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In the

Supreme Court of the United States

MAYO FOUNDATION FOR MEDICAL EDUCATION AND RESEARCH,
et. al.,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

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No. 09-837

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ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF OF TAX PROFESSOR CARLTON M. SMITH AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONERS

PROF. CARLTON M. SMITH
Counsel for Amicus Curiae
DIRECTOR, CARDOZO TAX CLINIC
Benjamin N. Cardozo School of Law
55 Fifth Avenue
New York, NY 10003
(212) 790-0381

DICK BAILEY SERVICE (212) 608-7666 (718) 522-4363 (516) 222-2470 (914) 682-0848 Fax: (718) 522-4024
1-800-531-2028

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF THE *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT 3

ARGUMENT 4

I. THIS COURT'S RULINGS ON THE ISSUE OF JUDICIAL DEFERENCE TO REGULATIONS 4

II. WHAT THE LOWER COURTS HAVE SAID ON THE ISSUE OF DEFERENCE TO INTERPRETIVE TAX REGULATIONS 19

III. WHAT THE EIGHTH CIRCUIT DID AND SHOULD HAVE DONE IN THIS CASE 31

CONCLUSION 40

TABLE OF AUTHORITIES

Page

Cases:

AT&T Corp. v. City of Portland,
216 F.3d 871 (9th Cir. 2000) 16, 22

Atlantic Mutual Ins. Co. v. Commissioner,
523 U.S. 382 (1998) 15

United States v. Boyle, 469 U.S. 241 (1985) 15

Boeing Co. v. United States,
537 U.S. 437 (2003) 15

Brand X Internet Services v. FCC,
345 F.3d 1120 (9th Cir. 2003) 16, 17

Central Pa. Savings Assn. & Subs. v. Commissioner,
104 T.C. 384 (1995) 19

Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,
467 U.S. 837 (1984) ....*passim*

United States v. Cleveland Indians Baseball Co.,
532 U.S. 200 (2001) 14-15, 26

Colony, Inc. v. Commissioner,
357 U.S. 28 (1958) 30

Commissioner v. Estate of Hubert,
520 U.S. 93 (1997) 15

Page

Cottage Savings Assn. v. Commissioner,
499 U.S. 554 (1991) 14

Iljazi v. Commissioner,
T.C. Summary Op. 2010-59........................... 1

Intermountain Ins. Serv. of Vail, LLC v. Commissioner,
134 T.C. No. 11 (May 6, 2010) 5, 27

Mayo Foundation v. United States,
568 F.3d 675 (8th Cir. 2009) 32

United States v. Mead Corp.,
533 U.S. 218 (2001) ....*passim*

National Cable & Telecomms. Assn. v. Brand X Internet Services,
545 U.S. 967 (2005) 3, 16

National Muffler Dealers Assn. v. United States,
440 U.S. 472 (1979) ....*passim*

Rowan Cos. v. United States,
452 U.S. 247 (1981) 10, 11

Skidmore v. Swift & Co.,
323 U.S. 134 (1944) 13

Swallows Holding, Ltd. v. Commissioner,
126 T.C. 96 (2006), rev'd 515 F.3d 162
(3d Cir. 2008) ....*passim*

Page

United States v. Vogel Fertilizer,
455 U.S. 16 (1982) 11

Welch v. Helvering, 290 U.S. 111 (1933) 38

Statutes and Regulations:

26 U.S.C. §501(c)(6).. 9

26 U.S.C. §3101 et seq. 10

26 U.S.C. §3121(l)(1) 7

26 U.S.C. §3301 et seq. 10

26 U.S.C. §6015(f) 2

26 U.S.C. §6229 26

26 U.S.C. §6501(a).. 26

26 U.S.C. §6501(e)(1)(A) 26

26 U.S.C. §7805(a) ....*passim*

26 C.F.R. §1.882-4(a)(3)(i) 5

26 C.F.R. §1.6015-5(b) 1

26 C.F.R. §301.6229(c)(2)-1T 5, 29

26 C.F.R. §301.6501(e)-1T 5, 29

Miscellaneous:

"ABA Section of Taxation Report of the Task Force on Judicial Deference", 57 *Tax Lawyer* 717 (Spring 2004) 6, 9, 15, 34, 35, 37, 38

Mark E. Berg, "Judicial Deference to Tax Regulations: A Reconsideration in Light of National Cable, Swallows Holding, and Other Developments", 61 *Tax Lawyer* 481 (Winter 2008) 7, 14, 15, 35-37

In re High-Speed Access,
17 F.C.C. Rcd. 4798 (2002).......................... 16

INTEREST OF THE *AMICUS CURIAE*[1]

Amicus is interested in this case because it involves the review of an interpretive Treasury Regulation. *Amicus* is a graduate of Harvard Law School. From 1981 to 1983, he served as a law clerk to Hon. Arthur L. Nims, III of the United States Tax Court. From 1983 to 1999, *amicus* was first an associate and then a partner conducting a tax controversy practice in New York City at Roberts & Holland, LLP. In 2000, *amicus* worked briefly for the Internal Revenue Service Chief Counsel's Office in its National Office.

Since 2003, *amicus* has been the Director of the Benjamin N. Cardozo School of Law Tax Clinic, where he supervises students representing low-income taxpayers in disputes with the Internal Revenue Service. Some of those disputes involve the validity of Treasury Regulations. *See Iljazi v. Commissioner*, T.C. Summary Op. 2010-59 (following Tax Court precedent in holding the 2-year period to request relief under 26 C.F.R. §1.6015-5(b) invalid as

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[1] Pursuant to Rule 37.3(a) of the Rules of this Court, the parties have consented to the filing of this brief.. See docket entries for July 29, 2010 and August 6, 2010. This brief was not written in whole or in part by counsel for any party, and no person or entity other than *amicus* or Yeshiva University has made a monetary contribution to the preparation and submission of this brief. Yeshiva University, of which the Benjamin N. Cardozo School of Law is a component, is an employer of *amicus*. *Amicus* wishes to acknowledge the assistance of commentator Mark E. Berg in reviewing this brief.

to requests for equitable relief under 26 U.S.C. §6015(f)). *Amicus* is currently a Clinical Associate Professor of Law at the Benjamin N. Cardozo School of Law. Since 2007, *amicus* has also been teaching, as an adjunct professor, the course "Civil Tax Controversies and Litigation" in the Graduate Tax Program at New York University School of Law. In his courses at both schools, *amicus* teaches his students about judicial review of Treasury Regulations.

