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# No More Excuses

## A CASE FOR THE IRS'S FULL COMPLIANCE WITH THE ADMINISTRATIVE PROCEDURE ACT

### INTRODUCTION

The Internal Revenue Service (IRS) is the only federal agency in the United States that has the legal right to take your money first, and then defend its right to the appropriation later.<sup>1</sup> The power of the IRS is tremendous. However, it is also the agency whose laws are the hardest to challenge because of its countless, ever-changing rules, regulations, and pronouncements.<sup>2</sup> It is no wonder that the public has such disdain for the IRS.<sup>3</sup>

This is unfortunate. The IRS serves the most fundamental role in America's democratic system of government—collection of revenue through taxation.<sup>4</sup> Without it, there would be no government.<sup>5</sup> Funds collected through taxation, for instance, are used to finance the various federal agencies of the executive branch and their projects.<sup>6</sup> Therefore,

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<sup>1</sup> See 26 U.S.C. § 6331 (2006); see also *Brian v. Gugin*, 853 F. Supp. 358, 361 (D. Idaho 1994).

<sup>2</sup> See Chris Edwards, *Income Tax Rife with Complexity and Inefficiency*, CATO INST. TAX & BUDGET BULL. (Apr. 2006), <http://www.cato.org/pubs/tbb/tbb-0604-33.pdf>.

<sup>3</sup> Kevin Bouly, *Take Advantage of Public Opinion: The SEC Is the Lowest Rated Agency*, LITIG. POSTSCRIPT (May 20, 2009), [http://www.litigationps.com/litigation\\_postscript\\_per/2009/05/take-advantage-of-public-opinion-the-sec-is-the-lowest-rated-agency.html](http://www.litigationps.com/litigation_postscript_per/2009/05/take-advantage-of-public-opinion-the-sec-is-the-lowest-rated-agency.html) (although the SEC was the lowest-rated agency following various scandals and oversights, the IRS came in at a close second and was cited as “the always-hated Internal Revenue Service”).

<sup>4</sup> See *Fact Sheet on Writing & Enacting Tax Legislation*, U.S. DEP'T OF THE TREASURY, <http://www.ustreas.gov/education/fact-sheets/taxes/writing.shtml> (last visited Jan. 14, 2010).

<sup>5</sup> Some might argue, as critics of big government do, that this is a good thing. But realistically speaking, we need some form of centralized government to ensure order and security. We agree to taxation in return for representation. Recall the famous outcry, “No taxation without representation.” *Britain, America, and the 1765 Stamp Act: An Exhibition by the Parliamentary Archives*, U. K. PARLIAMENT, [http://www.parliament.uk/parliamentary\\_publications\\_and\\_archives/parliamentary\\_archives/archives\\_\\_\\_stamp\\_act.cfm](http://www.parliament.uk/parliamentary_publications_and_archives/parliamentary_archives/archives___stamp_act.cfm) (last visited Jan. 14, 2010).

<sup>6</sup> The largest amount of tax revenue is allocated to the Department of Health and Human Services, Social Security Administration, Department of Defense—Military,

it is important for citizens to trust the IRS and cooperate in helping it execute this important role.

But how can the government accomplish this goal when people have disliked the IRS for so long? The answer is transparency and accountability—particularly through adherence to the Administrative Procedure Act (APA).<sup>7</sup> The root of the problem appears to be the unbridled power of the IRS.<sup>8</sup> People fear and dislike the IRS because they feel powerless against it. In *Cohen v. United States*,<sup>9</sup> the majority even joked, “A fool and his money are soon parted. It takes creative tax laws for the rest,”<sup>10</sup> and applied the quote to the IRS’s “aggressive interpretation of the tax code.”<sup>11</sup>

Congress’s power of taxation is remarkable. The Sixteenth Amendment gives Congress the “power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.”<sup>12</sup> Additionally, the definition of “income” has been interpreted expansively: “Gross income means all income from whatever source derived, unless excluded by law . . . [and] includes income realized in any form, whether in money, property, or services.”<sup>13</sup> Then, adding on to that broad taxing power, the Treasury interprets the tax laws with great flexibility, including issuing binding regulations without adhering to formal rulemaking procedures pursuant to the APA.<sup>14</sup>

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and Department of the Treasury. See A. Moore & A. Moah, *The Tax Breakdown Project 2008*, TAXBREAKDOWN.ORG, <http://www.taxbreakdown.org> (last visited July 11, 2010).

<sup>7</sup> Administrative Procedure Act, 5 U.S.C. §§ 551-559, 701-706 (2000 & Supp. IV 2004).

<sup>8</sup> See generally Byron York, *Health Care Reform Means More Power for the IRS*, THE WASH. EXAMINER, Sept. 2, 2009, available at <http://www.washingtonexaminer.com/politics/Health-care-reform-means-more-power-for-the-IRS-56781377.html> (“Under the Democrats’ health care proposals, the already powerful—and already feared—IRS would wield even more power and extend its reach even farther into the lives of ordinary Americans . . .”).

<sup>9</sup> 578 F.3d 1 (D.C. Cir. 2009); see also *infra* Part III.A.

<sup>10</sup> *Cohen*, 578 F.3d at 3 (quoting comic strip writer Bob Thaves) (internal quotation marks omitted).

<sup>11</sup> See *id.*

<sup>12</sup> U.S. CONST. amend. XVI.

<sup>13</sup> Treas. Reg. § 1.61-1(a) (1954); see also *Helvering v. Clifford*, 309 U.S. 331, 334 (1940); *Helvering v. Midland Mutual Life Ins. Co.*, 300 U.S. 216, 223 (1937); *Douglas v. Willcuts*, 296 U.S. 1, 9 (1935); *Irwin v. Gavit*, 268 U.S. 161, 166 (1925); *Cesarini v. United States*, 296 F. Supp. 3, 5 (N.D. Ohio 1969) (explaining that the U.S. Supreme Court has “frequently stated that this broad all-inclusive language was used by Congress to exert the full measure of its taxing power under the Sixteenth Amendment”) (citing *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955)).

<sup>14</sup> See *infra* Part III.B. The IRS publishes official documents that help taxpayers apply the law to their unique situations. These documents include revenue

However, if a taxpayer wants to challenge the IRS's appropriation of his or her funds and seek a refund, that taxpayer must pass myriad procedural hurdles, including forms and deadlines.<sup>15</sup> And if the case winds up in litigation, it is the agency's own interpretations found in Treasury regulations and revenue rulings and procedures that are provided as precedent,<sup>16</sup> thereby lessening the chances of a refund even more. Thus, the IRS has the power to affect taxpayers' rights and obligations almost freely and at the same time restrict their access to a remedy.

This result goes against all notions of fairness and due process. Separation of powers is one of the most fundamental principles of our democratic system of government—it protects citizens against the accumulation of too much power in any one branch of government.<sup>17</sup> However, when you have an independent agency like the IRS that has power to pass binding law and adjudicate matters in its own right, and whose members are secure in their jobs with no need to please the public in order to remain there,<sup>18</sup> the potential for abuse is sky-high and the need for regulation is imperative. However, as will be discussed, the IRS has failed to comply with the regulatory scheme that Congress established to monitor administrative actions.<sup>19</sup> This raised some concern in the past, but it was not until recently, when the D.C. Circuit decided *Cohen v. United States*, that the IRS's lack of full compliance with the APA became even more problematic.<sup>20</sup>

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rulings, revenue procedures, and notices. The Commissioner of the IRS also proposes regulations to the Treasury, which must get its approval before assuming the force of law. There are three types of Treasury regulations: proposed, temporary, or final. Only final and temporary regulations are binding as law, although temporary regulations expire after three years. Proposed regulations are not binding authority. 26 U.S.C. § 7805(e) (2006); *Internal Revenue Bulletins, Guide to Understanding the Differences Among Official IRS Documents*, UNCLEFED.COM, <http://www.unclefed.com/Tax-Bulls/OfficialDocsExp.html> (last visited Dec. 15, 2010); see also Internal Revenue Serv., *Understanding IRS Guidance—A Brief Primer*, IRS.GOV, <http://www.irs.gov/irs/article/0,,id=101102,00.html> (last updated Nov. 7, 2003).

<sup>15</sup> See Internal Revenue Serv., *Collection Appeal Rights*, available at <http://www.irs.gov/pub/irs-pdf/p1660.pdf> (last updated Mar. 4, 2010).

<sup>16</sup> See Internal Revenue Serv., *Tax Code, Regulations, and Official Guidance*, IRS.GOV, <http://www.irs.gov/taxpros/article/0,,id=98137,00.html> (last updated Nov. 12, 2010) (“Rulings and procedures reported in the [Internal Revenue Bulletins] do not have the force and effect of Treasury tax regulations, but they may be used as precedents.”).

<sup>17</sup> See THE FEDERALIST NO. 51 (James Madison).

<sup>18</sup> See KENNETH F. WARREN, *ADMINISTRATIVE LAW IN THE POLITICAL SYSTEM* 68 (4th ed. 2004).

<sup>19</sup> See *infra* Part III.B.

<sup>20</sup> See *infra* Part III.A.

