Life After *Mayo*: Silver Linings

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Most tax practitioners interpreted the Supreme Court's *Mayo* decision to mean that it is now virtually impossible for taxpayers to prevail in challenges to tax regulations and that the IRS can therefore do almost anything it wants. However, nothing in *Mayo* suggests the Court intended that result.

To the contrary, the Court's clear message in *Mayo* is that tax law and the IRS are governed by the same rules that apply to every other area of federal administration. That provides a powerful tool for taxpayers, who traditionally have not attempted to invoke against the IRS administrative law rules that limit agency discretion. Smith discusses those limitations, which include the Administrative Procedure Act's arbitrary and capricious standard and its requirements for reasoned agency decision-making and explanations, the general presumption against retroactivity in regulations, recent case law narrowing the classification of jurisdictions requirements for bringing suit, exceptions to the exhaustion of administrative remedies requirements, and the principle that nonregulatory agency guidance is given weight only according to its power to persuade.

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I. Background

When the Supreme Court issued its decision in *Mayo Foundation for Medical Education and Research v. United States*[1] in January, the reaction was quite strong and quite negative. Most tax practitioners were surprised and outraged. They thought that after *Mayo* it would be nearly impossible to persuade a court to invalidate any tax regulations.

As a result, the IRS could issue regulations saying whatever it wanted, many believed. That presumably explains the intense reaction to *Mayo*. Most tax practitioners do not challenge tax regulations and thus are not directly affected by *Mayo*. However, if the decision really does mean the IRS can do whatever it wants in issuing regulations — and if the Service took advantage of that power — *Mayo* would affect every tax practitioner.

This report considers three questions: Were the strongly negative reactions to *Mayo* justified? What does the decision really mean? Does it have any silver linings?[2]

II. Why *Mayo* Is Important

The issue in *Mayo* was whether medical residents qualify for the student exemption from FICA tax and, more specifically, whether it was proper for the IRS to adopt a rule that anyone working 40 or more hours a week could not qualify for the student exemption. The FICA tax issues are not what is important about *Mayo*, however.

What is important is that the Supreme Court changed — or clarified, depending on your perspective — the standards courts use in considering challenges to tax regulations. Those surprised by *Mayo* thought the proper standard was the test in *National Muffler*.[3]

A 1979 Supreme Court decision, *National Muffler*, listed various factors to be considered in determining if a tax regulation carried out congressional

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[1]131 S. Ct. 704 (2011), *Doc 2011-609*, *2011 TNT 8-10*.

[2]This report is far from the first attempt to map the landscape after *Mayo*. *See, e.g.*, Jeremiah Coder, "The State of Tax Guidance After *Mayo*," *Tax Notes*, Feb. 7, 2011, p. 615, *Doc 2011-2419*, or *2011 TNT 25-1*; Irving Salem, "*Mayo* Dissected: Some Dragons Slain, Some Still Breathing Fire," *Tax Notes*, Mar. 14, 2011, p. 1327, *Doc 2011-4255*, or *2011 TNT 50-5*; Steve R. Johnson, "*Mayo* and the Future of Tax Regulations," *Tax Notes*, Mar. 28, 2011, p. 1547, *Doc 2011-3829*, or *2011 TNT 60-5*.

[3]440 U.S. 472 (1979).

intent in a reasonable and proper manner. They include whether the regulation was adopted at the same time as the related statutory provision, and if not, the length of time the regulation had been in effect; and whether the position in the regulation was a consistently held position of the IRS.[4]

What those who were surprised by and unhappy with *Mayo* liked about *National Muffler* was probably not its specific factors, since those often would support challenged regulations. The appealing aspect of *National Muffler* for tax practitioners was presumably the sense that it was an easier standard for invalidating a tax regulation than the standard that will be applied after *Mayo*.

III. *Chevron*

The Supreme Court in *Mayo* adopted the standard prescribed in 1984 in *Chevron*,[5] which established a two-step test to evaluate the validity of agency regulations. Step one asks whether ''Congress had an intention on the precise question at issue.''[6] If so, that intent is controlling, and if the regulation takes a different position, the regulation is invalid.

Traditional tools of statutory construction are used in step one of the *Chevron* test for purposes of determining whether Congress had an intent on the particular issue.[7] Importantly, that determination is made not by looking at the contested statutory language in isolation, but rather in the context provided by related statutory language:

> In determining whether Congress has specifically addressed the question at issue, a reviewing court should not confine itself to examining a particular statutory provision in isolation. The meaning — or ambiguity — of certain words or phrases may only become evident when placed in context. It is a ''fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'' A court must therefore interpret the statute ''as a symmetrical and coherent regulatory scheme,'' and ''fit, if possible, all parts into an harmonious whole.''[8]

Thus, the traditional tools of statutory construction used in *Chevron* step one include not only the overarching principle that statutory language must be interpreted by reference to its context rather than in isolation but also more specific applications of that general principle, such as the principle that a statutory provision is to be interpreted, if possible, in a way that avoids rendering any words or provisions of the statute superfluous.

Step two of the *Chevron* test says that if the answer to step one is that Congress *did not* have an intent on the particular issue, the agency charged with administering the statute may adopt any reasonable interpretation.[9] The agency position does not have to be the ''best'' interpretation or the one the court would choose in the absence of an agency interpretation.[10] The agency is free to make a choice among reasonable alternatives based on policy considerations.[11] That broad, policy-based discretion that agencies are given under step two is the most significant aspect of *Chevron*.

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[4] *Id.* at 477. Other factors listed were ''the manner in which it evolved,'' ''the reliance placed on it,'' and ''the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute.'' *Id.*

[5] 467 U.S. 837 (1984).

[6] *Id.* at 843 n.9 and at 845 (''Congress did not have a specific intention on the applicability of the bubble concept in these cases.''). The Court also used a variety of other verbal formulations to describe the content of the step-one inquiry: ''whether Congress has directly spoken to the precise question at issue,'' ''if the intent of Congress is clear,'' ''the unambiguously expressed intent of Congress,'' ''if . . . Congress has not directly addressed the precise question at issue,'' and ''if the statute is silent or ambiguous with respect to the specific issue.'' *Id.* at 842-843. That use of alternative verbal formulations to describe the content of step one is the reason for the confusion and misunderstanding about what the step-one inquiry entails and whether, for example, legislative history is properly consulted as part of step one.

Another confusing aspect is the question of what level of certainty is required for a determination of congressional intent under step one. ''Traditional tools of statutory construction,'' by their very nature, can almost never lead to complete certainty. Consequently, complete certainty should not be required under step one.

[7] *Id.* at 843 n.9 (''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.'').

[8] *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132-133 (2000) (citations omitted).

[9] 467 U.S. at 844 (A ''court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.''). The Court also used various other formulations to describe the content of step two, including ''whether the agency's answer is based on a permissible construction of the statute,'' *id.* at 843; whether the agency's position is ''arbitrary, capricious, or manifestly contrary to the statute,'' *id.* at 844; and ''if this choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute,'' *id.* at 845 (internal quotation marks omitted).

[10] *Id.* at 843 n.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.'').

[11] *Id.* at 866 (''When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail.'').

What does it take for a challenge to succeed under *Chevron*? The predominant view is that the way to win is at step one, because if the court gets to step two, the agency is almost certain to prevail. Nevertheless, winning at step two is not impossible, particularly because of step two's relationship to the arbitrary and capricious standard, as discussed below. Arguments that a regulation fails step one will ordinarily rely on the traditional tools of statutory construction to demonstrate that Congress had an intent on the issue that is at variance with the provisions of the challenged regulation:

> Even for an agency able to claim all the authority possible under *Chevron*, deference to its statutory interpretation is called for only when the devices of judicial construction have been tried and found to yield no clear sense of congressional intent.[12]

IV. Was *Mayo* a Surprise?

One reason for the tax community's surprise at *Mayo* was that the Supreme Court had decided post-*Chevron* cases on the validity of tax regulations without suggesting *National Muffler* had been superseded by *Chevron*. However, the Court did not address the conflict between *National Muffler* and *Chevron* because it was not raised by the parties in those post-*Chevron* cases.[13] And the reason the parties never raised the issue was that tax practitioners at that time, including those representing the parties, were either unaware of *Chevron* or assumed it did not apply to tax cases.

