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## Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements

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ARTICLES

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COLORING OUTSIDE THE LINES: EXAMINING  
TREASURY'S (LACK OF) COMPLIANCE WITH  
ADMINISTRATIVE PROCEDURE ACT  
RULEMAKING REQUIREMENTS

*Kristin E. Hickman\**

INTRODUCTION ..... 1728

I. THE APA'S RULEMAKING REQUIREMENTS AND TREASURY'S  
RULEMAKING AUTHORITY ..... 1732

    A. *General Rulemaking Requirements of the APA* ..... 1732

    B. *Treasury's Rulemaking Authority* ..... 1735

II. EMPIRICAL STUDY: WHAT TREASURY ACTUALLY DOES ..... 1740

    A. *Methodology* ..... 1740

    B. *Findings* ..... 1748

III. DOCTRINAL PROBLEMS WITH TREASURY'S ACTIONS ..... 1759

    A. *Temporary Regulations* ..... 1759

        1. *The Interpretative Rule Exception* ..... 1760

        2. *The Procedural Rule Exception* ..... 1773

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3. The Good Cause Exception .....	1778
4. Summary .....	1786
B. <i>Straight to Final Regulations (or Good Cause, Redux)</i> .....	1787
C. <i>Corrective Amendments (or Good Cause III)</i> .....	1789
D. <i>The Harmless Error Rule</i> .....	1791
E. <i>Summary</i> .....	1795
IV. WHY TREASURY DOES WHAT IT DOES: ONE POSSIBLE EXPLANATION .....	1795
V. IMPLICATIONS .....	1799
CONCLUSION .....	1806

### INTRODUCTION

The Administrative Procedure Act of 1946 (APA) imposes procedural requirements on agencies for the purpose of protecting the interests of parties affected by agency action.<sup>1</sup> When the agency action in question is a regulation, or in APA terms a “rule,” section 553 of Title 5 of the United States Code (APA section 553) imposes procedures including but not limited to public notice and opportunity for comment, otherwise known as notice-and-comment rulemaking.<sup>2</sup> The purpose of these procedures is to encourage public participation in the rulemaking process.<sup>3</sup> “In enacting the APA, Congress made a judgment that notions of fairness and informed administrative decisionmaking require that agency decisions be made only after affording interested persons notice and an opportunity to comment.”<sup>4</sup> Agencies that fail to follow the procedural requirements of APA section 553 run the risk that courts will invalidate their rules and regulations.<sup>5</sup>

In the tax context, the Treasury Department has a strange relationship with the APA’s notice-and-comment rulemaking require-

1 PETER H. SCHUCK, *FOUNDATIONS OF ADMINISTRATIVE LAW* 53 (2d ed. 2004); *see also* Administrative Procedure Act, 5 U.S.C. §§ 551–59, 701–06 (2000 & Supp. IV 2004).

2 *See* 5 U.S.C. § 553 (2000); *see also* 1 RICHARD J. PIERCE, JR., *ADMINISTRATIVE LAW TREATISE* § 7.1 (4th ed. 2002).

3 U.S. DEP’T OF JUSTICE, *ATTORNEY GENERAL’S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT* 26 (1947) [hereinafter *ATTORNEY GENERAL’S MANUAL*].

4 *Chrysler Corp. v. Brown*, 441 U.S. 281, 316 (1979).

5 *See, e.g.*, *MCI Telecomms. Corp. v. FCC*, 57 F.3d 1136, 1142–43 (D.C. Cir. 1995) (invalidating rule for inadequate notice); *Am. Water Works Ass’n v. EPA*, 40 F.3d 1266, 1274–75 (D.C. Cir. 1994) (same); *Lloyd Noland Hosp. & Clinic v. Heckler*, 762 F.2d 1561, 1566–67 (11th Cir. 1985) (invalidating rule for inadequate basis and purpose statement); *cf. Cent. & S.W. Servs., Inc. v. EPA*, 220 F.3d 683, 692 (5th Cir. 2000) (remanding rule for failure to address comments in statement of basis and purpose).

ments.<sup>6</sup> Treasury annually adopts, modifies, and removes hundreds of pages of Treasury regulations interpreting the Internal Revenue Code (I.R.C.).<sup>7</sup> Treasury acknowledges that APA section 553 governs its various regulatory efforts.<sup>8</sup> Treasury also contends, however, that most Treasury regulations are interpretative in character and thus exempt from the public notice and comment requirements by the APA's own terms.<sup>9</sup> In individual rulemaking efforts, Treasury has explicitly asserted the APA's good cause exception from notice and comment.<sup>10</sup> Notwithstanding these claims, Treasury purports to util-

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6 The Internal Revenue Code delegates authority for promulgating regulations to the Secretary of the Treasury. *See, e.g.*, I.R.C. § 1502 (West Supp. 2006); I.R.C. § 7805(a) (2000). The Treasury Department formally issues all Treasury regulations interpreting the Internal Revenue Code, and Treasury's Office of Tax Policy is significantly involved in reviewing and drafting Treasury regulations. Historically, however, the Office of Chief Counsel of the IRS has performed the function of initially drafting most Treasury regulations. *See* I.R.S., INTERNAL REVENUE MANUAL § 32.1.1.4.4, (Aug. 11, 2004), <http://www.irs.gov/irm> [hereinafter INTERNAL REVENUE MANUAL]; *see also* LEANDRA LEDERMAN & STEPHEN W. MAZZA, TAX CONTROVERSIES § 1.04 (2d ed. 2002) (comparing Treasury and IRS involvement in regulation drafting); Paul F. Schmid, *The Tax Regulations Making Process—Then and Now*, 24 TAX LAW. 541, 542–46 (1971) (describing historic procedures for promulgating Treasury regulations). Accordingly, reference to Treasury and its practices in the course of this Article generally include both Treasury and the IRS.

7 Tax professionals tend to refer to the Internal Revenue Code as “the Code” rather than “the I.R.C.” In this Article, however, I will use the latter to avoid confusion between the Internal Revenue Code, the U.S. Code, and the Code of Federal Regulations, all of which are cited regularly herein.

8 *See* Treas. Reg. § 601.601(a)(2) (as amended in 1987) (“Where required by 5 U.S.C. [§] 553 and in such other instances as may be desirable, the Commissioner [or the Director, as applicable,] publishes in the *Federal Register* general notice of proposed rules . . . .”); INTERNAL REVENUE MANUAL, *supra* note 6, §§ 32.1.2.3, (“Several Federal administrative laws and procedures apply to the regulatory process. . . . The Administrative Procedure Act (APA) requires agencies to publish Notices of Proposed Rulemaking (NPRMs) in the *Federal Register* and permit the public to submit comments.”); *see also id.* § 32.1.5.4.7.5.1 (making similar statement).

9 *See* INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.5.4.7.5.1 (“Interpretative rules are not subject to the provisions of 5 U.S.C. [§] 553(b), (c), and (d). Although most IRS/Treasury regulations are interpretative, and therefore not subject to these provisions of the APA, the IRS usually solicits public comments on all NPRMs.”); *see also id.* § 32.1.2.3 (articulating similar position).

10 *See, e.g.*, Temporary Regulations; Guidance Under Section 1502; Treatment of Loss Carryovers From Separate Return Limitation Years (T.D. 9155), 69 Fed. Reg. 51,175 (Aug. 18, 2004), 2004-2 C.B. 562; Final and Temporary Regulations; Effect of Elections in Certain Multi-Step Transactions (T.D. 9071), 68 Fed. Reg. 40,766 (July 9, 2003), 2003-2 C.B. 560, 561; Temporary Regulations; Distributions of Interests in a Loss Corporation From Qualified Trusts (T.D. 9063), 68 Fed. Reg. 38,177 (June 27, 2003), 2003-2 C.B. 510, 511; *see also infra* Part III.A.3 (discussing the good cause exception and its application).

ize notice-and-comment rulemaking in promulgating most Treasury regulations.<sup>11</sup>

While a few scholars have noted certain aspects of Treasury's practices as potentially inconsistent with APA requirements,<sup>12</sup> to date no one has undertaken to study Treasury's APA compliance empirically. This Article documents a study of 232 separate regulatory projects interpreting the I.R.C. for which Treasury published Treasury Decisions (T.D.s)<sup>13</sup> and notices of proposed rulemaking (NPRMs) in the Federal Register between January 1, 2003 through December 31, 2005. In connection with this study, this Article compares Treasury's actual practices and exemption claims with current doctrinal trends in courts evaluating compliance with APA requirements across administrative agencies. The Article concludes that Treasury often fails to adhere to APA rulemaking requirements and thus leaves many of its regulations, including some of its most complex and controversial efforts, open to legal challenge on that basis.

Almost as often as not, Treasury does not follow the traditional APA-required pattern of issuing an NPRM, accepting and considering public comments, and only then publishing its final regulations. Established statutory exceptions from APA rulemaking requirements do not generally apply to excuse this noncompliance. Contrary to

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11 See, e.g., INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.2.3 (“[A]lthough most IRS/Treasury regulations are interpretative, the IRS usually publishes its NPRMs in the Federal Register and solicits public comments.”); see also *id.* § 32.1.5.4.7.5.1 (making similar claim).

12 See Michael Asimow, *Public Participation in the Adoption of Temporary Tax Regulations*, 44 TAX LAW. 343, 369–70 (1991) (concluding that “Treasury’s practice of adopting temporary regulations thus leaves in doubt the validity of numerous temporary and final regulations”); John F. Coverdale, *Chevron’s Reduced Domain: Judicial Review of Treasury Regulations and Revenue Rulings After Mead*, 55 ADMIN. L. REV. 39, 69–70 (2003) (noting Treasury’s use of temporary regulations and questioning Treasury’s basis for doing so); Juan J. Lavilla, *The Good Cause Exemption to Notice and Comment Rulemaking Requirements Under the Administrative Procedure Act*, 3 ADMIN. L.J. AM. U. 317, 341 (1989) (describing the IRS’s comparative misuse of the good cause exemption as “particularly remarkable”); Juan F. Vasquez, Jr. & Peter A. Lowy, *Challenging Temporary Treasury Regulations: An Analysis of the Administrative Procedure Act, Legislative Reenactment Doctrine, Deference, and Invalidity*, 3 HOUS. BUS. & TAX L.J. 248, 252–54 (2003) (describing Treasury’s practice of issuing temporary regulations as “obliterat[ing] the APA’s notice-and-comment procedures” and “an abuse of the process as well as an abuse of discretion”).

13 Treasury Decisions are the format that the Treasury Department uses to adopt legally binding Treasury regulations. See, e.g., INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.1.4 (describing Treasury regulations as “the most authoritative form of published guidance” interpreting the tax laws); Coverdale, *supra* note 12, at 67–68 (recognizing binding nature of Treasury regulations).

Treasury's position, most if not all Treasury regulations are legislative rather than interpretative in character when considered in light of modern doctrinal standards for distinguishing those categories. Consequently, Treasury regulations generally do not qualify for the interpretative rule exception from the APA's public notice and comment requirements. The procedural rule exception from notice and comment may apply occasionally, but not in most cases. Treasury may on occasion have a reasonable basis for claiming good cause; but Treasury's reliance on the good cause exception is typically poorly justified and often misplaced in light of jurisprudential trends. Thus, although Treasury usually does solicit public comment in the course of promulgating final regulations, Treasury's rulemaking practices are frequently inconsistent with APA requirements, or at least skirt doctrinal lines.

To support these conclusions, Part I of the Article briefly surveys the APA's rulemaking requirements generally and Treasury's rulemaking authority specifically. Part II outlines the study of Treasury's actual practices and its findings. Part III compares Treasury's practices with prevailing legal doctrine to demonstrate the weaknesses in Treasury's practices. Part IV offers a theory of why Treasury's practices so often deviate from APA rulemaking requirements. Part V discusses the implications of Treasury's actions.

This project raises at least as many questions as it answers. For example, in other areas of administrative law, regulated parties and public interest groups stand ready to challenge virtually any perceived failure to satisfy APA procedural requirements. If so many Treasury regulations are susceptible to legal challenge on such grounds, then why have so few taxpayers raised such claims?<sup>14</sup> Also, and perhaps relatedly, in many other areas of administrative law, regulated parties challenge regulations immediately post-promulgation. The courts thus have the opportunity to review and remand regulations before they govern regulated party behavior. Tax historically has been an area of post-enforcement litigation only, meaning that the cases require the courts to reach some conclusion as to the litigant taxpayer's tax liability. Under such circumstances, what remedy can the courts offer taxpayers for procedurally challenged regulations? These and other interesting questions raised by this Article will simply have to wait for another day.

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14 See, e.g., *Hosp. Corp. of Am. & Subsidiaries v. Comm'r*, 348 F.3d 136, 145 n.3 (6th Cir. 2003) (noting taxpayer's choice not to challenge temporary Treasury regulation as violation of APA section 553 and therefore not reaching that issue).

## I. THE APA'S RULEMAKING REQUIREMENTS AND TREASURY'S RULEMAKING AUTHORITY

APA section 553 imposes several procedural requirements upon agencies engaging in rulemaking. The I.R.C. in turn gives Treasury the authority to promulgate rules. It is well established that Congress may and often does include in an organic statute like the I.R.C. provisions deviating from APA requirements. Although Treasury's rulemaking efforts generally fall within the APA's scope, the I.R.C. includes a few tax-specific provisions that deviate from administrative law norms. To provide a context for comparing Treasury's actual practices to the APA's rulemaking requirements, therefore, this Part will summarize briefly APA section 553 and the I.R.C. provisions granting rulemaking authority to Treasury and dictating how Treasury may exercise that power.

### A. *General Rulemaking Requirements of the APA*

APA section 553 does two things. First, it imposes a series of default procedural requirements for agencies to follow in promulgating rules.<sup>15</sup> Second, APA section 553 provides several exceptions from some or all of those requirements.<sup>16</sup>

Beginning with the default procedures, APA section 553(b) first requires an agency to provide public notice of its proposed rulemaking through publication in the Federal Register.<sup>17</sup> Among other things, such notice must specify the legal authority under which the agency is proposing to promulgate rules.<sup>18</sup> In addition, the notice must offer "either the terms or substance of the proposed rule or a description of the subjects and issues involved."<sup>19</sup> Consequently, the courts generally do not allow agencies to promulgate final rules with provisions not "sufficiently foreshadowed" by an NPRM.<sup>20</sup> Put another way, final rules must be a "logical outgrowth" of those proposed.<sup>21</sup>

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15 5 U.S.C. § 553(b) (2000).

16 *Id.* § 553(b)(A), (B).

17 *See id.* § 553(b).

18 *See id.*

19 *Id.*

20 *See, e.g.,* *Natural Res. Def. Council v. EPA*, 279 F.3d 1180, 1187–88 (9th Cir. 2002); *Sw. Bell Tel. Co. v. FCC*, 168 F.3d 1344, 1353 (D.C. Cir. 1999); *see also* 1 PIERCE, *supra* note 2, § 7.3, at 428–29 (discussing the "sufficiently foreshadowed" test).

21 *See, e.g.,* *Envtl. Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005); *Natural Res. Def. Council*, 279 F.3d at 1186; *Nat'l Mining Ass'n v. Mine Safety & Health Admin.*, 116 F.3d 520, 531 (D.C. Cir. 1997); *see also* 1 PIERCE, *supra* note 2, § 7.3, at 428–29 (equating the "logical outgrowth" test and the "sufficiently foreshadowed"

Next, APA section 553(c) commands the agency pursuing the rulemaking process to offer interested persons an opportunity to participate through the submission of written comments.<sup>22</sup> Then, upon issuing final regulations, the agency must include a “concise general statement of their basis and purpose.”<sup>23</sup> Legislative history indicates that Congress intended this statement to explain the final regulations promulgated;<sup>24</sup> and the courts rely heavily on the statement to facilitate judicial review.<sup>25</sup> Hence, to satisfy judicial expectations, preambles to final regulations tend to be more comprehensive than concise, including detailed discussions of the regulations’ goals and methods, negative comments received, and the agency’s responses thereto.<sup>26</sup>

Finally, a rule will not be effective until at least thirty days after it is published in the Code of Federal Regulations (C.F.R.).<sup>27</sup> The reason for this delay is to give affected parties time to conform their con-

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test); Phillip M. Kannan, *The Logical Outgrowth Doctrine in Rulemaking*, 48 ADMIN. L. REV. 213, 217 (1996) (same).

22 See 5 U.S.C. § 553(c).

23 *Id.*

24 S. Doc. No. 79-248, at 20 (1946) (specifying that the concise statement of basis and purpose should be “fully explanatory of the complete factual and legal basis as well as the real object or objects sought”); see also *Schiller v. Towner Semiconductor Ltd.*, 449 F.3d 286, 302–03 (2d Cir. 2006) (citing *Indep. U.S. Tanker Owners Comm. v. Dole*, 809 F.2d 847, 852 (D.C. Cir. 1987)); *United Mine Workers v. Dole*, 870 F.2d 662, 667 (D.C. Cir. 1989) (quoting same); *Tanker Owners*, 809 F.2d at 852 (quoting APA legislative history).

25 *Alvarado Cmty. Hosp. v. Shalala*, 155 F.3d 1115, 1122 (9th Cir. 1998) (quoting *Mt. Diablo Hosp. v. Shalala*, 3 F.3d 1226, 1233–34 (9th Cir. 1993), amended by 166 F.3d 950 (9th Cir. 1999)); see also *Simms v. Nat’l Highway Traffic Safety Admin.*, 45 F.3d 999, 1005 (6th Cir. 1995) (quoting *Auto. Parts & Accessories Ass’n v. Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968)). Courts engaging in such review must take care not to impose procedural requirements beyond those required by the APA. See *Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 541–48 (1978) (rejecting additional procedures imposed by Court of Appeals as necessary “to ventilate the issues”). But see *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42–43 (1983) (supporting “hard look” review of agency process under the arbitrary and capricious standard of APA section 706(2)(A)).

26 Richard Pierce describes the typical statement of basis and purpose as one in which the agency refers to the evidentiary basis for all factual predicates, explains its method of reasoning from factual predicates to the expected effects of the rule, relates the factual predicates and expected effects of the rule to each of the statutory goals or purposes the agency is required to further or to consider, responds to all major criticisms contained in the comments on its proposed rule, and explains why it has rejected at least some of the most plausible alternatives to the rule it has adopted.

1 PIERCE, *supra* note 2, § 7.4, at 442.

27 See 5 U.S.C. § 553(d).



duct to the mandates of the new rule.<sup>28</sup> The language of APA section 553(d) allows agencies to postpone effectiveness for more than thirty days; and the courts occasionally require longer waiting periods.<sup>29</sup>

Proposed rules offer guidance as to the agency's interpretation of the relevant statute but are not legally binding on regulated parties, the courts, or even necessarily the agency itself.<sup>30</sup> Final rules may be legally binding, but if so they take effect only after the prescribed thirty-day period. Known collectively as notice-and-comment rulemaking, the requirements of APA section 553 anticipate a process by which an agency will issue proposed regulations and solicit public participation in the rulemaking process before issuing regulations with legally binding force.

APA section 553 grants four principal exceptions from the public notice and comment requirements of APA section 553(b) and (c): for interpretative rules, procedural rules, policy statements, and good cause.<sup>31</sup> As is discussed at length in Part III, whether Treasury complies with APA rulemaking requirements depends largely upon the extent to which these exceptions apply to many or most Treasury regulations. The APA does not define interpretative rules, procedural rules, or policy statements. Consequently, as is discussed at length in Part III, the courts have struggled in applying the exceptions for interpretative and procedural rules.<sup>32</sup> The good cause exception applies when notice and public comment would be "impracticable, unnecessary, or contrary to the public interest."<sup>33</sup> APA section 553(b) also directs an agency asserting the good cause exception to do so expressly and to explain its reasoning when issuing the related final

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28 See 1 PIERCE, *supra* note 2, § 7.3, at 424.

29 See, e.g., Nat'l Ass'n of Indep. Television Producers & Distributs. v. FCC, 502 F.2d 249, 254-55 (2d Cir. 1974) (deeming eight-month waiting period inadequate).

30 See *United States v. Springer*, 354 F.3d 772, 776 (8th Cir. 2004) (quoting *Sweet v. Sheahan*, 235 F.3d 80, 87 (2d Cir. 2000)); *Tedori v. United States*, 211 F.3d 488, 492 & n.13 (9th Cir. 2000); see also *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 845 (1986) ("It goes without saying that a proposed regulation does not represent an agency's considered interpretation of its statute and that an agency is entitled to consider alternative interpretations before settling on the view it considers most sound.").

31 5 U.S.C. § 553(b). APA section 553 also provides blanket exceptions for rules involving military or foreign affairs and rules "relating to agency management or personnel or to public property, loans, grants, benefits, or contracts." *Id.* § 553(a). These exceptions are not relevant for the purposes of this Article.

32 See generally Robert A. Anthony, "Interpretive" Rules, "Legislative" Rules and "Spurious" Rules: *Lifting the Smog*, 8 ADMIN. L.J. AM. U. 1, 2-6 (1994) (discussing the difficulty); John F. Manning, *Nonlegislative Rules*, 72 GEO. WASH. L. REV. 893, 893-97 (2004) (same).

33 5 U.S.C. § 553(b)(B).

regulations.<sup>34</sup> APA section 553(d)(3) separately allows an agency to invoke the good cause exception to avoid the thirty-day advance publication period for final rules.<sup>35</sup>

### B. Treasury's Rulemaking Authority

The requirements and exceptions of APA section 553 only apply when an agency is engaged in rulemaking. The I.R.C. expressly contemplates that Treasury will engage in rulemaking in administering its provisions. The I.R.C. also includes a few specific procedural provisions that supplement APA section 553.

The I.R.C. explicitly grants Treasury broad interpretative authority over the I.R.C.'s provisions.<sup>36</sup> Frequently, that power is conveyed through a specific authorization or mandate to promulgate regulations to fill a congressionally identified statutory gap.<sup>37</sup> In fact, the I.R.C. contains several hundred specific authority grants.<sup>38</sup> I.R.C. § 1502 may be the broadest of these, giving the Secretary of the Treasury the authority to develop whatever regulations he deems necessary to reflect clearly the income tax liability of groups of affiliated corporations filing a single return, whether or not such regulations differ from those that apply to corporations filing separately.<sup>39</sup> Most specific authority grants are more limited, as for example with I.R.C. § 23(i), which calls for implementing regulations to effectuate detailed statutory language providing a tax credit for qualified adoption expenses.<sup>40</sup> Additionally, I.R.C. § 7805(a) grants Treasury the general rulemaking authority to develop "all needful rules and regulations for the enforce-

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34 *Id.*

35 *Id.* § 553(d)(3).

36 *See, e.g.*, I.R.C. § 1502 (West Supp. 2006); I.R.C. § 7805(a) (2000); *see also* discussion *supra* note 6 and accompanying text.

37 *See, e.g.*, I.R.C. §§ 163(i)(5), 167(e)(6), 357(d)(3), 453(j)(1), 952(d), 1502 (West Supp. 2006). A search conducted on February 23, 2007 on Westlaw's "Federal Taxation—U.S. Code Annotated" database for specific authority delegations derived from just one common phrasing, "Secretary shall" /s "prescribe" /s "regulations," resulted in 293 hits.

38 *See, e.g., id.* §§ 163(i)(5), 167(e)(6), 357(d)(3), 453(j)(1), 952(d), 1502; *see also* N.Y. STATE BAR ASS'N TAX SECTION, REPORT ON LEGISLATIVE GRANTS OF REGULATORY AUTHORITY 2-6 (Nov. 3, 2006), *available at* [http://www.nysba.org/Content/ContentGroups/Section\\_Information1/Tax\\_Section\\_Reports/1121rpt.pdf](http://www.nysba.org/Content/ContentGroups/Section_Information1/Tax_Section_Reports/1121rpt.pdf) (claiming and categorizing more than 550 specific authority grants) [hereinafter N.Y. STATE BAR ASS'N REPORT].

39 *See* I.R.C. § 1502.

40 *See* I.R.C. § 23(i) (West Supp. 2006); *see also* N.Y. STATE BAR ASS'N REPORT, *supra* note 38, at 2-6 (listing numerous examples).

ment of” the I.R.C.<sup>41</sup> Treasury has utilized both specific and general rulemaking authority to adopt thousands of pages of regulations.<sup>42</sup> Treasury, the courts, and the tax bar all regard general as well as specific authority Treasury regulations to be legally binding on the government as well as on taxpayers.<sup>43</sup>

The I.R.C. does not specify particular procedures for Treasury to follow in promulgating its regulations. Treasury generally acknowledges that the APA applies for this purpose;<sup>44</sup> and under APA section 553, Treasury must utilize notice-and-comment rulemaking to promulgate Treasury regulations unless one of the available exceptions applies. The Internal Revenue Manual maintains that “most” Treasury regulations are interpretative rules exempt from the APA’s public notice and comment requirements, even though Treasury “usually publishes its NPRMs in the Federal Register and solicits public comments.”<sup>45</sup> The Internal Revenue Manual also discusses the possibility that the good cause exception may sometimes apply to its rulemaking efforts.<sup>46</sup> Thus, two unresolved questions are whether Treasury is correct that most of its regulations fall into the interpretative category and the extent to which other exceptions from APA rulemaking requirements such as the good cause exception might apply.

Congress has adopted a few tax-specific procedural rules which must be reconciled with the APA’s rulemaking procedures, however. The first involves the effective date for Treasury regulations. As already noted, APA section 553(d) generally requires regulations to be published in the Federal Register thirty days before they become effective.<sup>47</sup> This delay in effective date is coupled with a general pre-

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41 I.R.C. § 7805(a).

42 A recent check demonstrated that Treasury regulations interpreting the I.R.C. consume twenty volumes of the Code of Federal Regulations.

43 See, e.g., *Haffner’s Serv. Stations, Inc. v. Comm’r*, 326 F.3d 1, 3 (1st Cir. 2003) (recognizing binding force of Treasury regulations); *Suzy’s Zoo v. Comm’r*, 273 F.3d 875, 881 n.7 (9th Cir. 2001) (same); INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.1.4 (same); *Coverdale*, *supra* note 12, at 66–69 (discussing binding nature of Treasury regulations); *Irving Salem et al., ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 TAX LAW. 717, 737–44 (2004).

44 See discussion *supra* note 8 and accompanying text.

45 INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.2.3; see also *id.* § 32.1.5.4.7.5.1 (noting that “most IRS/Treasury regulations are interpretative, and therefore not subject to these provisions of the APA”).

46 *Id.* § 32.1.5.4.7.5.1 (noting that APA section 553(b) and (c) “do not apply if the agency finds that publishing an NPRM is impracticable, unnecessary, or contrary to the public interest,” and providing sample language “[i]f the agency determines that notice and comment is contrary to the public interest”).

47 See 5 U.S.C. § 553(d) (2000); see also *supra* text accompanying note 35.

sumption against retroactive rulemaking “unless that power is conveyed by express terms” by statute.<sup>48</sup> By contrast, I.R.C. § 7805(b)(1) states explicitly that a Treasury regulation may apply to a taxable period ending on or after the earliest of three dates: (1) the date that Treasury files the final regulation with the Federal Register, (2) the date on which Treasury filed with the Federal Register any proposed or temporary regulation to which the final regulation relates, or (3) the date on which Treasury publicly issued any notice describing the expected contents of the regulation.<sup>49</sup> I.R.C. § 7805(b) further allows full retroactivity under specified circumstances: for regulations involving internal Treasury procedures, for regulations that correct procedural defects of prior regulations, for regulations issued within eighteen months after Congress enacts the related statutory provision, and for regulations “to prevent abuse.”<sup>50</sup> Finally, I.R.C. § 7805(b)(7) gives Treasury the authority to allow taxpayers to elect to apply regulations to periods earlier than the dates specified in I.R.C. § 7805(b)(1).<sup>51</sup>

The precise relationship between I.R.C. § 7805(b) and APA section 553(d) is unclear. A few courts have suggested that, as a specific grant of authority, I.R.C. § 7805(b) takes precedence over the more general APA § 553(d).<sup>52</sup> However, the cases addressing this issue all considered an earlier version of I.R.C. § 7805(b) that required Treasury to state affirmatively the extent to which a regulation would *not* be applied retroactively—the opposite of the current statutory presumption.<sup>53</sup> Congress adopted the present, more prospectively-oriented language of I.R.C. § 7805(b) in 1996<sup>54</sup> out of fairness concerns and to limit Treasury’s discretion in making its regulations retroactively applicable.<sup>55</sup> On its face, I.R.C. § 7805(b)(1) gives Treasury substantial discretion to apply regulations retroactively at least to the date

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48 *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 204 (1988).