This note will discuss *Cohen v. United States*, as well as other factors and developments that support the case for the IRS's full compliance with the Administrative Procedure Act. Part I of this note describes the APA, its purpose, and some relevant provisions. Part II discusses the IRS, its rulemaking procedures, and its lack of compliance with the APA. Part III discusses the various reasons why it is in the IRS's best interests to comply with the APA: (a) *Cohen v. United States* might have opened the door for greater judicial review of IRS rulemaking, increasing the chances of a rule being invalidated; (b) compliance will help ensure deference in court proceedings, thereby saving the IRS the time and money it would have to spend defending reasons for a rule's receiving deference from the courts; (c) it supports the IRS's mission to focus on the taxpayers and will thus help the IRS meet its tax gap reduction goals in an efficient way; and (d) it upholds the integrity of the rule of law by supporting a democratic legislative process, thereby protecting taxpayer interests and increasing their confidence in the system. Part IV concludes the note by recognizing that, although it is not certain that courts will expand their judicial review of IRS rulemaking, it is clear that there are many other factors supporting the case for the IRS's full compliance with the APA.

## I. THE ADMINISTRATIVE PROCEDURE ACT

The administrative state was not born with the creation of American government. In fact, America actually opposed the "gradual development of a more concentrated, specialized, and penetrating state apparatus in Britain"<sup>21</sup>—some even believing that this was one cause of the American Revolution.<sup>22</sup> Instead, the administrative state developed over time;<sup>23</sup> and while there are differing interpretations of the development process,<sup>24</sup> it can be agreed that the administrative state evolved in response to "the growing need for vesting in a public authority supervision

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<sup>21</sup> STEVEN SKOWRONEK, BUILDING A NEW AMERICAN STATE: THE EXPANSION OF NATIONAL ADMINISTRATIVE CAPACITIES, 1877-1920 (1982), reprinted in PETER H. SCHUCK, FOUNDATIONS OF ADMINISTRATIVE LAW 33 (1994).

<sup>22</sup> *Id.*

<sup>23</sup> SCHUCK, *supra* note 21, at 31.

<sup>24</sup> See, e.g., GABRIEL KOLKO, THE TRIUMPH OF CONSERVATISM (1963); WILLIAM E. NELSON, THE ROOTS OF AMERICAN BUREAUCRACY, 1830-1900 (1982); James Q. Wilson, *The Rise of the Bureaucratic State*, 41 PUB. INT. 77 (1975).

over the economic integrity of industries.”<sup>25</sup> It was likewise a way to fill the gaps made by the deficiencies of the judiciary and the legislature.<sup>26</sup>

However, with the expansion of administrative agencies came criticism and calls for regulation,<sup>27</sup> as such agencies had the potential to infringe on fundamental due process rights.<sup>28</sup> The Administrative Procedure Act was the government’s answer to such concerns.<sup>29</sup> This section will explain the purpose of the Administrative Procedure Act and set out its relevant provisions as they relate to the IRS’s rulemaking authority.

#### A. *Purpose of the Administrative Procedure Act*

The Administrative Procedure Act was enacted in 1946 to promote “fair play and equal rights under the law” in keeping with the “tripartite form of our democracy.”<sup>30</sup> It was directly aimed at restraining the growing power of administrative agencies in America’s governmental structure because the potential for abuse of that power was palpable.<sup>31</sup>

Prior to the enactment of the APA, President Franklin Delano Roosevelt’s Committee on Administrative Management described administrative agencies as “miniature independent governments set up to deal with [various problems],” stating that they “constitute a headless ‘fourth branch’ of the Government, a haphazard deposit of irresponsible agencies and uncoordinated powers.”<sup>32</sup> In essence, they are a fusion of legislative, executive, and judicial powers.<sup>33</sup> In supporting the

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<sup>25</sup> JAMES LANDIS, *THE ADMINISTRATIVE PROCESS* (1938), *reprinted in* SCHUCK, *supra* note 21, at 14.

<sup>26</sup> *Id.* at 16.

<sup>27</sup> See ROBERT RABIN, *FEDERAL REGULATION IN HISTORICAL PERSPECTIVE* (1986), *reprinted in* SCHUCK, *supra* note 21, at 41.

<sup>28</sup> See *infra* notes 32-34 and accompanying text.

<sup>29</sup> RABIN, *supra* note 27, at 41.

<sup>30</sup> COMM. ON THE JUDICIARY, 79th CONG., *ADMINISTRATIVE PROCEDURE ACT: LEGISLATIVE HISTORY: 1944-46*, at III (1946) [hereinafter APA: LEGISLATIVE HISTORY].

<sup>31</sup> *Id.* at 350 (Statesman Elihu Root said, “Yet the powers that are committed to these regulating agencies, and which they must have to do their work, carry with them great and dangerous opportunities of oppression and wrong. If we are to continue a government of limited powers these agencies of regulation must themselves be regulated.”).

<sup>32</sup> *Id.* at 189 (quoting Report of President’s Committee on Administrative Management).

<sup>33</sup> See STEVEN J. CANN, *ADMINISTRATIVE LAW* 8 (4th ed. 2006) (“In the modern, complex, postindustrial world, policies are initiated, formulated, promulgated, and modified by technocratic experts who hold mid- to high-level positions in America’s bureaucracies (federal, state, and local). The same agencies that make the policies also

passage of the Administrative Procedure Act to put a check on agency action, President Roosevelt cautioned that “[t]he practice of creating independent regulatory commissions, who perform administrative work in addition to judicial work, threatens to develop a ‘fourth branch’ of the Government for which there is no sanction in the Constitution.”<sup>34</sup> The President’s Committee on Administrative Management added in its report that this “not only undermines judicial fairness; it weakens public confidence in that fairness.”<sup>35</sup>

As pointed out by Representative Francis E. Walter of Pennsylvania, who was a member of the House of Representatives Committee on the Judiciary during the enactment of the APA, “[administrative law] is administrative because it involves the exercise of legislative and judicial powers of government by officers who are neither legislators nor judges. It is law because what they do is binding upon the citizens exactly as statutes or judgments are binding.”<sup>36</sup> In the traditional form of American government, the three interdependent branches take on separate roles, and each branch is monitored by the other branches through the system of checks and balances.<sup>37</sup> Since agencies cannot be monitored in this way, it was essential that an alternate means of control be created.<sup>38</sup>

Representative Walter explained that federal agencies engage in three different functions: legislative, judicial, and investigative.<sup>39</sup> In order to put a check on those functions, the Act employs three different devices: public information, administrative operation, and judicial review.<sup>40</sup> Most relevant

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implement them. Pursuant to implementing their own policies, agencies also investigate infractions of those policies and adjudicate those infractions. The agencies also impose sanctions. Although there may be academic squabbles over the degree of power that bureaucracies have acquired, there is virtually no disagreement over the fact that the old dichotomy between policy making and policy implementation is gone and that administrative agencies now perform both functions, fused into one institution.”)

<sup>34</sup> APA: LEGISLATIVE HISTORY, *supra* note 30, at 189.

<sup>35</sup> *Id.* (quoting Report of President’s Committee on Administrative Management).

<sup>36</sup> *Id.* at 349.

<sup>37</sup> *Checks and Balances*, AMERICA.GOV (Jan. 3, 2008), <http://www.america.gov/st/usg-english/2008/January/20071116173344eafas0.9917719.html>.

<sup>38</sup> See Cass Sunstein, *Factions, Self-Interest, and the APA: Four Lessons Since 1946*, 72 VA. L. REV. 271, 271 (1986) (“In attempting to control administrative processes, the drafters of the APA responded to two quite general constitutional themes . . . . The first concerns the usurpation of government by powerful private groups. The second involves the danger of self-interested representation: the pursuit by political actors of interests that diverge from those of the citizenry.”).

<sup>39</sup> APA: LEGISLATIVE HISTORY, *supra* note 30, at 352-53.

<sup>40</sup> See *id.* at 353. The APA’s public information section requires that agencies disclose information about their organizational structure and procedures, as well as

to this note is the legislative function of federal agencies, as concerned with the IRS's rulemaking procedures.

*B. Relevant Provisions of the APA*

By means of introduction, Section 551(1) of the APA defines “agency” as “each authority of the Government of the United States, whether or not it is within or subject to review by another agency,” and also provides exceptions, none of which include the IRS.<sup>41</sup> The term “rule” is defined under Section 551(4) as “the whole or any part of any agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or to describe the organization, procedure, or practice requirements of any agency . . . .”<sup>42</sup> A pronouncement is a rule “to the extent that . . . [it] formally prescribe[s] a course of conduct for the future rather than merely pronounce[s] existing rights or liabilities.”<sup>43</sup> Thus, “[a]gencies are given discretion to dispense with notice (and consequently with public proceedings) in the case of interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice”<sup>44</sup>—all of which do not impose new “courses of conduct for the future.”

