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James M. Puckett

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REASONABLE TAX RULES: ADVANCING PROCESS VALUES WITH REMEDIAL RESTRAINT

by

*James M. Puckett**

ABSTRACT

The tax administration is at risk of an overcorrection with respect to its rulemaking process. Tax practitioners increasingly are mining the Administrative Procedure Act (APA) as well as chipping away at barriers to pre-enforcement review of tax rules. Tax rules include regulations, revenue rulings, revenue procedures, and more informal guidance to the public. APA-based challenges to tax rules have gained traction in the courts, typically alleging inadequate explanation or timing irregularities involving notice and comment. Such claims potentially pose major challenges for fair and efficient tax administration.

This Article integrates administrative law scholarship calling for a rule of reason with respect to remedies for inadequate explanation and postpromulgation comment. There is no conflict between the push-back against tax exceptionalism and an approach involving remedial restraint. The harmless error approach is rooted in the text of the APA, which requires a court to set aside agency action for "prejudicial"

* Professor of Law, Penn State Law (University Park). I thank Philip Hackney, Daniel Hemel, Jud Mathews, Dara Purvis, and Dan Walters for especially helpful comments or discussion. This work benefited from the Seattle University School of Law Summer Workshop Series and panel discussion at the Law and Society Association Annual Meeting in Toronto, Canada. I thank Nikita Tanwar, Samantha Skabelund, Megan Povenz, and Alex Felt for research assistance.

error. Judicial restraint is unlikely to chill robust participation by tax advisors and should promote the issuance of stable and reliable guidance, compliance with the tax law, and fair treatment of similarly situated taxpayers.

Introduction

The tax administration is at risk of an overcorrection with respect to its rulemaking process. Tax rules include regulations, revenue rulings, revenue procedures, and more informal guidance to the public. Following the Supreme Court's 2011 decision in *Mayo Foundation for Medical Education & Research v. United States*,[1] Administrative Procedure Act-based challenges to tax rules have gained traction in the courts.[2] Meanwhile, the weight of tax scholarship criticizes "tax exceptionalism"[3]—the notion that tax is deeply different from other fields of law or requires special administrative procedures or judicial review. Overcorrection, however, could also represent a kind of exceptionalism. This Article argues that judicial review of the tax administration's compliance with the Administrative Procedure Act[4] (APA) should avoid reflexive vacatur of rules that experienced process defects. Moreover, this argument does not amount to tax exceptionalism; scholarship and jurisprudence outside of tax inspire and support an approach to judicial review involving nuance and restraint.

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1. 562 U.S. 44, 55 (2011).

2. *See, e.g.*, CIC Servs., LLC. v. IRS, 925 F.3d 247 (6th Cir. 2019) (holding Anti-Injunction Act precluded pre-enforcement review), *cert. granted*, 140 S. Ct. 2737 (2020); Altera Corp. v. Comm'r, 926 F.3d 1061 (9th Cir. 2019) (deferring to the regulations and holding that the agency's decisionmaking process was clear enough), *rev'g* 145 T.C. 91 (2015) (unanimously invalidating as arbitrary and capricious regulations requiring parties to a Qualified Cost Sharing Agreement to include stock compensation costs in the cost pool to comply with the arm's length standard); Dominion Res., Inc. v. United States, 681 F.3d 1313 (Fed. Cir. 2012) (invalidating as arbitrary and capricious regulations requiring capitalization of costs related to self-produced property); Chamber of Com. of U.S. v. IRS, No. 1:16-CV-944-LY, 2017 WL 4682050, at *3–4 (W.D. Tex. Oct. 6, 2017) (invalidating temporary regulations for postpromulgation comment). Sometimes substantive review of tax rules has blended with perceived process shortcomings. *See* Good Fortune Shipping SA v. Comm'r, 897 F.3d 256 (D.C. Cir. 2018) (invalidating as unreasonable a regulation that would have reversed a prior rule).

3. *See infra* Part III.

4. Codified at 5 U.S.C. §§ 551–559.

Scholars concerned about exceptionalism rightly urge the tax administration to comply with the APA.[5] This could amount to more of an attitude adjustment than an earthquake. This is especially true if, as this Article suggests, the courts proceed to take a flexible approach to review of tax rules. Over time, such an approach may help distinguish policy preferences of tax practitioners from prejudicial errors of the tax administration. Thus, implementing a more thoughtful, systematic compliance with the APA should not end up wrecking the tax administration.

The tax community, to be sure, is still digesting the Supreme Court's landmark decision in *Mayo Foundation*.[6] The Mayo Foundation challenged a Treasury regulation clarifying whether medical residents

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5. *See, e.g.*, Kristin E. Hickman & Mark Thomson, *Open Minds and Harmless Errors: Judicial Review of Post-Promulgation Notice and Comment*, 101 Cornell L. Rev. 261, 308 (2016); Kristin E. Hickman, *Unpacking the Force of Law*, 66 Vand. L. Rev. 465 (2013); Stephanie Hoffer & Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 Minn. L. Rev. 221, 267–68 (2014); Leandra Lederman, *The Fight Over "Fighting Regs" and Judicial Deference in Tax Litigation*, 92 B.U. L. Rev. 643, 698–99 (2012); Toni Robinson, *Retroactivity: The Case for Better Regulation of Federal Tax Regulators*, 48 Ohio St. L.J. 773, 775 (1987). *But see* Bryan T. Camp, *A History of Tax Regulation Prior to the Administrative Procedure Act*, 63 Duke L.J. 1673, 1682 (2014) (criticizing "top-down" approach that "fail[s] to consider what came *before* the APA"); Stephanie Hunter McMahon, *The Perfect Process Is the Enemy of the Good Tax: Tax's Exceptional Regulatory Process*, 35 Va. Tax Rev. 553, 558 (2016) ("Instead of forcing all agencies to conform to one set of principles, Congress and the courts should figure out which principles work in different contexts to accomplish administrative law's underlying objectives."); Richard Murphy, *Pragmatic Administrative Law and Tax Exceptionalism*, 64 Duke L.J. Online 21, 23–24 (2014) (urging courts to apply the law in a "pragmatic spirit" and "give Treasury the benefit of any doubt" on interpretative rules); James M. Puckett, *Structural Tax Exceptionalism*, 49 Ga. L. Rev. 1067 (2015); Clinton G. Wallace, *Congressional Control of Tax Rulemaking*, 71 Tax L. Rev. 179, 195 (2017) (arguing that "congressional control of tax rulemaking should satisfy administrative law's demand for political accountability").

6. *Mayo Found.*, 562 U.S. at 55 ("Mayo has not advanced any justification for applying a less deferential standard of review. . . . In the absence of such justification, we are not inclined to carve out an approach . . . good for tax law only.").

qualified as students.[7] Given that the Treasury Department took an unremarkable notice and comment procedure before finalizing the regulation, the Supreme Court deferred under *Chevron*.[8] This clarification has not been uncontroversial among the tax bar. Practitioners also have pivoted from the Court's skepticism about "an approach . . . good for tax law only"[9] to bring APA-based challenges to tax regulations.[10]

In this period of borrowing, learning, deconstruction, and growth, the avoidance of exceptionalism should not be talismanic. There is a clear risk of oversimplification as tax lawyers, scholars, and jurists wrestle with APA concepts that have relatively recently started to come into focus.[11] Undoubtedly, the implication will sometimes be that courts subject tax rulemaking to costly procedural requirements under the APA or perhaps disallow administrative action that is apparently permitted by the I.R.C.[12] At the same time, a wide-ranging general administrative law literature and jurisprudence cautions against over-proceduralization of administrative action.[13]

At the risk that it may resemble exceptionalism, this Article posits that the case against hyper-formal compliance with the APA will benefit from tax-specific context. This is not to suggest that the tax

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7. *Id.* at 51.

8. *Id.* at 58. If the *Chevron* framework applies to an agency interpretation, a court should first determine whether Congress has "directly addressed the precise question at issue," and if not, the court "may not disturb an agency rule unless it is "arbitrary or capricious in substance, or manifestly contrary to the statute." *Id.* at 52–53 (quoting Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842 (1984); Household Credit Servs., Inc. v. Pfennig, 541 U.S. 232, 242 (2004)).

9. 562 U.S. at 55.

10. *See* cases cited *supra* note 2. Although beyond the scope of this Article, challenges are also being pursued under other procedural statutes, such as the Paperwork Reduction Act and Regulatory Flexibility Act. *See* Silver v. IRS, No. 1:19-cv-00247, 2019 WL 7168625 (D.D.C. Dec. 24, 2019); Monte Silver, *So You Want to Challenge a Treasury Regulation Issued Under the TCJA?*, 166 Tax Notes Fed. 1137 (Feb. 17, 2020); Andrew Velarde, *Suit Against GILTI Regs Alleges Administrative Law Violations*, 98 Tax Notes Int'l 1433 (Jun. 22, 2020).

11. *Cf.* Camp, *supra* note 5, at 1681–82 (criticizing the "top-down approach" that pays insufficient attention to the organic statute).

12. *See infra* Part II.

13. *See infra* note 22; Part III.A–B.

administration should take a system-wide free pass. Rather, it is important to anticipate the critique that anything but rigid compliance with the APA would be unacceptable or exceptionally harmful in the tax administration. Nothing about this context, however, gives great cause for concern.

Given the text of the I.R.C., the history of tax collection and administration, and the current context,[14] the general argument for judicial restraint maps naturally onto tax administration. Litigation about tax rules will be particularly imbalanced, even compared with a larger administrative state that is easily dominated by regulated groups. Taking this into account does not render the project an example of "exceptionalism" or "tax exceptionalism." The intent is to consider whether there is any cause for concern about a general approach to balancing agency effectiveness, public participation, and other values.[15] Even if there are important patterns in tax administration, courts should carefully consider the unique facts of each case. In general, courts reviewing agency action soften rules, if not openly balance, and are wary of imposing procedures that are not explicitly required. Even so, compliance is costly.[16] Whatever the potential benefits, additional funding for tax administration seems quite unlikely to be on the horizon.[17]

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14. *See infra* Part III.C.

15. *Cf.* Alice G. Abreu & Richard K. Greenstein, *Tax: Different, Not Exceptional*, 71 Admin. L. Rev. 663, 705–10, 716 (2019) (critiquing the use of "tax exceptionalism").

16. *See* Kathryn E. Kovacs, *Rules About Rulemaking and the Rise of the Unitary Executive*, 70 Admin. L. Rev. 515, 548 (2018) ("rule-making is time and resource intensive, sufficiently so that it dissuades agencies from undertaking the effort and presidents from relying on it"); Aaron L. Nielson, *Sticky Regulations*, 85 U. Chi. L. Rev. 85, 89 (2018) ("nearly everyone agrees that the procedures that give rise to ossification make it harder for agencies to regulate"); Lynn E. Blais & Wendy E. Wagner, *Emerging Science, Adaptive Regulation, and the Problem of Rulemaking Ruts*, 86 Tex. L. Rev. 1701, 1709 (2008) ("agencies are regulating too little and too slowly").

17. *See* IRS Advisory Council, Public Report 9 (2018) ("Far from 'consistently, adequately and appropriately' funding the IRS to fulfill its core service, compliance and enforcement missions, Congress has slashed the IRS budget every year since 2011."); William Hoffman, *Tax Pros Predict Filing Season Woes if IRS Budget Crunch Lasts*, 157 Tax Notes Today 1709, 1709 (Dec. 18, 2017) (noting that IRS budget "has shrunk from $12.1 billion in fiscal 2012 to $11.2 billion in 2016" amid increased responsibilities); Joshua P.

Professor Kristin Hickman and Mark Thomson have argued for opening the door—but seemingly just a crack—to a harmless error analysis in judicial review of postpromulgation comment.[18] Although this may be a step in the right direction, their proposal has a limited scope. Arbitrary and capricious review may prove more of a threat to tax rules than the timing of public comment. Moreover, Hickman and Thomson would put a heavy burden on agencies to show harmless error.[19] The showing they have envisioned would emphasize open-mindedness on the part of agencies.[20] This would be especially troublesome in the tax administration. Because standing to litigate tax matters is especially hard to demonstrate, the open mind would, even more than usual, tend to move in favor of special interests. If this approach leads to more litigation and provides false hope, it could be worse than a strict compliance approach.

This Article, in contrast, recommends a more flexible approach, drawing on many administrative law scholars who have questioned the benefits of rigid adherence to the APA. Even for seemingly bright-line rules, context matters, or should matter.[21] It is appropriate to question the benefits and costs of procedures or remedies—particularly when not explicitly required by statute.[22] In addition, judges have, at least

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Law, Note, *Balancing Efficient IRS Administration and Taxpayer Rights*, 43 Seton Hall Legis. J. 337, 338 (2019) (noting that computer software and hardware are out of date).

18. *See* Hickman & Thomson, *supra* note 5, at 306, 310–16 (suggesting that a "strong" burden should be on the agency to rebut with a "particularized defense subject to judicial scrutiny" and arguing that an agency's lack of "responsiveness" or swiftness in rejecting postpromulgation comments should be key factors against saving a challenged rule).

19. *Id.* at 312.

20. *Id.* at 294. *But see* Little Sisters of the Poor Saints Peter & Paul Home v. Pennsylvania, 140 S. Ct. 2367, 2385 (2020) (rejecting an inquiry into agency open-mindedness following an interim rule).

21. *Cf.* Joseph William Singer, *The Rule of Reason in Property Law*, 46 U.C. Davis L. Rev. 1369, 1420–21, 1433 (2013) (observing that bright-line rules "are not as different from flexible standards as we might think" due to latent ambiguities of scope, with "no rule for determining whether a case is easy or hard").

22. *See, e.g.*, Nicholas Bagley, *The Procedure Fetish*, 118 Mich. L. Rev. 345 (2019) (arguing that strict APA compliance is unnecessary to achieve the ends desired by APA proponents) [hereinafter Bagley, *Procedure Fetish*];

implicitly, struck a balance. To avoid tax exceptionalism, these themes must be considered carefully.

Executive orders, other forms of presidential control, or internal discretion may result in additional limits on the Treasury Department and IRS.[23] For example, on March 5, 2019, the Treasury Department announced a general, nonbinding policy of endeavoring to use notice and comment rulemaking to issue *regulations*, even if the APA does not require it; of avoiding the issuance of *temporary regulations* without good cause; and of forgoing claims of deference for *subregulatory guidance*.[24] Not long afterwards, the IRS Office of Chief Counsel issued a notice suggesting that it could still argue for a lesser form of deference for subregulatory guidance.[25] In addition, an October 9, 2019, executive order requires notice and comment for the issuance of a "significant

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Nicholas Bagley, *Remedial Restraint in Administrative Law*, 117 Colum. L. Rev. 253 (2017) [hereinafter Bagley, *Remedial Restraint*]; Murphy, *supra* note 5, at 23 (suggesting a "pragmatic and conservative" attitude about the "notice-and-comment gap"); Sidney A. Shapiro & Richard W. Murphy, *Arbitrariness Review Made Reasonable: Structural and Conceptual Reform of the "Hard Look*," 92 Notre Dame L. Rev. 331 (2016) (urging courts to be flexible about accepting certain post hoc justifications for rules); *cf.* Gillian E. Metzger, *Forward: 1930s Redux: The Administrative State Under Siege*, 131 Harv. L. Rev. 1, 6 (2017) (observing that "[l]ike today, the 1930s attack on 'agency government' took on a strongly constitutional and legal cast" and that such "efforts were plainly political, fueled by business and legal interests deeply opposed to pro-labor regulation and economic planning"); Cass R. Sunstein & Adrian Vermeule, *The Unbearable Rightness of* Auer, 84 U. Chi. L. Rev. 297, 300 (2017) (criticizing what the authors dub "the sign fallacy," i.e., the propensity of some commentators to "identify the likely *sign* of an effect and then to declare victory, without examining its *magnitude*—without asking whether it is realistic to think that the effect will be significant").

23. *See* Memorandum of Agreement, U.S. Treas. Dep't & Off. of Mgmt. & Budget, Review of Tax Regulations Under Executive Order 12866 (Apr. 11, 2018).

24. *See* U.S. Treas. Dep't, Policy Statement on the Tax Regulatory Process (Mar. 5, 2019).

25. *See* IRS Chief Couns. Notice CC-2019-006 (Sept. 17, 2019); Sean M. Akins, *Clutching to Fiat: The IRS's Continued Pursuit of Judicial Deference*, 164 Tax Notes Fed. 2255 (Sept. 30, 2019).

guidance document"; this may or may not be intended to supersede the apparent allowance of subregulatory guidance in the Policy Statement.[26]

Importantly, these general policies are not particularly sticky. Either of these policies could be waived or applied creatively by the Treasury or the President, respectively. Indeed, shortly afterwards, the Treasury Department issued temporary regulations claiming good cause for an APA exception from the usual notice and comment procedures.[27] Moreover, executive orders or policy statements can be reversed without any public participation.[28]

This Article proceeds in four parts. Part I notes that taxpayers call for rules on which they may rely, while the government also needs to craft more limiting rules to constrain tax avoidance. Safe harbors would be welcome by the public and difficult to challenge, whereas limiting rules are increasingly subject to challenge. Part II surveys challenges to rules under the APA, including some nuances in the tax administration. In Part III, the Article integrates the administrative law literature on remedial restraint. In short, courts and scholars should not neglect the rule of prejudicial error. Part IV seeks to limit and clarify the tax administration's friction with the APA. It argues that there is ample play in the joints under existing law for tax rules and regulations to qualify for the APA exception for interpretative rules. It explains how the retroactivity provisions of the I.R.C. may also be able to limit the impact of errors.[29] The Article concludes that a robust application of harmless error to the tax administration may save many rules. It cautions that robust and diverse public participation cannot be ensured by even a strict compliance approach and calls for additional attention to this problem.

I. Tax Rules Provide (Un)Welcome "Guidance"

Before proceeding to the problem of procedural challenges to tax rules, this section provides a brief background on two of the most critical functions of tax rules. Although there are undoubtedly more, two of the

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26. Exec. Order No. 13,891, Promoting the Rule of Law Through Improved Agency Guidance Documents, 84 Fed. Reg. 55,235 (Oct. 15, 2019).

27. *See* T.D. 9865, 84 Fed. Reg. 28,398, 28,405 (June 18, 2019).

28. *Cf.* Andrew Velarde, *Drafts of Hybrid Regs Show OIRA Took Light Touch Except with RFA*, 167 Tax Notes Fed. 1438 (May 25, 2020).

