[**Author's Note:** This draft is very much a work in progress, documenting preliminary results of an ongoing empirical study, with only initial thoughts regarding conclusions and implications. Suggestions for further development are most welcome.]

Treasury's Retroactivity

by Kristin E. Hickman[*]

Most government agencies have only limited ability to impose their interpretations of law upon regulated parties retroactively.[1] By comparison, in Internal Revenue Code (IRC) § 7805(b), Congress has explicitly given Treasury broad authority to adopt retroactively applicable regulations.[2] Taxpayers in recent years have often complained about Treasury and the IRS changing the rules in the middle of the game, so to speak, by exercising this power to adopt retroactively effective rules and regulations.[3] This complaint has surfaced principally—though not exclusively— in the context of so-called "fighting regs," where Treasury and the IRS adopt regulations or informal guidance documents in response to and during the pendency of litigation with the supposed goal of influencing case outcomes through judicial deference doctrine.[4]

For example, retroactive Treasury regulations were at the heart of litigation leading up to the Supreme Court's 2012 decision in *United States v. Home Concrete & Supply, LLC* concerning the validity of Treas. Reg. § 301.6501(e)-1.[5] Those regulations interpreted IRC § 6501, which generally requires the IRS to assess a tax deficiency within three years after a taxpayer files its return.[6] IRC § 6501(e)(1)(A) in turn extends that limitations period from three to six years "[i]f the taxpayer omits from gross income an amount properly includible therein" and certain other requirements are met.[7] The statutory question at issue in *Home Concrete* was whether an overstatement of asset basis, and the corresponding understatement of gain on the disposition of that asset, represented an omission of an amount from gross income that extended the limitations period for assessing a deficiency from three to six years. The United States Tax Court and two federal circuit courts had rejected IRS litigating positions that the six-year limitations period of IRC § 6501(e)(1)(A) extended to basis overstatements on the ground that the Supreme Court's decision in *Colony, Inc. v. Comm'r*[8] had rejected that interpretation.[9] In

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[1] *See* Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988) (rejecting retroactive rulemaking by agencies absent express congressional authorization).

[2] I.R.C. § 7805(b) (2012).

[3] Examples from Home Concrete literature; others?

[4] *E.g.*, Leandra Lederman, *The Fight Over "Fighting Regs" and Judicial Review in Tax Litigation*, 92 B.U. L. Rev. 643 (2012).

[5] 132 S. Ct. 1836 (2012).

[6] IRC § 6501(a).

[7] IRC § 6501(e)(1)(A).

[8] 357 U.S. 28 (1958).

response, Treasury issued temporary and proposed regulations in 2009[10] and final regulations in 2010[11] providing that basis overstatements constitute omissions from gross income under IRC § 6501(e)(1)(A).[12] Consistent with its authority under IRC § 7805(b), Treasury made its final regulation retroactively effective "to taxable years with respect to which the period for assessing tax was open on or after September 24, 2009," the publication date of the temporary regulation.[13] In practical effect, the regulations' effective date meant that thousands of taxpayers who thought their returns were no longer subject to examination and revision by the IRS found that not to be the case. Although the briefs in *Home Concrete* complained about and debated at some length the regulations' retroactive effect,[14] with the government claiming that the regulations merely "clarified rather than changed existing law,"[15] the Supreme Court invalidated the regulations without discussing that issue.[16]

More recently, on September 22, 2014, the IRS again courted controversy when it responded to a new wave of inversion transactions with Notice 2014-52, stating its intention to propose regulations at some unspecified future date that would interpret IRC §§367 and 7874 to alter the tax consequences of such transactions. Treasury and the IRS indicated that they would backdate the eventual regulations to cover all transactions that had not closed as of the date Notice 2014-52. Whether Treasury has the power to issue the regulations at all is unclear; Treasury Secretary Jacob Lew at one point claimed it does not,[17] but tax experts then argued that it does.[18] Notice 2014-52 offered some draft regulatory language but also requested comments regarding issues that Treasury had not yet decided whether or how to address in the eventual proposed regulations. To date, Treasury has not actually followed up with proposed regulations, let alone final ones. Merely by issuing Notice 2014-52, Treasury triggered its authority to adopt regulations retroactively effective to September 22, 2014, irrespective of when it gets around to issuing them. As a result, inversion transactions ground to a halt, even though several taxpayers had to pay sizeable breakup fees to terminate transactions that had been signed but not closed prior to Notice 2014-52.

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[9] *See* Salman Ranch Ltd. v. United States, 573, F.3d 1362 (Fed. Cir. 2009); Bakersfield Energy Partners LP v. Comm'r, 568 F.3d 767 (9th Cir. 2009); Bakersfield Energy Partners, LP v. Comm'r, 128 T.C. 207 (2007).
[10] T.D. 9466, 74 Fed. Reg. 49321 (Sept. 28, 2009).
[11] T.D. 9511, 75 Fed. Reg. 78897 (Dec. 17, 2010).
[12] *See* Treas. Reg. § 301.6501(e)-1(a)(1)(iii).
[13] *See* Treas. Reg. § 301.6501(e)-1(a)(1)(iii).
[14] Brief for Respondents, United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012), 2011 WL 6325858; Brief for the United States, United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012), 2011 WL 5591822.
[15] Brief for the United States, United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012), 2011 WL 5591822, at *12.
[16] 132 S. Ct. 1836 (2012).
[17] Maureen Farrell & Damian Paletta, *Obama Explores Tax-Code Weapons in Inversion-Merger Fight*, [Wall Street Journal Aug. 14, 2014] (quoting Secretary Lew as saying, "we do not believe we have the authority to address this inversion question through administrative action.").
[18] *E.g.*, Stephen E. Shay, *Mr. Secretary, Take the Tax Juice Out of Corporate Expatriation*, [Tax Notes July 28, 2014]; Steven M. Rosenthal, *Professor Shay Got It Right: Treasury Can Slow Inversions*, [Tax Notes Sept. 22, 2014]; Victor Fleischer, *How Obama Can Stop Corporate Expatriations, for Now*, http://dealbook.nytimes.com/2014/08/07/how-obama-can-stop-corporate-expatriations-for-now/?_php=true&_type=blogs&_php=true&_type=blogs&smid=tw-share&_r=1 (Aug. 7, 2014).

Treasury enjoys an unusual degree of authority to adopt retroactive regulations relative to other agencies because Congress has decided to give Treasury that power. Indeed, both the *Home Concrete* case and Notice 2014-52 addressed circumstances in which many observers most likely applauded Treasury's actions. The cases culminating in the *Home Concrete* decision arose from the government's efforts to assess deficiencies against participants in a prominent tax shelter that deprived the government of billions of dollars in tax revenue; inversion transactions are reviled by many as allowing large multinational corporations to avoid paying their fair share of taxes. Notably, IRC § 7805(b) gives Treasury particularly expansive authority to adopt retroactive regulations "to prevent abuse."[19] Although "abuse" for this purpose is undefined, and neither Treasury nor the IRS have offered a definition, so long as Treasury limits its use of its retroactive rulemaking power to countering transactions that are at least arguably abusive, few are likely to complain.

What is missing, however, is anything remotely approximating a thorough understanding of the circumstances in which Treasury employs this power. Such analysis is particularly worthwhile in light of empirical analysis demonstrating that a substantial percentage of new Treasury regulations implement programs and provisions in the Internal Revenue Code that involve government spending or the pursuit of other social and regulatory goals—like the Earned Income Tax Credit and the Affordable Care Act—rather than revenue raising.[20] If the regulations that Treasury adopts address programs, purposes, and goals that are substantively similar to those administered by other agencies, then should Treasury be able to adopt retroactive regulations when other agencies cannot?

Drawing from a larger and ongoing empirical study of tax administration and Treasury regulations, this Article offers a preliminary snapshot of how Treasury employs its authority to adopt retroactive Treasury regulations. The Article focuses on Treasury regulation projects completed by Treasury's Office of Tax Policy with the help of members of the IRS Chief Counsel's Office between January 1, 2008, and December 31, 2012. To provide context for the empirical analysis, Part I of the Article offers a comparison of the law concerning retroactive regulations in the general administrative law and federal tax contexts. Turning to the empirical study, Part II outlines study methodology and reports preliminary results. Part III will address implications of the study. Because the study is ongoing, this draft offers only initial suggestions. In particular, it is at least clear that Treasury ought to do a better job of justifying its choices to exercise its retroactive rulemaking power. Treasury's failure to do so leaves many of its regulations susceptible to legal challenge, and courts ought to take such challenges seriously. Given preliminary findings regarding Treasury's use of its retroactive rulemaking power in administering not only the revenue raising aspects of the IRC but also the social welfare and regulatory programs within its jurisdiction, the article will most likely propose congressional action to narrow and refine Treasury's power to adopt retroactively effective regulations.

