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Deference to Tax Agencies' Interpretation of Their Regulations

Steve R. Johnson
Florida State University College of Law

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by Steve R. Johnson

This installment closes a loop begun in the last installment of this column.[1] We have been exploring the degrees of deference accorded by the courts to interpretations and positions taken by state and local revenue agencies.[2] The last installment examined conditional deference doctrines, that is, deference specific to particular situations or conditioned on the existence of particular conditions. That installment noted one line of conditional deference, applying to cases in which agencies are interpreting their own regulations. This is often called *Auer* deference, after one of the most prominent cases of the line.[3] Because of the richness of the *Auer* line of cases, we deferred exploration of it to this installment.

Part I below describes *Auer* deference generally, considering both federal and state cases. Part II evaluates the rationales for the doctrine and the criticisms that have been leveled at it. In state and local tax cases, *Auer* deference will almost always be asserted by the government revenue authority. Thus Part III identifies arguments by which taxpayers may attempt to defuse assertions of *Auer* deference.

I. *Auer* Deference Generally

Tax is statutory. No one owes tax unless a statute or ordinance imposes that liability. Thus, all tax cases begin with the applicable statute. However, tax statutes sometimes are written in general terms, requiring that important details be filled in by regulations promulgated by the state or local tax agency. Because of the nearly infinite variety of actual transactions, though, not even regulations can anticipate all nuances that may become important in actual cases.

Thus, tax controversies often turn on how a court construes a particular tax regulation. What degree of deference should the court accord to the agency's construction of its regulation?

This question is not unique to tax, of course. Over 60 years ago, the U.S. Supreme Court offered this view in *Seminole Rock*:

> Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words is in doubt. The intention of [the legislature] or the principles of the Constitution in some situations may be relevant in the first instance in choosing between various constructions. But the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.[4]

In the ensuing decades, the Supreme Court often reaffirmed this approach.[5] However, the Court most often refers to this approach as the *Auer* principle, after the 1997 case in which the Court repeated its instruction that an agency's interpretation of its

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[1]Steve R. Johnson, "Conditional Deference to State Revenue Authorities," *State Tax Notes*, Apr. 25, 2011, p. 269, *Doc 2011-7239*, or *2011 STT 79-5*.

[2]Other installments in this series are "Judicial Deference to State Tax Agencies — An Overview," *State Tax Notes*, Nov. 29, 2010, p. 633, *Doc 2010-24563*, or *2010 STT 228-2*; "*Chevron* Deference to State Tax Agencies," *State Tax Notes*, Jan. 24, 2011, p. 285, *Doc 2010-27202*, or *2011 STT 15-2*; and "Deference — Questions of Fact Versus Issues of Law," *State Tax Notes*, Mar. 21, 2011, p. 883, *Doc 2011-3129*, or *2011 STT 54-2*.

[3]*Auer v. Robbins*, 519 U.S. 452 (1997).

[4]*Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413-414 (1945).

[5]*E.g.*, *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 171 (2007); *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 359 (1989); *Gardebring v. Jenkins*, 485 U.S. 415, 430 (1988); *United States v. Larionoff*, 431 U.S. 864, 872 (1977); *Udall v. Tallman*, 380 U.S. 1, 16-17 (1965).

own regulation is "controlling" unless it is "plainly erroneous or inconsistent with" the regulation.[6]

The federal cases have been highly influential at the state level. Numerous state decisions have taken a similar approach to deference, citing *Auer*, *Seminole Rock*, one of the other federal cases, or one of the similar state cases.[7] That includes many state and local tax cases.[8]

II. Rationales and Criticisms

The Supreme Court has said: "It is well established that an agency's construction of its own regulations is entitled to substantial deference."[9] But why should that be so? At least four justifications have been offered for *Auer* deference.

First, a separation of powers rationale has been advanced: that courts need to respect the constitutional role and position of agencies. However, courts have their constitutional responsibilities too, as ultimate arbiters of the meaning of the law. Thus, "balancing the necessary respect for an agency's knowledge, expertise, and constitutional office with the courts' role as interpreter of laws can be a delicate matter."[10]

Second, agencies apply their interpretations across numerous actual cases, only a small number of which, perhaps, result in litigation. For the courts to disturb the agency's position in the litigated cases could result in nonuniform, inharmonious outcomes across the range of similar situations.[11]

Third, the agency that promulgated the regulation is in the best position to know what the regulation means. For that reason, courts sometimes state that "an agency's interpretation of its own regulation is entitled to a level of deference even broader than deference to the agency's construction of a statute, because in the latter case the agency is addressing [the legislature's] intentions, while in the former it is addressing its own."[12]

Fourth, in recalling or reconstructing the agency's intended meaning, the agency can bring to bear its specialized knowledge and expertise, which often will exceed that of the courts. Thus, "because applying an agency's regulation to complex or changing circumstances calls upon the agency's unique expertise and policymaking prerogatives, [courts] presume that the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers."[13]

However, there is another side of the story. Some judges and commentators would abrogate *Auer*-type deference,[14] substituting for it *Skidmore*-like multifactoral conditional deference analysis.[15] Three concerns have predominated.