29. *See* 5 U.S.C. § 706.

most important goals of tax rules are to facilitate compliance and to prevent abuse. Although facilitative rules sought by taxpayers are a matter of no small concern, these rules are highly unlikely to be challenged. More limiting rules,[30] in contrast, have come under scrutiny in the courts. Procedural challenges have especially focused on the adequacy of explanation during the notice and comment process (or the timing or lack of comment). This unusual enforcement reality merits attention.

It goes without saying that the tax law is ever complex and complicated. One need only look to the Tax Cut and Jobs Act of 2017[31] to see the diverse demands placed on the tax administration.[32] All citizens and residents, and those with business or investment in the United States, must comply with U.S. tax law. In this arrangement, much of the tax law's obligation to pay is enforceable via litigation. The tax law could, in other words, often be executed even without the promulgation of rules by the Treasury Department.[33] Even so, the Treasury Department has sometimes gone above and beyond the legal requirements for public participation. One might expect that the point is to crack down on or deter abuse, but the reality is that tax rules are often responsive to taxpayer requests and facilitate their goals.[34]

Tax is not a domain in which agency inaction means that the dominant interest groups will be satisfied. As the 2017 Tax Act vividly demonstrates, Congress may enact complicated tax provisions that taxpayers would struggle to apply without guidance. Taxpayers and their

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30. *See* Stephanie Hunter McMahon, *Classifying Tax Guidance According to End Users*, 73 Tax Law. 245, 285 (2020) (dividing substantive guidance into "facilitative" and "limiting" guidance, though acknowledging that the distinction can be "thin" or "artificial").

31. Pub. L. No. 115-97, 131 Stat. 2054 (2017).

32. *See generally* Marie Sapirie, *Themes in the TCJA Guidance*, 162 Tax Notes 480 (Feb. 4, 2019) (noting the complexity, necessitating hundreds of pages of proposed regulations, and a need to prevent abuse).

33. *See* Wallace, *supra* note 5, at 207 (observing that "even when Treasury uses its general authority to issue regulations for the broadest provisions of the Code, Treasury's discretion may be constrained relative to the discretion Congress typically has granted in other areas of law" and that even the discretion to make adjustments to achieve clear reflection of income, "granted in § 482 is still a far cry from an environmental or public health delegation that empowers an agency to use its 'judgment' or to act 'reasonably'").

34. *See* McMahon, *supra* note 5, at 556.

professional representatives routinely call for administrative action in the form of guidance from the IRS.[35]

Interest groups that dominate the tax rulemaking processes tend to seek guidance that permits simplification or tax reduction.[36] These calls for guidance may, in some instances, evidence a subtle form of exceptionalism on the part of the tax bar. Tellingly, the IRS's actual guidance sometimes generates an outcry because it cannot be relied upon to avoid penalties.[37] Reliance, however, is not in alignment with the consensus on "guidance" in administrative law. The creation of strong reliance interests ought to be subject to meaningful public participation. But in tax, binding safe harbors granted to interest groups are not subject to any meaningful check by the public.[38]

Stepping back from tax, an agency that rushes to bind itself can face litigation from opposing interest groups. Although standing norms have been changing, environmental groups or competitors who had complied with existing rules might have some prospect of demonstrating

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35. *See* Michael L. Schler, Letter to the Editor, *Tax Regulations and the Rule of Law*, 162 Tax Notes 531 (Feb. 4, 2019); Eric Yauch, *ABA Calls for Definitional Clarity in Passthrough Regs*, 159 Tax Notes 1996 (June 25, 2018).

36. *See* Schler, *supra* note 35, at 531 (noting that pro-taxpayer regulations under the TCJA are "not difficult to find" and providing examples).

37. *See* Complaint for Injunctive and Declaratory Relief, McGruder v. Mnuchin, No. 2:20-cv-03590-CFK (E.D. Pa. July 22, 2020) (raising arbitrary and capricious challenges, among other theories); William Hoffman, *Stimulus Payment Delays Spurring Challenges to IRS Guidance*, 168 Tax Notes Fed. 789 (Aug. 3, 2020); William Hoffman, *IRS Relying More on Unreliable Guidance to Keep Up with Workload*, 168 Tax Notes Fed. 585 (July 27, 2020) (noting downside that FAQs are not subject to notice and comment nor suitable for reliance to avoid tax penalties).

38. *See* Stephanie Hunter McMahon, *Pre-Enforcement Litigation Needed for Taxing Procedures*, 92 Wash. L. Rev. 1317, 1374–77 (2017) (expressing concerns about tax favoritism and providing examples); Schler, *supra* note 35, at 532 ("As a result, by issuing pro-taxpayer regulations that go beyond the language of the code, the executive branch is spending taxpayer funds with little or no control by any other branch of government."); Jesse Drucker & Jim Tankersley, *How Big Companies Won New Tax Breaks from the Trump Administration*, N.Y. Times (Dec. 30, 2019), https://www.nytimes.com/2019/12/30/business/trump-tax-cuts-beat-gilti.html [https://perma.cc/T7KE-6VZL].

standing to challenge environmental deregulation.[39] Public interest groups, however, almost certainly would lack standing[40] to challenge a tax safe harbor.[41] "Hard look" review is no check if it is toothless due to standing. Notwithstanding this loophole, if tax safe harbors are produced through a notice and comment process, presumably the same process will be required for any revocation. Although standing limitations are not unique to tax, this phenomenon should be of concern for the viability of public participation legitimating rulemaking.

Tax and non-tax administration obviously are not just about providing guidance in a facilitative spirit. The government also needs to be able to compel compliance to ensure fairness and prevent abuse. Although interest groups are entitled to participate in some rulemaking processes, their views should not have the same weight as the agency charged with administering the tax law. This should be axiomatic, at one level, because that is the delegation that Congress has made. But some would counter that the government's will to win makes any deference to the Treasury illegitimate. That narrative seems overwrought given the propensity of the tax administration to provide

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39. *See, e.g.*, United States v. Students Challenging Regul. Agency Procs. (SCRAP), 412 U.S. 669 (1973); Sierra Club v. Morton, 405 U.S. 727 (1972); Christopher Gallu, Jr., *Who Says You Have to Play by the Same Rules: The Competitor Standing Doctrine After* Lujan, 64 Geo. Wash. L. Rev. 1205, 1213–14 (1996); McMahon, *supra* note 38, at 1375–78. In other contexts, when they have access to relevant information, third parties can functionally regulate or facilitate the achievement of regulatory goals. *See generally* Rory Van Loo, *The New Gatekeepers: Private Firms as Public Enforcers*, 106 Va. L. Rev. 467, 470–71 (2020) (listing examples of third-party enforcement). Outside of compliance with withholding obligations, this also does not seem like a promising avenue for balancing participation in tax rulemaking projects.

40. *See* Boris Bittker & Lawrence Lokken, Federal Taxation of Income, Estates and Gifts ¶ 118.9.4 (2020) (explaining why taxpayers rarely meet the constitutional requirement of standing to litigate). Recent litigation involving the donor disclosure rules for tax-exempt organizations raises issues of informational standing for states and does not open the door for taxpayers to sue on the basis of underenforcement of the tax law. *Cf.* Bullock v. IRS, 401 F.Supp. 3d 1144 (D. Mont. 2019).

41. *But see* McMahon, *supra* note 38, at 1398–1402 (arguing for creative application of injury in fact and possible waiver of defenses by the government).

taxpayer-friendly regulations, safe harbors, and private letter rulings.[42] It is also nothing new to assume that the Treasury has broad authority to fill in the details and that its interpretations are entitled to respect.[43]

Dovetailing from this less cooperative function, two sweeping criticisms of administrative power may be anticipated. First, tax practitioners and the public often think that there is something fundamentally unfair about the Treasury Department issuing regulations that are then applied to tax returns under examination, particularly if courts are likely to defer under *Chevron* or related doctrines.[44] This ship sailed some time ago.[45] Tax may actually be less suspect in this regard, with factual

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42. *See* Leigh Osofsky, *The Case for Categorical Nonenforcement*, 69 Tax L. Rev. 73, 85 (2015); Lawrence Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 Duke L.J. 829, 834 (2012).

43. *See* Camp, *supra* note 5, at 1702 (noting that in early tax jurisprudence, "all regulations properly enacted should receive heightened deference" and that arguably "there was neither a distinction between legislative and interpretative regulations, nor a distinction between specific and general regulatory authority").

44. As Professor Steve Johnson has documented, the initial reception from the tax bar was hostility and trepidation to *Chevron* deference to tax regulations:

> The reaction to *Mayo* from the community of taxpayers and their representatives has been decidedly negative. The most important aspect of this reaction has been the fear that *Mayo* radically tilts the "playing field" in favor of the Service, making it difficult, if not impossible, for taxpayers to effectively challenge Treasury regulations in many cases.

Steve R. Johnson, *Preserving Fairness in Tax Administration in the* Mayo *Era*, 32 Va. Tax Rev. 269, 272 (2012). To the extent that the Treasury is engaging in specification under a delegation rather than interpretation, the frame is even more off base. *See* Ilan Wurman, *The Specification Power*, 168 U. Pa. L. Rev. 689, 693 (2020) (urging against conflating "interpretation" and "specification" and supporting the specification power); *see also* Nicholas R. Bednar & Kristin E. Hickman, Chevron*'s Inevitability*, 85 Geo. Wash. L. Rev. 1392, 1461 (2017) (concluding that "casting *Chevron* as administrative law's bogeyman has always been a bit overwrought" and that its "basic premises represent a reasonable judicial response to the government we actually have").

45. *See* John O. McGinnis, *Presidential Review as Constitutional Restoration*, 51 Duke L.J. 901, 916 (2001) (critiquing such expansion of agency discretion as circumventing bicameralism and presentment).

determinations in an audit subject to de novo review in court.[46] Even sound legal conclusions are at some risk of jury nullification in refund court.

Second, although the tax authority needs to have power to combat abuse effectively, history suggests that presidents have pressured the IRS to pursue political opponents.[47] Whether or not the pressure was effective, there has certainly been a problem of appearance.[48] In general, however, one would expect that rulemaking checks, rather than enables, agency discretion.[49] Promoting rules rather than ad hoc enforcement would seem to be protective in this context. Moreover, nothing about public participation in an informal rulemaking seems particularly helpful toward limiting political pressure, or the potential appearance of political pressure. Nor would the impact of politics seem uniquely limited to tax administration.

Ultimately, tax rules should enhance the fairness of the system. Our tax system depends, to an important extent, on voluntary compliance of taxpayers.[50] Consequently, taxpayer morale is critical to the function of the system. And taxpayer morale suffers if the public perceives that different rules apply to similarly situated taxpayers. To the extent tax rules stand on shaky footing, they lose the ability to ensure compliance and deter abuse. In addition, the unreviewable creation of reliance interests in non-enforcement represents a substantial concern for the integrity of the system. Both of these de facto tax cuts will go to those who are willing to risk litigation and will be

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46. *See* Hoffer & Walker, *supra* note 5, at 267–68.

47. *See* John A. Andrew, III, Power to Destroy: The Political Uses of the IRS from Kennedy to Nixon 4–5 (2002); Joseph J. Thorndike, *IRS Stalking of Political Groups Under Kennedy and Nixon*, 139 Tax Notes 844 (May 20, 2013).

48. *See* Thorndike, *supra* note 47.

49. *Cf.* Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 Admin. L. Rev. 717, 751–52 (2001) (explaining that in the Civil War era, "[k]nowledge of secret precedents had made Bureau employees extremely valuable to corporate taxpayers, fostering a damaging rate of turnover" so "[o]nly the regular publication of BIR decisions could halt this outflow and ensure equal treatment for all taxpayers").

50. *See infra* Part III.C.3 (explaining why self-assessment and voluntary compliance are particularly important for effective tax administration).

especially concentrated in the hands of wealthy taxpayers.[51] This Article next examines the likely procedural challenges to tax rules under the APA.

II. Challenges to Agency Rules

This Part outlines how agency rules are challenged and identifies important nuances of tax administration. In 1946, the APA created a template for all federal agencies to follow.[52] The APA had four overarching purposes: to allow the public to be informed of agency organization, procedures, and rules; to allow for public participation in rulemaking; to impose standard procedures for on the record hearings and (less commonly) formal rulemaking; and to codify judicial review of agency action.[53]

The issues for tax administration defy easy characterization; a sketch of the most important and likely challenges follows. First, may the IRS and Treasury Department invite public comment *after* issuing regulations (or, for that matter, subregulatory authority)?[54] Next, and perhaps most important: how does "hard look" review under the arbitrary and capricious standard of the APA square with a system that may well allow courts to keep looking many years after a rule has been promulgated?[55] Although it may relate to substance and process,

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51. *See* Linda Sugin, *Invisible Taxpayers*, 69 Tax L. Rev. 617, 652, 665 (2016) (concluding that "the political process is unlikely to resolve the problems faced by invisible taxpayers" and that they lack standing to assert their interests).

52. *See generally* George B. Shepherd, *Fierce Compromise: The Administrative Procedure Act Emerges from New Deal Politics*, 90 Nw. U. L. Rev. 1557 (1996) (examining the political history of the APA).

53. Tom C. Clark, U.S. Dep't of Just., Attorney General's Manual on the Administrative Procedure Act 9 (1947) [hereinafter Attorney General's Manual].

54. *See, e.g.*, Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1740–59 (2007); Hickman & Thomson, *supra* note 5, at 266–67 (noting the scope of the problem extends beyond the tax administration).

55. John Kendrick, Note, *(Un)Limiting Administrative Review:* Wind River*, Section 2401(a), and the Right to Challenge Federal Agencies*,

questions have arisen concerning the retroactivity provisions in the I.R.C.[56] Finally, when a procedural error occurs, what is the appropriate remedy?[57]

As explained in Part I, much of the litigation to date has centered on binding tax rules. Nonbinding tax guidance as well as authoritative safe harbors have not led to as much controversy. Perhaps these pronouncements could not be challenged, given the difficulty of establishing general taxpayer standing.[58] The analysis is further complicated by the Anti-Injunction Act, which has been construed to prohibit taxpayers from challenging tax rules without first engaging in a transaction and risking tax liability.[59] Finally, if the I.R.C. can be taken at face value, tax administration may be guided by some non-standard principles. But scholars contest the extent to which the APA changes the traditional understanding of the I.R.C.[60]

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103 Va. L. Rev. 157, 178 (2017) ("No other source seriously engages with the *Wind River* doctrine.").

56. *See* Lederman, *supra* note 5; Andrew Pruitt, *Judicial Deference to Retroactive Interpretative Treasury Regulations*, 79 Geo. Wash. L. Rev. 1558 (2011); James M. Puckett, *Embracing the Queen of Hearts: Deference to Retroactive Tax Rules*, 40 Fla. St. U. L. Rev. 349 (2013).

57. *See* Hickman & Thomson, *supra* note 5, at 286–302 (identifying five analytical approaches to postpromulgation comment, which may militate toward vacatur, remand without vacatur, or no remedy at all); Hoffer & Walker, *supra* note 5, at 284, 289–93 (explaining the potential benefits of remands for agency decisionmaking and the path an iterative dialog between agencies and courts might follow).

58. *See* Bittker & Lokken, *supra* note 40, ¶ 118.9.4 (explaining why taxpayers rarely meet the constitutional requirement of standing to challenge tax rules that have not been enforced against such taxpayer).

59. I.R.C. § 7421(a); Hickman, *supra* note 5, at 530 (indicating that pre-enforcement review of tax rules is "a rarity"); Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683, 1688–90 (2017) (questioning a broad interpretation, which could "shield many Treasury regulations and IRS guidance documents from judicial review altogether").

60. *See* sources cited *supra* note 5 (noting the recent scholarly dialogue about tax exceptionalism); *see also infra* Part IV.B (arguing that the I.R.C.'s retroactivity provisions are consistent with the APA).

A. Impermissibility Under the Organic Statute

The APA prescribes a trial-like system for hearings "on the record" at an agency.[61] To ensure impartiality, there is a separation of functions between prosecutorial staff and administrative law judges.[62] There is also a prohibition on ex parte contact, consistent with the assumption of a decision based on the record.[63]

A reviewing court, in general, defers to the results of formal adjudication, generally under the substantial evidence test for questions of fact.[64] The agency typically receives deference under *Chevron* for rules and interpretations that are announced in formal adjudications or notice and comment rulemaking.[65] If the *Chevron* framework applies to an agency interpretation, a court should first determine whether Congress has directly addressed the precise question at issue, and if not, the court may not disturb an agency rule unless it is "arbitrary or capricious in substance, or manifestly contrary to the statute."[66]

Taxpayers, however, are not required to resolve a tax deficiency or refund claim at the IRS.[67] Whether the forum is the Tax Court, district court, or Court of Federal Claims, the facts are determined de novo.[68] Consequently, Congress has afforded the Treasury Department and IRS less capacity to make binding policy through adjudication. That

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61. 5 U.S.C. § 554.

62. *Id.* § 554(d).

63. *Id.*

64. *Id.* § 706(2)(E).

65. United States v. Mead Corp., 533 U.S. 218, 219, 231 (2001) ("Thus, the overwhelming number of cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication.").

66. *Id.* at 227.

67. *See* I.R.C. §§ 6015(e), 6212(a), (c), 6213(a); Michael Saltzman & Leslie Book, IRS Practice and Procedure ¶ 1.03[4] (2020).

68. *See* Saltzman & Book, *supra* note 67, ¶ 1.07. This analysis applies to deficiency determinations and refund claims. Certain narrowly confined matters, however, arguably should not be reviewed de novo. Specifically, Hoffer and Walker argue that discretion whether to grant equitable relief for innocent spouses, as well as determinations regarding collection due process, is reserved for the IRS. *See* Hoffer & Walker, *supra* note 5.

is because its tax return review is informal adjudication, not a hearing "on the record," and thus unlikely to qualify for *Chevron* deference.[69]

B. Timing of APA-Based Challenges to Rules

Federal court doctrines of standing and ripeness prescribe when challenges to agency action may be brought. Regulated groups often challenge a new administrative rule as soon as it is published.[70] Although such litigation is costly and can be disruptive, pre-enforcement review means the agency and the public can relatively quickly know whether the rule is invalid. Following the approach set forth in *Wind River*,[71] most of the U.S. Courts of Appeal have held that the statute of limitations provides the agency with repose from procedural challenges after six years, so that there is a limited potential for surprise long after the rule has been issued.[72]

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69. *See Mead Corp.*, 533 U.S at 218.