I. The Law of Retroactive Administrative Action

In 1988, in considering the validity of retroactive agency regulations *Bowen v. Georgetown University Hospital*, the Supreme Court said that "retroactivity is not favored in the

[19] 26 U.S.C. § 7805(b)(3).
[20] *See* Kristin E. Hickman, *Administering the Tax System We Have*, 63 Duke L.J. 1717 (2014).

law."[21] Legal scholars both before and after *Bowen* have echoed the sentiment.[22] Erwin Griswold described retroactive lawmaking as "usually unwise and unjust" and "an extreme measure," even if constitutional.[23] Lon Fuller more colorfully labeled retroactive lawmaking "a monstrosity," and backed up his point with the extreme and ghastly story of Hitler's Germany passing a retroactive statute to convert the political murders of the Roehm Purge of 1934 into lawful executions.[24] (Suffice it to say, most instances of retroactive lawmaking in the United States are more mundane.)

Yet, whether favored or not, retroactivity abounds in the law, and even the staunchest critics acknowledge that retroactivity is neither entirely avoidable nor always unjustified. In any common law system, courts routinely must resolve disputes in the face of legal uncertainty, and in so doing expand the law to encompass new facts and circumstances long after the events in question took place. Scholars sometimes describe such cases as merely clarify existing law rather than creating new law.[25] Such rhetoric does change the fact that judicial lawmaking belatedly tells parties who believed sincerely that their past behavior was consistent with the law that, in fact, it was not. In the realm of legislation, while the Constitution limits Congress's authority to adopt retroactively effective legislation somewhat, it may not do so as much as many people suppose.[26] The Supreme Court has upheld several statutes against claims of impermissible retroactivity.[27] Legal scholars have debated the legitimacy of retroactive legislation at some length,[28] but generally recognize the validity of retroactive legislation to resolve problems caused by poor drafting or flawed implementation of existing statutes.[29] Even those who object to retroactive lawmaking most strongly recognize that, sometimes, it is necessary or justified, if not practically unavoidable.

Retroactivity in the realm of administrative action is not altogether dissimilar, although it is subject to more caveats and limitations. The qualms that many have concerning retroactivity in lawmaking by Congress and courts are exacerbated by agencies' constitutionally subordinate status, their lack of democratic accountability, and their bureaucratic detachment.[30] Nevertheless, much like courts, agencies adjudicate individual cases and, in so doing, interpret statutes in ways that define the legal consequences of past actions, both for the parties at hand and for others similarly situated. Since at least 1943, with *SEC v. Chenery Corp.*, the Supreme

[21] *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988).
[22] *E.g.*, Kenneth Culp Davis, Handbook on Administrative Law § 60 (1951); [Daniel Troy; others?].
[23] Erwin N. Griswold, *A Summary of the Regulations Problem*, 54 Harv. L. Rev. 411-412 (1941).
[24] Lon L. Fuller, The Morality of Law 53-54 (1964).
[25] *See, e.g.*, Erwin Griswold, *A Summary of the Regulations Problem*, 54 Harv. L. Rev. 398, 412 (1941) (mocking gently, "Otherwise, we would be forced to concede that the court was making law!").
[26] *See* Richard J. Pierce, Jr., Administrative Law Treatise § 6.7 (5th edition 2010); Harold J. Krent, *The Puzzling Boundary Between Criminal and Civil Retroactive Lawmaking*, 84 Geo. L.J. 2143, 2146-52 (1996) (discussing the Court's relative permissibility concerning retroactive lawmaking by Congress in the civil context, as opposed to the criminal context); Charles B. Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692 (1960).
[27] [Examples from Krent article, Davis 1951 hornbook, Hochman article.]
[28] *E.g.*, Daniel E. Troy, Retroactive Legislation (1998) (challenging the legitimacy of retroactive legislation); Bernard W. Bell, *In Defense of Retroactive Laws*, 78 Tex. L. Rev. 235, 248-57 (1999) (offering several normative justifications for retroactive legislation)
[29] E.g., Fuller, supra, at 53-54.
[30] E.g., Kenneth Culp Davis, Handbook on Administrative Law § 60 (1951); [others].

Court has recognized that agencies with both rulemaking and adjudication powers can choose the latter as a means of announcing new legal "rules", notwithstanding the retroactive implications of doing so.[31] The *Chenery* Court did allow for the possibility that the negative consequences of retroactively applying an agency rule announced through adjudication might on occasion be sufficiently great to justify requiring prospective-only effect, and the lower courts have responded by developing criteria for evaluating such claims.[32]

All of the above analysis of retroactivity in the law applies to the tax and nontax contexts alike. When it comes to adopting regulations with retroactive effect, however, the tax and nontax approaches part ways—mostly, although not exclusively, because of Congress.

A. Retroactive Rulemaking in General Administrative Law

In 1988, in the aforementioned *Bowen v. Georgetown University Hospital*, the Supreme Court strongly discouraged giving regulations retroactive effect absent clear congressional intent to do so.[33] The case at bar concerned Medicare reimbursement regulations that the government adopted in 1984 and sought to apply retroactively to recoup prior payments made to hospitals between 1981 and 1984 under a different, older set of regulations. The new regulations were not unanticipated. In fact, the agency had adopted the exact same regulations in 1981, only to see them invalidated by a federal district court for failure to comply with Administrative Procedure Act procedural requirements. After satisfying those requirements, the agency merely sought to apply its 1984 regulations back to the date of their original "adoption," as if they had never been invalidated. Regardless, the Supreme Court not only refused to allow retroactive application of the Medicare reimbursement regulations, but sweepingly and substantially curtailed the possibility of retroactive regulations across the board.

> [A] statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms. Even where some substantial justification or retroactive rulemaking is presented, courts should be reluctant to find such authority absent an express statutory grant."[34]

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Notwithstanding this sweeping repudiation of retroactive agency regulations, before 1988, courts generally allowed agencies to adopt rules and regulations with retroactive effect so long as the circumstances did not suggest that doing so would be unreasonable.[35] Although the

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[31] 318 U.S. 80 (1943).

[32] The D.C. Circuit in particular has distinguished between adjudicatory rules that substitute "new law for old law that was reasonable clear" and those that are merely "new applications of [existing] law, clarifications, and additions." Verizon Tel. Cos. v. FCC, 269 F.3d 1098, 1109 (D.C. Cir. 2001) (quoting Pub. Serv. Co. of Colo. v. FERC, 91 F.3d 1478, 1488 (D.C. Cir. 1996)). To assess whether retroactive application of legal rules adopted through agency adjudication is appropriate, the D.C. Circuit has established a multi-factor balancing test that considers (1) whether the case is "one of first impression;" (2) whether the rule represents "an abrupt departure from well-established practice;" (3) to what extent the challenging party relied on the previous rule; (4) the burden imposed on the challenging party; and (5) the "statutory interest in applying a new rule." Retail, Wholesale & Dep't Store Union v. NLRB, 466 F.2d 380, 390 (D.C. Cir. 1972).

[33] 488 U.S. 204 (1988).

[34] Id. at 208-09 (internal citations omitted).

[35] *See* Richard J. Pierce, Jr., Administrative Law Treatise § 6.7 (5th Ed. 2010).

Bowen Court did not say so, the change undoubtedly derives from a gradual, decades-long shift in agency rulemaking practices and judicial understandings regarding the distinction between legislative and interpretative rules.

