

DEFERENCE UNDER THE CLEAR  
REFLECTION OF INCOME REQUIREMENT:  
*SUI GENERIS*

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I. INTRODUCTION

Much of administrative law is devoted to the questions of when and to what extent the court should defer to the decisions of an administrative agency.<sup>1</sup> Gaps in statutes often exist, and should the court decide that no deference is due the

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1. See Thomas W. Merrill, *The Mead Doctrine: Rules and Standards, Meta-Rules and Meta-Standards*, 54 ADMIN. L. REV. 807, 809 (2002). See also, ABA Section of Taxation: *Report of the Task Force on Judicial Deference*, 57 Tax Law. 717 (2004).

administrative branch, the judicial branch must fill the gaps in the manner the court deems most appropriate.<sup>2</sup> On the other hand, when deference to the administration is due, the court's task is one of determining whether the legislature has granted the agency the authority to fill the gaps, and if so, whether the agency has properly exercised its authority.<sup>3</sup> In the latter case, the issue for the court is not what is "the correct" interpretation or application of the statute, but whether the administrative rule clearly violates a legislative directive, and if not, whether the agency's answer is reasonable.<sup>4</sup>

In 1983, Henry P. Monaghan explained the concept and significance of deference as follows:

Deference, to be meaningful, imports agency displacement of what might have been the judicial view *res nova* – in short, administrative displacement of judicial judgment. Where there is meaningful deference, the agency, not the court, supplies at least part of the meaning of the law. Deference in this sense includes judicial decisions purporting to accept "reasonable" agency statutory construction, as well as judicial use of deference principles to resolve statutory "uncertainty" – a tie-breaker, so to speak – invoked when the court accepts the agency interpretation because it is satisfied that there is no one "correct" resolution of the statute's meaning.<sup>5</sup>

The Administrative Procedures Act<sup>6</sup> has some impact on how deference issues are decided, but in many instances the Supreme Court has been required to determine the precise roles of the judicial and administrative branches of government in filling gaps and resolving ambiguities created by the legislature.<sup>7</sup> As will be shown below, the courts have decided that it is appropriate for the administrative branch to have a much more influential role in resolving tax accounting issues than in other

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2. See Henry P. Monaghan, *Marbury and the Administrative State*, 83 COLUM. L. REV. 1, 6 (1983).

3. *Id.* at 5.

4. *Id.*

5. *Id.*

6. 5 U.S.C. §§ 551-706 (2001).

7. See Robert N. Anthony, *The Supreme Court and the AP: Sometimes They Just Don't Get It*, 10 ADMIN. L. J. AM. U. 1, 33 (1996).

areas of the law.<sup>8</sup>

Tax accounting is concerned with the timing of income or deductions – when the income or deduction is recognized.<sup>9</sup> As a result of the time value of money, a deferral of taxable income is tantamount to an exclusion of the earnings on the deferred taxes, and the acceleration of income is equivalent to a double inclusion in income for the return that would have been earned on the deferred taxes.<sup>10</sup> Thus, the resolutions of tax accounting issues are extremely important to taxpayers and the government. Moreover, tax accounting issues typically present a number of defensible solutions; therefore, if the administrative branch chooses any one of these solutions and receives deference, the issue is decided in favor of the agency regardless of the existence of an even better solution.<sup>11</sup>

This article explores the general deference principles in Parts I and II. Part III considers the special case of deference as applied to the “clear reflection of income” requirements in Code section 446 and 471. Part IV discusses the taxpayer’s defenses to the charge that the accounting method does not clearly reflect income. Part V presents examples of clear reflection of income cases where deference principles were correctly applied and where they were the principles were not recognized. Our conclusions are contained in Part VI.

## II. WHY SHOULD THE COURTS DEFER TO THE ADMINISTRATION?

The legal principles supporting the grant of deference to administrative determinations has developed along an uncertain course, but is generally founded on the practice by Congress of delegating legislative powers to the administrative branch.<sup>12</sup> In

8. See *infra* Part III.

9. See Daniel L. Halperin, *Interest in Disguise: Taxing the Time Value of Money*, 95 YALE L. J. 506, 508 (1986).

10. See, e.g., *id.* at 510; W. Eugene Seago, *A Modest Proposal Regarding the Matching Principle*, 90 TAX NOTES 1855, 1856 (2001).

11. See *Chevron U.S.A. v. Nat’l Res. Def. Council*, 467 U.S. 837, 843 n.11 (1984) (stating “[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.”); *FEC v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 39 (1981); *Zenith Radio Corp. v. United States*, 437 U.S. 443, 450, (1978); *Train v. Natural Res. Def. Council, Inc.*, 421 U.S. 60, 75, (1975); *Udall v. Tallman*, 380 U.S. 1, 16, (1965); *Unemployment Comp. Comm’n v. Aragon*, 329 U.S. 143, 153, (1946); *McLaren v. Fleischer*, 256 U.S. 477, 480-81 (1921).

12. *United States v. Mead*, 533 U.S. 218, 226-27 (2001) (stating “[w]e hold that administrative implementation of a particular statutory provision qualifies for 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

1940 the Supreme Court explained why the administrative agencies are delegated law making powers:

Delegation by Congress has long been recognized as necessary in order that the exertion of the legislative power does not become a futility. *Currin v. Wallace*, 306 U.S. 1, 15, and cases cited. But the effectiveness of both the legislative and administrative processes would become endangered if Congress were under the constitutional compulsion of filling in the detail beyond the liberal prescription here.<sup>13</sup>

Accordingly, the Court has limited its role as follows:

We do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing ‘all needful rules and regulations for the enforcement’ of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations ‘it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.’<sup>14</sup>

In a 1969 case the Supreme Court reasoned as follows:

[I]t is fundamental . . . that as ‘contemporaneous constructions by those charged with administration of the Code, [Treasury] Regulations ‘must be sustained unless unreasonable and plainly inconsistent with the revenue statutes, and ‘should not be overruled except for weighty reasons.’<sup>15</sup>

Thus, Congress can enact a statute requiring that the administrative branch collect taxes on income even though

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deference was promulgated in the exercise of that authority.”).

13. *Sunshine Anthracite Coal Co., v. Adkins*, 310 U.S. 381, 398 (1940); *see also* *Monaghan*, *supra* note 2, at 25 (stating “‘legislation’ is not a finished product when it leaves Congress.”).

14. *United States v. Correll*, 389 U.S. 299, 306-07 (1967).

15. *Bingler v. Johnson*, 394 U.S. 741, 749-750 (1969) (citing *Comm’r of Internal Revenue v. S. Tex. Lumber Co.*, 333 U.S. 496, 501 (1948)).

Congress has not defined income. Congress can require that taxable income must be computed in such a manner that it is “clearly reflected” when Congress could not possibly know the meaning of these terms. When the administrative agencies attempt to fill the gaps, the court can determine whether the agency has exceeded the bounds of its authority using standards of deference, as will be further discussed below.<sup>16</sup>

In some instances the delegation is explicit, as in section 59(g) of the Internal Revenue Code.<sup>17</sup>

Section 59(g) Tax Benefit Rule: The Secretary may prescribe regulations under which differently treated items shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer’s regular tax for the taxable year for which item is taken into account or for any other taxable year.<sup>18</sup>

Apparently, Congress recognized that the interplay between the alternative minimum tax and the tax benefit rule applicable to the “regular tax” can be extremely complicated, so much so that Congress, in section 59(g), explicitly delegated to the administration the authority to resolve these issues through regulations.<sup>19</sup> Thus, assume for a particular situation, persons technically proficient on the issue could devise two or more defensible methods to calculate the portion of a deduction that did not produce a tax benefit, but the regulations would accept only one of those methods. The regulation would be upheld because the Secretary was granted the authority to prescribe how taxable income is to be “properly adjusted.”<sup>20</sup> That the court may have preferred a different method of calculating the portion of the deduction which produced a tax benefit is of no import because Congress has directed that the method to be followed is the Secretary’s choosing.<sup>21</sup> To decide against the administration

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16. See *infra* Part II.

17. For a judicial and legislative history of section 59(g), see I.R.S. F.S.A. 1995 WL 1770330 (July 27, 1995); U.S. v. Deckelbaum, 784 F. Supp. 1206, 1208 n.3 (D. Md. 1992). Section 59(g) is somewhat unusual in that it provides the Secretary “may”, rather than “shall,” prescribe regulations, but if the Commissioner does provide the regulations it would seem the regulations would have the force of law.

18. I.R.C. § 59(g) (2000).

19. *Id.*

20. See Ronald M. Levin, *Mead and the Prospective Exercise of Discretion*, 54 ADMIN L. REV. 771, 776 (2002).

21. See *id.* at 776-77.

would be to reject the will of Congress.<sup>22</sup>

In some cases Congress has implicitly delegated law-making authority to the administration. For example, section 448(d)(5) provides that certain accrual basis service providers are not required to accrue income that “on the basis of experience” will not be collected.<sup>23</sup> Such language cries for clarification as to how the “basis of experience” is to be determined. It would be impossible to administer such a vague law fairly without the benefit of the Internal Revenue Service providing detailed guidance. This guidance – when accepted by the court – would create a single rule to be uniformly applied, resulting in a fair and consistent administration of the law.

The agency’s “expertise” is frequently mentioned as a justification for the legislature deferring to the administrative branch.<sup>24</sup> The legislature, as well as the courts, may consider itself incompetent to decide the more technical questions such as the merits of an accounting method, but the courts are competent to decide issues framed in terms of deference;<sup>25</sup> that is, whether the administration’s answer is reasonable, or not arbitrary.<sup>26</sup>

In *Chevron* the Supreme Court justified deference to the administration because of its political accountability for the policy choices Congress permits, and also because of the presumed expertise of the administrative agency.<sup>27</sup> In declaring valid an environmental regulation, the Court reasoned as follows:

Congress intended to accommodate both [environmental and business] interests, but did not do so itself on the level of specificity presented by these cases. Perhaps that body consciously

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22. *See id.* at 777.

23. *But see* *FDA v. Brown & Williamson Tobacco Co.*, 529 U.S. 120, 123 (2000) (reasoning that extraordinary circumstances may counter this presumption of implicit authority).

24. *See, e.g.*, *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 566, 568-69 (1980) (reasoning “a court that tries to chart a true course to the Act’s purpose embarks upon a voyage without a compass when it disregards the agency’s views . . . [a]nd striking the appropriate balance is an empirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices. Administrative agencies are simply better suited than courts to engage in such a process.”).

25. *See* *Brown v. Helvering*, 291 U.S. 193, 203 (1934); *see also* Cass R. Sunstein, *Law and Administration After Chevron*, 90 COLUM. L. REV. 2071, 2076 (1990) (making the point that while the court is competent to decide questions of law that the application of the law to facts call for a different standard, since the agency’s specialized fact-finding capacity and accountability are highly relevant).

26. Sunstein, *supra* note 25, at 2105.

27. *See Chevron*, 467 U.S. at 865.

desired the Administrator to strike the balance at this level, thinking that those with great expertise and charged with responsibility for administering the provision would be in a better position to do so; perhaps it simply did not consider the question at this level; and perhaps Congress was unable to forge a coalition on either side of the question, and those on each side decided to take their chances with the scheme devised by the agency. For judicial purposes, it matters not which of these things occurred. Judges are not experts in the field, and are not part of either political branch of the Government. Courts must, in some cases, reconcile competing political interests, but not on the basis of the judges' personal policy preferences. In contrast, an agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments. While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make such policy choices – resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.

. . . When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail. In such a case, federal judges—who have no constituency – have a duty to respect legitimate policy choices made by those who do. The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones: 'Our Constitution vests such responsibilities in the political branches.'<sup>28</sup>

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28. *Id.* at 865-66.

It should be noted that while section 706 of the Administrative Procedures Act (APA) provides that “the reviewing court shall decide all relevant questions of law . . . and determine the meaning and applicability of the terms of an agency action” the courts’ deference to the administrative branch does not violate the APA.<sup>29</sup> This is true because the question of law in these cases becomes whether the agency’s interpretation of a statute is reasonable.<sup>30</sup> Moreover, the APA must be applied in conjunction with the statutes pertinent to the case, and those statutes may enlarge the agency’s law making powers.<sup>31</sup> According to one commentator: “Justice Marshall’s exhortation in *Marbury v. Madison* that it is ‘the province and duty of the judicial department to say what the law is’ thus takes a back seat to an inquiry into the reasonableness of the agency’s legal interpretation . . . .”<sup>32</sup>

That deference is not contrary to the APA requirement as evidenced by the history of the “Bumper’s Amendment.”<sup>33</sup> The amendment was a failed legislative proposal which would have amended section 706 of the Administrative Procedures Act to provide: “In making determinations on other questions of law, as distinguished from questions of facts or discretion under this section, the court shall not accord any presumption in favor of or against agency action.”<sup>34</sup> However, the Bumpers amendment was not enacted, thus allowing the court to apply a presumption in favor of the agency; a form of deference.<sup>35</sup>

In summary, deference to the administrative branch is sometimes justified on the basis of Congressional intent, the balance of powers under the Constitution including the administrative branches authority to make policy in administering the law, and the expertise of the agencies.

