations.[224] In light of the many different courts of appeals that

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individual rights and duties, where the agency focuses fully and directly upon the issue, where the agency uses full notice and comment procedures to promulgate a rule, where the resulting rule falls within the statutory grant of authority, and where the rule itself is reasonable, then a court ordinarily assumes that Congress intended it to defer to the agency's determination.") (emphasis in original); *see also* Bankers Life & Cas. Co. v. United States, 142 F.3d 973, 981-82 (7th Cir. 1998), *cert. denied*, 525 U.S. 961 (1998); ABA Task Force Report, *supra* note 4, at 764 ("[T]he distance between a 'permissible construction' in step two of *Chevron* and a 'reasonable' construction in *National Muffler* might be negligible."). *But see* Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,390-91 (3d Cir. 2008) (drawing a sharp distinction between the "permissible construction" standard under *Chevron* and the *National Muffler* standard).

[220] *See Mead*, 533 U.S. at 230-31; Christensen v. Harris County, 529 U.S. 576, 596-97 (2000) (Breyer, J., dissenting).

[221] *See, e.g.*, I.R.C. §§ 163(f)(2)(C), 267(a)(3)(A) and (B)(ii), 305(c), 385(a) and (b), 863(b) (first sentence), 882(c)(1)(A), 1291(b)(3) and 1502.

[222] *Mead*, 533 U.S. at 227; *Chevron*, 467 U.S. at 843-44.

hear appeals from Tax Court decisions and the Tax Court's *Golsen* rule, it is somewhat remarkable that the standard applied by the Tax Court is so clear and consistently applied.

As illustrated by the courts of appeals' opinions in *Swallows Holding*, *Littriello*, and *McNamee*, however, the state of play outside the Tax Court is much less clear and coherent. In his dissenting opinion in *Swallows Holding* in 2006, Judge Holmes counted two circuits (the Ninth and Eleventh Circuits) that accorded arbitrary-and-capricious deference to section 7805(a) regulations, five circuits (the Fourth, Fifth, Eighth, Tenth, and Federal Circuits) that applied the *National Muffler* standard, three circuits (the Sixth, Seventh, and D.C. Circuits) that applied some sort of "*Chevron* review," and two circuits (the Second and Third) that at that point had either left this issue open or were reconsidering their view.[225] In 2007, the Second Circuit in *McNamee*, reflected the confusion in this area by citing both the express delegation language from *Chevron* and *Mead* and the *National Muffler* standard, and concluding that the check-the-box regulations are valid because they are not "arbitrary, capricious or unreasonable"[226] and the Sixth Circuit in *Littriello* reached the same conclusion without citing *National Muffler* and with little attempt even to articulate the applicable standard other than to refer to the regulations as "eminently reasonable."[227] By contrast, the Third Circuit in its 2008 opinion in *Swallows Holding* squarely faced the question of the continuing vitality of the *National Muffler* standard, but unfortunately based its conclusion that the Supreme Court had repudiated the *National Muffler* standard on a dubious reading of the Supreme Court's opinion in *Cleveland Indians*.[228]

The flip side of the above discussion of specific-authority regulations is that when Congress chooses not to enact a specific delegation in a particular case and leaves it to section 7805(a) to authorize the necessary regulations, it would appear that Congress is signaling that it intends and expects that section 7805(a) regulations will not be accorded the highest, arbitrary-and-capricious level of deference.[229] *National Cable*, a non-tax case in which the Court applied a permissible-construction or reasonableness standard to a regulation promulgated pursuant to a delegation quite similar to section 7805(a), further supports this position.[230] Indeed, it could well be in recogni-

[223] *See* Estate of Gerson v. Commissioner, 127 T.C. 139, 176-77 (2006) (Vasquez, J., dissenting); *Swallows Holding*, 126 T.C. at 176-82 (Holmes, J., dissenting).

[224] *See, e.g.*, Lewis v. Commissioner, 128 T.C. 48, 53-4 (2007); *Gerson*, 127 T.C. at 153-54; *Swallows Holding*, 126 T.C. at 131.

[225] *Swallows Holding*, 126 T.C. at 180-81 (Holmes, J., dissenting).

[226] McNamee v. Dep't of Treasury, 488 F.3d 100, 105-06, 109 (2d Cir. 2007).

[227] Littriello v. United States, 484 F.2d 372, 378 (6th Cir. 2007).

[228] Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,391 & n.8 (3d Cir. 2008).

[229] *Cf. Gerson*, 127 T.C. at 176 (Vasquez, J., dissenting) (the specific Code provisions authorizing the issuance of legislative regulations "would be superfluous if section 7805 were a delegation of authority from Congress to make rules or regulations carrying the force of law"). *But see Swallows Holding*, 126 T.C. at 176-79 (Holmes, J., dissenting).

tion of this distinction Congress draws between specific delegations and the general delegation under section 7805(a) that the Supreme Court has continued after *Chevron* and *Mead* to apply the *National Muffler* standard, rather than arbitrary-and-capricious deference, to section 7805(a) regulations.[231]

Assuming section 7805(a) regulations are not entitled to aribtrary-and-capricious deference, the remaining available standards of deference for section 7805(a) regulations are the *National* Muffler standard, which as noted involves a searching inquiry as to matters such as the contemporaneity of the regulation with the underlying statute and the consistency of the agency's position over time, the *Skidmore* standard, which as noted amounts to no deference at all, and the permissible-construction standard described in *Chevron* and its progeny, which would seem, at least outside the tax context, to be a somewhat higher level of deference than the *National Muffler* standard.

As noted, some have suggested that *Mead*'s focus on whether the agency pronouncement at issue was subjected to notice and comment procedures as a "very good indicator" of delegation meriting a high level of deference[232] means that section 7805(a) regulations, which are after all promulgated with notice and comment, should be given a higher level of deference than the *National Muffler* standard.[233] However, while this argument is surely sufficient to elevate section 7805(a) regulations to a higher level of deference than the *Skidmore* standard,[234] particularly given the similarity of the delegation in section 7805(a) to the delegation at issue in *National Cable*,[235] it does not compel the conclusion that a higher level of deference than the *National Muffler* standard should be applied to these regulations. This is particularly so since *Chevron*, *Mead*, and *National Cable* did not involve tax regulations and thus did not address the considerations peculiar to the tax area which indicate that it may be appropriate to accord tax regulations a lower level of deference than other agency pronouncements. These considerations are discussed below.

First, as the ABA Task Force Report persuasively notes, the Service's unique role as revenue collector for the federal government, its authority to impose the significant civil penalties and above-market interest charges prescribed

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[230] *See supra* note 205.

[231] *See supra* Part III.D. *But see Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,391-92 n.8 (taking the view that the Supreme Court has abandoned the *National Muffler* standard, but not necessarily in favor of arbitrary-and-capricious deference).

[232] *See Mead*, 533 U.S. at 229-30.

[233] *See Swallows Holding*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,391-92; *Swallows Holding*, 126 T.C. at 176-82 (Holmes, J., dissenting); *cf.* ABA Task Force Report, *supra* note 4, at 738-41.

