On May 6, the Tax Court unanimously, but on divided rationales, invalidated temporary Treasury regulations retroactively extending the six-year limitations period to income tax deficiencies resulting from basis overstatements. *Intermountain Insurance Service of Vail, LLC v. Commissioner*, 134 T.C. No 11 (2010). I think the result is correct but only on the procedural ground advanced by two concurring judges: that the regulations violated the Administrative Procedure Act (“APA”) for failure to satisfy the notice-and-comment requirements.

*Intermountain* is “must” reading for tax academics and practitioners. It is the richest decision in years (arguably ever) on issues relating to the procedural and substantive validity of tax regulations. Moreover, the opinions in the case, the subsequent cases that undoubtedly will be decided as to the issue, and commentary on these opinions and cases present genuine opportunity for improvement of the law.

Part I below describes *Intermountain*. This part may be omitted by those already knowledgeable as to the case and its context. Parts II and III address two of the most interesting aspects of the case. Part II discusses whether the regulations at issue in the case are legislative or interpretive in nature. This matters to the APA argument. Unless another exception applies (and none does in *Intermountain*), legislative regulatives must go through notice-and-comment, but interpretive regulations need not. I conclude that the challenged regulations are legislative. Part III examines the light shed by *Intermountain* on the *Brand X* rule as to when subsequent regulations may trump judicial interpretations of statutes. I conclude that *Intermountain* and similar cases may help at one level (whether “magic words” must appear in the judicial interpretations) but are unlikely to help at two other levels (what should be done if the
precedents’ characterizations are unsupportable and whether the *Brand X* analysis of the underlying statute turns on the statute’s language or embraces as well pertinent legislative history).

I. *Intermountain* and Its Context

A. Background

Code section 6501(a) provides that the IRS usually must assess tax liabilities within three years of the later of when the return is filed or is required to be filed. However, there are many exceptions to the usual three-year statute of limitations. One is section 6501(e)(1), which gives the IRS six years to assess income tax liabilities “[i]f the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return.” Section 6229(c)(2) provides a similar exception for cases governed by the TEFRA partnership audit and litigation rules.

These exceptions undoubtedly apply when the taxpayer omits enough taxable receipts, but it has been controversial whether they apply when the understatement arises instead from overstated basis of sold assets. The case law on the section 6501(e) overstated basis issue is divided, but the IRS suffered a string of high-profile defeats in 2009 cases. *See* Steve R. Johnson, *What’s Next in the Section 6501(e) Overstated Basis Controversy?*, ABA SECTION OF TAX’N NEWSQUARTERLY, Fall 2009, p. 19 (summarizing the cases).

To reverse its fortunes, Treasury issued regulations on September 29, 2009 in both temporary and proposed form. Temp Treas. Regs. §§ 301.6229(c)(2)-IT & 301.6501(e)-IT. Aggressively, the temporary regulations were declared to apply to tax years still open to assessment on the date of issuance, with the intention that they apply to all pending cases, including those which taxpayers had won but in which the decisions had not yet become final.
See T.D. 9466, 2009-43 I.R.B. 551. Both the new regulations and their effective date have been highly controversial from the start. See IRS Strikes Back Against Judicial Losses in Overstated Basis Cases, TAX NOTES, Oct. 5, 2009, p. 19.

B. The Intermountain Opinions

Intermountain concerns what the IRS considers to be an abusive tax shelter involving overstated basis. Having failed to act within the normal three years, the IRS relied on the six-year limitations period. Less than a month before issuance of the temporary regulations, the Tax Court decided the statute of limitations issue in Intermountain’s favor. T.C. Memo. 2009-195. Based on the new regulations, the IRS filed motions to vacate and for reconsideration of that decision.

By 13 to 0, the Tax Court held against the IRS, but the 13 judges fell into three camps. Seven judges, in an opinion written by Judge Wherry, explored the possibility that, as actually drafted, the effective date provision did not effectuate Treasury’s intention to reach not-yet-final decisions. Although advancing a questionable “plain meaning” analysis, the majority chose not to rest the decision on that ground.