49 I.R.C. § 7805(b)(1)(A)–(C) (2000).

50 *Id.* § 7805(b)(2)–(5).

51 *Id.* § 7805(b)(7).

52 *See, e.g., Stamos v. Comm’r*, 95 T.C. 624, 637–38 (1990) (suggesting that I.R.C. § 7805(b) takes precedence over APA section 553(d)), *aff’d*, 956 F.2d 1168 (9th Cir. 1992); *see also Redhouse v. Comm’r*, 728 F.2d 1249, 1253 (9th Cir. 1984) (same).

53 *See* I.R.C. § 7805(b) (1994) (“The Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.”); *see also Redhouse*, 728 F.2d at 1250–51 (discussing the presumption in favor of retroactivity that the pre-1996 language raised).

54 *See* Pub. L. No. 104-168, 110 Stat. 1452, 1468–69 (1996).

55 *See* Benjamin J. Cohen & Catherine A. Harrington, *Is the Internal Revenue Service Bound By Its Own Regulations and Rulings?*, *TAX LAW.*, Summer 1998, at 675, 697–701 (discussing the history of the 1996 amendments to I.R.C. § 7805(b)).

of proposal, while the other language in I.R.C. § 7805(b) articulates limited circumstances permitting even further retroactive effect.<sup>56</sup> Any exercise of such discretion would render APA section 553(d) superfluous as a practical matter. Yet the potential for retroactive application is not necessarily inconsistent with the general rule of a delayed effective date. The reasons for amending I.R.C. § 7805(b) in 1996 may support a narrower interpretation of I.R.C. § 7805(b) that coordinates more closely with APA section 553(b) and gives effect to both statutes, for example by requiring Treasury to show good cause before invoking its authority under I.R.C. § 7805(b).

The I.R.C. more clearly deviates from APA section 553 with I.R.C. § 9833. In that section, Congress expressly gave Treasury limited authority to issue “interim final rules” to carry out the provisions of Chapter 100 of the I.R.C.<sup>57</sup> Interim final rules are temporary but legally binding regulations issued without notice and comment for which an agency typically seeks post-promulgation public comment prior to finalization.<sup>58</sup> Agencies may issue interim final or temporary regulations under the APA, but only where one of the expressed exceptions from notice and comment applies.<sup>59</sup> By contrast, I.R.C. § 9833 specifically authorizes interim final rules whether or not one of those exceptions is available.

One could argue that I.R.C. § 7805(e), read broadly, represents a third I.R.C.-specific departure from APA rulemaking requirements.<sup>60</sup> I.R.C. § 7805(e) does two things. First, I.R.C. § 7805(e)(1) states that,

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56 A decision to make a regulation retroactively applicable pursuant to I.R.C. § 7805(b) would be subject to judicial review for abuse of discretion. *See, e.g., Redhouse*, 728 F.2d at 1251 (citing *Auto. Club of Mich. v. Comm’r*, 353 U.S. 180, 184 (1957); *Klamath Strategic Inv. Fund, LLC v. United States*, 440 F. Supp. 2d 608, 620–21, 623 (E.D. Tex. 2006).

57 I.R.C. § 9833 (2000). I.R.C. § 9833 reads in its entirety as follows:

The Secretary, consistent with section 104 of the Health Care Portability and Accountability Act of 1996, may promulgate such regulations as may be necessary or appropriate to carry out the provisions of this chapter. The Secretary may promulgate any interim final rules as the Secretary determines are appropriate to carry out this chapter.

*Id.* Chapter 100 consists of a mere eight I.R.C. sections governing group health plan requirements: I.R.C. §§ 9801–03, 9811, 9831–33 (2000); I.R.C. § 9812 (West Supp. 2006).

58 *See* Notice; Administrative Conference of the United States, Adoption of Recommendations, 60 Fed. Reg. 43,108, 43,111–12 (Aug. 18, 1995) (describing interim final regulations).

59 5 U.S.C. § 553(b)(B) (2000); Adoption of Recommendations, 60 Fed. Reg. at 43,111–12.

60 *See* Asimow, *supra* note 12, at 362–64 (acknowledging and rejecting this argument).

if Treasury issues a temporary regulation, it must also publish a corresponding NPRM.<sup>61</sup> Second, I.R.C. § 7805(e)(2) sunsets temporary regulations after three years.<sup>62</sup> Because I.R.C. § 7805(e) clearly contemplates that Treasury will issue temporary regulations, one could argue that I.R.C. § 7805(e), like I.R.C. § 9833, authorizes Treasury to promulgate temporary regulations whether or not the APA section 553(b) exceptions apply.

Reading I.R.C. § 7805(e) thusly seems overly broad. I.R.C. § 7805(e) at best only implies such authorization to the extent it acknowledges that Treasury in fact issues temporary regulations by telling Treasury what to do if it does. Since APA section 553(b) allows Treasury to issue temporary regulations if one of that provision's exceptions apply, it is not necessary to read I.R.C. § 7805(e) as independent authorization for temporary regulations in order to give that provision effect. By comparison, the more explicit language of I.R.C. § 9833 demonstrates that Congress knows how to authorize temporary or interim final regulations absent one of the APA section 553(b) exceptions when it means to do so. Further, while Congress could have addressed the problem of longstanding temporary Treasury regulations by barring them entirely, doing so would have rendered the I.R.C. less flexible than the APA by precluding such regulations even where Treasury can demonstrate that good cause or another APA section 553(b) exception applies.

Moreover, a narrow reading of I.R.C. § 7805(e) better effectuates the congressional purpose behind that provision. No meaningful legislative history explains Congress's intent with I.R.C. § 7805(e);<sup>63</sup> but scholars have documented the general understanding that Congress sought to end Treasury's then-habit of adopting and never finalizing temporary regulations and, correspondingly, to ensure that Treasury at least sought post-promulgation public comment in response to temporary regulations.<sup>64</sup> If Congress adopted I.R.C. § 7805(e) with an eye toward facilitating public participation in Treasury's rulemaking

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61 See I.R.C. § 7805(e)(1) (2000) ("Any temporary regulation issued by the Secretary shall also be issued as a proposed regulation.").

62 See *id.* § 7805(e)(2) ("Any temporary regulation shall expire within three years after the date of issuance of such regulation.").

63 The Senate and Conference Committee reports merely reiterate the provisions of I.R.C. § 7805(e) without offering further insight into congressional intent. See S. REP. NO. 100-309, at 7 (1988); H.R. REP. NO. 100-1104, at 217-18 (1988), as reprinted in 1988 U.S.C.C.A.N. 5048, 5048-54.

64 See Asimow, *supra* note 12, at 363-64 (discussing history of I.R.C. § 7805(e)); see also Vasquez & Lowy, *supra* note 12, at 254 (noting similar reasons for adopting I.R.C. § 7805(e)).

process, then a more narrow reading of I.R.C. § 7805(e) that still permits Treasury to adopt temporary regulations only when one of the APA section 553(b) exceptions applies better accomplishes that goal. In fact, one could and probably should read I.R.C. § 7805(e) as applying even to interim final rules issued pursuant to I.R.C. § 9833 for the same reason.

The argument for reading I.R.C. § 7805(e) broadly as a tax-specific exception from APA rulemaking requirements is a plausible one, but it stretches the text and ignores Congress's reputed concern for public participation in the promulgation of Treasury regulations. In sum, therefore, I.R.C. § 7805(b) may alter the thirty-day effective date delay of APA section 553(d), and I.R.C. § 9833 provides a very limited additional exception from the pre-promulgation notice and comment requirements of APA section 553(b) and (c); but most Treasury regulations must either follow notice-and-comment rulemaking or qualify for one of APA section 553(b)'s exceptions therefrom.<sup>65</sup>

## II. EMPIRICAL STUDY: WHAT TREASURY ACTUALLY DOES

As already noted, Treasury claims generally to follow notice-and-comment rulemaking even as it characterizes most Treasury regulations as interpretative rules exempt from the requirements of APA section 553.<sup>66</sup> As a regular reader of Treasury's T.D.s and NPRMs, my own sense has been that Treasury's adherence to APA procedural requirements is inconsistent and its claims to exemptions are exaggerated. The goal of this study was to test empirically the accuracy of those impressions.

### A. Methodology

To evaluate Treasury's faithfulness to APA rulemaking requirements, the study reviewed 232 separate regulatory projects for which

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<sup>65</sup> Theoretically one might also argue that I.R.C. § 7805(b) and (e) together displace APA section 553 notice-and-comment rulemaking requirements entirely in the tax context. Such an interpretation is simply implausible. The APA by its own terms requires Congress expressly to adopt any exceptions from its requirements. *See* 5 U.S.C. § 559 (2000). "Exceptions from the terms of the Administrative Procedure Act are not lightly to be presumed" given that explicit statutory requirement. *Marcello v. Bonds*, 349 U.S. 302, 310 (1955); *see also Dickinson v. Zurko*, 527 U.S. 150, 155 (1999) (recognizing uniformity as a goal of the APA and requiring clear statutory intent to deviate from that norm). While I.R.C. § 7805(b) and (e) clearly impose a tax-specific gloss on APA notice-and-comment rulemaking requirements, I.R.C. § 7805 is insufficiently comprehensive to suggest an alternative procedural scheme for promulgating regulations.

<sup>66</sup> *See* discussion *supra* note 45 and accompanying text.

Treasury published T.D.s or NPRMs in the Federal Register between January 1, 2003, and December 31, 2005. I limited the study to three years for manageability, and chose this period as the most recent and thus the most indicative of Treasury's current practices. Although the entire period studied falls within a single presidential administration, the Treasury and Internal Revenue Service (IRS) positions most directly responsible for promulgating Treasury regulations experienced substantial turnover during those three years.<sup>67</sup> Other scholars documented similar practices almost twenty years ago; and informal conversations with former Treasury and IRS officials and attorneys likewise suggest that this period is not particularly aberrational.<sup>68</sup> Future research could ascertain whether or not this is the case.

Treasury published 203 T.D.s and 163 NPRMs in the Federal Register during the three years studied.<sup>69</sup> In almost all of these T.D.s and NPRMs, Treasury relied on provisions of the I.R.C. as giving it the authority to promulgate regulations. Four T.D.s that Treasury issued during the period studied—T.D.s 9227, 9201, 9165, and 9086—involved the exercise solely of rulemaking authority granted by other statutes.<sup>70</sup> While such regulatory projects bear upon the Treasury's

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67 For example, Treasury's Office of Tax Policy and the Internal Revenue Service Assistant Secretary of the Treasury (Tax Policy) heads Treasury's Office of Tax Policy. In the three years studied, Mark Weinberger and Pamela Olson both served as Assistant Secretary of the Treasury (Tax Policy), Gregory Jenner held that position in an Acting capacity, and Eric Solomon handled the regulatory guidance responsibilities of the job beginning in December 2004 as Acting Deputy Assistant Secretary (Tax Policy) and Deputy Assistant Secretary (Regulatory Affairs). Charles Rossotti and Mark Everson both served as Commissioner of Internal Revenue, and B. John Williams and Donald Korb both held the position of I.R.C. Chief Counsel during the period studied.

68 See discussion *supra* note 12 and accompanying text (citing corresponding scholarly observations from the past twenty years); see also discussion *infra* Part IV (describing the evolution of Treasury's noncompliance with the APA and pursuit of other objectives).

69 In particular, Treasury published T.D.s 9035 through 9236 and also T.D. 9238 in the Federal Register between January 1, 2003, and December 31, 2005. See Temporary Regulations; Guidance Under Section 7874 for Determining Ownership by Former Shareholders or Partners of Domestic Entities (T.D. 9238), 70 Fed. Reg. 76,685 (Dec. 28, 2005); Final and Temporary Regulations; Constructive Transfers and Transfers of Property to a Third Party on Behalf of a Spouse (T.D. 9035), Fed. Reg. 1534 (Jan. 13, 2003). Although Treasury released T.D. 9237 on December 30, 2005, Treasury did not publish that T.D. in the Federal Register until January 3, 2006. See Final Regulations; Designated Roth Contributions to Cash or Deferred Arrangements Under Section 401(k) (T.D. 9237), 71 Fed. Reg. 6 (Jan. 3, 2006). Accordingly, the study did not include T.D. 9237.

70 T.D. 9227 addressed regulations concerning the IRS's employee performance evaluation system issued pursuant to a provision in Title 5 of the U.S. Code granting



efforts to administer the I.R.C. and taxpayers' attempts to meet their tax obligations, because these T.D.s do not purport to exercise Treasury's authority to promulgate regulations under the I.R.C., I excluded them from the study. I also eliminated T.D. 9166 from the study due to its reliance on I.R.C. § 9833.<sup>71</sup> By contrast, I retained as part of the study other T.D.s that relied upon I.R.C. § 7805(a)'s general rulemaking authority in conjunction with some other statutory grant.<sup>72</sup>

Considering each T.D. and NPRM independently is misleading. Many T.D.s represent the culmination of Treasury's rulemaking pro-

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Treasury specific management authority over IRS personnel. Final and Temporary Regulations; Balanced System for Measuring Organizational and Employee Performance Within the Internal Revenue Service (T.D. 9227), 70 Fed. Reg. 60,214 (Oct. 17, 2005), 2005-2 C.B. 924. Treasury issued T.D.s 9201 and 9165 in promulgating what are known as the Circular 230 regulations, governing the practice by tax advisors before the IRS. Final Regulations; Regulations Governing Practice Before the Internal Revenue Service (T.D. 9201), 70 Fed. Reg. 28,824 (May 19, 2005), 2005-1 C.B. 1153; Final Regulations; Regulations Governing Practice Before the Internal Revenue Service (T.D. 9165), 69 Fed. Reg. 75,839 (Dec. 20, 2004), 2005-1 C.B. 357. Treasury primarily exercised authority granted under Title 31 of the U.S. Code in developing these regulations, and Treasury did not cite any provision of the I.R.C. as supporting these regulations. Final Regulations (T.D. 9201), 70 Fed. Reg. at 28,824; Final Regulations (T.D. 9165), 69 Fed. Reg. at 75,840-41. Finally, T.D. 9086 adopted regulations governing user fees charged in connection offers in compromise pursuant to the Independent Offices Appropriation Act of 1952, which is also codified at 31 U.S.C. § 1701 (2000). Final Regulations; User Fees for Processing Orders to Compromise (T.D. 9086), 68 Fed. Reg. 48,785 (Aug. 15, 2003), 2003-2 C.B. 817.

71 See discussion *supra* note 57 and accompanying text (explaining the significance of I.R.C. § 9833). Issued by Treasury in conjunction with the Departments of Labor and Health and Human Services, T.D. 9166 adopted final regulations implementing provisions of the Health Insurance Portability and Accountability Act of 1996 (HIPAA), Pub. L. No. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 18, 26, 29, 42 U.S.C.). Final Regulations; Health Coverage Portability for Group Health Plans and Group Health Insurance Issuers Under HIPAA Titles I & IV (T.D. 9166), 69 Fed. Reg. 78,720 (Dec. 30, 2004), 2005-1 C.B. 558. Although Treasury also cited I.R.C. § 7805(a) and thus purported to exercise its general rulemaking authority in T.D. 9166, I interpreted this reliance as secondary and thus less significant than Treasury's citation of I.R.C. § 9833.

72 For example, T.D.s 9070 and 9173 amend regulations charging a fee for copying exempt organization materials for purposes of I.R.C. § 6104 in accordance with the Freedom of Information Act (FOIA), 5 U.S.C. § 552 (2000 & Supp. IV 2004). Final Regulations; Authority To Charge Fees for Furnishing Copies of Exempt Organizations' Material Open to Public Inspection (T.D. 9173), 70 Fed. Reg. 704 (Jan. 5, 2005), 2005-1 C.B. 557; Final Regulations; Authority To Charge Fees for Furnishing Copies of Exempt Organizations' Material Open to Public Inspection (T.D. 9070), 68 Fed. Reg. 40,768 (July 9, 2003), 2003-2 C.B. 574. In promulgating these regulations, Treasury relied upon regulatory authority granted to it by FOIA as well as I.R.C. § 7805(a).

cess, issued either after Treasury issues an NPRM and collects and considers public comments or when Treasury skips notice and comment altogether.<sup>73</sup> Where Treasury issued an NPRM and related subsequent T.D. both during the three-year period studied, I evaluated these documents together as a single project. Often, however, Treasury puts out a T.D. with temporary regulations simultaneously with the NPRM at the start of a project, then publishes another T.D. with final regulations at the end of the project.<sup>74</sup> Where Treasury issued two or more clearly related T.D.s during the three-year period, I evaluated them together as a single project to avoid double counting. Likewise, 102 of the 163 NPRMs that Treasury published in 2003, 2004, and 2005 related to T.D.s issued in the same period.<sup>75</sup> I did not evaluate these NPRMs separately but rather grouped them with their related T.D.s. Finally, Treasury occasionally issued more than one NPRM in connection with the same regulatory project, typically as one NPRM withdraws and replaces proposed regulations offered by

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73 See, e.g., Final Regulations; Value of Life Insurance Contracts When Distributed From a Qualified Retirement Plan (T.D. 9223), 70 Fed. Reg. 50,967 (Aug. 29, 2005), 2005-2 C.B. 591; Final Regulations; Electing Mark to Marketable Stock (T.D. 9123), 69 Fed. Reg. 24,071 (May 3, 2004), 2004-1 C.B. 907, 908; Final Regulations; Guidance Regarding the Definition of Foreign Personal Holding Company Income (T.D. 9039), 68 Fed. Reg. 4916 (Jan. 31, 2003), 2003-1 C.B. 561.

74 See, e.g., Final Regulations, Temporary Regulations, and Removal of Temporary Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9192), 70 Fed. Reg. 14,395 (Mar. 22, 2005), 2005-1 C.B. 866 (finalizing and removing temporary regulations issued in T.D. 9117, 2004-1 C.B. 721; T.D. 9098, 2003-2 C.B. 1248; and T.D. 9089, 2003-2 C.B. 906); Final and Temporary Regulations; Information Reporting and Backup Withholding for Payment Card Transactions (T.D. 9136), 69 Fed. Reg. 41,938 (Jul. 13, 2004), 2004-2 C.B. 112 (finalizing and removing temporary regulations issued in T.D. 9041, 2003-1 C.B. 510); Final Regulations and Removal of Temporary Regulations; Excise Tax Relating to Structured Settlement Factoring Transactions (T.D. 9134), 69 Fed. Reg. 41,192 (July 8, 2004), 2004-2 C.B. 70 (finalizing and removing temporary regulations issued in T.D. 9042, 2003-1 C.B. 564); Final Regulations and Removal of Temporary Regulations; Tax Return Preparers—Electronic Filing (T.D. 9119), 69 Fed. Reg. 15,248 (Mar. 25, 2004), 2004-1 C.B. 825 (finalizing and removing temporary regulations issued in T.D. 9053, 2003-1 C.B. 914).

75 See, e.g., Notice of Proposed Rulemaking; Sickness or Accident Disability Payments, 70 Fed. Reg. 12,164 (Mar. 11, 2005) (proposing regulations finalized in T.D. 9233, 2006-3 I.R.B. 303); Notice of Proposed Rulemaking; Designated Roth Contributions to Cash or Deferred Arrangements Under Section 401(k), 70 Fed. Reg. 10,062 (Mar. 2, 2005) (proposing regulations finalized in T.D. 9237, 2006-6 I.R.B. 394); Notice of Proposed Rulemaking; Treatment of a Stapled Foreign Corporation Under Sections 269B and 367(b), 69 Fed. Reg. 54,067, 54,070–72 (Sept. 7, 2004) (proposing regulations finalized in T.D. 9216, 2005-2 C.B. 461).

another, earlier NPRM.<sup>76</sup> I considered related NPRMs together as one project where they fit this pattern. Altogether, the study groups the 198 T.D.s retained and the 163 NPRMs into 232 separate regulatory projects.

Finally, for each of the 232 projects, I reviewed any related T.D.s or NPRMs published prior to the three-year period.<sup>77</sup> Treasury regularly issues a variety of other miscellaneous notices in the Federal Register in connection with its projects: e.g., notices scheduling or canceling public hearings, or correcting amendments.<sup>78</sup> I reviewed

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76 See Notice of Proposed Rulemaking; Application of Normalization Accounting Rules to Balances of Excess Deferred Income Taxes and Accumulated Deferred Investment Tax Credits of Public Utilities Whose Assets Cease To Be Public Utility Property, 70 Fed. Reg. 75,762, 75,764–65 (Dec. 21, 2005) (withdrawing and replacing proposed regulations issued with earlier Notice of Proposed Rulemaking; Application of Normalization Accounting Rules to Balances of Excess Deferred Income Taxes and Accumulated Deferred Investment Tax Credits of Public Utilities Whose Generation Assets Cease to be Public Utility Property, 68 Fed. Reg. 10,190 (Mar. 4, 2003)); Notice of Proposed Rulemaking; Partnership Equity for Services, 70 Fed. Reg. 29,675 (May 24, 2005) (withdrawing and replacing proposed regulations issued with earlier Notice of Proposed Rulemaking; Treatment of Property Transferred in Connection With Performance of Services, 36 Fed. Reg. 10,787 (June 3, 1971)); Notice of Proposed Rulemaking; Corporate Reorganizations; Transfers of Assets or Stock Following a Reorganization, 69 Fed. Reg. 51,209 (Aug. 18, 2004) (withdrawing and replacing proposed regulations issued with earlier Notice of Proposed Rulemaking; Corporate Reorganizations; Transfers of Assets or Stock Following a Reorganization, 69 Fed. Reg. 9771 (Mar. 2, 2004)).

77 For example, T.D. 9036 finalized temporary regulations adopted by T.D. 8968, which were issued simultaneously with a notice of proposed rulemaking. See Final Regulations and Removal of Temporary Regulations; Disclosure of Returns and Return Information by Other Agencies (T.D. 9036), 68 Fed. Reg. 2695 (Jan. 21, 2003), 2003-1 C.B. 533; Temporary Regulations (T.D. 8968), 66 Fed. Reg. 64,351 (Dec. 13, 2001), 2002-1 C.B. 274; Notice of Proposed Rulemaking; Disclosure of Returns and Return Information by Other Agencies, 66 Fed. Reg. 64,386 (Dec. 13, 2001). In evaluating the project represented by T.D. 9036, I reviewed T.D. 8968 and the corresponding NPRM.

78 See, e.g., Correction to Notice of Proposed Rulemaking and Notice of Public Hearing; Application of Normalization Accounting Rules, 70 Fed. Reg. 76,433 (Dec. 27, 2005) (correcting Notice of Proposed Rulemaking; Guidance on Public Utilities, 70 Fed. Reg. 75,762); Cancellation of Notice of Public Hearing on Proposed Rulemaking; Source of Income From Certain Space and Ocean Activities; Source of Communications Income, 70 Fed. Reg. 73,967 (Dec. 14, 2005) (cancelling hearing announced by Notice of Proposed Rulemaking and Notice of Public Hearing; Source of Income From Certain Space and Ocean Activities; Source of Communications Income, 70 Fed. Reg. 54,859 (Sept. 19, 2005)); Correcting Amendment; Guidance Under Section 951 for Determining Pro Rata Share, 70 Fed. Reg. 67,905 (Nov. 9, 2005) (correcting T.D. 9222, 2005-2 C.B. 614).

these as published through December 31, 2005, for each of the 232 projects as well.

The first step in the analysis was to identify what steps Treasury formally follows in promulgating regulations interpreting the I.R.C. As noted above, APA section 553 anticipates a particular sequence of events, with public notice and opportunity for comment preceding the issuance of final regulations along with a concise statement of basis and purpose. Consistent with this sequencing, Treasury regularly published a T.D. with final regulations and an explanatory preamble only after it first issued an NPRM and evaluated public comments. Projects represented only by one or more NPRMs for which Treasury had not yet issued any T.D. are also consistent with APA section 553. As noted, however, for other projects, Treasury issued one T.D. with temporary regulations in conjunction with an NPRM prior to seeking public comment and another T.D. upon finalizing the temporary regulations; and Treasury occasionally skipped notice and comment altogether in issuing a T.D. with final regulations. Accordingly, for each project with one or more T.D.s, I asked whether the regulations issued were temporary or final and whether Treasury issued an NPRM before the T.D., simultaneously therewith, or not at all.

Relatedly, the study also tracked explicit claims of exception from the APA's public notice and comment requirements. Every T.D. and NPRM included a preamble that discussed various aspects of the final, temporary, or proposed regulations being issued. Every preamble contained a section entitled "Special Analysis" wherein Treasury typically, though not always, stated its conclusion regarding the applicability of APA section 553(b). As discussed above, APA section 553(b) states particularly that an agency invoking the good cause exception should do so explicitly and explain its reasoning.<sup>79</sup> Accordingly, for each T.D. and NPRM, I noted whether Treasury claimed that the published rules were exempt from APA section 553(b), whether Treasury expressly asserted a particular exception under APA section 553(b)(B) and, if the answer to both of these questions was yes, then which exception Treasury invoked.

The next step in the study evaluated the sources of authority on which Treasury relied in issuing each set of proposed, temporary, or final regulations. APA section 553(b) requires each NPRM to identify the legal authority supporting the rules proposed,<sup>80</sup> and Treasury

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<sup>79</sup> See *supra* text accompanying note 34; see also 5 U.S.C. § 553(b)(B) (2000) (requiring a "brief statement of reasons therefor").

<sup>80</sup> 5 U.S.C. § 553(b)(2)

included in every T.D. and NPRM that it published a reference to the I.R.C. provision or provisions upon which it relied.<sup>81</sup> As I discuss further below, whether Treasury exercises specific or general authority in promulgating its regulations may indicate whether Treasury means to invoke the interpretative rule exception from notice and comment.<sup>82</sup> Accordingly, for each project, I documented whether Treasury relied solely upon its general authority under IRC § 7805, a specific authority grant, or both.

Finally, just because an agency invites public participation does not necessarily mean that the public responds. If the public shows no interest in participating in the regulatory process, then does it matter whether Treasury only pursues taxpayer input on temporary regulations post-promulgation? If a tree falls in the woods and no one is there to hear it, does it make a sound? Treasury invited written comments in every NPRM and many if not most of the T.D.s studied. Treasury often scheduled public hearings on proposed regulations regardless of whether Treasury simultaneously issued temporary regulations.<sup>83</sup> Treasury noted in all T.D.s issued after notice and comment whether it held public hearings or received comments.<sup>84</sup> Often,

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81 See, e.g., Final Regulations; Reduced Maximum Exclusion of Gain from Sale or Exchange of Principal Residence (T.D. 9152), 69 Fed. Reg. 50,302, 50,304 (Aug. 16, 2004), 2004-2 C.B. 509; Final and Temporary Regulations; Constructive Transfers and Transfers to a Third Party on Behalf of a Spouse (T.D. 9035), 68 Fed. Reg. 1534, 1536 (Jan. 13, 2003), 2003-1 C.B. 528, 531; Cancellation of Notice Public Hearing on Proposed Rulemaking; Revisions to Regulations Relating to Withholding of Tax on Certain U.S. Source Income Paid to Foreign Persons and Revisions of Information Reporting Regulations; Hearing Cancellation, 70 Fed. Reg. 40,675, 40,680 (July 14, 2005) (setting forth 26 U.S.C. § 7805 (2000) as authority).

