8-28-2006

Swallows as It Might Have Been: Regulations Revising Case Law

Steve R. Johnson
Florida State University College of Law

Swallows as It Might Have Been: Regulations Revising Case Law

By Steve R. Johnson

Steve R. Johnson is the E.L. Wiegand Professor at the William S. Boyd School of Law, University of Nevada, Las Vegas. The author invites comments addressed to steve.johnson@unlv.edu. The author thanks Matthew Engle and Annette Mann for their assistance.

In *Swallows Holding*, the Tax Court invalidated an interpretive regulation involving return filing by some foreign corporations. In a previous report, Johnson maintained that the regulation is consistent with prior case law and should be upheld under the *National Muffler* standard of deference. Therefore, *Swallows* should be reversed on appeal.

In this report, Johnson uses *Swallows* to explore *Chevron* and *Brand X* issues as to interpretive tax regulations generally. He maintains that *Chevron* typically should apply to challenges to those regulations (and specifically should apply to the challenge to the *Swallows* regulation) and *Brand X* should apply when tax regulations revise prior case law rules.

For the author's first report on *Swallows Holding*, see "*Swallows Holding* as It Is: The Distortion of *National Muffler*," *Tax Notes*, July 24, 2006, p. 351.

Table of Contents

This is the second of two reports on the *Swallows Holding* decision.[1] In that case, the Tax Court, over three dissenting opinions, invalidated a timing rule contained in a Treasury regulation under IRC section 882. That timing rule provided that some foreign corporations could not claim otherwise available deductions if their returns for the tax year were filed outside an 18-month grace period. The majority and the dissenters clashed over which line of authority — *Chevron*[2] or the pre-*Chevron* tax-specific line of decisions typified by *National Muffler*[3] — provides the governing standard for evaluating the validity of general authority tax regulations, and what result should be reached in the case under the governing standard.

The majority opinion in *Swallows* identified the *National Muffler* line of cases as controlling. The majority saw the regulation as contrary to prior cases, which the majority thought had rejected that the statute authorizes a timing limitation.[4] Thus, the regulation did not pass muster under *National Muffler* and also would not have passed muster under *Chevron* had *Chevron* provided the controlling standard.

I believe that *Swallows* was wrongly decided and should be reversed on appeal.[5] My first report[6] advanced the more modest case for reversal. The *Swallows* majority opinion misread the cases on which it relied. Properly analyzed, those cases establish, rather than reject the proposition, that a timing limitation is contemplated by the statute,[7] and they do not fix the point at which the limitation is triggered.[8] That being so, the only question is line-drawing. Treasury, not the courts, is the body

---

[1] *Swallows Holding, Ltd. v. Commissioner*, 126 T.C. 96, *Doc 2006-1541, 2006 TNT 18-10* (2006).

[2] *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

[3] *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979).

[4] *See* 126 T.C. at 137 and 148.

[5] The IRS filed its notice of appeal to the Third Circuit on July 5, 2006.

[6] Steve R. Johnson, "*Swallows Holding* as It Is: The Distortion of *National Muffler*," *Tax Notes*, July 24, 2006, p. 351.

[7] *See id.* Part II.

[8] *Id.* Part III.A.

authorized to fill in statutory gaps,[9] and the line drawn by the regulation is reasonable.[10] The lesson suggested in the first report is that the *Swallows* majority distorted the standard it purported to apply. *National Muffler* and the line of cases of which it is a part are deferential. In the hands of the *Swallows* majority, deference was improperly converted into strict scrutiny.[11]

If I am right in the above conclusions, *Swallows* could be reversed on fairly straightforward grounds without having to grapple with larger issues arising from *Chevron* and from the Supreme Court's *Brand X* decision last year.[12] In *Brand X*, the Supreme Court held: "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[13]

In light of those cases, there are two larger issues. First, should *Chevron*, not *National Muffler*, provide the controlling standard in *Swallows*? Second, does *Brand X* authorize the Treasury to, in effect, overrule prior case law via a general authority regulation? Those issues deserve examination, and if there had been a conflict in *Swallows* between the regulation and the earlier cases, *Swallows* would have been a good vehicle for that examination. Accordingly, in this report I assume a condition contrary to fact: that there is a genuine conflict between the regulation and the previous cases. I will sometimes refer to "mutated *Swallows*," to make clear that I am talking about the case as it might have been, not as it was.

I believe that, on *Chevron* and *Brand X* grounds, the regulation at issue in *Swallows* is valid, even in the mutated scenario. Parts I and II of this article provide the foundation. Part I sketches *Swallows*, emphasizing aspects relevant to the second report. Part II analyzes the prior cases on which the *Swallows* majority relied. It shows why those cases endorsed some timing limitation, and it assumes *arguendo* that they established a rule that the terminal date (the date after which the foreign corporation is barred from filing a return claiming otherwise allowable deductions) is the date on which the IRS prepares a substitute for return (SFR) for the year. That assumption would put the 18-month timing rule in the regulation in conflict with the timing rule emanating from the prior cases.

Part III considers the practical question: Does the choice of governing standard — *Chevron* or *National Muffler* — really matter? Will that choice change the outcome in an appreciable number of actual cases? My answer is that although the choice often will not matter, it can matter in situations like mutated *Swallows* in which a regulation contradicts prior case law.

Parts IV and V address whether *Chevron* should apply to *Swallows*. I conclude that it should. First, as argued in Part IV, general authority regulations — at least ones like the regulation at issue in *Swallows* — should be eligible for *Chevron* treatment. Second, as argued in Part V, the *Swallows* regulation should receive deference since that regulation passes scrutiny under both steps of *Chevron*'s two-step analysis. The regulation passes step one of *Chevron* because section 882(c)(2) does not unambiguously preclude the 18-month timing rule. The purpose of the statute — to encourage the filing of returns — is furthered by a timing limitation. Indeed, the absence of a timing rule would lead to absurd results. The regulation passes step two of *Chevron* because fixing the cutoff date at 18 months is within the range of reason.

Part VI makes the case that, under *Brand X*, any conflict between the regulation and the supposed prior judicial rule should be resolved in favor of the regulation. The precondition of *Brand X* — that the administrative construction is otherwise entitled to *Chevron* deference — is satisfied for the reasons set out in Parts IV and V. Also, the prior cases did not say — and could not have said — that their supposed "time of SFR" construction "follows from the unambiguous terms of [section 882(c)(2)] and thus leaves no room for agency discretion." The grounds on which the *Swallows* majority sought to distinguish *Brand X* are misplaced. Indeed, the purported distinctions contort *Chevron* and *Brand X* into other, lesser approaches to deference.

I. *Swallows*

A. Facts

The taxpayer was a foreign corporation that owned real property in the United States. The corporation was on a fiscal year ending on May 31. The tax years at issue were 1994 to 1996. The due dates for those returns were November 15 of 1994, 1995, and 1996, respectively.[14] The corporation did not file those returns until July 23, 1999. The corporation was treated as having elected to treat its U.S.-source income as effectively connected with a U.S. trade or business.[15] The corporation's deductions for the years at issue substantially exceeded its income. The IRS disallowed the claimed deductions and asserted deficiencies.

Section 882(c)(2) provides that a foreign corporation with effectively connected income can claim deductions "only by filing . . . a true and accurate return, in the manner prescribed in subtitle F, including therein all the information which the [IRS] may deem necessary for the calculation of such deductions." That requirement entered the law in 1928 and has been reenacted many times

[9] *Id.* Part III.B.

[10] *Id.* Part IV.

[11] *Id.* Part V.

[12] *National Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 125 S. Ct. 2688 (2005).

[13] 125 S. Ct. at 2700.

[14] Usually, a corporation must file its income tax return by the 15th day of the third month after the close of its tax year. Section 6072(b); reg. section 1.6072-(a). However, foreign corporations without an office or place of business in the United States (such as the *Swallows* taxpayer) may file up to the 15th day of the sixth month after the close of the year. Section 6072(c); reg. section 1.6072-2(b).

[15] 126 T.C. at 97; *see* section 882(d)(1).

without essential change.[16] Subtitle F contains the procedural sections of the code, including section 6072, that prescribe when income tax returns are to be filed.

Nearly 30 years after enactment of the original predecessor of section 882, regulations were promulgated in 1957. The regulations were amended in 1990 and again in 2002 and 2003.[17] The timing rule at issue in *Swallows* emanated from the 1990 amendments. Those amendments were first proposed in July 1989[18] and were finalized in December 1990, effective for tax years ending after July 31, 1990.[19] Before being finalized, the amendments went through the familiar notice-and-comment process.[20] Treasury stated, "These regulations are necessary so that the income tax returns [of foreign corporations and nonresident alien individuals] will be filed in a timely manner."[21]

The 1990 amendments set out timing rules for foreign corporations in reg. section 1.882-4 and broadly similar timing rules for nonresident alien individuals in reg. section 1.874-1. Under the amended regulation, a foreign corporation may avail itself of otherwise allowable deductions and credits for the year only if it files its federal income tax return by a specified time.[22]

The rules defining the terminal date include complexities and special rules unnecessary to explore for mutated *Swallows* purposes.[23] In general, and as applicable to the *Swallows* taxpayer, for the corporation to be allowed deductions, "the required return for the current taxable year must be filed within 18 months of the due date as set forth in section 6072 and the regulations, under that section, for filing the return for the current taxable year."[24] For simplicity, I use the 18-month terminal date throughout this report. It was the failure of the *Swallows* taxpayer to file its 1994, 1995, and 1996 returns within the 18-month period that prompted the IRS to disallow the deductions claimed for those years.

The taxpayer challenged the validity of the regulation. The majority opinion, invalidating the 18-month time limit in the regulation, was authored by Judge Laro, with 12 judges joining in the opinion and two judges concurring in the result only. Judges Swift, Halpern, and Holmes wrote dissenting opinions.

[16]The statutory history is recounted at 126 T.C. at 107-111.

[17]*Id.* at 125-129.

[18]54 *Fed. Reg.* 31545 (July 31, 1989).

[19]T.D. 8322, 1990-2 C.B. 172, 55 *Fed. Reg.* 50827-01 (Dec. 11, 1990), *corrected at* 56 *Fed. Reg.* 1361-01 (Jan. 14, 1991) and 56 *Fed. Reg.* 5455-07 (Feb. 11, 1991).

[20]*See* proc. reg. section 601.601; IRM 30(15) and 32.1.5.

[21]T.D. 8322, 1990-2 C.B. 172, 172.

[22]Reg. section 1.882-4(a)(2).

[23]For full statement of the rules, see reg. section 1.882-4(a)(3); *see also* 126 T.C. at 135 n.17 (majority opinion) and 151-53 (Swift, J., dissenting).

[24]Reg. section 1.882-4(a)(3)(i). The 1990 regulation allows the IRS to waive the 18-month requirement for good cause, based on the facts and circumstances, if shown by the foreign corporation. Reg. section 1.882-4(a)(3)(ii). It does not appear that the *Swallows* taxpayer sought that waiver.

B. Majority Opinion

Since the regulation in question was promulgated under the general authority of section 7805(a), not under specific authority within section 882 itself, the regulation is an interpretive regulation. The *Swallows* majority identified *National Muffler* as the standard by which to assess the validity of interpretive tax regulations.[25] In general, a regulation is valid under that standard if it implements Congress's intention in a reasonable manner — that is, if it "harmonizes with the plain language of the statute, its origin, and its purpose."[26] The majority concluded that the regulation failed under that standard. The majority suggested that it would have reached the same result under *Chevron*:

> We have previously stated . . . "we are inclined to the view that the traditional, *i.e., National Muffler* standard, has not been changed by *Chevron*, but has merely been restated in a practical two-part test with possibly subtle distinctions as to the role of legislative history and the degree of deference to be accorded to a regulation." . . . Here, we conclude likewise that we need not parse the semantics of the two tests to discern any substantive difference between them. While we apply a *Natl. Muffler* analysis, our result under a *Chevron* analysis would be the same.[27]

The majority did not explain that "same result" conclusion. Presumably, it rests on the majority's "plain meaning" argument. The majority stated: "A plain reading of the relevant text [of section 882(c)(2)] in the context of the . . . Code shows that the text includes no timely filing requirement."[28] The statute makes filing a return "in the manner prescribed by Subtitle F" a condition for allowance of deductions. However, the majority held that the "plain meaning of the word 'manner,' as used in the relevant text, does not include an element of time."[29] Thus, when the regulation added a timing rule for returns, it impermissibly went beyond the statute.

The majority noted many code and precode sections using both "manner" and "time."[30] It concluded that "Congress acted intentionally and purposefully when it included both 'time' and 'manner' in single sections of the referenced statutes but omitted the word 'time' in favor of only the word 'manner' in other single sections of those statutes."[31] Section 882(c)(2) uses the word "manner" but omits the word "time." Thus, the majority concluded, Congress intended that availability of deductions depends on the foreign corporation's filing a return

[25]126 T.C. at 129-131. The majority added, however, that the result it reached would have been the same had it applied *Chevron* instead of *National Muffler*. *Id.* at 131.

[26]440 U.S. at 476-477.

[27]126 T.C. at 131 (*quoting Central Pa. Sav. Ass'n v. Commissioner*, 104 T.C. 384, 392, *Doc 95-3474, 95 TNT 63-11* (1995)).

[28]*Id.* at 132.

[29]*Id.*

[30]*See id.* at 132-135.

[31]*Id.* at 134.

in the manner prescribed under subtitle F but does not depend on its filing a return when prescribed under subtitle F.

Central to the majority's plain meaning argument were the prior cases involving section 882(c)(2), substantially similar section 874(a),[32] and their predecessors. The line included nine cases from 1939 to 1996 decided by the Board of Tax Appeals (BTA), the Tax Court, and the Fourth Circuit. The *Swallows* majority believed the regulation to be inconsistent with those cases. According to the majority, those cases "repeatedly and consistently held that the relevant text did not include a timely filing requirement."[33] As a result, the regulation "merely readopted [the IRS's] unsuccessful litigating position."[34] As described in Part II below, I believe that the majority misread those cases.

