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# Reasoned Explanation and IRS Adjudication

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# REASONED EXPLANATION AND IRS ADJUDICATION

STEVE R. JOHNSON<sup>†</sup>

## ABSTRACT

*Under the Administrative Procedure Act (APA), an administrative action can be invalidated as arbitrary and capricious if the agency fails to sufficiently explain the reasons for its choices. This principle applies to agency adjudication as well as to agency rulemaking. How does this principle apply to IRS adjudications? Examining five paradigms of IRS decisionmaking, this Article first establishes that the IRS does engage in APA-style adjudication. The Article then examines tax-specific explanation requirements and asks whether a more robust explanation duty patterned on the APA should be imposed on IRS determinations. Based on a variety of legal and prudential considerations, the Article concludes that such an additional duty generally is not advisable as to IRS assessment determinations (that is, the amount of tax liability owed) but may be useful as to IRS collection determinations (that is, when and how to proceed with enforced collection after assessment).*

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## INTRODUCTION

The Administrative Procedure Act<sup>1</sup> (APA) clearly applies to the Treasury Department and the Internal Revenue Service (IRS).<sup>2</sup> Nonetheless, for generations, tax lawyers and administrators were slow to acknowledge the applicability of general administrative law to tax. Their attitudes toward this applicability (or intrusion, as some viewed it) ranged from outright denunciation to guerilla warfare to (most commonly) neglect, indifference, and disregard.<sup>3</sup>

Those days are gone. Recent decisions by the Supreme Court and lower federal courts have made it undeniable that administrative law applies to tax.<sup>4</sup> Tax lawyers and administrators are being dragged—some kicking and screaming, some in grudging resignation—into this realization.

To say that administrative law applies to tax, however, leaves open important questions as to just *how* it applies in particular circumstances. Administrative law is about nuance, and it must be adapted to the issues, agencies, and circumstances of the particular situation at hand.<sup>5</sup> “[T]he intensity of the court’s supervisory role

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1. Administrative Procedure Act, 5 U.S.C. §§ 551–559, 701–706 (2012).

2. *See id.* § 551(1) (defining “agency” as “each authority of the Government of the United States, whether or not it is within or subject to review by another agency,” subject to some exceptions not relevant here); *Comm’r v. Neal*, 557 F.3d 1262, 1278 (11th Cir. 2009) (Tjoflat, J., dissenting) (“I begin by stating the obvious: the IRS is an ‘agency’ as defined by the APA, the IRS has made findings of fact in this case, and such findings constitute ‘agency action.’”); U.S. DEP’T OF JUSTICE, ATTORNEY GENERAL’S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 9–10 (1947) (explaining the APA’s definition of the word “agency”).

3. For decades, occasional (and not always very good) discussions of administrative-law issues have popped up in tax decisions, but they have typically made only fleeting impressions in tax lawyers’ minds. *See, e.g.*, *Redhouse v. Comm’r*, 728 F.2d 1249, 1253 (9th Cir. 1984); *Am. Med. Ass’n v. United States*, 688 F. Supp. 358, 363–66 (N.D. Ill. 1988), *rev’d on other grounds*, 887 F.2d 760 (7th Cir. 1989); *Nat’l Rest. Ass’n v. Simon*, 411 F. Supp. 933, 999 (D.D.C. 1976); *Tax Analysts & Advocates v. Shultz*, 376 F. Supp. 889, 895 (D.D.C. 1974); *Estate of Gardner v. Comm’r*, 82 T.C. 989, 994 (1984); *Wing v. Comm’r*, 81 T.C. 17, 27–32 (1983); *Wendland v. Comm’r*, 79 T.C. 355, 379–82 (1982); *Dittler Bros. v. Comm’r*, 72 T.C. 896, 909 (1979), *aff’d*, 642 F.2d 1211 (5th Cir. 1981).

4. *See, e.g.*, *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 712–14 (2011); *Cohen v. United States*, 650 F.3d 717, 723 (D.C. Cir. 2011); *Intermountain Ins. of Vail, LLC v. Comm’r*, 134 T.C. 211, 236–48 (2010) (Halpern and Holmes, JJ., concurring in the result), *rev’d*, 650 F.3d 691 (D.C. Cir. 2011), *vacated*, 132 S. Ct. 2120 (2012). For a discussion of *Mayo Foundation for Medical Education & Research v. United States*, 131 S. Ct. 704 (2011), see generally Steve R. Johnson, *Preserving Fairness in Tax Administration in the Mayo Era*, 32 VA. TAX REV. 269 (2012).

5. *Cf., e.g.*, *Hamdi v. Rumsfeld*, 542 U.S. 507, 527–33 (2004) (displaying sensitivity to context in applying administrative law to military operations); *Sandin v. Connor*, 515 U.S. 472,

[over agencies] varies with context.”<sup>6</sup> This reality pervades administrative law generally,<sup>7</sup> including the celebrated, yet challenging, arbitrary-and-capricious standard.<sup>8</sup> Part of the challenge of “Taking Administrative Law to Tax” is the cultural difference between this fluidity of administrative law and the relatively greater determinacy of tax.<sup>9</sup>

This Article involves one of these second-generation issues. General administrative law, through the arbitrary-and-capricious standard, insists that agencies give reasoned explanations for their actions. This requirement “has come to play a central role in judicial review of agency decisions.”<sup>10</sup> How should it apply in the tax context?

Administrative-law authority and commentary—conveniently, though somewhat imprecisely—train principal attention on agencies’ quasi-legislation through promulgation of regulations and agencies’

482–83 (1995) (to prison administration); *Londoner v. Denver*, 210 U.S. 373, 385–86 (1908) (to revenue raising).

6. Peter L. Strauss, *Overseers or “The Deciders”—The Courts in Administrative Law*, 75 U. CHI. L. REV. 815, 817 (2008).

7. As Professors Richard Levy and Robert Glicksman have observed,

[A]dministrative law doctrine necessarily reflects the interaction between agency-specific law . . . and generally applicable law, such as the Administrative Procedure Act (APA). . . . [A]gencies have differing organic statutes and administer different regulatory and benefit programs, so some degree of variation is implicit in administrative law doctrine. . . . [Indeed,] the universality of administrative law doctrine may not be as pervasive as is commonly assumed.

Richard E. Levy & Robert L. Glicksman, *Agency-Specific Precedents*, 89 TEX. L. REV. 499, 500 (2011); see also Leslie Book, *The Collection Due Process Rights: A Misstep or a Step in the Right Direction?*, 41 HOUS. L. REV. 1145, 1161 (2004) (“[T]he extent of external constraints on agency discretion generally varies with the nature of the decision and the type of interest involved . . .”); Kristin E. Hickman, *Agency-Specific Precedents: Rational Ignorance or Deliberate Strategy*, 89 TEX. L. REV. SEE ALSO 89, 89 (2011) (“Given the diversity of organizational structures, practices, and goals among federal government agencies, is there or should there be a body of general principles labeled administrative law?”).

8. See Strauss, *supra* note 6, at 821 (“Arbitrary [or] capricious’ has one meaning for a court reviewing congressional judgments in enacting legislation, another for a court reviewing an agency’s decision to adopt a high-consequence regulation, another for a court reviewing an agency’s judgment to forego rulemaking it has been petitioned to undertake, and another for review of the products of informal adjudications in relatively low-consequence matters . . .” (first alteration in original) (citations omitted)).

9. Cf. *Wos v. E.M.A. ex rel. Johnson*, 133 S. Ct. 1391, 1403 (2013) (Breyer, J., concurring) (“[T]he Administrative Procedure Act is not the tax code. [Administrative-law] cases . . . provide rules of thumb, general principles meant to guide interpretation, not rigid rules that narrowly confine it.”).

10. Sidney A. Shapiro & Richard E. Levy, *Heightened Scrutiny of the Fourth Branch: Separation of Powers and the Requirement of Adequate Reasons for Agency Decisions*, 1987 DUKE L.J. 387, 388.

quasi-adjudication through decisions in particular cases.<sup>11</sup> This Article focuses on the reasoned-explanation requirement as applied to tax adjudication by the IRS.<sup>12</sup> It is the first to address the reasoned-explanation requirement across multiple dimensions of IRS adjudication.

The iconic dimension of IRS adjudication involves the IRS's issuance of a notice of deficiency, which usually is a prerequisite to its assessment of deficiencies of income, estate, and gift taxes.<sup>13</sup> The traditional, strongly asserted view is that APA-style, reasoned-explanation review is unavailable for notices of deficiency.<sup>14</sup> But the seminal cases standing for this position were decided before the enactment of the APA, and more recent cases have not reexamined IRS adjudication in light of the APA. Commentators have argued that the reasoned-explanation requirement should attach to IRS deficiency determinations, either broadly or narrowly.<sup>15</sup> Moreover, a number of circuit court and Tax Court judges have recently maintained in dissents that an APA analysis is appropriate in at least some deficiency or deficiency-related cases.<sup>16</sup>

Beyond deficiency determinations, there are other types of IRS adjudications. They include jeopardy- and termination-assessment

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11. “[T]he entire [APA] is based upon a dichotomy between rule making and adjudication.” U.S. DEP’T OF JUSTICE, *supra* note 2, at 14.

12. A later article of mine will examine the requirement as applied to tax regulations promulgated by the Treasury Department. *See, e.g.,* Dominion Res., Inc. v. United States, 681 F.3d 1313, 1317–19 (Fed. Cir. 2012) (invalidating on APA grounds a regulation as to the capitalization of interest expenses); Mannella v. Comm’r, 631 F.3d 115, 127–30 (3d Cir. 2011) (Ambro, J., dissenting) (urging the invalidation of a regulation limiting spousal relief, in part because of the arbitrary-and-capricious standard).

13. *See* I.R.C. § 6211–6213 (2012).

14. *See infra* Part III.A.1.

15. Professor Kenneth Davis once asked rhetorically, “[W]hen the IRS Appellate Division decides a question against a taxpayer, why is it not required to provide a reasoned opinion, including systematic findings of fact?” KENNETH CULP DAVIS, *ADMINISTRATIVE LAW TREATISE* § 12.13, at 462 (2d ed. 1979); *see also* Patrick J. Smith, *The APA’s Reasoned-Explanation Rule and IRS Deficiency Notices*, 134 TAX NOTES 331, 331 (2012) (arguing that the reasoned-explanation requirement should apply to notices of deficiency generally); Lawrence Zelenak, *Should Courts Require the Internal Revenue Service To Be Consistent?*, 40 TAX L. REV. 411, 411 (1985) (maintaining that the IRS should have a duty—borrowed from administrative law—to explain or to repudiate, or lose when it asserts seemingly inconsistent deficiency and other adjustments).

16. *E.g.,* Wilson v. Comm’r, 705 F.3d 980, 996–99 (9th Cir. 2013) (Bybee, J., dissenting); Comm’r v. Neal, 557 F.3d 1262, 1278–87 (11th Cir. 2009) (Tjoflat, J., dissenting); Ewing v. Comm’r, 122 T.C. 32, 61 (2004) (Halpern and Holmes, JJ., dissenting), *rev’d on other grounds*, 439 F.3d 1009 (9th Cir. 2006). These cases involved equitable spousal relief under I.R.C. § 6015(f).

determinations, collection due process (CDP) determinations, trust fund recovery determinations, and others.<sup>17</sup> Courts have cited key reasoned-explanation precedents, such as *Securities & Exchange Commission v. Chenery Corp. (Chenery I)*,<sup>18</sup> in several cases involving these types of determinations.<sup>19</sup> On many occasions, courts have invalidated or remanded IRS determinations because of inadequate explanations, although they have not specified whether they located the explanation duty within or outside of the APA.<sup>20</sup> In addition, courts have applied APA judicial-review standards that differ from the reasoned-explanation standard in cases involving IRS adjudication, especially CDP determinations.<sup>21</sup>

Yet the waters are murky. Many cases stand in opposition to the above decisions.<sup>22</sup> In some dimensions of IRS adjudication, little authority as to explanation exists. Moreover, it is unclear to what extent the various dimensions of IRS adjudication are comparable. This Article seeks to advance the understanding of this important yet understudied area.

The Article has five major parts. Part I describes the reasoned-explanation requirement, addressing its statutory bases, consequences, justifications, costs, and also cases on point. Part II establishes the proposition—not universally accepted—that the IRS does in fact adjudicate in an administrative-law sense. It then develops this idea through four paradigms: deficiency and cognate determinations, jeopardy and termination determinations, trust fund recovery “penalty” determinations, and CDP determinations. Part II concludes by noting that other types of IRS action may also constitute agency adjudication. Part III demonstrates that substantial-explanation requirements already exist as to most paradigms of IRS

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17. See *infra* Part II.

18. SEC v. *Chenery Corp. (Chenery I)*, 318 U.S. 80 (1943).

19. See, e.g., *Tucker v. Comm’r*, 676 F.3d 1129, 1136 (D.C. Cir. 2012) (citing *Chenery I*, 318 U.S. 80); *Salahuddin v. Comm’r*, No. 7050-11L, 2012 WL 1758628, at \*7 (T.C. May 17, 2012) (same); cf. *Hirschhorn v. United States*, 662 F. Supp. 887, 892 (S.D.N.Y. 1987) (invoking the *Chenery* principle but not citing the case). For a discussion of *Chenery*, see *infra* notes 46–62 and accompanying text.

20. E.g., *Walker v. United States*, 650 F. Supp. 877, 885 (E.D. Tenn. 1987); *Hoyle v. Comm’r*, 131 T.C. 197, 205 (2008); see *infra* Parts II.B–C.

21. E.g., *Robinette v. Comm’r*, 439 F.3d 455, 459–60 (8th Cir. 2006) (applying an abuse-of-discretion standard of review); see also *Danshera Cords, Administrative Law and Judicial Review of Tax Collection Decisions*, 52 ST. LOUIS U. L.J. 429, 441 (2008) (“[A]dministrative law and its principles are applicable to most tax collection cases.”).

22. See *infra* Parts II.B–C.

adjudication. However, these requirements sound mostly in tax law rather than in administrative law, and, in their application by the courts, the requirements sometimes lead to different outcomes than might be expected under the APA-style arbitrary-and-capricious analysis.

That being so, the question becomes whether tax-specific explanation rules should be supplemented by an APA level of analysis. Parts IV and V address this question. Recognizing the centrality of context in administrative law, this Article does not propose a one-size-fits-all solution. Instead, Part IV maintains that because of a variety of prudential and legal considerations, an APA explanation requirement should not be grafted onto existing tax explanation requirements involving deficiency and cognate determinations.

On similar grounds, Part V reaches the same conclusion as to IRS jeopardy and termination determinations, trust fund recovery penalty determinations, and CDP determinations as to liability. However, these prudential and legal considerations are absent from, or operate only weakly in, other contexts. Accordingly, Part V offers that an APA explanation requirement should be applied to CDP determinations involving collection—as opposed to liability—determinations. Similarly, although detailed consideration of such situations is beyond the scope of this Article, in IRS adjudications outside the above paradigms, the case for applying an APA explanation requirement is likely to be stronger in collection situations than in liability situations.

## I. THE REASONED-EXPLANATION REQUIREMENT

The reasoned-explanation requirement is part of a much larger “struggle to devise a successful theory of judicial review of administrative action.” This problem “is as old as administrative law itself,”<sup>23</sup> and no enduring theory has yet emerged. In fact, “[t]he courts have not developed a consistent approach to controlling agency discretion,” and “[l]acking an intelligible theoretical framework, the Supreme Court has oscillated between activism and restraint in reviewing agency decisions.”<sup>24</sup>

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23. Shapiro & Levy, *supra* note 10, at 440.

24. Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1325 (1986); see also JERRY L. MASHAW, BUREAUCRATIC JUSTICE: MANAGING SOCIAL



This difficulty has at least three roots. First, the doctrine reflects an attempt to balance the important but competing goals of facilitating government responses to social problems with preserving the traditions of limited government enshrined in our constitutional order.<sup>25</sup> This balance bobs on the tides of events and rarely remains stable for long.

Second, in theory, judges are supposed to supervise the regularity of agency decisions without “imposing on an agency the reviewing court’s perception of which value choices are legitimate and which are not.”<sup>26</sup> But exercising such discipline can be difficult in practice. Thus, “the suspicion has arisen . . . that the grand synthesizing principle that tells us whether the court will dig deeply or bow cursorily depends . . . on whether the judge agrees with the result of the administrative decision.”<sup>27</sup>

Third, the unsettled constitutional position of agencies further muddies the waters. “[T]he role and position of the agency, and the exact locus of its powers, present questions that are delicate, subtle, and complex. . . . [T]he amorphous character of the administrative agency in the constitutional system escapes simple explanation.”<sup>28</sup> As conceptions of the constitutional place of agencies change, so do doctrines of judicial review of administrative action. The eras and dominating models of American administrative law have been characterized in several ways. One scholar has traced trends in judicial review through four successive models: agency expertise (the

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SECURITY CLAIMS 1 (1983) (“[T]he history of American administrative law is a history of failed ideas.”).

25. See, e.g., *Bowen v. Am. Hosp. Ass’n*, 476 U.S. 610, 627 (1986) (“Our recognition of Congress’ need to vest administrative agencies with ample power to assist in the difficult task of governing a vast and complex industrial Nation carries with it the correlative responsibility of the agency to explain the rationale and factual basis for its decision . . . .”); Shapiro & Levy, *supra* note 10, at 390–96 (arguing that explanation requirements are part of the attempt to achieve this balance).

26. Mark Seidenfeld, *The Irrelevance of Politics for Arbitrary and Capricious Review*, 90 WASH. U. L. REV. 141, 160 (2012); cf. *Balt. Gas & Elec. Co. v. Natural Res. Def. Council, Inc.*, 462 U.S. 87, 105 (1983) (“It is not our task to determine what decision we, as Commissioners, would have reached.”).

27. William H. Rodgers, Jr., *Judicial Review of Risk Assessments: The Role of Decision Theory in Unscrambling the Benzene Decision*, 11 ENVTL. L. 301, 302 (1981); see Henry Friendly, *Chenery Revisited: Reflections on Reversal and Remand of Administrative Orders*, 1969 DUKE L.J. 199, 224; Thomas J. Miles & Cass R. Sunstein, *The Real World of Arbitrariness Review*, 75 U. CHI. L. REV. 761, 814 (2008).

28. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 536 (2009) (Kennedy, J., concurring in part and concurring in the judgment).

dominant model until the 1970s), reasoned decisionmaking (in the 1970s), counteracting interest groups (starting in the 1980s), and presidential control of agencies (currently the dominant model).<sup>29</sup>

Explanation requirements are buffeted by these shifting winds. Below, the Article discusses the statutory basis of the reasoned-explanation principle, its associated case law, and the principle's justifications, costs, and limits.

#### A. *Statutory Bases of the Requirement*

The APA was enacted in 1946.<sup>30</sup> Some of its sections govern agencies; others govern judicial review of agency actions. The first group is not of principal significance to this Article. For example, 5 U.S.C. § 553 contains a weak explanation requirement,<sup>31</sup> but that section applies only to agency rulemaking, not adjudication. Sections 554 through 558 establish a variety of rules, but they apply principally to formal adjudication and rulemaking.<sup>32</sup> IRS adjudications are informal, and so are largely outside these sections.<sup>33</sup>

In contrast, the APA provisions governing judicial review are pertinent here. These provisions apply “except to the extent that . . . (1) statutes preclude judicial review; or (2) agency action is committed to agency discretion by law.”<sup>34</sup> Judicial review under the

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29. Seidenfeld, *supra* note 26, 153–58. *But see* Shapiro & Levy, *supra* note 10, 396–412 (describing structuralist, proceduralist, and rationalist models).

30. Administrative Procedure Act, ch. 324, 60 Stat. 237 (1946) (codified as amended at 5 U.S.C. §§ 551–559, 701–706 (2012)).

31. *See* 5 U.S.C. § 553(c) (“[T]he agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.”).

32. As to informal adjudications, the only applicable constraints under these sections are that the agency must allow the party to be represented, to obtain copies of information she provides, and to receive a brief statement of the grounds of denial of an application or petition. *Id.* § 555.

33. Formal adjudication involves proceedings that are “required by statute to be determined on the record after opportunity for an agency hearing.” *Id.* § 554(a); *see* *United States v. Fla. E. Coast Ry.*, 410 U.S. 224, 241 (1973) (holding that the mere use of the word “hearing” in an enabling act does not trigger formal procedures); *cf.* 1 KENNETH CULP DAVIS & RICHARD J. PIERCE, JR., *ADMINISTRATIVE LAW TREATISE* § 8.2, at 381–86 (3d ed. 1994) (maintaining that the *Florida East Coast* result should apply to adjudications as well as to rulemaking). As described in Part III, the statutes governing IRS adjudications do not contain such language. *See, e.g.,* *Lunsford v. Comm’r*, 117 T.C. 159, 171 (2001) (Halpern, J., concurring) (“[A] determination under section 6330(c)(3) is not a formal adjudication.”); *Davis v. Comm’r*, 115 T.C. 35, 41–42 (2000) (holding that CDP determinations are informal adjudications).

