No. 09-9015

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

SALMAN RANCH, LTD., FRANCIS S. KOENIG,
TAX MATTERS PARTNER,

Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

ORAL ARGUMENT REQUESTED

ON APPEAL FROM THE ORDER AND DECISION OF
THE UNITED STATES TAX COURT (JUDGE HALPERN)

REPLY BRIEF FOR THE APPELLANT

JOHN A. DiCICCO
Acting Assistant Attorney General

GILBERT S. ROTHENBERG
Acting Deputy Assistant Attorney General

MICHAEL J. HAUNGS (202) 514-4343
JOAN I. OPPENHEIMER (202) 514-2954
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

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INTRODUCTION

In our opening brief, we urged that the recent temporary regulations are entitled to *Chevron* deference and are an intervening change in the law that precludes *Salman Ranch Ltd v. United States*, 573 F.3d 1362 (Fed. Cir. 2009), from having collateral estoppel effect here. The appellees respond, incorrectly, that regulations cannot deprive a prior decision of collateral estoppel effect, and they make meritless distinctions between this case and the numerous Supreme

Court cases holding that agency interpretations of an ambiguous statute are entitled to deference notwithstanding contrary judicial interpretations of the statutory language.

Apparently realizing that there is no real difference between this case and the Supreme Court cases on which we rely, the appellees and the amici seek to exempt the temporary regulations from *Chevron* deference by arguing that the legislative history, construed in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958), somehow makes ambiguous statutory language unambiguous and invalidates the contrary Treasury interpretation of that language. As we shall demonstrate, this analysis is backwards. It is the ambiguous statute that occasions resort to legislative history; legislative history does not magically eliminate that ambiguity.

As discussed below, we also disagree with the Tax Court's recent invalidation of the temporary regulations in a reviewed, *i.e.*, en banc, Tax Court opinion, in which four concurring judges declined to consider the "difficult and divisive" issues regarding the validity and applicability of the regulations. *Intermountain Ins. Serv. of Vail, LLC v. Commissioner*, 98 T.C.M. (CCH) 144 (2009), *supplemented on denial*

of reconsideration, No. 25868-06, 2010 WL 1838297 (Tax Ct. May 6, 2010).[1]

ARGUMENT

A. *Salman Ranch* has no collateral estoppel effect

The appellees do not challenge the legal principle that collateral estoppel is inapplicable when "a subsequent . . . change or development in the controlling legal principles . . . make[s] that [first] determination obsolete or erroneous, at least for future purposes." *Commissioner v. Sunnen*, 333 U.S. 591, 599 (1948). They urge, however, that regulations, unlike judicial decisions, cannot be the source of the legal change that makes collateral estoppel inapplicable. (Br. 22.) They cite no authority for this proposition, and the law is manifestly to the

[1] The seven-judge majority in *Intermountain* held that "*Colony* . . . unambiguously forecloses the agency's interpretation of sections 6229(c)(2) and 6501(e)(1)(A) and displaces respondent's temporary regulations." 2010 WL 1838297 at *8 (internal quotation marks and footnote omitted). The majority also held that another "plausible ground" for its ruling was "[t]the plain meaning of the temporary regulation's effective/applicability date provisions [which] indicates that the temporary regulations do not apply to this case." *Id.* at *6. Two concurring judges were "persuaded by neither of the majority's analyses" (*id.* at *9) and concluded that the regulations were procedurally invalid under the Administrative Procedure Act (*id.* at *17).

contrary. In *Sunnen*, the Supreme Court identified "alternation [*sic*] in the pertinent Treasury regulations" as a legal change that could make the use of collateral estoppel "unwarranted." 333 U.S. at 601. *Accord Bingaman v. Department of Treasury*, 127 F.3d 1431, 1438 (Fed. Cir. 1997) (identifying "a new administrative ruling as "a significant change in the 'legal atmosphere' . . . [that] can justify a later court's refusal to give collateral estoppel effect to an earlier decision"). Thus, for collateral estoppel purposes, there is no meaningful difference between a judicial interpretation and an agency interpretation of ambiguous statutory language.

Since the temporary regulations adopt an interpretation of ambiguous statutory language that differs from *Salman Ranch*'s interpretation, the regulations change the legal framework. Collateral estoppel is, therefore, inapplicable. The appellees' argument that the regulations do not constitute a significant change in controlling legal principles (Br. 20-24) is not only disingenuous, it is also inconsistent with their argument (Br. 27) that "[s]ince the Temporary Regulations are clearly intended to be substantive," they are invalid due to

Treasury's failure to follow the notice-and-comment requirements of the Administrative Procedure Act ("APA").

Moreover, the policy behind the inapplicability of collateral estoppel when the legal landscape has changed–the prevention of "inequalities in the administration of the revenue laws, [and] discriminatory distinctions in tax liability"[2]–supports the inapplicability of that doctrine. Otherwise, the Salman Ranch partners would escape taxation on their abusive transactions due to the three-year assessment period and would be treated more favorably than other taxpayers engaging in identical transactions in the same tax years, to whom, we submit, the six-year assessment period would apply due to the temporary regulations.

[2] *Sunnen*, 333 U.S. at 599.