Finally, the majority attempted to defuse *Brand X*. Initially, the majority observed: "Given that the Supreme Court has historically reviewed Federal tax regulations primarily under the reasonableness test of *Natl. Muffler* . . . , the question arises whether [*Brand X*], which neither cited *Natl. Muffler* nor involved a Federal tax regulation, applies to Federal tax regulations."[35] In light of its other points, the majority deemed it unnecessary to decide that question.[36]

The majority's principal point was identifying "significant contrasts" between the two cases, which made *Brand X* distinguishable from *Swallows* "for numerous reasons."[37] First, in *Brand X*, the agency (the Federal Communications Commission) "had carefully considered technological developments and its own related interpretations." The majority could find "no corresponding record of the [Treasury's] consideration of whether the relevant text in 1990 included a timely filing requirement; the Secretary's rationale for adopting the disputed regulations is at best perfunctory."[38]

Second, in *Brand X*, the FCC had not previously ruled on the relevant question, but its ruling "was consistent with prior FCC rulings." In contrast, the 1990 regulation adopted a rule not present in the 1957 regulation and "reverse[d] long-settled law."[39]

Third, the FCC had not been a party in the prior case[40] whose holding the later FCC interpretation contravened. "Here, the Commissioner was the unsuccessful party in all of the [prior] cases. . . . In addition, unlike the FCC, the Secretary, through the disputed regulations, is attempting to overturn the outcome of those cases through his general regulatory authority."[41]

Fourth, in *Brand X*, the contrary judicial interpretation had preceded the FCC's determination by only five years. In contrast, the first of the cases relied on by the *Swallows* majority preceded the 1990 regulation by over 50 years during which time, the majority thought, its holding had been sanctified by repeated congressional reenactment of the statute without essential change.[42]

Finally, the *Swallows* majority suggested that the 1990 regulation would be invalid even if *Brand X* could not be distinguished. As quoted above, under *Brand X*, the regulatory interpretation yields to a judicial interpretation when the court says the statute is unambiguous. The *Swallows* majority acknowledged that the prior cases "did not state explicitly that they were applying the unambiguous meaning of the word 'manner.'" Nonetheless, the majority said, "we believe that they did so."[43]

C. Dissenting Opinions

Five points offered in the dissents are relevant to this report. First, Judges Halpern and Holmes concluded that *Chevron*, not *National Muffler*, should provide the controlling standard and that the 1990 regulation is valid under *Chevron*.[44]

Second, the same judges agreed that Congress has not spoken directly to the question at hand — that the statute does not unambiguously preclude the timing rule set out in the regulation.[45] Judge Holmes responded to the majority's "manner" versus "time" analysis. He offered two examples in the tax law in which the statutory term "manner" has been interpreted to include a time aspect.[46] Moreover, arguing that we should "recognize that even tax statutes are written against a background of common law legal usage," Judge Holmes stated, "It is generally the case that when a legal instrument omits explicit time limits to do something permitted or required, it does not ordinarily mean that there are no time limits at all."[47]

Third, the dissenters thought that the timing limitation in the regulation is reasonable. Judge Swift opined:

> It would seem obvious that the increased number of foreign corporation Federal income tax returns filed with [the IRS] in today's world (as distinguished from the 1930s when the cases relied on by the majority were decided) and the increasingly

---

[32]In relevant respects, the section 874 rules as to nonresident alien individuals parallel the section 884 rules as to foreign corporations, including conditioning deductions on properly filed returns. Accordingly, the two sections are viewed as *in pari materia*. *E.g.*, *id.* at 112; *Espinosa v. Commissioner*, 107 T.C. 146, 153, *Doc 96-26161, 96 TNT 188-4* (1996).

[33]126 T.C. at 137.

[34]*Id.* The *Swallows* majority stated that the IRS "acknowledge[d] that [its position in *Swallows*] is the same as that rejected in [the earlier cases]." *Id.* at 99. The details of the purported concession and the necessity of it are not apparent.

[35]*Id.* at 143-144.

[36]*Id.* at 144.

[37]*Id.*

[38]*Id.*

[39]*Id.*

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

[41]126 T.C. at 144-145.

[42]*Id.* at 145. The "legislative reenactment" argument is rebutted by Johnson, *supra* note 6, Part V.A.

[43]126 T.C. at 145.

[44]*Id.* at 157-162 (Judge Halpern) and 172-182 (Judge Holmes).

[45]*Id.* at 158-160 (Judge Halpern) and 164-168 (Judge Holmes).

[46]*Id.* at 165-166 (citing reg. section 1.179-5(a) implementing section 179(c) and reg. section 1.826-1(c) implementing section 835(c)(2)).

[47]126 T.C. at 165-166 (citing contract law cases and commentary). *But see Estate of Camara v. Commissioner*, 91 T.C. 957, 960-963 (1986) (holding that a Form 872-A unlimited consent to extend the assessment statute of limitations does not expire after the passage of a "reasonable" period of time).

> complex tax laws and tax administration applicable thereto would support, per se, [the IRS's] effort, by properly promulgated regulation, to modify and clarify, in the above modest manner, the return filing deadline that has been applicable to foreign corporations.[48]

Judge Holmes agreed that the 1990 regulation is reasonable. He reasoned thusly:

> The Secretary faced an ambiguous phrase in a Code section unambiguously aimed at giving foreign corporations a major incentive to file their returns. He also learned by experience that some taxpayers would wait to file until a notice of deficiency was issued . . . or would file only after starting a case in this Court . . . or would refuse to file even after a revenue agent came calling. . . . To issue a regulation with a fixed grace period and provision for exceptions reflected experience, failed to consider no aspect of the problem, and ran counter to no reasonable evidence before him.[49]

Fourth, all three dissenting judges agreed that the majority gave too little shrift to *Brand X*. The grounds offered by the majority for distinguishing the cases "should not make a difference — [in *Brand X*] the Supreme Court did not balance carefulness of consideration, prior litigation history, or the amount of time that had passed between the case law and the new regulation. It simply looked to see if the agency had been delegated broad regulatory authority and whether its construction of an ambiguous statutory phrase was reasonable."[50]

Fifth, all three dissenters thought that the majority had misread the earlier cases. They concluded that the later cases of the line modified the earliest cases and permitted a timing limitation.[51]

II. The Prior Cases

Covering too many bases, the *Swallows* majority, in various places in its opinion, seemed to read the prior cases as standing for all of three different propositions: as rejecting that the foreign corporation's return must be filed by its due date in order for deductions to be available; as rejecting that the statute permits any timing limitation at all; or as establishing a timing rule that is different from the timing rule in the regulation.[52] That fluidity led Judge Halpern to describe (rather charitably) the majority's characterization as "confusing."[53]

The first proposition has a "straw man" quality. The 1990 regulation does not set the terminal date at the due date of the foreign corporation's return. Instead, the regulation allows an 18-month grace period. Reading the prior cases as rejecting a terminal date identical to the return due date would say nothing about the validity of the regulation. None of the prior cases tested whether an 18-month grace period would be valid.

As will be seen below, the second proposition — that the prior cases reject any timing element whatsoever — is impossible to sustain upon reading the cases. Indeed, all of the courts — the BTA, the Tax Court, and the Fourth Circuit — that decided the cases clearly held that some timing element is contemplated by the statute.

That leaves only the third proposition: that the cases establish a different timing rule from that in the regulation. As will be seen below, that proposition is not well founded. However, since that proposition is less wrong than the hopeless second proposition, I will assume the third proposition to be a valid reading of the prior cases to pursue the mutated *Swallows* analysis in Parts III through VI of this report. Specifically, I will assume that the prior cases established a rule that the terminal date for section 882(c)(2) purposes is the date the IRS prepares an SFR for the tax year.

A. The 'No Timing Rule' View

We will now review the prior cases to the degree necessary to show that they cannot stand for the proposition that the statute does not permit any timing limitation.[54] The *Swallows* majority's best support is the BTA's 1938 *Anglo-American* decision[55] although even that case has some ambiguity. The IRS's position appears to have been that returns filed even one day after their prescribed due dates preclude claiming deductions.[56] The BTA rejected that position in a reviewed decision without dissent. The board acknowledged that the word "manner" is linguistically ambiguous.

> It is true, as [the IRS] points out, that "manner" is a comprehensive term, and includes, but is more comprehensive than, "method, mode, or way." But whether it is broad enough to include the element of time is a more difficult question. In some instances it has been construed by courts as including time; while in others it has been construed as not including it.[57]

Nonetheless, the BTA thought that the term was clear (and did not include a time element) as it is used in the tax statutes.[58] However, the BTA did not frame its holding in absolute terms. "We hold . . . that the mere fact that the return was not filed within the time prescribed by

---

[48]126 T.C. at 153-154. The IRS had argued essentially to the same effect on brief. *See id.* at 126-127.

[49]*Id.* at 182.

[50]*Id.* at 171-172 (Judge Holmes); *see also id.* at 149 (Judge Swift) and 162 (Judge Halpern).

[51]*Id.* at 150-151 (Judge Swift), 158-160 (Judge Halpern), and 167-168 (Judge Holmes).

[52]*See, e.g., id.* at 137 (first proposition: "the relevant text [does] not include a timely filing requirement"), 140 (second proposition: "the relevant text contained no reference to a time element"), and 137 n.22 (third proposition: the preparation of an SFR by the IRS "divests the taxpayer of its entitlement to file a return for itself").

[53]*Id.* at 158.

[54]For a more detailed discussion of the cases, see Johnson, *supra* note 6, Part II.

[55]*Anglo-American Direct Tea Trading Co., Ltd. v. Commissioner*, 38 BTA 711 (1938). The IRS issued a nonacquiescence to *Anglo-American*. 1939-1 C.B. (pt. 1) 39.

[56]*See* 38 BTA at 713-714.

[57]*Id.* at 714 (numerous cited cases omitted).

[58]*Id.* at 715.

[what is now section 6072] does not, under the circumstances of this case, preclude the allowance of the deductions claimed."[59] Thus, the BTA did not necessarily reject all possible terminal dates, just a terminal date identical to the return due date, and even that only under the circumstances of the particular case, which may not be the circumstances of other cases. *Anglo-American* was quickly followed by two BTA memorandum decisions that adhered to *Anglo-American* without additional analysis.[60]

However, the line of cases was soon to take a different direction. Slightly over a year after *Anglo-American*, the BTA decided *Taylor Securities*.[61] In a reviewed decision over three dissents, the BTA distinguished *Anglo-American*[62] and held for the IRS. The *Taylor Securities* BTA held that the statute contemplates some time cutoff after which deductions may not be claimed. Under the statute:

> the allowance to foreign corporations of the credits and deductions ordinarily allowable is specifically predicated upon such corporations filing returns. In view of such a specific prerequisite it is inconceivable that Congress contemplated by that section that taxpayers could wait indefinitely to file returns and eventually when the [IRS] determined deficiencies against them that they could then by filing returns obtain all the benefits to which they would have been entitled if their returns had been timely filed. Such a construction would put a premium on evasion, since a taxpayer would have nothing to lose by not filing a return as required by the statute.[63]

All of the subsequent cases confirmed *Taylor Securities* in that respect: The statute contemplates a timing requirement. Both the BTA and the Fourth Circuit accepted that principle in *Ardbern*.[64]

In *Blenheim*, the BTA held for the IRS, stating that a taxpayer cannot "take advantage from an alleged return submitted not only after the [IRS prepared an SFR] but also after the issuance of a notice of deficiency."[65] The Fourth Circuit affirmed, noting that a timing rule is essential to sound tax administration.

> The many administrative problems inherent in the application of the federal income tax to foreign corporations . . . prompted Congress to impose special conditions on such corporations. . . . In express recognition of this fertile danger to the orderly administration of the income tax as applied to foreign corporations, Congress conditioned its grant of deductions upon the *timely* filing of true, proper and complete returns.[66]

Georday was a companion case to *Blenheim*. The BTA and the Fourth Circuit hewed to the same approach as they had in *Blenheim*, and both held for the IRS.[67] *Espinosa*[68] arose under section 874(a). Again invoking the administrative imperative, the Tax Court held for the IRS, stating that a timing limitation is implicit in the statute.[69] The final case, *InverWorld*, was a section 882(c)(2) decision. The Tax Court held for the IRS on the strength of *Georday* and *Blenheim*.[70]

That the IRS prevailed on the essential point in six of the nine prior cases makes the *Swallows* majority's repeated reference to a "failed" or "unsuccessful" IRS litigating position seem strange. More fundamentally, the foregoing demonstrates that the prior cases cannot reasonably be read to stand for the proposition that section 882(c)(2) permits no timing limitation whatsoever. Even *Anglo-American* did not unambiguously assert that proposition, and the subsequent cases plainly rejected it.

B. The 'Different Timing Rule' View

The only remaining possibility for a conflict between the 1990 regulation and the prior cases is the proposition that the cases established a timing rule, one different from the 18-month period under the regulation. In actuality, that proposition is wrong. The prior decisions did not "provide guidance of general applicability concerning timeliness: [they] merely resolve[d] issues created by unique fact patterns on a case-by-case basis. . . . Timeliness is required, but timeliness is not defined."[71] The *Blenheim* circuit court said that it was not "prescribing an absolute and rigid rule" regarding the terminal date or event,[72] and that is true of the other cases as well.

Possible terminal dates arguably suggested in the cases include a reasonable time after the date on which the IRS contacted the taxpayer about the missing return(s),[73] the date an IRS agent prepared an SFR,[74] the

---

[59] *Id.*

[60] *Mills, Spence & Co., Ltd. v. Commissioner*, 1938 WL 8403 (BTA memo. 1938); *American Inv. & Gen. Trust Co., Ltd. v. Commissioner*, 1939 WL 12044 (BTA memo. 1939).

[61] *Taylor Sec. Inc. v. Commissioner*, 40 BTA 696 (1939).

[62] Unlike the situation in *Taylor Securities*, the returns in *Anglo-American* had been filed before the IRS issued a notice of deficiency, the IRS audited the *Anglo-American* returns, and the SFRs prepared in *Anglo-American* had not been accepted by the commissioner. *Id.* at 702-703.

[63] *Id.* at 703-704.

