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Can Treasury Overrule the Supreme Court?

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CAN TREASURY OVERRULE THE SUPREME COURT?

GREGG D. POLSKY*

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* Associate Professor, University of Minnesota Law School. I wish to thank Guy-Uriel Charles, Shayna Sigman, Jim Chen, Dan Farber, Brant Hellwig, Ellen Aprill, Gregory Germain, Bruce Shneider, Victor Fleischer, Jeff Kahn, David Richardson, Martin McMahon, Jr., Michael Paulsen, Dan Gifford, Rachel Polsky, Mary Louise Fellows, Leandra Lederman, Nathan Honson, and Michael Kirsch for their comments on an earlier draft. I also thank George Mundstock and Mitchell Gans for helpful discussions on the topic. Eliot Wren and Dan Grimsrud provided valuable research assistance. Finally, I wish to thank my wife, Rina Lyubkin, for her immeasurable help and support. Of course, any errors or omissions are solely my responsibility.

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INTRODUCTION

The Treasury's "check-the-box regulations" govern the most basic of all corporate tax issues—namely, which entities are subject to the corporate tax. These fundamental regulations are practical, sensible, and (some would argue) indispensable.¹ However, they are also unlawful.

The check-the-box regulations govern the classification of business entities as corporations or partnerships for federal tax purposes.² In general, the earnings of an entity classified as a corporation are subject to two layers of tax: an entity-level tax—the corporate income tax—on the corporation's earnings; and an owner-level tax—the individual income tax—on distributions of earnings to the corporation's owners.³ Business entities not classified as corporations for tax purposes are generally classified as partnerships.⁴ Earnings of partnerships are subject to only a single level of tax at the owner level.⁵ Thus, the tax classification of an entity as either a corporation or a partnership is the most basic of all corporate tax issues because it determines whether or not the entity is subject to the corporate income tax.

Section 7701(a)(3) of the Internal Revenue Code (the "Code") provides that "[t]he term 'corporation' includes *associations*, joint-stock companies, and

¹ See 1 WILLIAM S. MCKEE ET AL., *FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS* ¶ 3.08, at 3-102 (3d ed. 1997 & Supp. 2002) (noting that the regulations "have evoked virtually universal approbation and support from private practitioners and taxpayers").

² Treas. Reg. § 301.7701-1 to -3 (as amended in 2003).

³ See 1 BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶¶ 1.01-1.03, at 1-3 to 1-11 (7th ed. 2000 & Supp. 2002) (describing in general how corporate earnings are taxed). In some cases, corporations are not subject to the double tax regime while in other cases, corporations are subject to unique taxing regimes. See *id.* ¶ 1.06, at 1-25 to 1-29 (describing these special regimes).

⁴ See I.R.C. § 7701(a)(2) (2000) (defining partnership as any business entity that is not otherwise determined to be a corporation, trust, or estate).

⁵ See generally 1 MCKEE ET AL., *supra* note 1, ¶ 1.01[1] (describing the taxation of income earned by partnerships).

insurance companies.”⁶ The federal tax law definition of “corporation” thus includes not only state law corporations but, more broadly, “associations.” As a result, associations are taxable as corporations. The language in § 7701(a)(3) (and its predecessor statutes) has remained unchanged for over eighty-five years.⁷

The question of which entities are included in the term “association” has confounded courts from the term’s first appearance in the Code.⁸ The United States Supreme Court attempted to clear the confusion in the 1935 case *Morrissey v. Commissioner*,⁹ interpreting the term to mean any unincorporated entity that resembles a state law corporation. In determining whether an entity resembles a corporation, the *Morrissey* Court identified four relevant corporate factors: limited liability for owners, free transferability of ownership interests, perpetual existence of the entity, and a centralized management structure.¹⁰

Unfortunately, *Morrissey* did not end the confusion. Even after the U.S. Treasury promulgated regulations that applied *Morrissey*’s corporate resemblance test in a relatively mechanical fashion, the test remained problematic. As a result, in 1996, the Treasury proposed the check-the-box regulations, defining the term “association” to mean any unincorporated business entity that elects to be taxed as a corporation. At the time, several commentators expressed concern that the regulations were invalid under the well-known *Chevron* doctrine.¹¹ In particular, they argued that by giving the term “association” an elective definition, the regulations were incompatible with the statutory language, which suggested that Congress intended the term to have substantive meaning. The issue of whether the regulations satisfied the *Chevron* standard was the subject of significant debate and was even analyzed by the Joint Committee on Taxation.¹² Notwithstanding these concerns, the Treasury soon promulgated the regulations in final form, apparently concluding that the regulations were valid under *Chevron*.

In this article, I argue that the check-the-box regulations are invalid because the Supreme Court’s decision in *Morrissey* forecloses any re-interpretation of the term “association” by the Treasury. Accordingly, the focus on *Chevron* in

⁶ I.R.C. § 7701(a)(3) (emphasis added).

⁷ Compare Revenue Act of 1918 § 1 (defining corporation as including “associations, joint-stock companies, and insurance companies”), with I.R.C. § 7701(a)(3) (same).

⁸ See, e.g., *Coleman-Gilbert Assoc. v. Comm’r*, 76 F.2d 191, 193 (1st Cir. 1935) (describing the confusion surrounding the definition of the term “association”).

⁹ 296 U.S. 344, 357-58 (1935).

¹⁰ *Id.* at 359.

¹¹ In very general terms, the *Chevron* doctrine requires that courts defer to any reasonable agency interpretation of an ambiguous statute. For a full discussion of *Chevron*, see *infra* Part I.

¹² STAFF OF THE JOINT COMM. ON TAXATION, 105th CONG., REVIEW OF SELECTED ENTITY CLASSIFICATION AND PARTNERSHIP TAX ISSUES 13-17 (Joint Comm. Print 1997) [hereinafter JCT REPORT].

the discussion of the validity of the regulations has been misplaced because, in assessing the validity of the regulations, one should never even reach the *Chevron* issue.

This conclusion is based on a trilogy of Supreme Court opinions holding that when the Court interprets a statutory term, that interpretation is binding on the executive branch and may be altered only by an act of Congress or a subsequent opinion of the Court.¹³ Therefore, these cases hold that, at least as far as the executive branch is concerned, a judicial interpretation of a statute is effectively incorporated into the underlying statute. Accordingly, because the check-the-box regulations' definition of association (i.e., any unincorporated entity that elects to be taxed as a corporation) is wholly inconsistent with the *Morrissey* definition (i.e., any unincorporated entity which resembles a corporation), the check-the-box regulations are invalid. To be clear, this article does not dispute the prevailing opinion that the regulations represent good tax policy;¹⁴ rather, it argues that the Treasury never had the authority to implement this policy in the first place.

After explaining why the check-the-box regulations are invalid, this article addresses several counter-arguments that, if successful, would save the regulations from invalidity. Ultimately, this article concludes that these counter-arguments are not fully persuasive.

Although this article focuses on only one specific regulatory action, the underlying issue has broad significance. It has been increasingly common for the Treasury to attempt to "fix" a Supreme Court interpretation that, for various reasons, the Treasury finds problematic. When faced with such a problematic interpretation, tax administrators have three choices: (1) propose

¹³ See *Neal v. United States*, 516 U.S. 284, 294-96 (1996) (holding that a United States Sentencing Commission interpretation was invalid because it was inconsistent with the Court's prior interpretation); *Lechmere, Inc. v. NLRB*, 502 U.S. 527 (1992) (holding that a National Labor Relations Board interpretation was invalid because it was inconsistent with the Court's prior interpretations); *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 134-35 (1990) (holding that an Interstate Commerce Commission interpretation was invalid because it was inconsistent with the Court's prior interpretation).

¹⁴ See, e.g., 1 MCKEE ET AL., *supra* note 1, ¶ 3.08, at 3-102 (praising the policy behind the regulations). In the international arena, however, the regulations have given rise to some unfortunate consequences. The regulations have facilitated the use of hybrid entities, which are treated as flow-through entities for U.S. federal tax purposes and corporations for foreign tax purposes or vice versa. For discussions of the potential abuse of hybrids that has been facilitated by the issuance of the check-the-box regulations and the Treasury's responses thereto, see William L. Bricker, Jr. et al., *Use of Hybrids in International Tax Planning: Past, Present and Future*, 13 ST. JOHN'S J. LEGAL COMMENT. 79 (1998); Thomas R. May, *Warning: Hybrid Entities—Proceed With Caution*, 86 TAX NOTES 533, 533-34 (Jan. 24, 2000), available at LEXIS 86 TN 533. The hybrid problem was not created by the regulations; however, the regulations did "make international tax-planning strategies that may not have been practical (due to the cost of implementation, probability of success, etc.) before their issuance both practical and attractive after their issuance." *Id.* at 533.

legislation to Congress to fix the problem, (2) promulgate regulations that fix the problem in a taxpayer-adverse manner, or (3) promulgate regulations that fix the problem in a taxpayer-friendly manner. This article will demonstrate that option number (1) (go to Congress) is the only valid solution. The Treasury, however, has recently shown a tendency to choose option number (3) (fix the problem in taxpayer-friendly manner). This phenomenon likely results from the very restrictive standing rules governing taxpayer lawsuits that reduce or eliminate the likelihood of challenges to these invalid rules.

This article is divided into five parts. Part I lays out the administrative law landscape, describing the *Chevron* doctrine and its interaction with judicial precedent. Part II traces the history of the interpretation of the term "association" from its inception in the predecessor to § 7701(a)(3) up through the check-the-box regulations. Part III then applies administrative law principles to the check-the-box regulations, concluding that they are invalid. Part III also addresses the colorable arguments that could be made to save the regulations, but ultimately concludes that these arguments are not persuasive. Part IV considers how the Treasury could have issued invalid regulations in such an important and visible area of the law. In this discussion, Part IV describes the context in which a challenge to the regulations might arise and the practical consequences of a successful challenge. Finally, Part V argues that the Treasury has developed a trend of issuing taxpayer-friendly rules that are, like the check-the-box regulations, invalid because they are inconsistent with Supreme Court decisions directly on point. Part V also discusses the implications of this trend.

I. ADMINISTRATIVE LAW BACKGROUND

A. *Pre-Chevron Law*

Prior to the Supreme Court's seminal 1984 decision in *Chevron U.S.A., Inc. v. Natural Resource Defense Council, Inc.*,¹⁵ there was no coherent theory or doctrine regarding the judicial review of agency interpretations of ambiguous statutes.¹⁶ When considering agency interpretations, the level of respect the Court afforded the agency's view often varied significantly from case to case.¹⁷ In general, the cases could be split into two vastly different categories. Sometimes, the Court deferred to any agency interpretation that was reasonable in light of the statutory scheme.¹⁸ Under this method, which has been called

¹⁵ 467 U.S. 837 (1984).

¹⁶ See 1 RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 3.1 (4th ed. 2002 & Supp. 2003) (describing pre-*Chevron* guidelines for judicial review of agency interpretations); Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L.J. 969, 972-75 (1992) (discussing the pre-1984 judicial review guidelines).

¹⁷ See Merrill, *supra* note 16, at 972.

¹⁸ See, e.g., *NLRB v. Hearst Publ'ns, Inc.*, 322 U.S. 111, 131 (1944) (upholding National Labor Relations Board's interpretation of the term "employee" in the National Labor

the deferential model, the Court would not actively interpret the statute at issue—rather, its “role was limited to determining whether the agency’s interpretation was reasonable.”¹⁹ In other words, under this model, the Court would not seek to find the single best interpretation but would merely ensure that the agency’s position was within the universe of rational interpretations and not arbitrary or capricious.²⁰ In these instances, the agency, rather than the judiciary, would have primary interpretive authority.²¹

In other cases, the Court would take primary interpretive authority and independently review the statute in an attempt to find the single best interpretation.²² Under this method, known as the independent judgment model, the Court would actively interpret the statute, rather than merely determining whether the agency’s proffered interpretation was reasonable.²³

Under the independent judgment model, even though the Court had primary interpretive authority, the agency’s view was not irrelevant. Because of the agency’s familiarity with the statutory scheme and its underlying policies, the agency’s “view of the proper meaning [was] a factor in the court’s analysis, [and was] given whatever persuasive effect it appear[ed] to merit in the

Relations Act as including newsboys, even though newsboys were characterized as independent contractors for other purposes, because the interpretation had “a reasonable basis in law”); see also PIERCE, *supra* note 16, § 3.1, at 139 (observing that, in certain instances prior to *Chevron*, the Court would defer to any interpretation promulgated by an agency so long as the interpretation was reasonable); Cynthia R. Farina, *Statutory Interpretation and the Balance of Power in the Administrative State*, 89 COLUM. L. REV. 452, 454 (1989) (same). Even though the deferential model was, in general, sporadically applied by courts, it was consistently applied where Congress made an explicit delegation of law-making authority to an agency. See, e.g., *United States v. Morton*, 467 U.S. 822, 834 (1984); *Schweiker v. Gray Panthers*, 453 U.S. 34, 44 (1981); *Batterton v. Francis*, 432 U.S. 416, 425 (1977); *Am. Tel. & Tel. Co. v. United States*, 299 U.S. 232, 235-37 (1936) (finding clear congressional intent to delegate interpretive authority to the respective agencies and applying the deferential model); see also Kenneth A. Bamberger, *Provisional Precedent: Protecting Flexibility in Administrative Policymaking*, 77 N.Y.U. L. REV. 1272, 1285 (2002) (“[*Chevron*] simply expanded the separation-of-powers model that the Supreme Court had applied since the beginning of the twentieth century to instances in which Congress explicitly assigned to agencies the power to construe regulatory statutes.”).

¹⁹ See Rebecca Hammer White, *The Stare Decisis “Exception” to the Chevron Deference Rule*, 44 FLA. L. REV. 723, 729 (1992).

²⁰ Farina, *supra* note 18, at 454.

²¹ See *id.* at 453-54.

²² See, e.g., *NLRB v. Bell Aerospace*, 416 U.S. 267 (1974) (independently determining that the term “employees” in the National Labor Relations Act did not include buyers despite the National Labor Relations Board’s conclusion to the contrary); see also PIERCE, *supra* note 16, § 3.1 (describing how, in certain instances prior to *Chevron*, the Court would independently interpret a statute in a manner contrary to an agency’s reasonable interpretation); Farina, *supra* note 18, at 453-54 (same).

²³ Farina, *supra* note 18, at 453-54.

circumstances."²⁴ At all times under this model, however, it was the Court that would decide the statute's single best meaning, even if the Court ultimately agreed with the agency's position.²⁵

Prior to *Chevron*, it was often impossible to predict in any given case whether the Court would apply the independent judgment model or the deferential model.²⁶ Furthermore, it was often difficult to characterize a decision as employing one or the other type of analysis.²⁷ The leading administrative law treatise described the hopelessly muddled state of affairs at the time: "The Court . . . substitutes judgment in some cases and uses the reasonable test [i.e., the deferential review model] in other cases, without providing any guide as to what actuates its choices."²⁸

B. *Chevron's Impact—Victory for the Deferential Model?*

In *Chevron*, the Court appeared to adopt conclusively the deferential model, articulating the precise steps a court should take in reviewing agency interpretations. When a court is faced with an agency interpretation of an agency-administered statute, *Chevron* instructed that the first step is for the court to determine whether Congress "has directly spoken to the precise question at issue."²⁹ Under this step one, a court should look to the words of the statute and "employ[] . . . traditional tools of statutory construction" to ascertain whether "Congress had an intention on the precise question at issue."³⁰ If so, the clear will of Congress as expressed in the statute controls, notwithstanding a contrary interpretation asserted by the agency.³¹

Step one is thus consistent with both the independent judgment and deferential models. If a case is concluded at that step, it means that the court has determined that the statute has a clear meaning. Under the independent judgment model, the court would have independently adopted that same meaning, and under the deferential model, the court would find "unreasonable" any contrary meaning.

If step one yields the determination that "Congress has not directly addressed the precise question at issue," *Chevron* then instructed the Court to

²⁴ *Id.* at 454.

²⁵ *Id.* at 453 (explaining that, under the independent judgment model, "the court exercises its own judgment to determine de novo what the statute means").

²⁶ *Id.* at 454-55.

²⁷ See Merrill, *supra* note 16, at 972 (describing pre-*Chevron* confusion and concluding that, although there existed cases falling neatly within the independent judgment model or the deferential model, "in practice, deference existed along a sliding scale, bridging these outer limits").

²⁸ KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE 375 (2d ed. 1958).

²⁹ *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984).

³⁰ *Id.* at 843 n.9.

³¹ *Id.* at 842-43.

move on to step two.³² In step two, a court “does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation.”³³ Rather, the court seeks to determine simply “whether the agency’s [position] is based on a permissible construction of the statute.”³⁴ To determine that an agency position is permissible, “[t]he court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.”³⁵ Rather, the court’s responsibility is to determine whether the agency’s position represents a “reasonable policy choice” in light of the congressional mandate articulated in the statute.³⁶ Thus, under step two, a court’s task is not to determine the single best interpretation of an ambiguous statute as it would under the independent judgment model; its task is to determine only whether the agency’s position is a reasonable one.³⁷

Therefore, although step one is consistent with both the independent judgment model and the deferential model, the deference shown to any reasonable interpretation under step two suggests that the deferential model won the day.³⁸ As discussed below, however, the 2001 *Mead* decision has now made clear that the independent judgment model did survive *Chevron*.³⁹

The doctrinal basis for *Chevron* deference has been the subject of significant

³² *Id.* at 843.

³³ *Id.* (footnote omitted).

³⁴ *Id.* (footnote omitted).

³⁵ *Id.* at 843 n.11.

³⁶ *Id.* at 845.

³⁷ The Supreme Court has never made clear how a court is supposed to determine when an interpretation plausible enough to survive step one is nonetheless unreasonable under *Chevron* step two. See Ronald M. Levin, *The Anatomy of Chevron: Step Two Reconsidered*, 72 CHI.-KENT L. REV. 1253, 1260 (1997) (arguing that the Court’s step two standard is vague and “seem[s] to verge on internal incoherence”). The leading view appears to be that step two deals with an agency’s decisionmaking process in arriving at an interpretation, focusing primarily on whether the agency adequately considered the matter at hand as opposed to making an arbitrary and capricious decision. See *Animal Def. Fund v. Glickman*, 204 F.3d 229, 234 (D.C. Cir. 2000) (concluding that step two is designed to strike down interpretations that, while plausible under the statute, were arbitrary and capricious); see also PIERCE, *supra* note 16, § 3.6, at 11 (2003 Supp.) (explaining that, in applying step two, the Supreme Court has been “evaluating the adequacy of an agency’s reasoning process, thereby demonstrating the convergence of the ‘reasonableness’ test in step two of *Chevron* with the duty to engage in reasoned decisionmaking”); Levin, *supra*, at 1263 (claiming that the D.C. Circuit “has transformed the *Chevron* step two question of whether the agency action was ‘reasonable’ into a question of whether it was ‘reasoned’”).

³⁸ See Farina, *supra* note 18, at 455 (concluding that *Chevron* “endorsed [the] deferen[tial model] in emphatic terms”); White, *supra* note 19, at 730 (stating that *Chevron* endorsed the deferential model).

³⁹ See *infra* Part I.C.

debate among scholars.⁴⁰ Some suggest that the doctrine has its roots in constitutional separation of powers principles,⁴¹ while others argue that it arose from judicial common law.⁴² The prevailing theory, however, based on language in recent Supreme Court cases,⁴³ is that *Chevron* deference is based on presumed congressional intent.⁴⁴ Under this theory, in the absence of a specific directive from Congress on how agency interpretations should be reviewed by courts, the Court has assumed the default rule that Congress desires that politically accountable agencies (rather than the politically insulated courts) be entrusted with primary interpretive responsibility with regard to ambiguities and gaps within agency-administered statutes.⁴⁵ This assumption (i.e., that Congress generally wants agencies to bear primary interpretive responsibility), however, has been described by some scholars as a fiction because it appears that "Congress rarely formulates an intent about who will decide particular questions of statutory meaning."⁴⁶ In fact, there is some evidence to suggest that legislators might actually prefer that courts, rather than agencies, reconcile ambiguities and gaps in statutes.⁴⁷

⁴⁰ See Thomas W. Merrill & Kristin E. Hickman, *Chevron's Domain*, 89 GEO. L.J. 833, 863-73 (2002) (discussing the debate surrounding the basis for *Chevron*).

⁴¹ See Douglas W. Kmiec, *Judicial Deference to Executive Agencies and the Decline of the Nondelegation Doctrine*, 2 ADMIN. L.J. 269, 287-90 (1988); Richard J. Pierce, Jr., *Reconciling Chevron and Stare Decisis*, 85 GEO. L.J. 2225, 2227 (1997); Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 YALE J. ON REG. 283, 308 (1986).

⁴² See Maureen B. Callahan, *Must Federal Courts Defer to Agency Interpretations of Statutes? A New Doctrinal Basis for Chevron* U.S.A. v. Natural Resources Defense Council, 1991 WIS. L. REV. 1275, 1289-94; William N. Eskridge, Jr. & Philip P. Frickey, *Quasi-Constitutional Law: Clear Statement Rules as Constitutional Lawmaking*, 45 VAND. L. REV. 593, 618-19 (1992); David M. Hasen, *The Ambiguous Basis of Judicial Deference to Administrative Rules*, 17 YALE J. ON REG. 327, 357-62 (2000).

⁴³ See, e.g., *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001) (applying *Chevron* deference "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority").

⁴⁴ See Merrill & Hickman, *supra* note 40, at 870-72 (explaining that "the congressional-intent theory is the best of the three explanations for the legal foundation of *Chevron* deference").

⁴⁵ Although the *Chevron* Court focused on an executive agency's responsiveness to the President's influences, see *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 865 (1984), it is clear that executive agencies are also responsive to influence by Congress and lobbyists. Einer Elhauge, *Preference-Estimating Statutory Default Rules*, 102 COLUM. L. REV. 2027, 2149-50 (2002).