The widely shared state of mind regarding *Chevron* was another cause — and probably the main one — for *Mayo*'s surprise to many. That state of mind considers tax to be special, different, self-contained, and self-sufficient, and thus simply not governed by the same rules that apply in other areas of law. That point of view has been referred to as "tax exceptionalism."[14]

That lack of awareness can also be explained by the attitude that it is hard enough just to keep up with developments in tax, so it is not realistically possible for tax practitioners to also stay abreast of legal developments outside tax. The lack of awareness of legal developments outside tax that might be relevant to tax has been referred to as "tax myopia."[15]

Mayo has been called a "cure for tax myopia."[16] That description seems premature. *Mayo* is a lesson in why tax myopia is dangerous. Tax myopia will not be cured until the tax community understands that it must start paying attention to developments in the law outside tax. The aspects of *Mayo* described below illustrate the advantages that tax practitioners can gain by looking for guidance outside tax.

V. What Does *Mayo* Really Mean?

Is it really the case that after *Mayo* it is nearly impossible for a taxpayer to prevail in a challenge to tax regulations? Is it true that the IRS can now do whatever it wants in regulations? If those fears are well founded, *Mayo* would be as much of a disaster as most of the tax community believes.

However, it seems unlikely that the Supreme Court intended to give the IRS completely unbounded discretion. What *Mayo* said instead was simply that tax regulations are not given *less* deference than regulations issued by other agencies; challenges to tax regulations are to be decided under the same principles that have applied to challenges to regulations issued by all other federal agencies since *Chevron* was decided in 1984.[17]

It is hard to see how that principle of treating tax regulations the same as regulations issued by other agencies translates into giving tax regulations *more* deference than is given other regulations. Since the *Chevron* decision in 1984, there have continued to be challenges to regulations issued by agencies other than the IRS, and those challenges succeed with some regularity.

One aspect of *Mayo* that some might think gives the decision special force is that it is a unanimous opinion written by the chief justice. However, Chief Justice John G. Roberts Jr. has previously written other unanimous opinions in tax cases.[18] It is possible he has adopted a policy of writing tax opinions to counter the traditional perception that the Supreme Court views tax cases as undesirable and

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[12]*General Dynamics Land Sys. Inc. v. Cline*, 540 U.S. 581, 600 (2004).

[13]*See* Brief of Amicus Curiae Kristin E. Hickman in Support of Respondent at 18, *Mayo*, 131 S. Ct. 704 (2011) (No. 09-837). Anyone working or writing in this area owes a great debt to Hickman, who almost always got there first.

[14]*See, e.g.*, Hickman, "The Need for *Mead*: Rejecting Tax Exceptionalism in Judicial Deference," 90 *Minn. L. Rev.* 1537 (2006).

[15]*See* Paul L. Caron, "Tax Myopia, or Mamas Don't Let Your Babies Grow Up to Be Tax Lawyers," 14 *Va. Tax Rev.* 517 (1994).

[16]Thomas Greenaway, "*Mayo Foundation* Cures Tax Myopia," TaxProf Blog (Jan. 18, 2011), *available at* http://taxprof.typepad.com/taxprof_blog/2011/01/greenaway-.html.

[17]*See Mayo*, 131 S. Ct. at 713 ("The principles underlying our decision in *Chevron* apply with full force in the tax context.").

[18]*See United States v. Clintwood Elkhorn Mining Co.*, 553 U.S. 1 (2008); *Knight v. Commissioner*, 552 U.S. 181 (2008); Coder, *supra* note 2, at 616 (noting these prior unanimous tax decisions by Chief Justice Roberts).

unimportant. Moreover, it is well known that Chief Justice Roberts has a strong preference for unanimous opinions. Consequently, that *Mayo* is a unanimous decision written by the chief justice is not a reason for reading more into the opinion than is there — namely a message that the IRS can do whatever it wants in writing regulations.

It seems as if some who interpret *Mayo* to mean the IRS can do whatever it wants are reading it as if it had included an explicit endorsement of one of the aspects of the Eighth Circuit decision that was affirmed in *Mayo*. The Eighth Circuit opinion said, in effect, that the code is so complex and difficult that it will almost never be possible to resolve an issue at *Chevron* step one:

> In numerous cases, the Supreme Court has upheld Treasury Regulations construing words in tax statutes that may have a common or plain meaning in other contexts. . . . When the context is a provision of the Internal Revenue Code, a Treasury Regulation interpreting the words is nearly always appropriate.[19]

However, *Mayo* clearly did not endorse that aspect of the Eighth Circuit opinion, even though the point was emphasized in the taxpayer's briefs to the Supreme Court. To the contrary, the Supreme Court's message in *Mayo* that tax law is subject to the same principles as other areas of law is clearly inconsistent with that aspect of the Eighth Circuit opinion. Thus, the tax community's overreaction to *Mayo* might be viewed as just the latest example of tax myopia.

Nevertheless, post-*Mayo* decisions in cases involving challenges to tax regulations do seem to reinforce the prevalent sense in the tax community that the IRS can now do whatever it wants in regulations. Two months after *Mayo*, the Federal Circuit in *Grapevine*[20] upheld tax regulations against a very strong challenge. The oral arguments in *Grapevine* took place the day after *Mayo* was released, and the decision received considerable emphasis in the government's presentation.[21]

Another example of this state of mind may be the attitude of the D.C. Circuit panel at the oral arguments in *Intermountain*,[22] a case dealing with the same regulations at issue in *Grapevine*.[23] Two of the judges seemed to display a strong inclination to accept the government's position.[24] Those cases appear to represent the same kind of overreaction to *Mayo* that has been widespread in the tax community, even though the judges are not tax specialists and thus presumably would not have been exposed to that reaction.

The most effective way to end this overreaction to *Mayo* would be for the Supreme Court to decide a case upholding a challenge to tax regulations, or to at least clarify in that case that it did not mean in *Mayo* to give the IRS unbounded discretion. With a particular regulation challenge now in multiple circuits, it seems likely that at least one of those cases will soon give the Supreme Court an opportunity to provide more direction on how much discretion it really intends the IRS to have in issuing regulations.

That controversy involves the regulations at issue in *Grapevine* and *Intermountain*. Those regulations provide that an overstated basis resulting in understated gross income is considered an omission from gross income for purposes of the rule extending the statute of limitations on assessments from three to six years when a taxpayer omits an amount from gross income and the omitted amount exceeds 25 percent of the gross income reported on the return.[25] The regulations overrule a 1958 Supreme Court decision that said a basis overstatement did not result in an omission from gross income for this purpose.[26] There is already a circuit split on the validity of the regulations.

There is a reasonable chance that when this issue reaches the Supreme Court, some of its members may not look favorably on the IRS overruling one of the Court's own opinions, despite the 2005 *Brand X*[27] decision in which the Court said that agencies have the power to overrule court decisions on issues of statutory interpretation in some circumstances. Justice John Paul Stevens has since retired,

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[19]568 F.3d 675, 679, 680 (8th Cir. 2009).

[20]636 F.3d 1368 (Fed. Cir. 2011), *Doc 2011-5233*, *2011 TNT 49-14*. The Tenth Circuit's opinion in *Salman Ranch Ltd. v. United States*, No. 09-9015 (10th Cir. 2011), largely followed the *Grapevine* decision.

[21]*See* Coder, "Federal Circuit Grapples With Aftermath of *Mayo*," *Tax Notes*, Jan. 17, 2011, p. 257, *Doc 2011-744*, or *2011 TNT 9-2*.