Instead, the majority examined the substantive validity of the temporary regulations. Assuming arguendo that Chevron provides the governing standard, the majority concluded that the regulations did not pass muster under Chevron Step One or Brand X. See National Cable & Telecomm. Ass’n v. Brand X Internet Services, 545 U.S. 967, 982 (2005); Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984). Specifically, the majority concluded that the Supreme Court’s Colony decision a half century ago had held that what is now section 6501(e) unambiguously precludes the position taken in the temporary regulations. Colony Inc. v.
Commissioner, 357 U.S. 28 (1958). The majority also noted, but felt it unnecessary to rule on, the taxpayer’s argument that the temporary regulations have impermissibly retroactive effect.

Four other judges concurred in an opinion penned by Judge Cohen. This concurrence would have resolved the case on narrower grounds. Motions such as the IRS’s typically are granted only in unusual circumstances. An intervening statutory change is such a circumstance. Alioto v. Commissioner, T.C. Memo. 2006-199. The concurrence would have held, however, that an intervening regulatory change does not rise to the same level, thus is insufficient to warrant vacating or reconsidering.

Judges Halpern and Holmes concurred in another opinion. These judges rejected the majority’s effective date and Chevron analyses but saw the temporary regulations as invalid on procedural grounds. The APA applies to rulemaking by federal agencies, including the Treasury Department. See 5 U.S.C. § 551(1). Unless a stated exception applies, regulations are validly promulgated only if they go through the notice-and-comment process prescribed by 5 U.S.C. § 553. The temporary regulations were not promulgated through this process. Nonetheless, the IRS defended their validity on two grounds: that the regulations fall within the APA exception for merely interpretive rules and that Congress implicitly excepted temporary tax regulations from the notice-and-comment requirement. The Halpern/Holmes concurrence rejected both contentions, thus would have held the regulations to be procedurally invalid under the APA.

C. Evaluation of the Issues

All three opinions in Intermountain reflected distaste for what the judges viewed as overly zealous use of the regulations process. The Service saw the Intermountain tax shelter as abusive. It is worth remembering that, not just taxpayers, but the Service too can commit tax abuse.
Although motivated by a common impulse, the Tax Court judges differed greatly as to the doctrine by which to make that impulse legally operative. In my view, Judges Halpern and Holmes had the best view of the case. The omission of notice-and-comment is not justified by either of the grounds asserted by the IRS. The Service’s “merely interpretive” argument is hopeless, as shown in Part II. The Service’s argument that Congress excepted temporary tax regulations from APA notice-and-comment is better but probably not good enough. The argument is based on inference, not explicit text. Yet Congress has provided that other statutes may modify APA requirements only expressly, not impliedly. 5 U.S.C. § 559.

The arguments advanced in the other Intermountain opinions do not strike me as persuasive. First, as pointed out by Judges Halpern and Holmes, the regulations’ effective date provision is ambiguous, not plain. The provision might be read to mean “open under the normal three-year period,” as the Intermountain majority read it, or it might mean “open under the six-year period, as that period is extended by this regulation,” as Treasury and the IRS intended. An agency’s construction of its own ambiguous regulation is entitled to deference. E.g., Auer v. Robbins, 519 U.S. 452, 461 (1997); Stinson v. United States, 508 U.S. 36, 44-46 (1993).

Second, the majority is wrong as to its Chevron Step One analysis. Colony itself did not say that its result was unambiguously commanded by the statute. Moreover, Colony construed a predecessor of current section 6501(e), and the current statute arguably is somewhat more congenial to the Service’s position. Finally, as noted above, the IRS won a number of the cases after Colony but before 2009. There are two possibilities. Either the courts holding for the Service failed to notice that Colony had settled the issue, or the Intermountain majority overplayed its hand in characterizing Colony’s holding. I think that the second of these alternatives better states the matter.
Third, the narrow ground offered by Judge Cohen and the judges joining her is dubious. Yes, a statute outranks a regulation. But, as developed in Part II, a validly promulgated legislative regulation has force of law status. Thus, the distinction offered by Judge Cohen’s concurrence is not a meaningful difference.

