ADMINISTRATIVE LAW — *CHEVRON* DEFERENCE — FEDERAL TAX COURT HOLDS PRE-*CHEVRON* JUDICIAL CONSTRUCTION OF STATUTE PRECLUDES SUBSEQUENT AGENCY INTERPRETATION IF PRIOR CONSTRUCTION WAS PREMISED ON LEGISLATIVE HISTORY. — *Intermountain Insurance Service of Vail, LLC v. Commissioner*, No. 25868-06, 2010 WL 1838297 (T.C. May 6, 2010).

For more than two decades after it was handed down, the Supreme Court's decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*[1] stood in tension with the doctrine of stare decisis.[2] After all, *Chevron* granted greater deference to administrative agencies in the arena of statutory interpretation, presumably at the expense of the courts,[3] than had ever been seen in administrative law.[4] In 2005, the Supreme Court attempted to resolve this tension, ruling in *National Cable & Telecommunications Ass'n v. Brand X Internet Services*[5] that, in the event of conflict between a prior court and an administrative agency on the score of statutory interpretation, the agency's interpretation merits deference unless the prior court held that "its construction follow[ed] from the unambiguous terms of the statute."[6]

Recently, in *Intermountain Insurance Service of Vail, LLC v. Commissioner*,[7] the United States Tax Court applied *Brand X* to strike down an agency's proposed statutory interpretation because that interpretation conflicted with judicial precedent.[8] *Intermountain* framed important questions for future courts of appeals[9] regarding the application of *Brand X* to pre-*Chevron* Supreme Court decisions. *Intermountain*'s approach to the *Brand X* inquiry, however, was seriously flawed. Instead of focusing its analysis on the holding of the prior court at issue, *Intermountain* considered what the court would have held had it decided the case after *Chevron* was handed down. In so doing, *Intermountain* ignored the specific mandate of *Brand X*, created an unpredictable framework for judicial review, and granted too much deference to judicial precedent. In place of its flawed ap-

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[1] 467 U.S. 837 (1984).

[2] *See* Richard J. Pierce, Jr., *Reconciling* Chevron *and Stare Decisis*, 85 GEO. L.J. 2225, 2225–26 (1997); Rebecca Hanner White, *The Stare Decisis "Exception" to the* Chevron *Deference Rule*, 44 FLA. L. REV. 723, 725 (1992).

[3] *See* Pierce, *supra* note 2.

[4] Thomas W. Merrill & Kristin E. Hickman, Chevron*'s Domain*, 89 GEO. L.J. 833, 833 (2001).

[5] 545 U.S. 967 (2005).

[6] *Id.* at 982; *see also* Jonathan Masur, *Judicial Deference and the Credibility of Agency Commitments*, 60 VAND. L. REV. 1021, 1024 (2007) (noting that the Court in *Brand X* "held for the first time that *Chevron* deference effectively 'trumped' stare decisis").

[7] No. 25868-06, 2010 WL 1838297 (T.C. May 6, 2010).

[8] *Id.* at *8.

[9] *See id.* at *7 n.17.

proach, *Intermountain* should have considered whether the holding of the prior case necessarily relied on a finding of unambiguous statutory meaning. Such an inquiry would have focused on the prior court's actual holding, as *Brand X* intended.

In 1999, Intermountain Insurance Service of Vail, LLC (Intermountain) engaged in a series of transactions that culminated in the sale of business assets for nearly two million dollars.[10] Intermountain reported the sales price, along with a concurrent increase in partnership basis,[11] on a tax return filed September 15, 2000.[12]

On September 14, 2006, the Commissioner of Internal Revenue issued a final partnership administrative adjustment[13] (FPAA) with respect to Intermountain's 1999 tax year.[14] In response, Intermountain challenged the timeliness of the FPAA, claiming that the Commissioner was precluded from issuing the partnership adjustment by a general three-year statute of limitations for assessing tax.[15] The Commissioner acknowledged that the three-year statute of limitations had expired, but argued that the FPAA could still be issued under an extended six-year statute of limitations because Intermountain had overstated its partnership basis.[16] The parties soon began a dispute over whether an overstatement of partnership basis is an "omission from gross income" that triggers the six-year statute of limitations specified in 26 U.S.C. §§ 6229(c)(2) and 6501(e)(1)(A).[17]