Amicus does not represent any particular client in filing this brief. Nor does *amicus* file this brief on behalf of either of his employers, who may, in other areas of their respective universities' medical schools, pay medical residents. *Amicus* simply wishes to ensure that the Court is aware of the substantial confusion among the Courts of Appeals concerning the applicable standard in assessing the validity of tax regulations issued under the general authority granted to the Treasury Department under 26 U.S.C. §7805(a) ("interpretive tax regulations"). That confusion, which stems from a misreading of this Court's clear precedents in this area by certain Courts of Appeals, was not discussed in the Eighth Circuit's opinion, the petition for *certiorari*, any of the *amicus* briefs filed in support of the petition for *certiorari*, or in the merits brief just filed by the Mayo Foundation. *Amicus* submits this brief primarily to urge the Court to clarify that the standard set out in *National Muffler Assn. v. United States*, 440 U.S. 472 (1979) -- relied on by the Eighth Circuit in this case, but ignored by several other Courts of Appeals -- remains the applicable standard for assessing the validity of interpretive tax

regulations. Further, *amicus* asks the Court to clarify that the higher level of deference described in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and *United States v. Mead Corp.,* 533 U.S. 218 (2001), is applicable to tax regulations only when Congress specifically delegates to the Treasury Department regulatory authority regarding a particular tax matter, as contrasted with the general delegation of authority to promulgate interpretive tax regulations. Finally, *amicus* urges the Court to address the impact of *National Cable & Telecomms. Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005), on the promulgation of tax regulations -- an important opinion of this Court that was barely mentioned by the Eighth Circuit and is not even mentioned at all in the brief filed by the Mayo Foundation.

SUMMARY OF ARGUMENT

In evaluating the validity of an interpretive tax regulation, the Court should continue its longstanding practice of applying the standard of reasonableness set out in *National Muffler Assn. v. United States*, 440 U.S. 472 (1979), which includes an evaluation of the manner in which the regulation evolved and the contemporaneity, longevity, and consistency of the rule set forth in the regulation in question, rather than the higher level of deference described in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and *United States v. Mead Corp.,* 533 U.S. 218 (2001) . Under the *National Muffler* reasonableness standard, *amicus* respectfully submits that the regulation in question in this case should be held

invalid. Moreover, while there is a strong argument that *National Cable & Telecomms. Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005), is distinguishable where, as here, the agency issuing the regulation in question was a party to the litigation giving rise to the prior judicial interpretation of the underlying statute, the regulation in question is also invalid under the standard set forth in that case, since several Courts of Appeals had previously held that the underlying statute unambiguously provides to the contrary.

ARGUMENT

I. THIS COURT'S RULINGS ON THE ISSUE OF JUDICIAL DEFERENCE TO REGULATIONS

When the instant case is decided by this Court, it is almost inevitable that this Court will (as did the Eighth Circuit in this case) cite either one or both of two important opinions of this Court concerning judicial deference to agency regulations, *National Muffler Assn. v. United States*, 440 U.S. 472 (1979), which dealt with interpretive tax regulations, and *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), which did not. Although this Court, both before and after *Chevron*, has made it clear that the standard of reasonableness set out in *National Muffler* is to be applied to review interpretive tax regulations, the Courts of Appeals are in a state of confusion on the subject of whether *National Muffler* or *Chevron* governs the judicial deference to be given to interpretive tax regulations, and much ink has been

spilled by commentators on this subject. *Amicus*' primary purpose in writing this brief is to alert the Court to this continuing and widening confusion in the lower courts. An *amicus* brief is too short to fully elucidate this subject, but *amicus* hopes to point the Court to some principal sources of argument and a proposed answer.

This case also involves at least the third occasion in two decades that the Treasury Department has promulgated a tax regulation under the general authority of 26 U.S.C. §7805(a) with the explicit purpose of overruling Courts of Appeals that consistently reached contrary taxpayer-favorable interpretations. The prior two occasions are:

1) 26 C.F.R. §1.882-4(a)(3)(i), adopted by T.D. 8322, 55 Fed. Reg. 50827 (December 11, 1990) -- held valid in *Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162 (3d Cir. 2008), after being held invalid by the United States Tax Court in 126 T.C. 96 (2006); and

2) 26 C.F.R. §§301.6229(c)(2)-1T and 301.6501(e)-1T, adopted by T.D. 9466, 74 Fed. Reg. 49321 (Sept. 28, 2009) -- held invalid in *Intermountain Ins. Serv. of Vail, LLC v. Commissioner*, 134 T.C. No. 11 (May 6, 2010).

Amicus believes that in the area of interpretive tax regulations, this Court should hold

that the rule of *National Cable & Telecomms. Assn. v. Brand X Internet Services,* 545 U.S. 967 (2005), does not apply to allow the government to adopt a regulation that produces more government revenue in the face of consistent Circuit Court interpretation to the contrary. In circumstances like those, Separation of Powers concerns dictate that the Executive should seek a statutory amendment, rather than assert primacy over the Judiciary by regulation.