⁴⁶ Farina, *supra* note 18, at 471; see also Elhauge, *supra* note 45, at 2132 (arguing that evidence of congressional intent to delegate interpretive authority to administrative agencies absent explicit authorization to do so is "weak" or "fictional").

⁴⁷ See Farina, *supra* note 18, at 473-74 (describing the near passage of the Bumpers Amendment in 1975, which would have required federal courts to review all matters of law de novo).

Despite these suspect underpinnings, the *Chevron* doctrine has generally been considered wise as a matter of policy.⁴⁸ The *Chevron* doctrine has been described as furthering a number of policy goals,⁴⁹ two of which are most significant in regard to this article. First, by giving the executive branch primary interpretive authority vis-à-vis the judicial branch with respect to ambiguities and gaps left by Congress, *Chevron* allocates policy-making power towards a politically accountable branch and away from a politically insulated branch.⁵⁰

Second, *Chevron* gives agencies the flexibility to change and adapt their policies to reflect the current state of affairs and political attitudes.⁵¹ Under the independent judgment model, the Court would interpret an ambiguous term on its own, and the Court's interpretation would be binding on the public and the executive branch by virtue of stare decisis.⁵² Thus, under this model, if the Court adopts interpretation X, that interpretation becomes binding precedent even if the term is susceptible to a different interpretation.⁵³ If an agency subsequently adopts interpretation Y, that interpretation would be invalid, at

⁴⁸ See, e.g., JERRY L. MASHAW, GREED, CHAOS AND GOVERNANCE 152-53 (1997); Callahan, *supra* note 42, at 1289; Michael Stokes Paulsen, *The Most Dangerous Branch: Executive Power to Say What the Law Is*, 83 GEO. L.J. 217, 333-34 (1993); Richard J. Pierce, Jr., *Political Control Versus Impermissible Bias in Agency Decisionmaking: Lessons from Chevron and Mistretta*, 57 U. CHI. L. REV. 481, 486 (1990); Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511, 517-20; Peter L. Strauss, *One Hundred Fifty Cases Per Year: Some Implications of the Supreme Court's Limited Resources for Judicial Review of Agency Action*, 87 COLUM. L. REV. 1093, 1121-22 (1987); Cass Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071, 2091-2104 (1990) (extolling the policy virtues of *Chevron*). This view that *Chevron* is a wise policy choice is by no means unanimous. See, e.g., Farina, *supra* note 18, at 515-16; Merrill, *supra* note 16, at 998; Mark Seidenfeld, *A Syncopated Chevron: Emphasizing Reasoned Decisionmaking in Reviewing Agency Interpretations of Statutes*, 73 TEX. L. REV. 83, 120-25 (1994) (contending that *Chevron* is not sound public policy).

⁴⁹ See, e.g., Pierce, *supra* note 41, at 2229-37 (discussing six goals furthered by *Chevron*).

⁵⁰ See *id.* at 2229 (“[A]gencies are in a position below Congress but above courts in the institutional hierarchy in the policymaking context.”).

⁵¹ See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 863-64 (1984) (“[T]he agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis.”); see also *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 742 (1996) (“[T]he whole point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agency.”); *Rust v. Sullivan*, 500 U.S. 173, 186-87 (1991) (emphasizing that agencies must be allowed to adapt their interpretations to adapt to changing circumstances).

⁵² See *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-75 (1989) (acknowledging the stare decisis effect on the executive branch).

⁵³ See Pierce, *supra* note 41, at 2225 (explaining that when courts “impose[] their own constructions on ambiguous agency-administered statutes . . . [they] create binding precedent”).

least to the extent that *Y* is inconsistent with *X*, even if *Y* is an entirely reasonable interpretation.⁵⁴ Thus, the independent judgment model results in a lock-in of a single interpretation, subject to change only by Congress.⁵⁵

On the other hand, when the Court implements the *Chevron* doctrine, there is no such lock-in effect. When the Court applies *Chevron*, it results in a very limited stare decisis effect.⁵⁶ For example, assume that the Court determines that a particular term is ambiguous under *Chevron* step one and that a particular agency interpretation (interpretation *X*) is permissible under *Chevron* step two. The only stare decisis effects resulting from such a determination are the following: (1) the particular term is ambiguous under *Chevron* step one,⁵⁷ and (2) interpretation *X* was reasonable under *Chevron* step two.⁵⁸ Stare decisis would have no impact on the validity of subsequent inconsistent interpretation *Y* promulgated by the agency.⁵⁹ So long as that interpretation passes *Chevron* step two, the latter interpretation would be valid.⁶⁰

C. United States v. Mead: *The Return of the Independent Judgment Model*

Although *Chevron* appeared to adopt conclusively the deferential model, the recent Supreme Court decision in *United States v. Mead Corp.*⁶¹ has suggested otherwise. Until *Mead*, it was not entirely clear what types of agency guidance were entitled to *Chevron* deference.⁶² Agency guidance can take a variety of

⁵⁴ See, e.g., *Neal v. United States*, 516 U.S. 284, 295-96 (1996) (holding invalid an agency interpretation that conflicted with the Court's prior interpretation made under the independent judgment model).

⁵⁵ See *United States v. Mead Corp.*, 533 U.S. 218, 247 (2001) (Scalia, J., dissenting) (stating that when the Court interprets an ambiguous term under the independent judgment model, "ambiguity (and hence flexibility) will cease with the first judicial resolution").

⁵⁶ See *id.* at 248 (claiming that under *Chevron*, "the court does not purport to give the statute a judicial interpretation").

⁵⁷ See *id.* (maintaining that, when *Chevron* applies, the only judgment of the court that is "final and irreversible" is the court's "identif[ication of] the scope of the statutory ambiguity").

⁵⁸ See *id.* (asserting that, when *Chevron* applies, the Court's approval of one reasonable agency interpretation of an ambiguous statute will not foreclose a later inconsistent, reasonable agency interpretation).

⁵⁹ See *id.*

⁶⁰ See *id.* ("[W]hen the agency's authoritative interpretation comes within the scope of that ambiguity—and the court therefore approves it—the court will not be 'overruling' the court's decision when it later decides that a different interpretation (still within the scope of ambiguity) is preferable.").

⁶¹ 533 U.S. 218.

⁶² John F. Coverdale, *Chevron's Reduced Domain: Judicial Review of Treasury Regulations and Revenue Rulings After Mead*, 55 ADMIN. L. REV. 39, 46 (noting that, until recently, the scope of *Chevron* was not clear). Although the Court had limited *Chevron* deference to cases where an interpretation was made by the agency charged with administering the particular statute, see *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649

forms, from the most formal and general (e.g., regulations) to the most informal and specific (e.g., litigating positions).⁶³ An expansive view of interpretations that qualify for *Chevron* deference would mean that many kinds of agency interpretations would fall within the scope of *Chevron*.⁶⁴ On the other hand, a narrow view would shrink *Chevron*'s scope by limiting the kinds of agency interpretations eligible for deference.⁶⁵ Closely related to the issue of *Chevron*'s scope is the question of what sort of respect, if any, should be afforded agency interpretations that do not qualify for *Chevron* deference.

In *Mead*, the Court provided some guidance on these issues.⁶⁶ In that case, the United States Customs Service ("Customs") interpreted a statutory term in a tariff classification ruling.⁶⁷ The threshold issue in *Mead* was whether the tariff classification ruling was an agency interpretation that qualified for *Chevron* deference.⁶⁸

The Court first determined that not all authoritative agency determinations triggered deference under *Chevron*.⁶⁹ Rather, the Court found that an agency interpretation would trigger *Chevron* deference only in two separate instances. First, *Chevron* deference is triggered when there is an "express delegation [by Congress] of specific interpretive authority."⁷⁰ Second, *Chevron* deference is triggered when it "appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency

(1990), and to cases where the agency had the statutory power to promulgate rules and regulations, *see* EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 250-51 (1991), it was unclear until *Mead* what types of interpretations by these agencies would not be given *Chevron* deference. *See* Coverdale, *supra*, at 46-47 ("As late as 2000, a plausible argument could be advanced that as a matter of positive law, *Chevron* deference applied to all positions that represented the official view of an agency charged with the administration of a statute and empowered to promulgate rules and regulations.").

⁶³ *See generally* Peter L. Strauss, *The Rulemaking Continuum*, 41 DUKE L.J. 1463, 1463-66 (describing the various forms in which agency positions are expressed).

⁶⁴ *See* Merrill & Hickman, *supra* note 40, at 835 (explaining that the scope of "*Chevron*'s domain" depends on "what sorts of agency interpretations [are subject to] the mandatory deference doctrine of *Chevron*").

⁶⁵ *See id.*

⁶⁶ The Supreme Court decision in *Christensen v. Harris County*, 529 U.S. 576 (2000), foreshadowed the holding in *Mead*. In *Christensen*, the issue was whether an agency position expressed in an opinion letter qualified for *Chevron* deference. *Id.* at 586. The five-member majority concluded that only agency positions that have the "force of law" so qualify, and that the position in question did not have the force of law. *Id.* at 587.

⁶⁷ *United States v. Mead Corp.*, 533 U.S. 218 (2001). The specific issue was whether the statutory term "[bound] [d]iaries" included day planners, described by the Court as "three-ring binders with pages having room for notes of daily schedules and phone numbers and addresses, together with a calendar and suchlike." *Id.* at 224-25.

⁶⁸ *Id.* at 226.

⁶⁹ *See id.* at 227.

⁷⁰ *Id.* at 229.

interpretation claiming deference was promulgated in the exercise of that authority."⁷¹ Thus, in order for an agency interpretation to obtain the benefit of *Chevron* deference in the absence of a specific directive from Congress, the agency must show that Congress gave it a general grant of authority to make rules having the effect of law in the particular form in which the interpretation was issued.

The Court went on to provide that such a general grant of authority "may be shown in a variety of ways, as by an agency's power to engage in adjudication or notice-and-comment rulemaking, or by some other indication of a comparable congressional intent."⁷² The Court reasoned that it could be assumed "that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force."⁷³

Turning to the tariff classification rulings at issue, the Court concluded that there was no specific congressional delegation to Customs to issue these rulings with the force of law.⁷⁴ Furthermore, although the Court found that Customs had been given a general grant of authority to issue *regulations* with the force of law, it found no such authority with respect to tariff classification rulings.⁷⁵ In reaching this conclusion, the Court noted that the rulings were issued without notice and comment, were treated by Customs as not binding on third parties, and were issued in large quantities by forty-six offices scattered around the United States.⁷⁶

After concluding that the tariff classification rulings did not qualify for *Chevron* deference, the Court next considered what level of respect, if any, was to be afforded the rulings in interpreting the statutory language at issue.⁷⁷ The Court concluded that these agency interpretations should be given an amount of respect proportional to their "power to persuade," citing the 1944 case *Skidmore v. Swift & Co.*⁷⁸ As a result, the *Mead* Court affirmed the continuing vitality of the independent judgment model in cases where the agency interpretation failed to qualify for *Chevron* deference. In these cases, the court will bear primary interpretive responsibility, and the weight given to the agency's view will depend "upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade . . ."⁷⁹

⁷¹ *Id.* at 226-27.

⁷² *Id.* at 227.

⁷³ *Id.* at 230.

⁷⁴ *Id.* at 231-32.

⁷⁵ *Id.* at 232.

⁷⁶ *Id.* at 233.

⁷⁷ *Id.* at 234.

⁷⁸ *Id.* at 235 (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)).

⁷⁹ *Id.* at 228 (quoting *Skidmore*, 323 U.S. at 140)

Unlike *Chevron* deference, “*Skidmore* respect”⁸⁰ is not based on any implied delegation by Congress, since such implied delegation must necessarily have been found lacking or else *Chevron* rather than *Skidmore* would have applied.⁸¹ Rather, *Skidmore* respect is based in judicial common law and on the notion that the view of an agency—expert in the relevant field and familiar with the statutory scheme—is a relevant consideration.⁸²

Therefore, *Mead* indicates a two-tier system for agency interpretations. With respect to agency interpretations in a format that Congress intends to have the force of law (*Mead*-qualified interpretations), an agency position that passes *Chevron*’s deferential standard will control. With respect to agency interpretations in any other format (non-*Mead*-qualified interpretations), the

⁸⁰ Courts have commonly used the phrase “*Skidmore* deference” to refer to the amount of respect accorded agency interpretations under *Skidmore*. See, e.g., *Scafar Contracting, Inc. v. Sec’y of Labor*, 325 F.3d 422, 428 (3d Cir. 2003) (discussing an agency interpretation that is sound when reviewed with *Skidmore* deference). This phrase, however, is an oxymoron. Under *Skidmore*, the Court is charged with the primary interpretive responsibility with regard to an ambiguous provision. See *Skidmore*, 323 U.S. at 140 (indicating that the agency interpretation in question was “not controlling upon the court by reason of [its] authority”); Clark Byse, *Scope of Judicial Review in Informal Rulemaking*, 33 ADMIN. L. REV. 183, 192 (1981) (stating that under the *Skidmore* formulation, the agency interpretation is only looked to for guidance). In determining the single best meaning of the provision, the court may or may not take into account the position of the expert agency, depending on the facts and circumstances. See *Skidmore*, 323 U.S. at 140 (holding that, while the agency interpretation in question was “not controlling upon the courts by reason of [its] authority,” the interpretation nevertheless could be resorted to “for guidance” and that the weight to be given such guidance depended upon the agency interpretation’s “power to persuade”). Thus, the court never technically defers to the agency position under *Skidmore* even if the court ultimately adopts the position; the agency position is mere evidence considered by the court in its attempt to determine the single best interpretation. See *Mead Corp.*, 533 U.S. at 247-48 (Scalia, J., dissenting) (explaining that while *Skidmore* deference gives some weight to the agency position, the Court ultimately decides the meaning of the statute). Under *Chevron*, a true deference doctrine, the Court does not purport to interpret an ambiguous statute, instead deferring to any reasonable agency interpretation. See *id.* at 247 (indicating that the Court does not make a binding interpretation under *Chevron*, but only approves the agency decision).

⁸¹ See *Mead Corp.*, 533 U.S. at 229.

⁸² See *Skidmore*, 323 U.S. at 139 (emphasizing that agency interpretations are “based upon more specialized experience and broader investigations and information than is likely to come to a judge in a particular case”). Other reasons have been cited for treating agency positions with respect under *Skidmore*. *Skidmore* itself also recognized a value in nationally uniform agency interpretations. See *id.* at 140 (arguing that interpretations should be uniform unless there is a good reason); Michael Asimow, *The Scope of Judicial Review of Decisions of California Administrative Agencies*, 42 UCLA L. REV. 1157, 1203-06 (1995) (asserting that judicial deference to agencies results in greater uniformity). In addition, some have cited inter-branch comity as a basis for *Skidmore* respect. See, e.g., Coverdale, *supra* note 62, at 55 (claiming *Skidmore* respect “reflects an elementary demand of interbranch comity which courts have long recognized”).

Court will ultimately decide the proper meaning of the statute, providing the agency view with some level of respect depending on context. As a result, it is now clear that the independent judgment model survived *Chevron* and applies to statutory interpretation cases that are decided without the benefit of a *Mead*-qualified agency position.⁸³

D. *The Conflict Between Chevron and Stare Decisis*

Prior to *Chevron*, when the Court interpreted a statutory term under the independent judgment model, such an interpretation would be given stare decisis effect until Congress amended the statute.⁸⁴ In fact, the Court has applied a "super-strong" presumption of correctness with regard to statutory interpretation precedent.⁸⁵ The foundation for this presumption is that, unlike in the constitutional interpretation context, Congress can always amend the law if it disagrees with the Court's interpretation.⁸⁶

The Court's strong reluctance to overturn its statutory interpretation precedent is therefore based on the presumption that Congress approves every Supreme Court interpretation unless Congress amends the underlying statute.⁸⁷ This presumption, like the presumption that underlies *Chevron* (that Congress wants agencies to bear primary interpretive responsibility),⁸⁸ is questionable.⁸⁹

⁸³ In fact, given the ambiguous "force of law" standard set forth by *Mead*, one could argue that the case returns administrative law to the pre-*Chevron* era when the level of judicial deference given to an agency's action was unpredictable. See David J. Barron & Elena Kagan, *Chevron's Nondelegation Doctrine*, 2001 SUP. CT. REV. 201, 226.

⁸⁴ See, e.g., *Patterson v. McLean Credit Union*, 491 U.S. 164, 172-75 (1989) (holding that stare decisis is important in areas of statutory interpretation because Congress remains free to act on the Court's decisions).

⁸⁵ See, e.g., *Neal v. United States*, 516 U.S. 284, 295 (1996) (describing the great weight of stare decisis in the area of statutory construction); *Hilton v. S.C. Pub. Rys. Comm'n*, 502 U.S. 197, 202 (1991) (finding that stare decisis "has special force in the area of statutory interpretation"); *Patterson*, 491 U.S. at 172 (explaining that "the burden borne by the party advocating the abandonment of an established precedent is greater where the Court is asked to overrule a point of statutory construction"); see also William N. Eskridge, Jr., *Overruling Statutory Precedents*, 76 GEO. L.J. 1361, 1362-63 (1988).

⁸⁶ See *Neal*, 516 U.S. at 295-96 (explaining that the basis for the super-strong presumption is the notion that Congress is free to change the court's interpretation of the legislation); *Hilton*, 502 U.S. at 202 (observing that with statutory interpretation, unlike constitutional interpretation, Congress can override the judgment of the courts).

⁸⁷ See *Hilton*, 502 U.S. at 202 (suggesting that if Congress does not alter legislation in response to a judicial decision, it has made a choice not to do so).

⁸⁸ See *supra* text accompanying notes 44-47.

⁸⁹ See William N. Eskridge, Jr., *Interpreting Legislative Inaction*, 87 MICH. L. REV. 67, 98-103 (1988) (casting doubt upon the ability to presume intent from the collective inaction of members of Congress). Eskridge also criticizes the super-strong presumption of correctness on other grounds. See *id.* at 95-98 (questioning the relevance of "subsequent" legislative intent); *id.* at 104-08 (arguing that the super-strong presumption may exacerbate

As William Eskridge has noted, it is often impossible to draw inferences of legislative support from inertia since “the structure of Congress makes it far more likely that something will not happen (inaction) than it will (action).”⁹⁰ Nevertheless, it is clear that the effect of stare decisis in statutory interpretation cases is quite formidable.⁹¹

What happens when an agency interprets a term in a manner that would otherwise be permissible under *Chevron* step two but is inconsistent with a prior Supreme Court interpretation⁹² of that term? This issue presents a conflict between stare decisis and *Chevron*.⁹³ If *Chevron* controls, the reasonable agency interpretation would prevail. Alternatively, if stare decisis controls, the prior Supreme Court determination would prevail since the later agency interpretation, even if reasonable, would be inconsistent with binding precedent. The Court has held in a trilogy of cases that stare decisis controls in this conflict.⁹⁴ These three cases therefore conclude that Supreme Court

existing dysfunctions in the legislative process).

⁹⁰ *Id.* at 98.

⁹¹ See, e.g., *Patterson v. McLean Credit Union*, 491 U.S. 164, 173-74 (1989) (explaining that statutory precedents are generally overruled where there has been an “intervening development of the law”).

⁹² To be clear, when I use the term “Supreme Court interpretation,” I mean interpretations by the Court under the independent judgment model, as opposed to interpretations that were merely approved of by the Court under the deferential model. When the Court implements the deferential model, it results in a very limited stare decisis effect. See *supra* text accompanying notes 56-60. Unlike decisions made under the independent judgment model, the Court does not determine the single best meaning of a term. Rather, the Court merely decides whether the term is reasonably susceptible to the agency’s proffered interpretation. This does not foreclose the possibility that a different interpretation may be permitted in future cases.

⁹³ *Pierce*, *supra* note 41, at 2226. This conflict could arise only between a prior judicial interpretation and *Chevron* step two, not between a prior judicial interpretation and *Chevron* step one. If the statutory term admits of only one interpretation (i.e., the prior judicial interpretation), the inconsistent agency interpretation would be struck down under *Chevron* step one. Because the outcome would be the same regardless of whether *Chevron* or stare decisis controlled, there would be no conflict. See *id.* at 2225.

⁹⁴ See *Neal v. United States*, 516 U.S. 284, 290 (1996) (holding that a United States Sentencing Commission interpretation was invalid because it was inconsistent with the Court’s prior interpretation); *Lechmere, Inc. v. NLRB*, 502 U.S. 527, 536-37 (1992) (holding that a National Labor Relations Board interpretation was invalid because it was inconsistent with the Court’s prior interpretation); *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 130-31 (1990) (holding that the Interstate Commerce Commission’s interpretation was inconsistent with the Court’s prior interpretation); see also *United States v. Mead Corp.*, 533 U.S. 218, 247 (2001) (Scalia, J., dissenting) (citing *Neal*, *Lechmere*, and *Maislin* for the proposition that “[o]nce the court has spoken, it becomes unlawful for the agency to take a contradictory position; the statute now says what the court has prescribed”); *Golden State Transit Corp. v. City of Los Angeles*, 493 U.S. 103, 112 (1989) (“A rule of law that is the product of judicial interpretation of a vague, ambiguous, or

interpretations trump the deference owed under *Chevron*. As a result, pre-*Chevron* Supreme Court interpretations are binding on the executive branch and can be altered only if Congress amends the statute or if the Court decides to overrule its prior interpretation despite its super-strong presumption of correctness.