70. *See* Hickman, *supra* note 5, at 520. Professor Hickman summarizes the typical timing of APA claims:

> Another key feature of the APA is its designation of the courts as a meaningful check against agency exercises of rulemaking power. Since the Court's decision in *Abbott Laboratories v. Gardner* in 1967, courts have interpreted the APA as establishing a presumption in favor of pre-enforcement judicial review of agency rulemaking efforts. Thus, regulated parties ordinarily may challenge the validity of legally binding agency rules in court as soon as the agency finalizes them, before the rules become too entrenched. In other words, regulated parties are not left with a choice between incurring the costs to organize their primary behavior to conform with arguably invalid rules or suffering the uncertainty and potential penalties of noncompliance.

Id. at 520–21 (footnotes omitted).

71. Wind River Mining Corp. v. United States, 946 F.2d 710 (9th Cir. 1991); *see also* Hyatt v. U.S. Pat. & Trademark Off., 904 F.3d 1361 (Fed. Cir. 2018).

72. *See* Kendrick, *supra* note 55, at 175.

APA-based challenges to tax rules typically involve the notice and comment procedure or the arbitrary and capricious standard. There may be some overlap between arbitrary and capricious challenges and substantive arguments based on the organic statute, though the distinction can be material:

> *State Farm* is used to evaluate whether a rule is procedurally defective as a result of flaws in the agency's decision-making process. *Chevron*, by contrast, is generally used to evaluate whether the conclusion reached as a result of that process—an agency's interpretation of a statutory provision it administers—is reasonable. A litigant challenging a rule may challenge it under *State Farm*, *Chevron*, or both.[73]

In case of substantive invalidity, the agency cannot subsequently adopt the interpretation. In contrast, in case of procedural invalidity, an agency could on remand adopt the same interpretation with an appropriate process.

Then-Judge Kavanaugh distinguished a "lack-of-reasoned-explanation claim" as "a more modest claim that the agency has failed to adequately address all of the relevant factors or to adequately explain its exercise of discretion in light of the information before it."[74] However, as the taxpayer's Tax Court victory in *Altera* exemplifies, a reasonable interpretation could be overturned for inadequate explanation.

Taxpayers rarely may bring stand-alone procedural challenges to tax rules.[75] That is because courts have construed the Anti-Injunction Act to bar facial challenges to tax rules; taxpayers must wait until a

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73. Catskill Mountains Chapter of Trout Unltd., Inc. v. EPA, 846 F.3d 492, 521 (2d Cir. 2017) (citations omitted).

74. Multicultural Media, Telecom & Internet Council v. FCC, 873 F.3d 932, 936 (D.C. Cir. 2017).

75. For more exhaustive treatments of this issue, see Leslie Book & Marilyn Ames, *The Morass of the Anti-Injunction Act: A Review of the Cases and Major Issues*, 73 Tax Law. 773 (2020); Hickman & Kerska, *supra* note 59, at 1764 (arguing that courts should "rediscover lost limitations on the AIA's reach"); Lynn D. Lu, *Standing in the Shadow of Tax Exceptionalism: Expanding Access to Judicial Review of Federal Agency Rules*, 66 Admin. L. Rev. 73 (2014) (criticizing imbalance and insulation of tax-exempt status determinations from review); McMahon, *supra* note 38, at 1362–74.

deficiency is asserted or a refund claimed.[76] Moreover, even without this hurdle, the constitutional requirement of standing is notoriously difficult to satisfy by taxpayers against whom a rule has not already been applied by the IRS to that taxpayer's detriment.[77]Associations[78] and states[79] have, to be sure, attempted to chip away at the edges of the standing roadblock. The Supreme Court may soon shed new light on the scope of the Anti-Injunction Act.[80]

As the Ninth Circuit explained in *Altera*, APA challenges are arising in tax cases following an unusual time sequence:

> Generally, strict APA-based challenges arise in the pre-enforcement context, which is less disruptive to the agency and which allows plaintiffs to avoid the six-year statute of limitations applicable to APA-based challenges. *See* 28 U.S.C. § 2401. By contrast, post-enforcement challenges, often brought after the six-year statute of limitations, are rarely brought under the APA, even if the APA proves relevant. Rather, courts are generally called on to address the degree of deference to which the agency is entitled. In these typical post-enforcement challenges, the ultimate question is not whether the agency action was procedurally defective

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76. *See* Hickman & Kerska, *supra* note 59, at 1692–93 (criticizing the Supreme Court's jurisprudence). *But see* Silver v. IRS, No. 1:19-cv-00247, 2019 WL 7168625, at *3 (D.D.C. Dec. 24, 2019) (asking whether the suit is "fundamentally a 'tax collection claim'"); Cohen v. United States, 650 F.3d 717, 736 (D.C. Cir. 2011) (allowing APA claim without a refund claim because there was "no other adequate remedy at law"); Ryan Finley, *Suit Challenging Transition Tax Regs Can Proceed to Merits*, 166 Tax Notes Fed. 155 (Jan. 6, 2020).

77. *See* Bittker & Lokken, *supra* note 40, ¶ 118.9.4.

78. *See* Chamber of Com. of U.S. v. IRS, No. 1:16-CV-944-LY, 2017 WL 4682050, at *3–4 (W.D. Tex. Oct. 6, 2017).

79. *See* Bullock v. IRS, 401 F.Supp. 3d 1144 (D. Mont. 2019).

80. *See* CIC Servs., LLC. v. IRS, 925 F.3d 247 (6th Cir. 2019) (holding AIA precluded pre-enforcement review), *cert. granted*, 140 S. Ct. 2737 (2020); Fla. Bankers Ass'n, 799 F.3d 1065, 1068 (D.C. Cir. 2015) (rejecting a pre-enforcement challenge to interest income reporting requirements); *see also* McMahon, *supra* note 38, at 1363–69.

> but rather whether it was a permissible exercise of executive authority.[81]

In *Altera*, the government was invited to argue that the statute of limitations barred the procedural challenge. Perhaps surprisingly, the government took the position that the six-year statute of limitations on APA-based challenges did not apply.[82]

Despite the Commissioner's position, the six-year statute of limitations may be jurisdictional.[83] Because it is not a plaintiff-centered rule, the *Wind River* doctrine often operates unfairly.[84] On the other hand, the necessity of risking tax liability to challenge a rule likely chills procedural challenges to tax rules.[85] But the timing of the challenge means there is no repose for the government; this could also lead to disruption and inequity. If the statute of limitations is tolled or nonjurisdictional, these considerations could potentially impact a court's analysis at the remedy stage, if it finds inadequate explanation for a tax rule.[86]

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81. Altera Corp. v. Comm'r, Nos. 16-70496, 16-70497, 2018 WL 3542989, at *10 n.6 (9th Cir. July 24, 2018), *withdrawn by* 898 F.3d 1266 (9th Cir. 2018) (withdrawn to allow for reconstituted panel).

82. *See* Letter-Brief in Response to the Court's Order Dated September 28, 2018, at 4, Altera Corp. v. Comm'r, Nos. 16-70496, 16-70497 (9th Cir. Oct. 9, 2018), 2018 WL 4929717, at *4 ("In sum, it is the Commissioner's position that the six-year statute of limitations that is generally applicable to procedural challenges to regulations under the APA, *see* 28 U.S.C. § 2401(a), does not apply to this case.").

83. *See* Ctr. for Biological Diversity v. Hamilton, 453 F.3d 1331, 1334 (11th Cir. 2006) (holding that the six-year statute of limitations is jurisdictional); Konecny v. United States, 388 F.2d 59, 61–62 (8th Cir. 1967) (jurisdictional); *cf.* Mendoza v. Perez, 754 F.3d 1002, 1018 (D.C. Cir. 2014) (dictum suggesting that the six-year statute of limitations would be jurisdictional).

84. *Cf.* Kendrick, *supra* note 55, at 191–92 (observing that the doctrine is not plaintiff-centered and "bars claims of plaintiffs who do not yet exist and claims of existing plaintiffs who are not yet 'adversely affected or aggrieved' by the agency's action" (quoting 5 U.S.C. § 702)).

85. *See* Hickman, *supra* note 5, at 530; Hickman, *supra* note 54, at 1804–05 (taxpayers unwilling to risk enforcement action rather than comply with rules that may be procedurally defective).

86. *See infra* Part IV.C.1.

C. "Hard Look" Review

The APA requires agency action of any modality to flow from a reasoned decisionmaking process.[87] At a high level of generality, it is hard to quarrel with this principle. But the application in the courts of this "hard look" doctrine can be unpredictable and demanding:

> One difficulty with hard look review is that the doctrine imposes no limits on the size, number, detail, or technicality of the issues that can be raised. Moreover, the level of review that is required for an agency rule to be upheld is not predictable; Professor Jerry Mashaw argues that courts function as "rob[]ed roulette wheels" when reviewing agency guidance. Agencies must decide whether to devote resources to the rebuttal of possibly meaningless comments without knowing courts' expectations, so agencies may rationally devote too much or too little resources to the process from a judicial perspective.[88]

The Treasury Department has been fairly sparing in its response to comments and instead has explained more descriptively how the rules in its regulations work.

Consequently, as others have observed, an uncharitable application of hard look review to tax rules could be fatal to most tax rules.[89] This could be particularly disruptive if the six-year statute of limitations does not apply in tax controversies. For example, *Altera* filed a petition with the Tax Court based on a notice of deficiency issued in 2011. Its APA-based claims related to regulations promulgated in 2003. This is anomalous under the *Wind River* doctrine,[90] barring procedural

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87. *See* 5 U.S.C. § 706(2)(A); *see also* William S. Jordan, III, *Ossification Revisited: Does Arbitrary and Capricious Review Significantly Interfere with Agency Ability to Achieve Regulatory Goals Through Informal Rulemaking?*, 94 Nw. U. L. Rev. 393, 394 (2000).

88. McMahon, *supra* note 5, at 579 (footnotes omitted) (quoting Jerry L. Mashaw, Greed, Chaos, and Governance 181 (1999)).

89. *See* Hickman, *supra* note 5, at 471; Wallace, *supra* note 5, at 189.

90. *See supra* Part II.B.

challenges under the six-year statute of limitations. By contrast, in a typical enforcement action, a challenger would need to show that the rule is impermissible under the statute.[91]

On the merits of the APA claims in *Altera*, the Tax Court unanimously invalidated the regulation for inadequate explanation.[92] The regulation provided that certain related parties must apportion the cost of stock options issued by one of the related parties.[93] This approach would superficially appear quite reasonable; moreover, one might argue that such an approach is almost compelled by the legislative history, which was concerned with shifting profits overseas.[94] But the Tax Court's "hard look" review rejected the Treasury Department's curt dismissal of comments from taxpayers opposing the proposal and concluded that the decision lacked a basis in fact.[95]

Although the government ultimately emerged victorious, this litigation may be a good example of Mashaw's "robed roulette" metaphor.[96] The Ninth Circuit reversed the Tax Court's unanimous decision, on the theory that Treasury's process was clear enough. The central argument for the taxpayer was that the Treasury had an obligation to examine, and explain away, comments that detailed transactions involving unrelated entities.[97] But the Treasury found these comments irrelevant under the commensurate with income standard.[98] As the Ninth Circuit explained, reversing the Tax Court, "exhaustive, contemporaneous legal arguments"[99] are not necessary to sustain a rulemaking; it is sufficient if the "regulatory path may be reasonably discerned."[100] In keeping with this framework, the preamble indicated adequately that the

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91. As Professor Wallace explains, even if a rule is not defective under the APA, the robustness of the procedure used may be relevant for deference doctrines. Wallace, *supra* note 5, at 189.

92. Altera Corp. v. Comm'r, 145 T.C. 91 (2015), *rev'd*, 926 F.3d 1061 (9th Cir. 2019).

93. *See* Treas. Reg. § 1.482–7A(d)(2).

94. *See Altera*, 926 F.3d at 1070–71; Wallace, *supra* note 5, at 228.

95. *Altera*, 145 T.C. at 122–25.

96. *Supra* text accompanying note 88.

97. *See Altera*, 936 F.3d at 1081.

98. *Id.* at 1081.

99. *Id.* at 1083 (quoting Nat'l Elec. Mfrs. Ass'n v. U.S. Dep't of Energy, 654 F.3d 496, 515 (4th Cir. 2011)).

100. *Id.* at 1086.

regulation would align with the commensurate with income standard and cited the legislative history supporting that choice.[101]

Agencies would prefer not to delay action as well as consume limited resources addressing comments, particularly if the comments are essentially heckling or fail to raise substantial concerns. But different judges deploy *State Farm* review differently.[102] At bottom, if agencies must exhaustively document their decisions, even with respect to comments that are arguably immaterial, then their work surely has to slow down or at least narrow in scope.

D. Notice and Comment and Related Problems of Retroactivity

Courts look to the organic statute to determine whether Congress has made a delegation to a particular agency.[103] Assuming that an agency has the power to make rules, the APA provides a relatively informal process unless the organic statute requires a hearing on the record.[104] This "notice and comment" process allows the agency to formulate a proposed rule and gives the public an opportunity to comment.[105] An

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101. *Id.* at 1083–84.

102. Numerous scholarly proposals have sought to mitigate or shape the uncertainty surrounding "hard look" review. *See, e.g.*, Frank B. Cross, *Shattering the Fragile Case for Judicial Review of Rulemaking*, 85 Va. L. Rev. 1243 (1999) (abolition); Elena Kagan, *Presidential Administration*, 114 Harv. L. Rev. 2245 (2001) (sliding scale); Scott A. Keller, *Depoliticizing Judicial Review of Agency Rulemaking*, 84 Wash. L. Rev. 419, 425 (2009) (rational basis with bite); Thomas O. McGarity, *Some Thoughts on "Deossifying" the Rulemaking Process*, 41 Duke L.J. 1385 (1992) (minimum rationality); Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 Admin. L. Rev. 59 (1995) (rationality review akin to the scrutiny employed under the Due Process Clause); Shapiro & Murphy, *supra* note 22 (urging courts to be flexible about accepting certain post hoc justifications for rules); Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 Duke L.J. 1321 (2010) (presumption of validity if balanced representation).

103. *See, e.g.*, Timothy A. Wilkins & Terrell E. Hunt, *Agency Discretion and Advances in Regulatory Theory: Flexible Agency Approaches Toward the Regulated Community as a Model for the Congress-Agency Relationship*, 63 Geo. Wash. L. Rev. 479, 506–15 (1995).

104. 5 U.S.C. § 553.

105. *Id.*

agency often makes no changes in the final rule but rather explains why it disagrees with important negative feedback.[106]

The APA requires 30 days' notice before a final rule may take effect.[107] As the Supreme Court explained in *Bowen v. Georgetown University Hospital*, "Retroactivity is not favored in the law. . . . and administrative rules will not be construed to have retroactive effect unless their language requires this result."[108] Moreover, "[b]y the same principle, a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms."[109]

The APA carves out an exception for "interpretative rules," "general statements of policy," and for "good cause."[110] Because of taxpayer standing limitations, it is unlikely that much litigation will arise in tax about the distinction between interpretative rules and general statements of policy. The good cause exception would seem ill-fitting for tax rulemaking.[111] However, the content of the "interpretative rules" exception would appear most important for tax disputes. Interpretative rules are not required to undergo notice and comment and may be applied retroactively even without a specific statutory authorization of retroactivity.

Because the I.R.C. does not require tax rules to be made after a hearing on the record, the APA "notice and comment" framework applies to tax rulemaking. In addition, courts will eventually have to construe the I.R.C. provisions on retroactivity of tax rules in light of the APA. This is complicated by the difficulty in applying the concept of "interpretative rules," which is compounded by the role of judicial deference and, relatedly, the Treasury's practice of inviting comments on proposed regulations that it claims are interpretative.

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106. *See* Stephanie Stern, *Cognitive Consistency: Theory Maintenance and Administrative Rulemaking*, 63 U. Pitt. L. Rev. 589, 620–30 (2002).

107. 5 U.S.C. § 553(d).

108. Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988).

109. *Id.*

110. 5 U.S.C. § 553(b), (d).

111. *See infra* note 278 and accompanying text.

Until 1996, retroactive application of tax rules to the enactment of the relevant statutory provision was the presumption.[112] For regulations relating to newer statutory provisions, retroactivity is generally limited to the date of the notice of proposed rulemaking.[113] There is an 18-month rule allowing retroactivity for regulations implementing new tax acts[114] as well as an unlimited time frame to prevent abuse.[115] It is unclear whether these provisions are intended to curtail retroactivity of interpretative rules or, more broadly, could permit even Treasury's legislative rules to be backdated retroactively.[116]

The I.R.C. also acknowledges that Treasury issues "temporary regulations," requiring that the notice of proposed rulemaking simultaneously invite comments and that the rule expire within three years if not finalized.[117] In a group of related tax cases, courts had split on whether the temporary/final process is permissible.[118] There are emerging

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112. *See* Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1101, 110 Stat. 1462, 1468–69 (1996); *see also* McMahon, *supra* note 5, at 586–87.

113. I.R.C. § 7805(b)(1).

114. I.R.C. § 7805(b)(2).

115. I.R.C. § 7805(b)(3).

116. *See infra* Part IV.B.

117. I.R.C. § 7805(e).

118. *See, e.g.*, Intermountain Ins. Serv. v. Comm'r, 650 F.3d 691 (D.C. Cir. 2011) (upholding temporary regulations assuming for the sake of argument that the procedure was defective), *vacated by* 2012 WL 2371486 (D.C. Cir. 2012); Grapevine Imps., Ltd. v. United States, 636 F.3d 1368, 1380 (Fed. Cir. 2011) (indicating that the process is mooted by finalization of temporary regulations), *vacated by* 566 U.S. 971 (2012); Beard v. Comm'r, 633 F.3d 616, 623 (7th Cir. 2011) (indicating in dictum that temporary regulations would not be procedurally invalid), *vacated by* 566 U.S. 971 (2012); Burks v. United States, 633 F.3d 347, 359 (5th Cir. 2011) (citing the resulting final regulations while questioning the effect of the process on the deference framework to be applied); Salman Ranch Ltd. v. United States, 573 F.3d 1362 (Fed. Cir. 2009); Lederman, *supra* note 5, at 683–87 (summarizing the jurisprudence on temporary regulations promulgated amid litigation). The procedural holdings of those cases were mooted by the Supreme Court's holding that the regulation was an impermissible construction of the statute of limitations. United States v. Home Concrete & Supply, LLC, 566 U.S. 478, 480 (2012) ("Following *Colony, Inc. v. Commissioner*, we hold that the provision does not apply to an overstatement of basis. Hence the 6-year period does not apply." (citation omitted)).

indications from the Supreme Court that this process may be less problematic than commentators had assumed.[119]

E. Remedies for the Violation of APA Requirements

The standard remedy for violation of an APA rulemaking requirement is to vacate the rule and remand the matter to the agency for further consideration. In tandem with vacatur, the APA's delayed effective date requirement can then "derail or delay" an administrative program:

> Rectifying the mistake may be no mean feat, especially if doing so requires the agency to trudge through the procedural thicket surrounding notice and comment. In the meantime, the agency action will be put on hold—delayed, often for years, as the agency decides how to respond. In the end, the agency might choose to abandon the action altogether: Its priorities may have changed, its staff may have been reassigned, or the external groups supporting action may have dispersed.[120]

If an agency's rule is vacated and the agency must start the rulemaking over, the effective date of the rule would be pushed even later. And if the vacated rule is necessary to enforce the organic statute, then enforcement would need to await finalization of a new rule.[121]

Courts have often, but not always, insisted upon compliance with the APA's procedures. Two important doctrinal workarounds are the harmless error standard and the remedy of remand without vacatur.[122] However, as Professor Nicholas Bagley explains, "the presumptive remedy is vacatur, whether or not the agency has solicited further

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119. *See infra* Part III.B.2.