Once it is established that an agency is subject to APA rulemaking requirements, the Act prescribes in Section 553 procedures for promulgating rules.<sup>45</sup> These procedures

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make public “substantive and interpretive rules which they have framed for the guidance of the public.” *Id.* The sections that deal with administrative operations require that agencies submit notices of proposed regulations and allow interested parties to submit comments in lieu of the traditional congressional hearing that would otherwise be held during the legislative process. *Id.* Those sections also outline the procedures for agency hearings and adjudications, and the limitations upon “penalties or relief which agencies may impose or confer in any case.” *Id.* at 354. Finally, the judicial review section “prescribes . . . when there may be judicial review and how far the courts may go in examining into a given case.” *Id.*

<sup>41</sup> 5 U.S.C. § 551(1) (2006); *see also* APA: LEGISLATIVE HISTORY, *supra* note 30, at 1, 354.

<sup>42</sup> 5 U.S.C. § 551(4).

<sup>43</sup> APA: LEGISLATIVE HISTORY, *supra* note 30, at 197.

<sup>44</sup> *Id.* at 200; *see also* 5 U.S.C. § 553(b).

<sup>45</sup> *See* CANN, *supra* note 33, at 293. Only substantive rules must go through the Section 553 rulemaking process, even though there are three types of rules: interpretive, procedural, and substantive. *Id.* at 294. However, all rules must be published in the *Federal Register* once adopted. *Id.* at 294-95.



“encourage public participation in the rulemaking process.”<sup>46</sup> They do this by requiring agencies to issue public notices of proposed regulations, collect public comments, and take those comments into consideration when finalizing the regulation.<sup>47</sup>

The general procedures are as follows: Section 553(b) requires an agency to publish in the *Federal Register* a public notice of its proposed rulemaking.<sup>48</sup> Next, Section 553(c) provides that the agency allow the public to submit comments on the proposed rule.<sup>49</sup> Once the agency has collected the public’s remarks regarding the proposed rule, it takes that input into consideration and only then writes out the rule. The agency will also include a “concise general statement of [the rule’s] basis and purpose,”<sup>50</sup> which the courts will use to review the validity of the rule.<sup>51</sup> The rule is then published in the *Federal Register* again, and only after thirty days does it become a final rule, binding the courts and the public.<sup>52</sup> Final rules may not be promulgated without first being publicly proposed.<sup>53</sup>

However, Section 553(b) provides exceptions to the notice-and-comment rulemaking requirements of Section 553.<sup>54</sup> These exceptions include interpretive rules, procedural rules, policy statements, and good cause.<sup>55</sup> Such items are excluded from notice-and-comment rulemaking because they do not dictate the future conduct of individuals, nor do they have the

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<sup>46</sup> 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, 1728 (2007).

<sup>47</sup> *Id.* at 1732-33.

<sup>48</sup> *Id.* at 1732 (citing 5 U.S.C. § 553(b)).

<sup>49</sup> *Id.* at 1733.

<sup>50</sup> CANN, *supra* note 33, at 293 (quoting 5 U.S.C. § 553(c)) (internal quotation marks omitted).

<sup>51</sup> Hickman, *supra* note 46, at 1733.

<sup>52</sup> CANN, *supra* note 33, at 293.

<sup>53</sup> Hickman, *supra* note 46, at 1732 (“[T]he courts generally do not allow agencies to promulgate final rules with provisions not ‘sufficiently foreshadowed’ by an NPRM.”). See *id.* at n.20 for cases and a treatise that discuss the “sufficiently foreshadowed” test.

<sup>54</sup> *Id.* at 1734.

<sup>55</sup> *Id.* Although these exceptions are available, all rules are still subject to publication and are open to challenge. Procedural and interpretive rules must be published in the *Federal Register* as soon as they are adopted. CANN, *supra* note 33, at 294-95. Additionally, interested parties adversely affected by an interpretive rule have the opportunity to challenge the rule in an adjudicatory hearing before suffering the effects of that rule. *Id.* at 298.

effect of law.<sup>56</sup> As discussed below, the IRS has used these exceptions to keep from complying with the APA.<sup>57</sup>

## II. THE IRS

The IRS assumes one of the greatest roles in our government: collecting revenue.<sup>58</sup> Such revenue is used to finance various governmental functions necessary to protect and help run the country.<sup>59</sup> The IRS is in turn given great powers to fulfill this role.<sup>60</sup> As discussed in Part II.A, the IRS assumes executive, legislative, and judicial powers in making sure that the government receives from taxpayers the tax revenue to which it is entitled. The IRS's primary focus is thus on the taxpayer. However, despite having such great powers and dealing directly with citizens, the IRS has failed to adhere to the APA, which was enacted to avoid this exact situation: the accumulation of power in one agency, threatening to overlook the interests of the people.<sup>61</sup> Part II.A gives a brief description of the IRS, along with its current mission, and Part II.B explains the IRS's lack of compliance with the APA.

### A. *In General*

The IRS had its beginnings in 1862 when President Abraham Lincoln appointed a Commissioner of Internal Revenue to collect income taxes to help finance the civil war.<sup>62</sup> This tax was repealed ten years later, and when Congress tried to reenact it in 1894, the Supreme Court struck it down as unconstitutional.<sup>63</sup> It was not until the ratification of the Sixteenth Amendment in 1913 that the power to collect income taxes was finally approved.<sup>64</sup> Today, personal income taxes generate almost half of the total

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<sup>56</sup> See *supra* notes 43-44 and accompanying text.

<sup>57</sup> See *infra* Part III.B.

<sup>58</sup> See *supra* note 4 and accompanying text.

<sup>59</sup> See *supra* note 6 and accompanying text.

<sup>60</sup> See *supra* notes 12-14 and accompanying text.

<sup>61</sup> See *supra* Part I.B.

<sup>62</sup> *Brief History of IRS*, IRS.GOV, <http://www.irs.gov/irs/article0,,id=149200,00.html> (last updated Nov. 1, 2007).

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

federal revenue.<sup>65</sup> Thus, the current focus of the IRS is predominantly on individual taxpayers.

In exercising its power to collect taxes, the IRS assumes the roles of the executive, legislative, and judicial branches.<sup>66</sup> It does this by executing the same laws and policies it promulgates.<sup>67</sup> Then, in implementing its formulated rules, the IRS scrutinizes taxpayers' filings when it suspects violations of those rules, and imposes sanctions accordingly.<sup>68</sup>

In keeping with its focus on taxpayers, the current mission of the IRS is as follows: "Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."<sup>69</sup> Based upon its mission statement, it is clear that the IRS wants to assist taxpayers and treat them fairly. However, although the IRS strives to be more taxpayer friendly, the tax code remains highly complex, which instead burdens taxpayers.<sup>70</sup> There are many regulations, rulings, notices, and other pronouncements that contribute to rule complexity and inequity, making the system inefficient and in dire need of reform.<sup>71</sup> In addition to, and more likely as a result of, this complexity and inequity, public opinion of the agency remains low.<sup>72</sup>

### *B. The IRS's Lack of Compliance with the APA*

In a study on the extent of the Treasury's compliance with the APA, Professor Kristin E. Hickman found that the Treasury has failed to follow the rulemaking requirements of the APA in 40.9% of the total strategically chosen rulemaking projects—spanning three years—that she studied.<sup>73</sup> She also found that in almost 90% of those nonconforming rules, or 36.2% of all of the projects studied, the "Treasury instead issued legally-binding temporary regulations simultaneously

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<sup>65</sup> U.S. CONGRESS, CONGRESSIONAL BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2005 TO 2014, at 72 (2004), available at <http://www.cbo.gov/ftpdocs/49xx/doc4985/01-26-BudgetOutlook-EntireReport.pdf>.

<sup>66</sup> See *supra* note 33 and accompanying text.

<sup>67</sup> See *supra* note 33 and accompanying text.

<sup>68</sup> See *supra* note 33 and accompanying text.

<sup>69</sup> *IRS Mission Statement and LMSB Vision Statement*, IRS.GOV, <http://www.irs.gov/businesses/article/0,,id=181225,00.html> (last updated June 23, 2010).

<sup>70</sup> See Edwards, *supra* note 2.

<sup>71</sup> See *id.*

<sup>72</sup> Bouilly, *supra* note 3.

<sup>73</sup> Hickman, *supra* note 46, at 1748.

with the [notices of proposed rulemaking (NPRM)], requesting public comments on the temporary regulations as proposed regulations also.”<sup>74</sup> This rulemaking process is backwards and defeats the purpose of the APA, which is to allow commenting and to protect affected parties before a rule becomes binding.<sup>75</sup> She explains that “[t]he typical pattern of these projects involves Treasury collecting public comments and evaluating them in promulgating the final regulations some months or years after issuing the NPRM.”<sup>76</sup> The remaining nonconforming rules were issued as final regulations without notice-and-comment altogether.<sup>77</sup>

To defend its actions, the Treasury argues that interpretive rules are exempt from the provisions of Section 553(b), (c), and (d), and then posits that most Treasury regulations fall under this interpretative rule exception, among others.<sup>78</sup> However, Professor Hickman concludes in her study that the “Treasury’s reliance on the interpretive rule, procedural rule, and good cause exemptions of APA section 553(b) is misplaced.”<sup>79</sup>

In general, the interpretive rule exception is questionable because “all Treasury regulations are legislative rules,” whether promulgated under specific authority or general authority.<sup>80</sup> It used to be that regulations promulgated under general authority did not have the force of law and were unequivocally considered to be interpretive, merely explaining the meaning of a statute.<sup>81</sup> However, that is no longer the case, as both general and specific authority regulations carry the

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<sup>74</sup> *Id.*

<sup>75</sup> *See supra* Parts I.A-B.