29. Administrative Procedure Act, Pub. L. No. 404, 60 Stat. 237, 243 (1946); 5 U.S.C. § 706 (2000).

30. See Monaghan, *supra* note 2, at 27 (stating “the judicial role is to specify what the statute cannot mean, and some of what it must mean, but not all that it means.”); see also Colin S. Diver, *Statutory Interpretation in the Administrative State*, 133 U. PA. L. REV. 549, 570 (1985). In his dissent in *United States v. Mead*, Justice Scalia opined that the legal question becomes whether the agency’s interpretation has gone beyond the scope of discretion that that the statutory ambiguity conferred. 533 U.S. at 242 n.2.

31. See Robert N. Anthony, *supra* note 7, at 24; Merrill, *supra* note 1, at 833.

32. Jim Rossi, *Respecting Deference: Conceptualizing Skidmore Within the Architecture of Chevron*, 42 WM. & MARY L. REV. 1105, 1115 (2001).

33. See James T. O’Reilly, *Deference Makes a Difference: A Study of Impacts of the Bumpers Judicial Review Amendment*, 49 U. CIN. L. REV. 739, 739 (1980).

34. See *id.* at 741; David R. Woodward and Ronald M. Levin, *In Defense of Deference: Judicial Review of Agency Actions*, 31 ADMIN L. REV. 329, 329-30 (1979).

35. See *Nat’l Labor Relations Bd. v. N. Ark. Elec. Coop.*, 446 F.2d 602, 607 (8th Cir. 1971).



However, the justification for deferring to an agency in a particular situation may impact the degree of deference, as will be seen below.

### III. THE VARIETIES OF DEFERENCE

In the above discussion, the term “deference” was used as though only one form of deference is applied by the courts in all situations. Actually, various types of deference have been applied, depending upon the particular statute in question, and the format in which the administrative position was presented.<sup>36</sup> The varieties of deference accorded to the various agencies have ranged from one in which the agency’s position need only be not arbitrary or not unreasonable (“full *Chevron* deference”<sup>37</sup>) to another in which only “respectful consideration” (*Skidmore* deference)<sup>38</sup> is required. Generally, *Chevron* deference has been applied to regulations that were issued after the public was given notice and the opportunity to comment. *Skidmore* deference has been ascribed to a variety of agency pronouncements, as will be further discussed below.<sup>39</sup>

#### A. Regulations

In regard to the income tax, section 7805(a) requires the Secretary of the Treasury to “prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code].”<sup>40</sup> All tax regulations are subjected to public comments in accordance with the Administrative Procedures Act.<sup>41</sup> Regulations issued under the general authority of section 7805 are generally referred to as “interpretative regulations.”<sup>42</sup> In addition, various sections of the Code direct the Secretary to issue regulations with varying charges (e.g., “such regulations as may be required”;<sup>43</sup> “such regulations as he may deem

36. See Ellen P. Aprill, *Muffled Chevron: Judicial Review of Tax Regulations*, 3 FLA. TAX. REV. 51, 58 (1996).

37. *Chevron U.S.A. v. Nat’l Res. Def. Council*, 467 U.S. 837, 865 (1984).

38. *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1940).

39. See *infra* Part II B.

40. It should be noted that deference to a regulation can be a two edged sword for the Commissioner. See, *Brookshire Holdings v. Comm’r*, 320 F.3d 507, 511 (5th Cir. 2003); see also *Woods Inv. Co. v. Comm’r*, 85 T.C. 274, 282 (1985) (where the Commissioner was bound by his regulations that had not been amended in response to other changes in the law that affected the application of the regulations).

41. See *Am. Standard, Inc. v. United States*, 602 F.2d 256, 268 (Ct. Cl. 1979).

42. See *Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981); *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 476 (1979).

43. I.R.C. § 263A(i) (2000).

necessary.”<sup>44</sup>). Regulations issued in accordance with these specific charges are referred to as “legislative regulations.”<sup>45</sup> Several of the accounting methods provisions in the Code (sections 446-483) direct the Secretary to prescribe regulations,<sup>46</sup> therefore creating the opportunity for the Service to issue legislative regulations.

It would seem that if Congress requires administrative agencies to issue regulations and other guidance, Congress would also explicitly say what authority those pronouncements would command. But Congress has left it to the Court to decide the weight of authority it should apply to agency rulings.<sup>47</sup> As previously discussed, some cases suggest that because of the “expertise” of the agency<sup>48</sup> it is better able to decide issues within its jurisdiction than are the courts; therefore, agency pronouncements generally should be upheld. While relative knowledge may be a practical way of deciding when the court should defer, the constitutionally correct justification for deference is that Congress has delegated authority to the agency to prescribe the rules to be followed.<sup>49</sup>

Before *Chevron* the Court sharply distinguished between interpretative regulations – agency interpretation of a statutory term as are issued under the general authority of section 7805 – and legislative regulations.<sup>50</sup> The legislative regulations were considered worthy of a higher level of deference than

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44. I.R.C. § 1502 (2000).

45. See *Rowan Cos.*, 452 U.S. at 253; *Nat'l Muffler Dealers Ass'n*, 440 U.S. at 476; see also *Aprill*, *supra* note 36, at 56-60.

46. See, e.g., I.R.C. §§ 263A(i), 446(c)(1), 447(f)(3), 453(j), 453A(c)(6), 453A(e), 453B(h), 460(h), 467(h), 469(l), 472(a), 472(f), 475(g), 481(c), 483(f); see also I.R.C. § 471(a) (2002) (providing that “Whenever in the opinion of the Secretary the use of inventories is necessary in order to clearly reflect income. . .”).

47. In a sense, Congress is permitting the Court to decide whether it should defer to the administrative agency. *Chevron*, 467 U.S. at 844.

48. See, e.g., *Udall v. Tallman*, 380 U.S. 1, 16 (1965); *Fulman v. United States*, 434 U.S. 528, 528-29 (1978); *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 556 (1980); *Bragdon v. Abbott*, 524 US 624, 642 (1998) (stating “[t]he well reasoned views of the agencies implementing a statute constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance” (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 139-40 (1944))). In *Chevron*, the Court acknowledged “We have long recognized that considerable weight should be accorded to an executive department’s construction of a statutory scheme it is entrusted to administer and the principle of deference to administrative interpretations has long been consistently followed by this Court whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations . . .” *Chevron*, 467 U.S. at 844.

49. *Chevron*, 467 U.S. at 865.

50. See *Hosp. Corp. of Am. v. Comm’r*, 348 F.3d 136, 140 (6th Cir. 2003).

interpretative regulations.<sup>51</sup> As previously mentioned, the regulations are “legislative” when Congress has delegated the Commissioner the authority to define a statutory term or prescribe a method of executing a statutory provision of the Internal Revenue Code<sup>52</sup> and regulations are accordingly issued. Interpretative regulations are thought to be those issued under the general authority in section 7805.<sup>53</sup> The distinction between legislative and interpretative regulations has been made without the benefit of precise definitions.<sup>54</sup> For example, the discussion of section 59(g) that was discussed above is a situation where the underlying regulations would be deemed “legislative” – a complex and vague statute that also includes a request or command that the administrative branch add clear rules to be applied to actual situations taxpayers will encounter.

Legislative regulations have always had the “force of law;” that is, the regulations are binding on taxpayers as well as IRS personnel.<sup>55</sup> But interpretative regulations were not afforded this deference in the past. Thus, in *Vogel Fertilizer* the Court invalidated the Commissioner’s section 1563 interpretative regulations:

The framework for analysis is refined by consideration of the source of the authority to promulgate the regulation at issue. The Commissioner has promulgated. Treasury Regulation section 1.1563-1(a)(3) interpreting this statute only under his general authority to ‘prescribe all needful rules and regulations.’ 26 U.S.C. § 7805(a). Accordingly, ‘we owe the interpretation less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of

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51. *Id.* at 144.

52. *Rowan v. United States*, 452 U.S. 247, 253 (1981) (stating “[b]ecause we therefore can measure the Commissioner’s interpretation against a specific provision in the Code, we owe the interpretation less deference than a regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision.”).

53. *Id.* at 252-53.

54. *See Batterton v. Francis*, 432 U.S. 416, 424 (concerning a statute that permits the administrative agency to interpret “unemployed” for purpose of the Aid to Families with Dependent Children-Unemployed Fathers AFDC-UF program); *see also* Richard J. Pierce, *Distinguishing Legislative Rules from Interpretative Rules*, 52 ADMIN L. REV. 547, 556-57 (2000) (where Pierce describes a legislative regulation as one that in its absence there would not be an adequate legislative basis for enforcement action).

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

executing a statutory provision.’ . . .

. . . We consider first whether the Regulation harmonizes with the statutory language. . . That language . . . while not completely unambiguous, is in closer harmony with the taxpayer’s interpretation than with the Commissioner’s Regulation.<sup>56</sup>

Assuming the Court’s terms, “not completely unambiguous,” means “ambiguous,” the Court favored the taxpayer’s interpretation of an ambiguous statute over that of the Commissioner and thus invalidated the regulation. It appears that no deference was afforded the administration. But this was before *Chevron*.

#### B. *The Chevron Two-step Analysis*

In *Chevron U.S.A. Inc. v. Natural Resources Defense Counsel, Inc.*, the Supreme Court was asked to determine the validity of an environmental protection agency regulation.<sup>57</sup> The regulation under scrutiny dealt with the boundaries of a zone used to measure the level of pollutants being emitted from a production facility.<sup>58</sup> The Court created a two-step analysis for determining the validity of regulations.<sup>59</sup>

Step one of the *Chevron* analysis requires the court to employ the “usual tools of statutory construction” to determine whether Congress has “directly spoken to the precise question at issue.”<sup>60</sup> An affirmative answer in step one means that the analysis has been completed: the legislature’s answer must be accepted.<sup>61</sup> Moreover, “the judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent.”<sup>62</sup>

56. See also *Gen. Elec. Co. v. Gilbert*, 429 U.S. 125, 143-45 (1976); *Morton v. Ruiz*, 415 U.S. 199, 231, 237 (1974).

57. 467 U.S. 837, 840 (1984).

58. *Id.* at 839-40.

59. It should be noted that the adoption of this two step analysis was made without any prodding from Congress and without any real evidence to suggest that the way the issues were being resolved was in desperate need of change. It is as though the Court stepped back and reviewed the situation and concluded “this is the way it should be done” without a compelling reason to justify its actions. *Id.* at 842-43.

60. *Id.*

61. See, e.g., *FDA v. Brown & Williamson Tobacco Co.*, 529 U.S. 120, 159 (2000); *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 600 (2004).

62. *Chevron*, 467 U.S. at 843 n.9; see also *Square D Co. v. Comm’r*, 118 T.C. 299, 308-09 (2002) (where the Tax Court applied *Chevron* to reverse its position in *Tate & Lyle, Inc. v. Comm.*, 103 T.C. 656, which had held the section 267(a) regulations invalid).

A negative answer in step one means the analysis proceeds to step two, where the deference mode is invoked.<sup>63</sup>

Step one of *Chevron* should be contrasted with the approach outlined by the Supreme Court in *National Muffler Dealer's Ass'n v. United States*.<sup>64</sup> According to the *National Muffler* decision, the Court looks to see whether a regulation “harmonizes with the plain language of the statute its origin, and its purpose.”<sup>65</sup> To complete this *National Muffler* analysis requires the Court to compare the regulation with the statute, whereas under *Chevron* the Court does not look to the regulations until step two - after it is determined the statute silent or ambiguous.<sup>66</sup> Given this comparison, *Chevron* seems to be the more logical approach. There is no need to consider a regulation unless the statute is ambiguous or silent, and with either ambiguity or silence on the issue, the regulation cannot “harmonize with the statute”.<sup>67</sup> How could one draft a regulation that harmonizes with the plain meaning of a statute that is ambiguous or silent on the particular issue?

Proceeding to step two, the analysis slightly differs for legislative (an explicit delegation) or and interpretative regulations (an implicit delegation):

If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are *arbitrary, capricious, or manifestly*

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63. See, e.g., *Alfaro v. Comm'r*, 349 F.3d 225, 228 (2003); see also *Robinson v. Comm'r*, 119 T.C. 44, 68 (2002) (where the Tax Court applied the *Chevron* two-step analysis to reverse its prior decision in *Redlark v. Comm'r*, 106 T.C. 31 (1996) that a regulation prohibiting the deduction for interest on a tax deficiency resulting from trade or business income was invalid).