In the first part of the twentieth century, relatively few agency regulations carried legal force. The general consensus among courts and scholars was that only narrow and specific statutory grants of rulemaking authority could support regulations carrying the force and effect of law.[36] More general grants giving agencies the power to adopt rules and regulations as they deemed necessary to effectuate the statutes they administered could not support binding regulations without violating the Constitution's separation of powers principles.[37] Regulations promulgated pursuant to such specific authority created "new law" and were deemed "legislative" in character.[38] By comparison, "interpretative regulations" adopted pursuant to more general grants of the "all necessary rules and regulations" variety were merely exercises of executive power, and they only reflected administrative officials' best guess of a statute's meaning.[39]

In this earlier era, most agency regulations fell into the interpretative category. Such regulations were presumptively retroactive because the statutes, rather than the regulations, were the law.[40] Analogized Griswold, "The theory here has been that an interpretive regulation is simply a construction of the statute and will normally be effective retroactively, just as a construction of the statute by judicial decision would be."[41] If an agency changed its mind and adopted a different rule, the perception was that the agency was merely correcting its previous mistaken interpretation. Kenneth Culp Davis derided this theory as "unreal and unsound" because "statutory interpretation frequently far transcends the discovery of a meaning or a legislative intent" and thus "involves creation of new law."[42] Nevertheless, as discussed in Part II.B. below, this thinking about interpretative rules remains pervasive.

Notably, *Bowen*'s near-prohibition of retroactively effective regulations only applies to legislative rules, not interpretative rules or other nonbinding pronouncements. By the time that the Court decided *Bowen*, however, the definition of what constituted a legislative rule had broadened substantially. The 1960s and 1970s saw a virtual explosion of agency rulemaking, with agencies seeking to achieve more policy objectives through regulations predicated solely on

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[36] *See, e.g.*, 1 F. Trowbridge vom Baur, Federal Administrative Law § 489 (1942); Frederic P. Lee, *Legislative and Interpretive Regulations*, 29 Geo. L.J. 1, 2-3, 21-25 (1940).

[37] *See, e.g.*, Ellsworth C. Alvord, *Treasury Regulations and the* Wilshire Oil *Case*, 40 Colum. L. Rev. 252, 260-61 (1940); Stanley Surrey, *The Scope and Effect of Treasury Regulations Under the Income, Estate, and Gift Taxes*, 88 U. Pa. L. Rev. 556, 557-58 (1940).

[38] *See, e.g.*, Columbia Broad. Sys. v. United States, 316 U.S. 407, 416-22 (1942) (recognizing the legal force of specific authority regulations); Md. Cas. Co. v. United States, 251 U.S. 342, 349 (1920) (describing such regulations as having "the force and effect of law if [they] be not in conflict with express statutory provision"); Kenneth Culp Davis, *Administrative Rules—Interpretative, Legislative, and Retroactive*, 57 Yale L.J. 919, 928-29 (1948); Frederic P. Lee, *Legislative and Interpretive Regulations*, 29 Geo. L.J. 1, 2-3 (1940).

[39] Cites

[40] *See, e.g.*, [Griswold, et al.]

[41] *Id.* at 412; *see also* Kenneth Culp Davis, Handbook on Administrative Law § 61 (1951) (recognizing and critiquing the same theory).

[42] Kenneth Culp Davis, Handbook on Administrative Law § 61 (1951).

general rulemaking authority.[43] Several factors contributed to this trend, including the enactment of several new federal statutes in the mid- to late-1960s that delegated rulemaking authority to new or existing agencies, scholarly support for rulemaking over adjudication as a more efficient means of accomplishing congressional and agency goals, and decisions of the Supreme Court that largely replaced formal procedures with informal ones under the Administrative Procedure Act § 553 as the norm for agency rulemaking.[44] Agencies increasingly utilized general rulemaking grants to choose among alternative reasonable interpretations of ambiguous statutes and defended their interpretive choices in those terms. The Supreme Court's decision in *Chevron USA Inc. v. Natural Resources Defense Council, Inc.*, and its subsequent *Chevron* jurisprudence, are expressly predicated upon this understanding of both general authority rulemaking and statutory interpretation by agencies.[45] By the 1980s, the nondelegation doctrine was dead, and no one doubted any longer that regulations adopted pursuant to general grants of rulemaking power could carry legal force.[46]

At least for the purposes of this article, however, it may be important further to appreciate that *Bowen* involved a legislative rule with a particular type of retroactive effect—"altering the past legal consequences of past actions."[47] Recall that the Medicare reimbursement regulation at issue in that case was adopted in 1984 but The Department of Health and Human Services had adopted a new method of calculating Medicare reimbursement rates in 1984, made the new method applicable to a fifteen-month period beginning in 1981, and sought repayment from hospitals of Medicare reimbursements previously paid to them for that period.[48] Courts and scholars recognize that, by comparison, many rules reflect different degrees of retroactivity and that *Bowen*'s reach, therefore, is necessarily limited. Writing in concurrence in *Bowen*, for example, Justice Scalia distinguished the unacceptable "primary" retroactivity of the regulations in that case from presumptively reasonable "secondary" retroactivity."[49] To illustrate his point, Justice Scalia maintained that the new Medicare reimbursement regulations could be applied prospectively to alter the amount that hospitals received for future services provided, "even though [the effected hospitals] may have been operating under long-term labor and supply contracts negotiated in reliance on the pre-existing rule."[50] As an additional example, Justice Scalia maintained that Treasury could adopt a regulation that made taxable in future years certain types of income previously treated as nontaxable, notwithstanding that taxpayers might have invested in particular assets precisely because of the nontaxable character of the income those

[43] *See* Richard J. Pierce, Jr., Administrative Law Treatise § 1.6 (5th edition 2010); Clark Byse, Vermont Yankee *and the Evolution of Administrative Procedure: A Somewhat Different View*, 91 Harv. L. Rev. 1823, 1823 (1978); Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 Harv. L. Rev. 467, 546-49 (2002).

[44] *See* Richard J. Pierce, Jr., Administrative Law Treatise § 1.6 (5th edition 2010).

[45] 467 U.S. 837, 842-43 (1984); *see also*, e.g., City of Arlington, Tex. v. FCC, 133 S. Ct. 1863 (2013); United States v. Mead Corp., 533 U.S. 218 (2001).

[46] *See* Kenneth Culp Davis, Administrative Law Treatise § 3.2 (2d ed. 1978) (describing nondelegation as a failed legal doctrine); Bernard Schwartz, Administrative Law § 12 (1976) (opining that the nondelegation doctrine "can not be taken literally").

[47] *Bowen*, 488 U.S. at 219 (Scalia, J. concurring).

[48] *Id.* at 207.

[49] *Id.* at 219 (Scalia, J. concurring) (citing McNulty, Corporations and the Intertemporal Conflict of Laws, 55 Cal. L. Rev. 12, 58-60 (1967)); *see also* William V. Luneburg, *Retroactivity and Administrative Rulemaking*, 1991 Duke L.J. 106, 157.

[50] *Bowen*, 488 U.S. at 219 (Scalia, J. concurring).

assets produce.[51] While Scalia's thoughts on retroactivity are controversial,[52] they nevertheless reflect the consensus about retroactivity in lawmaking more generally as sometimes necessary, and thus inevitable. according to William Luneburg, as a result of Justice Scalia's concurrence, many agencies have concluded that *Bowen* does not limit their ability to adopt legislative rules with some degree of retroactive impact.[53]

Moreover, regulations as well as statutes are often ambiguous in their application to particular facts and circumstances, and agencies routinely issue informal guidance documents clarifying these ambiguities. These informal guidance documents are not legally binding on regulated parties, and agencies do not use notice-and-comment rulemaking in promulgating them. Nevertheless, agencies routinely pursue enforcement actions consistent with their interpretations, and they cite their informal guidance documents in the ensuing litigation. For that matter, agencies frequently discover ambiguities in statutes through the course of administrative enforcement, and then proceed to issue informal guidance documents in the midst of litigation not only to notify similarly situated regulated parties of the agency's interpretation of the law but arguably also to influence case outcomes. While courts typically do not extend *Chevron* deference in such cases, courts do evaluate interpretations advanced through informal guidance documents using the *Skidmore* standard of review, which counsels judicial deference depending upon the presence or absence of various contextual factors like the validity of the agency's reasoning and the thoroughness of its consideration of the interpretive question.

In short, agencies have many opportunities to adopt retroactively effective rules, but *Bowen* does prevent agencies generally from adopting legally-binding "legislative" regulations with primary retroactive effect. Where *Bowen* does not apply, the courts have applied multi-factor balancing analysis to prevent agency arbitrariness.