[22]No. 10-1204 (D.C. Cir.), *Doc 2010-10163*, *2010 TNT 88-12*.

[23]Another example may be *Dominion Res. Inc. v. United States*, No. 08-195T (Fed. Cl. 2011), *Doc 2011-4145*, *2011 TNT 40-11*. I am one of the attorneys who represented the taxpayer in that case.

[24]*See* Coder, "D.C. Circuit Hears Oral Arguments in *Intermountain*," *Tax Notes*, Apr. 11, 2011, p. 135, *Doc 2011-7276*, or *2011 TNT 66-5*.

[25]I have discussed this issue and these cases in several prior articles. *See* Patrick J. Smith, "Omissions From Gross Income and Retroactivity," *Tax Notes*, Apr. 4, 2011, p. 57, *Doc 2011-4748*, or *2011 TNT 65-7*; "Omissions From Gross Income and the *Chenery* Rule," *Tax Notes*, Aug. 16, 2010, p. 763, *Doc 2010-16074*, or *2010 TNT 158-3*; "*Brand X* and Omissions From Gross Income," *Tax Notes*, Feb. 1, 2010, p. 665, *Doc 2010-604*, or *2010 TNT 22-5*.

[26]*Colony Inc. v. Commissioner*, 357 U.S. 28 (1958).

[27]545 U.S. 967 (2005).

but his concurring opinion questioned whether agencies' power to overrule court opinions should extend to overruling opinions of the Supreme Court.[28]

Although no one joined Justice Stevens's concurring opinion, it seems likely that the sentiment it expressed may find some support from other justices when they are faced with a case in which one of the Court's own opinions has been overruled by an agency, unlike *Brand X*, which involved an agency overruling a court of appeals decision.[29] Justice Antonin Scalia's dissent in *Brand X*, in which he vigorously disagreed with the concept that agencies could overrule the decisions of any court, let alone the Supreme Court,[30] suggests he would be unlikely to side with the government in this case.

Even without further guidance from the Supreme Court to clarify the meaning of *Mayo* on how much authority the IRS has when issuing regulations, there are significant silver linings to *Mayo*. They involve opportunities for taxpayers to make affirmative use of aspects of *Mayo* other than its main holding that *Chevron* applies to tax regulations. I have discussed several of these opportunities in prior articles, but those articles focused on the specific statutory issues in particular cases rather than on the broader context of the post-*Mayo* landscape.[31]

One thing *Mayo* clearly does mean is that the tax community has a lot of catching up to do — 27 years' worth, in fact. All other agencies and the private parties affected by those agencies have been living with *Chevron* since the case was decided in 1984. The tax world did not realize it needed to deal with *Chevron* until January of this year.

VI. Significant Aspects of *Mayo*

As an introduction to a more detailed discussion of some of the opportunities presented by *Mayo*, the following are significant aspects of the opinion in addition to its holding that *Chevron* applies to tax regulations. I emphasize the features of *Mayo* that are favorable to taxpayers in challenging IRS positions, whether those positions are reflected in regulations or in less formal guidance. First and most significantly, *Mayo* strongly expressed the important principle that tax law and the IRS are subject to the same administrative rules that apply to every other area of federal law and every other federal agency:

> We are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, we have expressly "recogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action."[32]

In *Mayo*, this principle favored the IRS. However, treating the IRS the same as all other federal agencies cuts both ways. Often this principle will favor taxpayers.

The notion that tax isn't special is by far the biggest silver lining to *Mayo*. There are rules of administrative law restricting agency action that taxpayers generally have not attempted to assert against the IRS. If they did, the principle endorsed in *Mayo* — that all agencies are subject to the same rules — would favor taxpayers rather than the IRS.

The general rule that tax law is subject to the same principles of administrative law that apply to all other agencies has important implications for *Mayo*'s holding that *Chevron* applies to tax. It means that all the subsidiary analytical apparatus associated with *Chevron* also applies to tax law, most importantly *Mead*,[33] and that case's guidance on which agency actions qualify for *Chevron* deference and the amount of deference that applies to those that do not qualify for *Chevron* deference. The Supreme Court cited *Mead* for the test used in *Mayo* to show tax regulations receive *Chevron* deference.

Mead provides the principles for deciding how much weight to give IRS guidance other than regulations, such as revenue rulings, revenue procedures, and notices. In light of *Mead*, there should be no doubt that those forms of guidance do not

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[28] *Id.* at 1003 (Stevens, J., concurring).

[29] It is easy to imagine that some members of the Supreme Court might share the views expressed by Judge J. Harvie Wilkinson III in a concurring opinion in one of the overstated basis cases, *Home Concrete & Supply LLC v. United States*, 634 F.3d 249, 259 (4th Cir. 2011) ("What the IRS seeks to do in extending the statutory limitations period goes against what I believe are the plain instructions of Congress, which have not been changed, and the plain words of the Court, which have not been retracted. . . . This seems to me something of an inversion of the universe and to pass the point where the beneficial application of agency expertise gives way to a lack of accountability and a risk of arbitrariness.").

[30] 545 U.S. at 1019 (Scalia, J., dissenting) ("When a court interprets a statute without *Chevron* deference to agency views, its interpretation (whether or not asserted to rest upon an unambiguous text) is the law."). The government argues that changes in the current statute compared with the one at issue in *Colony* make that 1958 decision no longer controlling, without regard to *Brand X*; however, as discussed in a prior article, I believe that argument is incorrect. *See* Smith, "Omissions From Gross Income and the *Chenery* Rule," *supra* note 25, at 766-768.

[31] *See* Smith, "*Mannella*, *State Farm*, and the Arbitrary and Capricious Standard," *Tax Notes*, Apr. 25, 2011, p. 387, *Doc 2011-6811*, or *2011 TNT 80-6*; "Omissions From Gross Income and Retroactivity," *supra* note 25.

[32] *Mayo*, 131 S. Ct. at 713 (citations omitted; alterations in original).

[33] 533 U.S. 218 (2001).

receive the same high level of deference *Chevron* gives to regulations. That clearly established lesser status for those other categories of IRS guidance is favorable for taxpayers.

The *Mead* principles also determine the weight to be given to IRS determinations such as private letter rulings, technical advice memorandums, and chief counsel advice. The IRS claims that documents in those categories that favor taxpayers (other than the specific taxpayers to whom the determination relates) carry no weight and should be ignored because section 6110(k)(3) provides they may not be cited as precedent. The principles in *Mead* say that those types of documents are not ignored but are instead given weight according to their power to persuade. They are evaluated under the same general principles that apply to revenue rulings, revenue procedures, and notices.

Another significant aspect of *Mayo* is that the Supreme Court noted the regulations at issue went through full notice and comment procedures — a factor supporting its conclusion that they should be given deference. Taxpayers can use that against the IRS in the case of guidance that unlike the *Mayo* regulations, is not the product of notice and comment procedures. The main potential impact is in challenges to temporary regulations.

Mayo also concluded that regulations issued under the general authority of section 7805(a) do not receive less deference than regulations issued under more specific statutory authority. That holding can be used against the IRS in challenges to temporary regulations, because in defending those, the IRS has relied on the supposed difference in status between regulations issued under section 7805(a) and those issued under more specific authority.

Mayo said regulations do not receive less deference if they were prompted by litigation.[34] Unfortunately, this rule does not have any silver lining. The overstated basis regulations case that ultimately reaches the Supreme Court will test whether there are any limits to that rule.