64. 440 U.S. 472, 476-77 (1979).

65. *Id.* at 477. In *FDA v. Brown & Williamson Tobacco Co.*, the Court reasoned that it may be necessary to look to more than a specific statute to determine congressional intent: “In determining whether Congress has specifically addressed the question at issue, a reviewing court should not confine itself to examining a particular statutory provision in isolation. The meaning—or ambiguity—of certain words or phrases may only become evident when placed in context.” 529 U.S. at 132.

66. *Nat'l Muffler*, 440 U.S. at 477.

67. See *Aprill*, *supra* note 36, at 89-91 (describing and advocating a fusion of *Chevron* and *Nat'l Muffler*); Paul L. Caron, *Tax Myopia Meets Tax Hyperopia: The Unproven Case of Increased Judicial Deference to Revenue Rulings*, 57 OHIO ST. L.J. 637, 668 (1996); *Diver*, *supra* note 30, at 562; *Vogel Fertilizer v. United States*, 455 U.S. 16, 25-26 (1982) (which can be interpreted to mean that the Court was rejecting the regulations based by applying *Nat'l Muffler* to reject the regulation under what would be an incorrect application of *Chevron's* step one).

*contrary to the statute.* .. Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a *reasonable interpretation* made by the administrator of an agency . . . .<sup>68</sup>  
[emphasis added]

Furthermore, “the Court need not conclude that the agency construction was the only one it permissibly could have adopted. . .or even the reading the Court would have reached if the question had arisen in a judicial proceeding.”<sup>69</sup>

In *Chevron* the statute did not address the relevant issue and the delegation was implicit, but the Commissioner’s position was clearly expressed in a regulation, which the Court found to be “reasonable.”<sup>70</sup> However, as discussed above, the Court also noted that a legislative regulation (explicit delegation) will be treated as law unless it is “arbitrary, capricious, or manifestly contrary to the statute.”<sup>71</sup> It is unknown how the two standards differ. Perhaps the “reasonable” standard requires stronger theoretical justification in terms of the specific issue the regulation addresses. For example, requiring taxpayers who use dollar-value LIFO to divide inventories into “pools” and then prohibiting the inclusion of manufactured and purchased goods in the same pool is not “arbitrary, capricious, or manifestly contrary to the statute” because of the differences in costs which can bias a LIFO index and therefore distort income.<sup>72</sup> However, prohibiting the purchaser of a manufacturing business from placing the items purchased and identical goods manufactured after the purchase in the same pool is “not reasonable,” absent some explanation as to why this would distort income.<sup>73</sup>

While *Chevron* addressed the deference that should be applied to the interpretative regulations issued by an agency authorized to issue them, the discussion in the case does not explain the significance of the fact that the case was framed as a challenge to a regulation, rather than a ruling, or simply the agency’s litigating position.<sup>74</sup> But other courts have concluded

68. *Chevron*, 467 U.S. at 842-44.

69. *Id.* at 843 n.11.

70. See Diver, *supra* note 30, at 597 for a discussion of the reasonableness standard.

71. *Chevron*, 467 U.S. at 844.

72. *Tate & Lyle, Inc. v. Comm’r*, 87 F.3d 99, 104 (1996).

73. *UFE, Inc. v. Comm’r*, 92 T.C. 1314 (1989).

74. Oris S. Kerr, *Shedding Light on Chevron: An Empirical Study of the Chevron Doctrine in the U.S. Courts of Appeals*, 15 YALE J. ON REG. 1, 19-20 (1998).

that only regulations are deserving of *Chevron* deference because they are issued subject to notice and comment.<sup>75</sup> In regard to tax regulations – which are always subject to notice and comment – the Seventh Circuit reasoned as follows:

General tax regulations [interpretative regulations] seem to carry the force of law, they are developed according to notice and comment, and they have the imprimatur of a congressional delegation of authority. In substance, general tax regulations fall short of being full legislative regulations only because the congressional delegation is general rather than specific. This distinction, however, may not have any effect at all on the standard of deference because *Chevron* itself dealt with a regulation promulgated under an arguably general grant of authority to the EPA under the Clean Air Act . . . . Furthermore, *Chevron* stated that its framework applied to implicit congressional delegations as well as to specific and explicit directives.<sup>76</sup>

Furthermore, in 2003 the Supreme Court opined in *Boeing Co. v. United States* that in regard to deference, legislative and interpretative regulations are not to be distinguished: “Even if we regard the challenged regulation as interpretive because it was promulgated under section 7805(a)’s general rulemaking grant rather than pursuant to a specific grant of authority, we must still treat the regulation with deference.”<sup>77</sup> Thus, both legislative and interpretative regulations can receive *Chevron* deference.<sup>78</sup>

That the Court concluded the administrative agency can gain its authority though implicit delegation of authority – created by a statute that was vague or ambiguous on the issue before the Court - is probably the most significant conclusion in

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75. See, e.g., *Peoples Fed. Sav. & Loan Ass’n v. Comm’r*, 948 F.2d 289, 300 (6th Cir. 1991); *Bankers Life & Cas. Co. v. United States*, 142 F.3d 973, 983-84 (7th Cir. 1998); *Conn. Gen. Life Ins. Co. v. Comm’r*, 177 F.3d 136, 144-45 (3d Cir. 1999); *Harbor Bancorp & Subsidiaries v. Comm’r*, 115 F.3d 722, 727 (9th Cir. 1997).

76. *Bankers Life & Cas. Co.*, 142 F.3d at 983-84 (citing *Chevron*, 467 U.S. at 844).

77. 537 U.S. 437, 448 (2003).

78. In proposed regulations under section 1363 (LIFO recapture following an S-election), the Service characterizes the regulations as pursuant to section 337(d)(1), which has legislative regulations language and is directed at assuring that corporate income will be taxed twice. See 69 Fed. Reg. 50109-10 (Aug. 13, 2004).

*Chevron*.<sup>79</sup> This expanded finding of delegation was justified by the administrative agency's role in policy making as well as their superior knowledge regarding the effects of those policies,<sup>80</sup> as was discussed above.

### C. *Skidmore Deference*

Generally, if the court determines that the administration's position is not worthy of *Chevron* deference, the court next refers to "*Skidmore* deference."<sup>81</sup> That is, *Skidmore* serves as a back-up to *Chevron* and would generally apply to agency rulings other than regulations.<sup>82</sup>

In *Skidmore v. Swift & Co.*, seven employees of Swift and Company sued for overtime pay under the Fair Labor Standards Act.<sup>83</sup> These employees, in addition to their normal daytime work, orally agreed to stay in or near the fire hall 3 to 4 nights a week.<sup>84</sup> On these nights the employees were responsible for answering calls but did not have to perform other duties.<sup>85</sup> The employees sued to receive compensation for the nights they remained at their duty station.<sup>86</sup>

The Fair Labor Standards Act did not create an agency to administer the act or determine the facts of individual cases.<sup>87</sup> It did create an administrator whose duties included bringing injunctions to restrain violations of the act.<sup>88</sup> The administrator issued an interpretive bulletin, an informal ruling concerning the application of the Act.<sup>89</sup> Basically the bulletin provided for a flexible solution based on facts and circumstances and illustrated the rules with examples, none of which directly apply to the facts in *Skidmore*.<sup>90</sup>

The Supreme Court was called upon to decide how much deference should be given to the bulletin and rulings of the administrator.<sup>91</sup> The Court began its analysis by acknowledging

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79. *Chevron*, 467 U.S. at 864.

80. *Id.* at 842-44.

81. In *United States v. Mead*, the Supreme Court remanded the case insofar as the tariff classifications applied *Skidmore* deference. 533 U.S. 218, 237 (2001).

82. *See id.* at 238-40; *Christensen v. Harris County*, 529 U.S. 576, 586-89 (2000).

83. *Skidmore v. Swift & Co.*, 323 U.S. 134, 135 (1944).

84. *Id.* at 136.

85. *Id.*

86. *Id.* at 137.

87. *Id.*

88. *Id.*

89. *Skidmore*, 323 U.S. at 138.

90. *Id.*

91. *Id.* at 139.



that the Act itself did not contain any provision that discusses deference to these rulings: “Instead, it put this responsibility on the courts.”<sup>92</sup> However, it recognized that the administrator had more experience and knowledge about conditions in different industries than the courts had.<sup>93</sup> In addition, in previous cases the Court had given weight to rulings of the Treasury Department and other agencies charged with administering laws.<sup>94</sup>

The Court concluded that these rulings by the administrator were not binding on the courts but provided informed judgment to which the courts and litigants can turn for guidance.<sup>95</sup> The fact that the Court would look to the administrative agency for “guidance,” while the Court would not look at the opposing counsel’s opinion for guidance means that the agency opinion is receiving some deference.<sup>96</sup> The Court found support for deference based on the “Administrator’s specialized experience and broader investigation and information than is likely to come to a judge in a particular case,”<sup>97</sup> and the Court then provided the following frequently applied guideline: “The weight of such a judgment [by the administrator] in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, and all those factors which give it power to persuade, if lacking power to control.”<sup>98</sup>

According to one commentator “*Skidmore* . . . makes clear that the weight given to the agency interpretation is always ultimately up to the court.”<sup>99</sup> Justice Scalia has opined that “*Skidmore* deference gives the agency’s current position some vague and certain amount of respect, but it does not, like *Chevron* leave the matter within the control of the Executive branch . . . .”<sup>100</sup> Nevertheless, when the Court found in *Mead* that

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92. *Id.* at 137.

93. *Id.* at 139.

94. *Id.* at 140.

95. *See* Raymond B. Yates, M.D., P.C. Profit Sharing v. Hendon, 124 S.Ct. 1330, 1342 (2004).

96. *Skidmore*, 323 U.S. at 140.

97. *Id.* at 139.

98. *Id.* at 140; *see also* Pierce, Jr., *supra* note 54, at 547 n.163.

99. Thomas W. Merrill & Kristin E. Hickman, *Chevron’s Domain*, 89 GEO. L.J. 833, 856 (2001).

100. *United States v. Mead Corp.*, 533 U.S. 218, 247 (2001) (Scalia, J. dissenting) (noting that the *Skidmore* deference is “an empty truism and a trifling statement of the obvious” and “a recipe for uncertainty, unpredictability, and endless litigation”); *Christensen v. Harris County*, 529 U.S. 576, 589 (2000) (Scalia, J. concurring) (characterizing *Skidmore* as an “anachronism”); *see also* *Equal Employment Opportunity Comm’n v. Arabian- Am. Oil Co.*, 499 U.S. 244, 258 (1991).

the administrative agency's manual did not warrant *Chevron* deference, the Court remanded the case, directing the lower court to decide the case using *Skidmore* deference.<sup>101</sup> Thus, the Supreme Court believes that *Skidmore* deference can make a difference.<sup>102</sup> If nothing else, *Skidmore* deference could serve as a "tie breaker," when both parties in the suit have equally defensible positions. Thus, while the exact contours of *Skidmore* deference are not known,<sup>103</sup> it appears to fall between *Chevron* deference and de novo review.

It would seem that the weight given to the government's opposing counsel would also depend upon the *Skidmore* factors (thoroughness, validity of reasoning, and persuasive power),<sup>104</sup> with perhaps the administrative agency attaining a slight advantage in regard to the "thoroughness evident in the consideration." This is true because the administration can present evidence regarding its many experiences in administering the law that resulted in its position, much like an expert witness, whereas the opposing counsel is merely a "hired gun." Also, in reaching its position, the administrative agency must realize that it may be creating a two-edged sword that may be used to the advantage of another taxpayer.

#### D. Revenue Rulings

As discussed above, deference to regulations is generally based on the fact they are subject to public notice and comments, as is required by the APA.<sup>105</sup> Deference for other rulings is made a possibility by *Mead*,<sup>106</sup> as will be further discussed below. IRS revenue rulings are issued without notice and the opportunity for taxpayers to comment and therefore do not enjoy the automatic pass of regulations.<sup>107</sup> The IRS is certainly not pretentious in portraying the status of the authority of revenue rulings.

A 'revenue ruling' is an official interpretation by  
the Service of the Internal Revenue laws and

101. *Mead*, 533 U.S. at 235-36, 238-239.

102. *Id.* at 259.

103. *See Rossi, supra* note 32, at 1109.

104. *See Linda Galler, Emerging Standards for Judicial Review of IRS Revenue Rulings*, 72 B.U. L. REV. 841, 892 n.126 (1992).

105. *See United States v. Haggard Apparel Co.*, 526 U.S. 380, 389 (1999).

106. *O'Shaughnessy v. Comm'r*, 332 F.3d 1125, 1130 (8th Cir. 2003).