82 See discussion *infra* Part III.A.1.

83 See, e.g., Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing; Clarification of Definitions, 69 Fed. Reg. 49,840 (Aug. 12, 2004) (scheduling public hearing regarding temporary regulations issued T.D. 9153, 2004-2 C.B. 517); Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing; Limitation on Use of the Nonaccrual-Experience Method of Accounting Under Section 448(d)(5), 68 Fed. Reg. 52,543 (Sept. 4, 2003) (scheduling public hearing regarding temporary regulations issued T.D. 9090, 2003-2 C.B. 891); Notice of Proposed Rulemaking and Notice of Public Hearing; Obligations of States and Political Subdivisions, 68 Fed. Reg. 25,845 (May 14, 2003) (scheduling public hearing regarding proposed regulations finalized with T.D. 9234, 2006-4 I.R.B. 329).

84 See, e.g., Final Regulations and Removal of Temporary Regulations; Electronic Payee Status (T.D. 9114), 69 Fed. Reg. 7567, 7567 (Feb. 18, 2004), 2004-1 C.B. 589, 590 (“The IRS received written comments on the proposed regulations. A public hearing was held on July 25, 2001.”); Final Regulations; Definition of Guaranteed Annuity and Lead Unitrust Interests (T.D. 9068), 68 Fed. Reg. 40,130, 40,130 (July 7, 2003), 2003-2, C.B. 538 (“No public hearing was requested or held, but one written

though not always, Treasury responded to comments by modifying its proposed regulations before finalizing them.<sup>85</sup> Accordingly, for each T.D. issued after notice and comment, I documented whether Treasury actually held public hearings or otherwise received comments and whether Treasury modified its proposed regulations in finalizing them.

Each of the questions asked was objective and binary: for example, Treasury either did or did not cite IRC § 7805 in each T.D. or NPRM; and Treasury either did or did not claim the good cause exception in each T.D. or NPRM. Evaluating the data simply involved comparing the number of “yes” versus “no” answers for each set of questions.

These are not the only questions worth evaluating. For example, well-established doctrine interpreting APA section 553(c) requires agencies to respond to all significant comments in promulgating final regulations.<sup>86</sup> Which comments are sufficiently important to require discussion in the statement of basis and purpose, however, is a subject of much litigation and debate.<sup>87</sup> Treasury responds to comments in

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comment was received.”); Final Regulations; Amendments to Rules for Determination of Basis of Partner’s Interest; Special Rules (T.D. 9049), 68 Fed. Reg. 12,815 (Mar. 18, 2003), 2003-1 C.B. 685 (“No written comments were received in response to the notice of proposed rulemaking, and no public hearing was requested or held.”).

85 See, e.g., Final Regulation; Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest (T.D. 9225), 70 Fed. Reg. 54,631, 54,631–34 (Sept. 16, 2005), 2005-2 C.B. 716 (acknowledging and discussing comments received and related changes to final regulations); Final Regulation; Remedial Actions Applicable To Tax-Exempt Bonds Issued by State and Local Governments (T.D. 9150), 69 Fed. Reg. 50,065, 50,065–66 (Aug. 13, 2004), 2004-2 C.B. 514 (same); Final Regulations and Removal of Temporary Regulations; Certain Transfers of Property to Regulated Investment Companies [RICs] and Real Estate Investment Trusts [REITs] (T.D. 9047), 68 Fed. Reg. 12,817, 12,818–19 (Mar. 18, 2003), 2003-1 C.B. 676 (same).

86 See, e.g., *Grand Canyon Air Tour Coal. v. FAA*, 154 F.3d 455, 467–68 (D.C. Cir. 1998) (citing rule and cases). But see *Thompson v. Clark*, 741 F.2d 401, 408–10 (D.C. Cir. 1984) (explaining that APA section 553(c) “has never been interpreted to require the agency to respond to every comment, or to analyze every issue . . . no matter how insubstantial.”).

87 See, e.g., *Cent. & S.W. Servs. v. EPA*, 220 F.3d 683, 692 (5th Cir. 2000) (noting that the agency must address comments where it has specifically requested comments and numerous comments are received on the matter); *Reytblatt v. Nuclear Regulatory Comm’n*, 105 F.3d 715, 723 (D.C. Cir. 1997) (finding that agency need not respond to late comments even if it indicated it would consider them); *Am. Mining Cong. v. EPA*, 965 F.2d 759, 771 (9th Cir. 1992) (claiming the agency need only address comments relevant to proposed rule); *St. James Hosp. v. Heckler*, 760 F.2d 1460, 1469–70 (7th Cir. 1985) (arguing that agency failed to respond to comments that the study the agency relied on was flawed); *Thompson*, 741 F.2d at 408–10 (finding that agency need not respond to comments that do not contain “any meaningful analysis or data refut-

the preambles to its T.D.s. Whether or not Treasury adequately addresses all significant comments is a different question, and a highly subjective one. For reasons of manageability, this study leaves such inquiries for future work. Frankly, the findings generated by the easy questions raised enough cause for concern.

### B. Findings

With most of its regulatory efforts, Treasury at some point does publish an NPRM in the Federal Register, request and consider public comments, and issue its final regulations with a detailed explanatory preamble. Treasury does not always comply with APA section 553 in doing so, however.

In 95 of the 232 rulemaking projects during the surveyed three-year period, or 40.9% of the total, Treasury did not follow the traditional APA procedures of issuing only a notice of proposed rulemaking with proposed regulations first, to be followed later by final regulations after a period for public comments and Treasury consideration thereof.<sup>88</sup> In 84 of those projects, or 36.2% of all projects, Treasury instead issued legally-binding temporary regulations simultaneously with the NPRM, requesting public comments on the temporary regulations as proposed regulations also.<sup>89</sup> The typical pattern of these projects involves Treasury collecting public comments and evaluating them in promulgating the final regulations some

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ing the agency's conclusions" or that provide information the agency already considered).

88 In determining that the 94 rulemaking projects represented 40.9% of the total, I categorized all 58 of the rulemaking projects in which only NPRMs had been issued during the three-year period as following the traditional APA model, rather than tracking post-2005 activity with respect to those NPRMs. Treasury may have strayed since or may yet deviate from the traditional model in these projects. *See, e.g.*, Temporary Regulations; Computer Software Under Section 199(c)(5)(B) (T.D. 9262), 71 Fed. Reg. 31,074 (June 1, 2006), 2006-24 I.R.B. 1040 (adopting temporary regulations under I.R.C. § 199 in response to comments received on earlier NPRM); Final and Temporary Regulations; Determination of Basis of Stock or Securities Received in Exchange for, or With Respect to Stock or Securities in Certain Transactions; Treatment of Excess Loss Accounts (T.D. 9244), 71 Fed. Reg. 4264 (Jan. 26, 2006), 2006-8 I.R.B. 463 (adopting temporary as well as final regulations in response to comments received on earlier NPRM). Consequently, the 40.4% figure ultimately represents an undercount.

89 Of the 84 projects in which Treasury issued temporary regulations simultaneously with a NPRM, using the date of the last T.D. issued for those projects with more than one T.D., 20 occurred in 2003, 30 occurred in 2004, and 34 occurred in 2005.

months or years after issuing the NPRM. The remaining 11 projects saw Treasury skip the notice-and-comment process altogether.<sup>90</sup>

TABLE 1. FOLLOWING THE STEPS OF APA SECTION 553(b) AND (c)

Description of Treasury Action Taken	Number of Projects	Percentage of Projects
Traditional APA process followed: NPRM, then final regulations	137	59.1%
Temporary regulations issued with NPRM	84	36.2%
Final regulations issued without notice and comment	11	4.7%
Total	232	100.0%

Regardless of whether or not it followed the traditional APA steps, Treasury usually disclaimed the applicability of APA section 553(b). Altogether, in fully 216 projects, or 92.70% of the total, Treasury claimed explicitly that the rulemaking requirements of APA section 553(b) did not apply. In 190 projects, or 81.55% of the total, Treasury failed to offer any basis for that position and instead offered only a conclusory statement that, “[i]t has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation,” or something to that effect.<sup>91</sup> Tre-

<sup>90</sup> Of the 11 projects for which Treasury skipped notice and comment altogether, 5 occurred in 2003, 2 occurred in 2004, and 4 occurred in 2005.

<sup>91</sup> In the context of instructions regarding Regulatory Flexibility Act applicability, the Internal Revenue Manual tells drafters of final regulations deemed interpretative to include the quoted language in the Special Analysis section of the preamble. See INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.5.4.7.5.4.3. Thus, it seems likely that including such a statement regarding the inapplicability of section 553(b) implicitly invokes the interpretative rule exception. See *infra* Part III.A.1. In three projects, the NPRM included such a statement but the corresponding T.D. remained silent on the matter. Compare Final Regulation; Source of Compensation for Labor or Personal Services (T.D. 9212), 70 Fed. Reg. 40,663, 40,665 (July 14, 2005), 2005-2 C.B. 429, 431 (failing to mention section 553(b)), and Final Regulations; Exclusions From Gross Income of Foreign Corporations (T.D. 9087), 68 Fed. Reg. 51,394, 51,399 (Aug. 26, 2003), 2003-2 C.B. 781, 787 (same), and Final Regulations; Golden Parachute Payments (T.D. 9083), 68 Fed. Reg. 45,745, 45,750 (Aug. 4, 2003), 2003-2 C.B. 700, 705 (same), with Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking; Source of Compensation for Labor or Personal Services, 69 Fed. Reg. 47,816, 47,818 (Aug. 6, 2004) (including statement), and Withdrawal of Previously Proposed Rules; Notice of Proposed Rulemaking; and Notice of Public Hearing; Exclusions From Gross Income of Foreign Corporations, 67 Fed. Reg. 50,510, 50,519 (Aug. 2, 2002) (same), and Notice of Proposed Rulemaking and Notice of Public Hearing; Golden Parachute Payments, 67 Fed. Reg. 7630, 7635 (Feb. 20, 2002)



sury expressly asserted one or more of the APA-specified exceptions from notice and comment only 23 times, or 9.87% of the total.<sup>92</sup>

TABLE 2. ASSERTIONS OF APA SECTION 553(b) INAPPLICABILITY

Position Asserted by Treasury	Number of Projects <sup>93</sup>	Percentage of Projects
Interpretative Rule Exception	1	0.43%
Procedural Rule Exception	1	0.43%
Good Cause Exception	21	9.01%
Claim of Inapplicability—No Reason Given	190	81.55%
Silent as to Applicability	20	8.58%
Total	233	100.00%

Of course, if Treasury follows the traditional APA steps of issuing an NPRM and seeking public comment before issuing final regulations, then it hardly matters whether Treasury simultaneously claims that the APA's procedural requirements do not apply. However, Treasury's assertions of the APA's inapplicability follow a similar pattern in the projects in which Treasury instead issued temporary regulations or skipped notice and comment altogether.

TABLE 2A. ASSERTIONS OF APA SECTION 553 INAPPLICABILITY:  
TEMPORARY REGULATIONS ISSUED WITH NPRM

Position Asserted by Treasury	Number of Projects	Percentage of Projects
Good Cause Exception	15	17.86%
Claim of Inapplicability—No Reason Given	66	78.57%
Silent as to Applicability	3	3.57%
Total	84	100.00%

(same). Accordingly, I counted these three projects as remaining silent regarding APA § 553(b) applicability on the theory that the drafters considered the final regulations to be legislative, notwithstanding an earlier statement to the contrary in the NPRM.

<sup>92</sup> T.D. 9156 asserted both the procedural rule exception and the good cause exception from APA section 553(b). Final Regulations; Place for Filing (T.D. 9156), 69 Fed. Reg. 55,743 (Sept. 16, 2004), 2004-2 C.B. 669.

<sup>93</sup> The total number of projects in this table exceeds the 232 total previously reported as studied because T.D. 9156 asserts both the procedural rule exception and the good cause exception from APA section 553(b).

TABLE 2B. ASSERTIONS OF APA SECTION 553(b) INAPPLICABILITY:  
FINAL REGULATIONS ISSUED WITHOUT NOTICE AND COMMENT

Position Asserted by Treasury	Number of Projects <sup>94</sup>	Percentage of Projects
Interpretative Rule Exception	1	8.33%
Procedural Rule Exception	1	8.33%
Good Cause Exception	6	50.00%
Claim of Inapplicability—No Reason Given	4	33.34%
Total	12	100.00%

Treasury's claims of APA inapplicability—whatever the reason—must mean that Treasury believes that an exception from notice-and-comment rulemaking applies. As already noted, Treasury claims particularly that most of its regulations are interpretative.<sup>95</sup> Although Treasury offers no basis for this conclusion, Treasury's reliance on specific versus general authority may be relevant to this determination.<sup>96</sup> Treasury relies heavily on its general rulemaking authority as the basis for its actions. Every single T.D. and NPRM examined cited I.R.C. § 7805 as authority on which Treasury relied in proposing or adopting the regulations therein. Treasury did so even when simultaneously citing specific authority, which it did in 95 projects, or 40.9% of the total.<sup>97</sup>

TABLE 3. SPECIFIC VERSUS GENERAL AUTHORITY

Source of Authority for Treasury Action	Number of Projects	Percentage of Projects
Specific and general authority	95	40.9%
General authority only	137	59.1%
Total	232	100.0%

Given the Internal Revenue Manual's characterization of most Treasury regulations as interpretative, where a T.D. or NPRM claims

94 The total number of projects in this table exceeds the 11 previously reported in Table 1 in which Treasury issued final regulations without notice and comment because T.D. 9156 asserts both the procedural rule exception and the good cause exception from APA § 553(b). See discussion *supra* note 70 and accompanying text.

95 See discussion *supra* notes 9, 45 and accompanying text.

96 See discussion *infra* Part III.A.1.

97 T.D.s 9070 and 9173, which were counted as a single project, cited 5 U.S.C. § 552 as authority in addition to I.R.C. § 7805. Because 5 U.S.C. § 552 is a general statute that does not confer legislative authority upon any one agency, I did not count this project as relying upon a specific authority grant.

that APA section 553(b) does not apply, but fails to offer a particular reason why this is the case, one might infer that Treasury believes that the interpretative rule exception applies. Yet of the 190 projects for which Treasury disclaimed applicability of APA section 553(b) without offering a reason, 74 involve citations to one or more I.R.C. specific authority grants in support of the regulations being promulgated.<sup>98</sup>

TABLE 3A. SOURCE OF RULEMAKING AUTHORITY WHERE  
INAPPLICABILITY CLAIMED WITHOUT REASON

Claim of Inapplicability—No Reason Given	Number of Projects	Percentage of Projects
I.R.C. § 7805 only offered as authority	116	61.1%
Specific authority grant cited	74	38.9%
Total	190	100.0%

Correspondingly, where Treasury did not mention APA applicability at all, one might conclude that Treasury accepted that APA section 553(b) applied. Yet of the 20 projects in which Treasury was silent as to APA section 553(b) applicability, 9 relied solely on I.R.C. § 7805 as the source of authority.

TABLE 3B. SOURCE OF RULEMAKING AUTHORITY WHERE SILENT ABOUT  
APA APPLICABILITY

Silent as to Applicability of APA § 553(b)	Number of Projects	Percentage of Projects
I.R.C. § 7805 only offered as authority	9	45.0%
Specific authority grant cited	11	55.0%
Total	20	100.0%

Overall, however, there was little correlation between the procedures followed by Treasury and the source of authority upon which Treasury premised its actions. Treasury only cited specific as well as general authority in 1 of the 11 projects in which it skipped pre-promulgation notice and comment altogether. Yet Treasury relied upon specific as well as general rulemaking authority in 36.5% of projects and general authority only in 63.5% of projects in which it followed the traditional process of issuing the NPRM, taking comments, and then issuing final regulations. When issuing temporary regulations, Treasury premised its actions upon specific as well as general rulemak-

<sup>98</sup> See discussion *supra* note 97 and accompanying text. The same assumption applies to this finding as well.

ing authority slightly more often than general authority alone: 52.4% to 47.6%, respectively.

TABLE 3C. PROCEDURES FOLLOWED COMPARED WITH SOURCE OF AUTHORITY: TRADITIONAL PROCESS FOLLOWED

NPRM, Then Final Regulations	Number of Projects	Percentage of Projects
Under specific and general authority	50	36.5%
Under general authority only	87	63.5%
Total	137	100.0%

TABLE 3D. PROCEDURES FOLLOWED COMPARED WITH SOURCE OF AUTHORITY: TEMPORARY REGULATIONS ISSUED WITH NPRM

Temporary Regulations Issued in Conjunction with NPRM	Number of Projects	Percentage of Projects
Under specific and general authority	44	52.4%
Under general authority only	40	47.6%
Total	84	100.0%

TABLE 3E. PROCEDURES FOLLOWED COMPARED WITH SOURCE OF AUTHORITY: FINAL REGULATIONS ISSUED WITHOUT NOTICE AND COMMENT

Final Regulations Issued Without Notice and Comment	Number of Projects	Percentage of Projects
Under specific and general authority	1	9.1%
Under general authority only	10	90.9%
Total	11	100.0%

If Treasury does accord any significance to specific as opposed to general authority grants for purposes of APA compliance, however, then Treasury either overly relies on the latter or underreports the applicability of the former.<sup>99</sup> Citing I.R.C. § 7805 routinely as Tre-

99 One commenter to this Article suggested that Treasury recognizes the legislative character of its regulations and believes itself to be citing to specific authority more often than is readily apparent from the T.D.s or NPRMs. Many T.D.s and NPRMs that lack obvious citation to specific authority nevertheless include three asterisks after the citation to I.R.C. § 7805 general authority as follows: "Authority: 26 U.S.C. 7805 \* \* \*." See, e.g., Final and Temporary Regulations; Uniform Capitalization of Interest Expense in Safe Harbor Sale and Leaseback Transactions (T.D. 9129), 69

sury does is merely prudent, suggesting that Treasury employs general authority as a backstop even where a specific authority grant seems to apply. In several cases, however, the I.R.C. section under which the regulations fall contains a specific authority grant that Treasury fails to cite in the T.D. or the NPRM, even where the specific authority grant seems applicable.

For example, T.D.s 9129 and 9179 respectively adopt first temporary and then final regulations governing the capitalization of interest expense incurred in sale/leaseback transactions under 263A(f).<sup>100</sup>

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Fed. Reg. 29,066, 29,067 (May 20, 2004) (utilizing the three-asterisk signal); Notice of Proposed Rulemaking; Special Rule Regarding Certain Section 951 Pro Rata Share Allocations, 70 Fed. Reg. 49,894, 49,896 (Aug. 25, 2005) (same). Those three asterisks in turn serve as an agreed-upon signal from the I.R.S. to the Office of the Federal Register (O.F.R.) regarding the authority upon which Treasury is relying in promulgating the related regulations. Specifically, the beginning of each Part of Title 26 of the C.F.R. lists the rulemaking authority for all Treasury regulations contained within that Part. Because Part 1 of C.F.R. Title 26 consists of several volumes, each volume begins with a list of the authority upon which Treasury relied in promulgating the regulations within that volume. If final or proposed regulations merely amend an existing regulation, and Treasury relies upon specific authority already listed for that regulation at the beginning of the relevant C.F.R. volume, then Treasury includes the three asterisks in the T.D. or NPRM to signal the O.F.R. that no change is required to that C.F.R. authority citation list. *See* INTERNAL REVENUE MANUAL, *supra* note 6, at § 32.1.5.7.4.4 (alluding to this arrangement). The commenter suggested accordingly that, under such circumstances, Treasury's inclusion of the three asterisks in an NPRM amending that regulation should satisfy the authority citation requirement of APA section 553(b)(2), even if Treasury for other, unspecified reasons simultaneously disclaims the applicability of APA section 553 more generally. This contention is simply incredible. APA section 553(b)(2) requires agencies to include reference to supporting legal authority in their NPRMs for the purpose of notifying ordinary interested parties of the statutory authority supporting the agency's proposed regulations, so that such persons can raise relevant legal issues in their comments. *See* ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 46-47. Whatever I.R.S. attorneys and the O.F.R. staff understand the three asterisks to mean, few other persons interested in proposed Treasury regulations are likely to appreciate the asterisks' inclusion in an NPRM as a reference to specific authority cited in the corresponding volume of the C.F.R. Even beyond the inherently cryptic quality of the three-asterisk signal, the Internal Revenue Manual's discussions of authority citation and the meaning of asterisks in regulatory preambles fail to mention any relationship with the APA rulemaking requirements. *See* INTERNAL REVENUE MANUAL, *supra* note 6, at §§ 32.1.5.7.4.2, 32.1.5.7.4.4, 32.1.5.7.4.6. In short, interested parties have no way of knowing that Treasury's inclusion of three asterisks in some NPRMs represents an invocation of specific authority as legal support for regulations proposed. Allowing the three-asterisk signal to satisfy APA section 553(b)(2) would render that notice requirement virtually meaningless.

100 *See* Final Regulations; Uniform Capitalization of Interest Expense in Safe Harbor Sale and Leaseback Transactions (T.D. 9179), 79 Fed. Reg. 8729 (Feb. 23, 2005), 2005-1 C.B. 707; Final and Temporary Regulations; Uniform Capitalization of Interest

Section 263A(i) contains a blanket specific authority grant to promulgate regulations “as may be necessary or appropriate to carry out the purposes of this section, including regulations to prevent the use of related parties, pass-thru entities, or intermediaries to avoid the application of this section . . . .”<sup>101</sup> The regulations adopted in T.D.s 9129 and 9179 certainly seem to fit within the broad specific authority grant contained in the first clause of that excerpt, and would seem to fit the narrower example specifically noted in the statute.

Several T.D.s adopting consolidated return regulations further exemplify this particular omission. I.R.C. § 1502 contains an exceptionally broad grant authorizing Treasury to promulgate such regulations,<sup>102</sup> such that scholars and practitioners routinely cite this section as the prototypical legislative authority grant in the I.R.C.<sup>103</sup> T.D. 9122 adopted final language under Treasury Regulation § 1.1502-31 guiding the determination of basis in the stock of a former common parent corporation following a change in the structure of a consolidated group. T.D.s 9118, 9154, and 9155 all issued temporary regulations under I.R.C. § 1502 addressing various overlapping consolidated return issues, including most prominently the void left by the Federal Circuit’s invalidation in *Rite Aid Corp. v. United States*<sup>104</sup> of a significant

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Expense in Safe Harbor Sale and Leaseback Transactions (T.D. 9129), 69 Fed. Reg. 29,066 (May 20, 2004), 2004-1 C.B. 1046.

101 I.R.C. § 263A(i) (2000).

102 I.R.C. § 1502 (West Supp. 2006) provides in total:

The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. In carrying out the preceding sentence, the Secretary may prescribe rules that are different from the provisions of chapter 1 that would apply if such corporations filed separate returns.

103 See, e.g., Ellen P. Aprill, *The Interpretive Voice*, 38 LOY. L.A. L. REV. 2081, 2097 n.73 (2005) (describing I.R.C. § 1502 as “perhaps the most famous legislative delegation” in the I.R.C.); Sheldon I. Banoff, *Dealing with the “Authorities”: Determining Valid Authority in Advising Clients, Rendering Opinions, Preparing Tax Returns and Avoiding Penalties*, 66 TAXES 1072, 1086 (1988) (citing regulations issued under I.R.C. § 1502 as exemplifying legislative regulations); Don Leatherman, *Why Rite Aid Is Wrong*, 52 AM. U. L. REV. 811, 818 (2003) (recognizing regulations under I.R.C. § 1502 as legislative).

104 255 F.3d 1357 (Fed. Cir. 2001).

loss disallowance provision of Treasury Regulation § 1.1502-20.<sup>105</sup> Among other things, T.D. 9187 finalized the I.R.C. § 1502 regulations proposed in conjunction with T.D.s 9118, 9154, and 9155.<sup>106</sup> T.D. 9192 adopted regulations under I.R.C. § 1502 resolving certain questions raised by the Supreme Court's decision in *United Dominion Industries, Inc. v. United States*.<sup>107</sup> Yet in all of T.D.s 9122, 9118, 9154, and 9155, Treasury relied solely on I.R.C. § 7805 as the source of its authority without any corresponding citation to I.R.C. § 1502; T.D. 9187 cites only I.R.C. § 337(d) for some additional regulations adopted under that provision; and T.D. 9192 cites I.R.C. § 1502 for a new Treasury Regulation § 1.1502-28 but not for extensive changes to several other regulations under that section.<sup>108</sup>

These findings are consistent with the Supreme Court's observations in *Boeing Co. v. United States*.<sup>109</sup> *Boeing* concerned the validity of a Treasury regulation addressing the accounting for research and development expenditures in computing "combined taxable income" for "domestic international sales corporations" or "DISCs."<sup>110</sup> As the *Boeing* Court observed, then-I.R.C. § 994 contained a specific grant of authority to promulgate the regulations in question.<sup>111</sup> On brief in the case, the government asserted that the regulation at issue conse-

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105 Temporary Regulations; Guidance Under Section 1502; Treatment of Loss Carryovers From Separate Return Limitation Years (T.D. 9155), 69 Fed. Reg. 51,175 (Aug. 18, 2004), 2004-2 C.B. 562; Temporary Regulations; Extension of Time To Elect Method for Determining Allowable Loss (T.D. 9154), 69 Fed. Reg. 52,419 (Aug. 26, 2004), 2004-2 C.B. 560; Final and Temporary Regulations; Loss Limitation Rules (T.D. 9118), 69 Fed. Reg. 12,799 (Mar. 18, 2004), 2004-1 C.B. 718; *see also Rite Aid*, 255 F.3d at 1359-60 (invalidating Treas. Reg. § 1.1502-20 in part).

106 *See* Final and Temporary Regulations; Loss Limitation Rules (T.D. 9187), 70 Fed. Reg. 10,319 (Mar. 3, 2005), 2005-1 C.B. 778.

107 532 U.S. 822 (2001).

108 *See* Final Regulations, Temporary Regulations, and Removal of Temporary Regulations; Application of Section 108 to Members of a Consolidated Group (T.D. 9192), 70 Fed. Reg. 14,395, 14,399 (Mar. 22, 2005), 2005-1 C.B. 866, 867; Temporary Regulations (T.D. 9155), 69 Fed. Reg. at 51,176; Temporary Regulations (T.D. 9154), 69 Fed. Reg. at 52,421; Final Regulation; Guidance Under Section 1502; Stock Basis After a Group Structure Change (T.D. 9122), 69 Fed. Reg. 22,399, 22,399 (Apr. 26, 2004), 2004-1 C.B. 886; Final and Temporary Regulations (T.D. 9118), 69 Fed. Reg. at 12,800.

109 537 U.S. 437 (2003).

110 *Id.* at 446.

111 *Id.* at 447-48.

quently was legislative in character.<sup>112</sup> Yet in adopting the regulations, Treasury relied solely on its general authority under I.R.C. § 7805.<sup>113</sup>

In sum, the only pattern with respect to APA compliance that emerges from analyzing Treasury's reliance on specific as opposed to general authority is no pattern at all. Perhaps, notwithstanding the Internal Revenue Manual's characterization of most Treasury regulations as interpretative, Treasury does not base its claims of APA inapplicability on the interpretative rule exception. For many if not most projects, such a conclusion leaves the good cause exception as the only alternative exception from the APA notice and comment requirements. Alternatively, Treasury may not use specific versus general authority to characterize regulations as legislative rather than interpretative. If this is the case, however, then such a conclusion begs the question as to Treasury's basis for declaring most of its regulations to be interpretative.

Finally, regarding the extent to which the public actually participates in Treasury's rulemaking efforts, Treasury's typical practice is to acknowledge whether comments have been received in connection with the regulatory project at hand.<sup>114</sup> Where T.D.s are issued simultaneously with an NPRM, the public typically has not yet had an opportunity to comment on the related temporary and proposed regulations, except on those rare occasions when the IRS has previously issued either an advanced notice of public rulemaking or some other notice requesting comments in advance of temporary or proposed regulations.<sup>115</sup> Of the NPRMs studied for which Treasury did not

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112 See *id.*; see also Brief for the United States at 19, *Boeing*, 537 U.S. 437 (Nos. 01-1209, 01-1382), 2002 WL 31557669.