34. 5 U.S.C. § 701(a). The second exception is “very narrow . . . [and only] applicable in those rare instances where ‘statutes are drawn in such broad terms that in a given case there is no law to apply.’” *Heckler v. Chaney*, 470 U.S. 821, 830 (1985) (quoting S. REP. NO. 79-752, at

APA is available to persons “suffering legal wrong because of agency action, or adversely affected” by it<sup>35</sup> and reaches “[a]gency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court.”<sup>36</sup> However, the APA does not confer subject-matter jurisdiction. Courts apply APA rules only if other statutes confer upon them jurisdiction to hear a case.<sup>37</sup>

Under 5 U.S.C. § 706, and subject to a harmless-error rule,<sup>38</sup> reviewing courts may “hold unlawful and set aside agency action, findings, and conclusions” for any of six reasons.<sup>39</sup> One reason is that the action was “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”<sup>40</sup> These terms have not been given separate meaning. They are understood to provide a single standard, known as the arbitrary-and-capricious standard.<sup>41</sup> This standard is not limited to formal adjudication or rulemaking. The statutory text is broader, reaching agency “action, findings, and conclusions,” and the case law establishes that the standard applies to review of all kinds of agency actions, including adjudications.<sup>42</sup>

Neither the text of § 706 nor its legislative history clarifies the contents of this standard or how stringently it is to be applied.<sup>43</sup> As

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26 (1945)). Nonetheless, this exception sometimes has operated in tax cases. For instance, the IRS has authority to abate liability for interest under some circumstances. I.R.C. § 6404(e). Before amendment of the statute to provide for judicial review, cases held that interest-abatement decisions were committed to the discretion of the IRS, and thus, courts were precluded by the APA exception from hearing taxpayer challenges to IRS decisions not to abate interest. *E.g.*, *Argabright v. United States*, 35 F.3d 472, 473 (9th Cir. 1994).

35. 5 U.S.C. § 702.

36. *Id.* § 704.

37. *E.g.*, *Califano v. Sanders*, 430 U.S. 99, 104–07 (1977).

38. *See* 5 U.S.C. § 706 (“[D]ue account shall be taken of the rule of prejudicial error.”); *see also, e.g.*, *Shinseki v. Sanders*, 556 U.S. 396, 406 (2009) (applying a statute with the same wording as 5 U.S.C. § 706 to require the “Veterans Court to apply the same kind of ‘harmless error’ rule that courts ordinarily apply in civil cases”). *See generally* Craig Smith, Note, *Taking “Due Account” of the APA’s Prejudicial-Error Rule*, 96 VA. L. REV. 1727 (2010).

39. 5 U.S.C. § 706(2).

40. *Id.* § 706(2)(A). The other bases are that the agency action was contrary to constitutional rights, in excess of the agency’s statutory authority, inconsistent with procedures required by law, unsupported by substantial evidence (if there is a formal record), or unwarranted by the facts (if subject to trial de novo). *Id.* §§ 706(2)(B)–(F).

41. *E.g.*, *Matassarini v. Lynch*, 174 F.3d 549, 563 (5th Cir. 1999); *Salahuddin v. Comm’r*, No. 7050-11L, 2012 WL 1758628, at \*6 (T.C. May 17, 2012).

42. *E.g.*, *Citizens To Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 413–14 (1971); *see* RICHARD J. PIERCE, JR., 2 ADMINISTRATIVE LAW TREATISE § 11.4, at 1022 (5th ed. 2010); Seidenfeld, *supra* note 26, at 144 n.15.

43. *See* Note, *Rationalizing Hard Look Review After the Fact*, 122 HARV. L. REV. 1909, 1910 (2009).

shown below, explanation requirements and other aspects of arbitrary-and-capricious review predated enactment of the APA, and the stringency of their application by courts has varied over time. Nonetheless, to the extent that the APA's reasoned-explanation requirement applies to IRS adjudication, it applies by virtue of § 706.

*B. Judicial Evolution of the Requirement*

1. *Pre-APA Cases.* The roots of the reasoned-explanation requirement extend back generations before 1946. The earliest cases involved agency adjudication, not rulemaking. In these cases, courts instructed agencies to state the reasons and factual findings on which their orders were based.<sup>44</sup> This approach was not followed consistently, however.<sup>45</sup>

The key case of the early period is the Supreme Court's 1943 *Chenery* decision.<sup>46</sup> The Securities and Exchange Commission (SEC) issued an order prohibiting officers and directors of a public utility holding company from buying stock during reorganization.<sup>47</sup> The SEC based this order on its understanding of fiduciary law.<sup>48</sup> The Court intimated that the SEC had the authority to issue the order under a different theory, but that the SEC was wrong in its view of fiduciary law.<sup>49</sup> It invalidated the order and remanded, holding that "an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained."<sup>50</sup> On remand, the SEC issued the same order, but based it on the alternative ground suggested by the Court in *Chenery I*.<sup>51</sup> The Court in *Securities & Exchange Commission v. Chenery Corp. (Chenery II)*<sup>52</sup> upheld the new order.<sup>53</sup> *Chenery I* is

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44. *E.g.*, *Wichita R.R. & Light Co. v. Pub. Utils. Comm'n*, 260 U.S. 48, 58–59 (1922); *Am. Express Co. v. Caldwell*, 244 U.S. 617, 625–26 (1917).

45. *See, e.g.*, *Beaumont, Sour Lake & W. Ry. Co. v. United States*, 282 U.S. 74, 86–87 (1930) (upholding an order despite the agency's failure to state the facts and reasoning behind it).

46. *SEC v. Chenery Corp. (Chenery I)*, 318 U.S. 80 (1943).

47. *Id.* at 81.

48. *Id.* at 85.

49. *Id.* at 85–88.

50. *Id.* at 95. For further discussion of *Chenery I*, see generally Kevin M. Stack, *The Constitutional Foundations of Chenery*, 116 *YALE L. J.* 952 (2007).

51. *See SEC v. Chenery Corp. (Chenery II)*, 332 U.S. 194, 207 (1947).

52. *SEC v. Chenery Corp. (Chenery II)*, 332 U.S. 194 (1947).

53. *Id.* at 209.

understood to mean that the propriety of an agency's action must be evaluated on the basis of the reason(s) the agency articulated at the time, not on the basis of reasons developed later, even if they could have sufficed had they been advanced earlier.<sup>54</sup>

The *Chenery* cases are often thought to sound in the separation of powers. The Supreme Court explained that a court "is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis. To do so would propel the court into the domain which Congress has set aside exclusively for the administrative agency."<sup>55</sup>

Instrumental concerns are also at play. A position advanced by an agency's lawyer on brief or in argument may not reflect the agency's special expertise. Nonetheless, the mere fact that the persuasive rationale appears for the first time in a legal brief does not categorically "make it unworthy of deference" if, under the circumstances at hand, it appears that the interpretation still reflects "the agency's fair and considered judgment on the matter in question."<sup>56</sup> Similarly, post hoc rationales may be unobjectionable in situations in which "no special agency expertise is involved."<sup>57</sup>

The *Chenery I* principle has been called "well established,"<sup>58</sup> "elementary,"<sup>59</sup> and "black-letter law."<sup>60</sup> Nonetheless, as seen above, there are exceptions. Sometimes the principle is just ignored.<sup>61</sup> Other

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54. *E.g.*, *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962).

55. *Chenery II*, 332 U.S. at 196; *see also* *Atlixco Coal. v. Maggiore*, 965 P.2d 370, 377 (N.M. Ct. App. 1998) (reasoning that "is not consistent with the doctrine of separation of powers" for reviewing courts to supply reasons for administrative actions when the legislature directs an agency to do so).

56. *Auer v. Robbins*, 519 U.S. 452, 462 (1997). For further discussion of *Auer*, see generally Steve R. Johnson, *Auer/Seminole Rock Deference in the Tax Court*, 11 PITT. TAX REV. 1 (2013).

57. *Ashland Oil, Inc. v. FTC*, 548 F.2d 977, 981 & n.6 (D.C. Cir. 1976); *see* *Am. Farm Bureau Fed'n v. EPA*, 559 F.3d 512, 522 (D.C. Cir. 2009).

58. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 50 (1983).

59. *Harberson v. NLRB*, 810 F.2d 977, 984 (10th Cir. 1987).

60. *Hasan v. U.S. Dep't of Labor*, 545 F.3d 248, 251 (3d Cir. 2008).

61. For example, in one case the EPA changed its justification for a decision while the litigation was in progress. The Ninth Circuit held the EPA's reliance on its new interpretation to be arbitrary and capricious. By five to four, however, the Supreme Court upheld the agency's actions. *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 649 (2007). *But see id.* at 684 (Stevens, J., dissenting) (accusing the majority of ignoring *Chenery I*'s "hoary principle of administrative law and substitut[ing] a post-hoc interpretation . . . for that of the relevant agency").

times, the new position is accorded lesser deference rather than being entirely excluded from consideration.<sup>62</sup>

2. *Post-APA Cases.* Arbitrariness review was highly deferential for several decades after the enactment of the APA.<sup>63</sup> This changed as New Deal enthusiasm gave way to post-World War II disenchantment with the performance of agencies and as fears grew of agencies being captured by the industries they were supposed to regulate.<sup>64</sup> As a result, courts developed a hard-look approach to arbitrary-and-capricious review. The Supreme Court's 1971 decision in *Citizens To Preserve Overton Park v. Volpe*<sup>65</sup> was significant in this movement.

At issue in *Overton Park* was legislation providing that the U.S. Department of Transportation could expend federal funds on roads through public parks only if no "feasible and prudent alternative" existed and only after "all possible planning to minimize harm" to the park.<sup>66</sup> The Department approved such use of federal funds without factual findings as to these predicates.<sup>67</sup>

The lower courts upheld the Department's decision on the basis of litigation affidavits presented by the Department.<sup>68</sup> The Supreme Court reversed and remanded for the development of a more thorough record.<sup>69</sup> Invoking *Chenery I*, the Court found the affidavits to be "merely '*post hoc*' rationalizations"<sup>70</sup> insufficient to allow the courts to fulfill their duty to ascertain whether the Department had been faithful to the statutes and whether its decision passed arbitrary-and-capricious muster. In a remarkable display of double-talk, the Court instructed that the scope of review is "narrow," yet the review

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62. *E.g.*, *Sec. Indus. Ass'n v. Bd. of Governors*, 468 U.S. 137, 144 (1984); see Richard Murphy, *Chenery Unmasked: Reasonable Limits on the Duty To Give Reasons*, 80 U. CIN. L. REV. 817, 821-22 (2012) (noting how "[c]ourts, confronted by *Chenery's* overreach, find ways around it").

63. Martin Shapiro, *APA: Past, Present, Future*, 72 VA. L. REV. 447, 454 (1986); Cass R. Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 422 (1987).

64. See, e.g., Thomas W. Merrill, *Capture Theory and the Courts: 1967-1983*, 72 CHI.-KENT L. REV. 1039, 1056 (1997); Mark Seidenfeld, *A Civic Republican Justification for the Bureaucratic State*, 105 HARV. L. REV. 1511, 1555 (1992).

65. *Citizens To Preserve Overton Park v. Volpe*, 401 U.S. 402 (1971).

66. See *id.* at 405 (quoting Department of Transportation Act of 1966, 49 U.S.C. § 1653(f) (Supp. V 1964); Federal-Aid Highway Act of 1968, 23 U.S.C. § 138 (Supp. V 1964)).

67. *Id.* at 408.

68. *Id.* at 409.

69. *Id.* at 420.

70. *Id.* at 419.

is to be “searching and careful,”<sup>71</sup> and that the agency “is entitled to a presumption of regularity,” but the presumption does not shield the agency’s decision “from a thorough, probing, in-depth review.”<sup>72</sup>

The next milestone was the Supreme Court’s 1983 decision in *Motor Vehicles Manufacturers Ass’n v. State Farm Mutual Automobile Insurance Co.*<sup>73</sup> After President Ronald Reagan succeeded President Jimmy Carter, the National Highway Traffic Safety Administration revoked regulations that would have required manufacturers to install either automatic seatbelts or airbags in their cars.<sup>74</sup> The Court unanimously found that the agency had failed to consider plausible alternatives, had improperly weighed costs and benefits, and had “failed to present an adequate basis and explanation for rescinding the passive restraint requirement,” rendering the decision arbitrary and capricious.<sup>75</sup> In so doing, the Court delivered the most frequently quoted summary of the elements of arbitrary-and-capricious review. Specifically,

An agency[’s] [action] would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.<sup>76</sup>

To this partial enumeration may be added two matters that make the explanation reasoned. The first involves the detail and specification (or lack thereof) of the agency’s prelitigation explanation. The Court in *State Farm* noted that an agency must “articulate a satisfactory explanation for its action . . . . [It] must cogently explain why it has exercised its discretion in a given

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71. *Id.* at 416.

72. *Id.* at 415.

73. *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983).

74. *Id.* at 36–37.

75. *Id.* at 34.

76. *Id.* at 43. It is unclear whether *State Farm* has meaningfully altered the rate at which courts invalidate agency decisions. The most recent scholarship suggests that the reversal rate under *State Farm* is about the same as reversal rates under most other major standards of review used in administrative law. Richard J. Pierce, Jr. & Joshua Weiss, *An Empirical Study of Judicial Review of Agency Interpretations of Agency Rules*, 63 ADMIN. L. REV. 515, 515 (2011). See generally David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135 (2010).

manner.”<sup>77</sup> As hard-look review evolved, “the courts demanded increasingly detailed explanations of the agency’s rationale; they required specification of the agency’s policy premises, its reasoning, and its factual support.”<sup>78</sup> The second involves considering and responding to comments and possible weaknesses in the agency’s analysis. Hard-look review is meant “to ensure that agencies disclose relevant data and provide reasoned responses to material objections raised during the rulemaking process.”<sup>79</sup>

In the Supreme Court’s 2009 decision in *FCC v. Fox Television Stations, Inc.*,<sup>80</sup> the Federal Communications Commission (FCC) held that a change in agency position imposed no heightened duty of explanation. Prior to 2009, the FCC made its indecency policy stricter to reflect its reinterpretation of the constraints of First Amendment case law upon its enforcement power.<sup>81</sup> It then issued notices of apparent liability against a television station for indecent broadcasts.<sup>82</sup>

A sharply divided Supreme Court rejected an arbitrary-and-capricious challenge to the new policy.<sup>83</sup> The *Fox* majority first rehearsed general principles. It noted that the arbitrary-and-capricious standard was “narrow,” that a court should not substitute its policy judgment for that of the agency, and that an agency explanation “of less than ideal clarity” should nonetheless be upheld “if the agency’s path may reasonably be discerned.”<sup>84</sup> The majority then held that there was “no basis” in either the APA or *State Farm* “for a requirement that all agency change be subjected to more searching review.”<sup>85</sup> Further, the majority held:

[T]he requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it is changing position. . . . And of course the agency must show that there are good reasons for the new policy. But it need not [always] demonstrate . . . that the reasons for the new policy are *better* than

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77. *State Farm*, 463 U.S. at 43, 48–49.

78. Merrick B. Garland, *Deregulation and Judicial Review*, 98 HARV. L. REV. 505, 526 (1985).

79. Catherine M. Sharkey, *Federalism Accountability: “Agency-Forcing” Measures*, 58 DUKE L.J. 2125, 2181 (2009); see Seidenfeld, *supra* note 26, at 155.

80. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502 (2009).

81. *Id.* at 507–08.

82. *Id.* at 510.

83. *Id.* at 530.

84. *Id.* at 513–14.

85. *Id.* at 514.



the reasons for the old one . . . . Sometimes it must—when, for example, its new policy rests upon factual findings that contradict those which underlay its prior policy; or when its prior policy has engendered serious reliance interests that must be taken into account.<sup>86</sup>

In short, the leading cases teach us that there is a reasoned-explanation requirement. That requirement applies to all agencies and to all final agency actions (adjudication as well as rulemaking). However, there is no formula for how much explanation is enough. The sufficiency of the explanation depends on the circumstances.

### C. *Remedying Violations of the Reasoned-Explanation Requirement*

When an agency fails to satisfy the reasoned-explanation requirement, the usual consequence is remand to the agency.<sup>87</sup> What happens then depends upon the nature and complexity of the matter. Professors Sidney Shapiro and Richard Levy have outlined three possible scenarios:

First, there may be an easily remedied flaw in the agency's logic or gap in its reasoning process. In such a case, the agency on remand need not engage in any additional procedures to correct this flaw. Second, an agency may be required to provide additional factual support for its decision, which might lead to additional proceedings pursuant to the APA. Finally, in rare cases the agency may be unable to elicit adequate support for its reasoning without engaging in some form of hybrid procedures.<sup>88</sup>

When regulations are concerned, remand usually delays, rather than prevents, the action the agency wants to take. One study found that agencies “successfully implemented their policies in approximately 80% of the instances in which courts have originally remanded rules as arbitrary and capricious,” and that the average

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86. *Id.* at 515 (citing *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 742 (1996)). Justice Kennedy concluded that the reasons given by the FCC “[were] not so precise, detailed, or elaborated as to be a model for agency explanation” but sufficed. *Id.* at 538 (Kennedy, J., concurring in part and concurring in the judgment). Four dissenting Justices would have imposed a higher burden of explanation when agencies change positions and would have invalidated the new policy because the FCC failed “at least minimally” to consider two allegedly important issues. *Id.* at 546, 553 (Breyer, J., dissenting).

87. *E.g.*, *Air Transp. Ass'n of Can. v. FAA*, 254 F.3d 271, 279 (D.C. Cir. 2001), *vacated*, 276 F.3d 599 (D.C. Cir. 2001); *AT&T Corp. v. FCC*, 236 F.3d 729, 737 (D.C. Cir. 2001).

88. Shapiro & Levy, *supra* note 10, at 435 (footnotes omitted).

delay between remand and recovery was about two years.<sup>89</sup> The extent to which remand can and should be used in the context of tax regulations has not been tested in the courts and is in dispute among commentators.<sup>90</sup>

The effects outside of the rulemaking context have not been studied systematically. *Chenery I* did not significantly impair the SEC's ability to impose its orders.<sup>91</sup> However, *Overton Park*—which invoked the now disfavored<sup>92</sup> approach of remand to the trial court, not the agency<sup>93</sup>—caused the Department of Transportation to abandon its decision to fund the project.<sup>94</sup>

#### D. Justifications for the Requirement

“The practice of providing reasons for decisions has long been considered an essential aspect of legal culture.”<sup>95</sup> Numerous justifications have been adduced for the reasoned-explanation requirement and for the larger arbitrary-and-capricious review of which it is a part. The justifications fall into three main categories: constitutional considerations, political-process considerations, and decisional-quality considerations. Some of the justifications apply with different force in the rulemaking versus the adjudication context. Nonetheless, all are worth noting for their contribution to the development of the doctrine.

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89. William S. Jordan, III, *Ossification Revisited: Does Arbitrary and Capricious Review Significantly Interfere with Agency Ability To Achieve Regulatory Goals Through Informal Rulemaking?*, 94 NW. U. L. REV. 393, 440 (2000).

90. *Compare* Dominion Resources, Inc. v. United States, 681 F.3d 1313 (Fed. Cir. 2012), 126 HARV. L. REV. 1747, 1753–54 (2013) (suggesting that remand without vacatur can be used to avoid disruption when tax regulations are invalidated on APA grounds), *with* Patrick J. Smith, *May Regulations that Violate the APA Be Remanded to the IRS?*, 141 TAX NOTES 84, 85 (2013) (arguing that remand without vacatur is unavailable as to tax regulations because of the Anti-Injunction Act, I.R.C. § 7421).

91. *See supra* notes 46–55 and accompanying text.

92. *See, e.g.*, *Camp v. Pitts*, 411 U.S. 138, 139–40 (1973) (per curiam).

93. *See* *Citizens To Preserve Overton Park v. Volpe*, 401 U.S. 402, 420 (1971) (remanding the case to the district court for “plenary review of the Secretary’s decision,” including, if necessary, taking the testimony of the administrative officials who participated in the decision).

94. *See* Nathaniel L. Nathanson, *Probing the Mind of the Administrator: Hearing Variations and Standards of Judicial Review Under the Administrative Procedure Act and Other Federal Statutes*, 75 COLUM. L. REV. 721, 723 n.18 (1975).