Before discussing what the lower courts have recently said about interpretive tax regulations, a little background on this Court's jurisprudence on the standards by which the validity of regulations (tax and otherwise) are to be tested is in order:

Although one could go back much farther in this Court's opinions, for simplicity, *amicus* starts with the Court's 1979 opinion in *National Muffler.*[2] In that opinion, this Court evaluated an interpretive tax regulation promulgated under the general authority of 26 U.S.C. §7805(a), which provides: "[T]he Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in

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[2] *National Muffler* was far from the first case of this Court reviewing an interpretive tax regulation, but it has been described as providing the "fullest statement of this [Court's] reasonableness test" applied to tax regulations. See "ABA Section of Taxation Report of the Task Force on Judicial Deference", 57 *Tax Lawyer* 717, 721 (Spring 2004).

relation to internal revenue." Not all regulations issued by the Treasury Department are "interpretive". Some regulations are considered "legislative" because specific wording in the Internal Revenue Code directs or specifically authorizes the Treasury Department to promulgate them. For example, in the employment tax provision at issue in this case, there is a subsection that contemplates issuance of "legislative" regulations to govern agreements entered into between the Internal Revenue Service and foreign affiliates of American employers. 26 U.S.C. §3121(l)(1) ("the American employer will comply with such regulations relating to payments and reports as the Secretary may prescribe to carry out the purposes of this subsection."). By contrast, the regulation at issue in the current case is considered "interpretive" because it was not one promulgated under any such specific grant of regulatory authority, but rather was promulgated pursuant to the general authority of 26 U.S.C. §7805(a). For an excellent discussion of "legislative" versus "interpretive" regulations (and a taxonomy of the various kinds of "legislative" regulation authorizations in the Internal Revenue Code), see Mark E. Berg, "Judicial Deference to Tax Regulations: A Reconsideration in Light of *National Cable*, *Swallows Holding*, and Other Developments", 61 *Tax Lawyer* 481, 485-490 (Winter 2008).

It should also be noted that the words "legislative" and "interpretive" are used differently as addressed to Treasury regulations than those terms are used under the Administrative Procedure Act. *Id.* at 486-487. An American Bar Association

Tax Section Task Force summarizes the situation as follows:

> The Administrative Procedure Act (APA) defines a "rule" as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency." 5 U.S.C. §551(4). The APA requires agencies to follow notice-and-comment procedures when they promulgate rules that bind the public. 5 U.S.C. §553(b). In administrative law generally, such binding rules are known generally as legislative rules or regulations. The APA explicitly exempts from the notice-and-comment requirements "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." *Id.* In the case of regulations, tax law has used a different basis to distinguish between legislative and interpretive rules. 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 authority of section 7805(a), which directs the Secretary of the Treasury "to prescribe all needful rules and regulations for the enforcement of this title." In promulgating interpretive regulations, the IRS invariably specifies that "section 553(b) of the Administrative

> Procedure Act (5 U.S.C. § 553) does not apply to these regulations." At the same time, however, it is the customary practice of the IRS to follow notice-and-comment procedures for interpretive regulations.

"ABA Section of Taxation Report of the Task Force on Judicial Deference", 57 *Tax Lawyer* 717, 728 (Spring 2004) (hereinafter, "ABA Task Force") (footnotes omitted).

In *National Muffler*, the issue was the validity of an interpretive tax regulation which, according to the complaining organization, appeared to cut back on the meaning of the statutory term "business league" as used in 26 U.S.C. §501(c)(6). Prior to upholding the regulation, this Court set forth a list of factors that it would consider in determining the reasonableness of the regulation in such a case:

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

National Muffler, 440 U.S. at 477 (citations omitted).

A few years later, this Court faced an issue very similar to the one in the present case: In *Rowan Cos. v. United States*, 452 U.S. 247 (1981), the issue was whether the value of meals and lodging provided to employees on offshore oil rigs was excludible from "wages" for purposes of the Federal Insurance Contribution Act, 26 U.S.C. §3101 *et seq.*, and the Federal Unemployment Tax Act, 26 U.S.C. §3301 *et seq.* Interpretive regulations promulgated under the general authority of 26 U.S.C. §7805(a) purported to provide the answer. After noting that the *National Muffler* factors relating to reasonableness would apply to these regulations, the Court indicated that higher deference would be due to them if there were within these statutory provisions a specific grant of authority for issuing regulations defining "wages":

> Congress itself defined the word at issue – "wages" -- and the Commissioner interpreted Congress' definition only under his general authority to "prescribe all needful rules." 26 U.S.C. §7805(a). Because we therefore can measure the Commissioner's interpretation against a specific provision in the Code, we owe the interpretation 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. . . . Where the Commissioner acts under specific authority, our primary inquiry is whether the interpretation or method is within the delegation of authority.

Rowan Cos., 452 U.S. at 253 (citations omitted). *Accord United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982) (less deference owed to interpretive regulations promulgated under 26 U.S.C. §7805(a)).

Then, in 1984, came the watershed case of *Chevron*. *Chevron* did not involve an interpretive tax regulation, but rather a regulation issued by the Environmental Protection Agency. There the Court stated:

> 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. 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.

Chevron, 467 U.S. at 842-843 (references omitted). Significantly, the Court in *Chevron* drew a sharp distinction between regulations promulgated pursuant to specific delegations of regulatory authority and other regulations, holding that where Congress has made "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation," the regulations promulgated thereunder are to be upheld "unless they are arbitrary, capricious, or manifestly contrary to the statute," whereas if "the legislative delegation to an agency on a particular question is implicit rather than explicit," the question becomes whether the regulation sets forth a "reasonable interpretation" of the statute. *Id.* at 843-844.

In 2001, the Court further elucidated the *Chevron* standard in *United States v. Mead Corp.,* 533 U.S. 218 (2001). In *Mead*, the issue was the validity of a customs ruling that had not been subjected to public notice and comment before issuance. The Court held that the customs ruling letter was not subject to *Chevron* deference, stating:

> We hold 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. Delegation of such authority may be shown in a variety of ways, as by an agency's power to engage in

> adjudication or notice-and-comment rulemaking, or by some other indication of a comparable congressional intent. The Customs ruling at issue here fails to qualify, although the possibility that it deserves some deference under *Skidmore [v. Swift & Co.*, 323 U.S. 134 (1944)] leads us to vacate and remand.

Id. at 226-227. By way of further explanation, the Court stated:

> This Court in *Chevron* recognized that Congress not only engages in express delegation of specific interpretive authority, but 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*.