II. Legislative Versus Interpretive Tax Regulations

The APA notice-and-comment rules are important. They are “the procedure by which the persons affected by legislative rules are enabled to communicate their concerns in a comprehensive and systematic fashion to legislating agency.” *Hoctor v. United States Dep’t of Agriculture*, 82 F.3d 165, 171 (7th Cir. 1986).

Nonetheless, there are exceptions to the APA’s command that regulations go through notice-and-comment. One exception arguably relevant here operates when the regulation is interpretive, not legislative, in nature. 5 U.S.C. § 553(b). In attempting to deflect Intermountain’s APA argument, the IRS relied in part on this exception. Indeed, this is a position that Treasury and the IRS often take as to their regulations. Unfortunately, this position is defective.

At least in its main strokes, the meanings of legislative regulations and interpretive regulations are reasonably settled for APA purposes. Legislative regulations have “force of law” character (they make binding law or change the law) while interpretive regulations merely notify the public of what the agency believes the statute to mean. *E.g.*, *Chrysler Corp. v. Brown*, 441 U.S. 281, 301-02 (1979).

The temporary regulations clearly are legislative under the above definition. Treasury and the IRS weren’t simply announcing their view of section 6501(e) – that view was already well known from the many cases (most of them losses) in which the Government had advanced
it. Instead, the whole point of the regulations is to change the law by administratively reversing
the law as articulated by these cases.

I see three possible rejoinders to this analysis, but none of them works. First, many
courts and commentators define legislative regulation more fully than I did above, adding an
extra element. The Halpern/Holmes concurrence said: “a rule is legislative if Congress has given
the agency authority to issue rules with the force of law and the agency intended to use that
authority.” *Intermountain* slip op. at 53 (emphasis added).

Could the Government escape the legislative regulation category by arguing that,
although it has authority to issue force-of-law rules, the temporary regulations were not intended
to be an exercise of that authority? No, for two reasons. The Halpern/Holmes concurrence
developed at length the ways in which courts have held such intent to be manifested, and
convincingly showed those ways (or enough of them, at least) to be present here. More
importantly, were the Government to present and win such an argument it would have won the
battle but lost the war. If the new regulations were not intended to have and do not have force of
law status, they are not binding and so do not achieve the effect of reversing the IRS’s case law
defeats.

The second possible rejoinder – and this was argued by the IRS in *Intermountain* – relies
on an error that Treasury and the IRS have perpetuated for decades and which taxpayers and
even courts have too often accepted. This error equates interpretive regulations with regulations
issued under the general authority of Code section 7805(a) and equates legislative regulations
with regulations issued under specific authority within the particular substantive Code section at
issue. Since the temporary regulations were issued under section 7805(a), not under authority
within sections 6501 and 6229, the IRS claims that they are only interpretive.
The problem is that the equations on which the IRS’s argument rests are dead wrong, and the mere fact that much of the tax community has long sloppily or uncritically intoned these equations does not make the wrong right. The classification of a regulation as legislative or interpretive depends on whether the regulation has the force of law, not on which section of the Code the regulation was promulgated under. Tax regulations that make binding law are legislative whether they are promulgated under specific authority or general authority.

The third possible rejoinder was not argued by the IRS in *Intermountain*. It is the strongest of the rejoinders although it is not strong enough. In *Hoctor*, a non-tax case, the Seventh Circuit took a different tack to defining interpretive regulations. Writing for the court, Chief Judge Posner offered that a regulation is interpretive “only if it can be derived from the [statute or other governing law] by a process reasonably described as interpretation.” *Hoctor*, supra, at 170.