95. Frederick Schauer, *Giving Reasons*, 47 STAN. L. REV. 633, 633 (1995). And not just American legal culture. For a discussion of cognate principles in Europe, see generally Jerry L. Mashaw, *Reasoned Administration: The European Union, the United States, and the Project of Democratic Governance*, 76 GEO. WASH. L. REV. 99 (2007); and Martin Shapiro, *The Giving Reasons Requirement*, 1992 U. CHI. LEGAL F. 179 (1992).

1. *Constitutional Considerations.* Many commentators and judges root the reasoned-explanation requirement in the separation-of-powers principle.<sup>96</sup> Some view the requirement as a necessary condition for judicial review, allowing the courts to fulfill their Article III duties.<sup>97</sup> The requirement might also be thought of as a way to prevent courts from exceeding their constitutional role. Giving reasons helps to separate value judgments (which administrators can legitimately make but judges cannot) from objective analysis (which judges can legitimately review).<sup>98</sup> And, of course, requiring reasons also helps keep agencies from exceeding their constitutional roles, as “arbitrariness review can be seen as a substitute for the failed nondelegation doctrine, the former limiting agencies’ discretion in light of the latter’s inability to do the same.”<sup>99</sup>

2. *Political-Process Considerations.* By compelling agencies to give reasons and respond to objections, the reasoned-explanation requirement makes them disclose the relevant data, the values and assumptions in play, and the trade-offs entailed in the choice.<sup>100</sup> This is thought to protect citizen participation in government,<sup>101</sup> foster informed political dialogue,<sup>102</sup> facilitate political accountability,<sup>103</sup> express the respect that government owes to its citizens,<sup>104</sup> and put “less connected interest groups on the same footing . . . as more focused groups like the regulated industry.”<sup>105</sup> In addition, judicial

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96. *E.g.*, Shapiro & Levy, *supra* note 10, at 388; Stack, *supra* note 50, at 956–58.

97. *See supra* note 55 and accompanying text.

98. *E.g.*, Verizon Commc’ns Inc. v. FCC, 535 U.S. 467, 541–42 (2002) (Breyer, J., concurring in part and dissenting in part); Orum v. Comm’r, 412 F.3d 819, 821 (7th Cir. 2005); *see* Seidenfeld, *supra* note 26, at 148.

99. Note, *supra* note 43, at 1912. *See generally* Mark Seidenfeld & Jim Rossi, *The False Promise of the New Nondelegation Doctrine*, 76 NOTRE DAME L. REV. 1 (2000).

100. *See, e.g.*, Sharkey, *supra* note 79, at 2181.

101. Jim Rossi, *Redeeming Judicial Review: The Hard Look Doctrine and Federal Regulatory Efforts To Restructure the Electric Utility Industry*, 1994 WIS. L. REV. 763, 768.

102. Colin Diver, *Policymaking Paradigms in Administrative Law*, 95 HARV. L. REV. 393, 414 (1981).

103. Seidenfeld, *supra* note 26, at 148. *See generally* Glen Staszewski, *Reason-Giving and Accountability*, 93 MINN. L. REV. 1253 (2009).

104. *Cf.* Bernard W. Bell, *Legislative History Without Legislative Intent: The Public Justification Approach to Statutory Interpretation*, 60 OHIO ST. L. J. 1, 9 (1999) (offering this justification in support of a contention that legislatures have an obligation to explain the laws they enact).

105. Seidenfeld, *supra* note 26, at 157.

review provides “a crucial legitimating function in the modern administrative process.”<sup>106</sup>

3. *Decisional-Quality Considerations.* In theory, a reasoned explanation might improve the quality of agency decisionmaking. The doctrine might cause agencies to rethink close calls.<sup>107</sup> And, it may serve a useful signaling function, identifying the need for additional scrutiny of agency positions that either received inadequate deliberation,<sup>108</sup> or reflected political payoffs or agency capture rather than good public policy.<sup>109</sup> Are such theories borne out in fact? Commentators disagree.<sup>110</sup>

#### E. *Objections to the Requirement*

Two principal objections have been lodged against explanation requirements, and against arbitrary-and-capricious review more generally. Specifically, they are thought to contribute to outcome-driven judicial decisionmaking and regulatory ossification. These concerns are described below.

1. *Outcome-Driven Decisionmaking.* As noted above, one claimed advantage of hard-look review is that it allows courts to ensure that agencies did their job seriously but leaves policy decisions to the agencies. That is nice in theory and, no doubt, is realized in some instances. But a darker potential also exists.

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106. Thomas O. Sargentich, *The Critique of Active Judicial Review of Administrative Agencies: A Reevaluation*, 49 ADMIN. L. REV. 599, 642 (1997); see also LOUIS L. JAFFE, JUDICIAL CONTROL OF ADMINISTRATIVE ACTION 320 (1965) (“The availability of judicial review is the necessary condition, psychologically if not logically, of a system of administrative power which purports to be legitimate, or legally valid.”).

107. E.g., Friendly, *supra* note 27, at 207–08.

108. Matthew C. Stephenson, *A Costly Signaling Theory of “Hard Look” Judicial Review*, 58 ADMIN. L. REV. 753, 755 (2006).

109. E.g., Mark Seidenfeld, *Demystifying Deossification: Rethinking Recent Proposals To Modify Judicial Review of Notice and Comment Rulemaking*, 75 TEX. L. REV. 483, 510 (1997); Seidenfeld, *supra* note 26, at 154, 178.

110. Compare Joseph L. Sax, *The (Unhappy) Truth About NEPA*, 26 OKLA. L. REV. 239, 239 (1973) (“I know of no solid evidence to support the belief that requiring articulation, detailed findings or reasoned opinions enhances the integrity or propriety of the administrative decisions.”), with Friendly, *supra* note 27, at 207–08 (concluding that remands for better explanation have significantly improved agency decisionmaking), and Mark Seidenfeld, *Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking*, 87 CORNELL L. REV. 486, 543–48 (2002) (noting that “assessing the impact of judicial review on these processes requires some speculation,” but providing reasons to think that it improves agency decisionmaking).

A judge would be rightly taken to task for writing an opinion that forthrightly says “I am reversing because, by my constellation of values, the agency’s chosen outcome was unwise, unjust, and just plain dumb.” It is far safer for the judge to accomplish a substantive outcome through procedural means. For example, an opinion that disingenuously says “I say nothing about the substance of the agency’s end result; it is just that the agency used the wrong process in reaching that result,” is far more likely to be palatable.

Justice Black gave voice to this concern in his *Chenery I* dissent,<sup>111</sup> as have scholars.<sup>112</sup> One may be forgiven for suspecting that such policymaking by indirection was at work in *Overton Park*, and quite probably in other cases as well.<sup>113</sup> Scholars have studied the correlation of judges’ political affiliation and ideological orientation with their pro- or anti-agency holdings.<sup>114</sup> In the context of review of IRS adjudications, such factors presumably would operate rarely. But another kind of subterfuge effect—sympathy for individual taxpayers—might rear its head.

2. *Ossification.* Ossification is a much-masticated morsel in administrative law. The notion is that, when courts make agencies jump through procedural hoops, the extent and quality of agencies’ regulatory efforts may suffer.<sup>115</sup> Yet ossification is not always bad. Inhibiting unwise agency actions would be no loss. Ossification can be seen as “the price society pays for reducing agencies’ error[]” costs.<sup>116</sup>

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111. *SEC v. Chenery Corp. (Chenery I)*, 318 U.S. 80, 99 (1943) (Black, J., dissenting) (“Hypercritical exactions as to findings can provide a handy but an almost invisible glideway enabling courts to pass ‘from the narrow confines of law into the more spacious domain of policy.’” (quoting *Phelps Dodge Corp. v. NLRB*, 313 U.S. 177, 194 (1941))).

112. *E.g.*, Richard J. Pierce, Jr., *The Role of Constitutional and Political Theory in Administrative Law*, 64 *TEX. L. REV.* 469, 504–07 (1985).

113. *See generally* Peter L. Strauss, *Revisiting Overton Park: Political and Judicial Controls over Administrative Actions Affecting the Community*, 39 *UCLA L. REV.* 1251 (1992).

114. *See, e.g.*, Richard J. Pierce, Jr., *Is Standing Law or Politics?*, 77 *N.C. L. REV.* 1741, 1746 (1999); Sidney A. Shapiro & Richard W. Murphy, *Eight Things Americans Can’t Figure Out About Controlling Administrative Power*, 61 *ADMIN. L. REV.* 5, 24–26 & n.80 (2009).

115. *E.g.*, Richard J. Pierce, Jr., *Seven Ways To Deossify Agency Rulemaking*, 47 *ADMIN. L. REV.* 59, 62–66 (1995); Richard J. Pierce, Jr., *Two Problems in Administrative Law: Political Polarity on the District of Columbia Circuit and Judicial Deterrence of Agency Rulemaking*, 1988 *DUKE L.J.* 300, 310. *But see* Jordan, *supra* note 89, at 403–07 (questioning the ossification theory).

116. Note, *supra* note 43, at 1910; *see also* Seidenfeld, *supra* note 26, at 189 (“At the administrative level, hard-look review plays somewhat the same role that bicameralism and presentment are meant to play at the legislative level.”).

Ossification is discussed far more often in the context of rulemaking than in the context of adjudication.<sup>117</sup> However, somewhat comparable costs could arise as to IRS adjudication. This possibility is explored in Part IV.A below.<sup>118</sup>

#### F. *Limits of the Requirement*

Reflecting the attempt to balance the benefits and costs described above, courts have developed a number of limitations on the required extent of explanation. Unsurprisingly, courts differ as to how they draw the contours of these limitations. The following are among the principal limitations. First, courts “will uphold a decision of less than ideal clarity if the agency’s path may reasonably be discerned.”<sup>119</sup> Accordingly, despite *Chenery I*, courts may accept post hoc explanations that “merely illuminate reasons obscured but implicit in the administrative record.”<sup>120</sup> Similarly, explanation is unnecessary when the reason for the agency’s action is obvious.<sup>121</sup> It is, after all, a hoary maxim that the law does not command performance of meaningless acts.<sup>122</sup>

Second, the agency’s consideration of alternatives is not deficient “simply because the agency failed to include every alternative device and thought conceivable by the mind of man.”<sup>123</sup> Generally, the

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117. In tax, for example, fears have been expressed that greater attention to the APA’s rulemaking requirements would inhibit the ability of Treasury to issue guidance needed by taxpayers. I doubt it. *See generally* Steve R. Johnson, *Following the APA Will Not Eliminate Useful Guidance*, 130 TAX NOTES 128 (2011).

118. *See infra* Part IV.A.

119. *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 286 (1974); *Casino Airlines, Inc. v. NTSB*, 439 F.3d 715, 717 (D.C. Cir. 2006) (quoting *Bowman*, 419 U.S. at 286); *see also* *Camp v. Pitts*, 411 U.S. 138, 143 (1973) (per curiam) (“The [agency’s] explanation may have been curt, but it surely indicated the determinative reason for the final action taken . . .”).

120. *Consumer Fed’n of Am. v. U.S. Dep’t of Health & Human Servs.*, 83 F.3d 1497, 1507 (D.C. Cir. 1996) (quoting *Clifford v. Pena*, 77 F.3d 1414, 1418 (D.C. Cir. 1996)).

121. *See, e.g.*, Michael Asimov, *The Scope of Judicial Review of Decisions of California Administrative Agencies*, 42 UCLA L. REV. 1157, 1238 (1995); *cf.* *Sheppard v. Sullivan*, 906 F.2d 756, 762 (D.C. Cir. 1990) (finding harmless an agency’s failure to undertake formal notice and comment because the agency’s substantive approach was “the only reasonable one”).

122. *E.g.*, *Lessinger v. Comm’r*, 872 F.2d 519, 522 (2d Cir. 1989).

123. *Vermont Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 551 (1978); *see, e.g.*, *Laguna Greenbelt, Inc. v. Dept. of Transp.*, 42 F.3d 517, 524–25 (9th Cir. 1994); *Ctr. for Auto Safety v. Peck*, 751 F.2d 1336, 1361 (D.C. Cir. 1985).

agency needs to respond only to comments it has received, and even then only to relevant, significant, and viable comments.<sup>124</sup>

Third, explanation and support may not be demanded beyond the bounds of reason and feasibility. For example, “[t]here are some propositions for which scant empirical evidence can be marshaled . . . . It is one thing to set aside agency action under the [APA] because of failure to adduce empirical data that can readily be obtained. . . . It is something else to insist upon obtaining the unobtainable.”<sup>125</sup>

Fourth, a technical breach will be excused if the complaining party suffered no detriment. In such cases, the harmless-error rule applies.<sup>126</sup> For example, “[w]hen it is clear that based on the valid findings the agency would have reached the same ultimate result, [a court will] not improperly invade the administrative province by affirming.”<sup>127</sup>

## II. IRS ADJUDICATION

When one thinks of administrative adjudication, images of hearings before administrative-law judges (ALJ) or agency commissioners may come to mind. Such proceedings do not typify federal tax practice,<sup>128</sup> but there are other kinds of agency adjudication.

Tax professionals are not accustomed to thinking of the IRS as an adjudicatory body, but the IRS does engage in what constitutes adjudication in an administrative-law sense. The APA defines “adjudication” as an “agency process for the formulation of an

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124. *E.g.*, *Interstate Natural Gas Ass’n of Am. v. FERC*, 494 F.3d 1092, 1096 (D.C. Cir. 2007); *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1169 (D.C. Cir. 1987); *Career Coll. Ass’n v. Duncan*, 796 F. Supp. 2d 108, 123 (D.D.C. 2011).

125. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 519 (2009).

126. *E.g.*, *Nat’l Ass’n of Homebuilders v. Defenders of Wildlife*, 551 U.S. 644, 659 (2007); *PKD Labs., Inc. v. DEA*, 362 F.3d 786, 799 (D.C. Cir. 2004); *Greater Bos. Television Corp. v. FCC*, 444 F.2d 841, 851 (D.C. Cir. 1970).

127. *Salt River Project Ag. Improvement & Power Dist. v. United States*, 762 F.2d 1053, 1060–61 n.8 (D.C. Cir. 1985); *see also* *Consol. Coal Co. v. Smith*, 837 F.2d 321, 323 (8th Cir. 1988); *cf.* *Bank of Am., N.A. v. FDIC*, 244 F.3d 1309, 1319 (11th Cir. 2001) (holding that *Chenery I*’s prohibition on post hoc rationales does not apply to agency arguments offered under step one of *Chevron* analysis).

128. There are rare exceptions to this statement. *See* 31 C.F.R. §§ 10.1–10.9, 10.20–10.38 (2013) (setting out hearing procedures for tax professionals subject to discipline for violation of rules of ethical practice before the IRS).

order,”<sup>129</sup> and it defines “order” as “the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing.”<sup>130</sup>

As a general matter, two conditions must be satisfied for agency action to be “final”: First, the action must mark the “consummation” of the agency’s decisionmaking process—it must not be of merely tentative or interlocutory nature. And second, the action must be one by which “rights or obligations have been determined,” or from which “legal consequences will flow.”<sup>131</sup>

Under these definitions, many determinations made by the IRS can rightly be called adjudications. For reasons of manageability and principle, this Article focuses on four paradigm determinations—deficiency, jeopardy and termination, trust fund recovery penalty, and CDP determinations—then briefly adverts to other types of IRS determinations. This Part develops these four paradigms of IRS adjudication. The next Part addresses whether—as a matter of current law and practice—the IRS explains its adjudicatory decisions in the context of these paradigms.

#### A. *Deficiency Determinations*

At one time, there was no prepayment remedy available to taxpayers contesting federal tax liabilities. Taxpayers had to pay the determined liabilities, then bring suit for refund of taxes illegally assessed and collected. After enactment of the modern federal income tax in 1913,<sup>132</sup> however, pressure to create a prepayment forum became irresistible. The forum evolved from a unit within the then-styled Internal Revenue Bureau itself, to an independent administrative agency known as the Board of Tax Appeals, to the Tax

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129. 5 U.S.C. § 551(7) (2012).

130. *Id.* § 551(6). Professor Alan Morrison, by reading a number of provisions in concert, concludes that “[u]nder the APA, any agency action that is not a rulemaking is an adjudication.” Alan B. Morrison, *Administrative Agencies Are Just Like Legislatures and Courts—Except When They’re Not*, 59 ADMIN. L. REV. 79, 98 (2007).

131. *Bennett v. Spear*, 520 U.S. 154, 177–78 (1997) (quoting *Chi. & S. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948); *Port of Bos. Marine Terminal Ass’n v. Rederiaktiebolaget Transatlantic*, 400 U.S. 62, 71 (1970)).

132. Underwood Tariff Act, ch. 16, 38 Stat. 114 (1913).



Court of the United States (still an administrative agency), and finally to the current United States Tax Court (an Article I court).<sup>133</sup>

The IRS lacks legal authority to assess and collect certain major taxes—income, estate, gift, and some excise taxes—until the taxpayer has had the opportunity to contest the liabilities in Tax Court.<sup>134</sup> In brief, the process is as follows: First, the taxpayer files a return. Second, the IRS selects the return for examination. Third, if the IRS agent believes that correct liability exceeds liability reported on the return (that is, that a deficiency exists), the agent issues to the taxpayer a preliminary document (the Revenue Agent's Report or thirty-day letter) setting out proposed adjustments. Fourth, if the taxpayer disagrees, she can obtain administrative review by filing a protest with the IRS Appeals Office. Fifth, if Appeals Office consideration is not requested or no resolution is reached at Appeals, the IRS issues a notice of deficiency (also called a ninety-day letter). Sixth, the taxpayer may contest the determinations in the notice of deficiency by filing a timely petition with the Tax Court. Seventh, if the taxpayer fails to file a timely petition or if the Tax Court holds against the taxpayer in whole or part, the IRS may then assess and collect the deficiency (and interest and penalties, if any).<sup>135</sup>

The notice of deficiency represents the IRS's final determination.<sup>136</sup> It is the taxpayer's "ticket to the Tax Court."<sup>137</sup> The taxpayer may not invoke the Tax Court's jurisdiction until the notice of deficiency has been issued.<sup>138</sup> The IRS Chief Counsel's Office must review and approve certain notices of deficiency, including those from cases involving substantial deficiencies, certain penalties, complex or unique legal issues, or otherwise sensitive matters.<sup>139</sup>

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133. The history is developed by HAROLD DUBROFF, *THE TAX COURT: AN HISTORICAL ANALYSIS* (1979), Steve R. Johnson, *Reforming Federal Tax Litigation: An Agenda*, 41 FLA. ST. U. L. REV. (forthcoming 2014), available at <http://ssrn.com/abstract=2243632>, and Leandra Lederman, *(Un)Appealing Deference to the Tax Court*, 63 DUKE L.J. 1835 (2014).

134. I.R.C. § 6212(a) (2012). Statutory exceptions exist. For example, the IRS can immediately assess amounts reported on the taxpayer's return and underpayments attributable to math errors on the return. *Id.* §§ 6201(a), (b)(1).

135. *See id.* §§ 6211–6215. For greater detail, see generally DAVID M. RICHARDSON, JEROME BORISON & STEVE JOHNSON, *CIVIL TAX PROCEDURE* 93–133, 207–33 (2d ed. 2008).

136. I.R.C. § 6212(a). The taxpayer may seek reconsideration of the determinations in the notice, and the IRS has authority to compromise its determinations and even to rescind the notice. I.R.C. §§ 6212(d), 7122(a). However, agency action is final even when reconsideration is possible. 5 U.S.C. § 704; *Darby v. Cisneros*, 509 U.S. 137, 145 (1993).

137. *Comm'r v. Shapiro*, 424 U.S. 614, 630 n.12 (1976).

138. I.R.C. § 6213(a).

139. IRM 4.8.9.2.1 (July 9, 2013).

Income-tax liabilities arising from the operation of some partnerships are handled under a special regime.<sup>140</sup> That regime establishes cognate rules to the deficiency procedures, requiring issuance of a Final Partnership Administrative Adjustment (FPAA) resembling a notice of deficiency.<sup>141</sup> The determinations in an FPAA may be challenged in court on a preassessment basis roughly comparable to Tax Court consideration of a notice of deficiency.<sup>142</sup>

Cognate procedures also exist as to transferee and fiduciary liabilities, which are secondary collection mechanisms available as to income, estate, gift, and some excise taxes.<sup>143</sup> Such liabilities are required to “be assessed, paid, and collected in the same manner and subject to the same provisions and limitations” as the taxes to which they relate.<sup>144</sup> Thus, when a notice of deficiency (followed by the opportunity for prepayment judicial consideration) would have been required before assessment of the underlying tax, a notice of transferee (or fiduciary) liability (followed by the opportunity for prepayment judicial consideration) is required before assessment of the secondary liability for the unpaid amount.