In its initial ruling on the matter, *Intermountain Insurance Service of Vail, LLC v. Commissioner*[18] (*Intermountain I*), the Tax Court held that an overstatement of basis does not trigger the six-year statute of limitations.[19] Quoting its decision in *Bakersfield Energy Partners, LP*

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[10] Intermountain Ins. Serv. of Vail, LLC v. Comm'r (*Intermountain I*), 98 T.C.M. (CCH) 144, 144 (2009).

[11] Partnership basis is the cost of acquiring assets, as adjusted by factors such as asset depreciation over time. *See* 26 U.S.C. § 1012 (2006).

[12] *Intermountain I*, 98 T.C.M. (CCH) at 144.

[13] A final partnership administrative adjustment is a notice to affected taxpayers that the IRS has made an adjustment of claimed partnership assets or gross income in order to recalculate owed taxes for a given tax year. *See* Clovis I v. Comm'r, 88 T.C. 980, 982 (1987).

[14] *Intermountain I*, 98 T.C.M. (CCH) at 144. The FPAA claimed that some of the transactions in which Intermountain had engaged were a "sham," and that Intermountain had overstated its partnership basis to avoid tax liability. *Intermountain*, 2010 WL 1838297, at *1.

[15] *See* 26 U.S.C. § 6501(a) ("[T]he amount of any tax imposed by this title shall be assessed within 3 years after the return was filed . . . and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period."); *see also id.* § 6229(a).

[16] *Intermountain*, 2010 WL 1838297, at *1. The relevant tax code provisions state that, if a taxpayer "omits from gross income an amount properly includible therein," the statute of limitations for assessing the tax is six years after the return was filed. 26 U.S.C. §§ 6229(c)(2), 6501(e)(1)(A).

[17] *Intermountain*, 2010 WL 1838297, at *1.

[18] 98 T.C.M. (CCH) 144.

[19] *Id.* at 145.

v. Commissioner,[20] the court noted that the extended period of limitations applies only "to situations where specific income receipts have been 'left out' in the computation of gross income."[21] The *Bakersfield* holding was based on the Supreme Court's decision in *Colony, Inc. v. Commissioner*,[22] a 1958 case in which the Court offered an identical interpretation of statutory language that mirrored the provisions in 26 U.S.C. §§ 6229(c)(2) and 6501(e)(1)(A).[23]

After the Tax Court handed down its opinion, the IRS issued temporary regulations[24] under 26 U.S.C. §§ 6229(c)(2) and 6501(e)(1)(A).[25] The regulations provided in relevant part that "an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of . . . [sections 6229(c)(2) and 6501(e)(1)(A)]."[26] The regulations thus offered an interpretation of "omi[ssion] from gross income"[27] that ran contrary to the Tax Court's interpretation in *Bakersfield* and to the Supreme Court's interpretation in *Colony*.[28] After issuing its temporary regulations, the IRS filed a motion to vacate the decision in *Intermountain I* and reconsider the case, on the ground that *Intermountain I* was based on a statutory construction that had since been replaced by the agency's own interpretation.[29]

The Tax Court denied the IRS Commissioner's motions to vacate and reconsider.[30] Writing for the court, Judge Wherry[31] first rejected the temporary regulations because they conflicted with the Court's holding in *Bakersfield*, and therefore with law that had been established in 2006, the year the Commissioner issued the Intermountain FPAA.[32] Judge Wherry next turned to the issue of judicial deference.[33] Using *Brand X* as a template, Judge Wherry noted that the pre-*Chevron* Court in *Colony* had used legislative history to interpret the statute at issue.[34] Since "[m]any courts . . . have accepted the use of

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[20] 128 T.C. 207 (2007), *aff'd*, 568 F.3d 767 (9th Cir. 2009).

[21] *Intermountain I*, 98 T.C.M. (CCH) at 145 (quoting *Bakersfield*, 128 T.C. at 213).