120. Bagley, *Remedial Restraint*, *supra* note 22, at 263.

121. *See generally* Ronald M. Levin, *"Vacation" at Sea: Judicial Remedies and Equitable Discretion in Administrative Law*, 53 DUKE L.J. 291, 299 (2003) (explaining the standard remedy of vacatur and noting instances of forbearance).

122. *See* Hickman & Thomson, *supra* note 5; Levin, *supra* note 121.

comments."[123] Although Hickman and Thomson largely agree with this approach,[124] Bagley is far more skeptical and, outside of the tax context, discusses several "odd results" that may obtain.[125]

If the backdating provisions under the I.R.C. apply to all rules, not just interpretative rules, this might permit a functional equivalent of remand without vacatur.[126] Suppose the Treasury Department inadequately responds to a comment in a rulemaking; it might consider the comment and re-issue the rule, applying the rule to prior taxable periods.[127] Similarly, if a temporary regulation were invalidated on grounds of postpromulgation comment, perhaps the Treasury Department may start again and treat the temporary regulation as "notice" of the later rule for backdating purposes.[128]

III. Remedial Restraint

Just as tax scholars should benefit from insights from other fields,[129] it is important to borrow critically and carefully from administrative law. However, in early stages of borrowing, it may be particularly difficult to avoid literalism because of limited contextual knowledge.[130] As this Part explains, nuance surrounding the APA and remedial doctrines should not be conflated with tax exceptionalism. The APA and the Supreme Court are clear that there is a place for the rule of prejudicial error, although the Court has given very little guidance on how to distinguish harmless error. The "remedial purity" approach need not be the standard by which the tax administration measures compliance.[131]

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123. Bagley, *Remedial Restraint*, *supra* note 22, at 285.

124. Hickman & Thomson, *supra* note 5.

125. Bagley, *Remedial Restraint*, *supra* note 22, at 285–89.

126. *See* Puckett, *supra* note 5, at 1095–1101.

127. I.R.C. § 7805(b)(1).

128. *See id.*

129. *See generally* Abreu & Greenstein, *supra* note 15, at 666 (suggesting that a "robust tax jurisprudence" needs exposure to other fields of law).

130. *Cf.* Bagley, *Remedial Restraint*, *supra* note 22, at 309 ("It *feels* right to read remedial inflexibility into the APA, even if that's not what the APA says.").

131. *Id.* (criticizing "the norm of remedial purity"); Shapiro & Murphy, *supra* note 22, at 332 (noting the "administrative law comedy" in the "transformation" of procedures by the D.C. Circuit in the face of the Supreme

A. The Rule of Prejudicial Error

As discussed above, courts faced with a defective agency rule typically vacate the rule and remand it for further consideration at the agency.[132] Bagley argues that the APA supposed judicial review would be with a "light touch" and that courts mostly forgot about the rule of prejudicial error for decades.[133] Without providing much gloss on the meaning of the concept, the Supreme Court has cited the rule occasionally.[134] Moreover, "as courts in the 1970s intensified the rigors of notice and comment to accord with their views about what it ought to accomplish, so too could courts today adjust what the rule of prejudicial error entails."[135]

The case for remedial purity is relatively straightforward:

> The sign fallacy and the focusing illusion help explain the enduring appeal of remedial purity in administrative law. It's true that excusing more agency mistakes would give agencies greater latitude to make those mistakes. If you assume that the incentive effect is large, cutting agencies slack will lead directly to the rise of procedurally defective and poorly reasoned rules. To discourage bad behavior, it's essential to swiftly and severely punish agencies when they err. Courts thus embrace a rigid remedial rule, confident that they need not worry unduly about the costs of disrupting agency business. Those costs must pale in comparison to the damage that unrestrained agencies could inflict.[136]

Court's "categorical refusal to allow judicial usurpation of control over rulemaking procedures").

132. *See supra* Part II.E.

133. Bagley, *Remedial Restraint*, *supra* note 22, at 258–59.

134. *See* Little Sisters of the Poor Saints Peter & Paul Home v. Pennsylvania, 140 S. Ct. 2367, 2385 (2020); Shinseki v. Sanders, 556 U.S. 396, 406 (2009); Nat'l Ass'n of Home Builders v. Defs. of Wildlife, 551 U.S. 644, 659–60 (2007).

135. Bagley, *Remedial Restraint*, *supra* note 22, at 291.

136. *Id.* at 313.

This approach almost invariably leads to vacatur of defective agency rules. However, a somewhat more charitable view can flow from this general approach.

Hickman and Thomson resist the trend to vacate upon finding any defect.[137] For example, postpromulgation comment can sometimes adequately open a rulemaking to public participation. In any event, they advise courts to explicitly adopt a strong presumption against the agency that missteps.[138] And they would explicitly place the burden of persuasion on the agency to rebut the presumption.[139] Bagley acknowledges that Hickman and Thomson are "unusually attentive" to the benefits of nuanced analysis at the remedy stage.[140] Ultimately, Bagley assesses a "strong presumption against" postpromulgation comment as an example of the sign fallacy.[141]

The APA's text instructs courts to take "due account" of "the rule of prejudicial error."[142] Courts have often, but not always, construed harmless error narrowly, refusing to remand a procedurally defective rule without vacatur.[143] However, the purpose of procedural requirements should be the focus on review of alleged defects rather than insistence on perfect adherence to form. Scholars have long recognized that vacatur can be extraordinarily costly.[144] Professors Jacob Gersen and Adrian Vermeule found that "hard look" review can be relatively flexible in practice, perhaps to compensate if the standard remedy would be disproportionate.[145]

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137. *See* Hickman & Thomson, *supra* note 5, at 322.

138. *See id.* at 310.

139. *See id.* at 312.

140. Bagley, *Remedial Restraint*, *supra* note 22, at 312.

141. *Id.*

142. 5 U.S.C. § 706.

143. *See* Hickman & Thomson, *supra* note 5, at 285–86, 291, 294 (summarizing the "muddle" of decisions).

144. *See, e.g.*, Bagley, *Remedial Restraint*, *supra* note 22, at 263 n.65 (citing Jerry L. Mashaw & David L. Harfst, The Struggle for Auto Safety (1990); R. Shep Melnick, Regulation and the Courts: The Case of the Clean Air Act (1983); Richard J. Pierce, Jr., *The Unintended Effects of Judicial Review of Agency Rules: How Federal Courts Have Contributed to the Electricity Crisis of the 1990s*, 43 Admin. L. Rev. 7 (1991)); *see also supra* note 16.

145. Jacob Gersen & Adrian Vermeule, *Thin Rationality Review*, 114 Mich. L. Rev. 1355, 1361–67 (2016) (concluding that the implications

Professor Bagley has recommended an "invigorated" rule of prejudicial error with the burden on the challenger:

> Instead of presuming harm, why not insist on a demonstration of prejudice before invalidating agency rules? There's no magic in strict adherence to notice-and-comment formalities. As a matter of due process, notice and comment isn't required. The "good cause" exception, available when "notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest," affords courts one reason to excuse compliance with the notice-and-comment rules. But the existence of one excuse doesn't imply the nonexistence of others. To the contrary, the rule of prejudicial error applies, per § 706, to judicial review of any agency action, including informal rulemaking. Just as courts in the 1970s intensified the rigors of notice and comment to accord with their views about what it ought to accomplish, so too could courts today adjust what the rule of prejudicial error entails. For notice-and-comment cases, the rule could easily be understood to require courts to undertake a context-sensitive inquiry into prejudice.[146]

A downside of this approach, as Bagley acknowledges, is that "Courts would face the taxing responsibility of sifting an expansive record to determine whether the parties challenging the rule suffered any real harm from the procedural violation."[147]

But, as Bagley anticipates, "the questions can't be avoided"; defenders of reflexive vacatur "must believe that adhering strictly to procedural rules has a big and salutary effect on the substance of agency decisions."[148] It is not, however, apparent that remedial restraint would cause oppression, quality reduction, or block interested parties from

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from the Supreme Court's holdings are "to apply a thin form of rationality review").

146. Bagley, *Remedial Restraint*, *supra* note 22, at 290–91 (footnotes omitted).

147. *Id.* at 292.

148. *Id.* at 314.

participating. That is true even if judicial restraint aligns with undesirable incentives at the agency. "Competing incentives—to do the job right while preserving agency resources, to preserve credibility, to assuage interest groups and congressional overseers, to avoid litigation if at all possible—will usually swamp the incentives created by modest adjustments to remedial doctrine."[149]

Ensuring a robust role for harmless error seems superior to strict compliance. To that extent, the Hickman and Thomson proposal provides clarity and may improve upon a strict approach to APA compliance.[150] On the other hand, if harmless error review turns out to be a false hope, without any real application, then the review would be a waste of agency and judicial resources. Moreover, a strong presumption against validity may open the door for bias in judicial review. At the possible risk of committing the sign fallacy, one might question whether judges will feel convinced that a strong presumption has been rebutted more often when they agree with the substance of the rule. This could introduce a troubling new element of randomness (if not illegitimacy) into an administrative law that is tilted toward inertia.[151]

At bottom, neither a "strong presumption" against restraint nor a more balanced approach would necessarily be tax exceptionalist. The justification for restraint can be located in the APA itself and the holdings of a number of cases that have nothing in particular to do with tax. Notably, the Supreme Court's most recent pronouncement seems to remind courts to take harmless error more seriously.[152]

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149. *Id*.

150. *See id*. at 289–90 (arguing that notice and comment is often unnecessary for encouraging feedback but noting that courts more often take a "purist approach" to defects concerning notice and comment).

151. *See* Bagley, *Procedure Fetish*, *supra* note 22, at 359–60 (contesting that administrative law is evenhanded and positing that it has "an identifiably libertarian, anti-statist tilt"); Daniel E. Walters, *Symmetry's Mandate: Constraining the Politicization of American Administrative Law*, 119 Mich. L. Rev. 455 (2020).

152. *See* Little Sisters of the Poor Saints Peter & Paul Home v. Pennsylvania, 140 S. Ct. 2367, 2367 (2020); *infra* text accompanying notes 172 to 181.

B. Circumstances Indicative of Harmless Error

This section reviews the principal factual considerations identified in the literature that may motivate a court to exercise remedial restraint. Although there are other types of procedural challenges beyond inadequate explanation and irregularities relating to notice and comment, this Article focuses on those scenarios, given their relative importance to tax administration. Although there is no guarantee that a court will agree with a case against remedial purity, the Supreme Court has recently signaled the validity of the rule of prejudicial error.

1. Inadequate Explanation

Professor Richard Murphy has argued that vacatur for inadequate explanation calls for "sound discretion" rather than "application of a falsely categorical rule" against post hoc rationalizations.[153] Murphy surveys what he dubs instances of "*Chenery* cheating" or "playing the harmless error card."[154] Professors Sidney Shapiro and Murphy argue that courts should be more receptive to post hoc rationalizations by agencies, at least if "the underlying information supporting these arguments was disclosed to outside scrutiny during the rulemaking process."[155]

Murphy has outlined a host of factors that should be taken into account in exercising the court's discretion:

- Whether the post hoc rationale was offered early enough in the process to avoid wasting court time or sandbagging litigants;

- Whether the reviewing court has substantial grounds for significant doubt as to whether the post hoc rationale accords with the views of the agency itself;

- Whether there are reasonable grounds for the agency's failure to include the post hoc rationale in a contemporaneous explanation;

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153. Richard Murphy, Chenery *Unmasked: Reasonable Limits on the Duty to Give Reasons*, 80 U. Cin. L. Rev. 817, 822 (2012).

154. *Id.* at 858, 864 & n.233.

155. Shapiro & Murphy, *supra* note 22, at 362.

- Whether repeating a vacated action would require the agency to spend substantial resources;

- Whether the nature of the agency action subject to review suggests that any later explanation would likely suffer from equally serious flaws; and

- Whether vacation poses a threat to administration of an important regulatory program.[156]

Murphy posits that remand without vacatur will often be appropriate.[157] Effectiveness and efficiency, in context, may not be arbitrary; requiring voluminous explanations in the "concise" statement "runs counter to a whole body of judicial precedents declaring that agencies, not courts, are best situated to allocate scarce agency resources and that agencies should be left to do so free of judicial intervention."[158] But "where an agency ignores an obviously powerful objection," courts may enjoin enforcement during review.[159]

Would the cost of flexibility and restraint in this context outweigh the savings to agencies? Shapiro and Murphy respond that devoting resources to respond to comments does not necessarily improve the resulting rules; remedial restraint does not require courts to infringe upon agency discretion and is unlikely to cause agencies to "sandbag" their arguments or become lazy.[160]

A key consideration defusing many of the potential objections to accepting post hoc rationalizations is that "courts have, in effect, required agencies to make something close to final policymaking decisions before issuing their proposals."[161] Because of the effort devoted to issuing a notice of proposed rulemaking, "ironically enough . . . the concise general statements that agencies publish as contemporaneous rationales of their final rules might be better regarded as post hoc rationalizations of their proposed rules."[162] A study by Professors Oei and

156. Murphy, *supra* note 153, at 876–77.
157. *Id.* at 877.
158. Shapiro & Murphy, *supra* note 22, at 369, 377–78.
159. *Id.* at 378.
160. *Id.* at 374–78.
161. *Id.* at 376.
162. *Id.* at 376–77.

Osofsky examining the section 199A regulations corroborates this intuition in the tax context and amplifies the problem of imbalanced input into tax regulations.[163]

As Shapiro and Murphy demonstrate, "rationalizations should be accepted as inevitable rather than condemned" and "rules should be tested by their reasonability, not by agency sincerity."[164] It remains to be seen whether the Supreme Court would embrace this logic in an appropriate case.[165]

2. Notice and Comment

Agencies could certainly choose to forego notice and comment improperly and intentionally seek to insulate their decisions from public participation.[166] But this is not necessarily the case, and a variety of other possibilities exist to explain an apparent problem of notice and comment. This section summarizes the principal considerations that could persuade a court that there was no prejudicial error.

Given the goals of allowing for participation, it may be compelling if the public had fair notice of the rule by means other than a traditional notice of proposed rulemaking.[167] This is particularly true if comments were received through informal channels. Even if there was no real opportunity for comment, a court may be persuaded that there is no harm to the challenger if the agency anticipated a challenger's

163. *See generally* Shu-Yi Oei & Leigh Osofsky, *Legislation and Comment: The Making of the § 199A Regulations*, 69 Emory L.J. 209 (2019).

164. Shapiro & Murphy, *supra* note 22, at 377.

165. *See* Dep't of Homeland Sec. v. Regents of Univ., 140 S. Ct. 1891, 1908–09 (2020) (noting prohibition on post hoc rationalizations); *see also* Christopher J. Walker, *What the DACA Rescission Case Means for Administrative Law: A New Frontier for* Chenery I*'s Ordinary Remand Rule?*, Yale J. on Regul.: Notice & Comment (June 19, 2020), https://www.yalejreg.com/nc/what-the-daca-rescission-case-means-for-administrative-law-a-new-frontier-for-chenery-is-ordinary-remand-rule/ [https://perma.cc/2STR-Q7LF] (questioning whether the DACA case should be taken as a warning sign for remand without vacatur due to the unusual facts of the case and the lack of disruption due to vacatur).

166. *Cf.* Bagley, *Remedial Restraint*, *supra* note 22, at 317.

167. *See* U.S. Telecom Ass'n v. FCC, 825 F.3d 674, 689, 725–26 (D.C. Cir. 2016); Bagley, *Remedial Restraint*, *supra* note 22, at 289–90.

comments in the preamble to the rule.[168] An agency interpretation relating to a binary ambiguity may have a higher chance of success under harmless error analysis than a rule that requires a "nuanced and detailed" analysis.[169]

Bagley argues that courts should be more open-minded toward reasonable mistakes surrounding the exceptions for interpretative rules and good cause, particularly when there are opportunities for feedback outside the formal process.[170] This is particularly acute because good faith mistakes are unavoidable, meaning that vacatur would bring no marginal discipline to agencies.[171] Courts have not warmed much to such arguments. The Supreme Court's analysis in a recent case does little to clarify this area, although it does at least point toward a continuing role for harmless error.[172]

In *Little Sisters of the Poor*, the rollback of a contraception insurance coverage mandate was subject, among other challenges, to an objection that postpromulgation comment violated the APA. Before the final rules were released, a number of Departments released "Interim Final Rules with Request for Comment" instead of a notice of proposed rulemaking.[173] The Supreme Court found this error to be harmless. The Court stated that all of the elements required in a notice of proposed rulemaking were present in this interim rule; the only difference was that the challenged rule had a different name than what was required, and therefore the respondents "do not come close to

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168. *See* United States v. Johnson, 632 F.3d 912, 930–33 (5th Cir. 2011). *But see* Bagley, *Remedial Restraint*, *supra* note 22, at 287 (noting the "unusual" result and that four other circuits vacated the rule); Hickman & Thomson, *supra* note 5, at 286–89 (summarizing cases that view postpromulgation comment as "irretrievably flawed").

169. *See Johnson*, 632 F.3d at 932; Hickman & Thomson, *supra* note 5, at 297.