#### *B. Jeopardy and Termination Determinations*

The operation of the deficiency procedures takes years. Normally, lack of celerity is tolerable because the IRS eventually collects and interest accrues throughout the period.<sup>145</sup> But the delay tempts some taxpayers to hide, transfer, or dissipate their assets in anticipation of ultimately losing in Tax Court, rendering the IRS’s victory fiscally hollow. To protect the fisc when such contingencies materialize, the Internal Revenue Code (I.R.C.) allows the IRS to shortcut the normal deficiency procedures by making immediate termination and jeopardy assessments followed by immediate collection of determined liabilities.<sup>146</sup>

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140. I.R.C. §§ 6221–6255. *See generally* RICHARDSON ET AL., *supra* note 135, at 161–78.

141. I.R.C. § 6223(a)(2).

142. *Id.* § 6226.

143. *See* Steve R. Johnson, *Unfinished Business on the Taxpayer Rights Agenda: Achieving Fairness in Transferee Liability Cases*, 19 VA. TAX. REV. 403, 406–07 (2000).

144. I.R.C. § 6901(a).

145. *See id.* §§ 6601, 6621.

146. Termination assessments are of income taxes for not-yet-ended tax years. I.R.C. § 6851. Jeopardy assessments are of income, estate, gift, and certain excise taxes for tax periods already completed. *Id.* § 6861; *see* RICHARDSON ET AL., *supra* note 135, at 184.

Mindful of due process implications, and to prevent the IRS from overreaching in using these powerful devices,<sup>147</sup> Congress enacted I.R.C. § 7429.<sup>148</sup> It requires, in addition to other internal approvals, that the IRS Chief Counsel's Office approve the expedited assessment or levy.<sup>149</sup> Then, the IRS must, within five days, send the taxpayer "a written statement of the information upon which [it] relied in making [the] assessment or levy."<sup>150</sup>

Thereafter, the taxpayer may, within thirty days, seek review by the IRS Appeals Office, which is required to determine the reasonableness of the making and amount of the assessment or levy.<sup>151</sup> If the taxpayer is dissatisfied with that determination, she may bring an action, usually in federal district court, to dispute it.<sup>152</sup> Within twenty days, the district court must decide whether the making of the assessment or levy and the amount thereof were "reasonable under the circumstances."<sup>153</sup> This decision is "final and conclusive and shall not be reviewed by any other court."<sup>154</sup> This proceeding does not resolve the underlying merits. The idea is to freeze the situation to prevent erosion of collection protection but not to determine with finality the correct amount of liability. The IRS still must issue a notice of deficiency,<sup>155</sup> giving the taxpayer the opportunity for a review by the Tax Court to determine the merits.

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147. See, e.g., *Laing v. United States*, 423 U.S. 161, 185–88 (1976) (Brennan, J., concurring); *Breen v. United States*, No. C81-517a, 1981 WL 1936, at \*3 (N.D. Ga. Dec. 18, 1981).

148. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1204, 90 Stat. 1520, 1695 (codified as amended at I.R.C. § 7429).

149. I.R.C. § 7429(a)(1)(A).

150. *Id.* § 7429(a)(1)(B).

151. *Id.* §§ 7429(a)(2)–(3).

152. *Id.* §§ 7429(b)(1)–(2).

153. *Id.* §§ 7429(b)(3)–(4). This standard is fairly deferential to the IRS. It requires something more than "not arbitrary and capricious" but something less than "substantial evidence." *E.g.*, *Harvey v. United States*, 730 F. Supp. 1097, 1104 (S.D. Fla. 1990).

154. I.R.C. § 7429(f). Despite this language, some circuits have held that § 7429 decisions are appealable for limited purposes, such as whether the trial court exceeded its authority, improperly evaluated standing, or committed procedural errors. *E.g.*, *Morgan v. United States*, 958 F.2d 950, 951–52 (9th Cir. 1992).

155. See, e.g., I.R.C. § 6851(b) (termination assessments); *id.* § 6861(b) (jeopardy assessments).

### C. CDP Determinations

Legislation passed in 1998 made over sixty IRS “reforms.”<sup>156</sup> Some of these changes were harmful, many were purely cosmetic, and a few were beneficial.<sup>157</sup> The most significant of the 1998 changes was the introduction of CDP rules in I.R.C. §§ 6320 and 6330. The IRS has long possessed collection weapons more powerful than those available to private creditors.<sup>158</sup> The introduction of CDP rules reflected Congress’s concern that the IRS sometimes wielded these weapons too aggressively and with insufficient sensitivity to their effects on the delinquent taxpayers.<sup>159</sup>

With stated exceptions, the CDP rules kick in when the IRS files notice of its tax lien or before the IRS levies on property.<sup>160</sup> They require the IRS to notify the taxpayer of the action, explaining “in simple and nontechnical terms” the amount of unpaid tax, the taxpayer’s right to a hearing and administrative appeal, and the rules governing actions the IRS intends to take.<sup>161</sup>

Within thirty days, the taxpayer may request a hearing with the Appeals Office.<sup>162</sup> At the hearing, the Appeals Officer must obtain verification that the IRS has followed required procedures and must consider nonfrivolous arguments raised by the taxpayer, including

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156. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 5, 23, 26, and 38 U.S.C.). This episode in the “sausage factory” is chronicled in Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules*, 84 IOWA L. REV. 413, 446–57 (1999), and commented upon by Bryan T. Camp, *Theory and Practice in Tax Administration*, 29 VA. TAX REV. 227, 271 (2009).

157. For a description of the changes, see generally Robert Manning & David F. Windish, *The IRS Restructuring and Reform Act: An Explanation*, 80 TAX NOTES 83 (1998).

158. See, e.g., Steve R. Johnson, *The IRS as Super Creditor*, 92 TAX NOTES 655, 655–56 (2001).

159. S. REP. NO. 105-174, at 44, 67 (1998); see Leandra Lederman & Stephen W. Mazza, *Addressing Imperfections in the Tax System: Procedural or Substantive Reform?*, 103 MICH L. REV. 1423, 1441 (2005).

The CDP regime is controversial. Some urge its outright repeal; some suggest modifications; and some defend its necessity. See, e.g., 1 NAT’L TAXPAYER ADVOCATE, INTERNAL REVENUE SERV., 2004 ANNUAL REPORT TO CONGRESS 226–45, 451–70, 498–510 (2004), available at <http://www.irs.gov/pub/tas/ntafy2004annualreport.pdf>; Cords, *supra* note 21, at 444 & n.91; Steve R. Johnson, *The 1998 Act and the Resources Link Between Compliance and Tax Simplification*, 51 U. KAN. L. REV. 1031, 1061 (2003). See generally Book, *supra* note 7; Bryan T. Camp, *The Failure of Adversarial Process in the Administrative State*, 84 IND. L. J. 57 (2009).

160. I.R.C. §§ 6320(a), 6330(a).

161. *Id.* §§ 6320(a)(3), 6330(a)(3).

162. *Id.* §§ 6320(a)(3)(B), 6330(a).

spousal defenses, the appropriateness of collection actions, collection alternatives, and (when the taxpayer did not have previous opportunity to dispute them) the existence and amount of the underlying liability.<sup>163</sup> The Appeals Officer's decision is set out in a notice of determination.<sup>164</sup> Within thirty days thereafter, the taxpayer may appeal the decision to the Tax Court.<sup>165</sup>

In general, the IRS is precluded from taking forced collection action during administrative and judicial review.<sup>166</sup> As a consequence, the normal statute of limitations on IRS collection activity is suspended during this period.<sup>167</sup> A taxpayer who fails to timely invoke the CDP process may request an "equivalent hearing" at the Appeals Office, but collection is not suspended and judicial review is not available.<sup>168</sup>

#### *D. Trust Fund Recovery Penalty Determinations*

Employers deduct from their employees' paychecks withholding on federal income tax and the employees' share of Federal Insurance Contributions Act taxes. Employers are supposed to pay these amounts (called trust fund taxes) over to the IRS at specified intervals.<sup>169</sup> When employers experiencing financial difficulties fail to make these remittances, trying to collect from the employers would be futile. Thus, Congress gave the IRS a secondary collection mechanism: I.R.C. § 6672 allows the IRS to assert personal liability against "responsible persons," that is, the principal officers and owners of the employer who decided not to pay the trust fund taxes to the IRS.<sup>170</sup>

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163. *Id.* §§ 6320(c), 6330(c), (g).

164. For an example of a notice of determination, see *Davis v. Comm'r*, 115 T.C. 35, 38 (2000).

165. I.R.C. §§ 6320(c), 6330(d)(1).

166. *Id.* § 6330(a)(1). Exceptions are set out in § 6330(f). *See, e.g.*, *Burke v. Comm'r*, 124 T.C. 189, 196 (2005).

167. I.R.C. §§ 6320(e)(1), 6330(e)(1); *see id.* §§ 6502, 6503 (setting out the collection statute-of-limitation rules).

168. *See, e.g.*, *Herrick v. Comm'r*, 85 T.C.M. (CCH) 1467, 1469 (2003).

169. I.R.C. §§ 3121(a), 3402.

170. *See* RICHARDSON ET AL., *supra* note 135, at 384. This device is popularly known as the "trust fund recovery penalty," the "responsible person penalty," or the "100 percent penalty." Actually, it is a collection device, not a penalty. The IRS is not permitted to collect and retain amounts in excess of the unpaid trust fund taxes. *E.g.*, *Allan v. United States*, 386 F. Supp. 499, 501 (N.D. Tex. 1975), *aff'd*, 514 F.2d 1070 (5th Cir. 1975).

Before assessing § 6672 liabilities, the IRS is required to send the responsible person a sixty-day letter, specifying how much liability it has determined for each tax period.<sup>171</sup> This gives the responsible person the opportunity to file a protest, triggering Appeals Office consideration. If the protest is timely filed, the IRS may not assess the liabilities until after the Appeals Office renders its final determination.<sup>172</sup> If no protest is filed or the case is not resolved at Appeals, the IRS assesses the liability. Postpayment judicial review is available in district court or the Court of Federal Claims.<sup>173</sup>

#### *E. Other IRS Determinations*

The four paradigms just limned constitute agency adjudication as understood by administrative law. Each is required by statute. Each is consequential in the sense that its application is a prerequisite to the IRS's assessment or collection of taxes.<sup>174</sup> Each prescribes a particular type of written decision by the IRS. And each represents the IRS's final decision after review of the preliminary conclusions of the line agent handling the case.<sup>175</sup>

Other types of IRS determinations possess some of these attributes and arguably rise to the level of adjudication. For example, Professor Bryan Camp maintains that the IRS makes an adjudication decision every time it assesses liabilities reported on income-tax returns or refund overpayments claimed on such returns.<sup>176</sup> Moreover, I.R.C. § 6013(d)(3) provides generally that both spouses are responsible for liabilities as to their joint income-tax returns.<sup>177</sup> To mitigate potentially harsh consequences, § 6015 relieves spouses of

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171. I.R.C. §§ 6672(b)(1)–(2).

172. Except in jeopardy situations. The running of the statute of limitations on collection is suspended during the protest and administrative appeals process. *Id.* §§ 6672(b), (c).

173. *Id.* § 6672(c)(1). The Tax Court also can hear § 6672 issues if the CDP process is invoked.

174. In addition, such determinations sometimes have significant collateral consequences. For example, liabilities determined in a notice of deficiency, even though not confirmed through litigation, can be treated as binding in computing a convict's eligibility for parole. *Kramer v. Jenkins*, 803 F.2d 896, 901–02 (7th Cir. 1986), *reh'g granted*, 806 F.2d 140 (7th Cir. 1986).

175. *See* 5 U.S.C. §§ 551(6)–(7) (defining adjudication as the process for formulating the agency's "final disposition"); *see also* *Lunsford v. Comm'r*, 117 T.C. 159, 170 (2001) (Halpern, J., concurring) (stating that an IRS CDP determination "is, within the meaning of the APA, an 'adjudication'").

176. Bryan T. Camp, *'Loving' Return Preparer Regulation*, 140 TAX NOTES 457, 463–66 (2013).

177. I.R.C. § 6013(d)(3).

liability in particular circumstances.<sup>178</sup> This Article does not treat § 6015 cases as a separate paradigm because, although “stand-alone” cases are possible, spousal relief controversies usually play out in either the deficiency or CDP contexts. Nonetheless, there is a sizable body of instructive case law under § 6015, on which this Article will later draw.<sup>179</sup> Similarly, if the deficiency procedures do not apply in a particular situation, or they would apply but the taxpayer chooses not to invoke them, the taxpayer can still obtain postpayment review by fully paying the additional tax determined by the IRS, timely filing a refund claim with the IRS, and, after the IRS denies or ignores the refund claim, timely filing a refund suit in federal district court or the Court of Federal Claims.<sup>180</sup>

The IRS denies a refund claim by issuing to the taxpayer a notice of disallowance.<sup>181</sup> This Article does not include such determinations among its paradigms because they are less consequential than a deficiency notice. A deficiency notice is a legal prerequisite to Tax Court litigation and to assessment and collection. In a refund claim situation, however, the IRS has already made the assessment and has the money. Moreover, the disallowance notice is not a prerequisite to refund litigation. Even if the IRS issues no such notice, the taxpayer may sue after six months have elapsed from the filing of the refund claim.<sup>182</sup> Despite these differences, however, some might see a refund claim disallowance determination as an IRS adjudication.

Other IRS determinations arguably also may be adjudications.<sup>183</sup> It would exhaust both author and reader to plumb the depths of all possible examples. However, Part V below offers some preliminary thoughts as to how APA-style explanation arguments might be handled in these other contexts.

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178. *Id.* § 6015.

179. *See infra* Part III.A.3.

180. *See* I.R.C. §§ 6511, 6532, 7522; 28 U.S.C. § 1346(a)(1).

181. *See* IRM 34.5.2.2 (Dec. 21, 2012).

182. I.R.C. § 6532(a)(1).

183. For example, I.R.C. § 7428(a)(1) provides for judicial consideration of IRS “determination[s]” relating to the tax status of various organizations. Section 7436(a) authorizes judicial consideration of IRS “determination[s]” as to the employment status of workers. And § 6404(b) involves IRS decisions to not abate liability for interest.

### III. CURRENT LAW AND PRACTICE OF IRS EXPLANATIONS

This Part considers two matters. The first and longer issue looks at whether and to what extent current law requires the IRS to provide explanations of its adjudicatory decisions. Does the IRS now have duties of explanation? If so, how extensive are they and what legal rules authorize the imposition of these duties? The second matter involves current practice. Whether under the goad of legal compulsion or simply as a matter of administrative practice, does the IRS give explanations of its adjudicatory determinations? If so, how adequate are they?

#### A. *The Law Governing IRS Explanations*

Currently, there is not a single rule as to required explanations that cuts across and operates with uniformity in all areas of IRS adjudication. Instead, there are multiple sources of duties of explanation. Judges and commentators have anchored perceived duties of explanation variously in tax law, the APA, or administrative common law. Often they have just asserted the existence of a duty but have not moored it in any particular law. Moreover, the relevant case law is thin. Some significant questions have never been settled, while some seemingly settled principles have recently been questioned as being outmoded. This Part wades into these murky waters. It orients the discussion around the four paradigms of IRS adjudication developed in Part II.

1. *Deficiency Determinations.* As described in Section II.A above, in some instances the IRS may not assess tax liabilities until the deficiency procedures have run their course. Central to these procedures is the issuance of a notice of deficiency. According to Professor Leandra Lederman, a notice of deficiency “plays three conceptually distinct roles in tax litigation. First, it is . . . the jurisdictional ‘ticket to Tax Court.’ Second, it notifies the taxpayer of the IRS’s determination, comparable to legal process. Third, it also functions as a pleading in ensuing Tax Court litigation.”<sup>184</sup>

But deficiency notices traditionally have been conceptualized more narrowly. Many judges and scholars have emphasized the first of the above functions, seeing a notice of deficiency as “nothing more

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184. Leandra Lederman, “Civilizing Tax Procedure: Applying General Federal Learning to Statutory Notices of Deficiency,” 30 U.C. DAVIS L. REV. 183, 203 (1996) (footnotes omitted).



than ‘a jurisdictional prerequisite to a taxpayer’s suit seeking the Tax Court’s redetermination of [the IRS’s] determination of the tax liability.’”<sup>185</sup>

Perhaps reflecting that narrow view—as well as the fact that I.R.C. § 6212 prescribes no particular contents for a deficiency notice<sup>186</sup>—there is a long line of cases (starting in the 1930s) holding that a valid notice can have only minimal content and need not take a particular form.<sup>187</sup> Under this line of cases, a notice is valid as long as it specifies the deficiency and identifies the tax period to which it relates,<sup>188</sup> even if it contains no explanation of the basis on which the IRS determined the deficiency.<sup>189</sup>

Moreover, courts typically hold that they will not “go behind” the notice to examine the mindset of the IRS or the procedures it used in the particular case.<sup>190</sup> However, I.R.C. § 6212(a) does require that the IRS “determine[]” the deficiency.<sup>191</sup> Thus, it “clearly contemplates” that the IRS must make “a thoughtful and considered determination.”<sup>192</sup> This has given rise to limited taxpayer protective rules. For example, if it is clear from the face of the notice that the IRS did not make a considered determination as to the particular taxpayer, the notice is invalid.<sup>193</sup> Alternatively, if the IRS’s determination is utterly without factual foundation, it is arbitrary and

185. *Scar v. Comm’r*, 814 F.2d 1363, 1372 (9th Cir. 1987) (Hall, J., dissenting) (quoting *Stamm Int’l Corp. v. Comm’r*, 84 T.C. 248, 252 (1985)).

186. *E.g.*, *United States v. Lehigh*, 201 F. Supp. 224, 232 (W.D. Ark. 1961).

187. *E.g.*, *Comm’r v. Forest Glen Creamery Co.*, 98 F.2d 968, 971 (7th Cir. 1938); *see, e.g.*, *Olsen v. Helvering*, 88 F.2d 650, 651 (2d Cir. 1937) (“[T]he notice is only to advise the person who is to pay the deficiency that the [IRS] means to assess him; anything that does this unequivocally is good enough.”).

188. *E.g.*, *Foster v. Comm’r*, 80 T.C. 34, 229–30 (1983), *aff’d in part*, 756 F.2d 1430 (9th Cir. 1985); *Jarvis v. Comm’r*, 78 T.C. 646, 655–56 (1982).

189. *E.g.*, *Abrams v. Comm’r*, 787 F.2d 939, 941 (4th Cir. 1986); *Abatti v. Comm’r*, 644 F.2d 1385, 1389 (9th Cir. 1981); *Barnes v. Comm’r*, 408 F.2d 65, 68 (7th Cir. 1969); *Comm’r v. Stewart*, 186 F.2d 239, 242 (6th Cir. 1951).

190. *E.g.*, *Estate of Brimm v. Comm’r*, 70 T.C. 15, 23 (1978); *Greenberg’s Express, Inc. v. Comm’r*, 62 T.C. 324, 327 (1974).

191. I.R.C. § 6212(a) (2012).

192. *Couzens v. Comm’r*, 11 B.T.A. 1040, 1159 (1928); *see also In re Terminal Wine Co.*, 1 B.T.A. 697, 701 (1925) (“By its very definition and etymology the word ‘determination’ irresistibly connotes consideration, resolution, conclusion, and judgment.”).

193. The key case is *Scar v. Commissioner*, 814 F.2d 1363, 1370 (9th Cir. 1987). In *Scar*, the notice disallowed deductions from a tax shelter the taxpayers had not participated in and from which their return claimed no deductions. *Id.* at 1365. The IRS conceded that the notice was erroneous. *Id.* The court emphasized, however, that application of this principle would be rare. *Id.* at 1367 n.6.

capricious.<sup>194</sup> This strips the notice of the presumption of regularity to which the IRS normally is entitled and shifts the burden of proof to the IRS.<sup>195</sup>

Even under the strikingly indulgent principles above, deficiency notices sometimes were invalidated because they were inadequately explained. On those rare occasions, however, the basis of the explanation duty was seen as a matter of federal tax law—that is, as a construction of the term “determine[]” in I.R.C. § 6212(a)—rather than as a construction of 5 U.S.C. § 706(2)(A), or any other feature of general administrative law.<sup>196</sup>

The landscape was altered by the enactment of I.R.C. § 7522 in 1988.<sup>197</sup> It provides that for any IRS notice to which the section applies, the IRS is required both to identify the amounts of liability it has determined and to state “the basis” for the determination.<sup>198</sup> This requirement applies to notices of deficiency, postassessment notices and demands for payment, notices generated by IRS information-return matching programs, and revenue agent reports (thirty-day letters).<sup>199</sup>

Section 7522 “does not articulate specific standards for determining whether the description of the Commissioner’s basis is adequate.”<sup>200</sup> Interpreting this section, courts have reached three conclusions. First, the notice must contain enough information to allow the taxpayer to craft a meaningful Tax Court petition challenging the notice.<sup>201</sup> Second, § 7522 does not require the IRS to identify the statutory provisions supporting the adjustments in the

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194. *E.g.*, *United States v. Janis*, 428 U.S. 433, 442 (1976).

