DOES THE INTERNAL REVENUE SERVICE HAVE A DUTY TO TREAT SIMILARLY SITUATED TAXPAYERS SIMILARLY?

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I. INTRODUCTION

Nearly two decades ago, Professor Lawrence Zelenak considered whether the courts should require the Internal Revenue Service (IRS) to be consistent in the treatment of similarly situated taxpayers.[1] A number of high profile cases and an intervening statutory change have occurred since his article was written, insisting that attention to this issue be revived.

Professor Zelenak concluded that "it is appropriate for courts to require the Service to afford one taxpayer the same favorable treatment it has given all other similarly-situated taxpayers, even if the treatment is inconsistent with that mandated by Congress."[2] I do not believe that a duty of consistency exists; however, it does not follow that the IRS has the discretion to treat similarly situated taxpayers differently. These two statements may appear hopelessly conflicted; however, they are merely mutually exclusive. A general duty of consistency does not prevent such disparate treatment; instead, the statutory authority that exists under § 7805(b) of the Internal Revenue Code (IRC) permits courts to mandate similar treatment of taxpayers in certain circumstances. In this context, an abuse of discretion standard under § 7805(b) promotes more uniformity than an arbitrarily administered duty of consistency that, when applied, elevates consistency over substantive law.

The significance of this issue is heightened by the high stakes in three recently filed cases. In April 2004, GlaxoSmithKline filed a $1 billion tax case in the United States Tax Court after its Advance Pricing Agreement (APA) Program request was denied.[3] Based on an additional notice of deficiency issued by the IRS for subsequent tax years, the total amount in issue could exceed $7 billion.[4] GlaxoSmithKline contends

1. Lawrence Zelenak, *Should Courts Require the Internal Revenue Service to be Consistent?*, 40 TAX L. REV. 411 (1985).

2. *Id.* at 425.

3. Petition ¶¶ 4, 5(m), 7, GlaxoSmithKline Holdings (Americas) Inc. & Subsidiaries v. Comm'r, No. 5750-04 (T.C. Apr. 2, 2004) [hereinafter Glaxo Petition]. Glaxo petitioned the Tax Court for a redetermination of a statutory notice of deficiency issued by the IRS on January 6, 2004, of an amount in excess of $2.6 billion for tax years 1989–1996. *Id.* ¶ 3(a). *See* Kevin A. Bell, *Glaxo Petition Raises Novel APA Issue*, TAX NOTES, Apr. 12, 2004, at 148; Martin A. Sullivan, *With Billions at Stake, Glaxo Puts APA Program on Trial*, TAX NOTES, Apr. 26, 2004, at 388.

4. GlaxoSmithKline announced on January 26, 2005, that the IRS issued a new statutory notice of deficiency for tax years 1997–2000 in the amount of $1.9 billion. Combined with the $2.6 billion in issue for tax years 1989–1996, the total tax liability was $4.5 billion. In addition, interest associated with the initial notice of deficiency was $2.5 billion and interest on the second notice of deficiency was

that the IRS granted a favorable APA to a former competitor SmithKline Beecham Plc for its ulcer drug, Tagamet, in 1993, and that its 1994 request for a similar APA for its ulcer drug, Zantac, was not acted upon by the IRS even though the Zantac product was similar to Tagamet.[5] As a result, GlaxoSmithKline alleges that the IRS improperly discriminated against it in treating a similarly situated taxpayer differently.[6] The result, according to GlaxoSmithKline, is that the IRS violated its duty of consistency.[7]

In a second case concerning the duty of consistency, Black & Decker Corporation initiated a refund action against the United States for more than $57 million, plus interest, which it contends was erroneously assessed and collected in tax years 1995 through 2000.[8] The United States affirmatively asserted $41 million in accuracy-related penalties under § 6662(h) of the IRC.[9] Black & Decker claims that the IRS improperly denied its request for penalty relief under Announcement 2002-2 and maintains that the denial was inconsistent with relief granted to other similarly situated taxpayers.[10] Moreover, Black & Decker

$700 million. As a result, the total amount in issue was approximately $7.7 billion. *See Glaxo Faces Another Multibillion-Dollar Deficiency*, TAX NOTES, Jan. 30, 2005. The trial is set for October 2006. *See IRS Seeks Billions in Back Taxes from GSK*, PHARMACEUTICAL CORPORATE COMPLIANCE REPORT, Jan. 31, 2005.

5. Glaxo Petition ¶¶ 6–7. On August 11, 1992, SmithKline Beecham plc requested an APA covering Tagamet, which the Commissioner granted on June 28, 1993. The APA was applicable to tax years 1987–1994. *Id.* ¶ 7(g)–(h). On June 30, 1994, Glaxo requested an APA covering Zantac and other products. *Id.* 7(l). Glaxo alleges that the Commissioner refused to act on its APA application. *Id.*

6. *Id.* ¶ 5(m) ("[The Commissioner] has failed, without adequate basis, to treat Petitioner administratively in as favorable a way as one or more of its direct competitors in substantially similar circumstances."). *Id.* ¶ 7(m) ("The Commissioner discriminated against Petitioner by failing to provide Petitioner transfer pricing treatment comparable to that provided to [SmithKline Beecham plc] . . . in violation of his administrative obligation to apply I.R.C. section 482 in a non-discriminatory fashion to similarly-situated taxpayers in the same industry.") GlaxoSmithKline apparently discovered the favorable APA issued to SmithKline Beecham when Glaxo merged with SmithKline Beecham in 2000. Molly Moses, *Uphill Battle Predicted for Glaxo on APA Discrimination Claim*, BNA-DAILY TAX REPORT, May 17, 2004.

7. Glaxo Petition ¶¶ 5(m), 7(m).

8. Black & Decker Corp. v. United States, 340 F. Supp. 2d 621, 622 (D. Md. 2004). In this case, Black & Decker incurred substantial capital gains in 1998 as a result of the sale of three of its businesses. Black & Decker invested in a contingent liability transaction and sold the stock to a third party for $1 million. In 2001, Black & Decker claimed a $560 million capital loss claiming both carryback and carryforward losses. *Id.*

9. *Id.* at 622–23; Sheryl Stratton, *IRS Denial of Penalty Relief at Issue in Black & Decker*, TAX NOTES, Sept. 13, 2004, at 1203.

10. Stratton, *supra* note 9, at 1204–05. Announcement 2002-2 offered a disclosure initiative to encourage taxpayers to disclose their tax treatment of tax shelters for which the imposition of an accuracy-related penalty under § 6662 may be appropriate if an underpayment of tax exists. Internal Revenue Serv. Announcement 2002-2 (Dec. 21, 2001). Under this offer, if a taxpayer discloses any item under the provisions of the Announcement within a certain specified time period, the IRS would

contends that a survey of the penalty relief program under Announcement 2002-2 conducted by the IRS's Office of Tax Shelter Analysis proves its discrimination claim.[11]

Finally, Bristol-Myers Barceloneta, Inc. (Bristol-Myers) sought to recover more than $67 million in tax overpayments, alleging that the IRS permitted competitors to obtain certain tax benefits denied to Bristol-Myers even though the taxpayers at issue were "identically situated."[12] Bristol-Myers alleged that it made a proper election under § 936 of the IRC, which encourages companies to invest in Puerto Rico by providing a tax credit for income earned in Puerto Rico.[13] In 1993, Congress reduced the permissible tax credit effective December 31, 1993.[14] Bristol-Myers sought to change its tax year to retain the increased tax credit through October 1, 2004, and filed amended returns claiming a refund of approximately $67 million.[15] In its Amended Complaint, Bristol-Myers alleged that "the IRS has permitted other identically situated taxpayers with Section 936 elections, including competitors of . . . Bristol-Myers, to obtain the very tax benefits that are being denied to [Bristol-Myers]."[16]

To resolve cases such as *GlaxoSmithKline*, *Black & Decker*, and *Bristol-Myers*, courts should adopt a uniform abuse of discretion standard of review under § 7805(b), promoting more uniformity than the duty of consistency imposed on the IRS by a few courts. A duty of consistency, premised on a mistaken view of a 1965 case, *International Business Machines Corp. v. United States* (*IBM*),[17] invites courts to create law that is not grounded in substance but in the laudable goal of consistency. Instead, application of the abuse of discretion standard under § 7805(b) permits review of a decision of the agency charged by Congress with the administration of tax law and the court's determination is not predicated on the substantive issue before it.

Adoption of an abuse of discretion standard, however, is simply the first step. Congress should amend § 7805(b) to permit courts to review decisions of the IRS under an abuse of discretion standard not only for applying a ruling "without retroactive effect," but also to permit review

waive the accuracy-related penalty for any underpayment of tax attributable to that item. *Id.*

11. Stratton, *supra* note 9, at 1204–06.

12. Amended Complaint ¶¶ 1–2, Bristol-Myers Barceloneta, Inc. v. United States, No. 97-2567CC, (D.P.R. Feb. 13, 1998).

13. *Id.* ¶ 8.

14. *Id.* ¶ 10.

15. *Id.* ¶¶ 11, 17.

16. *Id.* ¶ 19.

17. 343 F.2d 914 (Ct. Cl. 1965).

of decisions of the Secretary of the Treasury to apply a ruling prospectively.[18] Such an amendment would eliminate a long-abandoned vestige of the law and would remove the retroactive-prospective distinction with respect to private letter rulings in much the same way Congress removed the distinction with respect to regulations.[19] This symmetry of review would recognize the current state of the law and permit an abuse of discretion review by an appropriate judicial forum for either retroactive or prospective application.

II. THE IBM DECISION AND ITS PROGENY

The duty of consistency standard is based on a belief that the IRS is required to treat similarly situated taxpayers similarly. The genesis of "duty of consistency" cases is *International Business Machines Corp. v. United States* (*IBM*).[20] In challenges by taxpayers claiming inconsistent treatment, courts have been conflicted in their application of *IBM* and unpredictable in resolving disparate treatment claims. These divergent views emanate from a misapplication of *IBM* for nearly forty years. Most courts, following a long line of cases with little analysis, assume that *IBM* establishes a duty of consistency, and this mistaken assumption forces an analysis to focus upon the similarity or dissimilarity of the facts and circumstances at issue with the facts and circumstances of *IBM*. This assumption, however, is incorrect. While the *IBM* court does not clearly define the scope of its decision, *IBM* is, at its core, an abuse of discretion case under § 7805, i.e., the case focused on whether the IRS abused its discretion in treating similarly situated taxpayers differently.[21] Many courts stumble upon the correct result, yet these decisions are often based on a faulty premise. Three different lines of cases emerge from the decision in *IBM*.

First, some courts require the IRS to treat similarly situated taxpayers similarly notwithstanding that the mandated treatment is contrary to substantive law. Second, some courts apply a duty of consistency in limited circumstances—if other similarly situated taxpayers receive more favorable treatment and the IRS intentionally singled out a particular taxpayer for arbitrary or irrational reasons. Third, some courts

18. *See* 26 U.S.C. § 7805(b)(8) (2000).

19. *See id.* § 7805(b)(1)–(7).

20. 343 F.2d 914.

21. Zelenak, *supra* note 1, at 421 ("Despite its ringing language in favor of a requirement of equal treatment, . . . [t]he court based its decision squarely on section 7805(b).").

elevate substantive law over a duty to treat similarly situated taxpayers similarly.

A. IBM Created a Duty of Consistency—A Flawed View

First, some cases mandate a duty of consistency by requiring the IRS to treat similarly situated taxpayers similarly. Justice Frankfurter's concurring opinion in *United States v. Kaiser* formed the root of equal treatment for taxpayers.[22] Justice Frankfurter opined in *Kaiser* that equal treatment by the Commissioner is an "overriding principle" because the "Commissioner cannot tax one and not tax another without some rational basis for the difference."[23] In such a circumstance, Justice Frankfurter believed that inequality can be an "independent ground of decision that the Commissioner has been inconsistent."[24] Nonetheless, the Commissioner was able to distinguish earlier pronouncements on the particular issue without denying equal treatment to the taxpayer in *Kaiser*.[25]

Six years later, *International Business Machines Corp. v. United States* was presumed to follow the lead of Justice Frankfurter.[26] Remington Rand (Rand), an IBM competitor, requested a ruling from the Commissioner that certain of its computing devices be exempt from excise taxes.[27] Rand received a favorable private letter ruling two days later,[28] prompting IBM to seek a similar private ruling for its competing computer devices, which were identical in all significant respects to the Rand computer.[29] Notwithstanding IBM's pleas for an expedited review, the Commissioner did not act on its request for more than two years, during which time IBM continued to pay excise taxes.[30] During the period, Rand was exempt from the tax and even received a refund for previous years in which it had paid excise taxes.[31]

22. 363 U.S. 299 (1960) (Frankfurter, J., concurring).

23. *Id.* at 308.

24. *Id.*

25. *Id.* at 309.

26. 343 F.2d 914 (Ct. Cl. 1965).

27. *Id.* at 915–16.

28. *Id.* at 916.

29. *Id.* The letter from IBM to the IRS was captioned "Urgent! Please Expedite[.]" *Id.* The letter concluded, "In view of the extreme urgency of this matter, your immediate ruling, wire collect, is respectfully requested." *Id.*

30. *Id.*

31. *Id.* In July 1956, Rand received a refund of approximately $86,000 for the period of 1953 through April 1955. *Id.*

Subsequently, the IRS informed both Rand and IBM that excise taxes would be imposed on their devices.[32] While Rand was notified of the revocation of its ruling on May 1, 1957, the IRS delayed its effective date for nine months to February 1, 1958.[33] Rand was thus exempt from excise taxes from January 1952 through January 1958, a six-year period.[34]

The treatment IBM received from the IRS was not nearly as gracious. On November 26, 1957, the Commissioner informed IBM that its computing systems were subject to excise taxes and that "the manufacturer of the machines which compete with and are similar to the taxable machines herein involved (i.e., Remington Rand) . . . is being appropriately advised by us regarding the taxability of such machines of its manufacture."[35] The IRS denied IBM's claims for a refund for excise taxes paid from June 1, 1951, through January 31, 1958, roughly corresponding to the period that Rand was exempt from excise taxes.[36]

The Commissioner made the ruling prospective for Rand because its private letter ruling concluded that its devices were not subject to excise tax.[37] Yet, the Commissioner denied the claim by IBM for a refund of the excise taxes that it paid during the period in which Rand did not have to pay taxes.[38] In effect, the prospective revocation of Rand's ruling, combined with the delayed effective date of the prospective ruling, allowed Rand to avoid paying federal excise taxes on the sale of its computer systems for six years. During this period, IBM was required to pay the tax on sales of its identical computer systems.

32. *Id.* On May 1, 1957, the IRS advised Rand that it was subject to excise taxes on its manufactured devices. *Id.*

33. In recognizing its change in position, the IRS provided Rand a hold-harmless period: "we will withhold further action on the matter for a period of thirty days from the date of this letter in order to afford you an opportunity, should you so desire, of submitting a protest or requesting a hearing in this case." *Id.* Of course, Rand took advantage of the opportunity to delay implementation and requested a conference on May 31, 1957. *Id.* A conference was held on June 25, 1957, and Rand submitted written reasons for the previous tax treatment on July 25, 1957. *Id.* More than four months later, on December 3, 1957, the IRS notified Rand that its computing systems were subject to excise taxes. *Id.* In its final ruling, the IRS allowed for further delay in implementation of its decision—the ruling applies only to sales made and leases in effect "on and after the first day of the first month which begins thirty days after the date of this letter[.]" *Id.* As such, the systems became taxable on February 1, 1958, exactly nine months after Rand was notified that its computer systems were no longer exempt from excise taxes. *Id.*

34. *Id.*

35. *Id.* at 916–17.