Id. at 229 (emphasis added and citations omitted).[3]

This Court has had several occasions after deciding *Chevron* and *Mead* to apply these principles to interpretive tax regulations promulgated pursuant to the general authority under 26 U.S.C. §7805(a). Significantly, in each such case, the Court has made it clear that the standard of reasonableness under *National Muffler*, rather than the higher standard of deference under *Chevron*, is applicable to interpretive tax regulations (such as the regulation at issue in this case) -- in most cases not even mentioning *Chevron* in this context. For example, in each of *Cottage Savings Association v. Commissioner*, 499 U.S. 554 (1991), *United States v.*

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[3] One commentator has observed of this last passage that it confirms 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 of "generally conferred authority" . . . .

Berg, *op. cit.*, at 497.

Cleveland Indians Baseball Co., 532 U.S. 200 (2001), and *Boeing Co. v. United States*, 537 U.S. 437 (2003), the Court assessed the validity of an interpretive tax regulation by applying the *National Muffler* standard, without so much as mentioning *Chevron*. *See also Atlantic Mutual Insurance Co. v. Commissioner*, 523 U.S. 382 (1998) (citing *Chevron* only for the longstanding proposition that courts and agencies must give effect to the unambiguously expressed intent of Congress); *Commissioner v. Estate of Hubert*, 520 U.S. 93, 127 (1997) (Scalia, J., dissenting) (discussing judicial deference to interpretive tax regulations by reference to *National Muffler*, without mentioning *Chevron*); *United States v. Boyle*, 469 U.S. 241 (1985) (mentioning *Chevron* in a tax case not involving the validity of a regulation).

From this clear line of authority, it is widely acknowledged that *Chevron* deference is due from the courts to "legislative" regulations promulgated under specific regulatory authority granted by Congress to the Treasury Department in a provision of the Internal Revenue Code other than 26 U.S.C. §7805(a). *See* ABA Task Force, 57 *Tax Lawyer* at 737-738 ("Federal courts should give *Chevron* deference to regulations promulgated by the IRS, with . . . legislative tax regulations receiving controlling deference under *Chevron* so long as they are not arbitrary, capricious, or manifestly contrary to the statute . . . ."); *see also* Berg, *op. cit.*, at 525-527. As noted below, however, the lower courts have not uniformly applied this Court's clear guidance that the reasonableness standard under *National Muffler* (rather than the higher level of deference under *Chevron*) is to be applied to interpretive tax

regulations promulgated under the general authority of 26 U.S.C. §7805(a).

The final important opinion of this Court in this regard is *National Cable & Telecomms. Assn. v. Brand X Internet Services,* 545 U.S. 967 (2005). In *National Cable*, the issue was the validity of a ruling by the Federal Communications Commission. Several years before the ruling, in a suit by AT&T Corp. against the City of Portland, Oregon, the Ninth Circuit had held that broadband cable modem service is a "telecommunication service" within the meaning of the Communications Act of 1934, as amended. *AT&T Corp. v. City of Portland*, 216 F.3d 871 (9th Cir. 2000). At the time of the Ninth Circuit's holding, the FCC had declined, both in its regulatory capacity and as *amicus curiae*, to address the issue before the Ninth Circuit. *Id*., at 876. Thereafter, the FCC decided to hold hearings on the issue. After receiving some 250 comments and meeting with a variety of industry representatives, consumer advocates, and state and local government officials, in 2002, the FCC issued a declaratory ruling along with a notice of proposed rulemaking. In the ruling, the FCC concluded that "cable modem service, as it is currently offered, is properly classified as an interstate information service, not as a cable service, and that there is no separate offering of telecommunications service. "*In re High-Speed Access*, 17 F.C.C. Rcd. 4798, 4802 (2002)." Since this ruling was in conflict with the prior holding of the Ninth Circuit, the parties brought the issue back to the Ninth Circuit. The Ninth Circuit, relying largely on *stare decisis*, followed its prior holding. *Brand X*

Internet Services v. FCC, 345 F.3d 1120 (9th Cir. 2003).

This Court reviewed the Ninth Circuit and reversed. In pertinent part, this Court stated:

> The Court of Appeals declined to apply *Chevron* because it thought the Commission's interpretation of the Communications Act foreclosed by the conflicting construction of the Act it had adopted in *Portland*. See 345 F.3d, at 1127-1132. It based that holding on the assumption that *Portland*'s construction overrode the Commission's, regardless of whether *Portland* had held the statute to be unambiguous. 345 F.3d, at 1131. That reasoning was incorrect.
>
> 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." *Smiley*, *supra*, at 740-741. 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. See 467 U.S., at 843-844, and n. 11. 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.

A contrary rule would produce anomalous results. It would mean that whether an agency's interpretation of an ambiguous statute is entitled to *Chevron* deference would turn on the order in which the interpretations issue: If the court's construction came first, its construction would prevail, whereas if the agency's came first, the agency's construction would command *Chevron* deference. Yet whether Congress has delegated to an agency the authority to interpret a statute does not depend on the order in which the judicial and administrative constructions occur. The Court of Appeals' rule, moreover, would "lead to the ossification of large portions of our statutory law," *Mead*, 553 U.S., at 247 (Scalia, J., dissenting), by precluding agencies from revising unwise judicial constructions of

> ambiguous statutes. Neither *Chevron* nor the doctrine of *stare decisis* requires these haphazard results.

National Cable, 545 U.S. at 982-983.

II. WHAT THE LOWER COURTS HAVE SAID ON THE ISSUE OF DEFERENCE TO INTERPRETIVE TAX REGULATIONS

Notwithstanding this Court's clear guidance regarding the distinction between regulations promulgated pursuant to a specific grant by Congress of regulatory authority and regulations promulgated pursuant to a general grant of authority such as 26 U.S.C. §7805(a), the lower courts have come to a variety of conclusions regarding whether *National Muffler*, *Chevron*, or both apply in reviewing interpretive tax regulations.