[234] *See Mead*, 538 U.S. at 226-27, 229-30. *But see* Estate of Gerson v. Commissioner, 127 T.C. 139, 176-77 (2006) (Vasquez, J., dissenting).

[235] *See supra* note 205.

by Congress, and its inherent advantages over taxpayers in tax proceedings (for example, the general presumption of correctness of its determinations and the oft-cited rule that tax deductions and credits are a matter of "legislative grace") "argue[] in favor of a cautious approach to a grant of broad deference."[236]

In addition, the notice and comment process for tax regulations is fundamentally different from that in many other agencies. When, for example, the FCC issues a proposed rule for public comment, the rule would presumably affect different segments of the telecommunications and information industries in different ways, to the benefit of some competitors and the detriment of others. As a result, one would expect a spirited exchange of views by those commenting on the proposed rule, with those companies and industries whose "ox is gored" expressing heated opposition and those whose financial prospects would be enhanced singing the praises of the rule. While something similar can occur with tax regulations, by and large proposed tax regulations do not pit the fortunes of one company or industry against another's, but rather place taxpayers as a group on one side of the comment process and the Treasury Department on the other, with the commenting parties all expressing either outrage or satisfaction with the proposed regulations. To be sure, bar associations and other professional societies such as the AICPA often weigh in with more general policy comments, many of which commendably address tax policy issues in a neutral matter rather than taking solely pro-taxpayer positions. Nonetheless, the fundamental difference between the nature of the public comment process regarding tax and other regulations remains.

The above considerations, particularly when considered in conjunction with the Treasury Department's position that section 7805(a) regulations are not subject to the APA notice and comment procedures, suggests that in determining the level of deference to be given to section 7805(a) regulations, somewhat less importance should be attached to the application of the notice and comment procedures in the tax context. As a result, and since the Supreme Court not only has not repudiated the *National Muffler* standard for tax regulations, but has affirmatively continued to apply it in post-*Chevron* and -*Mead* tax cases, it seems clear that the *National Muffler* standard continues to be the applicable standard by which to determine the validity of section 7805(a) regulations, and that notwithstanding the Third Circuit's conclusion to the contrary in *Swallows Holding*, the notion that *Mead* and *National Cable* raised the level of deference to section 7805(a) regulations beyond the *National Muffler* standard should be rejected.[237]

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[236]ABA Task Force Report, *supra* note 4, at 723-24; *see* INDOPCO v. Commissioner, 503 U.S. 79, 84 (1992) (noting "the 'familiar rule' that 'an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer'"). *But cf.* I.R.C. § 7491 (placing the burden of proof in a court proceeding on the Service in certain limited circumstances).

c. *Purpose-Authority Regulations and Provision-Authority Regulations*. As noted above, somewhere between specific delegations and section 7805(a) are the newer categories of congressional delegations described above as purpose delegations and provision delegations. Under the traditional formulation, since these delegations are by definition found in Code provisions other than section 7805(a), all purpose-authority regulations and provision-authority regulations would be treated as legislative regulations, and thus would enjoy the highest level of deference under the arbitrary-and-capricious standard.

Viewed, however, through *Mead*'s lens of congressional delegative intent, this traditional view is difficult to justify for a number of reasons. First, while purpose delegations and provision delegations apply only to one or more specific provisions of the Code, they do not mention any specific matters to be covered, or statutory gaps to be filled, by regulations. As a result, these types of delegations meet neither *Chevron*'s requirement of "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation"[238] nor *Mead*'s requirement of "express delegation of authority on a particular question."[239] Moreover, just as Congress presumably tells us something about its delegative intent when it delegates certain regulation-writing authority in specific delegations rather than relying on the general delegation in section 7805(a), Congress also expresses its delegative intent when it includes in the same Code provision or set of provisions both a purpose

[237]It could be argued that the unique nature of the Tax Court, where many of these issues tend to arise in the first instance, is a further indication that less deference should be given to tax regulations. Outside the tax context, the deference question raises the basic administrative law and separation-of-powers issue of whether and to what extent a court of general jurisdiction should defer to a determination by an agency comprised of experts in the particular field, with the courts understandably tending to give more deference in cases involving carefully considered, highly technical determinations involving high levels of specialized expertise. *See, e.g.*, Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 865 (1984) (noting that the "regulatory scheme is technical and complex [and] the agency considered the matter in a detailed and reasonable fashion"); United States v. Mead Corp., 533 U.S. 218, 235 (2001) (quoting with approval *Skidmore*'s focus on the agency's "thoroughness, logic and expertness"); Swallows Holding v. Commissioner, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,393 (3d Cir. 2008). Unlike most courts, however, the Tax Court itself is comprised of specialist judges who are tax professionals and who hear only tax cases. As a result, at least some of the administrative law concerns animating the decisions in *Chevron*, *Mead*, and, perhaps particularly, *National Cable* do not arise when a Treasury regulation promulgated by the tax-specialist agency is being reviewed by the tax-specialist court. A problem with this argument, however, is that followed to its logical conclusion, the standards of deference applied to a particular regulation by the Tax Court would be different from those applied to the same regulation by the other trial courts with jurisdiction over tax matters (that is, the Court of Federal Claims and the District Courts) and even from those applied by the higher courts that review the decisions of the Tax Court.

[238]*Chevron*, 467 U.S. at 843-44.

[239]*Mead,* 533 U.S. at 227.

delegation or provision delegation and one or more specific delegations. For example, the PFIC provisions enacted in 1986 include both section 1298(f), which delegates authority to issue purpose-authority regulations with respect to all of sections 1291 to 1298, and several separate specific delegations in and with respect to provisions within sections 1291 through 1298.[240] In such cases, Congress has made it quite clear that its purpose and provision delegations are to be treated as something different from its specific delegations. As a result, it seems inappropriate to accord arbitrary-and-capricious deference to purpose-authority regulations or provision-authority regulations.[241]

For the reasons set out above in respect of section 7805(a) regulations, purpose-authority regulations and provision-authority regulations should be accorded a higher level of deference than the *Skidmore* standard. The question, then, becomes whether these regulations should be given a level of deference that is higher than that accorded to section 7805(a) regulations. Put another way, is the delegative intent in respect of a section 1298(f)-type delegation, which authorizes "such regulations as may be necessary or appropriate to carry out the purposes of [sections 1291 through 1298]," and a section 7701(e)(6)-type delegation, which authorizes "such regulations as may be necessary or appropriate to carry out the provisions of [section 7701(e)]," different from the delegative intent in respect of section 7805(a), which directs the Treasury Department to "prescribe all needful rules and regulations for the enforcement of [the Code]"?

The analysis starts, as always, with the statutory language. It is clear that the Code provisions in respect of which purpose and provision delegations authorize the Treasury Department to promulgate regulations are included within the scope of section 7805(a), since that provision delegates to the Trea-

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[240]See, for example, I.R.C. § 514(c)(9)(E)(iii), enacted in 1987, which specifically delegates regulation-writing authority in respect of section 514(c)(9)(E) notwithstanding that the purpose delegation in section 514(g), enacted in 1984, authorizes regulations under all of section 514, and section 453(k), enacted in 1986, which includes a specific delegation notwithstanding that the provision delegation in section 453(j)(1), enacted in 1980, authorizes regulations under all of section 453.