36. *Id.* On July 29, 1955, IBM filed an administrative refund claim for excise taxes paid from June 1, 1951, through May 31, 1955, and a second claim for refund in April 1958 for excise taxes paid from June 1, 1955, through January 31, 1958. *Id.*

37. *Id.* at 916.

38. *Id.* at 916–17.

The denial of IBM's refund claims prompted a lawsuit in the Court of Federal Claims to recover more than $13 million in excise taxes paid during the period that Rand was exempt from excise taxes.[39] IBM did not dispute that its computers were subject to excise taxes; instead, IBM claimed that the treatment Rand received with identical computers should have invalidated the excise taxes that IBM paid during the period that Rand was exempt from excise taxes.[40] The court determined that the IRS abused its discretion by retroactively applying an unfavorable ruling to IBM.[41] The IBM court examined § 7805(b) of the IRC, noting that the IRS has the discretion to apply rulings and regulations retroactively.[42]

Generally, cases holding that the IRS has a duty of consistency find their support in *IBM*, presumably following the concurrence of Justice Frankfurter in *Kaiser*. Despite this presumed lineage, the duty of consistency does not emanate from the decision in *IBM* because *IBM* was an abuse of discretion case under § 7805(b). Courts referring to *IBM* as duty of consistency case are not entirely at fault, because the decision does tempt courts with language suggesting that its holding is grounded in a violation of a duty of consistency by the IRS. This mistaken view perpetuates the lack of a statutory basis for requiring the IRS to treat similarly situated taxpayers similarly and promotes the substitution of a court's judgment for that of the agency charged with the administration of the tax laws.

In its decision, the *IBM* court, citing a long list of cases, pronounces that "[t]he Commissioner cannot tax one and not tax another . . . ."[43] Further, the court notes that "[e]quality of treatment is so dominant in our understanding of justice that discretion, where it is allowed a role, must pay the strictest heed."[44] Accordingly, the court concludes that "[f]or all tax rulings, it is important that there be like treatment to those

39. *Id.* at 917. On February 3, 1959, the IRS denied both claims for refund and IBM instituted its action for refund on February 1, 1961. *Id.*

40. *Id.*

41. *Id.* at 921.

42. *Id.* at 919–20.

43. *Id.* at 920 (citing United States v. Kaiser, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring)). *See* Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 185–86 (1957); Exch. Parts Co. v. United States, 279 F.2d 251, 254 (Ct. Cl. 1960); Conn. Ry. & Lighting Co. v. United States, 142 F. Supp. 907, 908–09 (Ct. Cl. 1956); Wolinsky v. United States, 271 F.2d 865, 868 (2d Cir. 1959); Weller v. Comm'r, 270 F.2d 294, 299 (3d Cir. 1959); Goodstein v. Comm'r, 267 F.2d 127, 132 (1st Cir. 1959); City Loan & Sav. Co. v. United States, 177 F. Supp. 843, 851 (N.D. Ohio, 1959), *aff'd*, 287 F.2d 612, 616 (6th Cir. 1961).

44. *IBM*, 343 F.2d at 920.

who should be dealt with on the same basis,"[45] and that "[p]arity in the levying [of] a manufacturers' excises is peculiarly essential to free and fair competition."[46]

While espousing its views concerning equal treatment for similarly situated taxpayers, the court grounded each assertion "on a right granted by Congress, not merely on principles of estoppel evolved judicially as part of a limited 'common law' effort to further fairness."[47] The court, therefore, did not ground its decision on equity, but on authority granted by Congress for review of agency determinations. This right of review, created under § 7805, "direct[s] the [IRS] and the courts to take account, in a specified area, of discrimination, of equality of treatment, and of the tax burdens imposed on competitors or persons in the same or a comparable situation."[48]

The courts' review authority under § 7805 requires the IRS to exercise its discretion by giving to it "the power as well as the obligation to consider the totality of the circumstances surrounding the handing down of a ruling—including the comparative or differential effect on the other taxpayers in the same class."[49] The authority under § 7805 mandates that "[t]he Commissioner cannot tax one and not another without some rational basis for the difference."[50] Equity is not a universal principle independent of the authority under § 7805. The role of the courts, as properly described in *IBM*, is to review the exercise of discretion under an abuse of discretion standard.[51] As such, the appropriate question is "whether the Commissioner of Internal Revenue abused his discretion under Section 7805(b)."[52]

In *IBM*, the court had the discretion to determine whether its ruling on the request of IBM should be applied without retroactive effect. Instead, the court looked to the ruling of Rand to determine that that same ruling should be applied to IBM without retroactive effect. The Court of Federal Claims, therefore, exceeded the discretion afforded it under § 7805(b) inasmuch as the retroactive or prospective nature is the ruling to IBM itself, not another taxpayer. As a result, the court applied the discretion to the wrong party, thereby exceeding its review authority.

45. *Id.* at 923. *See Auto. Club of Mich.*, 353 U.S at 186.

46. *IBM*, 343 F.2d at 923. *See Exch. Parts*, 279 F.2d at 253; H. REP. NO. 72-708, at 31, 32 (1932).

47. *IBM*, 343 F.2d at 925.

48. *Id.* at 919.

49. *Id.* at 920.

50. *See id.*; United States v. Kaiser, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring).

51. *See IBM*, 343 F.2d at 920.

52. *Id.* at 921.

This distinction, however, is not central or even pertinent to this Article's argument that the standard against which the discretion of the IRS should be measured is the abuse of discretion standard under § 7805 and not an equitable standard without statutory base. Instead, the illegitimate legacy of *IBM* is that it serves as a foundation for future decisions that an independent duty of consistency exists.

IBM is an abuse of discretion case governed by § 7805 and subject to appropriate review by the courts. It does not hail the creation of a duty of consistency elevating equity over substantive law. And, the *IBM* court itself declared that it was an abuse of discretion case stating that "[i]t is plain that Section 7805(b) . . . governs plaintiff's case."[53] Unfortunately, *IBM* has been misinterpreted since 1965, and subsequent cases cite it for the requirement that similarly situated taxpayers be treated similarly, all grounded in the duty of consistency that elevates that duty over codified, substantive law.[54]

For example, *Gateway Equipment Corp. v. United States*[55] was factually similar to *IBM*. In *Gateway*, competitors were able to sell the same equipment that was sold by Gateway; however, Gateway was subject to a twelve percent excise tax while its competitors were not.[56] As a result, the court concluded that this inconsistent treatment harmed Gateway and favored its competitors.[57]

In agreeing with Gateway, the court purported to rely on *IBM*, but followed a fairness argument that was not central to the *IBM* decision, considering the underpinnings of *IBM* out of context. According to the *Gateway* court, *IBM* held that "[f]or all tax rulings, it is important that

53. *Id.* at 920. "We rest on the . . . basis that IBM . . . was entitled to have the Service's ruling . . . controlled by the standard of equality and fairness incorporated in Section 7805(b)." *Id.* at 924.

54. *See* Oshkosh Truck Corp. v. United States, 123 F.3d 1477, 1481 (Fed. Cir. 1997) (holding that IRS refusal of the exemption was "inconsistent with the frequently expressed view that, unless there is a rational reason for different treatment, similarly-situated taxpayers should be treated similarly" (citations omitted)); Ogiony v. Comm'r, 617 F.2d 14, 18 (2d Cir. 1980) (Oakes, J., concurring) ("It is my view that consistency over time and uniformity of treatment among taxpayers are proper benchmarks from which to judge IRS actions."); Sirbo Holdings, Inc. v. Comm'r, 476 F.2d 981, 987 (2d Cir. 1973) ("[T]he Commissioner has a duty of consistency toward similarly situated taxpayers; he cannot properly concede capital gains treatment in one case and, without adequate explanation, dispute it in another having seemingly identical facts which is pending at the same time." (citations omitted)), *aff'd*, 509 F.2d 1220 (2d Cir. 1975); Farmers' & Merchants' Bank v. United States, 476 F.2d 406 (4th Cir. 1973) (holding that IRS arbitrarily and impermissibly discriminated between similarly situated taxpayers when its revenue ruling denied a deduction, except to the extent that the deduction had been claimed for taxable years ending shortly after the ruling was released); Exch. Parts Co. v. United States, 279 F.2d 251, 254 (Ct. Cl. 1960) (differentiating between taxpayers constitutes prejudicial discrimination).

55. 247 F. Supp. 2d 299 (W.D.N.Y. 2003).

56. *Id.* at 318.

57. *Id.*

there be like treatment to those who should be dealt with on the same basis . . . . Parity in the levying [of] a manufacturers' excises is peculiarly essential to free and fair competition."[58] The court continued: "The Commissioner cannot tax one and not tax another without some rational basis for the difference."[59] Moreover, the *Gateway* court concluded that the "*IBM* court grounded its holding on fairness."[60]

In addition, a number of courts conclude, citing *IBM*, that the IRS may not discriminate between similarly situated taxpayers by retroactively applying a ruling to one taxpayer and prospectively applying a ruling to others.[61] This mistaken view creates sporadic application by some courts of a duty of consistency based on a common refrain that "uniformity often trumps decisional methodology."[62] There is, however, a difference between uniformity (or consistency) by the IRS in the implementation of tax law and the uniformity (or consistency) of the courts in reviewing what the IRS has done administratively. In the former, the IRS applies the law with uniformity as a goal. In the latter,

58. *Id.* (quoting *IBM*, 343 F.2d at 923) (alteration in original). *See* Computer Sciences Corp. v. United States, 50 Fed. Cl. 388, 398 (Fed. Cl. 2001) (holding that IRS use of an arbitrary distinction to distinguish between otherwise similarly situated taxpayers is unreasonable discrimination between those similarly situated taxpayers); Vesco v. Comm'r, 39 T.C.M (CCH) 101, 129–30 (1979) (holding that IRS practice in effect for the last eight years should be applied to the taxpayer on same basis as other taxpayers). *See also* Conn. Ry. & Lighting Co. v. United States, 142 F. Supp 907, 908–09 (Ct. Cl. 1956) (holding that, while the IRS ruling was substantively correct, a refund was ordered because the rulings discriminated between taxpayers without any rational basis for such discrimination, and that retroactive application of ruling is only invalid in certain circumstances); *Sirbo Holdings, Inc.*, 476 F.2d at 988 (holding that IRS cannot concede capital gains treatment to one taxpayer and deny it to another who received a virtually identical payment); Baker v. Comm'r, 787 F.2d 637, 643–44 (D.C. Cir. 1986) (holding that IRS cannot deny exclusion to one taxpayer and grant exclusion to another at same employer); *Farmers' & Merchants' Bank*, 476 F.2d at 408–10 (holding that IRS decision to deny favorable method of calculating a bad debt reserve lacked rational basis). *See also* Moses, *supra* note 6.

59. *Gateway Equip. Corp.*, 247 F. Supp. at 318 (quoting *IBM*, 343 F.2d at 920).

60. *Id.* "Equality of treatment is so dominant in our understanding of justice that discretion, where it is allowed a role, must pay the strictest heed." *Id.* at 319 (quoting *IBM*, 343 F.2d at 920). The *Gateway* court does acknowledge that *IBM* held that the IRS abused its discretion under § 7805 but claims that the rationale was "'one of equality of treatment.'" *Id.* (citing MICHAEL I. SALTZMAN, IRS PRACTICE & PROCEDURE ¶ 1.06[2] (2001)).

61. Mulholland v. United States, 16 Cl. Ct. 252, 262 (Cl. Ct. 1989); Chock Full O' Nuts Corp. v. United States, 453 F.2d 300, 302–03 (2d Cir. 1971); Lane-Burlsem v. Comm'r, 70 T.C. 613, 623 n.7 (1978), *aff'd on other grounds*, 659 F.2d 209 (D.C. Cir. 1981); Kaiser Cement Corp. v. United States, 8 Cl. Ct. 34, 40 (Cl. Ct. 1985). *See* Exch. Parts Co. v. United States, 279 F.2d 251, 254 (Cl. Ct. 1960); *Conn. Ry. & Lighting*, 142 F. Supp. at 909.

62. Linda Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 OHIO ST. L.J. 1037, 1093 (1995). *See* Erwin N. Griswold, *The Need for a Court of Tax Appeals*, 57 HARV. L. REV. 1153, 1159–60 (1944). *See also* Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting) ("[I]t is more important that the applicable rule of law be settled than that it be settled right." (citation omitted)).

courts have been divergent in their review of administrative determinations, creating less uniformity.

Adopting a uniform abuse of discretion standard in cases falling within the parameters of § 7805(b) promotes more uniformity than the duty of consistency imposed on the IRS by a few courts. A duty of consistency, premised on *IBM*, invites courts to create law that is not grounded in substance but in the laudable goal of consistency.[63] Application of the abuse of discretion standard under § 7805(b) permits review of a decision of the agency charged by Congress with the administration of tax law and the determination by a court is not predicated on the substantive issue before the court. In other words, an analysis under § 7805(b), whether correct or not, is grounded in an affirmative duty of a court premised on an act of Congress to review decisions of the IRS on a deferential, abuse of discretion basis. It does not permit the creation of new law.[64]

B. A Duty of Consistency Exists in Limited Circumstances—Conflicting Messages

A second line of cases emerging from the decision in *IBM* mistakenly recognizes a duty of consistency in limited circumstances. *Bunce v. United States* is representative of cases applying a duty of consistency in limited circumstances.[65] In *Bunce*, the Court of Federal Claims established a test for determining whether a duty of consistency should apply. Under this two-part test, a taxpayer must demonstrate that (1) other similarly situated taxpayers have received more favorable treatment and (2) the IRS intentionally singled out the taxpayer for arbitrary or irrational reasons.[66]

63. Many courts, not choosing to follow *IBM*, simply state that *IBM* has been strictly limited to its particular circumstances. It should be. However, these courts incorrectly address this limitation in the duty of consistency area. *IBM* did not create a duty of consistency and those courts attempting to distinguish it as a duty of consistency case begin their analysis with the wrong premise. Collins Music Co. v. United States, 21 F.3d 1330, 1336–37, 1336 n.12 (4th Cir. 1994) (questioning soundness of *IBM*); Diebold, Inc. v. United States, 16 Cl. Ct. 193, 213 (Cl. Ct.) ("*IBM* has been strictly limited to its particular circumstances."), *aff'd*, 891 F.2d 1579 (Fed. Cir. 1989); Carpenter v. United States, 7 Cl. Ct. 732, 739 (Cl. Ct. 1985) ("The Court of Claims subsequently restricted [*IBM*] to the particular circumstances of that case."), *aff'd*, 790 F.2d 91 (Fed. Cir. 1986); Bookwalter v. Brecklein, 357 F.2d 78, 84 (8th Cir. 1966) ("*I.B.M.* was not intended to be a blanket ruling . . . .").

