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Home Concrete: After the Cheering, Problems

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Home Concrete: One Case, Two Perspectives

NewsQuarterly is pleased to present two perspectives on the Supreme Court's recent decision in *Home Concrete*. The first is by regular contributor Professor Steve R. Johnson. The second is by IRS Chief Counsel William J. Wilkins from remarks he delivered at the Tax Section's 2012 May Meeting.

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After the Cheering, Problems

By Steve R. Johnson*

First impressions sometimes are deceiving. When, last year, the Supreme Court decided *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011), there was widespread chagrin in the taxpayer community. That reaction seems to have abated, however, perhaps because taxpayers have not been losing cases notably more frequently after *Mayo* than before it. (This history is developed in my article *Preserving Fairness in Tax Administration in the Mayo Era*, 32 VA. TAX REV. _ (forthcoming Summer 2012).)

On April 25, 2012, the Supreme Court handed down its long-awaited decision in *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012). Initial taxpayer reaction to *Home Concrete* was distinctly positive. But this reaction too may prove premature. The benefits of the decision may prove limited or fleeting, yet the harms created by the case in terms of doctrinal confusion may bedevil tax litigation for years to come.

Background

The facts of *Home Concrete* are widely known. Section 6501(e)(1)(A)(i) grants the Service a six-year limitations period to assess a deficiency when the taxpayer "omits from gross income an amount properly includible therein [which] is in excess of 25 percent of the amount of gross income stated in the return." This provision clearly applies to omissions of sufficient amounts of taxable receipts. Does it also apply to understatements which arise because the taxpayer substantially overstated her basis in property she sold or as to which she took deductions?

In *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958), the Supreme Court answered that question in the negative under a cognate section of the 1939 Code. However, the government maintained that changes to the provision in its recodification in the 1954 Code limited the effect of *Colony*, and it continued to litigate the issue in some contexts, including many recent tax shelter cases in which the Service had failed to act within the normal three-year limitations period.

The outcomes of the post-*Colony* cases were mixed. After a string of high-profile losses, the Treasury amended section 301.6501(e)-1 to instantiate the government's

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litigating position that the six-year period applies in overstated-basis situations. Treasury sought to apply the amended regulation to all open cases, including ones in which judicial decisions had been rendered but had not yet become final. Taxpayers challenged the validity of the amended regulation. A split among the lower courts caused the Supreme Court to hear the issue.

In *Home Concrete*, the Court held for the taxpayer, invalidating the regulation. The Court was seriously divided, however. Justice Breyer wrote an opinion which three other justices joined in full. Justice Scalia concurred in part and concurred in the judgment. Justice Kennedy filed a dissenting opinion which three other justices joined.

Taxpayer-Friendly Aspects

Three aspects of *Home Concrete* will be encouraging to taxpayers. The first, of course, is the holding. As noted, most of the recent cases—including *Home Concrete* itself—involved tax shelters. As a result of the Supreme Court's holding, decisions have been or will be entered for taxpayers in these cases. It has been estimated that the government will lose as much as $1 billion in revenue. But not just tax shelter "investors" and promoters will be cheered by the *Home Concrete* holding. The amended regulation was not limited to tax shelters. Non-shelter taxpayers were the unrepresented parties in interest in *Home Concrete* and are equally the beneficiaries of it.

Second, *Home Concrete* vindicates rule-of-law values. To me and many others, the government's conduct had a "the ends justify the means" quality about it. The government's briefs in this line of cases repeatedly stressed that the case involved a tax shelter. So what? Short of fraud, the nature of the transaction is irrelevant to the statute of limitations. To paraphrase *Matthew* 5:45, the Code causes the sunlight of section 6501 to shine on both the good and the bad taxpayers.

One of the main rule-of-law values is protecting reasonable reliance interests. "[J]ustifiable taxpayer reliance" was important to Justice Scalia. 132 S. Ct. at 1846. The four dissenters also cared about this value although they thought the state of the law to be too uncertain to imperil "legitimate settled expectations." *Id.* at 1853. We may hope that this strand of *Home Concrete* is reflected in future tax cases involving reasonable reliance.

Third, *Home Concrete* helps allay fears arising from *Mayo*. *Mayo* held that challenges to tax regulations generally are evaluated under the deferential *Chevron* two-step, see *Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and it dispatched some of the stock contentions taxpayers had been using to challenge regulations. Many feared that these holdings, especially when combined with other rules deferential to agencies, could dramatically tip the scales in the government's favor in future tax litigation.