Another noteworthy aspect of *Mayo* is that in its *Chevron* step-two analysis, the Supreme Court relied on administrative convenience to justify a bright-line rule. That reliance on administrative convenience will be cited by the IRS in support of bright-line rules in other regulations. However, there was no real basis for an argument that the 40-hour per week bright-line rule in the *Mayo* regulations conflicted with the statutory provision. For other statutory provisions and other regulations, taxpayers often will be able to argue that a particular bright-line rule conflicts with some aspect of the relevant statutory provision.[35]

VII. Tax Isn't Special

As noted above, by far the most important aspect of *Mayo*, apart from the holding that *Chevron* applies to tax regulations, was the Supreme Court's emphasis on the principle that tax law is subject to the same administrative law rules that apply in all other areas of federal law and to all federal agencies other than the IRS. While this principle favored the IRS in *Mayo*, it can also favor taxpayers in challenging IRS action. Applications of this principle are illustrated below.

A. Arbitrary and Capricious Standard

As I discussed in a prior article,[36] the arbitrary and capricious standard in the Administrative Procedure Act (APA) provides an important set of limitations on agency action that have almost never even been asserted by taxpayers against the IRS. *Mayo*'s emphasis on the principle that tax is subject to the same administrative law principles that apply to all other agencies leaves no room for doubt that the IRS is subject to the arbitrary and capricious standard. IRS regulations and other IRS guidance documents are particularly vulnerable to challenges under the arbitrary and capricious standard, because the IRS has not made any attempt to ensure that its guidance satisfies the requirements of that standard.

The APA says that when a court reviews actions taken by federal agencies, it must set aside any agency action that is arbitrary or capricious.[37] In an important 1983 decision, *State Farm*,[38] the Supreme Court clarified that the arbitrary and capricious standard includes the following requirements:

1. The agency must engage in reasoned decision-making.

2. The agency decision must be based on a consideration of relevant factors and not on improper factors.

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[34]The regulations in *Mayo* were issued in response to a court of appeals decision that favored the taxpayers' position.

[35]For example, another issue pending in multiple cases in the courts of appeals involves the validity of a regulatory rule that imposes a two-year time limit on filing claims for innocent spouse relief under section 6015(f). It can be argued the two-year limit conflicts with the statutory directive that the IRS must take into account all the facts and circumstances in deciding whether innocent spouse relief is warranted in a particular case. For a more complete discussion, see Smith, "Gaps in the Seventh Circuit's Reasoning in *Lantz*," *Tax Notes*, Sept. 27, 2010, p. 1375, *Doc 2010-18745*, or *2010 TNT 186-19*.

[36]*See* Smith, "*Mannella*, *State Farm*, and the Arbitrary and Capricious Standard," *supra* note 31. That article discussed the issues addressed in this section in considerably greater detail.

[37]5 U.S.C. section 706(2)(A).

[38]463 U.S. 29 (1983).

> 3. The agency must provide an explanation of its reasons for reaching its decision at the time the decision is announced, so that a court reviewing the agency's action will be able to determine whether the agency has in fact engaged in reasoned decision-making and has relied on proper factors in making the decision.
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> 4. A court is not permitted to uphold agency action based on *post hoc* rationalizations presented by lawyers representing the agency in court if the agency did not articulate those same reasons when it made its decision. Accepting those *post hoc* rationalizations would allow those lawyers to usurp the function that was supposed to be performed by the agency.

The general understanding is that the arbitrary and capricious standard is very similar to *Chevron* step two and thus provides content for step two. Under *Chevron* step two, a court will accept an agency determination as long as it is reasonable. Whether the agency decision is reasonable involves the same considerations that apply under the APA arbitrary and capricious standard. After *Mayo* was decided, some tax practitioners complained that there is no way to know what is or is not reasonable under *Chevron* step two. The arbitrary and capricious standard provides an answer.

Violation of the APA arbitrary and capricious standard is asserted in almost every nontax case in which an agency action is challenged, and it is often the entire basis for the challenge. The most common basis for a challenge under the arbitrary and capricious standard is the agency's failure to adequately explain the reasons for its decision.

It is fair to say that outside tax, the arbitrary and capricious standard is the bread and butter of an administrative law practice. Yet, asserted violations of the APA arbitrary and capricious standard are almost unknown in tax litigation. Nevertheless, the IRS is just as subject to challenge under the arbitrary and capricious standard as every other agency.

In fact, the IRS is more vulnerable than other agencies to challenge on this ground because it seems completely unaware of the need to explain its reasoning when it issues regulations. In most cases, the only explanation the IRS provides in the preambles is a description of how the rules in the regulations operate. The preambles sometimes explain the reasoning behind the choices that were made in deciding what the rules should say. However, the IRS usually does not provide an explanation, and that practice makes tax regulations especially vulnerable to challenges based on asserted violations of the APA arbitrary and capricious standard.

Moreover, the application of the APA arbitrary and capricious standard is not limited to regulations; it applies to any form of agency action. Thus, for example, it is a well established principle under the arbitrary and capricious standard that an agency may not treat one party that is subject to its jurisdiction differently than it has treated similarly situated parties in the past unless the agency provides a reasoned explanation for the differential treatment.[39] Clearly, that principle has potential application in taxpayer dealings with the IRS.

B. Retroactivity of Regulations

The issue of when the IRS may validly make regulations retroactive is another area in which the agency has benefited from tax myopia.[40] In challenging retroactive tax regulations, taxpayers have made very little use of important Supreme Court cases dealing with retroactivity in nontax contexts and the substantial body of lower court precedent interpreting and applying those Supreme Court decisions.

Those cases make clear that there is a strong presumption in the law against retroactive statutes and regulations.[41] In light of *Mayo*'s emphasis that the IRS is subject to the same principles of administrative law that apply to all other federal agencies, those nontax retroactivity authorities should be no less applicable to retroactivity issues in tax law.

Moreover, although the government persuaded the Supreme Court that *Chevron* and related cases

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[39]*See, e.g.*, *Burlington N. & Santa Fe Ry. v. Surface Transportation Bd.*, 403 F.3d 771, 777 (D.C. Cir. 2005) ("Where an agency applies different standards to similarly situated entities and fails to support this disparate treatment with a reasoned explanation and substantial evidence in the record, its action is arbitrary and capricious and cannot be upheld."); *Westar Energy Inc. v. Fed. Energy Regulatory Comm'n*, 473 F.3d 1239, 1241 (D.C. Cir. 2007) ("A fundamental norm of administrative procedure requires an agency to treat like cases alike."; "The Commission's dissimilar treatment of evidently identical cases . . . seems the quintessence of arbitrariness and caprice.") (alterations in original); *Point Park Univ. v. NLRB*, 457 F.3d 42, 49 (D.C. Cir. 2006) ("where 'a party makes a significant showing that analogous cases have been decided differently, the agency must do more than simply ignore that argument'"); *Honeywell Int'l Inc. v. NRC*, No. 10-1022, slip op. at 16 (D.C. Cir. Dec. 21, 2010) ("An agency may change its policy only if it provides a reasoned analysis indicating that prior policies and standards are deliberately changed, not casually ignored.") (internal quotation marks omitted).

[40]Smith, "Omissions From Gross Income and Retroactivity," *supra* note 25. That article addresses the retroactivity issues discussed in this section in considerably greater depth.

[41]*See, e.g.*, *Landgraf v. USI Film Products*, 511 U.S. 244, 264 (1994) (noting "the axiom that 'retroactivity is not favored in the law,' and its interpretive corollary that 'congressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result'") (quoting *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988)).

apply to tax law, that success comes at a price to the IRS. Part of that price is the conclusion that whatever Congress meant in 1954 when it enacted the original version of section 7805(b), which explicitly authorized retroactive regulations, it clearly did not contemplate retroactive exercise of the breadth of discretion now successfully claimed by the IRS under *Chevron*.