113 See *Boeing*, 537 U.S. at 448; see also Notice of Proposed Rulemaking; Gross Income: Allocation and Apportionment of Deductions, 41 Fed. Reg. 49,160 (Nov. 4, 1976) ("The proposed regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code . . ."). Although noting the issue, the *Boeing* Court decided the case before it without resolving the question of the regulation's characterization. *Boeing*, 537 U.S. at 448.

114 See, e.g., Final Regulation; Testimony or Production of Records in a Court or Other Proceeding (T.D. 9178), 70 Fed. Reg. 7396 (Feb. 14, 2005), 2005-1 C.B. 708 ("No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held."); Final and Temporary Regulations; Statutory Mergers and Consolidations (T.D. 9038), 68 Fed. Reg. 3384 (Jan. 24, 2003), 2003-1 C.B. 524 ("No public hearing regarding the 2001 proposed regulations was requested or held. Nonetheless, a number of written comments were received.").

115 Occasionally Treasury does begin its regulatory process by issuing a Notice or other less formal guidance requesting initial taxpayer input prior to publishing temporary or proposed regulations in the Federal Register. See, e.g., I.R.S. Notice 2003-36, 2003-1 C.B. 992 (requesting comments in anticipation of rulemaking and preceding temporary regulations issued with Final and Temporary Regulations; Guidance



issue a related T.D. within the three-year period, three NPRMs superseded earlier, related NPRMs and offered revised proposed regulations in response to comments.<sup>116</sup> Otherwise, those NPRMs represented Treasury's first notice of a project and request for comments.

More often than not, Treasury receives significant input from the public in connection with its regulatory efforts. Of the 232 regulatory projects evaluated, only 131 had reached a stage at which Treasury disclosed in the Federal Register whether or not it had received comments; but of those 131, a full 96, or 73.3%, generated at least one comment raising concerns or suggesting changes. Nevertheless, many projects do not receive such negative public reaction. For 31 of those 131 projects, or 23.7%, Treasury received no comments whatsoever. For another 4 of the 131 projects, or 3.1%, Treasury received only comments expressing approval and/or urging it to finalize the proposed regulations quickly.

TABLE 4. PUBLIC PARTICIPATION IN TREASURY REGULATORY EFFORTS

Comments Received	Number of Projects	Percentage of Projects
No comments received	31	23.7%
Only favorable comments received	4	3.1%
Negative comments or suggestions for change received	96	73.3%
Total	131	100.0%

In at least 31 of the 96 projects in which Treasury received negative comments or suggestions for changes, Treasury received such input after issuing temporary regulations; but Treasury received no

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Regarding the Simplified Service Cost Method and the Simplified Production Method (T.D. 9217), 70 Fed. Reg. 44,467 (Aug. 3, 2005), 2005-2 C.B. 498); Advance Notice of Proposed Rulemaking; Guidance Regarding Deduction and Capitalization of Expenditures, 67 Fed. Reg. 3461 (Jan. 24, 2002) (requesting comments in anticipation of forthcoming proposed regulations and preceding Notice of Proposed Rulemaking and Notice of Public Hearing; Guidance Regarding Deduction and Capitalization of Expenditures, 67 Fed. Reg. 77,701 (Dec. 19, 2002), and subsequent final regulations in Final Regulations; Guidance Regarding Deduction and Capitalization of Expenditures (T.D. 9107), 68 Fed. Reg. 436, 2004-1 C.B. 447); Rev. Rul. 2001-46, 2001-2 C.B. 321, 323 (requesting comments and preceding temporary regulations in Final and Temporary Regulations; Effect of Elections in Certain Multi-Step Transactions (T.D. 9071), 68 Fed. Reg. 40,766 (July 9, 2003), 2003-2 C.B. 560).

116 See discussion *supra* note 76 and accompanying text (documenting these three projects).

comments whatsoever for 17 projects in which it issued temporary regulations. In short, a substantial percentage of Treasury's regulatory projects were wholly noncontroversial, generating no negative public comments whatsoever; but in most projects, the notice-and-comment process yields public participation.

### III. DOCTRINAL PROBLEMS WITH TREASURY'S ACTIONS

The above analysis demonstrates that Treasury does not follow the sequence of events mandated by APA section 553 and quantifies that failure as 40.9% of the projects studied. As noted, the Internal Revenue Manual maintains that most Treasury regulations are interpretative rules exempt from APA notice and comment requirements;<sup>117</sup> and the study also documents that Treasury routinely contends in its preambles that APA section 553(b) does not apply.<sup>118</sup> If Treasury is correct that its regulations are exempt, then its failure to satisfy the APA's rulemaking requirements would be legally inconsequential. Treasury offers little or no explanation for its exemption claims, however. The following analysis demonstrates that Treasury's reliance on the interpretative rule, procedural rule, and good cause exemptions of APA section 553(b) is misplaced.<sup>119</sup>

#### A. *Temporary Regulations*

Treasury most habitually deviates from APA rulemaking requirements by promulgating binding temporary regulations in conjunction with its NPRMs. Treasury and the IRS treat temporary Treasury regulations as legally binding on taxpayers as well as the government.<sup>120</sup>

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117 See discussion *supra* notes 9, 45 and accompanying text.

118 See discussion *supra* notes 91–94 and accompanying text.

119 There is no real doubt that the policy statement exception from notice and comment is inapplicable to Treasury regulations. The APA does not define this exception. See 5 U.S.C. § 553(b)(A) (2000). However, the *Attorney General's Manual on the Administrative Procedure Act*, generally regarded as an authoritative interpretation of the APA, defines a policy statement as “issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power.” ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 30 n.3; see also *Chrysler Corp. v. Brown*, 441 U.S. 281, 302 (1979) (giving weight to *Attorney General's Manual* definitions and explanations); *Vt. Yankee Nuclear Power Corp. v. Natural Res. Def. Council, Inc.*, 435 U.S. 519, 546 (1978) (same). Treasury regulations clearly do not fit this description. No one has ever suggested that Treasury regulations are mere policy statements. Accordingly, there is no need to evaluate in greater depth whether Treasury might reasonably rely upon the policy statement exception in promulgating Treasury regulations without notice and comment.

120 This is in contrast to Revenue Rulings and Notices, which do not carry the notes both in Treasury regulations and in the Internal Revenue Bulletin, and which

By contrast, while the IRS generally is supposed to act consistently with proposed regulations,<sup>121</sup> taxpayers are not bound by proposed regulations and may only rely upon them if Treasury expressly allows them to do so via a statement in the NPRM.<sup>122</sup> Moreover, the courts arguably extend greater deference to temporary regulations than to proposed regulations.<sup>123</sup>

Treasury is not the only agency that promulgates binding regulations in advance of seeking and considering public comments.<sup>124</sup> Nevertheless, the courts generally consider regulations issued through such a process procedurally invalid unless one of the four exceptions listed in APA section 553 applies.<sup>125</sup> Many if not most Treasury regulations do not fall within the scope of those exceptions.

### 1. The Interpretative Rule Exception

As already noted, the Internal Revenue Manual contends that most Treasury regulations are interpretative in character.<sup>126</sup> Elsewhere, in the context of instructions regarding Regulatory Flexibility Act applicability, the Internal Revenue Manual instructs drafters of final regulations that they deem interpretative to include in the Special Analysis section of the preamble the conclusory sentence noted above, that APA section 553(b) does not apply to this regulation.<sup>127</sup>

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do not carry the legal weight of Treasury regulations. See *Treas. Reg.* § 601.601(d)(2)(v)(d) (as amended in 1987).

121 See INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.1.2.2.

122 See *id.*

123 See Thomas W. Merrill & Kristin E. Hickman, *Chevron's Domain*, 89 GEO. L.J. 833, 846-47 (2001) (discussing applicability of *Chevron* judicial deference doctrine to temporary and proposed regulations).

124 See, e.g., *Adoption of Recommendations*, 60 Fed. Reg. 43,108, 43,111 (Aug. 18, 1995) (noting that "[a]gencies have increasingly used a post-promulgation comment process commonly referred to as 'interim final rulemaking' to describe the issuance of a final rule without prior notice and comment, but with a post-promulgation opportunity for comment."); Michael Asimow, *Interim-Final Rules: Making Haste Slowly*, 51 ADMIN. L. REV. 703, 712-15 (1999) (offering statistics for agency use of interim-final rulemaking).

125 See, e.g., *Chrysler Corp. v. Brown*, 441 U.S. 281, 315 (1979) (noting that post-promulgation comment opportunity does not comply with APA section 553); *Sharon Steel Corp. v. EPA*, 597 F.2d 377, 381 (3d Cir. 1979) (holding same); *Adoption of Recommendations*, 60 Fed. Reg. at 43,111 (acknowledging that interim-final rulemaking is inconsistent with APA rulemaking requirements); Asimow, *supra* note 124, at 706 (1999) (noting the need for an APA-approved exception before interim-final rulemaking is permissible).

126 See discussion *supra* notes 9, 45 and accompanying text.

127 See INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.5.4.7.5.4; *supra* note 88 and accompanying text. Although this instruction relates to Regulatory Flexibility Act

The Internal Revenue Manual offers regulation drafters no criteria or other guidance for characterizing their regulations as interpretative, however.<sup>128</sup>

Among the projects studied, Treasury did not expressly invoke the interpretative rule exception in the preambles to its temporary regulations;<sup>129</sup> but the APA does not require an agency claiming the interpretative rule exception to say so contemporaneously.<sup>130</sup> Nevertheless, given the Internal Revenue Manual's claim that most of its regulations are interpretative, one could read the blanket assertion of APA section 553(b) inapplicability contained in more than 80% of the projects studied to represent an implicit assertion of that exception from notice-and-comment rulemaking.

The tax community generally tends to differentiate the two types of Treasury regulations by calling specific authority regulations "legislative" and general authority ones "interpretative."<sup>131</sup> Even if these labels were correct, then Treasury would still need to satisfy APA section 553 notice-and-comment rulemaking requirements where it relies upon specific I.R.C. provisions as authority in support of its regulations. As noted above, at least in the period studied, Treasury cited specific authority in 40.9% of all of its projects, including 52.4% of those projects in which Treasury issued temporary regulations.<sup>132</sup>

Regardless, the practice of labeling general authority Treasury regulations as interpretative, while historically based, is of questionable contemporary accuracy, at least for the purposes of APA section 553. In the first part of the twentieth century, the general consensus among courts and scholars held that a general authority grant that authorized legally binding regulations would violate the nondelega-

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analysis, the instruction offers different language for legislative regulations, and requires the drafter to assess the legislative versus interpretative characterization of the regulations in addressing the Regulatory Flexibility Act checklist item. See INTERNAL REVENUE MANUAL, *supra* note 6, §§ 32.1.5.4.7.5.4.3, 32.1.5.4.7.5.4.4.

128 See INTERNAL REVENUE MANUAL, *supra* note 6, §§ 32.1.1.6, 32.1.1.7 (reserving for future guidance the topics of "Legislative Regulations" and "Interpretative Regulations").

129 See *supra* Tables 2, 2a, and 2b.

130 Compare 5 U.S.C. § 553(b)(A) (2000) (articulating the interpretative rule exception), with *id.* § 553(b)(B) (specifying good cause exception requirements).

131 See, e.g., LEDERMAN & MAZZA, *supra* note 6, § 9.02[A][1]; MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE, ¶ 3.02[3][a]–[b], at 3-12 to -14 (rev. ed. 2002); Aprill, *supra* note 103, at 2097; John F. Coverdale, *Court Review of Tax Regulations and Rulings in the Chevron Era*, 64 GEO. WASH. L. REV. 35, 44 (1995); Salem et al., *supra* note 43, at 728; Vasquez & Lowy, *supra* note 12, at 249–50.

132 See *supra* note 97, accompanying text; Tables 3 and 3d, and accompanying text.

tion doctrine and thus be constitutionally invalid.<sup>133</sup> Accordingly, grants of general authority to promulgate “all necessary rules and regulations” merely recognized inherent executive power to interpret the laws in the course of enforcing them.<sup>134</sup> Regulations issued pursuant to such grants only interpreted existing law and bound government officials but not the regulated public or the courts.<sup>135</sup> When the APA was adopted in 1946, general authority regulations—whether tax or nontax—were indeed interpretative rules.<sup>136</sup>

The nondelegation doctrine has long since ceased to yield such results,<sup>137</sup> and, at least outside of the tax area, specific versus general authority origins no longer distinguish legislative from interpretative rules.<sup>138</sup> Regulations that bind both the government and regulated parties are legislative, whether promulgated pursuant to specific or

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133 See, e.g., Ellsworth C. Alvord, *Treasury Regulations and the Wilshire Oil Case*, 40 COLUM. L. REV. 252, 260–61 (1940); Stanley S. Surrey, *The Scope and Effect of Treasury Regulations Under the Income, Estate, and Gift Taxes*, 88 U. PA. L. REV. 556, 557–58 (1940).

134 See, e.g., John A. Fairlie, *Administrative Legislation*, 18 MICH. L. REV. 181, 189 (1920); Surrey, *supra* note 133, at 558.

135 See, e.g., 1 F. TROWBRIDGE VOM BAUR, FEDERAL ADMINISTRATIVE LAW § 489 (1942); Alvord, *supra* note 133, at 260–61; Kenneth Culp Davis, *Administrative Rules—Interpretative, Legislative, and Retroactive*, 57 YALE L.J. 919, 928–29 (1948); Surrey, *supra* note 133, at 557–58.

136 The *Attorney General's Manual on the Administrative Procedure Act* reflects this understanding. The *Manual* defines legislative regulations (which it calls “substantive rules”) as “rules, other than organizational or procedural . . . issued by an agency pursuant to statutory authority and which implement the statute.” ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 30 n.3; see also discussion *supra* note 119 (discussing the significance of the *Manual*). The *Manual* notes that such rules carry the force and effect of law. See ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 30 n.3. By contrast, the *Manual* defines as interpretative rules “rules or statements issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers.” Cf. Kristin E. Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1564–72 (2006) (discussing the historical understanding at greater length).

137 See, e.g., 1 KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE, § 3.2, at 150 (2d ed. 1978) (describing nondelegation as a failed legal doctrine); 1 PIERCE, *supra* note 2, § 2.6, at 91–93 (discussing the nondelegation doctrine's lack of contemporary bite); BERNARD SCHWARTZ, ADMINISTRATIVE LAW § 12, at 14 (1976) (opining that the nondelegation doctrine “can not be taken literally”).

138 See, e.g., 2 DAVIS, *supra* note 137, §§ 7.13, 7.15 (documenting judicial blurring of the old specific versus general authority distinction between legislative and interpretative regulations); Michael Asimow, *Nonlegislative Rulemaking and Regulatory Reform*, 1985 DUKE L.J. 381, 393–401 (noting the declining relevance of the specific versus general authority distinction).

general statutory authority.<sup>139</sup> In other areas of administrative law, regulations adopted under general authority carry the same legal force and effect as those promulgated pursuant to specific authority.<sup>140</sup> Likewise, Treasury, the IRS, and the tax community at large all operate under the belief that regulations promulgated under the general authority of I.R.C. § 7805(a) are just as legally binding on taxpayers as specific authority regulations.<sup>141</sup> Through I.R.C. § 6662 and the regulations thereunder, Congress and Treasury impose the penalties for disregarding both specific and general authority Treasury regulations in filing tax returns.<sup>142</sup> Consistent generally with the shift in the legal weight of general authority regulations, courts and agencies regularly recognize such regulations in other areas of administrative law

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139 See *Shalala v. Guernsey Memorial Hosp.*, 514 U.S. 87, 99 (1995) (noting that interpretative rules do not require notice and comment because they do not have the force and effect of law); see also Anthony, *supra* note 32, at 10 (noting that interpretative rules are not legally binding); William Funk, *A Primer on Nonlegislative Rules*, 53 ADMIN. L. REV. 1321, 1324–25 (2001) (recognizing legislative rules as legally binding and interpretative rules as not); Peter L. Strauss, *The Rulemaking Continuum*, 41 DUKE L.J. 1463, 1464 (1992) (designating regulations that bind both the government and regulated parties as legislative rules).

140 See, e.g., *Am. Hosp. Ass'n v. NLRB*, 499 U.S. 606, 609–10 (1991) (recognizing general authority grant in 29 U.S.C. § 156 as authorizing legally binding regulations); *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 866 (1984) (treating regulation promulgated by EPA under Clean Air Act general authority, 42 U.S.C. § 7601(a)(1), as legally binding on the general public); *Nat'l Ass'n of Pharm. Mfrs. v. FDA*, 637 F.2d 877, 879–80 (2d Cir. 1981) (discussing doctrinal shift and holding FDA general authority regulations to be legislative); *Nat'l Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672 (D.C. Cir. 1973) (analyzing at length FTC's general rulemaking authority as supporting binding regulations and comparing to general authority grants in other statutes); see also Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 HARV. L. REV. 467, 473, 546–70 (2002) (documenting the evolution in judicial recognition of rulemaking authority).

141 See, e.g., *Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 979 (7th Cir. 1998) (observing that specific and general authority Treasury regulations have the force of law); *United States v. Harvis Constr. Co., Inc.*, 857 F.2d 1360, 1363 (9th Cir. 1988) (noting that general authority Treasury regulation carries the same binding effect); Banoff, *supra* note 103, at 1086 (noting that all Treasury regulations bind the IRS and taxpayers); Coverdale, *supra* note 131, at 56. But see *Estate of Gerson v. Comm'r*, No. 13534-04, 2006 WL 3019177 (T.C. Oct. 24, 2006) (Vasquez, J. dissenting) (opining that general authority Treasury regulations do not carry the force of law).

142 See I.R.C. § 6662(a)–(b) (West Supp. 2006) (stating that the 20% penalty for underpayment of taxes “shall apply to the portion of any underpayment which is attributable to . . . negligence or disregard of rules or regulations”); Treas. Reg. § 1.6662-3(b)(2) (as amended in 2003) (defining “rules and regulations” as including “temporary or final Treasury regulations issued under the [I.R.C.]”).

as subject to the notice and comment requirements of APA § 553(b) and (c).<sup>143</sup> Why tax should be different is unclear.<sup>144</sup>

Nevertheless, most courts have acknowledged the tax community's characterization of specific authority regulations as legislative and general authority regulations as interpretative; but the courts typically have done so either *arguendo* or without any discussion at all in considering the extent to which Treasury regulations are entitled to judicial deference.<sup>145</sup> Because taxpayers rarely challenge Treasury

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143 See, e.g., *Elm Grove Coal Co. v. Director, O.W.C.P.*, No. 05-1108, 2007 WL 678248, at \*10 (4th Cir. Mar. 7, 2007) (recognizing general rulemaking grant of 30 U.S.C. § 936 as authority to promulgate legislative rules through notice-and-comment rulemaking); *Syncor Intern. Corp. v. Shalala*, 127 F.3d 90, 95 (D.C. Cir. 1997) (holding FDA publication to be an exercise of general rulemaking authority subject to notice and comment requirements as a legislative rule); *Natural Res. Def. Council v. EPA*, 22 F.3d 1125, 1146-47 (D.C. Cir. 1994) (describing Clean Air Act general authority provision as authorizing legislative rules subject to notice-and-comment rulemaking requirements); see also *United States v. Mead Corp.*, 533 U.S. 218, 231-32 (2001) (noting that "it is true that the general rulemaking power conferred on Customs, see 19 U.S.C. § 1624, authorizes some regulation with the force of law").

144 Thomas Merrill and Kathryn Watts have identified a penalty-based convention by which Congress signals its intent regarding the force and effect of agency regulations generally and argued that Congress intended for tax to be different from other areas of administrative law. See Merrill & Watts, *supra* note 140, at 571-75. I have argued elsewhere that Merrill & Watts misinterpret the early income tax statute penalty provisions and fail to consider more recent congressional action in that area. See Hickman, *supra* note 136, at 1603-05. Merrill and Watts concede more generally that, whatever Congress intended, commentators and the courts throughout the twentieth century failed to recognize or give effect to the congressional convention they claim demarked legislative versus interpretative rules. See Merrill & Watts, *supra* note 140, at 503. Accordingly, I believe both that Merrill and Watts are incorrect in their assertion of tax exceptionalism and that the penalty-based convention that they identify ultimately supports the conclusion that general authority Treasury regulations are legislative in character.

145 See, e.g., *Boeing Co. v. United States*, 537 U.S. 437, 447-48 (2003) ("Even if we regard the challenged regulation as interpretative because it was promulgated under § 7805(a)'s general rulemaking grant rather than a specific grant of authority" (emphasis added)); *Hosp. Corp. of Am. & Subsidiaries v. Comm'r*, 348 F.3d 136, 140-41, 145 n.3 (6th Cir. 2003) (quoting same language from *Boeing* in similar spirit in deference discussion and separately reserving the question of whether Treasury must utilize notice-and-comment rulemaking in promulgating general authority Treasury regulations); *Swallows Holding, Ltd. v. Comm'r*, 126 T.C. 96, 129 (2006) (recognizing the specific versus general distinction in the course of discussing deference). Prior to *Chevron*, the Supreme Court linked the level of deference accorded Treasury regulations to whether the regulations were issued pursuant to general or specific authority. See *United States v. Vogel Fertilizer Co.*, 455 U.S. 16, 24-25 (1982); *Rowan Cos., Inc. v. United States*, 452 U.S. 247, 252-53 (1981). This pre-*Chevron* delineation was not limited to the tax context, however, but rather applied across various fields of administrative law. See, e.g., *Batterton v. Francis*, 432 U.S. 416, 424-25 (1977) (apply-

regulations on procedural grounds, the courts have had little opportunity to apply contemporary administrative law principles for distinguishing legislative from interpretative rules in the tax context. The Seventh Circuit has recognized in dicta that general authority Treasury regulations carry the force and effect of law, and thus cannot be interpretative for purposes of APA section 553(b).<sup>146</sup> Judge Holmes of the Tax Court recently made a similar observation.<sup>147</sup> Most tax scholars who have lately considered the matter agree that, by these modern standards, general as well as specific authority Treasury regulations are most likely legislative and not interpretative in character.<sup>148</sup>

Even if there were any real question about the legal force and appropriate characterization of general authority Treasury regulations, the actual tests applied by the courts should quickly resolve the matter. Since the courts have moved away from characterizing legislative and interpretative rules based on the source of their authority, distinguishing between the two types of rules presents a significant challenge.<sup>149</sup> Typically the difficulty arises because an agency claims that a particular rule is not legally binding but in practice treats the rule as having that effect.<sup>150</sup> The courts give weight to an agency's

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ing this rule to health, education and welfare regulations). Notably, however, in both *Vogel Fertilizer* and *Rowan Cos.*, the Court never used the "interpretative" label to describe the regulations in question, but rather merely addressed the issue of deference with respect to regulations promulgated pursuant to I.R.C. § 7805(a). In tax cases, though not in other areas of administrative law, courts and scholars continue to disagree over which standard of judicial deference should apply to general authority Treasury regulations. See Hickman, *supra* note 136, at 1556–63 (summarizing the disagreement). The characterization of general authority Treasury regulations as legislative or interpretative influences but does not necessarily resolve the deference question. See *id.*

146 See *Bankers Life*, 142 F.3d at 978–79.

147 See *Swallows Holding, Ltd.*, 126 T.C. at 176–77 (Holmes, J., dissenting). Judge Swift registered his agreement with Judge Holmes's opinion. *Id.* at 182 (Swift, J., dissenting).

148 See Noël B. Cunningham & James R. Repetti, *Textualism and Tax Shelters*, 24 VA. TAX REV. 1, 46 (2004) (acknowledging that general authority Treasury regulations are legislative under general administrative law standards); Salem et al., *supra* note 43, at 738–39 (concluding same); see also Banoff, *supra* note 103, at 1087 (questioning the ongoing vitality of labeling general authority Treasury regulations as interpretative).

149 See generally Manning, *supra* note 32, at 894–97 (noting the problem and attempting to analyze it in terms of judicial manageability).

150 See, e.g., Robert A. Anthony, *Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them to Bind the Public?*, 41 DUKE L.J. 1311, 1327–55 (1992) (illustrating extensively how agencies use nonlegislative rules to bind the public); Funk, *supra* note 139, at 1327 (noting that "if the agency is defending a rule as an interpretive rule, it always claims that the rule is not legally binding"). Thus, the real quandary for the legislative versus interpretative rule inquiry is not



characterization of its own rules but also recognize that agencies have an incentive to avoid the burdens of notice-and-comment rulemaking.<sup>151</sup> Thus, the label the agency attaches to a particular rule is not dispositive.<sup>152</sup> Instead, the courts have developed standards that delve beyond the label to evaluate whether a rule is legislative or interpretative.

The dominant standard, often called the “*American Mining Congress* test” for the case in which it originated,<sup>153</sup> looks for the presence of any one of several factors that the courts consider conclusive evidence that a rule carries the “force of law” or is “legally binding”<sup>154</sup>: whether the rule is necessary to support an enforcement action, to confer benefits, or to impose obligations;<sup>155</sup> whether the statute is too ambiguous or open-ended to be effectuated only with interpretative rules;<sup>156</sup> or whether the rule in question repudiates or amends

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evaluating legally-binding regulations like those promulgated under I.R.C. § 7805(a), but rather categorizing less formal guidance, like revenue rulings or notices, that Treasury contends are nonbinding but potentially carry penalties as well. *Compare* Treas. Reg. § 601.601(d)(2)(v)(d) (as amended in 1987) (noting that revenue rulings “do not have the force and effect of Treasury Department Regulations (including Treasury decisions)”), *and* INTERNAL REVENUE MANUAL, *supra* note 6, § 32.2.2.10 (same), *with* Treas. Reg. § 1.6662-3(b)(2) (as amended in 2003) (extending the twenty percent underpayment penalty under certain circumstances to taxpayers who fail to follow revenue rulings and notices).

151 *See, e.g.*, *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1020 (D.C. Cir. 2000); *see also* Manning, *supra* note 32, at 915 (making similar observation); Richard J. Pierce, Jr., *Seven Ways To Deossify Agency Rulemaking*, 47 ADMIN. L. REV. 59, 83 (1995) (same).

152 *See, e.g.*, *Hemp Indus. Ass’n v. DEA*, 333 F.3d 1082, 1087 (9th Cir. 2003); *Mejia-Ruiz v. INS*, 51 F.3d 358, 363–65 (2d Cir. 1995); *see also* Richard J. Pierce, Jr., *Distinguishing Legislative Rules from Interpretive Rules*, 52 ADMIN. L. REV. 547, 555 (2000) (asserting that the critical question for courts is whether the agency at issue intended to issue a rule with “force of law”).

153 *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106 (D.C. Cir. 1993).

154 *Id.* at 1109–11; *see also* *Hemp Indus.*, 333 F.3d at 1087 (applying the standard); *N.Y. City Employees’ Ret. Sys. v. SEC*, 45 F.3d 7, 13 (2d Cir. 1995) (same); 1 PIERCE, *supra* note 2, § 6.4, at 345 (noting that several circuits utilize this standard). The factors have changed somewhat since the D.C. Circuit first announced the test in *American Mining Congress*. *See id.* § 6.4, at 340–45 (discussing the evolution of its various factors); Anthony, *supra* note 32, at 16–22 (discussing this test as articulated in *American Mining Congress*); Funk, *supra* note 139, at 1326–32 (describing the different factors that the courts have considered in connection with this test).

155 *Am. Mining Cong.*, 995 F.2d at 1109; *see also* 1 PIERCE, *supra* note 2, § 6.4, at 340–45 (discussing the evolution of this factor); Funk, *supra* note 139, at 1327 (discussing variations of this factor).