[22] 357 U.S. 28 (1958).

[23] *Intermountain*, 2010 WL 1838297, at *2. As a result of this interpretation, the court in *Intermountain I* granted Intermountain's motion for summary judgment and voided the FPAA. *Id.*

[24] Temp. Treas. Reg. § 301.6501(e) (2009).

[25] *Intermountain*, 2010 WL 1838297, at *2.

[26] *Id.* (alterations in original) (quoting Temp. Treas. Reg. § 301.6501(e)) (internal quotation marks omitted).

[27] 26 U.S.C. §§ 6229(c)(2), 6501(e)(1)(A) (2006).

[28] *See Intermountain*, 2010 WL 1838297, at *2.

[29] *Id.* at *3.

[30] *Id.* at *8.

[31] Chief Judge Colvin and Judges Wells, Vasquez, Goeke, Kroupa, and Paris joined the majority opinion.

[32] *Intermountain*, 2010 WL 1838297, at *5.

[33] *Id.* at *6.

[34] *Id.* at *7.

legislative history as an important element in *Chevron* step one,"[35] Judge Wherry construed *Colony* as holding that the statute "unambiguously foreclose[d] the agency's interpretation."[36]

Judge Cohen[37] concurred, writing separately to argue that the Commissioner's motions should have been denied because they were untimely.[38]

Judges Halpern and Holmes concurred in the judgment only.[39] They argued that the temporary regulations were invalid because the Commissioner had failed to provide notice and solicit comment according to Administrative Procedure Act guidelines.[40] However, pointing to a significant circuit split regarding the place of legislative history within the *Chevron* two-step analysis,[41] Judges Halpern and Holmes declined to rule on the question whether the temporary regulations deserved judicial deference, favoring the "firmer" argument that the regulations were procedurally invalid.[42]

Intermountain's repeated reference in its *Brand X* inquiry to the *Colony* Court's use of legislative history was misplaced. The pre-*Chevron* Court in *Colony*, after all, was unaware of where post-*Chevron* jurists would place legislative history within the *Chevron* two-step analysis. At best, then, the court's inquiry in *Intermountain*, referencing *Colony*'s use of legislative history to determine whether *Colony* was a holding at step one or step two, merely highlights what the *Colony* Court would have held had it been operating in a post-*Chevron* world. In place of such an approach, and in order to remain faithful to *Brand X*, the *Intermountain* Court should have considered whether the result in *Colony* required a holding that the statute at issue was unambiguous — at the very least, this type of test would focus on the holding of the prior court, as *Brand X* intended.

Since 1984, administrative law has been complicated by the tension between the doctrine of stare decisis and *Chevron* deference.[43] On the one hand, courts' adherence to prior judicial constructions is rooted in the principle that "[l]egal terms have only a single meaning, and . . . courts 'say' what that meaning 'is.'"[44] On the other hand,

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[35] *Id.*

[36] *Id.* (quoting Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 983 (2005)).

[37] Judge Cohen was joined by Judges Gale, Thornton, and Marvel.

[38] *Id.* at *9 (Cohen, J., concurring).

[39] *Id.* (Halpern and Holmes, JJ., concurring in the judgment).

[40] *Id.* at *17.

[41] *Id.* at *14.

[42] *Id.* at *17.

[43] Kenneth A. Bamberger, *Provisional Precedent: Protecting Flexibility in Administrative Policymaking*, 77 N.Y.U. L. REV. 1272, 1272–75 (2002).

[44] *Id.* at 1272 (quoting Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803)).