170. Bagley, *Remedial Restraint*, *supra* note 22, at 317.

171. *See id.*

172. Little Sisters of the Poor Saints Peter & Paul Home v. Pennsylvania, 140 S. Ct. 2367, 2385 (2020) ("We have previously noted that the rule of prejudicial error is treated as an 'administrative law . . . harmless error rule'") (omission in original; quoting Nat'l Ass'n of Home Builders v. Defs. of Wildlife, 551 U.S. 644, 659–60 (2007)).

173. *Id.* at 2384.

demonstrating that they experienced any harm from the title of the document, let alone have they satisfied [the] harmless error rule."[174]

Citing *Vermont Yankee*,[175] the Court rejected a searching inquiry as to whether the Departments had remained openminded about subsequent comments.[176] The Court observed that "the open-mindedness test violates the 'general proposition that courts are not free to impose upon agencies specific procedural requirements that have no basis in the APA.'"[177] The Court had noted, in explaining the sufficiency of the interim rule for notice, that the challengers "do not—and cannot—argue that the IFRs failed to air the relevant issues with sufficient detail for respondents to understand the Departments' position."[178]

Thus, *Little Sisters* superficially seems receptive to postpromulgation comment. But the opinion appears to leave open the question of what might happen if there had been no postpromulgation comment. This might happen if an agency claimed an APA exception such as good cause. Moreover, even with postpromulgation comment, the opinion does not address what would happen if the rule's finalization was pending at the time of argument or judgment. Would a court then treat the rule as a mere proposal or perhaps an invalid rule with legal force? Professor Hickman's preliminary reaction seems to be that this is a naïve way to frame the question, because agencies can move quickly to finalize an interim rule if need be.[179]

Although this Article has argued for judicial receptivity to postpromulgation comment, there is reason to be cautious about extrapolating from one decision with unusual facts. The Court in *Little Sisters* was careful to note that the APA requires notice of proposed rulemaking before a rule with "legal force."[180] It may be that the Court would not be so charitable if an agency attempted to impose new obligations via

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174. *Id*. at 2385.

175. Vt. Yankee Nuclear Power Corp. v. Nat'l Res. Def. Council, Inc., 435 U.S. 519 (1978).

176. *Little Sisters of the Poor*, 140 S. Ct. at 2385–86.

177. *Id*. at 2385 (quoting Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 654 (1990)).

178. *Id*. at 2384–85.

179. *See* Kristin E. Hickman, *Did* Little Sisters of the Poor *Just Gut APA Rulemaking Procedures?*, Yale J. on Regul.: Notice & Comment (Jul. 9, 2020), https://www.yalejreg.com/nc/did-little-sisters-of-the-poor-just-gut-apa-rulemaking-procedures/ [https://perma.cc/GL5Z-3ATW].

180. *Little Sisters of the Poor*, 140 S. Ct. at 2386.

interim rule rather than grant an exemption from a requirement. On the other hand, the granting of exemptions may harm third parties and should be treated on par with any other change. Despite the likelihood of harm from underenforcement, rulemaking is often unnecessary for an agency to avoid enforcing the law. So, the Court might see fit to distinguish regulation from exemption, on the theory that imposing new obligations via interim rules impermissibly evades the APA delayed effective date requirement.[181]

C. No Tax-Specific Considerations Against Remedial Restraint

As discussed above, it is not exceptional to suggest an approach involving remedial flexibility or restraint in judicial review of agency action. However, this Article anticipates the critique that, if anywhere, remedial vigilance is necessary in the tax administration. As this section explains, there is no particular cause for concern about taking this approach to tax. It would be more difficult to conclude that such an approach is especially necessary for tax. Complexity,[182] even if combined with the importance of collecting revenue,[183] does not seem sufficient to justify a particularly distinct approach to tax administration. This Article does not make that claim. On the other hand, it may be that occasionally the nuances of tax administration will be seen in the assessment of harmless error, given the open-endedness of the analysis.

There is also some truth in the idea that exceptionalism is not all that unusual. But no matter how special every administrative agency may be, it is clear that the tax law has long been administered very differently.[184] If, in this context, the APA is concerned primarily with fair

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181. *See* 5 U.S.C. § 553(d)(1).

182. *See generally* Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up To Be Tax Lawyers*, 13 Va. Tax Rev. 517, 531 (1994) (criticizing the view that tax law is self-contained and advocating a "synergistic" relationship between tax and other areas of law).

183. *See* Stephanie Hunter McMahon, *Tax as Part of a Broken Budget: Good Taxes Are Good Enough Cause*, 2018 Mich. St. L. Rev. 513 (arguing that Congress's assumptions regarding budget estimates are sufficient to justify judicial expansion of the "good cause" exception from the APA's notice and comment procedures even for legislative tax rules).

184. *See supra* note 43.

notice and an opportunity to participate when new rights or obligations are created by agencies, then one can and should assess whether tax complies in substance even if not form. Moreover, there is no guarantee that leaning on the APA means that the Treasury Department will issue more regulations full of safe harbors. It could resort to guidance that gives little detail and creates little in the way of reliance interests.[185]

1. Congressional Control

As Professor Clint Wallace has explained, Congress exerts an unusual degree of control over the tax system. As an anchor, consider the lack of accountability fostered by the typical "empty standard":[186] For example, "just and reasonable" is an applicable standard for the Federal Energy Regulatory Commission rates for natural gas pipelines, but "'just and reasonable' describes any result the agency can explain."[187] As another example, the Federal Communications Commission grants broadcast licenses "if public convenience, interest, or necessity will be served thereby."[188] As Michael Asimow observed, "[b]road and vague delegations of rulemaking power to agencies are an inevitable part of modern political life."[189]

The discretion afforded by empty standards can be constrained by presidential control and robust public participation. To the extent that Congress provides robust limits in the first place, public participation would seem to be less important in holding agencies accountable. In tax, Congress has stepped up much more to the task. Wallace explains how the Joint Committee on Taxation (JCT) affords Congress such an unusual ability to control tax administration. The JCT includes Senators and Representatives as well as a staff of lawyers and economists.

The JCT's expertise comes to bear in at least three ways. First, the JCT staff provides advice from the beginning, comparing potential approaches to solving a policy problem and remaining "engaged,

185. *See supra* text accompanying notes 311 to 312.

186. *See* Wallace, *supra* note 5, at 192 n.64.

187. *Id*. at 192.

188. *Id.* at 192 n.64 (quoting 47 U.S.C. § 307(a)).

189. Michael Asimow, *On Pressing McNollgast to the Limits: The Problem of Regulatory Costs*, Law & Contemp. Probs., Winter 1994, at 127, 137 (quoted in Wallace, *supra* note 5, at 193 n.65).

providing assistance with drafting tax legislation."[190] Second, given the JCT's involvement in revenue estimates, it may sometimes be "possible to trace the legislative language back to those explanations."[191] Finally, the "JCT staff participates in meetings and hearings, markups, and conference committee negotiations" and prepares conceptual summaries.[192]

Wallace concludes that the "JCT's expertise allows for Congress consistently to legislate at a level of detail uncommon to other areas of statutory law, accomplishing a sort of preemptive gap-filling."[193] This is corroborated by the results of an admittedly older empirical study by David Epstein and Sharyn O'Halloran, concluding that tax laws afford less discretion than any other administrative domain besides patent and Social Security.[194] Moreover, the role of the JCT combined with Congress's reliance "makes this legislative history particularly insightful as to how tax provisions are expected to be construed and the particular content of anticipated regulations contemporaneous with the enactment of the legislative provisions."[195]

As a result of this statutory specificity, the IRS will generally be able to identify a statutory basis for a tax deficiency.[196] This is not to say that tax rules and regulations are useless. Agency rules may make a statutory claim easier to resolve even if not absolutely necessary to sustain a deficiency. The fact that tax law is heavily codified and not so much left to the Treasury Department and the Internal Revenue Service

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190. Wallace, *supra* note 5, at 197.

191. *Id.* at 200.

192. *Id.*

193. *Id.* at 201.

194. David Epstein & Sharyn O'Halloran, Delegating Powers: A Transaction Cost Politics Approach to Policy Making Under Separate Powers 196–206 (1999).

195. Wallace, *supra* note 5, at 202.

196. In a reviewed Tax Court opinion applying "hard look" review to a pre-*Mayo* tax regulation governing conservation easements, Judge Toro's concurring opinion illustrates how difficult APA issues could potentially be avoided if a court discerns an adequate statutory justification for a tax deficiency. Oakbrook Land Holdings, LLC v. Comm'r, 154 T.C. 180, 201 (2020) (Toro, J., concurring) ("Since applying the text of the statute to the terms of the easement before us suffices to resolve the dispute before the Court, there is no need to address the much more difficult question of the validity of section 1.170A–14(g)(6), Income Tax Regs.").

should not be surprising. Consider how politicized and polarized the tax legislative process has become. Congress presumably opted for specificity, at least in part, because it would not want major questions under the Tax Cut and Jobs Act of 2017 to be undermined whenever there is a new occupant in the White House. And even in more bipartisan times, tax legislation has been marked by particular specificity.

Congress could well have made an intentional, rational choice to constrain the courts from making, or nullifying,[197] tax policy by facilitating action by the IRS and Treasury Department on matters where the statute is relatively specific. Courts, as the runner-up, would be harder to control.[198] Professor Blake Emerson has argued that we should refocus on the Progressive foundations of the administrative state.[199] Although focused on "major questions," Emerson's central narrative applies even more resoundingly in the context of relatively minor questions:

> The Progressives conceived of agencies as engaging the democratic public in three ways: (1) through the implementation of democratically enacted law; (2) through the input of the President; and (3) through deliberation with the affected public. They presumed that agencies would tackle ethically charged political questions, but they aimed to ensure that they would do so in a rational and inclusive fashion. At the same time, they recognized that the extent of public participation would need to be balanced against the requirements of efficient state action. They were skeptical that the courts were the best forum in which to ensure the democratic integrity of government, and thus sought to enhance the

197. *Cf.* Jerry L. Mashaw, Creating the Administrative Constitution: The Lost One Hundred Years of American Administrative Law 71–73, 308 (2012) (describing early practice of tax nullification in state courts as well as how judicial review could be "paralyzing, at the hands of nineteenth-century courts and juries").

198. *Cf.* Sean Farhang, *Legislating for Litigation: Delegation, Public Policy, and Democracy*, 106 Cal. L. Rev. 1529, 1552 (2018).

199. *See* Blake Emerson, *Administrative Answers to Major Questions: On the Democratic Legitimacy of Agency Statutory Interpretation*, 102 Minn. L. Rev. 2019, 2073 (2018).

> democratic credentials of the administrative process itself.[200]

Even with the President as a "powerful spokesperson for public opinion,"[201] notice and comment rulemaking in the United States is more demanding than in the European Union.[202] It is critical that we strike "an appropriate balance between deliberative integrity and efficient protection of the public interest."[203]

2. Judicial Review

Deference doctrines and complexity have not led to an abdication of the judicial role in tax.[204] All agencies are subject to judicial review, but most do not face the prospect of litigating the facts de novo before a fully independent tribunal with special expertise in the statute being administered. Most tax cases find their way to Tax Court, allowing a taxpayer to contest a tax deficiency before payment of the amount in controversy.[205]

The Tax Court's expertise makes it particularly well situated to call attention to the weak points in technical arguments for deference to tax guidance. Refund courts also play an important role, and this Article does not suggest that generalist judges cannot process technical tax arguments. Refund courts would seem comparatively well situated to draw lessons from non-tax law and offer factfinding by jury. Having two

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200. *Id.* at 2073.

201. *Id.* at 2080.

202. *Id.* at 2083 & n.346 (citing Catherine Donnelly, *Participation and Expertise: Judicial Attitudes in Comparative Perspective*, *in* Comparative Administrative Law 370, 370–74 (Susan Rose-Ackerman et al. eds., 2d ed. 2017); Susan Rose-Ackerman, Controlling Environmental Policy: The Limits of Public Law in Germany and the United States 10 (1995)).

203. Emerson, *supra* note 199, at 2086.

204. *See* Altera Corp. v. Comm'r, 145 T.C. 91 (2015) (sustaining arbitrary and capricious challenge to a tax regulation), *rev'd*, 926 F.3d 1016 (9th Cir. 2019); United States v. Home Concrete & Supply, LLC, 566 U.S. 478, 480 (2012) (finding "omission" unambiguous contrary to IRS argument that an omission from income includes an overstatement of tax basis in an asset).

205. Saltzman & Book, *supra* note 67, ¶ 1.03[4]; Hoffer & Walker, *supra* note 5, at 224.

routes to review with different institutional strengths adds to accountability.[206]

On the other hand, interference by another expert may have a cost in terms of expertise. That is, under the assumption that Congress delegated administration to the IRS and Treasury Department, even though judges of the Tax Court are experts, they have not been the object of a delegation to fill in gaps. As Stephanie Hoffer and Chris Walker have explained, the Tax Court has not been shy to substitute its judgment, even in non-deficiency matters seemingly committed to the discretion of the IRS.[207] In any event, review by the Tax Court has proved to be a potent check on the IRS;[208] this cuts against generic objections to agency overreach.

3. Self-Assessment and Voluntary Compliance

It is a truism that our tax system is based on voluntary compliance.[209] This may, of course, be true to an extent with many administrative

206. *See* Leandra Lederman, *(Un)Appealing Deference to the Tax Court*, 63 Duke L.J. 1835, 1880–81 (2014) (contrasting expertise of the Tax Court, with the limits of expertise and the benefits of input from generalist judges).

207. *See* Hoffer & Walker, *supra* note 5, at 250–51, 258–59, 261–62.

208. *See generally* David Laro, *The Evolution of the Tax Court as an Independent Tribunal*, 1995 U. Ill. L. Rev. 17 (1995); James Edward Maule, *Instant Replay, Weak Teams, and Disputed Calls: An Empirical Study of Alleged Tax Court Judge Bias*, 66 Tenn. L. Rev. 351, 399, 425 (1999) (concluding that the Tax Court "is not biased in favor of the IRS" and that "it might be biased in favor of taxpayers" but reserving on the latter question); *cf.* Steve R. Johnson, *Reforming Federal Tax Litigation: An Agenda*, 41 Fla. St. U. L. Rev. 205, 254 (2013) ("The better studies refute rather than confirm the Tax Court's alleged pro-IRS bias.").

209. Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 Ohio St. L.J. 1453 (2003); J.T. Manhire, *Tax Compliance as a Wicked System*, 18 Fla. Tax Rev. 235 (2016) [hereinafter, Manhire, *Wicked System*]; J.T. Manhire, *There Is No Spoon: Reconsidering the Tax Compliance Puzzle*, 17 Fla. Tax Rev. 623 (2015); J.T. Manhire, *What Does Voluntary Tax Compliance Mean?: A Government Perspective*, 164 U. Pa. L. Rev. Online 11 (2015); Bret Wells, *Voluntary Compliance: "This Return* Might Be *Correct But* Probably *Isn't*," 29 Va. Tax Rev. 645 (2010).

regimes.[210] Tax may be unique in terms of the breadth of recurring application to millions of taxpayers, complexity, and continued budgetary constraints of the IRS. Adopting a regime that signals a weakened ability of the government to audit—especially when elite taxpayers achieve salient victories—may have particularly strong negative consequences for the tax system.

Various models explain why taxpayers comply, given an audit rate that is so low in the United States. Deterrence clearly explains some compliance. But scholars have been surprised at the extent that deterrence fails to account for the high degree of compliance.[211] Behaviorism and signaling may account for the difference.[212]

Behavioral theories suggest that bounded rationality limits a taxpayer's ability to make utility-maximizing decisions. Behaviorists also posit that social norms, such as perceptions of fairness, patriotism, and reciprocity may drive compliance.[213] Signaling theory "focuses on the taxpayers' perception of the government as a 'strong' auditor; the tax authority has a reputation both for accurately selecting tax returns for audit that contain noncompliance, and the audits themselves are very effective at discovering noncompliance on an audited tax return."[214]

Accordingly, it is important that the tax system be perceived as fair and that the IRS be perceived as effective. Fairness cuts both ways in the context of administrative procedure, though effectiveness only cuts against vacating tax rules on technicalities. All other things being equal, the ability of the public to participate in a rulemaking would seem likely to promote perceptions of fairness.[215] On the other hand, the APA rules for participation do not seem critical to promoting the appearance

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210. *See, e.g.*, Sidney A. Shapiro & Randy S. Rabinowitz, *Punishment Versus Cooperation in Regulatory Enforcement: A Case Study of OSHA*, 49 Admin L. Rev. 713 (1997).

211. *See* Manhire, *Wicked System*, *supra* note 209, at 248–50.

212. *Id.* at 251–52.

213. *Id.* at 250–52.

214. *Id.* at 252.

215. *See* E. Allan Lind & Tom R. Tyler, The Social Psychology of Procedural Justice 242 (1988) (observing that individuals "pay a great deal of attention to the way things are done and the nuances of their treatment by others"); Elizabeth Chamblee Burch, *Procedural Justice in Nonclass Aggregation*, 44 Wake Forest L. Rev. 1, 5–6 (2009) (noting the significance of fair procedure for compliance).

of fairness.[216] Moreover, the business interests that dominate tax rulemakings do not care about process values so much as outcomes.[217]

The I.R.C.'s system of accuracy-related penalties promotes reporting uncertain positions, which also ties into deterrence. These penalties have been a part of the I.R.C. since 1918 and 1921.[218] The Treasury later expanded upon these provisions in regulations:

> [I]n 1991, Treasury adopted Treas. Reg. §§ 1.6662–3 and 1.6694–3, in which it expressly defined rules and regulations for purposes of these penalty provisions as including temporary regulations, revenue rulings, and IRS notices, while suggesting in the regulatory preamble that the same would be true of at least some revenue procedures. After comments to the proposed definition objected particularly to the inclusion of revenue rulings on the ground that those documents lacked public notice and comment, Treasury contended that the 1976 legislative history "expressly provides that rules and regulations include regulations and 'IRS rulings.'"[219]

These penalties are important to reduce the incentive to play the "audit lottery." Importantly, a taxpayer is not absolutely prohibited from taking a position contrary to published tax rules or regulations. Depending on the type of authority, the taxpayer's position may need to meet the substantial authority standard or have a reasonable basis and be disclosed on the tax return.[220] A position dependent on the invalidity of a

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216. *See* Bagley, *Procedure Fetish*, *supra* note 22, at 384 (asserting that "the public neither knows nor cares if the IRS cuts the APA's procedural corners") (citing Ilya Somin, Democracy and Political Ignorance (2013)).