64. *See* Stockstrom v. Comm'r, 190 F.2d 283, 289 (D.C. Cir. 1951) (Prettyman, J., dissenting) ("I reluctantly dissent from the judgment of my brethren in this case. I wish the law were as they find it to be . . . ."), *overruled by* Auto. Club of Mich. v. Comm'r, 353 U.S. 180 (1957).

65. 28 Fed. Cl. 500, 510 (Fed. Cl. 1993), *aff'd*, 26 F.3d 138 (Fed. Cir. 1994).

66. *Id.* at 510. *See* Fresoli v. Comm'r, 55 T.C.M. (CCH) 1624, 1626 (1988) (holding that in order to prevail on such an argument petitioners would have to show not only that other similarly

In *Davis v. Commissioner*, the petitioner challenged the IRS's denial of a deduction for expenses associated with a Ph.D. program.[67] The IRS denied the deduction on the ground that the degree was the minimum amount of education normally required for employment as a full-time, permanent faculty member.[68] The petitioner argued that the court should require the IRS to treat similarly situated taxpayers similarly and impose a duty of consistency.[69] To further the duty of consistency argument, the petitioner requested that the Commissioner produce letter rulings by the IRS "bearing on the question of the deductibility of expenses incurred by one in getting a Ph.D."[70]

Though the petitioner's contention was rejected because of a procedural defect, the Tax Court provided mixed signals for the application of a duty of consistency theory. First, the court suggested, following other Tax Court cases, that:

> It has long been the position of this Court that our responsibility is to apply the law to the facts of the case before us and determine the tax liability of the parties before us; how the Commissioner may have treated other taxpayers has generally been considered irrelevant in making that determination.[71]

Nonetheless, the Tax Court offered its support for equality among taxpayers:

> Were we to embrace the principles urged by Mr. Davis, the task would be magnified. Every trial would be extended, for it would then become necessary to allow the petitioner to inquire into the Commissioner's treatment of other similarly situated taxpayers. . . . Although the implementation of the position advocated by Mr. Davis would present many problems, those problems may not be insurmountable, and the notion of equal justice has strong appeal in our society and might lead to the conclusion that his position should ultimately be adopted. Yet, a full

situated taxpayers have been offered more favorable settlements but also that they were subjected to invidious discrimination by respondent).

67. 65 T.C. 1014 (1976).

68. *Id.* at 1018.

69. *Id.* at 1021.

70. *Id.* at 1016.

71. *Id.* at 1022. *See* Teichgraeber v. Comm'r, 64 T.C. 453, 456 (1975); Goodstein v. Comm'r, 30 T.C. 1178, 1190–91 (1958), *aff'd*, 267 F.2d 127 (1st Cir. 1959); Minchin v. Comm'r, 335 F.2d 30, 32–33 (2d Cir. 1964); Carpenter v. Comm'r, 322 F.2d 733, 736 (3d Cir. 1963); Gerstell v. Comm'r, 319 F.2d 131 (3d Cir. 1963). *See also* Bookwalter v. Brecklein, 357 F.2d 78, 82 (8th Cir. 1966); Weller v. Comm'r, 270 F.2d 294, 298–99 (3d Cir. 1959); Shakespeare Co. v. United States, 389 F.2d 772, 777 (Ct. Cl. 1968), *dismissed by* 419 F.2d 839 (Ct. Cl. 1969); Knetsch v. United States, 348 F.2d 932, 940 (Ct. Cl. 1965); Dixon v. United States, 381 U.S. 68, 72–76 (1965); Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 183–84 (1957).

> appreciation of the ramifications of this matter makes abundantly clear that it should be approached cautiously. In accordance with sound judicial administration, such a matter should only be considered when necessary to do so in order to decide the case before us.[72]

While *Davis* provided mixed indicators, that case was not alone. The Tax Court also sent varied signals on whether a duty of consistency should apply in *Avers v. Commissioner*.[73] The *Avers* court determined that the failure of the IRS to follow the procedures set forth in the Internal Revenue Manual was a per se violation of due process.[74] Notwithstanding this statement, the court held that petitioners must demonstrate that other similarly situated taxpayers have been extended a more favorable settlement offer, and that discriminatory selection by the IRS was based on impermissible considerations or arbitrary classifications.[75] The Tax Court concluded:

> [W]e cannot find the administrative actions of respondent's agents in extending inconsistent settlement offers so improper as to be invalid or in violation of the [C]onstitution. That being the case, petitioners cannot avoid tax liability by showing that others have been treated generously, leniently or erroneously by respondent; rather, each petitioner must rest on the validity of his own position under the applicable taxing provisions, independently of others.[76]

This line of cases provides no better rationale than cases recognizing a general duty of consistency. While the application of a requirement to treat similarly situated taxpayers similarly is more restricted, the equitable substitution of the judgment of a court for the judgment of the agency essentially creates a de novo standard of review. This approach flies against the statutory discretion provided to the Secretary of the

72. *Davis*, 65 T.C. at 1023.

73. 55 T.C.M. (CCH) 678 (1988).

74. *Id.* at 693.

75. *Id. See* Sunday Lake Iron Co. v. Wakefield Twp., 247 U.S. 350, 352–53 (1918) (holding that intentional systemic action is denial of equal protection).

76. *Avers*, 55 T.C.M. (CCH) at 694. In *Davis v. Commissioner*, the Tax Court noted that, in certain cases, materials of other taxpayers might be relevant in establishing that the IRS violated a duty of consistency owed to the taxpayer. 69 T.C. 716, 718 (1978). However, the Tax Court nonetheless concluded that:

> The Commissioner's rulings have only such force as Congress chooses to give them, and Congress has not given them the force of law. Consequently it would appear that the Commissioner's acquiescence in an erroneous decision, published as a ruling, cannot in and of itself bar the United States from collecting a tax otherwise lawfully due.

Id. at 722.

Treasury under § 7805 and promotes a random application of an equitable principle to treat similarly situated taxpayers similarly.

C. There Is No Duty of Consistency—Substantive Law Prevails

IBM does not require courts to substitute equity for substantive law. Instead, courts rejecting a duty of consistency theory elevate substantive law over consistent treatment. Courts following this line of cases regard *IBM* as *sui generis*, or at best limited "to a case where the taxpayer has requested a private [letter] ruling and has received different treatment from another [taxpayer] receiving a private [letter] ruling."[77]

Vons Companies, Inc. v. United States[78] is representative of those cases elevating substantive law over a duty to treat similarly situated taxpayers similarly. In *Vons*, a taxpayer challenged the disallowance of certain deductions for contributions it made to a multi-employer defined benefit plan, and sought discovery of documents pertaining to private letter rulings issued to similarly situated taxpayers.[79] The IRS opposed the discovery request, arguing that the material was irrelevant because it had no precedential value.[80]

The *Vons* court rejected the consistency argument, and instead relied on the rationale that Congress has the power to make law and that positions taken by the IRS in administrative materials do not require the court to apply a mistaken view of the law to a particular taxpayer, even if that mistaken view was applied to another taxpayer.[81] It provided:

> In general, notwithstanding Justice Frankfurter's oft-quoted statement that "[t]he Commissioner cannot tax one and not tax another without

77. Austin v. United States, 611 F.2d 117, 120 (5th Cir. 1980) (refusing to apply *IBM* where the taxpayer had not obtained a private letter ruling even though the taxpayer complained that not all parties in the same transaction were assessed deficiencies). *See also* Diebold, Inc. v. United States, 16 Cl. Ct. 193, 213 (Cl. Ct.) ("*IBM* has been strictly limited to its particular circumstances."), *aff'd*, 891 F.2d 1579 (Fed. Cir. 1989); Carpenter v. United States, 7 Cl. Ct. 732, 739 (Cl. Ct. 1985) (rejecting argument that fairness in administration of tax laws required the Commissioner to accept taxpayer's method of valuing a gift because his sister had not been assessed a deficiency when she used the same method of valuing the same gift, and noting that "[t]he Court of Claims subsequently restricted [*IBM*] to the particular circumstances of that case"), *aff'd*, 790 F.2d 91 (Fed. Cir. 1986); Rue R. Elston Company, Inc. v. United States, 532 F.2d 1176, 1180–81 (8th Cir. 1976) (distinguishing *IBM* and holding that "the taxpayer cannot demand parity simply because the person obtaining a favorable private ruling was a competitor"); Bookwalter v. Brecklein, 357 F.2d 78, 84 (8th Cir. 1966) ("I.B.M. was not intended to be a blanket ruling . . . .").

78. 51 Fed. Cl. 1 (Fed. Cl. 2001).

79. *Id.* at 4. Vons requested production of files of the IRS concerning a revenue ruling, sixteen private letter rulings, technical advice memoranda, and General Counsel Memoranda. *Id.*

80. *Id.* at 5.

81. *Id.* at 10.

> some rational basis for the difference," . . . the manifest weight of precedent rejects a "least common denominator" notion of federal taxation, in which the law that the Congress actually enacts can be short-circuited and disregarded any time the IRS has afforded a single taxpayer or even a group of taxpayers treatment more favorable than the law provides.[82]

In so ruling, the court held that private letter rulings are neither the law nor binding precedent.[83] However, private letter rulings may be used to demonstrate that the Commissioner has abused his discretion under § 7805 by issuing different rulings to two directly competing taxpayers.[84]

The United States Court of Appeals for the D.C. Circuit followed the same rationale in *Stichting Pensioenfonds Voor de Gezondheid, Geestelijke en Maatschappelijke Belangen v. United States*, holding that "'[w]hile even-handed treatment should be the Commissioner's goal . . . [t]he making of an error in one case, if error it was, gives other taxpayers no right to its perpetuation.'"[85] Similarly, in *Jaggard v. Commissioner*, the Tax Court disregarded the consistency argument of the taxpayer:

> It has long been the position of this Court that our responsibility is to apply the law to the facts of the case before us and determine the tax liability of the parties before us; how the Commissioner may have treated other taxpayers has generally been considered irrelevant in making that

82. *Id.* at 10 n.10 (quoting Computer Sciences Corp. v. United States, 50 Fed. Cl. 388, 394 (Fed. Cl. 2001) (citations omitted)).

83. *Id.* at 12.

84. *Id.*

85. 129 F.3d 195, 201 (D.C. Cir. 1997) (quoting Sirbo Holdings, Inc. v. Comm'r, 509 F.2d 1220, 1222 (2d Cir. 1975). *See* Dickman v. Comm'r, 465 U.S. 330, 343 (1984) ("[T]he Commissioner may change an earlier interpretation of the law . . . . This rule applies even though a taxpayer may have relied to his detriment upon the Commissioner's prior position."); Shakespeare Co. v. United States, 389 F.2d 772 (Ct. Cl. 1968) (holding that a mere allegation that IRS has issued inconsistent private letter rulings is insufficient to bind government); Easter House v. United States, 12 Cl. Ct. 476, 490 (Cl. Ct. 1987) ("[T]his case involves its own particular, and perhaps unique, set of circumstances which generated the IRS determination under attack. The fact that other adoption agencies may have qualified for exemption is immaterial under the facts of this case." (footnote omitted)); Penn-Field Indus., Inc. v. Comm'r, 74 T.C. 720, 724 (1980) ("It is not the function of this Court to decide whether the Commissioner's selection of a particular class of taxpayers for audit was cost-efficient or wise, but only whether it was based upon a constitutionally impermissible criterion[,]" such as race, religion, or other arbitrary classification); Mid-Continent Supply Co. v. Comm'r, 571 F.2d 1371, 1376 (5th Cir. 1978) (upholding denial of motion to continue trial to permit discovery of a technical advice memorandum issued by the Commissioner in connection with the audit of another taxpayer's return because it would not have been material); City of Galveston v. United States, 33 Fed. Cl. 685, 708 (Fed. Cl. 1995) ("A taxpayer cannot premise its right to an exemption by showing that others have been treated more generously, leniently, or even erroneously by the IRS. The fact that there may be some taxpayers who have avoided paying a tax does not relieve other similarly situated taxpayers from paying their taxes."), *aff'd without published opinion*, 82 F.3d 433 (Fed. Cir. 1996).

determination.[86]

IBM created three distinct views of a duty of consistency and created chaos among the judiciary as a whole. For forty years, courts have yet to settle on what *IBM* means. However, *IBM* is clearly the starting point, and three lines of cases have emerged. In the first line, *IBM* requires the IRS to treat similarly situated taxpayers similarly and courts must remedy the failure of the IRS to carry out its duty of consistency. Under the second line of cases, *IBM* requires the IRS to treat similarly situated taxpayers similarly, and courts may remedy the failure of the IRS to carry out its duty of consistency if a taxpayer demonstrates that other similarly situated taxpayers have received more favorable treatment and that the IRS intentionally singled out the taxpayer for arbitrary or irrational reasons.[87] In the third line of cases, *IBM* does not require the IRS to treat similarly situated taxpayers similarly.

While the application of a so-called duty of consistency is inherently inconsistent because of its subjective standards, the problem is

86. 76 T.C. 222, 226 (1981). *See* Malinowski v. Comm'r, 71 T.C. 1120 (1979). In many other duty of consistency cases, taxpayers contend that they fall within the parameters of a private letter ruling issued to another taxpayer. In such cases, courts have universally rejected this argument. *See* Bookwalter v. Brecklein, 357 F.2d 78 (8th Cir. 1966) ("The evidence does not show that the appellee . . . is being treated any worse or any differently from other taxpayers in his position who did not request [or] receive private letter rulings."); Knetsch v. United States, 348 F.2d 932, 940 (Ct. Cl. 1965) ("Insofar as taxpayers' contention is that there is prejudicial discrimination because of a difference in treatment in favor of those who received and relied upon private rulings issued to them as against the instant taxpayers who neither applied for, nor received, a ruling of their own but relied solely on the private ruling issued to other taxpayers, we think there is no merit to such a contention."); Bornstein v. United States, 345 F.2d 558 (Ct. Cl. 1965) (noting that while the situation of the plaintiff was identical to that of another taxpayer who had received a favorable private letter ruling, plaintiff did not secure a ruling in his favor and despite a showing of reliance on the ruling issued to another taxpayer, the issuance of a private ruling to a particular taxpayer provided a sufficient basis for the Commissioner to apply a change in position retroactively as to taxpayers who had not received rulings); Teichgraeber v. Comm'r, 64 T.C 453, 456 (1975) ("Even if it be assumed that a private letter ruling had been issued to another brokerage house or one of its partners which proposed a different, even inconsistent, treatment than that accorded to petitioners in these cases, that circumstance would not render the respondent's determination here arbitrary. In numerous cases, it has been held that where the Commissioner has issued a private ruling to one taxpayer, another taxpayer (who has not received a ruling) may not rely on the holding in the issued ruling so as to require that he be given the same treatment that the first taxpayer was accorded."); Austin v. United States, 611 F.2d 117, 199 (5th Cir. 1980) (finding taxpayer's failure to obtain private letter ruling determinative); Knetsch v. United States, 348 F.2d 932, 940 n.14 (Ct. Cl. 1965) (holding that IRS can restrict parameters of private letter ruling to those taxpayers who sought private letter ruling); Rue R. Elston Co., Inc. v. United States, 532 F.2d 1176, 1181 (8th Cir. 1976) ("[T]he taxpayer cannot demand parity simply because the person obtaining a favorable private ruling was a competitor.").