195. *Ruth v. United States*, 823 F.2d 1091, 1094 (7th Cir. 1987). Again, this rule operates only in “rare cases,” that is, “[i]n certain quite limited circumstances.” *Id.*

196. *E.g.*, *United States v. Lehigh*, 201 F. Supp. 224, 232–34 (W.D. Ark. 1961).

197. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6233, 102 Stat. 3342, 3735 (codified as amended at I.R.C. § 7522 (2012)).

198. I.R.C. § 7522(a).

199. *Id.* § 7522(b). The Senate bill would have applied the direction more broadly, and the Conference Committee stated: “Although the provision is limited to the specified notices, the conferees expect the IRS to make every effort to improve the clarity of all notices and explanations that are sent to taxpayers.” H.R. REP. NO. 100-1104, pt. 2, at 219 (1988) (Conf. Rep.), *reprinted in* 1988 U.S.C.C.A.N. 5048, 5279.

200. *Shea v. Comm’r*, 112 T.C. 183, 196 n.20 (1999), *nonacq.*, 2000-44 I.R.B. 430.

201. *Caldwell v. Comm’r*, 136 T.C. 38, 49 (2011), *aff’d*, 483 F. App’x 847 (4th Cir. 2012).

notice.<sup>202</sup> Third, the IRS does not have to set out the factual bases of its determinations.<sup>203</sup>

Section 7522 imposes an obligation of explanation on the IRS but no judicial remedy if the IRS fails to meet that obligation. It provides: “An inadequate description . . . shall not invalidate such notice.”<sup>204</sup> Yet violation of § 7522 is not costless to the IRS. Taxpayer complaints may catch the ear of Congress. Moreover, the Tax Court has held that, when the IRS violates § 7522, the burden of proof on the issue can shift to the IRS.<sup>205</sup> Thus, even without judicial enforcement, the IRS has reasons to take § 7522 seriously.

One commentator questions the continuing vitality of the above cases in light of *State Farm* and other APA case law, finding § 7522 to be insufficient protection for taxpayers.<sup>206</sup> He proposes that a level of APA reasoned-explanation analysis be added to existing dimensions of judicial review of deficiency determinations. In addition, some judges have supported applying APA judicial-review standards to deficiency cases involving equitable spousal relief.<sup>207</sup>

Courts often apply a type of harmless-error analysis to uphold explanations of less than ideal clarity. They do so in cases in which the taxpayer received additional information from other sources more or less related to the IRS notice, such that the taxpayer was not prejudiced. There are similar cases involving explanatory challenges to notices of deficiency,<sup>208</sup> although they are fewer in number.

One category of deficiency litigation deserves particular attention. The IRS has elaborate review mechanisms to promote decisional consistency. Nonetheless, because of changed views of law

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202. *E.g.*, *Wheeler v. Comm’r*, 127 T.C. 200, 205 (2006), *aff’d*, 521 F.3d 1289 (10th Cir. 2008).

203. *E.g.*, *Ocmulgee Fields, Inc. v. Comm’r*, 132 T.C. 105, 113 (2009), *aff’d*, 613 F.3d 1360 (11th Cir. 2010).

204. I.R.C. § 7522(a).

205. *Shea*, 112 T.C. at 197; *see also* *Ludwig v. Comm’r*, 68 T.C.M. (CCH) 961, 963 (1994) (suggesting that, in appropriate cases, courts might shift the burden of proof to the government when the IRS violates § 7522(a)); *cf.* *Sellers v. Comm’r*, 80 T.C.M. (CCH) 135, 138–39 (2000) (considering whether the government should bear the burden of proof, but concluding that the notice of deficiency was nonetheless adequate).

206. *See generally* *Smith*, *supra* note 15.

207. *See supra* note 16.

208. *See, e.g.*, *Bitker v. Comm’r*, 86 T.C.M. (CCH) 72, 78–79 (2003) (evaluating a notice of deficiency issued to partners in light of explanations set out in IRS notices issued to his partnership); *see also* TAX CT. R. 160 (establishing a harmless-error rule under which the Tax Court “at every stage of case will disregard any error or defect which does not affect the substantial rights of the parties”).

or policy or simply because of the volume of cases it handles, the IRS sometimes takes a position in one case that is, or appears to be, incompatible with positions it took in prior cases or in published guidance.

A substantial body of case law has grown up in this area, but the doctrine is in shambles. Numerous views have been offered in the cases and commentary, but no settled rule exists.<sup>209</sup> Many cases say that there is no judicially enforceable duty of consistency on the IRS,<sup>210</sup> but many other cases say there is.<sup>211</sup>

Authorities supporting the existence of a judicially enforceable duty often are vague about the legal basis for the duty.<sup>212</sup> Borrowing from general administrative law, Professor Lawrence Zelenak has proposed that the IRS be bound to its prior position unless, in the later case, it explains why the positions are consistent or why its later view is better than the view it is repudiating.<sup>213</sup> Professor Zelenak suggests three main possible sources for such a duty: agency-specific (that is, tax) statutes, administrative common law, or the APA arbitrary-and-capricious standard.<sup>214</sup> One candidate statute is I.R.C. § 7805(b), which allows the IRS to prescribe the extent to which tax rulings “shall be applied without retroactive effect.”<sup>215</sup>

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209. See, e.g., Stephanie Hoffer, *Hobgoblins of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 UTAH L. REV. 317, 318–19 (proposing imposition of a “duty of consistency” on IRS actions against taxpayers); Timothy Jacobs, *Barnes Group: Tax Court Turns Blind Eye to Ravenhorst*, 140 TAX NOTES 481, 481 (2013) (arguing that a recent Tax Court decision permitting the IRS to argue against revenue rulings is “unworkable”); Steve R. Johnson, *An IRS Duty of Consistency: The Failure of Common Law Making and Proposed Legislative Solution*, 77 TENN. L. REV. 563, 567–68 (2010) (suggesting that taxpayers should be able to show reliance on “high-level Treasury or IRS positions” that are “later contradicted or disregarded”).

210. See, e.g., *Dixon v. United States*, 381 U.S. 68, 72–76 (1965) (holding that the IRS may retroactively withdraw an acquiescence in Tax Court rulings); *Manhattan Gen. Equip. Co. v. Comm’r*, 297 U.S. 129, 133–34 (1936) (agreeing with lower courts that an amended Treasury regulation governs stock transaction).

211. See, e.g., *Estate of McLendon v. Comm’r*, 135 F.3d 1017, 1024 (5th Cir. 1998) (“[T]he Commissioner may not retroactively abrogate a ruling in an unclear area with respect to any taxpayer who has relied on it.”); *Powell v. United States*, 945 F.2d 374, 377–78 (11th Cir. 1991) (noting that taxpayers may argue “administrative inconsistency”).

212. See, e.g., *Vesco v. Comm’r*, 39 T.C.M. (CCH) 101, 129–30 (1979) (ruling against the IRS in a deficiency case for disparate treatment of differing taxpayers but not explaining from where such a duty of consistency comes).

213. Zelenak, *supra* note 15, at 412 (citing DAVIS, *supra* note 15, § 8.9, at 198).

214. *Id.* at 413–14 & n.14. In extreme cases of invidious discrimination, he adds a fourth possible source, the Fifth Amendment. U.S. CONST., amend. V.

215. I.R.C. § 7805(b)(8) (2012). Courts have construed this section as creating a presumption in favor of retroactivity but allowing taxpayers to challenge retroactive

However, most of the inconsistency cases do not root their result in that section. Moreover, the zest with which some courts once deployed administrative common law has been chilled by the Supreme Court's decision in *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*<sup>216</sup>

That leaves the arbitrary-and-capricious standard as the best foundation for a duty of the IRS to explain or repudiate. If (a big "if") the cases imposing a consistency duty are right, their best hope for a sound mooring is in the reasoned-explanation requirement.

2. *Jeopardy and Termination Determinations.* The IRS must, within five days of making a jeopardy or termination assessment or levy, provide the taxpayer "a written statement of the information upon which [it] relied in making such assessment or levy."<sup>217</sup> The object "is to give the taxpayer notice of the information on which the government relies so that the taxpayer may raise any available defenses."<sup>218</sup>

The principal grounds justifying a jeopardy or termination assessment are that collection is imperiled because the taxpayer either appears to be hiding himself; appears to be hiding, transferring, or dissipating his assets; or is insolvent.<sup>219</sup> As the cases cited below show, several decades ago, five-day notifications sometimes just parroted these conditions without giving any supporting details or, even worse, just said, in words or effect, "you are acting in ways that imperil collection." Such statements are insufficient to meet the underlying purpose of the notification requirement.<sup>220</sup>

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applications on an abuse-of-discretion standard. *E.g.*, *Manocchio v. Comm'r*, 710 F.2d 1400, 1403 (9th Cir. 1983); *Lesavoy Found. v. Comm'r*, 238 F.2d 589, 593–94 (3d Cir. 1956).

216. *Vermont Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519 (1978); *see id.* at 543 (instructing lower courts not to impose on agencies procedural requirements beyond those in the APA and enabling acts absent "constitutional constraints or extremely compelling circumstances").

217. I.R.C. § 7429(a)(1)(B).

218. *Zion Coptic Church, Inc. v. United States*, No. 78-1984-CIV-WMH, 1979 WL 1333, at \*2 (S.D. Fla. Mar. 19, 1979).

219. I.R.C. § 6851(a)(1); Treas. Reg. §§ 1.6851-1(a) (as amended in 1978), 301.6861-1(a) (as amended in 1995), 301.6862-1(a) (as amended in 1982). Many courts have also considered additional circumstances, especially criminal activity by the taxpayer. *See, e.g.*, *Albury v. United States*, Nos. 88-0788-CIV-RYSKAMP, 88-0789-CIV-RYSKAMP, 1988 WL 125768, at \*2 (S.D. Fla. Aug. 9, 1988) ("[A]n indication that a taxpayer is engaged in criminal activity is significant in assessing whether the taxpayer is likely to conceal his assets.").

220. *Cf. Gonzales v. Oregon*, 546 U.S. 243, 255–56 (2006) (refusing to accord deference to an agency's interpretation of a regulation that merely parroted the statutory language).

Two lines of cases arose with respect to insufficient § 7429 statements. In the first line, courts that were initially indulgent of conclusory notifications became increasingly frustrated by the IRS's practice of continuing to issue such notifications despite judicial rebuke. They asserted that jeopardy and termination assessments could be abated because of inadequately explanatory five-day notifications,<sup>221</sup> they threatened to order such abatement should violations persist,<sup>222</sup> and they sometimes actually did order abatement.<sup>223</sup>

These cases did not make clear the basis upon which the courts claimed authority to invalidate assessments for inadequate explanation. Presumably, as in the cases invalidating deficiency notices for inadequate explanation, the basis was in the interpretation of the applicable tax statute, here, § 7429(a)(1)(B).

In these cases, however, there are occasional hints that administrative-law principles may also have been at work. In one case, the IRS sought to justify its termination assessment on the grounds that the taxpayer was attempting to conceal both himself and his assets.<sup>224</sup> The court refused to consider these grounds because they were not set out in the five-day notification.<sup>225</sup> This is black-letter administrative law under *Chenery I*,<sup>226</sup> but it is bad tax law.<sup>227</sup> Thus, either the court misunderstood tax law, or it was glossing tax law with administrative law. Another case compared the § 7429 reasonableness

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221. See, e.g., *Hirschhorn v. United States*, 662 F. Supp. 887, 892 (S.D.N.Y. 1987) (finding that omission of IRS conclusions from a termination notice “would be fatal to that assessment”); *Berkery v. United States*, 544 F. Supp. 1, 5 (E.D. Pa. 1982) (acknowledging that a mere letter announcing a termination agreement would be insufficient notice, but concluding that the IRS provided the taxpayer with sufficient documentary support); *Barry v. United States*, 534 F. Supp. 304, 308 (E.D. Pa. 1982) (noting that a threadbare statement that the taxpayer’s gambling warranted a termination assessment would constitute invalid notice but that the government provided various enclosures tying it to the taxpayer’s gambling records in this case).

222. See, e.g., *DeLauri v. United States*, 492 F. Supp. 442, 444–45 (W.D. Tex. 1980) (reasoning that the taxpayer’s refusal to provide information counseled against abatement but that it would be necessitated by inadequate IRS notice in future proceedings).

223. See, e.g., *Walker v. United States*, 650 F. Supp. 877, 885 (E.D. Tenn. 1987) (abating a jeopardy assessment when the IRS notice was “completely bare” of supporting information).

224. *Hirschhorn*, 662 F. Supp. at 891.

225. *Id.*

226. See *supra* note 60 and accompanying text.

227. It is settled that in a § 7429 review proceeding, the court may consider all relevant grounds and information, whether known when the assessment was made or discovered only later. E.g., *Loretto v. United States*, 440 F. Supp. 1168, 1173–74 (E.D. Pa. 1977); S. REP. NO. 94–938, at 364–65 (1976), *reprinted in* 1976 U.S.C.A.N. 3439, 3793–94.

standard to two APA standards. It concluded that the § 7429 standard is somewhat more demanding than “arbitrary[] [and] capricious” under 5 U.S.C. § 706(2)(A), but somewhat less demanding than “substantial evidence” under § 706(2)(E).<sup>228</sup>

Cases of the second line are considerably more numerous. They found conclusory five-day notifications to be insufficient but refused to invalidate them. These cases applied a harmless-error approach—although they cited neither 5 U.S.C. § 706 nor any other source of a harmless-error rule.<sup>229</sup> The cases excused defective explanations because the taxpayers suffered insufficient prejudice. The information omitted from the five-day notifications was received by the taxpayers by way of either informal production before the hearing, formal discovery before the hearing, or prior proceedings against the IRS.<sup>230</sup>

3. *CDP Determinations.* Although there are differences, CDP bears similarities to the jeopardy-and-termination regime just discussed. First, at least in theory,<sup>231</sup> as to most issues, the CDP standard of proof is deferential: abuse of discretion as to CDP<sup>232</sup> and reasonableness as to jeopardy and termination assessments and levies.

Second, as seen in the preceding Section, jeopardy-and-termination review is not limited to the record made by the IRS. Similarly, the Tax Court claims the ability to go outside the record in CDP cases, although this ability is controversial.<sup>233</sup> One can

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228. *Loretto*, 440 F. Supp. at 1172.

229. *E.g.*, *Hagaman v. United States*, No. CIV-1-90-75, 1990 WL 86017, at \*1 (E.D. Tenn. Apr. 10, 1990); *Revis v. United States*, 558 F. Supp. 1071, 1076 (D.R.I. 1983).

230. *E.g.*, *Hagaman*, 1990 WL 86017, at \*1; *Revis*, 558 F. Supp. at 1076.

231. The Tax Court and generalist courts often use the same words but are animated by different spirits in applying them. Abuse-of-discretion review in the Tax Court is notably stricter than such review in the district and circuit courts. *See, e.g.*, *Dalton v. Comm’r*, 682 F.3d 149, 155 (1st Cir. 2012), *rev’g* 101 T.C.M. (CCH) 1653 (2011) (“[A] court cannot be expected to conduct the same level of judicial review that would follow, say, a bench trial or a more formal agency proceeding.”); *see also* *Cords*, *supra* note 21, at 441 (explaining the basis for using different standards of review).

232. *E.g.*, *Jones v. Comm’r*, 338 F.3d 463, 466 (5th Cir. 2003). Some circuits are even more deferential: “[L]est the judiciary become involved on a daily basis with tax enforcement details that Congress intended to leave with the IRS.” *Robinette v. Comm’r*, 439 F.3d 455, 459 (8th Cir. 2006).

233. *E.g.*, *Robinette*, 439 F.3d at 459–62, *rev’g* 123 T.C. 85, 96–104 (2004). *See generally* Christine K. Lane, *On-the-Record Review of CDP Determinations: An Examination of Policy Reasons Encouraging Judges To Stick to the Administrative Record*, 6 FLA. ST. U. BUS. L. REV. 149 (2007).

understand the temptation to go outside the record because it often is sparse in CDP cases.<sup>234</sup> However, “Congress knew about the incomplete nature of the record that would be available”;<sup>235</sup> taxpayers often are the ones responsible for record gaps because they failed to provide information requested by the IRS;<sup>236</sup> and “[i]t is a basic principle of administrative law that review of administrative decisions is ‘ordinarily limited to consideration of the decision of the agency . . . and of the evidence on which it was based.’”<sup>237</sup>

Third, as seen in Part III.A.2, some courts in the jeopardy-and-termination context asserted the power to invalidate assessments and levies when the IRS notification failed to explain the bases of the IRS’s determination. Similarly, courts in CDP cases have often found notices of determination to be inadequately explanatory, necessitating remand to the Appeals Office.<sup>238</sup> In practical terms, CDP remand and jeopardy-and-termination invalidation have much the same effect. Remand stops the IRS’s intended collection action, but the IRS will later be able to proceed if it develops a satisfactorily reasoned explanation. Similarly, when its first jeopardy or termination assessment or levy is invalidated, the IRS can make a second one, hopefully to be adequately explained in the new five-day notification.

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234. In CDP review there is no obligation to conduct a face-to-face hearing, no formal discovery, and no requirement for testimony, cross examination, or a transcript. The hearing usually consists of informal oral and written communication between the taxpayer and the IRS. Treas. Reg. § 301.6330-1(d)(2)A-D6 (as amended in 2006).

235. *Dalton*, 682 F.3d at 156.

236. *E.g.*, *Olsen v. Comm’r*, 414 F.3d, 144, 149, 151 (1st Cir. 2005).

237. *Robinette*, 439 F.3d at 459 (second alteration in original) (quoting *United States v. Carlo Bianchi & Co.*, 373 U.S. 709, 714–15 (1963)). And, outside the APA context, when Congress provides for judicial review without defining its scope and procedures, normally “consideration is to be confined to the administrative record.” *Bianchi*, 373 U.S. at 715.

238. *E.g.*, *Mesa Oil, Inc. v. United States*, No. CIV-A. 00-B-851, 2000 WL 1745280, at \*4–5 (D. Colo. Nov. 21, 2000), *nonacq.*, 2001-2 C.B. 176; *Salahuddin v. Comm’r*, No. 7050-11L, 2012 WL 1758628, at \*7 (T.C. May 17, 2012); *Leago v. Comm’r*, No. 13070-08L, 2012 WL 407493, at \*9 (T.C. Feb. 9, 2012); *Fairlamb v. Comm’r*, 92 T.C.M. (CCH) 1103, 1107 (2010); *Hoyle v. Comm’r*, 131 T.C. 197, 204–05 (2008); *Oman v. Comm’r*, 92 T.C.M (CCH) 372, 375–76 (2006).

The IRS agrees that remand is appropriate when the appeals officer “failed to make necessary findings of fact” or “failed to perform an analysis that is necessary in making the determination” and when “the administrative record contains no indication of the documents or evidence the officer considered in making the determination or the reasons for the determination.” I.R.S. Chief Counsel Notice 2004-031, *Litigating Cases Brought Under I.R.C. §§ 6320(c) and 6330(d) (2004)*, available at <http://www.unclefed.com/ForTaxProfs/irs-ccd/2004/cc-2004-031.pdf>.



Fourth, in the CDP situation, as in the jeopardy-and-termination situation, it is unclear on what authority the courts relied in fashioning their remedies. The CDP courts ordering remand did not invoke the APA, but neither did they assert any other basis of authority. Some courts did cite *Chenery I* in discarding rationales not stated in the notice of determination.<sup>239</sup>

This matter is unlikely to be settled as long as a more fundamental difference between the Tax Court and some generalist courts remains unresolved. The Tax Court has declared: “[W]hen reviewing for abuse of discretion [for CDP purposes], we are not limited by the [APA],”<sup>240</sup> a view rejected by some generalist courts.<sup>241</sup> The Tax Court took a similar position as to equitable spousal relief under I.R.C. § 6015.<sup>242</sup>

Part of the Tax Court’s rationale is that the APA does not apply to courts,<sup>243</sup> and the Tax Court is a court.<sup>244</sup> Right premises, wrong conclusion. The Tax Court surely is a court.<sup>245</sup> Indeed, its predecessor, although formally an administrative agency, was “in its essentials practically a court of record” as far back as 1924.<sup>246</sup> But that is beside the point. The APA is law that is applied *by* a court when reviewing

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239. *E.g.*, *Salahuddin*, 2012 WL 1758628, at \*7; *see Fairlamb*, 99 T.C.M (CCH) at 1106–07 (using the *Chenery I* principle but not citing the case by name); *cf.* *Tucker v. Comm’r*, 676 F.3d 1129, 1136 (D.C. Cir. 2012) (noting *Chenery I* but rejecting the taxpayer’s argument based on it).