B. The History of Retroactive Tax Regulations

Retroactivity in the tax context is a little different, and always has been—most notably in that Congress has expressly authorized Treasury to adopt rules and regulations with primary retroactive effect. Section 3791(b) of the 1939 Internal Revenue Code, titled "Retroactivity of Regulations or Rulings," read "[t]he Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."[54] The Internal Revenue Code of 1954 renumbered that provision as § 7805 and only slightly altered its language to apply only to regulations and rulings and to change "Commissioner" to the Secretary's "delegate."[55] By this language, Treasury regulations and rulings were statutorily presumed to be retroactive to the date of the statutes they interpreted, unless the Secretary

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[51] *See id.* at 219 (Scalia, J. concurring).
[52] *See, e.g.*, Daniel E. Troy, Retroactive Legislation 8-9 (1998) (summarizing reactions to Scalia's primary versus secondary categorization).
[53] *See* Luneburg, *supra* note [ ], at 157-58.
[54] Internal Revenue Code of 1939, § 3791, 53 Stat. 467.
[55] Internal Revenue Code of 1954, § 7805(b), 68A Stat. 917. In 1976, Congress replaced all references to "the Secretary or his delegate" with "the Secretary." Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1834.

exercised his discretion to limit retroactive applicability.[56] The Supreme Court repeatedly acknowledged Treasury's ability to give retroactive effect to its rulings.[57]

Still, the Secretary's discretion not to make a ruling or regulation prospective only was not unlimited. Legislative history suggests that permitting the Secretary to limit the retroactive effect of a ruling or regulation reflected Congress's view that retroactive application could cause "inequitable results."[58] Consistent with that concern, in 1965, then-IRS Chief Counsel Mitchell Rogovin wrote about Treasury and IRS application of IRC § 7805(b),

> [I]n recent years it has been the administrative practice of the Treasury and the Commissioner to exercise the discretion granted under [the old] Section 7805(b) by making any changes in Regulations which would act to the detriment of the taxpayer prospective. On the other hand changes in Regulations benefiting the taxpayer have generally been applied retroactively to all open years. Similarly, amendments to the Regulations that merely provide certainty as to the problems not previously covered by the Regulations or which clarify an ambiguity in existing Regulations are generally retroactive in application.[59]

Further, where a taxpayer challenged the Secretary's failure to limit a ruling or regulation to prospective-only applicability, a court reviewed the Secretary's actions for abuse of discretion.[60] For many years, the leading case on what might constitute abuse of discretion with respect to a retroactive regulation was a Fifth Circuit case, *Anderson, Clayton & Co. v. United States*.[61] *Anderson* addressed a refund suit involving the proper sourcing of foreign income for purposes of calculating per-country limitations on the foreign tax credit. The taxpayer, a large multinational corporation, received a distribution from a first-tier Swiss subsidiary.[62] The Swiss subsidiary, in turn, had earned the income from its operations in Argentina, Brazil, and Peru.[63] The taxpayer argued that the distribution should be sourced proportionately to each of those countries (*i.e.*, to the countries where the income was earned); the government argued that the

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[56] Dixon v. United States, 381 U.S. 68, 80 (1965) ("Congress has seen fit to allow the Commissioner to correct mistakes of law, and in § 7805(b) has given him a large measure of discretion in determining when to apply his corrections retroactively. In the circumstances of this case we cannot say that this discretion was abused."); John S. Nolan & Victor Thuronyi, *Retroactive Application of Changes in IRS or Treasury Department Position*, 61 TAXES 777, 783 (1983) ("More recently, courts have taken the approach that any retroactive application of a regulation may be reviewed for abuse of discretion, although such abuse is rarely found.").

[57] [Cites.]

[58] Automobile Club of Michigan v. Comm'r, 353 U.S. 180, 184 (1957) ("Congress . . . confirmed the authority of the Commissioner to correct any ruling, regulation, or Treasury decision retroactively, but empowered him, in his discretion, to limit retroactive application to the extent necessary to avoid inequitable results.").

[59] Mitchell Rogovin, The Four R's: Regulations, Rulings, Reliance and Retroactivity: A View from Within, 43 Taxes 756, 762-63 (1965); see also John S. Nolan & Victor Thuronyi, Retroactive Application of Changes in IRS or Treasury Department Position, 61 Taxes 777, 778 (1983) (recognizing the same general practice).

[60] *Id.* (interpreting § 3791(b) of the Internal Revenue Code of 1939, the precursor to § 7805(b)). *See also* Cent. Ill. Pub. Serv. Co. v. United States, 435 U.S. 21 (1978) ("Those who administer the Internal Revenue Code unquestionably have broad authority to make tax rulings and regulations retroactive. . . . That authority is not unfettered, however, and conditions are present here that would make retroactive application . . . an abuse of discretion.").

[61] 562 F.2d 972 (1977), *rehearing and rehearing en banc denied, cert. denied*.

[62] *Id.* at 974–75.

[63] *Id.*

distribution should be sourced entirely to Switzerland (*i.e.*, to the country where the first-tier subsidiary was incorporated).[64] At the time of the distribution, there was no clear statutory or regulatory guidance on the disputed issue.[65] During the pendency of the litigation, Treasury promulgated a regulation clearly adopting the "country of incorporation" rule.[66] Because the regulation was plainly on point, the issue was whether the regulation could be applied retroactively to the distribution in question.

The *Anderson* court, purporting to summarize existing case law, identified four considerations relevant to a review of the Secretary's exercise of discretion under IRC § 7805(b)—considerations that resemble those applied by the courts more generally in evaluating whether an agency has behaved unreasonably in adopting a retroactively effective rule through adjudication:

> (1) whether and to what extent the taxpayer justifiably relied on settled prior law or policy and whether or to what extent the putatively retroactive regulation alters the law; (2) the extent, if any, to which the prior law or policy has been implicitly approved by Congress; (3) whether retroactivity would advance or frustrate the interest in equality of treatment among similarly situated taxpayers; and (4) whether according retroactive effect would produce an inordinately harsh result.[67]

According to the *Anderson* court, the factors "merely reflect[ed] a distillation of prior case law," and were meant to be "neither exhaustive nor exclusive."[68]

The *Anderson* court rejected a possible fifth consideration recognized by the Second Circuit six years prior in *Chock Full O'Nuts v. United States*[69]—namely whether the Commissioner had promulgated the "retroactive regulations during the course of litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations."[70] *Chock Full O'Nuts* involved the deductibility of original issue discount with respect to convertible debentures. The taxpayer had issued such debentures with a par value of $100; according to stipulated facts, without the conversion feature the value would have been $89.625. The taxpayer sought to deduct the difference between the two values as "original issue discount" within the meaning of the relevant Code provision, which defined original issue discount as the "difference between the issue price and stated redemption price at maturity." During the pendency of the litigation, Treasury promulgated a revised regulation that purported to define "issue price" as including any premium paid for a conversion privilege. The *Chock Full O'Nuts* court, in dicta, questioned whether such a regulation would represent "a valid exercise of the Commissioner's power to promulgate retroactive regulations."[71] However, the

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[64] *Id.* at 978.
[65] *Id.* at 975.
[66] *Id.* at 975–76, 978–79.
[67] *Id.* at 981.
[68] Snap-Drape Inc. v. Comm'r, 98 F.3d 194, 202 (5th Cir. 1996) (citing *Anderson*, 562 F.2d at 981).
[69] 453 F.2d 300 (2d Cir. 1971).
[70] *Id.* at 303. The court, in a footnote, also noted several of the same factors later summarized in *Anderson*: whether the regulation "would work a change in settled law," whether it would "lead to inequality of treatment between taxpayers," and whether the result would be "unduly harsh." *Id.* at 303 n.6.
[71] *Id.* at 303.

court found that even absent the new regulation, there was no "original issue discount" and the taxpayer was not entitled to a deduction. Thus the court found it unnecessary to determine whether retroactive application was proper.[72] The *Anderson* court rejected the Second Circuit's suggestion that merely promulgating a regulation during the course of litigation would be an abuse of discretion, and noted that no court had so held.[73] Rather, the *Anderson* court suggested that the focus should be on the relationship between the new regulation and prior law, and went on to articulate the non-exhaustive list of considerations as described above.