87. *See* Bunce v. United States, 28 Fed. Cl. 500, 510 (Fed. Cl. 1993), *aff'd*, 26 F.3d 138 (Fed. Cir. 1994). *See also* Fresoli v. Comm'r, 55 T.C.M. (CCH) 1624 (1988) (holding that in order to prevail on such an argument petitioners would have to show not only that other similarly situated taxpayers have been offered more favorable settlements but also that they were subjected to invidious discrimination by respondent).

exacerbated by the inconsistency of the courts in its application. The result, therefore, is inconsistent treatment among similarly situated taxpayers based not on the similarities or differences between two taxpayers, but whether the similarities arise in certain fora.

III. WHY DUTY OF CONSISTENCY CASES ARE LIMITED TO PRIVATE LETTER RULINGS

A private letter ruling is a written determination issued to a taxpayer by the IRS that interprets and applies the tax laws to the specific set of facts provided by the taxpayer.[88] Private letter rulings are issued to specific taxpayers and are binding on the IRS only with respect to that taxpayer.[89] Thus, a taxpayer may not rely on a private letter ruling issued to another taxpayer.[90] Moreover, the IRS is not required to issue a private letter ruling to a taxpayer simply because it issued a ruling to a similar taxpayer.[91] Because private letter rulings can be inherently inconsistent as they apply to a specific taxpayer, for practical purposes a duty of consistency claim arises principally in the application of a duty of consistency to private letter rulings.[92]

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88. Rev. Proc. 2005-1, 2005-1 I.R.B. 1.

89. *Id.* Private letter rulings are often utilized by taxpayers to provide a degree of certainty regarding the tax consequences of a proposed transaction and are generally requested prior to completing the transaction. *See* Treas. Reg. § 601.201(b)(1) ("[IRS] issues rulings on prospective transactions and on completed transactions before the return is filed."). Private letter rulings, however, are not issued "if the identical issue is present in a return of the taxpayer for a prior year which is under active examination or audit" or being considered by Appeals. *Id. See also* Norman A. Sugerman, *Federal Tax Rulings Procedure*, 10 TAX. L. REV. 1, 4 (1954) (noting private letter rulings "take the gamble out of a business transaction").

90. 26 U.S.C. § 6110(k)(3) (2000). This section provides that "a written determination may not be used or cited as precedent." *Id.* § 6110(k)(3). The legislative history confirms that the provision was intended to prohibit a taxpayer from relying on a ruling issued to another taxpayer. H.R. REP. NO. 94-658, at 312, 315 (1976), *reprinted in* 1976 U.S.C.C.A.N 3208, 3211; S. REP. NO. 94-938, pt.1, at 303 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3438, 3732–33. In addition, taxpayers that receive a private letter ruling may only rely on the ruling concerning the specific transaction identified in the ruling and may not rely on the ruling for subsequent similar transactions unless the ruling specifically provides that the taxpayer may rely on the ruling in such transactions. H.R. REP. NO. 94-658, at 312, 323, *reprinted in* 1976 U.S.C.C.A.N 3208, 3219; S. REP. NO. 94-938, pt.1, at 311, *reprinted in* 1976 U.S.C.C.A.N 3438, 3740–41. While the legislative history in 1976 reflects congressional intention with respect to subsection (j) of 26 U.S.C. § 6110 (2000), Pub. L. No. 105-206, § 3509(b) (1997) redesignated former subsection (j) as subsection (k).

91. *See* Galler, *supra* note 62, at 1057 (citing Letter from Thomas F. Field to Gerald G. Portney dated March 18, 1981), 12 TAX NOTES 626, 627 (1981).

92. *See* Zelenak, *supra* note 1, at 434–35. The two additional administrative determinations are regulations and revenue rulings, but the possibility of a duty of consistency argument is limited in scope. Treasury Regulations implement a statute and may be based on either a specific grant of legislative authority from Congress or a general grant of rulemaking authority. *See* Schweiker v. Gray Panthers, 453 U.S. 34, 44 (1981) (specific grant of authority). *See, e.g.*, 26 U.S.C.A. § 469(l) (West 2002 & Supp.

The duty of consistency argument in private letter rulings traditionally arises in four circumstances. In the first instance, a taxpayer makes an application to the IRS to be recognized as a tax-exempt organization. The taxpayer claims entitlement to this status based upon the treatment of a prior applicant that the IRS recognized as a tax-exempt organization. The taxpayer asserts that it is similarly situated to the organization recognized by the IRS as tax exempt; yet the IRS denies the request of the taxpayer for tax-exempt status.

A second example involves a taxpayer who enters into settlement discussions with the IRS regarding a particular tax matter. Either prior to an agreement or subsequent to a resolution by settlement, the settling taxpayer becomes aware of a settlement offer made to or entered into by another taxpayer. The settling taxpayer claims that he is similarly situated to the other taxpayer and insists on the same settlement terms as the other taxpayer. The IRS refuses to grant the more favorable settlement terms to the settling taxpayer, leading to allegations of inequitable treatment.

Third, a taxpayer might claim that another taxpayer in the same or a similar industry is receiving preferential treatment on a particular tax matter. The taxpayer further alleges that the treatment produces a competitive disadvantage. The IRS typically responds to these allegations by denying the request for similar treatment.

Finally, a situation may arise when a taxpayer claims that the IRS applied a ruling retroactively against him resulting in an inconsistency with the prospective application of IRS policy to a similarly situated taxpayer.

In addressing the four potential inconsistencies, the Internal Revenue Manual (the Manual) provides some guidelines. While the Manual does

2005) ("The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out provisions of this section . . . ."). *Cf.* General Electric Co. v. Gilbert, 429 U.S. 125, 141–42 (1976). A general grant of authority arises from the authority provided by Congress to enforce the internal revenue laws under 26 U.S.C. § 7805(a), which provides that "[t]he Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." 26 U.S.C. § 7805(a) (2000). It is unlikely that a duty of consistency argument will arise in response to the application of a regulation since they apply uniformly to all taxpayers. Similarly, revenue rulings describe a set of hypothetical facts, apply those facts to the law, and offer a legal conclusion for all taxpayers concerning what the IRS believes the result would be in such a situation. *See* Rev. Proc. 89-14, 1989-1 C.B. 814. "Revenue rulings . . . are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose." *Id.* Moreover, revenue rulings involve substantive law and reflect conclusions responsive to the facts addressed in the ruling. *Id.* Finally, a revenue ruling is an official interpretation by the IRS and is published in the Internal Revenue Bulletin. Treas. Reg. § 601.201(a)(6) (2005). Therefore, little opportunity exists for disparate treatment among similarly situated taxpayers.

not confer substantive or procedural rights to taxpayers and taxpayers have no standing to challenge the IRS for failing to follow the Manual, it is the starting point for IRS agents in applying the law to taxpayers.[93] In addition to providing a roadmap for specific tax matters, the Manual provides generic guidance in dealing with all taxpayers in all tax matters:

> [An IRS] representative in his/her conclusions of fact or application of the law, shall hew to the law and the recognized standards of legal construction. It shall be his/her duty to determine the correct amount of the tax, with strict impartiality as between the taxpayer and the Government, and without favoritism or discrimination as between taxpayers.[94]

The language "without favoritism or discrimination as between taxpayers" suggests a broad application of a duty of consistency; however, its practical application is much more tenuous. The mere fact that one taxpayer is treated differently from another taxpayer does not necessarily suggest a sinister motive. Instead, disparate treatment may be attributable to the vagaries of audits, settlements, and the closure of a tax year on statute of limitations issues.

The first two instances described above are easily resolved. As to the first situation, tax-exempt organizations are inherently different. Like the companies in *IBM*, organizations can make the same or similar products, and argue that their tax treatment is the only difference and that such a distinction may arguably result in a disparate treatment claim. However, treatment of organizations as a whole—which is necessary for a determination of tax-exempt status—provides ample ammunition for the IRS to discover dissimilar characteristics that distinguish one organization from another. Thus, claims of a duty of consistency can readily be dismissed on factual grounds.[95]

93. United States v. Caceres, 440 U.S. 741, 752–53 (1979) (holding that error by an executive agency in interpreting its own regulations does not raise any constitutional questions); Fortney v. United States, 59 F.3d 117, 120–21 n.2 (9th Cir. 1995) (holding that conduct of IRS agent is governed by the statute, not a manual); Keado v. United States, 853 F.2d 1209, 1214 (5th Cir. 1988) ("Procedures or rules adopted by the IRS are not law."); Groder v. United States, 816 F.2d 139, 142 (4th Cir. 1987) (noting that internal rules of agency procedure "confer[] no substantive rights or privileges upon taxpayers"); United States v. Will, 671 F.2d 963, 967 (6th Cir. 1982) (stating that guideline "adopted solely for the internal administration of the IRS, rather than for the protection for the taxpayer, does not confer any rights upon the taxpayer" (citations omitted)); United States v. Equitable Trust Co., 611 F.2d 492, 500 (4th Cir. 1979) (holding that violation by IRS of own regulations is not proof by itself of bad faith of IRS).

94. INTERNAL REVENUE MANUAL § 1.2.1.4.5, *available at* http://www.irs.gov/irm/part1/ch02s02.html.

95. *See generally* Zelenak, *supra* note 1, at 413.

A settlement dispute is just as easily dismissed, but the dismissal is based on the nature of settlements. Taxpayers are unsuccessful in arguing that they are entitled to more favorable settlement terms based on a settlement offered to a similarly situated taxpayer. The ease of resolution in favor of disparate treatment in settlement rests on the fundamental difference between interpretative discretion (the discretion of the IRS in interpreting tax laws) and settlement discretion (the discretion of the IRS in offering a settlement package to a particular taxpayer).

In *Bunce v. United States*, the Court of Federal Claims based its decision on the distinction between interpretative discretion and settlement discretion, noting a "fundamental difference between the type of discretion Congress grants the IRS to interpret or apply tax laws and the type of discretion granted to compromise tax cases."[96] According to the *Bunce* court: "In exercising its interpretative discretion, the IRS might have the discretion to decide whether or not an item is taxable, but once the decision is made, it must be applied equally to all taxpayers."[97]

"Settlement discretion, on the other hand, is at its heart a discretion to treat similarly situated taxpayers differently."[98] As such, taxpayers have no right to settlement, much less to demand specific settlement terms.[99] More fundamentally, if the IRS were required to offer the same settlement terms to all similarly situated taxpayers, any discretion to settle would cease to exist, because a settlement with one taxpayer would obligate the IRS to compromise with all taxpayers.[100] Because of the discretion inherent in settlements, "there is not even an obligation on the part of the IRS to treat co-investors in the same venture equally for settlement purposes."[101]

96. 28 Fed. Cl. 500, 508–09 (Fed. Cl. 1993), *aff'd*, 26 F.3d 138 (Fed. Cir. 1994). The IRS may compromise with a taxpayer, but is not thereby required to offer the same—or even any—deal to other taxpayers. *Id.*

97. *Id.* at 509.

98. *Id.* ("[T]he discretion vested in the IRS to settle tax cases is by its very nature a discretion to treat similarly-situated taxpayers differently."). *See* Int'l Bus. Mach. Corp. v. United States (*IBM*), 343 F.2d 914 (Ct. Cl. 1965).

99. *Bunce*, 28 Fed. Cl. at 509. *See* Avers v. Comm'r, 55 T.C.M. (CCH) 678, 693 (1988) (stating that IRS settlement offers are "not dictated by law"). *See* Estate of Campion, 110 T.C. 165, 170 (1998) (finding that taxpayers do not have the right to settle with the IRS), *aff'd sub. nom.* Drake Oil Tech. Partners v. Comm'r, 211 F.3d 1277 (10th Cir. 2000); Tucek v. Comm'r, 198 F.3d 259 (10th Cir. 1999) (same). *See also* Norfolk S. Corp. v. Comm'r, 104 T.C. 13, 58 (1995) (finding that IRS not required to offer same settlement proposal to different taxpayers), *aff'd*, 140 F.3d 240 (4th Cir. 1998); Davis v. Comm'r, 65 T.C. 1014, 1022 (1976) (same).

100. *See Bunce*, 28 Fed. Cl. at 511.

101. *Id.* at 509.

When settlement is at issue, as long as no abuse of discretion or other invidious discrimination exists, "[p]etitioners cannot avoid tax liability by showing that others have been treated generously, leniently or erroneously by [the IRS]; rather, each petitioner must rest on the validity of his own position under the applicable taxing provisions, independently of others."[102]

The discretion of the IRS, however, is not (nor should it be) unbounded. The strictures of the Equal Protection Clause provide the outer limits to this discretion and, of course, the IRS is bound by this constitutional requirement.[103] While no right exists to settle a particular tax liability, taxpayers do have a right not to be discriminated against in seeking a settlement with the IRS.[104]

In *Penn-Field Industries, Inc. v. Commissioner*, the Tax Court held that a taxpayer must satisfy two criteria to support an allegation of discrimination by the IRS in settlements:

> It must first demonstrate that, while others similarly situated have not generally been [subject to IRS action] . . . it has been singled out [for adverse treatment] . . . and second, that the Commissioner's discriminatory selection of it has been based upon impermissible considerations such as race, religion, or the desire to prevent the exercise of constitutional rights.[105]

Therefore, if there is no proof of impermissible discrimination, the Equal Protection Clause is not implicated even if disparate treatment exists.[106]

Some tax cases, however, require a lesser showing of discrimination for settlement. These cases conclude that not only does the IRS breach

102. *Id.* at 511 (quoting *Avers*, 55 T.C.M. (CCH) at 694).

103. *See* Zelenak, *supra* note 1, at 414.

104. A duty of fairness analysis governs a discrimination analysis under the Due Process Clause of the Fifth Amendment and linked to equal protection. Bolling v. Sharpe, 347 U.S. 497, 499 (1954). *See* Rostker v. Goldberg, 453 U.S. 57, 62 n.3 (1981) ("[T]he Fifth Amendment's Due Process Clause prohibits the federal government from engaging in discrimination that is 'so unjustifiable as to be violative of due process.' [*Bolling*, 347 U.S. at 499]" (quoting Schlesinger v. Ballard, 419 U.S. 498, 500 n.3 (1975))).

105. 74 T.C. 720, 723 (1980); *see* Norfolk S. Corp. v. Comm'r, 104 T.C. 13, 58–59 (1995); Estate of Campion, 110 T.C. 165, 170 (1998); United States v. Stout, 601 F.2d 325 (7th Cir. 1979); United States v. Kahl, 583 F.2d 1351 (5th Cir. 1978); United States v. Scott, 520 F.2d 697 (9th Cir. 1975); United States v. Swanson, 509 F.2d 1205 (8th Cir. 1975); United States v. Berrios, 501 F.2d 1207 (2d Cir. 1974); United States v. Malinowski, 472 F.2d 850 (3d Cir. 1973). *See also* Fresoli v. Comm'r, 55 T.C.M. (CCH) 1624, 1626 (1988) (explaining that disparate treatment will not breach the duty of consistency if no discrimination was shown); Avers v. Comm'r, 55 T.C.M. (CCH) 678, 692–94 (1988) (same); Jaggard v. Comm'r, 76 T.C. 222, 226–28 (1981) (discussing general duty of consistency); Davis v. Comm'r, 65 T.C. 1014, 1022–23 (1976) (same).