107. For an exhaustive discussion of the courts deference to Revenue Rulings through 1995 see Linda Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 OHIO L. J. 1037, 1095 n.90 (1995); *see also Caron, supra* note 67, at 670 n.16.

related statutes, treaties, and regulations, that has been published in the Bulletin. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Service officials and others concerned.<sup>108</sup>

It should be noted that, in a sense, revenue rulings have the “force of law” in that failure to follow rulings subjects taxpayers to penalties under IRC section 6662.<sup>109</sup>

In *O’Shaughnessy v. Commissioner*,<sup>110</sup> the IRS argued (based on *Mead*) that revenue rulings command *Skidmore* deference - commensurate with “the degree of the agency’s care, its consistency, formality, and relative expertness . . . .”<sup>111</sup> However, the Tax Court has not accepted this position.<sup>112</sup>

The Tax Court has ruled that it is not bound by revenue rulings, although the court believes that taxpayers should be able to rely upon them.<sup>113</sup> On the other hand, the Sixth Circuit once extended *Chevron* deference to a revenue ruling,<sup>114</sup> although it has more recently concluded that revenue rulings may not be warranted *Chevron* deference but should carry “at least some added persuasive force.”<sup>115</sup> The Federal Circuit Court leans toward the Tax Court position, although its position is not as strong.<sup>116</sup> The Supreme Court at first appeared to apply *Chevron*

108. Rev. Proc. 89-14, 1989-1 C.B. 814; *see also* Rev. Proc. 2004-4, 2004-1 I.R.B. 125.

109. *O’Shaughnessy*, 332 F.3d at 1130.

110. *Id.*

111. *Mead*, 533 U.S. at 228.

112. *See, e.g.*, *Lunsford v. Comm’r*, 117 T.C. 159 (2001); *Ind. Pub. Serv. Co. v. Comm’r*, 105 T.C. 341, 350 (2001).

113. *Baker v. Comm’r*, 122 T.C. No. 8, at note 21 (2004), and cases cited therein. Nevertheless, the Tax Court will hold the Service to its prior rulings in cases where the Commissioner contradicts his long-standing and clearly articulated administrative position as set forth in prior rulings. *But see Vons Cos., Inc. v. United States*, 51 Fed. Cl. 1, 6 (2001).

114. *Johnson City Med. Ctr. v. United States*, 999 F.2d 973, 975 (6th Cir.1993).

115. *Ammex, Inc. v. United States*, 367 F.3d 530, 535 (6th Cir. 2004); *see also Aeroquip-Vickers, Inc. v. Comm’r*, 347 F.3d 173, 181 (6th Cir. 2003); *see also Keller v. Comm’r*, 725 F.2d 1173, 1182 (8th Cir.1984) (which ruled that Revenue Rulings are not “controlling authority”); *Del Commercial Prop., Inc. v. Comm’r*, 251 F.3d 210, 214 (D.C. Cir. 2001) (holding that Revenue Rulings should be accorded *Skidmore* deference); *Vons Cos, Inc.*, 51 Fed. Cl. at 8 n.5; *see also Esden v. Bank of Boston*, 229 F.3d 154, 169 n.19 (2d. Cir. 2000) (extending *Skidmore* deference to an IRS Notice).

116. *See Vons Cos, Inc.*, 51 Fed. Cl. at 15 (where the Federal Circuit provides an excellent summary of the status of deference for revenue rulings by the various courts). “The various decisions can be arrayed over a spectrum starting with those affording such rulings the least amount of deference and ending with those affording the most. If one end of the spectrum is reserved for courts according revenue rulings little or no weight then that position is undoubtedly occupied by the Tax Court (and those circuits following its lead), which has historically held that revenue rulings merely “represent the position

to Revenue Rulings,<sup>117</sup> but later merely noted that the rulings do not have the force and effect of regulations.<sup>118</sup> Although the Revenue Ruling was not entitled to Chevron deference, the Court concluded in *Cleveland Indians Baseball Co. v. United States* that “the Rulings simply reflect the agency’s longstanding interpretation of its own regulations. Because that interpretation is reasonable, it attracts substantial judicial deference,”<sup>119</sup> and in *Christensen v. Harris County*, the Supreme Court applied *Skidmore* to an administrative position expressed in a format similar to a revenue rulings.<sup>120</sup>

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of one of the parties” before the court. *Id.*; see, e.g., *Browne v. Comm’r*, 73 T.C. 723, 731 (1980) (Hall, J., concurring); see also *Estate of Kosow*, 45 F.3d 1524, 1529 n.4 (11th Cir. 1995) (a revenue ruling “is merely an opinion of an IRS attorney”); *Stubbs, Overbeck & Assoc., Inc. v. United States*, 445 F.2d 1142, 1146-47 (5th Cir. 1971) (“A ruling is merely the opinion of a lawyer in the agency and must be accepted as such.”). More toward the middle of the spectrum lies those courts which have held that revenue rulings, while not binding, are, nonetheless, entitled to consideration as a “body of experienced and informed judgment.” *Ricards v. United States*, 683 F.2d 1219, 1224 n.12 (9th Cir. 1981); see also *Foil v. Comm’r*, 920 F.2d 1196, 1201 (5th Cir. 1990) (revenue rulings are “to be given weight as expressing the studied view of the agency whose duty it is to carry out the statute”). Then, at the polar opposite of the Tax Court are federal courts that have held, in terms analogous to those sometimes applied to interpretative Treasury regulations, that revenue rulings “have the force of legal precedents unless unreasonable or inconsistent with the provisions of the Internal Revenue Code. See *Dunn v. United States*, 468 F.Supp. 991, 993 (S.D.N.Y. 1979); see also *In re Kaplan*, 104 F.3d 589, 599 (3d Cir. 1997).

The Federal Circuit, whose precedents, of course, are binding on this court, appears to lie somewhere in the middle of this continuum, possibly with a slight cant towards the position of the Tax Court. Thus, in *Spang Indus., Inc. v. United States*, that court stated that “a revenue ruling is entitled to some weight as reflecting the Commissioner’s interpretation of the regulation, but does not have the same force as a regulation.” 791 F.2d 906, 913 (Fed. Cir.1986); see also *Xerox Corp. v. United States*, 228 Ct. Cl. 406, 656 F.2d 659, 671 n.20 (1981) (“[w]hile these rulings are not binding on the Secretary of Treasury or the courts, they may be helpful in interpreting a statute”). On another occasion, however, the Federal Circuit quoted, with approval, language from a 1934 Supreme Court decision which stated that revenue rulings cited by the Commissioner “have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of law.” *Xerox Corp. v. United States*, 41 F.3d 647, 657 (Fed. Cir.1994) (quoting *Helvering v. N.Y. Trust Co.*, 292 U.S. 455, 468 (1934)). Following the Federal Circuit’s lead, this court has mapped out a position that considers revenue rulings, but also does not afford them binding precedence. See *Int’l Bus. Mach. Corp. v. United States*, 38 Fed. Cl. 661, 675 (1997); *Ridenour v. United States*, 3 Cl. Ct. 128, 137 (1983) (“Although revenue rulings do not constitute ‘binding precedent,’ they provide some guidance as to the correct interpretation of the Internal Revenue Code.”)

117. See *Davis v. United States*, 495 U.S. 472, 484 (1990), criticized in *Galler*, *supra* note 104, at 857-58.

118. *Comm’r v. Schleier*, 515 U.S. 323, 336 n.8 (1995); *Cleveland Indians Baseball Co. v. United States*, 532 U.S. 200, 219 (2001).

119. *Cleveland*, 532 U.S. at 220, but the Supreme Court saved for another day the issue of whether revenue rulings “themselves” should receive any deference.

120. Revenue Rulings are “entitled to respect” to the extent that they “have the power to persuade,” *Christenson v. Harris County*, 529 U.S. 576, 587 (2000); see *Travelers Ins. Co. v. United States*, 303 F.3d 1373, 1382 n.12 ( Fed. Cir. 2001) (where the court of

Finally, the probability that a Revenue Ruling will receive any deference is greatly increased if the ruling is consistent with a longstanding, public position of the Service.<sup>121</sup> The converse of this is also true.<sup>122</sup>

#### E. A Mere Litigating Position

As discussed above, *Chevron* deference applies to regulations, but the Supreme Court has not applied *Chevron* to a revenue ruling, but in *Mead* the Court indicated that *Chevron* deference could possibly be extended to agency pronouncements other than regulations, which could possibly include a revenue ruling.<sup>123</sup> However, in *Bowen v. Georgetown University Hospital*, the Secretary of Health and Human Service attempted to apply regulations that had been issued without the opportunity for review and comment, which were therefore invalid, and argued that he was nevertheless entitled to deference, the Court ruled against the Secretary.<sup>124</sup> The Court ruled “we have never applied the principle of [*Chevron*] . . . to agency litigating positions that are wholly unsupported by regulations, rulings, or administrative practice.”<sup>125</sup> The Court reasoned that to extend deference to agency counsel’s interpretation of a statute when the agency itself has not articulated a position on the question would be extending to counsel the responsibility Congress delegated to the agency.<sup>126</sup> However, the Court has accorded deference, even to agency interpretations appearing for the first time in an *amicus* brief, where there was “simply no reason to suspect that the interpretation does not reflect the agency’s fair and

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federal appeals deferred to the Commissioner when the taxpayer’s method was inconsistent with the method prescribed in a revenue ruling).

121. *Am. Bankers Ins. Group, Inc. v. United States*, 308 F. Supp. 2d 1360, 1371 (S.D. Fla. 2004) (applying *Skidmore* deference to Revenue Ruling 79-404); *but see Office Max, Inc. v. United States*, 309 F. Supp. 2d 984, 994-95 (N.D. Ohio 2004) (rejecting the ruling).

122. *CSI Hydrostatic Testers, Inc. v. Comm’r*, 103 T.C. 398, 409 (1994). In short, unless an agency’s interpretation of a statute or a regulation is a matter of public record and is an interpretation upon which the public is entitled to rely when planning their affairs, it will not be accorded any special deference. *S. Pac. Transp. Co. v. Comm’r*, 75 T.C. 497, 541-42 (1980).

123. *United States v. Mead Corp.*, 533 U.S. 218, 230-31 (2001).

124. *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212-13 (1988).

125. *Id.* at 212.

126. *Id.* There is no deference due to Commissioner’s interpretation where it is neither longstanding nor a matter of public record upon which the public is entitled to rely when planning its affairs. *CSI Hydrostatic*, 103 T.C. at 409. “An agency interpretation . . . which conflicts with the agency’s earlier interpretation is ‘entitled to considerably less deference’ than a consistently held agency view.” *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30 (1987).

considered judgment on the matter in question.”<sup>127</sup>

#### F. *Seminole Rock Deference*

Administrative agencies, just as the legislature, are constrained by the limitations on the use of language. Thus, the agency finds itself interpreting its own rules and regulation, creating a double entendre arising out of an ambiguous statute. Applying a *Chevron*-like analysis, one would first look to see if the regulation is ambiguous or contains gaps. If so, one would look to see whether the agency’s interpretation is “reasonable.” The issue is whether the agency should be granted deference in interpreting its rules and regulations.

In *Bowles v. Seminole Rock & Sand Co.* the Court was asked to interpret a regulation.<sup>128</sup> The Court concluded, without much analysis, that the administrative interpretation must be “controlling weight unless it is plainly erroneous or inconsistent with the regulation.”<sup>129</sup> “Our only tools, therefore, are plain words of the regulation and any relevant interpretations of the Administrator.”<sup>130</sup> More recently in *Auer v. Robbins* the Court again applied *Seminole Rock* deference to an interpretation of a regulation submitted by the Secretary of Labor in an amicus brief.<sup>131</sup> The petitioner in the case argued that the brief was tantamount to a mere litigating position.<sup>132</sup> Justice Scalia, in the majority opinion, found no reason to suspect the brief did not reflect the agency’s “fair and considered judgment” on the issue.<sup>133</sup> In other circumstances, the Tax Court has not been so receptive, withholding deference except in cases where the interpretation is a matter of public record and is an interpretation upon which the public is entitled to rely.<sup>134</sup>

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127. *Auer v. Robbins*, 519 U.S. 452, 462 (1997); *see also* *Marseilles Land and Water Co. v. Fed. Energy Comm’n*, 345 F.3d 916, 920-21 (D.C. Cir. 2003); *Udall v. Tallman*, 380 U.S. 1, 16 (1965) (stating “[w]hen the construction of an administrative regulation rather than a statute is at issue, deference is even more clearly in order”); *see also* *Am. Express Co. v. United States*, 362 F.3d 1376, 1382 (Fed. Cir. 2001) (deferring to the Commissioner’s interpretation of his own revenue procedure).