240. *Robinette v. Comm’r*, 123 T.C. 85, 95 (2004), *rev’d*, 439 F.3d 455 (8th Cir. 2006). Despite being reversed in *Robinette*, the Tax Court clings to its view. *E.g.*, *Oropeza v. Comm’r*, 95 T.C.M (CCH) 1367, 1369 (2008).

241. *E.g.*, *Robinette*, 439 F.3d at 461; *Olsen*, 414 F.3d at 155.

242. *See Ewing v. United States*, 122 T.C. 32, 37–38 (2004) (“[T]he APA does not apply to deficiency cases in this Court . . . . We see no material difference between [equitable spousal relief under § 6015] and [deficiency cases] . . . .”), *rev’d in part, vacated in part on other grounds*, 439 F.3d 1009 (9th Cir. 2006).

243. *See* 5 U.S.C. § 551(1)(B) (2012).

244. *E.g.*, *Robinette*, 123 T.C. at 96; *Nappi v. Comm’r*, 58 T.C. 282, 284 (1972). Surprisingly, some have accepted, or nearly accepted, this misguided analysis. *E.g.*, *Wilson v. Comm’r*, 705 F.3d 980, 990 n.16 (9th Cir. 2013). Despite the above protestation, the Tax Court has applied the APA in some situations. *E.g.*, *Mailman v. Comm’r*, 91 T.C. 1079, 1082–83 (1988); *Estate of Gardner v. Comm’r*, 82 T.C. 989, 994 (1984); *Dittler Bros. v. Comm’r*, 72 T.C. 896, 909–10 (1979), *aff’d*, 642 F.2d 1211 (5th Cir. 1981).

245. *E.g.*, *Freytag v. Comm’r*, 501 U.S. 868, 890–91 (1991); *see* Steve R. Johnson, *The Phoenix and the Perils of the Second Best: Why Heightened Appellate Deference to Tax Court Decisions Is Undesirable*, 77 OR. L. REV. 235, 280–82 (1998).

246. *See* DUBROFF, *supra* note 133, at 66 (reprinting President Calvin Coolidge’s signing statement of the Revenue Act of 1924, ch. 234, § 900, 43 Stat. 253, 336, creating the Board of Tax Appeals). Nonetheless, the formal status of the Tax Court was an agency, not a court, at the time the APA was enacted. *See generally* Malvern B. Fink, Note, *Effect of the Administrative Procedure Act on Decisions of the Tax Court*, 2 TAX L. REV. 103 (1946).

agency action, not law applied *to* the court. The question is not whether the Tax Court is exempt from the APA, but whether the IRS is.<sup>247</sup>

The true roots of the Tax Court's reluctance are cultural. Throughout its existence, the Tax Court has been accustomed to conducting de novo proceedings. The Article III federal courts are far more familiar with APA-style review. This difference in experience is reflected in other aspects of the Tax Court's often less-than-stellar treatment of administrative law, such as its foot-dragging on accepting the standard of review set out in *Chevron U.S.A., Inc. v. Natural Resources Defense Council Inc.*,<sup>248</sup> its embrace of the government's benighted understanding of the difference between legislative and interpretive regulations,<sup>249</sup> and its turning of supposedly deferential review into virtual de novo review in many cases.<sup>250</sup>

4. *Trust Fund Recovery Penalty Determinations.* The explanatory adequacy of sixty-day letters has not thus far been subject to substantial litigation.<sup>251</sup> Somewhat similar issues have been raised as to another part of the § 6672 regime, however, and courts' treatment of these issues suggests that they will behave in the § 6672 area in like fashion to how they behave in other IRS adjudication contexts.<sup>252</sup>

After the IRS has assessed § 6672 liabilities, I.R.C. § 6203 provides that the assessed person is entitled, upon request, to receive

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247. *E.g.*, *Robinette v. Comm'r*, 439 F.3d 455, 461 n.5 (8th Cir. 2006).

248. *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984); *see, e.g.*, *Swallows Holding, Ltd. v. Comm'r*, 126 T.C. 96, 129–31 (2006), *rev'd*, 515 F.3d 162 (3d Cir. 2008).

249. *E.g.*, *Wing v. Comm'r*, 81 T.C. 17, 26–28 (1983). For description of the government's understanding of the distinction and why that understanding is wrong, see Steve R. Johnson, *Swallows as It Might Have Been: Regulations Revising Case Law*, 112 TAX NOTES 773, 780–81 (2006).

250. *See, e.g.*, Book, *supra* note 7, at 1194–97; Cords, *supra* note 21, at 445.

251. The current regime was enacted in 1996. Taxpayer Bill of Rights, Pub. L. No. 104-168, §§ 901–903, 110 Stat. 1452, 1465–67 (1996) (codified as amended at I.R.C. § 6672 (2012)). A § 6672 target raised the sixty-day-letter issue in one case, but the court properly did not consider it because the relevant events happened before the 1996 effective date. *United States v. Long*, No. 4:CV-97-1432, 1999 WL 250737, at \*4 (M.D. Pa. Mar. 11, 1999). In another case, the assessed person failed to raise the adequate-reasoning argument at trial, jeopardizing his ability to advance it on appeal. *See* Brief for the Appellee at 20, *Nakano v. Comm'r*, No. 12-70992 (9th Cir. Aug. 22, 2012), 2012 WL 3835216, at \*20.

252. Although limited law exists on the point, there may be at least one difference. As seen in Part III.A.1 above, the Tax Court has held that inadequate explanation can shift the burden of proof to the IRS in the deficiency contest. A district court has refused to do so in the § 6672 context. *Curley v. United States*, 791 F. Supp. 52, 56 (E.D.N.Y. 1992).

a copy of the record of assessment from the IRS. This consists of the summary record and supporting records providing “identification of the taxpayer, the character of the liability assessed, the taxable period . . . and the amount of the assessment.”<sup>253</sup> This is all required by the statute and regulations.

Targets sometimes have complained that the information provided by the IRS contained defects or omissions, requiring invalidation of the assessment.<sup>254</sup> In such cases, “[g]enerally courts are liberal in finding that an assessment has been properly made and technical defects are ignored in the absence of prejudice.”<sup>255</sup> In some cases, there was no prejudice because the erroneous or missing information was inconsequential<sup>256</sup> or was not required by statute or regulation.<sup>257</sup> In other cases, there was no prejudice because the assessed person received the missing information through other means.<sup>258</sup> Beyond the question of prejudice, some courts stated or implied that notice defects, categorically, cannot invalidate an otherwise proper assessment.<sup>259</sup>

There are two lessons here. First, one way the target can receive the missing information is through prior proceedings.<sup>260</sup> This fits the § 6672 situation. Under that section, the IRS seeks to impose secondary liability on responsible persons of companies that do not meet their obligations.<sup>261</sup> The IRS’s actions against their companies

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253. I.R.C. § 6203; Treas. Reg. § 301.6203-1 (1967).

254. *See, e.g.,* Howell v. United States, 164 F.3d 523, 524 (10th Cir. 1998) (reversing the district court decision for the assessed person); Attick v. United States, 904 F. Supp. 77, 80 (D. Conn. 1995) (denying the government’s motion for summary judgment initially, but then granting the motion after the IRS provided additional information).

255. *In re* Dewberry, 158 B.R. 979, 982 (Bankr. W.D. Mich. 1993) (citing Planned Invs., Inc. v. United States, 881 F.2d 340, 344 (6th Cir. 1989)).

256. *E.g.,* Conway v. Comm’r, 137 T.C. 209, 217 (2012).

257. *E.g.,* Allan v. United States, 386 F. Supp. 499, 504 (N.D. Tex. 1975), *aff’d*, 514 F.2d 1070 (5th Cir. 1975); *see* Curley v. United States, 791 F. Supp. 52, 56 (E.D.N.Y. 1992) (“It appears that the IRM guidelines were not followed. However, . . . the provisions of the IRM are not law and do not create any substantive rights in [the assessed person].”).

258. *E.g.,* Anuforo v. Comm’r, 614 F.3d 799, 805 (8th Cir. 2010); *Curley*, 791 F. Supp. at 56.

259. *Howell*, 164 F.3d at 526.

260. *Cf.* Evans v. United States, 672 F. Supp. 1118, 1125 (S.D. Ind. 1987) (holding that a taxpayer failed to show prejudice when, although a jeopardy assessment might have been inadequate on its face, the taxpayer had notice of the information obtained from discovery in four pending criminal indictments); Zion Coptic Church, Inc. v. United States, No. 78-1984-CIV-WMH, 1979 WL 1333, at \*2 (S.D. Fla. Mar. 19, 1979) (holding that the taxpayer had actual notice by virtue of a similar jeopardy-assessment case as to a transferee of the taxpayer’s).

261. I.R.C. § 6672 (2012).

typically provide target owners and officers with substantial information bearing on their potential § 6672 liabilities.

Second, *Chenery I*—a bedrock of administrative-law reasoned-explanation analysis—applies weakly here. The target unsuccessfully made a *Chenery*-like argument in one § 6672 case.<sup>262</sup> This lack of success is unsurprising. Many cases noted above allowed the IRS to remedy initial imprecisions and omissions by subsequent disclosure. This harmless-error approach largely swallows *Chenery I* in this context.

### B. *The Practice of IRS Explanations*

This Section advances two conclusions. First, IRS determinations usually provide meaningful explanation. Second, however, courts have varied widely in the detail they demand of agency explanations under the arbitrary-and-capricious standard. Accordingly, it is possible, indeed likely, that some IRS determinations would be invalidated if the APA's reasoned-explanation requirement were held to be applicable to IRS adjudications.

#### 1. *Current Level of Explanation.* A 1976 Tax Court case stated:

Here, we have a vague notice of deficiency, that is, a notice of deficiency in which the [IRS] makes a determination that may be based on any one of a number of grounds but in which [it] fails to advise the taxpayer of the grounds on which [the IRS] relies. For years, such notices of deficiency have created problems in proceedings in this Court.<sup>263</sup>

Similarly, “[c]ommentators have long complained about the inadequacy of the explanation portion of many statutory notices.”<sup>264</sup> But most such complaints preceded 1988. The IRS received wakeup calls in 1987 in *Scar v. Commissioner*<sup>265</sup> and in 1988 in I.R.C. § 7522,<sup>266</sup> and the quality of its explanations has improved.

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262. See *Howell v. Rogers*, 164 F.3d 523, 525 n.1 (10th Cir. 1998) (noting a taxpayer's argument that supporting documents as to the § 6203 record must have been prepared contemporaneously with the assessment).

263. *Estate of Allensworth v. Comm'r*, 66 T.C. 33, 34 (1976).

264. Lederman, *supra* note 159, at 224; see also Mary Ferrari, “*Was Blind but Now I See*” (Or What's Behind the Notice of Deficiency and Why Won't the Tax Court Look?), 55 ALB. L. REV. 407, 437–45 (1991) (discussing cases).

265. *Scar v. Comm'r*, 814 F.2d 1363 (9th Cir. 1987).

266. For discussion of *Scar* and § 7522, see *supra* Part III.A.1.

The Internal Revenue Manual sets out procedures for IRS personnel drafting notices of deficiency.<sup>267</sup> Deficiency notices contain several components. First is a letter stating the taxpayer's name and address, the type of tax, the tax period, and the amount of the deficiency plus any penalties asserted. The letter also informs the taxpayer of the availability of Tax Court review. Next in the deficiency notice is a waiver form for taxpayers who wish to forgo Tax Court by consenting to immediate assessment. This is followed by a listing of the adjustments determined by the IRS along with a recomputation of tax liability based on the adjustments, accompanied by one or more pages explaining, in one or more paragraphs per adjustment, why each adjustment is being made.<sup>268</sup> These explanatory paragraphs have two purposes: first, "[t]o inform the taxpayer in clear and concise language of the adjustments," and second, "[t]o state the position or positions of the IRS with respect to the adjustments."<sup>269</sup> Poorly explained notices of deficiency sometimes sneak through IRS review processes, but the frequency of this failure has declined.

A similar story can be told about jeopardy- and termination-assessment notices. Part III.A.2 above rehearsed the case law as to the explanation of such determinations.<sup>270</sup> Overwhelmingly, the cases explained in this section are from the 1970s and 1980s. The increased care with which the IRS has prepared notices of deficiency since 1988 has spilled over into how the IRS prepares jeopardy and termination notifications.

The situation as to CDP determinations remains mixed, however. In many cases, such determinations are amply explained.<sup>271</sup> In other cases, unfortunately, the same cannot be said.<sup>272</sup>

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267. IRM 4.8.9.8–4.8.9.9 (July 9, 2013).

268. *E.g.*, *Straight v. Comm'r*, 74 T.C.M. (CCH) 1457, 1461–62 (1997), *rev'd*, No. 23658-94, 1999 WL 33587419 (T.C. May 6, 1999).

269. IRM 4.8.9.8.6 (July 9, 2013).

270. *See supra* Part III.A.2.

271. *E.g.*, *Jackson v. United States*, No. Civ-06-643-D, 2010 WL 1372486, at \*4 (W.D. Okla. Mar. 31, 2010) (finding that the notice of determination analyzed each of thirteen potentially relevant considerations); *Bennett v. Comm'r*, 96 T.C.M. (CCH) 319, 321 (2008) (noting that the IRS "has diligently presented an exhaustive narrative to justify [its] conclusion").

272. *E.g.*, *Mesa Oil, Inc. v. United States*, No. Civ.A. 00-B-851, 2000 WL 1745280, at \*4 (D. Colo. Nov. 21, 2000) (explaining that the notice of determination included "no statement of facts, no legal analysis, and no explanation of how or why the proposed levy balanced the need for collection with [the taxpayer's] interests," but instead contained a mere "blank recitation of the statute"), *nonacq.*, 2001-2 C.B. 176.

2. *Comparison to APA Explanation.* “Arbitrary and capricious” is flexible language. The spirit in which the standard is applied matters more than the verbal formulation. As seen in Part I.B, courts vary in the degree of detail and specificity they require. Thus, one could reasonably expect that, were an APA-style reasoned-explanation requirement to be applied to IRS adjudications, some courts would find the level of explanation that now prevails to suffice, but others would not.

For example, assume that the taxpayer claimed loss deductions on account of XYZ tax shelter and the IRS disallowed the deductions because the shelter lacked economic substance. Under current law, in cases “to which the economic substance doctrine is relevant,” the taxpayer prevails only by showing both that the transactions changed the taxpayer’s economic position “in a meaningful way” independent of tax savings and that the taxpayer had a “substantial,” tax-independent purpose for entering into the transaction.<sup>273</sup> Various special rules modify, define, or clarify these general requirements.<sup>274</sup>

In a notice of deficiency in the above situation, what level of specificity would be needed to satisfy the reasoned-explanation requirement? There are multiple possibilities: First, the notice might say: “Your loss deductions claimed as a result of XYZ are disallowed because you have not established that XYZ had economic substance.” This would give notice of the adjustment and the conclusion on which the adjustment is based. Second, the notice might say the above and then add: “You have not shown that the economic substance doctrine is not relevant to this situation. You also have not shown that the transaction had a meaningful economic effect and/or that you had a substantial non-tax purpose for entering into the transactions.” This would give notice of the adjustment, the conclusion on which it is based, and the subsidiary conclusions that are the elements of the main conclusion. Third, the notice might state all of the above and then add specific findings of fact under one or more of the subconclusions. Fourth, the notice might state all of the above and add conclusions and findings of fact as to the special rules.

If a court held the first or second version satisfactory, there would be little change from what prevails under existing tax explanation requirements. Requiring the third or fourth version would be a major change, and would invalidate many notices of

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273. I.R.C. § 7701(o)(1) (2012).

274. *Id.* §§ 7701(o)(2)–(5).

deficiency. In all likelihood, different judges would choose different versions. At least one commentator has predicted that the application of an APA-style reasoned-explanation requirement would lead to more taxpayer successes.<sup>275</sup> Depending on the level of specificity reviewing courts require, that prediction could prove correct.<sup>276</sup>

#### IV. REASONED EXPLANATION AS TO DEFICIENCY DETERMINATIONS

This Part considers whether it would be desirable to engraft an APA-style reasoned-explanation requirement onto IRS deficiency determinations, and whether it would be permissible to do so within the existing state of the law. Such an engrafting would be neither wise nor permissible under existing doctrine.

##### A. *Policy Considerations*

Parts I.D and I.E rehearsed the principal advantages and costs of requiring reasoned explanations. This Part considers those advantages most relevant to the notice-of-deficiency context and also explores related considerations.

1. *Possible Advantages.* Part I.D noted the constitutional, political-process, and decisional-quality benefits offered as justifications for the reasoned-explanation requirement. However, many of these benefits are more applicable to agency regulations—which involve policy discretion and are subject to deferential review—than to IRS notices of deficiency, which involve adjustments to statutory rules and are subject to *de novo* review. For example, there is little doubt that in making determinations of tax liability, the IRS operates within the role assigned to it by Congress. In addition, courts are less likely to stray outside their role when applying defined statutory rules than when passing on value-laden regulatory choices made by agencies. Political-process values are more obviously at stake in the quasi-legislation of agency rulemaking than in individualized tax liability determinations. And information

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275. Smith, *supra* note 15, at 343.

276. For an example of explanatory paragraphs in the notice of deficiency, how a taxpayer suggested they should have been written, and how the court chose between the proffered alternatives, see *Elliott v. Comm'r*, 82 T.C.M. (CCH) 13, 16–19 (2001), *aff'd*, 54 F. App'x 413 (5th Cir. 2002).

asymmetries in the latter context favor the taxpayer (who participated in the transactions at issue) rather than the IRS.

A robust explanation requirement might promote good ossification if it caused the IRS to abandon bad positions earlier in the process. This would save taxpayers time, money, fear, and frustration. However, the possibility of losing at trial—a genuine possibility under a *de novo* standard of review—hopefully provides adequate incentive to the IRS to sharpen its thought processes and to avoid setting up bootless adjustments.<sup>277</sup>

It sometimes is argued that the loose tax explanation regime “encourages—even rewards—vagueness and imprecision in . . . deficiency notices.”<sup>278</sup> However, the explanatory quality of notices of deficiency appears to have improved, not deteriorated, in recent decades. The various institutional costs of vagary described earlier<sup>279</sup> appear to be sufficient disincentives.

In short, tax law already contains tax-specific explanation rules. Little would be gained by adding to them a possibly more robust explanation requirement. Shifting the burden of proof to the IRS—already possible<sup>280</sup>—is a better-calibrated response.

2. *Possible Costs.* As seen in Part I.E, concerns about explanation requirements include fears of results-oriented adjudication and administrative ossification. The first of these concerns probably would not be significant in tax adjudications. Courts occasionally have sought to massage flexible doctrine to favor sympathetic taxpayers.<sup>281</sup> However, most courts steel themselves to the harshness that sometimes arises from technically correct

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277. Moreover, the IRS risks the shifting to it of the taxpayer’s legal fees and other expenses if it takes a substantially unjustified position at trial. I.R.C. § 7430.

278. *Shea v. Comm’r*, 112 T.C. 183, 208 (1999) (Beghe, J., concurring), *nonacq.*, 2000-44 I.R.B. 430.

279. *See supra* notes 204–05 and accompanying text.

280. *See supra* note 205 and accompanying text.

281. For example, I.R.C. § 7403 allows the IRS to seek judicial sale of property in which a tax delinquent has an interest. Courts have limited equitable discretion to refuse to make such sales. *United States v. Rodgers*, 461 U.S. 677, 703–11 (1983). In sympathetic cases, district courts sometimes abuse that limited discretion and have to be reined in. *E.g.*, *United States v. Winsper*, No. 3:08CV-631-H, 2010 WL 3829408 (W.D. Ky. Sept. 10, 2010), *rev’d*, 680 F.3d 482 (6th Cir. 2012).



application of the tax laws,<sup>282</sup> so problems in our contexts likely would remain within tolerable bounds.

Bad ossification could occur, however, along with other problems if an APA-style reasoned-explanation requirement was superimposed upon notices of deficiency. The potential costs of such an approach are described below.