[64] *Ardbern Co., Ltd. v. Commissioner*, 41 BTA 910, 920 (1940), *modified and remanded on other grounds*, 120 F.2d 424, 426 (4th Cir. 1941). The circuit court's modification was based on an equitable consideration (the taxpayer had tried to file the returns earlier with the wrong IRS office, and the IRS failed to tell the taxpayer where it should have filed) that is not present in *Swallows*.

[65] *Blenheim Co., Ltd. v. Commissioner*, 42 BTA 1248, 1251 (1940), *aff'd*, 125 F.2d 906 (4th Cir. 1942).

[66] 125 F.2d at 909 (emphasis added).

[67] *Georday Enter., Ltd. v. Commissioner*, 1940 WL 10265 (BTA memo. 1940), *aff'd*, 126 F.2d 384, 388 (4th Cir. 1942).

[68] *Espinosa v. Commissioner*, 107 T.C. 146, *Doc 96-26161, 96 TNT 188-4* (1996).

[69] 107 T.C. at 156-157.

[70] *InverWorld v. Commissioner*, T.C. Memo. 1996-301, *Doc 96-18802, 96 TNT 127-14*, 71 T.C.M. (CCH) 3231, 3237-3256.

[71] 126 T.C. at 160 (Halpern, J., dissenting).

[72] 125 F.2d at 910.

[73] *Espinosa*, 107 T.C. at 157.

[74] *E.g., Blenheim*, 42 BTA at 1251 and 125 F.2d at 910. The SFRs that occur in that context are those described in section 6020(b). They are prepared by the IRS from available information, but unlike section 6020(a) SFRs, are not signed by the taxpayer.

date the SFR was formally accepted or acted upon,[75] the date the IRS sent the taxpayer a "doomsday letter,"[76] the date the IRS issued the notice of deficiency,[77] the dates pleadings were filed in court,[78] the date the case was tried,[79] and the date the IRS made the assessment.[80] In short, the prior cases did not establish a rule.

Nonetheless, the *Swallows* majority, in one part of its opinion, read the prior cases as standing for a "preparation of an SFR" terminal date.[81] Accordingly, to explore *Chevron* and *Brand X* issues via mutated *Swallows*, I will assume throughout the rest of this report that the prior cases stand for that rule.

III. Significance of Choice of Standard

I believe *National Muffler* and *Chevron* should be seen as cases of the same line, not as two separate and competing standards of deference. I will develop this thought in a future article. The current report, however, accepts *arguendo* the usual view that the cases represent two separate standards. On that premise, this section describes *Chevron* and the tax-specific line of cases of which *National Muffler* is a part. It then evaluates the potential effect on the outcomes of actual cases of the choice of governing standard, particularly in situations of conflict between regulations and prior case law.

A. *Chevron*

This ground is well trodden, so it can be covered quickly. In *Chevron*, the Supreme Court reversed a circuit court decision invalidating a regulation promulgated by the Environmental Protection Agency. The Court framed the proper role of a reviewing court in the now famous two-step analysis:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[82]

At step one in the analysis, the court exercises its independent judgment and employs "traditional tools of statutory construction."[83] If step two is reached, however, the analysis becomes more deferential.

> The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding. . . . The power of an administrative agency to administer a congressionally created program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress.[84]

The two-step analysis provides the framework for cases to which *Chevron* applies. *Chevron*, however, did not tell us to what types of agency interpretations it applies. When that question is taken into account, the two-step analysis becomes a three-step analysis. Since determining whether *Chevron* applies at all is logically anterior to the other steps, the additional inquiry has been called step zero.[85]

The vacuum that *Chevron* left with respect to step zero was filled, although less than satisfactorily, by the subsequent *Haggar, Christensen, Mead, Barnhart,* and *Brand X* cases.[86] Those cases are discussed in detail in Part IV.B below. For now, it suffices to note that those cases revivified the pre-*Chevron Skidmore* standard by instructing that *Skidmore* can apply when *Chevron* does not.[87] *Skidmore* stated:

> The rulings, interpretations and opinions of the Administrator under the Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.[88]

B. Tax-Specific Line of Cases

Notions of deference have been in the tax jurisprudence for generations.[89] A recognizably modern form of

---

[75]*Taylor Securities*, 40 BTA at 702.

[76]*Espinosa*, 107 T.C. at 151. Such a letter informs the taxpayer that, because of the delinquency of the return, the taxpayer may not claim otherwise available deductions for the year.

[77]*E.g., Taylor Securities*, 40 BTA at 703.

[78]*Georday*, 126 F.2d at 388; *Taylor Securities*, 40 BTA at 702.

[79]*InverWorld*, 71 T.C.M. at 3237-3256.

[80]*Ardbern*, 120 F.2d at 426.

[81]126 T.C. at 137 n.22.

[82]*Id.* at 842-843.

[83]*Id.* at 843.

[84]*Id.* (citations and punctuation marks omitted).

[85]Cass R. Sunstein, "*Chevron* Step Zero," 92 *Va. L. Rev.* 187, 191 (2006).

[86]*United States v. Haggar Apparel Co.*, 526 U.S. 380 (1999); *Christensen v. Harris*, 529 U.S. 576 (2000); *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Barnhart v. Walton*, 535 U.S. 212 (2002); *National Cable & Telecomm. Ass'n v. Brand X Internet Servs.*, 125 S. Ct. 2688 (2005).

[87]*E.g., Mead*, 533 U.S. at 221; *Christensen*, 529 U.S. at 587.

[88]*Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1994).

[89]*E.g., Fawcus Mach. Co. v. United States*, 282 U.S. 375, 378 (1931) (tax regulations "are valid unless unreasonable or inconsistent with the statute"); *cf. International Ry. Co. v. Davidson*, 257 U.S. 506, 514 (1922) (stating the following as to customs duties

(Footnote continued on next page.)

deference doctrine began to appear shortly after World War II. Between then and 1984, when *Chevron* was decided, more than a half dozen Supreme Court cases[90] and numerous lower court cases considered deference in the tax context. The Supreme Court's *National Muffler* decision — perhaps the most frequently cited case of this line and the case on which the *Swallows* majority relied — distilled the following factors from prior cases:

> In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent reenactments of the statute.[91]

Many cases of this line distinguish between two types of regulations: legislative (also called substantive) and interpretive.[92] Those terms can be confusing, however. They have different meanings in tax than in administrative law. In tax, interpretive regulations are issued under section 7805(a)'s broad delegation to the Treasury to "prescribe all needful rules and regulations for the enforcement of [the code]" while legislative regulations are issued under a specific delegation within the particular code section.[93] In contrast, in administrative law, an interpretive regulation is clarifying or advisory in that it "express[es] an agency's intended course of action or its view of the meaning of a statute" while a legislative regulation makes new, enforceable law, "creat[ing] law just as the statute itself does, by changing existing rights and obligations."[94] To avoid the confusion that may arise from those different usages, this report follows Prof. Coverdale's suggested terminology.[95] Thus, this report typically refers to "general authority" regulations instead of interpretative regulations, and to "specific authority" regulations instead of legislative regulations.

Numerous cases have stated that general authority tax regulations receive less deference than do specific authority regulations.[96] However, the significance of that distinction is questionable for three reasons. First, invocations of the distinction are more often ritualistic than outcome determinative. Attacks on general authority regulations usually fail, and attacks on specific authority regulations sometimes succeed.[97] Indeed, it would be a challenge to identify an appreciable number of actual cases in which general authority regulations were invalidated when they would likely have been upheld had they been specific authority regulations. Even *Swallows* is not such a case. One of the majority's rationales was that the regulation at issue is inconsistent with the plain meaning of the statute.[98] If so,[99] the regulation would have been invalidated even had it been a specific authority regulation.[100]

Second, even if a difference exists in practice as well as rhetorically, that difference likely is small.[101] To say general authority regulations receive less deference than do specific authority regulations may distract from the fact that the former still receive a lot of deference. Referring specifically to general authority tax regulations, the Supreme Court remarked in a frequently cited case:

> We recognize that this Court is not in the business of administering the tax laws of this Nation. Congress has delegated that task to the Secretary of the Treasury, 26 U.S.C. § 7805(a), and regulations promulgated under his authority, if found to implement the congressional mandate in some reasonable manner, must be upheld.[102]

Similarly, the Third Circuit has said: "In the tax area, we are still required to treat regulations issued under a

---

that the Court called "virtually [the] laying [of] a tax": "A regulation to be valid must be reasonable and must be consistent with law").

[90]*E.g., Commissioner v. Portland Cement Co.*, 450 U.S. 156, 169 (1981); *Bingler v. Johnson*, 394 U.S. 741, 749-751 (1969); *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948).

[91]*National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472, 477 (1979).

[92]*See generally* Ellen P. Aprill, "Muffled *Chevron*: Judicial Review of Tax Regulations," 3 *Fla. Tax Rev.* 51, 55-57 (1996); Michael Asimow, "Public Participation in the Adoption of Temporary Tax Regulations," 44 *Tax Law.* 343, 350-362 (1991).

[93]*E.g., United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982).

[94]Bernard Schwartz, *Administrative Law* 181 (3d ed. 1991) (quotation marks and footnotes omitted); *see Chrysler Corp. v. Brown*, 441 U.S. 281, 301-302 (1979).

[95]John F. Coverdale, "Court Review of Tax Regulations and Revenue Rulings in the *Chevron* Era," 64 *Geo. Wash. L. Rev.* 35, 52 (1995); *see also Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 978-979, *Doc 98-12811, 98 TNT 76-8* (7th Cir. 1998), *cert. denied*, 525 U.S. 961, *Doc 98-32323, 98 TNT 212-4* (1998).

(Footnote continued in next column.)

[96]*E.g., Rowan Cos., Inc. v. Commissioner*, 452 U.S. 247, 253 (1981).

[97]*E.g., Rite Aid Corp. v. United States*, 255 F.3d 1357, *Doc 2001-18688, 2001 TNT 132-10* (Fed. Cir. 2001); *Tate & Lyle, Inc. v. Commissioner*, 103 T.C. 656, *Doc 94-10271, 94 TNT 224-11* (1994), *rev'd*, 87 F.3d 99, *Doc 96-19729, 96 TNT 135-12* (3d Cir. 1996) (legislative regulation invalidated by Tax Court but validated on appeal).

[98]126 T.C. at 132-136.

[99]I disagree with the majority's conclusion in this regard in Part V.A.

[100]A regulation (of any sort) that flouts the plain meaning of the statute fails step one of *Chevron*. *See Chevron*, 467 U.S. at 843. It also would fail under the pre-*Chevron* tax-specific line of authority.

[101]*See, e.g.*, Boris I. Bittker, Martin J. McMahon Jr., and Lawrence A. Zelenak, *Federal Income Taxation of Individuals* 46-5 (3d ed. 2002) (noting the distinction "at least in theory; but in practice this dichotomy is ethereal, and taxpayers rarely succeed in upsetting regulations of either type").

[102]*United States v. Cartwright*, 411 U.S. 546, 550 (1973) (quotation marks and citations omitted).

general grant of authority with broad deference, although to a somewhat lesser degree than when Congress has made a specific delegation of authority in a specific statute."[103]

Third, the two types of regulations are identical in an important respect. The Administrative Procedure Act prescribes notice and comment processes that agencies are to follow to promulgate binding rules.[104] Interpretive rules (in the nontax sense) are expressly exempted from notice and comment requirements.[105] As shown in Part IV.C below, whether a particular regulation has gone through the notice and comment process is a significant factor in determining the degree of deference it will receive. Significantly, the two kinds of tax regulations are essentially equal in that regard. Not only do specific authority regulations go through the notice and comment process, but virtually all general authority regulations go through it as well.[106]

This tax-specific line of cases has retained vigor even after *Chevron*. As described in greater detail in Part IV.A below, post-*Chevron* tax cases have cited, as providing the controlling standard, *Chevron* alone, the *National Muffler* cases, or both in ways that defy confident categorization. *National Muffler* and the line of cases of which it is a part are discussed at length in my first report on *Swallows*. I conclude that the case and the line are deferential, not hostile, to tax regulations.[107]

C. Effect on Actual Outcomes

The *Swallows* majority posed the question whether the Supreme Court intended *Chevron* to replace the *National Muffler* line of cases as the standard for evaluating the validity of tax regulations. It answered that question by adhering to the view expressed in a previous decision that "'the traditional, i.e., *National Muffler* standard, has not been [greatly] changed by *Chevron*, but has merely been restated [by it].'"[108]

I agree that there is limited profit in endlessly teasing and torturing the verbal formulations of various standards. The spirit in which a standard is applied typically matters more than the precise wording of the standard. A deferential court applying *National Muffler* is more likely to uphold a rule or regulation than is an active court applying *Chevron*.[109] Courts wishing to invalidate a rule or regulation under *Chevron* often achieve that result by finding clear at step one of the two-step analysis what others would have found ambiguous[110] or by selectively applying indicia of reasonableness at step two.[111]

I doubt that the choice of standard matters a great deal *in most cases*.[112] However, some types of cases — including mutated *Swallows* — may be exceptions. The choice between *Chevron* and the *National Muffler* line may be outcome-significant in cases in which a general authority tax regulation contradicts prior cases.[113]

Skidmore often produces less deference than *Chevron*,[114] and *National Muffler* has some structural and substantive similarity to *Skidmore*. After setting out a more general standard, *National Muffler* lists six factors.[115] *Skidmore* too lists factors,[116] and there is overlap between the two lists. The *Swallows* majority found "consistency with prior case law" to be within the scope of the *National Muffler* factors,[117] and *Skidmore*'s catchall language[118] is broad enough to encompass a similar inquiry.

Of course, reasonableness (*Chevron*'s step two) also is extremely broad in scope.[119] Thus, another consideration

---

[103]*E.I. du Pont de Nemours & Co. v. Commissioner*, 41 F.3d 130, 135, *Doc 94-10819*, *94 TNT 240-6* (3d Cir. 1994); *see also Hospital Corp. of Am. v. Commissioner*, 348 F.3d 136, 140-141, *Doc 2003-23580*, *2003 TNT 211-8* (6th Cir. 2003), *cert. denied*, 543 U.S. 813, *Doc 2004-3710*, *2004 TNT 36-8* (2004); *Snowa v. Commissioner*, 123 F.3d 190, 197, *Doc 97-24194*, *97 TNT 163-8* (4th Cir. 1997) (after classifying the regulation at issue as interpretive not legislative, saying "the regulation is still entitled to considerable deference").