In 1996, as part of the Taxpayer Bill of Rights 2, Congress substantially amended IRC § 7805(b).[74] Although legislative history explains the change as "[t]he Congress believed that it is generally inappropriate for Treasury to issue retroactive regulations,"[75] the amended IRC § 7805(b) does not actually put an end to retroactive Treasury regulations. Instead, the amended IRC § 7805(b) merely shifts the presumption of retroactivity, making Treasury regulations prospective unless Treasury provides otherwise, and continuing to authorize retroactivity in a variety of circumstances. As amended, IRC § 7805(b) provides particularly that "no temporary, proposed, or final regulation relating to the internal revenue laws shall apply to any taxable period ending before the earliest of" certain specified dates relating to public notice: (1) the date on which the regulation was published in the Federal Register, (2) in the case of a final regulation, the date on which any related proposed or temporary regulation was published in the Federal Register, or (3) the date on which is issued any public notice substantially describing the expected contents of the proposed, temporary, or final regulation.[76] The presumption in favor of retroactivity remains in effect with respect to informal guidance documents,[77] and also for regulations relating to statutory provisions enacted prior to the amendment.[78]

IRC § 7805(b) offers six further exceptions to the presumption against retroactivity. First, a regulation issued "promptly," i.e., within eighteen months of the enactment of the statutory provision to which it relates, may apply to an earlier taxable period.[79] Second, the Secretary may make any regulation retroactive "to prevent abuse."[80] Third, the Secretary may make any regulation retroactive to correct a procedural defect.[81] Fourth, regulations relating to internal Treasury Department policies, practices, or procedures may be applied retroactively.[82] Fifth, Congress may explicitly authorize Treasury to determine the effective date of a

[72] *Id.*
[73] 562 F.2d 972, 980-81 (1977). The court left open, in dicta, the possibility that an attempt by the Commissioner "to change settled law at the eleventh hour in order to defend against [a] taxpayer's claim" might lead to a different result. *Id.* at 981.
[74] Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1101(a), 110 Stat. 1468 (1996).
[75] Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 104th Congress, JCS-12-96 No. 4 (Dec. 18, 1996).
[76] IRC § 7805(b)(1).
[77] Specifically, § 7805(b)(8) leaves to the Secretary the discretion to "prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect," thus mimicking the old IRC § 7805(b) for such pronouncements.
[78] Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1101(b), 110 Stat. 1468 (1996).
[79] 26 U.S.C. § 7805(b)(2) (2006).
[80] *Id.* § 7805(b)(3).
[81] *Id.* § 7805(b)(4).
[82] *Id.* § 7805(b)(5).

regulation.[83] Sixth, the Secretary may provide for a taxpayer to elect to have the new regulation apply retroactively.[84]

The precise parameters of Treasury's authority under IRC § 7805(b) remains unexplored. Only a few cases consider the breadth or limitations of the individual exceptions, and those cases also speak more generally in abuse of discretion terms. For example, several cases discuss the exception "to prevent abuse." All of those cases concern challenges to the same Treasury Regulation, which requires partners to reduce their basis in partnership interests when the partnership assumes certain liabilities of the partner.[85] One district court in the Central District of California upheld the retroactive regulation, not only on the grounds of congressional authorization, but also apparently on the grounds that retroactive application would prevent abuse.[86] In contrast, the Court of Federal Claims and another district court in Colorado held the same regulation invalid as neither expressly authorized by Congress under § 7805(b)(6) nor a proper exercise of the power to prevent abuse under § 7805(b)(3).[87] In so doing, these courts focused on the purpose of the underlying statute, and found that the "abuse" the statute was meant to prevent was the acceleration or duplication of losses, not the artificial inflation of basis.[88] Since the regulation, by reaching the latter evil as well as the former, swept too broadly, it "exceed[ed] the congressional mandate to address transactions that accelerate and duplicate losses" and did not qualify for the exception of § 7805(b)(3).[89]

As controversial as retroactive tax regulations may be at times, they nevertheless retain a fair amount of support in tax policy circles, for a few reasons, I think. At least anecdotally, my sense is that both tax administrators and the transaction planners who populate the elite tax bar believe that most tax provisions support only one objectively correct interpretation. The IRS and taxpayers may disagree over what that objectively correct interpretation is in a given case, but resolving such disputes is simply a function of carefully analyzing statutory text, history, and purpose—not choosing among competing policy alternatives. Deductions and credits derive from legislative grace so should be narrowly construed, irrespective of whether doing so would accomplish other congressional goals.[90] When in doubt, Treasury and the IRS are expected to err in favor of protecting the fisc.[91] Tax commentators also generally embrace an ethos of

[83] *Id.* § 7805(b)(6).
[84] *Id.* § 7805(b)(7).
[85] Treas. Reg. § 1.752-6.
[86] Maguire Partners-Master Investments, LLC v. United States, No. CV 06-07371, 2009 WL 4907033, at *19 n.4 (C.D. Cal. Dec. 11, 2009); *id.* at 19 ("[T]he Treasury Department simply applied the pre-existing rule contained in Revenue Ruling 88-77 *to address the possibility of abuse* . . . .") (emphasis added).
[87] Murfam Farms, LLC v. United States, 88 Fed. Cl. 516 (2009); Stobie Creek Investments, LLC v. United States, 82 Fed. Cl. 636 (2008); Sala v. United States, 552 F. Supp. 2d 1167 (2008), *rev'd on other grounds*, 613 F.3d 1249 (10th Cir. 2010).
[88] *See Stobie Creek*, 82 Fed. Cl. at 669–71.
[89] *Id.* at 671; *see also Sala*, 552 F. Supp. 2d. at 1202 ("[The regulation] directly contradicts the underlying statutes … the abuse of which it supposedly prevents.").
[90] INDOPCO v. Comm'r, 503 U.S. 79, 84 (1992); Bingler v. Johnson, 394 U.S. 721 (1969).
[91] *E.g.*, Salem et al., *ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 Tax Lawyer 717, 722-725 (2004).

treating similarly-situated taxpayers alike remains a common theme in tax policy circles.[92] This ethos in many circumstances counsels in favor of retroactivity; the law's need for closure, meanwhile, is served by the IRC's limitations on the time that the IRS can take in assessing deficiencies, limit the extent to which Treasury and the IRS can carry back their interpretations.[93]

Where this thinking begins to fall apart is in recognizing the extent to which Congress has extended both the IRC and thus Treasury's regulatory jurisdiction beyond mere revenue raising. The I.R.C. now contains hundreds of tax expenditure items representing more than $1 trillion of indirect government spending each year. Former Joint Committee on Taxation Chief of Staff Edward Kleinbard has called tax expenditures "the dominant instruments for implementing new discretionary spending policies."[94] As further observed by former Assistant Secretary of the Treasury for Tax Policy Pamela Olson,

> The continual enactment of targeted tax provisions leaves the IRS with responsibility for the administration of policies aimed at the environment, conservation, green energy, manufacturing, innovation, education, saving, retirement, health care, child care, welfare, corporate governance, export promotion, charitable giving, governance of tax exempt organizations, and economic development, to name a few.[95]

Following a similar theme, several former IRS Commissioners recently advised the D.C. Circuit that "Congress has decided to administer an increasingly wide variety of government assistance programs through the federal income tax system, including assistance for low income families, health care, education, and homebuyers."[96]

In an earlier study, I evaluated Treasury and IRS regulatory efforts for their focus on tax expenditures and other social welfare and regulatory programs as opposed to revenue raising.[97] According to that study, from 2008 through 2012, Treasury and the IRS spent almost as much time and effort drafting regulations addressing tax expenditures and other social welfare and regulatory matters like the Affordable Care Act, ERISA, and exempt organizations as they did drafting regulations addressing individual and corporate income tax matters.[98] Specifically, Treasury and the IRS published 154 major rulemaking documents totaling 1,364 pages of proposed, temporary, and final regulations and explanations thereof in connection with 86 regulation projects addressing tax expenditures, the ACA, exempt organizations, ERISA, and

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[92] John S. Nolan & Victor Thuronyi, Retroactive Application of Changes in IRS or Treasury Department Position, 61 Taxes 777, 779 (1983) ("Statements of position by the IRS to provide uniformity or permit planning must apply evenhandedly to all taxpayers and thus ordinarily must be retroactive.").

[93] See IRC § 6501.

94. Edward D. Kleinbard, Professor of Law, Woodworth Memorial Lecture: The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes (May 7, 2009), *in* 36 OHIO N.U. L. REV. 1, 3 (2010).

95. Pamela F. Olson, Woodworth Memorial Lecture: And Then Cnut Told Reagan . . . Lessons from the Tax Reform Act of 1986, (May 6, 2010), *in* 38 OHIO N.U. L. REV. 1, 12–13 (2011) (citations omitted).