First, "if the court is bound by the agency's interpretation of the meaning of its own regulation, there is no independent interpreter; the agency lawmaker has effective control of the exposition of the legal text that it has created." Other deference doctrines — *Chevron*,[16] *Skidmore*, and the like — retain an independent judicial interpretative check, but a vigorous *Auer* approach "leaves in place *no* independent interpretive check on lawmaking by an administrative agency."[17]

Empirical data at the federal level suggest that this concern may have substance. Under most deference doctrines, the rates at which courts affirm agency positions cluster within fairly comparable ranges, averaging around 70 percent. "The one notable exception is the *Auer* doctrine. The Supreme Court affirms agency interpretations of agency rules at a much higher rate — 90.9 percent — than the roughly 70 percent rate at which it upholds other agency decisions."[18] It is unclear that the lower

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[6]519 U.S. at 461.

[7]*E.g.*, *McCullar v. Universal Underwriters Life Insurance Co.*, 687 So. 2d 156, 163 (Ala. 1996); *Beach v. Great Western Bank*, 692 So. 2d 146, 149 (Fla. 1997); *Friends of Columbia Gorge, Inc. v. Columbia River Gorge Comm'n*, 179 P.3d 706, 243-44 (Or. App. 2008), *aff'd*, 212 P.3d 1243, 1251 n.14 (2009) (*en banc*); *Buffalo Township v. Jones*, 778 A.2d 1269, 1276 n.8 (Pa. Commw. 2001), *aff'd*, 813 A.2d 659 (Pa. 2002), *cert. denied*, 540 U.S. 821 (2003).

[8]*E.g.*, *United Parcel Service Co. v. State Dep't of Revenue*, 1 P.3d 83, 84 (Alas. 2000) (fuel tax); *Town of East Lyme v. New England National, LLC*, 2000 WL 1784127, *4 (Conn. Super. 2000) (unpublished opinion), *aff'd*, 796 A. 2d 1220 (Conn. App. 2002) (tax lien foreclosure); *Texas Citrus Exchange v. Sharp*, 995 S.W.2d 164, 169-170 (Texas App. 1997) (sales, use, and excise taxes).

[9]*Martin v. OSHRC*, 499 U.S. 144, 150 (1991).

[10]*Gonzales v. Oregon*, 546 U.S. 243, 255 (2006).

[11]*E.g.*, *French v. District of Columbia Bd. of Zoning Adjustment*, 658 A.2d 1023, 1033 (D.C. App. 1995).

[12]*Abbott Laboratories v. United States*, 573 F.3d 1327, 1330 (Fed. Cir. 2009) (punctuation and citation omitted).

[13]*Martin*, *supra* note 9, at 151.

[14]*See, e.g.*, *Cookman Realty Group, Inc. v. Taylor*, 566 S.E.2d 294, 303-305 (W. Va. 2002) (Starcher, J., concurring); Robert A. Anthony, "The Supreme Court and the APA: Sometimes They Just Don't Get It," 10 *Admin. L.J. Am. U.* 1 (1996); John F. Manning, "Constitutional Structure and Judicial Deference to Agency Interpretation of Agency Rules," 96 *Colum. L. Rev.* 612 (1996).

[15]*Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944). For discussion of *Skidmore*, see Johnson, *supra* note 1.

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

[17]Manning, *supra* note 13, at 639 (emphasis in original) (footnotes omitted).

[18]Richard J. Pierce Jr., "What Do the Studies of Judicial Review of Agency Actions Mean?" 63 *Admin. L. Rev.* 77, 85 (2011) (citations omitted). However, questions always can be raised about purported quantifications. For instance, in *Ballard v. Comm'r*, 544 U.S. 40 (2005), the Supreme Court held that the Tax Court misinterpreted one of the Tax Court's own

(Footnote continued on next page.)

federal courts and the state courts are as extremely deferential under *Auer* and related cases as the Supreme Court is.[19] If they are, however, a 91 percent agency win rate comes close to confirming the fear that *Auer* makes agency interpretations of their regulations almost judicially unreviewable.