In *Central Pa. Savings Assn. & Subs. v. Commissioner*, 104 T.C. 384 (1995), the Tax Court stated: "[W]e are 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." *Id*. at 392.

The Tax Court has reiterated this position in numerous cases, including *Swallows Holding, Ltd. v. Commissioner*, 126 T.C. 96 (2006). There, the Tax Court faced the question of the validity of an

interpretive tax regulation that disallowed all deductions to a foreign corporation that had not filed its return within 18 months after its original due date. In *Swallows Holding*, the Tax Court stated: "[W]e 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." *Id*. at 131. *Swallows Holding* represented a bold attempt by the Treasury Department to overrule judicial precedents issued by the predecessor of the Tax Court and the Court of Appeals for the Fourth Circuit interpreting a provision of the Internal Revenue Code that went back over 50 years. In applying the *National Muffler* factors, the Tax Court found the regulation invalid because it, among other things, was not issued contemporaneously with the statutory provision, was inconsistent with the law as interpreted previously by courts and longstanding regulations, and effected a change in interpretation in the face of multiple Congressional reenactments.

With regard to the Treasury Department's argument that it was entitled to overrule judicial precedent under the principles of *National Cable*, the Tax Court stated as follows:

> Given that the Supreme Court has historically reviewed Federal tax regulations primarily under the reasonableness test of *Natl. Muffler Dealers Association v. United States*, 440 U.S. 472 (1979), the question arises whether *Natl. Cable & Telecomm. Association v. Brand X Internet Servs.*, *supra*,

which neither cited *Natl. Muffler* nor involved a Federal tax regulation, applies to Federal tax regulations. We do not decide that question because we conclude that *Nat'l Cable* is distinguishable from this case and, thus, its holding is not controlling here. While we take seriously the Supreme Court's holding in *Natl. Cable*, we likewise take seriously that Court's discussion of its rationale for, and the context of, that holding. After considering that discussion, and the significant contrasts between that case and the case before us, we are persuaded for numerous reasons that the holding of *Natl. Cable* does not govern here.

First, the issue in *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, *supra*, was whether broadband was subject to regulation as a telecommunications service. Before ruling, the Federal Communications Commission (FCC) had carefully considered technological developments and its own related interpretations. The Supreme Court's extensive discussion of the FCC's work on its ruling suggests that it was exactly the kind of agency decision that is most entitled to deference. Here, we find no corresponding record of the Secretary's consideration of whether the relevant text in 1990 included a timely filing requirement; the Secretary's rationale for adopting the disputed regulations is at best perfunctory.

Second, the Supreme Court in *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet*

Servs., *supra*, noted that the FCC had not previously ruled on the question at hand, but that its ruling regarding broadband was consistent with prior FCC rulings. Here, the Secretary in 1990 directly altered regulations adopted in (and unchanged since) 1957. Thus, unlike *Natl. Cable*, the instant case raises questions as to the reasonableness and how much deference applies when the Secretary issues an interpretative regulation that reverses long-settled law.

Third, in *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, *supra*, the FCC was not a party to *AT&T Corp. v. Portland*, 216 F.3d 871 (9th Cir. 2000), the prior case that the Court of Appeals for the Ninth Circuit had treated as controlling. Here, the Commissioner was the unsuccessful party in all of the cases holding that timely filing is not required for a foreign corporation to claim its deductions and credits. In addition, unlike the FCC, the Secretary through the disputed regulations is attempting to overturn the outcome of those cases through his general regulatory authority.

Fourth, *AT&T Corp. v. Portland*, *supra*, which the Supreme Court declined to permit to "trump" the FCC ruling, had been decided only approximately 5 years before *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, *supra*. Here, *Anglo-Am. Direct Tea Trading Co. v. Commissioner*, 38 B.T.A. 711

(1938), and its progeny were decided approximately 50 years before the disputed regulations were issued. Thus, in *Natl. Cable* the Supreme Court was not faced with the question of whether a longstanding judicial interpretation is entitled to more deference than a recent judicial interpretation. Nor was that Court faced with the question of the effect of the reenactment of the underlying statute on a prior judicial interpretation. The case of *Natl. Cable* also did not involve an agency that was seeking to reverse course from a preexisting, decades old regulatory position that was consistent with judicial precedents of even greater antiquity.

Moreover, apart from the previously mentioned differences, the Court in *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, *supra*, stated that regulatory interpretations do not prevail over a contrary previous judicial interpretation when the judicial tribunal referred to the interpreted statute as unambiguous. Although the judicial tribunals in *Ardbern Co. v. Commissioner*, 120 F.2d 424 (4th Cir. 1941), *Blenheim Co. v. Commissioner*, 125 F.2d 906 (4th Cir. 1942), and *Anglo-Am. Direct Tea Trading Co. v. Commissioner*, *supra*, did not state explicitly that they were applying the unambiguous meaning of the word "manner", we believe that they did so, given their analysis and the fact that their interpretation of that word was purely one of statutory construction that resulted from the

> employment of traditional tools of statutory construction. "It is emphatically, the province and duty of the judicial department to say what the law is", *Marbury v. Madison*, 5 U.S. 137, 177 (1803).

Swallows Holding, 126 T.C., at 143-145.

In his dissent in *Swallows Holding*, Tax Court Judge Holmes noted the various positions of the different Courts of Appeals as to whether *National Muffler* or *Chevron* applied to interpretive tax regulations. He also argued that there were important distinctions between the two opinions, which the majority had not acknowledged. *Swallows Holding*, 126 T.C. at 181-182 (Holmes, J., dissenting).

The Third Circuit, in reversing the Tax Court, agreed with Judge Holmes. The Third Circuit stated:

> This case, grounded in the principles of administrative law, requires that we review the validity of an Internal Revenue Service (IRS) regulation. The Tax Court, in considering this regulation, analyzed it under the factors provided in *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979), and concluded that the regulation was invalid. In coming to this conclusion, the Tax Court explained that the standard established in *National Muffler* had not been replaced by *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837 (1984), and that the result under either standard would be the same. We do not

> agree with the outcome reached by the Tax Court. We have determined that the result would not be the same under *Chevron* analysis as it would be under *National Muffler* and that the regulation here should be given *Chevron* deference.