[241]See Professional Equities, Inc. v. Commissioner, 89 T.C. 165, 181 (1987), *acq.*, 1988-2 C.B. 1 (invalidating Temp. Reg. § 15A.453-1(b)(3)(ii), which was promulgated pursuant to the provision delegation in section 453(j)(1), under the *National Muffler* standard rather than the arbitrary-and-capricious standard). Dicta in another Tax Court decision could be cited, but does not necessarily stand, for the proposition that a purpose-authority regulation should be considered a "legislative regulation" entitled to arbitrary-and-capricious deference. *See* W. Nat'l. Mut. Ins. Co. v. Commissioner, 102 T.C. 338, 357 (1994) (Reg. § 1.846-3(c) is an "interpretive regulation" rather than a "legislative regulation" because it is an attempt to carry out the purpose of section 1023(e) of the Tax Reform Act of 1986, rather than section 846, possibly implying that had the regulation instead carried out the purposes of section 846, it would have been a legislative regulation by reason of the delegation in section 846(g), but perhaps merely withholding judgment on such question until it becomes necessary to decide it), *aff'd*, 65 F.3d 90 (8th Cir. 1995). In Atlantic Mutual Insurance Co. v. Commissioner, 523 U.S. 382, 391 (1998), the Supreme Court affirmed a Third Circuit decision that disagreed with the Tax Court and the Eighth Circuit in *Western National*.

sury Department regulation-writing authority in respect of the entire Code. This being the case, and bearing in mind the rule of statutory construction requiring that the Code be construed "so that one section will explain and support and not defeat or destroy another section,"[242] one is left to wonder why Congress thinks it necessary to enact purpose and provision delegations rather than relying on section 7805(a) to authorize the desired regulations.

One possibility, which focuses on the differences in the language used in section 7805(a) and the various purpose and provision delegations, is that Congress believes that the delegation in section 7805(a) authorizes regulations dealing only with such "enforcement" matters as the assessment and collection of tax and the imposition of civil penalties and criminal sanctions, and thus that purpose and provision delegations are necessary to give the Treasury Department broader regulation-writing authority than this. Another possibility, which focuses instead on giving meaning to both section 7805(a) and the various purpose and provision delegations, is to conclude that Congress intended purpose-authority regulations and provision-authority regulations to be accorded a higher level of deference than section 7805(a) regulations.

Unfortunately, the legislative history of the various purpose and provision delegations is not particularly illuminating on the question of why Congress thought it necessary to enact these provisions rather than relying on section 7805(a) to authorize the necessary regulations. For example, when Congress added the PFIC provisions to the Code in 1986, the conference committee report did not mention section 1298(f), and the Joint Committee "bluebook" gave some examples of regulations that may be considered necessary, but no indication of the level of deference it was expected such regulations would receive or why section 1298(f) was thought necessary.[243] Similarly, the legislative history of section 7701(e), added to the Code in 1984, does not mention section 7701(e)(6) or the regulations required thereunder.[244] Nor has Congress provided any insight into its intention on the occasions where it expanded existing specific delegations to include purpose delegation language.[245]

Turning first to the possibility that Congress intended section 7805(a) to authorize only regulations regarding "enforcement" in the narrow sense of

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[242]*See, e.g.*, Estate of Gerson v. Commissioner, 127 T.C. 139, 176-77 (2006) (Vasquez, J., dissenting).

[243]*See* H.R. Rep. No. 99-841, at II-640-45 (1986) (Conf. Rep.); Joint Comm. on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986, at 1032 (Comm. Print 1987).

[244]*See* H.R. Rep. No. 98-861, at 789-790 (1984) (Conf. Rep.); *see also* H.R. Rep. No. 98-432, at 1152-59 (1984).

[245]For example, section 338(i) was amended in 1984, as a "technical correction" to the 1982 tax legislation, to broaden the scope of the required regulations from "such regulations as may be necessary to ensure that the purposes of this section to require consistency of treatment of stock and asset purchases . . . may not be circumvented through the use of any provision of law or regulations (including the consolidation return regulations)" to "such regulations as may

matters such as assessment and collection, a problem with this approach is that courts have not so limited the scope of the delegation in section 7805(a) and its predecessors. Indeed, the section 7805(a) regulations upheld by the courts in, for example, *National Muffler* and *Estate of Gerson* cannot be said to relate to "enforcement" in this narrow sense.[246] In addition, such legislative history as there is in respect of the first predecessor of section 7805(a), which was enacted in 1917, provides little if any support for this position.[247]

However, the alternative possibility, that Congress was expressing a delegative intent that purpose-authority regulations and provision-authority regulations are to be accorded a higher degree of deference than section 7805(a) regulations, is difficult to square with the language used in the various provisions. In the case of a provision delegation such as section 7701(e)(6), which authorizes the Treasury Department to prescribe regulations to "carry out the provisions"[248] of the particular statute, it is very difficult to discern any meaningful difference from section 7805(a), which delegates the authority to prescribe "needful rules and regulations for the enforcement"[249] of the Code provisions. As a result, it would appear that regulations issued under a provision delegation should not be given any more (or less) deference than section

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be necessary or appropriate to carry out the purposes of this section, including" regulations addressing the matter previously described in section 338(i) plus one additional item. The legislative history of this amendment, however, mentions only the newly added matter. *See* H.R. Rep. No. 98-861, at 1222 (1984) (Conf. Rep.); *see also* I.R.C. § 1092(a)(2)(C) (specific delegation enacted in 1981 and expanded in 2005 to include purpose delegation language without relevant comment in the legislative history); *cf.* I.R.C. § 1446(f) (purpose delegation enacted in 1986, converted in a 1998 technical correction to a mixed delegation setting out one matter for the regulations to include, and expanded in 1989 to add two additional matters, all without relevant comment in the legislative history).

[246]*See* Reg. §§ 1.501(c)(6)-1, 26.2601-1(b)(1)(i).

[247]Section 1005 of the Revenue Act of 1917, Pub. L. 65-50 (the "1917 Act") authorized the Commissioner, with the approval of the Treasury Secretary, "to make all needful rules and regulations for the enforcement of the provisions of this Act." War Revenue Act of 1917, ch. 63, § 1005, Pub. L. No. 65-50, 40 Stat. 300, 326. Title XI of the 1917 Act, of which section 1005 was a part, also included provisions regarding the filing of returns and recordkeeping, and imposing penalties for failure to follow the requirements of the 1917 Act or regulations promulgated under the authority granted thereunder. War Revenue Act § 1005. The House Report in respect of the 1917 Act states that the provisions of what later became Title XI "are administrative and relate to the making of returns under the provisions of this act, the collection of the taxes, and provide penalties for failure to comply with the provisions thereof." H.R. Rep. No. 65-45, at 10 (1917). One might conclude from this language that the regulation-writing authority granted by the predecessor of section 7805(a) relates only to enforcement matters such as returns and collection. However, another provision of Title XI of the 1917 Act stated that "in all cases where *the method of collecting the tax* imposed by this Act is not specifically provided, the tax shall be *collected* in such manner as the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury may prescribe." §1003, 40 Stat. at 325 (emphasis added). In light of this separate delegation by the same Congress of authority relating to collection, it seems clear that the predecessor of section 7805(a) was not intended to delegate regulation-writing authority only in the context of enforcement in the narrow sense.