106. *See Fresoli*, 55 T.C.M. (CCH) at 1626; *Avers*, 55 T.C.M. (CCH) at 693.

its duty in cases concerning suspect equal protection classifications (race, religion, etc.), it also breaches its duty when it uses irrational or arbitrary classifications to differentiate among similarly situated taxpayers.[107] This irrational or arbitrary rationale provides an appropriate starting point for resolving the third and fourth possibilities for disparate treatment claims.

In the third possibility, a taxpayer receives preferential treatment on a particular tax matter and that treatment produces a competitive disadvantage for other taxpayers in the industry. The final possibility occurs when the IRS applies a ruling retroactively, resulting in an inconsistency with the prospective application of IRS policy to a similarly situated taxpayer.

These two remaining possibilities can be collectively described as interpretative discretion cases, and the analysis for such cases is based not on a duty of consistency theory, but instead on an abuse of discretion standard that is statutorily established in § 7805(b). Professor Kenneth Culp Davis argues that inconsistency undermines the administrative process.[108] Imposing a duty of consistency, however, misappropriates congressional authority. Claims of disparate treatment should not be resolved under an amorphous duty of consistency ungrounded in substantive law. Instead, interpretative discretion cases should be analyzed utilizing the statutory scheme authorized by Congress, which adheres to the substantive law yet restricts the ability of the IRS to indiscriminately favor one taxpayer over another.[109]

107. *See Fresoli*, 55 T.C.M. (CCH) at 1626 (noting that settlement offers based upon either impermissible considerations or an arbitrary classification may be improper discrimination); *Avers*, 55 T.C.M. (CCH) at 694 (requiring a "'rational reason for the disparate treatment [to] exist'" to avoid invalid discrimination (quoting Johnson v. Smith, 696 F.2d 1334, 1337 (11th Cir. 1983)). *See also Penn-Field Indus.*, 74 T.C. at 723 ("[U]njustifiable standard[s include] race, religion, or other arbitrary classification.").

108. *See* Hatch v. Fed. Energy Regulatory Comm'n, 654 F.2d 825, 835 (D.C. Cir. 1981).

109. Equal treatment and sense of fairness principles should mandate that the law and its application should treat all taxpayers alike, particularly similarly situated taxpayers. *See* James W. Bowers, *Incomplete Law*, 62 LA. L. REV. 1229, 1251 (2002). Moreover, equal treatment applied uniformly through an abuse of discretion standard assists as a check and a balance for and against the IRS. Homogeneous standards assist in remedying public perception problems with the IRS. *See* Christopher M. Pietruszkiewicz, *A Constitutional Cause of Action and the Internal Revenue Code: Can You Shoot (Sue) the Messenger?*, 54 SYRACUSE L. REV. 1, 3 (2004) [hereinafter Pietruszkiewicz, *A Constitutional Cause of Action*] (discussing series of public hearings branding the IRS and its employees as renegades). *See also* Christopher M. Pietruszkiewicz, *Of Summonses, Required Records and Artificial Entities: Liberating the IRS from Itself*, 73 MISS. L.J. 921, 925 n.15 (2004) [hereinafter Pietruszkiewicz, *Liberating the IRS from Itself*]. A uniform standard also promotes the elimination of the agency problem that the IRS and its employees favor allies, political or otherwise, and abuse their power to strike at political detractors. *See* Bowers, *supra*, at 1251 n.75.

IV. ANALYSIS UNDER § 7805 IS APPROPRIATE IN RESOLVING CLAIMS OF DISPARATE TREATMENT

Section 7805(b) of the IRC addresses whether regulations, administrative determinations, or judicial decisions can be applied either retroactively or prospectively. Originally enacted as part of the Revenue Act of 1921,[110] present day § 7805 grants discretion to the Secretary of the Treasury regarding whether to apply administrative determinations and judicial decisions prospectively.[111] This suggests that the general rule is that retroactive application is the norm, providing the Secretary with the discretion to set aside the norm in appropriate circumstances.[112]

The opposite presumption is true, however, for regulations.[113] Unless the Secretary meets certain time constraints prescribed by the IRC, any temporary, proposed, or final regulations may only be applied prospectively.[114] Section 7805(b) provides in pertinent part:

> (b) Retroactivity of regulations—
> (1) In general—Except as otherwise provided in this subsection, no temporary, proposed, or final regulation relating to the internal revenue laws shall apply to any taxable period ending before the earliest of the following dates:
> (A) The date on which such regulation is filed with the Federal Register.
> (B) In the case of any final regulation, the date on which any proposed or temporary regulation to which such final regulation relates was filed with the Federal Register.
> (C) The date on which any notice substantially describing the expected contents of any temporary, proposed, or final regulation is issued to the public.
> (2) Exception for promptly issued regulations.—Paragraph (1) shall not apply to regulations filed or issued within 18 months of the date of the enactment of the statutory provision to which the regulation relates.[115]

110. Revenue Act of 1921, ch. 136, § 1314, 314 (1921).

111. 26 U.S.C. § 7805(b)(8) (2000).

112. *See* Becker v. Comm'r, 751 F.2d. 146, 150 (3d Cir. 1984) ("The language of I.R.C. § 7805(b) presumes that these agency rulings will be given retroactive effect unless otherwise specified."); Manocchio v. Comm'r, 710 F.2d 1400, 1403 (9th Cir. 1983) ("I.R.C. § 7805(b) (1976) establishes a presumption that rulings will be retroactive unless otherwise specified . . . .").

113. 26 U.S.C. § 7805(b)(1).

114. *Id.*

115. Thus, the Secretary may apply regulations retroactively only if certain objective requirements are met. In addition to the exception for promptly issued regulations, the Secretary may issue retroactive regulations to correct procedural defects, for internal regulations, based on specific congressional authorization, or regulations may be applied retroactively at the request of a taxpayer. 26 U.S.C. § 7805(b)(3)–(7) provide:

> (3) Prevention of abuse.—The Secretary may provide that any regulation may take effect

A. Discretion of the Secretary Under § 7805 Should Eliminate the Distinction Between Prospective Application and Retroactive Application

History suggests that the distinction in the Secretary's discretion to apply a ruling prospectively or retroactively under § 7805 is obsolete. Until 1921, retroactive application was universal, grounded in the declaratory theory of Sir William Blackstone.[116] The theory is based upon certain assumptions about the role of the lawmaker and the role of the IRS.[117] It is "Congress, not the Commissioner, [that] prescribes the tax laws."[118] Correspondingly, the Commissioner should retroactively correct mistakes of law.[119] Therefore, administrative determinations, by definition, are not the law. Mandatory retroactive application of administrative determinations does not alter the law, but determines what the law was and how it was meant to be interpreted.[120]

Based on this theory, retroactive application is necessary; otherwise, a taxpayer would be entitled to demand an incorrect interpretation of tax law, thereby obtaining a benefit not intended by the tax law as

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or apply retroactively to prevent abuse.

(4) Correction of procedural defects.—The Secretary may provide that any regulation may apply retroactively to correct a procedural defect in the issuance of any prior regulation.

(5) Internal regulations.—The limitation of paragraph (1) shall not apply to any regulation relating to internal Treasury Department policies, practices, or procedures.

(6) Congressional authorization.—The limitation of paragraph (1) may be superseded by a legislative grant from Congress authorizing the Secretary to prescribe the effective date with respect to any regulation.

(7) Election to apply retroactively.—The Secretary may provide for any taxpayer to elect to apply any regulation before the dates specified in paragraph (1).

116. 1 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 69–70 (1765).

117. *Id.*

118. Dixon v. United States, 381 U.S. 68, 73 (1965).

119. *Id.* at 72 (allowing retroactive application of revenue rulings and regulations because the Commissioner should not be prevented from correcting a mistake in law); Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 183 (1957) (same). *See* Manhattan Gen. Equip. Co. v. Comm'r, 297 U.S. 129, 134 (1936); Becker v. Comm'r, 751 F.2d 146, 151 (3d Cir. 1984); Wolinsky v. United States, 271 F.2d 865, 868 (2d Cir. 1959); Exch. Parts Co. v. United States, 279 F.2d 251, 254 (Ct. Cl. 1960); City Loan & Sav. Co. v. United States, 177 F. Supp. 843, 851 (N.D. Ohio 1959).

120. According to this theory, the statute is the law while regulations and rulings simply interpret the law. As such, if a regulation or ruling is a mistaken interpretation of the law, the Secretary may correct an interpretation retroactively to conform to the statute—i.e., the law. *See* David W. Ball, *Retroactive Application of Treasury Rules and Regulations*, 17 N.M. L. REV. 139, 142 (1987). *See also* Paul Gordon Hoffman, *Limits on Retroactive Decision Making by the Internal Revenue Service: Redefining Abuse of Discretion Under § 7805(b)*, 23 UCLA L. REV. 529, 532 (1976) ("Since an incorrect interpretation was therefore a nullity, a correct interpretation necessarily operated retroactively to the date of adoption of the legislation.").

promulgated by Congress.[121] Mandatory retroactive application of an administrative determination, however, would significantly burden the IRS by mandating that resolved matters be re-opened because of faulty administrative determinations, while at the same time burdening taxpayers who incorrectly believed that they had resolved a tax matter based on a prior administrative determination.[122] Absent express congressional approval for applying a ruling prospectively, the Secretary was concerned that prospective application was the equivalent of granting a taxpayer a tax exemption.[123] To alleviate the burden on taxpayers and the IRS, the Secretary requested and Congress enacted § 1314 as part of the Revenue Act of 1921, permitting the Commissioner to apply regulations and Treasury decisions without retroactive effect.[124] Section 1314 effectively permits the Secretary, for prior periods, to respect and apply interpretations later regarded as incorrect.[125] Section 1314 provided:

> That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.[126]

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121. *See* Schuster v. Comm'r, 312 F.2d 311, 317 (9th Cir. 1962).

122. H.R. REP. NO. 67-350, at 15–16 (1921) (causing the IRS to reopen "thousands of settled cases").

123. *Id.*

124. *See* Toni Robinson, *Retroactivity: The Case for Better Regulation of Federal Tax Regulators*, 48 OHIO ST. L.J. 773, 780 (1987).

125. American Bar Ass'n Section of Taxation Planning Committee, *Report on Exercise by the Treasury Department and the Internal Revenue Service of the Authority Granted by Internal Revenue Code Section 7805(b) to Prescribe the Extent to which Tax Rulings or Regulations Shall Be Applied Without Retroactive Effect*, 42 TAX LAW. 621, 626 (1989) [hereinafter "ABA Report on Retroactivity"].

126. Revenue Act of 1921, ch. 136, 314 (1921). This provision was included in the Revenue Act of 1924, ch. 234, § 1008(a), 340, 341 and the Revenue Act of 1926, ch. 27, § 1008(a), 114. The legislative history is consistent with the enactment of § 1314:

> Section 1002 [section 1314 of the 1921 Act] would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required by a decision of a court of competent jurisdiction. This would facilitate the administration of the internal revenue laws in that it would make it unnecessary to reopen thousands of settled cases.

H.R. REP. NO. 67-350, at 15–16; S. REP. NO. 67-275, at 32 (1921). *See* Robinson, *supra* note 124, at 780 n.49. The basis for enactment was a request by the Secretary of the Treasury in "Notes on the

The 1921 legislation effectively provided the Secretary with limited discretion to apply prospectively a new regulation or Treasury decision that reversed an existing regulation or Treasury decision, provided that the reversal was not the result of a decision by a court. The Senate subsequently passed the Revenue Bill of 1926, but the Conference Committee rejected it.[127] The Revenue Bill of 1926 would have determined tax liability based on regulations and decisions in existence at the time a tax return was filed.[128] Significantly, the provision would have required the IRS to apply regulations and decisions only with prospective effect, thereby eliminating the discretion to apply decisions prospectively and requiring mandatory prospective application.[129]

Section 1314 of the Revenue Act of 1921 was reenacted by Section 605 of the Revenue Act of 1928, and it expanded the ability of the IRS to issue prospective rulings:

> In case a regulation or Treasury decision relating to the internal revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.[130]

The 1928 legislation granted discretion to the Secretary not only to prospectively apply regulations and Treasury decisions that reversed existing policy, but also to grant the discretion to prospectively apply regulations and Treasury decisions that merely amended prior regulations or Treasury decisions.[131] Additionally, this legislation

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Revenue Act of 1918" to the House Ways and Means Committee that the Commissioner of Internal Revenue, with approval of the Secretary of the Treasury, make regulations or decisions that reversed an existing regulation or decision effective only from the date of approval and not require retroactivity. *See* ABA Report on Retroactivity, *supra* note 125, at 622.

127. ABA Report on Retroactivity, *supra* note 125, at 623.

128. *Id.*

129. *See id*.

130. Revenue Act of 1928, § 605, 45 Stat. 791, 874 (1928). Through this provision, Congress intended to give the Commissioner the ability to "correct misinterpretations, inaccuracies, or omissions in the regulations and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively." Helvering v. R.J. Reynolds Tobacco Co., 306 U.S. 110, 116 (1939). According to the Conference Committee:

> It is hoped that this provision will prevent the constant reopening of cases on account of changes in regulations or Treasury decision, and it is believed that sound administration properly places upon the Government the responsibility and burden of interpreting the law and of prescribing regulations upon which the taxpayers may rely.

H.R. REP. NO. 70-1882, at 22 (1928) (Conf. Rep.).

131. Existent policy was based on section 1314 of the Revenue Act of 1921, which provided the Secretary with discretion to apply prospectively a new regulation or Treasury decision that reversed an

granted the Secretary the discretion to prospectively apply regulations or Treasury decisions resulting from the implementation of a court decision, thereby eliminating the restriction mandated by the Revenue Act of 1921.[132]

Section 506 of the Revenue Act of 1934 modified § 605 of the Revenue Act of 1928 to provide that "[t]he Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."[133]

The 1934 amendment modified the 1928 legislation substantively in three respects. First, the amendment permitted the Secretary to prospectively apply rulings in addition to the previous authority to prospectively apply regulations and Treasury decisions.[134] Second, the 1921 legislation and the 1928 legislation granted discretion to the Secretary to prospectively apply regulations and Treasury decisions only if they reversed or amended an existing regulation or Treasury decision.[135] The 1934 legislation eliminated this restriction, providing the Secretary with the authority to apply regulations, Treasury decisions, and rulings prospectively without regard to whether they reversed or amended prior regulations, Treasury decisions, or rulings.[136] Prospective application was permitted for regulations, Treasury decisions, and rulings that were not previously issued.[137] Third, the legislation added the language "[to] the extent," permitting partial prospective application of a regulation, Treasury decision, or ruling.[138]

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existing regulation or Treasury decision, provided that the reversal was not the result of a decision by a court.

132. Revenue Act of 1928 § 605.

133. Revenue Act of 1934, § 506, 48 Stat. 680, 757 (1934). The Committee Reports indicate that the amendment was intended to permit the Commissioner to avoid the burden on taxpayers who had closed transactions with the IRS relying on "existing practice" and that the:

> [A]mendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the . . . the Commissioner . . . to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect.