In the cases litigated before issuance of the temporary regulations, the IRS advanced many plausible (although usually ultimately unavailing) statutory interpretation arguments for its view that basis overstatements are within the ambit of the six-year limitations period. Thus, the Government could argue that the regulations are derived from sections 6501 and 6229 “by a process reasonably described as interpretation.”

There would be four problems with such an argument, however. One is that it is not clear that *Hoctor* was trying to establish a universal or even general test. Another problem is that the *Hoctor* approach is not widely followed. Another problem is that the *Hoctor* approach may be in tension with the dominant “force of law” definition of legislative regulations. One can imagine situations in which a regulation could be derived via interpretation so would be interpretive under *Hoctor* but would make binding law so would be legislative under the dominant test. The
final problem is that this argument might work better on a clean slate than in the current posture. It might be easier to say that the temporary regulations were derived via interpretation before the majority of the cases rejected the interpretations on which the position is based.

In short, I believe the new regulations are legislative in character. Thus, they do not qualify for the interpretive rule exception to the APA notice-and-comment requirements.

III. *Intermountain and Brand X*

The temporary regulations are an attempt by an agency to reverse judicial statutory interpretation. Can agencies do that? *Brand X* is a key case in this regard. The Supreme Court held that a regulation trumps prior judicial interpretations as long as two conditions are met: (1) the regulation qualifies for *Chevron* deference and (2) the prior cases did not say their results were commanded by an unambiguous statute. 545 U.S. at 982.

The *Intermountain* majority concluded that section 6501(e) unambiguously precludes the IRS’s position (thus defeating *Chevron* deference) and that the Supreme Court had so held in *Colony*. As noted in Part IC, I disagree with these conclusions. It will be interesting to see whether future decisions embrace or reject them.

*Brand X* is a comparatively recent decision, and important questions raised by it still must be resolved. *Intermountain* and comparable cases may help on some of these questions but not on others. Three such questions are addressed below.

An introductory caution. *Brand X* has been cited about 1300 times since it was decided in 2005, mostly by non-tax cases, agency memoranda, commentaries, and briefs. As of the time of this writing, I have reviewed only some of the non-tax *Brand X* authorities. Thus my conclusions now are tentative, and no one should rely on them without further research.
A. What *Intermountain*-Type Cases May Help Clarify

The first question is the “magic words” issue. Is *Brand X*’s second condition satisfied only if the prior case(s) expressly used the word “unambiguous” or a synonym in characterizing the statute? Courts have grappled with similar issues in other areas of administrative law. For example, the APA distinguishes between informal and formal rulemaking. When a regulation may be promulgated informally, the notice-and-comment process suffices. When formal rulemaking is required, additional steps prescribed by 5 U.S.C. sections 556 and 557 must be taken. Formal rulemaking is required when the underlying statute, the agency’s enabling act, states that the rules in question “are required … to be made on the record after opportunity for an agency hearing.” 5 U.S.C. § 553(c). Must precisely or essentially these words appear in the enabling act, or may a court hold that formal rulemaking is triggered by some lesser statutory language? The case law is not wholly consistent. The Supreme Court, however, has embraced the former alternative, the “magic words” approach. *E.g.*, *United States v. Florida East Coast Railway*, 410 U.S. 224, 241-42 (1973).

But context is everything in law, and the “magic words” question need not be handled the same way for *Brand X* purposes as for informal versus formal rulemaking purposes. Implicitly the *Intermountain* majority rejected that the word “unambiguous” need appear in the prior case(s) a regulation is trying to reverse. I think it was right to do so.