[104]5 U.S.C. sections 553(b)-(e).

[105]*Id.* section 553(b).

[106]*See* proc. reg. section 601.601; IRM section 30(15).

[107]Johnson, *supra* note 6, Part V.

[108]126 T.C. at 131 (quoting *Central Pa. Sav. Ass'n v. Commissioner*, 104 T.C. 384, 392 (1995)).

[109]*See generally* Mark Seidenfeld, "A Syncopated Chevron: Emphasizing Reasoned Decisionmaking in Reviewing Agency Interpretations of Statutes," *73 Tex. L. Rev.* 83, 94-95 (1994) (describing deferential and active courts in reference to *Chevron*); *see also* Cynthia R. Farina, "Statutory Interpretation and the Balance of Power in the Administrative State," *89 Colum. L. Rev.* 452, 453-454 (1989) (describing the deferential model and independent judgment model of judicial behavior in interpreting statutes also interpreted by agencies).

[110]*See, e.g.*, Richard J. Pierce Jr., "The Supreme Court's New Hypertextualism: An Invitation to Cacophony and Incoherence in the Administrative State," *95 Colum. L. Rev.* 749, 750 (1995).

[111]*See, e.g.*, Ronald A. Cass, Colin S. Diver, and Jack M. Beermann, *Administrative Law: Cases and Materials* 143 (5th ed. 2006) (Step Two "has proved to be no less difficult than Step One").

[112]*See, e.g., Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 981-983 (7th Cir. 1998), *cert. denied*, 525 U.S. 961 (1998); David A. Brennan, "Treasury Regulations and Judicial Deference in the Post-Chevron Era," *13 Ga. St. U.L. Rev.* 387, 430 (1997); Noel B. Cunningham and James R. Repetti, "Textualism and Tax Shelters," *24 Va. Tax Rev.* 1, 47 (2004).

[113]*See* 126 T.C. at 173 (Holmes, J., dissenting) (suggesting that "in most cases, applying either *National Muffler* or *Chevron* will end up producing the same result" but that "the most important class of cases in which results under the two tests diverge is the one into which this case falls").

[114]"*Skidmore* is commonly understood to be 'weak deference.'" Jim Rossi, "Respecting Deference: Conceptualizing *Skidmore* Within the Architecture of *Chevron*," *42 Wm. & Mary L. Rev.* 1105, 1109 (2001); *see also* Michael Asimow, "The Scope of Judicial Review of Decisions of California Administrative Agencies," *42 UCLA L. Rev.* 1157, 1194-1198 (1995); Colin S. Diver, "Statutory Interpretation in the Administrative State," *133 U. Pa. L. Rev.* 549, 565 (1985) (both cited by Rossi, *supra*, at 1109 n.10).

[115]440 U.S. at 477. My first article criticized the *Swallows* majority for letting attachment to the factors blur the deferential spirit and general standard of *National Muffler*. Johnson, *supra* note 6, Part V.B.

[116]323 U.S. at 140, *quoted supra* at note 88.

[117]126 T.C. at 137.

[118]323 U.S. at 140 (referring to "all those factors which give [an agency's interpretation] power to persuade").

[119]The ambiguity of the term "reasonable" is such that courts typically accord substantial deference to agency constructions of

(Footnote continued in next column.)

(Footnote continued on next page.)

is of greater moment. As maintained in Part VI below, *Brand X* significantly shifts the needle towards an agency interpretation in cases of conflict between such an interpretation and prior case law. *Brand X* said that its rule applies to "an agency construction otherwise entitled to *Chevron* deference."[120] Therefore, by choosing *National Muffler* over *Chevron* as the governing standard, the court reviewing a challenged regulation can, at least arguably, avoid giving the regulation the benefit of *Brand X*.[121]

IV. Applicability of *Chevron*

In the early years after *Chevron* was decided, some questioned whether it applied at all in the tax context.[122] By now, it is clear that *Chevron* applies to at least some administrative interpretations of the code.[123] It is generally agreed, for example, that *Chevron* applies to specific authority tax regulations.[124] The Tax Court itself has so held in numerous cases.[125]

But the regulation at issue in *Swallows* is a general authority regulation. The *Swallows* majority questioned whether *Chevron* applies to general authority regulations.[126] That question is fairly asked because the cases addressing the issue thus far have hardly spoken with one voice.[127] I summarize those cases below and then describe the Supreme Court's teaching as to step zero. I then explain why I believe that the regulation at issue in *Swallows* is entitled to be analyzed through the *Chevron* framework.

A. Case Law

The Supreme Court has decided four post-*Chevron* cases involving the validity of general authority tax regulations: *Boyle*, *Cottage Savings*, *Atlantic Mutual*, and *Boeing*.[128] The Court upheld the regulation in question in all four cases. Taking the cases as a whole, however, the Court neither clearly held nor clearly rejected that *Chevron* provides the standard for determining such validity. In *Boyle*, the Court cited *Chevron* but not *National Muffler*.[129] In *Cottage Savings*, the Court cited *National Muffler*'s general language but not its six enumerated considerations,[130] and it did not cite *Chevron*.[131] In *Atlantic Mutual*, the Court cited *Chevron* and *Cottage Savings* but not *National Muffler*.[132] In *Boeing*, the Court cited *Cottage Savings* but not *Chevron* or *National Muffler*.[133] In none of those cases did the Court explain why it was using the lines it was using or eschewing the lines it wasn't using.

Given the Supreme Court's failure to provide clear guidance, it is not surprising that "the relationship between *Chevron* and *National Muffler* has long puzzled lower courts."[134] Judge Holmes surveyed the circuits in his *Swallows* dissent. The circuits break down into three categories. Circuits applying *Chevron* to general authority tax regulations constitute the largest cluster, consisting of six circuits. Four circuits apply the *National Muffler* line. The question remains open in three circuits,[135] including the Third Circuit, to which *Swallows* has been appealed. In a 1994 case, the Third Circuit said that general authority tax regulations receive less deference than specific authority regulations, but it left open the possibility that general authority regulations may qualify for *Chevron*

---

it when the word is used in a statute. *E.g.*, *Metrophones Telecomms., Inc. v. Global Crossing Telecomms., Inc.*, 423 F.3d 1056, 1067 (9th Cir. 2005), *cert. granted*, 126 S. Ct. 1329 (2006); *Capital Network Sys., Inc. v. FCC*, 28 F.3d 201, 204 (D.C. Cir. 1994).

[120]125 S. Ct. at 2700.

[121]Another class of cases in which the choice may matter involves administrative inconsistency. *National Muffler* and *Skidmore* seem more concerned with an agency's changing its mind than is *Chevron*. *Compare National Muffler*, 440 U.S. at 477, and *Skidmore*, 323 U.S. at 140, *with Chevron*, 467 U.S. at 843 and 863; *see also* Johnson, *supra* note 6, Part V.B.1 (criticizing the *Swallows* majority's administrative inconsistency argument).

For discussion of the related question whether the IRS can be held to a previous position under a governmental duty of consistency, see, e.g., Christopher M. Pietruszkiewicz, "Does the Internal Revenue Service Have a Duty to Treat Similarly Situated Taxpayers Similarly?," 74 *U. Cin. L. Rev.* 531 (2005); Lawrence Zelenak, "Should Courts Require the Internal Revenue Service to Be Consistent?," 40 *Tax L. Rev.* 411 (1985).

[122]*See, e.g.*, Coverdale, *supra* note 95, at 53-57; Mitchell M. Gans, "Deference and the End of Tax Practice," 36 *Real Prop. Probate & Trust J.* 731, 749-750 (2002).

[123]*See, e.g.*, Sunstein, *supra* note 85, at 189.

[124]*See, e.g.*, Gregg D. Polsky, "Can Treasury Overrule the Supreme Court?," 84 *B.U.L. Rev.* 185, 210 (2004); Edward J. Schnee and W. Eugene Seago, "Deference Issues in the Tax Law: Mead Clarifies the Chevron Rule — Or Does It?," 96 *J. Tax'n* 366, 371 (2002); American Bar Association Section of Taxation Report on Judicial Deference [hereafter "ABA Deference Report"], 57 *Tax Law.* 717, 737-738 (2004).

[125]*E.g.*, *Carlos v. Commissioner*, 123 T.C. 275, 280, *Doc 2004-18624, 2004 TNT 183-9* (2004); *Estate of Clause v. Commissioner*, 122 T.C. 115, 119, *Doc 2004-2720, 2004 TNT 27-12* (2004); *Square D Co. v. Commissioner*, 118 T.C. 299, 307, *Doc 2002-7591, 2002 TNT 60-8* (2002), *aff'd*, 438 F.3d 739, *Doc 2006-2877, 2006 TNT 30-9* (7th Cir. 2006).

[126]126 T.C. at 131.

[127]*See, e.g.*, *Robinson v. Commissioner*, 119 T.C. 44, 117-118, *Doc 2002-20462, 2002 TNT 173-4* (2002) (Vasquez, J., dissenting);

(Footnote continued in next column.)

Central Pa. Sav. Ass'n v. Commissioner, 104 T.C. 384, 391 (1995) ("*Chevron* has had a checkered career in the tax arena").

[128]*United States v. Boyle*, 469 U.S. 241 (1985); *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554 (1991); *Atlantic Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, *Doc 98-12876, 98 TNT 77-8* (1998); *Boeing Co. v. United States*, 537 U.S. 437, *Doc 2003-5648, 2003 TNT 43-7* (2003).

[129]469 U.S. at 247 n.4. *But see* ABA Deference Report, *supra* note 124, at 761 n.112 (suggesting that *Boyle* only weakly invoked *Chevron*).

[130]*See* Part III.B *supra*.

[131]499 U.S. at 560-561.

[132]523 U.S. at 387 and 389; *see* Gans, *supra* note 122, at 750 (stating that *Atlantic Mutual* "made it clear that *Chevron*'s framework is applicable to interpretive regulations"); Polsky, *supra* note 124, at 209 and n.139 (stating that *Atlantic Mutual* "appl[ied] the *Chevron* methodology").

[133]537 U.S. at 448.

[134]ABA Deference Report, *supra* note 124, at 763; *see, e.g.*, *General Elec. Co. v. Commissioner*, 245 F.3d 149, 154 n.8, *Doc 2001-9634, 2001 TNT 65-18* (2d Cir. 2001), *acq. in result*, 2003-49 IRB 1172; *Wolpaw v. Commissioner*, 47 F.3d 787, 790, *Doc 95-2224, 95 TNT 35-12* (6th Cir. 1995).

[135]126 T.C. at 180-181 (citing cases); *see also Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 982 (7th Cir. 1998), *cert. denied*, 525 U.S. 961 (1998); ABA Deference Report, *supra* note 124, at 763-766.

deference.[136] The Third Circuit has accorded *Chevron* deference to nontax regulations that have gone through the notice and comment process.[137]

In light of the question raised by the *Swallows* majority, one might think that the Tax Court has rejected application of *Chevron* to general authority regulations. But once again the picture is mixed. Sometimes the Tax Court has tested those regulations under the *National Muffler* line;[138] other times it has invoked *Chevron*.[139] Frequently it has referred to both.[140]

That checkered history in the various courts hearing federal tax cases gives rise to two conclusions. First, to produce that division, there must be significant considerations (or ingrained habits) on both sides of the issue. Second, arguing, as I will, for the application of *Chevron* to the regulation at issue in *Swallows* is not foreclosed by a settled judicial consensus.

B. Considerations Governing Step Zero

As noted above, the key cases for *Chevron* step zero analysis are *Haggar, Christensen, Mead, Barnhart,* and *Brand X,* none of which are tax cases. In *Haggar,* the Court accorded *Chevron* deference to a Customs Service regulation. The discursive style of the opinion makes it hard to identify a clear step-zero test. However, the Court mentioned that the regulation was "intend[ed] to bind the public," that it helped "to define the legal relations between the Government and regulated entities," and especially that the Customs Service "utilized the notice-and-comment rulemaking process before issuing the regulations."[141]

Christensen denied *Chevron* entitlement to an agency interpretation "contained in an opinion letter, not one arrived at after, for example, a formal adjudication or notice-and-comment rulemaking. Interpretations such as those in opinion letters — like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law — do not warrant *Chevron*-style deference."[142]

Mead denied *Chevron* entitlement to a tariff classification contained in a letter issued by the Customs Service. The Court said:

> administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law and that the agency interpretation claiming deference was promulgated in the exercise of that authority. . . . Delegation of such authority may be shown in a variety of ways, as by an agency's power to engage in adjudication or notice-and-comment rulemaking, or by some other indication of a comparable congressional intent.[143]

The classification did not go through the notice-and-comment process. "As significant as notice-and-comment is in pointing to *Chevron* authority,"[144] its absence was not dispositive. The Court has "sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded."[145] Also important, among other factors, were the diffuse authority for issuing those classifications and the volume of those classifications. "Any suggestion that rulings intended to have the force of law are being churned out at a rate of 10,000 a year at the agency's 46 scattered offices is simply self-refuting."[146]

Barnhart accorded *Chevron* entitlement to an agency interpretation originally set out in a manual, a ruling, and a letter. The Court said:

> the fact that the Agency . . . reached its interpretation through means less formal than "notice and comment" rulemaking . . . does not automatically deprive that interpretation of the judicial deference otherwise its due. . . . Indeed, *Mead* pointed to instances in which the Court has applied *Chevron* deference to agency interpretations that did not emerge out of notice-and-comment rulemaking. . . . It indicated that whether a court should give such deference depends in significant part upon the interpretive method used and the nature of the question at issue. . . . And it discussed at length why *Chevron* did not require deference in the circumstances there present — a discussion that would have been superfluous had the presence or absence of notice-and-comment rulemaking been dispositive.[147]

The Court listed the following factors in support of according *Chevron* entitlement to the agency's interpretation: the long-standing nature of the interpretation, the respect usually accorded an agency's interpretation of its own rules, "the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of that administration, and the careful consideration the Agency has given the question over a long period of time."[148]

Most recently, step zero was revisited in *Brand X* although in Justice Scalia's dissent and Justice Breyer's

---

[136]*E.I. du Pont de Nemours & Co. v. Commissioner*, 41 F.3d 130, 135-136 and n.23 (1994).