Swallows Holding, Ltd. v. Commissioner, 515 F.3d 162, 164 (3d Cir. 2008). The Third Circuit went on to state:

> The Tax Court relied heavily on factors that, although relevant to the *National Muffler* standard, are not mandatory or dispositive inquiries under *Chevron*. As we set out above, the Tax Court reasoned that the challenged regulation was not a contemporaneous construction of the statute; the Tax Court found that the Fourth Circuit Court of Appeals and the Board of Tax Appeals had interpreted the statute as not including a timing element, and the Tax Court relied on the existence of several re-enactments of the statute without any change to the governing statutory language.

Swallows Holding, Ltd. v. Commissioner, 515 F.3d, at 167-168 (footnote omitted).

In effect, the Third Circuit, in a case involving an interpretive tax regulation, determined that this Court in *Chevron* repudiated the *National Muffler* standard, notwithstanding this Court's clear guidance, described above, that the *National Muffler* standard continues to be applicable to interpretive

tax regulations. Most remarkably, the Third Circuit cited for this proposition this Court's decision in *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200 (2001), which, as noted above, is one of the post-*Chevron* cases, contemporaneous with *Mead*, in which this Court applied the reasonableness test under *National Muffler* to an interpretive tax regulation without so much as mentioning *Chevron*.

Regarding *National Cable*, the Third Circuit found that the many prior judicial decisions interpreting the provision in issue were not "unambiguous" interpretations, and therefore did not foreclose the Treasury Department's interpretation.

Fresh off its 2008 victory in *Swallows Holding*, the Treasury last year tried another, even bolder, contortion of this Court's opinions in *National Cable* and *Chevron* to overrule judicial interpretations of the statute by issuing interpretive tax regulations.

26 U.S.C. §6501(a) provides an ordinary statute of limitations for assessing tax deficiencies of three years from the filing of a tax return. An exception to this 3-year rule is a 6-year statute of limitations in the case of omissions of gross income exceeding 25% of the gross income stated in the return. 26 U.S.C. §6501(e)(1)(A). Similar 3-year and 6-year rules apply to the time to issue a notice of final partnership administrative adjustment (hereinafter, an "FPAA"). *See* 26 U.S.C. §§6229(a) and (c)(2). The Internal Revenue Service is currently litigating cases against certain

partnerships that, it claims, overstated the tax basis in their assets, arguing that such an overstatement of basis can give rise to an understatement of gross income for purposes of the 6-year statutes of limitations – giving the Service up to six years to issue the FPAAs. In several cases over the past few years, the IRS has lost this argument in the Tax Court and two Courts of Appeals. Rather than seek review of these courts' holdings in this Court or seek a legislative amendment, the IRS has simply adopted a Temporary regulation under 26 U.S.C. §7805(a) interpreting the statute contrary to the courts' holdings. It has then gone back to the courts asking them to reconsider their rulings on the basis of these newly-issued temporary regulations. This was the procedural posture in *Intermountain Ins. Services of Vail, LLC v. Commissioner*, 134 T.C. No. 11 (May 6, 2010). The Tax Court there put the matter as follows:

> This was not an issue of first impression. In *Bakersfield Energy Partners, LP v. Commissioner*, *supra*, [128 T.C. 207 (2007), aff'd 568 F.3d 767 (9th Cir. 2009),] we held that a basis overstatement was not an omission from gross income for purposes of sections 6229(c)(2) and 6501(e)(1)(A). In reaching our conclusion, we applied the holding of *Colony, Inc. v. Commissioner*, 357 U.S. 28, 33, 1958-2 C.B. 1005 (1958), in which the Supreme Court was faced with identical language in section 6501(e)(1)(A)'s predecessor – section 275(c) of the Internal Revenue Code of 1939. See *Bakersfield Energy Partners, LP v. Commissioner*, *supra* at 215 ("We are

unpersuaded by respondent's attempt to distinguish and diminish the Supreme Court's holding in *Colony, Inc. v. Commissioner*".). The Supreme Court's holding, as we described it, was "that the extended period of limitations applies to situations where specific income receipts have been 'left out' in the computation of gross income and not when an understatement of gross income resulted from an overstatement of basis." *Id.* at 213. The Supreme Court had reviewed the statute's legislative history and determined that Congress had not intended a basis overstatement to be an omission from gross income. See *Colony, Inc. v. Commissioner*, *supra* at 33, 36.

We adhered to our precedent in *Bakersfield Energy Partners, LP v. Commissioner*, *supra*, when we issued our September 1, 2009, opinion in this case. See *Intermountain Ins. Services of Vail, LLC v. Commissioner*, T.C. Memo. 2009-195. Accordingly, in our September 1, 2009, order and decision, we granted petitioner's motion for summary judgment and decided that the adjustments in respondent's FPAA were barred by the general 3-year limitations period. That was not the end of the matter, however.

On September 24, 2009, less than a month after our order and decision in this case, respondent and the Treasury Department issued temporary regulations

under sections 6229(c)(2) and 6501(e)(1)(A). See secs. 301.6229(c)(2)-1T and 301.6501(e)-1T, Temporary Proced. & Admin. Regs., *supra*. These temporary regulations were simultaneously issued as proposed regulations. See sec. 7805(e). On September 28, 2009, notice was published and comments were sought for sections 301.6229(c)(2)-1T and 301.6501(e)-1T, Proposed Proced. & Admin. Regs., see Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations, 74 Fed, Reg. 49354 (Sept. 28, 2009), and the temporary regulations were published in the Federal Register, see secs. 301.6229(c)(2)-1T and 301.6501(e)-1T, Temporary Proced. & Admin. Regs., *supra*.