*Colony* and some of the other precedents were decided before *Brand X* and even *Chevron* were handed down. Unless they be charged with a burden of precognition, the justices and judges deciding those cases had no reason to know that their omitting particular words from their opinions could affect the allocation of power between courts and agencies.
Thus, the test under Brand X should be whether the prior cases, fairly read, suggest a view that the statute is unambiguous, not that the talismanic word “unambiguous” actually appear in the prior cases. If that construction prevails, Intermountain will have contributed to clarifying Brand X. See generally Thomas W. Merrill & Kristin E. Hickman, Chevron’s Domain, 89 GEO. L.J. 833, 917 (2001); Note, Implementing Brand X: What Counts as a Step One Holding?, 119 HARV. L. REV. 1532 (2006) (both exploring alternative approaches to this issue).

Unfortunately, the Intermountain majority misapplied this approach. The majority felt that Colony holds the statute to be unambiguous based on the legislative history. The majority cited pages 33 and 36 of Colony for this proposition. Yet page 33 calls the legislative history “persuasive evidence,” and page 36 says the legislative history “shows to our satisfaction” that Congress intended the result reached. This quoted language surely reflects a comfort level of over 50%, but it strikes me as falling short of “unambiguous.”

Colony can be compared to the prior judicial interpretation at issue in Brand X. In Brand X, the Ninth Circuit had held against the agency (the FCC) because the agency’s position was incompatible with the prior judicial interpretation of the governing statute in AT&T Corp. v. City of Portland, 216 F.3d 871 (9th Cir. 2000). The Supreme Court reversed the Ninth Circuit in Brand X, finding that the Portland court had not treated the underlying statute as unambiguous but had “held only that [its reading was] the best reading of [the statute].” 545 U.S. at 984. Similarly, the Colony opinion seems to me to reach only a “best reading” conclusion, not an “unambiguous” conclusion.

B. What Intermountain-Type Cases Probably Won’t Clarify

One unsettled question as to Brand X is what should be done if the precedents’ conclusions as to ambiguity are insupportable. What if the precedents declared the statute to be
unambiguous, but better analysis would have called it ambiguous? What if the precedents declared the statute to be unambiguous, but better analysis would have called it unambiguous?

I don’t think that Intermountain presents either of these situations. In my view, (1) the predecessor of section 6501(e) was ambiguous as to whether basis overstatements are covered, and current section 6501(e) remains ambiguous on this point and (2) contrary to the Intermountain majority’s conclusion, Colony cannot reasonably be read as declaring the statute to unambiguously exclude basis overstatements.

What, however, if I am right as to the first of these conclusions but wrong as to the second? In other words, what if Colony erroneously treated an ambiguous statute as unambiguous? If that situation obtains, future courts would either have to reject Brand X protection for the new regulations even though the Colony Court was wrong as to ambiguity, or they would protect the regulations under Brand X on the ground that Colony’s conclusion was wrong. The choice made by the courts between these alternatives would clarify the implementation of the Brand X rule.

However, Intermountain-type cases are not a good vehicle for achieving that clarification. Colony was a Supreme Court decision, and lower courts are not authorized to declare that Supreme Court decisions were wrongly reasoned. Only the Supreme Court can do that. E.g., Agostini v. Felton, 521 U.S. 203, 237 (1997) (requiring lower courts to adhere to the Court’s directly controlling precedents, even those resting on rationales rejected in other decisions). Thus, this clarification would be achieved only if the Supreme Court heard and decided Intermountain or a future case of this line. Given the number of tax cases the Supreme Court takes each year, this scenario is unlikely to eventuate and would be many years delayed even if, against the odds, it did eventuate.
I also doubt that *Intermountain*-type cases, or indeed cases of any type, will lead to resolution of the third of *Brand X*’s ambiguities: whether the clarity of the statute is to be determined only from the statutory text or whether the legislative history also may be examined as part of the inquiry. The *Intermountain* majority believed that resort to legislative history is properly part of the process. Slip op. at 21-25. To the contrary, the Halpern/Holmes concurrence believed text to be controlling, thus that “*Colony*’s resort to legislative history in the first place shows a gap that [Treasury] is ipso facto allowed to fill.” *Id.* at 43.