H.R. REP. NO. 73-704, at 38 (1934); S. REP. NO. 73-558, at 48 (1934).

134. Robinson, *supra* note 124, at 780 n.49. *See* H.R. Rep. No. 73-704, at 38.

135. Revenue Act of 1921 § 1314; Revenue Act of 1928 § 605.

136. Revenue Act of 1934 § 506.

137. Robinson, *supra* note 124, at 780 n.49. *See* H.R. Rep. No. 73-704, at 38.

138. Revenue Act of 1934 § 506.

Consequently, the 1921, 1928, and 1934 Revenue Acts granted greater flexibility to the Secretary to grant relief to taxpayers who rely on existing court rulings and administrative determinations by eliminating the requirement that, in the exercise of his discretion, the Secretary must either fully apply a ruling, regulation, or Treasury decision prospectively or not at all.[139]

The legislative history of the Revenue Act of 1934 makes clear that Congress intended that rulings, regulations, and Treasury decisions should have "universal application" that encompasses both retroactive and prospective effect:

> Regulations, Treasury decisions, and rulings which are merely interpretative of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance on existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.[140]

Thus, Congress intended for the Secretary to have discretion to grant relief from any inequity that may result from retroactive, rather than prospective, application of a regulation, ruling, or Treasury decision.[141] The legislation was also clearly intended as a "taxpayer-relief provision":

> The history of section 7805(b) . . . reveals that the section originally was conceived as a way to permit the Secretary of the Treasury to assist taxpayers who were adversely affected by subsequent changes in the regulations. In other words, section 7805(b) was intended to be a taxpayer-relief provision by granting the Internal Revenue Service power to avoid inequitable results by applying its regulations and rulings with prospective effect only. As such, retroactive effect was presumed, and prospective application could only be achieved by specific provision.[142]

As a taxpayer relief provision, the 1934 legislation was intended by Congress to minimize adverse taxpayer impact. As discussed below,

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139. Robinson, *supra* note 124, at 780 n.49; H.R. REP. NO. 73-704, at 6; S. REP. NO. 73-558, at 48 (1934).

140. H.R. REP. NO. 73-704, at 38; S. REP. NO. 73-558, at 48.

141. *See* Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 184 (1957) ("Congress thereby confirmed the authority of the Commissioner to correct any ruling, regulation or Treasury decision retroactively" and "empower[] him, in his discretion, to limit retroactive application to the extent necessary to avoid inequitable results.").

142. Wendland v. Comm'r, 79 T.C. 355, 380–81 (1982), *aff'd*, 739 F.2d 580 (11th Cir.), *also aff'd sub nom*. Redhouse v. Comm'r, 728 F.2d 1249 (9th Cir. 1984).

this same rationale should carry through to review of the Secretary's decisions to apply rulings prospectively. The text of the Revenue Act of 1934 became § 3791 of the Internal Revenue Code of 1939, and became § 7805 of the Internal Revenue Codes of 1954 and 1986.[143]

In 1992, Congress passed legislation to reverse the presumption of retroactivity with respect to regulations,[144] but President Bush vetoed the legislation.[145] Section 7805(b) was amended in 1996 to reverse the presumption of retroactivity, again only with respect to Treasury Regulations, thus requiring that Treasury Regulations generally be applied prospectively.[146] The Report to § 1101(a) of the Taxpayer Bill of Rights 2 for the Ways and Means Committee of the House of Representatives and the Joint Committee Report provide little insight. The Joint Committee Report simply provides that "Congress believed that it is generally inappropriate for Treasury to issue retroactive regulations."[147] The Subcommittee on Oversight of the Ways and Means Committee provides better context:

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143. Although not a substantive change, the Internal Revenue Code of 1954 eliminated the words "Treasury decision." ABA Report on Retroactivity, *supra* note 125, at 623. In addition, the words "Secretary, or the Commissioner with the approval of the Secretary" were modified in the Internal Revenue Code of 1954 to "Secretary or his delegate." *Id.* at 623–24. This language was subsequently modified by the Tax Reform Act of 1976 to "Secretary." *Id.* at 624.

144. Benjamin J. Cohen & Catherine A. Harrington, *Is the Internal Revenue Service Bound by Its Own Regulations and Rulings?*, 51 TAX LAW. 675, 697–98 (1998) (citing H.R. 11, 102d Cong. (1992); S. 2239, 102d Cong. (1992); S. 532, 102d Cong. (1991); S. 3161, 101st Cong. (1990); Taxpayer Bill of Rights 2, H.R. 3838, 102d Cong. (1991); H.R. 4287, 102d Cong. (1992); H.R. 4210, 102d Cong. (1992)).

145. H.R. 11 was passed by both the House and Senate as the Revenue Bill of 1992 but was vetoed by President Bush in November 1992 because of his continued objection to an increase in tax rates. Cohen & Harrington, *supra* note 144, at 698 n.135. *See Bush Vetoes Tax Bill*, TAX NOTES TODAY, Nov. 5, 1992; *Bush Affirms Intention to Veto Tax Bill*, TAX NOTES TODAY, Oct. 19, 1992.

146. Pub L. No. 104-168, § 1101, 110 Stat. 1452, 1468 (1996); 26 U.S.C. § 7805(b)(1)–(b)(7) (1996). The effective date of the 1996 amendments was July 30, 1996. *Id.* Temporary and proposed regulations are not to be applied retroactively to any taxable period ending before such regulations are filed in the Federal Register. I.R.C. § 7805(b)(1)(A). Final regulations are not to be applied retroactively to any taxable period ending before the earlier of the date that the final regulations are published in the Federal Register or the date that the temporary or proposed regulations to which the final regulations relate are published in the Federal Register. A number of exceptions exist to the general rule. Regulations may be applied retroactively:

> [(1) If the regulations are issued or filed] within [eighteen] months of the date of the enactment of the statutory provision to which the regulations relates . . . . [; (2)] to prevent abuse . . . . [; (3)] to correct procedural defects . . . . [; (4) that] relate[] to internal Treasury department policies, practices, or procedures . . . .[; (5) that is authorized by] Congress . . . . [; or (6)] at the election of the taxpayer . . . .

I.R.C. § 7805(b)(1)–(7).

147. Staff of the Joint Committee on Taxation, 104th Cong., 2d Sess., General Explanation of Tax Legislation Enacted in the 104th Congress, at 44 (Comm. Print 1996). *See also* H.R. REP. NO. 104-506, at 44 (1996).

> The complexity of the tax regulations and the lengthy period of time it takes the IRS to publish them[,] . . . create[s] a significant hardship for taxpayers who seek in good faith to comply with the statutory tax law in the period of time before the regulations are published. If the taxpayer interprets the law in a way which is different from the position taken in a subsequent regulation, the taxpayer may be subject to additional taxes, penalties, and interest. The Subcommittee believes taxpayers should have more protections from the retroactive application of regulations.[148]

Senator Pryor, a proponent of eliminating the discretion of the Treasury Department to issue retroactive regulations, was more specific: "It is time we level the playing field, and it is time we took this stifling, awesome power [of issuing retroactive regulations] and removed it once and for all from the Internal Revenue Service."[149] The purpose § 1101 of the Taxpayer Bill of Rights 2 was evidently to "protect taxpayers against any change in applicable rules resulting from the adoption of retroactive regulations."[150]

The amendments to § 7805(b), however, do not create the same presumption for rulings and Treasury decisions.[151] In fact, new § 7805(b) preserves for the Secretary the discretion to determine whether to apply rulings and Treasury decisions prospectively, continuing their retroactive presumption.[152] The legislative history confirms this presumption, noting that "[p]resent law with respect to

148. Staff of Comm. on Ways and Means, 104th Cong., Oversight Initiative Report on Need for Taxpayer Bill of Rights 2 Legislation and Reform of the Internal Revenue Service (Comm. Print 1995), *reprinted in* TAX NOTES TODAY, Sept. 18, 1995, at 1386–87.

149. 138 CONG. REC. S15356 (daily ed. Sept. 26, 1992). Notwithstanding such political grandstanding, a comprehensive report by the Tax Section of the American Bar Association found that, in almost all cases, regulations and rulings that represented a change in policy of the IRS was made prospective under the discretion provided to the Secretary under § 7805(b) and did not, in general, adversely affect taxpayers that complied with existing regulations and rulings. ABA Report on Retroactivity, *supra* note 125, at 625. The Report concluded that the standards used by the Treasury Department in exercising its discretion under § 7805(b) was "reasonably" administered. *Id.* at 664. This same conclusion was reached by the New York State Bar Association. *See NYSBA Opposes Legislation to Prevent Retroactive Application of Regs*, TAX NOTES TODAY, May 12, 1992 (letter from John A. Corry, Chair of the Tax Section of the New York State Bar Association).

This corresponded with a series of oversight hearings by Congress that recounted a "parade of horribles" bestowed on taxpayers by an out of control IRS that "brand[ed] the Internal Revenue Service and its employees as renegades." Pietruszkiewicz, *A Constitutional Cause of Action*, *supra* note 109, at 3. Similar to the report on administrative discretion, many of the stories recounted by congressional committees at the oversight hearings could not be confirmed. *Id.* at 5. *See* GAO/OSI-99-9R, Doc. 2000-11360, 2000 TNT 80-13 (Apr. 25, 2000); Ryan J. Donmoyer, *Secret GAO Report Is Latest to Discredit Roth's IRS Hearings*, TAX NOTES TODAY, Apr. 24, 2000, at 463.

150. Cohen & Harrington, *supra* note 144, at 701.

151. 26 U.S.C. § 7805(b)(8) (2005). *See* Staff of Joint Comm. on Taxation, 104th Cong., General Explanation of Tax Legislation Enacted in the 104th Congress (Comm. Print 1996).

152. *Id.* § 7805(b) (1996).

rulings is unchanged."[153] It appears that Congress made a conscious decision to retain retroactive application of rulings and Treasury decisions as the rule, since Congress considered the effect on taxpayers on multiple occasions and explicitly reconfirmed the general rule of retroactive application absent the Secretary exercising the discretion specifically granted in § 7805(b)(8).

B. Application of Discretion to Letter Rulings Under § 7805(b)

As part of the Taxpayer Bill of Rights 2, Congress reversed the presumption against retroactivity in 1996. However, the reversal applied exclusively to regulations, continuing the presumption of retroactivity concerning rulings and Treasury decisions.[154] In addition, Congress added § 7805(b)(7), which authorized taxpayers, with the concurrence of the Secretary, to elect retroactive application of new regulations prior to the mandated effective dates.[155] Accordingly, § 7805(b) and its predecessors are taxpayer friendly to the extent that an election of retroactive application would be made by taxpayers only in those situations where retroactive application would be beneficial.[156]

While retroactivity is the rule rather than the exception,[157] the extent to which retroactive application should occur remains unsettled. Some appellate courts have adopted a secondary rule that the statutory presumption of retroactivity relates back to the effective date of the statute to which the administrative determination relates.[158] Originally, the Revenue Act of 1921 intended to provide the Secretary with discretion to make regulations prospective in nature.[159] However, it was not until 1934 that the Secretary was actually afforded the discretion to apply rulings on a prospective basis.[160] Notwithstanding its original objective, application of § 7805(b) recently "has [b]een restricted almost

153. *See* H.R. REP. NO. 104-506, at 44 (1996), *reprinted in* 1996 U.S.C.C.A.N. 1167.

154. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1101, 110 Stat. 1452, 1468 (1996).

155. § 7805(b)(7).

156. Wendland v. Comm'r, 79 T.C. 355, 381 (1982). *See* Zelenak, *supra* note 1, at 421 ("The grant of discretion to the Service in section 7805 to apply rulings prospectively was primarily, perhaps exclusively, intended for the situation where a favorable regulation or ruling on which a taxpayer has reasonably relied . . . is being revoked, and it is appropriate to exclude retroactive application to protect reliance interests."). *See also* Hoffman, *supra* note 120, at 532.

157. *See* Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 184 (1957).

158. *See* Redhouse v. Comm'r, 728 F.2d 1249, 1251 (9th Cir. 1984) ("[T]reasury regulations are ordinarily retroactive to the effective date of the statute to which they relate . . . .").

159. Revenue Act of 1921, ch. 136, sec. 1314, 42 Stat. 227, 314 (1921).

160. Revenue Act of 1934, § 506, 48 Stat. 680, 757 (1934).

exclusively to rulings."[161] Therefore, the main impetus of § 7805(b) is the Secretary's discretion to apply a letter ruling prospectively.[162]

Even though the statutory discretion provided under § 7805(b) is undefined, the IRS promulgated guidelines for its exercise in Revenue Procedure 2005-1. Under this Revenue Procedure, a letter ruling that is in error (i.e., a letter ruling that does not conform to the present views of the IRS) may be revoked or modified, unless the letter ruling is part of a closing agreement.[163] Unless the IRS affirmatively exercises its discretionary authority under § 7805(b) to limit the decision's retroactive effect, the revocation or modification applies to all years open under the statute of limitations.[164]

The Secretary will not, however, limit the revocation or modification of a ruling's retroactivity if the taxpayer misstates or omits controlling facts; if the controlling facts of the transaction are materially different than those found in the letter ruling; or if the controlling facts change during the course of a transaction involving a continuing action or series of actions.[165] Except in rare or unusual circumstances, the revocation or modification of a letter ruling is applied prospectively.[166] In any event,

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161. ABA Report on Retroactivity, *supra* note 125, at 624–25.

162. 26 U.S.C. § 7805(b)(8) (1996). While § 7805(b) provides that the norm in the issuance of rulings is retroactivity, it does provide for prospective treatment, presumably immediate prospective treatment. Section 7805(b), however, does not address the ability of the Secretary to issue deferred prospective dates in which the ruling becomes effective. The Secretary has issued rulings with deferred effective dates in, for example, Revenue Ruling 86-137 and Revenue Ruling 87-127. It would seem this discretion would satisfy the overall purpose of § 7805(b)(8) and provide appropriate time, in certain circumstances, for taxpayers to incorporate appropriate changes necessary as a result of change in the position of the IRS, particularly in circumstances in which the IRS issues a ruling that reverses an existing policy. *See* ABA Report on Retroactivity, *supra* note 125, at 638.

163. Rev. Proc. 2005-1, § 11.04 I.R.B. 1. "A 'closing agreement' is a final agreement between the [Internal Revenue] Service and a taxpayer on a specific issue or liability. It is entered into under the authority in § 7121 and is final unless fraud, malfeasance, or misrepresentation of a material fact can be shown." Rev. Proc. 2005-1, § 2.02.

164. Rev. Proc. 2005-1, § 11.04. A letter ruling may be revoked or modified by:

> (1) [A] notice to the taxpayer to whom the letter ruling was issued; (2) the enactment of legislation or ratification of a tax treaty; (3) a decision of the United States Supreme Court; (4) the issuance of temporary or final regulations; or (5) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin.