[248]I.R.C. § 7701(e)(6).

[249]I.R.C. § 7805(a).

7805(a) regulations. While such an interpretation would seem to violate the usual rule disfavoring interpretations that would render a statutory provision (here, the provision delegation) mere surplusage, the extremely similar language used by Congress in purpose delegations and section 7805(a) makes it difficult to reach any other conclusion, perhaps suggesting that the usual rule should have limited applicability where, as in the case of the Code, the various provisions have been enacted by Congress over a period of nearly 100 years.[250]

Turning to purpose delegations such as section 1298(f), which authorize or require the Treasury Department to prescribe regulations to "carry out the purpose"[251] of the underlying Code provision(s), it could be argued that such delegations give the Treasury Department somewhat more leeway than section 7805(a), since they authorize a determination and effectuation not only of the letter of the provisions but also their purpose. Under this view, when the Treasury Department acts pursuant to section 7805(a), it is limited to bringing into effect the words of the underlying statute, and is not authorized to prescribe rules effectuating a perceived congressional purpose not enunciated in the statute itself, but when it acts pursuant to a purpose delegation such as section 1298(f), it is free to issue regulations that carry out the congressional purpose, whether articulated in the statute, in the legislative history, or elsewhere.

To this observer at least, this position appears to be untenable, since under the *National Muffler* standard section 7805(a) is considered not only to permit, but to require, the Treasury Department to promulgate regulations that "harmonize[] with the plain language of the statute, its origin *and its purpose*."[252] Since both section 7805(a) regulations and purpose-authority regulations are required to be reflective of the statutory language and purpose, the role of legislative purpose does not, with one possible exception discussed below regarding so-called anti-abuse rules, justify a distinction in the level of deference to be accorded the two types of regulations. As with provision-authority regulations, perhaps the best one can say is that Congress over the nearly 100-year history of the Code and its predecessors, and in the 90 years since the first predecessor to section 7805(a) was enacted, has chosen different ways to enunciate essentially the same sorts of delegations meriting

[250]For example, section 7701(e)(6) and the predecessor to section 7805(a) were enacted 67 years apart. In this connection, it should be noted that tax cases invoking the "mere surplusage" maxim tend to do so in the context of a party's interpretation of a single provision that would render language within that provision mere surplusage, rather than an interpretation of one Code provision that would render another provision enacted many years earlier or later mere surplusage. *See, e.g.*, Microsoft Corp. v. Commissioner, 311 F.3d 1178, 1184 (9th Cir. 2002); Zapara v. Commissioner, 126 T.C. 215, 231 (2006).

[251]I.R.C. § 1298(f).

[252]Nat'l Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979) (emphasis added).

the same level of deference.[253] Since there is thus little or no indication that Congress' delegative intent was such that purpose-authority Regulations are to be accorded a higher level of deference than section 7805(a) regulations, it is reasonable to conclude that both types of regulations should be evaluated under the *National Muffler* standard.

d. *Regulations Issued Under Mixed Delegations*. As noted, a mixed delegation combines features of a purpose or provision delegation (it delegates authority to issue regulations that carry out the purpose of a provision or the provision itself) and a specific delegation (it also enumerates specific matters to be dealt with in the regulations). While under the traditional view any regulations issued under a mixed delegation would be considered "legislative" in nature because the delegation is found in a Code provision other than section 7805(a), from the foregoing discussion it can be seen that it would be more appropriate to treat a mixed delegation in effect as two separate delegations—a purpose or provision delegation and a specific delegation—and to apply to the regulations promulgated thereunder a level of deference that is commensurate with which of the two delegations authorized them. Under this approach, regulations that address one or more of the enumerated matters in a mixed delegation would be treated as specific-authority regulations,[254] and any other regulations promulgated pursuant to the mixed delegation would be treated as purpose-authority regulations or provision-authority regulations, as the case may be. Alternatives such as applying to all regulations promulgated under a mixed delegation either arbitrary-and-capricious deference or the *National Muffler* standard would appear to run afoul of the delegative intent expressed in one or the other discrete parts of the mixed delegation. For example, since in light of the extremely similar wording of a specific delegation such as section 305(c) and the enumerated list of items in a mixed delegation such as section 382(m), it is very difficult to discern a different delegative intent for these two types of delegations, it is difficult to justify a lower level of deference for regulations promulgated regarding the enumerated items in a mixed delegation than for specific-authority regulations.

2. *Applying the Deference Standards*

[253]The length of time between the enactment of the first predecessor to section 7805(a) in 1917 and the purpose and provision delegations in the 1980s and thereafter can be contrasted with situations such as the enactment in 1986 of both section 1298(f) and the various specific delegations in sections 1291-1298.

[254]Under the traditional formulation, the courts have followed this approach and treated regulations addressing one of the matters enumerated in a mixed delegation as a "legislative regulation" entitled to arbitrary-and-capricious deference. *See, e.g.*, Beecher v. Commissioner, 481 F.3d 717, 721-23 (9th Cir. 2007) (Reg. § 1.469-2(f)(6), promulgated pursuant to section 469(l)(3)); Krukowski v. Commissioner, 279 F.3d 547, 551-52 (7th Cir. 2002) (same regulation); Sidell v. Commissioner, 225 F.3d 103, 106-08 (1st Cir. 2000) (same regulation); Fransen v. United States, 191 F.3d 599, 600-02 (5th Cir. 1999) (same regulation); Schaefer v. Commissioner, 105 T.C. 227, 230-31 & n.5 (1995) (Temp. Reg. § 1.469-2T(c)(7)(iv), promulgated pursuant to section 469(l)(2)).

Where does all this leave the courts, the Service, and taxpayers in dealing with particular cases? Short of a definitive answer from Congress or the Supreme Court, neither of which seems particularly likely in the near future,[255] perhaps the best way to answer this question given the current state of play is to discuss a few situations in which the deference issue arises:

a. *Regulations that are Contrary to the Code*. Starting with the easiest case, it is presumably a matter of general agreement that the Treasury Department has no authority to issue regulations that purport to impose requirements beyond those imposed by statute, even when the relevant delegation is a specific delegation. Obvious examples include regulations that purport to increase the statutory tax, interest, or penalty rate, or to impose tax, interest, or penalties in circumstances to which the Code would not apply them, any of which would obviously be extremely difficult to describe as "needful rules and regulations for the enforcement of [the Code]".[256] While these examples may seem absurd and impossible to imagine, the Treasury Department has from time to time issued regulations that come close to or cross this line and therefore are of suspect validity.[257]

b. *"Anti-abuse" Regulations*. Unlike certain other countries' legislatures,

[255]Regarding the Supreme Court, it seems unlikely that *Littriello*, or *McNamee* will be a vehicle for such a pronouncement, given the lack of a conflict among the courts of appeals. Indeed, the Supreme Court recently denied the taxpayer's petition for certiorari in *Littriello*. 76 U.S.L.W. 3439 (2008). It is conceivable that the Third Circuit's questionable reading in *Swallows Holding* of the Supreme Court's opinion in *Cleveland Indians* (see *supra* notes 125-126 and accompanying text), or perhaps a perceived conflict between *Swallows Holding* and the Fourth Circuit's prior decisions regarding the meaning of the word "manner" (see the cases cited *supra* in note 101), might engage the Court's interest, but this may well be wishful thinking. For a proposal to Congress to regularize the language of its tax delegations, see *NYSBA Report*, *supra* note 20.