96. Brief *Amici Curiae* of Former Commissioners of Internal Revenue in Support of Defendants-Appellants at 22, Loving v. IRS, No. 13-5061 (D.C. Cir. Apr. 5, 2013), 2013 WL 1386248, at *22.

[97] Kristin E. Hickman, *Administering the Tax System We Have*, 63 Duke L.J. 1717 (2014).

[98] *Ibid.* at 1746–1753.

campaign finance, and excise tax issues.[99] By comparison, Treasury and the IRS published 171 major rulemaking documents totaling 1117 pages in connection with 104 regulation projects pertaining to the individual and corporate income tax matters as well as partnerships and other pass-through entities.[100] In 2012, roughly 86% of IRS revenue collections came from the individual income tax and payroll taxes, with the corporate income tax providing another 11%.[101] Yet across several measures, tax administrators spent only about 20% of their regulation drafting efforts on the revenue raising aspects of the individual income tax and payroll taxes, and another 20% on the corporate income tax, while dedicating between 33% and 40% to tax expenditures and other regulatory and social welfare programs.[102]

The expansion of Treasury's regulatory brief matters for retroactivity precisely because those same programs, if located elsewhere in the U.S. Code and administered by other agencies, would not be eligible for retroactive rulemaking.

II. Empirical Analysis

Maybe Treasury only uses its authority to promulgate retroactive regulation on those rare occasions in which it is concerned about abuse. Unfortunately, no systematic study of Treasury's use of its retroactive rulemaking authority is available. My goal with this project is to offer at least a preliminary sense of the circumstances and ways in which Treasury utilizes its retroactive rulemaking authority. To achieve this goal, the Article evaluates Treasury regulation projects completed during the five-year period between January 1, 2008, and December 31, 2012.

A. Methodology

To provide at least a preliminary snapshot of Treasury's use of its retroactive rulemaking power, the study reviewed 164 separate regulatory projects completed by Treasury in the period between January 1, 2008, and December 31, 2012.[103] To identify these projects, I drew upon work performed for a different, recently-published study that examined all major rulemaking documents published between January 1, 2008, and December 31, 2012, in the Federal Register and the Internal Revenue Bulletin.[104]

1. Completed Regulation Projects Only

The previous study evaluated all major rulemaking documents, consisting principally of notices of proposed rulemaking (NOPRs) and Treasury Decisions (TDs), both individually and project-by-project, published during that same period, whether or not the regulations contained therein were proposed, temporary, or final. The present study considers only completed projects for the following reasons.

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[99] *Ibid.*
[100] *Ibid.*
[101] Internal Revenue Service, *Internal Revenue Service Databook, 2012* 3 (2013), available at http://www.irs.gov/pub/irs-soi/12databk.pdf.
[102] Hickman, *supra*, at 1746–1753.
[103] For more detail on the process of grouping NOPRs and TDs into projects, see Appendix 1.
[104] *See* Kristin E. Hickman, *Administering the Tax System We Have*, 63 Duke L.J. 1717 (2014).

Like most agencies, Treasury and the IRS promulgate regulations using notice-and-comment rulemaking,[105] publishing its proposed, temporary, and final regulations in the Federal Register and the Internal Revenue Bulletin. Consistent with Administrative Procedure Act requirements, in many instances, Treasury formally begins a regulation project by issuing a NOPR, processes comments received in response thereto, and then finalizes the project by publishing a TD with final regulations. Many other projects follow a different pattern in which Treasury simultaneously publishes one TD with legally-binding temporary regulations and a separate NOPR cross-referencing the TD and seeing comments, then after accepting and processing comments received, finalizes the temporary regulations with a second TD. Occasionally, a project may stretch to include more than one NOPR or more than two TDs with proposed and temporary regulations. Either way, the process of finalizing regulations may take months or even years after the publication of an initial NOPR or TD with proposed or temporary regulations. Consequently, some projects for which Treasury and the IRS published NOPRs or TDs within study's time frame had not been finalized by December 31, 2012.

As indicated above, IRC § 7805(b) authorizes Treasury to extend the effectiveness of its final regulations back in time either to the date that related proposed or temporary regulations were filed with the Federal Rester or to the date of any IRS Notice substantially describing the final regulations' content. Consequently, some proposed or temporary regulations are not themselves retroactive in their application but indicate that Treasury and the IRS intend to make eventual final regulations retroactive. Correspondingly, some temporary regulations that were not finalized by December 31, 2012, were themselves retroactively effective to the date of an earlier IRS Notice. Both proposed and temporary regulations are subject to revision by Treasury and the IRS. Taxpayer comments submitted in response to those proposed and temporary regulations may persuade Treasury and the IRS to reverse or moderate the retroactive effect of the regulations in question. Correspondingly, at least in theory, Treasury and the IRS could decide to extend the effective date of final regulations retroactively, even if they did not previously signal their intent to do so in the associated proposed or temporary regulations. Given this potential fluidity, limiting the scope of the study to regulation projects that had been finalized seemed appropriate.

2. Subject Matter Categorization

A key aspect of the previous study on which the present one builds was its categorization of Treasury regulation projects and associated major documents by subject matter category. The purpose of the earlier study was to make a preliminary assessment of the extent to which Treasury and the IRS dedicate their regulatory efforts to social welfare or regulatory purposes, goals, and functions rather than traditional revenue raising. While it would be impossible to meaningfully categorize Treasury regulations as serving an exclusive social welfare, regulatory, or revenue raising purpose, fairly common categories of tax provisions are readily identifiable as being more or less heavily oriented toward non-revenue raising functions. The subject matter categories are as follows:

[105] *See* 5 U.S.C. § 553(b)-(d) (describing notice-and-comment rulemaking procedures generally); Internal Revenue Manual 32.1.2.3(3) (Sept. 23, 2011) (referencing the Administrative Procedure Act and asserting that "the IRS usually publishes its [Notices of Proposed Rulemaking] in the Federal Register and solicits public comments").

- Tax expenditures
- Affordable Care Act
- ERISA
- Exempt organizations
- Campaign finance
- Corporate/international that is primarily corporate
- Gifts, trusts, and estates
- Non-ACA excise taxes
- Administration and procedure
- Individual/not obviously corporate
- Partnerships and other non-T&E pass through
- Employment taxes

Most or all of these categories should be familiar and unobjectionable to tax experts. For the most part, the listed categories are drawn directly from large and specifically identifiable programs administered by the IRS; from I.R.C. subtitles, chapters, and subchapters; and from government documents reporting taxes collected and returns filed. The campaign finance category corresponds to Subtitle H provisions concerning the financing of presidential election campaigns. Of these categories, those of tax expenditures, the Affordable Care Act, ERISA, exempt organizations, and campaign finance in particular have little or nothing to do with the tax system's traditional revenue raising mission.

3. Additional Variables

All of the projects were additionally coded for whether they adopted new regulations or amended old regulation, as well as for whether their preambles indicated Treasury felt prompted to act in whole or in part due to new legislation, a court case, or a tax shelter or other transaction of which Treasury and the IRS disapproved. Further, recent Treasury Decisions, at least, contain two separate statements regarding the included regulations' effective date. At the top of the preamble, each TD states outright the date on which the regulations contained therein are effective. For tracking purposes, I have tentatively labeled the date included in this statement as the "primary effective date." Typically, however, the regulatory text adopted includes one or more provisions that speak to the regulations' effective date as well. Often, the dates contained within these provisions are not the same as the primary effective date. For tracking purposes, therefore, I have labeled the date or dates included within the regulations themselves as the "secondary effective date." I have tracked both the primary effective date and the secondary effective date for each observation.

B. Preliminary Observations

[**Author's Note:** The results documented in this section are preliminary and do not yet cover the entire period. Preliminary coding has been completed for the period between February 11, 2009, and December 31, 2012. I have no reason to suspect that pulling in the remaining 13 months of data will alter the below results meaningfully. The preliminary results do indicate, however, a need for additional digging into the data to elaborate some of the findings and develop a more comprehensive picture of Treasury's use of its retroactive rulemaking authority.]

1. Retroactivity and § 7805(b)

Looking first and foremost at the primary effective dates—those stated at the top of regulatory preambles—very few of the regulation projects finalized between February 2009 and December 2012 reflected retroactive primary effective dates. Most preambles were labeled as effective as of the date of publication in the Federal Register. A few listed an effective date more than 30 days after publication in the Federal Register. A few more listed an effective date that was a few days prior to publication in the Federal Register, which such preambles separately indicated as the date when the TD was filed for publication.