For example, in the 1996 case of *Neal v. United States*, the most recent case in this trilogy, the Court considered the meaning of the statutory term "mixture or substance" in determining the weight of lysergic acid diethylamide ("LSD") to be taken into account for criminal sentencing purposes.⁹⁵ The Court had previously interpreted the term in *Chapman v. United States* to include the actual weight of blotter paper,⁹⁶ even though such interpretation would result in a "significant disparity of punishment meted out to LSD offenders relative to other narcotics traffickers."⁹⁷ Two years after *Chapman*, the United States Sentencing Commission (the "Commission") took the position that each dose

incomplete statutory provision is no less binding than a rule that is based on the plain meaning of the statute."); PIERCE, *supra* note 16, § 3.6, at 185 ("The [Supreme] Court has consistently held that a Supreme Court precedent trumps *Chevron* deference."); Bamberger, *supra* note 18, at 1293-94 ("[E]ven after *Chevron* . . . court precedents always trump *Chevron* deference."); Einer Elhauge, *Preference-Eliciting Statutory Default Rules*, 102 COLUM. L. REV. 2162, 2262 (2002) (stating that "the *Chevron* doctrine of deference to agency interpretations does not apply when the agency deviates from a court's own precedent interpreting the statute"); Merrill, *supra* note 16, at 989 (arguing that *Maislin* "emphatically rejected the idea that an agency might disregard a previous judicial construction of a statute, at least when it is a precedent of the Supreme Court"); Merrill & Hickman, *supra* note 40, at 915 ("The Supreme Court has consistently ruled that agency interpretations of statutes that deviate from the Court's own precedents are not entitled to *Chevron* deference."); Pierce, *supra* note 41, 2226 (citing *Neal*, *Lechmere*, and *Maislin* as the basis for the "mechanical rule[]" that "Supreme Court precedents always trump the deference owed under *Chevron*").

Although the Supreme Court has concluded that *its own* precedents trump *Chevron*, it has frequently upheld agency interpretations that are at odds with existing lower court precedent. *See, e.g.*, *Sutton v. United Air Lines*, 527 U.S. 471, 477, 482 (1999). The circuit courts are divided on the issue of whether a prior interpretation of a term by the circuit will foreclose any subsequent inconsistent agency interpretation with regard to that circuit. *Compare* *Satellite Broad. & Communications Ass'n of Am. v. Oman*, 17 F.3d 344, 348 (11th Cir. 1994) (holding that its precedent interpreting an ambiguous statutory term does not foreclose subsequent inconsistent agency interpretation of that term), *with* *Bankers Trust N.Y. Corp. v. United States*, 225 F.3d 1368, 1376 (Fed. Cir. 2000) (holding that precedent interpreting an ambiguous statutory term forecloses subsequent inconsistent agency interpretation of that term), *Indus. Turnaround Corp. v. NLRB*, 115 F.3d 248, 254 (4th Cir. 1997) (same), *Aguirre v. INS*, 79 F.3d 315, 317 (2d Cir. 1996) (same), *and* *BPS Guard Services, Inc. v. NLRB*, 942 F.2d 519, 523 (8th Cir. 1991) (same).

⁹⁵ 516 U.S. at 288-90.

⁹⁶ *Chapman v. United States*, 500 U.S. 453, 468 (1991) (holding that "the weight of the carrier medium must be included").

⁹⁷ *Neal*, 516 U.S. at 295.

of LSD on any carrier medium would automatically be given a presumed weight of 0.4 milligrams.⁹⁸ Citing to the first two cases in the trilogy, the *Neal* Court unanimously held that the Commission's interpretation was invalid because it could not be squared with the Court's prior holding in *Chapman* that actual weight be used:

In these circumstances, we need not decide what, if any, deference is owed the Commission in order to reject its . . . interpretation. Once we have determined a statute's meaning, we adhere to our ruling under the doctrine of *stare decisis*, and we assess an agency's later interpretation of the statute against that settled law.⁹⁹

Essentially, this trilogy of decisions ending with *Neal* provides that when the Court has independently interpreted a term on a prior occasion, that interpretation becomes "incorporated" into the statute and binds the executive branch.¹⁰⁰ Therefore, the ambiguity that existed with regard to the statutory language at issue is settled, leaving no "space, so to speak, for the exercise of continuing agency discretion."¹⁰¹

Because *Chevron* limited the ability of a court to interpret a statutory term independently, this "incorporation rule"¹⁰² generally will apply only in two distinct contexts. The first instance is where the judicial interpretation was made in the pre-*Chevron* era under the independent judgment model, rather than the deferential model.¹⁰³ The second instance is where the judicial

⁹⁸ *Id.* at 287.

⁹⁹ *Id.* at 295. It is important to emphasize that the *Neal* Court decided that actual weight was required to be used not because a contrary interpretation was inconsistent with the statutory text, but rather because the contrary interpretation was inconsistent with its prior interpretation of the statutory text in *Chapman*. See *id.* at 294.

¹⁰⁰ See *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 130 (1990) (holding invalid the Interstate Commerce Commission's interpretation because it is inconsistent with the Interstate Commerce Act "as it incorporates" the Court's prior interpretation of the Act); see also *White*, *supra* note 19, at 727 ("Judicial interpretations of statutes in essence become part of the statutory scheme, until overruled by the Court or Congress, and are binding on the agency").

¹⁰¹ *United States v. Mead Corp.*, 533 U.S. 218, 247 (2001) (Scalia, J., dissenting).

¹⁰² This article uses the term "incorporation rule" to refer to the doctrine described *supra* in the text accompanying notes 84-92. The term refers to the principle that the Supreme Court's interpretation of a term under the independent judgment model effectively incorporates that interpretation into the underlying statute. This forecloses any re-interpretation of that term by the executive branch, even if such re-interpretation would have been upheld under *Chevron* had it been issued in the absence of the earlier judicial interpretation.

¹⁰³ See, e.g., *Lechmere, Inc. v. NLRB*, 502 U.S. 527, 538 (1992) (holding that a 1955 precedent was controlling); *Maislin*, 497 U.S. at 131 (holding that a 1915 precedent was controlling); see also *Merrill & Hickman*, *supra* note 40, at 915-20 (discussing the application of the incorporation rule in cases when the judicial interpretation was not made "in full awareness of *Chevron* and its two-step procedure"). It is important to note that in

interpretation was made post-*Chevron* in the absence of a *Mead*-qualified agency interpretation.¹⁰⁴ This second instance will occur if the judicial interpretation was made in the absence of any agency position whatsoever,¹⁰⁵ or if the judicial interpretation was made after considering a non-*Mead*-qualified agency position.¹⁰⁶ In both instances, the Court will have independently interpreted the statute and that interpretation will trump any later inconsistent agency interpretation. This trumping will occur *even if the Court, while independently interpreting the statute, adopts the precise interpretation advocated by the agency after according the position appropriate respect under Skidmore*.¹⁰⁷

Commentators have criticized the incorporation rule, arguing that the rule is inconsistent with the policy justifications underlying *Chevron*.¹⁰⁸ While *Chevron* recognizes that politically accountable agencies should bear primary

these cases, the Court determined that its pre-*Chevron* interpretations "need not be reconsidered after *Chevron* in light of agency regulations that were already in force when [the pre-*Chevron*] decisions were issued." *Alexander v. Sandoval*, 532 U.S. 275, 281 n.1 (2001). In other words, pre-*Chevron* Supreme Court interpretations are controlling on the agency, even if they were inconsistent with then-existing agency positions that would have been upheld under *Chevron* if the case had taken place in the post-*Chevron* era. Simply put, *Chevron* does not apply retroactively to Supreme Court cases that were decided prior to *Chevron*.

¹⁰⁴ See, e.g., *Neal*, 516 U.S. at 295-96 (holding that a 1991 precedent was controlling); see also Bamberger, *supra* note 18, at 1298-99 (discussing the application of the incorporation rule where the judicial interpretation was made in the absence of a *Mead*-qualified interpretation). Bamberger also notes that the incorporation rule could be implicated in one other context: where a post-*Chevron* independent judicial interpretation is made because a *Mead*-qualified agency interpretation is nonetheless struck down under *Chevron* step two. *Id.* at 1298. This will rarely, if ever, occur, however, because *Chevron* step two failures rarely, if ever, occur. See Levin, *supra* note 37, at 1261 (stating that as of 1997, "the [Supreme] Court has never once struck down an agency's interpretation, by relying squarely on the second *Chevron* step").

¹⁰⁵ See, e.g., *Neal*, 516 U.S. at 289 (involving a prior interpretation rendered in the absence of an agency position on the matter).

¹⁰⁶ See *Mead Corp.*, 533 U.S. at 249-50 (Scalia, J., dissenting) ("What a court says is the law after according *Skidmore* deference will be the law forever, beyond the power of the agency to change even through rulemaking."); see also Bamberger, *supra* note 18, at 1300-01 (describing the application of the incorporation rule where the post-*Chevron* judicial interpretation was rendered after giving *Skidmore* respect to an agency position).

¹⁰⁷ See *Mead Corp.*, 533 U.S. at 249-50 (Scalia, J., dissenting).

¹⁰⁸ See Merrill, *supra* note 16, at 989 (observing that "if a court has construed an ambiguous statute one way (without the benefit of an agency view), and an agency later has occasion to read the statute differently, the logic of *Chevron* would seem to indicate that the court should follow the agency interpretation, rather than the earlier judicial pronouncement"); see also Bamberger, *supra* note 18, at 1302 (suggesting that the incorporation rule "frustrates the very policy justifications for the administrative state articulated by the Supreme Court").

interpretive responsibility with regard to ambiguous statutory language, the incorporation rule, to the extent it applies, transfers this responsibility to the politically-insulated judiciary.¹⁰⁹ Furthermore, because the incorporation rule locks in the Court's interpretation pursuant to the doctrine of stare decisis, the rule restricts the flexibility of agencies to amend the interpretation of an ambiguous statute to reflect current political preferences and adapt to current realities.¹¹⁰

In addition, the incorporation rule results in wholly bizarre and unfortunate practical consequences. Under the rule, if litigation involving an ambiguous statute arrives at the Court prior to an agency rendering a *Mead*-qualified interpretation, the Court will interpret the term independently, and its interpretation will control forever, unless and until Congress amends the statute or the Court takes the highly unusual step of overruling its precedent.¹¹¹ Alternatively, if an agency renders a *Mead*-qualified interpretation before the Court hears the case, the agency will forever bear primary interpretive responsibility with regard to the statute, allowing the agency to change its mind subject only to *Chevron* step two.¹¹² As a result, the practical import of the incorporation rule is that "the timing of judicial challenges becomes a significant factor in determining policy; vagaries replace values."¹¹³

¹⁰⁹ See Bamberger, *supra* note 18, at 1295 (arguing that the incorporation rule undermines *Chevron* in that, while "*Chevron* places the discretion to construe statutory ambiguity outside the judicial ambit, the incorporation conception of precedent brings policymaking within it").

¹¹⁰ *Mead Corp.*, 533 U.S. at 247 (Scalia, J., dissenting) (maintaining that, unlike a judicial determination that an agency interpretation is permissible under *Chevron*, a judicial interpretation rendered without the benefit of a *Mead*-qualified interpretation "does not . . . leave the matter within the control of the Executive Branch for the future").

¹¹¹ See *supra* text accompanying notes 93-107.

¹¹² See *supra* text accompanying notes 56-60.

¹¹³ Bamberger, *supra* note 18, at 1304. In addition, in cases in which the agency interpretation prevails, the incorporation rule places great importance as the basis for such victory. For instance, if the agency position prevails because it was permissible under *Chevron* step two, then a later reasonable, though inconsistent, position would be upheld. See *supra* text accompanying notes 56-60. If, however, the agency position prevails because it was the result of an independent judicial determination after giving the position appropriate respect under *Skidmore*, then a later inconsistent though reasonable position would be struck down. See *supra* text accompanying notes 80-86. The majority in *Edelman v. Lynchburg College*, 535 U.S. 106 (2002), did not appreciate the effect of this subtle yet significant distinction. In that case, the majority upheld an EEOC regulation's interpretation without specifying the rationale for its decision. The Court found that "the EEOC rule [was] not only a reasonable one, but the position [it] would adopt even if there were no formal rule and [the Court was] interpreting the statute from scratch." *Id.* at 114. The Court further stated that "because [it] so clearly agree[d] with the EEOC, there [was] no occasion to defer and no point in asking what kind of deference, or how much." *Id.* Accompanying this last sentence was a footnote clarifying that the Court was not holding "that the EEOC's position is the 'only one permissible,'" implying that the EEOC was free to change its position

Even worse, this nonsensical result, which could never be desired by any rational legislator,¹¹⁴ is actually the product of two doctrines that are based on imputed legislative intent. As previously discussed, the *Chevron* doctrine is based on the notion that Congress generally wants politically accountable agencies to reconcile gaps and ambiguities,¹¹⁵ while the Court's reluctance to overturn its statutory interpretation precedents is based on the notion that any Supreme Court interpretation left unchanged by Congress reflects Congress's intention.¹¹⁶ While these factual inferences are questionable, they are at least facially plausible; however, the effect of their interaction (i.e., the importance placed on the timing of judicial challenges) is preposterous.

This emphasis on timing creates unfortunate incentives for both agencies and the Supreme Court. It creates the incentive for agencies to hastily draft ambiguous *Mead*-qualified interpretations (such as notice-and-comment regulations) in order to beat the Supreme Court to the punch and retain "jurisdiction" over the statutory ambiguities.¹¹⁷ These agencies could thereafter issue less formal guidance clarifying the ambiguous *Mead*-qualified interpretations. Because the Court gives *Chevron*-like deference to agency interpretations of their own regulations,¹¹⁸ this method would be a successful

subject only to *Chevron* step two. *Id.* at 114 n.8. As Justice O'Connor noted in her concurring opinion, however, this footnote's implication (that the agency retained flexibility) is only true if the Court's conclusion was based on *Chevron* deference. *Id.* at 122 (O'Connor, J., concurring). Otherwise, the Court was independently interpreting the statute, and such interpretation would necessarily foreclose any future inconsistent interpretation. *Id.* Therefore, there was a "point in asking what kind of deference" was afforded the EEOC position—namely, to give guidance to the EEOC regarding the validity of a later, inconsistent interpretation. *Id.* at 114 (Souter, J.).

¹¹⁴ This silliness is clear when you consider the potential responses to the following hypothetical question posed to a legislator drafting new legislation: "Who do you want to have primary interpretive responsibility with regard to ambiguities and gaps in the new statute?" The response that "it depends on whether a controversy arrives at the Supreme Court before the agency issues a *Mead*-qualified interpretation" is completely implausible.

¹¹⁵ See *supra* text accompanying notes 43-47.

¹¹⁶ See *supra* text accompanying notes 76-77.

¹¹⁷ See Bamberger, *supra* note 18, at 1302-03.

¹¹⁸ See *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001) (holding that an agency's reasonable interpretation of its own regulations is entitled to substantial judicial deference); *Auer v. Robbins*, 519 U.S. 452, 461 (1997) (finding that a court should defer to an agency's construction of its regulations unless it is "plainly erroneous or inconsistent with the regulation" (quoting *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945))); *Merrill & Hickman*, *supra* note 40, at 899 (identifying "a substantial parallel between the *Chevron* doctrine and the *Seminole Rock* doctrine"). The *Seminole Rock* doctrine has been criticized on various grounds. See John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 COLUM. L. REV. 612, 686-90 (1996) (criticizing the *Seminole Rock* doctrine because it is inconsistent with contemporary separation of powers principles, and suggesting the doctrine does not give agencies an adequate incentive to draft clear regulations).

end run around the incorporation rule. Unfortunately, this end run results in greater ambiguity and less deliberation with respect to formal guidance and the proliferation of informal guidance.¹¹⁹

With respect to the Supreme Court, the importance of timing creates improper incentives with regard to its case management. For instance, if the Court embraces *Chevron* and its underlying principles, it will want to refrain from granting certiorari in statutory interpretation cases where the agency charged with administering the statute has not yet rendered a *Mead*-qualified interpretation. By refusing to hear these cases, the Court leaves “a space, so to speak, for the exercise of continuing agency discretion,”¹²⁰ giving the agency the opportunity to interpret the term in a *Mead*-qualified manner and thus retain primary interpretative authority. Had the Court accepted the case, it would be forced to interpret the term independently, thereby locking in the interpretation under stare decisis.¹²¹

¹¹⁹ The *Mead* decision, granting *Chevron* deference to only relatively formal agency action, has itself been criticized for creating incentives for agencies to “rush out barebones, ambiguous rules construing statutory ambiguities, which they can then in turn further clarify through informal rulings entitled to judicial respect.” *United States v. Mead Corp.*, 533 U.S. 218, 246 (2001) (Scalia, J., dissenting). For this strategy to be successful, the incorporation rule requires the *Mead*-qualified rule to be promulgated prior to a Supreme Court interpretation of the statute in question. Otherwise, the Supreme Court’s interpretation will be binding.

¹²⁰ *Id.* at 247. A pro-*Chevron* Court would be especially hesitant to take a case in which the agency had issued a regulation that, because it lacked retroactive effect, would not apply in that case. For example, assume that the case involved a tax issue that arose in 2000 when there was no *Mead*-qualified interpretation on point. In 2001, the Treasury promulgates a *Mead*-qualified regulation that resolved the issue; however, the regulation (like most tax regulations) lacked retroactive effect. See I.R.C. § 7805(b) (2000) (stating the general rule that tax regulations are not retroactive). The Supreme Court, if it granted certiorari, would independently interpret the term (without the benefit of the regulation because it would not apply to the taxpayer’s case), thereby locking in the judicial definition whether it was consistent or inconsistent with the Treasury regulation. By denying certiorari, however, the Treasury regulation would control going forward, and the Treasury would retain the flexibility to change the regulation subject only to *Chevron* step two.

¹²¹ See *supra* text accompanying notes 80-82. Kenneth Bamberger has recently noted that a pro-*Chevron* Court might revitalize the “primary jurisdiction” doctrine in an attempt to leave the ambiguous statutory term within the jurisdiction of the agency. Bamberger, *supra* note 18, at 1309-10. Under this doctrine, which Bamberger notes has not been applied by the Court since *Chevron*, the Court would refer “specific issues of the type usually resolved in agency adjudication” back to the agency prior to resolution of the case by the Court. *Id.* at 1309. Bamberger ultimately concludes that the use of this doctrine to avoid the problems caused by the incorporation rule would itself raise significant problems such as increased costs and delay. *Id.* In the tax context, the primary jurisdiction doctrine would be unworkable because the *Mead*-qualified interpretations of the Treasury (i.e., regulations) generally cannot have retroactive effect. See I.R.C. § 7805(b). Therefore, any Treasury regulations promulgated after a referral by the Court under the “primary

Alternatively, if the Court is hostile to *Chevron* and its principles, the emphasis on timing will create an incentive for the Court to accept statutory interpretation cases lacking a *Mead*-qualified interpretation. Such a Court would be aggressive in seeking out these cases so that it could lock in a judicial interpretation, thereby taking away agency discretion. As a result, the Court would shift power from the executive branch to the judiciary. Accordingly, regardless of the disposition of the Court towards *Chevron*, the "race" to interpret creates a case management incentive that is entirely unrelated to the merits of the petition for certiorari.

In summary, the incorporation rule undermines the principles behind *Chevron* and places tremendous importance on the timing of judicial challenges. This emphasis on timing in turn creates improper incentives for both agencies and the Supreme Court in their "race" to interpret ambiguous statutes. Nonetheless, the incorporation rule persists. In fact, it is so entrenched that the Court has recently concluded that it is a "settled principle."¹²²

E. *Chevron's Applicability to Tax Regulations*

1. Pre-*Chevron* Law

Prior to *Chevron*, tax law had a relatively well-developed body of law regarding the standard of judicial review of Treasury regulations interpreting ambiguous tax statutes.¹²³ The standard depended on whether the regulation was issued pursuant to authority granted in a specific Code provision (a specific authority regulation),¹²⁴ or whether the regulation was issued pursuant to the general grant of authority contained in § 7805(a) (a general authority regulation).¹²⁵

The traditional view was that specific authority regulations¹²⁶ were

jurisdiction" doctrine would be issued too late to have any relevance to the taxpayer's case.

¹²² *Alexander v. Sandoval*, 532 U.S. 275, 281 n.1 (2001).

¹²³ See *Merrill & Hickman*, *supra* note 40, at 838 (mentioning that tax had "substantial bodies of precedent [about deference] that preexisted *Chevron* and deviated from it in important respects"); see also *Coverdale*, *supra* note 62, at 72-76 (discussing traditional tax deference doctrine with regard to Treasury regulations).

¹²⁴ See, e.g., I.R.C. § 121(c)(2)(B) (authorizing Treasury to promulgate regulations defining the term "unforeseen circumstances" for purposes of determining whether the gain from the sale of principal residence may be excluded from gross income). There are over one-thousand of these specific authority grants in the Code. See Edward J. Schnee & W. Eugene Seago, *Deference Issues in the Tax Law: Mead Clarifies the Chevron Rule—Or Does It?*, 96 J. TAX'N 366, 371 (2002) (counting approximately 1220 delegations of authority in the Code).

¹²⁵ I.R.C. § 7805(a) authorizes the Treasury to "prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code]." I.R.C. § 7805(a) (2000).