B. The temporary regulations support application of the six-year assessment period

1. Since the regulations are properly classified as "interpretive," they are exempt from the APA's notice-and-comment requirements

The appellees and the amicus, Bausch & Lomb Incorporated ("B&L"), urge that the temporary regulations are invalid for lack of compliance with the APA's notice-and-comment requirements. They are wrong; the regulations are exempt from these requirements on two alternate grounds. First, Congress exempted temporary Treasury regulations from the APA's requirements. Second, the regulations are properly classified as "interpretive," not "legislative," and interpretive regulations are exempt from the APA's procedural requirements.

The provisions of § 7805(e), added to the Code in 1988,[3] show that Congress authorized Treasury to issue temporary regulations without notice and comment by requiring any temporary regulation to be issued also as a proposed regulation. *See* I.R.C. § 7805(e)(1). The legislative history also supports this argument. It provides that the expiration of

[3] *See* Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342, § 6232(a).

the temporary regulations at the end of three years (*see* I.R.C. § 7805(e)(2)) "is not to affect the validity of those regulations" during this period. H.R. Conf. Rep. No. 100-1104 at 218 (1988), *reprinted in* 1988-3 C.B. 473, 708. If the absence of notice and comment could deprive temporary regulations of validity, then § 7805(e) would be meaningless, violating the canon of construction that "a legislature is presumed to have used no superfluous words." *Bailey v. United States*, 516 U.S. 137, 145 (1995); *Platt v. Union Pac. R.R. Co.*, 99 U.S. 48, 58 (1878).

Congress's decision to exempt temporary Treasury regulations from the notice-and-comment requirement is not surprising. Recognizing that "taxes are the lifeblood of government, and their prompt and certain availability an imperious need," Congress has given Treasury special powers that other agencies do not enjoy. *Bull v. United States*, 295 U.S. 247, 259 (1935). For example, a tax assessment has the force of a judgment, and administrative officials are authorized to seize a taxpayer's property to satisfy the debt. *Id.*; I.R.C. §§ 6321, 6331. Similarly, in § 7805(e), Congress codified Treasury's policy and practice of issuing temporary regulations as long as they were issued at

the same time as identical proposed regulations providing notice and an opportunity for public comment.[4]

Moreover, the APA exempts interpretive regulations from the notice-and-comment requirements. 5 U.S.C. § 553(b)(3)(A). "A rule is interpretive if it is promulgated by an agency having authority to issue substantive rules and if it attempts to clarify an existing rule but does not change existing law, policy, or practice." *Rocky Mountain Helicopters, Inc. v. F.A.A.*, 971 F.2d 544, 546-547 (10th Cir. 1992). *Accord Paralyzed Veterans of America v. West*, 138 F.3d 1434, 1436 (Fed. Cir. 1998) (interpretive rules "clarify or explain existing law or regulations"); *United States v. Yuzary*, 55 F.3d 47, 51 (2d Cir. 1995) (same).

A regulation can conflict with judicial interpretations of pre-regulation law and still be a clarification of existing law. *See Levy v.*

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[4] The temporary regulations were issued simultaneously as a notice of proposed rulemaking – Prop. Treas. Reg. §§ 301.6229(c)(2)-1, 301.6501(e)-1. This notice of proposed rulemaking provides for comments from the public and for requests for a public hearing. 74 Fed. Reg. at 49354. Although the IRS believes that regulations issued under I.R.C. § 7805(a) do not require notice and comment (*see* discussion *infra*, pp. 6-7), it usually follows notice-and-comment procedures anyway. *Bankers Life and Cas. Co. v. United States*, 142 F.3d 973, 978 (7th Cir. 1998).

Sterling Holding Co., LLC, 544 F.3d 493, 507 (3d Cir. 2008), *cert. denied*, 129 S. Ct. 2827 (2009); *National Organization of Veterans' Advocates, Inc. v. Secretary of Veterans Affairs*, 260 F.3d 1365, 1375-1377 (Fed. Cir. 2001) ("*NOVA*"). In *NOVA*, the Federal Circuit held that an amended regulation was "interpretive" for purposes of notice and comment even though the agency interpreted ambiguous statutory language differently from the Court of Appeals for Veterans Claims and even though the regulation altered the parties' rights by precluding benefits that were available under the court decisions. The court explained (260 F.3d at 1375-1376):

> The agency . . . promulgated the revisions to § 3.22 to make clear that those judicial decisions did "not accurately reflect the requirements of the statute [38 U.S.C. § 1318] and the [Department of Veterans Affairs'] intention in issuing that regulation [38 C.F.R. § 3.22]." Final Rule, 65 Fed. Reg. at 3,390. In short, the . . . revisions merely clarified the Department of Veterans Affairs' interpretation (in 38 C.F.R. § 3.22) of 38 U.S.C. § 1318. And a rule that does no more than clarify the interpretation of a statute is necessarily interpretive in character, even if that interpretation has consequences for the rights of the parties.[5]

[5] Since a regulation can be "interpretive" even though "that

(continued...)