128. 325 U.S. 410, 411 (1945).

129. *Id.* at 414.

130. *Id.*

131. 519 U.S. 452, 461 (1997).

132. *Id.* at 462.

133. *Id.*

134. *S. Pac. Transp. Co. v. Comm’r*, 75 T.C. 497, 541- not satisfy the notice requirement. 92 T.C. 1165, 1170 (1989). 42 (1980); *CSI Hydrostatic*, 103 T.C. at 409. Moreover, in *Tandy Corp. v. Comm’r* the court held that issuing a revenue ruling when litigation proceedings have started will not satisfy the notice requirement. 92 T.C. 1165, 1170 (1989).

However, *Seminole Rock* deference can only be applied after a finding that the regulation is ambiguous.<sup>135</sup> In *Christensen v. Harris County*, the Department of Labor administrator offered an opinion letter interpreting the regulations of the Wages and Hours Division.<sup>136</sup> The Court first concluded that the opinion letter lacked the force of law, but should be accorded respect under *Skidmore*.<sup>137</sup> Next the Government argued that the opinion letter should be granted *Seminole Rock* deference.<sup>138</sup> This was rejected because the underlying regulation was unambiguous.<sup>139</sup> The Court reasoned that “to defer to the agency’s position would be to permit the agency, under the guise of interpreting a regulation, to create de facto a new regulation.”<sup>140</sup>

The Seventh Circuit has expressed caution in granting deference to the interpretation of vague regulations:

With full *Chevron* deference, agencies could pass broad or vague regulations through notice-and-comment procedures, and then proceed to create rules through *ad hoc* interpretations that were subject only to limited judicial review. All told, we think this is a clear case for the flexible approach *Mead* described, relying on the Supreme Court’s earlier decision in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), and we thus proceed on that basis.<sup>141</sup>

Nevertheless, the Supreme Court applied *Seminole Rock* deference as recently as 1994.<sup>142</sup> Thus it appears that *Seminole*

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135. *Christensen v. Harris County*, 529 U.S. 576, 588 (2000).

136. *Id.* at 580-81.

137. *Id.* at 587.

138. *Id.* at 588.

139. *Id.*

140. *Id.*

141. *U.S. Freightways Corp. v. Comm’r*, 270 F.3d 1137, 1139, 1142 (7th Cir. 2001); *see also Schlumberger Tech. Corp. v. United States*, 55 Fed. Cl. 203, 211 n.5 (2003) (considering a revenue ruling to be an interpretation of a regulation in that case, and thus accorded the ruling “some deference” even though *Seminole Rock* was not cited); *see also* John F. Coverdale, *Chevron’s Reduced Domain: Judicial Review of Treasury Regulations and Revenue Rulings After Mead*, ADMIN. L. REV. 39, 90 (2003); Robert N. Anthony, *The Supreme Court and the AP: Sometimes They Just Don’t Get It*, 10 AM. U. ADMIN. L. J. 1, 4 (1996) (criticizing the *Seminole Rock* doctrine).

142. *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (stating “[i]n other words, we must defer to the Secretary’s interpretation unless an “alternative reading is compelled by the regulation’s plain language or by other indications of the Secretary’s intent at the time of the regulation’s promulgation”); *see also* *United States v. Swank*, 451

*Rock* deference exists in cases in which *Chevron* is inapplicable. Specifically the courts are willing to defer to an agency's interpretation of its own pronouncements absent abuse by the agency.<sup>143</sup> *Chevron* does not apply to these situations because it is limited to agency interpretations of statutes.<sup>144</sup>

### G. Increasing *Chevron's* Octane Level

The Court amplified *Chevron* in *United States v. Mead Corporation*<sup>145</sup> when it explained that regulations can attain *Chevron* deference under the following conditions: Congress granted the authority to the agency to make rules carrying the force of law, and the agency utilized the notice and public comment procedures as set forth in section 553 of the APA (that are generally applied to all income tax regulations.)<sup>146</sup> That the regulations attain the "force of law" means they are binding on all taxpayers as well as the IRS.<sup>147</sup>

The amplification made it clear that interpretative regulations as well as legislative regulations are worthy of *Chevron* deference, provided they are issued with appropriate notice and comment procedures.<sup>148</sup> Thus, the regulations in question in *United States v. Vogel Fertilizer Co.*,<sup>149</sup> (discussed above) which satisfied the notice and comment standard, probably would have been upheld under the *Chevron* analysis, if it had been applied. This is true because instead of applying *Chevron* the Court rejected the Treasury's regulation on the ground that the taxpayer's procedures more nearly harmonized with the ambiguous statute,<sup>150</sup> as though the Court's role was to choose the superior interpretation. That the taxpayer's method "more nearly harmonizes" with the statute implies that the regulation was not unreasonable, and thus it would have been upheld using the *Chevron* analysis.

In addition to clarifying the evaluation of interpretative

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U.S. 571, 589 (1981); *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 566 (1980).

143. *Shalala*, 512 U.S. at 512.

144. *Id.* at 525.

145. 533 U.S. 218, 229-31 (2001).

146. *See, e.g.*, T.D. 8584, 1995-1 C.B. 20 (stating that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to general authority regulations under section 263A(f)).

147. *See Merrill, supra* note 1, at 809; 5 U.S.C. § 533(a) (1996).

148. *United States v. Mead Corp.*, 533 U.S. 218, 230-31 (2001). As discussed above, legislative regulations are valid unless they are plainly inconsistent with the law, and interpretative regulations are valid if they are "reasonable." *See supra* Section D.

149. 455 U.S. 16, 17-18 (1982).

150. *Id.* at 25.



regulations, *Mead* holds that *Chevron* deference is not limited to regulations issued subject to notice and comments.<sup>151</sup> Other statutory circumstances may indicate that the agency's pronouncements should be afforded *Chevron* deference.<sup>152</sup> While the Court did not indicate what other circumstances were required, the Court cited other cases in which the Court deferred to the administrator's opinion that was not presented in a regulation subject to notice and comment.<sup>153</sup> One of the cases cited in *Mead*, *Barnhart v. Walton*, involved a claim for disability benefits under the Social Security Act.<sup>154</sup> The Social Security Agency denied the claim on the basis that the Act's requirement of inability to engage in gainful employment included a 12-month absence requirement.<sup>155</sup> The Fourth Circuit Court of Appeals held that this interpretation of the act by the agency was incorrect.<sup>156</sup> The Supreme Court reversed the decision on the grounds that the interpretation was valid under *Chevron*.<sup>157</sup> As an explanation (or justification for) of its conclusion the Court stated in *Barnhart*:

In this case, the interstitial nature of the legal question, the related expertise of the Agency, the importance of the question to administration of the statute, the complexity of the administration and the careful consideration the Agency has given the question over a long period of time all indicate that *Chevron* provides the appropriate legal lens through which to view the legality of the Agency interpretation. . . .<sup>158</sup>

In another case cited in *Mead*, *NationsBank of N.C. v. Variable Annuity Life Insurance Co.*,<sup>159</sup> *Chevron* deference was applied to a determination letter issued by the Controller of the Currency who was charged with enforcing the banking laws.<sup>160</sup> In effect, the bank was asking the Controller whether selling

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151. See also *Hosp. Corp. of Am. v. Comm'r*, 348 F.3d 136, 140 (6th Cir. 2003) (granting deference to proposed regulations).

152. *Mead*, 533 U.S. at 229.

153. *Id.* at 230-31.

154. 535 U.S. 212, 214-15 (2002).

155. *Id.* at 215.

156. *Id.* at 216.

157. *Id.* at 221-22.

158. *Id.* at 222.

159. 513 U.S. 251 (1995).

160. *Id.* at 254, 257, 260.

annuities would violate the banking laws that the Controller was in charge of enforcing.<sup>161</sup> The Controller interpreted the statute as permitting the bank to sell annuity contracts, and thus authorized the bank to enter into that business.<sup>162</sup> The Court concluded as follows:

The Controller of the Currency is charged with the enforcement of banking laws to an extent that warrants the invocation of [the rule of deference] with respect to his deliberative conclusions as to the meaning of these laws.<sup>163</sup>

As will be discussed below, *Mead* and *Barnhart* may provide a justification for the courts deferring to the administration's positions on tax accounting matters that are not included in regulations.<sup>164</sup>

In a pre-*Chevron* case that is analogous to *NationsBank, Ford Motor Credit Co. v. Milhollin*, the Supreme Court deferred to the statutory interpretation of the Truth in Lending Act in an opinion letter issued by the staff of the Federal Reserve Board, the agency charged with administering the law.<sup>165</sup> The Court found deference appropriate in these circumstances by the fact that the statutes provided creditors with a defense against liability arising out of good faith reliance on staff interpretations.<sup>166</sup> Moreover, language in the legislative history indicated "a preference for resolving interpretative issues by uniform administrative decisions, rather than piecemeal legislation."<sup>167</sup>

*Barnhart* and *NationsBank* are just two examples of the Court's willingness to defer to reasonable administrative actions that were not necessarily supported by regulations directly on point. Justice Scalia, dissenting in *Mead*, notes many other examples of deference to administrative positions that are not supported by regulations.<sup>168</sup> In 1985 Colin S. Diver compiled a list

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161. *Id.* at 254-55.

162. *Id.* at 255.

163. *Id.* at 256-57.

164. *See Auer v. Robbins*, 519 U.S. 452, 462 (1997) (affording *Chevron* deference to the Secretary of Labor's interpretation of the Fair Labor Standards Act in its amicus brief because it was not a *post hoc* rationalization and reflected the agency's fair and considered judgment).

165. 444 U.S. 555, 566, 568 (1980).

166. *Id.* at 566-67.

167. *Id.* at 568.

168. *Mead*, 533 U.S. at 253-54.

of factors that are weighted heavily toward accepting the administration's interpretations and this list is still valid:

(1) whether the agency construction was rendered contemporaneously with the statute's passage, see, e.g., *Norwegian Nitrogen Prods. Co. v. United States*, 288 U.S. 294, 315 (1933); (2) whether the agency's construction is of longstanding application, see, e.g., *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 275 (1974); (3) whether the agency has maintained its position consistently (even if infrequently), see, e.g., *Haig v. Agee*, 453 U.S. 280, 293 (1981); (4) whether the public has relied on the agency's interpretation, see, e.g., *Udall v. Tallman*, 380 U.S. 1, 18 (1965); (5) whether the interpretation involves a matter of 'public controversy,' see, e.g., *United States v. Rutherford*, 442 U.S. 544, 545 (1979); (6) whether the interpretation is based on 'expertise' or involves a 'technical and complex' subject, see, e.g., *Aluminum Co. of Am. v. Central Lincoln People's Util. Dist.*, 52 U.S.L.W. 4716, 4719 (U.S. June 5, 1984) (No. 82-1071); (7) whether the agency has rulemaking authority, see, e.g., *FCC v. National Citizens Comm. for Broadcasting*, 436 U.S. 775, 793 (1978); (8) whether agency action is necessary to set the statute in motion, see, e.g., *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 565-66 (1980); (9) whether Congress was aware of the agency interpretation and failed to repudiate it, see, e.g., *Zemel v. Rusk*, 381 U.S. 1, 11 (1965); and (10) whether the agency has expressly addressed the application of the statute to its proposed action, see, e.g., *Investment Co. Inst. v. Camp*, 401 U.S. 617, 627-28 (1971).<sup>169</sup>

#### IV. THE SPECIAL CASE OF INCOME TAX ACCOUNTING

John F. Coverdale has examined the deference issue and its post-*Chevron* developments through *Christensen* and *Mead* as applied to tax regulations and rulings.<sup>170</sup> Early in his discussion he summarizes as follows:

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169. Diver, *supra* note 30, at 599 n.95.

170. Coverdale, *supra* note 141, at 41.

*Mead*, like *Christensen*, continues to leave open the possibility of granting Chevron deference to agency positions reached outside of notice-and-comment rulemaking, because it treats notice-and-comment rulemaking and adjudication only as indicators that Congress has granted the agency the authority to speak with the force of law and that the agency has done so.<sup>171</sup>

*Mead* also instructs “different statutes present different reasons for considering respect for the exercise of administrative authority or deference to it.”<sup>172</sup> It is clear that in all cases the courts should defer to a regulation and be afforded *Chevron* deference if the regulation is (1) issued by an agency that Congress has charged with the duty of enforcing a particular set of laws, and (2) subjected to notice-and-comment.<sup>173</sup> But the deference received, if any, by positions expressed in other formats depend upon Congressional intent as determined on a case by case basis.<sup>174</sup>

The starting point on this case-by-case approach in the situations not involving a regulation, but requiring a determination of congressional intent, must be the relevant statutes. Consider the general requirement the taxpayer’s accounting method must satisfy as provided in section 446(b):

If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income.<sup>175</sup>

The ambiguity in “clearly reflects income” is apparent,<sup>176</sup> and

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171. *Id.* at 54; Coverdale, as well as Justice Scalia in his dissent, find problems with the Court’s emphasis on finding that Congress intends the agency to have rule making power. However, this is not an issue on tax issues because of the general authority granted the Secretary of Treasury in section 7805. *Id.* at 81-82; *Mead*, 533 U.S. at 239.