¹²⁶ Tax lawyers generally refer to these regulations as "legislative regulations" and general authority regulations as "interpretive regulations." *Coverdale*, *supra* note 62, at 65-

controlling unless they were determined to be arbitrary, capricious, or manifestly contrary to the will of Congress.¹²⁷ Although it appears that this standard is merely the product of merging *Chevron*'s two steps into one,¹²⁸ it has been argued that the historical deference afforded specific authority regulations might actually be greater than that afforded under *Chevron*.¹²⁹

With regard to general authority regulations, they would be upheld if they were reasonable implementations of congressional directives.¹³⁰ In determining reasonableness, a court would focus on "whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose."¹³¹ Pursuant to this analysis, a court could consider a number of factors, including "the length of time the regulation has been in effect, the reliance placed on it, the

66. I refrain from using these terms because administrative law draws distinctions between these terms in a vastly different way. See Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 HARV. L. REV. 467, 476-77 (2002) (defining legislative regulations as "those that have the force and effect of law [such that] [f]rom the perspective of agency personnel, regulated parties, and courts, these rules have a status akin to that of a statute" and interpretive regulations as all other regulations). Therefore, in areas of the law other than tax, a regulation may be deemed legislative regardless of whether it was promulgated pursuant to a general grant of authority. See *id.* at 570 (explaining that unlike the FTC, FDA, and NLRB, the IRS "continues to adhere to the notion that the . . . general rulemaking grant in section 7805(a) . . . confers only interpretive, not legislative, rulemaking authority"). Because of the inconsistent use of these terms, and because administrative law places great importance on the characterization of a regulation as legislative or interpretive (as those terms are used for administrative law purposes), see *id.* at 477-81, I will use the terms "specific authority" and "general authority" rather than "legislative" and "interpretive."

¹²⁷ See Coverdale, *supra* note 62, at 73-74 (describing the pre-*Chevron* standard with respect to specific authority regulations).

¹²⁸ With regard to specific authority regulations, Congress has specifically delegated policy-making authority to the Treasury. See *supra* note 124 and accompanying text. Therefore, under a *Chevron* standard, these regulations would almost inevitably pass step one, since Congress has explicitly left a gap for the Treasury to fill. See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984). As a result, one would usually move directly to step two, which appears to operate much like the traditional standard. See *id.* at 843.

¹²⁹ See John F. Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the Chevron Era*, 64 GEO. WASH. L. REV. 35, 54-55 (1995) (suggesting that, because the historical deference standard gave weight to Treasury's view even at step one of the analysis, the historical standard may be even more deferential than *Chevron*). Coverdale acknowledges that this distinction will not likely matter with regard to specific authority regulations where Congress has intentionally left a gap for Treasury to fill since it is "unlikely [in those instances] that a court would be able to find that Congress had directly addressed the precise issue raised." *Id.*

¹³⁰ *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 476-77 (1979); see also Ellen P. Aprill, *Muffled Chevron: Judicial Review of Tax Regulations*, 3 FLA. TAX REV. 51, 57-61 (1996) (examining the pre-*Chevron* range of judicial deference).

¹³¹ *Nat'l Muffler Dealers Ass'n.*, 440 U.S. at 477.

consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute."¹³²

This multi-factor standard differs from *Chevron's* two step analysis.¹³³ Many of the factors seem to have little or no significance under *Chevron*, although some might be relevant under *Chevron* step two.¹³⁴ Despite this difference, it is unclear to what extent, if any, the multi-factor test produced outcomes different than that which would have resulted under *Chevron*.¹³⁵

2. Does *Chevron* Apply to Tax Law?

In the decade or so after *Chevron*, it was unclear to what extent, if any, this well-developed deference law was displaced by *Chevron*.¹³⁶ During this period, courts reviewing tax regulations sometimes used the traditional standard of review and other times used the *Chevron* standard. Professor John Coverdale has attributed this failure to apply *Chevron* consistently to "the sociology of the tax bar and bench."¹³⁷ Coverdale explains, "The tax bar is highly specialized, and its members rarely litigate cases that challenge non-tax regulations. Senior tax lawyers in the private sector, in the IRS or on the bench of the Tax Court may, therefore, simply be unaware of *Chevron*."¹³⁸ Eventually, however, the tide turned and the courts began to apply the *Chevron* methodology to tax cases on a consistent basis.¹³⁹

¹³² *Id.*

¹³³ For a discussion of the multi-factor standard and its relationship to *Chevron* in tax cases, see generally Aprill, *supra* note 130.

¹³⁴ For example, if an agency changes a long-standing interpretation that has been frequently relied upon, a court might require a very thoughtful deliberation by the agency before accepting the new interpretation under *Chevron* step two. See Pierce, *supra* note 41, at 2252-53 (emphasizing the significance the Court places on the decisionmaking process when applying *Chevron* step two to changes in agency precedent).

¹³⁵ See Aprill, *supra* note 130 at 58-59, 63-73 (discussing and comparing multi-factor and *Chevron* standards).

¹³⁶ See Coverdale, *supra* note 129, at 53-57 (concluding that between 1984 and 1995, out of the more than fifty cases analyzing the validity of specific authority regulations, only fourteen cited *Chevron*, and that as of 1995, "[c]ourts rarely apply *Chevron's* two-step mode of analysis to general authority regulations"). But see David A. Brennan, *Treasury Regulations and Judicial Deference in the Post-Chevron Era*, 13 GA. ST. U. L. REV. 387, 417 (1997) (suggesting that the decisions in Coverdale's sample were consistent with the outcomes that would have resulted under *Chevron's* methodology).

¹³⁷ Coverdale, *supra* note 129, at 53 n.121.

¹³⁸ *Id.*

¹³⁹ See, e.g., *Atl. Mut. Ins. Co. v. Comm'r*, 523 U.S. 382, 387 (1998); *Conn. Gen. Life Ins. Co. v. Comm'r*, 177 F.3d 136, 143-45 (3d Cir. 1999); *Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 983-84 (7th Cir. 1998); *ABC Rentals of San Antonio, Inc. v. Comm'r*, 142 F.3d 1200, 1207 (10th Cir. 1998); *Redlark v. Comm'r*, 141 F.3d 936, 939-40 (9th Cir. 1998); *Harbor Bancorp & Subsidiaries v. Comm'r*, 115 F.3d 722, 727 (9th Cir.

3. Are General Authority Regulations *Mead*-Qualified?

Under *Mead*, *Chevron* deference clearly applies to specific authority regulations where Congress has specifically delegated gap-filling authority for the Treasury to implement through regulation.¹⁴⁰ The question that remains is whether *Chevron* deference or, alternatively, *Skidmore* respect, applies to general authority regulations.¹⁴¹

General authority regulations would qualify for *Chevron* deference if “it [was] apparent from the [Treasury’s] generally conferred authority and other statutory circumstances that Congress would expect” that these regulations would carry “the force of law.”¹⁴² Although the resolution of this issue is not entirely clear,¹⁴³ the courts, in the few cases that have addressed the issue since

1997); *Tate & Lyle, Inc. v. Comm’r*, 87 F.3d 99, 104-06 (3d Cir. 1996); *Peoples Fed. Sav. & Loan Ass’n of Sidney v. Comm’r*, 948 F.2d 289, 299 (6th Cir. 1991); *Robinson v. Comm’r*, 119 T.C. 44, 68 (2002) (each citing *Chevron* while analyzing the validity of a Treasury regulation). *Accord* *PIERCE*, *supra* note 16, § 3.5 at 167-68 (concluding that *Chevron* applies to tax regulations); *Coverdale*, *supra* note 62, at 77 (concluding that “as the years went by [the courts have] turned somewhat more frequently to *Chevron*” when analyzing the validity of specific authority regulations). The Supreme Court has never made it entirely clear that *Chevron* displaced traditional notions of tax deference. For example, in *Atlantic Mutual Insurance Co. v. Commissioner*, the Court cited *Chevron* with regard to step one of its analysis but then curiously cited *Cottage Savings Ass’n v. Commissioner*, 499 U.S. 554, 560-61 (1991), rather than *Chevron* for its step two analysis. *Atl. Mut. Ins. Co.*, 523 U.S. at 387, 389. More recently, in *Boeing Co. v. United States*, even though the Court failed to cite *Chevron* in analyzing the validity of a general authority regulation, it applied a very *Chevron*-like analysis, concluding that the regulation was entitled to “deference” and upholding the regulation because it was “not arbitrary.” 537 U.S. 437, 449, 451 (2003).

¹⁴⁰ *United States v. Mead Corp.*, 533 U.S. 218, 229 (2001).

¹⁴¹ Recall that this distinction affects not only the *quantity* of respect given to the regulation, but also the *quality* of the judicial action necessitated by a review of the regulation. If *Chevron* deference applies, the court will not independently interpret the term; if *Skidmore* respect applies, the court will independently interpret the term and *stare decisis* will be triggered with regard to such interpretation. *See supra* text accompanying notes 77-83.

¹⁴² *Mead Corp.*, 533 U.S. at 229.

¹⁴³ *Chevron* itself involved an environmental regulation promulgated pursuant to the EPA’s general grant of authority to prescribe such regulations as necessary, *see* 42 U.S.C. § 7601(a)(1), suggesting that the Treasury’s general authority regulations should likewise merit *Chevron* deference. If Treasury’s only mechanism for making policy was through the promulgation of regulations that were specifically authorized by Congress, it would undermine the *Chevron* notion that Congress implicitly leaves policy-making authority to the agency (rather than the courts) when it leaves ambiguities and gaps within its statutes. *See Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984). Furthermore, Treasury’s general authority regulations are promulgated after notice and comment, a procedural formality emphasized by the *Mead* Court as indicative of force-of-law interpretations. *See Mead Corp.*, 533 U.S. at 230-31. Additionally, a general authority regulation is a rule of general applicability rather than an agency action that is limited in its

Mead, appear to be giving *Chevron* deference to these regulations.¹⁴⁴ Because this article argues that the check-the-box regulations, which were issued pursuant to Treasury's general authority,¹⁴⁵ are invalid, it is assumed below

operation, another factor considered by the *Mead* Court. *See id.* at 233-34.

Some commentators have argued, however, that general authority regulations do not merit *Chevron* deference. *See Coverdale, supra* note 62, at 83-89; Schneer & Seago, *supra* note 124, at 369-70. They note that Treasury, by deciding that these regulations do not require notice and comment, essentially admits that they lack the "force of law." Coverdale, *supra* note 62, at 84-85. Although Treasury takes the position that notice and comment is not required, it regularly submits to notice and comment on a voluntary basis. MICHAEL J. SALTZMAN, *IRS PRACTICE AND PROCEDURE* § 3.02[3], at 3-6 (2d ed. 1991). Furthermore, these commentators believe that Congress's frequent use of specific authority in the Code suggests that Congress does not desire that Treasury act with the force of law when it promulgates general authority regulations. Coverdale, *supra* note 62, at 85. In addition, the commentators argue that the historical tax deference doctrine, which treated general authority regulations with less respect than specific authority regulations, should be understood as a backdrop against which Congress legislated. *Id.* at 86-87. According to this argument, by giving specific authority in the Code, Congress signals its desire to have the courts defer to the Treasury's position; by failing to give such specific authority, Congress signals its desire to have the courts give greater scrutiny to the Treasury's position. *Id.* Finally, the commentators point to pervasive congressional involvement in tax law, evidencing "Congress's strong preference for making policy choices itself rather than leaving them to the Treasury." *Id.* at 87.

¹⁴⁴ *See, e.g.,* Marsh & McLennan Cos. v. United States, 302 F.3d 1369, 1375 (Fed. Cir. 2002) (citing *Mead* in applying *Chevron* to a general authority regulation without discussing the distinction between general authority and specific authority regulations); Tax Analysts v. I.R.S., 215 F. Supp. 2d 192, 198 (D.D.C. 2002) (citing *Mead* for the proposition that *Chevron* applies to general authority regulation because the regulation was "enacted . . . in a formal rulemaking process"); Robinson v. Comm'r, 119 T.C. 44, 68-70 (2002) (applying *Chevron* to a temporary general authority regulation post-*Mead* without citing or discussing *Mead*); *see also* U.S. Freightways Corp. v. Comm'r, 270 F.3d 1137, 1141 (7th Cir. 2001); Landmark Legal Found. v. I.R.S., 267 F.3d 1132, 1135-36 (D.C. Cir. 2001); Am. Express Co. v. United States, 262 F.3d 1376, 1382 (Fed. Cir. 2001); Schlumberger Tech. Corp. v. United States, 55 Fed. Cl. 203, 212-13 n.5 (2003) (each suggesting in dicta that *Mead* mandates giving *Chevron* deference to all regulations promulgated with full notice and comment); Mitchell M. Gans, *Deference and the End of Tax Practice*, 36 REAL PROP. PROB. & TR. J. 731, 750 (2002) (concluding that after *Mead*, it is "clear that *Chevron*'s framework is applicable to [general authority] regulations"). *But see* Robinson, 119 T.C. at 119-20 (Vasquez, J., dissenting); Coverdale, *supra* note 62, at 83-89; Schneer & Seago, *supra* note 124, at 369 (arguing that general authority regulations do not qualify for *Chevron* deference under *Mead*). As noted in note 139, *supra*, in *Boeing Co. v. United States*, the Court recently upheld a general authority regulation, reasoning that it merited "deference" and was "not arbitrary." 537 U.S. 437, 448-49 (2003). Curiously, even though the Court applied a very *Chevron*-like analysis by deferring to a non-arbitrary agency position, it cited neither *Mead* nor *Chevron*.

¹⁴⁵ *See* Simplification of Entity Classification Rules, 61 Fed. Reg. 66,584 (Dec. 18, 1996) (to be codified at 26 C.F.R. pts. 1, 301, 602) (codifying regulations that classify business

that they qualify for the highly deferential *Chevron* standard of review. However, the analysis would be equally applicable even if they qualified only for respect under *Skidmore*.

II. THE HISTORICAL DEFINITION OF "ASSOCIATION": FROM *MORRISEY* TO CHECK-THE-BOX

The check-the-box regulations govern the classification of unincorporated business entities as corporations or partnerships for federal income tax purposes.¹⁴⁶ This classification is critical, primarily because the earnings of a corporation are generally subject to two levels of tax, while the earnings of a partnership are subject only to one.

When a corporation earns income, a corporate income tax is imposed on the corporation with respect to that income.¹⁴⁷ When the corporation then distributes its after-tax earnings to its shareholders, an individual income tax is imposed on the shareholders with respect to the distribution.¹⁴⁸ On the other hand, when a partnership earns income, only its shareholders are taxed on their share of the income,¹⁴⁹ and there is no additional tax imposed when the partnership then distributes the income to its partners.¹⁵⁰ In other words, the income of a partnership flows through the partnership to its partners and is reported on the partners' individual tax returns.

In general, every business entity is classified as either a corporation or a partnership for tax purposes.¹⁵¹ In classifying a business entity, one first looks to the definition of "corporation" in § 7701(a)(3). Any business entity that falls outside this definition is classified by default as a partnership pursuant to § 7701(a)(2).

Since 1918, § 7701(a)(3) and its predecessors have defined the term corporation as follows: "The term 'corporation' includes associations, joint-stock companies, and insurance companies."¹⁵² As a result, the Code imposes

organizations under an elective regime).

¹⁴⁶ Treas. Reg. § 301.7701-1 to -3 (as amended in 2002).

¹⁴⁷ I.R.C. § 11 (2000). Certain corporations are subject to unique taxing regimes. *See supra* note 3.

¹⁴⁸ *See* I.R.C. §§ 61(a)(7), 301(c)(1), 316 (2000) (providing that dividends are included in gross income and defining the term dividend as corporate distributions out of earnings and profits).

¹⁴⁹ *See* I.R.C. §§ 701, 702 (2000) (providing that partners, and not the partnership itself, are taxed on partnership income and that partners are taxed on their distributive shares of partnership income, respectively).

¹⁵⁰ I.R.C. § 705(a)(1)(A) (2000).

¹⁵¹ Treas. Reg. § 301.7701-2(a) (as amended in 2002). Business entities with a single owner are classified either as a corporation or as an entity that is disregarded for tax purposes. Treas. Reg. § 301.7701-3(a) (as amended in 2002). For simplicity purposes, I assume that all business entities discussed below have at least two owners.

¹⁵² I.R.C. § 7701(a)(3). *See also* Revenue Act of 1918, ch. 18, § 1. As far back as 1894,

an income tax not only on state-law corporations, but also on associations.¹⁵³ During the infancy of the income tax, the definition of the term "association" baffled courts and administrators.¹⁵⁴ In 1935, the Supreme Court in *Morrissey v. Commissioner*¹⁵⁵ finally provided some definitive guidance as to the meaning of "association."

A. *Morrissey v. Commissioner*

In *Morrissey*, the question was whether, during the taxable years of 1924 through 1926, a trust was taxable as a corporation, which in turn depended on whether the trust constituted an association.¹⁵⁶ Pursuant to the trust instrument, the trustees were authorized to acquire, construct, and operate golf courses.¹⁵⁷ The trust also provided that the beneficiaries would not be personally responsible for the trust's debts.¹⁵⁸ The beneficial interests of the trust were evidenced by transferable certificates similar to stock certificates issued by corporations.¹⁵⁹ All of the decisions with respect to the trust corpus would be made by the trustees, and the beneficiaries had no power to elect or remove trustees.¹⁶⁰ The term of the trust was twenty-five years, notwithstanding the death of any trustee or beneficiary.¹⁶¹

The trust's position that it was not an association was based on Regulation 45, which was promulgated in 1921¹⁶² and superceded by the issuance of Regulation 65 in 1924.¹⁶³ Regulation 45 provided that a trust would constitute an association only if the beneficiaries "have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or

the tax laws used the term "association" interchangeably with "corporation." See Revenue Act of 1894, ch. 349, § 32 (applying tax on "corporations, companies, or associations"); Revenue Act of 1909, ch. 6, § 38 (applying tax on "every corporation, joint stock company, or association"); Revenue Act of 1913, ch. 16, § IIG(a) (applying tax on the net income of "every corporation, joint-stock company or association"); Revenue Act of 1916, ch. 463, § 10 (taxing "every corporation, joint-stock companies or association").

¹⁵³ See I.R.C. § 11(a) (2000) (imposing a tax on the taxable income of every corporation).

¹⁵⁴ See *Coleman-Gilbert Assocs. v. Comm'r*, 76 F.2d 191, 193 (1st Cir. 1935) (describing the law dealing with the definition of association as being "in a hopeless state of confusion").

¹⁵⁵ 296 U.S. 344 (1935).

¹⁵⁶ *Id.* at 347.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* The trustees could voluntarily hold meetings "for the purpose of making reports or considering recommendations, but the votes of the [beneficiaries] were to be advisory only." *Id.*

¹⁶¹ *Id.* at 347-48.

¹⁶² Treas. Reg. 45, art. 1504, T.D. 3146, 23 Treas. Dec. Int. Rev. 352, 591 (1921).

¹⁶³ Treas. Reg. 65, art. 1504, T.D. 3640, 26 Treas. Dec. Int. Rev. 745, 1003 (1924).

otherwise."¹⁶⁴ Thus, Regulation 45 announced a control test: only if the beneficiaries had some control over the corpus of the trust would the trust be considered an association.¹⁶⁵

In Regulation 65, Treasury discarded the control test, deciding that the key issue was whether the trust was "carrying on some business enterprise."¹⁶⁶ Under this business enterprise test, a trust that engaged in any business activity would be considered an association, regardless of the level of beneficiary control.¹⁶⁷

The trust in *Morrissey* argued that, since the beneficiaries had no control over the trust corpus, the trust was not an association under Regulation 45.¹⁶⁸ The trust argued that Regulation 65, which ordinarily would apply to the taxable years in question, was invalid because the standard set forth in Regulation 45 was effectively "incorporated" into the statute by virtue of the intervening congressional enactment of the Revenue Act of 1924, which re-enacted the definition of corporation as including associations.¹⁶⁹ The Court disposed of this argument in a manner that foreshadowed *Chevron*:

As the statute merely provided that the term "corporation" should include "associations," without further definition, the Treasury Department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction. Nor can this authority be deemed to be so restricted that the regulations, once issued, could not later be clarified or enlarged so as meet administrative exigencies or conform to judicial decision. We find no ground for the contention that by the enactment of the Revenue Act of 1924 the Department was limited to its previous regulations as to associations.¹⁷⁰

In finding an ambiguity in the statute, the *Morrissey* Court recognized a "space, so to speak, for the exercise of continuing agency discretion."¹⁷¹ As a result, the Court determined that the agency could change its mind with respect to the interpretation of the term association, notwithstanding an intervening re-enactment of the underlying statute.

¹⁶⁴ Treas. Reg. 45, art. 1504, T.D. 3146, 23 Treas. Dec. Int. Rev. at 591.

¹⁶⁵ *Id.*

¹⁶⁶ Treas. Reg. 65, art. 1504, T.D. 3640, 26 Treas. Dec. Int. Rev. at 1003.

¹⁶⁷ *Id.* The regulation contrasted trusts that carry on some business enterprise with "[h]olding trusts, in which the trustees [were] merely holding property for the collection of the income and its distribution among the beneficiaries." *Id.* (holding trusts would not constitute associations).

¹⁶⁸ *Morrissey v. Comm'r*, 296 U.S. 344, 348-49 (1935).

¹⁶⁹ Brief for the Petitioner at 30-35, *Morrissey* (No. 17). The Revenue Act of 1924 was enacted on June 2, 1924, *see* Revenue Act of 1924, ch. 234, 43 Stat. 253, between the promulgation of Regulation 45 in 1921, *see* 23 Treas. Dec. Int. Rev. 625, and the promulgation of Regulation 65 on October 6, 1924, *see* 26 Treas. Dec. Int. Rev. 1049.

¹⁷⁰ 296 U.S. at 354-55 (citation omitted).

¹⁷¹ *United States v. Mead Corp.*, 533 U.S. 218, 247 (2001) (Scalia, J., dissenting).