[137]*E.g., Cleary v. Waldman*, 167 F.3d 801, 807 (1999), *cert. denied*, 528 U.S. 870 (1999).

[138]*E.g., Anderson v. Commissioner*, 123 T.C. 219, 234, *Doc 2004-16911, 2004 TNT 162-7* (2004), *aff'd*, 137 Fed. Appx. 373, *Doc 2005-14477, 2005 TNT 129-7* (1st Cir. 2005), *cert. denied sub nom. Latos v. Commissioner*, 126 S. Ct. 1595 (2006).

[139]*E.g., Lemishow v. Commissioner*, 110 T.C. 346, 346, *Doc 98-17478, 98 TNT 106-11* (1998).

[140]*E.g., Robinson v. Commissioner*, 119 T.C. 44, 69-70 (2002); *Walton v. Commissioner*, 115 T.C. 589, 597-598 (2000), *acq.*, Notice 2003-72, 2003-2 C.B. 964; *Tutor-Saliba Corp. v. Commissioner*, 115 T.C. 1, 7-9, *Doc 2000-19280, 2000 TNT 138-17* (2000); *Hospital Corp. of Am. v. Commissioner*, 107 T.C. 116, 134 (1996), *aff'd*, 348 F.3d 136, 140 (6th Cir. 2003), *cert. denied*, 543 U.S. 813 (2004).

[141]526 U.S. at 388-389.

[142]529 U.S. at 587.

[143]533 U.S. at 226-227.

[144]*Id.* at 230-231.

[145]*Id.* at 231 (*citing NationsBank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 256-257 (1995)).

[146]533 U.S. at 233.

[147]535 U.S. at 221-222.

[148]*Id.* at 522.

concurrence, not in the opinion for the Court. Justice Scalia read *Mead* thusly: "Some unspecified degree of formal process [is] required — or [is] at least the only safe harbor."[149] He proposed instead a broader test: "Any agency position that plainly has the approval of the agency head" should be entitled to *Chevron* deference.[150] In Justice Breyer's view, however, *Mead* teaches that:

> An agency action qualifies for *Chevron* deference when Congress has explicitly or implicitly delegated to the agency the authority to "fill" a statutory "gap," including an interpretive gap created through an ambiguity in the language of a statute's provisions. The Court said in *Mead* that such delegation "may be shown in a *variety of ways, as by* an agency's power to engage in adjudication or notice-and-comment rulemaking, *or by some other indication of a comparable congressional intent.* The court explicitly stated that the absence of notice-and-comment rulemaking did "not decide the case," for the Court has "sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded." And the Court repeated that it "has recognized a *variety of indicators* that Congress would expect *Chevron* deference."[151]

Justice Breyer thus concluded that "the existence of a formal rulemaking proceeding is neither a necessary nor a sufficient condition for according *Chevron* deference to an agency's interpretation of a statute."[152] Formal rulemaking "is not a necessary condition because an agency might arrive at an authoritative interpretation of a congressional enactment in other ways, including ways that Justice Scalia mentions."[153] However, formal rulemaking "is not a sufficient condition because Congress may have intended *not* to leave the matter of a particular interpretation up to the agency, irrespective of the procedure the agency uses to arrive at that interpretation, say, where an unusually basic legal question is at issue."[154]

C. Argument

I believe that virtually all general authority tax regulations should be *Chevron*-entitled, a case I intend to make in a future article. In this report, I undertake only the narrower, easier task of maintaining that the regulation at issue in *Swallows* qualifies under *Chevron* step zero. There are six reasons why that regulation should be *Chevron*-entitled. Three are common to all or nearly all general authority tax regulations, and three are particular to this regulation.

First, nearly all final general authority tax regulations go through the notice and comment process.[155] As noted in Part I.A, the *Swallows* regulation went through it. That factor may not be dispositive, but it is close to it. As seen in Part IV.B above, *Haggar, Christensen, Mead, Barnhart,* and the Breyer concurrence, as well as the Scalia dissent in *Brand X,* all adverted to that consideration as important to *Chevron* entitlement.

Second, general authority tax regulations receive approval at the highest relevant administrative level. They are "prescribed by the Commissioner and approved by the Secretary [of the Treasury] or his delegate."[156] That contrasts significantly with the highly decentralized (46 separate offices) approval and issuance process for the classification letters denied *Chevron* entitlement by *Mead.*[157] In Justice Scalia's view, approval by the agency head suffices to qualify an agency interpretation for *Chevron* treatment.[158]

Third, whatever "force of law" means, general authority tax regulations probably have it. *Christensen* adverted to "force of law" status.[159] So did *Mead,*[160] but in a fashion that "squarely rejected a possible reading of *Christensen*: that agency interpretations lacking force of law, or not preceded by formal procedures, would always [fail to receive *Chevron* treatment]."[161] *Barnhart* — which accorded *Chevron* difference to an interpretation even in its agency manual phase of development[162] — made it clear that force-of-law status is helpful but not indispensable to *Chevron* qualification.[163]

I advance a force-of-law argument with some hesitancy because no one knows for sure what the phrase means.[164] Nonetheless, general authority tax regulations in general and the *Swallows* regulation in particular likely have the force of law, however that concept is defined. General authority regulations are intended to have general applicability,[165] bind taxpayers and the IRS,[166] are

---

[149]125 S. Ct. at 2718-2719.

[150]*Id.* at 2719 n.10.

[151]*Id.* at 2712 (emphasis in original) (citations omitted).

[152]*Id.*

[153]*Id.*

[154]*Id.* at 2713 (emphasis in original).

[155]*Bankers Life & Cas. Co. v. United States,* 142 F.3d 973, 978 (7th Cir. 1998), *cert. denied,* 525 U.S. 961 (1998); proc. reg. sections 601.601(a) and (b). *See generally* Michael I. Saltzman, *IRS Practice*

(Footnote continued in next column.)

and Procedure paras. 3.02[1] and [2] (rev. 2d ed. stud. ed. 2002); Paul F. Schmid, "The Tax Regulations Making Process — Then and Now," 24 *Tax. Law.* 541 (1971); Laurens Williams, "Preparation and Promulgation of Treasury Department Regulations," 8 *USC Tax Inst.* 733 (1956).

[156]Proc. reg. section 601.601(a)(1); *see also* Bittker, McMahon, and Zelenak, *supra* note 101, at 46-5.

[157]533 U.S. at 232-233; *see Hospital Corp. of America v. Commissioner,* 348 F.3d 136, 144-145 (6th Cir. 2003) (according *Chevron* deference to tax regulations "arrived at centrally by the Treasury Department, after careful consideration" and contrasting those regulations with the *Mead* letters), *cert. denied,* 543 U.S. 813 (2004).

[158]*Brand X,* 125 S. Ct. at 2719 n.10 (Scalia, J., dissenting).

[159]529 U.S. at 587.

[160]533 U.S. at 226.

[161]Sunstein, *supra* note 85, at 214-215.

[162]535 U.S. at 221.

[163]Sunstein, *supra* note 85, at 216.

[164]*See, e.g.,* Richard W. Murphy, "Judicial Deference, Agency Commitment, and Force of Law," 66 *Ohio St. L.J.* 1013, 1016 (2005) (calling the concept "incoherent").

[165]Saltzman, *supra* note 155, at 3-7; *see* Murphy, *supra* note 164, at 1017 (force of law exists when the agency interpretation applies uniformly across time and parties).

[166]*See General Elec. Co. v. Commissioner, supra* note 134 (both parties conceded that they are bound by a valid regulation); Bittker, McMahon, and Zelenak, *supra* note 101, at 46-5; Mitchell

(Footnote continued on next page.)

time consuming and costly to change because of the steps required to promulgate and amend them,[167] and entail sanctions for their violation.[168]

There is a pre-*Christensen* body of cases that discusses the phrase "force of law" in connection with tax regulations and lower-level IRS interpretations. Several decisions stated that general authority regulations have force-of-law status, either without apparent qualification[169] or under particular circumstances, such as the regulation being of long standing and having survived successive statutory reenactments.[170] I intend to explore that body of cases in detail in a future article. For now, I note the cases but put limited reliance on them because the cases do not speak with a single voice and because it is not clear that *Christensen, Mead*, and the earlier cases had the same thing in mind when using the phrase "force of law."

The three remaining arguments for *Chevron* entitlement are particular to the *Swallows* regulation. Those arguments emerge from additional considerations for such entitlement mentioned in *Barnhart*.[171] Of those considerations, the following bear with particular force on our situation.

Fourth, *Chevron* entitlement is supported by "the importance of the question to administration of the statute," one of the *Barnhart* factors.[172] Section 882(c)(2) expressly conditions taking deductions on filing returns. As shown in Part II.A, the courts have held that, in light of that requirement, "it is inconceivable that Congress contemplated . . . that taxpayers could wait indefinitely to file returns."[173] As shown in Part V.A below, the 18-month rule in the regulation advances the congressional purpose of inducing foreign corporations to file returns.

Fifth, *Chevron* entitlement is supported by "the complexity of [the] administration [of the statute]," another *Barnhart* factor.[174] The *Swallows* majority stated: "The judiciary has enough expertise and experience to ascertain congressional intent with respect to [the word 'manner' in the statute]."[175] But there are more dimensions that had to be considered than just that. Once the prior cases, after considering "manner" and the rest of the statute, had decided that section 882(c)(2) contemplates some timing limitation, Treasury and the IRS had to determine how to define that limitation — that is, where to draw the line. In so doing, Treasury and the IRS had to consider the importance of receiving returns, the possibilities of obtaining information in other ways, the degree of administrative burden in time and expense that pursuing other ways would entail, and what degrees of burden foreign taxpayers would bear as a result of different possibilities regarding where the line could be drawn. Assessing and balancing those considerations entailed complexity, required administrative expertise (another *Barnhart* consideration),[176] and involved matters of policy that are properly the province of agencies, not of the courts.[177]

Sixth, *Chevron* entitlement is supported by "the interstitial nature of the legal question," another *Barnhart* factor.[178] The *Swallows* majority expressed its view that the regulation constituted "an unauthorized assumption by the Secretary of major policy decisions properly made by Congress: e.g., here, a foreign corporation's forfeiture of deductions absent its filing of a timely tax return."[179] Were the majority right in that, the regulation would be invalid. The Supreme Court has taught that deference does not extend as far as to allow an agency to make fundamental decisions that properly are the responsibility of Congress.[180]

However, the majority is wrong. *Congress* made the decision that those deductions are forfeited if the foreign corporation fails to file returns, and Congress wrote that decision into section 882(c)(2). As shown in Part II.A, the courts held that a timing limitation is implicit in Congress's decision. Thus, in promulgating the 18-month rule, Treasury and the IRS were not making the "major policy decision." They were only filling a gap necessary to implement the decision Congress already had made. The Supreme Court has made it clear that the courts should respect such interstitial administrative actions. "If the administrator's reading fills a gap or defines a term in

---

Rogovin, "The Four R's: Regulations, Rulings, Reliance and Retroactivity," 43 *Taxes* 756, 763 (1965); *see United States v. Haggar Apparel Co.*, 526 U.S. 380, 388 (1999) (noting that the *Chevron*-entitled regulation was intended "to bind the public" and "to define legal relations between the Government and regulated entities"); Sunstein, *supra* note 85, at 222 (force of law may exist when an agency position binds private parties and perhaps the agency itself).

[167]*See* Saltzman, *supra* note 155, para. 3.02[2] (detailing the steps); Murphy, *supra* note 164, at 1017 (maintaining that those facts demonstrate agency commitment to the position indicative of force of law).

[168]*See* section 6662(b)(1) ("disregard of tax rules and regulations" can be a basis for imposition of the accuracy-related penalty). *But see* ABA Deference Report, *supra* note 124, at 726-727 (questioning that position). Also, of course, violation of the *Swallows* regulation subjects the taxpayer to the loss of otherwise allowable deductions. *See* Thomas W. Merrill and Kathryn Tongue Watts, "Agency Rules With the Force of Law: The Original Convention," 116 *Harv. L. Rev.* 467 (2002) (arguing that "force of law" was once defined by the imposition of sanctions for violation, and exploring the desirability of restoring that convention).

[169]*E.g., Wing v. Commissioner*, 81 T.C. 17, 28 (1983).

[170]*E.g., Century Elec. Co. v. Commissioner*, 192 F.2d 155, 160 (8th Cir. 1951), *cert. denied*, 342 U.S. 954 (1952); *Community Bank v. Commissioner*, 79 T.C. 789, 791-792 (1982), *aff'd*, 819 F.2d 940 (9th Cir. 1987); *McShain v. Commissioner*, 68 T.C. 154, 162 (1977).

[171]535 U.S. at 522; *see* text accompanying note 148 *supra*.

[172]535 U.S. at 222.

[173]*Taylor Securities*, 40 BTA at 703-704; *see also Espinosa*, 107 T.C. at 157.

[174]*See supra* note 171.

[175]126 T.C. at 136.

[176]*See supra* note 171.

[177]*E.g., Chevron*, 467 U.S. at 844-845; *Redlark v. Commissioner*, 141 F.3d 936, 939, *Doc 98-12203, 98 TNT 71-3* (9th Cir. 1998).

[178]*See supra* note 171.

[179]126 T.C. at 136; *see also id.* at 147-148.