> ***Some courts — particularly state courts — say that ambiguous tax statutes are construed adversely to the government. Shouldn't the same approach apply to regulations?***

Second, some argue that extreme deference can "increase the potential for governmental arbitrariness, since vague regulations provide neither regulators nor regulated parties with expert guidance as to the standard by which particular conduct may be measured."[20]

Third, the most common complaint concerns incentive effects. It is a common rule that ambiguous contracts are interpreted against the party who drafted the contract: The idea is to encourage care in drafting. Similarly, some courts — particularly state courts — say that ambiguous tax statutes are construed adversely to the government.[21] Shouldn't the same approach apply to regulations? Some judges and commentators maintain that *Auer* creates an incentive for agencies to rely on vague regulations, defeating the purpose of notice-and-comment rulemaking.[22]

III. Responding to *Auer* Arguments

Despite the objections described above, *Auer* deference remains well established. When a state or local revenue agency urges a court to accord that deference to its interpretation of one of its regulations, how may a taxpayer seek to counter?

The possibilities suggested by the case law fall into two categories: situations in which *Auer* will not apply and situations in which the regulation will be found invalid even though *Auer* does apply.

Nonapplicability

Courts differ regarding when deference attaches to agency interpretation of regulations. The following are occasions when, according to some courts, such deference is inappropriate.

Regulation not ambiguous: For many courts, deference attaches only when the regulation in question is ambiguous.[23] If it is not, there is no need for interpretation. To accord deference to an agency construction of an otherwise clear regulation would risk allowing the agency to amend or rewrite the regulation under the guise of interpretation.[24]

Agency interpretation not settled: For some courts, the agency's interpretation must be "settled" before deference may attach. Accordingly, several courts have refused to apply *Auer* and its kin when the agency has taken inconsistent or confusing positions on the meaning of the regulation.[25]

Agency not interpreting its own regulation: The case for deference is markedly weaker when the agency is interpreting not its own regulation but a regulation promulgated by a different administrative body, whether local, state, or federal.[26] One situation in which that could arise is income tax in states that use the Internal Revenue Code as the starting point for their own income tax bases. A state tax agency interpretation of a Treasury regulation or IRS ruling might not qualify for *Auer*-like deference.

Medium in which the interpretation is expressed: How and when did the agency express the interpretation at issue? For some courts, deference will not

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rules. The majority and the concurrence did not disagree with the dissent's contention, *see id.* at 70 (Rehnquist, C.J., dissenting), that *Seminole Rock* should apply — they simply ignored the contention. A case in which the doctrine might have been considered but wasn't will not show up in the computation of the agency affirmance rate.

[19]Application of *Auer*-like approaches has not been studied at the state court level to the same degree that it has at the federal level. In the absence of studies, it is my impression from review of the case law that state courts do not affirm agencies as often under such approaches as the Supreme Court does.

[20]*Cookman Realty*, *supra* note 14, at 303.

[21]*See* Steve R. Johnson, "Pro-Taxpayer Interpretation of State-Local Tax Laws," *State Tax Notes*, Feb. 9, 2009, p. 441, *Doc 2009-1826*, or *2009 STT 25-2*.

[22]*E.g.*, *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 525 (1994) (Thomas, J. dissenting); Anthony, *supra* note 14, at 12.

[23]*E.g.*, *Cookman Realty*, *supra* note 14, at 297 (describing rationale of lower court). The Supreme Court has been inconsistent on this point, sometimes including but other times omitting the word "ambiguous" from its statement of the *Auer* rule.

[24]*Id.* at 298.

[25]*E.g.*, *Gose v. U.S. Postal Service*, 451 F.3d 831, 837-38 (Fed. Cir. 2006); *Maine School Administrative District No. 15 v. Reynolds*, 413 A.2d 523, 531-32 (Maine 1980); *Orion Flight Services, Inc. v. Basler Flight Service*, 714 N.W.2d 130, 145 (Wis. 2006).

[26]*E.g.*, *Cookman Realty*, *supra* note 14, at 297 (describing rationale of lower court). Some other state courts, however, do not make this distinction. *See, e.g.*, Mehmet K. Konar-Steenberg, *"In re Annandale* and the Disconnections Between Minnesota and Federal Deference Doctrine," 34 *Wm Mitchell L. Rev.* 1375, 1397 (2008) (arguing, on the strength of *Annandale*, that Minnesota courts may "extend strong deference to an agency's interpretation of an ambiguous regulation authored by another agency" although federal courts would not).

attach if that expression was made in the wrong medium. For instance, some federal judges have questioned whether deference is available when the agency's interpretation was set out in a brief or informal announcement.[27] Similarly, state courts have sometimes expressed reservations about positions that constitute "post hoc agency litigating positions."[28]

Contents of the regulation: In some cases, the contents of the regulation may preclude judicial deference to the agency's interpretation of the regulation. For example, a Nebraska case denied deference when the key terms to be construed did not appear in the regulation itself.[29] Similarly, the Supreme Court rejected *Auer* deference when the regulation was not a product of the agency's experience and expertise but merely parroted or restated the language of the statute.[30]

No Deference Despite Applicability

The mere fact that *Auer* is potentially applicable to the case at hand does not guarantee that the tax agency will win. As described below, taxpayer's counsel has several potential avenues for argument.