Even though the Court dismissed the trust's arguments in a *Chevron*-like manner, the similarities end there. The government argued that the standard set forth in Regulation 65, that all business trusts constituted associations, should control.¹⁷² Had the case arisen post-*Chevron*, the Court's task would have been merely to determine whether the Treasury's *Mead*-qualified position in Regulation 65 was permissible under step two,¹⁷³ as the Court had already found the term in question to be ambiguous.¹⁷⁴ Because the regulation would likely have passed this deferential standard, the Court would then have applied the regulation and concluded that the trust was an association because it conducted a business enterprise.¹⁷⁵

Instead of merely deferring to the regulation's business enterprise test, however, the *Morrissey* Court did exactly what *Chevron* now proscribes.¹⁷⁶ Applying the independent judgment model, the Court exalted its own view over the judgment of the Treasury.¹⁷⁷ After "a further examination of the congressional intent," the Court disregarded the regulation and independently

¹⁷² *Morrissey*, 296 U.S. at 349. The Court continued:

The Government insists that the distinction between associations and the trusts [not taxable as associations] is between "business trusts on the one side" and other trusts "which are engaged merely in collecting the income and conserving the property against the day when it is to be distributed to the beneficiaries"; that Congress intended that all "business trusts" should be taxed as associations.

Id.; see also Brief for the Respondent at 6, *Morrissey* (No. 17) ("We submit that Congress intended that all business trusts should be taxed as associations, and hence that the 'doing business' test which is emphasized by many decisions is the single criterion on which this case should depend.") The government's alternative argument was that a corporate resemblance test should be applied. *Id.* at 7 ("If it is necessary to have regard for anything more than the activities of the organization and doing business is not the sole test, we think that an organization which does business and enjoys the substantial advantages of centralized control, continuity, and limited liability is an association within the meaning of the statute."). The government preferred the business enterprise test to the corporate resemblance test ultimately adopted by the Court because it believed the latter test was too imprecise. *Id.* at 20-21.

¹⁷³ See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984) (setting out the two-step test).

¹⁷⁴ See *Morrissey*, 296 U.S. at 354-55 (pointing out that the statute was not clear enough in defining the rule that associations should be included in the term "corporation").

¹⁷⁵ The Court did in fact determine that the trust "involved what was essentially a business enterprise." *Id.* at 360. Accordingly, under the business enterprise test, the trust would have been characterized as an association.

¹⁷⁶ One might believe that, because *Morrissey* violates *Chevron* principles, *Morrissey* could be overruled on the basis that it is demonstrably erroneous. The Court has determined, however, that it is a "settled principle" that pre-*Chevron* interpretations "need not be reconsidered after *Chevron* in light of agency regulations that were already in force when [the pre-*Chevron*] decisions were issued." *Alexander v. Sandoval*, 532 U.S. 275, 281 n.1 (2001).

¹⁷⁷ *Morrissey*, 296 U.S. at 356-57.

interpreted the term "association" to mean any unincorporated business entity that resembles a corporation.¹⁷⁸ In applying this corporate resemblance test, the Court identified the following four corporate factors: (1) perpetual existence of the entity notwithstanding the death of owners or their agents, (2) centralization of the entity's management (through, for example, a board of directors or trustees), (3) free transferability of beneficial interests without affecting the continuity of the business entity, and (4) the entity's provision of limited liability for its owners.¹⁷⁹

In announcing this test, the Court did not identify the weight to be given to each of these factors, appearing to use an overall facts and circumstances test.¹⁸⁰ Nor did the Court provide any guidance regarding the degree of corporate similarity necessary in order for an entity to be considered an association.¹⁸¹

Despite the imprecision of *Morrissey's* corporate resemblance test, the standard was easy to apply to the trust at issue. The Court found all four corporate factors present and therefore determined that the trust constituted an association.¹⁸² Notably, this is the same conclusion that would have resulted had the Court merely applied Regulation 65's business enterprise test.¹⁸³

B. *The Kintner Regulations*

Morrissey's imprecise corporate resemblance test remained intact until 1960.¹⁸⁴ In 1960, the Treasury promulgated regulations, commonly known as the *Kintner Regulations*,¹⁸⁵ which provided a more quantifiable standard.¹⁸⁶ Although the *Kintner Regulations* cited to *Morrissey*,¹⁸⁷ retained its corporate

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 359. For an extensive discussion of these factors, see Stephen B. Scallen, *Federal Income Taxation of Professional Associations and Corporations*, 49 MINN. L. REV. 603, 631-37 (1965).

¹⁸⁰ *Morrissey*, 296 U.S. at 358-59; see also *Kurzner v. United States*, 413 F.2d 97, 104 (5th Cir. 1969) (asserting that *Morrissey* "gave no indication of the relative weight to be accorded the corporate attributes discussed").

¹⁸¹ See *Kurzner*, 413 F.2d at 104 (remarking that, although *Morrissey* emphasized similarity, it "unfortunately did not specify a requisite degree of similarity").

¹⁸² *Morrissey*, 296 U.S. at 360-61.

¹⁸³ *Id.* at 353-54

¹⁸⁴ See, e.g., *United States v. Kintner*, 216 F.2d 418, 421-24 (9th Cir. 1954) (applying the *Morrissey* standard); Rev. Rul. 57-341, 1957-2 C.B. 884, 886 (1957) (same).

¹⁸⁵ See Scallen, *supra* note 179, at 671 (describing the 1960 regulations as "'Kintner' Regulations"). This name arose from the case *United States v. Kintner*, which held that a professional association constituted a corporation for tax purposes. 216 F.2d at 428.

¹⁸⁶ See Treas. Reg. § 301.7701-1 to -11 (1960); T.D. 6503, 1960-2 C.B. 409 ("An unincorporated organization shall not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics.").

¹⁸⁷ T.D. 6503, 1960-2 C.B. 409, 413 (adopting regulation § 301.7701-2(a)(1) which cites *Morrissey* for the proposition that an organization is treated as an association if it

resemblance standard,¹⁸⁸ and used its corporate factors,¹⁸⁹ the regulations provided a mechanical, bright-line test as opposed to *Morrissey*'s vague overall facts and circumstances standard.¹⁹⁰

In particular, the regulations differed from *Morrissey* in two important ways. First, while *Morrissey* did not specify the relative weight to be given to each of the four corporate factors, the *Kintner* Regulations assigned each factor an equal weight.¹⁹¹ Second, while *Morrissey* never explained how much corporate resemblance is required, the regulations provided that, in order for an unincorporated business entity to be classified as an association, the entity would have to possess at least three of the four corporate factors.¹⁹²

Despite the regulations' retention of the corporate resemblance test, it is clear that the regulations were intended to create different substantive results than would occur under *Morrissey*. The Treasury's motivation in promulgating these regulations was to restrict the ability of professionals to form associations in order to take advantage of pension and profit-sharing benefits then available only to corporations.¹⁹³ This restriction was accomplished by forcing an unincorporated entity to have at least three out of the four corporate factors in order to be classified as an association.¹⁹⁴

"resembles a corporation" and § 301.7701-2(c)(2), which cites *Morrissey* in a discussion of the centralization of management in an organization).

¹⁸⁸ See *id.* (adopting regulation § 301.7701-2(a)(1), which states that "[a]n organization will be treated as an association if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or trust").

¹⁸⁹ See *id.* at 414-17 (adopting regulation §§ 301.7701-2(b), discussing continuity of life, -2(c), discussing centralization of management, -2(d), discussing limited liability, and -2(e), discussing free transferability of interests).

¹⁹⁰ See *id.* at 414 (adopting § 301.7701-2(a)(3)).

¹⁹¹ See *id.* at 413-14 (describing four corporate characteristics, and requiring more corporate characteristics than not for an organization to be classified as an association).

¹⁹² See *id.*

¹⁹³ 1 MCKEE ET AL., *supra* note 1, ¶ 3.06, at 3-57 (concluding that "there is no question that the proximate inspiration for the 1960 Regulations was to limit the availability of qualified pension benefits by narrowing the substantive scope of the association concept").

¹⁹⁴ At the time the *Kintner* Regulations were promulgated, professionals were generally unable to form corporations under state law. See Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44 CATH. U. L. REV. 437, 489 (1995). In response to the *Kintner* Regulations, state legislatures began adopting professional corporation statutes. See *id.* In turn, the Treasury amended the *Kintner* Regulations to deny corporate status to professional corporations. T.D. 6797, 1965-1 C.B. 553 ("[A] professional service organization . . . would not be classified for purposes of taxation as a 'corporation' merely because the organization was so labeled under local law."). This amendment was repeatedly struck down by courts as arbitrary and capricious. See, e.g., *Kurzner v. United States*, 413 F.2d 97, 112 (5th Cir. 1969). The IRS finally conceded defeat in 1970. See Rev. Rul. 70-101, 1970-1 C.B. 278 (1970) (ruling that it will treat professional corporations as corporations for tax purposes). For a discussion of the Treasury's losing war with professional associations, see Hobbs, *supra*, at 488-91.

Under the incorporation rule previously discussed,¹⁹⁵ it is arguable whether the mechanical *Kintner* Regulations were valid because they were inconsistent with *Morrissey*'s overall facts and circumstances standard in determining what constitutes an association.¹⁹⁶ The regulations did, however, retain the corporate resemblance framework, using the very same factors identified in *Morrissey*. In support of the regulations, one could argue that they merely provide a permissible clarification of the *Morrissey* framework. In *Chevron* terms, *Morrissey* left some gaps to fill (i.e., how much weight to give each factor and how much overall resemblance was required) and the Treasury arguably filled these gaps in a reasonable manner.¹⁹⁷ Although commentators criticized the regulations as straying from the *Morrissey* standard,¹⁹⁸ they were never challenged on that ground during their thirty-six-year existence.¹⁹⁹ Thus, no court ever considered whether the regulations were invalid in light of *Morrissey*.

C. *The Enactment of § 7704*

The next major development in the tax classification of business entities was Congress's enactment of § 7704 in 1987.²⁰⁰ Section 7704 automatically classified publicly traded partnerships as corporations, even though they would not be so classified under the *Kintner* Regulations.²⁰¹ Prior to the enactment of § 7704, these publicly traded partnerships were structured to fail two corporate characteristics in order to avoid corporate status;²⁰² however, in practical

¹⁹⁵ See *supra* text accompanying notes 92-101.

¹⁹⁶ See *supra* text accompanying notes 191-197 (describing the differences between the *Kintner* Regulations and the *Morrissey* standard).

¹⁹⁷ See White, *supra* note 19, at 759 (arguing that, "when a silence or ambiguity exists in the Court's construction of the statute, realization of the values underlying *Chevron* is best accomplished when the Court defers to the agency's resolution of such policy choices").

¹⁹⁸ See, e.g., Scallen, *supra* note 179, at 693-94 (criticizing the *Kintner* Regulations as inconsistent with *Morrissey* and subsequent case law).

¹⁹⁹ See 1 MCKEE ET AL., *supra* note 1, ¶ 3.06, at 3-58 n.223 (noting that the validity of the *Kintner* Regulations was never challenged).

²⁰⁰ See Revenue Act of 1987, Pub. L. No. 100-203, § 10211, 101 Stat. 1330-382, 1330-403 (1987).

²⁰¹ See I.R.C. § 7704(a), (b) (treating partnerships that are publicly traded as corporations).

²⁰² These partnerships typically did not exhibit the corporate characteristics of limited liability and perpetual existence. See, e.g., *Larson v. Comm'r*, 66 T.C. 159, 175, 183, 185 (1976) (concluding that the two limited partnerships involved were not taxable as corporations under the *Kintner* Regulations because they lacked the corporate characteristics of limited liability and perpetual existence). These entities generally failed to meet the perpetual existence standard because they would automatically dissolve upon the will or bankruptcy of a general partner and failed limited liability because a sufficiently capitalized general partner remained responsible for the partnership's debts. See, e.g., *id.* at 173-75, 179-82.

effect, they operated much like publicly traded corporations.²⁰³ The impetus behind § 7704 was congressional concern that, because of the similarity between these partnerships and publicly traded corporations, the publicly traded partnership would soon become the entity of choice for publicly traded businesses, resulting in a significant erosion of the corporate tax base.²⁰⁴ To prevent this erosion, § 7704 automatically classified publicly traded partnerships as corporations, ensuring consistent tax treatment for these entities and publicly-traded corporations.²⁰⁵

It is important to emphasize that § 7704 was built upon the groundwork laid by *Morrissey*. The text of § 7704 clearly indicates that the section concerns only partnerships,²⁰⁶ which were defined through an application of the corporate resemblance test at the time § 7704 was enacted.²⁰⁷ Therefore, in

²⁰³ See H.R. REP. NO. 100-391(II), at 1066 (1987), reprinted in 1987 U.S.C.C.A.N. 2313-378, 2313-681 (reasoning that "[p]ublicly traded partnerships resemble publicly traded corporations in their business functions and in the way their interests are marketed, and limited partners as a practical matter resemble corporate shareholders").

²⁰⁴ See *id.* at 1065 (remarking that "[t]he recent proliferation of publicly traded partnerships . . . has caused concern about long-term erosion of the corporate tax base"). See also STAFF OF JOINT COMM. ON TAXATION, 100TH CONG., TAX TREATMENT OF MASTER LIMITED PARTNERSHIPS 31-34 (Comm. Print 1987) [hereinafter MLP REPORT] (discussing potential erosion of the corporate tax base). With regard to the proliferation of publicly traded partnerships, there were concerns other than the erosion of the corporate tax base. As a practical matter, only certain types of businesses would have the opportunity to use the publicly traded partnership form and avoid the corporate tax, resulting in a tax-created competitive advantage for these businesses. See *id.* at 35. In addition, there was some concern that the highly complex partnership tax rules governing partnerships were not well designed to deal with entities with a substantial number of owners. See *id.* at 24-25.

²⁰⁵ I.R.C. § 7704(a) (indicating that "a publicly traded partnership shall be treated as a corporation"). For purposes of § 7704, the term "publicly traded partnership" is generally defined as any partnership the interests of which are either "traded on an established securities market" or "are readily tradable on a secondary market." *Id.* § 7704(b). Certain partnerships with primarily passive income are excluded from the definition. See *id.* § 7704(c), (d) (exempting a publicly traded partnership from being treated as a corporation if ninety percent of its income is derived from interest, dividends, real property rents or sales, mining, sales of capital assets, commodities, futures, forwards, and options). In addition, § 7704(g) provides for transition rules for certain publicly traded partnerships in existence prior to the enactment of § 7704. See *id.* § 7704(g) (providing opportunity for existing partnerships to elect a 3.5% tax on gross income instead of being taxed as a corporation). For a detailed discussion of § 7704 and related regulations, see 1 MCKEE ET AL., *supra* note 1, ¶ 3.09, at 3-116 to 3-127.

²⁰⁶ See I.R.C. § 7704(b) (defining the term "publicly traded partnership" as any partnership whose interests are "traded on an established securities market" or "readily tradable on a secondary market").

²⁰⁷ See MLP REPORT, *supra* note 204, at 8 (describing how the *Kintner* Regulations enacted after *Morrissey* classified business entities as partnerships or corporations via the corporate resemblance test).

determining whether an entity was subject to § 7704, the first step was to analyze whether the entity constituted a partnership under such test.²⁰⁸ Only after concluding that the entity was a partnership would the second step of determining whether the entity was publicly traded become necessary.²⁰⁹ As a result, the text of § 7704 clearly indicates that, in enacting the provision, Congress was aware of the corporate resemblance test then applicable.²¹⁰

After the enactment of § 7704, all publicly traded entities would be taxable as corporations.²¹¹ Accordingly, the *Morrissey* standard remained relevant only in the classification of unincorporated, nonpublicly-traded entities. It is in this context that the next major development in the tax classification of business entities occurred.

D. *The Proliferation of the Limited Liability Company*

Beginning in the late 1980s, a novel business entity form began to grow in popularity.²¹² This entity, the limited liability company (“LLC”), was designed by states to combine the most beneficial attribute of the partnership form (single level of taxation) with the most beneficial attribute of the corporate form (limited liability).²¹³ The LLC statutes also generally allowed owners the flexibility to choose among the less important corporate factors of centralized management, free transferability of interests, and perpetual existence.²¹⁴ Importantly, because these statutes allowed a particular entity to fail at least

²⁰⁸ See I.R.C. § 7704(b).

²⁰⁹ See *id.*

²¹⁰ See *id.*; see also H.R. CONF. REP. NO. 100-495, at 943-45 (1987), reprinted in 1987 U.S.C.C.A.N. 2313-1245, 2313-1689 to 2313-1690; H.R. REP. NO. 100-391(II), pt. B(1), at 1063-67 (1987), reprinted in 1987 U.S.C.C.A.N. 2313-378, 2313-678 to 2313-682 (discussing the corporate resemblance standard and recognizing that § 7704 would apply to publicly traded entities that otherwise would be classified as partnerships under such standard).

²¹¹ See I.R.C. § 7704(a) (automatically classifying publicly traded partnerships as corporations).

²¹² See Hobbs, *supra* note 194, at 515-17 (describing the proliferation of the limited liability company after the IRS issued Rev. Rul. 88-76, 1988-2 C.B. 360, 360-61, which classified a limited liability company formed under Wyoming law as a partnership for federal income tax purposes).

²¹³ See GEORGE MUNDSTOCK, A UNIFIED APPROACH TO SUBCHAPTERS K & S 10 (2002) (observing that “[t]he LLC provides the single-tax and tax loss pass-through benefits of [partnerships] with limited state-law liability”); Hobbs, *supra* note 194, at 510 (characterizing LLCs as combining “the limited liability of corporations with the tax aspects of partnerships”).

²¹⁴ See, e.g., Rev. Rul. 93-38, 1993-1 C.B. 233, 235-36 (describing a Delaware statute that allowed owners to opt-in to the secondary corporate characteristics of free transferability, continuity of life, and centralized management); see also 1 BITTKER & EUSTICE, *supra* note 3, ¶ 2.05[2], at 2-34 (“LLC statutes often create choices to be exercised in the LLC’s organizing agreement.”).

two of these secondary corporate attributes, they ensured that, with proper planning, the entity would not be classified as an association under the *Kintner* Regulations.²¹⁵

As a result, by using the LLC form, any non-publicly traded business could combine pass-through taxation, limited liability, and one of the secondary corporate characteristics. Furthermore, because the two forgone secondary corporate characteristics were generally insignificant to a closely held business,²¹⁶ the LLC allowed owners to easily accommodate all of their important goals.²¹⁷

Like the publicly traded partnership, the LLC highlighted the inadequacies of the corporate resemblance test, this time in the non-publicly traded context. Closely held LLCs looked and behaved in all important respects like closely held corporations yet were taxed differently because of relatively insignificant distinctions. Recognizing this and tiring of the perpetual classification battles with taxpayers, the Treasury finally capitulated in 1996 with the promulgation of the "check-the-box" regulations.²¹⁸

III. ANALYSIS OF THE VALIDITY OF THE CHECK-THE-BOX REGULATIONS

The check-the-box regulations, which became effective on January 1, 1997,²¹⁹ marked the apparent end of the corporate resemblance test. These regulations provided that, for purposes of § 7701(a)(3), any unincorporated business entity generally could elect whether or not to be classified as an association,²²⁰ unless it was a publicly traded partnership covered by § 7704.²²¹ Therefore, after the promulgation of these regulations, a non-publicly traded, unincorporated business could generally elect whether or not to be subject to

²¹⁵ See 1 BITTKER & EUSTICE, *supra* note 3, ¶ 2.05[2], at 2-34 (explaining that state statutes allow LLCs to plan to be classified as either partnerships or associations for tax purposes). Some statutes were designed to be fool-proof in ensuring non-association status by preventing the LLC from having more than two corporate characteristics. See, e.g., Wyoming Limited Liability Company Act, WYO. STAT. ANN. §§ 17-15-122 to -123 (Michie 2003) (ensuring that Wyoming LLCs would lack the corporate characteristics of continuity of life and free transferability).

²¹⁶ See Hobbs, *supra* note 194, at 514 (explaining that the owners of closely held businesses generally did not care about continuity of life or free transferability of interests).

²¹⁷ See *id.*

²¹⁸ 61 Fed. Reg. 66584, 66584-85 (Dec. 18, 1996) (to be codified at 26 C.F.R. pts. 1, 301, 602) (summarizing regulations providing a generally elective system for classifying business organizations effective January 1, 1997).

²¹⁹ *Id.* at 66584.

²²⁰ Treas. Reg. § 301.7701-3 (as amended in 2001).

²²¹ Treas. Reg. § 301.7701-2(b)(7). In addition, certain foreign entities, such as the Mexican Sociedad Anonima, are treated as per se corporations under the regulations. Treas. Reg. § 301.7701-2(b)(8) (listing entities in eighty jurisdictions that are automatically regarded as corporations). The regulations also provide default rules that classify entities in the absence of an affirmative election. See *infra* text accompanying notes 318-321.

the corporate tax.

The regulations were praised from the beginning. The leading corporate tax treatise remarked that the regulations “were concise, clear, and surprisingly simple . . . and they were happily embraced by tax practitioners with near unanimity.”²²² The prestigious Tax Section of the New York State Bar Association called the elective regime a “bold and innovative proposal that would avoid the substantial expenditure of resources on entity classification issues that is required of both taxpayers and the government under the traditional four-factor test.”²²³ Lost in this overwhelming praise, however, was any serious discussion of whether the regulations’ elective methodology was foreclosed by the Supreme Court’s decision in *Morrissey*.

A. *The Validity of the Regulations under a Chevron Analysis*

From the outset, the government was concerned about whether the Treasury had the authority to issue these regulations. For example, when the IRS first raised the possibility of an elective regime, it requested public commentary regarding the appropriateness of implementing it via regulatory action.²²⁴ Although there was not unanimity, the clear consensus was that the Treasury had the requisite authority. As discussed below, however, the commentators focused exclusively on the regulations’ validity under the *Chevron* two step methodology, failing to recognize that, because of the incorporation rule, that analysis was misplaced and irrelevant.

1. Arguments Made Against Validity

Among the commentary, the distinct minority view was that the Treasury lacked authority to promulgate the regulations. The basis for this view was that the statutory language itself, rather than *Morrissey*, foreclosed any possibility of an elective regime. Thus, these arguments were all grounded in *Chevron* step one in that they were premised on the idea that Congress had specifically ruled out an elective regime.