156 *See* *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 584–85 (D.C. Cir. 1997); *Hector v. U.S. Dep’t of Agric.*, 82 F.3d 165, 169–71 (7th Cir. 1996); *see also*

another legislative rule.<sup>157</sup> Other, less dispositive factors include whether the agency explicitly invoked legislative authority in promulgating the rule or, to the contrary, told the public that the rule being issued is interpretative and not legally binding, or whether the agency has published the rule in the C.F.R.<sup>158</sup> Some of these factors aim to determine whether context requires a legislative rule, while others focus on the agency's contemporaneous intent. Regardless, application of these factors renders Treasury regulations legislative in character.

Treasury's expressed reliance in all of its T.D.s on I.R.C. § 7805(a)'s clear delegation of authority to promulgate regulations should be sufficient to render them legislative, given the general understanding that rules so promulgated are legally binding and the penalties imposed for failure to follow them.<sup>159</sup> Although the publication in the C.F.R. is merely nondispositive evidence of agency intent,<sup>160</sup> the fact that Treasury so publishes all of its regulations further mitigates against its claim that any of its regulations are merely interpretative.

Moreover, many Treasury regulations promulgated solely under general authority are sufficiently extensive to be essential to sustain an enforcement action, confer tax benefits, or impose obligations.<sup>161</sup>

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Funk, *supra* note 139, at 1327 (describing this factor in similar though slightly different terms).

157 Only a legislative rule can amend a legislative rule. See, e.g., *Am. Mining Cong.*, 995 F.2d at 1109–10; see also *Hemp Indus.*, 333 F.3d at 1087 (applying this rule); *N.Y. City Employees*, 45 F.3d at 13 (same); 1 PIERCE, *supra* note 2, § 8.6, at 556–57 (discussing the rule). Indeed, in *Paralyzed Veterans of America v. D.C. Arena L.P.*, the D.C. Circuit required a legislative rule to amend an interpretative rule. See *Paralyzed Veterans*, 117 F.3d at 586–88. Scholars have criticized this holding as excessive, however. See, e.g., 1 PIERCE, *supra* note 2, § 6.4, at 346–48.

158 See also Funk, *supra* note 139, at 1330 (noting these factors as recognized but more doubtful).

159 See, e.g., *Erringer v. Thompson*, 371 F.3d 625, 630 (9th Cir. 2004) (citing *Am. Mining Cong.*, 995 F.2d at 1110) (interpreting this element of *American Mining Congress* as including invocations of general authority grants).

160 See *Health Ins. Ass'n of Am., Inc. v. Shalala*, 23 F.3d 412, 423 (D.C. Cir. 1994).

161 See, e.g., *Treas. Reg. § 1.701-2* (as amended in 1995) (interpreting the “intent of subchapter K”—the partnership anti-abuse regulations); *Treas. Reg. § 301.7701-1 to -3* (as amended in 2006) (interpreting “corporation”—the “check-the-box” regulations); see also *Paralyzed Veterans*, 117 F.3d at 588 (“If the statute or rule to be interpreted is itself very general . . . and the ‘interpretation’ really provides all the guidance, then the latter will more likely be a [legislative] regulation.”). Treasury's propensity for relying on I.R.C. § 7805(a) even for regulations that arguably are specifically authorized only reinforces this point. See discussion *supra* note 72 and accompanying text. But see *Health Ins. Ass'n*, 23 F.3d at 423 (“The dividing line . . . is whether

Consider one pre-study example: the “check-the-box” regulations of Treasury Regulation §§ 301.7701-1, -2, and -3, purporting to interpret the definitions of “partnership” and “corporation” in I.R.C. § 7701.<sup>162</sup> I.R.C. § 7701(a)(2) defines the term “partnership” as including (but not limited to) “a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation.”<sup>163</sup> I.R.C. § 7701(a)(3) defines the term “corporation” as including (but not limited to) “associations, joint-stock companies, and insurance companies.”<sup>164</sup> I.R.C. § 7701 provides no guidance for characterizing certain state-recognized but unincorporated business entities such as limited liability companies. For decades, Treasury employed a multi-factor test for determining whether an unincorporated business entity should be classified as a partnership or a corporation for federal income tax purposes.<sup>165</sup> In the mid-1990s, however, Treasury promulgated the check-the-box regulations, which replaced the old multi-factor approach with a new elective regime.<sup>166</sup> While the multi-factor test was drawn from judicial opinions, the new check-the-box regulations were cut from whole cloth. Treasury relied solely on its authority under I.R.C. § 7805(a) in promulgating these regulations.<sup>167</sup>

During the period studied, Treasury promulgated several comparatively significant temporary regulations based solely on general authority. For example, in T.D. 9038, citing only I.R.C. § 7805(a) as supporting authority, Treasury issued new temporary regulations addressing the applicability of the tax-free merger provisions of I.R.C. § 368 and related regulations to entities such as single-member limited liability companies that, under the check-the-box regulations, are disregarded for federal income tax purposes.<sup>168</sup> I.R.C. § 368 exempts

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implementing regulations are necessary in order to make a statutory scheme fully operative . . .”).

162 Treas. Reg. §§ 301.7701-1 to -3 (as amended in 2006).

163 I.R.C. § 7701(a)(2) (West Supp. 2006).

164 *Id.* § 7701(a)(3).

165 See Steven A. Dean, *Attractive Complexity: Tax Deregulation, the Check-the-Box Election, and the Future of Tax Simplification*, 34 HOFSTRA L. REV. 405, 425–37 (2005).

166 See Treas. Reg. § 301.7701-1 to -3 (as amended in 2006); see also Dean, *supra* note 165, at 438–41 (describing the check-the-box regulations).

167 See Final Regulations; Simplification of Entity Classification Rules (T.D. 8697), 61 Fed. Reg. 66,584, 66,588 (Dec. 18, 1996), 1997-1 C.B. 215, 219 (adopting these regulations and citing I.R.C. § 7805 (2000) as providing the requisite authority to do so).

168 See Final and Temporary Regulations; Statutory Mergers and Consolidations (T.D. 9038), 68 Fed. Reg. 3384 (Jan. 24, 2003), 2003-1 C.B. 524.

from taxation various mergers and other restructuring transactions involving corporations and their shareholders.<sup>169</sup> Prior to T.D. 9038, no one could be quite certain whether or how I.R.C. § 368 would apply to a merger between a corporation and a disregarded entity.<sup>170</sup> Under state law, such entities can be structured almost identically to corporations and engage in the same sorts of transactions as are exempted from taxation by I.R.C. § 368; but under the check-the-box regulations, such entities do not exist for federal income tax purposes.<sup>171</sup> What are the consequences of merging with something that does not exist? A savvy tax theoretician can intuit her way to many results under the I.R.C.; but as Joseph Isenbergh recognized, “there is no natural law of reverse triangular mergers.”<sup>172</sup> The IRS could not have enforced the rules adopted by T.D. 9038 as general principles. Hence, even though these regulations were promulgated pursuant to the general authority granted by I.R.C. § 7805(a), under the *American Mining Congress* force of law test, they are legislative rules.

At least one circuit uses an older standard known as the “substantial impact test.” This standard provides that a regulation is legislative rather than interpretative if it has a substantial impact on regulated parties.<sup>173</sup> The test has been criticized as overly inclusive.<sup>174</sup> Yet, the Fifth Circuit still applies a variation of the substantial impact test. In *Professionals & Patients for Customized Care v. Shalala*,<sup>175</sup> that court asked whether the rule at issue was binding in that it imposed “‘rights and obligations’” on regulated parties and also whether the rule “‘leaves the agency and its decisionmakers free to exercise discretion’” or, conversely, binds the agency as well as regulated parties.<sup>176</sup> All Treasury regulations, whether specific or general authority, satisfy both aspects of the substantial impact test. As already noted, I.R.C. § 6662

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169 I.R.C. § 368(a) (2000).

170 See generally Richard W. Bailine, *When Is an “A” not an “A”? When It’s a Fish*, 28 J. CORP. TAX’N, 30, 30–32 (2001) (discussing the difficulties in reconciling tax-free reorganizations and disregarded entities).

171 See *id.* at 30–31.

172 Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 879 (1982).

173 See Funk, *supra* note 139, at 1326.

174 See, e.g., *First Nat’l Bank of Lexington v. Sanders*, 946 F.2d 1185, 1189 n.2 (6th Cir. 1991) (acknowledging questionability of substantial impact test but applying it as appropriate for the case at bar); see also Funk, *supra* note 139, at 1326 (noting the criticism of the substantial impact test).

175 56 F.3d 592 (5th Cir. 1995).

176 *Id.* at 595 (quoting *Cnty. Nutrition Inst. v. Young*, 818 F.2d 943, 946 & n.4 (D.C. Cir. 1987)); see also *Tex. Sav. & Cmty. Bankers Ass’n v. Fed. Hous. Fin. Bd.*, 201 F.3d 551, 556 (5th Cir. 2000) (applying test).

and the regulations thereunder clearly impose penalties for disregarding any Treasury regulation in filing tax returns.<sup>177</sup> Treasury regulations have always been binding on government officials, even at a time when courts and scholars agreed that such regulations could not bind taxpayers or the courts.<sup>178</sup>

Some who defend the interpretative label for general authority Treasury regulations turn to rhetoric often employed by the courts that legislative rules “create new law, rights or duties,” while interpretative rules merely state “what the administrative agency thinks the statute means.”<sup>179</sup> Applying such language alone, many general authority Treasury regulations might seem to qualify as interpretative because they merely clarify the statute’s meaning in a way that any court could likewise discern on its own. In fact, while many Treasury regulations offer rules that no court on its own could discern from the I.R.C., it is not at all unusual for Treasury regulations simply to reiterate the related I.R.C. language with some reasonably obvious clarifying language. Consider another example that pre-dates the study, Treasury Regulation § 1.61-2, elaborating on “compensation for services” as an item of “gross income” under I.R.C. § 61.<sup>180</sup>

I.R.C. § 61 defines “gross income” as income “from whatever source derived” and provides a nonexclusive list of income types including “compensation for services, including fees, commissions, fringe benefits, and similar items.”<sup>181</sup> Treasury Regulation § 1.61-2 reiterates this statutory language, adds several additional items like tips and bonuses, and then cross-references some of the subsequent sections offering exclusions.<sup>182</sup> Even without this regulation, one could reasonably conclude that a tip or a bonus is compensation for services, as some courts did before they felt bound by Treasury Regulation § 1.61-2.<sup>183</sup> So, in some sense, one might argue that this regulation merely states what Treasury thinks the statute means.

Nevertheless, legislative rules as well as interpretative ones can interpret and clarify statutes. As currently understood, when Treasury indicates in Treasury Regulation § 1.61-2 that tips and bonuses constitute gross income as compensation for services performed, Treasury is

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177 I.R.C. § 6662 (West Supp. 2006), *amended by* Pub. L. No. 109-280 § 1219, 120 Stat. 1083; Treas. Reg. § 1.6662-3 (as amended in 2003).

178 *See, e.g.*, Alvord, *supra* note 133, at 261; Surrey, *supra* note 133, at 557.

179 *Gen. Motors Corp. v. Ruckelshaus*, 742 F.2d 1561, 1565 (D.C. Cir. 1984).

180 Treas. Reg. § 1.61-2 (as amended in 2003).

181 I.R.C. § 61 (2000).

182 Treas. Reg. § 1.61-2 (as amended in 2003).

183 *See, e.g.*, *Roberts v. Comm’r*, 176 F.2d 221, 223-26 (9th Cir. 1949) (discussing at length why tips are income).

not merely offering its interpretation of I.R.C. § 61 to compete before the courts with other, equally reasonable interpretations. Instead, Treasury is imposing a definition that taxpayers as well as Treasury are legally bound to follow. It is in this sense that Treasury Regulation § 1.61-2 not only says what Treasury believes I.R.C. § 61 means but also creates new law.

Judge Vasquez of the Tax Court has taken a different view, expressing the opinion that Treasury regulations issued under the general authority of I.R.C. § 7805(a) do not in fact carry the force and effect of law.<sup>184</sup> Judge Vasquez contends that giving general authority Treasury regulations binding legal force would render specific authority regulations “superfluous,” and the courts must construe each section of the I.R.C. “so that one section will explain and support and not defeat or destroy another section.”<sup>185</sup> Judge Vasquez’s analysis of the issue is incomplete.

Treating Treasury regulations promulgated under I.R.C. § 7805(a) as nonbinding denies full effect to the language of I.R.C. § 6662, which does not distinguish among Treasury regulations in assessing penalties for underpayment of taxes. In addition, as noted above, many other regulatory statutes contain both specific and general authority grants resembling those in the I.R.C., and the courts continually treat general authority regulations under those statutes as legally binding on all parties. Judge Vasquez’s analysis would seem to apply equally to those statutes, yet the courts continually treat general authority regulations promulgated thereunder as legally binding, and Judge Vasquez offers no justification for tax exceptionalism.

Moreover, Judge Vasquez’s interpretation of I.R.C. § 7805(a) ignores the many varieties of specific authority grants, some of which are quite general themselves.<sup>186</sup> For example, I.R.C. § 382(m) contains a list of several specific items for Treasury to address in regulations, such as “the application of [ §§ 382 and ] 383 in the case of a short taxable year”<sup>187</sup> and “the application of [ § 382(g)(4) ] where there is only 1 corporation involved,”<sup>188</sup> in addition to more general authority to “prescribe such regulations as may be necessary or appropriate to carry out the purposes of” I.R.C. §§ 382 and 383.<sup>189</sup> Simi-

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184 See *Estate of Gerson v. Comm’r*, No. 13534-04, 2006 WL 3019177 (T.C. Oct. 24, 2006) (Vasquez, J., dissenting).

185 *Id.*

186 See generally N.Y. STATE BAR ASS’N REPORT, *supra* note 38, at 2–6 (discussing various types of specific authority grants).

187 I.R.C. § 382(m)(2) (2000).

188 *Id.* § 382(m)(4).

189 *Id.* § 382(m) (flush language).

larly, I.R.C. § 197(f)(9), a provision that addresses excessive turnover or “churning” of intangibles to inflate amortization potential, also instructs the Secretary to promulgate regulations for “the determination of whether the user of property changes as part of a transaction;”<sup>190</sup> yet I.R.C. § 197(g) more generally gives Treasury the authority to “prescribe such regulations as may be appropriate to carry out the purposes of this section.”<sup>191</sup> The more general language of I.R.C. §§ 197(g) and 382(m) arguably gives Treasury no more authority than it already possesses as a result of I.R.C. § 7805(a). Judge Vasquez’s argument would seem to apply with equal force to the general language of those provisions; and it makes little sense to grant legal effect to regulations issued under I.R.C. § 197(g) or the generalized language of I.R.C. § 382(m) but not those promulgated under I.R.C. § 7805(a). Yet denying such specific authority regulations the force of law would be unprecedented and would open a whole new field of argument over which specific authority language is too general to sustain binding regulations. Indeed, Judge Vasquez seems to draw his line solely upon I.R.C. § 7805(a), again without differentiating that provision from more generalized specific authority grants.

An alternative explanation for all of these provisions exists that better fulfills the canon of construction invoked by Judge Vasquez and effectuates the penalty provisions of I.R.C. § 6662. With specific authority grants that address a particular issue, Congress identifies particular ambiguities that exist in a statute and tells the administering agency to address them. With complex regulatory statutes such as, but not limited to, the I.R.C., however, it is often impossible to appreciate which statutory language is unclear or to anticipate every circumstance to which a given provision might or might not apply. With a general authority grant like I.R.C. § 7805(a), or more generalized specific authority grants as in I.R.C. §§ 197(g) and 382(m), Congress acknowledges that there may be other, unforeseen ambiguities and designates the administering agency as primarily responsible for filling those unanticipated gaps.<sup>192</sup> The Supreme Court accepted as much in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,<sup>193</sup> when it described a general authority grant in the Clean Air Act as an “implicit” delegation of legislative authority.<sup>194</sup> Under this interpretation, the courts can respect the significance of specific authority

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190 *Id.* § 197(f)(9)(A).

191 *Id.* § 197(g).

192 See N.Y. STATE BAR ASS’N REPORT, *supra* note 38, at 2–6 (explaining generalized specific authority grants and I.R.C. § 7805(a) similarly).

193 467 U.S. 837 (1984).

194 *Id.* at 843–44.

grants yet treat all Treasury regulations as legally binding on taxpayers, fully effectuate the language of I.R.C. § 6662, and avoid conflicts among different grant provision phraseologies.

In short, all Treasury regulations are legislative rules, whether they were promulgated under specific authority or I.R.C. § 7805(a) general authority, for the simple reason that they are legally binding on taxpayers and the government alike. There was a time when general authority Treasury regulations did not carry such legal force, and thus such regulations were considered to be interpretative rules, but that time has long since passed. For many years now, general as well as specific authority Treasury regulations have carried the force and effect of law. Consequently, Treasury cannot rely on the interpretative rule exception to excuse its failure to adhere to APA section 553 in promulgating temporary regulations.

## 2. The Procedural Rule Exception

As noted above, APA section 553(b) also exempts from notice-and-comment rulemaking “rules of agency organization, procedure or practice.”<sup>195</sup> Unlike interpretative rules, procedural rules may be and often are legally binding, so the legal force that Treasury regulations carry does not preclude Treasury from claiming that the procedural rule exception applies. Treasury did not assert the procedural rule exception in connection with any of the projects studied that involved temporary regulations.<sup>196</sup> As with the interpretative rule exception, and in contrast to the good cause exception, however, the APA does not require an agency to assert the procedural rule exception as a condition of its applicability.<sup>197</sup> But whereas the Internal Revenue Manual explicitly discusses both interpretative rules and good cause, it is silent regarding procedural rules.<sup>198</sup>

Subchapter F of Title 26 of the C.F.R. contains Treasury regulations involving procedure and administration.<sup>199</sup> Notwithstanding the label, many regulations in Subchapter F, such as the check-the-box

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195 5 U.S.C. § 553(b)(A) (2000).

196 Treasury skipped notice-and-comment rulemaking altogether in the only project studied for which Treasury contemporaneously asserted the procedural rule exception. See Final Regulations; Place for Filing (T.D. 9156), 69 Fed. Reg. 55,743 (Sept. 16, 2004), 2004-2 C.B. 669; see also discussion *supra* notes 92–94 (discussing T.D. 9156).

197 Compare 5 U.S.C. § 553(b)(A) (articulating the interpretative and procedural rule exceptions), with 5 U.S.C. § 553(b)(B) (specifying good cause exception requirements).

198 INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.5.4.7.5.1.

199 *Id.* § 32.1.1.3.2.3.



regulations of Treasury Regulation §§ 301.7701-1, -2, and -3, have a major substantive impact on taxpayers.<sup>200</sup> Meanwhile, many Treasury regulations not in Subchapter F are arguably procedural in nature, for example those instructing taxpayers on the time and manner for making certain statutorily provided elections<sup>201</sup> or governing other communications between the taxpayers and the IRS.<sup>202</sup> Moreover, among the projects studied, Treasury often either did not issue temporary regulations under Subchapter F<sup>203</sup> or adopted such regulations in conjunction with others not under Subchapter F.<sup>204</sup>

Consequently, it seems improbable that Treasury's regular practice of issuing temporary regulations without notice and comment reflects a belief that the procedural rule exception of APA section 553(b) applies. Nevertheless, in some of the projects studied, Treasury might plausibly claim the procedural rule exception.

The courts apply two separate but somewhat overlapping standards to determine whether a rule is substantive or procedural. One

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200 By designating certain entities as per se corporations and providing default rules for classifying other entities in the absence of an elective filing, the check-the-box regulations dictate the federal income tax consequences for a significant number of taxpayers. *See* Treas. Reg. §§ 301.7701-1 to -3 (as amended in 2006). These regulations also radically overhauled the I.R.C.'s previous approach to entity classification and departed from Supreme Court precedent on the issue. *See* Dean, *supra* note 165, at 421–51 (describing entity classification before and after check-the-box); *see also supra* notes 162–65 and accompanying text (discussing legislative character of check-the-box regulations).

201 *See, e.g.*, Treas. Reg. § 1.43-6 (1992) (providing time and manner for electing out of I.R.C. § 43 enhanced oil recovery credit); *id.* § 1.83-2 (1978) (providing time and manner for electing to recognize income from property transferred in connection with the performance of services in the year of transfer under I.R.C. § 83(b)).

202 *See, e.g., id.* § 1.6015-5 (as amended in 2002) (providing time and manner for requesting innocent spouse relief under I.R.C. § 6015).

203 *See, e.g.*, Temporary Regulations; Credit for Increasing Research Activities (T.D. 9205), 70 Fed. Reg. 29,596 (May 24, 2005), 2005-1 C.B. 1267 (adopting temporary regulations concerning computation and allocation of research credit among members of a controlled group); Final and Temporary Regulations; Partner's Distributive Share: Foreign Tax Expenditures (T.D. 9121), 69 Fed. Reg. 21,405 (Apr. 21, 2004), 2004-1 C.B. 903 (issuing temporary regulations regarding allocation of partnership expenditures for foreign taxes).

204 *See, e.g.*, Final and Temporary Regulations; Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes (T.D. 9194), 70 Fed. Reg. 18,920 (Apr. 11, 2005), 2005-1 C.B. 1016 (issuing temporary regulations, only partly under Subchapter F, concerning residency and source of income in connection with certain U.S. possessions); Final and Temporary Regulations; Guidance Necessary To Facilitate Business Electronic Filing (T.D. 9100), 68 Fed. Reg. 70,701 (Dec. 19, 2003), 2004-1 C.B. 297 (adopting temporary regulations, only partly under Subchapter F, to remove regulatory obstacles to electronic filing).

test asks whether the rule in question has a “substantial impact” on regulated parties.<sup>205</sup> This test emphasizes the magnitude of the burden imposed by a rule over the rule’s actual nature in determining when to require public notice and comment.<sup>206</sup> Other courts have moved away from the substantial impact test toward another standard that asks whether the rule in question “encodes a substantive value judgment.”<sup>207</sup> By this “value judgment” standard,<sup>208</sup> procedural rules may impose great burdens on regulated parties so long as they merely “alter the manner in which the parties present themselves or their viewpoints to the agency,” as opposed to the parties’ substantive rights and interests.<sup>209</sup>

The substantial impact and value judgment tests are both frustratingly vague. There is some debate over the extent to which the two tests overlap in practice.<sup>210</sup> Hence, the goal of the courts sometimes is merely to keep the procedural rule exception from swallowing the

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205 See, e.g., *Phillips Petroleum Co. v. Johnson*, 22 F.3d 616, 620–21 (5th Cir. 1994) (discussing and applying the substantial impact test), *modified*, 36 F.3d 89 (5th Cir. 1994) (unpublished table decision); *U.S. Dep’t of Labor v. Kast Metals Corp.*, 744 F.2d 1145, 1153 (5th Cir. 1984) (same); *Nat’l Motor Freight Traffic Ass’n v. United States*, 268 F. Supp. 90, 96 (D.D.C. 1967) (three-judge court), *aff’d* 393 U.S. 18 (1968).

206 See Jeffrey S. Lubbers & Nancy G. Miller, *The APA Procedural Rule Exemption: Looking for a Way to Clear the Air*, 6 ADMIN. L.J. AM. U. 481, 485–86 (1992) (describing the substantial impact test).

207 See *Pub. Citizen v. Dep’t of State*, 276 F.3d 634, 640 (D.C. Cir. 2002) (noting the shift); *Am. Hosp. Ass’n v. Bowen*, 834 F.2d 1037, 1047 (D.C. Cir. 1987) (same); see also *RSM, Inc. v. Buckles*, 254 F.3d 61, 68–69 (4th Cir. 2001) (applying the value judgment test).

208 There does not seem to be a common label for this test. Jeffrey Lubbers and Nancy Miller refer to it as the “encoding” test. Lubbers & Miller, *supra* note 206, at 487. Tracy Corell Hauser calls it the “substantive value” test. Tracy Corell Hauser, *The Administrative Procedure Act, Procedural Rule Exception to the Notice and Comment Requirement—A Survey of Cases*, 5 ADMIN. L.J. 519, 543–44 (1991). I use the label “value judgment” here as more descriptive than “encoding” and less likely than “substantial value” to be confused with “substantial impact.”

209 *JEM Broad. Co. v. FCC*, 22 F.3d 320, 326 (D.C. Cir. 1994) (quoting *Batterton v. Marshall*, 648 F.2d 694, 707 (D.C. Cir. 1987)); see also *RSM*, 254 F.3d at 68–69 (quoting *JEM Broadcasting*).

210 See *RSM*, 254 F.3d at 68–69 (applying the value judgment test but using substantial interest language); *Chamber of Commerce v. U.S. Dep’t of Labor*, 174 F.3d 206, 211 (D.C. Cir. 1999) (employing both substantial impact and value judgment language); Hauser, *supra* note 208, at 544 (suggesting that the value judgment standard is “merely the substantial impact test with a new name”). But see Lubbers & Miller, *supra* note 206, at 486 n.31 (disagreeing with Hauser and claiming that the standards are distinct).

notice-and-comment rule.<sup>211</sup> For example, in *JEM Broadcasting Co. v. FCC*,<sup>212</sup> the D.C. Circuit considered a “hard look” rule that dismissed without opportunity to cure any broadcasting license application that was not “substantially complete.”<sup>213</sup> Even though the FCC’s hard look rule might operate to “cause the loss of substantive rights,” the *JEM* court found the rule to be procedural because it “did not change the *substantive standards* by which the FCC evaluate[d] license applications.”<sup>214</sup>

Similarly, in *National Whistleblower Center v. Nuclear Regulatory Commission (NRC)*,<sup>215</sup> the D.C. Circuit assessed a rule stating that extensions of time to file requests to intervene in nuclear power plant license renewal proceedings would be granted only “when warranted by unavoidable and extreme circumstances.”<sup>216</sup> Although the NRC’s extension standard functioned to preclude the petitioner from presenting its views in a particular license renewal hearing, the court found the rule to be procedural because it did not foreclose third-party participation in such hearings altogether, but instead merely demanded that interested parties offer good reasons for failing to meet reasonable deadlines.<sup>217</sup>

Considering both the standards as articulated and examples of their application, Treasury might plausibly claim the procedural rule exception for several of the projects studied. For example, T.D. 9175 adopted temporary regulations requiring certain corporate and exempt organization taxpayers to file their tax returns electronically but offering a potential hardship waiver provision for exceptional circumstances.<sup>218</sup> These regulations would seem to fall directly in the procedural rule category, as filing electronically as opposed to in paper form does not alter any taxpayer’s tax liability but merely changes how that the origins of that tax liability are communicated to the IRS. Another project, represented by T.D. 9168, adopted regulations providing the time and manner for electing a ten-year write-off

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211 See, e.g., *JEM Broad.*, 22 F.3d at 327 (acknowledging but rejecting litigant’s argument from precedent for this reason).

212 22 F.3d 320.

213 *Id.* at 322–23.

214 *Id.* at 327.

215 208 F.3d 256 (D.C. Cir. 2000).

216 *Id.* at 259 (quoting Policy on Conduct of Adjudicatory Proceedings, 63 Fed. Reg. 41,872, 41,874 (Aug. 5, 1998)).

217 *Id.* at 262–63.

218 Temporary Regulations; Returns Required on Magnetic Media (T.D. 9175), 70 Fed. Reg. 2012 (Jan. 12, 2005), 2005-1 C.B. 665.

period for certain tax preference items under I.R.C. § 59(e).<sup>219</sup> Because the statute provides for the election—and thus the substantive tax consequences—regulations that merely detail the process by which a taxpayer may make that election seem at least arguably procedural.<sup>220</sup>

Nevertheless, most of the temporary Treasury regulations evaluated in the study were not procedural rules. There is simply no good argument that temporary regulations extending the availability of I.R.C. § 338(h)(10) elections to certain multi-step transactions,<sup>221</sup> resolving a circuit split over whether and when changes in computing depreciation or amortization represent accounting method changes requiring IRS approval,<sup>222</sup> or providing new ordering rules for asset basis reductions in bankruptcy<sup>223</sup> are procedural in character. Such

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219 Final Regulation; Optional 10-year Writeoff of Certain Preferences (T.D. 9168), 69 Fed. Reg. 76,614 (Dec. 22, 2004), 2005-1 C.B. 354.