The rationale of *NOVA* applies here. The temporary regulations do "no more than clarify" the interpretation of statutory language that has been held to be ambiguous, and they are consistent with Treasury's prior interpretation of that language. *See* T.D. 9466, 74 Fed. Reg. 49321, 49322 (2009). They are therefore interpretive. *NOVA*, *supra*; *see York v. Secretary of Treasury*, 774 F.2d 417, 420 (10th Cir. 1985) (ruling "that further defines the language of 26 U.S.C. § 5846(b) was merely an interpretive rule not subject to . . . notice and comment procedure under 5 U.S.C. § 553. . .").

The Treasury Department's promulgation of the regulations pursuant to the general rule-making authority contained in I.R.C. § 7805(a) (*see* T.D. 9466, 74 Fed. Reg. 49321, 49322 (2009)) also shows that the regulations are interpretive.[6] *See Boeing Co. v. United States*, 537 U.S. 437, 448 (2003) (characterizing "regulations promulgated

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[5](...continued)
interpretation has consequences for the rights of the parties" (*NOVA*, 260 F.3d at 1376), there is no inconsistency between our position that a regulation can be "interpretive" under the APA, while constituting a change in the legal landscape for collateral estoppel purposes.

[6] Section 7805(a) provides that "the Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of this title," *i.e.*, Title 26 of the United States Code.

under § 7805(a)'s general rulemaking grant rather than pursuant to a specific grant of authority" as "interpretive"); *Pickus v. U.S. Bd. of Parole*, 507 F.2d 1107, 1113 (D.C. Cir. 1974) ("Treasury Regulations interpreting the Internal Revenue Code are a prime example" of interpretive rules).

2. *Chevron* governs review of the temporary regulations

B&L argues (Br. 12-14) that "interpretive" regulations are not entitled to *Chevron* deference, but are judged under the lesser power-to-persuade standard of *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), or the multi-factor approach of *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979).[7] Under *Skidmore*, the weight given to any

[7] B&L also incorrectly argues (B&L Br. 12 n.30) that, if the regulations are "interpretive," they violate the Regulatory Flexibility Act ("RFA"), 5 U.S.C. §§ 601-612. The RFA is inapplicable because it only applies to interpretive regulations involving the internal revenue laws to the extent that these regulations impose a collection of information requirement on small entities. 5 U.S.C. § 603(a). These regulations do no such thing. *See* 74 Fed. Reg. at 49354. Treas. Reg. § 301.6501(e)-1T(a)(1)(iv), on which B&L relies for its assertion that there is an RFA violation (B&L Br. 12 n.30), does not require a collection of information for purposes of the RFA, but merely acknowledges the adequate disclosure safe harbor in I.R.C. § 6501(e)(1)(A)(ii). Accordingly, any reporting requirement flows from the statute, not the regulations.

agency determination "depend[s] upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." 323 U.S. at 140. The factors considered under *National Muffler* include whether the regulation harmonizes with the statutory language and purpose; whether the regulation is a contemporaneous construction of the statute by those presumed to have been aware of congressional intent; the manner in which a regulation from a later period evolved; the length of time the regulation has been in effect; and the consistency of the Commissioner's interpretation. 440 U.S. at 477.

Regardless of whether the regulations are "legislative" or "interpretive," we submit that *Chevron*–not *Skidmore* or *National Muffler*–governs in determining their validity. *Chevron* provides a two-step process for determining a regulation's validity:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of

> Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-843 (1984) (footnotes omitted.). Thus, if the statutory language is ambiguous or silent on the issue, the agency's regulation receives controlling weight unless it is arbitrary, capricious, or manifestly contrary to the statute. *Chevron*, 467 U.S. at 843-844.

In *United States v. Mead Corp.*, 533 U.S. 218 (2001), the Court, refining its *Chevron* analysis, determined that *Chevron* deference was available to any administrative implementation of a statute "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law," and "the agency interpretation claiming deference was promulgated in the exercise of that authority." *Id.* at 226-227. This reference to regulations having the "force of law" is not confined to so-called "legislative" regulations – *i.e.*, regulations issued pursuant to "expressly delegated authority or responsibility

to . . . fill a particular gap" – but applies equally to regulations issued pursuant to an agency's "generally conferred authority" to interpret and enforce the law. *Id*. at 229. *See also* Kristin Hickman, *The Need for* Mead*: Rejecting Tax Exceptionalism in Judicial Deference*, 90 Minn. L. Rev. 1537, 1548 (2006) ("The more revolutionary but less often recognized aspect of *Chevron* is its call for strong, mandatory deference not only where Congress specifically mandates regulations, but also where Congress implicitly delegates rulemaking authority through the combination of statutory ambiguity and administrative responsibility. . . .").

It is readily apparent that Congress intended that rules and regulations issued under the authority granted by I.R.C. § 7805(a) to enforce the Internal Revenue Code would bind all persons subject to the federal tax laws. *E.g.*, *United States v. Correll*, 389 U.S. 299, 307 (1967) (describing I.R.C. § 7805(a) as imposing a "congressional mandate" to prescribe rules and regulations).

The language of I.R.C. § 7805(a) is also similar to the language of other statutes authorizing issuance of regulations that have been held to warrant *Chevron* deference. *E.g.*, *National Cable & Telecomms.*

Ass'n v. Brand X Internet Servs., 545 U.S. 967, 980-981 (2005) (applying *Chevron* to regulations issued pursuant to statute granting FCC authority to "execute and enforce" the Communications Act, and to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions" of the Act).