Regulations under statutory provisions enacted before section 7805(b) was amended in 1996 are governed by the 1954 version of section 7805(b). The traditional understanding is that if the IRS issues retroactive regulations under the original version of section 7805(b), its decision to make those regulations retroactive is evaluated by the courts under a deferential abuse of discretion standard.[42]

However, it is impossible that Congress in 1954 intended that section 7805(b) allow retroactive tax regulations exercising the extreme degree of agency discretion authorized by *Chevron* and the cases that followed it, such as *Brand X* (which authorizes agencies to overrule court cases), because *Chevron* was not decided until 30 years later and *Brand X* more than 50 years later. That is particularly true because *Mayo* made clear only this year that this broad discretion fully applies to tax regulations. Even when section 7805(b) was amended in 1996, *Mayo*'s clarification that *Chevron* and related cases apply to tax law was still 15 years in the future.

Consequently, there is a very good case for concluding that the traditional highly deferential abuse of discretion standard for evaluating the validity of retroactive tax regulations should be reexamined and abandoned as obsolete. That conclusion also is supported by the nontax retroactivity cases discussed above, which are not reflected in the traditional abuse of discretion standard that has been applied to retroactivity issues in tax cases.

The broad discretion the IRS has been given under *Mayo*, *Chevron*, and *Brand X* regarding the substantive content of regulations does not extend to the decision by the IRS as to whether particular exercises of that broad substantive discretion should be applied retroactively.

C. Variance Rule for Refund Claims

Another area in which general principles of law that have been ignored in tax may potentially be used against the IRS involves the variance rule for refund claims. The variance rule says that in a refund suit, a taxpayer cannot recover on a legal theory different from those stated in the refund claim filed with the IRS as a prerequisite to filing the suit.[43]

The variance rule is a specific instance of a more general principle of administrative law requiring that a party exhaust its administrative remedies before seeking a remedy against the agency in court.[44] However, I know of no litigated variance rule case in which there was reliance on the exhaustion of administrative remedies principle.[45] *Mayo* makes clear that general principles of administrative law, such as exhaustion of administrative remedies, are fully applicable in tax cases.

As an example of application of the variance rule, the Justice Department maintains that if a taxpayer filed a refund claim saying a particular regulation is invalid because it is inconsistent with the statute, the taxpayer violates the variance rule if she argues in the refund suit that the regulation is also invalid because it was issued in violation of the APA notice and comment rules or the APA arbitrary and capricious standard.[46] As a consequence of the variance rule and the DOJ's position, it is necessary to draft refund claims comprehensively to cover all potential grounds for challenge. However, a good argument can be made that the law concerning the variance rule is obsolete because of nontax legal developments.

It is common for courts applying the variance rule to say the rule is jurisdictional.[47] If that is correct, it would mean that a court would not have jurisdiction to decide a refund case based on a legal theory that the taxpayer attempted to rely on in the suit but did not assert in the refund claim. More significantly, lack of jurisdiction can be raised for the first time at any stage of the litigation, even by the court acting on its own, as a basis to dismiss that aspect of the case.

Over the last decade or so, the Supreme Court has decided a series of nontax cases making the

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[42]*See, e.g.*, *Anderson, Clayton & Co. v. United States*, 562 F.2d 972, 980-981 (5th Cir. 1977).

[43]*See, e.g.*, *Lockheed Martin Corp. v. United States*, 210 F.3d 1366, 1371 (Fed. Cir. 2000). The variance rule is set forth in reg. section 301.6402-2(b)(1) (''No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period.'').

[44]*See, e.g.*, *Quarty v. United States*, 170 F.3d 961, 972 (9th Cir. 1999) (referring to variance rule as an ''exhaustion requirement'').

[45]Apart from one pending case in which I am involved that raises the issues discussed in this section.

[46]*See, e.g.*, Brief for the Appellee at 54-57, *CNG Transmission Mgmt. VEBA v. United States*, 588 F.3d 1376 (Fed. Cir. 2009) (No. 2009-5025). I was one of the attorneys who represented the taxpayer in this appeal.

[47]*See, e.g.*, *Nick's Cigarette City Inc. v. United States*, 531 F.3d 516, 526 (7th Cir. 2008), *Doc 2008-14674*, *2008 TNT 129-11*.

point that courts have been far too free in using the term ''jurisdictional'' to describe various legal requirements related to bringing suit. The Court has said that in most instances, those uses of the term have been incorrect.[48]

Based on the principles applied in that line of cases to decide when particular requirements really are jurisdictional, a good case can be made that the traditional use of the term ''jurisdictional'' to describe the variance rule has been incorrect.[49] For example, that the variance rule is contained in a regulation rather than a statutory provision strongly suggests it is not jurisdictional. The reason it matters is that for non-jurisdictional requirements regarding exhaustion of administrative remedies, courts have recognized exceptions to the exhaustion rule.[50] If the variance rule for refund claims is not truly jurisdictional, taxpayers may be able to take advantage of those exceptions.

D. *Mead*

As noted above, a significant consequence of *Mayo*'s holding that *Chevron* applies to tax regulations is that all the subsidiary analytical apparatus that has grown up under *Chevron* also applies. The Supreme Court's decision in *Mead*[51] is a principal example. *Mead*'s main application is on the issue of the weight to be given to agency guidance other than regulations.

Chevron left unclear whether all forms of agency guidance could receive *Chevron* deference or, if not, which forms of guidance were covered. That issue was not addressed comprehensively until *Mead* in 2001.

The *Mead* Court said that not all agency guidance documents qualify for *Chevron* deference. Instead, particular forms of guidance receive *Chevron* deference only if ''Congress delegated authority to the agency generally to make rules carrying the force of law, and . . . the agency interpretation claiming deference was promulgated in the exercise of that authority.''[52] Thus, the only agency guidance that is given *Chevron* deference is guidance that the agency intended to have ''the force of law.''

As a result, generally only relatively formal agency guidance, such as regulations, receives *Chevron* deference.[53] The agency's use of notice and comment procedures to issue guidance usually shows that it intended the guidance to have the force of law,[54] and guidance issued under those procedures will ordinarily receive *Chevron* deference.[55] It is this aspect of *Mead* that the Supreme

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[48]*See, e.g.*, *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 91 (1998) (''Drive-by jurisdictional rulings of this sort . . . have no precedential effect.''); *Kontrick v. Ryan*, 540 U.S. 443, 454 (2004) ('''Jurisdiction,' the Court has aptly observed, 'is a word of many, too many, meanings.'") (quoting *Steel*, 523 U.S. at 90); *Eberhart v. United States*, 546 U.S. 12, 16 (2005) (referring to ''the confusion generated by the 'less than meticulous' uses of the term 'jurisdictional' in our earlier cases''); *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 510, 516 (2006) (''This Court, no less than other courts, has sometimes been profligate in its use of the term'' jurisdiction; ''When Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character''); *Reed Elsevier Inc. v. Muchnick*, 130 S. Ct. 1237, 1243 (2010) (''Courts — including this Court — have sometimes mischaracterized claim-processing rules or elements of a cause of action as jurisdictional limitations, particularly when that characterization was not central to the case, and thus did not require close analysis. Our recent cases evince a marked desire to curtail such 'drive-by jurisdictional rulings.'") (citations omitted); *Union Pac. Ry. Co. v. Bhd. Locomotive Eng'r & Trainmen*, 130 S. Ct. 584, 596 (2009) (''Recognizing that the word 'jurisdiction' has been used by courts, including this Court, to convey 'many, too many, meanings,' we have cautioned, in recent decisions, against profligate use of the term.'') (citation omitted); *Henderson v. Shinseki*, 131 S. Ct. 1197, 1202 (2011) (''Because the consequences that attach to the jurisdictional label may be so drastic, we have tried in recent cases to bring some discipline to the use of this term.'').

[49]In *Hoogerheide v. IRS*, No. 10-1126 (6th Cir. 2011), *Doc 2011-7826*, *2011 TNT 71-16*, the Sixth Circuit recently applied this line of Supreme Court authority to hold that the explicit statutory exhaustion of administrative remedies requirement in section 7433(d) is not jurisdictional.