Degree of deference: Jurisdictions differ on the weight to be accorded to the agency's view when *Auer* applies.[31] Obviously, the taxpayer's counsel will want to contend for a lesser weight, which may be outweighted in the balance by other arguments that the taxpayer can adduce.

Inconsistency with the statute: A regulation that is inconsistent with the underlying statute is invalid. It follows that an agency interpretation of a regulation (even if compatible with the regulation) will be rejected if it contravenes the statutory text, context, or purpose. Thus, a Texas opinion involving sales, excise, and use taxes noted *Seminole Rock* but nonetheless refused to grant deference because the regulation, as interpreted by the agency, deviated from the statute.[32]

Unreasonable construction of the regulation: The *Auer* rule is one of deference, not abdication. If the agency's interpretation is unreasonable, the courts will reject it.[33] That approach is necessary to keep agencies from exercising "unbounded and unshackled discretion" extending their powers beyond those delegated to them by the legislature.[34] Different courts, of course, use different angles of vision in determining the reasonableness of the interpretation.[35]

Conclusion

As the foregoing demonstrates, there are depths to the type of conditional deference that involves interpretations by agencies of their own regulations. There are policies and precedents on both sides, ones on the basis of which state and local tax agencies can argue for robust deference and ones on the basis of which taxpayers can argue, in appropriate cases, that little or no deference is appropriate. *Auer*-style deference is recognized in most states, but abundant room exists for skillful advocacy regarding the proper contours and strength of the doctrine. ☆

Interpretation Matters is a column by Steve R. Johnson, the E.L. Wiegand Professor of Law, William S. Boyd School of Law, University of Nevada, Las Vegas.

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[27] *E.g.*, *Eastman Kodak v. STWB, Inc.*, 452 F.3d 215, 222 n.8 (2d Cir. 2006); *Keys v. Barnhart*, 347 F.3d 990, 993-994 (7th Cir. 2003); *Houston Police Officers' Union v. City of Houston*, 330 F.3d 298, 305 (5th Cir. 2003). *But see Abbott Laboratories*, *supra* note 12, at 1332-1333 (comments by government litigating counsel during argument are not entitled to deference but the agency's position in a brief may be entitled to deference "if the brief represents the agency's considered position and not merely the views of litigating counsel").

[28] *Mississippi Gaming Comm'n v. Six Electronic Video Gambling Devices*, 792 So. 2d 321, 328-329 (Miss. App. 2001); *see also Cookman Realty*, *supra* note 14, at 297 (describing rationale of lower court).

[29] *Brown v. Dep't of Social Services*, 1993 WL 7692, at *4 (Neb. App. 1993) (unpublished opinion) (citing a tax case, *Vulcraft v. Karnes*, 428 N.W.2d 505 (Neb. 1988)).

[30] *Gonzales*, *supra* note 10 at 256-257.

[31] *Compare State Tax Comm'n v. Mask*, 667 So. 2d 1313, 1314 (Miss. 1996) (sales tax and production tax) ("great deference") *to Lyng v. Payne*, 476 U.S. 926, 939 (1986) ("substantial deference") *to Canteen Corp. v. Commonwealth*, 818 A.2d 594, 599 n.11 (Pa. Commw. 2003) (corporate income tax) ("some measure of deference"), *aff'd*, 854 A.2d 440 (Pa. 2004).

[32] *Texas Citrus Exchange v. Sharp*, 955 S.W.2d 164, 169-171 (Texas App. 1997). The court also noted that the agency's interpretation was an "unwritten policy" and one "on which the Comptroller has flip-flopped three times in thirteen years." *Id.* at 171.

[33] *E.g.*, *Friends of Columbia Gorge*, *supra* note 7, at 1251.

[34] *E.g.*, *Gulf States Utilities Co. v. Public Utility Comm'n*, 784 S.W.2d 519, 528 (Texas App. 1990), *aff'd*, 809 S.W.2d 201 (Texas 1991).

[35] *Compare Ashikian v. State Horse Racing Comm'n*, 188 P.3d 148, 156-157 (Okla. 2008) (rejecting the agency's position because it led to absurd results) *to Rogers v. Watson*, 594 A.2d 409, 413 (Vt. 1991) (upholding the agency on substantive and administrability grounds and also based on the constructional canon that exemptions are construed narrowly). *See also French*, *supra* note 11, at 1033 (also considering administrability); Steve R. Johnson, "The Absurd Results' Doctrine in State and Local Tax Cases," *State Tax Notes*, Oct. 19, 2009, p. 195, *Doc 2009-21703*, or *2009 STT 199-4*. Johnson, "Interpreting State Tax Exemptions, Deductions, and Credits," *State Tax Notes*, Feb. 23, 2009, p. 607, *Doc 2009-2323*, or *2009 STT 34-7*.