[256]I.R.C. § 7805(a).

[257]See, for example, Reg. § 1.1445-1(e)(3)(ii), which purports to impose interest on the transferor of a United States real property interest who is required to deduct and withhold tax under section 1445 but fails to do so, even if the transferee satisfies the underlying tax liability by filing a tax return and paying the tax due, and Reg. § 1.1441-3(d)(1), which purports to require a payor of an amount the portion (if any) of which that represents U.S.-source income subject to withholding under section 1441 cannot be determined to withhold or escrow up to 30% of such amount. For an example of a section 7805(a) regulation that the courts ultimately upheld (over the objection of the Tax Court initially), largely on the basis of language in the Joint Committee on Taxation "Bluebook", notwithstanding that the regulation reaches a result that is clearly both contrary to the language of the underlying statute and inconsistent with the congressional committee reports, see Temp. Reg. § 1.163-9T(b)(2)(i)(A) (interest on a federal income tax deficiency relating to the taxpayer's trade or business is nondeductible "personal interest" under section 163(h), notwithstanding that section 163(h)(2)(A) excludes from the definition of "personal interest" interest "properly allocable to a trade or business"), *upheld in* Kikalos v. Commissioner, 190 F.3d 791 (7th Cir. 1999), McDonnell v. United States, 180 F.3d 721 (6th Cir. 1999), Allen v. United States, 173 F.3d 533 (4th Cir. 1999), Commissioner v. Redlark, 141 F.3d 936 (9th Cir. 1998), Miller v. United States, 65 F.3d 687 (8th Cir. 1995), Robinson v. Commissioner, 119 T.C. 44 (2002), *overruling* Redlark v. Commissioner, 106 T.C. 31 (1996).

Congress, at least for now, has chosen not to enact general "anti-abuse" tax legislation.[258] Rather, Congress in numerous specific contexts has explicitly authorized the Treasury Department to prescribe regulations to prevent a particular type of tax avoidance, whether in specific delegations or as part of mixed delegations. For example, section 355(d)(9)(A) requires the Treasury Department to prescribe "regulations to prevent the avoidance of the purposes of [section 355(d)] through the use of related persons, intermediaries, pass-thru entities, options, or other arrangements".[259] As noted, this Article suggests that regulations promulgated under a specific delegation or the specific-delegation portion of a mixed delegation should be entitled to deference under the arbitrary-and-capricious standard, and this would include anti-abuse rules specifically required or authorized thereunder.

But what of anti-abuse rules issued by the Treasury Department in the absence of such a specific delegation? Looking once again to Congress' delegative intent as expressed by the statutes Congress has (and has not) enacted, it is significant that Congress has granted specific delegations of authority to issue anti-abuse rules in certain cases, and purpose delegations calling for regulations to carry out the purposes of the underlying provisions in other cases, either of which would appear to authorize the issuance of anti-abuse regulations. As discussed above, the validity of such regulations should be determined under the arbitrary-and-capricious standard in the case of regulations issued under a specific delegation or the specific-delegation portion of a mixed delegation, and under the *National Muffler* standard in the case of regulations issued under a purpose delegation.

It follows from this that where Congress has not delegated authority to issue anti-abuse regulations in one of these two manners, and the Treasury Department instead purports to issue anti-abuse regulations pursuant to either section 7805(a) or a provision delegation, Congress did not intend for such regulations to be issued at all, much less given deference.[260] Under this analysis, the validity of regulations such as Regulation section 1.701-2 (the so-called subchapter K anti-abuse regulations), which purport to have been issued pursuant to section 7805(a) and for which one can point to no specific

[258] The so-called codification of the economic-substance doctrine that has been included in numerous tax bills over recent years but to date has not been enacted, possibly due in part to the Treasury Department's opposition to such a provision, would be a step in this direction. It should be noted in this connection that section 7805(b)(3) authorizes the Treasury Department to "provide that any regulation may take effect or apply retroactively to prevent abuse." Rather than being a delegation of authority to promulgate anti-abuse regulations, this provision merely permits the Treasury Department to make otherwise-valid regulations retroactive where retroactivity is necessary to prevent abuse.

[259] *See also* I.R.C. §§ 172(h)(5)(B), 448(d)(8), 1059(g)(2), 7701(f), (*l*).

[260] *Cf.* NYSBA Report, *supra* note 20, at 13 (suggesting that Congress amend section 7805(a) to authorize anti-abuse regulations explicitly, so as to avoid this problem).

delegation or purpose delegation, seems highly suspect.[261]

c. *Taxpayer-favorable Regulations*. The Treasury Department has on occasion issued regulations that, while of questionable validity as a technical matter, are so favorable to taxpayers that they seem immune from challenge as a practical matter.[262] As noted, the check-the-box regulations initially seemed to be this sort of regulation, but turned out to be detrimental to certain taxpayers, who challenged them, unsuccessfully, in two courts of appeals. While commentators have been troubled by the notion that the Treasury Department would issue regulations known to be invalid because they are unlikely to be challenged,[263] it should be noted that Congress has provided authority in the APA for giving agencies more leeway when their actions relieve rather than impose burdens,[264] which would surely be the case if the Treasury Department promulgated a regulation that was taxpayer friendly in all cases.

d. *Regulations Changing a Longstanding Regulatory Interpretation*. Suppose that after the regulations interpreting a particular Code provision have been in effect virtually unchanged for 20 or 30 years, with no material amendment to such Code section during that period, the Treasury Department, with notice and comment, revises the regulations to change the interpretation in a manner that is unfavorable to taxpayers. For now, suppose further that there have been no judicial interpretations of the portion of the statute to which the regulations relate, so that the *National Cable/Swallows Holding* issue is not implicated and the Treasury Department cannot be said to be attempting to bootstrap an unsuccessful litigating position. Under the *National Muffler* standard, the inconsistency of the new regulation with the Treasury Department's longstanding prior interpretation, the length of time passing between the enactment of the underlying statute and the promulgation of the revised

[261] *See, e.g.*, Mark E. Berg, *Recasting Havoc: The Impact of the Proposed Partnership Anti-Abuse Rules on S Corporations as Partners*, 6 J. Corp. Tax'n 317, 327-28 (1995). For recent indications that auditors have been asserting deficiencies on the basis of the subchapter K anti-abuse regulations, see *Countryside Limited Partnership v. Commissioner*, 95 T.C.M. (CCH) 1006, 2008 T.C.M. (RIA) ¶ 2008,003; *Jade Trading, LLC v. United States*, 80 Fed. Cl. 11 (2007), *appeal docketed*, No. 08-5045 (Fed. Cir. Feb. 26, 2008).