[50]*See, e.g.*, *Ace Prop. & Cas. Ins. Co. v. Fed. Crop Ins. Corp.*, 440 F.3d 992, 996 (8th Cir. 2006) (a non-jurisdictional exhaustion of administrative remedies requirement ''may be excused by a limited number of exceptions to the general rule''); *Munsell v. Dep't of Agric.*, 509 F.3d 572, 579 (D.C. Cir. 2007) (a ''mandatory [but non-jurisdictional] exhaustion requirement may be excused in appropriate circumstances, whereas a jurisdictional exhaustion requirement never may be excused by a court''); *Dawson Farms LLC v. Farm Serv. Agency*, 504 F.3d 592, 597 (5th Cir. 2007) (non-jurisdictional exhaustion requirements ''may be excused by a federal court under a limited number of exceptions'').

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On the nature of these exceptions to the exhaustion requirement, see, *e.g.*, *Ace Prop.*, 440 F.3d at 1000 (''A party may be excused from exhausting administrative remedies . . . if further administrative procedures would be futile, or if the issues to be decided are primarily legal rather than factual.'') (citations omitted); *Avocados Plus Inc. v. Veneman*, 370 F.3d 1243, 1247 (D.C. Cir. 2004) (''There may be no facts in dispute, the disputed issue may be outside the agency's expertise, or the agency may not have the authority to change its decision in a way that would satisfy the challenger's objections.'') (citations omitted).

[51]533 U.S. 218.

[52]*Id.* at 226-227.

[53]*Mead* also referred to agency adjudication as another type of agency action that ordinarily would have the formality necessary to qualify for *Chevron* deference, but that type of agency action is not generally relevant with the IRS.

[54]533 U.S. at 230 (''It is fair to assume generally that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force.'').

[55]The Court's studied avoidance of any direct reference to the APA's notice and comment requirements is quite striking. The discussion makes it seem as though Congress typically

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Court relied on to support its conclusion that the *Mayo* regulations, which it noted had gone through full notice and comment, were entitled to deference.

The *Mead* Court also noted, however, that sometimes agency guidance that has not gone through notice and comment will still receive *Chevron* deference.[56] That qualification to the general principle that notice and comment is necessary for agency guidance to receive *Chevron* deference is clearly the most unsatisfactory aspect of *Mead*. Nevertheless, it might be inferred from *Mead* that the Court intended it to be a relatively unusual case in which *Chevron* deference would be given to agency guidance that had not gone through notice and comment.[57]

However, lower courts have sometimes applied that exception more liberally than might have been expected from *Mead*, and the IRS and DOJ invariably cite the qualification to assert that temporary regulations should be given *Chevron* deference even though they have not gone through notice and comment. The question of how to determine if particular agency guidance that is not the product of notice and comment receives *Chevron* deference is murky.[58]

But that uncertainty is fortunate from one perspective, because agencies know that the only sure way to obtain *Chevron* deference is through the use of notice and comment procedures. The Supreme Court's reliance on the fact that the *Mayo* regulations were the product of notice and comment procedures should make clear — especially to the IRS — that those procedures are the only certain path to *Chevron* deference for particular guidance.[59]

The Supreme Court in *Mead* also said that the effect of not qualifying for *Chevron* deference is not that the guidance receives no deference at all, but rather that it is given the weight determined under *Skidmore*.[60] Under that standard, agency guidance receives weight based on the document's ''power to persuade,'' which ''will depend on the thoroughness evident in its consideration; the validity of its reasoning; its consistency with earlier and later pronouncement; and all those factors which give it power to persuade, if lacking power to control.''[61]

E. Revenue Rulings and Revenue Procedures

Thus, *Mayo* benefits taxpayers by clarifying that the *Mead* principles apply in tax. When the *Mead* test is applied to revenue rulings, revenue procedures, and notices, the conclusion is that they are not among the types of agency guidance that receive *Chevron*'s high level of deference.

The IRS does not claim that revenue rulings and procedures have the force of law,[62] and those categories of documents are not ordinarily subjected to

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makes a specific reference to notice and comment procedures in the statutory provision authorizing the agency to engage in rulemaking. The reality, which can be discerned by a careful reading of the Court's discussion, is in fact otherwise. Namely, Congress typically authorizes an agency to engage in rulemaking, and the agency's exercise of that authority brings into play the APA's notice and comment requirements, under the terms of the APA, without any need for specific reference to those requirements in the statutory provision authorizing the agency to engage in rulemaking. The nature of this link between rulemaking authorization and the application of the APA notice and comment requirements seemed to be a connection the Court wished to avoid acknowledging, perhaps because of its reluctance to make notice and comment a prerequisite for deference.

[56]533 U.S. at 230-231.

[57]The Court cited only one prior instance in which it had granted *Chevron* deference in the absence of either notice and comment rulemaking or agency adjudication, 533 U.S. at 231 n.13, whereas it cited 19 instances in which it had granted *Chevron* deference in cases involving notice and comment rulemaking, 533 U.S. at 230 n.12.

[58]For the principal post-*Mead* example of such a case, see *Barnhart v. Walton*, 535 U.S. 212, 221-222 (2002) (''The interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time all indicate that *Chevron* provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue.''). The analysis used in this case to determine whether *Chevron* deference *applies* sounds very much like the analysis prescribed in *Mead* for the evaluation of agency guidance that *does not qualify* for *Chevron* deference.

[59]*See, e.g.*, prepared remarks of IRS Chief Counsel William J. Wilkins (Jan. 25, 2011), *Doc 2011-2194, 2011 TNT 22-15* (''It does not escape our attention that this case involved notice-and-comment regulations; and that the opinion cited that fact as an indication that the *Chevron* standard should apply. It may or may not be the case that other kinds of guidance will receive *Chevron* deference, but at least we know that notice-and-comment regulations will.'').

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

[61]*Id.* at 140.

[62]*See, e.g.*, reg. section 601.601(d)(2)(v)(d) (''Revenue rulings published in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose.''); reg. section 601.601(d)(2)(i)(a) (''A Revenue Ruling is an official interpretation by the Service that has been published in the Internal Revenue Bulletin. Revenue Rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and others concerned.''); reg. section 601.601(d)(2)(v)(a) (''The conclusions expressed in Revenue Rulings will be directly responsive to and limited in scope by the pivotal facts stated in the revenue ruling.''); reg. section 601.601(d)(2)(e) (''Since each Revenue Ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same.'').

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any form of notice and comment procedures. Accordingly, the *Mead* test leads to the result that revenue rulings and procedures do not receive *Chevron* deference. Those forms of guidance are therefore evaluated under the *Skidmore* test instead. For example, under *Skidmore* a revenue ruling or procedure that contains no reasoning is given no weight.[63]

Any pre-*Mayo* case law on the status of revenue rulings, revenue procedures, and notices should generally be considered obsolete unless the opinion reflects *Mead* analysis. The clear conclusion that those forms of guidance do not qualify for the level of deference described in *Chevron* is another benefit to taxpayers from *Mayo*.

F. Letter Rulings and Similar Guidance

Paired with the issue of the weight to be given revenue rulings, revenue procedures, and notices is the weight to be given other IRS documents such as private letter rulings, technical advice memorandums, and chief counsel advice. Based on *Mayo* and *Mead*, the *Skidmore* test applies to these documents as well.

It is typically a taxpayer rather than the IRS that wants to make use of private letter rulings, technical advice memorandums, and chief counsel advice, which were prepared regarding other taxpayers. In response, the IRS asserts that section 6110(k)(3), which provides that ''a written determination may not be used or cited as precedent,'' precludes a taxpayer from making any use of documents of that type that were issued to other taxpayers. *Mayo* and *Mead* provide taxpayers a strong basis for arguing that the IRS's reliance on section 6110(k)(3) is misplaced.