Chevron acknowledges that statutory text may be open to multiple interpretations, and that Congress has delegated interpretive authority over ambiguous statutes to administrative agencies.[45]

The Supreme Court attempted to resolve the tension between these two doctrines with its 2005 decision in *Brand X*, establishing that a prior court's statutory interpretation merits deference only if the court left no gap for subsequent agency construction.[46] *Brand X* represented a "much more deferential . . . approach to statutory interpretation,"[47] and therefore a break from the Court's "incorporation approach to precedent" in the face of conflicting agency interpretation.[48] In establishing a more deferential framework, *Brand X* focused its inquiry on the actual holding of the prior court, noting that "[a] court's prior judicial construction . . . trumps an agency construction . . . only if the prior court decision *holds* that its construction follows from the unambiguous terms of the statute."[49]

Although purporting to ground its decision in established doctrine, *Intermountain* made a central error in its *Brand X* analysis by construing *Colony*'s use of legislative history to signal a holding that the statute at issue was unambiguous.[50] Justifying its conclusion, *Intermountain* noted that many circuits have considered legislative history as an interpretive tool at *Chevron* step one.[51] Contemporary understandings of where legislative history belongs in the *Chevron* two-step analysis, however, tell us nothing about the actual holding of *Colony*. At best, *Intermountain*'s inquiry sheds light on what the pre-*Chevron* *Colony* Court would have held had it been operating in a post-*Chevron* world. Such an inquiry may have merit as an academic exercise, but it fails to help discern the actual holding of *Colony* as *Brand X* intended.

Intermountain's approach to *Brand X* is problematic for three reasons. First, *Intermountain* increases the risk that future courts will be too deferential to judicial precedent. *Chevron* — which *Brand X* reaffirmed — stands as a rejection of unrestrained judicial "discretion to reach an authoritative construction" of statutory language.[52] Except in the rare case of an explicit statement foreclosing subsequent agency in-

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45 Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–44 (1984).

46 Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 982 (2005).

47 Richard Murphy, *The* Brand X *Constitution*, 2007 BYU L. REV. 1247, 1257.

48 Bamberger, *supra* note 43, at 1274; *see also id.* at 1273 (explaining the Court's pre–*Brand X* position that a judicial construction became an unalterable part of the statute itself).

49 *Brand X*, 545 U.S. at 982 (emphasis added). Although the rule seems clear enough, the *Brand X* analysis is often complicated by the failure of prior courts, and especially pre-*Chevron* courts, to articulate fully whether they have foreclosed a subsequent agency interpretation. *See* Merrill & Hickman, *supra* note 4, at 915–17.

50 *See Intermountain*, 2010 WL 1838297, at *7.

51 *Id.*

52 Kenneth A. Bamberger, *Normative Canons in the Review of Administrative Policymaking*, 118 YALE L.J. 64, 72 (2008).

terpretation, then, *Brand X* understood prior judicial constructions as merely provisional interpretations.[53] *Intermountain*, however, ignored the direction of *Brand X*, choosing to defer to *Colony*'s statutory interpretation even though, writing regarding the statute at issue, the *Colony* Court admitted that the statutory language was not "unambiguous."[54] *Intermountain*'s justification that *Colony*'s use of legislative history underscored its *Chevron* step one holding is unavailing. The Supreme Court has never spoken clearly on the issue of legislative history's place in the *Chevron* framework[55] — as a result, the courts of appeals remain conflicted on this issue.[56] Such severe doctrinal incoherence[57] makes it impossible to say with any certainty that a pre-*Chevron* Court like *Colony* intended its use of legislative history to support what would now be considered a holding at *Chevron* step one. Given *Brand X*'s preference for agency expertise over judicial precedent, *Intermountain* would have done better to ignore such unreliable evidence regarding the scope of *Colony*'s holding and instead require an explicit statement before declining deference to the IRS.

Second, *Intermountain*'s approach is also problematic because it lends itself to unpredictable results. Professors Thomas Merrill and Kristin Hickman have noted that "the Supreme Court does not have the institutional capacity to engage in wholesale reexamination of each

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[53] Kenneth A. Bamberger & Peter L. Strauss, Chevron*'s Two Steps*, 95 VA. L. REV. 611, 619 (2009); *see also* Brian G. Slocum, *The Importance of Being Ambiguous: Substantive Canons, Stare Decisis, and the Central Role of Ambiguity Determinations in the Administrative State*, 69 MD. L. REV. 791, 799 (2010) ("[R]eviewing courts should treat the *Brand X* understanding of the relationship between courts and agencies as a relaxation of the traditional stare decisis standard.").