[262] *See, e.g.*, Polsky, *supra* note 84, at 238-39 (discussing this point in terms of the "taxpayer standing doctrine" enunciated in Massachusetts v. Mellon, 262 U.S. 447 (1923)); *see also* Hein v. Freedom From Religion Found., Inc., 127 S. Ct. 2553 (2007); Flast v. Cohen, 392 U.S 83 (1968).

[263] *See, e.g.*, Polsky, *supra* note 84, at 238-39 (characterizing this as a "cynical explanation" for the issuance of invalid regulations).

[264] *See* APA § 553(d)(1) (exempting from the prohibition against substantive rules and regulations coming into force less than 30 days after the APA notice requirements are complied with "a substantive rule which grants or recognizes an exemption or relieves a restriction"); *cf.* Swallows Holding v. Commissioner, 126 T.C. 96, 136 (2006) (invalidating a regulation that added "an impermissible restriction to the statute"), *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008).

regulation, and, perhaps, the re-enactment by Congress of the statute without criticism of the longstanding prior interpretation by the Treasury Department would all point toward the invalidity of the revised regulation.[265] Indeed, the Tax Court in *Swallows Holding* explicitly held that "considerably less deference" is due to "an agency's statutory interpretation that conflicts with the agency's previous interpretation of the same statute," only to have the Third Circuit reverse and discount the importance of *National Muffler* factors such as consistency of the agency's interpretation over time.[266]

To be sure, should a court wish to avoid invalidating the revised regulation, there is ample language in *Chevron* and *National Cable* that it could cite for the proposition that deference is due even to revisions of longstanding regulations, particularly if the Treasury Department has given a reasoned explanation for the change.[267] The courts in *Littriello* and *McNamee* are recent examples of courts that did just that.[268] And, of course, it would be helpful to the Treasury Department in this regard were the revised regulation to be in harmony with the language and purpose of the statute. But if the survival of the *National Muffler* standard after *Chevron*, *Mead* and *National Cable* means anything, it must mean that changes by the Treasury Department to a longstanding regulatory interpretation of a Code provision will continue to be subjected to searching scrutiny, and considerably less deference than other section 7805(a) regulations, under the *National Muffler* standard.[269]

Applying this standard, the Tax Court invalidated a section 7805(a) regulation in *Swallows Holding* (only to be reversed by the Third Circuit) but upheld another section 7805(a) regulation in *Estate of Gerson*.[270] While both of the regulations in question in these cases effected a change to a prior regulation, it is possible to reconcile the two cases. First, the prior regulation in *Estate of Gerson* was of a much more recent vintage than was the prior regula-

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[265] *See* Nat'l Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979); *Swallows Holding*, 126 T.C. at 136-39, *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008).

[266] *Swallows Holding*, 126 T.C. at 138 n.24, *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008).

[267] *See* Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 863-64 (1984); Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 535 U.S. 967, 981-82 (2005). Similarly, the *Chevron* step-one inquiry as to whether Congress has spoken on the issue leaves judges ample discretion–and room for mischief. *See, e.g.*, Robinson v. Commissioner, 119 T.C. 44 (2002), *overruling* Redlark v. Commissioner, 106 T.C. 31 (1996).

[268] *See* McNamee v. Department of the Treasury, 488 F.3d 100, 109-10 (2d Cir. 2007), Littriello v. United States, 484 F.3d 372, 377-78 (6th Cir. 2007).

[269] The language of section 7805(a) itself provides some support for this position, as it includes in the general delegation of regulation-writing authority the authority to prescribe "all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue," which at least implies an absence of authority to make a major substantive change to a section 7805(a) regulation absent a change in the underlying statute or judicial interpretations thereof. I.R.C. § 7805(a).

[270] 127 T.C. 139 (2006), *aff'd*, 507 F.3d 435 (6th Cir. 2007), *petition for cert. filed*, No. 07-1064 (Feb. 7, 2008).

tion in *Swallows Holding*. More significantly, the prior regulation in *Estate of Gerson* did not address the issue in that case one way or the other, but merely recited the statutory rule, and the revised regulation filled in a gap left both in the statute and in the prior regulation, in a manner that the Tax Court found to be in harmony with the statutory language and purpose. By contrast, the revised regulation in *Swallows Holding* imposed a deadline not found in either the statute (or its purpose) or the prior regulation, thus adding, in the words of the Tax Court, "an impermissible restriction to the statute."[271]

The above discussion relates to an attempt by the Treasury Department to revise a longstanding regulation in a manner unfavorable to taxpayers. But suppose the revision is favorable to taxpayers (as the Treasury Department undoubtedly thought was the case with the check-the-box regulations), and is promulgated with a prospective-only effective date.[272] In such a case, while presumably no taxpayer would challenge the validity of the regulation, the question is whether taxpayers are entitled to apply the more favorable rule to years falling before its effective date. The taxpayer's argument here would be that since there can be only one true interpretation of a statutory provision, when the Treasury Department changes its interpretation it is in effect determining that its prior interpretation was incorrect, with the result that the new interpretation, unless itself invalid, must be made available to affected taxpayers for prior, open years.

In *Littriello* and *McNamee*, the taxpayers made this argument in respect of *proposed* regulations which, if they had then been finalized, would have provided that a single-member LLC will be treated as a separate entity for employment tax purposes.[273] Intriguingly, the Sixth and Second Circuits dismissed this argument, but did not do so on the ground that taxpayers are not entitled to the benefit of a changed interpretation prior to its effective date. Rather, the courts held that the Service cannot be required to apply a rule set forth in a proposed regulation, which cannot be said to represent the Treasury Department's considered view on the subject.[274] This leaves open the possibility that the result in those cases might have been different had the proposed

[271] *Swallows Holding*, 126 T.C. at 136, *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008).

[272] In many, but not all, cases, the Treasury Department avoids this issue by permitting taxpayers to elect to apply the new rules to prior open years, as it is permitted to do under section 7805(b)(7). *See, e.g.*, Reg. § 1.367(b)-6(a)(1). For an example of a change in a regulation for which no elective effective date was provided, see T.D. 9212, 2005-2 C.B. 429, 431-35 (amending Reg. § 1.861-4(b) and -4(d) (last sentence)).

[273] *See* Littriello v. United States, 484 F.3d 372 (6th Cir. 2007), *reh'g denied*, 2007 U.S. App. LEXIS 23640 (6th Cir. Sept. 25, 2007), *cert. denied*, 76 U.S.L.W. 3439 (Feb. 19, 2008); McNamee v. Dep't of Treasury, 488 F.3d 100 (2d Cir. 2007).