<sup>76</sup> Hickman, *supra* note 46, at 1748-49.

<sup>77</sup> *Id.* at 1749.

<sup>78</sup> INTERNAL REVENUE MANUAL § 32.1.1.4.4 (2004), available at <http://www.irs.gov/irm>. It is important to note here that although the IRS claims that it is exempt from the notice-and-comment rulemaking procedures of the APA, it nonetheless conforms to such procedures more often than not. Professor Hickman found that the IRS followed the traditional APA rulemaking process in 59.1% of the projects studied. Hickman, *supra* note 46, at 1749 tbl. 1. However, in almost all of the projects studied—92.70%—Professor Hickman found that the “Treasury claimed explicitly that the rulemaking requirements of APA section 553(b) did not apply.” *Id.* at 1749. And, in 81.55% of the total, the Treasury did not provide any reason or “basis” for making such a “conclusory statement.” *Id.*

<sup>79</sup> Hickman, *supra* note 46, at 1759.

<sup>80</sup> *Id.* at 1773.

<sup>81</sup> *Id.*

force of law by affecting people's rights and obligations,<sup>82</sup> thus making them legislative rules by definition.<sup>83</sup> As a result, subjecting all, or at least most, regulations to notice-and-comment rulemaking would be in line with the essential purpose of the APA, which is to allow taxpayers to place a check on an agency that has the potential to abuse its power by promulgating binding rules that it simultaneously enforces.<sup>84</sup> It would be absurd to think that Congress intended to exempt rules that altered people's rights and obligations from complying with the APA. The rules that the IRS claims are interpretive are in fact legislative because they affect people's rights and obligations. Accordingly, such rules should be subject to APA notice-and-comment rulemaking procedures to ensure people's rights are not exploited.

Likewise, the use of the procedural rule exception is questionable because the temporary regulations the IRS claimed were procedural rules actually "elaborated substantive provisions of the [Internal Revenue Code] in substantive ways" rather than "merely tweak the way that taxpayers interact with the government."<sup>85</sup> As discussed in the preceding paragraph, any rule that treads on people's rights and obligations must be subject to notice-and-comment rulemaking procedures to ensure that the IRS is not overstepping its boundaries and is treating people fairly. The IRS should not be allowed to claim exceptions for something that does not fit the definition of what qualifies for such exception. The IRS, of all agencies, should be very familiar with how narrowly exceptions should be applied.<sup>86</sup>

And finally, the good cause exception is misplaced. First, it fails on procedural grounds because the APA requires that if an agency wants to invoke the good cause exception, it must do so expressly and "provide 'a brief statement of reasons' along with the regulations being issued."<sup>87</sup> Second, the good cause

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<sup>82</sup> *Id.*; see also Michael Asimow, *Nonlegislative Rulemaking and Regulatory Reform*, 1985 DUKE L.J. 381, 393-401 (noting the declining relevance of the specific versus general authority distinction).

<sup>83</sup> See *supra* notes 43-44 and accompanying text.

<sup>84</sup> See *supra* notes 30-39 and accompanying text.

<sup>85</sup> Hickman, *supra* note 46, at 1777-78.

<sup>86</sup> When taxpayers claim exemptions on their tax returns, such exemptions must adhere to strict definitions set forth by the IRS. Narrow applications of such exemptions are in the IRS's best interests because it wants to allow as few people and organizations as possible to not pay taxes.

<sup>87</sup> Hickman, *supra* note 46, at 1778 (quoting 5 U.S.C. § 553(b)(B) (2006)).

exception fails on substantive grounds because it is a narrow provision meant to provide agencies with “flexibility in dealing with emergencies and typographical errors, plus the occasional situation in which advance notice would be counterproductive.”<sup>88</sup> In her study, Professor Hickman found that the Treasury did not have a valid purpose for invoking this narrow exception, or at least that its purposes were questionable.<sup>89</sup>

Surely it is more convenient for the IRS to bypass the APA’s procedural hurdles. There may even be an argument in favor of noncompliance because it allows the Treasury to keep up with social and economic events that may be corrected through the tax system. However, if we want to maintain the integrity of our democratic system of government and protect taxpayers’ rights, we must subject the IRS to scrutiny through notice-and-comment rulemaking.

### III. WHY THE IRS SHOULD ADHERE TO THE APA

In addition to the doctrinal flaws in the Treasury’s use of the exemptions to Section 553(b), there are more practical reasons that warrant the IRS’s compliance with the APA’s rulemaking requirements. By complying with the APA, the IRS could protect itself against courts striking down its rules for failure to adhere to notice-and-comment rulemaking procedures. This is especially important in the face of a recent circuit court decision that might have opened the door to judicial review of preenforcement agency action. Additionally, the IRS could ensure that the rules are given the utmost deference in litigation proceedings involving those rules. Furthermore, adhering to the APA would increase taxpayer confidence in the system, and would in turn help the IRS accomplish its goal of reducing the tax gap. And finally, engaging the IRS in the notice-and-comment rulemaking process would uphold the integrity of the law, along with the fundamental principles of separation of powers.

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<sup>88</sup> *Id.* at 1782-86.

<sup>89</sup> *Id.*

## A. *Judicial Review*

### 1. *Cohen v. United States* and Judicial Review of Preenforcement Agency Action

*Cohen v. United States* was initiated when “various [multidistrict litigation] lawsuits arose challenging the refund process” for “[excise] taxes erroneously collected between February 28, 2003 and August 1, 2006.”<sup>90</sup> The refund process was announced in Notice 2006-50<sup>91</sup> (“the Notice”) after five circuit courts ruled that the tax was invalid.<sup>92</sup> The United States District Court for the District of Columbia dismissed the cases, holding that the appellants “failed to exhaust their administrative remedies for their refund claims and failed to state valid claims under federal law, including the APA.”<sup>93</sup> The Court of Appeals for the D.C. Circuit reversed the dismissal of appellants’s APA claims, and affirmed the dismissal of Cohen’s refund claim.<sup>94</sup>

Generally, when it comes to tax cases, the D.C. Circuit has limited jurisdiction.<sup>95</sup> It may hear cases involving disputed funds only after the petitioner has exhausted the refund procedures found in the tax code.<sup>96</sup> Otherwise, a party must

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<sup>90</sup> *Cohen v. United States*, 578 F.3d 1, 4 (D.C. Cir. 2009). Pursuant to 26 U.S.C. § 4252(b), the IRS collects a three percent excise tax on long-distance phone calls whose charges “vary with distance and transmission time.” *Id.* at 3. However, when the IRS continued to collect these taxes despite a shift in the telecommunications industry practice that led to “many consumers . . . pay[ing] strictly based on transmission time” and without reference to distance, taxpayers challenged the tax. *Id.* Five circuit courts sided with the taxpayers and held the tax “inapplicable to long-distance calls charged without reference to the distance variable.” *Id.* at 4.

<sup>91</sup> I.R.S. Notice 2006-50, 2006-1 C.B. 1141.

<sup>92</sup> *Cohen*, 578 F.3d at 4.

<sup>93</sup> *Id.*

<sup>94</sup> *Id.* A rehearing en banc had been scheduled for September 29, 2010. *Cohen v. United States*, 599 F.3d 652, 652 (D.C. Cir. 2010) (per curiam). As of the date of this note, the D.C. Circuit had not released an opinion.

<sup>95</sup> Under Article III of the Constitution, federal courts may only hear “cases or controversies involving conflicts that may arise under either the Constitution or laws of the federal government.” CANN, *supra* note 33, at 115. However, Congress may allow federal courts appellate jurisdiction, meaning that the courts may review the decisions of some lower courts absent a constitutional or federal issue. *Id.* at 128.

<sup>96</sup> *Cohen*, 578 F.3d at 6; see also 5 U.S.C. § 702 (2006).