172. *Mead*, 533 U.S. at 238.

173. *Id.* at 226-27.

174. *See id.* at 243 (Scalia, J. dissenting).

175. I.R.C. § 446(b) (2000).

176. Professor Boris Bittker notes the circularity of the statute:

The statutory phrase [clear reflection of income] is not only hopelessly vague but circular to boot, because the ‘income’ that must be clearly

determinations as to whether the requirement has been satisfied must be made on a case by case basis.<sup>177</sup> It is equally apparent that Congress intentionally enacted an ambiguous statute. Thus, the issue is: Who did the Congress intend to resolve this ambiguity- the courts or the Internal Revenue Service? Given the Treasury's general powers to issue regulations under section 7805, then to the extent that regulations can be written to cover the myriad of situations that can arise about the timing of income and expenses, *Chevron* deference would apply to the regulations.<sup>178</sup> In addition, if *Seminole Rock* deference is applied to ambiguities in the regulations, the boundaries would be clear: The regulations and all reasonable agency interpretations of the regulations would receive deference.<sup>179</sup>

However, it is not feasible for the Service to issue regulations that would address a substantial portion of the issues that can arise, and Congress is undoubtedly aware of the limitations on the Services' capacity to subject the numerous clear reflection of income issues to notice and comment procedures. Moreover, assuming the case is made that the taxpayer's method does not clearly reflect income, and thus the Secretary requires the taxpayer to change to a method that, "in the opinion of the Secretary, does clearly reflect income," it seems unlikely that Congress intended to limit the Secretary's choice of a method to those prescribed in existing regulations.<sup>180</sup> If Congress had intended a limit on this power, beyond a "reasonableness" requirement, Congress would not have referred to the Secretary's opinion without appropriate limitations or explanation.

The Commissioner has filled a void in the statute by adding to the regulations that "no method of accounting is acceptable,

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reflected by the taxpayer's accounting method is taxable income, not financial, economic, or any other variety of income. In short, income is clearly reflected by an accounting method if the ultimate result of using the method is taxable income.

Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts*, § 105.1.7 (2d ed. 1989).

177. *Ford Motor Co. v. Comm'r*, 102 T.C. 87, 91-92 (1994), *aff'd*, 71 F.3d 209 (6th Cir.1995).

178. *Coverdale*, *supra* note 141, at 92.

179. *Id.* at 61.

180. *See Mulholland v. United States*, 28 Fed. Cl. 320, 334 (1993) (reasoning that the Commissioner's discretion to determine whether a method does not clearly reflect income is more narrow than his authority to prescribe another method for the taxpayer); *but see Dana Corp. v. United States*, 38 Fed. Cl. 356, 353 (1997) (noting that *Mulholland* is incorrect in extending a *de novo* standard of review to whether or not a taxpayer's method of accounting clearly reflects income and instead examining *de novo* the Commissioner's exercise of discretion in making the determination).

unless in the opinion of the Commissioner, it clearly reflects income.”<sup>181</sup> That regulation has been in existence for almost 50 years,<sup>182</sup> and was subject of notice and comment and therefore has the force of law.

Long before *Chevron*, the Supreme Court deferred to the administration on tax accounting issues when it declared “it is not the province of the court to weigh and determine the relative merits of systems of accounting.”<sup>183</sup> In another early tax accounting case, the Supreme Court deferred to the Service in determining whether the taxpayer’s method of accounting clearly reflected income:

Much latitude for discretion is thus given to the administrative board charged with the duty of enforcing the Act. “Its interpretation of the statute and the practice adopted by it should not be interfered with unless clearly unlawful.”<sup>184</sup>

More recently, in *Thor Power Tool v. Commissioner*, the Court concluded:

The Code and Regulations give the Commissioner “wide discretion in determining whether a particular method of inventory accounting should be disallowed as not clearly reflective of income.”<sup>185</sup>

Moreover, in another case the Court held that it is proper to first look to the intent of Congress as expressed by “longstanding committees expertly grounded in tax problems.”<sup>186</sup> In the particular case Congress had not addressed the issue, and the Court deferred to the administration’s position as not having abused his discretion.<sup>187</sup>

Based on the Supreme Court’s early decisions regarding the Commissioner’s authority under section 446(b) and a long history of lower court decisions, a court addressing a tax accounting decision will often begin its opinion as follows:

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181. I.R.C. § 1.446-1(a)(2) (2004).

182. T.D. 6282, 1958-1 C.B. 59.

183. *Brown v. Helvering*, 291 U.S. 193, 204-05 (1934) (citing *Lucas v. Am. Code Co., Inc.*, 280 U.S. 445, 449 (1930)); *see also* *United States v. Catto*, 384 U.S. 102, 114 (1966).

184. *Lucas v. Am. Code Co., Inc.*, 280 U.S. 445, 449 (1930).

185. 439 U.S. 522, 532 (1979).

186. *Am. Auto. Ass’n v. United States*, 367 U.S. 687, 698 (1961).

187. *Id.*

In *Thor Power Tool Co. v. Commissioner*, the Supreme Court explained: It is obvious that on their face, secs. 446 and 471, with their accompanying Regulations, vest the Commissioner with wide discretion in determining whether a particular method of inventory accounting should be disallowed as not clearly reflective of income. 439 U.S. 522, 540 (1979). This Court's cases confirm the breadth of this discretion. In construing Sec. 446 and its predecessors, the Court has held that "[t]he Commissioner has broad powers in determining whether accounting methods used by a taxpayer clearly reflect income." *Hansen v. Commissioner*, 360 U.S. 446, 467 (1959). Since the Commissioner has "[m]uch latitude for discretion," his interpretation of the statute's clear-reflection standard "should not be interfered with unless clearly unlawful." *Lucas v. Am. Code Co.*, 280 U.S. 445, 449 (1930). \* \* \* In construing \* \* \* a predecessor of Sec. 471, the Court held that the taxpayer bears a "heavy burden of [proof]," and that the Commissioner's disallowance of an inventory accounting method is not to be set aside unless shown to be "plainly arbitrary." *Lucas v. Structural Steel Co.*, 281 U.S. 264, 271 (1930).<sup>188</sup>

The Commissioner's determination with respect to clear reflection of income is entitled to more than the usual presumption of correctness, and the taxpayer bears a heavy burden of overcoming a determination that a method of accounting does not clearly reflect income.<sup>189</sup>

The respondent's determination pursuant to his authority under Section 446(b) is presumptively correct and must be upheld unless the petitioner has proved it clearly erroneous or arbitrary.<sup>190</sup>

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188. See, e.g., *Honeywell Inc. v. Comm'r*, 64 T.C.M. 1992-453 (CCH) 437 (1992) (citing *Lucas v. Kan. City Structural Steel Co.*, 281 U.S. 264, 271 (1930)).

189. *Rotolo v. Comm'r*, 88 T.C. 1500, 1513-14 (1987); see also, e.g., *Peninsula Steel Prod. & Equip. Co. v. Comm'r*, 78 T.C. 1029, 1044-45 (1982); *RCA Corp. v. United States*, 664 F.2d 881, 886 (2d Cir. 1981); *Dana Corp. v. United States*, 174 F.3d 1344, 1347-48 (Fed. Cir. 1999); *Am. Express Co. v. United States*, 262 F.3d 1376, 1379 (Fed. Cir. 2001).

190. *Brooks-Massey Dodge, Inc. v. Comm'r*, 60 T.C. 884, 891 (1973).

Therefore, it appears that the courts have concluded that the Commissioner is comparable to the Controller of Currency in *NationsBank* and the staff of the Federal Reserve Board in *Ford Motor Credit*.<sup>191</sup> That is, Congress has implicitly expressed its intent that the Commissioner commands *Chevron* deference on tax accounting issues when his authority is expressed in a manner other than regulations.<sup>192</sup> It follows from *Mead* that the Secretary's opinion regarding the clear reflection of income, regardless of the format in which it is presented, should be accorded the same deference as a regulation issued with notice and comments.<sup>193</sup> The only modification to this conclusion is that the interpretation should be that of the agency, and not merely the opinion of a litigating attorney or some other employee who does not have the authority to speak for the agency. These qualifications will be revisited below.

While our conclusion may sound like the writers have simply adopted Justice Scalia's dissenting opinion in *Mead*,<sup>194</sup> our conclusion is based on the specific language of section 446(b).<sup>195</sup> Thus, the agency opinions about whether an accounting method clearly reflects income may not be in a class entirely by themselves in regard to deference; rather, those opinions should be in the same class as regulations that were subjected to notice and comment.

As discussed above, the courts should defer to the agency's position on a determination regarding tax accounting unless that position is "clearly unlawful" or "plainly arbitrary."<sup>196</sup> *Chevron* uses the terms "arbitrary, capricious, or manifestly contrary to the statute" in regard to legislative regulations.<sup>197</sup> In the case of interpretative regulation "a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency."<sup>198</sup>

The Court does not elaborate on the distinction between the

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191. See *NationsBank of N.C. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 256-57 (1995); see also *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 55, 565-66 (1980).

192. *Mead*, 533 U.S. at 219.

193. *Id.* at 226-27 (holding that "administrative implementation of a particular statutory provision qualifies for *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").

194. *Id.* at 239-40 (Scalia, J., dissenting).

195. I.R.C. § 446(b) (2000).

196. *Honeywell*, 64 T.C.M. (CCH) 437 (1992).

197. *Chevron U.S.A. v. Natural Res. Def. Council*, 467 U.S. 837, 844 (1984).

198. *Id.*



“arbitrary, capricious, or manifestly contrary” standard and the reasonableness test.<sup>199</sup> Thus, it is not clear when an agency determination would satisfy the former test but not the latter. However, because the statute and regulations give the Commissioner the power to determine whether the taxpayer’s method clearly reflects income,<sup>200</sup> the present authors submit that the agency determination is tantamount to a legislative regulation. Therefore, the IRS’s determination on the accounting methods issue should be subjected to the “arbitrary, capricious, or manifestly contrary” standard. Indeed, in the Supreme Court decisions discussed above, the Court used the terms “plainly arbitrary” and “clearly unlawful.”<sup>201</sup>

The Supreme Court has ruled that an agency’s action is “arbitrary and capricious” if the agency (1) relied on factors which Congress has not intended to be considered, (2) entirely failed to consider an important aspect of the problem, (3) offered an explanation for its decision that runs counter to the evidence before the agency, or (4) is so implausible that it could not be ascribed to a different view or be the product of the agency expertise.<sup>202</sup> In *United States v. U.S. Gypsum Co.*, the Supreme Court explained that “a finding is ‘clearly erroneous’ when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.”<sup>203</sup> This standard has generally been applied by appellate courts to determine when to defer to the trial court on a finding of facts or law.<sup>204</sup>

## V. THE TAXPAYER’S ANSWER

In the tax accounting cases, the Commissioner charges that the taxpayer’s method does not clearly reflect income, and the taxpayer must explain how the Commissioner’s position is

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199. *Id.*

200. Treas. Reg. § 1.446-1(a)(2) (2004).

201. See Jennifer C. Root, *The Commissioner’s Clear Reflection of Income Power Under § 446(b) and the Abuse of Discretion Standard of Review: Where has the Rule of Law Gone and Can We Get it Back?*, 15 AKRON TAX J. 69, 99-100 (2000) (discussing the distinction between the abuse of discretion and clearly erroneous standards); see also Francis M. Allegra, *Section 482: Mapping the Contours of the Abuse of Discretion Standard of Judicial Review*, 13 VA. TAX. REV. 423, 480 (1994).

202. *Motor Vehicle Mfr. Ass’n v. State Farm Ins. Co.*, 463 U.S. 29, 43 (1983).

203. 333 U.S. 364, 395 (1948).

204. *But see Florida Progress Corp. v. Comm’r*, 348 F.3d 954 (11th Cir. 2003) (concluding the Tax Court’s characterization of events as a “rate adjustment” rather than a refund for purposes of section 1341); see also *Consolidated Mfg., Inc. v. Comm’r*, 249 F.3d 1231, 1239 (10th Cir. 2001).

arbitrary or unreasonable.<sup>205</sup> The Commissioner cannot reject a method authorized by the Internal Revenue Code, nor, generally, can the Commissioner reject a method authorized by the regulations.<sup>206</sup> Moreover, the fact that the taxpayer's method of accounting is in accordance with generally accepted accounting principles is a consideration in the taxpayer's favor,<sup>207</sup> as will be further discussed below.