Accordingly, the validity of the temporary regulations should be evaluated under *Chevron*, rather than under the differing standards of pre-*Chevron* jurisprudence. There is no basis for according less deference to regulations issued by the Treasury Department pursuant to I.R.C. § 7805(a) than is accorded to regulations issued under similar statutes, using similar procedures, by other agencies. Indeed, several appellate courts have recently held that *all* Treasury regulations are entitled to *Chevron* deference, regardless of whether they are described as "interpretive" or "legislative." *See Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162, 169 (3d Cir. 2008); *Hosp. Corp. of Am. & Subs. v. Commissioner*, 348 F.3d 136, 140-141 (6th Cir. 2003). And, as discussed in our opening brief (p. 29), temporary regulations are entitled to the same weight as final regulations. *See, e.g., E. Norman*

Peterson Marital Trust v. Commissioner, 78 F.3d 795, 798 (2d Cir. 1996).

That the temporary regulations were promulgated before notice and comment does not preclude giving them *Chevron* deference. *See Mead*, 533 U.S. at 226-227, 230-231 (while notice-and-comment rulemaking almost always assures *Chevron* deference, absence of such formalities does not preclude such deference when it appears that Congress intended to grant agency the power to make rules with the "force of law" and "the agency interpretation claiming deference was promulgated in the exercise of that authority"); *Barnhart v. Walton*, 535 U.S. 212, 221-222 (2002) (*Chevron* deference accorded to agency interpretation reached through "means less formal than 'notice and comment' rulemaking"); *A.T. Massey Coal Co. v. Holland*, 472 F.3d 148, 166 (4th Cir. 2006) (absence of notice-and-comment rulemaking "not conclusive" as to whether agency action deserves *Chevron* deference); *Hosp. Corp.*, 348 F.3d at 140-141, 144 (*Chevron* deference accorded to temporary Treasury Regulations adopted without notice and comment). Since a final regulation interpreting the statutory phrase "omits from gross income" would be entitled to *Chevron* deference, the temporary

regulations interpreting that phrase are also entitled to *Chevron* deference.

We recognize that this Court has declined to give *Chevron* deference to agency interpretations issued without notice and comment, and only gave *Skidmore* deference in *Tax and Accounting Software Corp. v. United States*, 301 F.3d 1254, 1260 (10th Cir. 2002). However, more recent Supreme Court jurisprudence has emphasized that the absence of notice-and-comment rulemaking does not preclude *Chevron* deference:

> [T]hat the Agency previously reached its interpretation through means less formal than "notice and comment" rulemaking, *see* 5 U.S.C. § 553, does not automatically deprive that interpretation of the judicial deference otherwise its due. *Cf. Chevron*, 467 U.S., at 843. . . . Indeed, *Mead* pointed to instances in which the Court has applied *Chevron* deference to agency interpretations that did not emerge out of notice-and-comment rulemaking. 533 U.S. at 230-231. . . . It indicated that whether a court should give such deference depends in significant part upon the interpretive method used and the nature of the question at issue. . . . . And it discussed at length why *Chevron* did not require deference in the circumstances there present–a discussion that would have been superfluous had the presence or absence of notice-and-comment rulemaking been dispositive.

Barnhart, 535 U.S. at 222. *See also Coeur Alaska, Inc. v. Southeast Alaska Conservation Council*, 129 S. Ct. 2458, 2479 (2009) (suggesting that Court's deference to agency memorandum not subject to notice and comment was "identical to *Chevron* deference except for the name") (Scalia, J., concurring). Indeed, even the Tax Court majority in *Intermountain*, in determining the validity of the temporary regulations, assumed that *Chevron* deference applied. 2010 WL 1838297 at *6.

3. The regulations are valid

As demonstrated in our opening brief (pp. 30-32), the temporary regulations pass muster under *Chevron*, as they are consistent with and supported by the express language of the Internal Revenue Code. Indeed, even though it felt constrained by *Colony* to reject the Commissioner's position, the Ninth Circuit recently characterized the interpretation of the statutory language, now incorporated in the regulations, as both "reasonable" and "sensible." *Bakersfield Energy Partners, LP v. Commissioner*, 568 F.3d 767, 775, 778 (9th Cir. 2009).

The regulations provide that, in general, the term "gross income" in §§ 6229(c)(2) and 6501(e)(1)(A) "has the same meaning as provided in

section 61(a)" of the Internal Revenue Code. Temp. Treas. Reg. §§ 301.6501(e)-1T(a)(1)(iii), 301.6229(c)(2)-1T(a)(1)(iii). Section 61 broadly defines "gross income" as "all income from whatever source derived," and it explicitly includes within the meaning of that term "[g]ains derived from dealings in property." I.R.C. § 61(a) & 61(a)(3). Because gain is determined mathematically, by subtracting basis from the amount realized (*see* I.R.C. § 1001(a)), the Treasury Department reasonably concluded that "an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of section 6501(e)(1)(A)." Temp. Treas. Reg. § 301.6501(e)-1T(a)(1)(iii).