This is called a postenforcement or “enforcement-based” action, meaning that the rule has been applied, it adversely affected a party, and that party wants to challenge the application of the rule rather than the general “substantive or procedural validity of a regulation.” Kristin E. Hickman, *A Problem of Remedy: Responding to Treasury’s (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 76 GEO. WASH. L. REV. 1153, 1164 n.46 (2008). Generally, there are two types of post-enforcement actions: (1) “refund litigation” where the taxpayer was assessed a deficiency, paid it over to the IRS,

have been “adversely affected or aggrieved by agency action within the meaning of a relevant statute.”<sup>97</sup> The circuit court viewed *Cohen v. United States* as that extraordinary tax case that fell under its federal question jurisdiction.<sup>98</sup>

The issue in the case was the classification of the Notice issued by the IRS: whether it was a “substantive rule” or a “general statement of policy.”<sup>99</sup> As mentioned above, the Notice set forth procedures for claiming a refund for the improperly collected excise taxes.<sup>100</sup> The court, refusing to accept the IRS’s position that this Notice was a general statement of policy and thus not subject to APA challenges, held that the Notice was indeed subject to challenges under the APA.<sup>101</sup> It found that the Notice “constituted a final agency action that aggrieved taxpayers by hindering their access to court” and remanded the case for further consideration under the appellants’ APA claims.<sup>102</sup>

In reaching its holding, the court reasoned that under the APA, “[a] substantive rule constitutes a binding final agency action and is reviewable,”<sup>103</sup> whereas a general policy statement is not.<sup>104</sup> It applied a two-prong test for determining whether a rule is binding and thus reviewable.<sup>105</sup> That test looks to whether the rule “(1) marked the ‘consummation’ of the IRS’s decision-making process and (2) either affects legal ‘rights or obligations’ or results in ‘legal consequences.’”<sup>106</sup> The court found that the Notice at issue met the test because it “operates as a substantive rule that binds the IRS, excise tax collectors, and taxpayers,”<sup>107</sup> and it is thus subject to scrutiny under the APA.

This is the first time the Court of Appeals for the D.C. Circuit has directly scrutinized the substantive and procedural aspects of an agency action without a tax refund claim pending

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and is seeking a refund; and (2) “deficiency litigation” where a deficiency has been assessed, is due, but has not yet been paid over to the IRS. *Id.* at 1164.

<sup>97</sup> 5 U.S.C. § 702.

<sup>98</sup> *Cohen*, 578 F.3d at 6 (“[O]nly in the anomalous case where the wrongful assessment is not disputed and litigants do not seek a refund is a standalone claim under the APA viable. This is that case.”). *See id.* at 5.

<sup>99</sup> *Id.* at 7.

<sup>100</sup> *See supra* notes 90-91 and accompanying text.

<sup>101</sup> *Cohen*, 578 F.3d at 12.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 6.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* (citing *Bennett v. Spear*, 520 U.S. 154, 177-78 (1997)).

<sup>107</sup> *Id.*



in the forefront of that action.<sup>108</sup> The IRS should heed this decision because, historically, other circuits have followed the D.C. Circuit when it comes to administrative law issues.<sup>109</sup>

Notably, the fact that the court did not find the IRS's characterization of the Notice dispositive should speak volumes to the IRS.<sup>110</sup> It seems that the court will apply its own independent test in determining whether an agency action is substantive or whether it is merely interpretive, regardless of how the IRS characterizes it.

Perhaps the IRS will choose to limit this case to its facts and refuse to follow it; but the fact remains that the D.C. Circuit has opened the door for judicial scrutiny of IRS action under the APA without an underlying tax dispute. Likewise, even if this holding is vacated upon a rehearing en banc, it is important because it shows the D.C. Circuit's willingness to rule in this manner, and other circuits can still look to the vacated ruling for guidance.<sup>111</sup> Additionally, the law still stands that if an agency action is found to be a substantive rather than merely interpretive rule, it will be subject to judicial review under the APA. Consequently, the *Cohen* decision demonstrates the court's potential willingness to engage in independent analysis of the IRS's actions without deferring to the agency's characterization of its actions as determinative, and its willingness to do so without a tax refund claim pending in the forefront of the action.

Although the court made clear that "this is a *post-enforcement* case,"<sup>112</sup> it nevertheless hinted that there is nothing in the case law to preclude courts from scrutinizing a

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<sup>108</sup> The court ruled that the refund claim had not ripened at the time of the suit, and so the district court did not err by dismissing the refund claim. *Id.* at 22. The courts of appeals generally review the validity of IRS rules only when there is an appeal of a tax dispute. *See supra* note 96 and accompanying text.

<sup>109</sup> Paul L. Caron, Hickman: *D.C. Circuit Delivers a Doozy*, TAX PROF BLOG (Aug. 8, 2009), [http://taxprof.typepad.com/taxprof\\_blog/2009/08/hickman-dc-circuit.html](http://taxprof.typepad.com/taxprof_blog/2009/08/hickman-dc-circuit.html).

<sup>110</sup> *See* John F. Manning, *Nonlegislative Rules*, 72 GEO. WASH. L. REV. 893, 893 (2004) ("If a purported nonlegislative rule has operative characteristics that only a legislative rule can legitimately possess, courts will not hesitate to invalidate that rule on the ground that the agency did not use proper procedures to adopt it.")

<sup>111</sup> The rehearing was scheduled on the following issues: (1) Whether the Administrative Procedure Act claims of the plaintiffs are barred at this time under 28 U.S.C. § 2201(a) or 26 U.S.C. § 7421(a); (2) Should D.C. Circuit precedent interpreting the Anti-Injunction Act and the Declaratory Judgment Act as "coterminous" be overruled? (3) If the Anti-Injunction Act or the Declaratory Judgment Act bars the court from hearing plaintiffs' APA claims, may plaintiffs still challenge IRS Notice 2006-50 in a refund suit under 26 U.S.C. § 7422? (4) Does APA Section 702 waive sovereign immunity for plaintiffs' APA claims? *Cohen*, 599 F.3d at 652.

<sup>112</sup> *Cohen*, 578 F.3d at 13.

preenforcement action: “the dissent similarly cannot point to any case that has disallowed a pre-enforcement APA challenge in a context like this one.”<sup>113</sup> The court even asserted that “[n]o agency operates beyond the reach of the law,”<sup>114</sup> and made clear that “[o]nce the limits of the protections Congress provided have been surpassed, . . . the IRS is subject to the same legal requirements as other administrative agencies.”<sup>115</sup>

In sum, the D.C. Circuit refused to accept the IRS’s characterization of the ruling as a general “policy statement” and engaged in its own analysis of whether the rule was interpretive or legislative.<sup>116</sup> This shows that courts will take it upon themselves to review agency action and determine whether such an action is subject to the APA. And more importantly, because members of the court, albeit in dissent, pointed out that there is an argument that *Cohen* is in fact a preenforcement action,<sup>117</sup> it leaves open the chance for such independent judicial scrutiny of preenforcement actions under the APA. The following section explains why such a reading of the case is plausible.

## 2. Policy Reasons for Reading *Cohen* Broadly to Allow for Judicial Review of Preenforcement Agency Action

There are valid policy reasons for reading *Cohen* broadly and thus implementing preenforcement judicial review of IRS action. For one, preenforcement judicial review would discourage the IRS from promulgating rules without complying with the APA’s notice-and-comment rulemaking requirements by making it clear that all rules and regulations will be subject to challenges under the APA whether or not they have been enforced. In other words, rules will be subject to judicial review immediately after promulgation rather than post-enforcement. This will ensure across-the-board compliance with the APA.

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<sup>113</sup> *Id.* The dissent relied on the characterization of the case as a preenforcement action, opining that the ripeness doctrine precluded the court from hearing the case at that time. *Id.* at 21 (Kavanaugh, J., dissenting in part).

<sup>114</sup> *Id.* at 14 (majority opinion).

<sup>115</sup> *Id.* (referring to the protections Congress afforded to relieve the IRS from some, albeit not all, of the requirements of the APA).

<sup>116</sup> *Id.* at 8.

<sup>117</sup> *Id.* at 21 (Kavanaugh, J., dissenting in part) (“Until plaintiffs seek a larger refund from the IRS and are denied, Notice 2006-50 will not have been enforced against them by the IRS. So this lawsuit is a pre-enforcement suit targeting Notice 2006-50. And the ripeness doctrine, in my judgment, precludes hearing this pre-enforcement case at this time.”).

Similarly, as in *Cohen*, the mere possibility that a court could invalidate a regulation for putting unreasonable restrictions or burdens on taxpayers in redeeming refunds might encourage the IRS to make sure there are no such hurdles at the outset. In addition to deterring the IRS from abusing its power, allowing for preenforcement judicial review would foster the type of balance that exists between the branches of government. Because administrative agencies have been deemed the “fourth branch” of government,<sup>118</sup> it is appropriate to subject them to the same regulatory scheme employed by the original three branches in which each one is subject to some sort of “check” by the others.<sup>119</sup> This judicial “check” on the IRS would ultimately bring about a more democratic legislative process, as the agency is essentially doing the job of Congress in promulgating binding law that affects the rights and obligations of citizens.<sup>120</sup> As one scholar points out, “there has always been in our traditions particular concern with the judicial role where governmental interference with the ‘private rights’ of ‘liberty’ and ‘property’ was involved.”<sup>121</sup> In terms of the role of judicial review in the modern administrative state, “[Justice] Brandeis . . . asserted that ‘[t]he supremacy of law demands that there shall be an opportunity to have some court decide whether an erroneous rule was applied.’”<sup>122</sup>

Although Congress has implemented various exemptions to the IRS’s compliance with various regulatory schemes that stand in the way of judicial review,<sup>123</sup> *Cohen* and the underlying principles that would support preenforcement judicial review of agency action suggest that a shift to greater and more aggressive judicial review of IRS rule-making procedures might be imminent. As such, it is in the best interest of the IRS to begin complying with the APA across the board as soon as possible to ensure that its rules will be safe from APA challenges in the future. By continuing its practice of noncompliance, coupled with questionable explanations for

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<sup>118</sup> See *supra* note 32 and accompanying text.