217. *See* Nancy A. Welsh, *Making Deals in Court-Connected Mediation: What's Justice Got to Do With It?*, 79 Wash. U. L.Q. 787, 817–18 & nn.148–149 (2001) (citing studies that suggest a distinction between individual and institutional litigants).

218. *See* Hickman, *supra* note 5, at 526.

219. *Id.* at 527 (footnotes omitted; quoting T.D. 8381, 1992–1 C.B. 374).

220. *See* Treas. Reg. §§ 1.6662–3; 1.6694–3(c); *see also* Dennis J. Ventry, Jr. & Bradley T. Borden, *Probability, Professionalism, and Protecting Taxpayers*, 68 Tax Law. 83, 112–16 (2014).

regulation must represent a good faith challenge and identify the regulation.[221]

The critical importance of voluntary compliance and self-assessment for the function of the tax system counsels caution in embracing demanding procedural regimes that could undermine the IRS's ability to audit. The existence of reliable tax rules taps into important signaling mechanisms as well as deterrence. If tax rules are hanging on by a thread, with dated[222] APA claims lurking around every corner, taxpayers may feel more and more willing to disregard them and fail to disclose inconsistent positions.[223]

4. Public Participation in Tax Rulemaking

To the extent that the purposes of public participation matter, the interest group model "demands robust and diverse participation in the process, which appears to be lacking in tax rulemaking."[224]

First, elite taxpayer interests already dominate the comment process. Professors Oei and Osofsky recently documented the pre-comment period influence of well-organized stakeholders toward the section 199A regulations.[225] As Professor Stephanie McMahon has noted, notwithstanding the existence of a statutory process for commenting, "many scholars argue that the majority of comments received on tax regulations are informal and delivered over the phone."[226] Professor Wallace conducted a sample of rulemaking activity by the IRS and Treasury Department post-*Mayo* and concluded that "there often has been very close to zero participation," and "the few participants have been heavily weighted towards private interests, often

221. Treas. Reg. § 1.6694–3(c)(2).

222. *See supra* Part II.B.

223. *Cf.* Alex Raskolnikov, *Probabilistic Compliance*, 34 YALE J. ON REG. 491, 543 (2017) (concluding, in part, that "greater certainty mostly leads to greater compliance" and the "market for legal advice tends to increase the perceived certainty of the law and make uncertain standards appear more permissive").

224. *See* Wallace, *supra* note 5, at 217.

225. *See* Oei & Osofsky, *supra* note 163.

226. *See* McMahon, *supra* note 5, at 562–63.

sophisticated business taxpayers seeking to reduce tax liability in ways that were wholly predictable when Congress addressed the issue."[227]

Further, McMahon argues that despite the irregularities in comparison with the APA, there is no substantive problem with the process actually provided: "Historically, there has been little complaint from practitioners about any of the forms of tax guidance, particularly on procedural grounds. 'Most members of the tax community believe that Treasury does a decent job in drafting regulations and instead focus their grumbling on issues where guidance is lacking.'"[228] Wallace observes that an "important feature of the archetype notice-and-comment process is . . . missing from responses to many proposed tax regulations: These rules often do not seem to prompt useful data or insights to inform the rulemaking process."[229]

It may be puzzling why the Treasury Department so often entertains comments, even before the proposed rulemaking and even when it claims an exemption from the APA. Perhaps the agency is following its own self-interest. To the extent that a rulemaking is interpretative, the statutory arguments made in the comments may be helpful in assessing the government's likelihood of achieving deference to the regulations. To the extent that sophisticated taxpayers have sophisticated textual arguments related to a proposed rule, the government's interest aligns with the taxpayer's interest in considering those arguments.[230]

On the other hand, if the Treasury Department is acting under a delegation that is closer to a meaningless standard, it may, to some extent, perceive public comments to be a nuisance. Whatever the Treasury's attitude, such comments, assuming a level of materiality, must be given adequate consideration. And, if the Treasury had already decided on the content of the rule, then there could potentially be little

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227. *See* Wallace, *supra* note 5, at 217.

228. *See* McMahon, supra note 5, at 568 (quoting Hickman, *supra* note 54, at 1800).

229. *See* Wallace, *supra* note 5, at 224.

230. *Cf.* Ronald M. Levin, *Rulemaking and the Guidance Exemption*, 70 Admin. L. Rev. 263, 328 (2018) ("the suggestion that public input on such questions would not be helpful to an administrative agency seems startling"). *But cf. id.* ("The *best* justification for the exemption would be that the agency does not need to offer the public an opportunity to be heard when an interpretive rule is issued because that opportunity will be made available later in the administrative process.").

perceived benefit to comments. That is because, if the agency can adequately address a policy objection, the ultimate decision belongs to the agency if permissible under the organic statute. This is not to suggest that Treasury does not value public comment, but some comments are inevitably more constructive than others. The agency ultimately does not have to remain neutral and is accountable.[231]

Thus, to the extent that even imbalanced public participation legitimates, restraining the tax administration would seem to be more important when it is applying specific authority delegations that are closer to the prototypical meaningless standard. Even though interpretative rules are excepted from the APA's notice and comment requirement, it is probably in the Treasury's own interest to get feedback on such rules sooner than litigation. This may not always be practicable. Although the government should be more nuanced in its analysis and not simply assume that general-authority regulations are interpretative, some impactful rules should be able to qualify as interpretative under the APA. Unfortunately, the lack of clarity surrounding the contours of "interpretative rules" destabilizes tax rules; this is particularly acute if the statute of limitations on APA-based challenges has no teeth in litigation surrounding tax rules.[232]

IV. Clarifying the Tax Administration's Friction with the APA

To think about prejudicial and harmless error, it is necessary first to clarify what counts as an error at all. Much attention has been devoted to the potential for chilling public participation when the Treasury promulgates temporary regulations. This Article posits that there are more important challenges on the horizon for Treasury and the IRS.

First, Treasury and the IRS should anticipate substantiating their reasoned decisionmaking in court. Notwithstanding a major victory in *Altera*, this will be a growing problem for the tax administration even

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231. *Cf.* Kristin E. Hickman, *The Need for* Mead*: Rejecting Tax Exceptionalism in Judicial Deference*, 90 Minn. L. Rev. 1537, 1539 (2006) ("Treasury officials are more democratically accountable, are better positioned to respond through regulations to changes in taxpayer behavior and tax policy trends, and possess significantly more expertise over the complexities of the tax laws than most judges.").

232. *See supra* Part II.B–C.

more so than for other agencies. Unless the government pursues and obtains repose under the statute of limitations, notwithstanding potential unfairness on account of the Anti-Injunction Act, there will be instability if the courts invariably vacate procedurally defective rules.

This Article also posits that the potential for retroactivity of tax rules will be increasingly important to clarify. This is probably most important if the tax legislative process follows a speedy path that ends up implying broad delegations to the Treasury. The problem is even more acute if the application of the "interpretative rules" exception under the APA suffers from a crabbed tax jurisprudence.

In short, this Part urges courts and commentators to accept that tax rules (including regulations) can—under the prevailing jurisprudence—qualify as interpretative. Second, although it is a closer call, this Part explains the need for judicial resolution of whether tax rules and regulations that cannot qualify as "interpretative rules" can be backdated.[233] Finally, this Part offers preliminary thoughts on how harmless error analysis may (or may not) be extended to some of the principal process defects that are likely to be implicated in tax rulemaking.

A. Tax Rules (Including Regulations) May Qualify as "Interpretative Rules"

Important consequences turn on the APA distinction between substantive or legislative rules, on the one hand, and "interpretative" rules, on the other.[234] Courts have struggled to apply these principles to concrete

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233. *See infra* Part IV.B.

234. *See supra* Part II.D; *see also* Nat'l Mining Ass'n v. McCarthy, 758 F.3d 243, 251 (D.C. Cir. 2014). As then-Judge Kavanaugh explained:

> So given all of that, we need to know how to classify an agency action as a legislative rule, interpretive rule, or general statement of policy. That inquiry turns out to be quite difficult and confused. It should not be that way. Rather, given all of the consequences that flow, all relevant parties should instantly be able to tell whether an agency action is a legislative rule, an interpretive rule, or a general statement of policy—and thus immediately know the procedural and substantive requirements and consequences. An important continuing project for the Executive Branch, the courts, the administrative law bar, and the legal academy—and perhaps

scenarios. Even focusing on the law of a particular circuit, the jurisprudence can be muddled.[235]

1. Defining "Interpretative" Rules

As with many APA concepts, the interpretative distinction is not easy to apply.[236] Courts typically ask whether the agency's rule is in the nature of a clarification of the statute.[237] Or, does the agency have no basis to enforce the organic statute without the rule? If, in the language of the often-cited Attorney General's Manual, the agency's action goes further than to "advise the public of the agency's construction of the statutes and rules which it administers,"[238] then the nature of the rule must be substantive rather than interpretative.

Clarifications are not necessarily toothless or unimportant. Interpretative is not synonymous with merely stating the obvious: "[A] true 'no-brainer' interpretation would be exempt from rulemaking requirements anyway. The APA has a separate exemption for situations in which public procedures would be 'unnecessary,' meaning that members of the public would have no interest in commenting on the rule in question."[239] An agency may draw from case law and its experience

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> for Congress—will be to get the law into such a place of clarity and predictability.

Id.

235. *See generally* Morgan Douglas Mitchell, Note, *Wolf or Sheep? Is an Agency Pronouncement a Legislative Rule, Interpretive Rule, or Policy Statement?*, 62 Ala. L. Rev. 839 (2011) (survey of the tests employed across the Circuit Courts of Appeals).

236. *See* Kovacs, *supra* note 16, at 532 (noting that the APA was a compromise made possible through intentional ambiguity); Levin, *supra* note 230, at 316–17 ("Asimow elsewhere called the distinction 'exceptionally elusive' and 'maddeningly indeterminate.' To Elizabeth Magill, it is 'a notoriously difficult enterprise.' According to Jacob Gersen, 'To describe the legislative rule debate is to conjure doctrinal phantoms, circular analytics, and fundamental disagreement even about correct vocabulary.'" (footnotes omitted)).

237. *See* Hoctor v. USDA, 82 F.3d 165, 170 (7th Cir. 1996).

238. Attorney General's Manual, *supra* note 53, at 30 n.3.

239. *See* Levin, *supra* note 230, at 329 (footnotes omitted).

about the facts to issue an interpretative rule.[240] Moreover, under this approach, interpretative rules may draw quantitative lines that are not apparent from the text of a statute.[241] But if an agency rule is necessary for an agency to maintain an action against a regulated party, then it could not properly be classified as interpretative.[242]

Professor Levin has been a vocal critic of this "most common" approach to the issue.[243] Although it "follow[s] logically from the . . . [statutory] language," Levin argues that the test is "incoherent" and "pointless"[244]; that "the courts took a wrong turn decades ago when they embraced that approach, and that the result has been bafflement ever since."[245]

Levin encapsulates the case against following the plain language of the APA interpretative rules exception as follows:

> [T]he interpretive rules exemption matters only in relation to *debatable* issues of interpretation. As to those issues, any notion that the agency's chosen interpretation must be already implicit in (discernible from) the underlying statute or regulation is an exercise in question-begging. Indeed, the agency will likely have issued the interpretive rule *because* affected persons have previously disagreed about its subject matter.[246]

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240. *See* Cent. Tex. Tel. Coop. v. FCC, 402 F.3d 205 (D.C. Cir. 2005).

241. *See* Shalala v. Guernsey Mem'l Hosp., 514 U.S. 87, 111 (1995) (O'Connor, J., dissenting) (approving of "detailed examples, including step-by-step calculations, of how certain rules should be applied to particular facts" but disagreeing that reversal of a prior rule could qualify as interpretative); *Hoctor*, 82 F.3d at 171.

242. *See* Levin, *supra* note 230, at 323–24; *see also* Wurman, *supra* note 44, at 731 (positing that "insofar as the rule is not merely an interpretation, but actually a specification" public participation "is and ought to be required by the APA").

243. Ronald M. Levin, *Unifying the APA Exemptions for Policy Statements and Interpretive Rules*, Admin & Reg. L. News, Winter 2018, at 4, 5.

244. *Id.*

245. *See* Levin, *supra* note 230, at 317.

246. *Id.* at 329.

Levin's assertion seeks to rebut a potential counterargument that the cost of agencies undertaking notice and comment rulemaking outweighs the benefits of public participation, at least for interpretative rules. True enough, if an issue is debatable, there is probably some benefit to participation. But that does not compel the conclusion that it is always worth the cost.[247]

Different administrators may either have different views of whether interpretative rules may bind or may not have focused much on the particular issue. Professor Nicholas Parrillo's study focuses on guidance, how it may practically bind, and what to do about it; for purposes of the study, "guidance" was defined to exclude guidance that an interviewee thought was legally binding.[248] Although not the central question, Professor Parrillo's interviews with agency officials and former officials uncovered a divergence of views, or lack of confidence in some cases, about whether interpretative rules may legally bind.[249]

As an example aligning with the most common judicial approach to the question whether interpretative rules may legally bind, "a large law firm partner, not a specialist on a particular agency, said the courts and the bar generally did understand that interpretive rules could bind, and that was how most regulated entities approached the issue."[250] In contrast, Marc Freedman, the executive director of labor law policy for the U.S. Chamber of Commerce, "said the Chamber assumed that, when DOL issued guidance, it intended to make that guidance 'stick'—the Department would not commit resources to issuing a document to which it would not adhere—but when asked about the theory that *interpretive status* conferred power to bind, he said that 'seems academic.'"[251] One comment, on the other hand, is telling about the (lack of) salience of this issue, as "a former senior EPA official with cross-office responsibilities, recalled the agency proceeding by interpretative rule for the

247. For a discussion of imbalanced participation in tax rulemaking, see *supra* Part II.A and D.

248. *See* Nicholas R. Parrillo, *Federal Agency Guidance and the Power to Bind: An Empirical Study of Agencies and Industries*, 36 Yale. J. on Reg. 165, 168 n.6 (2019).

249. *See* Nicholas R. Parrillo, Report for the Administrative Conference of the United States, Federal Agency Guidance: An Institutional Perspective 22–26 (Oct. 12, 2017).

250. *Id.* at 25 n.36.

251. *Id.* at 24 n.36.

specific reason that such a vehicle would be binding, though she said she only saw this happen 'once' during her tenure."[252]

The IRS and Treasury Department have consistently asserted that, in general, tax rules and regulations are interpretative, but without providing specific reasons.[253] This test is not terrible as a heuristic. Broad delegations enacted by Congress to allow the Treasury Department to craft tax rules are less common.[254] Although there is something to be said for the general-versus-specific distinction, it fails fully to grapple with the fuzzy legal tests in this area.[255] An agency need not have virtually unfettered discretion for its action to cross the line between interpretative and substantive rulemaking.

Professor Hickman, on the other hand, has argued that practically all tax rules are legislative:

> If the goal is to determine which agency actions carry the force of law, then distinguishing between temporary Treasury regulations and IRB guidance based on the relative severity or leniency of Treasury's penalty standards, as the *Kornman* court did, draws the line in the wrong place. Under either standard, the government seeks to impose penalties for noncompliance on at least some taxpayers who fail to comply with interpretations advanced in the listed formats. If one associates congressionally imposed penalty provisions (and agency interpretations thereof) with the delegation of authority to act with the force of law, then the relevant line ought instead to be between formats that carry penalties and those that do not.[256]

Hickman's gloss derives from a historical convention suggesting that penalties for violation of a rule indicate that it carries the force of law.[257]

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252. *Id.* at 23–24 n.36.

253. *See* Hickman, *supra* note 5, at 467–68; Hickman, *supra* note 54, at 1757.

254. *See generally* Wallace, *supra* note 5 (arguing that Congress takes more control of tax policy than other administrative areas to take credit for the policies).

255. *Cf.* Levin, *supra* note 230, at 337–40.

256. *See* Hickman, *supra* note 5, at 529.

257. *Id.* at 526.

In respect of a deficiency in tax, the accuracy-related penalty would generally apply if a taxpayer's tax deficiency is attributable to the disregard of rules or regulations.[258] In turn, Hickman argues that any tax rules that count as authority have been promulgated in the exercise of Treasury's authority to act with the force of law.[259] The Tax Court applied something resembling Hickman's proposal in *Altera*,[260] before applying the standard test more recently in *Oakbrook Land Holdings*.[261]

Professor Hickman's rule would be attractively easy to apply and somewhat resembles Professor Levin's suggestion to focus on binding norms and whether an agency has afforded a fair and adequate opportunity to participate later.[262] But this makes too much of the incentive to disclose tax return positions that are contrary to tax rules. Interpretative rules can create incentives for regulated parties to study the rules and consider costly action to comply or work around the rules.[263] Moreover, the I.R.C. acknowledges that there will be tiers of guidance, rather than all rules collapsing into one "binding" category. The IRS cannot and does not argue for a strict liability penalty for violating tax rules. The I.R.C. and Treasury regulations provide play in the joints for taxpayers to take uncertain tax positions,[264] which will sometimes be contrary to administrative guidance.

Courts also should not adopt a bright-line test for what tax rules count as interpretative. The IRS and Treasury Department cannot

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258. *Id.* at 526–27; *see also supra* text accompanying notes 218 to 219.

259. *Id.* at 529.

260. Altera Corp. v. Comm'r, 145 T.C. 91, 116–17 (2015), *rev'd*, 926 F.3d 1061 (9th Cir. 2019).

261. Oakbrook Land Holdings, LLC v. Comm'r, 154 T.C. 180, 189 (2020) ("An interpretative rule merely clarifies or explains preexisting substantive law or regulations.").

262. *See* Levin, *supra* note 230, at 356–57.

263. *See id.* at 344 ("Yet the function of an interpretive rule—its only reason for existing—is to specify *which* of various imaginable meanings of the underlying statute or regulation the agency considers correct. Thus, to say that, because the statute is binding, the interpretation that the agency happens to have selected must also be binding begs the question.").

264. *See* Hickman, *supra* note 5, at 467–69.

simply declare any rule "interpretative,"[265] nor would it be appropriate to require all tax regulations to undergo notice and comment under the APA. This would go against consistent administrative practice, though the scope of the problem is blurred by the Treasury's propensity to go through notice and comment.[266] Instead, the courts should apply the flexible, judge-made standards to tax rulemaking that are being applied to other administrative rulemaking.[267] Tax cases post-*Mayo*

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265. In contrast, the Internal Revenue Manual states:

> [M]ost IRS/Treasury regulations will be interpretative regulations because they fill gaps in legislation or have a prior existence in the law. . . . [and] the underlying Internal Revenue Code section imposing the tax or providing for collection of a tax will provide an adequate legislative basis for the action in the regulations.