Their concurrence noted that this clash, this ambiguity in *Brand X* is “not [an issue] that we as a trial court can possibly solve on our own.” *Id.* I would go further. I doubt that this issue will ever be resolved by the courts, whether trial, intermediary appellate, or Supreme. That is because the dispute ultimately reflects the clash between textualism and purposivism in statutory interpretation. That underlying clash has not been resolved and likely never will be resolved. That being so, the subsidiary *Brand X* issue is unlikely ever to be settled.

The main support for the position that *Brand X* ambiguity analysis includes legislative history is *Chevron*, which states that Step One is answered by resort to “traditional tools of statutory construction,” 467 U.S. at 843, which of course, for many judges, would include legislative history. *Chevron* was written by Justice Stevens, a leading purposivist. But the *Brand X* opinion for the Court was written by Justice Thomas, a textualist. Justice Thomas framed the *Brand X* inquiry as whether “the prior court decision holds that its construction follows from the unambiguous terms of the statute,” 545 U.S. at 982 (emphasis added), a locution which seems to limit the inquiry to the statutory language (and perhaps statutory structure and maybe some canons; *Brand X* itself referred to a substantive canon: the rule of lenity, 545 U.S. at 985). See, e.g., *AARP v. EEOC*, 390 F. Supp. 2d 437, 445 (E.D. Pa. 2005)
(stating that “terms” in *Brand X* “clarified the *Chevron* standard itself”), aff’d on other grounds, 489 F.3d 558 (3d Cir. 2007).

Future *Brand X* decisions will sometimes be written by purposivist judges, who will embrace resort to legislative history, and sometimes by textualist judges, who will eschew it. With each new decision, one side or the other will gain an ascendancy, but only temporarily, only until the next opinion penned by a jurist of the contrary statutory interpretation persuasion. *Intermountain*-type cases won’t resolve the legislative history issue nor, I believe, will it ever be resolved.

I take *Chevron* as support for my pessimist conclusion. The post-*Chevron* case law is a mess, largely because of the Supreme Court’s own vacillation and divisions as to the cases purport. *E.g.*, Adrian Vermeule, *Mead in the Trenches*, 71 Geo. Wash. L. Rev. 347, 361 (2003) (“the Court has inadvertently sent the lower courts stumbling into a no-man’s land”). The passage of decades has made the situation, if anything, more not less confused. In part because of this, serious calls have been sounded to relegate *Chevron* to the doctrinal dust-bin. *E.g.*, William R. Andersen, *Against Chevron: A Modest Proposal*, 56 Admin. L. Rev 957, 964-69 (2004); Jack M. Beerman, *End the Failed Chevron Experiment Now: How Chevron Has Failed and Why It Can and Should Be Overruled*, 42 Conn. L. Rev. 779, 783 (2010) (“Currently, the application of the *Chevron* doctrine is highly unpredictable, and the decision itself is cited for opposing propositions.”). I expect no better of *Brand X*, at least with respect to the legislative history issue.

**CONCLUSION**

The Tax Court’s *Intermountain* decision surely is not the last shot that will be fired in the overstated basis statute of limitations battle. The Government may appeal *Intermountain*, and
the validity and applicability of the new regulations will surely be tested in other cases in the future.

Based on the above analysis, the temporary regulations should continue to be invalidated. However, once they have been finalized after completion of notice-and-comment, the regulations should be upheld, particularly if applied only prospectively. Taxpayers who already have won their cases should be safe, but taxpayers whose cases have not yet been decided will be in jeopardy.

The points elaborated in Parts II and III above are only some of the interesting points raised by *Intermountain*. The case is a treasure trove for those interested in tax procedure, and we can anticipate the delight of opening more chests of sparkling gems when future decisions are issued as to the validity of the basis overstatement statute of limitations regulations.