<sup>119</sup> See *supra* notes 34-40 and accompanying text.

<sup>120</sup> See *supra* note 36 and accompanying text.

<sup>121</sup> Henry P. Monaghan, *Marbury and the Administrative State*, 83 COLUM. L. REV. 1, 17 (1983).

<sup>122</sup> *Id.* at 19 (citing *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38, 84 (1936) (Brandeis, J., concurring)) (alteration in original).

<sup>123</sup> See *Hickman*, *supra* note 96, at 1162-81 (describing the limitations on preenforcement judicial review).

exemption,<sup>124</sup> the IRS is digging a deeper hole for itself because the more rules and regulations it promulgates improperly, the harder it will be to clean up the mess once the courts take on preenforcement challenges against such improperly enacted rules and regulations.

*B. Guarantee Courts' Deference in Litigation Proceedings*

In addition to guarding itself against preenforcement judicial review by complying with the APA's notice-and-comment rulemaking requirements, compliance with the APA will help the IRS become more efficient by guaranteeing that judges will defer to its rules and regulations.<sup>125</sup> Achieving such deference would reduce the time and effort it takes to defend the validity of the IRS's rules and regulations once a case has gone to litigation.<sup>126</sup>

The state of the law in terms of judicial deference to tax regulations, and agency rules in general, is unclear.<sup>127</sup> The reason for this uncertainty lies in the ever-debated legislative/interpretive dichotomy. Traditionally, if a rule was legislative, courts honored the agency's position "unless it was in conflict with the statute, or was arbitrary and capricious."<sup>128</sup> But if the rule was interpretive, courts were free to adopt their own interpretation of the statute, giving the rule only "respectful consideration."<sup>129</sup> However, *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* required courts to defer to agency action if they find that that action was

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<sup>124</sup> See *supra* notes 78-89 and accompanying text.

<sup>125</sup> See *infra* notes 139-45 and accompanying text.

<sup>126</sup> For the fiscal year 2009, the IRS chief counsel received 34,478 tax litigation cases, closed 35,520 tax litigation cases, and had 32,421 tax litigation cases pending as of September 30, 2009. DEP'T OF THE TREASURY, INTERNAL REVENUE SERVICE DATA BOOK 61 (2009), available at <http://www.irs.gov/pub/irs-soi/09databk.pdf>. The total amount of operating costs incurred by the IRS in 2009 was \$11.7 billion. *Id.* at 66. Of that total, \$4.8 billion was incurred for enforcement activities. *Id.* at 65. Moreover, because the issue of what principles will be used to decide whether deference is owed to IRS regulations has not yet been established, the IRS must continue to expend great effort to prove that a regulation should be deferred to. See Alan Horowitz, *Supreme Court to Address Deference Owed to Regulation Governing FICA Taxation of Medical Residents*, TAX APPELLATE BLOG (Aug. 2, 2010), <http://appellatetax.com/2010/08/02/supreme-court-to-address-deference-owed-to-regulation-governing-fica-taxation-of-medical-residents>.

<sup>127</sup> Kristin E. Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1538 (2006).

<sup>128</sup> John F. Coverdale, *Chevron's Reduced Domain: Judicial Review of Treasury Regulations and Revenue Rulings After Mead*, 55 ADMIN. L. REV. 39, 44 (2003).

<sup>129</sup> *Id.* at 45.

reasonable,<sup>130</sup> regardless whether the rule was deemed legislative or interpretive.<sup>131</sup> Nevertheless, as will be discussed, two other cases, and possibly even a third, have muddied the waters. Therefore, it is advisable for the IRS to take a conservative approach to its rulemaking authority by ensuring that all potentially legislative rules comply with the APA.

The *Chevron* standard is very broad: it “requires accepting all reasonable agency positions, as opposed to giving more or less weight to the agency’s position in the course of deciding what is the best interpretation of the statute.”<sup>132</sup> Demonstrably, the Supreme Court has applied *Chevron* deference to legislative and interpretive rules alike,<sup>133</sup> straying from the traditional legislative/interpretive dichotomy.

However, in 2000 and 2001 respectively, two Supreme Court cases—*Christensen v. Harris County*<sup>134</sup> and *United States v. Mead Corp.*<sup>135</sup>—reined in the broad reach of the *Chevron* standard. In 2000, *Christensen* held that “[i]nterpretations such as those in opinion letters—like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant *Chevron*-style deference.”<sup>136</sup> It fell short, however, in fully defining the limits of *Chevron* deference because it did not specify how a court would go about determining whether a rule has the force of law.<sup>137</sup> It was not until the following year that the Supreme Court in *Mead* took on the task of defining *Chevron*’s scope.

In limiting *Chevron*’s applicability, *Mead* first rejected the presumption in *Chevron* that every rule promulgated by an agency by virtue of its policymaking authority is entitled to deference as long as it is reasonable.<sup>138</sup> Instead, the Court looked to the intent of Congress to determine whether to grant *Chevron* deference.<sup>139</sup> To demonstrate that intent, the Court set

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<sup>130</sup> *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 845 (1984).

<sup>131</sup> See *infra* note 133 and accompanying text.

<sup>132</sup> Coverdale, *supra* note 128, at 45.

<sup>133</sup> *Id.* at 46 (stating that although most of the regulations deferred to by the Supreme Court were issued pursuant to notice-and-comment requirements, “the Court applied *Chevron* to a broad range of agency positions that had not been subject to notice and comment”).

<sup>134</sup> 529 U.S. 576 (2000).

<sup>135</sup> 533 U.S. 218 (2001).

<sup>136</sup> *Christensen*, 529 U.S. at 587.

<sup>137</sup> See *id.* at 587-88.

<sup>138</sup> Coverdale, *supra* note 128, at 49.

<sup>139</sup> *Mead*, 533 U.S. at 226-27.

out two conditions that must be met: (1) “Congress delegated authority to the agency generally to make rules carrying the force of law,” and (2) “the agency interpretation claiming deference was promulgated in the exercise of that authority.”<sup>140</sup>

In setting out those two conditions, “*Mead* presumes that when an agency pronouncement is to have [the force of law], Congress wants to insure ‘fairness and deliberation’ which ‘relatively formal administrative procedure[s] tend[] to foster.’”<sup>141</sup> And, although the Court urged that a lack of notice-and-comment rulemaking is not dispositive of the issue,<sup>142</sup> the Court’s failure to suggest “indicators”—other than notice-and-comment rulemaking or formal adjudication—that show that the agency is acting pursuant to Congress’s grant of authority in promulgating its rules suggests otherwise.<sup>143</sup> Thus, notice-and-comment rulemaking and formal adjudication are important indicators that a rule was promulgated under the authority to give such rule the force of law, thereby entitling it to *Chevron* deference.<sup>144</sup>

Moreover, making formal adjudication or notice-and-comment rulemaking one of the conditions of awarding *Chevron* deference to agency pronouncements would be a clearer standard and would yield the same results as the *Mead* court’s test.<sup>145</sup> It must be recognized that the reason why the court did not make notice-and-comment rulemaking the only requirement for applying *Chevron* deference was probably because “[m]aking notice and comment a requirement for inferring that Congress intends *Chevron* deference would . . . have required the Court to overrule a number of its earlier cases.”<sup>146</sup> Nevertheless, judging from the Court’s loose application of the *Mead* test to the facts of that case, and its inability to cite alternative examples that would indicate that Congress granted the agency authority to promulgate binding rules, “although unwilling to say so, the Court considers notice-and-comment rulemaking or adjudication virtually the *sin qua non* of *Chevron* deference.”<sup>147</sup>

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<sup>140</sup> *Id.*

<sup>141</sup> Coverdale, *supra* note 128, at 50 (quoting *Mead*, 533 U.S. at 230).

<sup>142</sup> *Mead*, 533 U.S. at 231.

<sup>143</sup> Coverdale, *supra* note 128, at 51, 54; *see also Mead*, 533 U.S. at 230-31.

<sup>144</sup> Coverdale, *supra* note 128, at 51.

<sup>145</sup> *Id.* at 52.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

Given this reading of *Mead*, it is in the IRS's best interest to fully comply with notice-and-comment requirements. Unless the Supreme Court is going to completely defer to any reasonable agency action, it is going to look to the agency's delegated authority and the formal administrative procedures used in exercising that authority to determine whether or not the agency's actions have infringed on the democratic legislative process.<sup>148</sup> And from the *Mead* opinion, it is evident that notice-and-comment rulemaking is the most concrete indication that Congress granted the agency the authority to promulgate rules carrying the force of law.