One of those other deferential rules emanates from *National Cable & Telecommunications Assn. v. Brand X Internet Servs.*, 545 U.S. 967 (2005). In that case, the Court held that an agency may, by regulation, trump a prior judicial construction of a statute as long as the regulation is *Chevron* entitled and the prior court did not reach its result based on an unambiguous statute. Yet neither *Mayo,* nor *Brand X,* nor their combination saved the regulation at issue in *Home Concrete*. Taxpayers may thus hope that, despite *Mayo*, we are not in a "deference run riot" world.

At least some of the initial encouragement produced by *Home Concrete* may fade, however. Having found litigation and regulation unavailing, the government may now turn to legislation. Treasury could ask Congress to amend section 6501(e) to incorporate the position in the amended regulation (although preoccupation with the upcoming elections might delay such action).

Moreover, a 4–1–4 decision is hardly so firm a foundation as to inspire unbridled confidence that rule-of-law values will be honored in future litigation and that pro-government rules of deference will not be applied to shield overly zealous tax administration. In short, enthusiasm about the pro-taxpayer aspects of *Home Concrete* must be tempered by awareness of what the future may bring.

Problems with *Home Concrete*

There are two unfortunate aspects of the Court's decision. First, important issues in the intersection of tax and administrative law were unresolved by the decision despite their having been briefed by the parties and the amici. Here are three examples. (1) When are tax regulations invalid because of their retroactivity? Only the dissent addressed this, and its remarks were brief. *See* 132 S. Ct. at 1853. (2) Does *Brand X* empower agencies to trump even Supreme Court decisions? *Home Concrete* addressed this only situationally (in terms of *Colony*), not globally. (3) Treasury had adopted the amended regulation initially as a temporary regulation which did not go through the notice-and-comment process prescribed by the Administrative Procedure Act (APA), 5 U.S.C. section 553. The subsequent final regulation did go through notice-and-comment. Does the initial failure to follow the APA taint the later exercise that did follow the APA? The lower courts disagreed about this; yet the Supreme Court was silent as to the question. These and other important matters will have to be addressed through possibly protracted future litigation. Opportunities were missed in *Home Concrete*.

The second problem is even worse. I and a growing number of others believe that *Chevron* is a disaster. For many reasons (detailed in part in the forthcoming *Virginia Tax Review* article cited above), *Chevron* was misguided when originally decided, and it has

only gotten worse as a result of subsequent decisions.

Two of the problems with *Chevron* are the unpredictability of its application and the ease with which it can be manipulated by judges to accommodate results-oriented decision-making. *Home Concrete* exacerbates these problems.

There are two competing models as to the proper roles of courts and agencies. The "independent judgment" model puts courts at the center of statutory interpretation. *E.g., Marbury v. Madison*, 1 Cranch 137, 177 (1803) ("It is emphatically the province and duty of the judicial department to say what the law is."). The Court rejected that approach in *Chevron*, following instead a model in which courts defer substantially, though not entirely, to agencies. *Brand X* followed the logic of that deferential model to a perhaps uncomfortable extreme.

Chevron became worse when, in *Mead* and other subsequent cases, the Court held that *Chevron* applies only sometimes in agency cases and when it rejected possible bright lines for when *Chevron* does and does not apply. *See United States v. Mead Corp.*, 533 U.S. 218 (2001).

Home Concrete does to *Brand X* what *Mead* did to *Chevron*. The Court could have chosen a bright line, such as that *Brand X* authorizes agencies to overturn only decisions of the lower courts, not those of the Supreme Court. But (unsurprisingly given the fact that Justice Breyer wrote the opinion) the *Home Concrete* plurality eschewed this and all other bright lines.

Instead, if the plurality's approach holds in future cases, *Brand X* will require at least two separate inquiries: (1) whether the statute is ambiguous and (2) if it is, whether Congress intended to delegate to Treasury and the Service the power to fill the gap. *See* 132 S. Ct. at 1843–44. This makes decision-making less predictable and more readily manipulable.

Justice Scalia accused the *Home Concrete* plurality of "revising *yet again* the meaning of *Chevron*— and revising it *yet again* in a direction that will create confusion and uncertainty," thus making the Court's "judicial-review jurisprudence curiouser and curiouser." *Id.* at 1847 (emphasis in original), 1848. Sadly, that may be the most enduring legacy of *Home Concrete*. ■