I.R.M. § 32.1.5.4.7.4.1(2). Clearly, however, some tax rules will indeed be legislative. It is insufficient for the IRS and Treasury to reflexively invoke the exception for interpretative rules.

266. *See* Camp, *supra* note 5, at 1680. As Professor Camp summarizes:

> This is the new orthodoxy: it is wrong to treat tax administration differently from the work of other administrative agencies. There is no better evidence of orthodoxy than to find the idea encapsulated in a student note that dutifully summarizes the story this way: "For years, generally applicable administrative law was not applied to taxation under the doctrine of tax exceptionalism."

Id. (quoting *Recent Case, Dominion Resources, Inc. v. United States, 681 F.3d 1313 (Fed. Cir. 2012)*, 126 Harv. L. Rev. 1747, 1747 (2013)).

267. *See, e.g.*, Dismas Charities, Inc. v. U.S. Dep't of Just., 401 F.3d 666, 679 (6th Cir. 2005); Warder v. Shalala, 149 F.3d 73, 79–80 (1st Cir. 1998); Hoctor v. USDA, 82 F.3d 165, 171–72 (7th Cir. 1996); *cf.* Am. Mining Cong. v. Mine Safety & Health Admin., 995 F.2d 1106, 1112 (D.C. Cir. 1993) (emphasizing "whether in the absence of the rule there would not be an adequate legislative basis for enforcement action or other agency action to confer benefits or ensure the performance of duties"). *But see* Mada-Luna v. Fitzpatrick, 813 F.2d 1006, 1016 (9th Cir. 1987) (focusing on whether there is binding effect on the agency).

clearly are applying the general administrative law test, although not always.[268] Sometimes the government will lose on its theory that a rule qualifies as "interpretative."[269] But that is a far cry from applying a bright line rule against interpretative tax regulations or other rules that go beyond safe harbors.[270]

2. The I.R.C.'s Retroactivity Provisions Corroborate the Concept of Interpretative Tax Rules (Including Regulations)

As discussed above, the "interpretative rules" exception under the APA should encompass a variety of tax rules (including regulations). Following that general approach would relieve some of the apparent friction between the tax administration and the APA. That approach is probably sufficient; however, this section observes that the I.R.C. corroborates the notion that there will be interpretative tax rules and regulations.

Section 7805 allows the IRS and Treasury Department to specify the retroactive effect of rules.[271] As Part II explained, until 1996, retroactive application to the date of the statutory provision was the presumption for tax rules; moreover, there are a variety of allowances for retroactive rules relating to more recently enacted statutory provisions.[272]

Although interpretative rules may apply retroactively, the Supreme Court has been reluctant to infer agency power to apply other rules with retroactive effect.[273] But section 7805(b) should not be given

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268. *See* Bullock v. IRS, 401 F. Supp. 3d 1144 (D. Mont. 2019); Oakbrook Land Holdings, LLC v. Comm'r, 154 T.C. 180 (2020). *But see* Altera Corp. v. Comm'r, 145 T.C. 91, 116–17 (2015), *rev'd*, 926 F.3d 1061 (9th Cir. 2019).

269. *Bullock*, 401 F. Supp. 3d at 1158. Although the opinion is unclear, the court seemed to characterize the revenue procedure as legislative, because the Secretary was implementing an open-ended delegation to require (or cease to require) "other information" to be included on an information return. The court largely ignored the government's argument that the revenue procedure could qualify as a rule of "procedure or practice." *Id.* at 1155.

270. *Cf.* Health Ins. Ass'n of Am., Inc. v. Shalala, 23 F.3d 412, 423 (D.C. Cir. 1994) (clarifying that publication in the C.F.R. is nothing more than a "snippet of evidence of agency intent").

271. *See* I.R.C. § 7805(b).

272. *See* text accompanying notes 112 to 117.

273. *See* text accompanying notes 107 to 111.

an absurdly narrow reading. At a minimum, this suggests that tax rules can be interpretative, though it will be a heavier lift to conclude that legislative tax rules may be applied retroactively.[274]

Moreover, if no tax rules could be interpretative, it would be puzzling for Congress to refer to "rules" as distinct from "regulations." In the restrictive view, both would have to undergo a process involving public participation, yet "rules" would not carry as much weight. It seems more likely that the tiers of authority are available for the accuracy-related penalty as well as for retroactivity purposes.[275]

Some tax scholars point to the possibility of a "good cause" escape hatch from the APA.[276] Professor McMahon argues that good cause should be read more expansively,[277] although Professor Hickman stresses persuasively that the APA's "good cause" exception rarely will be plausible for tax rules.[278] Even if good cause could plausibly excuse

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274. *See infra* Part IV.B.

275. *But cf.* Hickman, *supra* note 54, at 1773 (identifying multiple specific references to both "rules" (or "rulings") and "regulations" in legislative history though concluding the argument is weak).

276. *See* Hickman, *supra* note 5, at 522 ("More generally, in the APA itself, Congress provided the good cause exception whereby agencies can adopt legislative rules without notice and comment given the right circumstances. If Congress has authorized alternative procedures for binding regulated parties with the force of law, then it makes little sense to deny the resulting rules legal force and thus *Chevron* deference because the agency did not follow the APA's notice and comment procedures."); *see also id.* at 532 (suggesting that the good cause exception might apply in the case of tax shelter transactions).

277. McMahon, *supra* note 183, at 575–84.

278. *See* Mack Trucks, Inc. v. EPA, 682 F.3d 87, 93–94 (D.C. Cir. 2012) ("narrowly construed and only reluctantly countenanced" in "emergency situations, where delay could result in serious harm" rather than an "escape clause" (citations omitted)); Hickman, *supra* note 5, at 494 ("truly unusual circumstances, such as when public safety is threatened or advance notice of a rule might undermine its application"); James Kim, *For a Good Cause: Reforming the Good Cause Exception to Notice and Comment Rulemaking Under the Administrative Procedure Act*, 18 Geo. Mason L. Rev. 1045, 1053 (2011) ("On the whole, judicial decisions recognize an agency's reliance on the good cause exemption in three situations: (1) where there is an immediate threat to the public health, safety, or welfare; (2) where prior notice of a proposed rule causes harm and frustrates the purpose of the rule; and (3) where Congress has explicitly or implicitly exempted a specific rule

postpromulgation comment with respect to an occasional temporary regulation, this narrow exception from the APA would not align plausibly with the general rules of section 7805(b).

On balance, Congress seems to have assumed it would be quite possible for the Treasury to promulgate a retroactive tax rule. The following section examines whether I.R.C. section 7805 creates a more expansive exception to the APA requirements that could apply beyond interpretative rules.

B. Retroactivity of Tax Rules

Some tensions between the APA and the I.R.C. can be avoided by a standard application of generally applicable jurisprudence on interpretative rules. But the availability of a robust interpretative rules exception from the APA notice and comment process cannot resolve all the tensions. For example, what if Congress continues to enact complicated tax acts, with the expectation that the Treasury Department will move quickly to issue appropriate regulations to implement the new statutory provisions? The government can only lean so hard on the interpretative rules exception; eventually, it will be critical to know the reach of the I.R.C. backdating provisions. For example, do regulations implementing a new tax act or aimed at preventing abuse have to comply with the general presumption against retroactivity, along with the delayed effective date requirement of APA section 553(d)? Moreover, if courts were to take up whether the Treasury's power to backdate is limited to interpretative rules, this relates to a substantive question of permissibility. This question does not seem susceptible to an approach of remedial restraint; the rule of prejudicial error cannot convert an impermissible statutory interpretation into one that is permissible.

Arguably, the I.R.C. provisions on retroactivity do not conflict with APA section 553(d) and are clear enough to rebut the general presumption against retroactivity. This reading seems especially necessary with respect to new tax acts and the prevention of abuse. A

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from informal rulemaking procedure."). *But see* McMahon, *supra* note 183, at 575–84 (citing the cumulative effect of delay and dysfunction to argue that "the good cause exception from notice and comment should be available under its prongs of 'impracticability' and 'contrary to the public interest' any time Congress incorporates revenue estimates for tax legislation into the budget").

challenge for a sweeping construction of I.R.C. section 7805(b) is a canon of construction prescribed by the APA: "No subsequent legislation shall be held to supersede or modify the provisions of this Act except to the extent that such legislation shall do so expressly."[279] Accordingly, although courts and commentators have long thought that retroactivity is not limited to interpretative tax rules, one might insist section 7805(b) should apply only if a tax rule qualifies as an interpretative rule.[280]

Very limited applications of the I.R.C. backdating provisions are easily reconcilable with the APA. This is true of interpretative rules (subject to the ambiguities of the concept[281]) that are backdated to the notice of proposed rulemaking. But the I.R.C. also calls for backdating to prevent abuse[282] and to implement new statutory provisions of the I.R.C. within 18 months.[283] These provisions seem likely to involve broader gap filling than the interpretative rules exception can accommodate. Unfortunately, nothing in section 7805 expressly addresses the requirements of the APA.

Despite the APA's rule of construction, courts have left the door open to repeal by implication. As Justice Scalia explained in *Lockhart*:

> Among the powers of a legislature that a prior legislature cannot abridge is, of course, the power to make its will known in whatever fashion it deems appropriate—including the repeal of pre-existing provisions by

279. Administrative Procedure Act § 12, 60 Stat. 237, 244 (1946).

280. *Compare* Anderson, Clayton & Co. v. United States, 562 F.2d 972, 984–85 (5th Cir. 1977) ("settled law" that legislative rules may be retroactive); Bryan T. Camp, Note, *The Retroactivity of Treasury Regulations: Paths to Finding Abuse of Discretion*, 7 Va. Tax Rev. 509, 512–13 (1988) (noting split in case law on retroactivity, with some cases holding that only legislative regulations were reviewable); Hickman, *supra* note 54, at 1738 (observing that "the potential for retroactive application is not necessarily inconsistent with the general rule of a delayed effective date"), *with* David Berke, *Reworking the Revolution: Treasury Rulemaking and Administrative Law*, 7 Mich. J. Env't & Admin. L. 353, 400–401, 412 (2018) (concluding that "tax regulations can be interpretive" and arguing that the "plain language of § 7805(b) does not independently authorize retroactive regulations").

281. *See supra* Part IV.A.

282. I.R.C. § 7805(b)(3).

283. I.R.C. § 7805(b)(2).

> simply and clearly contradicting them. Thus, in *Marcello v. Bonds*, 349 U.S. 302 (1955), we interpreted the Immigration and Nationality Act as impliedly exempting deportation hearings from the procedures of the [APA], despite the requirement in § 12 of the APA that "[n]o subsequent legislation shall be held to supersede or modify the provisions of this Act except to the extent that such legislation shall do so expressly," 60 Stat. 244. The Court refused "to require the Congress to employ magical passwords in order to effectuate an exemption from the Administrative Procedure Act." 349 U.S., at 310. We have made clear in other cases as well, that an express-reference or express-statement provision cannot nullify the unambiguous import of a subsequent statute. In *Great Northern R. Co.* v. *United States*, 208 U.S. 452, 465 (1908), we said of an express-statement requirement that "[a]s the section . . . in question has only the force of a statute, its provisions cannot justify a disregard of the will of Congress as manifested either expressly *or by necessary implication* in a subsequent enactment." . . . A subsequent Congress, we have said, may exempt itself from such requirements by "fair implication"—that is, *without* an express statement.[284]

If, as Justice Scalia reasoned, fair implication is the applicable standard rather than a "magical password" rule, then section 7805(b) may be clear enough. The answer may also depend on the precise framing of the conflict. Courts might be more flexible in analyzing whether Congress has authorized the retroactivity of tax rules, which would be contrary to a general presumption but would not directly conflict with the text of the APA.

A few cases have suggested that I.R.C. section 7805(b) need not be read narrowly to avoid a conflict with the APA. The central logic is that the rules of I.R.C. section 7805(b) rebut the general presumption against retroactivity and either supersede or do not conflict with the

284. *See* Lockhart v. United States, 546 U.S. 142, 148 (2005) (Scalia, J., concurring) (citations shortened).

delayed effective date requirement of APA section 553(d).[285]As the Tax Court has explained, backdating was long the norm for all tax rules; section 7805(b) was originally conceived of as a discretionary relief provision.[286] The Tax Court also has reasoned that "the conflict is more apparent than real" when backdating under the I.R.C. follows a notice and comment process.[287] That is because "[t]he legislative history of the APA reveals that the purpose of the 30-day rule of 5 U.S.C. sec. 553(d) was to afford affected persons a reasonable time to prepare for final effectiveness of a rule."[288] This logic would seem to depend on the Treasury proceeding by notice of proposed rulemaking, with the notice signaling an intent to backdate, and that the final rule be a logical outgrowth of the proposed rule.

A narrower reading would hinge on the interpretative rules distinction. Although the text of the APA does not address the retroactivity of interpretative rules, Professor Kenneth Culp Davis addressed the various roles administrative rules can play in a seminal article.[289] Davis's observations have withstood the test of time.[290] Acknowledging that

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285. Redhouse v. Comm'r, 728 F.2d 1249 (9th Cir 1984) ("The specific statute giving the Secretary of the Treasury discretion to apply statutes retroactively (I.R.C. § 7805(b)) would in any conflict take precedence over the general notice statute (5 U.S.C. § 553(d))."); Wing v. Comm'r, 81 T.C. 17, 30 n.15A (1983) (explaining that although the "APA is a general statute, applying equally to all Federal agencies," the "Code, and more specifically section 7805, reflects a specific Congressional action to address a particular issue (the power of the Secretary to establish regulations necessary to accomplish the raising and collecting of revenue)").

286. Wendland v. Comm'r, 79 T.C. 355, 381 (1982) (observing that "section 7805(b) was intended to be a taxpayer-relief provision by granting the Internal Revenue Service power to avoid inequitable results" and that "retroactive effect was presumed, and prospective application could only be achieved by specific provision").

287. *Id*. at 382.

288. *Id*. at 381; *see also* Hickman, *supra* note 54, at 1738 ("[T]he potential for retroactive application is not necessarily inconsistent with the general rule of a delayed effective date."). *But see* Berke, *supra* note 280, at 412–14 (arguing that this logic elevates form over substance).

289. Kenneth Culp Davis, *Administrative Rules—Interpretative, Legislative, and Retroactive*, 57 YALE L.J. 919 (1948).

290. *See e.g.*, Beller v. Health & Hosp. Corp., 703 F.3d 388 (2012) (holding that a new rule may be applied retroactively because the rule was

interpretative and legislative rules are often difficult to distinguish,[291] Davis noted that one distinguishing feature is *how* retroactivity applies to either type of rule.[292] While agencies could give retroactive effect to legislative rules,[293] interpretative rules naturally have more retroactive application.[294]

Davis combined the logic of declaratory theory and the definition of interpretative rules to define why such rules may be applied retroactively:

> If an interpretative rule is merely an interpretation of a statute, and if the meaning of the statute has been there from the time of its original enactment, then no problem of a retroactive interpretative rule can arise, for either the interpretative rule expresses the true meaning of the statute or it does not; if it does, then that is

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"merely" clarifying what the agency always considered EMTALA, the statute upon which the rule was based, to mean. The court further stated, perhaps to not appear to be fully relying upon the declaratory theory, that if the new rule was "patently inconsistent" with an older rule concerning the same statute, then the new rule could not be applied retroactively.); *see also* William V. Luneburg, *Retroactivity and Administrative Rulemaking*, Duke L.J. 106, 144 n.209 (1991).

291. The distinguishing factors for legislative and interpretative rules considered for this section are that legislative rules *add* to the existing statute while interpretative merely *clarify* the statute upon which they are based. *See* McKenzie v. Bowen, 787 F.2d 1216, 1222 (8th Cir. 1986) ("An interpretive rule, as distinguished from a substantive or legislative rule, clarifies or explains existing law or regulations."). *But see* Health Ins. Ass'n of Am., Inc. v. Shalala, 23 F.3d 412 (D.C. Cir. 1994) ("Where we part company with the government is in its notion that interpretive rules merely echo things 'that are already express in the statute'. . . . A rule may be interpretive even though it 'interprets' a vague statutory duty or right into a sharply delineated duty or right." (citations omitted)).

292. Davis, *supra* note 289, at 944.

293. *See id.* at 945–48. Davis even advocated that retroactive legislative rules may have a necessary role. *See* Kenneth Culp Davis, Administrative Law of the Seventies: Supplementing Administrative Law Treatise § 5.08 (Supp. 1976). *But see* Bowen v. Georgetown Hosp., 488 U.S. 204, 208 (1988) (holding legislative rules may not be applied retroactively unless "that power is conveyed by Congress in express terms").

294. *See* Davis, *supra* note 289, at 949–50.

> what the statute has always meant and the rule has not changed the law retroactively; if it does not, then it does not matter whether the rule can be made retroactive, for the rule is invalid in that it is inconsistent with the statute.[295]

Multiple cases have used such logic over the years to justify retroactively applying interpretative rules.[296]

The current section 7805(b) limitations on backdating were enacted in 1996.[297] Prior versions assumed that administrative authorities would be applied retroactively, pending discretionary relief. Dean Griswold, writing in 1941, reached only a "should"-level conclusion, ostensibly on policy grounds, that retroactivity would be inappropriate for legislative tax rules.[298] In 1983, John S. Nolan and Victor Thuronyi observed that administrative practice "usually" resulted in legislative

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295. Kenneth Culp Davis, Administrative Law Treatise § 5.09 (1958).

296. *See* Manhattan Gen. Equip. Co. v. Comm'r, 297 U.S. 129, 135 (1936) ("The regulation constitutes only a step in the administrative process. It does not, and could not, alter the statute. It is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand."); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 213–14 (1976) ("The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.' (quoting Dixon v. United States, 381 U.S. 68, 74 (1965), in turn quoting *Manhattan*, 297 U.S. at 134 (1936))); Utah Hotel Co. v. Indus. Comm'n, 151 P.2d 467, 471 (1944) (reasoning that "new rulings are not retroactive" but "are in fact but the first correct application of the law"); *see also* Geoffrey C. Weien, Note, *Retroactive Rulemaking*, 30 Harv. J.L. & Pub. Pol'y 749, 754 (2007) ("Under the prevailing jurisprudence in this area, interpretative nonlegislative rules do not create new policy but merely clarify and restate what the law 'is and always has been.'" (quoting Orr v. Hawk, 156 F.3d 651, 654 (6th Cir. 1998)).