Figure 1: Primary Effective Date Analysis

Date	**Count**	**Percent**
More than 30 days after TD was published	5	4%
Date TD was published in the Federal Register	99	88%
When the TD was submitted for publication (i.e., a few days before the TD was published)	9	8%
Total	113	

Technically, this last category is retroactively effective, if only by a couple of days. That said, labeling this small number of projects as retroactively effective on this basis alone seems specious. Although it is possible the pre-publication effective date carries some independent significance, most likely, this group simply reflects an imperfectly implemented intent to follow the broader norm of making regulations effective as of the date of publication. Assuming this supposition is effect, then judging by the primary effective date alone, all of the regulation projects evaluated thus far were prospective only. At most, 8% carried retroactive effective dates.

Digging deeper into the secondary effective dates, however, the picture is much different. For final Treasury Decisions published between February 2009 and December 2012, quite a number indicate that they are partly or entirely effective or applicable retroactively. Because lengthy or complex regulations sometimes list more than one secondary effective date applicable to different provisions contained therein, the numbers here exceed the number of TDs evaluated.

Figure 2: Secondary Effective Date Analysis

Date	**Count**	**Percent[a]**	
Prospective			
More than 30 days after TD was published	19	13%	
1 to 30 days after TD was published	17	12%	
Date TD was published	42	29%	
When the TD was submitted for publication (i.e., a few days before the TD was published)	5	3%	
Retroactive			
When the notice of proposed rulemaking and/or temporary regulations were published	11	8%	
When an IRS notice was published	1	1%	42%
Date of legislative enactment	6	4%	
Other retroactive	42	29%	
Total	143		

[a]Less than 100% total due to rounding.

As a simply matter of drafting, the differences between Figures 1 and 2 raises an initial question about what Treasury means with the primary effective date statements. Clearly Treasury does not intend these statements to apply to the regulations themselves, since the effective dates contained within the regulations are so much more varied.

Regardless, when one considers the regulatory text itself, fully 42% of regulation projects studied thus far contain at least some regulations that apply retroactively. Of those, several are dated back to the notice of proposed rulemaking, temporary regulations, or an IRS notice, and thus are consistent textually with the authorization contained in IRC § 7805(b)(1). Several others are dated back to corresponding legislation, and thus may be consistent the authorization contained in IRC § 7805(b)(2); further work is needed to confirm that those regulations were finalized within eighteen months of the legislative enactment in question.

Further work is needed, also, to analyze the contents of the “other retroactive” category. Notably, the effective dates of the projects assigned to this category were not immediately traceable to any of the authorizing events listed in IRC § 7805(b). For many of the projects in this category, the provisions regarding the regulations’ applicability cross-reference other, existing statutory and regulatory provisions. Tracing those cross-references may make clear that Treasury is, in fact, attempting to exercise its authority under IRC § 7805(b)(1) or (2). Alternatively, Treasury may be relying upon more subjective authorization of IRC § 7805(b)(3) to prevenut abuse.

Most preambles lack extended discussion of the reasons that Treasury is making all or part of the regulations retroactive. Nevertheless, many preambles identify one or more events that prompted Treasury to undertake the regulation project in question. Regarding the projects studied thus far, Figure 3 shows whether the preambles to the retroactive regulations offered such signals. The total number of triggers exceeds the number of retroactive regulations because a few preambles indicated more than one triggering event.

Figure 3: Regulation Triggers Breakdown

Triggering Event	Count[a]	Percent[b]
Legislation	32	49%
Court case	6	9%
Disapproved transaction or return position	10	15%
No trigger identified	17	26%
Total	65	

[a] Greater than the number of retroactive regulations due to indications of more than one triggering event.
[b]Less than 100% total due to rounding.

These results would seem to suggest, at least, that Treasury is not limiting its use of the authority to adopt retroactive regulations to circumstances in which taxpayers are behaving badly. Only 15% of retroactive regulations explicitly mentioned a transaction or return position of which the IRS disapproved.

2. Retroactivity by Subject

Beyond the incidence of and justifications for Treasury's adopting retroactively effective regulations, the subject matter breakdown of retroactive projects is interesting.

Figure 4: Retroactivity by Subject Matter Category

Subject Matter Category	Count	Percent[a]	
Tax expenditures	13	22%	
Affordable Care Act implementation	1	2%	32%
Exempt organizations	5	8%	
Corporate/international that is primarily corporate	13	22%	
Gifts, trusts, and estates	3	5%	
Non-ACA excise taxes	2	3%	
Administration and procedure	12	20%	
Individual/not obviously corporate	10	17%	
Partnerships and other non-T&E pass through	1	2%	
Total	60		

[a]Less than 100% total due to rounding.

Notably, these results are not appreciably different from those of my previous study evaluating all Treasury regulation activity over the five years from January 1, 2008, through December 31, 2012. The earlier study was somewhat broader than the present one, in that it included all regulation projects for which Treasury published proposed, temporary, or final regulations during the period in question, rather than merely those projects that Treasury finalized.

Figure 5. All Regulation Projects by Subject Matter[106]

Subject Matter Category	Count	Percent[a]	
Tax expenditures	50	19%	
Affordable Care Act	18	7%	
Exempt organizations	9	3%	31%
ERISA	5	2%	
Campaign finance	1	0%	
Corporate/international that is primarily corporate	50	19%	
Gifts, trusts, and estates	12	5%	
Non-ACA excise taxes	3	1%	
Administration and procedure	57	22%	
Individual/not obviously corporate	40	15%	
Partnerships and other non-T&E pass through	14	5%	
Employment taxes	3	1%	
Total	262	100%	

[a]Less than 100% total due to rounding.

In short, Treasury's use of its authority to adopt retroactively effective regulations does not seem to be skewed in favor of particular subject matter areas, but rather seems to be distributed more or less proportionally across the various matters that Treasury regulations cover.

One exception is the Affordable Care Act. According to Figure 5 above, 7% of the regulation projects for which Treasury published major rulemaking documents between 2008 and 2012 concerned the Affordable Care Act. If anything, that percentage disguises the amount of time that Treasury dedicated to drafting Affordable Care Act regulations during the relevant period. Several of those projects were quite large, and other measures documented in the earlier study showed as much as 16% of Treasury's regulatory attention focused on Affordable Care Act regulations. Yet almost all of those regulations were prospective only. Only one Affordable Care Act regulation was retroactive in its application: a regulation issued on December 6, 2012, implementing a fee/excise tax imposed on issuers of insurance policies, applied retroactively to insurance policies with policy or plan years ending after October 1, 2012.[107]

On the other hand, thus far, more than half of the regulation projects concerning exempt organizations have been applied retroactively.

IV. Implications

The study is still in progress, and more work is warranted to flesh out further details. Nevertheless, a few preliminary implications are clear, and I think unlikely to change.

[106] This figure is derived from one at Hickman, *supra* note 20, at 1748.
[107] See T.D. 9602.

A. Susceptibility to Legal Challenge

Although IRC § 7805(b) gives Treasury the authority to adopt retroactively effective regulations, that power is discretionary. Treasury chooses to make some regulations retroactively effective and others only prospective in their application. As indicated above, Treasury rarely justifies is choices respecting retroactivity—neither explaining why retroactivity is needed nor even identifying which category of retroactive rulemaking authority is being invoked.

This lack of explanation is not unusual for Treasury; Treasury and the IRS generally do not justify the substantive policy choices contained in their regulations, either.[108] The Internal Revenue Manual prompts this approach, instructing IRS regulation drafters that "it is not necessary to justify the rules that are being proposed or adopted or alternatives that were considered."[109] Hence, preambles to Treasury regulations describe how the adopted regulations operate, but they typically do not explain why Treasury and the IRS chose one approach over other available alternatives.

Black letter administrative law doctrine, however, calls for administering agencies to contemporaneously justify their actions. In *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*,[110] the Supreme Court held the arbitrary and capricious standard of the Administrative Procedure Act[111] requires an agency to "articulate a satisfactory explanation for its action including 'a rational connection between the facts found and the choice made,'" to allow a reviewing court to "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."[112] In nontax cases, both Court in *State Farm* and the lower courts have employed this "hard look review" to invalidate agency regulations based on the inadequacy of the adopting agency's explanations for its choices.