220 *Compare* I.R.C. § 59(e) (2000) (establishing the nature and scope of the tax preference write-off election), *with* Treas. Reg. § 1.59-1 (2004) (setting forth the time and manner of election).

221 *See* Final and Temporary Regulations; Effect of Elections in Certain Multi-Step Transactions (T.D. 9071), 68 Fed. Reg. 40,766 (July 9, 2003), 2003-2 C.B. 560 (adopting temporary regulations permitting I.R.C. § 338(h)(10) elections for certain multi-step transactions). I.R.C. § 338(h)(10) allows a buyer and seller of the stock of a target corporation that is part of a consolidated group to elect to treat the stock sale as a liquidation of the target followed by a sale of the target's assets to the purchaser, thus triggering target-level asset gain recognition prior to the sale but permitting the target to go forward under the new ownership with a stepped-up basis in its assets for depreciation and other tax purposes. *See* I.R.C. § 338(h)(10).

222 *See* Final and Temporary Regulations; Changes in Computing Depreciation (T.D. 9105), 69 Fed. Reg. 5 (Jan. 2, 2004), 2004-1 C.B. 419, 420 (adopting temporary regulations to resolve the circuit split). I.R.C. § 446(e) generally requires a taxpayer to seek consent of the Secretary of the Treasury before changing accounting methods. *See* I.R.C. § 446(e). *Compare* *Comm'r v. Brookshire Bros. Holding*, 320 F.3d 507, 513 (5th Cir. 2003) (holding that an asset classification change and resulting cost recovery period change was not an accounting method change), *O'Shaughnessy v. Comm'r*, 332 F.3d 1125, 1131-32 (8th Cir. 2003) (same), *and* *Green Forest Mfg. Inc. v. Comm'r*, 85 T.C.M. (CCH) 1020, 1024 (2003) (same), *with* *Kurzet v. Comm'r*, 222 F.2d 830, 842-45 (10th Cir. 2000) (holding that an asset classification change and resulting cost recovery period change was an accounting method change).

223 *See* Final and Temporary Regulations; Reduction of Tax Attributes Due to Discharge of Indebtedness (T.D. 9080), 68 Fed. Reg. 42,590 (July 18, 2003), 2003-2 C.B. 696 (adopting temporary regulations providing new ordering rules governing attribute reduction under I.R.C. §§ 108 and 1017 in certain bankruptcy contexts). I.R.C. § 108 allows certain bankrupt taxpayers to exclude income from the discharge of indebtedness from taxable income but requires such taxpayers to correspondingly reduce tax attributes such as asset basis in accordance with ordering rules provided in I.R.C. §§ 108 and 1017. I.R.C. §§ 108(a)-(b), 1017. T.D. 9080 reversed earlier, informal guidance regarding basis reduction for assets acquired from certain bankrupt

regulations did not merely tweak the way that taxpayers interact with the government. Instead, they elaborated substantive provisions of the I.R.C. in substantive ways, for example granting tax benefits to some taxpayers while denying them to others on the merits.

Accordingly, the procedural rule exception does not explain Treasury's use of temporary regulations generally. Nevertheless, Treasury may be able to rely upon that exception successfully to excuse its decision to issue temporary regulations in some projects.

### 3. The Good Cause Exception

As already noted, APA section 553(b) provides a good cause exception from notice and comment where an agency finds that process to be "impracticable, unnecessary, or contrary to the public interest."<sup>224</sup> In almost all of these projects, Treasury's reliance on the good cause exception presents problems of form, substance, or both.

First, the APA requires an agency invoking the good cause exception to do so expressly and to provide "a brief statement of reasons" along with the regulations being issued.<sup>225</sup> Treasury explicitly asserted the good cause exception in only fifteen of the eighty-four projects studied in which it promulgated temporary regulations.<sup>226</sup> In most of the others, Treasury merely included in the preamble a statement to the effect that "it has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations."<sup>227</sup> The remaining three T.D.s were wholly silent regarding the APA.

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entities. *See* I.R.S. Field Serv. Advice 200145009 (July 31, 2001). Treasury subsequently issued final regulations narrowing the scope of the temporary regulations. *See* Final and Temporary Regulations; Reduction of Tax Attributes Due to Discharge of Indebtedness (T.D. 9127), 69 Fed. Reg. 26,038 (May 11, 2004), 2004-1 C.B. 1042. *See generally* Janara N. Jones & Maryann D'Angelo, *Sections 108 and 1017 Regulations: Was It Really Too Much Candy for the Nickel?*, CORP. TAX'N, July/Aug. 2004, at 3, 5-6 (comparing the final regulations with the temporary regulations and the earlier Field Service Advice).

<sup>224</sup> 5 U.S.C. § 553(b)(B) (2000); *see also* discussion *supra* notes 33-35 and accompanying text (discussing the good cause exception).

<sup>225</sup> 5 U.S.C. § 553(b)(B).

<sup>226</sup> *See, e.g.*, Temporary Regulations; Guidance Under Section 1502; Treatment of Loss Carryovers From Separate Return Limitation Years (T.D. 9155), 69 Fed. Reg. 51,175 (Aug. 18, 2004), 2004-2 C.B. 562; Final and Temporary Regulations (T.D. 9071), 68 Fed. Reg. 40,766; Temporary Regulations; Distributions of Interests in a Loss Corporation from Qualified Trusts (T.D. 9063), 68 Fed. Reg. 38,177 (June 27, 2003), 2003-2 C.B. 510, 511.

<sup>227</sup> *See* Final Regulations; Sickness or Accident Disability Payments (T.D. 9233), 70 Fed. Reg. 74,198, 74,199 (Dec. 15, 2005), 2006-3 I.R.B. 303, 304; *see also* Final Regula-

The courts have been inconsistent in requiring agencies to invoke the good cause exception explicitly.<sup>228</sup> Some courts have refused to recognize good cause unless the agency contemporaneously and expressly invoked the good cause exception.<sup>229</sup> For example, in *Bohner v. Daniels*,<sup>230</sup> the Bureau of Prisons published interim final rules concerning an early release program with only the statement that it was “‘publishing this change as an interim rule in order to solicit public comment while continuing to provide consideration for early release to qualified inmates.’”<sup>231</sup> The court considered this language inadequate to assert good cause.<sup>232</sup>

Other courts have recognized as sufficient nonexplicit language in a preamble, like the blanket disclaimer commonly found in T.D.s that “[i]t has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation.”<sup>233</sup> For example, in *National Customs Brokers & Forwarders Ass’n of America v. United States*,<sup>234</sup> the court accepted an agency’s vague assertion that its regulations were “‘not subject to the notice and public procedure requirements of 5 U.S.C. § 553’” as a claim of good cause.<sup>235</sup> Similarly, in *Utility Solid Waste Activities Group v. EPA*,<sup>236</sup> the

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tion; Testimony or Production of Records in a Court or Other Proceeding (T.D. 9178), 70 Fed. Reg. 7396, 7396 (Feb. 14, 2005), 2005-1 C.B. 708, 709 (containing similar language); Final and Temporary Regulations; Electronic Filing of Duplicate Forms 5472 (T.D. 9113), 69 Fed. Reg. 5931, 5931 (Feb. 9, 2004), 2004-1 C.B. 524, 525 (same).

228 See, e.g., 1 CHARLES KOCH, ADMINISTRATIVE LAW AND PRACTICE § 4.14, at 344–45 (2d ed. 1997) (noting judicial inconsistency and citing cases).

229 See, e.g., *Buschmann v. Schweiker*, 676 F.2d 352, 356–57 (9th Cir. 1982); *Bohner v. Daniels*, 243 F. Supp. 2d 1171, 1176 (D. Or. 2003).

230 243 F. Supp. 2d 1171.

231 *Id.* at 1176 (quoting Drug Abuse Treatment and Intensive Confinement Center Programs: Early Release Consideration, 62 Fed. Reg. 53,690 (Oct. 15, 1997)).

232 *Id.*

233 INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.5.4.7.5.4.3 (suggesting this language); see also Temporary Regulations; Credit for Increasing Research Activities (T.D. 9205), 70 Fed. Reg. 29,596, 29,600 (May 24, 2005), 2005-1 C.B. 1267, 1271 (using nearly identical language); Final Regulation; Real Estate Mortgage Investment Conduits; Application of Section 446 With Respect to Inducement Fees (T.D. 9128), 69 Fed. Reg. 26,040, 26,040 (May 11, 2004), 2004-1 C.B. 943, 944 (same); Final and Temporary Regulations; Constructive Transfers and Transfers of Property to a Third Party on Behalf of a Spouse (T.D. 9035), 68 Fed. Reg. 1534, 1536 (Jan. 13, 2003), 2003-1 C.B. 528, 531 (same). But see *supra* note 91 and accompanying text (hypothesizing from the Internal Revenue Manual that such language intends to invoke the interpretative rule exception).

234 59 F.3d 1219 (Fed. Cir. 1995).

235 *Id.* at 1224 (quoting Express Consignments; Formal and Informal Entries of Merchandise; Administrative Exemptions, 59 Fed. Reg. 30,289, 30,293 (June 13,

court held that the agency invoked good cause with a single sentence in the preamble describing the action in question as “minor, routine clarifications that will not have a significant effect on industry or the public.”<sup>237</sup>

Even if Treasury’s customary sentence suffices to invoke the good cause exception, the APA also requires an agency invoking the good cause exception to provide a contemporaneous explanation of its reasons for doing so. The court in *National Customs Brokers* recognized the agency’s vague assertion of good cause as adequate largely because the preamble also included a long and detailed explanation of the agency’s basis for finding good cause.<sup>238</sup> In both *Bohner* and *Utility Solid Waste Activities Group*, by contrast, the courts emphasized the inadequacy of the language offered to satisfy this requirement.<sup>239</sup> Some courts have been willing to glean good cause from a rule’s context;<sup>240</sup> but in general, the courts are unlikely to find Treasury’s blanket assertions of APA section 553(b)’s inapplicability sufficient explanation to sustain a claim of good cause.<sup>241</sup>

Treasury’s more explicit assertions of the good cause exception are unlikely to fare much better. In evaluating good cause claims, the courts balance an attitude of deference to agency judgment against a need to prevent the exception from overwhelming the notice-and-comment rule.<sup>242</sup> To achieve that goal, the courts emphasize the need for specific and particularized explanations of the necessity for avoiding notice and comment.<sup>243</sup> Correspondingly, the courts typically consider brief and generic declarations of the need for immediate action or guidance inadequate to sustain a finding of good

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1994)); *see also id.* at 1223–24 (accepting agency’s assertion that regulations were not subject to requirements of APA section 553 based upon agency’s detailed explanation of good cause, notwithstanding agency’s failure to assert the exception explicitly).

236 236 F.3d 749 (D.C. Cir. 2001).

237 *Id.* at 754–55.

238 *See Nat’l Customs Brokers*, 59 F.3d at 1223–24.

239 *See Util. Solid Waste Activities Group*, 236 F.3d at 754–55; *Bohner v. Daniels*, 243 F. Supp. 2d 1171, 1176 (D. Or. 2003).

240 *See, e.g., Nader v. Sawhill*, 514 F.2d 1064, 1068–69 (Temp. Emer. Ct. App. 1975).

241 *See* 1 KOCH, *supra* note 228, § 4.14, at 345 (observing that the trend is toward requiring and scrutinizing agency explanations).

242 *See, e.g., Xin-Chang Zhang v. Slattery*, 55 F.3d 732, 743–56 (2d Cir. 1995); *see also* 1 PIERCE, *supra* note 2, § 7.10 at 506–07 (discussing the good cause exemption and cases where courts considered its application).

243 *See, e.g., Natural Res. Def. Council, Inc. v. Evans*, 316 F.3d 904, 912 (9th Cir. 2003) (requiring context-specific analysis); *Consumer Energy Council of Am. v. FERC*, 673 F.2d 425, 447 (D.C. Cir. 1982) (requiring contemporaneous explanation of rationale supporting good cause claim).

cause.<sup>244</sup> While the length of an agency's explanation is not necessarily determinative, the likelihood of an agency's success in invoking the good cause exception correlates to the degree of detail offered.<sup>245</sup> Conclusory statements of good cause are generally inadequate, while extensive and fact-specific justifications more often prevail.

Yet where a drafter of Treasury regulations finds notice and comment to be contrary to the public interest, the Internal Revenue Manual recommends only the following explanatory language: "These regulations are necessary to provide taxpayers with immediate guidance."<sup>246</sup> Several projects studied asserted good cause using only this language, or something closely resembling it.<sup>247</sup> Such projects included T.D. 9117, which adopted complex temporary regulations for the applicability of I.R.C. § 108 tax attribution rules in the consolidated group context,<sup>248</sup> and T.D. 9048, which promulgated detailed regulations under I.R.C. § 1502 concerning the deductibility of cer-

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244 See *Xin-Chang Zhang*, 55 F.3d at 746 ("A mere recitation that good cause exists, coupled with a desire to provide immediate guidance [or take immediate action], does not amount to good cause."); see also, e.g., *Mobil Oil Corp. v. Dep't of Energy*, 610 F.2d 796, 803 (Temp. Emer. Ct. App. 1979) ("It is axiomatic that a mere recital of good cause does not create good cause. Similarly, a desire to provide immediate guidance, without more, does not suffice for good cause."); *Nader*, 514 F.2d at 1068 (agreeing with appellants that permitting a conclusory statement to establish good cause would allow the exemption to the notice requirement to "swallow the rule").

245 Compare, e.g., *Natural Res. Def. Council*, 316 F.3d at 906, 912 (rejecting good cause explanation as insufficiently context-specific), with *Or. Trollers Ass'n v. Gutierrez*, 452 F.3d 1104, 1124-25 (9th Cir. 2006) (approving longer and more detailed good cause explanation under similar circumstances), *petition for cert. filed*, 75 U.S.L.W. 3266 (U.S. Nov. 2, 2006) (No. 06-622).

246 INTERNAL REVENUE MANUAL, *supra* note 6, § 32.1.5.4.7.5.1. The Internal Revenue Manual's emphasis on the contrary to the public interest prong of the good cause exception is contradicted by the claim in one prominent treatise that Treasury promulgates temporary regulations based on the exception's impracticability prong. See BORIS I. BITTKER ET AL., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 46.04[1] (3d ed. 2002).

247 See, e.g., Temporary Regulations; Guidance Under Section 1502; Treatment of Loss Carryovers From Separate Return Limitation Years (T.D. 9155), 69 Fed. Reg. 51,175 (Aug. 18, 2004), 2004-2 C.B. 562; Final Regulations and Removal of Temporary Regulations; Return of Partnership Income (T.D. 9117), 69 Fed. Reg. 12,069 (Mar. 15, 2004), 2004-1 C.B. 721, 723; Temporary Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9098), 68 Fed. Reg. 69,024 (Dec. 11, 2003), 2003-2 C.B. 1248, 1249; Final and Temporary Regulations; Effect of Elections in Certain Multi-Step Transactions (T.D. 9071), 68 Fed. Reg. 40,766 (July 9, 2003), 2003-2 C.B. 560, 561; Final and Temporary Regulations; Guidance Under Section 1502; Suspension of Losses on Certain Stock Dispositions (T.D. 9048), 68 Fed. Reg. 12,287 (Mar. 14, 2003), 2003-1 C.B. 645, 648

248 See Final Regulations and Removal of Temporary Regulations (T.D. 9117), 69 Fed. Reg. 12,069.



tain subsidiary stock losses after the *Rite Aid* court invalidated predecessor regulations.<sup>249</sup>

Inadequacies of form are not Treasury's only problem with the good cause exception, however. The courts at least purport to construe the good cause exception narrowly; and it is unlikely that many Treasury regulations satisfy the substantive requirements for invoking the good cause exception.

As originally conceived, the good cause exception was intended for a limited set of situations. APA section 553(b) provides that the good cause exception is available where an agency finds the public notice-and-comment process to be "impracticable, unnecessary, or contrary to the public interest."<sup>250</sup> APA section 553(b)(B) uses the disjunctive "or,"<sup>251</sup> so both the *Attorney General's Manual on the Administrative Procedure Act* and many judicial opinions assume three separate and distinct categories under which an agency might establish good cause.<sup>252</sup> Impracticability applies primarily when "due and timely execution of [an agency's] functions would be impeded by" notice and comment.<sup>253</sup> Notice and comment are "unnecessary" if the agency action in question is "a minor rule or amendment in which the public is not particularly interested."<sup>254</sup> Finally, the public interest aspect of the exception applies where "the interest of the public would be defeated by any requirement of advance notice."<sup>255</sup> In other words, the good cause exception exists principally to give agencies flexibility in dealing with emergencies and typographical errors, plus the occasional situation in which advance notice would be counterproductive.

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249 See Final and Temporary Regulations (T.D. 9048), 68 Fed. Reg. 12,287; see also discussion *supra* note 105 and accompanying text (discussing *Rite Aid* and related T.D.s, all of which claimed the good cause exception on similar grounds).

250 5 U.S.C. § 553(b)(B) (2000).

251 *Id.*

252 See, e.g., *Natural Res. Def. Council v. Evans*, 316 F.3d 904, 911–12 (9th Cir. 2003) (discussing and applying impracticability prong); *Util. Solid Waste Activities Group v. EPA*, 236 F.3d 749, 754–55 (D.C. Cir. 2001) (analyzing each prong individually); *Nat'l Customs Brokers & Forwarders Ass'n of Am. v. U.S.*, 59 F.3d 1219, 1223–24 (Fed. Cir. 1995) (considering agency's separate claims under unnecessary and public interest prongs); *Xin-Chang Zhang v. Slattery*, 55 F.3d 732, 746–47 (2d Cir. 1995) (recognizing inquiry raised by each prong); ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 30–31 (discussing good cause exception as three separate categories); see also discussion *supra* note 119 (noting the authoritative weight that the courts give the Attorney General's Manual in interpreting the APA).

253 ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 30.

254 *Id.* at 31.

255 *Id.*

In actual application, cases considering agency invocation of the good cause exception are sufficiently fact-specific as to render easy categorization difficult. For example, expressions of “generic timeliness concerns” and/or complaints about the difficulty in meeting congressionally imposed deadlines are inadequate to sustain a claim of impracticability;<sup>256</sup> but such rationales accompanied by specific details may be sufficient.<sup>257</sup> As noted, the courts are often skeptical of generic assertions of the need for immediate guidance;<sup>258</sup> yet courts have been sympathetic to agency claims of the need for quick action in the face of suddenly changed circumstances,<sup>259</sup> particularly where the rules adopted are interim in nature and the agency simultaneously seeks public comment and considers such input in subsequently issuing final rules.<sup>260</sup> Airline pilot certification regulations in the months after the September 11, 2001, terrorist attacks qualified for the good cause exception,<sup>261</sup> as did air safety regulations following a spate of fatal air tour accidents.<sup>262</sup> The good cause exception applied to interim final regulations promulgated to resolve a federal court split regarding county employee overtime pay that created an “enormous unforeseen liability of [State and local] governments” that potentially “threaten[ed] their fiscal integrity.”<sup>263</sup>

The circumstances in which Treasury issues temporary regulations typically are not particularly dire. For example, in 2003, Treasury issued T.D. 9089 with temporary regulations governing the reduction of tax attributes within consolidated groups upon the exclu-

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256 See, e.g., *Natural Res. Def. Council*, 316 F.3d at 912; *Cal-Almond v. U.S. Dep’t of Agric.*, 14 F.3d 429, 441–42 (9th Cir. 1993); *Air Transp. Ass’n of Am. v. Dep’t of Transp.*, 900 F.2d 369, 379 (D.C. Cir. 1990), *vacated by* 498 U.S. 1023 (1991).

257 See, e.g., *Or. Trollers Ass’n v. Gutierrez*, 452 F.3d 1104, 1125 (9th Cir. 2006), *petition for cert. filed*, 75 U.S.L.W. 3266 (U.S. Nov. 2, 2006) (No. 06-622); *Xin-Chang Zhang v. Slattery*, 55 F.3d 732, 746 (2d Cir. 1995); *Methodist Hosp. of Sacramento v. Shalala*, 38 F.3d 1225, 1236–37 (D.C. Cir. 1994).

258 See *supra* note 244 and accompanying text.

259 See, e.g., *Jifrey v. FAA*, 370 F.3d 1174, 1179–80 (D.C. Cir. 2004); *Haw. Helicopter Operators Ass’n v. FAA*, 51 F.3d 212, 214 (9th Cir. 1995).

260 See, e.g., *Nat’l Customs Brokers & Forwarders Ass’n of Am. v. United States*, 59 F.3d 1219, 1223–24 (Fed. Cir. 1995).

261 See *Jifrey*, 370 F.3d at 1179–80.

262 See *Haw. Helicopter Operators*, 51 F.3d at 214.

263 *Service Employees Intern. Union, Local 102 v. County of San Diego*, 60 F.3d 1346, 1352 n.3 (9th Cir. 1994) (quoting Exemptions From Minimum Wage and Overtime Compensation Requirements of the Fair Labor Standards Act; *Public Sector Employers*, 56 Fed. Reg. 45,824, 45,825 (Sept. 6, 1991)).

sion by a member of debt forgiveness income under I.R.C. § 108.<sup>264</sup> These regulations were drafted to elaborate the consequences of the Supreme Court's decision two years earlier in June 2001 in *United Dominion Industries, Inc. v. United States*<sup>265</sup> on that topic. With one of its more elaborate good cause explanations, Treasury claimed that "[c]urrent circumstances have made the application of section 108 in the consolidated group context an issue that needs to be addressed at this time" and that "consolidated groups may be taking positions that are inconsistent with the policies underlying section 108 and the principle enunciated by the Supreme Court in" *United Dominion*.<sup>266</sup> Yet, in the more than two years between *United Dominion* and T.D. 9089, consolidated groups had been filing returns, perhaps misinterpreting the Court's murky *United Dominion* analysis, or perhaps not. Treasury offered no argument that failing to address *United Dominion* immediately through binding regulations would imperil the fisc; and the delay in Treasury's reaction to *United Dominion* raises some doubt as to the sudden need for immediate guidance two years later.

Similarly, in T.D. 9158, Treasury adopted temporary regulations that provided a methodology for treating a contingent nuclear power plant decommissioning liability assumed in connection with a bulk asset acquisition as part of the purchase price to be allocated as basis among the assets acquired.<sup>267</sup> Treasury again asserted the good cause exception on the ground that the regulations were necessary immediately "to remove an impediment to such transactions."<sup>268</sup> Yet the IRS had been issuing private letter rulings to taxpayers for years in such transactions, admittedly with a different approach to the problem.<sup>269</sup> The IRS's past practice in handling the matter through informal guidance and Treasury's delay in addressing the issue render suspect Treasury's claimed need for immediate guidance in T.D. 9158.

Occasionally, a court has upheld a claim of good cause in less-than-emergency circumstances. In *National Customs Brokers & Forward-*

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264 See Temporary Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9089), 68 Fed. Reg. 52,487 (Sept. 4, 2003), 2003-2 C.B. 906.

265 532 U.S. 822 (2001).

266 Temporary Regulations (T.D. 9089), 68 Fed. Reg. 52,487.

267 See Final and Temporary Regulations; Treatment of Certain Nuclear Decommissioning Funds for Purposes of Allocating Purchase Price in Certain Deemed and Actual Asset Acquisitions (T.D. 9158), 69 Fed. Reg. 55,740 (Sept. 16, 2004), 2004-2 C.B. 665.

268 *Id.*

269 See, e.g., I.R.S. Priv. Ltr. Rul. 2001-21-028 (May 25, 2001); I.R.S. Priv. Ltr. Rul. 2000-49021 (Dec. 8, 2000); I.R.S. Priv. Ltr. Rul. 2000-04-040 (Jan. 28, 2000).

*ers Ass'n of America v. United States*,<sup>270</sup> the court upheld a claim of good cause for temporary Customs Service regulations concerning the importation of merchandise valued at \$200.<sup>271</sup> The agency persuaded the court that pre-promulgation notice and comment was both unnecessary because Congress directed the regulations' promulgation in legislation enacted only six months previously and contrary to the public interest because the public would benefit from resulting savings and efficiencies.<sup>272</sup> None of the temporary regulations evaluated seem precisely to fit this scenario, but future temporary regulations might.

Another area in which Treasury might plausibly assert good cause for issuing temporary binding regulations without the benefit of notice and comment is in its efforts to combat abusive tax shelters. In explaining the public interest prong of the good cause exception, the *Attorney General's Manual on the Administrative Procedure Act* offers price controls as a situation in which "the interest of the public would be defeated by any requirement of advance notice."<sup>273</sup> The rationale is obvious: Advance public knowledge of price controls would distort the market and undermine the goals that the government seeks to accomplish in imposing the controls. Similarly, Treasury might plausibly argue that temporary regulations are necessary to combat tax shelter abuse by demonstrating that issuing proposed regulations alone would prompt taxpayers merely to execute their abusive transactions before Treasury could finalize the regulations. Treasury's ability under I.R.C. § 7805(b) to make Treasury regulations retroactively applicable may undercut such an argument, however.<sup>274</sup>

In the projects evaluated for the study, Treasury attempted a few times to make such a claim, but did so only in the most general terms. For example, T.D. 9062 issued temporary regulations intended to combat a series of tax shelters that exploited an ambiguity in the I.R.C. regarding the treatment of liabilities transferred in connection with property to a partnership in exchange for a partnership interest.<sup>275</sup> In issuing the temporary regulations, Treasury asserted the good cause exception, but with only a brief, conclusory statement that

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270 59 F.3d 1219 (Fed. Cir. 1995).

271 *Id.* at 1220–21.

272 *Id.* at 1223–24.

273 ATTORNEY GENERAL'S MANUAL, *supra* note 3, at 31.

274 See I.R.C. § 7805(b) (2000).

275 Temporary Regulations; Assumption of Partner Liabilities (T.D. 9062), 68 Fed. Reg. 37,414 (June 24, 2003), 2003-2 C.B. 46.

the regulations were “necessary to prevent abusive transactions.”<sup>276</sup> Moreover, in the case of T.D. 9062, Treasury adopted the temporary regulations a full two years after issuing a nonbinding notice condemning the same transaction.<sup>277</sup> Nevertheless, T.D. 9062 explained at length the transaction the regulations being promulgated were intended to combat;<sup>278</sup> and Treasury might be able to persuade a court of the need for legally binding temporary regulations to prevent taxpayers from consummating transactions while final regulations were pending.

In short, if Treasury is relying on the good cause exception to justify generally its promulgation of temporary regulations in many of its regulatory projects, then Treasury is making a big gamble. On occasion, circumstances may exist around which Treasury could plausibly argue that good cause exists for seeking comment only after promulgating temporary regulations, but usually that is not the case. Even where such conditions may be present, however, Treasury leaves its good cause claims susceptible to legal challenge by not asserting the exception clearly or explaining its reasoning with specificity and particularity.

#### 4. Summary

In summary, Treasury’s frequent use of temporary regulations with only post-promulgation opportunity for comment is potentially problematic and leaves many of Treasury’s regulations open to legal challenge as adopted inconsistently with the rulemaking requirements of APA section 553. Treasury’s position that most of its regulations are interpretative and therefore exempt is based on an anachronistic understanding of the exception and misguided in light of modern legal doctrine. A few Treasury regulations evaluated in the study might qualify for the procedural rule exception, but not very many. Treasury only explicitly invoked the good cause exception as required by APA section 553(b)(B) in a small number of projects. Even where it did, Treasury’s findings of good cause were usually inadequately explained, if indeed such justification actually existed. The exceptions from APA section 553 rulemaking requirements do not support Treasury’s utilization of temporary regulations without notice and comment.