Although all of the arguments for invalidity were based on plain meaning, the formulations of the argument differed slightly among commentators. Some argued that an elective regime was simply foreclosed by the statutory language in § 7701(a)(3), which indicated that Congress intended the term “association” to have substantive meaning.²²⁵ Others argued that the statutory scheme in

²²² 1 BITTKER & EUSTICE, *supra* note 3, ¶ 2.02[3][a], at 2-13.

²²³ N.Y. State Bar Ass’n Tax Section, *Report on the “Check the Box” Entity Classification System Proposed in Notice 95-14*, TAX NOTES TODAY, Sept. 5, 1995, available at LEXIS 95 TNT 147-46 [hereinafter *NY State Bar Report*].

²²⁴ I.R.S. Notice 95-14, 1995-1 C.B. 297, 299.

²²⁵ See Susan Pace Hamill, *A Case for Eliminating the Partnership Regulations*, 68 TAX NOTES 335, 337 n.15 (July 17, 1995), available at LEXIS 68 TN 335 (arguing that, because the Code “defin[es] ‘corporation’ to include ‘associations’[, it] clearly contemplates that at least some unincorporated organizations will be classified as associations and subject to the

§§ 7701(a)(2) and (a)(3), which define "corporation" and "partnership" as mutually exclusive, mandated that two entities which are identical in all substantive respects may not be classified inconsistently.²²⁶

2. Arguments Made in Favor of Validity

The vast majority of commentators found the regulations to be permissible.²²⁷ In general, these commentators concluded that the term "association" had no plain meaning under *Chevron* step one²²⁸ and then

corporate tax provisions"); Philip F. Postlewaite & John S. Pennell, *JCT's Partnership Tax Proposals—'Houston, We Have a Problem'*, 76 TAX NOTES 527, 532 (July 28, 1997), available at LEXIS 76 TN 527 (concluding that "it appears irrefutable that implicit in the statutory formulation is that the taxpayer . . . is not entitled to determine the enterprise's classification by a mere expression of preference").

²²⁶ See 1 MCKEE ET AL., *supra* note 1, ¶ 3.08, at 3-102 (suggesting that Treasury exceeded its authority when it promulgated "a rule that permits substantively identical entities to elect to be classified as either an association taxable as a corporation or a partnership").

²²⁷ See, e.g., Am. Bar Ass'n Section of Taxation, *Comments on Notice 95-14, 1995-14 I.R.B. 7, Proposed Revisions to the Entity Classification Rules*, TAX NOTES TODAY, July 26, 1995, available at LEXIS 95 TNT 145-25 [hereafter *Tax Section Report*]; Ass'n of the Bar of the City of N.Y., Comm. on Taxation of Partnerships and Other Pass-Through Entities, *Report on "Check-the-Box" Proposal for Entity Classification (Notice 95-14)*, TAX NOTES TODAY, Aug. 24, 1995, available at LEXIS 95 TNT 166-43 [hereinafter *Bar of NYC Report*]; *NY State Bar Report*, *supra* note 223; see also Victor E. Fleischer, Note, "If It Looks Like a Duck": *Corporate Resemblance and Check-the-Box Elective Tax Classification*, 96 COLUM. L. REV. 518, 532-37 (1996).

²²⁸ See, e.g., *Bar of NYC Report*, *supra* note 227 (maintaining that because the Code does not define the term "association," it gives Treasury authority to define the term); *NY State Bar Report*, *supra* note 223 (arguing that because the terms "association" and "partnership" are not defined in the tax code, the Treasury has regulatory authority to define those terms and implement the check-the-box system); see also Fleischer, *supra* note 227, at 535 (concluding that the check-the-box regulations survive step one because the term "association" lacks plain meaning). This application of *Chevron* step one (asking whether the term at issue has a plain meaning) is a narrow view of that step. See Levin, *supra* note 37, at 1283. In step one, *Chevron* asked whether Congress has "directly addressed the precise question at issue." *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984). A broader view of step one, and the one used by the commentators who argued that the check-the-box regulations were invalid, would formulate the "precise question at issue" as whether Congress had ruled out the interpretation proffered by the agency. See Levin, *supra* note 37, at 1283 (predicting that if one frames the "'precise question at issue' as whether Congress has ruled out an option the agency has chosen, the stage may be set for reversal at step one"). The Supreme Court has occasionally framed the step one inquiry in this broad manner. See, e.g., *City of Chicago v. Envtl. Def. Fund*, 511 U.S. 328, 339 (1994) (finding Congress ruled out exempting Chicago's use of an ash incinerator from hazardous waste regulation under the Resource Conservation and Recovery Act of 1976); *Pittston Coal Group v. Sebben*, 488 U.S. 105, 113-14 (1988) (holding Congress ruled out more restrictive regulations promulgated by the Secretary of Labor in the

determined that the elective regime was reasonable under step two.²²⁹

In concluding that the regulations survived step two, proponents of the regulations generally made one of two arguments. Some proponents argued that the corporate resemblance test as clarified by the *Kintner* Regulations had effectively become an elective regime; therefore, according to these proponents, the regulations were merely “a change in form rather than in substance.”²³⁰ This point is dubious, as explained by Philip Postlewaite and John Pennell, who noted, “If the prior classification system was truly elective, then what need was there for the new regulations? If not, then the check-the-box approach is an alteration of the classification system.”²³¹ Simply put, under the corporate resemblance test, an unincorporated entity with more than two of the substantive corporate characteristics could not avoid corporate treatment. Under the check-the-box regime, this was now possible.²³² Accordingly, contrary to the arguments of these proponents, the check-the-box regulations did substantively change the classification test.

Other proponents conceded that the regulations made a substantive change, but argued that the policy choice made by Treasury was reasonable and therefore permissible under *Chevron*.²³³ These commentators argued that, when viewed in conjunction with the publicly traded partnership provision in § 7704, the regulations constituted a reasonable implementation of the

Black Lung Benefits Reform Act of 1977); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 445-48 (1987) (holding that two standards through which an alien may seek relief in the Immigration and Nationality Act are distinct despite interpretation of Board of Immigration Appeals that they are equivalent). Because the narrow view will often result in the court moving on to lenient step two, this view would also increase the likelihood of the court upholding the agency interpretation. See Levin, *supra* note 37, at 1282 (observing that, where the court has used the narrow view of step one, it “[u]sually . . . leads to affirmance of the agency’s action”).

²²⁹ See, e.g., Fleischer, *supra* note 227, at 549 (concluding that the regulations implement the congressional mandate in a reasonable manner).

²³⁰ JCT REPORT, *supra* note 12, at 15. See also *Tax Section Report*, *supra* note 227 (concluding that the regulations would be valid because under the *Kintner* Regulations, “taxpayers [could] in effect, elect whether to have their business enterprises classified as corporations or partnerships . . .”); *Bar of NYC Report*, *supra* note 227 (concluding that the regulations would be valid because the pre-check-the-box regime “in effect[] already provide an election”); *NY State Bar Report*, *supra* note 223 (arguing that because the regulations would “codify the effectively elective nature of the current classification system, as well as reduce burdens on taxpayers and the government, . . . the Treasury has the authority to promulgate such regulations”).

²³¹ Postlewaite & Pennell, *supra* note 225, at 531 n.36.

²³² See State Bar of Cal. Taxation Section, “*Check the Box*” *Elective Partnership Taxation and Reduced Cost Entity Conversions: A Proposal for Simplicity and Horizontal Equity*, TAX NOTES TODAY, July 28, 1995, available at LEXIS 95 TNT 147-41 (observing that under pre-check-the-box law, an LLC could not have all four corporate characteristics and qualify for flow-through tax treatment).

²³³ See JCT REPORT, *supra* note 12, at 14-15; Fleischer, *supra* note 227, at 544-49.

congressional mandate in § 7701(a)(3) that corporate-like entities be taxed as corporations.²³⁴ Commentators supporting this view observed that, under a check-the-box regime, only publicly traded entities would generally be subject to the corporate tax because closely held organizations would almost always elect partnership classification.²³⁵ As a result, the argument went, the check-the-box regulations merely "shift the focus of the resemblance test to the pivotal factor of whether an unincorporated organization is publicly traded."²³⁶ Furthermore, according to these commentators, using public trading as a proxy for "corporateness" is a wise policy choice.²³⁷

The argument that public trading should, as a policy matter, be the distinguishing feature in determining whether an entity should be subject to the corporate tax has a good deal of merit.²³⁸ It remains difficult, if not impossible, however, to reconcile this notion with the statute because the regulations interpret the statutory term "association" as devoid of any substantive meaning.²³⁹ Even though § 7704 in effect automatically treats publicly traded partnerships as associations, when Congress enacted the provision, it left the historical definition of corporation as including "associations" intact.²⁴⁰ By leaving this definition untouched in the process of radically changing the classification landscape, Congress indicated a clear intention that entities other than publicly traded partnerships and state-law corporations be treated as corporations for tax purposes. Thus, even though the regulations may represent a reasonable or even wise policy choice, it appears difficult to square them with the language of § 7701(a)(3).

Nevertheless, since this article argues that one never even gets to *Chevron* because of *Morrissey* and the incorporation rule, it is not necessary to resolve the question of whether the check-the-box regulations would survive a *Chevron* analysis. Accordingly, even though there are very strong arguments that the regulations would not survive a *Chevron* analysis, for the remainder of this article it is assumed that the regulations would be upheld under *Chevron* had they been issued on a clean slate.²⁴¹

²³⁴ See JCT REPORT, *supra* note 12 at 15-16; Fleischer, *supra* note 227, at 544-49.

²³⁵ See Fleischer, *supra* note 227, at 542.

²³⁶ See *id.* at 522.

²³⁷ See *id.* at 549-55.

²³⁸ See *id.* at 553-55 (arguing that using public trading is wise because it will not significantly decrease the corporate tax base, it will simplify the law, and it will bring tax law more in line with securities law). In fact, because the check-the-box regulations have remained in effect since 1997, the publicly traded distinction is the one that has been in place since then. There has been no discussion about terminating the elective regime, which supports the notion that the publicly traded distinction has survived the test of time thus far.

²³⁹ See *supra* text accompanying note 225 (observing that Congress intended "association" to have substantive meaning in § 7701(a)(3)).

²⁴⁰ See *supra* text accompanying notes 206-210.

²⁴¹ By using the term "issued on a clean slate," I mean if the regulations were issued in the absence of *Morrissey* or any other judicial interpretation of the term "association."

B. *Appropriate Analysis of the Validity of the Check-the-Box Regulations*

Despite the Treasury's initial concern about the validity of the check-the-box regulations and the voluminous commentary devoted to the issue, the incorporation rule has never been discussed with regard to the regulations. Although a few commentators briefly alluded to the general notion that *Morrissey's* interpretation of association might foreclose an elective regime,²⁴² none of the trilogy of cases underlying the incorporation rule were ever cited or discussed.²⁴³ This failure is particularly striking given the importance of the regulations, the wealth of commentary on the regulations, and the identity of those who specifically commented on the regulations' validity, including the Joint Committee on Taxation and the tax sections of the New York and California state bar associations.

1. Application of the Incorporation Rule

Applying the incorporation rule to the check-the-box regulations is relatively straightforward. In *Morrissey*, the Supreme Court independently interpreted the term "association" to mean any unincorporated entity that

²⁴² See, e.g., JCT REPORT, *supra* note 12, at 15 ("Some might argue that the *Morrissey* decision requires the Treasury Department to apply a corporate resemblance test in any regulations for determining whether an entity is an association taxable as a corporation."); *NY State Bar Report*, *supra* note 223 (arguing that although it believes the regulations to be valid, "it is possible to construct an argument that Treasury does not have the authority to adopt the 'check the box' system by way of regulation, which argument would rely on the fact that the four-factor test is grounded in the early case law that purports to classify based upon corporate resemblance."); see also William B. Brannan, *The Subchapter K Reform Act of 1997*, 75 TAX NOTES 121, 141 n.106 (Apr. 7, 1997), available at LEXIS 75 TN 121 (explaining that while he "is alarmed about the suggestion" that the regulations might be invalid, the "principal argument [in favor of invalidity] would be that the corporate resemblance approach reflected in the prior regulations were [sic] grounded in established case law beginning with . . . *Morrissey* . . . and, therefore, the Treasury Department could not now fundamentally change the classification law by adopting new regulations"); Hamill, *supra* note 225, at 337 n.15 (arguing that the regulations are invalid because they "eliminat[e] the relevance of the corporate resemblance test, [thereby] completely overturn[ing] the Supreme Court's interpretation of section 7701(a)(3) that has been in force for 60 years"). Notably, Professor Hamill was the only commentator to definitively conclude that the regulations would be invalid on the grounds that they conflict with *Morrissey*, although she did not cite the cases underlying the incorporation rule in support of her position.

²⁴³ All of the commentary except for the Joint Committee on Taxation's was published before *Neal*, the last case in the trilogy, was decided on January 22, 1996. See *Neal v. United States*, 516 U.S. 284 (1996). All of the commentary, however, was published well after the second case of the trilogy, *Lechmere, Inc. v. NLRB*, was decided on January 27, 1992. See *Lechmere, Inc. v. NLRB*, 502 U.S. 527 (1992). The Joint Committee's report, which specifically and extensively discussed the issue of whether the regulations were valid, was published on April 8, 1997, well after the *Neal* decision. See JCT REPORT, *supra* note 12, at 13-17.

sufficiently resembled a corporation and instructed that, in determining resemblance, the four corporate characteristics were to be analyzed.²⁴⁴ This definition was the result of an independent judicial interpretation made after "a further examination of the congressional intent";²⁴⁵ it was not made in deference to the government's position, which was explicitly rejected by the Court.²⁴⁶

Under the incorporation rule, the Supreme Court definition effectively became part of the governing statute, at least until the Court overrules its precedent or Congress amends the statute.²⁴⁷ The check-the-box regulations, which allow an entity that has all four corporate characteristics to avoid association status, are inconsistent with the *Morrissey* definition, which would classify such an entity as an association. Because of this inconsistency and because Congress has not amended the definition of corporation in § 7701(a)(3), the regulations are invalid.

2. Possible Counter-Arguments

There are five colorable arguments that could be made in an attempt to save the regulations from invalidity, but all are ultimately unpersuasive. These arguments are discussed below, beginning with two made by the Joint Committee on Taxation.

a. Consistency with *Morrissey*

The Joint Committee made the following argument in response to the general notion that *Morrissey* might foreclose an elective regime:

Some might argue that the *Morrissey* decision requires the Treasury Department to apply a corporate resemblance test in any regulations for determining whether an entity is an association taxable as a corporation. On the other hand, it has been argued that the check-the-box regulations in fact represent an implementation of the corporate resemblance test, when viewed in conjunction with the present-law rules generally treating publicly traded partnerships as corporations. The publicly traded partnership rules could be viewed as reflecting a determination by Congress that public trading is an effective index of whether an entity resembles a corporation.²⁴⁸

This argument appears to be based on the view that the check-the-box regime

²⁴⁴ See *supra* text accompanying notes 176-179 (identifying the four factors to be applied).

²⁴⁵ *Morrissey v. Comm'r*, 296 U.S. 344, 356 (1935).

²⁴⁶ See *supra* text accompanying notes 172-179 (observing that *Morrissey* rejected the business enterprise test that the governing regulation used and that was the basis of the government's argument that the trust constituted an association).

²⁴⁷ See *supra* text accompanying notes 92-101.

²⁴⁸ JCT REPORT, *supra* note 12, at 15-16 (footnotes omitted).

is not inconsistent with the holding in *Morrissey*. Under this view, the check-the-box regime merely changes the “index” of corporate resemblance from the four-factor test to public trading.

This argument is unpersuasive regardless of whether one takes an expansive or narrow view of *Morrissey*'s holding. Under a broad view, *Morrissey* instructed a reviewing court to analyze the four identified corporate factors,²⁴⁹ which is clearly inconsistent with the check-the-box regime under which these factors are irrelevant.²⁵⁰ In other words, *Morrissey* explicitly provided the index of corporate resemblance and any change of that index is inconsistent with this broad view of *Morrissey*'s holding.

Under a narrow view, the Court held that an unincorporated business entity with all four corporate characteristics constitutes an association.²⁵¹ This is also inconsistent with the check-the-box regime where such an entity would be able to elect its classification.²⁵² Therefore, under the check-the-box regulations, the actual outcome in *Morrissey* would have been different. Accordingly, when viewed from either a broad or narrow perspective, the holding of *Morrissey* is incompatible with an elective regime.

b. *Super-Chevron Powers in Entity Classification?*

In addressing the concern that *Morrissey* might foreclose an elective regime, the Joint Committee noted that “the standard of review articulated in the *Morrissey* case . . . grant[s] the Treasury Department considerable leeway to devise a different [classification] test,”²⁵³ citing the following language from *Morrissey*:

As the statute merely provided the term “corporation” should include “associations,” without further definition, the Treasury department was authorized to supply rules for the enforcement of the Act within the permissible bounds of administrative construction. *Nor can this authority be deemed to be so restricted that the regulations, once issued, could not later be clarified or enlarged so as to meet administrative exigencies or conform to judicial decision.*²⁵⁴

Other proponents of the regulations also suggested that this language gave the Treasury extremely broad latitude, a sort of “super-*Chevron*” power, in developing classification tests.²⁵⁵

²⁴⁹ See *Morrissey*, 296 U.S. at 359.

²⁵⁰ See Treas. Reg. § 301.7701-3(a) (as amended in 2003) (allowing unincorporated entities to elect their classification).

²⁵¹ See *Morrissey*, 296 U.S. at 360-61.

²⁵² See Treas. Reg. § 301.7701-3(a) (allowing unincorporated entities to elect their classifications).

²⁵³ JCT Report, *supra* note 12, at 16.

²⁵⁴ *Id.* at 16 n.27 (quoting *Morrissey v. Comm'r*, 296 U.S. 344, 354-55 (1935) (emphasis added)).

²⁵⁵ See, e.g., *Tax Section Report*, *supra* note 227 (arguing that this language gives “the

These commentators, however, read this language entirely out of context. In the excerpt above, the Court was specifically responding to the trust's argument that the Treasury's old regulatory standard, pursuant to which the trust would be treated as an association only if the beneficiaries had control over the corpus, was binding on the government.²⁵⁶ The Court was simply explaining that the Treasury was not bound by its superceded regulations. The Court was not addressing the different and much more radical notion that the Treasury could, in the course of issuing a new regulation, disregard a prior Supreme Court decision directly on point. As a result, this language does not support the validity of the regulations.

c. *Alternatives to the Incorporation Rule*

A proponent of the check-the-box regulations might also argue that the Court should overrule the trilogy of cases underlying the incorporation rule. As previously discussed, the incorporation rule undermines the *Chevron* principle that politically accountable agencies, rather than politically insulated judges, should bear primary interpretative responsibility with regard to ambiguous agency-administered statutes.²⁵⁷ Furthermore, the rule restricts the flexibility granted by *Chevron*, which allows agencies to deal with changed circumstances.²⁵⁸ In addition to undermining *Chevron*, the incorporation rule places undue importance on timing,²⁵⁹ which itself creates improper incentives for both agencies²⁶⁰ and courts.²⁶¹

As a result, some have suggested that the incorporation rule should be overruled judicially in favor of a different methodology for resolving the conflict between *stare decisis* and *Chevron*. Two approaches have recently been discussed.

i. Re-Examination Approach

Thomas Merrill and Kristin Hickman have discussed the conflict between *stare decisis* and *Chevron* in cases where a pre-*Chevron* judicial interpretation conflicts with a later *Mead*-qualified agency interpretation.²⁶² They considered

Treasury . . . broad latitude to promulgate regulations in this area"); Tax Executives Inst., Inc., *Comments of Tax Executives Institute, Inc. on Notice 95-14 Relating to Entity Classification*, TAX NOTES TODAY, July 28, 1995, available at LEXIS 95 TNT 147-41 (arguing that the language "confirms Treasury's authority to amend the regulations 'to meet administrative exigencies'").

²⁵⁶ See *supra* text accompanying notes 168-170 (finding that the Revenue Act of 1924 did not bind Treasury to its previous regulations regarding the definition of association).

²⁵⁷ *Supra* text accompanying notes 108-109.

²⁵⁸ *Supra* text accompanying note 110.

²⁵⁹ *Supra* text accompanying notes 111-113.

²⁶⁰ See *supra* text accompanying notes 117-119.

²⁶¹ See *supra* text accompanying notes 120-121.

²⁶² See Merrill & Hickman, *supra* note 40, at 915-20.

“the need for a transitional rule—a special rule of adjustment that mediates between the pre-*Chevron* and the post-*Chevron* worlds.”²⁶³

There are really only two options for [pre-*Chevron*] decisions. One is to examine each pre-*Chevron* precedent on a case-by-case basis, in an attempt to determine as best as is possible whether the precedent would have been a step-one precedent or a step-two precedent if, counterfactually, the court had applied the *Chevron* doctrine. The other is to adopt a blanket presumption that all pre-*Chevron* precedent is step-one precedent. . . . The Supreme Court’s treatment of its own precedent is best understood as adopting the second option—the blanket presumption that all past Supreme Court precedents are step-one precedents.²⁶⁴

In Merrill and Hickman’s terminology, the incorporation rule can be understood as “a blanket presumption that all pre-*Chevron* [Supreme Court] precedent is step-one precedent.”²⁶⁵ Branding this precedent automatically as step one precedent has the same effect as treating the judicial interpretation as incorporated into the statute because the agency would be similarly bound in either case.²⁶⁶ Applying this blanket step one approach, the check-the-box regulations would be invalid since they are inconsistent with the Court’s deemed step one interpretation of the term “association.”