Id. If a letter ruling refers to a continuing action or a series of actions, the ruling will generally be applied until any one of the events set forth above transpires or until the ruling is withdrawn. *Id.*

165. Rev. Proc. 2005-1, § 11.05.

166. *Id.* § 11.06. This assumes that the law has not changed, that the ruling was originally issued for a proposed transaction, that the taxpayer acted in good faith in relying on the letter ruling, and that revoking or modifying the letter ruling retroactively would be a detriment to the taxpayer. *Id.* The ruling is only with respect to the taxpayer for the particular transaction. If the IRS determines that the ruling was in error and no longer comports with the position of the IRS, the ruling will not protect a

a taxpayer to whom a letter ruling has been issued may request that the revocation or modification of a ruling be applied prospectively or, consistent with the discretion of the Secretary under § 7805(b)(8), issued without retroactive effect.[167]

In addition, a taxpayer may request that the IRS limit the retroactive effect of a revocation or modification of a letter ruling through a separate ruling.[168] Therefore, a taxpayer has two options when seeking to limit a retroactive effect: (1) as part of a request for a letter ruling, a taxpayer may ask that a revocation or modification of a letter ruling limit the retroactive effect, or (2) at any time prior to the issuance of a letter ruling, the taxpayer may request that a revocation or modification of a letter ruling limit the retroactive effect.[169]

C. Abuse of Discretion Standard for Letter Rulings Under § 7805(b)

Since 1921, the Commissioner has had at least some discretion to apply administrative determinations prospectively. Despite the inclusion of relief from retroactive application in 1921, subsequent modifications in 1934, and the inclusion of relief in the Internal Revenue Code of

similar transaction of the taxpayer in the same year or later year. *Id.* § 11.07. If, however, a taxpayer completes a transaction prior to the issuance of a ruling, a taxpayer did not rely on the ruling and, therefore, is not protected against retroactive revocation or modification. *Id.* § 11.10.

167. *Id.* § 11.11. A request for relief to limit the retroactive effect under § 7805(b) must satisfy the general requirements for a letter ruling. *Id.* The general requirements for a letter ruling include a complete statement of facts and other information; copies of all contracts, wills, deeds, agreements, instruments, other documents, and foreign laws; an analysis of material facts; a statement regarding whether the same issue is in an earlier return; a statement regarding whether a same or similar issue was previously ruled on or requested, or is currently pending; a statement regarding interpretation of a substantive provision of an income or estate tax treaty; a letter from the Bureau of Indian Affairs relating to a letter ruling request for recognition of Indian tribal government status or status as a political subdivision of an Indian tribal government; a statement of supporting authorities; a statement of contrary authorities; a statement identifying pending legislation; a statement identifying information to be deleted from a copy of a letter ruling or determination letter for public inspection; a signature by taxpayer or authorized representative; a power of attorney and declaration of a representative; a penalties of perjury statement; and the submission of the appropriate number of copies. *Id.* § 7.01.

In addition, a request for relief from the retroactive effect of § 7805(b) must include a statement that relief is sought under § 7805(b), along with a statement of the relief sought, an explanation of the reasons and arguments in support of the relief requested, and any documents bearing on the request. *Id.* § 11.11. The explanation must include a statement that a letter ruling is permitted in this area and that the request is not prohibited with respect to the area in which the letter ruling is requested. *Id.* §§ 11.05, 11.06, and 11.11.

168. Rev. Proc. 2005-1, 2005-1 I.R.B. 1, § 11.11. In a usual circumstance, a request for limiting retroactive effect is made if a ruling modifies or revokes a letter ruling or if the IRS informs a taxpayer of a change of position that has the effect of revoking or modifying a letter ruling. *Id.*

169. Rev. Proc. 2005-1, 2005 I.R.B. 1, § 11.11. A taxpayer that requests that the Secretary exercise his discretion under § 7805(b) has a right to a conference with the IRS. *Id.* For treatment of requests to limit retroactive effect of determination letters, see Rev. Proc. 2005-1, 2005 I.R.B. 1, § 13.

1954, courts did not adopt a standard for measuring the discretion of the Secretary until 1956, when they adopted an abuse of discretion standard.[170]

In *Lesavoy Foundation v. Commissioner*, the IRS granted tax-exempt status to a charitable organization.[171] Notwithstanding this exemption, the Commissioner retroactively revoked the tax-exempt status of the organization and assessed a tax deficiency.[172] The Third Circuit held that the Commissioner abused his discretion by retroactively revoking the tax-exempt status of the taxpayer, indicating that its reliance on a letter ruling was reasonable and justifiable.[173] Significantly, the court was troubled that retroactive application of the letter ruling would result in a greater tax liability than the net assets of the taxpayer.[174] As a result, the Secretary exceeded "the bounds of permissible discretion."[175]

One year later, the U.S. Supreme Court summarily rejected the argument that the Commissioner should be estopped from applying rules retroactively, but sanctioned the abuse of discretion standard in *Automobile Club of Michigan v. Commissioner*.[176] The Automobile Club of Michigan applied for and was granted tax-exempt status by rulings in 1934 and 1938.[177] In 1943, though, the Commissioner reversed course and determined that automobile clubs should not be tax-exempt organizations.[178] Two years later, the Commissioner revoked the tax-exempt status of the Automobile Club and made the revocation retroactive to 1943, the date that the Commissioner announced that automobile clubs should not be tax-exempt organizations.[179] The taxpayer argued that the doctrine of estoppel should prohibit the

170. *See* Lesavoy Found. v. Comm'r, 238 F.2d 589 (3d Cir. 1956); Dixon v. Comm'r, 381 U.S. 68, 74–76 (1965); Auto. Club of Mich. v. Comm'r, 353 U.S. 180 (1957). *See also* Robinson, *supra* note 124, at 784 n.63.

171. *Lesavoy Found.*, 238 F.2d at 590.

172. *Id.* at 590.

173. *Id.* at 593–94.

174. *Id.* at 590. The assessment by the IRS was greater than the net worth of the organization. *Id.*

175. *Id.* at 591. ("[W]e think the Commissioner went beyond his authority in revoking the certificate of exemption retroactively. . . . [T]he Commissioner may change his mind when he believes he has made a mistake in a matter of fact or law. . . . But it is quite a different matter to say that having once changed his mind the Commissioner may arbitrarily and without limit have the effect of that change go back over previous years during which the taxpayer operated under the previous ruling."). *See* Hoffman, *supra* note 120, at 535; Theodore S. Lynn & Mervyn S. Gerson, *Quasi-Estoppel and Abuse of Discretion as Applied Against the United States in Federal Tax Controversies*, 19 TAX L. REV. 487, 511 (1964).

176. 353 U.S. 180 (1957).

177. Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 181 (1957).

178. *Id.* at 185.

179. *Id.* at 182–83.

Commissioner from applying the revocation of tax-exempt status retroactively.[180]

The Supreme Court dismissed the taxpayer's estoppel argument as meritless, determining that "[t]he doctrine of equitable estoppel is not a bar to the correction by the Commissioner of a mistake of law."[181] The Court's reasoning was sound. If a statutorily based abuse of discretion standard were to rely on purely equitable principles, the notion of congressionally authorized discretion would be defeated.[182] Accordingly, in applying § 7805(b), a court should not consider the equitable principles of reliance and detriment. Instead, the Supreme Court correctly analyzed the retroactive application under the predecessor to § 7805(b),[183] utilizing an abuse of discretion standard.[184]

The strictures of the abuse of discretion standard were initially formed seven years later in *Dixon v. United States*.[185] In *Dixon*, the Supreme Court reviewed the Commissioner's decision to revoke a published acquiescence retroactively. Petitioners argued that they relied on the public acquiescence of the Commissioner and that the acquiescence was not withdrawn by the Commissioner until after the transaction in issue closed.[186]

In rejecting the taxpayer's argument, the Court laid the foundation for the abuse of discretion standard: "It is not for us to pass upon the wisdom of any such distinction. It suffices that . . . the distinction was [not] so devoid of rational basis that we must now overturn the Commissioner's judgment."[187] In reaching this conclusion, the Court relied on the discretion provided to the Commissioner by Congress:

> [The taxpayer's] arguments are more appropriately addressed to

180. *Id.* at 183.

181. *Id. See* Keystone Auto. Club v. Comm'r, 181 F.2d 402 (3d Cir. 1950); Schafer v. Helvering, 83 F.2d 317 (D.C. Cir.), *aff'd*, 299 U.S. 171 (1936); John M. Parker Co. v. Comm'r, 49 F.2d 254 (5th Cir. 1931); S. Md. Agric. Fair Ass'n v. Comm'r, 40 B.T.A. 549 (1939); Yokohama Ki-Ito Kwaisha, Ltd., 5 B.T.A. 1248 (1927).

182. Should an estoppel argument prevail when confronted with specific statutory guidance on the same issue, it would elevate the decision of a court over a decision of the Congress in a legislative area, an area clearly within the province of Congress.

183. *Auto. Club of Mich.*, 353 U.S. at 184. Section 3791(b) of the Internal Revenue Code of 1939 is the predecessor to § 7805(b), and provides: "Retroactivity of regulations or rulings. The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

184. *Id.* at 186.

185. 381 U.S. 68 (1965).

186. *Id.* at 70–71.

187. *Id.* at 79.

> Congress. Congress has seen fit to allow the Commissioner to correct [his] mistakes of law, and in § 7805(b) has given him a large measure of discretion in determining when to apply his corrections retroactively. In the circumstances of this case we cannot say that this discretion was abused.[188]

To determine whether the Commissioner abused the discretion provided by Congress, one must begin with the presumption in favor of retroactive application of rulings. Therefore, the burden of overcoming the statutory presumption of retroactivity falls on a taxpayer challenging the retroactive application.[189] Because § 6110(k)(3) provides, in part, that "a written determination may not be used or cited as precedent," abuse of discretion under § 7805(b) cannot be based on a right to rely upon a ruling received by another taxpayer.[190] Rather, abuse of discretion must be based on discriminatory treatment between taxpayers who requested rulings.[191]

D. Letter Rulings and the Obsolete Distinction Between Prospective and Retroactive Discretion of the Secretary Under § 7805(b)

Section 7805 is drafted in a manner that prescribes retroactive application. As such, retroactive application of an administrative determination should not be measured under an abuse of discretion standard. Instead, the Commissioner's failure to apply an administrative determination "without retroactive effect" should be reviewed.[192] In other words, the abuse of discretion standard is used if the Commissioner does not apply an administrative determination prospectively. This distinction is obsolete and should be eliminated.

The predecessor to § 7805(b) provided discretion to the Secretary at a time when Blackstone's theory—the law is what the law is—prevailed, and at a time when discretion was thought necessary to avoid the harsh results of retroactive application. This theory is grounded on the belief that a statute alone constituted the law and that an incorrect

188. *Id.* at 80.

189. *See* Herculite Protective Fabrics Corp. v. Comm'r, 387 F.2d 475, 476 (3d Cir. 1968); World Publ'g Co. v. United States, 169 F.2d 186, 189 (10th Cir. 1948); *In re* Silver Eagle Co., 262 B.R. 534, 537 (Bankr. D. Or. 2001); Estate of Walton v. Comm'r, 42 B.T.A. 300, 303 (1940). *See also* Gerstenberger v. Comm'r, 81 T.C.M. (CCH) 1253 (2001).

190. I.R.C. § 6110(k)(3).

191. *See* Lane-Burslem v. Comm'r, 70 T.C. 613, 623 n.7 (1978), *reh'g denied*, 72 T.C. 849 (1979), *aff'd*, 659 F.2d 209 (D.C. Cir. 1981) ("Where the exercise of respondent's discretion under § 7805(b) is questioned, however, a showing of discriminatory treatment of taxpayers who are similarly situated will tend to show an abuse of discretion." (citations omitted)).

192. Robinson, *supra* note 124, at 784 n.63.

interpretation by an agency did not alter the meaning of the law.[193] Instead, only Congress could modify the law that it created by statute.[194] As a result, incorrect interpretations never existed and newly minted, correct interpretations necessarily operated retroactively to the date that the statute became effective.[195] Since 1965, however, the Supreme Court has rejected Blackstone's theory.[196] In *Linkletter v. Walker*, the Supreme Court faced the question of whether the rule announced by the Court in *Mapp v. Ohio* should apply retroactively.[197] In *Mapp*, the Supreme Court determined that evidence seized in violation of the constitutional rights of a defendant was not admissible in a prosecution in state court.[198] The *Linkletter* Court broke with the Blackstone theory and applied its decision prospectively, determining that the previously entered state convictions should not be disturbed.[199]

While the Supreme Court no longer adheres to Blackstone's theory, its legacy continues to linger in § 7805(b)(8). That is, Congress gave the Secretary discretion to apply private letter rulings, among other things, "without retroactive effect." As a result, the Secretary can potentially abuse his discretion by not applying a ruling prospectively. The language also supports the position that there is no standard by which the Secretary can be judged if he applies a ruling prospectively. Section 7805(b)(8) does not address a situation in which the Secretary elects to apply a ruling prospectively even though a taxpayer would prefer that it apply retroactively. This view is supported by congressional changes to § 7805 that address the issue of whether regulations should be applied retroactively or prospectively.[200]

Specifically, § 7805(b)(1) provides that regulations shall not be applied to any taxable period before the earlier of the date that the regulation is filed in the Federal Register, the date that the proposed or temporary regulation is filed in the Federal Register if the application concerns final regulations, or the date on which any notice that

193. Raoul Berger, *Estoppel Against the Government*, 21 U. CHI. L. REV. 680, 686–87 (1954).

194. *Id.*

195. David L. Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy*, 78 HARV. L. REV. 921, 933 (1965).

196. Linkletter v. Walker, 381 U.S. 618, 628 (1965), *overruled on other grounds by* Griffith v. Kentucky, 479 U.S. 314 (1987).

197. *Id.* (referring to Mapp v. Ohio, 367 U.S. 643 (1965)).

198. *Mapp*, 367 U.S. at 654–55. In *Weeks v. United States*, 232 U.S. 383, 398 (1914), the Supreme Court previously held that the Fourth Amendment barred the use of illegally seized evidence in a federal prosecution. *See* Wolf v. Colorado, 338 U.S. 25, 28 (1949).

199. *Linkletter*, 381 U.S. at 639–40.

200. I.R.C. § 7805(b)(1) (1996).

substantially describes the expected contents of any regulation is issued to the public.[201] Therefore, the general rule is that regulations apply prospectively.[202] Significantly, Congress provided that the Secretary may permit any taxpayer to elect to apply a regulation retroactively.[203] By this provision, Congress provided that the Secretary "may" apply a regulation retroactively at the request of a taxpayer. The "may" language is discretionary language, which suggests that the refusal of the Secretary to grant retroactive application of a regulation may be reviewed by a court under an abuse of discretion standard.

In 1996, therefore, Congress eliminated all remnants of Blackstone's theory, but only in the case of regulations. That same language—and therefore that same discretion—does not exist in § 7805(b)(8) with respect to rulings. While the predecessor of § 7805(b)(8) was created in part to help taxpayers avoid the harsh results of retroactive application, the law did not consider the alternative of potentially harsh results of prospective application of rulings. If Congress wants to change the result, it certainly is aware of how to do it; after all, Congress did so in the same subsection with respect to regulations.