[180]*E.g., Whitman v. American Trucking Ass'ns Inc.*, 531 U.S. 457 (2001); *FDA v. Brown & Williamson Tobacco Co.*, 529 U.S. 120 (2000); *MCI Telecomms. Corp. v. American Tel. & Tel. Co.*, 512 U.S. 218 (1994).

a way that is reasonable in light of the legislature's revealed design, we give the administrator's judgment 'controlling weight.'"[181]

The *Swallows* majority committed a related error. It stated: "Congress is the only body that may amend the relevant text."[182] Similarly, in other cases, the Tax Court has said that "the Secretary may not usurp the authority of Congress by adding restrictions to a statute which are not there."[183]

Those statements are correct, but they apply to a context different from *Swallows*. The Supreme Court defined that context: When "the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation."[184] However, "where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts."[185] *Swallows* fits the latter category because the statute implies a timing limitation but does not set the terms of that limitation. In cases applying *Chevron* and upholding challenged regulations, the Tax Court has held that:

> to invoke these passages from our decisions for the general proposition that regulations may not add rules not found in the statute and not precluded by the statute is to misread them. Indeed, supplementation of a statute is a necessary and proper part of the Secretary's role in the administration of our tax laws.[186]

In summary, the regulation at issue in *Swallows* passes step zero for some of the same reasons that all or nearly all general authority tax regulations should so pass: The regulation went through the notice and comment process, it was approved at the highest relevant administrative level, and it probably has the force of law. Also, the *Swallows* regulation is supported by considerations identified in *Barnhart*, specifically the importance of the timing limitation to administration of the statute, the complexity of the matters bearing on when to fix the terminal date, and the interstitial nature of drawing the timing line. Accordingly, the regulation is qualified to be analyzed under *Chevron*.

V. Validity of the Regulation Under *Chevron*

If, as argued in Part IV, the validity of the *Swallows* regulation is entitled to be analyzed under the *Chevron* framework, the next task is to scrutinize the regulation under the two-step analysis. In my opinion, the regulation passes step-one scrutiny because section 882(c)(2) does not unambiguously preclude an 18-month timing limitation, and it passes step-two scrutiny because the 18-month limitation is within the range of reason.

A. Step One

Under step one, no deference is accorded to the agency's interpretation if "Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; [the court and the agency] must give effect to the unambiguously expressed intent of Congress."[187] Justice Scalia noted a major question regarding step one: "How clear is clear? It is here, if *Chevron* is not abandoned, that the future battles over acceptance of agency interpretations of law will be fought."[188] There has been little judicial consistency in that regard. Different courts have treated step one with different degrees of stringency.[189] In part, at least, those outcomes may be unavoidable since "it may be that . . . the strict dichotomy between clarity and ambiguity is artificial, that what we have is a continuum, a probability of meaning."[190]

While that history inspires caution as to any conclusions, I believe the regulation at issue in *Swallows* passes step-one muster. Congress, in section 882(c)(2), did not unambiguously express its intention to exclude an 18-month timing rule. Even *Anglo-American*, the polestar for the *Swallows* majority, acknowledged that as a linguistic matter, the statutory term "manner" "is a comprehensive term, and includes, but is more comprehensive than, 'method, mode, or way,'" and that in nontax cases, "manner" has been construed sometimes to include and sometimes not to refer to time.[191]

Although some judges have a penchant for using dictionary definitions,[192] it is widely recognized that, for step one, statutory meanings depend on context.[193] *Anglo-American* concluded that, in the context of the

---

[181]*NationsBank v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 257 (1995) (quoting *Chevron*, 467 U.S. at 844).

[182]126 T.C. at 148 n.31.

[183]*Western Waste Inds. v. Commissioner*, 104 T.C. 472, 476, *Doc 95-3943, 95 TNT 73-7* (1995) (citing cases).

[184]*Koshland v. Helvering*, 298 U.S. 441, 447 (1936).

[185]*Id.* at 446.

[186]*Hachette USA, Inc. v. Commissioner*, 105 T.C. 234, 251, *Doc 95-8926, 95 TNT 188-30* (1995), *aff'd*, 87 F.3d 43, *Doc 96-18801, 96 TNT 127-13* (2d Cir. 1996); *see also Greenberg Bros. Partnership #4 v. Commissioner*, 111 T.C. 198, 206-207, *Doc 98-26388, 98 TNT 164-12* (1998), *aff'd sub nom. Cinema '84 v. Commissioner*, 294 F.3d 432, *Doc 2002-12370, 2002 TNT 187-17* (2d Cir. 2002).

[187]*Chevron*, 467 U.S. at 842-843.

[188]Antonin Scalia, "Judicial Deference to Administrative Interpretations of Law," 1989 *Duke L.J.* 511, 520-521.

[189]Prof. Seidenfeld has observed: "To the extent that Chevron has generated dissension among lower courts, the dispute primarily concerns the vigor with which judges inquire, at step one, whether a statute has resolved the question addressed by the agency." Seidenfeld, *supra* note 109, at 94-95; *see also* Note, "'How Clear Is Clear' in Chevron's Step One?" 118 *Harv. L. Rev.* 1687, 1687, 1691-1692 (2005).

[190]*PDK Labs. Inc. v. DEA*, 362 F.3d 786, 797 (D.C. Cir. 2004).

[191]38 BTA at 714.

[192]*See, e.g., Rapanos v. United States*, 126 S. Ct. 2208, 2221 & 2223 n.7 (2006) (plurality opinion); *Amoco Prod. Co. v. Southern Ute Indian Tribe*, 526 U.S. 865, 874 (1999); *National Railroad Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 418 (1992); *American Express Co. v. United States*, 262 F.3d 1376, 1381 n.5, *Doc 2001-22501, 2001 TNT 165-6* (Fed. Cir. 2001). *See generally* Ellen P. Aprill, "The Law of the Word: Dictionary Shopping in the Supreme Court," 30 *Ariz. St. L.J.* 275 (1988).

[193]*E.g., FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) ("the words of a statute must be read in their context and with a view to their place in the overall statutory scheme"); *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 132

(Footnote continued on next page.)

predecessor of section 882(c)(2), "manner" does not include time,[194] and the *Swallows* majority concluded that, throughout the code, "Congress has consistently used the word 'time' together with the word 'manner' when it intended to include the meanings of both words in a single taxing section."[195]

Judge Holmes maintained that there are counter-examples in the code in which "manner" has been understood to include a time element.[196] Be that as it may, I wish to advance a more fundamental case. I believe the regulation would survive step-one scrutiny even if the *Swallows* majority, rather than Judge Holmes, is correct as to the word "manner." That's because statutory language, although obviously important, is not the sole measure of "the unambiguously expressed intent of Congress." Statutory purpose is important. In *Swallows*, that purpose supports a timing limitation. Moreover, the canons of statutory construction also are significant. In *Swallows*, the canon in favor of interpreting statutes to avoid absurd results supports a timing limitation.

1. Statutory purpose. Step one requires considering the congressional purpose. In addition to considering the "words of the statute . . . read in context [and] the statute's place in the overall statutory scheme," the court should consider "the problem Congress sought to solve" in determining whether Congress's intent unambiguously forecloses the agency's interpretation.[197] The step-one inquiry ceases "if the statutory language is unambiguous *and* the statutory scheme is coherent and consistent."[198] Indeed, "it is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute."[199]

In assessing whether section 882(c)(2) unambiguously precludes a timing rule, it is worth noting that the BTA, the Tax Court, and the Fourth Circuit all agreed that it does not. As discussed in Part II, in *Taylor Securities*, *Ardbern*, *Blenheim*, *Georday*, *Espinosa*, and *InverWorld*, those courts held that the statute, far from prohibiting a timing limitation, contemplates one. The reason for their view is the purpose behind the statute.

Section 882(c)(2) expressly conditions availability of deductions on the filing of a return. Congress imposed that condition to provide a strong incentive for foreign corporations to file returns[200] and to mitigate the formidable obstacles to effectively applying the federal income tax to foreign corporations.[201] *Anglo-American* was concerned about the potentially harsh consequences of denying deductions.[202] Later cases observed that that was precisely the point — the important administrative purpose of obtaining returns is furthered by the *in terrorem* effect of the denial.[203]

In view of the statute's specifically requiring that returns be filed, "it is inconceivable that Congress contemplated . . . that taxpayers could wait indefinitely to file returns and [still be allowed to claim deductions]."[204] By providing a bright-line demarcation for when returns are too late, the regulation's 18-month rule advances the reason Congress wrote section 882(c)(2) into the code.[205]

In a portion of its opinion potentially relevant to step one,[206] the *Swallows* majority said: "As to the 18-month period set forth in the regulations, it is not only arbitrary but without any statutory basis at all. . . . Where [the rule] came from, we do not know."[207] That remark ignores the Supreme Court's teaching in a delinquency penalty tax case that "deadlines are inherently arbitrary; fixed dates, however, are often essential to accomplish necessary results."[208] Moreover, the majority fractures the step-one inquiry. Step one asks whether the statute unambiguously forecloses the agency's interpretation, not whether the agency's interpretation can be traced to some affirmative basis set out in the statute. That the timing rule in the regulation advances the statutory purpose is sufficient justification for it.

2. "Absurd results" canon. *Chevron* stated that, in considering whether "Congress had an intention on the precise question at issue," the court should "employ traditional tools of statutory construction."[209] Those tools

(1985) (finding a statutory term inherently ambiguous despite its seeming to be clear at the purely linguistic level); *Chevron*, 467 U.S. at 861.

[194]38 BTA at 715.

[195]126 T.C. at 132.

[196]*Id.* at 165.

[197]*Goldstein v. SEC*, 451 F.3d 873, 878 (D.C. Cir. 2006); *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 796 (D.C. Cir. 2004); *see also Snowa v. Commissioner*, 123 F.3d 190, 198 (4th Cir. 1997); *Nalle v. Commissioner*, 997 F.2d 1134, 1137-1138, *Doc 93-8870*, *93 TNT 172-12* (5th Cir. 1993).

[198]*Robinson v. Shell Oil Co.*, 519 U.S. 337, 340 (1997) (emphasis added) (quotation marks and citations omitted); *Gorospe v. Commissioner*, 446 F.3d 1014, 1016, *Doc 2006-8564*, *2006 TNT 86-10* (9th Cir. 2006).

[199]*Bob Jones Univ. v. United States*, 461 U.S. 574, 586 (1983); *see, e.g., Brown v. Duchesne*, 60 U.S. 183, 194 (1857); *Prophit v. Commissioner*, 57 T.C. 507, 510-511 (1972), *aff'd per curiam*, 470 F.2d 1370 (5th Cir. 1973). In the frequently quoted language of Learned Hand, "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning." *Cabell v. Markham*, 148 F.2d 737, 739 (2d Cir. 1945), *aff'd*, 326 U.S. 404 (1945).

[200]*E.g., Taylor Securities*, 40 BTA at 703.

[201]*Blenheim*, 125 F.2d at 909.

[202]38 BTA at 715.

[203]*E.g., Espinosa*, 107 T.C. at 157.

[204]*Taylor Securities*, 40 BTA at 703-704.

[205]*See* Johnson, *supra* note 6, Part IV.A.

[206]The observation appears in a section entitled "Plain Meaning of the Relevant Text" 126 T.C. at 132-136. That section follows on the heels of the majority's statement that the case would come out the same under either *Chevron* or *National Muffler*, *id.* at 131, and it precedes the majority's *National Muffler* analysis.

[207]*Id.* at 135 n.17.

[208]*United States v. Boyle*, 469 U.S. 241, 249 (1985).

[209]467 U.S. at 843 n.9.

include the canons of construction.[210] That text — for tax law — is not all-conquering and can be trumped by canons is powerfully underlined by *Coltec*, an important recent decision.[211] In that case, the IRS attacked a tax shelter on statutory (sections 357 and 358) and economic substance grounds. The Court of Federal Claims held for the taxpayer in all respects, strongly endorsing textualism, if not literalism.[212] The Federal Circuit vacated the decision. It agreed with the trial court that the taxpayer had complied with the literal terms of the statutes, but it held that the IRS could nonetheless prevail because of the economic substance doctrine, saying, "The economic substance doctrine is *not unlike other canons of construction* that are employed in circumstances where the literal terms of a statute can undermine the ultimate purpose of the statute."[213]

Particularly relevant in the *Swallows* context is the canon that statutes should be construed so avoid producing absurd results. The absurdity canon is well established. "From the earliest days of the Republic, the Supreme Court has subscribed to the idea that judges may deviate from even the clearest statutory text when a given application would otherwise produce 'absurd' results. . . . Indeed, the absurdity doctrine has been one of the few fixed points in the Court's frequently shifting interpretive regimes."[214] The Court has applied the absurdity canon in many cases.[215] Even textualist judges generally agree that "interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available."[216]

An absurd result would obtain were section 882(c)(2) not backstopped by a timing limitation. Instead of filing by a date certain, the foreign corporation could "wait and see." Perhaps waiting to file the return until after the trial court's decision becomes final would be too late because of the rule of *res judicata*.[217] Short of that, however, great delay and protraction would be possible. If section 882(c)(2) were interpreted to exclude any timing limitation, the foreign corporation could wait until contacted by the IRS, still wait until the IRS issued a notice of deficiency, and wait longer still until some time after it filed a Tax Court petition challenging the notice of deficiency.[218] If there is no time limit, the corporation could still claim available deductions despite the delay. To say that a statute, the purpose of which is to encourage the filing of returns, permits that result would be absurd.

The absurdity would be compounded if one considered the effect of that outcome on IRS enforcement of the statute. The IRS's enforcement incentive would be considerably eroded if an audit, a deficiency notice, and the Tax Court's pleadings could be undone by a subsequent return.

A parallel exists for adjustment clauses under the gift tax. Under those clauses, the amount of noncash property transferred from the donor to the donee is adjusted downward (to an amount within the annual exclusion limit) if the IRS audits and determines that the value of the property exceeds the annual exclusion under section 2503(b). If those clauses were effective, the IRS's incentive to audit would be greatly reduced since the result of the audit would be that there was no deficiency. For that reason, the IRS takes the position that the clauses are invalid as contrary to public policy,[219] and the courts have upheld that position.[220] That parallel emphasizes the absurdity of allowing IRS enforcement against delinquent foreign corporations to be undercut by a largely open-ended filing regime.

3. Summary. The statutory term "manner" is linguistically ambiguous, and its meaning under the code is arguable. In any event, a timing limitation is implicit in the statutory purpose, and excluding that limitation would produce absurd results. If the validity of some timing rule is accepted, the 18-month rule is not unambiguously precluded by the statute because section 882(c)(2) does not set or bar any specific time period. Accordingly, the regulation at issue in *Swallows* passes scrutiny under step one of *Chevron*.