[274] *Littriello*, 484 F.3d at 379; *McNamee*, 488 F.3d at 110. *But see* Reg. § 1.6662-4(d)(3)(iii) (treating proposed regulations as "authority" to be taken into account in determining whether there is "substantial authority" for a position for purposes of determining whether the accuracy-related penalty imposed by section 6662 applies).

regulations (which, as noted, have since been finalized)[275] also been issued as temporary regulations or finalized by the time the decisions were rendered.

e. *Regulations Conflicting with Prior Judicial Interpretation(s)*. Now suppose that the interpretation set out in the new regulation not only revises a prior Treasury Department interpretation but is also inconsistent with one or more prior judicial constructions of the same statute, thus raising the *National Cable/Swallows Holding* issue. The Supreme Court in *National Cable* held that so long as a prior court decision was not based on a holding that its construction followed from the unambiguous terms of the statute, a later court should defer to a different interpretation by the agency.[276] But as noted, the Tax Court has reserved judgment as to whether *National Cable* even applies to tax regulations, and in any event the Tax Court in *Swallows Holding* was able to determine that the prior cases had held that the statute in question was unambiguous even though such cases did not say so explicitly, but was reversed by the Third Circuit on this latter point.[277]

This issue is further complicated in the Tax Court because of its unique nature. As noted, 12 different courts of appeals hear appeals from the Tax Court and, under the *Golsen* rule, the Tax Court does not consider itself to be bound in a particular case by rulings of courts of appeals for circuits other than that to which the case is appealable. As a result, even if *National Cable* were to apply to tax regulations, the question would arise whether the Tax Court would consider itself bound by *National Cable* to rule that a construction of the statute by a court of appeals other than the one in which an appeal would lie "trumps" the regulation.[278] Presumably, since *National Cable*, if applicable to tax regulations at all, would bind the court of appeals to which the Tax Court's case is appealable to follow a prior judicial determination that the statute unambiguously requires a different result from that set out in the regulation, under the *Golsen* rule the Tax Court would feel bound to follow that approach as well. A prior construction of the statute by the Supreme Court, of course, would be binding in any event.[279]

Littriello and *McNamee* also raised this issue, but determined that the judi-

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[275] *See supra* note 190.

[276] Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005).

[277] *Swallows Holding*, 126 T.C. at 143-47, *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,392 n.11 (3d Cir. 2008). While the Third Circuit in *Swallows Holding* cited *National Cable*, it did not explicitly take a view regarding the applicability of that case to tax regulations. 2008-1 U.S.T.C. (CCH) ¶ 50,188, at 83,392.

[278] *See* Estate of Gerson v. Commissioner, 127 T.C. 139, 166 n.5 (Thornton, J., concurring) (*National Cable* does not compel a finding of invalidity because, among other things, "[u]nder . . . *Golsen* . . ., this Court is not required to follow *Simpson* and *Bachler* in this case, which is not appealable to either of the circuits in which those cases arose").

[279] *See supra* note 85. Given the Third Circuit's extremely broad view of agency discretion in *Swallows Holding*, one wonders whether that court would consider even a prior statutory interpretation by the Supreme Court to foreclose an agency from coming up with a different interpretation in a later regulation.

cial construction in question (by the Supreme Court in *Morrissey*) expressly found the statute to be ambiguous. In such a case, *National Cable*, were it applicable to tax regulations, would seem to require that the prior judicial construction give way to the regulation. But suppose the regulation in question represents a change not only from the interpretation of the Code in a prior court case, but also from that in a prior regulation. Assuming that the *National Muffler* standard, which views regulatory change with skepticism, survived *Chevron* and *National Cable*, which emphasize the need to permit agencies to change their regulations in light of changed circumstances, one would think that the regulation could be invalidated without regard to the prior judicial interpretation. In such a case, however, a court might well find the reasoning employed by the prior court to be relevant to the *National Muffler* inquiry regarding harmonization with the statute and its purpose. If the prior court found the statute unambiguously to require a different interpretation, then even *National Cable* would require the conflicting agency interpretation to give way.

The issue becomes more complicated still when there are conflicting judicial interpretations of the underlying statutory provision. As noted in Judge Swift's concurring opinion in *Estate of Gerson*, it cannot be that the Treasury Department is powerless to act one way or the other where different courts have decided a particular interpretive question differently until such time, if ever, as the Supreme Court resolves the matter.[280] Rather, the Tax Court seems to have been on firm ground when it held that even if *National Cable* applies to tax regulations, it does not require a ruling that the regulations in question are invalid where some courts have found the statute unambiguously to require a different interpretation from that adopted in the regulations and others have not.[281] Less convincing, however, was the Tax Court's reliance on two District Court cases that had been reversed on appeal in finding that there were conflicting judicial decisions.[282]

f. *Regulations Conflicting with a Substantive Tax Principle*. Now suppose that the regulations in question conflict not with a prior judicial construction of the underlying Code provision, but rather with a basic and longstanding substantive tax principle. Take, for example, the long line of cases holding that, with certain very limited exceptions, so-called personal service corporations furnishing the services of individuals to service recipients are to be respected as such, and transactions involving such corporations are not to be recharacterized as transactions effected directly between the service recipient and the individual, whether under the assignment-of-income doctrine, an

[280] *See Swallows Holding, 126 T.C.* at 161 (Swift, J., concurring).
[281] *Id.* at 152-53.
[282] *See id.* at 152.

agency theory, section 482, or otherwise.[283] Suppose that notwithstanding these cases, the Treasury Department were to promulgate regulations purporting to treat payments by service recipients to such corporations as payments directly to the individuals for, say, withholding purposes. Such a regulation would appear not to qualify for deference under any standard, and would raise even more sharply the fundamental administrative law question discussed in *National Cable*: While *Chevron* and its progeny provide considerable leeway to agencies in interpreting and administering the statutes entrusted to them, courts' pronouncements of basic substantive legal principles in cases before them, perhaps even more than judicial statutory construction, lie at the heart of the judicial power and form part of the basic legal landscape against which an agency is engaging in the lawmaking activity delegated to it. Agencies should not be able to change these principles any more than they can change the statutory language.[284]

g. Non-Interpretive Section 7805(a) Regulations. As noted, while many section 7805(a) regulations are interpretive in nature, others are more administrative in nature. Examples of these types of regulations abound, including regulations setting forth methods of allocating items of income or deduction, special rules to deal with certain categories of taxpayers, safe harbors, and the like. While much of the language in *Chevron* and its progeny deals specifically with agencies' interpretations of statutes, these cases also refer to the delegation by Congress of administrative authority to the agencies.[285] Moreover, the authority delegated to the Treasury Department in section 7805(a) to prescribe "all needful rules and regulations for the enforcement of [the Code]"[286] is not expressly limited to interpretive authority and cannot fairly be read to exclude the authority to prescribe non-interpretive regulations. To be sure, non-interpretive section 7805(a) regulations do not raise the same level of administrative law and separation-of-powers issues that interpretive regulations do, since courts and agencies both have authority in the context of statutory interpretation but not in non-interpretive administration. But

[283]See, for example, *Sargent v. Commissioner*, 929 F.2d 1252 (8th Cir. 1991), *nonacq. recommended*, A.O.D. 1991-022 (Oct. 22, 1991), and the numerous cases cited therein.