The temporary regulations provide, in pertinent part, that "an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of * * * [sections 6229(c)(2) and 65011(e)(1)(A)]." See secs. 301.6229(c)(2)-1T and 301.6501(e)-1T, Temporary Proced. & Admin. Regs., *supra*. The interpretation espoused by the temporary regulations runs contrary to the interpretation adopted by this Court in *Bakersfield Energy Partners, LP v. Commissioner*, 128 T.C. 207 (2007), and by the Courts of Appeals for the Ninth and Federal Circuits in *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767 (9th Cir. 2009), and *Salman Ranch Ltd. v. United States*, 573

> F.3d 1362 (Fed. Cir. 2009), respectively. See T.D. 9466, 2009-43 I.R.B. 551, 552 ("The Treasury Department and the Internal Revenue Service disagree with these courts that the Supreme Court's reading of the predecessor to section 6501(e) in *Colony* applies to sections 6501(e)(1)(A) and 6229(c)(2).").
>
> Bolstered by the temporary regulations, respondent, on October 16, 2009, lodged -- and on November 25, 2009, was permitted to file -- an otherwise late motion to vacate our September 1, 2009, decision and a motion to reconsider our September 1, 2009, opinion.

Intermountain Ins. Services of Vail, LLC, *supra*, 134 T.C. No. 11 (slip op. at 6-10) (footnote omitted).

In *Intermountain*, the Tax Court rejected the IRS' attempt to overrule it (and this Court) by regulation. First, the Tax Court found that the effective date of the Temporary regulations was such that it did not govern the *Intermountain* case. Second, the Tax Court said it need not decide whether *Chevron* or *National Muffler* deference applied because "even if the temporary regulations are entitled to review under *Chevron*, they face a formidable obstacle to deference -- *Colony, Inc. v. Commissioner*, 357 U.S. 28, 33, 1958-2 C.B. 1005 (1958)." *Id.*, slip op. at 22. Third, applying *National Cable*, the Tax Court found that this Court in *Colony, Inc.* held that the statute unambiguously provided that an overstatement of tax basis is not an omission of gross income, such that, even under

Chevron, there was no room for the Treasury to fill in any gap. *Id.*, slip op. at 22-32.

Faced with the Treasury Department's increasingly aggressive assertions of regulatory authority, often citing this Court's opinions in *Chevron* and *National Cable*, the lower courts have taken widely disparate views regarding the level of deference to be applied to interpretive tax regulations promulgated under the authority of 26 U.S.C. §7805(a), with some courts applying the reasonableness test under *National Muffler*, others applying full arbitrary-and-capricious deference under *Chevron*, and still others falling somewhere in between. For surveys of the positions taken by the various Courts of Appeals, see *Swallows Holding*, 126 T.C. at 180-181 (Holmes, J., dissenting); Berg, *op. cit.*, at 502-523. Without guidance from this Court in this case, one can only expect increasingly aggressive issuances of interpretive tax regulations to overrule judicial precedent and more confusion in this area.

III. WHAT THE EIGHTH CIRCUIT DID AND SHOULD HAVE DONE IN THIS CASE

In the instant case, just as in *Swallows Holding* and *Intermountain*, the IRS could not win in court, so it decided to go back to court after having first amended an interpretive tax regulation to buttress its position. In December 2004, the amended Treasury regulation adopted a definition of "student" that excluded certain students because of their long hours. Thereafter, the IRS eventually got

before the Eighth Circuit, citing *Chevron* and *National Cable* as requiring that court to defer to the amended Treasury regulation's interpretation.

The Eight Circuit began its analysis of the amended regulation's validity by applying *Chevron* step one – determining whether the statute was unambiguous. Finding that the statute was ambiguous, the court then, with a "see generally" cite to *National Cable*, effectively held that the regulation could trump judicial rulings by four prior circuits that previously had held that "students" could not be limited by the number of hours worked. *Mayo Foundation v. United States*, 568 F.3d 675, 679-680 (8th Cir. 2009).

However, before holding the regulation valid, the Eighth Circuit – without acknowledging the confusion in the lower courts regarding how to review interpretive tax regulations – wrote: "Having concluded that the statute is silent or ambiguous on this question, we turn to the second part of the *Chevron* analysis, determining whether the Commissioner's amended regulation is a permissible interpretation of the statute. For this inquiry, the Supreme Court's opinion in *National Muffler* is instructive:" *Id.*, at 680. At this point, the Eighth Circuit quoted the above-quoted passage from *National Muffler* setting forth the various factors for determining "reasonableness" -- the very factors that the Third Circuit a year earlier had held were irrelevant in *Swallows Holding*. While acknowledging "that the full-time employee provision is of recent vintage"; *Id.*, at 682; the Eighth Circuit held that the IRS had not changed its

position: "[T]he historical record reflects a consistent substantive policy applying the generally worded 'incident to' regulation as not including full-time student employees." *Id.*, at 683. The Eighth Circuit concluded: "We conclude that this interpretation of the student exception, while not the only permissible interpretation, does not conflict with the plain language of the statute, and is consistent with the origin and purpose of the student exception as initially enacted and with Congress's frequent expansion of Social Security coverage in the last fifty years." *Id.* This conclusory language seems to ignore most of the *National Muffler* factors just cited and, essentially, to apply *Chevron* step two.

Amicus believes that while the Eighth Circuit garbled both the *Chevron* and *National Muffler* tests, its instincts were in the right place. *Amicus* agrees with those commentators who argue that, when it comes to interpretive tax regulations adopted under the general authority of 26 U.S.C. §7805(a), the courts should look to a regulation's reasonableness under the *National Muffler* standard. As noted, this Court in *Chevron* and *Mead* explicitly recognized a distinction in deference based on whether a regulation was promulgated under an explicit delegation to fill in a gap or only "generally conferred authority". *Chevron*, *supra*, 467 U.S., at 842-846; *Mead*, *supra*, 533 U.S. at 229. And indeed, this Court's opinions issued since *Chevron* apply the *National Muffler* "reasonableness" factors to the evaluation of interpretive tax regulations. The ABA Task Force stated:

> This Report reviews post-*Chevron* tax cases through the end of 2003, and concludes that although *Chevron*'s two-step process has been affirmed for tax cases, the Supreme Court nonetheless has consistently applied the *National Muffler* test to determine if a general authority regulation is reasonable. The distinction is also appropriate since *Chevron* offers no apparent guidance for applying the reasonableness test, while *National Muffler* provides considerable guidance.