Treasury and the IRS are not exempt from this requirement. In *Mayo Foundation for Education and Research v. United States*, the Supreme Court admonished, "[W]e are not inclined to carve out an approach to administrative review good for tax law only."[113] A few months later, the D.C. Circuit Court of Appeals, sitting en banc in Cohen v. United States, reinforced this same notion. In allowing a suit challenging IRS guidance for failing to comply with general administrative law requirements, that court declared, "The IRS is not special in this regard; no exception exists shielding it—unlike the rest of the Federal government—from suits under the [Administrative Procedure Act]." In *Dominion Resources, Inc. v. United States*, the Federal Circuit Court of Appeals became the first circuit court to reject a Treasury regulation not for its inconsistency with statutory meaning but for the IRS's failure to explain contemporaneously its reasons for choosing one interpretation rather than another—a long-time expectation in other

[108] Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (2012).
[109] Internal Revenue Manual § 32.1.5.4.7.3(1).
[110] 463 U.S. 29 (1983).
[111] 5 U.S.C. § 706(2)(A) (calling on reviewing courts to set aside agency actions found to be "arbitrary, capricious, an abuse of discretion, or contrary to law").
[112] *State Farm*, 463 U.S. at 43.
[113] 131 S. Ct. 704, 713 (2011).

areas of government regulation that courts had not previously imposed on tax administrators.[114] Other tax commentators have recognized Treasury's susceptibility to hard look challenges for the inadequacy of its regulatory preambles.[115]

Factors previously developed by the courts in cases like *Anderson, Clayton & Co. v. United States* and *Chock Full O'Nuts v. United States* for evaluating Treasury's exercises of discretion with respect to retroactivity fit neatly with *State Farm*'s interpretation of the APA's arbitrary and capricious standard. Moreover, employing hard look review to require Treasury to explain its choices with respect to retroactivity would serve two related purposes. First, consistent with concerns articulated in all of those cases, courts would be able to confirm that, in fact, Treasury's choices regarding retroactivity are the product of reasoned decisionmaking. Second, courts could require Treasury specifically to identify which of the categories it is relying on when it chooses to make a particular set of regulations retroactively effective. This specific identification would, in turn, offer opportunities for the courts to explore substantively the breadth or limits of those categories. If, as speculated above, Treasury is indeed relying on an expansive definition of what it means "to prevent abuse," then courts and commentators would have the opportunity to consider the validity of that definition as a matter of statutory interpretation.

B. The Need for Congressional Reform

Given preliminary findings that Treasury uses its retroactive rulemaking power in administering not only the revenue raising aspects of the IRC but also the social welfare and regulatory programs within its jurisdiction, the article will most likely propose congressional action to narrow and refine Treasury's power to adopt retroactively effective regulations. The precise parameters of this proposal remain undeveloped. But a need for congressional reform of IRC § 7805(b) seems worth considering.

[114] Dominion Resources, Inc. v. United States, 681 F.3d 1313 (Fed. Cir. 2012); *see also* Mannella v. Comm'r, 631 F.3d 115, 127 (3d Cir. 2011) (Ambro, J., dissenting); Carpenter Family Inv., LLC v. Comm'r, 136 T.C. 373, 395-96, 404 (2011) (Halpern & Holmes, JJ., concurring).

[115] E.g., Steve Johnson, *Using Administrative Law to Challenge IRS Determinations*, 88 Fla. B.J. 81 (2014); Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (2012).

APPENDIX 1:
METHODOLOGY—DEFINING A TREASURY REGULATION PROJECT

As noted in Part II of the Article, for most Treasury regulation projects, Treasury and the IRS will publish at least one NOPR and one TD. A standard regulation project will contain only one of each, as Treasury and the IRS first propose a set of regulations and then finalize them after giving the public an opportunity to comment. For many other projects, Treasury and the IRS publish a TD with legally binding, temporary regulations simultaneously with the NOPR, and then replace or withdraw the temporary regulations with a second TD that contains the final regulations.[116] Sometimes, Treasury and the IRS will publish more than one TD with temporary regulations and more than one NOPR before issuing a final TD. On very rare occasions, Treasury and the IRS publish a TD with final regulations without also publishing a NOPR or allowing an opportunity for public comment. Some NOPRs, and even certain TDs with temporary regulations, are withdrawn without ever being finalized. Some NOPRs remain open, seemingly in perpetuity. In short, a single Treasury regulation project may contain anywhere from one to several NOPRs or TDs.

The most useful way of identifying which NOPRs and TDs relate to one another is to compare one or both of the Counsel Automated Systems Environment Management Information System (CASE-MIS) number and the Regulation Identifier Number (RIN) listed on each such document.[117] The Internal Revenue Manual instructs IRS attorneys to obtain a CASE-MIS number when opening a regulation project and to continue using that project number until Treasury publishes a final regulation or closes the project without issuing regulations. Most NOPRs include the project's CASE-MIS number in their title sections, although most TDs do not. Most TDs do, however, mention the project's CASE-MIS number when referring to the associated NOPR in the background section of the preamble text. Separately, the Internal Revenue Manual instructs IRS attorneys to use the RIN in the heading of any regulation published in the Federal Register and also to use that same RIN for both final regulations and their associated NOPRs.[118]

With a very straightforward project that contains a single NOPR and TD, all of the documents will bear the same RIN. The Internal Revenue Manual goes on to instruct, however, that if a single NOPR leads to more than one TD containing final regulations, new RINs should be obtained for the later TDs.[119] Also, when Treasury publishes a TD with temporary regulations and simultaneously publishes a NOPR that proposes those same regulations by cross-referencing the TD, the Internal Revenue Manual calls for the TD and the NOPR to have different RINs.[120] Consequently, it is not uncommon for a Treasury regulation project with one or more sets of temporary regulations to bear multiple RINs. Often, references to the CASE-MIS number remain consistent throughout, thereby facilitating grouping.

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116. *See* Internal Revenue Manual 32.1.1.3 (Aug. 11, 2004) (describing IRS use of temporary regulations).

117. *See* Internal Revenue Manual 32.1.2.2 (Aug. 11, 2004) (explaining the purpose of the CASE-MIS); *id*. 32.1.2.2.5 (Aug. 11, 2004) (instructing drafting attorneys to obtain an RIN for each regulation project from the Regulatory Information Service Center of the General Services Administration).

118. *Id.* 32.1.2.2.5.

119. *Id.*

120. *Id.*

Nevertheless, even with the CASE-MIS numbers and RINs, idiosyncrasies occasionally present additional grouping challenges. For example, Treasury and the IRS sometimes will pursue simultaneously more than one project interpreting a particular I.R.C. section. Even if different Treasury and IRS attorneys work on these simultaneous projects, one would expect them to confer with one another. Should two projects that overlap with respect to both timing and I.R.C. section, but do not cross-reference one another in their NOPRs and TDs, be treated as a single project? If Treasury formally identified the documents as comprising two separate projects, for example by assigning different CASE-MIS numbers, I did as well.

Also, Treasury and the IRS sometimes will publish a TD with final regulations that explicitly leaves open a particular issue and then, on the same day or shortly thereafter, will publish another NOPR, or even a TD with temporary regulations, addressing that same issue and discussing the first TD as part of its background section. Again, the two successive projects presumably are staffed by the same Treasury and IRS attorneys who might reasonably consider the latter NOPR or TD as simply continuing a larger project that includes the earlier documents. On other occasions, it may be months or even years before Treasury and the IRS issue a NOPR or TD with temporary regulations to address an issue left open by an earlier TD. The longer the break between the two events, the less likely it seems that the same team of attorneys were involved. Yet, the later NOPR or TD may still cross-reference and describe the earlier regulation project. Should two successive projects that address related issues and cross-reference one another in this way ever be combined? If so, then is there some point at which too much time has passed between projects to consider them so related? Again, I have generally followed the government's lead: where Treasury and the IRS formally classified the documents as separate projects, for example by assigning different CASE-MIS numbers, so did I. On at least one occasion, however, Treasury and the IRS finalized one set of temporary and proposed regulations in the same TD as it adopted a new, second set of temporary regulations, which it then simultaneously proposed with a NOPR in the same edition of the Federal Register. In that case, because Treasury and the IRS combined the two, arguably separate projects into a single TD, I treated these efforts as a single project.