Additionally, in 2008 the Third Circuit in *Swallows Holding, Ltd. v. Commissioner*<sup>149</sup> "provide[d] an unsettling reminder of the confusing state of the law concerning when courts should defer to federal tax regulations,"<sup>150</sup> and further confirmed the importance of notice-and-comment rulemaking requirements. There, the court reversed the Tax Court and upheld the validity of a Treasury regulation that was deemed to be interpretive by the Tax Court.<sup>151</sup> In reaching its decision, the Third Circuit applied *Chevron* deference without drawing a distinction between the legislative or interpretive nature of the regulations.<sup>152</sup> Instead, it found that *Chevron* deference was applicable because the regulation was opened to public comment—"a move that is indicative of agency action that carries the force of law."<sup>153</sup>

In utilizing notice-and-comment rulemaking as its basis for deference, the circuit court "set[] the stage for the level of judicial deference to be decided based on whether the IRS complies with the rulemaking provisions of the Administrative Procedure Act."<sup>154</sup> This, however, raises the issue of what level of deference will be given to regulations that are purported to carry the force of law but were not promulgated under the formal rulemaking requirements of the APA.<sup>155</sup>

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<sup>148</sup> *Mead*, 533 U.S. at 226-30.

<sup>149</sup> 515 F.3d 162 (3d Cir. 2008).

<sup>150</sup> Eve Elgin, *Swallows Decision Renews Questions About Judicial Deference to Tax Regs*, THE TAX ADVISOR, June 1, 2008, available at <http://www.aicpa.org/Publications/TaxAdviser/2008/jun/Pages/SwallowsDecisionRenewsQuestionsAboutJudicialDeferencetoTaxRegs.aspx?>.

<sup>151</sup> *Swallows Holding*, 515 F.3d at 164.

<sup>152</sup> *Id.* at 169.

<sup>153</sup> *Id.* at 169-70.

<sup>154</sup> Elgin, *supra* note 150.

<sup>155</sup> *Id.*

In sum, it is unclear whether legislative regulations will receive *Chevron* deference while interpretive regulations will not. Nor is it clear that notice-and-comment rulemaking is the sole indicator of an action that carries the force of law. What is clear is that, either way, it is best for the IRS to move away from its characterization of regulations and rulings as interpretive and to begin complying with the APA across the board. Even if courts do not base their decisions on the legislative/interpretive dichotomy, which would favor the IRS's position by allowing interpretive regulations to receive deference, courts will nonetheless place great emphasis on whether the rule was promulgated using the APA's notice-and-comment requirements. And since many rules promulgated by the IRS fail to conform to APA rulemaking requirements,<sup>156</sup> it leaves these rules open to challenges, meaning that the IRS will need to expend extra resources to prove to courts that their rules and regulations are valid. Consequently, if the IRS continues its noncompliance with the APA, it will delay litigation by taking the focus off the merits of the case, increase the agency's litigation costs, and ultimately undercut the efficiency of its enforcement procedures.

C. *Increase Taxpayer Confidence and Help Close the Tax Gap*

Because the majority of tax revenue is generated by the individual income tax, the IRS's focus has shifted to the taxpayer.<sup>157</sup> Its current mission to support and protect taxpayers in the taxing process evidences this fact.<sup>158</sup> Additionally, the IRS has not lost sight of its primary goal: collection of every dollar of tax revenue it is entitled to under the law.<sup>159</sup> Thus, in addition to its mission, the IRS has put forth goals for reducing the tax gap, which is a problem that has created a deficiency of approximately \$290 billion in expected revenues.<sup>160</sup> The tax gap consists of underreporting, underpayment, and nonfiling.<sup>161</sup> Underreporting makes up over fifty percent of the total tax gap. And, more importantly, the

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<sup>156</sup> See *supra* Part II.B.

<sup>157</sup> See *supra* Part II.A.

<sup>158</sup> See *supra* note 69 and accompanying text.

<sup>159</sup> See *supra* notes 58-61 and accompanying text.

<sup>160</sup> DEPT OF THE TREASURY, UPDATE ON REDUCING THE FEDERAL TAX GAP AND IMPROVING VOLUNTARY COMPLIANCE 2 (2009), available at [http://www.irs.gov/pub/newsroom/tax\\_gap\\_report\\_final\\_version.pdf](http://www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf).

<sup>161</sup> *Id.* at 2-3.



individual income tax is the “single largest sub-component of underreporting.”<sup>162</sup> Consequently, the report places great emphasis on taxpayer assistance as well: “The Administration recognizes the particular value of those efforts and initiatives that improve voluntary compliance by making the tax filing process easier and more taxpayer-friendly,” which is also in line with the overall mission of the IRS.<sup>163</sup>

In setting forth this key goal, the IRS conceded the complexity of the tax code, and reiterated the fact that “effective taxpayer assistance is necessary to help taxpayers understand and comply with their obligations.”<sup>164</sup> Moreover, the IRS emphasized the importance of “simple, clear communication” to make compliance easier for taxpayers.<sup>165</sup> Certainly, the issuance of various guiding documents such as regulations, revenue rulings, and notices—some binding, some not—does not help promote simplicity, since it is unlikely that the average taxpayer would have the time and resources to understand the documents and how they apply. This strengthens the case for full compliance with the APA, which would allow a clear distinction to be made between the various guidance documents that are binding and carry the force of law, and those that are not and are hence merely interpretive.

Part of the IRS’s current plan in reforming and simplifying the tax law is working with Congress “to enact simplification legislative provisions.”<sup>166</sup> Certainly, this will help alleviate the confusion created by the various interpretive regulations and rulings; but quite frankly, it will take a long time to reenact every obscure tax law since Congress’s capacity to enact laws greatly trails that of federal agencies.<sup>167</sup>

Admittedly, it would be ideal for Congress to enact any potential simplification legislation, as this would be consistent with our traditional sense of democracy, in which we elect representatives to be our voice in creating laws and policies.<sup>168</sup> However, living in a postindustrial society, as we do today, where there are more problems to deal with and where those

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<sup>162</sup> *Id.* at 3.

<sup>163</sup> *Id.* at 2.

<sup>164</sup> *Id.* at 21.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.* at 25.

<sup>167</sup> Congress has averaged 288 public laws per year from 1975 to 1996, while administrative agencies approve nearly 4000 per year. CANN, *supra* note 33, at 19.

<sup>168</sup> *Id.* at 7.

problems are increasingly complex,<sup>169</sup> it is more efficient to have an administrative agency like the Department of the Treasury assume the task of setting policy and ironing out the ambiguities in the law.<sup>170</sup> After all, that is the underlying reason for the creation of “the administrative state.”<sup>171</sup> However, because such efficiency comes with a price—namely, the potential for overreaching—agencies should be regulated in order to maintain fairness and ensure that the simplification process is democratic.<sup>172</sup>

Thus, since it will be difficult and time-consuming for the IRS to simplify its tax laws by working with Congress to enact simplification legislation, and since the alternative route is agency rulemaking, which, if unbridled, has much potential for abuse and overreaching, the IRS should comply with the APA in lieu of working directly with Congress. Compliance with the APA will eliminate the inherent problems of a “fourth branch of government” and ensure fairness and accountability.<sup>173</sup> This will allow the IRS to achieve its goal of closing the tax gap more efficiently without undermining its mission of taxpayer assistance and fairness to all.<sup>174</sup>

#### D. Uphold the Integrity of the Rule of Law

Our democratic form of government is predicated upon separation of powers and the system of checks and balances. The system of checks and balances was established to place a check on each branch of government and prevent any one branch from overpowering the other branches.<sup>175</sup>

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<sup>169</sup> *Id.* at 9 (pointing out that with industrialization came urbanization, which “exacerbate[d] problems such as poverty, poor housing, poor health, crime, hunger, malnutrition, sewage disposal, and alienation,” and that limited government “is not an instrument for dealing with such problems”). Additionally, because of industrialization, society began to demand that government step in to regulate the economy and people’s lives because of the idea that “some individuals cannot achieve their fullest potential without help and that help generally will come from government.” *Id.* at 10. As a result, government was called on to regulate things such as child labor, child education, food, and monopolies, to name just a few. *Id.*

<sup>170</sup> *Id.* at 10-11.

<sup>171</sup> *Id.* “The administrative state” is an expression used to describe “[t]he notion of policy making by agencies and bureaucracies rather than by popularly elected (and accountable) representatives.” *Id.* at 8. It is also known as “the fourth branch of government.” *Id.*

<sup>172</sup> See *supra* Part II.A.

<sup>173</sup> See *supra* note 34 and accompanying text.

<sup>174</sup> See *supra* note 70 and accompanying text.

<sup>175</sup> See *supra* note 17 and accompanying text.

Whether the IRS is promulgating a rule or making a procedural change within the organization itself, public information is essential to maintaining checks and balances in our government.<sup>176</sup> When the growth of the administrative state began to threaten this system, Congress decided it was necessary to employ an external device to place a check on the agencies.<sup>177</sup> This led to the passage of the APA.<sup>178</sup>

Additionally, because there is no equivalent of a legislature within the agencies to represent the will of the people like in Congress, public information and notice-and-comment rulemaking have to take its place.<sup>179</sup> As expressed in the APA's legislative history, "[t]he public information requirements . . . are in many ways among the most important, far-reaching, and useful provisions of the bill."<sup>180</sup> "[They] require[] that agencies state their organizational set-ups, promulgate statements respecting their procedures, and make available as regulations the substantive and interpretive rules which they have framed for the guidance of the public."<sup>181</sup>

The government obtains its power from the people,<sup>182</sup> and so it must answer to the public when making laws that affect their rights and liabilities.<sup>183</sup> The people delegated to the government the power to make choices on their behalf, but only under the condition that their interests would be protected.<sup>184</sup> Thus, when a government agency has no check on its power, and may assume the role of either the legislative, executive, or judicial branch without restraint, the people must be informed and be given an opportunity to express their concerns and ensure that their interests are being protected.<sup>185</sup> Complying with the APA accomplishes this need and provides for a more

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<sup>176</sup> APA LEGISLATIVE HISTORY, *supra* note 30, at 198.