The type of agency guidance at issue in *Mead*, which was held by the Supreme Court to be subject to evaluation under *Skidmore*, bore some resemblance to private letter rulings. *Mead* involved tariff classification rulings issued to individual parties by the U.S. Customs Service, which, like the IRS, is a part of the Treasury Department.[64]

The Court noted that the regulations governing the issuance of those tariff classification rulings ''provide that 'no other person [than the person to whom the ruling is addressed] should rely on the ruling letter or assume that the principles of that ruling will be applied in connection with any transaction other than the one described in the letter.'''[65] This regulatory provision resembles section 6110(k)(3). The Court referred to the provision in analyzing why the tariff classification rulings did not qualify for *Chevron* deference,[66] but it is not referenced in the portion of the discussion in which the Court concluded that the rulings should be evaluated under *Skidmore*.[67]

Thus, the Court in *Mead* did not view the regulations' no-reliance provision as an obstacle to evaluating the tariff classification rulings under *Skidmore*. That aspect of *Mead* provides a powerful response to the IRS's reliance on section 6110(k)(3) as preventing any weight being given to private letter rulings or other IRS documents that are

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However, the DOJ, in litigation in the courts of appeals, has argued that revenue rulings and procedures do in fact have the force of law for purposes of the *Mead* test. *See* Hickman, ''IRB Guidance: The No Man's Land of Tax Code Interpretation,'' 2009 *Mich. St. L. Rev.* 239, 263 n.139 (2009) (citing appellate briefs in which the DOJ asserted that revenue rulings and procedures have the force of law for purposes of *Mead* and *Chevron*). In that pre-*Mayo* article, Hickman discusses in detail the issues relating to the status of revenue rulings, revenue procedures, and notices.

After this report was completed, Gilbert Rothenberg, appellate section chief in the DOJ's Tax Division, announced at the May meeting of the American Bar Association Section of Taxation that the DOJ would no longer argue in litigation that revenue rulings and procedures should receive *Chevron* deference. *See* Marie Sapirie, ''DOJ Won't Push Chevron Deference for Revenue Rulings,'' *Tax Notes*, May 16, 2011, p. 674, *Doc 2011-9936*, or *2011 TNT 90-7*.

[63]*See, e.g., Fed. Nat'l Mortg. Ass'n v. United States*, 379 F.3d 1303, 1309 (Fed. Cir. 2004), *Doc 2004-16430*, *2004 TNT 157-9* (''Revenue Procedure 99-43 sets forth no reasoning in support of its conclusion. . . . Accordingly, the revenue procedure does not provide a basis for resolving the present appeal.''); *Exxon Mobil Corp. v. Commissioner*, 136 T.C. No. 5, slip op. at 33 (2011), *Doc 2011-2431*, *2011 TNT 24-10* (''Because the pronouncement in the Rev. Proc. 99-43 . . . is unaccompanied by any supporting rationale, it is not entitled to deference and does not provide a basis for resolving the issues before us.'').

[64]19 U.S.C. section 2071 (''There shall be in the Department of the Treasury a service to be known as the United States Customs Service.'').

[65]533 U.S. at 223 (quoting 19 C.F.R. section 177.9(c)) (alteration added).

[66]533 U.S. at 233 (''Their treatment by the agency makes it clear that a letter's binding character as a ruling stops short of third parties; Customs has regarded a classification as conclusive only as between itself and the importer to whom it was issued, 19 C.F.R. section 177.9(c) (2000), and even then only until Customs has given advance notice of intended change, section 177.9(a), (c). Other importers are in fact warned against assuming any right of detrimental reliance. Section 177.9(c).''). In the factual section of the opinion, the Court quoted a provision of the regulations stating that ''in the absence of a change of practice or other modification or revocation which affects the principle of the ruling set forth in the ruling letter, that principle may be cited as authority in the disposition of transactions involving the same circumstances.'' 533 U.S. at 222 (quoting 19 C.F.R. section 177.9(a).). However, the Court did not discuss this provision in its opinion, and it appears that the provision applies to a broader class of rulings than the tariff classification rulings at issue in the case, since several provisions of the regulations have separate provisions dealing solely with tariff classification rulings. *See, e.g.*, 19 C.F.R. section 177.2(b)(2)(ii); 19 C.F.R. section 177.9(b)(2).

[67]533 U.S. at 234-235.

subject to section 6110(k)(3). Since, as noted above, it is typically taxpayers, rather than the IRS, that wish to make use of private letter rulings, technical advice memorandums, and chief counsel advice, *Mayo*'s clarification that *Chevron* and associated cases such as *Mead* are fully applicable in a tax context provides taxpayers a significant benefit by clarifying that those types of guidance documents are evaluated under the same *Skidmore* standard that applies to revenue rulings, revenue procedures, and notices.[68]

Taxpayers may therefore argue that under *Skidmore*, if an IRS document such as a private letter ruling or technical advice memorandum is well reasoned, it should be given appropriate weight. Any such document that contains no reasoning would ordinarily be given no weight under *Skidmore*. For example, most private letter rulings involving corporate reorganizations and spinoffs contain little reasoning and accordingly would receive no weight under *Skidmore*. In contrast, most technical advice memorandums contain extensive reasoning and thus would be more likely to receive weight under *Skidmore*.

G. Temporary Regulations

As noted above, several aspects of *Mayo* are favorable for taxpayers challenging the validity of temporary regulations. *Mayo*'s reliance on the fact that the student exception regulations had been issued using full notice and comment procedures presents a clear point on which to distinguish them from all IRS temporary regulations, which are issued without the benefit of any prior notice and comment.[69] Well before *Mayo*, the IRS practice of issuing temporary regulations without prior notice and comment was criticized by commentators,[70] and it was later challenged in court cases as a violation of the APA notice and comment rules.[71]

The APA requires that any substantive rules issued by an agency go through notice and comment procedures.[72] That means that before an agency can issue a rule that is effective, it must undertake the following steps:

1. The agency must first publish a notice in the *Federal Register* announcing that it is planning to issue rules on a particular subject.
2. The agency must give the public the opportunity to submit written comments.
3. The agency must take any comments that are submitted into consideration in making a decision on the content of the final rule.

The IRS does in fact use full notice and comment procedures in issuing most regulations. The one exception is temporary regulations. As noted above, the defining characteristic of IRS temporary regulations is that they are issued without prior notice and comment.

The IRS uses various rationales to defend that practice. One of its main defenses is that regulations issued under the general authority of section 7805(a), as opposed to a more specific grant of authority, necessarily and automatically qualify for the ''interpretative rules'' exemption from the APA's notice and comment requirements.[73]

It would seem that *Mayo* significantly undercuts that position. The Supreme Court in *Mayo* said tax regulations issued under the general authority of section 7805(a) do not receive less deference than

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[68]Although taxpayers might be concerned that applying *Skidmore* to documents such as private letter rulings could in some cases benefit the IRS, the fact that *Skidmore* analysis assigns weight according to the quality and thoroughness of a document's reasoning should mean that the IRS would not gain any benefit from those documents except when the Service's substantive position had merit — and in those cases, it is unlikely that the existence of another IRS document supporting the Service's position would add much force to that position. In contrast, when a taxpayer can point to an IRS document that supports the taxpayer's position, that ability should provide more benefit to the taxpayer than what the IRS would gain by being able to support its position by pointing to a taxpayer-specific document relating to a different taxpayer.

[69]This distinction was noted by the Fifth Circuit in its holding for the taxpayer in one of the overstated basis regulation challenges. *See Burks v. United States*, 633 F.3d 347, 360, n.9 (5th Cir. 2011), *Doc 2011-2857*, *2011 TNT 28-12* (''*Mayo* emphasized that the regulations at issue had been promulgated following notice and comment procedures, 'a consideration identified . . . as a significant sign that a rule merits *Chevron* deference.' 131 S. Ct. at 714. Legislative regulations are generally subject to notice and comment procedure pursuant to the Administrative Procedure Act. *See* 5 U.S.C. section 553(b)(A). Here, the government issued the Temporary Regulations without subjecting them to notice and comment procedures.'') (alterations in original).