[54] Colony, Inc. v. Comm'r, 357 U.S. 28, 33 (1958).

[55] *Compare* Coeur Alaska, Inc. v. Se. Alaska Conservation Council, 129 S. Ct. 2458, 2469 (2009) (implying that legislative history merits no consideration at step one), *with* FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) (considering legislative history at step one).

[56] For example, the First, Second, Fifth, Tenth, and Eleventh Circuits have all considered legislative history at *Chevron* step one. *See, e.g.*, Cohen v. J.P. Morgan Chase & Co., 498 F.3d 111, 122–24 (2d Cir. 2007); Succar v. Ashcroft, 394 F.3d 8, 30–34 (1st Cir. 2005); Cliffs Synfuel Corp. v. Norton, 291 F.3d 1250, 1257 (10th Cir. 2002); Sierra Club v. U.S. Fish & Wildlife Serv., 245 F.3d 434, 442 n.51 (5th Cir. 2001); Guaranty Fin. Servs., Inc. v. Ryan, 928 F.2d 994, 1004–06 (11th Cir. 1991). Conversely, the Third and Eighth Circuits have excluded legislative history from consideration at step one. *See, e.g.*, Mayo Found. for Med. Educ. & Research v. United States, 568 F.3d 675, 681–82 (8th Cir. 2009); United States v. Geiser, 527 F.3d 288, 293 (3d Cir. 2008). And other circuits continue to offer conflicting opinions on the issue. *Compare* Natural Res. Def. Council v. EPA, 526 F.3d 591, 603 (9th Cir. 2008) (placing legislative history in step one), *with* Schneider v. Chertoff, 450 F.3d 944, 955 n.15 (9th Cir. 2006) (explaining that courts cannot consider legislative history at step one).

[57] This incoherence is made even worse by the argument of Professors Matthew Stephenson and Adrian Vermeule that the two-step *Chevron* framework is itself something of a red herring. Matthew C. Stephenson & Adrian Vermeule, Essay, Chevron *Has Only One Step*, 95 VA. L. REV. 597, 599–600 (2009) (arguing that courts ask the same question at steps one and two — whether Congress unambiguously foreclosed the agency interpretation at issue). The question of whether a prior court employed legislative history at step one or two therefore assumes a distinction that may not exist in fact.

of its pre-*Chevron* interpretations . . . and classify them as step one or step two [holdings]."[58] As a result, the task of reexamination would fall to the lower courts. Such a case-by-case inquiry, however, "would magnify the uncertainty of the reexamination process, and would increase the likelihood of conflict among the circuits."[59] The problem of reexamination, of course, would exist under any regime that mandated recategorization of past statutory interpretation.[60] However, *Intermountain*'s method of recategorization is especially problematic given the significant circuit split on the issue of where legislative history belongs in the *Chevron* two-step analysis. In an *Intermountain*-style inquiry, any case-by-case reexamination would likely lead to deep intercircuit disagreement.

Finally, *Intermountain*'s approach will likely generate excessive judicial cost. Indeed, the task of recategorizing past precedent within the *Chevron* framework would likely be too difficult and labor intensive for courts already saddled with significant and growing caseloads.[61] The interplay in *Intermountain* between Judge Wherry on one side and Judges Halpern and Holmes on the other underscores the point — in the wake of *Brand X*, courts looking to *Intermountain* for guidance will likely spend most of their time bickering over whether a tool like legislative history should be considered at *Chevron* step one or step two.

Instead of trying to reclassify *Colony* within the *Chevron* framework, *Intermountain* should have asked whether a finding of statutory clarity was necessary for *Colony* to reach its ultimate result.[62] This "if necessary" approach[63] is rooted in the judicial tendency to distinguish holdings from dicta based on "whether the proposition [in question] was necessary to the outcome of the case."[64] In a *Brand X* analysis, the "if necessary" test therefore substitutes consideration of a prior

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[58] Merrill & Hickman, *supra* note 4, at 919.