The taxpayer will often defend its method as matching expenses with revenues. That is, the method of accounting results in the expense to earn the income being deducted in the same year as the revenues are reported, whereas, the Commissioner's method would result in a mismatching of revenues and expenses. While this is not a complete defense, it is often persuasive.<sup>208</sup>

Finally, if the taxpayer can demonstrate that the Commissioner has been inconsistent in his treatment among taxpayers, and thus violated the principle of horizontal equity, the Commissioner is more likely to be deemed arbitrary.<sup>209</sup> However, that is not to say that the Commissioner cannot change positions over time after more experience has been gained.

#### VI. EXAMPLES OF THE COURTS' APPLICATIONS AND FAILURES TO APPLY PRINCIPLES OF DEFERENCE

As indicated above, in an accounting method case the taxpayer must demonstrate to the court that the taxpayer's method of accounting "clearly reflects income."<sup>210</sup> The IRS or the Government must then present its reasons for rejecting the

205. *Ford Motor Co. v. Comm'r*, 102 T.C. 87, 92 (1994).

206. *See, e.g.*, *Fidelity Assoc. v. Comm'r*, T.C.M. (CCH) 2327 (1992); *but see Ford Motor Co.*, 102 T.C. at 93-94, *aff'd*, 71 F.3d 209 (6th Cir. 1995) (noting that the taxpayer's application of the regulation produced a ridiculous result (in favor of the taxpayer) under the facts of the case and the Commissioner was permitted to set aside his regulations).

207. *Treas. Reg.* § 1.446-1(a)(2).

208. *See, e.g.*, *Lincoln Elec. Co. v. Comm'r*, 54 T.C. 926, 932 (1970) (considering the matching principle as the heart of the clear reflection of income requirement); *see also Seago*, *supra* note 10, at 1858-59; *but see Alan Gunn, Matching of Costs and Revenues as a Goal of Tax Accounting*, 4 VA. TAX. REV. 1, 14-17, 19, 35 (1984).

209. *See, e.g.*, *RLC Gas Co., v. Comm'r*, 98 T.C. 457, 491-92 (1992); *Bay State Gas Co. v. Comm'r*, 75 T.C. 410, 422-24 (1981); *U.S. Freightways Corp. v. Comm'r*, 270 F.3d 1137, 1145 (7th Cir. 2001).

210. For an exhaustive discussion of the "rule of law" versus "rule of men" aspect of the clear reflection of income requirement see Edward A Morris, *Reflections on the Rule of Law and "Clear Reflection of Income": What Constrains Discretion?*, 8 CORNELL J. OF L. & PUB. POL'Y, 445, 446-51 (1999).

taxpayer's method.<sup>211</sup> Given that the Government can decide which cases to litigate, and because of the deference granted the Commissioner, it is rare that the taxpayer will prevail in court.<sup>212</sup> Nevertheless, some taxpayers have succeeded, especially in the Tax Court.<sup>213</sup> In many of these cases, the reason for success is that the deference rules are not rigorously applied.

One consideration presented by the regulations that can run in the taxpayer's favor is the use of an accounting method that is in accordance with generally accepted accounting principles (GAAP).<sup>214</sup> This is true because Treasury Regulation 1.446-1(a)(2) provides that "ordinarily" the consistent application of a method that is in accordance with GAAP will clearly reflect income.<sup>215</sup> However, according to the Supreme Court in *Thor Power Tool Company*, the regulations provide two prongs to the clear reflection of income test. First, the method must be consistent with GAAP. But second, "no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income."<sup>216</sup> The regulations were characterized as providing a two-pronged test to refute the taxpayer's argument that when the method used satisfies GAAP a presumption is created that the taxpayer's method clearly reflects income.<sup>217</sup> The Court ruled that no such presumption could be created, but in the process created the impression that GAAP was irrelevant because there is only one test: Whether "in the opinion of the Commissioner" the taxpayer's method clearly reflects income.<sup>218</sup> However, with a two pronged test where one prong is "paramount," it logically follows that failing that test but passing the GAAP test does nothing for the taxpayer. It seems clear that satisfying GAAP is a consideration that runs in favor of the taxpayer but is not the determining factor, as subsequent cases have illustrated.<sup>219</sup> Thus, when a tax accounting method is challenged and the taxpayer presents expert testimony that the method is in accordance with GAAP, the chances the taxpayer will prevail are improved, but not guaranteed.<sup>220</sup>

211. *Id.* at 496-97, 499-501.

212. *Id.* at 499-501.

213. *Id.*

214. See generally Harold Dubroff, M. Connie Cahill and Michael D. Norris, *Tax Accounting: The Relationship of Clear Reflection of Income To Generally Accepted Accounting Principles*, 47 ALB. L. REV. 354, 360-61, 389, 396-97 (1983).

215. Treas. Reg. § 1.446-1(a)(2).

216. *Thor Power Tool Co. v. Comm'r*, 539 U.S. 522, 540 (1979).

217. *Id.* at 538-40.

218. *Id.* at 540.

219. *Id.*

220. See, e.g., *LaCrosse Footwear Inc., v. United States*, 191 F.3d 1372, 1379-80 (Fed.

*American Automobile Ass'n v. United States*, a pre-*Chevron* case, is the high water mark in regard to the Court's deference to the Commissioner.<sup>221</sup> In AAA, the taxpayer's accounting method was in accordance with GAAP, but the Supreme Court held that the method could be rejected by the Commissioner as not clearly reflecting income.<sup>222</sup> The association sold three-year service contracts and attempted to spread the income over the life of the contracts, which was required by GAAP.<sup>223</sup> The taxpayer argued that in addition to satisfying GAAP, spreading the income resulted in matching expenses incurred under the contracts with their revenues, and thus clearly reflected income.<sup>224</sup> The Supreme Court rejected the taxpayer's method.<sup>225</sup> The Court justified its holding by stating that the taxpayer could not relate the recognition of revenues from individual contracts with the costs of servicing the contracts.<sup>226</sup> This would be a "lame" argument, but for the fact that the Court was applying deference. That is, nothing in the code, regulations, or prior court decisions mentioned that the clear reflection of income could not be based on the overall performance of the accounting method as applied to all customers. The argument was accepted because it was adopted by the IRS and was not unreasonable, given the void in the statutory language in regard to when income must be recognized.<sup>227</sup> Indeed, in inventory accounting, it is not necessary to relate the actual cost of goods transferred to the revenue from the goods that physically flow to the customers.<sup>228</sup> Aside from the validity of deference, the decision is indefensible.

In *Peninsula Steel Products v. Commissioner*, the Tax Court reached a conclusion applying analysis that was consistent with *Chevron*.<sup>229</sup> The manufacturer of pollution control equipment in *Peninsula Steel* convinced the Tax Court that a LIFO inventory approach to assigning the cost of materials to specific contracts whose income was determined under the completed contract

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Cir. 1999); *Dayton Hudson Corp., v. Comm'r*, 153 F.3d 660, 665-66 (8th Cir. 1998); *Apollo Computer, Inc. v. United States* 32 Fed. Cl. 334, 349-50 (1994).

221. 367 U.S. 687, 697-98 (1961); *see also Schlude v. Comm'r*, 372 U.S. 128, 135 (1963).

222. AAA, 367 U.S. at 690, 697-98.

223. *Id.* at 690.

224. *Id.* at 690-93.

225. *Id.* at 689, 692-93.

226. *Id.* at 693-94.

227. *Id.* at 695-98.

228. Treas. Reg. § 1.471-2(d) (2004).

229. 78 T.C. 1029, 1053-56 (1982); *see also Spang Indus., Inc. v. United States*, 791 F.2d 906, 908, 912 (Fed. Cir. 1986); *Reco Indus., Inc. v. Comm'r*, 83 T.C. 912, 917-18 (1984).

method satisfied the clear reflection of income requirement.<sup>230</sup> Peninsula's experts presented testimony that the method was in accordance with GAAP, and the Service did not challenge the expert's opinion.<sup>231</sup> Rather, the Service argued that the use of an inventory approach to materials cost was incompatible with the completed contract method.<sup>232</sup> The Tax Court found that the regulations addressed the time at which the materials cost should be added to the contract but did not address the manner in which the cost of the materials was to be determined.<sup>233</sup> In the process of rejecting the Service's argument that LIFO could not be used to determine the cost of materials, the Service summarily dismissed a revenue ruling on point.<sup>234</sup> *Skidmore* was not cited in the case, although one could argue that silence on the cost assignment issue did not create ambiguity in the regulations.<sup>235</sup> The Tax Court did recite the usual shibboleth about the heavy burden the taxpayer must bear when the Service challenges an accounting method, but then the court recognized a congressional intent that the LIFO method should be available to all taxpayers who use purchase goods and materials for use in their products.<sup>236</sup> Moreover, the Commissioner failed to present any policy arguments in the context of this case for rejecting Congress's intent that LIFO should be generally available to taxpayers.<sup>237</sup> Thus, although the Tax Court did not acknowledge the *Chevron* analysis, the Court essentially decided the case on the basis of *Chevron* step one: Using the usual tools of statutory interpretation, the court concluded that LIFO applies to all materials used in production.<sup>238</sup> Because the taxpayer was producing goods for customer, the taxpayer should be allowed to use LIFO to account for the materials cost.

On the other hand, *Honeywell Inc., v. Commissioner*<sup>239</sup>

230. *Peninsula Steel*, 78 T.C. at 1053.

231. *Id.* at 1048.

232. *Id.* at 1050.

233. See Steve R. Looney, *Using LIFO to Value Costs Under the Completed Contract Method: A Tale of Two Accounting Methods*, 39 TAX LAW. 235, 253 (1986).

234. Rev. Rul. 59-329, 1959-2 C.B. 138; *Peninsula Steel*, 78 T.C. at 1052 (stating a lack of belief "that respondent has authority to promulgate by a revenue ruling the absolute rule of law . . . he seeks to apply in the instant case").

235. *Skidmore* was also conspicuous by its absence in *RLC Indus. v. Comm'r*, where the Tax Court did not grant the Commissioner any latitude in applying the regulations. *Skidmore v. Swift & Co.*, 323 U.S. 134, 139-40 (1944); *RLC Indus.*, 98 T.C. 457, 489-91, 497-99, 500-03 (1992).

236. *Peninsula Steel*, 78 T.C. at 1058-59.

237. *Id.* at 1059.

238. *Id.* at 1058-59.

239. 64 T.C.M. (CCH) 437 (1992).

represents the low-water mark in deference, in the present authors' opinion. The issue was whether the taxpayer was required to account for parts used on service contracts as inventory.<sup>240</sup> The outcome of the case depended upon the interpretation of Regulations section 1.471-1.<sup>241</sup> That regulation requires the taxpayer to use an inventory system to account for the cost of goods "in every case in which the production, purchase, or sale of merchandise is an income-producing factor."<sup>242</sup> The taxpayer argued that the parts were not "merchandise" because they were not "held for sale."<sup>243</sup> Instead of treating the case as one of determining whether the Commissioner was making a reasonable interpretation of the regulations and apply *Seminole Rock* deference, the Tax Court viewed the case as one of determining "the correct treatment" of the parts.<sup>244</sup> Although Judge Cohen recited the usual language regarding the deference due the Commissioner, she proceeded to consider how the customers viewed the transaction (i.e., the purchase of a service contract rather than the purchase of parts), and the fact that customers paid a fixed price regardless of the cost of the parts used, to conclude that the transactions were not sales of merchandise.<sup>245</sup> While this was not the classic transfer of property for cash, the taxpayer did transfer property for consideration and thus, a little deference was all that was required to reach a decision in favor of the Commissioner; but no deference was granted.<sup>246</sup>

As another example of the Tax Court's failure to grant the administration deference when the court should have, consider the case of *Osteopathic Medical Oncology & Hematology, P.C. v. Commissioner*.<sup>247</sup> The professional services corporation used substantial amounts of chemicals and drugs in treating cancer patients.<sup>248</sup> The Service argued that the drugs and chemicals were inventories and therefore, the inventory accounting rules should be applied.<sup>249</sup> Section 471 clearly gave the Commissioner

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240. *Id.*

241. *Id.*

242. *Id.*

243. *Id.*

244. *Honeywell*, 64 T.C.M. (CCH) 437.

245. *Id.*

246. *See also* *Hewlett-Packard Co. v. United States* 71 F.3d 398, 402-03 (Fed. Cir. 1996), *reversing* *Apollo Computer, Inc. v. United States*, 32 Fed. Cl. 334 (1994).

247. 113 T.C. 376, 392-93 (1999); *see also* Note, *Cash Method of Accounting for Professional Health Services Corporations: Osteopathic Medical and Hematology, P.C. v. Commissioner*, 54 TAX LAW 223, 231 (2000).