The *Intermountain* majority, however, "was hesitant to contradict the Supreme Court's ruling in *Colony*." 2010 WL 1838297 at *6 n.14. It relied (*id.*) on *Rodriguez de Quijas v. Shearson/American Exp., Inc.*, 490 U.S. 477, 484 (1989), where the Court stated, "If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions."

Rodriguez de Quijas, however, predated *Brand X*, where the Supreme Court rejected the Ninth Circuit's construction of certain Supreme Court opinions as "establish[ing] that a prior judicial construction of a statute categorically controls an agency's contrary construction." 545 U.S. at 984. The Supreme Court ruled that its prior decisions, *e.g.*, *Neal v. United States*, 516 U.S. 284 (1996), "established only that a precedent holding a statute to be *unambiguous* forecloses a contrary agency construction." *Id.* (emphasis added). Thus, as concurring Judge Halpern recognized in *Intermountain*, "The validity of the regulation after *Brand X* cannot depend entirely on whether prior caselaw conflicts with a later regulation." 2010 WL 1838297 at *12. *See also id.* ("We simply can't reasonably assert, a quarter-century after *Chevron* and, now, after *Brand X*, that 'courts have traditionally determined the meaning of statutes,' majority op. note 12. . .").

The appellees (Br. 36-38) and the *Intermountain* majority (2010 WL 1838297 at *7-*8) err in considering *Colony*'s analysis of the legislative history of § 275(c) of the 1939 Code in applying *Chevron*'s step one. Reliance on legislative history to determine whether a statute is ambiguous is backwards. A judicial analysis of legislative

history does not make an ambiguous statute unambiguous; it is the ambiguity of the statute that occasions a court's resort to legislative history in the first place. *See, e.g.*, *Colony*, 357 U.S. at 33 (since "it cannot be said that the language is unambiguous . . . we turn to the legislative history of § 275(c)").[8] And if a statute is ambiguous, under *Chevron* and *Brand X*, an agency can validly issue a regulation interpreting that statute in a manner different from that of the Supreme Court.

In *Brand X*, the Court made it clear that an agency regulation was foreclosed only if the statutory language was unambiguous:

> A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from *the unambiguous terms of the statute* and thus leaves no room for agency discretion.

545 U.S. at 982 (emphasis added). *Brand X* also clarified that the *Chevron* step one analysis focuses on the statute's plain text:

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[8] To be sure, the Supreme Court, while characterizing the language "omits from gross income" under the 1939 Code as ambiguous, in dicta described § 6501(e)(1)(A) of the Internal Revenue Code of 1954 as "unambiguous." *Colony*, 357 U.S. at 37. The Ninth Circuit refused to rely on this characterization because "[t]he Court expressly avoided construing the 1954 Code. . . ." *Bakersfield*, 568 F.3d at 778.

> At the first step, we ask whether the *statute's plain terms* directly addres[s] the precise question at issue. *If the statute is ambiguous* on this point, we defer at step two to the agency's interpretation. . . .

Id. at 986 (internal quotation marks omitted; emphasis added). As one district court has observed, "In applying *Chevron*' s first step to the regulation at issue in *Brand X*, the Supreme Court did not ask merely whether Congress had 'spoken to the precise question at issue,' *Chevron*, 467 U.S. at 843, . . . but rather 'whether the statute's plain terms "directly addres[s] the precise question at issue." ' " *AARP v. E.E.O.C.*, 390 F. Supp. 2d 437, 445 (E.D. Pa. 2005), *aff'd on other grounds*, 489 F.3d 558 (3d Cir. 2007). *Brand X* also established that where a court's holding states merely the "best" interpretation of a statute, not the "only permissible" interpretation, that decision does not foreclose a later, differing agency interpretation. *Brand X*, 545 U.S. at 985; *see AARP*, 390 F. Supp. 2d at 442, 448.

In *Colony*, the Court did not state that its interpretation of "omits from gross income" was the only possible interpretation. Instead, it recognized that the language was susceptible of differing interpretations, and it therefore examined legislative history to

determine the best possible meaning. *See* 357 U.S. at 33-36. In light of *Brand X*, this legislative history cannot preclude the Treasury Department from construing the statutory language differently from the Supreme Court. *See Intermountain*, 2010 WL 1838297 at *15 (". . . *Colony*'s resort to legislative history in the first place shows a gap that the Secretary is ipso facto allowed to fill") (Halpern, J., concurring); *AARP*, 390 F. Supp. 2d at 448-450 (Third Circuit's interpretation of Age Discrimination in Employment Act, which interpretation was partially based on legislative history, did not foreclose contrary agency interpretation).

Furthermore, the legislative history discussed in *Colony* does not bear the weight the *Intermountain* majority placed upon it. In *Colony* the Court did not characterize the legislative history of § 275(c) as "conclusive," but merely as "persuasive." 357 U.S. at 33. Moreover, statutory changes in 1954 limit the significance of this history. In enacting § 6501(e), which replaced § 275(c) of the 1939 Code, Congress "changed the existing law in several respects." H.R. Rep. No. 83-1337 at A14 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4017, 4561. In § 6501(e)(1)(A)(i), Congress "redefined" the term "gross income" so that

in the context of the sale of goods or services by a trade or business, "gross income" means gross receipts, undiminished by basis. *Id*. The definition of "gross income" is not so limited in any other circumstances. In § 6501(e)(1)(A)(ii), Congress created a "safe harbor" for adequate disclosure by excluding from the 25% omission computation any amount adequately disclosed on the return. Thus, the legislative history analyzed in *Colony* has limited significance after the 1954 amendments. *See* T.D. 9466, 74 Fed. Reg. at 49321 ("by amending the Internal Revenue Code, including the addition of a special definition of 'gross income' with respect to a trade or business, Congress effectively limited what ultimately became the holding in *Colony*, to cases subject to section 275(c) of the 1939 Internal Revenue Code").