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<sup>276</sup> *Id.*; see also I.R.S. Notice 2000-44, 2000-2 C.B. 255 (describing the abusive transactions which T.D. 9062 addresses).

<sup>277</sup> Temporary Regulations (T.D. 9062), 68 Fed. Reg. 37,414; I.R.S. Notice 2000-44, 2000-2 C.B. 255.

<sup>278</sup> Temporary Regulations (T.D. 9062), 68 Fed. Reg. 37,414.

*B. Straight to Final Regulations (or Good Cause, Redux)*

Unfortunately, temporary regulations are not Treasury's only procedural weakness. As noted above, Treasury skipped the notice-and-comment process altogether in eleven projects. In one such project, reflected in T.D. 9224, Treasury contemporaneously invoked the interpretative rule exception,<sup>279</sup> which is inapplicable to Treasury regulations for the reasons discussed above.<sup>280</sup> In another project studied for which Treasury bypassed notice and comment, represented by T.D. 9156, Treasury contemporaneously asserted the procedural rule exception.<sup>281</sup> With T.D. 9156, Treasury amended regulations regarding the place for filing tax returns and other taxpayer documents to reflect changes in the IRS's organizational structure.<sup>282</sup> For example, the revised regulations instruct corporate taxpayers to deliver their returns to "any person assigned the responsibility to receive returns" in the relevant local IRS office rather than "the district director" for the applicable IRS district.<sup>283</sup> As discussed above, regulations such as these may indeed qualify for the procedural rule exception.<sup>284</sup>

As with the temporary regulations, however, in most of the projects in which Treasury did not pursue notice and comment at all, Treasury either explicitly asserted the good cause exception as the reason for doing so<sup>285</sup> or merely asserted the inapplicability of APA section 553(b) without explanation.<sup>286</sup> As discussed above, the

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279 See Final Regulations; Updating Estimated Income Tax Regulations Under Section 6654 (T.D. 9224), 70 Fed. Reg. 52,299 (Sept. 2, 2005), 2005-2 C.B. 688 (adopting regulations updating rules and procedures for estimated income tax payments).

280 See *supra* Part III.A.1.

281 See Final Regulations; Place for Filing (T.D. 9156), 69 Fed. Reg. 55,743 (Sept. 16, 2004), 2004-2 C.B. 669. Treasury also asserted the good cause exception, discussed in Parts III.A.3 and III.B, as an additional basis for bypassing notice and comment.

282 *Id.*

283 Treas. Reg. § 1.6091-2(b) (as amended by Final Regulations; Place for Filing (T.D. 9156), 69 Fed. Reg. 55,743 (Sept. 16, 2004), 2004-2 C.B. 669).

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

285 See Removal of Temporary Regulation; Transitional Rule for Vested Accrued Vacation Pay (T.D. 9138), 69 Fed. Reg. 42,559, 42,560 (July 16, 2004), 2004-2 C.B. 160; Final Regulations; Confidential Transactions (T.D. 9108), 68 Fed. Reg. 75,128, 75,129 (Dec. 30, 2003), 2004-1 C.B. 429, 430; Final Regulations; Information Statements for Certain Substitute Payments (T.D. 9103), 68 Fed. Reg. 74,847, 74,848 (Dec. 29, 2003), 2004-1 C.B. 306, 306; Removal of Final Regulations; Installment Payments (T.D. 9096), 68 Fed. Reg. 67,595, 67,595 (Dec. 3, 2003), 2003-2 C.B. 1222, 1222; Final Rule; Amendment of 26 C.F.R. 301.6103(n)-1 to Incorporate Taxpayer Browsing Protection Act (T.D. 9044), 68 Fed. Reg. 11,739, 11,740 (Mar. 12, 2003), 2003-1 C.B. 690, 691.

286 See Final Regulations; Low-Income Housing Credit Allocation and Certification (T.D. 9228), 70 Fed. Reg. 67,355, 67,355 (Nov. 7, 2005), 2005-2 C.B. 972, 973; Final

interpretative rule exception does not apply to excuse Treasury's decision not to pursue notice-and-comment rulemaking. The procedural rule exception may apply to excuse a few more projects, such as T.D. 9228, which allows taxpayers eligible for the low-income housing credit to file a required form once every fifteen years rather than yearly.<sup>287</sup> For many of these projects, however, the procedural rule exception clearly will not apply. That leaves good cause as the only exception available to justify Treasury's actions.

Treasury's reliance on the good cause exception in promulgating final regulations without notice and comment raises many of the same issues of form noted above with respect to temporary regulations.<sup>288</sup> Where Treasury did not assert the good cause exception explicitly but merely denied the applicability of APA section 553(b) in conclusory fashion, Treasury ignored the express requirement of APA section 553(b)(B). Where Treasury clearly claimed good cause, Treasury offered only very brief explanations.

In some cases, Treasury's minimalist style seemed appropriate. For example, T.D.s 9174, 9138, and 9096 simply removed Treasury regulations that Congress rendered obsolete when it repealed the related statutes twenty years ago.<sup>289</sup> Treasury explicitly asserted the good cause exception in T.D.s 9138 and 9096, and its explanation in each was brief but to the point: "Because this rule merely removes regulatory provisions made obsolete by statute, prior notice and comment and a delayed effective date are unnecessary and contrary to the public interest."<sup>290</sup> For other projects, however, good cause is more doubtful. For example, in T.D. 9108, Treasury skipped notice and

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Rule; Delay of Effective Date; Exclusions from Gross Income of Foreign Corporations (T.D. 9218), 70 Fed. Reg. 45,529, 45,530 (Aug. 8, 2005), 2005-2 C.B. 503, 504; Final Regulations; Substantial Understatement of Income Tax Liability (T.D. 9174), 70 Fed. Reg. 704, 704 (Jan. 5, 2005), 2005-1 C.B. 629, 629; Final Regulations; Low-Income Housing Credit Allocation Certification; Electronic Filing (T.D. 9112), 69 Fed. Reg. 3826, 3826 (Jan. 27, 2004), 2004-1 C.B. 523, 523; Final Regulations; Earned Income Credit for Taxable Years Beginning After December 31, 1978 (T.D. 9045), 68 Fed. Reg. 10,655, 10,656 (Mar. 6, 2003), 2003-1 C.B. 610, 610.

287 See, e.g., Final Regulations; Low-Income Housing Credit Allocation and Certification; Revisions (T.D. 9228), 70 Fed. Reg. 67,355 (Nov. 7, 2005), 2005-2 C.B. 972.

288 See discussion *supra* Part III.A.3.

289 See Final Regulations; Substantial Understatement of Income Tax Liability (T.D. 9174), 70 Fed. Reg. 704 (Jan. 5, 2005), 2005-1 C.B. 629; Removal of Temporary Regulation, Transitional Rule for Vested Accrued Vacation Pay (T.D. 9138), 69 Fed. Reg. 42,559 (July 16, 2004), 2004-2 C.B. 160; Removal of Final Regulations; Installment Payments (T.D. 9096), 68 Fed. Reg. 67,595 (Dec. 3, 2003), 2003-2 C.B. 1222, 1222.

290 Removal of Temporary Regulation, Transitional Rule for Vested Accrued Vacation Pay (T.D. 9138), 69 Fed. Reg. 42,559, 42,560 (July 16, 2004), 2004-2 C.B. 160;

comment in promulgating final regulations that modified tax shelter reporting regulations by narrowing the definitions that render transactions reportable.<sup>291</sup> Given Treasury's propensity for temporary regulations, it is unclear why they issued these amendments in final form. T.D. 9108 solicited comments regarding the impact of the amendments and offered to hold a public hearing if affected parties expressed sufficient interest.<sup>292</sup> The amendments offered some relief from the burden of the existing regulations, so they were likely popular among regulated parties. Nevertheless, Treasury could face a challenge from someone facing an enforcement action whose burden was not relieved and who could assert that the amendments thus did not go far enough.

In sum, most of the projects in which Treasury issued final regulations without the benefit of notice and comment seem to be good candidates for either the procedural rule exception or the good cause exception. A few of these projects, such as T.D. 9108, may raise issues, and Treasury's form (or lack thereof) in invoking the good cause exception either explicitly or implicitly may be problematic, even if the circumstances otherwise render that exception appropriate. Nevertheless, Treasury's utilization of temporary regulations remains a much bigger problem than Treasury's failure to undergo notice-and-comment rulemaking altogether.

### C. *Corrective Amendments (or Good Cause III)*

Finally, one more implicit and questionable use of the good cause exception arises with respect to Treasury's issuance of corrective amendments. This was not an item that I set out to track in the study, but rather one that I occasionally observed that merits mentioning.

Ordinarily, an agency cannot change a legislative regulation promulgated through notice and comment without pursuing a new notice-and-comment rulemaking for the changes.<sup>293</sup> It is not unusual for agencies to issue corrective amendments to final regulations with-

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Removal of Final Regulations; Installment Payments (T.D. 9096), 68 Fed. Reg. 67,595, 67,595 (Dec. 3, 2003), 2003-2 C.B. 1222.

<sup>291</sup> See Final Regulations; Confidential Transactions (T.D. 9108), 68 Fed. Reg. 75,128 (Dec. 30, 2003), 2004-1 C.B. 429.

<sup>292</sup> *Id.*

<sup>293</sup> See, e.g., *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109-10 (D.C. Cir. 1993); *Nat'l Family Planning & Reprod. Health Ass'n v. Sullivan*, 979 F.2d 227, 235 (D.C. Cir. 1992); *Homemakers N. Shore, Inc. v. Bowen*, 832 F.2d 408, 412 (7th Cir. 1987); see also Asimow, *supra* note 138, at 396 nn. 72-74 (citing additional cases).



out notice and comment, however.<sup>294</sup> Such amendments frequently correct typographical errors, and thus clearly fall within the scope of the “unnecessary” prong of the good cause exception.<sup>295</sup> Most of Treasury’s corrective amendments clearly fall into this category, correcting obvious minor grammatical or cross-referencing errors<sup>296</sup> or making other non-substantive language adjustments.<sup>297</sup> Whether or not the agency explicitly makes a finding of good cause in issuing a corrective amendment, it seems highly improbable either that anyone would challenge such fixes, let alone that a reviewing court would give credence to such a challenge.

Where so-called technical or corrective amendments affected substantive changes in the applicability of final regulations and changed the responsibilities or obligations of regulated parties, the courts have been much less willing to allow the agency to make changes without notice-and-comment rulemaking. For example, in *Utility Solid Waste Activities Group v. EPA*, the agency issued a “minor technical amendment[ ]” replacing one unit of measure with another in a regulatory provision to correct what was described as a word processing error.<sup>298</sup>

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294 See, e.g., Final Rule: Clarifying and Corrective Amendments; Licenses for Industrial Radiography and Radiation Safety Requirements for Industrial Radiographic Operations, 63 Fed. Reg. 37,059 (Jul. 9, 1998) (codified at 10 C.F.R. pt. 34) (amending earlier final NRC regulations); Correcting Amendments; Emergency Alert System Correcting Amendments, 67 Fed. Reg. 77,174 (Dec. 17, 2002) (codified at 47 C.F.R. pt. 11) (amending earlier FCC regulations).

295 See, e.g., *Xin-Chang Zhang v. Slattery*, 55 F.3d 732, 746–47 (2d Cir. 1995); *N. Arapahoe Tribe v. Hodel*, 808 F.2d 741, 751 (10th Cir. 1987); S. REP. NO. 79-752, at 14 (1945).

296 See, e.g., Correction to Final Regulations; Value of Life Insurance Contracts When Distributed from a Qualified Retirement Plan, 70 Fed. Reg. 57,750 (Oct. 4, 2005) (codified at 26 C.F.R. pt. 1) (replacing preamble reference to “§1.79-(d)” with “§1.79-1(d)"); Correcting Amendment; Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes, 70 Fed. Reg. 32,489 (June 3, 2005) (codified at 26 C.F.R. pts. 1, 301) (replacing “election filed” with “election is filed” in Temp. Treas. Reg. § 1.935-1T(e)(1)(ii) and “(c)(4)(B)” with “(c)(4)(i)(B)” in Temp. Treas. Reg. § 1.937-1T(c)(4)(ii)(B), among other changes).

297 See, e.g., Correction to Final Regulations; Sickness or Accidental Disability Payments; Correction, 71 Fed. Reg. 4042 (Jan. 25, 2006) (codified at 26 C.F.R. pts. 31–32) (replacing preamble language “for Federal Insurance Contributions Act (FICA) purposes payments made on” with “for FICA purposes payment made on” and “[t]he Service has” with “[t]he IRS has”); Correction to Final Regulations; Tax Shelter Regulations (T.D. 9046), 68 Fed. Reg. 15,942 (Apr. 2, 2003), 2003-1 C.B. 614 (replacing old OMB numbers with new OMB numbers); Correction to Final Regulations; Guidance Necessary To Facilitate Electronic Tax Administration (T.D. 9040), 68 Fed. Reg. 24,644 (May 8, 2003), 2003-1 C.B. 568 (correcting error in published RIN number).

298 *Util. Solid Waste Activities Group v. EPA*, 236 F.3d 749, 752 (D.C. Cir. 2001).

Because the change altered the obligations of regulated parties, the court refused to allow it to be made without notice and comment, notwithstanding the agency's assertion of typographical error.<sup>299</sup>

Some of Treasury's correcting amendments to T.D.s appear arguably to be more than nonsubstantive changes. For example, an amendment to T.D. 9083 regarding golden parachute payments changed language in Treasury Regulation § 1.280G-1, A-11 defining "payment in the nature of compensation" as including the right "to receive cash, or a transfer of property" to include instead the right "to receive cash (including the value of accelerated vesting under Q/A-24(c)), or a transfer of property."<sup>300</sup> Another amendment to T.D. 9194, concerning U.S. taxation of residents of the U.S. Virgin Islands, altered the expression of a formula in a regulatory example.<sup>301</sup>

Neither of these changes seems as pivotal as the one in *Utility Solid Waste Activities Group*. Most likely, such corrections will never face legal challenge. Nevertheless, it is difficult to characterize either of these changes as either wholly non-substantive or merely fixing obvious typographical errors.

#### D. *The Harmless Error Rule*

The APA offers one more provision that might operate to excuse at least some of Treasury's failures to adhere to the procedural requirements of APA section 553. Recognizing that "[n]o administrative agency is perfect,"<sup>302</sup> APA section 706 instructs courts reviewing agency action to take "due account . . . of the rule of prejudicial error."<sup>303</sup> The courts occasionally employ this "harmless error" rule to excuse deviations from APA rulemaking requirements.<sup>304</sup>

Absent good cause or some other APA section 553(b) exception, the harmless error rule will not save the regulations from those projects in which Treasury skips notice and comment altogether. The notice-and-comment requirements are the very heart of APA section 553. Thus, several circuits hold an agency's "failure to provide notice and comment [to be] harmless only where the agency's mistake

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299 *Id.* at 753.

300 Correction to Final Regulations; Golden Parachute Payments; Correction, 68 Fed. Reg. 59,114 (Oct. 14, 2003) (codified at 26 C.F.R. pt.1).

301 Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes; Corrections, 70 Fed. Reg. 32,489 (June 3, 2005) (codified at 26 C.F.R. pts. 1, 301).

302 JAMES T. O'REILLY, ADMINISTRATIVE RULEMAKING § 16.04, at 316 (1983).

303 5 U.S.C. § 706 (2000).

304 *See, e.g.,* Riverbend Farms, Inc. v. Madigan, 958 F.2d 1479, 1487 (9th Cir. 1992).

clearly had no bearing on the procedure used or the substance of decision reached.”<sup>305</sup> The D.C. Circuit follows a rule that “an utter failure to comply with notice and comment cannot be considered harmless if there is any uncertainty at all as to the effect of that failure.”<sup>306</sup> Under such circumstances, the degree of uncertainty required to defeat an agency’s harmless error claim is not great.<sup>307</sup> It is simply too difficult to prove that pursuing the notice-and-comment process would have made absolutely no difference. Even where agencies can demonstrate that interested parties have been given the opportunity to present their concerns in other ways, the courts generally have been reluctant to excuse agencies from APA notice and comment.<sup>308</sup>

Treasury’s extensive reliance on temporary regulations with only post-promulgation notice and comment is not much more likely to represent harmless error. The courts have not looked favorably upon agency use of temporary or interim final rulemaking.<sup>309</sup> The point of the APA’s notice-and-comment rulemaking requirements is “to assure

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305 *City of Sausalito v. O’Neill*, 386 F.3d 1186, 1220 (9th Cir. 2004) (discussing different standards for different kinds of agency procedural errors); *see also* *Silverton Snowmobile Club v. U.S. Forest Serv.*, 433 F.3d 772, 786 n.6 (10th Cir. 2006) (articulating the same standard for failure to provide notice and comment); *Paulsen v. Daniels*, 413 F.3d 999, 1006 (9th Cir. 2005) (quoting *Riverbend Farms*, 958 F.2d at 1487) (applying the same standard); *Conservation Law Found. v. Evans*, 360 F.3d 21, 29 (1st Cir. 2004) (same).

306 *Chamber of Commerce v. SEC*, 443 F.3d 890, 904 (D.C. Cir. 2006) (quoting *Sugar Cane Growers Coop. v. Veneman*, 289 F.3d 89, 96 (D.C. Cir. 2002)); *Sprint Corp. v. FCC*, 315 F.3d 369, 376 (D.C. Cir. 2003) (quoting *Sugar Cane Growers Coop.*, 289 F.3d at 96).

307 *See, e.g., Chamber of Commerce*, 443 F.3d at 904 (noting that “[t]he court has not required a particularly robust showing of prejudice in notice-and-comment cases”); *Sugar Cane Growers Coop.*, 289 F.3d at 97 (stating that the appellants need not articulate considerations they would have raised in a comment procedure to demonstrate prejudice); *McLouth Steel Prods. Corp. v. Thomas*, 838 F.2d 1317, 1324 (D.C. Cir. 1988) (“Even if the challenger presents no bases for invalidating the rule on substantive grounds, we cannot say with certainty whether petitioner’s comments would have had some effect if they had been considered when the issue was open.”). The courts occasionally have found an agency’s failure to pursue notice and comment to be harmless, but typically in circumstances that do not at all resemble Treasury regulation promulgation. *See, e.g., Cal-Almond, Inc. v. U.S. Dep’t of Agric.*, 14 F.3d 429, 441–42 (9th Cir. 1993), *abrogated by* 521 U.S. 1113 (1997) (holding failure to pursue APA notice and comment to be harmless error where regulated parties had alternative notice and opportunity to participate and in fact did join weekly meetings to discuss the pending rules).

308 *See Sugar Cane Growers Coop.*, 289 F.3d at 96–97.

309 *See supra* note 125 and accompanying text (citing cases).

fairness and mature consideration of rules of general application<sup>310</sup> and to allow parties who would be “prejudiced by the absence of an opportunity” to “mount a credible challenge”<sup>311</sup> to a proposed rule to have an opportunity to present their case first before the agency.<sup>312</sup> Where an agency has promulgated a legislative rule and cannot claim the good cause exception, the courts have been reluctant to apply the harmless error rule.<sup>313</sup> In those situations where Treasury receives no comments in response to its NPRM, finalizes its regulations without change, and could make its final regulation retroactive in any event, Treasury’s inappropriate utilization of temporary regulations might represent harmless error.<sup>314</sup> Under such circumstances, it is difficult to see how any party could demonstrate prejudice from Treasury’s deviation from APA rulemaking procedures. Nevertheless, as noted above, more often than not, Treasury receives some or even many negative comments when it adopts temporary regulations in conjunction with a NPRM.<sup>315</sup>

Recognizing the potential harm from delays caused by the inefficiencies of the notice-and-comment process, the now-disbanded Administrative Conference of the United States once recommended that leniency for interim final regulations with post-promulgation notice and comment.<sup>316</sup> Another potentially analogous scenario exists where Treasury solicits comments before issuing temporary regulations. For example, with T.D. 9038, Treasury promulgated temporary regulations only after issuing two successive NPRMs and evaluating comments received in response thereto.<sup>317</sup> Those tempo-

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310 *NLRB v. Wyman-Gordon Co.*, 394 U.S. 759, 764 (1969).

311 *Util. Solid Waste Activities Group v. EPA*, 236 F.3d 749, 755 (D.C. Cir. 2001).

312 *See, e.g., id.*; *see also Sagebrush Rebellion, Inc. v. Hodel*, 790 F.2d 760, 765 (9th Cir. 1986) (excusing failure to follow Federal Land Policy and Management Act notice and comment requirements by analogy to APA harmless error rule).

313 *See, e.g., Util. Solid Waste Activities Group*, 236 F.3d at 755.

314 *See supra* notes 47–51 and accompanying text (analyzing Treasury’s authority under I.R.C. § 7805(b) to give its regulations retroactive effect).

315 *See supra* Table 4 and accompanying text.

316 *See* Notice; Administrative Conference of the United States, Adoption of Recommendations, 60 Fed. Reg. 43,108, 43,111 (Aug. 18, 1995).

317 *See* Final and Temporary Regulations; Statutory Mergers and Consolidations (T.D. 9038), 68 Fed. Reg. 3384 (Jan. 24, 2003), 2003-1 C.B. 524; *see also* Notice of Proposed Rulemaking and Notice of Public Hearing; Statutory Mergers and Consolidations, 66 Fed. Reg. 57,400 (Nov. 15, 2001) (announcing proposed regulations to define the term “statutory merger or consolidation”); Notice of Proposed Rulemaking and Notice of Public Hearing; Certain Corporate Reorganizations Involving Disordered Entities, 65 Fed. Reg. 31,115 (proposed May 16, 2000) (announcing proposed regulations to determine whether “certain transactions qualify as corporate reorganization”).

rary regulations were issued without the full benefit of the notice-and-comment process, as Treasury was still reviewing and evaluating comments, did not address all of the significant comments received at that time, and subsequently altered the regulations further both before and upon finalization.<sup>318</sup> Yet the temporary regulations in T.D. 9038 were issued with the benefit of public participation via the earlier two NPRMs.

In some cases, however, the courts of appeals have rejected such an approach on the ground that “[i]t is antithetical to the structure and purpose of the APA for an agency to implement a rule first, and then seek comment later.”<sup>319</sup> The court in *Federal Express Corp. v. Mineta*<sup>320</sup> was more sympathetic. That case involved a series of final rules involving the airline industry, adopted by the Department of Transportation (DOT) without notice and comment, in the aftermath of the 9/11 crisis.<sup>321</sup> The first set of rules was adopted pursuant to the good cause exception, but interested parties were given the opportunity subsequently to submit comments.<sup>322</sup> The agency adopted second, third, and fourth versions of the rules similarly.<sup>323</sup> Regulated parties challenged particularly the third and fourth sets of rules on the ground that they had not been given notice and opportunity for comment prior to finalization.<sup>324</sup> The court agreed that DOT should have pursued notice and comment before finalizing the regulations, but decided not to invalidate the regulations on the ground that DOT gave regulated parties the opportunity to comment before declaring the regulations set in “‘bureaucratic stone.’”<sup>325</sup> Under the circum-

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318 In January 2005, Treasury issued one more NPRM, amending the January 2003 proposed regulations but not Temporary Treasury Regulation § 1.368-2T. *See* Amendment of Previously Proposed Regulations and Notice of Public Hearing; Statutory Mergers and Consolidations, 70 Fed. Reg. 746 (proposed Jan. 5, 2005) (to be codified at 26 C.F.R. pt. 1). Finally, in January 2006, Treasury finalized its temporary and proposed regulations with “certain technical changes” as the new Treasury Regulation § 1.368-2. Final Regulations; Statutory Mergers and Consolidations (T.D. 9242), 71 Fed. Reg. 4259 (Jan. 26, 2006), 2006-7 I.R.B. 422. Because this T.D. was published after 2006, it is not officially part of the study except as the ultimate resolution of the temporary regulations issued with T.D. 9038.

319 *See, e.g.*, *Paulsen v. Daniels*, 413 F.3d 999, 1005 (9th Cir. 2005).

320 373 F.3d 112 (D.C. Cir. 2004).

321 *Id.* at 113–14.

322 *Id.* at 114.

323 *Id.*

324 *Id.* at 115–16.

325 *Id.* at 120 (quoting *Am. Fed’n of Gov’t Employees v. Block*, 655 F.2d 1153, 1157 (D.C. Cir. 1981)).

stances, the court noted that remanding for the agency to take further comments “would serve no useful purpose whatsoever.”<sup>326</sup>

Treasury should not rely upon the harmless error rule to support its habit of failing to follow the notice-and-comment rulemaking procedures of APA section 553. The courts concede harmless error sparingly, and an agency that depends upon such a rule to justify regular noncompliance is playing with fire. Nevertheless, the harmless error rule exists, and Treasury may justifiably invoke it under certain narrow circumstances.

#### *E. Summary*

In summary, the 40.9% of Treasury regulation projects for which Treasury failed to follow the proper notice-and-comment sequence as required by APA section 553 are unlikely to qualify for any of the exceptions from those procedures. Contrary to Treasury’s claim, most if not all Treasury regulations are legislative rather than interpretative rules as modern doctrine interprets those categories for APA purposes. Some Treasury regulations may be procedural rules. For a few others, Treasury may have a colorable argument that good cause existed for disregarding the requirements of APA section 553. Even where the good cause might arguably be present, however, Treasury’s frequent failure to assert the exception explicitly and explain with specificity why it applies may render it inapplicable. Treasury may face similar problems with some of its corrective amendments. The harmless error exception of APA section 706 is unlikely to offer Treasury much, if any, relief. Altogether, therefore, a substantial percentage of the projects studied present APA compliance issues that render the resulting Treasury regulations susceptible to legal challenge on procedural grounds.

#### IV. WHY TREASURY DOES WHAT IT DOES: ONE POSSIBLE EXPLANATION

The APA is the law. The judicial doctrines elaborating the requirements of APA section 553 are fairly settled, even if they permit the courts some flexibility in their application. Treasury knows that the APA applies to its regulatory activities, even if Treasury would like to be able to claim exemption from notice-and-comment rulemaking. Treasury and IRS attorneys enjoy reasonably good reputations among the tax community for their regulatory efforts. My own sense has always been that Treasury and IRS attorneys are conscientious about

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326 *Id.*

doing the best possible job in promulgating Treasury regulations. So why do Treasury's practices deviate so significantly from what is fairly settled doctrine regarding the APA's rulemaking requirements?

This question is more difficult to research. Empirics of the type employed in connection with this Article cannot be utilized to identify a clear answer. To gain some preliminary insight into Treasury's actions, however, I discussed my findings informally with several former Treasury and IRS officials and attorneys and read articles and interviews by others.<sup>327</sup> From these efforts, a story emerged that offers at least one possible explanation for Treasury's practices.

In the decades immediately following the APA's enactment in 1946, significant responsibility for regulation drafting fell to a small group of attorneys in the Legislation and Regulation (L&R) Division of the Office of Chief Counsel of the IRS.<sup>328</sup> The L&R Division may have been influenced by Stanley Surrey, who held the positions of Tax Legislative Counsel and later Assistant Secretary of the Treasury (Tax Policy), and Randolph Paul, who served as General Counsel at Treasury, both of whom wrote articles addressing issues of agency regulatory authority and regulation characterization.<sup>329</sup> For whatever reason, the L&R Division attorneys thought about and actively discussed the APA's rulemaking requirements and whether to characterize particular regulations as legislative, interpretative, or procedural. Congress and Treasury also involved the L&R Division attorneys in drafting tax legislation. Consequently, Congress addressed more issues directly in the I.R.C., the I.R.C. contained fewer specific authority grants, and Treasury premised more regulations solely and legiti-

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327 I would like to thank Brian Camp, Sheldon Cohen, Michael Doran, Fred Goldberg, James Edward Maule, Reginald Mombrun, and Irving Salem for taking the time to answer my questions and offer their thoughts.