*a. Resources.* Evaluating the adequacy of the explanations in IRS notifications of deficiency is a preliminary exercise to the main contest: deciding the merits in the de novo Tax Court or refund litigation. At some point, the investment of time, money, and effort in preliminary exercises becomes excessive for the IRS, the courts, and the taxpayers themselves.<sup>283</sup> Deficiency determinations, after all, are informal, not formal, adjudications under the APA.<sup>284</sup> For, judicial review that is too exacting, especially on preliminary matters, “would defeat the very purpose of . . . informal procedures before the agency—saving time and effort in cases not worth detailed formal consideration or not requiring a hearing on the record.”<sup>285</sup>

Legal process should be administered with a sense of proportion.<sup>286</sup> The IRS audit rate already is quite low,<sup>287</sup> which contributes to a tax gap that is quite high.<sup>288</sup> Time taken to write or rewrite notices to satisfy exacting explanation requirements would be time that could not be devoted to auditing more returns.<sup>289</sup>

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282. See, e.g., *Kenseth v. Comm’r*, 259 F.3d 881, 885 (7th Cir. 2001) (“[I]t is not a feasible judicial undertaking to achieve global equity in taxation . . . . And if it were a feasible judicial undertaking, it still would not be a proper one, equity in taxation being a political rather than a jural concept.”); *Carlton v. United States*, 385 F.2d 238, 243 (5th Cir. 1967) (“[T]here is no equity in tax law.”); *Speltz v. Comm’r* 124 T.C. 165, 176–77 (2005) (citing cases rejecting challenges based on equity), *aff’d*, 454 F.3d 782 (8th Cir. 2006).

283. E.g., *Clapp v. Comm’r*, 875 F.2d 1396, 1403 (9th Cir. 1989).

284. See *supra* note 33 and accompanying text.

285. *Florida Power & Light Co. v. Lorion*, 470 U.S. 729, 742–43 (1985).

286. See, e.g., *Dalton v. Comm’r*, 682 F.3d 149, 154 (1st Cir. 2012) (“In the exercise of powers of judicial review, one size does not fit all.”).

287. Currently, the IRS audits only about one out of every hundred returns filed, only about one-fifth of the audit rate in the 1990s. RICHARDSON ET AL., *supra* note 135, at 95.

288. The IRS estimates that about \$450 billion of taxes that should have been paid have not been. *Tax Gap “Map” Tax Year 2006*, IRS (Dec. 2011), [http://www.irs.gov/pub/newsroom/tax\\_gap\\_map\\_2006.pdf](http://www.irs.gov/pub/newsroom/tax_gap_map_2006.pdf).

289. The sheer number of deficiency notices adds to the concern. The IRS issued slightly over 352,000 such notices in fiscal year 2012, of which only about .04 percent were challenged in Tax Court. 2 NAT’L TAXPAYER ADVOCATE, INTERNAL REVENUE SERV., 2012 ANNUAL REPORT TO CONGRESS 82 n.43 (2012), available at <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-2.pdf>.

*b. Role of the Courts.* The role of the courts must also be considered in assessing the costs of such an approach. Congress charged the IRS, not the courts, with administering the I.R.C. In the CDP and deficiency contexts, courts have warned about approaches to review under which “the judiciary will inevitably become involved on a daily basis with tax enforcement details that judges are neither qualified, nor have the time, to administer.”<sup>290</sup>

A jeopardy assessment/levy case illustrates this danger. In *Fidelity Equipment Leasing Corp. v. United States*,<sup>291</sup> contrary to usual practice, a court imposed elaborate conditions on the parties, assuming essentially a supervisory role.<sup>292</sup> Predictably, this approach failed, and the court was forced to retreat to essentially upholding the assessment and levy.<sup>293</sup> Subsequent courts have not repeated this error.

Too exacting a review of explanations in deficiency notices would risk such embroilment. Especially when de novo review is in the offing, courts should confine preliminary review to broad strokes rather than attempt to micromanage.

*c. Horizontal Equity.* When a court remands a regulation because of inadequate explanation, all persons potentially subject to the regulation are similarly affected. There may be different practical consequences, but all are in formally the same position. In contrast, IRS deficiency adjudications are individualized affairs. All taxpayers are subject to the same statute, but case-by-case application creates the possibility that similarly situated taxpayers may be treated differently.

Part III.B.2 noted the likelihood that different judges would use varying levels of rigor in applying an APA-style reasoned-explanation requirement to deficiency determinations.<sup>294</sup> Thus, there would be times when a notice of deficiency would be invalidated in

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290. See *Living Care Alts. of Utica, Inc. v. United States*, 411 F.3d 621, 631 (6th Cir. 2005) (writing in the CDP context); see also *Scar v. Comm’r*, 814 F.2d 1363, 1368 (9th Cir. 1987) (stating in the deficiency context that “courts should avoid oversight of the [IRS’s] internal operations and the adequacy of procedures employed”).

291. *Fid. Equip. Leasing Corp. v. United States*, 462 F. Supp. 845 (N.D. Ga. 1978), *vacated in part*, No. C78-1811A, 1981 WL 1755 (N.D. Ga. Mar. 12, 1981).

292. *Id.* at 851–52.

293. *Fid. Equip. Leasing Corp. v. United States*, No. C78-1811A, 1981 WL 1755, at \*9 (N.D. Ga. Mar. 12, 1981).

294. See *supra* Part III.B.2.

one case while, in another case, a notice of no better explanatory quality would be upheld. Considering the frequency of deficiency litigation, such disparate outcomes would be inevitable. This result would contravene horizontal equity, an important goal of our tax system.<sup>295</sup>

*d. Decisional Accuracy.* It sometimes happens that the IRS Examination Division fails to recognize the best theory for a particular adjustment or even misses legitimate adjustments entirely during an audit. As a result, these theories and adjustments are not included in notices of deficiency. The appropriate theories or adjustments are discovered later by the government's lawyer before trial. Under current law, the government is allowed to raise the new theory or adjustment in an answer or amended answer, as long as the taxpayer is not seriously prejudiced thereby.<sup>296</sup> If the new item alters the original deficiency or requires different evidence, the burden of proof will be on the IRS. Otherwise, the burden will (typically) remain on the taxpayer.<sup>297</sup>

The IRS's ability to raise such new matters can be important to accurately determining tax liability. For instance, in one case the taxpayer petitioned the Tax Court with respect to approximately \$16,000 of liability determined in the deficiency notice. However, IRS counsel identified, raised, and won a new issue, resulting in the taxpayer being liable for approximately \$1,025,000.<sup>298</sup> Would the IRS still be able to raise such new matters in an APA-style reasoned-explanation environment? Strict application of the *Chenery I* principle<sup>299</sup> might suggest a negative answer, which would undermine decisional accuracy.

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295. *E.g.*, *Comm'r v. Sunnen*, 333 U.S. 591, 599 (1948); *Ogiony v. Comm'r*, 617 F.2d 14, 18 (2d Cir. 1980) (Oakes, J., concurring). *But see generally* James R. Repetti & Diane M. Ring, *Horizontal Equity Revisited*, 13 FLA. TAX REV. 135 (2012) (maintaining that horizontal equity lacks normative content and should be understood as part of vertical equity).

296. *See* TAX CT. R. 41(a) (allowing liberal amendment of pleadings in the interest of justice).

297. *Id.* 142(a)(1); *see* *Carlebach v. Comm'r*, 139 T.C. 1, 14 (2012).

298. *Raskob v. Comm'r*, 37 B.T.A. 1283, 1283 (1938), *aff'd sub nom.* *Du Pont v. Comm'r*, 118 F.2d 544, 548 (3d Cir. 1941); *cf.* *Trans Miss. Corp. v. United States*, 494 F.2d 770 (5th Cir. 1974) (claimed refund of \$78,000 turned into an additional liability of over \$370,000 as a result of a new item raised by the government).

299. *See supra* notes 58–62 and accompanying text.

*e. Revenue Effect.* As shown in Part I.C above, the typical remedy for an insufficient explanation is remand to the agency. However, many notices of deficiency are issued at or near the end of the statute-of-limitations period for assessing liabilities.<sup>300</sup> If the limitations period continues to run in remand situations, the IRS will often be time-barred from assessing legitimate liabilities.

Normally, the running of the limitations period is tolled by the issuance of a deficiency notice,<sup>301</sup> but there is doubt as to whether an invalid notice effects tolling. On harmless-error grounds, some cases have allowed tolling when there is only a technical defect in the notice and the taxpayer is not prejudiced.<sup>302</sup> But other cases have held that invalid notices did not suspend the running of the limitations period.<sup>303</sup> Some courts say categorically that “[a]n invalid notice of deficiency does not suspend the running of the period of limitations for assessment.”<sup>304</sup> Thus, there is a substantial chance that notices held invalid for inadequate explanation would be found not to suspend the running of the limitations period.<sup>305</sup> Were this to be the case, adoption of a stricter explanation rule would come at a heavy cost to revenue.

#### *B. Legal Necessity*

As shown in Part IV.A, the policy arguments against stricter explanation requirements for IRS deficiency determinations outweigh the policy arguments in their favor.<sup>306</sup> But policy, although relevant, is not dispositive. Even an unfortunate regime must be obeyed as long as it is the law.<sup>307</sup> Thus, this Section asks whether stricter requirements, even if unfortunate, nonetheless are compelled by law.

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300. Unless an exception applies, the IRS must assess additional liabilities within three years of the later of when the return was filed or when it was due to be filed. I.R.C. § 6501(a) (2012); *see, e.g.*, *Jones v. United States*, 60 F.3d 584, 589 (9th Cir. 1995); *Stallard v. United States*, 12 F.3d 489, 493 (5th Cir. 1994).

301. I.R.C. § 6503(a)(1).

302. *E.g.*, *St. Joseph Lease Capital Corp. v. Comm’r*, 235 F.3d 886, 888–92 (4th Cir. 2000).

303. *E.g.*, *Mulvania v. Comm’r*, 769 F.2d 1376, 1380–81 (9th Cir. 1985); *Weber v. Comm’r*, 46 T.C.M. (CCH) 1568, 1570 (1983); *Reddock v. Comm’r*, 72 T.C. 21, 27–28 (1979), *acq.*, 1979-2 C.B. 1.

304. *Napoliello v. Comm’r*, 655 F.3d 1060, 1063 (9th Cir. 2011) (quoting *Shockley v. Comm’r*, 101 T.C.M. (CCH) 1451, 1456 (2011), *rev’d*, 686 F.3d 1228 (11th Cir. 2012)).

305. *See Smith, supra* note 15, at 345 (taking this view).

306. *See supra* Part IV.A.

307. *Cf., e.g.*, *Florida Power & Light Co. v. Lorion*, 470 U.S. 729, 746 (1985) (stating that the rule adopted “must of course be governed by the intent of Congress and not by any views we may have about sound policy”).

It concludes that they are not, and that there are powerful reasons to believe that the law precludes the application of such requirements in the context of IRS deficiency determinations.

There are two principal legal obstacles to applying the APA-style reasoned-explanation analysis to tax deficiency cases: first, the general APA standards are preempted by the specific, *de novo* deficiency review procedures, and second, application of the APA standard would contravene I.R.C. § 7522, a conflict the APA does not countenance. These obstacles are developed below.

1. *Preemption.* For tax traditionalists, this is not an open question. The standards set forth in 5 U.S.C. § 706 are available to a “reviewing court.”<sup>308</sup> Over a half century ago, the Fourth Circuit declared in *O’Dwyer v. Commissioner*<sup>309</sup> that “the Tax Court, rather than being a ‘reviewing court’, within the meaning of [the APA] reviewing the ‘record’, is a court in which the facts are triable *de novo* . . . . [T]he Tax Court is not subject to the [APA].”<sup>310</sup> Many other judges have been equally emphatic in subsequent cases.<sup>311</sup>

But the matter is hardly settled. *O’Dwyer* has been criticized as being “premised on a now outmoded understanding” of administrative law.<sup>312</sup> And the notion that the Tax Court (or, in a refund action, the district court or Court of Federal Claims) is not a “reviewing court” is debatable. When the court decides a case involving a notice of deficiency, an ordinary-meaning approach would surely see the court as reviewing the notice.<sup>313</sup> The contrary approach

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308. 5 U.S.C. § 706 (2012).

309. *O’Dwyer v. Comm’r*, 266 F.2d 575 (4th Cir. 1959).

310. *Id.* at 580.

311. *E.g.*, *Bratcher v. Comm’r*, No. 96-3877, 1997 WL 334976, at \*2 (7th Cir. June 5, 1997); *Ewing v. Comm’r*, 122 T.C. 32, 37 (2004), *rev’d on other grounds*, 439 F.3d 1009 (9th Cir. 2006); *cf.* *Steadman v. SEC*, 450 U.S. 91, 105 (1981) (Powell, J., dissenting) (making a similar argument in the context of disciplinary proceedings brought under securities laws); *ASG Inds., Inc. v. United States*, 467 F. Supp. 1200, 1234 (Cust. Ct. 1979) (citing *O’Dwyer* in making the same argument regarding the former U.S. Customs Court). In a 2013 unpublished order, the Tax Court reaffirmed its adherence to *O’Dwyer* in rejecting an APA-based challenge to the sufficiency of explanations in a notice of deficiency. *QinetiQ U.S. Holdings, Inc. v. Comm’r*, No. 14122-13, at 2–3 (T.C. Dec. 27, 2013) (on file with the *Duke Law Journal*).

312. *Robinette v. Comm’r*, 439 F.3d 455, 461 (8th Cir. 2006); *see also Ewing*, 122 T.C. at 61 (Halpern and Holmes, JJ., dissenting) (“[T]he continuing relevance of the APA discussion in *O’Dwyer* is dubious at best.”). *But see* *Porter v. Comm’r*, 130 T.C. 115, 131 & n.3 (2008) (Thornton, J., concurring) (defending *O’Dwyer*).

313. Indeed, even judges sympathetic to the *O’Dwyer* view sometimes describe Tax Court deficiency proceedings as “review.” *E.g.*, *Ewing*, 122 T.C. at 52 (Thornton, J., concurring).

is based on the idea that, to be a reviewing court, the court must be confined to the administrative record. But it seems unduly narrow to say that a court cannot be a reviewing court just because it is empowered to hear evidence that the agency did not consider.<sup>314</sup>

Although there are substantial arguments on both sides, the traditional view is preferable: *de novo* review of deficiency notices should preclude the APA's arbitrary-and-capricious review of such notices. As shown below, the traditional view, although not compelled by the plain language of the APA, is the better construction of the statute.

*a. Statutory Text.* Many APA provisions are suggestive, but none are dispositive, as to the preemption question. First, 5 U.S.C. § 554 defines procedures governing agency adjudication, but it excludes from its reach all matters “subject to a subsequent trial of the law and the facts *de novo* in a court.”<sup>315</sup> The legislative history of the APA confirms that the Tax Court's review of deficiency notices falls within this exception.<sup>316</sup> However, § 554 governs formal agency adjudication, and IRS adjudication is informal.

Second, 5 U.S.C. § 559 states that the APA rules “do not limit or repeal additional requirements imposed by statute or otherwise recognized by law.”<sup>317</sup> The *de novo* nature of the Tax Court's review of deficiency determinations has been recognized law since well before 1946.<sup>318</sup> However, saying that APA rules do not limit or repeal the *de novo* rules does not conversely say that the *de novo* rules limit or repeal APA rules, which is the question at hand.

Third, 5 U.S.C. § 703 provides: “The form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute . . . .”<sup>319</sup> Tax Court litigation is the special statutory review proceeding specified for deficiency determinations under I.R.C. § 6213.<sup>320</sup> However, to say that

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314. See, e.g., *Wilson v. Comm'r*, 705 F.3d 980, 996 (9th Cir. 2013) (Bybee, J., dissenting) (“[T]he Tax Court is a ‘reviewing court’ for purposes of the judicial review provisions of the APA.”).

315. 5 U.S.C. § 554(a)(1) (2012).

316. See H.R. REP. NO. 79-1980, at 45 (1946); S. REP. NO. 79-752, at 28 (1945).

317. 5 U.S.C. § 559.

318. E.g., *Phillips v. Comm'r*, 283 U.S. 589, 598 (1931); *Blair v. Oesterlein Mach. Co.*, 17 F.2d 663, 665 (D.C. Cir. 1927).

319. 5 U.S.C. § 703.

320. I.R.C. § 6213(a).

this is the form of the proceeding does not define the contents of the proceeding. In this way, 5 U.S.C. § 703 does not foreclose the possibility that § 706 standards could be employed as part of the proceeding.<sup>321</sup>

Fourth, 5 U.S.C. § 704 states that judicial review extends to “[a]gency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court.”<sup>322</sup> “[T]he primary thrust of § 704 was to codify the exhaustion [of administrative remedies] requirement,” but § 704 “also makes it clear that Congress did not intend the general grant of review in the APA to duplicate existing procedures for review of agency action.”<sup>323</sup> In various nontax cases, the availability of express, adequate remedies has been sufficient reason to reject APA remedies.<sup>324</sup> Similar reasoning—although not always specifically linked to the APA—has sometimes appeared in tax cases.<sup>325</sup> In our context, however, no duplication of procedures would be necessary. The same Tax Court or refund proceedings that are available now would still be used. The court would just have an additional option: invalidating the deficiency notice for explanatory insufficiency without needing to reach the substantive merits of the adjustments in the notice.

Fifth, 5 U.S.C. § 706(2) allows “[t]he reviewing court” to “hold unlawful and set aside agency action, findings, and conclusions” found deficient under any of six standards, one being the arbitrary-and-capricious standard,<sup>326</sup> another being “without observance of procedure required by law,”<sup>327</sup> and another being “unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.”<sup>328</sup> One possible reading is that when the Tax Court conducts de novo proceedings, it is not operating outside of the APA but instead is operating within § 706(2)(F),<sup>329</sup> and that the six

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321. See *Ewing v. Comm’r*, 122 T.C. 32, 54 (2004) (Thornton, J., concurring) (agreeing that “in appropriate circumstances, [the Tax Court should] borrow principles of judicial review embodied in the APA”), *rev’d on other grounds*, 439 F.3d 1009 (9th Cir. 2006).

322. 5 U.S.C. § 704.

323. *Brown v. Massachusetts*, 487 U.S. 879, 903 (1988).

324. *E.g.*, *Wash. Toxics Coal. v. EPA*, 413 F.3d 1024, 1034 (9th Cir. 2005).

325. *E.g.*, *Clapp v. Comm’r*, 875 F.2d 1396, 1403 (9th Cir. 1989); *Scar v. Comm’r*, 814 F.2d 1363, 1375 (9th Cir. 1987) (Hall, J., dissenting).

326. 5 U.S.C. § 706(2)(A).

327. *Id.* § 706(2)(D).

328. *Id.* § 706(2)(F).

329. See, *e.g.*, *Wilson v. Comm’r*, 705 F.3d 980, 1003 n.3 (9th Cir. 2013) (Bybee, J., dissenting); *Ewing v. Comm’r*, 122 T.C. 32, 61 (2004) (Halpern & Holmes, J.J., dissenting), *rev’d*

standards in § 706(2) are cumulative, not exclusive.<sup>330</sup> On this reading, a court considering IRS deficiency determinations could employ an arbitrary-and-capricious standard of review under § 706(2)(A) within the context of a proceeding that is de novo under § 706(2)(F). If this reading is accepted, there is no necessary incompatibility as to simultaneous application of the two standards.

In short, courts often say that the de novo nature of Tax Court deficiency proceedings preempts arbitrary-and-capricious review, but none of the potentially applicable statutes command such an outcome by plain language. Construction is necessary, and it is to construction that this Article now turns.

*b. Construction.* If the statutory text does not compel an answer, what is the better construction? There are arguments in favor of allowing APA analysis to supplement traditional tax analysis. For example, Congress intended the APA to “cover a broad spectrum of administrative actions,” and the Supreme Court has held that the APA’s “generous review provisions must be given a hospitable interpretation.”<sup>331</sup> Moreover, the Court has stressed “the importance of maintaining a uniform approach to judicial review of administrative action . . . . The APA was meant to bring uniformity to a field full of variation and diversity. It would frustrate that purpose to permit divergence on the basis of [mere ambiguity].”<sup>332</sup>

However, this policy is no Procrustean bed. In the Supreme Court’s seminal decision in *Mayo Foundation for Medical Education & Research v. United States*,<sup>333</sup> a unanimous Court suggested that context-specific deviations from general principles of administrative law are permissible when justification exists.<sup>334</sup> There are reasons to

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*on other grounds*, 439 F.3d 1009 (9th Cir. 2006); *see also* Porter v. Comm’r, 130 T.C. 115, 131 n.3 (2008) (Thornton, J., concurring) (criticizing the view of Judges Halpern and Holmes).