4. *Colony*'s contrary interpretation of the statutory phrase "omits from gross income" does not diminish the deference due the regulations

As discussed in our opening brief (pp. 32-34), a prior judicial interpretation of an ambiguous statute, such as that contained in *Colony*, is no impediment to the Treasury Department's subsequent issuance of a regulation containing a different interpretation. *See, e.g.*,

Brand X, 545 U.S. at 982-983; *Bakersfield*, 568 F.3d at 778; *Mayo Foundation for Medical Educ. and Research v. United States*, 568 F.3d 675, 683 (8th Cir. 2009), *cert. granted* (Sup. Ct. Jun. 1, 2010) (No. 09-837). As stated in *Brand X*, 545 U.S. at 982:

> [A]llowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute . . . would allow a court's interpretation to override an agency's. *Chevron*'s premise is that it is for agencies, not courts, to fill statutory gaps.

B&L misconstrues *Brand X* as holding that "an agency cannot reverse a prior court ruling applying a different interpretation or say that the ruling was wrong – the prior ruling 'remains binding law.'" (B&L Br. 21.) To the contrary, the *Brand X* Court stated (545 U.S. at 983) that an agency's differing construction is not an attempt to "reverse" the court ruling:

> [T]he agency's decision to construe that statute differently from a court does not say that the court's holding was legally wrong. Instead, the agency may, consistent with the court's holding, choose a different construction. . . . In all other respects, the court's prior ruling remains binding law (for example, as to agency interpretations to which *Chevron* is inapplicable).

The appellees and B&L also incorrectly argue that an agency cannot adopt a different construction of an ambiguous statute from the

construction adopted by the Supreme Court. (Br. 45; B&L Br. 19-21.) The cases on which they rely – *Neal v. United States*, 516 U.S. 284 (1996); *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116 (1990), and *Lechmere, Inc. v. NLRB*, 502 U.S. 527 (1992) (B&L Br. 21 n. 62), were distinguished by the Supreme Court in *Brand X* on the ground that they precluded a regulation from trumping a court's determination *only* when the statute was *un*ambiguous. *See, e.g.*, 545 U.S. at 984 ("*Neal* established only that a precedent holding a statute to be unambiguous forecloses a contrary agency construction"). *See also id.* at 982.

B&L misinterprets *Cuomo v. Clearing House Ass'n, L.L.C.*, 129 S. Ct. 2710 (2009), as limiting the reach of *Brand X*. (B&L Br. 20.) In *Cuomo*, the Court merely observed that the statutory term "visitorial powers" contained "some ambiguity," that "[t]he Comptroller [of the Currency] can give authoritative meaning to the statute within the bounds of that uncertainty," but that "the presence of some uncertainty does not expand *Chevron* deference to cover virtually any interpretation of the National Bank Act." *Id.* at 2715. Further, this Court has recently confirmed that, under the principles elucidated in *Brand X*, "a subsequent, reasonable agency interpretation of an ambiguous

statute . . . is due deference notwithstanding the Supreme Court's earlier contrary interpretation of the statute." *Hernandez-Carrera v. Carlson*, 547 F.3d 1237, 1242 (10th Cir. 2008), *cert. denied*, 78 U.S.L.W. 3360 (Dec. 14, 2009). *Accord Marquez-Coromina v. Hollingsworth*, 2010 WL 610745 at *7 (D. Md. Feb. 18, 2010) ("persuasive reasoning of *Hernandez-Carrera* is consistent with Fourth Circuit precedent addressing similar issues").

5. The issuance of the regulations during the pendency of this litigation does not affect the deference due them

There is no merit to the appellees' contention (*e.g.*, Br. 11-12, 44) that when, as here, an agency issues regulations partly in response to litigation, they are not entitled to deference. As discussed in our opening brief (pp. 34-38), the law is to the contrary. *See, e.g., Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 740-741 (1996); *United States v. Morton*, 467 U.S. 822 (1984). *See also Mayo*, 568 F.3d at 683 (*Chevron* deference accorded to Treasury regulations promulgated under I.R.C. § 3121(b)(1) after Government lost excise tax cases under prior regulation); *Estate of Gerson v. Commissioner*, 507 F.3d 435 (6th Cir. 2007), *cert. denied sub nom. Kleinman v. Commissioner*, 128 S. Ct. 2502

(2008) (*Chevron* deference accorded to Treasury regulations issued under § 2601 after Government lost Eighth Circuit case under prior regulations).