[284]Justice Breyer in his concurring opinion in *National Cable* touched on this important point when he pointed out that even when an agency engages in formal notice- and-comment rulemaking, its rules are not necessarily entitled to deference where "an unusually basic legal question is at issue," since in such a case "Congress may have intended *not* to leave the matter of a particular interpretation up to the agency." Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 1004 (Breyer, J., concurring) (emphasis in original); *see also* Swallows Holding v. Commissioner, 126 T.C. 96, 138 (describing the regulation at issue as "an unreasonable attempt by the Secretary to circumvent the firmly established legal terrain"), *rev'd*, 2008-1 U.S.T.C. (CCH) ¶ 50,188 (3d Cir. 2008).

[285]*Nat'l Cable*, 545 U.S. at 980-81; United States v. Mead Corp., 533 U.S. 218, 221-22 (2001); Barnhart v. Walton, 535 U.S. 212, 217-18 (2002).

[286]I.R.C. § 7805(a).

since there is also no indication in any of the Supreme Court's decisions that the *National Muffler* standard applies only to interpretive section 7805(a) regulations, such standard should be applied equally to both types of section 7805(a) regulations.[287]

A special issue arises in this regard when a regulation creates a special, less favorable rule for a certain category of taxpayers, who are not singled out in the Code for special treatment.[288] In addition to any Equal Protection or other constitutional issues that such a provision might raise, a court applying the *National Muffler* standard presumably would carefully consider whether the special rule is in harmony with the statute and its purpose, how long the regulation was in force without the special rule, and how long after the statute was enacted the Treasury Department decided to create the special rule.

VII. Conclusion

Although (or perhaps because) much ink has been spilled by courts and commentators regarding the standards to be applied in determining whether a tax regulation is valid, confusion reigns. This Article identifies three categories of congressional delegations of regulation-writing authority—purpose delegations, provision delegations, and mixed delegations—all of which have traditionally been treated as delegations authorizing the promulgation of "legislative regulations," and concludes that the *National Muffler* standard survived the Supreme Court's decisions in *Chevron*, *Mead*, and *National Cable*, and remains the applicable standard not only for section 7805(a) regulations but also for tax regulations promulgated pursuant to purpose delegations, provision delegations, and the portion of a mixed delegation other than the enumeration of specific matters to be covered in the regulations.

In the context of these types of regulations, the searching inquiry under the *National Muffler* standard is more appropriate than the less-rigorous standard that the traditional approach would apply in these cases (either arbitrary-and-capricious deference or the permissible-construction standard), since it serves as a necessary judicial check on a Treasury Department that has become increasingly aggressive in arrogating lawmaking power to itself by promulgating regulations of previously unimaginable scope. By according a greater degree of deference to section 7805(a) regulations that were promulgated relatively contemporaneously with the underlying Code provision and have

[287] *Cf.* I.R.C. § 7805(b)(5) (regulations relating to "internal Treasury Department policies, practices or procedures" are exempt from the general rule of section 7805(b)(1) against retroactive tax regulations). *But cf.* United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 (1982) (giving less deference to a regulation adding a clarifying gloss to a term well-defined in the Code than to a regulation interpreting a general term in the Code).

[288] *See, e.g.*, Reg. § 1.861-4(b)(3) (reservation for a possible special source rule for compensation for services performed by artists and athletes); Prop. Reg. §1.861-4(b), 72 Fed. Reg. 58787 (Oct. 16, 2007) (proposing such a special source rule).

been in force without substantial change for many years than to those that have been substantially revised on numerous occasions and that purport to change a longstanding judicial interpretation or substantive tax principle, the *National Muffler* standard strikes an appropriate balance between the Treasury Department's legitimate interests in proper administration of the tax laws and raising revenue and taxpayers' legitimate interest in predictable rules that are consistent with the laws Congress has enacted. This approach also appropriately resolves the administrative law and separation-of-powers concerns raised by the deference issue in a manner that takes into account the relevant differences between the functions and powers of the Treasury Department and those of other federal agencies, which differences justify a lower level of deference for tax regulations and presumably explain the Supreme Court's consistent application, even after *Chevron* and *Mead*, of the *National Muffler* standard rather than the *Chevron* standard to section 7805(a) regulations.

While the Tax Court and certain other courts have embraced the *National Muffler* standard in the context of section 7805(a) regulations, other courts, including most recently the Third Circuit in *Swallows Holding*, have taken a much broader view of the Treasury Department's rulemaking authority under section 7805(a). Under the Third Circuit's approach, it becomes difficult to imagine a section 7805(a) regulation that would not be considered valid, irrespective of the length of time that has passed between the enactment of the underlying Code provision and the promulgation of the regulation in question, the number of times the Treasury Department has changed its mind regarding the subject matter of the regulation in question before promulgating it, and how difficult it is to square the positions taken in the regulation in question with the language of the underlying Code provision and prior judicial pronouncements on the subject. Indeed, under the Third Circuit's approach, it is not clear whether section 7805(a) regulations would be accorded any less deference than regulations specifically authorized in a Code provision other than section 7805(a), traditionally known as legislative regulations.

As noted in this Article, an approach such as that taken by the Third Circuit in *Swallows Holding* raises many serious concerns, including its inconsistency not only with the Supreme Court's opinions in *Chevron*, *Mead* and *National Cable*, which make it clear that the level of deference to be accorded to a regulation varies with the specificity of the congressional delegation at issue, but also with the strong indications of Congress' delegative intent that may be discerned by comparing section 7805(a) with the numerous specific delegations of regulatory authority scattered throughout the Code. The practical difference between these two approaches to deference is highly significant in many cases; to paraphrase Judge Holmes' dissenting opinion in *Swallows Holding*, the *National Muffler* approach asks whether the regulation is in harmony with the language of the underlying statute ("where did this come from?"), while the *Chevron* approach instead asks whether the result set out in the regulation is precluded by the Code ("does the Code prohibit

it?").[289] As the recent court decisions discussed in this Article make clear, the two approaches provide very different answers to such important questions as whether a lower level of deference, and a higher degree of skepticism, is appropriate in the case of regulations that reflect a change in a longstanding position of the Treasury Department (not to mention the most recent iteration of regulations that have been frequently revised over the years), or regulations that take a position that is contrary to prior interpretations of the Code or basic substantive tax principles enunciated by the courts. Particularly in light of the Treasury Department's increasingly bold approach to promulgating tax regulations, the conflict among the Tax Court and the various courts of appeals regarding the level of deference to be accorded to section 7805(a) regulations raises questions of fundamental importance regarding the respective roles of Congress, the courts and the Treasury Department in the making of tax law, which conflict it is hoped the Supreme Court will see fit to resolve.

[289] *See* Swallows Holding v. Commissioner, 126 T.C. 96, 175 (2006) (Holmes, J., dissenting).