330. *E.g.*, *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 284 (1974); *Ass’n of Data Processing Serv. Orgs. v. Bd. of Governors*, 745 F.2d 677, 683 (D.C. Cir. 1984).

331. *Brown v. Massachusetts*, 487 U.S. 879, 904 (1988) (quoting *Abbott Labs. v. Gardner*, 387 U.S. 136, 140–41 (1967)) (quotation marks omitted); *see* *Shaughnessy v. Pedreiro*, 349 U.S. 48, 51 (1955).

332. *Dickinson v. Zurko*, 527 U.S. 150, 154–55 (1999).

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

334. *See id.* at 713 (“[The taxpayer] has not advanced any justification for applying a [different standard] to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only.”).



construe the APA's arbitrary-and-capricious standard as being inapplicable to de novo review of deficiency and cognate determinations.

First, although no single APA section described above is conclusive, their cumulative impact should be considered. The Supreme Court has repeatedly instructed that construction involves considering "the overall statutory scheme"<sup>335</sup> to reconcile statutes, to "get[] them to 'make sense' in combination."<sup>336</sup> In this spirit, "[t]he provisions of the [APA] must be read and construed together."<sup>337</sup> Read in concert, the above near-miss sections of the APA suggest a direction that is more felicitous to the *O'Dwyer* view than hostile to it.

Second, the deficiency litigation regime has been defined through statutes, court rules, and case law over generations. This comprehensive set of rules contrasts with the generality of the arbitrary-and-capricious standard of 5 U.S.C. § 706(2)(A). It is a "well-established principle that, in most contexts, a precisely drawn, detailed statute pre-empts more general remedies."<sup>338</sup> Therefore, this comprehensive set of rules should preempt an APA-style explanation here.

Third, as always, context must be considered. As seen in Part I.F, otherwise inadequate explanations are acceptable when it is clear what the ultimate result would be in the situation.<sup>339</sup> There are areas in which the IRS has discretion.<sup>340</sup> However, in deficiency cases, the outcome usually depends not on policy choices made by the IRS, but on rules established by statute or Treasury regulations.<sup>341</sup> In most

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335. *Roberts v. Sea-Land Servs., Inc.*, 132 S. Ct. 1350, 1357 (2012) (quoting *Davis v. Mich. Dep't of Treasury*, 489 U.S. 803, 809 (1989)) (quotation marks omitted).

336. *United States v. Fausto*, 484 U.S. 439, 453 (1988); *see FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000); *Loving v. IRS*, 917 F. Supp. 2d 67, 76–79 (D.D.C. 2013), *aff'd*, No. 13-5061, 2014 WL 519224 (D.C. Cir. Feb. 11, 2014).

337. *O'Dwyer v. Comm'r*, 266 F.2d 575, 580 (4th Cir. 1959).

338. *Hinck v. United States*, 550 U.S. 501, 506 (2007) (quoting *EC Term of Years Trust v. United States*, 550 U.S. 429, 434 (2007)) (quotation marks omitted).

339. *See supra* note 127 and accompanying text.

340. *E.g.*, I.R.C. § 446(b) (2012) (deviations from normal accounting method); *id.* § 481 (adjustments on account of changes in accounting method); *id.* § 1362(f)(4) (adjustments on account of inadvertent invalid S-corporation elections and terminations).

341. When the relevant provision is clear, Treasury and the IRS have "no power to amend it [even] by regulation." *Koshland v. Helvering*, 298 U.S. 441, 447 (1936); *see also Swallows Holding, Ltd. v. Comm'r*, 126 T.C. 96, 129 (2006) ("[T]he authority delegated to the Secretary . . . is not limitless and, if exercised improperly, may usurp the role of Congress . . ."), *rev'd on other grounds*, 515 F.3d 162 (3d Cir. 2008). Treasury often has considerable freedom in

deficiency cases, therefore, arbitrary-and-capricious review should have limited purchase.

2. *Section 7522*. As seen in Part III.A.1, I.R.C. § 7522 requires the IRS to explain the basis of adjustments set out in notices of deficiency.<sup>342</sup> Such explanations are less complete than explanations under the arbitrary-and-capricious standard might require.<sup>343</sup> Nonetheless, Congress expressly provided that “[a]n inadequate description under [§ 7522] shall not invalidate [the notice of deficiency].”<sup>344</sup> Short of invalidation, the Tax Court has held that shifting the burden of proof to the IRS is an appropriate remedy for violation of § 7522.<sup>345</sup>

Section 7522’s “no invalidation for inadequate description” direction strongly argues against applying APA-style reasoned-explanation analysis to IRS deficiency determinations.<sup>346</sup> Invalidating a notice of deficiency because of its descriptive insufficiency would be precisely what Congress said that it did not want to happen.

A possible rejoinder involves 5 U.S.C. § 559, which provides: “Subsequent statute may not be held to supersede or modify [various APA sections, including § 706] except to the extent that it does so expressly.”<sup>347</sup> I.R.C. § 7522 was enacted after the 5 U.S.C. § 706, and the former section does not refer expressly to the latter section.<sup>348</sup>

But it would be a mistake to take the language in § 559 at face value. Express language is one of several devices by which previous legislatures attempt to entrench their work against change by later legislatures. But at a certain point, entrenchment becomes constitutionally dubious. It is fundamental that “one legislature

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how it writes a regulation. Once the regulation has been finalized, however, it binds the IRS and taxpayers alike.

342. See *supra* notes 198–99 and accompanying text.

343. See *supra* notes 190–95 and accompanying text.

344. See I.R.C. § 7522(a) (Any notice to which this section applies shall describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice. *An inadequate description under the preceding sentence shall not invalidate such notice.* (emphasis added)).

345. See *supra* note 205 and accompanying text.

346. See I.R.C. § 7522(a).

347. 5 U.S.C. § 559.

348. Compare Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6233, 102 Stat. 3735, 3735 (codified as amended at I.R.C. § 7522), with Administrative Procedure Act, ch. 324, § 10, 60 Stat. 237, 243 (1946) (codified at 5 U.S.C. § 706).

cannot abridge the powers of a succeeding legislature.”<sup>349</sup> Thus, a prescription indicating that a later enactment can have effect only if it expressly refers to the APA is of questionable legitimacy.<sup>350</sup>

Accordingly, despite occasional overly exuberant remarks in some cases,<sup>351</sup> language such as that in § 559 does not create an absolute rule of law but operates only as a “background canon[] of interpretation of which Congress is presumptively aware.”<sup>352</sup> A later statute may overcome an entrenchment attempt “either expressly or by necessary implication.”<sup>353</sup> A “fair implication” in the later statute can suffice.<sup>354</sup> Specifically, in *Marcello v. Bonds*,<sup>355</sup> the Supreme Court refused “to require Congress to employ magical passwords in order to effectuate an exemption from the [APA],” and it held that a later statute impliedly exempted deportation hearings from APA procedures despite § 559’s “expressly” language.<sup>356</sup>

The necessary, fair, indeed inescapable implication of I.R.C. § 7522 is that Congress does not want notices of deficiency to be invalidated because of explanatory shortcomings. Congress’s intent trumps 5 U.S.C. § 559 and defeats the possible application of the APA’s reasoned-explanation analysis to IRS deficiency determinations.

## V. REASONED EXPLANATION AS TO OTHER IRS DETERMINATIONS

For the reasons set out in Part IV above, the case is quite strong for not applying the APA’s reasoned-explanation requirement to deficiency determinations. The balance of considerations is different as to other types of IRS adjudication, however, resulting in different levels of confidence and even different conclusions.

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349. *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 135 (1810).

350. *See generally* Amandeep S. Grewal, *Legislative Entrenchment Rules in Tax Law*, 62 ADMIN L. REV. 1011 (2010).

351. *See, e.g.*, *Wilson v. Comm’r*, 705 F.3d 980, 999 (9th Cir. 2013) (Bybee, J., dissenting) (“Exceptions to the APA may not be inferred, but must be express . . .”). *But see* *Robinette v. Comm’r*, 439 U.S. 455, 460 (8th Cir. 2006) (taking a less committal view of the matter).

352. *Lockhart v. United States*, 546 U.S. 142, 148 (2005) (Scalia, J., concurring). *But see* 2 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 11.1, at 772 (4th ed. 2002) (“The majority [opinion in *Dickinson v. Zurko*, 527 U.S. 150 (1999),] . . . seemed to establish a presumption in favor of uniformity in standards for judicial review of agency actions that can be overcome only by ‘clear’ evidence in support of a departure.”).

353. *Great N. Ry. Co. v. United States*, 208 U.S. 452, 465 (1908).

354. *Warden v. Marrero*, 417 U.S. 653, 660 n.10 (1974).

355. *Marcello v. Bonds*, 349 U.S. 302 (1955).

356. *Id.* at 310.

A. *Jeopardy and Termination Determinations*

The § 7522 argument, which, as shown, is strong in the deficiency context, appears at first blush not to apply in jeopardy and termination situations. Jeopardy and termination notifications are not among the vehicles listed in § 7522(b), and, unlike the deficiency procedures that date back to the 1920s, § 7429 was enacted in 1976,<sup>357</sup> thirty years after the enactment of the APA.

Could an argument be made, however, that § 7429 is so linked to the deficiency process that it is within the penumbra of § 7522? The spousal relief rules of § 6015 were enacted in 1998<sup>358</sup>—although a predecessor of § 6015 had roots in the 1970s. Nonetheless, some judges have stated that § 6015 is part and parcel of the deficiency process and, therefore, should be viewed as outside the reach of the APA.<sup>359</sup>

But that approach has been criticized even in the § 6015 context,<sup>360</sup> and such an argument would be even more of a stretch in the jeopardy-and-termination context. Spousal relief decisions under § 6015 are part of the process of determining liability, as are deficiency determinations. As seen in Part II.B, jeopardy and termination decisions do not determine liability. They merely freeze the status quo to preserve collection potential should the IRS eventually prevail. The merits of the liability determination come later, in independent Tax Court or refund proceedings.

Despite the unavailability of a § 7522 argument, the balance of considerations favors not applying APA-style reasoned-explanation analysis to IRS jeopardy and termination assessments. First, the extraordinary need for expedition in jeopardy and termination cases makes adding an extra level of procedure unwise. Second, there is little need for the addition of a new analysis. The IRS's issuance of large numbers of notifications merely parroting the statutory language is a practice that is decades in the past. Should the bad old

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357. Tax Reform Act of 1976, Pub. L. 94-455, § 1204(a), 90 Stat. 1520, 1695 (codified as amended at I.R.C. § 7429 (2012)).

358. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, § 3201, 112 Stat. 685, 734 (codified as amended at I.R.C. § 6015).

359. *E.g.*, *Comm'r v. Neal*, 557 F.3d 1262, 1273 (11th Cir. 2009); *Ewing v. Comm'r*, 122 T.C. 32, 52 (2004) (Thornton, J., concurring), *rev'd on other grounds*, 439 F.3d 1009 (9th Cir. 2006).

360. *E.g.*, *Wilson v. Comm'r*, 705 F.3d 980, 1003 n.3 (9th Cir. 2013) (Bybee, J., dissenting); *see Ewing*, 122 T.C. at 64 n.11 (Halpern and Holmes, JJ., dissenting) (“[W]e emphatically do not agree that sec. 6015 is ‘part and parcel’ of the ‘specific statutory framework for reviewing deficiency determinations . . . .’” (quoting *id.* at 52 (Thornton, J., concurring))).

days return, courts have established a context-specific explanation duty,<sup>361</sup> rendering an APA explanation duty unnecessary. Third, when courts choose not to invoke that tax-specific duty, it is because the taxpayer suffered no substantial prejudice.<sup>362</sup> The harmless-error rule is a recognized exception to the APA's reasoned-explanation requirement.<sup>363</sup> In the area of IRS adjudication, the rule has been applied most often in jeopardy and termination cases, and it serves well in this context. It would be wrong to exempt all IRS adjudications from reasoned-explanation analysis based on blanket assertion of harmless error. Harmless error is a narrow rule to be applied on a case-by-case basis rather than categorically,<sup>364</sup> and this is how it has been used in the jeopardy-and-termination context.

### B. CDP Determinations

1. *Collection Issues.* Collection is involved in most issues in CDP hearings, such as whether the IRS has taken the right procedural steps for collection and whether less harsh collection alternatives exist. The balance of considerations favors allowing APA-style reasoned-explanation analysis for CDP collection issues.

The legal arguments counseling a different outcome in the deficiency context do not operate as to CDP collection issues. The CDP regime was added to the I.R.C. in 1998.<sup>365</sup> CDP notices of determination are not mentioned in § 7522, and CDP was a distinct innovation, not part and parcel of the deficiency process.<sup>366</sup> Harmless-

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361. See *supra* notes 198–203 and accompanying text.

362. See *supra* note 208 and accompanying text.

363. See *supra* notes 38, 126–27 and accompanying text.

364. See, e.g., *Shinseki v. Sanders*, 556 U.S. 396, 407 (2009) (warning against “the use of mandatory presumptions and rigid rules rather than case-specific application of judgment” in reviewing the harmless-error framework the Federal Circuit applied to decisions by the Department of Veterans Affairs); *Sugar Cane Grower Coop. of Fla. v. Veneman*, 289 F.3d 89, 96 (D.C. Cir. 2002) (rejecting a broad harmless-error claim that “would have us virtually repeal” a part of the APA, and adding that “an utter failure to comply with [an APA requirement] cannot be considered harmless if there is any uncertainty at all as to the effect of that failure”). Some moderation of the traditional rule may be developing. See, e.g., *Shinseki*, 556 U.S. at 411 (acknowledging that “courts may sometimes make empirically based generalizations about what kinds of errors are likely, as a factual matter, to prove harmful”); Smith, *supra* note 38, at 1729 (observing that, although case-by-case inquiry has been the norm, patterns of application have started to develop).

365. See *supra* note 156 and accompanying text.

366. Cf. *supra* note 359 and accompanying text.

error analysis is far less prominent in CDP than in jeopardy-and-termination review.

At the level of policy, as seen in Part IV.A.2.e, one major concern in the deficiency context is that invalidation of the notice of deficiency on explanation grounds would leave the IRS unable to proceed because of expiration of the statute of limitations on assessment. But CDP collection issues arise after the tax already has been assessed, and the IRS has ample time to effect collection: at least ten years.<sup>367</sup> Moreover, the scope of IRS discretion typically is greater in collection than in deficiency contexts.

In short, neither legal compulsion nor policy exigencies operate in CDP collection determinations to the degree they do in deficiency determinations. As to collection issues in CDP, there is insufficient warrant to depart from broad and uniform application of the APA.

2. *Liability Issues.* Liability issues sometimes are considered at CDP hearings. Section 6015 spousal relief issues may be considered, as well as the merits of the underlying liabilities “if the person did not receive any statutory notice of deficiency . . . or did not otherwise have an opportunity to dispute such tax liability.”<sup>368</sup> This context presents a weaker case for preemption of APA analysis than does the deficiency determination context, but a stronger case for this analysis than does the CDP collection issues context. Revenue exigencies do not operate strongly because CDP hearings come after the tax already has been assessed.

Perhaps most compelling is the incongruity that would exist were deficiency decisions under CDP to be treated more favorably for taxpayers than deficiency decisions outside of CDP. For example, in one case, the IRS properly sent a sixty-day letter (notifying the taxpayer of § 6672 liability) to the target’s home.<sup>369</sup> There, it was signed for by the target’s twenty-three-year-old son, who (in the best tradition of adolescence) threw the letter “somewhere” in the basement instead of giving it to his father.<sup>370</sup> The court held that the target had not had a prior opportunity, so it allowed him to contest the § 6672 merits in the CDP hearing.<sup>371</sup> The Tax Court also has held

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367. I.R.C. § 6502(a) (2012).

368. *Id.* §§ 6330(c)(2)(A)(i), (B).

369. *Lepore v. Comm’r*, No. 11698-11L, 2013 WL 2359486, at \*1 (T.C. May 30, 2013).

370. *Id.* at \*4.

371. *Id.* at \*5.

that taxpayers who allegedly overstated their liabilities on the returns they filed can dispute those liabilities in CDP hearings.<sup>372</sup>

If the APA-style reasoned-explanation requirement were to apply to liability issues in CDP hearings—but not in the normal deficiency process—parents of irresponsible offspring would have greater procedural protections than parents of responsible offspring. And taxpayers who file inaccurate returns and then enter the CDP process would have greater protections than those in deficiency and refund proceedings. It would be fairer to subject taxpayers to the same procedures whether their liability issues are contested in deficiency proceedings, refund proceedings, or CDP hearings. For, as shown in Part IV, the APA's reasoned-explanation requirement should not be applied to liabilities determined in deficiency cases, neither should it be applied to liabilities in CDP hearings. This approach would result in two sets of rules being applied in the same CDP case: the APA's reasoned-explanation requirement would apply to collection issues but would not apply to liability issues in the same CDP case. But this result would be tolerable.<sup>373</sup>

### C. *Trust Fund Recovery Penalty Determinations*

Explanations in sixty-day letters present yet another concatenation of considerations. Section 6672 is actually a collection device,<sup>374</sup> a fact that normally diminishes the need to preempt APA analysis. However, § 6672 liability must be assessed before it can be collected. The IRS must assess § 6672 liabilities against the responsible persons within three years of the filing of the return that has given rise to the unpaid liability.<sup>375</sup> That being so, the statute-of-limitations-based concern about loss of revenue from reasoned-explanation remands would operate in the § 6672 context. This concern—coupled with the infrequency of complaints about inadequately descriptive sixty-day letters and the existence of a harmless-error line of cases in the area—should tip the balance against applying APA-style reasoned-explanation requirements to sixty-day letters.

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372. *Montgomery v. Comm'r*, 122 T.C. 1, 2 (2004), *acq.*, 2005-2 C.B. 1152.

373. A different split rule, distinguishing between liability and collection issues, already exists in the CDP context. CDP liability decisions are reviewed *de novo*, whereas CDP collection decisions are reviewed deferentially. *E.g.*, *Goza v. Comm'r*, 114 T.C. 176, 181 (2000).

374. *See supra* note 170.

375. *See supra* note 300.

#### D. Other IRS Adjudications

The considerations discussed in Parts IV and V might be useful in resolving questions about the application of explanation requirements to IRS adjudications outside the four paradigms explored in this Article. The case for such application is likely to be stronger in collection than in liability contexts and in situations in which a statute of limitations imposes no special need for expedition. In contrast, the case for application is likely to be weaker when a long-established and carefully detailed tradition of rigorous review exists, when the IRS has little discretion in applying the substantive rules, when skimpy explanations are likely to be harmless, when tax-specific explanation rules already operate with some vigor, or when a practice of substantial explanation already prevails.

#### CONCLUSION

Commentators, including Professors Kristin Hickman and Leandra Lederman, have rightfully decried the tendency of tax professionals to consider “tax law an island, apart from all other bodies of law.”<sup>376</sup> But our objection should be to mindless calls for parochial difference. The tradition of American administrative law is sensitivity to context, not straitjacketing or lock-step conformity.

Reflecting this tradition, this Article has considered whether reasoned-explanation analysis under the APA’s arbitrary-and-capricious standard should be added as a further level of review of IRS adjudicative decisions. The Article concludes that this would be a bad idea for deficiency determinations and would probably be a bad idea in the contexts of jeopardy and termination determinations, trust fund recovery penalty determinations, and CDP liability determinations. Nevertheless, it would be a good idea for CDP collection determinations, and, pending particularized analysis, might be a good idea as to some other types of IRS adjudications.

It is apparent from the foregoing that there are many difficult issues in reconciling the APA’s reasoned-explanation requirement

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376. Lane, *supra* note 233, at 166; *see also* Paul L. Caron, *Tax Myopia, or Mamas Don’t Let Your Babies Grow Up To Be Tax Lawyers*, 13 VA. TAX REV. 517, 518 (1994) (noting the “myth that tax law is somehow *different* from other areas of the law”); Kristin E. Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1542 (2006) (arguing that “tax does not have, has never had, and should not have its own unique deference tradition”); Lederman, *supra* note 184, at 183 (describing the tendency as “tax insularity”).



with IRS adjudication. But the issues relating to them are one part of scores, probably hundreds, of areas of potential controversy that arise from the recent short-run marriage of tax and administrative law. To paraphrase Glen Campbell, there'll be a load of compromisin' on the road to our tax horizon<sup>377</sup> before these newlyweds gradually, sometimes painfully, learn the principles of successful cohabitation.

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377. Cf. GLEN CAMPBELL, *Rhinestone Cowboy*, on RHINESTONE COWBOY (Capitol Records 1975).