In support of their argument to the contrary, the appellees rely (Br. 43-44) on such cases as *Tallahassee Mem'l Reg'l Med. Ctr. v. Bowen*, 815 F.2d 1435, 1456 (11th Cir. 1987), and *Chock Full o' Nuts Corp. v. United States*, 453 F.2d 300 (2d Cir. 1971), which pre-date *Brand X* and thus are no longer viable. *Tallahassee* is not on point in any event. The "abuse of the interaction between administrative agencies and the courts" in *Tallahassee* referred to an agency's ability to "avoid [judicial] review of an agency action . . . by replacing a challenged regulation with a similar rule after years of litigation" and "require the plaintiff parties to start the entire administrative and judicial review process all over again." 815 F.2d at 1435, 1452, 1456. Here, the Commissioner is not seeking to moot this case by promulgating regulations. Instead, he seeks a judicial interpretation of the Code that is consistent with the regulations.

6. The regulations apply here

As discussed in our opening brief (pp. 38-39), the temporary regulations apply to tax years in which the assessment period under I.R.C. §§ 6229(c)(2) and 6501(e)(1)(A), as interpreted in the temporary regulations, did not expire before September 24, 2009. *See* CC-2010-001, 2009 WL 4753220.[9] *See Intermountain*, 2010 WL 1838297 at *11 (citing CC-2010-010 to support conclusion that "the Secretary meant the temporary regulations to apply if either the 3-year or 6-year period of limitations were open on September 24, 2009, but that he was inartful in saying so") (Halpern, J., concurring).

The *Intermountain* majority incorrectly concluded that the "plain meaning of the effective/applicability date provisions indicates that the temporary regulations do not apply. . . ." 2010 WL 1838297 at *5. The effective date provision does not have a "plain meaning," because the phrase "applicable period for assessing tax," contained therein, is undefined and, therefore, must be construed. *Id.* at *10 (Halpern, J., concurring). The majority's view that the three-year period applies

[9] An agency's interpretation of its own regulations is entitled to deference. *See Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 171 (2007); *Auer v. Robbins*, 519 U.S. 452, 461(1997).

because two appellate courts have said so begs the question, as it seems to recognize. *See* 2010 WL 1838297 at *19 n.12. The temporary regulations were issued to interpret the ambiguous statutory language in a manner different from that of the appellate courts in *Salman Ranch* and *Bakersfield* (*see* T.D. 9466, 74 Fed. Reg. 49321) – a course the Supreme Court has specifically authorized agencies to take. *See* discussion of *Brand X*, *supra*, pp. 21-22. Indeed, the majority must have recognized the inherent weakness of its conclusion that the regulations were inapplicable, as it described this only as "a plausible ground" for denying the Commissioner's motions. *Id.* at *6.

Any doubt concerning the applicability of the regulations is resolved by I.R.C. § 7805(b) (26 U.S.C. 1994 ed.), which allows Treasury to "prescribe the extent, if any, to which any . . . regulation, relating to internal revenue laws, shall be applied without retroactive effect." Section 7805(b) thus establishes a presumption that regulations will apply retroactively unless otherwise specified.[10] *Snap-Drape, Inc. v.*

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[10] In 1996, Congress amended § 7805(b) to preclude retroactive regulations, except in certain circumstances, such as the prevention of abuse, the correction of procedural defects, etc. *See* Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452, § 1101(a). The amended § 7805(b) applies "with respect to regulations which relate to statutory

(continued...)

Commissioner, 98 F.3d 194, 202 (5th Cir. 1996); *Likins-Foster Honolulu Corp. v. Commissioner*, 840 F.2d 642, 647 (9th Cir. 1988). Since the temporary regulations do not specify that they apply prospectively only, their application encompasses the years at issue. *See Intermountain*, 2010 WL 1838297 at *10-*11 (Halpern, J., concurring).

To be sure, Treasury's failure to limit regulations to prospective application is judicially reviewable, but only for abuse of discretion. *Likins-Foster*, 840 F.2d at 647; *Anderson, Clayton & Co. v. United States*, 562 F.2d 972, 980-981 (5th Cir. 1977). Abuse may be found where retroactive application of a regulation produces an unduly harsh result. *Snap-Drape*, 98 F.3d at 202; *Likins-Foster*, 840 F.2d at 647. Other relevant factors include: (1) the extent to which a taxpayer justifiably relied on "settled prior law or policy," (2) the extent to which that law or policy has received implicit Congressional approval, and (3) whether retroactivity would advance or frustrate equal treatment of similarly situated taxpayers. *Snap-Drape*, 98 F.3d at 202.

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[10](...continued)
provisions enacted on or after the date of the enactment of this Act," *i.e.*, July 30, 1996. *Id.* § 1101(b). Since §§ 6229(c)(2) and 6501(e)(1)(A) were enacted before July 30, 1996, the amended version of § 7805(b) is inapplicable, as the appellees concede (Br. 32 & n.10).