[59] *Id.*

[60] *Id.* at 917 (suggesting the adoption of a "blanket presumption that all pre-*Chevron* precedent is step-one precedent" in order to avoid case-by-case reexamination and unpredictable results across disparate circuits).

[61] *See* Note, *Implementing* Brand X*: What Counts as a Step One Holding?*, 119 HARV. L. REV. 1532, 1546 (2006) [hereinafter *Implementing* Brand X].

[62] Such a finding would be necessary if *Colony*, due to an interpretive doctrine like the rule of lenity, "could have reached the result it did only by holding that its interpretation was the only reasonable one." *Id.* at 1540.

[63] *Id.*; *see also* Note, *The New Rule of Lenity*, 119 HARV. L. REV. 2420, 2441 (2006) ("[*Brand X*] stated that 'ambiguity' in the context of *Chevron* is the same as 'ambiguity' in the context of lenity. After *Brand X*, then, a finding that a statute is clear in order to avoid triggering the rule of lenity also means that it is clear for the purposes of *Chevron* . . . ." (footnote omitted)).

[64] *Implementing* Brand X, *supra* note 61, at 1542; *see also* Michael Abramowicz & Maxwell Stearns, *Defining Dicta*, 57 STAN. L. REV. 953, 1056 (2005).

court's actual holding for *Intermountain*'s speculation regarding how a pre-*Chevron* court would have ruled after 1984.

The "if necessary" rule is preferable to the *Intermountain* approach even though courts have yet to establish an absolute consensus on the holding/dicta distinction.[65] Although some judges continue to define holdings by reference to a standard that ignores the question of necessity,[66] the absence of consensus on this issue will not lead to prohibitive decision costs. In the first place, "[e]very circuit has, at one time, defined holdings and dicta with reference to necessity."[67] As a result, judges will be less likely to bicker over the distinguishing characteristics of a holding than over whether resources like legislative history should be considered at *Chevron* step one or step two. Moreover, unlike the *Intermountain* approach, which provides judges with an unpredictable analytic standard,[68] the "if necessary" test functions as a more predictable, and therefore more efficient, decisional rule.

Finally, the "if necessary" test finds significant support in the text of *Brand X*. Explaining that the prior court at issue had not foreclosed a subsequent agency interpretation, *Brand X* noted that the court had "invoked no other rule of construction . . . requiring it to conclude that the statute was unambiguous to reach its judgment."[69] *Brand X*'s emphasis on what the prior court needed to hold for its conclusion underscores the centrality of the "if necessary" test to a *Brand X* analysis.[70]

By ignoring the question of necessity in its *Brand X* inquiry, the *Intermountain* court therefore undermined the intent of *Brand X* itself. Given the importance of the prior court's holding to a *Brand X* analysis, *Intermountain*'s counterfactual *Chevron* inquiry was misplaced — *Brand X* is hard enough to apply without introducing unnecessary guesswork into the analysis.

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[65] *Compare* United States v. Bloom, 149 F.3d 649, 653 (7th Cir. 1998) (interpreting a prior court's analysis as a holding because it was not a "stray remark or aside"), *with* United States v. Enas, 204 F.3d 915, 920 (9th Cir. 2000) (holding that a prior court's analysis was dictum because it was "not necessary to the court's decision").

[66] *See, e.g.*, United States v. Johnson, 256 F.3d 895, 915 (9th Cir. 2001) (Kozinski, J., concurring) (noting that holdings should only be found when the prior court "undeniably decided the issue, not [when] it was unavoidable for [the court to] do so" (citing United States v. Weems, 49 F.3d 528, 532 (9th Cir. 1995))).

[67] *Implementing* Brand X, *supra* note 61, at 1542.

[68] *Intermountain* can be described as advocating a "totality of the opinion," standard-like approach to the *Brand X* inquiry. *Id.* at 1538 (internal quotation marks omitted). This approach allows reviewing courts to consider a wide variety of factors in determining what a pre-*Chevron* court would have held had it applied the *Chevron* doctrine. *See id.* at 1538–39.

[69] Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967, 985 (2005).

[70] *See Implementing* Brand X, *supra* note 61, at 1541.