328 The L&R Division consisted of forty-five attorneys in 1965, *see* Mitchell Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity: A View from Within*, 43 TAXES 756, 758 n.3 (1965), up to approximately sixty attorneys by the end of the 1980s when the IRS eliminated that office. *See* Fed. Bar Assoc., *Interview with Donald L. Korb, Chief Counsel, IRS*, SEC TAX'N REP., Fall 2005, at 1, 6. At one time, initial drafting of many projects started with non-lawyers in the Technical Planning Division under the Assistant Commissioner (Technical) of the IRS, but initial drafts of regulations so prepared subsequently underwent exhaustive review by the attorneys in the L&R Division. *See* Laurens Williams, *Preparation and Promulgation of Treasury Department Regulations Under Internal Revenue Code of 1954*, in 8 MAJOR TAX PLANNING 733, 748-50 (1956).

329 *See generally* Randolph E. Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, 49 YALE L.J. 660 (1940) (arguing that administrative authority should have "flexible discretion" to promulgate tax regulations, while suggesting a role for courts in reviewing retroactive application of such rules); Surrey, *supra* note 133, at 557-59 (explaining how much weight is to be given to Treasury Regulations).

mately on its general rulemaking authority than is the case today.<sup>330</sup> Finally, as already noted, the 1950s and 1960s were decades of consensus that general authority regulations throughout administrative law were nonbinding and, therefore, interpretative in character.<sup>331</sup> Hence, the position that most Treasury regulations were exempt from APA section 553 rulemaking requirements was both factually accurate and consistent with prevailing legal doctrine.

The evolution of jurisprudence recognizing general authority regulations as legislative was gradual, as was Congress's addition of more and more specific authority grants into the I.R.C.<sup>332</sup> Treasury also first started issuing temporary regulations in the 1970s. At first, Treasury adopted temporary regulations only to provide the procedures for effectuating various congressionally approved taxpayer elections—regulations that potentially fell within the APA's procedural rule exception if not the interpretative rule or good cause exceptions. In the 1980s, however, Congress passed several major tax bills and reorganized the entire I.R.C.<sup>333</sup> As a result, Treasury accumulated a huge backlog of regulatory projects and started experimenting with more substantive temporary regulations to alleviate that burden.<sup>334</sup>

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330 Several of the attorneys with whom I discussed my findings expressed this perception. Yet more than one contemporaneous source noted the existence of 1338 specific authority grants in the 1954 I.R.C., see 1 KENNETH DAVIS, ADMINISTRATIVE LAW TREATISE § 5.04, at 129 (Supp. 1965); Williams, *supra* note 328, at 736, while current estimates of specific authority grants are substantially lower. See N.Y. STATE BAR ASS'N REPORT, *supra* note 38, at 2–6 (claiming and categorizing more than 550 specific authority grants). The discrepancy may arise at least partly from counting individual specific authority grants as opposed to sections containing such specific authority, since some sections include more than one such grant. See *supra* notes 187–89 and accompanying text.

331 See *supra* notes 133–42 and accompanying text (discussing evolution of jurisprudence and APA interpretation).

332 See *id.* But see discussion *supra* note 330 (noting potential discrepancy in numbers of specific authority grants over time).

333 Between 1976 and 1986, Congress enacted six separate pieces of significant tax reform legislation. See Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2810 (codified as amended in scattered sections of 26 U.S.C.); Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (codified as amended in scattered sections of 26 U.S.C.); Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.); Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.); Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (codified as amended in scattered sections of 26 U.S.C.); Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified as amended in scattered sections of 26 U.S.C.).

334 See Asimow, *supra* note 12, at 343 (identifying the 1980s as the time and complex new tax laws as the reason for Treasury's increased use of temporary regulations); Vasquez & Lowy, *supra* note 12, at 252 (same).



Also in the 1980s, the Office of Chief Counsel of the IRS reorganized its operations to group its attorneys by substantive tax area rather than function.<sup>335</sup> In so doing, the IRS eliminated the old L&R Division and dispersed responsibility for regulation drafting across the new substantive groups.<sup>336</sup> Good reasons supported this reorganization. Treasury had curtailed the L&R Division's involvement in drafting tax legislation. L&R Division attorneys were an elite group, but highly specialized in the arcana of drafting legislation and regulations and arguably detached from the realities of tax practice. The IRS needed to accomplish more with fewer employees, and the new organizational structure promised greater efficiency. Also, the IRS sought to attract a better pool of job applicants by offering attorneys the opportunity at a wider range of work in a single substantive area. Nevertheless, when the IRS eliminated the L&R Division, its accumulated institutional knowledge and regulation drafting culture drifted away.<sup>337</sup>

In recent decades, tax lawyers with varying levels of experience with the tax laws, but little knowledge of administrative law, staff Treasury's Offices of Tax Policy and Tax Legislative Counsel and the IRS's Office of Chief Counsel. These lawyers draft Treasury regulations, and in so doing rely heavily on the Internal Revenue Manual's guidance to comply with APA rulemaking requirements. The Internal Revenue Manual, in turn, touches only briefly on various aspects of the APA rulemaking requirements while simultaneously telling these lawyers that the APA's rules rarely apply to them.<sup>338</sup> Further, the Internal Revenue Manual reduces compliance with the APA down to a handful of boilerplate statements observed in most T.D.s and NPRMs.<sup>339</sup> Treasury and IRS attorneys decide whether to issue temporary regulations based on perceived taxpayer demand for guidance with little or no thought of the APA. These attorneys also prefer temporary regulations to less formal guidance formats like revenue rulings and notices because the latter are nonbinding and receive less deference from the courts. APA compliance review is left almost exclusively to the end of the process, when a single attorney in Treasury's Office of General Counsel with expertise in administrative law reviews and approves the regulations.

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335 See Fed. Bar Assoc., *supra* note 328, at 6, 9 (noting Chief Counsel's Office reorganization and elimination of L&R Division in 1980s).

336 See *id.*

337 See *id.*

338 See, e.g., INTERNAL REVENUE MANUAL, *supra* note 6, §§ 32.1.2.3, 32.1.5.4.7.5.1.

339 See *id.* § 32.1.5.4.7.5.1.

In drafting Treasury regulations, Treasury and IRS attorneys value public input, particularly from big firm tax attorneys and organizations like the American Bar Association and New York State Bar Association Tax Sections. Often, however, such feedback comes informally or even unsolicited before regulation drafting begins. The attorneys with whom I spoke whose tenure with the government was more recent did not link public participation in the rulemaking process with the APA notice-and-comment requirements. This contrasts sharply with representations by IRS officials from the 1950s and 1960s, who did relate the two.<sup>340</sup>

In sum, my preliminary hypothesis is that Treasury's inadherence to the APA is not the result of any particular determination to play fast and loose with the rules. Instead, the status quo evolved slowly, with APA noncompliance the unanticipated and unintended consequence of the well-intentioned pursuit of alternative priorities. Future study evaluating this theory, in conjunction with the vast literature discussing bureaucratic incentives and their role in the development of government agencies and their attitudes toward regulation, may offer additional insights into the evolution of Treasury's rulemaking practices.<sup>341</sup>

## V. IMPLICATIONS

Regardless of why Treasury regularly fails to follow APA rulemaking requirements, the implications of that failure are substantial. One obvious consequence is that Treasury regulations promulgated inconsistently with the requirements of APA section 553(b) are susceptible to invalidation by the courts on that basis.<sup>342</sup> Lawsuits tie up resources

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340 See Mortimer M. Caplin, *The Role of the Commissioner*, 1962 MAJOR TAX PLANNING 1, 12 (discussing efforts to solicit input from taxpayers and tax professionals); Williams, *supra* note 328, at 753 (describing APA notice and comment as "one of the most important parts of the whole [regulatory] process").

341 See generally ANTHONY DOWNS, *INSIDE BUREAUCRACY* (1967); WILLIAM A. NISKANEN, JR., *BUREAUCRACY AND PUBLIC ECONOMICS* 36-42 (1994); Daryl J. Levinson, *Empire-Building Government in Constitutional Law*, 118 HARV. L. REV. 915, 923-37 (2005); David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 GEO. L.J. 97, 106-41 (2000).

342 See, e.g., *Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979) ("Certainly regulations subject to the APA cannot be afforded the 'force and effect of law' if not promulgated pursuant to the statutory procedural minimum found in that Act."); *Paulsen v. Daniels*, 413 F.3d 999, 1008 (9th Cir. 2005) ("Ordinarily when a regulation is not promulgated in compliance with the APA, the regulation is invalid." (quoting *Idaho Farm Bureau Fed'n v. Babbitt*, 58 F.3d 1392, 1405 (9th Cir. 1995))); *Alaska v. U.S. Dep't of Transp.*, 868 F.2d 441, 445 (D.C. Cir. 1989) (invalidating rules for lack of notice and comment); *Buschmann v. Schweiker*, 676 F.2d 352, 355-56 (9th Cir.

that could be better used in other, more productive ways, and if taxpayers succeed in persuading courts to invalidate Treasury regulations for procedural reasons, Treasury and the IRS will be forced to expend even further resources re-promulgating existing regulations rather than addressing newer issues.

Historically, taxpayers have not often challenged Treasury regulations on procedural grounds. Most members of the tax community believe that Treasury does a decent job in drafting regulations and instead focus their grumbling on issues where guidance is lacking. Perhaps all is well with the tax system, and enforcing APA notice-and-comment rulemaking requirements through the courts is unnecessary.

I am skeptical that this is the case, however. Several alternative explanations exist for why taxpayers do not challenge Treasury regulations on procedural grounds more frequently. In my own experience, members of the tax community tend to know little about administrative law doctrine or the intricacies of APA section 553, so they accept at face value Treasury's representation that most of its regulations are interpretative and exempt from APA rulemaking requirements. Standing and sovereign immunity issues may discourage pre-enforcement challenges of Treasury regulations.<sup>343</sup> Remedy limitations may deter litigants in tax cases from bothering with APA challenges.<sup>344</sup>

Nevertheless, Treasury may not always escape such challenges. In other areas of administrative law, regulated parties are quick to contest regulations on procedural grounds. The fact that notice-and-comment rulemaking procedures are legally required and that Treasury faces potential consequences for not following the law should be reason enough for Treasury to alter its practices.

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1982) ("A regulation is invalid if the agency fails to follow procedures required by the Administrative Procedures [sic] Act, 5 U.S.C. § 553.")

343 See, e.g., I.R.C. § 7421(a) (2000) (precluding the courts from enjoining the assessment and collection of taxes).

344 For example, interpretations of law advanced in Treasury regulations receive substantial deference from the courts; but the courts defer to interpretations articulated in less formal formats such as revenue rulings as well. See generally Coverdale, *supra* note 12, at 72–92 (discussing judicial deference to Treasury regulations); Hickman, *supra* note 136, at 1564–72 (same); Salem et al., *supra* note 43, at 759–76 (same). In post-enforcement litigation, a reviewing court that invalidated a Treasury regulation on procedural grounds would still need to resolve the matter before it, including determining the taxpayer's liability for taxes due. Under such circumstances, would the reviewing court still defer to the invalidated regulation, just under a lesser standard? Would such an outcome provide sufficient incentive for the taxpayer to expend the time and money to litigate the procedural issue?

Depending upon one's reading of I.R.C. § 7805(b), one might argue, too, that tax should be different from other areas of administrative law because Congress allows Treasury tremendous discretion in applying Treasury regulations retroactively, and making a regulation retroactively applicable to the date the NPRM is issued is not too different from issuing a binding temporary regulation before receiving and considering public comments in finalizing that regulation.<sup>345</sup> There are qualitative differences between the two approaches, however.

First, taxpayers and their representatives may be discouraged from making comments by the comparative finality of temporary regulations as opposed to regulations that are merely proposed. Drawing from cognitive psychology literature, Stephanie Stern has suggested that the APA's notice-and-comment process itself reduces public participation in agency rulemaking by prematurely committing agency officials to a single set of proposed rules and increasing perceptions of agency bias in favor of one approach to a particular problem.<sup>346</sup> Assuming that Stern's hypothesis is correct, it is reasonable to infer that deferring notice and comment until after Treasury publishes binding temporary regulations would only exacerbate this phenomenon. In fact, the Administrative Conference of the United States expressed precisely this concern about the practice of interim final regulations, particularly in the absence of good cause, to discourage agency utilization of that model.<sup>347</sup>

Second, the evolution of a few of the projects evaluated in the study suggests that Treasury's use of temporary regulations may yield worse results than if Treasury followed the APA. In response to the Court's 2001 opinion in *United Dominion*,<sup>348</sup> Treasury started its rulemaking process in September 2003 with T.D. 9089 and a full set of temporary regulations governing the application of I.R.C. § 108 in the consolidated group context.<sup>349</sup> T.D. 9089 was accompanied by an

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345 See *supra* notes 47–51 and accompanying text (analyzing Treasury's authority under I.R.C. § 7805(b)).

346 Stephanie Stern, *Cognitive Consistency: Theory Maintenance and Administrative Rulemaking*, 63 U. PITT. L. REV. 589, 620–30 (2002).

347 Notice; Administrative Conference of the United States, Adoption of Recommendations, 60 Fed. Reg. 43,108, 43,111–12 (Aug. 18, 1995) (providing recommendations from the fifty-second plenary session of the Administrative Conference of the United States).

348 *United Dominion Industries, Inc. v. United States*, 532 U.S. 822 (2001).

349 See Temporary Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9089), 68 Fed. Reg. 52,487 (Sept. 4, 2003), 2003-2 C.B. 906.

NPRM seeking public comment in response to these regulations,<sup>350</sup> but Treasury asserted the need for immediate guidance as good cause for issuing binding temporary regulations.<sup>351</sup> Three months later, in December 2003, based on comments received, Treasury amended these temporary regulations with T.D. 9098 and made the amendments effective retroactively to the same date as the temporary regulations issued in T.D. 9089.<sup>352</sup> Again, Treasury invoked the good cause exception based on the need for immediate guidance.<sup>353</sup> After another three months, in March 2004, Treasury issued T.D. 9117, again amending the temporary regulations first published with T.D. 9089, and claimed the need for immediate guidance yet again as justifying its lack of prior notice.<sup>354</sup> Finally, in March 2005, Treasury issued T.D. 9192, revising and finalizing the *United Dominion* regulations and removing all of the earlier temporary regulations. In short, in the eighteen months that it took Treasury to finalize these regulations, taxpayers to whom they applied were forced to deal with four different sets of regulations. Taxpayers who failed to adhere to these temporary regulations would be subject to penalties under I.R.C. § 6662.

Though it hardly seems possible, Treasury's reaction to the *Rite Aid* case may have been even less conducive to considered rulemaking and meaningful participation. The Federal Circuit invalidated the loss disallowance rules of Treasury Regulation § 1.1502-20 in October 2001.<sup>355</sup> In a notice issued just four months later, Treasury acquiesced to this decision and notified taxpayers of its intention to issue temporary regulations with a different methodology.<sup>356</sup> Shortly thereafter, in March 2002, Treasury issued the first set of temporary and proposed regulations inspired by *Rite Aid*.<sup>357</sup> Over the next three years,

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350 See Notice of Proposed Rulemaking; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group, 68 Fed. Reg. 52,542 (Sept. 4, 2003) (to be codified at 26 C.F.R. §§ 1.1502-19, -21, -28, -32).

351 Temporary Regulations (T.D. 9089), 68 Fed. Reg. 52,487.

352 See Temporary Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9098), 68 Fed. Reg. 69,024 (Dec. 11, 2003), 2003-2 C.B. 1248.

353 *Id.*

354 Final Regulations and Removal of Temporary Regulations; Return of Partnership Income (T.D. 9117), 69 Fed. Reg. 12,069 (Mar. 15, 2004), 2004-1 C.B. 721, 723-24.

355 See *Rite Aid Corp. v. United States*, 255 F.3d 1357, 1360 (Fed. Cir. 2001).

356 See I.R.S. Notice 2002-11, 2002-1 C.B. 526.

357 See Final and Temporary Regulations; Loss Limitation Rules (T.D. 8984), 67 Fed. Reg. 11,034 (Mar. 12, 2002), 2002-1 C.B. 668; Notice of Proposed Rulemaking and Notice of Public Hearing; Loss Limitation Rules, 67 Fed. Reg. 11,070 (Mar. 12,

Treasury adopted five more sets of temporary regulations dealing with *Rite Aid* issues before promulgating final regulations in March 2005.<sup>358</sup> Each successive T.D. addressed one or more sub-issues as they arose over the course of Treasury's evaluation of its new approach, sometimes revising earlier T.D.s and sometimes not; yet whereas the T.D.s addressing the *United Dominion* issue at least cross-referenced one another, those with respect to the *Rite Aid* problem did not, making it even more difficult for interested parties to track let alone comply with Treasury's actions.<sup>359</sup> All of these T.D.s invoked the good cause exception from pre-promulgation notice and comment based on the need for immediate guidance.

Whether or not Treasury's use of temporary regulations chilled public participation in these rulemaking efforts, the piecemeal development of the *United Dominion* and *Rite Aid* regulations is wholly inconsistent with the APA's goal of a careful and considered rulemaking process with meaningful public participation. Moreover, the

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2002); *see also* I.R.S. Notice 2002-18, 2002-1 C.B. 644 (announcing temporary and proposed regulations while also soliciting public comment).

358 *See* Final and Temporary Regulations; Loss Limitation Rules (T.D. 9187), 70 Fed. Reg. 10,319 (Mar. 3, 2005), 2005-1 C.B. 778; Temporary Regulations; Guidance Under Section 1502; Treatment of Loss Carryovers From Separate Return Limitation Years (T.D. 9155), 69 Fed. Reg. 51,175 (Aug. 18, 2004), 2004-2 C.B. 562; Temporary Regulations; Extension of Time To Elect Method for Determining Allowable Loss (T.D. 9154), 69 Fed. Reg. 52,419 (Aug. 26, 2004), 2004-2 C.B. 560; Final and Temporary Regulations; Loss Limitation Rules (T.D. 9118), 69 Fed. Reg. 12,799 (Mar. 18, 2004), 2004-1 C.B. 718; Temporary Regulations; Guidance Under Section 1502; Amendment of Waiver of Loss Carryovers From Separate Return Limitation Years (T.D. 9057), 68 Fed. Reg. 24,351 (May 7, 2003), 2003-1 C.B. 964; Final and Temporary Regulations; Guidance Under Section 1502; Suspension of Losses on Certain Stock Dispositions (T.D. 9048), 68 Fed. Reg. 12,287 (Mar. 14, 2003), 2003-1 C.B. 645.

359 *Compare* Final Regulations; Temporary Regulations, and Removal of Temporary Regulations, Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9192), 70 Fed. Reg. 14,395, 14,395-96 (Mar. 22, 2005) (summarizing project background including cross-reference to earlier T.D.s), *and* Temporary and Final Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9117), 69 Fed. Reg. 12,069, 12,069 (Mar. 15, 2004), 2004-1 C.B. 721 (same), *and* Temporary Regulations; Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group (T.D. 9098), 68 Fed. Reg. 69,024, 69,024 (Dec. 11, 2003), 2003-2 C.B. 1248 (same), *with* Temporary Regulations; Guidance Under Section 1502; Treatment of Loss Carryovers from Separate Return Limitation Years (T.D. 9155), 69 Fed. Reg. 51,175, 51,175-76 (Aug. 18, 2004) (modifying temporary regulation adopted with T.D. 9048, but not mentioning T.D. 9048), *and* Temporary Regulations; Extension of Time To Elect Method for Determining Allowable Loss (T.D. 9154), 69 Fed. Reg. 52,419, 52,420-21 (Aug. 26, 2004) (modifying temporary regulations adopted with T.D. 9057, but not mentioning T.D. 9057).

uncertainty created by multiple versions of legally binding temporary regulations issued in a short time frame contradicts Treasury's own stated goal of providing meaningful taxpayer guidance.

Treasury regulations are not the only means by which Treasury and the IRS can provide taxpayers with substantive guidance. The IRS can issue revenue rulings to offer its interpretation of the I.R.C., Treasury regulations, and case law as applied to hypothetical fact patterns.<sup>360</sup> Treasury can issue notices to articulate its interpretations and policies on a variety of issues.<sup>361</sup> In fact, Treasury has at times in the past utilized notices to offer draft rules and authorize taxpayers to rely upon them while awaiting formal proposed and final regulations.<sup>362</sup> In Notice 2003-12, for example, Treasury issued detailed guidelines concerning the utilization of the nonaccrual-experience method of accounting by accrual basis taxpayers under I.R.C. § 448(d)(5).<sup>363</sup> Treasury used the notice essentially as an advanced notice of public rulemaking, requesting comments on the guidelines offered and using those guidelines as a basis for proposed regulations offered in an NPRM issued later that year.<sup>364</sup> In so doing, however, Treasury also provided taxpayers with guidance and at least temporary certainty in their efforts to comply with the tax laws.

Revenue rulings and notices are not legally binding on taxpayers in the same way as final or even temporary regulations.<sup>365</sup> Hence, it is

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360 See INTERNAL REVENUE MANUAL, *supra* note 6, § 32.2.2.3.1 (defining revenue ruling).

361 See *id.* § 32.2.2.3.3 (defining notice). For example, in I.R.S. Notice 2000-29, 2000-1 C.B. 1241, the IRS requested public comments.

362 See, e.g., I.R.S. Notice 2003-12, 2003-1 C.B. 422 (offering detailed guidelines concerning the nonaccrual experience method of accounting). The guidelines issued in Notice 2003-12 were superseded by temporary Treasury regulations promulgated in T.D. 9090, issued simultaneously with an NPRM. See Temporary Regulations; Limitation on Use of the Nonaccrual-Experience Method of Accounting Under Section 448(d)(5) (T.D. 9090), 68 Fed. Reg. 52,496, 52,497 (Sept. 4, 2003), 2003-2 C.B. 891.

363 I.R.S. Notice 2003-12, 2003-1 C.B. 422.

364 See Notice of Proposed Rulemaking; Limitation on Use of the Nonaccrual-Experience Method of Accounting Under Section 448(d)(5), 68 Fed. Reg. 52,543 (proposed Sept. 4, 2003) (to be codified at 26 C.F.R. pt. 1). Notably, however, these proposed regulations were simultaneously adopted as temporary Treasury regulations, raising several issues discussed in this Article. See Temporary Regulations (T.D. 9090), 68 Fed. Reg. at 52,497.

365 See INTERNAL REVENUE MANUAL, *supra* note 6, § 32.2.2.10. A ten percent underpayment penalty may still apply to taxpayers who disregard notices and revenue rulings, but under a significantly more lenient standard than applies to Treasury regulations. See Treas. Reg. § 1.6662-3(b)(1) (as amended in 2003). A taxpayer who disregards a revenue ruling or notice in preparing its tax return will not be penalized for

generally accepted that they are not subject to notice-and-comment rulemaking.<sup>366</sup> Nevertheless, most taxpayers are inclined to adhere even to informal IRS interpretations of the law rather than risk an enforcement action. Accordingly these formats serve Treasury's oft-expressed purpose of providing immediate guidance to taxpayers. To the extent that Treasury believes necessary, I.R.C. § 7805(b)(1)(B) arguably allows Treasury to make final regulations retroactively applicable to the date they were proposed in the Federal Register.<sup>367</sup> Finally, if Treasury has a bona fide concern about tax arbitrage potential while final regulations are pending, the good cause exception is still available—with the requisite contemporaneous articulation of the basis for claiming good cause.

Finally, adhering to procedural requirements serves loftier democratic goals as well. Agencies are a necessary component of modern governance. In a society that relies as heavily as ours on federal governmental action, Congress simply lacks the resources to do the job alone. Hence, Congress has no choice but to delegate substantial responsibility to agencies like Treasury and the IRS, but congressional reliance on the regulatory apparatus comes at a price. Agencies enjoy great discretion over the statutes that they administer. As noted above, scholars debate over the motivations and incentives that guide agency behavior.<sup>368</sup> Yet relative to Congress, though not to the courts, agencies lack political accountability and thus democratic legitimacy.

APA rulemaking requirements, combined with judicial review, are part of an effort to gain the benefits of agency manpower and expertise yet guard against the worst elements of agency behavior. Procedural requirements are perhaps most important when agencies act to dictate or restrict the actions of regulated parties with the force and effect of law, as through binding regulations. Legislative regulations are practically indistinguishable from the statutes under which they are promulgated, yet they are not derived from the same legisla-

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doing so "if the contrary position has a realistic possibility of being sustained on its merits." *Id.* § 1.6662-3(b)(2). By contrast, a taxpayer filing a return inconsistent with a Treasury regulation must not only satisfy that threshold but must also file a special form with the return disclosing the contrary position taken in the return in order to avoid the underpayment penalty. *See Id.* § 1.6662-3(c).

366 *See, e.g.,* Linda Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 OHIO ST. L.J. 1037, 1044–45 (1995); Dale F. Rubin, *Private Letter and Revenue Rulings: Remedy or Ruse?*, 28 N. KY. L. REV. 50, 52 (2001).

367 I.R.C. § 7805(b)(1)(B) (2000); *see also supra* notes 47–52 and accompanying text (discussing authority under the I.R.C. for retroactive application of Treasury regulations).

368 *See supra* note 341 and accompanying text (noting just a few representative pieces of this vast literature).



tive process as statutes. Instead, the notice-and-comment procedures imposed by the APA on such regulations, with their emphasis on public participation, are an important if imperfect proxy for a more democratic legislative process.

Judicial review serves to enforce adherence to these procedures and guard against arbitrary and capricious agency action.<sup>369</sup> Doctrines of judicial deference toward agency findings of fact and legal interpretations at least theoretically preclude judges from intruding too heavily into policy choices that agencies are better equipped (or at least congressionally preferred) to make. But heavy judicial scrutiny of agency adherence to APA procedural requirements ensures that procedures designed to at least approximate the legislative process function as intended. Judges accomplish the greatest good in policing agency action by emphasizing adherence to procedural requirements while de-emphasizing the "rightness" or "wrongness" of agency policy choices.

It is axiomatic that federal government agencies are bound to follow the laws that govern them. Among government agencies, however, Treasury and the IRS ought to be particularly sensitive to the importance of adhering to the APA's rules. Many taxpayers regard the federal tax laws and the government's administration thereof with skepticism, suspicion, and even disdain. Under such circumstances, one would expect Treasury and the IRS to seek the legitimacy conferred by the APA's notice-and-comment rulemaking process. There is a huge demand for guidance from Treasury regarding the proper interpretation of the tax laws; but taxpayer demand alone cannot justify Treasury's failure to follow the APA in issuing legally binding regulations.

#### CONCLUSION

In promulgating regulations interpreting the I.R.C., Treasury does a poor job of following the APA's procedural requirements. Treasury's regular use of temporary regulations and occasional promulgation of final regulations without notice and comment is inconsistent with the default requirements of APA section 553. Although the procedural rule exception may apply to excuse some such failures, Treasury's position regarding the interpretative nature of most of its regulations is untenable, and its occasional invocations of the good

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369 See, e.g., *Chrysler Corp. v. Brown*, 441 U.S. 281, 313 (1979) (emphasizing the courts' role in "ensuring that agencies comply with the 'outline of minimum essential rights and procedures' set out in the APA" (quoting H.R. REP. NO. 79-1980, at 16 (1946))).

cause exception are often inappropriate and generally insufficiently justified to survive judicial review. Treasury's lapses in this area are too routine and significant to constitute harmless error.

In making these findings, I do not mean to suggest that Treasury and the IRS are intentionally manipulating the rules to accomplish nefarious ends. Even assuming the best of intentions, however, Treasury's practices at least contradict the democratic impulses driving the APA and may lead to less effective guidance. Even where strict adherence would not change the outcome, however, Treasury's lack of adherence to APA rulemaking procedures renders its regulations susceptible to judicial invalidation on procedural grounds and puts Treasury in the position of demanding that taxpayers follow the law while declining to do so itself. Treasury has been fortunate thus far to avoid widespread legal challenges for its failure to adhere to APA rulemaking requirements. Treasury may not always be so lucky.