The result is the same even under Merrill and Hickman’s re-examination of the pre-*Chevron* precedent approach. Applying this approach to *Morrissey*, one would re-examine the opinion to best determine whether the case “correspond[s] to either step one or step two of *Chevron*.”²⁶⁷ This is another way of asking whether the case would fall under the independent judgment model (where the court independently determined the meaning of the term) or the deferential model (where the court deferred to any reasonable agency

²⁶³ *Id.* at 916.

²⁶⁴ *Id.* at 917. Merrill and Hickman do not address the similar conflict that arises when a judicial interpretation that was made post-*Chevron* (but without the benefit of a *Mead*-qualified agency interpretation) is inconsistent with a later *Mead*-qualified interpretation. See Bamberger, *supra* note 18, at 1296-1301. Rather, they focused only on the transitional issue of how to treat a pre-*Chevron* judicial interpretation in a post-*Chevron* world. See Merrill & Hickman, *supra* note 40, at 917.

²⁶⁵ See Merrill & Hickman, *supra* note 40, at 917.

²⁶⁶ There might be a slight difference between these two approaches with regard to the Court’s willingness to overrule its prior interpretation. It is unclear, under Merrill and Hickman’s blanket step one presumption, how the Court would decide whether to overrule its precedent.

²⁶⁷ *Id.* at 918. Although the language quoted in the text accompanying note 264, *supra*, might suggest that the re-examination approach would require the Court to speculate as to what the pre-*Chevron* court actually would have done had it applied *Chevron*, it is clear that this is not what Merrill and Hickman suggest. Rather, under the re-examination approach, the pre-*Chevron* decision is analyzed closely to determine whether it better corresponds with step one or step two under *Chevron*. See Merrill & Hickman, *supra* note 40, at 918.

definition).²⁶⁸ As previously discussed, the Court in *Morrissey* rejected the government's view and independently interpreted the statutory language at issue.²⁶⁹ As a result, even under this re-examination approach, the check-the-box regulations would be invalid.²⁷⁰

ii. Provisional Precedent Approach

Kenneth Bamberger recently proposed a more radical alternative to the incorporation rule.²⁷¹ To address the problems resulting from the incorporation rule, Bamberger proposed giving judicial interpretations of ambiguous agency-administered statutes only provisional stare decisis effect.²⁷² Under this approach, when Congress leaves ambiguity to agency discretion, "a judicial choice of one option within the zone of indeterminacy, although it would be authoritative in resolving the case or controversy, would constitute binding precedent only until an agency puts forth a different one in a manner deserving Chevron treatment."²⁷³ In other words, a rule of provisional precedent would allow a *Mead*-qualified agency interpretation to trump a judicial interpretation so long as the agency interpretation would be upheld under *Chevron*.²⁷⁴

If the Court adopted Bamberger's proposal of provisional precedent, the validity of check-the-box regulations would be analyzed very differently. *Morrissey*, because it acknowledged that the term "association" was ambiguous,²⁷⁵ would be considered provisional precedent subject to subsequent *Mead*-qualified Treasury action that passes the *Chevron* standard.²⁷⁶ Therefore, assuming that the check-the-box regulations were issued in a form that qualifies for *Chevron* deference under *Mead*,²⁷⁷ the

²⁶⁸ See *supra* Part I.A.

²⁶⁹ See *supra* text accompanying notes 162-179.

²⁷⁰ Merrill and Hickman ultimately support the blanket step one presumption as the best transition rule, concluding that the benefits of the re-examination approach would be outweighed by its difficulties and inefficiencies. See Merrill & Hickman, *supra* note 40, at 918-20.

²⁷¹ Bamberger, *supra* note 18, at 1310-20 (outlining provisional precedent analysis).

²⁷² *Id.* at 1310-11.

²⁷³ *Id.* at 1311.

²⁷⁴ *Id.*

²⁷⁵ *Morrissey v. Comm'r*, 296 U.S. 344, 356 (1935).

²⁷⁶ By acknowledging that the term was ambiguous, *Morrissey* leaves the Treasury the opportunity to amend the judicial interpretation by regulation under a rule of provisional precedent. See Bamberger, *supra* note 18, at 1310-11. If the Court had found plain meaning in *Morrissey*, then a subsequent inconsistent Treasury regulation would be invalid even under this rule not because it conflicted with judicial precedent, but because it conflicted with the plain meaning of the statute (as previously determined by the Court) under *Chevron* step one. See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984).

²⁷⁷ See *supra* Part I.E.3 (discussing whether general authority regulations qualify for *Chevron* deference under *Mead*).

regulations would be upheld if they pass *Chevron*'s two step analysis.²⁷⁸

Accordingly, if the Court adopted a rule of provisional precedent, the regulations might be saved. While a full analysis of Bamberger's proposal is beyond the scope of this article, it is enough to say that it is unlikely to be adopted by the Court in the near term simply because it would represent "a landmark abdication of judicial power."²⁷⁹ In this regard, Justice Scalia notes:

I know of no case, in the entire history of the federal courts, in which we have allowed a judicial interpretation of a statute to be set aside by an agency—or have allowed a lower court to render an interpretation of a statute subject to correction by an agency.²⁸⁰

Indeed, "there would be something unsettling about a world in which executive branch administrators could 'overrule' Supreme Court decisions."²⁸¹

d. *Overruling Morrissey*

A proponent of the check-the-box regulations might argue that the Court should overrule its holding in *Morrissey*. This is a difficult argument to win, given the Court's well-established reluctance to overruling its statutory interpretation precedents.²⁸²

In discussing the merits of this strategy, it should first be noted that the context for this argument (i.e., that the Court should overrule its own statutory interpretation precedent) would be quite unusual. A party generally makes this argument by requesting that the Court strike down the old interpretation and *adopt a new, alternative judicial interpretation*.²⁸³ In this case, however, a proponent of the check-the-box regulations would be arguing for the Court merely to strike down the old precedent; the proponent would not ask the Court to adopt a new judicial interpretation. Rather, the proponent would ask the Court to leave the Treasury space to operate.²⁸⁴ In other words, the proponent

²⁷⁸ See *supra* Part III.A (discussing whether the check-the-box regulations would be upheld under a *Chevron* analysis).

²⁷⁹ *United States v. Mead Corp.*, 533 U.S. 218, 248 (2001) (Scalia, J., dissenting).

²⁸⁰ *Id.* at 248-49.

²⁸¹ Merrill, *supra* note 16, at 989.

²⁸² See, e.g., *Neal v. United States*, 516 U.S. 284, 295-96 (1996); *Ankenbrandt v. Richards*, 504 U.S. 689, 699-700 (1992); *Hilton v. S.C. Pub. Rys. Comm'n*, 502 U.S. 197, 202 (1991); *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) (indicating that *stare decisis* has special force in the statutory interpretation context); see also Eskridge, *supra* note 89, at 1362-63 (describing the Court's "super-strong presumption of correctness" with regard to its statutory interpretation precedents).

²⁸³ See, e.g., *Ankenbrandt*, 504 U.S. at 699-700; *Hilton*, 502 U.S. at 202; *Patterson*, 491 U.S. at 172 (upholding earlier judicial interpretation despite arguments that the Court should adopt a different interpretation).

²⁸⁴ One might wonder whether the proponent could ask the Court to overrule *Morrissey* and then adopt the check-the-box regulations' definition of association. The regulations' elective regime, however, involves a highly bureaucratic process. For example, the

would be asking the Court to wipe the slate clean, thereby allowing the *Mead*-qualified check-the-box regulations to stand.

It is unclear whether this different context would make it more or less likely for the Court to take the unusual step of overruling its own precedent. On the one hand, in this context the agency charged with administering the statute has spoken in a formal *Mead*-qualified manner, concluding that a different interpretation would be best.²⁸⁵ Because of this expert opinion, and perhaps in the interest of inter-branch comity, this unusual context might cause the Court to be more receptive than usual to the argument that it should overrule its statutory interpretation precedent.

On the other hand, the Court might be offended by an agency's brazenness in so clearly contradicting an existing Supreme Court precedent directly on point.²⁸⁶ In such a case, the Court might desire to send a strong message to the executive branch that such tactics will not result in a successful end run around the general rule that agencies must go to Congress to change settled law. The Court could send such a message by summarily refusing an invitation to reconsider its precedent in this context, thereby forcing the agency to turn to Congress.

In what appears to be the only case in which the issue arose in this context, the Court rejected the argument that it should overrule its prior statutory interpretation precedent. In the *Neal* case discussed earlier,²⁸⁷ the defendant asked the Court to reconsider its precedent holding in *Chapman v. United*

regulations specify the time, place, and method for filing the classification election with the IRS. See Treas. Reg. § 301.7701-3(c). Because of this bureaucratic process, it is difficult to see how the Court itself could reinterpret the term association as the regulations do.

²⁸⁵ See *Pierce*, *supra* note 41, at 2260 (suggesting that in this context, the Court "should use the occasion of the announcement of the agency construction as an indication of the need to reconsider the precedent").

²⁸⁶ See *Chi. & S. Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948). The Court maintained:

[I]f the President may completely disregard the judgment of the court, it would be only because it is one the courts were not authorized to render. Judgments within the powers vested in courts by the Judiciary Article of the Constitution may not lawfully be revised, overturned or refused faith and credit by another Department of Government.

Id. Cf. *City of Boerne v. Flores*, 521 U.S. 507, 536 (1997) ("When the political branches of the Government act against the background of a judicial interpretation of the Constitution already issued, it must be understood that in later cases and controversies the Court will treat its precedents with the respect due them under settled principles, including *stare decisis*, and contrary expectations must be disappointed.").

²⁸⁷ See *supra* text accompanying notes 95-99. In the other two cases in the incorporation rule trilogy, the Court, in deciding that the agency action was foreclosed by its precedent holding, did not extensively address the argument that it should overrule the precedent. In *Lechmere, Inc. v. NLRB*, the Court did not address the argument at all. 502 U.S. 527 (1992). In *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, the Court very briefly addressed the argument, stating in a conclusory manner that "Congress has not diverged from [the Court's prior] interpretation and we decline to revisit it ourselves." 497 U.S. 116, 131 (1990).

*States*²⁸⁸ that, in calculating the amount of a “mixture or substance” of LSD for criminal sentencing purposes, the actual weight of blotter paper was to be counted.²⁸⁹ The defendant, however, did not request that the Court adopt a new judicial interpretation; rather the defendant asked the Court to defer to the position of the United States Sentencing Commission that every dose of LSD on any carrier medium would automatically be given a presumed weight of 0.4 milligrams.²⁹⁰ The Court quickly disposed of the defendant’s request that the Court overrule its precedent:

Our reluctance to overturn precedents derives in part from institutional concerns about the relationship of the Judiciary to Congress. One reason that we give great weight to *stare decisis* in the area of statutory construction is that “Congress is free to change this Court’s interpretation of its legislation.” We have overruled our precedents when the intervening development of the law has “removed or weakened the conceptual underpinnings from the prior decision, or where the later law has rendered the decision irreconcilable with competing legal doctrines or policies.” Absent those changes or compelling evidence bearing on Congress’ original intent, our system demands that we adhere to our prior interpretations of statutes. Entrusted within its sphere to make policy judgments, the Commission may abandon its old methods in favor of what it has deemed a more desirable “approach” to calculating LSD quantities. We, however, do not have the same latitude to forsake prior interpretations of a statute. True, there may be little in logic to defend the statute’s treatment of LSD; it results in significant disparity of punishment meted out to LSD offenders relative to other narcotics traffickers. . . . Even so, Congress, not this Court, has the responsibility for revising its statutes. Were we to alter our statutory interpretations from case to case, Congress would have less reason to exercise its responsibility to correct statutes that are thought to be unwise or unfair.²⁹¹

The *Neal* Court, while acknowledging that *Chapman* was probably unwise from a policy perspective, refused to reconsider the decision in the absence of either (1) an intervening development in the law that had “removed or weakened [the prior decision’s] conceptual underpinnings” or “rendered [it] irreconcilable with competing legal doctrines or policies” or (2) the emergence of “compelling evidence bearing on Congress’ original intent.”²⁹² *Neal* also explained that the basis for the Court’s reluctance to overrule its statutory precedents is the recognition that Congress is free to change any interpretation

²⁸⁸ 500 U.S. 453, 455 (1991).

²⁸⁹ *Neal v. United States*, 516 U.S. 284, 295-96 (1996).

²⁹⁰ *Id.* at 289.

²⁹¹ *Id.* at 295-96 (citations omitted).

²⁹² *Id.* at 295 (internal quotations omitted).

of which it does not approve.²⁹³ In addition, the *Neal* Court was concerned that frequent reconsideration of statutory precedents would reduce the incentive for Congress to amend statutes that it considers unsatisfactory.²⁹⁴

A similar analysis of the *Morrissey* decision leads to the conclusion that it, like *Chapman*, should not be overruled. Since there has been no new evidence bearing on Congress's original intent with regard to its use of the term "association," the only remaining issue under *Neal* is whether there has been an "intervening development of the law, through either the growth of judicial doctrine or further action taken by Congress,"²⁹⁵ that might affect the continuing vitality of *Morrissey*.

Intervening developments in law actually *support*, rather than undermine, the vitality of *Morrissey*. In 1987, over fifty years after *Morrissey*, Congress enacted § 7704 against the classification backdrop created by the *Morrissey* Court.²⁹⁶ This enactment, the most recent legislative action in the classification area, by its text governs only partnerships, which were then defined through the application of the corporate resemblance test.²⁹⁷ Thus, *Morrissey* is the foundation on which § 7704 was built, and as a result, the enactment of this section indicates congressional approval of the corporate resemblance test.²⁹⁸

Therefore, it seems that intervening developments in law (i.e., the enactment of § 7704) actually serve to ratify the corporate resemblance test created by *Morrissey*. A proponent of the check-the-box regulations might argue, however, that intervening developments in *state* law since the enactment of § 7704, namely the advent of the LLC, undermine the vitality of *Morrissey*. According to this argument, the popularity of the LLC essentially made *Morrissey* obsolete, since non-publicly traded entities could manipulate the four factors to their satisfaction. This, however, is not a change in the law that weakens *Morrissey*'s conceptual underpinnings. Rather, the proliferation of LLCs, like the proliferation of publicly traded partnerships that triggered the enactment of § 7704, is a change in *facts*, and a change in facts is insufficient

²⁹³ *Id.*

²⁹⁴ *Id.* at 296.

²⁹⁵ *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989).

²⁹⁶ *See supra* text accompanying notes 206-207.

²⁹⁷ *Id.*

²⁹⁸ The building block nature of *Morrissey* with regard to § 7704 is confirmed by § 7704's legislative history. This legislative history extensively discusses the corporate resemblance test created by *Morrissey*. *See* authorities cited *supra* note 210. Section 7704 supports the vitality of *Morrissey* in another way. In enacting § 7704, Congress drastically altered the classification landscape by taxing publicly traded partnerships as per se corporations for the first time. *See supra* text accompanying notes 200-205. In making such a drastic change, however, Congress did not see fit to repeal the corporate resemblance test. In leaving the corporate resemblance definition of "association" untouched in the process of substantially altering the law of the tax classification of business entities, Congress appeared to ratify the corporate resemblance test.

to support a Court overruling its prior statutory interpretation.²⁹⁹ Congress is charged with the responsibility of adapting settled law to new facts. Overruling *Morrissey* would give Congress “less reason to exercise [this] responsibility.”³⁰⁰

In summary, it is unlikely that the Court would overrule its interpretation in *Morrissey* in order to validate the check-the-box regulations because Congress, through subsequent legislative enactment of § 7704, appeared to ratify the holding of *Morrissey*. As a result, the Court would likely conclude that only Congress could dispose of the corporate resemblance test.³⁰¹

e. *Ratification of the Regulations by Acquiescence*

Because it has been over six years since the check-the-box regulations became effective, one might argue that congressional inaction in the classification area since that time indicates approval of the elective regime. Under this view, congressional inaction indicates tacit acquiescence to the new regime.

Scholars have generally been very skeptical of drawing inferences from congressional inaction.³⁰² As a result, this argument could be attacked from that perspective. These arguments, however, are unnecessary because the argument that congressional inaction ratifies the regulations by acquiescence should fail on much simpler grounds.

First, the doctrine of legislative acquiescence is used by courts to uphold one arguably plausible agency interpretation of an ambiguous statute instead of adopting a different, arguably more plausible judicial interpretation.³⁰³ It cannot be used to uphold an agency interpretation that the statute simply will not bear.³⁰⁴ Therefore, the doctrine of acquiescence does not allow Congress

²⁹⁹ See *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989) (stating that “an intervening development of the law,” not facts, is a basis for overruling statutory interpretation precedent (emphasis added)). Cf. *Planned Parenthood of Southeastern Pa. v. Casey*, 505 U.S. 833, 860 (1992) (noting that changed factual circumstances may justify a departure from precedent in the constitutional interpretation context).

³⁰⁰ *Neal v. United States*, 516 U.S. 284, 296 (1996).

³⁰¹ See *California v. FERC*, 495 U.S. 490, 499 (1990) (recognizing the respect the Court “must accord to [its] longstanding and well-entrenched decisions, especially those interpreting statutes that underlie complex regulatory regimes”).

³⁰² See, e.g., *Eskridge*, *supra* note 89, at 95-108 (questioning the ability to presume intent from the collective inaction of Congress).

³⁰³ See, e.g., *Bob Jones Univ. v. United States*, 461 U.S. 574, 599-601 (1983) (attributing significance to congressional inaction over the course of twelve years in the face of numerous proposals to overturn an IRS interpretation of a prior statute).

³⁰⁴ See *Leary v. United States*, 395 U.S. 6, 25 (1969) (concluding that “[w]hen a regulation conflicts with the statute, the fact of subsequent re-enactment ‘is immaterial, for Congress could not add to or expand [the] statute by impliedly approving the regulation’” (second alteration in the original) (quoting *Commissioner v. Acker*, 361 U.S. 87, 93 (1959))); *Louisville & Nashville R.R. Co. v. United States*, 282 U.S. 740, 759 (1931)

to change the statute by inaction;³⁰⁵ rather, it only allows Congress to confirm a plausible interpretation of the statute by inaction.

The incorporation rule treats the *Morrissey* standard as though it is part of the underlying statute.³⁰⁶ Accordingly, using the acquiescence doctrine to uphold a different standard would allow Congress to effectively change the statute through inaction, an impermissible use of the doctrine.³⁰⁷

Second, it is unclear to which "law" Congress would be acquiescing. If a legislator reviewed the state of the law immediately after the regulations were issued, the legislator might conclude, as this article does, that the regulations were invalid and that the *Morrissey* corporate resemblance test still controlled. At the time the regulations were promulgated, the Court had just unanimously confirmed in *Neal* that its interpretations trump subsequent agency interpretations.³⁰⁸ Accordingly, it then appeared that *Morrissey* remained "good law." Therefore, if this legislator did nothing, one might conclude that the legislator approved of this good law, not the invalid elective regime. This second problem is related to the first problem because, in the usual case, the upheld interpretation (i.e., a plausible interpretation) is not patently unlawful.³⁰⁹

("Long continued practice and the approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, but cannot alter provisions that are clear and explicit . . .").

³⁰⁵ See *Leary*, 395 U.S. at 25 (concluding that Congress cannot change a statute through inaction, by "impliedly approving" a regulation which contradicts the statute).

³⁰⁶ See *supra* Part III.B.1.

³⁰⁷ See *Biddle v. Comm'r*, 302 U.S. 573, 582 (1938) ("Where the law is plain the subsequent re-enactment of a statute does not constitute adoption of its administrative construction.").

³⁰⁸ See *Neal v. United States*, 516 U.S. 284, 295 (Jan. 22, 1996) ("Once we have determined a statute's meaning, we adhere to our ruling under the doctrine of *stare decisis*, and we assess an agency's later interpretation of the statute against that settled law."); 61 Fed. Reg. 66,584 (Dec. 18, 1996) (to be codified at 26 C.F.R. pts. 1, 301, 602) (finalizing the check-the-box regulations).

³⁰⁹ In the usual case in which the acquiescence doctrine is applied, the Court is considering whether to change one plausible interpretation of a statute by an agency to another. See *supra* text accompanying note 303. In this context, a legislator reviewing the statute after the initial interpretation might do nothing if he was satisfied with the interpretation, believing that legislation was unnecessary because the issue had already been settled. Accordingly, one could surmise from inaction that the legislator approved of the initial interpretation. If, however, the initial interpretation was clearly invalid (because, for example, it was incompatible with the statutory text), the implications of the inaction of a legislator depend on the legislator's knowledge that the interpretation was invalid. If the legislator knew the interpretation was invalid, he might do nothing if he disapproved of it, knowing that a court would ultimately strike it down. If the legislator mistakenly thought the interpretation was valid, he might do nothing if he approved of it, thinking that the interpretation was now settled.

IV. HOW COULD TREASURY HAVE ISSUED INVALID REGULATIONS?

This Part considers how the Treasury could have promulgated the check-the-box regulations despite their invalidity in light of *Morrissey*. This action by the Treasury is somewhat remarkable in two respects. First, the regulations deal with an important and pervasive area of tax law that affects the classification of almost every unincorporated business entity.³¹⁰ The regulations do not cover some arcane, technical area of tax law that affects only a few taxpayers, where such an error might be understandable. Second, the validity of the regulations was specifically highlighted as an issue when an elective regime was first raised, and many distinguished commentators, including the Joint Committee on Taxation³¹¹ and the New York State Bar Association Tax Section,³¹² specifically addressed the issue, but failed to discuss the incorporation rule.

There are two possible explanations for the Treasury's action, although an accurate explanation probably involves some combination of the two. These possible explanations are discussed below.