---

[210]*See, e.g., Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 230 (1992) (stating that the "*de minimis non curat lex*" canon "is part of the established background of legal principles against which all enactments are adopted"); *Dole v. United Steelworkers*, 494 U.S. 26, 36 (1990) (applying the "*noscitur a sociis*" canon at step one).

[211]*Coltec Inds., Inc. v. United States*, 2006-2 U.S.T.C. para. 50,389, *Doc 2006-13276, 2006 TNT 134-10* (Fed. Cir. 2006), *vacating and remanding* 62 Fed. Cl. 716, *Doc 2004-21316, 2004 TNT 214-16* (2004). For discussion of *Coltec* and other authorities, see Lee A. Sheppard, "A More Intelligent Economic Substance Doctrine," *Tax Notes*, July 24, 2006, p. 325.

[212]As to differences between textualism and literalism, see William D. Popkin, *Materials on Legislation: Poltiical Language and the Political Process* para. 5.04 (4th ed. 2005).

[213]2006-2 U.S.T.C. at 85,100.

[214]John F. Manning, "The Absurdity Doctrine," 116 *Harv. L. Rev.* 2387, 2388 (2003). *See generally* William N. Eskridge Jr., Philip P. Frickey, and Elizabeth Garrett, *Legislation and Statutory Interpretation* 267-71 (2d ed. 2006); Popkin, *supra* note 212, at 31-33 and 254-59 (describing the golden rule of avoiding absurd results).

[215]*E.g., Public Citizen v. United States Dep't of Justice*, 491 U.S. 440, 454 (1989); *Green v. Bock Laundry Mach. Co.*, 490 U.S. 504, 509-510 (1989); *United States v. Brown*, 333 U.S. 18, 27 (1948); *United States v. Kirby*, 74 U.S. 482, 486-487 (1868); *see also Public Cit. v. United States Dep't of Justice*, 491 U.S. 440, 470-471 (1989) (Scalia, J., concurring).

[216]*Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982) (Rehnquist, J., writing for the Court); *see* Manning, *supra* note 214, at 2388.

[217]*See* section 7481 (finality of Tax Court decisions).

[218]The Tax Court petition would not have to allege that the return had been filed. It could be amended later to claim the deductions after the return had been filed. The opportunity to amend a pleading is not infinite. However, "leave [to amend a pleading] shall be given freely when justice so requires." Tax Ct. R. 41(a).

[219]*E.g.*, Rev. Rul. 86-41, 1986-1 C.B. 300.

[220]*E.g., Commissioner v. Procter*, 142 F.2d 824, 827-828 (4th Cir. 1944), *cert. denied*, 323 U.S. 756 (1944); *Ward v. Commissioner*, 87 T.C. 78, 110-114 (1986).

B. Step Two

If an agency position survives step one, it often is thought, it is highly likely to be found reasonable at step two.[221] Nonetheless, it would be unwise for an agency to take step two lightly. Some prominent cases have been resolved adversely to agencies at step two.[222]

Although the step-two inquiry can sometimes be challenging, I do not believe that it is in mutated *Swallows*. The regulation at issue easily passes muster as reasonable. We have assumed that the prior cases established a "date of SFR" termination. But that date, while it may fall within the range of reason, does not define the boundaries of that range. An important teaching of *Chevron* regarding step two is that "the court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[223]

At least in part, "the 'reasonableness' of an agency's construction depends on the construction's 'fit' with the statutory language as well as its conformity to statutory purposes."[224] The regulation's 18-month rule and the assumed case law rule regarding the date of SFR are indistinguishable in terms of their fit with the language of section 882(c)(2). The regulation's rule is superior to the case law's rule in conformity to the purpose behind section 882(c)(2). The regulation provides the more definitive rule. A time certain has a greater *in terrorem* effect than does an event (the SFR) that may come soon, late, or not at all.[225] It is possible that, in some cases, the IRS could prepare an SFR in less than 18 months from the return due date, in which case the regulation would provide a longer period than the assumed case law rule.[226] In far more cases, 18 months will be shorter than the assumed case law period. That too will further the statutory purpose by encouraging more prompt compliance.[227]

[221]*See, e.g., Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 978 (7th Cir. 1998), *cert. denied*, 525 U.S. 961 (1998); *Continental Air Lines, Inc. v. Department of Transp.*, 843 F.2d 1444, 1453 (D.C. Cir. 1988); Seidenfeld, *supra* note 109, at 96; "Developments in Judicial Review with Emphasis on the Concepts of Standing and Deference to the Agency," 4 *Admin. L.J.* 113, 124 (comments of Judge Stephen Williams).

[222]*E.g., Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006); *Northpoint Tech., Ltd. v. FCC*, 412 F.3d 145 (D.C. Cir. 2005); *Abbott Labs. v. Young*, 920 F.2d 984 (D.C. Cir. 1990), *cert. denied*, 502 U.S. 819 (1991).

[223]467 U.S. at 843 n.11.

[224]*Abbott Labs. v. Young*, 920 F.2d 984, 988 (D.C. Cir. 1990).

[225]*See* Johnson, *supra* note 6, Part IV.A.

[226]126 T.C. at 162 (Holmes, J. dissenting) ("The 18-month grace period might be shorter or longer than the old judicially construed one. It is undeniably more definite.") (footnote omitted).

[227]Nor can it be said that this would be accomplished at the price of an unreasonable burden on taxpayers. An 18-month grace period hardly is excessively onerous. *See* Johnson, *supra* note 6, Part IV.B.

VI. Validity of the Regulation Under *Brand X*

Brand X is a major administrative law decision.[228] Because it's so recent, however, important questions raised by the case remain to be answered. This section considers *Brand X*, first generally, then in the mutated *Swallows* context. I believe that, under *Brand X*, the regulation at issue in *Swallows* should control over the assumed contrary rule emanating from the prior case law.

A. *Brand X*

Before *Chevron*, an interpretation of a statute by the Supreme Court generally was binding on agencies under the rule of *stare decisis*.[229] As many commentators have noted, *Chevron* created a tension between its rule of deference and the doctrine of *stare decisis*.[230] The tensions between administrative flexibility on one hand, and stability, reliance, and legitimacy on the other hand, generated significant commentary in both administrative law[231] and tax law[232] even before the *Brand X* decision was handed down.

Initially, *stare decisis* appeared ascendant under a trilogy of 1990s Supreme Court cases.[233] The contours of the rule were controversial, however. "Although the Supreme Court . . . concluded that *its own* precedents trump *Chevron*, it . . . frequently upheld agency interpretations . . . at odds with existing lower court precedent."[234]

[228]*See, e.g.*, Randolph J. May, "Defining Deference Down: Independent Agencies and *Chevron* Deference," 58 *Admin. L. Rev.* 429, 431 (2006). Other commentary on *Brand X* includes Kathryn A. Watts, "Adapting to Administrative Law's *Erie* Doctrine," 101 *Nw. U.L. Rev.* ___ (forthcoming 2007); Note, "Implementing *Brand X*: What Counts as a Step One Holding?" 119 *Harv. L. Rev.* 1532 (2006).

[229]*See* Polsky, *supra* note 124, at 199-209.

[230]*E.g.*, Paul A. Dame, "Stare Decisis, Chevron, and Skidmore: Do Administrative Agencies Have the Power to Overrule Courts?," 44 *Wm. & Mary L. Rev.* 405 (2002); Richard W. Murphy, "A 'New' Counter-Marbury: Reconciling Skidmore Deference and Agency Interpretive Freedom," 56 *Admin. L. Rev.* 1 (2004); Timothy Zick, "Marbury Ascendant: The Rehnquist Court and the Power to 'Say What the Law Is,'" 59 *Wash & Lee L. Rev.* 839, 841-842 (2002).

[231]*Id. See also, e.g.*, Kenneth A. Bamberger, "Provisional Precedent: Protecting Flexibility in Administrative Policymaking," 77 *N.Y.U.L. Rev.* 1272 (2002); David H.E. Becker, "Judicial Review of INS Adjudication: When May the Agency Make Sudden Changes in Policy and Apply Its Decision Retroactively?" 52 *Admin. L. Rev.* 219 (2000); David M. Gossett, "Chevron, Take Two: Deference to Revised Agency Interpretations of Statutes," 64 *U. Chi. L. Rev.* 681 (1997).

[232]*See* Polsky, *supra* note 124. For further discussion, see *Littriello v. United States*, 2005 WL 1173277, *Doc 2005-12029, 2005 TNT 106-20* (W.D. Ky. 2005) (on appeal to the Sixth Circuit); Brant J. Hellwig and Gregg D. Polsky, "The Employment Tax Challenge to the Check-the-Box Regulations," *Tax Notes*, May 29, 2006, p. 1039.

[233]*Neal v. United States*, 516 U.S. 284, 290 (1996); *Lechmere, Inc. v. NLRB*, 502 U.S. 527, 536-537 (1992); *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 130-131 (1990).

[234]Polsky, *supra* note 124, at 201 n.94 (emphasis in original) (citing *Sutton v. United Air Lines*, 527 U.S. 471, 477, 482 (1999)). Although not a *Chevron* case, the Court in *United States v. Craft*, 535 U.S. 274 (2002), upheld the IRS's view as to the reach of the

(Footnote continued on next page.)

Circuit courts disagreed whether their own precedents precluded contrary agency interpretations.[235]

And as always, context matters. The "deference versus precedent" question could arise in any of three postures: "where a court interpreted a statute before *Chevron* was decided; where a court interpreted a statute after *Chevron* and deferred to the agency; and where a court interpreted a statute after *Chevron* and, for one reason or another, refused to defer to the agency's interpretation."[236] Pre-*Brand X* commentators argued that precedent should control in the third situation[237] but not in the first[238] or second.[239]

Brand X dramatically altered the landscape. The Communications Act of 1934, as amended, subjects to mandatory common-carrier regulation all those who provide "telecommunication services."[240] In 2002 the FCC issued a ruling that cable companies selling broadband Internet service are not providing telecommunications services and so are exempt from that regulation.

Numerous parties petitioned for judicial review of the ruling. By judicial lottery, the Ninth Circuit was selected as the venue for the challenge. In relevant part, the Ninth Circuit vacated the FCC's ruling as an impermissible construction of the statute. In so doing, the Ninth Circuit chose not to apply *Chevron* but instead based its decision on *stare decisis*.[241] In the previous case, *AT&T Corp. v. City of Portland*[242] — which had not involved the FCC as a party and had been decided several years before the FCC issued the challenged ruling — the Ninth Circuit reached a holding contrary to the conclusion in the ruling. In *Brand X*, the Ninth Circuit held that, under the Supreme Court's *Neal* decision,[243] *AT&T* overrode the FCC's contrary ruling.

The Supreme Court reversed. The Court held that *Chevron* provided the appropriate standard of review. Congress made a delegation to the FCC similar to the delegation made to the Treasury under section 7805(a).[244] That delegation gave the FCC "the authority to promulgate binding legal rules; the Commission issued the order under review in the exercise of that authority; and no one questions that the order is within the Commission's jurisdiction. . . . Hence, as we have in the past, we apply the *Chevron* framework."[245]

Those challenging the FCC's ruling disputed the applicability of *Chevron* on the grounds that the ruling is inconsistent with the FCC's past practice. The Court said: "We reject this argument. Agency inconsistency is not a basis for declining to analyze the agency's interpretation under the *Chevron* framework."[246]

The Court then laid down the rule that matters for mutated *Swallows*, providing that prior judicial construction "trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[247] The Court distinguished *Neal*,[248] and it supported its new rule in three ways. First, the Court stated that "this principle follows from *Chevron* itself." Specifically, "allowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute . . . would allow a court's interpretation to override an agency's. *Chevron*'s premise is that it is for agencies, not courts, to fill statutory gaps."[249]

Second, the Court offered two policy arguments. One was that the Ninth Circuit's position "would 'lead to the ossification of large parts of our statutory law.'"[250] The other was the following anomaly. The Ninth Circuit's position:

> would mean that whether an agency's interpretation of an ambiguous statute is entitled to *Chevron* deference would turn on the order in which the interpretations issue: If the court's construction came first, its construction would prevail, whereas if the agency's came first, the agency's construction would command *Chevron* deference. Yet whether Congress has delegated to an agency the authority to interpret a statute does not depend on the order in which the judicial and administrative constructions occur.[251]

Third, the Court responded to an objection raised by Justice Scalia's dissent. Justice Scalia accused the majority of "inventing yet another breathtaking novelty: judicial decisions subject to reversal by Executive officers."[252] The *Brand X* majority disagreed.

> Since *Chevron* teaches that a court's opinion as to the best reading of an ambiguous statute an agency is charged with administering is not authoritative,

---

federal tax lien under section 6321 despite the fact that generations of nearly unanimous lower court cases were to the contrary.

[235]*Compare EEOC v. Metropolitan Educ. Enter., Inc.*, 60 F.3d 1225, 1229-1230 (7th Cir. 1995), *rev'd on other grounds*, 519 U.S. 202 (1997), *with Satellite Broad. & Commun. Ass'n v. Oman*, 17 F.3d 344, 348 (11th Cir. 1994), *cert. denied*, 513 U.S. 823 (1994).

[236]Gossett, *supra* note 231, at 692 n.53.

[237]*Id.*

[238]Jahan Sharifi, "Precedents Construing Statutes Administered by Federal Agencies After the *Chevron* Decision: What Gives?" 60 *U. Chi. U.L. Rev.* 223, 229, 244-247 (1993).

[239]Rebecca Hanner White, "The Stare Decisis 'Exception' to the *Chevron* Deference Rule," 44 *Fla. L. Rev.* 723, 726-728 (1992).

[240]47 U.S.C. section 153(44).

[241]345 F.3d 1120, 1127 (9th Cir. 2003), *rev'd*, 125 S. Ct. 2688 (2005).

[242]216 F.3d 871 (9th Cir. 2000).

[243]*Neal v. United States*, 516 U.S. 284 (1996).

[244]The FCC was given the power to "execute and enforce" the Communications Act and to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions" of the act. 47 U.S.C. sections 151 and 201(b).