(Footnote continued in next column.)

[70]*See, e.g.*, 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 Tax Regulations,'' 44 *Tax Law.* 343 (1991). The pre-*Mayo* state of the law on the validity of IRS temporary regulations is discussed extensively in Hickman's article.

[71]*See, e.g.*, the cases challenging the overstated basis regulations discussed in Smith, ''Omissions From Gross Income and Retroactivity,'' *supra* note 25.

[72]5 U.S.C. section 553.

[73]Another rationale that the IRS has often relied on in defending temporary regulations against asserted violations of the APA notice and comment requirements is that the ''good cause'' exception to the notice and comment requirements applies. However, the case law on the good cause exception makes clear that it is applied narrowly and is limited to genuine emergency situations that ordinarily relate to public health or public safety.

tax regulations issued under more specific authority granted by the code section to which the regulations relate.[74] Thus, for purposes of deference, there is no distinction between regulations issued under section 7805(a) and regulations issued under more specific authority, according to *Mayo*. That conclusion is clearly inconsistent with the premise underlying the IRS's claim that regulations issued under section 7805(a) are automatically considered ''interpretative rules'' for purposes of the APA.

Section 7805(a) says the IRS ''shall prescribe all needful rules and regulations for the enforcement of this title.'' The consolidated return regulations, issued under authority in section 1502, are an example of regulations issued under specific authority. There are many other examples of code sections providing specific authority for regulations.

In recent years, whenever a new code section is enacted, it is typical for it to include a subsection specifically authorizing the promulgation of regulations to implement that section. For example, in section 263A, enacted in 1986 to provide uniform cost capitalization rules for inventory and other types of property, section 263A(i) authorizes ''such regulations as may be necessary or appropriate to carry out the purposes of this section.''

Several pre-*Chevron* Supreme Court cases said specific authority tax regulations receive more deference than general authority tax regulations.[75] But *Chevron*, in addition to the two-step test for which it is famous, also said the presence of ambiguity in a statutory provision is an implicit authorization to the responsible agency to interpret that provision in a way that will receive deference, no less than when a statute specifically authorizes an agency to issue regulations on a specific subject.[76]

Mayo said that aspect of *Chevron* clearly means the pre-*Chevron* Supreme Court tax cases distinguishing between general authority tax regulations and specific authority tax regulations are no longer good law. Thus, *Mayo* rejected any distinction between regulations issued under the general authority of section 7805(a) and regulations issued under more specific authority in determining the deference given the regulations.

It would seem that aspect of *Mayo* would likewise remove whatever basis the IRS had for claiming that regulations issued under section 7805(a) automatically qualify for the exemption from the APA notice and comment requirements for interpretative rules. It is traditional in the tax world to refer to regulations issued under section 7805(a) as ''interpretative'' and regulations issued under specific authority as ''legislative,'' but *Mayo* makes that distinction obsolete.

Moreover, it is profoundly inconsistent for the IRS to claim, as it has in the overstated basis cases, for example, that regulations issued under section 7805(a) are interpretative rules and therefore exempt from notice and comment but that they nevertheless qualify for *Chevron* deference.[77] This is inconsistent because to get *Chevron* deference, an agency position must be intended by the agency to have the force of law. However, it is well established that the essence of interpretative rules for purposes of the exemption from notice and comment under the APA is that those rules do not have the force of law.[78]

An additional inconsistency is the IRS's practice of using notice and comment on *all* regulations (except temporary regulations), regardless of whether they are issued under specific authority. Many of the regulations are issued under section 7805(a) and, under the IRS's own theory, would be exempt from notice and comment as interpretative rules. A further inconsistency is that the IRS issues temporary regulations in specific authority cases as often as it issues regulations under section 7805(a), even though regulations issued under more specific authority would not be exempted from the notice and comment requirements under the IRS's theory.

Because the IRS has issued so many temporary regulations, it is not unusual for issues to arise that

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[74]131 S. Ct. at 713-714.

[75]*Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981); *United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982) (both cited in *Mayo*, 131 S. Ct. at 713).

[76]467 U.S. at 844.

[77]*See* Hickman, ''IRB Guidance,'' *supra* note 62, at 264 (''If the force of law is truly the critical dividing line between both *Chevron* and *Skidmore* on the one hand and legislative and interpretative rules on the other, and if we accept that the force of law concept has only one meaning, then the government's litigating positions seem wholly inconsistent.''); *Burks*, No. 09-11061, slip op. at 23 n.9 (''the treasury frequently issues purportedly binding temporary regulations open to notice and comment only after promulgation and often denies the applicability of the notice and comment procedure when issuing its regulations . . . while continuing to assert that the regulations are entitled to legislative regulation level deference before the courts'') (paraphrasing Hickman).

[78]*See, e.g.*, *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 99 (1995) (''Interpretive rules do not require notice and comment, although . . . they also do not have the force and effect of law and are not accorded that weight in the adjudicatory process.''). It is far from clear how to decide if a particular rule is interpretative for purposes of exemption from notice and comment under the APA. The case law on this subject is highly unsatisfactory. The leading case is *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106 (D.C. Cir. 1993).

are governed by temporary regulations. The addition of section 7805(e) in 1988, requiring a three-year expiration for new temporary regulations, did not apply to temporary regulations already in existence. Thus, older temporary regulations remain outstanding.

For temporary regulations issued after the effective date of section 7805(e), the IRS generally attempts to issue final versions before the end of the three-year expiration period. However, there appears to be no corresponding effort to issue final versions of the older temporary regulations. Those older regulations are particularly vulnerable to challenge as having been issued in violation of the APA notice and comment requirements. That is because the IRS cannot argue, as it does for post-1988 temporary regulations, that any notice and comment violations were cured by the solicitation of comments on the proposed regulations, which are now required by section 7805(e) to be issued at the same time as any new temporary regulations.

H. Notice and Comment for Other Guidance

While it is clear that the APA notice and comment requirements apply to regulations, there is a question whether those requirements can apply to other forms of IRS guidance such as revenue rulings, revenue procedures, and notices. Those categories of IRS guidance should be potentially subject to the APA notice and comment requirements if their content purports to be sufficiently binding.

In *Cohen v. United States*, a D.C. Circuit panel held that an IRS notice was a substantive rule under the APA.[79] Although the notice and comment requirements were not at issue in *Cohen*, the APA contrasts substantive rules from interpretive rules and general statements of policy for purposes of those requirements.

As the appellate panel decision in *Cohen* illustrates, agency guidance that does not take the form of regulations can still be subject to the APA notice and comment requirements. Thus, revenue rulings, revenue procedures, and notices are potentially subject to challenge as having been issued in violation of the APA notice and comment requirements.

VIII. Conclusion

In spite of the tax community's strongly negative reaction to the Supreme Court's decision in *Mayo*, several aspects of the decision may in fact assist taxpayers in challenging IRS positions. By far the most significant of *Mayo*'s taxpayer-favorable aspects is the Court's strong emphasis on the principle that tax law and the IRS are subject to the same rules of administrative law that apply to every other area of federal law and every other federal agency. By allowing taxpayers to invoke rules of administrative law they have generally not attempted to assert against the IRS, this principle represents a potentially powerful tool in challenges to IRS actions.

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[79]578 F.3d 1, 6 (D.C. Cir. 2009), *Doc 2009-17950, 2009 TNT 151-17* ("We conclude Notice 2006-50 operates as a substantive rule that binds the IRS, excise tax collectors, and taxpayers."). The D.C. Circuit later granted the government's petition for a rehearing *en banc* and vacated the panel decision. That action was based not on the panel's conclusion that the notice was a substantive rule but rather on the issue of whether the suit could be heard at all, since it was not brought as a refund suit and no refund claim had been filed. 599 F.3d 652 (D.C. Cir. 2010), *Doc 2010-5407, 2010 TNT 49-19*.