<sup>177</sup> See Sunstein, *supra* note 38, at 271.

<sup>178</sup> *Id.*

<sup>179</sup> See *Ariz. Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370, 386 (1932) (emphasizing that when Congress delegates its lawmaking power to an agency, that agency "speaks as the legislature, and its pronouncement has the force of a statute"). However, despite assuming the legislature's role, there are no specially elected representatives who will represent the will of the people. See *supra* note 18 and accompanying text.

<sup>180</sup> APA: LEGISLATIVE HISTORY, *supra* note 30, at 198.

<sup>181</sup> *Id.* at 353.

<sup>182</sup> THE DECLARATION OF INDEPENDENCE para. 2 (U.S. 1776) ("Governments are instituted among Men, deriving their just powers from the consent of the governed.").

<sup>183</sup> See Marci A. Hamilton, *Representation and Nondelegation: Back to Basics*, 20 CARDOZO L. REV. 807, 809, 814 (1999).

<sup>184</sup> *Id.*

<sup>185</sup> See *supra* notes 30-34 and accompanying text.

legitimate rulemaking process.<sup>186</sup> By complying with the APA, an agency shows respect for the public and demonstrates that it is concerned with protecting the public's interests. This undoubtedly increases people's confidence in that agency.

Additionally, notice-and-comment rulemaking makes it more likely that an agency will "apply the law evenhandedly, rather than engage in ad hoc decisionmaking."<sup>187</sup> By publicizing a proposed rule and accepting input from the public before promulgating the final product, the agency ensures that narrow interests are not favored at the expense of the general public's interests, and it also creates consistency in the law.<sup>188</sup> Furthermore, if an agency seeks to enact a binding rule that will have the full force of law, then it must employ procedures that mirror those of the traditional legislative process.<sup>189</sup>

#### IV. CONCLUSION

The IRS is one of the most powerful agencies in our government, and it serves one of the most important functions therein—a function upon which all other functions of government rely: collection of revenue through taxation. However, with such great power comes the potential for abuse and overreaching. That is not to say that the IRS engages in such abuse of power, but the combination of complexity in the tax code and the IRS's lack of compliance with the APA in promulgating rules have contributed to the IRS's tarnished image.

With today's increasing national debt,<sup>190</sup> it is even more critical than before that the IRS operate efficiently and successfully in collecting all the tax revenue it is entitled to under the tax laws. Because it is inadvisable to impose new taxes on individuals during a recession, it is important to use current tax laws to collect as much money as possible.<sup>191</sup>

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<sup>186</sup> Asimow, *supra* note 82, at 402 ("The APA notice and comment procedure infuses the rulemaking process with significant elements of openness, accountability, and legitimacy.").

<sup>187</sup> Manning, *supra* note 110, at 905.

<sup>188</sup> Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 N.Y.U. L. REV. 461, 539 (2003).

<sup>189</sup> *Id.* ("The law-like decisionmaking requirement ensures that when agencies claim the force of law, they actually have made law.").

<sup>190</sup> See generally Brian M. Riedl, *The Obama Budget: Spending, Taxes, and Doubling the National Debt*, BACKGROUND (Mar. 16, 2009), <http://www.heritage.org/Research/budget/bg2249.cfm>.

<sup>191</sup> See *id.* at 7 ("While there is never a good time to raise taxes, President Obama's proposal to raise taxes during a recession is especially problematic.").

Consequently, it is important for the IRS to ensure that those rules it wants to operate with the force of law actually do so, so as to improve the IRS's efficiency and lower the costs of litigation proceedings when rules are challenged. This is particularly important because of the implications for the IRS of the recently decided D.C. Circuit case, *Cohen v. United States*, and because of the lack of certainty in the law governing judicial deference to administrative agencies.

By complying with the APA, the IRS will protect itself against the risk that courts will scrutinize rules preenforcement rather than postenforcement; ensure deference in litigation proceedings, thereby creating efficiency and cutting costs; achieve its goal in reducing the tax gap; and maintain integrity of the law by supporting a democratic legislative process, thereby protecting taxpayer interests and increasing their confidence in the system.

It is not certain that courts will embrace the practice of reviewing agency actions under the APA without there being a tax dispute in the forefront of the matter. However, provided that there is an argument to be made, along with supporting policy reasons, that *Cohen v. United States* should be read expansively to allow for preenforcement judicial review, it is in the IRS's best interests to fully comply with the APA in order to protect itself in the event that courts continue to shift focus. Additionally, it would be wise for the IRS to begin complying with the APA as soon as possible so that if courts do decide to go in the direction of preenforcement judicial review,<sup>192</sup> the IRS will not have to expend money and other resources to go back and make sure that rules that were not promulgated under notice-and-comment rulemaking procedures adhere to such procedures.

When it comes to the issue of deference the courts give to agency rules, the only thing that is certain is that the law in this area is uncertain. From the broad *Chevron* deference to its restricting successor cases, courts are not settled upon a clear standard for determining when to defer to an administrative rule.<sup>193</sup> However, an important development has materialized: engaging in notice-and-comment rulemaking is a good indication that a rule was promulgated under the authority from Congress necessary to make the rule operate with the

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<sup>192</sup> Even if courts do not adopt preenforcement judicial review now, it is likely that they will sometime in the near future since the APA is such an important check on agency power, and hence needs to be enforced.

<sup>193</sup> See *supra* Part III.B.

force of law.<sup>194</sup> Thus, the safe bet for the IRS is to comply with notice-and-comment rulemaking across the board for all rules it wishes to have the force of law.

Even more important in making the case for the IRS's full compliance with the APA is that such compliance will provide accountability and transparency in the government. People are generally distrustful of government<sup>195</sup>—they condemn the accumulation of too much power in one organization.<sup>196</sup> People want to ensure that their interests are protected when the government acts.<sup>197</sup> Full compliance with the APA would engage the public in the rulemaking process, put taxpayers on notice of the potential rules that might bind them in the future, and give them a voice in the matter to ensure that those rules are fair and that the IRS is not overstepping its bounds.

It may be that the IRS does not promulgate all of its rules using APA rulemaking procedures because the process is time-consuming and can be costly; however, at the same time, the value of maintaining a democratic legislative system must be recognized as well.<sup>198</sup> The IRS does not have to promulgate all

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<sup>194</sup> Agencies obtain their lawmaking powers from Congress. Congress delegates such authority by passing statutes authorizing agencies to act; thus, in order for the agency's rules to carry the force of law, they must comply with those statutes. See Manning, *supra* note 110, at 898.

<sup>195</sup> PEW RESEARCH CTR., THE PEOPLE AND THEIR GOVERNMENT: DISTRUST, DISCONTENT, ANGER AND PARTISAN RANCOR 18 (2010), <http://people-press.org/reports/pdf/606.pdf> (showing that the average trust in government has ranged from 22% to 42% since the 1960s without ever reaching the 68% figure it reached during the Kennedy administration and demonstrating that since that time less than 50% of people trust the government).

<sup>196</sup> *Id.* at 8 (“The size and power of the federal government also engender considerable concern. A 52% majority says it is a major problem that the government is too big and powerful, while 58% say that the federal government is interfering too much in state and local matters.”).

<sup>197</sup> See *id.* at 43 (“Large majorities across partisan lines see elected officials as not careful with the government’s money, influenced by special interest money, overly concerned about their own careers, unwilling to compromise and out of touch with regular Americans.”).

<sup>198</sup> See Recommendations of the Administrative Conference to the United States, 57 Fed. Reg. 30,101, 30,102 (July 8, 1992) (“The Conference has long advocated the value of notice and comment in rulemaking, and this recommendation encourages agencies to use such processes voluntarily in promulgating rules of procedure or practice. Notice and comment can provide the agency with valuable input from the public as well as furnish enhanced public acceptance of the rules. On the other hand, there can be costs to the agency in using notice-and-comment procedures, including the time and effort of agency personnel, the cost of Federal Register publication, and the additional delay in implementation that results from seeking public comments and responding to them. For significant procedural rule changes, the benefits seem likely to outweigh the costs; but this may not be the case for minor procedural amendments.”).

of its rules using notice-and-comment rulemaking procedures, but it should at least take a more conscious and systematic approach to promulgating rules that will affect the future conduct of taxpayers to ensure that the taxpayers' interests are protected and that the integrity of the law is upheld.

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Thus, unless the costs outweigh the benefits, we strongly encourage agencies voluntarily to use notice and comment even where an APA exemption applies.”).

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