[245]125 S. Ct. at 2699.

[246]*Id.*

[247]*Id.* at 2700.

[248]*Id.* at 2701. The Court did acknowledge: "There is genuine confusion in the lower courts over the interaction between the *Chevron* doctrine and *stare decisis* principles." *Id.* at 2702.

[249]*Id.* at 2700.

[250]*Id.* at 2700-2701 (*quoting Mead*, 533 U.S. at 247 (Scalia, J., dissenting)).

[251]125 S. Ct. at 2700.

[252]*Id.* at 2719.

> the agency's decision to construe that statute differently from a court does not say that the court's holding was legally wrong. Instead, the agency may . . . choose a different construction, since the agency remains the authoritative interpreter (within the limits of reason) of such statutes. In all other respects, the court's prior ruling remains binding law (for example, as to agency interpretations to which *Chevron* is inapplicable).[253]

Having established its rule, the *Brand X* Court applied it. The Court held that the *AT&T* case did not say its result was compelled by an unambiguous statute. That case "held only that [its construction was] the best reading . . . not that it was the only permissible reading of the statute."[254] That being so, and because the FCC's position survived scrutiny under both step one and step two of *Chevron*,[255] the FCC's interpretation prevailed over the prior contrary Ninth Circuit decision.

Major decisions often raise at least as many questions as they answer, and that surely is true of *Brand X*. The following are among the questions that may be addressed by future cases:

- Does "unambiguous" mean the same thing for *Brand X* purposes as it does under *Chevron* step one? "If so, . . . every case that reaches Step Two of *Chevron* will be agency-reversible" under *Brand X*.[256]
- Will the court's decision regarding ambiguity be conclusive? For example, can the agency, in the later case in which it is defending its interpretation, argue, "Yes, the earlier court said its interpretation was based on an unambiguous statute, but that conclusion is wrong"?
- Will the later court have to decide whether the assertion of unambiguity was dictum or holding?[257]
- "Does the 'unambiguous' dictum produce *stare decisis* effect even when a court is *affirming*, rather than *reversing*, agency action — so that in the future the agency *must adhere* to that affirmed interpretation?"[258]
- "If so, does the victorious agency have the right to appeal a Court of Appeals judgment in its favor, on the ground that the text in question is in fact not (as the Court of Appeals held) unambiguous, so the agency should be able to change its view in the future?"[259]

[253]*Id.* at 2701. The Court added: "The precedent has not been 'reversed' by the agency, any more than a federal court's interpretation of a State's law can be said to have been 'reversed' by the state court that adopts a conflicting (yet authoritative) interpretation of state law." *Id.*

[254]*Id.* at 2701.

[255]*See id.* at 2704-2710.

[256]*Id.* at 2721 (Scalia, J., dissenting).

[257]Note, *supra* note 228, at 1538. Justice Scalia said that such assertions would "presumably [be] in dictum." 125 S. Ct. at 2720.

[258]125 S. Ct. at 2721 (Scalia, J., dissenting).

[259]*Id.*

B. *Brand X* Applied to the *Swallows* Regulation

Few of the implementation questions sketched above are present in mutated *Swallows*. There is a straightforward *Brand X* case for permitting the regulation at issue to trump the assumed time of SFR terminal date under the prior cases. As shown in Parts IV and V, the regulation is entitled to *Chevron* deference. And, as shown below, the prior cases did not hold that the time of SFR terminal date follows from the unambiguous terms of section 882(c)(2).

One interesting question could arise were *Chevron* held inapplicable to the regulation at issue in *Swallows*. Could the government claim the benefit of *Brand X* anyway? The Tax Court said in both *Swallows* and elsewhere that *Chevron* merely restated *National Muffler* with a few "possibly subtle distinctions."[260] If the two tests are essentially equivalent, and if, as I argue in the first report,[261] the 1990 regulation would be entitled to deference under *National Muffler*, it could be argued that *Brand X* still should apply. Meeting *Chevron* in substance (via equivalency), even if not in name, should suffice to satisfy the precondition of the *Brand X* rule. Of course, we need not go down this road if, as I believe, the regulation is *Chevron*-entitled.

The *Swallows* majority's responses to *Brand X* are unconvincing. The majority first offered: "Given that the Supreme Court has historically reviewed Federal tax regulations primarily under the reasonableness test of *Natl. Muffler* . . . , the question arises whether [*Brand X*], which neither cited *Natl. Muffler* nor involved a Federal tax regulation, applies to Federal tax regulations."[262] That doesn't go very far. As described in Part IV.A, the Supreme Court's application of *Chevron* in tax cases has been unexplained and haphazard. However, if *Chevron* does apply, then *Brand X* would as well. *Brand X* is an elaboration of *Chevron*. To say that *Chevron* applies but *Brand X* does not would be to sunder the inseparable.

The *Swallows* majority next advanced four grounds on which it thought *Brand X* to be distinguishable. First, the FCC had carefully considered the issue, but "here we find no corresponding record . . . the Secretary's rationale for adopting the disputed regulations is at best perfunctory."[263] Second, the FCC's ruling was consistent with prior FCC rulings, but the 1990 regulation "directly altered regulations adopted in (and unchanged since) 1957."[264] Third, the FCC had not been a party to the *AT&T* case, but "here, the Commissioner was the unsuccessful party in all the [prior] cases."[265] Fourth, *AT&T*

[260]126 T.C. at 131 (*quoting Central Pa. Sav. Ass'n v. Commissioner*, 104 T.C. 384, 392 (1995)).

[261]Johnson, *supra* note 6, Part VI.

[262]126 T.C. at 143-144.

[263]*Id.* at 144.

[264]*Id.*

[265]*Id.* The *Swallows* majority persists in its curious habit of calling the IRS "the unsuccessful party" in the previous cases despite the fact that the IRS won most of them.

preceded *Brand X* by only about five years, while *Anglo-American* preceded the 1990 regulation by about 50 years.[266]

Judge Holmes said: "These distinctions should not make a difference — the Supreme Court did not balance carefulness of consideration, prior litigation history, or the amount of time that had passed between the case law and the new regulation. It simply looked to see if the agency had been delegated broad regulatory authority and whether its construction of an ambiguous statutory phrase was reasonable."[267]

Judge Holmes's point is right, but it may not afford enough security. As shown in Part IV.A, *Chevron* was "refined" in sometimes surprising ways by subsequent cases. The same fate might befall *Brand X*. If the above-described implementation questions prove difficult, or if some justices change their minds or are succeeded by differently minded jurists, *Brand X* could be subject to a process of common law revision. Thus, we should consider not just whether the proffered distinctions appeared in *Brand X* but also whether they should.

I think they should not. Most of the four grounds mentioned above are addressed to the wrong level. If they have any validity, they should be taken into account when deciding whether the agency's interpretation qualifies for *Chevron* deference in the first place. If that deference attaches, the grounds should play no further role. They do not provide reasons to sever *Brand X* preference from *Chevron* eligibility. Further, individually, each one of the four grounds offered by the majority lacks merit, as shown below.

Care in consideration: The *Swallows* majority understated the degree of consideration the IRS and Treasury gave to the terminal date. The Treasury decision accompanying the finalized regulation shows that Treasury made several changes to the proposed regulation based on consideration of comments received.[268] It also makes clear that the IRS specifically considered objections to a terminal date but rejected them for both statutory and administrability reasons.[269] Moreover, the IRS's position incubated during the decades of litigation of the issue, and the explanations the IRS gave should be read in conjunction with the explanations given by the prior cases as to the necessity of a terminal date in the statutory scheme.[270]

Agency consistency: The 1957 regulation did not say that there is no terminal date; it simply was silent on the subject. Throughout the prior cases, the IRS argued for a terminal date (although not the 18-month date). The IRS litigated and won *Espinosa* and *InverWorld* after the 1957 regulation was promulgated. Therefore, the suggestion of IRS inconsistency can be overplayed.

There is also a more fundamental problem. In *Brand X*, the FCC's opponents accused the FCC of inconsistency. As quoted in Part VI.A, the principal reason the Court rejected that argument was not that the FCC had been consistent but that agencies are permitted to change their mind.[271] That view should remain part of *Brand X* even if reconstructed since that view is solidly rooted in *Chevron* itself.[272]

IRS a party in prior cases: Reinterpreting *Brand X* in this way would seriously undermine the teaching of that case. The *Swallows* situation (in which the agency was a party to the prior case or cases) is much more common than the *AT&T* situation (in which the agency was not a party). Confining *Brand X* to situations in which the agency had not been a party in the prior case would make *Brand X* an aspect of collateral estoppel-type reasoning[273] rather than a concomitant of *Chevron*. That is not what *Brand X* contemplated. The *Brand X* majority noted that the FCC had not been a party in *AT&T*, but it gave no indication that its rule was confined to those situations. Justice Scalia said in dissent that he had made no "calculation of how many hundreds of past statutory decisions" would be affected by *Brand X*, but that he suspected the number was very large.[274] That prediction shows that, like the majority, the dissenters did not understand *Brand X* to apply only when the agency had been a party in the prior litigation.

Time between prior cases and agency interpretation: Why would that matter? Conceivably, a long-settled rule could engender a reliance interest, but no reasonable reliance could exist in the *Swallows* situation. The IRS continued to litigate — and win — the issue over the decades, and the 1990 regulation was proposed and finalized years before the tax years at issue in *Swallows*.[275] The *Swallows* majority linked the time gap to the legislative reenactment doctrine.[276] However, as shown in my first report, that doctrine is of dubious applicability to *Swallows* and, if it applies, supports rather than undercuts the validity of the 1990 regulation.[277]

There is another problem with the *Swallows* majority's argument. Were it accepted that too long a gap is problematic, the courts would be enmeshed in line-drawing exercises. How long is too long? Courts probably would be reluctant to set a fixed time (as the prior cases were reluctant to settle on a fixed terminal date), and exploring the facts and circumstances of each case would waste judicial resources. Those exercises are best avoided by declining the invitation of the *Swallows* majority to amend *Brand X* to include a "time gap" factor.

---

[266] *Id.* at 145.
[267] *Id.* at 171-172 (Holmes, J., dissenting).
[268] *See* T.D. 8322, 1990-2 C.B. 172, 172-173.
[269] *Id.* at 172.
[270] See Part II.A *supra*.
[271] 125 S. Ct. at 2699.
[272] "An initial agency interpretation is not instantly carved in stone. On the contrary, the agency . . . must consider varying interpretations and the wisdom of its policy on a continuing basis." *Chevron*, 467 U.S. at 863-864. Indeed, the EPA position that the Court upheld in *Chevron* was a change from the agency's previous position.
[273] *See, e.g., Meier v. Commissioner*, 91 T.C. 273, 282-283 (1988) (discussing evolution of the doctrine of mutuality in collateral estoppel).
[274] 125 S. Ct. at 2721.
[275] Johnson, *supra* note 6, Part V.B.1.
[276] 126 T.C. at 145.
[277] Johnson, *supra* note 6, Part V.B.1.

In the *du Pont* case, the Third Circuit stated: "Although there may be situations in which substantial and prejudicial delay in exercising rule-making authority might alter the degree of deference accorded a regulation, we see no express prejudice here nor do we discern any other factors that would change the nature of our review."[278] The same situation exists in *Swallows*.

In the event of failure of its distinctions, the *Swallows* majority had a last line of defense. Although it conceded that the prior cases "did not state explicitly that they were applying the unambiguous meaning of the word 'manner' [in section 882(c)(2)]," the majority said that "we believe that they did so."[279]

I believe that argument is indefensible. As shown in Part II, if the prior cases held anything unambiguously, it was that section 882(c)(2) contemplates some terminal date. Those cases hinted at many possible terminal dates or events but settled on none of them. We have assumed, for mutated *Swallows* purposes, that the prior cases stood for a time of SFR terminal date. However, neither collectively nor individually did the prior cases hold that the time of SFR terminal date is unambiguously commanded by section 882(c)(2). Indeed, they couldn't. Nothing in the statutory language or purpose points to the date of SFR any more clearly than it points to 18 months.

C. Summary

Under *Brand X*, conflict between the regulation and the assumed case law rule should be resolved in favor of the regulation. The regulation is *Chevron*-entitled, and the prior cases did not declare — nor on section 882(c)(2) as it exists could they have declared — that their rule followed unambiguously from the statute and so precluded administrative discretion. The arguments offered by the *Swallows* majority against *Brand X* are contrary to *Brand X* as it stands and should not be engrafted onto *Brand X* if the rule of that case is revised in the future.

VII. Conclusion

My previous report examined *Swallows* as it is. The prior cases taught that some timing limitation is implicit in section 882(c)(2), but neither the statute nor the cases defined that limitation. Filling statutory gaps is a role for Treasury and the IRS, and the 18-month rule in the regulation is reasonable. If *National Muffler* provides the appropriate standard, the regulation easily passes muster under it.

This second report examined mutated *Swallows*, assuming that the prior cases established a date of SFR timing limitation inconsistent with the 18-month rule in the regulation. Even on that assumption, the regulation should be upheld. The regulation is *Chevron*-entitled at step zero, and it passes scrutiny at both step one and step two. Because the regulation qualifies for *Chevron* deference, the *Brand X* precondition is satisfied. Moreover, the prior cases neither said — nor, on section 8829(c)(2) as it exists, could they have said — that the date of SFR rule is unambiguously commanded by the statute, leaving Treasury and the IRS no discretion to promulgate the 18-month rule. Accordingly, under *Brand X*, any conflict between the regulation and the prior cases should be resolved in favor of the regulation.

In short, the regulation should be upheld regardless of whether *National Muffler* or *Chevron* provides the governing standard. The Third Circuit should reverse *Swallows*. Whatever the outcome of *Swallows*, however, the issues discussed in this report will eventually be encountered in other tax cases. When regulations contravene prior case law, we will have to grapple with the significance of *Brand X* in tax. In turn, to the extent that *Brand X* depends on *Chevron*, that will compel us to rethink the roles of *Chevron* and the *National Muffler* line of cases.

---

[278] *E.I. du Pont de Nemours & Co. v. Commissioner*, 41 F.3d 130, 135 (3d Cir. 1994).

[279] 126 T.C. at 145.