According retroactive effect to the regulations in this case would not produce an unduly harsh result or frustrate the policy of equal treatment. To the contrary, it would treat taxpayers' tax liabilities the same as those of taxpayers to whom the six-year assessment period was held applicable in cases predating the regulations. *See Phinney v. Chambers*, 392 F.2d 680 (5th Cir. 1968); *Brandon Ridge Partners v. United States*, 100 A.F.T.R.2d (RIA) 5347, 5355 (M.D. Fla. 2007); *Home Concrete & Supply, LLC v. United States*, 599 F. Supp. 2d 678 (E.D.N.C. 2008), *appeal docketed*, No. 09-2353 (4th Cir. Dec. 9, 2009); *Burks v. United States*, 2009 WL 2600358 at *3 (N.D. Tex. 2008), *appeal docketed*, No. 09-11061 (5th Cir. Oct 26, 2009).

Appellees cannot establish reliance. They had no justifiable expectation that the three-year assessment period would apply given the uncertain state of the law and the Commissioner's consistent position that, in cases where an overstated basis causes understated income, that overstated basis must be taken into account in determining whether the six-year period applies. They are unable to point to anything they would have done differently had they known of the effect of the Treasury regulations when they engaged in the short-sale

transactions. *See Rodriguez v. Peake*, 511 F.3d 1147, 1155 (Fed. Cir. 2008).

Finally, it cannot be said that *Colony* has received Congressional approval; the Supreme Court has repeatedly stated that Congressional silence lacks persuasive significance. As concurring Justice Scalia stated in *United States v. Estate of Romani*, 523 U.S. 517, 535-536 (1998):

> . . . Congress cannot express its will by a failure to legislate. The act of refusing to enact a law (if that can be called an act) has utterly no legal effect, and thus has utterly no place in a serious discussion of the law. . . . .
>
> Second, even if Congress could express its will by not legislating, the will of a later Congress that a law enacted by an earlier Congress should bear a particular meaning is of no effect whatever. The Constitution puts Congress in the business of writing new laws, not interpreting old ones.

Accord Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 186 (1994) ("It is impossible to assert with any degree of assurance that congressional failure to act represents affirmative congressional approval of the [courts'] statutory interpretation") (internal quotation marks omitted); *Helvering v. Hallock*, 309 U.S. 106, 119-120 (1940) ("To explain the cause of

non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities") (footnote omitted).

Furthermore, "[n]o case has held that the Secretary abused his discretion to promulgate retroactive regulations merely because the regulation at issue affected a legal matter pending before a court at the time the regulation was adopted." *Anderson*, 562 F.2d at 980. Accordingly, the Secretary did not abuse his discretion in failing to limit the regulations to prospective application.[11]

The appellees' argument (Br. 30-32) that the temporary regulations cannot reopen a closed tax year incorrectly assumes the premise that must be proved – that the three-year assessment period clearly applied and that 2000 and 2001 were closed. But the applicability of the three-year assessment period is the very thing at

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[11] Since all regulations are presumptively retroactive under I.R.C. § 7805(b) (26 U.S.C. 1994 ed.), there is no inconsistency between our position that the regulations can apply to years predating their adoption and our position that the regulations constitute a change in the legal landscape for collateral estoppel purposes. And since a regulation can change a party's substantive rights and nevertheless be a clarifying regulation that is properly applied to pre-regulation conduct (*see Rodriguez v. Peake*, *supra*), there is no merit to the appellees' claim (Br. 20 n.6) that a regulation cannot be a mere clarification for purposes of retroactivity while changing the legal landscape for purposes of collateral estoppel.

issue, and no final determination has been made. The Tax Court decision does not become final until this appeal has been determined and the time for seeking Supreme Court review has expired, or, if such review is granted, until the Court has decided the case. I.R.C. § 7481.

As discussed in our opening brief (pp. 39-41), when, as here, a regulation merely clarifies existing law, that regulation can constitutionally be applied to pre-promulgation conduct. *See, e.g., Levy*, 544 F.3d 493, 506; *First Nat'l Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472, 478 (7th Cir. 1999). Neither the appellees nor the amicus challenges these principles, discusses the cases we cite, or addresses our argument (Op. Br. 42-43), that an analysis of the relevant factors shows that the new regulations are clarifications of, not changes to, existing law.

Instead, they rely (Br. 30; B&L Br. 24) on cases involving statutes significantly changing the law. *See, e.g., Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 949 (1997) ("extension of an FCA cause of action to private parties in circumstances where the action was previously foreclosed is not insignificant"); *Margolies v. Deason*, 464 F.3d 547, 553 (5th Cir. 2006) ("fact that the statute would permit a cause of action on July 31, 2002, that was definitively time-barred on

July 29, 2002, indicates a retroactive effect if applied as such"). However, the relevant statutes, I.R.C. § 6229(c)(2), 6501(e)(1)(A), have remained unchanged since 1982 and 1954, respectively, as has the IRS's interpretation of them. Moreover, § 7805(b) specifically authorized the application of regulations to conduct predating them. Accordingly, the argument that Treasury lacked authority to apply the regulations to years predating their issuance is meritless.

Respectfully submitted,

JOHN A. DiCICCO
Acting Assistant Attorney General

GILBERT S. ROTHENBERG
Acting Deputy Assistant Attorney General

/s/ Joan I. Oppenheimer
MICHAEL J. HAUNGS (202) 514-4343
JOAN I. OPPENHEIMER (202) 514-2954
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044
Joan.I.Oppenheimer@usdoj.gov
Appellate.Taxcivil@usdoj.gov

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