A. *Negligence and the Sociology of the Tax Community*

One explanation could be pure ignorance of the incorporation rule on the part of the tax community, which tends to have an unduly myopic vision of the law.³¹³ Professor Coverdale used this theory to explain why courts reviewing tax regulations were so inconsistent in citing *Chevron* and using its two step methodology, emphasizing the isolation of the highly specialized tax bar and bench.³¹⁴

Under this theory, the tax experts at the Treasury, IRS, and Joint Committee on Taxation erroneously applied administrative law doctrine, jumping directly to the question of whether the regulations would be upheld under *Chevron* without adequately considering the impact of *Morrissey*. Likewise, under this view, the private tax practitioners who specifically commented on the regulations' validity merely got the administrative law wrong.

B. *Intent and the Effect of Taxpayer Standing Doctrine*

A more cynical explanation is that the Treasury was aware of the regulations' invalidity yet issued them anyway because it severely discounted

³¹⁰ See *supra* text accompanying notes 220-221.

³¹¹ See JCT REPORT, *supra* note 12, at 13-17.

³¹² See NY State Bar Report, *supra* note 223.

³¹³ See Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up To Be Tax Lawyers*, 13 VA. TAX REV. 517, 518 (1994) (observing that "tax law too often is mistakenly viewed by lawyers, judges, and law professors as a self-contained body of law").

³¹⁴ Coverdale, *supra* note 129, at 53-54 n.121 (hypothesizing that the "highly specialized" nature of tax law leaves tax lawyers and judges either unaware of *Chevron* or under the impression "that other doctrines are controlling in tax"); see also *supra* text accompanying notes 136-144.

the likelihood of any judicial challenge. Under this view, the Treasury intentionally promulgated invalid regulations but determined that the regulations were insulated from a challenge due the very restrictive taxpayer standing doctrine discussed below. If, however, the Treasury had this troubling view, it was short-sighted because, although a taxpayer with standing to challenge the regulations might be hard to find, it is inevitable that such taxpayers exist.

In general, taxpayers do not have standing in a suit that concerns someone else's taxes because the relief sought would not benefit the taxpayer in any tangible way.³¹⁵ In other words, a person does not have standing to challenge a tax rule merely because of one's status as a taxpayer; rather, the person must suffer a tangible injury in order to challenge the validity of a regulation.

Applying this taxpayer standing doctrine to the check-the-box regulations, a taxpayer challenging the validity of the regulations would have to show that his tax liability is higher under the regulations than under *Morrissey's* corporate resemblance test. Because the check-the-box regulations allow an entity to elect its classification, it might appear on first glance that all taxpayers in all instances will fare no worse under the regulations than under *Morrissey*. If this were the case, no one would have standing to challenge the regulations. Although these regulations will generally work to the taxpayer's benefit (or at least not to the taxpayer's detriment), there will be certain situations where the taxpayer would be better off under the corporate resemblance test.³¹⁶ One could think of a number of such scenarios; three examples are provided below.

1. The Case of the Foreign Entity's Failure to Elect

Under the check-the-box regulations, eligible entities elect whether to be classified as a corporation or a partnership by filing Form 8832 with the IRS.³¹⁷ The regulations contain default rules that classify unincorporated entities in the absence of an affirmative election.³¹⁸ The default rules classify all domestic entities as partnerships,³¹⁹ classify foreign entities that *do not* provide limited liability for all of their owners as partnerships,³²⁰ and classify

³¹⁵ See *Massachusetts v. Mellon*, 262 U.S. 447, 487 (1923) (explaining that any statute that produces additional taxes is "a matter of public and not of individual concern"); see also *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 46 (1976) (Stewart, J., concurring) ("I cannot now imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else."); BORIS I. BITTKER ET AL., *FEDERAL INCOME TAXATION OF INDIVIDUALS* ¶ 51.10[4], at 51-58 to 51-60 (3d ed. 2002) (discussing standing barriers to suits brought by plaintiffs concerning someone else's taxes).

³¹⁶ 1 MCKEE ET AL., *supra* note 1, ¶ 3.08[1] n.421.

³¹⁷ Treas. Reg. § 301.7701-3(c)(1) (as amended in 2001).

³¹⁸ See *id.* § 301.7701-3(b).

³¹⁹ *Id.* § 301.7701-3(b)(1).

³²⁰ *Id.* § 301.7701-3(b)(2)(A).

foreign entities that *do* provide limited liability for all of their owners as corporations.³²¹

Because partnership classification is generally desirable due to flow-through taxation,³²² the default rules that classify entities as partnerships are taxpayer-favorable. Under these default rules, no entity will receive the generally less desirable corporate classification unless it affirmatively elects otherwise.³²³

With regard to foreign entities that provide limited liability for all of their owners, however, the default rules are unfavorable. These entities will receive the generally less desirable corporate classification if they fail to make an affirmative election.³²⁴

Accordingly, if one of these entities accidentally failed to elect partnership status, it would have standing to challenge the regulations' validity if the corporate resemblance test would have classified the entity as a partnership. For example, assume that a foreign entity that provides all of its owners with limited liability accidentally fails to elect partnership status. If the entity lacks two of the remaining three corporate characteristics of perpetual existence, free transferability of interests, and centralized management, the entity would have been classified as a partnership under the corporate resemblance test.³²⁵ However, because the entity failed to make an affirmative election under the check-the-box regulations, it is taxed as a corporation.³²⁶ In an attempt to avoid the corporate tax on its income, the entity would have standing to challenge the validity of the check-the-box regulations.

2. The Case of the Partner Trying to Avoid an Allocation of Ordinary Income

If the IRS asserts a deficiency arising out of an allocation of income from a partnership (as classified under the check-the-box regulations), the taxpayer could avoid that allocation by showing that the partnership was really a corporation, as corporate income does not flow through to its shareholders.³²⁷ Thus, if the allocation came from an LLC that had all four corporate characteristics, the taxpayer could attempt to avoid the allocation by arguing that the check-the-box regulations were invalid. If the argument succeeds, the LLC would be classified as a corporation under the corporate resemblance test.³²⁸

Although this may be a successful strategy to avoid an allocation, the

³²¹ *Id.* § 301.7701-3(b)(2)(B).

³²² See MUNDSTOCK, *supra* note 213, at 10.

³²³ See Treas. Reg. § 301.7701-3(b)(1).

³²⁴ See *id.* § 301.7701-3(b)(2)(B).

³²⁵ See *supra* text accompanying notes 191-194.

³²⁶ See Treas. Reg. § 301.7701-3(b)(2)(B).

³²⁷ Cf. I.R.C. § 702(a) (requiring a partner to include his or her distributive share of the partnership's income in his or her gross income).

³²⁸ See *supra* text accompanying notes 191-194.

taxpayer would have to take into account collateral issues before undertaking this strategy. For example, the LLC would now be considered a corporation, and thus all of its income would be subject to the double tax regime.³²⁹ Furthermore, if the taxpayer had previously received the benefit of flow-through losses, they would now be lost.³³⁰ In fact, even if the flow-through losses involved taxable years for which the statute of limitations had run, the IRS might be able to reverse the taxpayer's tax benefits resulting from those losses under "the uncertain and confusing judicial doctrines of equitable estoppel and recoupment"³³¹ because of the taxpayer's inconsistent positions taken with regard to the LLC's classification (first as a partnership, then as a corporation). In short, arguing that the regulations are invalid in order to avoid an allocation of income would not be wise in most cases because the taxpayer would essentially win the battle (by avoiding the allocation of income) but lose the war (by implicating these collateral concerns).

One could, however, envision a scenario where these collateral concerns are absent or minimal. For example, assume that on January 1, 2000, Taxpayer acquires a 50% membership interest in an LLC, a partnership under the check-the-box regulations but a corporation under the corporate resemblance test. Taxpayer acquires his interest for \$1,000,000. In 2000, the LLC earns \$10,000,000 of income and reinvests the income, rather than distributing it. On January 2, 2001, Taxpayer sells his 50% interest to a third party for \$6,000,000.

Under the check-the-box regulations, Taxpayer would have ordinary income (taxed at a maximum rate of 35%³³²) on the \$5,000,000 allocation of ordinary income to him from the partnership.³³³ Because Taxpayer's basis in his partnership interest would be adjusted to reflect this allocation,³³⁴ no additional tax would be due in 2001 when he sells his interest.³³⁵

³²⁹ See *supra* text accompanying notes 147-150 (explaining how corporation income is generally taxed twice, once at the corporate level and once at the shareholder level).

³³⁰ Cf. I.R.C. § 702(a) (allowing a partner to include his or her distributive share of the partnership's losses on his or her individual income tax return).

³³¹ BITTKER ET AL., *supra* note 315, ¶ 49.10, at 49-27.

³³² See I.R.C. § 1(a)-(d) (setting tax rates for individuals).

³³³ See I.R.C. §§ 702(a), 704(a) (requiring partners to include distributive share of partnership income in gross income and providing that in general partner's distributive share shall be determined by the agreement of the partners).

³³⁴ See I.R.C. § 705(a)(1)(A) (providing that partner's basis in partnership interest is adjusted upwards to reflect partner's distributive share of partnership income).

³³⁵ Taxpayer's initial basis in his partnership interest is its cost of \$1,000,000. See I.R.C. § 1012 (explaining that the basis of property is the cost of that property). Section 705(a) requires that this basis is adjusted upward to reflect the \$5,000,000 of income allocated to Taxpayer. Accordingly, at the time of sale, Taxpayer's basis is \$6,000,000. Consequently, when Taxpayer sells the interest for \$6,000,000, he has no gain or loss. See I.R.C. § 1001(a) (computing gain or loss on sale as the difference between the amount realized and basis); *id.* § 1001(b) (defining amount realized as amount of money plus the fair market value of

However, under *Morrissey*, Taxpayer would have no tax liability in 2000 because the LLC would be classified as a corporation.³³⁶ In 2001, when Taxpayer sells his "stock," he would recognize a long-term capital gain (taxed at a maximum rate of 15%) of \$5,000,000.³³⁷ Therefore, by arguing that the check-the-box regulations are invalid, Taxpayer could save up to \$1,000,000 by effectively converting ordinary income into a long-term capital gain.³³⁸

3. The Case of the Corporate Purchaser Attempting to Preserve Losses

The last example involves a corporate purchaser of an LLC, which is classified as a partnership under the check-the-box regulations but would have been classified as a corporation under the corporate resemblance test, that had incurred significant losses prior to the purchase. Under a partnership classification, the LLC's losses would have flowed through to the prior owners to be reported on their prior returns.³³⁹ Alternatively, under a corporate classification, the losses would be carried forward by the LLC for future use.³⁴⁰ Therefore, the purchaser might argue that the check-the-box regulations were invalid in order to preserve these losses for future use.

Under this argument, the LLC would be considered a wholly owned subsidiary of the corporate purchaser; as a result, the corporate purchaser would either be able to consolidate its tax returns with the LLC³⁴¹ or be

property received).

³³⁶ Cf. I.R.C. § 702(a) (requiring partner to include distributive share of partnership income in gross income).

³³⁷ See I.R.C. § 1001(a) (computing gain or loss on sale as the difference between the amount realized and basis); *id.* § 1001(b) (defining amount realized as amount of money plus the fair market value of property received). Taxpayer's basis in the stock is \$1,000,000. See I.R.C. § 1012 (explaining that the basis of property is the cost of that property). His amount realized on the sale is \$6,000,000. See I.R.C. § 1001(b) (defining amount realized as amount of money plus the fair market value of property received). As a result, he has a \$5,000,000 gain on the sale. See I.R.C. § 1001(a) (computing gain or loss on sale as the difference between the amount realized and basis). Since the stock is a capital asset, see I.R.C. § 1221(a), that has been held for more than a year, the gain is classified as a long-term capital gain. See I.R.C. § 1222(3) (defining "long-term capital gain" as a "gain from the sale or exchange of a capital asset held for more than 1 year"). Therefore, the gain is taxed at a maximum rate of 15%. See I.R.C. § 1(h) (setting maximum capital gain rates).

³³⁸ Assuming that all income is taxed at the maximum rate, Taxpayer would owe tax of \$1,750,000 (35% of \$5,000,000) if the LLC is considered a partnership and tax of \$750,000 (15% of \$5,000,000) if the LLC is considered a corporation.

³³⁹ See I.R.C. § 702(a) (requiring partners to include their distributive shares of partnership losses on their individual tax returns); I.R.C. § 703(a)(2)(D) (precluding a partnership from taking deductions for net operating losses).

³⁴⁰ See I.R.C. § 172(a) (allowing a deduction for net operating losses).

³⁴¹ See I.R.C. § 1501 (allowing an "affiliated group of corporations" to file consolidated returns); I.R.C. § 1504(a) (defining the term "affiliated group of corporations" to include a parent and a wholly owned subsidiary).

eligible for the dividends-received deduction with regard to distributions from the LLC.³⁴² Therefore, the corporate purchaser will suffer no adverse consequences from reclassifying the LLC as a corporation by arguing that the check-the-box regulations are invalid.

In summary, one can conceive of many situations in which a taxpayer would benefit from transmuting his partnership interest into an interest in a corporation by arguing that the check-the-box regulations are invalid. Therefore, if the Treasury knowingly promulgated these invalid regulations because it determined that no one would ever have standing to challenge the regulations, it was mistaken. It would appear to be only a matter of time before the right taxpayer with the right facts will challenge the validity of the regulations.³⁴³

Finding the true explanation for the Treasury's decision to promulgate these invalid regulations involves some speculation. The explanation probably lies somewhere between the two extremes. The Treasury might have believed that the regulations were at least arguably valid, while recognizing that a court would strive hard to find them valid. Furthermore, the Treasury was possibly comforted by the mistaken belief that no taxpayer would ever have standing to challenge the regulations.

V. TREASURY'S TREND

When faced with a Supreme Court interpretation of an ambiguous statutory term in the Code that it wants changed, the Treasury has three options. First, it could propose legislation to Congress to amend the underlying statute. Second, it could promulgate regulations that purport to change the interpretation in a taxpayer-adverse manner. Third, it could promulgate regulations that purport to change the interpretation in a taxpayer-friendly manner. This article has shown that only the first solution—go to Congress—is valid.³⁴⁴ Despite this reality, however, the Treasury has shown a recent tendency to choose the third solution—attempting to change the interpretation in a taxpayer-friendly manner.

The check-the-box regulations, the subject of this article, represent one example of this trend. Another example is the Treasury's recent promulgation of regulations regarding the important issue of whether an expense can be immediately deducted or must be capitalized.³⁴⁵ Like the check-the-box regulations, these regulations are generally taxpayer-friendly³⁴⁶ (although not

³⁴² See I.R.C. § 243(a), (b) (allowing a parent of a wholly owned subsidiary a 100% dividends received deduction with respect to dividend distributions from subsidiary to parent).

³⁴³ See 1 MCKEE ET AL., *supra* note 1, at ¶ 3.08 n.421.

³⁴⁴ See *supra* Part I.D.

³⁴⁵ See Guidance Regarding Deduction and Capitalization of Expenditures, 69 Fed. Reg. 436 (Jan. 5, 2004) (to be codified at 26 C.F.R. pt. 1).

³⁴⁶ See Calvin H. Johnson, *Destroying Tax Base: The Proposed INDOPCO*

in every single case³⁴⁷) and have been extensively praised by private practitioners.³⁴⁸ Like the check-the-box regulations, these regulations are also inconsistent with a Supreme Court decision, *INDOPCO v. Commissioner*,³⁴⁹ that is directly on point.³⁵⁰ Accordingly, these regulations are invalid to the extent they are inconsistent with *INDOPCO*.

Yet another example involves the tax treatment of expenses for auditing and training sessions paid by members of the Church of Scientology. In 1993, the IRS issued Revenue Ruling 93-73, which allowed Church of Scientology members to deduct these expenses as charitable contributions.³⁵¹ Like the check-the-box regulations, this Revenue Ruling was taxpayer-friendly because the ruling allowed deductions for expenses that were otherwise non-deductible.³⁵² The ruling is also, like the check-the-box regulations, inconsistent with a Supreme Court decision, *Hernandez v. Commissioner*, that is directly on point.³⁵³ As a result, this Revenue Ruling is invalid.

Capitalization Regulations, 99 TAX NOTES 1381, 1382 (June 2, 2003), available at LEXIS 99 TN 1381 (explaining that the regulations make it easier for a taxpayer to deduct a cost instead of capitalizing it).

³⁴⁷ In general, time value of money principles dictate that, all else being equal, the taxpayer prefers an earlier deduction to a later deduction. See generally Lawrence Lokken, *The Time Value of Money Rules*, 42 TAX L. REV. 1, 20 (1986). Consequently, the regulations are generally taxpayer-friendly in that they make it easier for a taxpayer to deduct rather than capitalize a cost. See Johnson, *supra* note 346, at 1382 (stating that the regulations allow taxpayers to deduct costs that would otherwise need to be capitalized). In certain instances, however, a taxpayer might prefer to delay a deduction, notwithstanding time value of money concerns. For instance, if the taxpayer will in the future be in a higher tax rate bracket, delaying a deduction until such future time will be beneficial to the taxpayer if the benefit of the tax rate differential exceeds the time value of money cost of delaying the deduction. In such a case, the regulations would be taxpayer-adverse.

³⁴⁸ See, e.g., N.Y. State Bar Ass'n Tax Section, *Report on Notice of Proposed Rulemaking on Deduction & Capitalization of Expenditures Relating to Intangibles*, TAX NOTES TODAY, Mar. 26, 2003, available at LEXIS 2003 TNT 58-18; see also Cheyaña L. Jaffke, *Sleeping with the Enemy? The IRS' Advanced Notice of Rulemaking Regarding Capitalization*, 32 BALTIMORE L. REV. 51, 64 (2002) (describing "the widespread support for the regulation" among taxpayers).

³⁴⁹ 503 U.S. 79 (1992).

³⁵⁰ See Johnson, *supra* note 346, at 1386 (stating that the regulations are inconsistent with *INDOPCO*).

³⁵¹ See also Sklar v. Comm'r, 282 F.3d 610, 614 (9th Cir. 2002) (discussing the IRS's private agreement with the Church of Scientology to allow these deductions, which resulted in the issuance of Rev. Rul. 93-73).

³⁵² Rev. Rul. 93-73, 1993-2 C.B. 75. Unlike the check-the-box regulations and the capitalization regulations, it is likely that no taxpayer may possibly have standing to challenge Revenue Ruling 93-73 except perhaps on First Amendment grounds. See BITTKER ET AL., *supra* note 315, § 49.10 (suggesting that "it is highly unlikely . . . that anyone would have standing to challenge [the ruling]").

³⁵³ 490 U.S. 680, 690-91 (1989) (concluding that Church of Scientology members may

It is likely that the restrictive taxpayer standing doctrine plays a role in the Treasury's issuance of these invalid rules. It is not unreasonable to assume that if the Treasury chose to fix problematic Supreme Court interpretations by issuing rules that were taxpayer-adverse, taxpayers would be rushing to the courthouse to challenge the validity of these rules. For instance, if instead of issuing the check-the-box regulations, the Treasury had attempted to cure the quagmire created by the corporate resemblance test by issuing a regulation that made limited liability the sole criterion for association status, many challenges would quickly have ensued.

What does all of this mean for the Treasury? With regard to the check-the-box regulations, the Treasury should propose "check-the-box" legislation to Congress or legislation that would specifically authorize the Treasury to create an elective classification regime. Likewise, the Treasury should withdraw the invalid capitalization regulations and seek legislative action instead.

More generally, the Treasury should recognize that Supreme Court interpretations are binding on the executive branch and that any change to such an interpretation always, without exception, requires legislative action. Furthermore, the Treasury should appreciate that, although it might be difficult to find taxpayers who have standing to challenge taxpayer-friendly rules, it is almost inevitable that they do exist.

CONCLUSION

After approximately eighty years of seemingly endless classification battles with taxpayers, the Treasury finally capitulated by promulgating the check-the-box regulations. These fundamental regulations, which have been extensively praised by taxpayers, allow nonpublicly traded, unincorporated business entities to elect their classification for tax purposes. As a result, the regulations appear to relegate the *Morrissey* corporate resemblance standard to a historical footnote. Unfortunately, while discarding this standard may well represent a wise policy choice, the choice was not the Treasury's to make.

Had the regulations been issued on a clean slate, it is arguable that they would have satisfied the deferential *Chevron* two step test and been upheld. Nonetheless, the trilogy of Supreme Court cases underlying the incorporation rule makes clear that the executive branch cannot simply discard a Supreme Court interpretation of an ambiguous statutory term and insert a *Mead*-qualified interpretation in its stead. Rather, the executive branch is inexorably bound by the Court's interpretation until Congress amends the underlying

not deduct expenses for auditing and training sessions); see also Douglas A. Kahn & Jeffrey H. Kahn, "Gifts, Gifts and Gifts"—*The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 506-509 (discussing *Hernandez* and Rev. Rul. 93-73 and maintaining that the "current tax law is in the awkward posture of the Service having effectively repudiated its own victory in obtaining a Supreme Court ruling and instead allowing deductions for what the Supreme Court held to be [non-deductible]").

statute or the Court takes the highly unusual step of overruling its statutory interpretation precedent. Since Congress has not amended the underlying statute, and because it is unlikely that the Court would overrule *Morrissey* in light of Congress's ratification of the decision through its enactment of § 7704, the Treasury's promulgation of the check-the-box regulations was unlawful.

These invalid regulations are but one example of the Treasury's recent trend of overlooking Supreme Court decisions directly on point in the process of issuing taxpayer-friendly rules. The impetus behind this trend likely involves a potent combination of the Treasury's ignorance of administrative law principles and the restrictive taxpayer standing doctrine governing taxpayer lawsuits. Despite the restrictive standing doctrine, it is inevitable that there exist taxpayers who will have both standing to challenge these rules and a significant financial incentive to make such a challenge. Upon such a challenge, these rules, which have been commonly assumed by scholars, practitioners, and commentators to be valid, will likely be declared invalid.