297. *See supra* note 112 and accompanying text.

298. *See* Erwin N. Griswold, *A Summary of the Regulations Problem*, 54 Harv. L. Rev. 398, 411 (1941) ("[A]s a matter of wise tax administration, the Treasury should be held to have no power to amend a legislative regulation retroactively.").

regulations taking prospective-only effect.[299] Section 7805(a), at least by the general administrative law understanding, almost certainly permits both interpretative rules and legislative rules.[300] That view does not align with the traditional heuristic for the classification of tax rules according to general authority versus specific authority.[301] It seems fairer to say that the traditional tax approach has involved a blurring of concepts.[302]

Even if the history uncovers confusion about the general administrative law content of "interpretative" rules, this need not be dispositive of the scope of section 7805(b). It is possible for courts to update the law with respect to deference doctrines and notice and comment requirements without limiting backdating or the general authority for rulemaking under I.R.C. section 7805. But the interpretative-rules-only reading of section 7805(b) would represent an abrupt limitation on the power of the Treasury. That reading would elevate hindsight over contemporary practice and the reluctance of courts to disturb retroactive tax rules.[303] Given the history, Congress must have been aware that the Treasury's rules—even legislative rules—could be retroactive. Moreover, notwithstanding Justice Scalia's APA-based concurrence, the opinion of the Court in *Bowen v. Georgetown Hospital* rooted the presumption against retroactivity in general principles relating to administrative law.[304] So, it should also not be dispositive that Congress made no reference to the APA when it acknowledged the Treasury's retroactive rulemaking authority.

On balance, it is not clear that courts will, or should, substantially curtail the retroactivity of tax rules. Although reasonable minds may differ, section 7805(b) should not be limited to interpretative rules.

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299. *See* John S. Nolan & Victor Thuronyi, *Retroactive Application of Changes in IRS or Treasury Department Position*, 61 TAXES 777, 783 (1983) (noting that "Treasury *usually* follows the practice" (emphasis added)).

300. *See* Camp, *supra* note 5, at 1714 (citing student edition of DAVIS, *supra* note 295).

301. *See id.* (noting that if this is "in some sense, a pretextual fiction, it is one that has persisted").

302. BITTKER & LOKKEN, *supra* note 40, ¶ 110.5.

303. *See* Camp, *supra* note 5, at 1709–1713 (describing the rhetorical or political tension against admitting that tax regulations could be legislative); Camp, *supra* note 280, at 513 (observing that even when courts reviewed for abuse of discretion, "the taxpayer still has a long, hard journey to make before a court will find against the Service under this standard").

304. 488 U.S. 204, 208 (1988).

At a minimum, section 7805(b) clearly evidences an intent that the Treasury will act to prevent abuse and foster equitable application of new tax acts. Both these purposes could be especially frustrated by a strict construction of section 7805(b), the text of which does not address interpretative rules. Commentators had assumed that Treasury's retroactivity was a good thing because it helped achieve equal treatment of similarly situated taxpayers.[305] Limiting section 7805(b) to interpretative rules arguably asks too much of a general presumption against retroactivity and is not necessary to avoid conflict with the text of the APA.

C. Principal Challenges

This Part has thus far attempted to minimize some potential frictions between the I.R.C. and the APA. Building on the clarifications, this section now offers a general outline of how harmless error analysis should (or should not) be extended to some of the principal process defects that are likely to be implicated in tax rulemaking.

Questions about fair notice and opportunity to participate meaningfully in rulemaking projects are generally questions of degree. And these values should be balanced against other values. There is, in short, no clear path to overall improvement in subjecting the tax administration to strict compliance with the APA. Public participation probably brings some benefits and at least marginally legitimates agencies' exercise of discretion.[306] Participation, unfortunately, can be very costly depending on the remedy for an APA-based claim. [307]

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305. *See* Mitchell Rogovin & Donald L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance and Retroactivity in the 21st Century: A View from Within*, 87 Taxes, Aug. 2009, at 21.

306. *See, e.g.*, Hickman & Thomson, *supra* note 5, at 267; Lederman, *supra* note 5, at 684; *see also* Levin, *supra* note 230, at 274.

307. *See* Murphy, *supra* note 5, at 29. Professor Murphy suggests that the courts should adopt an attitude of restraint in the face of highly questionable cost-benefit analysis:

> [W]hereas closing the *Chevron* gap was very cheap, closing the notice-and-comment gap could prove quite costly. Moreover, the primary reason for this cost is that the courts, through extremely creative construction of the APA, have made notice-and-comment procedures very expensive. Worsening matters, these same courts have never been able

Moreover, prepromulgation notice and comment combined with "hard look" review hardly guarantee diverse and robust participation.[308]

Nor will strict scrutiny necessarily bring the outcomes sought by interest groups. The difference between deference regimes may be more theoretical than real.[309] Thus, unless interpretative tax rules cannot stand, taxpayers would still be likely to confront a tax administration that receives deference. Reliance-worthy safe harbors are also not destined to emerge from a regime of judicial review that imposes more and more costs to promulgate a rule.[310] Perhaps a future administration would adjust by enacting relatively sweeping, vague tax regulations, carefully responding to comments.[311] But, having paid up-front, Treasury could perhaps implement the regulations through subsequent interpretative rules (and courts may defer).[312]

> to devise a clear test for determining which rules require notice-and-comment and which do not.

Id.

308. *See* Leslie Book, *A New Paradigm for IRS Guidance: Ensuring Input and Enhancing Participation*, 12 Fla. Tax Rev. 517, 566–70 (2012); Michael Sant'Ambrogio & Glen Staszewski, *Democratizing Rule Development*, 98 Wash. U. L. Rev. 793, 826–30 (2021).

309. *See* David Zaring, *Reasonable Agencies*, 96 Va. L. Rev. 135, 186 (2010) (concluding that the "reality is, in fact, much simpler" and advising that "courts and scholars should focus more on the unarticulated bases for reversal in administrative law and less on the standards of review").

310. *See* Jasper L. Cummings, Jr., *Foreign Partners Don't Pay Tax—Do They?*, 164 Tax Notes Fed. 695, 695 (July 29, 2019) (criticizing potential for diminished "guidance" after Treasury's "large roadblock in the way of subregulatory guidance").

311. *See* Levin, *supra* note 230, at 338 ("Once an agency has engaged in *some* rulemaking to implement an intransitive statute, it can then issue guidance to interpret the regulation."); John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 Colum. L. Rev. 612, 657 (1996) (observing that "if an agency issues an imprecise or vague regulation, it does so secure in the knowledge that it can insist upon an unobvious interpretation, so long as its choice is not '*plainly* erroneous'" (quoting, with emphasis added by Manning, Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414 (1945)).

312. *See* Cummings, *supra* note 310, at 705 (criticizing abuse of entity regulation or creating "a vast discretionary authority in the commissioner without any specific grant of authority, instead relying on

It is doubtful that the Treasury would leverage administrative law in this manner.[313] Even if one doubts the balanced incentives for good behavior of agencies, the Supreme Court has been chipping away at deference to agencies' interpretations of their own rules.[314] Rather, insisting on a perfect rulemaking process may not lead to diverse, robust, legitimating participation—a highly optimistic narrative at best—or even largely elective safe harbors. Strained for resources, even if nonbinding guidance keeps flowing from the Treasury Department, it could be of relatively low quality and unsuitable for taxpayer reliance. Recent complaints about FAQs may be a harbinger of future patterns.[315]

1. Inadequate Explanation Challenges

All agency action, even the promulgation of interpretative rules, is subject to challenge as arbitrary and capricious. The problem of "post hoc rationalizations" could prove staggering for the tax administration unless the courts take a pragmatic approach to judicial review. It is conceivable that the government could deflect some of the challenges by raising the statute of limitations, but it is far from clear how this will operate in tax. This Article assumes that the expansive interpretation of the Anti-Injunction Act will not be reversed, notwithstanding a pending case at the Supreme Court.[316] If that is the case, arbitrary and capricious challenges will probably proliferate and relate to tax rules that were promulgated many years ago.

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section 7805(a)"); Levin, *supra* note 230, at 336 ("Even if the agency's exercise of the rulemaking authority looks decidedly perfunctory, the courts do not normally use the rulemaking provisions of the APA to foreclose such guidance.").

313. *See* Daniel E. Walters, *The Self-Delegation False Alarm: Analyzing* Auer *Deference's Effects on Agency Rules*, 119 Colum. L. Rev. 85, 114–15, 164 (2019) (summarizing countervailing agency incentives and finding "no empirical evidence that agencies respond to *Auer*'s rule-writing incentives in any systematic way").

314. *See* Kisor v. Wilkie, 139 S. Ct. 2400 (2019); Christopher v. SmithKline Beecham Corp., 567 U.S. 142 (2012); *see also* Matthew A. Melone, Kisor v. Wilkie: Auer *Deference Is Alive but Not So Well. Is* Chevron *Next?*, 12 Ne. U. L. Rev. 581 (2020).

315. *See supra* note 37 and accompanying text.

316. CIC Servs., LLC. v. IRS, 925 F.3d 247 (6th Cir. 2019), *cert. granted*, 140 S. Ct. 2737 (2020); *see also* sources cited *supra* note 75.

In this context, inadequate explanation findings under "hard look" review should often be excused as harmless error. Although courts must take into account the unique facts of each case, tax rulemaking often involves "heuristic reasoning" and would not ordinarily necessitate data sets.[317] Even if not a model of clarity, the Treasury typically will be openly balancing competing values of equity and administrability; striving for clarity to avoid unintended consequences; and identifying statutory language in addition to its general authority to make rules. Although it is generally agreed that many existing tax rules have not been issued with painstaking attention to responding to comments, detailed responses may not even be necessary under a standard application of the doctrine.[318] As Shapiro and Murphy have argued, if there is adequate disclosure of information in the rulemaking, post hoc rationalizations should not be prejudicial.[319]

Exacerbating what is already a tricky question of degree, the six-year statute of limitations[320] on APA-based claims may not be applicable to APA-based claims seeking to invalidate tax rules. If that is true, it is even more important for courts to adopt some measure of restraint in crafting remedies for APA violations in the issuance of tax rules. As the Tax Court's approach in *Altera* and *Oakbrook Land Holdings* demonstrates, the issue of which comments are important enough to merit a detailed response will often not lend itself to clear answers.[321] Nonetheless, even with a harmless error mindset, courts could still vacate a rule in extreme cases involving an objectively unreasonable decision to ignore a major comment.

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317. *See* Berke, *supra* note 280, at 416; McMahon, *supra* note 5, at 603.

318. *See* Berke, *supra* note 280, at 416 (opining that "these principles can generally be explained pithily").

319. *See* Shapiro & Murphy, *supra* note 22, at 362 (arguing that "challengers would continue to have the information they need to intelligently participate in the rulemaking process as well as to provide an informed, adversarial point of view to courts during judicial review").

320. *See* 28 U.S.C. § 2401(a).

321. *Compare* Altera Corp. v. Comm'r, 145 T.C. 91, 121–22 (2015) (rejecting explanation given in response to a comment), *with* Oakbrook Land Holdings, LLC v. Comm'r, 154 T.C. 180, 191–92 (2020) (accepting brief statement that "comments from 90 organizations and individuals who supplied voluminous commentary on many aspects of the proposed regulations" were considered in making revisions to the proposed regulations).

A potential problem of timing lurks around remedial restraint in tax. This may require legislation to address if courts are to have a viable option to remand rather than simply excuse (or hold prejudicial) a process defect. Suppose a taxpayer's tax liability hinges on whether a regulation is valid, and the problem is not the permissibility of the interpretation but rather the adequacy of the explanation for the rule. If the Treasury made a reasonable mistake in failing to address a comment, a court could remand for further consideration. If the case is in Tax Court, a pre-payment forum, it may be no great hardship for the matter to be remanded to the IRS. But if the taxpayer has paid her entire tax liability and gone to refund court, a remand may be prejudicial to the taxpayer. It is far from clear that any such prejudice would be fundamentally unfair. If the taxpayer ultimately wins, the taxpayer may be entitled to interest on the overpayment. And a court could impose a deadline for an adequate explanation. An arbitrary deadline, however, could also make for an even worse explanation—or effectively resurrect a strict compliance approach. A potential solution is for a (partial) refund to be awarded, subject to further proceedings on remand. This would create an incentive for expeditious consideration without a hard-edged deadline that could lead to poor reasoning on the part of the agency.

Although a harmless error approach would not completely gut inadequate explanation review, it would substantially curtail unfair surprises in the tax context. If the goal in this context is not to provide three or more bites at the apple, but rather transparency and reasoned decisionmaking—within reason—this can be achieved with a pragmatic approach that acknowledges the tension between nimble, effective administration and addressing any matter that any other decisionmaker might deem a substantial objection.

2. Challenges Alleging Defective Notice and Comment

Postpromulgation comment for legislative rules may suddenly be much easier to excuse than post hoc rationalizations. Although the scope of *Little Sisters* could be narrower than meets the eye, the Supreme Court may indeed be serious that courts should not penalize postpromulgation comment. As explained previously, it may be premature to rely on a robust application of *Little Sisters*.[322] Moreover, even if a temporary rule counts as proper *notice*, presumably the rule could not be *effective*

322. *See* text accompanying notes 170 to 181.

(without an APA exception) unless and until properly finalized after comment.

The timing of challenges to tax rules, combined with the fuzziness of the interpretative rules distinction, counsel in favor of a rule of reason that does not place a particularly heavy burden on the government. As explained previously, because the doctrine is particularly muddled, it is unrealistic to see abuse whenever the government makes a mistake. And it is not necessary to crack down on those mistakes to afford notice and a meaningful opportunity to participate.

Now that the Treasury Department is making greater efforts to provide an opportunity for public comment on rulemaking projects, the interpretative rules distinction should be most important for pre-2011 rules. Arguably, the six-year statute of limitations should bar APA challenges to regulations and other rules issued pre-*Mayo*. But if challenges to older rules are not barred, a court could remedy the error by allowing for postpromulgation comment and treating the invalid rule as a notice of proposed rulemaking. Depending on how courts interpret I.R.C. section 7805(b), backdating the newly finalized rule may be permissible.

On balance, this Article urges courts to align judicial review with the overarching value of reasoned decisionmaking. This would permit the Treasury Department to treat a procedurally defective rule as a proposed rule, if a reasonable (even if flawed) theory supported the Treasury's decision against taking comments before promulgation of a rule. This would, consequently, allow for a backdated effective date under section 7805(b). If no significant comments are received, overturning the rule would be a windfall for the taxpayer. If there are serious, noninterpretive policy questions surrounding the rule, the Treasury Department may not be able to overcome those comments. It is not incumbent upon taxpayers to anticipate major changes to a substantive rule, and the Treasury Department may ultimately be compelled to change the rule to adapt to persuasive comments. Substantial changes, however—if combined with backdating to the date of a stale notice of proposed rulemaking—would raise serious questions about retroactivity independent of the APA.

This is one pathway to excusing defects, but *Little Sisters* may have answered this question even more permissively. Only time will tell whether the case turned on its particular facts or truly represents a permissive shift toward postpromulgation comment. Pending further clarification, the Treasury would be wise to thoroughly address any plausible APA exceptions in the preamble to its rules.

3. Retroactivity

As this Part has discussed, questions surrounding the retroactivity of tax rules are likely on the horizon. The prohibition on retroactivity of legislative rules stems from general administrative law jurisprudence. Notwithstanding section 7805(b), the overlap may be a question that is not delegated to the Treasury. The Article assumes that backdating of legislative tax rules will either be permissible, or not, depending on whether section 7805 can extend beyond interpretative rules. This does not seem amenable to a harmless error approach. But if retroactivity is permissible for legislative tax rules, the Treasury's decision to select the applicable tax periods may be subject to abuse of discretion review along with the substance of the rule.[323]

Separate from the timing of comment, courts will sooner or later have to adjudicate issues concerning the scope of the I.R.C. backdating provisions. These stand in contrast to the APA delayed effective date requirement for legislative rules. As discussed previously, this Article argues that the I.R.C. is clear enough about backdating authority and does not truly conflict with the APA. Accordingly, I.R.C. section 7805(b) and its predecessor should not be limited, e.g., to rules that would qualify as interpretative. Thus, there would be no procedural error at all if the Treasury Department conducts a notice and comment rulemaking—and consistent with an I.R.C. provision, backdates a final rule that is identical to the proposed rule. In contrast, the backdating of a final, non-interpretative rule that differed materially from a proposed rule would often raise independent concerns about retroactivity that lie beyond the scope of this Article.

Concerns about fair notice and adequate time to comply with new rules are important, though independent of the timing of comments on a new rule. For example, postpromulgation comment may be entirely consistent with promoting transparency and affording commenters an opportunity to participate. Postpromulgation comment does not, however, do anything to enable taxpayers to comply with a new rule of which they had no prior notice. This concern would be particularly true if the government required, without both a delayed effective date *and* applicability date, new reporting or withholding with respect to a new set of

323. *See, e.g.*, Anderson, Clayton & Co. v. United States, 562 F.2d 972 (5th Cir. 1977); Camp, *supra* note 280.

transactions. For abusive transactions, however, these concerns may well be outweighed by other concerns (e.g., deterrence).

Conclusion

This Article has clarified the contours of error in the tax administration's process for making rules, such as regulations, revenue rulings, and more informal guidance. Far from an exceptionalist approach, the Article builds on non-tax and tax scholarship to make a limited claim that there is no particular cause for concern if courts utilize nuance and flexibility in this administrative context. The Article describes several potential applications of harmless error principles. If applied, these principles would afford the Treasury Department flexibility without chilling participation by the public or ignoring concerns about fair notice.

If not stretched beyond recognition, this approach should promote thoughtful, reliance-worthy rulemaking, as well as equity among similarly situated taxpayers. Flexibility and restraint are unlikely to chill robust participation by tax advisors, a core goal of the APA in this context.

Different measures would be necessary to guarantee that the Treasury Department carefully considers the feedback of policy analysts, public interest groups, and the general public. There are tools that could help balance participation;[324] however, this may be challenging to enforce. This is particularly true considering that standing to challenge taxpayer-favorable rules is notoriously difficult to establish.

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324. *See* Book, *supra* note 308, at 573–76 (suggesting how to enhance the role of the Taxpayer Advocate Service); Sant'Ambrogio & Staszewski, *supra* note 308, at 831–43 (offering a "blueprint" for encouraging agencies to plan early, reach missing stakeholders, and engage effectively).