ABA Task Force, 57 *Tax Lawyer* at 740 (footnotes omitted). The ABA Task Force explicitly endorses this practice, recommending:

> Federal courts should give *Chevron* deference to regulations promulgated by the Treasury and the IRS, with (i) legislative tax regulations receiving controlling deference under *Chevron* so long as they are not arbitrary, capricious, or manifestly contrary to the statute, and (ii) interpretive tax regulations receiving the same controlling deference if they are reasonable under the test of *National Muffler,* which examines such factors as the extent to which the regulation harmonizes with the plain language, origin, and purpose of the statute; the manner in which the regulation evolved; the length of time the regulation has been in effect; the reliance placed on it; the consistency of interpretation; and the

> degree of scrutiny Congress has devoted to the regulation . . . .

Id., at 737-738. In accord is Berg, *op. cit.*, at 528 ("[W]hen 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." (footnote omitted)). Berg goes on to note, *id.*:

> *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. Indeed, it could well be in recognition 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.

Amicus takes issue with the Eighth Circuit only as to its incomplete application of the *National Muffler* "reasonableness" factors to the regulation at issue defining "student".

The other problem that *amicus* sees in the Eight Circuit's approach is that it applies the

National Cable opinion uncritically in the tax area. As the Tax Court and commentators have noted, tax regulations differ from the FCC regulations that were at issue in *National Cable*. The IRS is the tax collector. It is hardly a neutral arbiter of the Internal Revenue Code in the same way that other government agencies, such as the FCC, would be an arbiter between competing groups of the public. As Berg puts it, *id*., at 530:

> 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-tax-payer positions. Nonetheless, the fundamental difference between the nature of the public comment process regarding tax and other regulations remains.

The ABA Task Force said it this way:

> [T]he primary purpose of the IRS is to raise money for the government. "The major responsibility of the Internal Revenue Service is to protect the public fisc." *United States v. Hughes Properties, Inc.*, 476 U.S. 593, 603 (1986). This unique purpose, in litigation outside the Tax Court, gives rise to unique laws as to administrative procedure. The Supreme Court in *Bull v. United States,* 295 U.S. 247, 259-60 (1935), recognized the unique nature of our tax assessment and collection system:
>
>> Taxes are the life-blood of government, and their prompt and certain availability an imperious need. . . . Thus the usual procedure for the recovery of debts is reversed in the field of taxation. Payment precedes defense. . . . The assessment supersedes the pleading, proof and judgment necessary in an action at law, and has the force of such a judgment. . . . The taxpayer often is afforded his hearing after judgment and

> after payment, and his only redress for unjust administrative action is the right to claim restitution.
>
> This function of the IRS may encourage the agency to issue rulings or to promulgate regulations that test the outer limits of reasonableness. Courts have scolded the IRS for twisting laws to further revenue collections rather than Congressional purpose.

ABA Task Force, 57 *Tax Lawyer* at 724-725.

The ABA Task Force also noted the inherent advantages of the IRS in tax controversies: In judicial proceedings, the assessment or determination of the IRS is presumed to be correct. See *Welch v. Helvering*, 290 U.S. 111, 115 (1933). And,

> a general policy of broad deference seems unjustified in view of the very large, almost punitive, amounts of penalties, as well as interest charges that go well beyond time value of money considerations, that often accumulate in large tax cases and which can far exceed the original deficiency. The IRS's ability to impose confiscatory penalties and rates of interest not consistent with time value concepts warrants caution in applying deference to agency pronouncements.

ABA Task Force, 57 *Tax Lawyer* at 724.

Then, there is the matter of *National Cable*'s allowing an agency to correct its prior errors by overruling judicial opinions. As the Tax Court noted in *Swallows Holding*,

> [I]n *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, *supra*, the FCC was not a party to *AT&T Corp. v. Portland*, 216 F.3d 871 (9th Cir. 2000), the prior case that the Court of Appeals for the Ninth Circuit had treated as controlling. Here, the Commissioner was the unsuccessful party in all of the cases holding that timely filing is not required for a foreign corporation to claim its deductions and credits.

Swallows Holding, *supra*, 126 T.C., at 144-145. Thus, *National Cable* is distinguishable.

For all of these reasons, the courts should not allow the Treasury Department, merely by the issuance of an interpretive tax regulation under the general authority of 26 U.S.C. §7805(a), to overrule consistent taxpayer-favorable judicial interpretations of provisions of the Internal Revenue Code. In circumstances, such as this one, where the Treasury Department has consistently lost the issue in the courts, unlike the case with other agencies, the Treasury Department should be required to seek reversal in Congress. *Amicus* is not a big fan of "tax exceptionalism", but to apply *National Cable*'s holding in the tax area uncritically is to give more power to an agency that is, at least in this respect, already "exceptional". A less stringent application of *National Cable* in the tax context thus becomes a

way of leveling the playing field somewhat in the context of interpreting the Internal Revenue Code.

CONCLUSION

In reversing the Eighth Circuit, this Court should (1) clarify that the *National Muffler* reasonableness test remains the standard by which interpretive tax regulations promulgated under the authority of 26 U.S.C. §7805(a) are to be evaluated, and (2) hold that no deference is to be given to interpretive tax regulations that are contrary to longstanding, consistent judicial interpretations favoring the taxpayer concerning the same statutory language.

Respectfully submitted,

PROF. CARLTON M. SMITH
Counsel for *Amicus Curiae*
Director, Cardozo Tax Clinic
Benjamin N. Cardozo School of Law
55 Fifth Avenue
New York, New York 10003
(212) 790-0381

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