248. *Osteopathic Med.*, 113 T.C. at 377.

249. *Id.* at 379-80.

the power to invoke the inventory rules.<sup>250</sup> The Code does not define inventories but Treasury Regulation 1.471-1 provides that inventory accounting is required whenever the “production, purchase, or sale of merchandise is an income-producing factor.”<sup>251</sup>

Because the Code did not provide the answer by leaving the term “inventory” undefined, it would have been appropriate for the court to proceed to *Chevron* step two. Under step two, looking to the regulations was of little help because it did not define “merchandise.” The court then proceeded to look to other areas of law for the meaning of merchandise, a search that also proved fruitless.<sup>252</sup> Most importantly, the majority of the Tax Court judges believed that doctors are the “quintessential” service providers,<sup>253</sup> and accordingly, that drugs were “subordinate to the medical services.”<sup>254</sup>

The Service directed its arguments to the effects of inventory accounting on the clear reflection of income by emphasizing the fact that drugs are a significant factor (twenty-six percent of gross receipts from operations) in measuring income. This is contrary to the common view of the nature of medical practice.<sup>255</sup> In the present writers’ opinion, the arguments were compelling and the Commissioner should have won the case, without being granted any deference. With the benefit of deference, based on the Commissioner’s knowledge of income measurement (relative to a Tax Court judge), it should have been a slam-dunk for the Commissioner.

Contractors have played a major role in a series of cases in which little regard has been given to the deference issue and mixed results have been attained on the inventory issue.<sup>256</sup> In *Ansley-Sheppard-Burgess Co. v. Commissioner*, an electrical contractor was permitted to use the cash method of accounting – the method clearly reflected income – even though materials costs were substantial.<sup>257</sup> However, the IRS failed to argue that the

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250. I.R.C. § 471(a) (2000).

251. Treas. Reg. § 1.471-1 (2004).

252. *Osteopathic Med.*, 113 T.C. at 382-83.

253. *Id.* at 384.

254. *Id.* at 385; see also *Hosp. Corp. of Am. v. Comm’r*, 107 T.C. 116, 144 (1996).

255. *Osteopathic Med.*, 113 T.C. at 390; see *Wilkenson-Beane v. Comm’r*, 420 F.2d 352, 355 (1st Cir. 1970) (concluding that a funeral director was selling merchandise).

256. See *Jim Turin & Sons, Inc. v. Comm’r*, 75 T.C.M. (CCH) 2534 (1998) (citing *Galedrige Constr., Inc. v. Comm’r*, 73 T.C.M. (CCH) 2838 (1997) (finding that asphalt is not merchandise)).

257. 104 T.C. 367, 377 (1995).

materials were subject to the inventory rules.<sup>258</sup> Having learned from *Ansley-Sheppard*, the service argued that a paving company's asphalt was inventory,<sup>259</sup> but the Tax Court concluded that the asphalt was not inventory because of its "ephemeral" quality, as though that had anything to do with the clear reflection of income.<sup>260</sup> These cases were decided after a case in which a roofing contractor's materials were deemed to be inventory.<sup>261</sup>

The Tax Court's complete disregard for the deference due the Commissioner was evident in one of the contractor cases, *Osteopathic Medical Oncology & Hematology, P.C. v. Commissioner*. This decision caused the Service to give up the quest to make small businesses with significant materials cost use the accrual method.<sup>262</sup> In 2001, the Service issued Revenue Procedure 2001-10, permitting these businesses to use the cash method without regard to whether the materials used might be classified as inventory.<sup>263</sup> While this may have been a laudable change in terms of simplifying the law, the law would not have been so complex as to require the change in policy, if the courts had regard for deference principles so that the businesses would have known their tax accounting requirements.

## VII. LIFO POOLS AND ITEMS

The dollar-value LIFO regulations contain many rules regarding pooling and pricing inventory items without expressing the rationale for the rules, and often provide only skeletal definitions.<sup>264</sup> When the IRS is challenged on the application of the regulations, the Tax Court has been receptive to the Service's "at trial" offering of a rationale for the rules, as support for finding the regulations to be "reasonable."<sup>265</sup>

The LIFO inventory method has produced some cases where the courts have paid more regard for the deference the Commissioner should enjoy. In *Amity Leather Products v. Commissioner* the domestic parent corporation and its foreign

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258. *See id.* at 368.

259. *Galedrige Constr., Inc. v. Comm'r*, 73 T.C.M. (CCH) 2838 (1997).

260. *Id.*; *see also RACMP Enters. v. Comm'r*, 114 T.C. 211 (2000) (holding that a cement contractor was not employing inventories because of the "ephemeral" qualities of cement).

261. *J.P. Sheahan Assocs., Inc. v. Comm'r*, T.C.M. (CCH) 2842 (1992).

262. *Osteopathic Med.*, 113 T.C. at 382-83.

263. Rev. Proc. 2001-10, 2001-1 C.B. 272.

264. Treas. Reg. § 1.472-8 (2004).

265. *See Amity Leather Prods. v. Comm'r*, 82 T.C. 726, 736 (1984).



subsidiary produced identical products.<sup>266</sup> The foreign subsidiary sold its goods to the domestic parent.<sup>267</sup> One of the issues in the case was whether the foreign and domestically produced goods could be combined into one dollar-value LIFO pool.<sup>268</sup> The regulations in question provided that a taxpayer who produces goods for resale and who also purchases goods for resale must maintain separate pools for the produced goods and purchased goods.<sup>269</sup> It is not apparent why separate pools would be required, and the regulation offers no explanation.<sup>270</sup> But in enforcing the regulation, the Tax Court accepted the Service's explanation that "a narrow definition of an item within a pool will generally lead to a more accurate measure of inflation . . . and thereby lead to a clearer reflection of income."<sup>271</sup> While this justification for maintaining separate pools seems to confuse the concept of inventory items and inventory pools, it was good enough to satisfy the "reasonableness" requirement of the second *Chevron* step.<sup>272</sup>

On the other hand, in *UFE, Inc. v. Commissioner*, the taxpayer purchased the assets of a manufacturing business, which included an inventory of finished goods and goods in process.<sup>273</sup> The bargain purchase price was allocated among the assets in a manner that resulted in a low valuation of the inventory.<sup>274</sup> UFE elected the dollar-value LIFO inventory method, treating the purchased goods as the base period LIFO inventory.<sup>275</sup> After the purchase the taxpayer continued producing the same goods.<sup>276</sup> Relying on the regulations as interpreted in *Amity Leather*, the Service argued that the beginning inventory was purchased goods that must be included in a dollar-value LIFO pool, separate from the goods produced after the acquisition.<sup>277</sup> That is, according to the Service, UFE operated a wholesale business in regard to the purchased goods, and a manufacturing business in regard to the post-acquisition production. However, the mere recitation of the regulations and

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266. *Id.* at 728-29.

267. *Id.* at 729.

268. *Id.* at 734.

269. *Id.* at 735 (citing Treas. Reg. § 1.472-8 (2004)).

270. Treas. Reg. § 1.472-8 (2004).

271. *Amity Leather*, 82 T.C. at 734, 736.

272. *Id.* at 734, 736.

273. 92 T.C. 1314, 1318-19 (1989).

274. *Id.* at 1319.

275. *Id.*

276. *Id.* at 1322.

277. *Id.* at 1319-21.

a citation to *Amity Leather* was not convincing - the Tax Court dug deeper. *Amity Leather* was distinguished because it involved a continuing process of purchasing goods, selling them and replacing them with other purchased goods, whereas UFE made a one-time purchase of the beginning inventory that would be sold and replaced with identical goods it produced.<sup>278</sup> The Tax Court further reasoned that:

It would, in our view, distort income to remove the small amount of finished inventory from the business' ongoing flow of inventory accounting. We conclude that petitioner properly included the finished inventory in a single pool. This accounting treatment serves the overriding purpose of the LIFO regulations which is to match current costs against current income.<sup>279</sup>

Thus, the Tax Court required a plausible explanation for finding the opaque regulation reasonable in the context of the taxpayer's situation, and absent that explanation by the Service, the Service's position was rejected, as would be done under Chevron step two.

The Service found a plausible theory to address the same bargain purchase issue in *Hamilton Indus. v. Commissioner*.<sup>280</sup> Instead of arguing that the purchased and produced goods should be included in separate pools, the Service argued that the purchased and produced goods were different dollar-value LIFO inventory items, and treating them as the same item would distort income.<sup>281</sup> That is, to clearly reflect income using dollar-value LIFO, inflation should be eliminated from the ending inventory valuation. But if the goods produced are price according to the prices of the purchased goods, the proper inflation adjustments will not be made. However, the Service appears to have prevailed because it had the better argument, rather than as a result of receiving any deference.<sup>282</sup>

Finally, a taxpayer who has computed taxable income in accordance with the regulations generally satisfies the clear reflection of income requirement.<sup>283</sup> However, in one case, *Ford*

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278. UFE, Inc. v. Comm'r, 92 T.C. 1314, 1321-22 (1989).

279. *Id.* at 1322.

280. 97 T.C. 120, 127 (1991).

281. *Id.*

282. *Id.* at 147-50.

283. *Ford Motor Co. v. Comm'r*, 102 T.C. 87, 97 (1994).

*Motor Company v. Commissioner*, the result attained under the regulation produced results that were so “outrageous” under the facts that the Tax Court – agreeing with the Commissioner – set aside the regulation.<sup>284</sup> This rejection of a regulation that has been subjected to notice and comments, but on the request of the administration, appears to be the ultimate form of deference.

### VIII. CONCLUSIONS

In the above discussion we have concluded that the Commissioner has not received his deference due in tax accounting cases. Moreover, *Chevron* deference should be afforded the Commissioner when the issue is whether the taxpayer’s accounting method clearly reflects income, regardless of the format in which the Commissioner’s position is expressed. In applying this principle it becomes important to distinguish the Commissioner’s position, as opposed to a mere employee of the Internal Revenue Service.

In *Bowen v. Georgetown University Hospital*, the Court ruled, “We have declined to give deference to an agency counsel’s interpretation of a statute where the agency itself has articulated no position on the question.”<sup>285</sup> Preceding the quote, the Court commented, “We have never applied the principle of those cases [deference under *Chevron*] to agency litigating positions that are wholly unsupported by regulations, rulings, or administrative practice.”<sup>286</sup>

When the litigating position is supported by “rulings” or “administrative practice,” however, deference is consistent with legislative intent in regard to the clear reflection of income. An agency position that has not undergone the rigors of notice and comment should attain *Chevron* deference when the authorities express the official position of the Internal Revenue Service and the taxpayers have been provided adequate notice of the agency’s position. In *Mead*, the Court did not think that the thousands of customs agents making interpretations of rulings could speak for the entire Customs Agency and in *Georgetown Hospital*, the Court reasoned that “Congress has delegated to the administrative official and not to appellate counsel the responsibility for elaborating and enforcing statutory commands.”<sup>287</sup> However, in *Martin v. Occupational Safety and*

284. *Id.* at 94, 104.

285. 488 U.S. 204, 212 (1988).

286. *Id.*

287. *United States v. Mead Corp.*, 533 U.S. 218, 258 n.6 (2001); *Bowen*, 488 U.S. at 212 (quoting *Inv. Co. Inst. v. Camp*, 401 U.S. 617, 628 (1971)).

*Health Review Commission*, the Court reasoned that the Secretary of Labor's decision to enforce an employee's citation of violation was "an agency action," and not a *post hoc* rationalization and was worthy of *Chevron* deference.<sup>288</sup> Moreover, in *Hospital Corp. of America v. Commissioner*, the appellate court concluded that temporary regulations that had not been subject to notice and comment were "arrived at centrally by the Treasury Department, after careful consideration" and therefore deserved *Chevron* deference.<sup>289</sup>

Thus, it follows from the specific delegation of authority to the Commissioner under IRC sections 446 and 471 and from the Supreme Court decisions discussed in this paper that the Commissioner's actions in enforcing the clear reflection of income are worthy of *Chevron* deference. The deference should be applied to the litigation positions on tax accounting issues taken by the Commissioner in litigation, as well as in revenue rulings and other forms of public notice. This will require the Internal Revenue Service to be very deliberate in choosing litigating positions and issuing revenue rulings, but will result in a reduced burden on the courts.

The downside to deference is that it will reduce experimentation. That is, once the Service has decided its position on a tax accounting matter, the taxpayer will have no incentive to develop a superior method that can be easily trumped by the Commissioner's choice.

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288. 499 U.S. 144, 145 (1991); *but see* Anthony, *supra* note 141, at 10.

289. 348 F.3d 136, 144-45 (6th Cir. 2003).