We have outlived the utility of the distinction between retroactive and prospective application. As originally created, the discretion to limit retroactivity created a benefit to taxpayers at a time when the Supreme Court subscribed to Blackstone's declaratory theory. The discretion also helped the IRS by not requiring the reopening of previously resolved cases. The impact of Blackstone's theory has declined, but the goals of the retroactive-prospective application still survive. Therefore, symmetry suggests that the Secretary be given discretion to provide either retroactive or prospective application of a private letter ruling. Such discretion would recognize the current state of the law and permit an abuse of discretion review by an appropriate judicial forum for either retroactive or prospective application.[204]

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201. *Id.*

202. Congress provides six exceptions to the prospective application rule. First, a regulation may be applied retroactively if it is filed or issued within eighteen months of the date of the enactment of the statutory provision to which the regulation relates. Second, the Secretary may apply any regulation retroactively to prevent abuse. Third, the Secretary may apply any regulation retroactively to correct a procedural defect in a prior regulation. Fourth, the Secretary may apply any regulation retroactively provided that it relates to an internal Treasury Department policy, practice, or procedure. Fifth, Congress may authorize the Secretary to apply any regulation retroactively. Finally, the Secretary may provide that a taxpayer may elect to apply a regulation retroactively. *Id.* § 7805(b)(2)–(7).

203. *Id.* § 7805(b)(7).

204. Under the abuse of discretion standard, § 6110(k)(3), a provision that provides that taxpayers cannot rely on the ruling of another taxpayer is not affected. Specifically, § 6110(k)(3) provides that "[u]nless the Secretary otherwise establishes by regulations, a written determination may not be used or

E. The Standard of Review for Abuse of Discretion Under the Proposed Retroactive and Prospective Discretion of the Secretary Under § 7805

A court does not write on a blank slate when reviewing an administrative determination under an abuse of discretion standard. A court should not make a determination as to whether application of an administrative determination should be prospective.[205] Instead, a court should review a determination by the Commissioner to apply an administrative determination without retroactive effect (or without prospective effect) and determine whether the Commissioner abused his discretion in that determination. This abuse of discretion standard is more rigorous and, ironically, more consistent than an unstructured duty of consistency determination.[206]

The IRS may arguably abuse its discretion in other circumstances,[207] and the doctrine of discrimination may be an independent ground to

cited as precedent." Under the retroactive-prospective dichotomy described above, § 6110(k)(3) is not affected because it does not change the reliance standard or provide for a duty of consistency, which effectively creates substantive law by relying on a determination of another taxpayer. The proposed modification to § 7805(b) merely permits judicial review in the same manner that a court may review the discretion of the Secretary to apply a ruling "without retroactive effect." While the abuse of discretion review looks to a letter ruling of another taxpayer to determine if the Secretary abused his discretion, it does not rely on the ruling to another taxpayer to serve as the basis for decision. *See* Zelenak, *supra* note 1, at 437 ("[M]erely allowing taxpayers to use letter rulings to show inconsistent treatment . . . does not permit taxpayers to rely on those rulings."). In this, Professor Zelenak and this Article agree—§ 6110(k)(3) only contemplates the prohibition on reliance; it does not prohibit utilizing letter rulings to show inconsistent treatment. *Id.* at 437–38 (citing Staff of Joint Comm. on Internal Revenue Taxation, 94th Cong., 1st Sess., Private Letter Rulings 1 (Comm. Print 1975)).

205. Robinson, *supra* note 124, at 784 n.64.

206. *See, e.g.*, Weil v. Retirement Plan Admin. Comm., 933 F.2d 106, 110 (2d Cir. 1991) (holding that Commissioner may retroactively change an earlier interpretation of the law even if a taxpayer relied to his detriment on the Commissioner's prior position); Cohen v. Comm'r, 910 F.2d 422, 427–28 (7th Cir. 1990) (upholding retroactive change in interest rates); Schuster v. Comm'r, 800 F.2d 672, 676 (7th Cir. 1986) (noting that Dickman "fully authorizes the Commissioner to change his position on an issue, if he chooses to do so"); Etter Grain Co. v. United States, 462 F.2d 259, 265 (5th Cir. 1972) (allowing Commissioner to correct mistake of law by retroactively revoking letter ruling); Knights of Columbus Council No. 3660 v. United States, 783 F.2d 69 (7th Cir. 1986) (finding that Commissioner did not abuse discretion in retroactively applying position even if taxpayer detrimentally relied on prior actions of the Commissioner); Becker v. Comm'r, 751 F.2d 146, 150 (3d Cir. 1984) (finding no abuse of discretion in retroactive application of ruling notwithstanding ruling changed prior ruling on which taxpayer relied); Wis. Nipple & Fabricating Corp. v. Comm'r, 581 F.2d 1235, 1237–38 (7th Cir. 1978) (finding no abuse of discretion in retroactively revoking favorable determination to taxpayer); Wilson v. United States, 588 F.2d 1168, 1171–73 (6th Cir. 1978) (finding no abuse of discretion in retroactively applying a regulation issued during the pendency of litigation).

207. Cohen & Harrington, *supra* note 144, at 678, 690. *See* Tidy v. United States, 762 F. Supp. 122, 125–26 (W.D.N.C. 1991), *vacated on other grounds*, 956 F.2d 1163 (4th Cir. 1992); Prabel v. Comm'r, 91 T.C. 1101, 1121 (1988), *aff'd*, 882 F.2d 820 (3d Cir. 1989); Burleson v. Comm'r, 68 T.C.M. (CCH) 288, 290–91 (1994).

require the IRS to treat similarly situated taxpayers in a similar manner pursuant to the Equal Protection Clause.[208] Absent discrimination rising to the level of constitutional infringement, the abuse of discretion standard under § 7805(b)—the only remedy authorized by Congress—should provide an exclusive remedy for differentiation between similarly situated taxpayers.[209]

In assessing whether the Secretary abused his discretion, Congress significantly did not cede its substantive rulemaking authority to the IRS. Rather, Congress delegated the discretion to the IRS to apply a ruling retroactively.[210] Therefore, the interpretation of the substantive

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208. The Equal Protection Clause of the Fourteenth Amendment provides:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. CONST. amend. XIV, § 1. The Fourteenth Amendment is not applicable to the federal government; however, actions by the federal government that discriminate will, under circumstances similar to the Fourteenth Amendment, violate the Due Process Clause of the Fifth Amendment. In *Schlesinger v. Ballard*, the Supreme Court determined that, "[a]lthough [the Fifth Amendment] contains no Equal Protection Clause as does the Fourteenth Amendment, the Fifth Amendment's Due Process Clause prohibits the Federal Government from engaging in discrimination that is 'so unjustifiable as to be violative of due process.'" 419 U.S. 498, 500 n.3 (1975) (quoting Bolling v. Sharpe, 347 U.S. 497, 499 (1954)). *See* Rostker v. Goldberg, 453 U.S. 57, 62 n.3 (1981). *See also* Schweiker v. Wilson, 450 U.S. 221, 227 n.6 (1981) (explaining that Fifth Amendment imposes on the federal government the same standard required of state legislation by the Equal Protection Clause of the Fourteenth Amendment). The Fifth Amendment provides:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

U.S. CONST. amend. V.

209. Cohen & Harrington, *supra* note 144, at 678–79, 690. *See* Fogarty v. United States, 780 F.2d 1005, 1011 (Fed. Cir. 1986); Baker v. United States, 748 F.2d 1465, 1467–70 (11th Cir. 1984); Farmers' & Merchants' Bank v. United States, 476 F.2d 406, 409–10 (4th Cir. 1973); United States v. Cocke, 399 F.2d 433, 451 (5th Cir. 1968); Exch. Parts Co. v. United States, 279 F.2d 251, 254 (Ct. Cl. 1960); Bookwalter v. Brecklein, 357 F.2d 78, 85–86 (8th Cir. 1966) (Johnson, J., dissenting); Conn. Ry. & Lighting Co. v. United States, 142 F. Supp. 907, 909 (Ct. Cl. 1956); Prabel v. Comm'r, 91 T.C. 1101, 1121 (1988), *aff'd*, 882 F.2d 820 (3d Cir. 1989); Becker v. Comm'r, 85 T.C. 291, 294 (1985); Teong-Chan Gaw v. Comm'r, 70 T.C.M. (CCH) 1196 (1995).

210. Section 7805(b) involves a "specific grant of discretion" and a court may impose consistency in the exercising the discretion granted under § 7805(b) "without at the same time contravening the intent of Congress as expressed in the Code." Zelenak, *supra* note 1, at 421.

law is not subject to discretion, but instead the discretion to exercise the substantive rule without retroactive effect must be tested.

Questions arising under application of § 7805(b) may be brought before courts of general jurisdiction or the more specialized United States Tax Court. While their experiences vary, the standard of review should not. Exceptions exist, but it is widely thought that "[g]eneralist judges live in mortal fear of tax cases."[211] In the more specialized Tax Court, nineteen judges, in the aggregate, average about 22,000 cases per year and render approximately 800 final decisions. Since a determination under § 7805(b) originates from a specific delegation by Congress, a de novo determination of the intricacies of tax law is not appropriate under either system. Instead, a court should apply a standard common to all judges—ascertaining whether the agency charged with the administration of the tax law and with the discretion to apply rulings prospectively under § 7805(b) abused its discretion.

In the discriminatory settlement cases and the abuse of discretion cases, courts seek to mitigate the evil of discriminatory treatment of similarly situated taxpayers.[212] In particular, abuse may arise in circumstances in which the IRS applies a ruling retroactively to one taxpayer and prospectively to another. In these circumstances, many interpretative discretion cases are often couched in the language of equal protection.[213] While equal protection may serve as an independent

211. Martin D. Ginsburg, *The Federal Courts Study Committee on Claims Court Tax Jurisdiction*, 40 CATH. U. L. REV. 631, 635 (1991). *See* J. Andrew Hoerner, *Peterson Blasts Proposal for National Court of Tax Appeals*, 46 TAX NOTES 1256, 1256 (1990) (referring to a "pervasive attitude that, '[t]ax law is a special form of witchcraft and should be left to the witch doctors, and that other mortals should not mess around with it, because of the danger that, like the sorcerer's apprentice, they might flood the workshop'" (quoting M. Carr Ferguson, Jr., Remarks at the Federal Bar Association Section of Taxation's 14th Annual Tax Law Conference (Mar. 2, 1990))); Learned Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947) ("In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most ordinate expenditure of time."). *See generally* Galler, *supra* note 62, at 1077–82.

212. *See* Avers v. Comm'r, 55 T.C.M. (CCH) 678, 693 (1988) (requiring "discriminatory selection" before relief can be granted); Fresoli v. Comm'r, 55 T.C.M. (CCH) 1624, 1626 (1988) (requiring plaintiffs to show "invidious discrimination" to prevail); Penn-Field Indus., Inc. v. Comm'r, 74 T.C. 720, 723 (1980) (same). *Cf.* Sibro Holdings, Inc. v. Comm'r, 476 F.2d 981, 987 (2d Cir. 1973) (stating that taxpayers are "entitled to a non-discriminatory administration of the tax laws"); Int'l Bus. Mach. Corp. v. United States (*IBM*), 343 F.2d 914, 923 (Ct. Cl. 1965) (finding "unjustifiable discrimination" and granting relief to taxpayer); Exch. Parts Co. v. United States, 279 F.2d 251, 254 (Ct. Cl. 1960) (holding that taxpayer cannot be "made the object of prejudicial discrimination").

213. Sibro Holdings, Inc. v. Comm'r, 509 F.2d 1220, 1222 (2d Cir. 1975) ("[E]ven-handed treatment should be the Commissioner's goal . . . ."); *IBM*, 343 F.2d at 920, 923 (citing "[e]quality of treatment" as the goal and noting that "fairness called upon the Commissioner . . . to establish a greater

ground, invidious discrimination such as race or religion should not provide the only basis for redress. Section 7805(b) provides a second avenue of relief for taxpayers.

Relief under § 7805(b) should be granted if a taxpayer satisfies a two-prong test. As a threshold matter, a taxpayer must be able to demonstrate that another similarly situated taxpayer received more favorable treatment, despite the taxpayer's request for the same treatment.[214] Second, the IRS must have abused its discretion under § 7805(b) when it used irrational or arbitrary classifications to differentiate among similarly situated taxpayers.[215]

The Supreme Court has held that the Commissioner has broad discretion, under § 7805(b) and its predecessors, to decide whether to revoke a ruling retroactively; that determination is reviewable by the courts only for an abuse of discretion.[216] Thus, in reviewing a decision of an administrative agency, a court "must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."[217] Under this standard, the "inquiry into the facts is to be searching and careful"; however, a court "is not empowered to substitute its judgment for that of the agency."[218] While

measure of equality").

214. *See* Austin v. United States, 611 F.2d 117, 120 (5th Cir. 1980) (requiring a taxpayer to first request a private letter ruling to challenge treatment compared to other taxpayers who obtained a private letter ruling).

215. *Fresoli*, 55 T.C.M. (CCH) at 1626 (noting that settlement offers based upon either impermissible considerations or an arbitrary classification may be improper discrimination); *Avers*, 55 T.C.M. (CCH) at 694 (stating that a "'rational reason for the disparate treatment must exist'" to avoid invalid discrimination (quoting Johnson v. Smith, 696 F.2d 1334, 1337 (11th Cir. 1983)). *See* Jett v. Blue Cross & Blue Shield of Ala., Inc., 890 F.2d 1137, 1139 (11th Cir. 1989) (holding that there is no distinction between the arbitrary and capricious and the abuse of discretion standard).

216. Auto. Club of Mich. v. Comm'r, 353 U.S. 180, 184 (1957). The broad discretion of the Commissioner under § 7805(b) is limited only by a finding of abuse. *Id.* at 183 (interpreting the predecessor to § 7805(b) of the 1954 Code). *See* Dixon v. United States, 381 U.S. 68 (1965). Where the exercise of respondent's discretion under § 7805(b) is questioned, however, a showing of discriminatory treatment of taxpayers who are similarly situated will tend to show an abuse of discretion. *Dixon*, 381 U.S. at 79; *Auto. Club of Mich.*, 353 U.S. at 180; *IBM*, 343 F.2d at 914; Weller v. Comm'r, 270 F.2d 294 (3d Cir. 1959); Goodstein v. Comm'r, 267 F.2d 127 (1st Cir. 1959).

217. Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971), *overruled on other grounds by* Califano v. Sanders, 430 U.S. 99 (1977) (citations omitted). *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983). *See also* AllGlass Sys. Inc. v. Comm'r, 330 F. Supp. 2d 540, 544 (E.D. Pa. 2004).

218. *Volpe*, 401 U.S. at 416. *See* Liti v. Comm'r, No. 03-71398, 2003 WL 23098587 (9th Cir. Dec. 19, 2003) (noting that courts cannot substitute their discretion); Zinniel v. Comm'r, 883 F.2d 1350, 1356 (7th Cir. 1989) (same); Balani v. INS, 669 F.2d 1157, 1162 (6th Cir. 1982) (same). Buzzetta Constr. Corp. v. Comm'r, 92 T.C. 641, 648 (same); Mailman v. Comm'r, 91 T.C. 1079, 1084 (1988), *rev'd on other grounds*, *In re* True v. Comm'r, 390 F.3d 1210 (10th Cir. 2004) (same); Pulver Roofing Co. v. Comm'r, 70 T.C. 1001, 1011 (1978) (same). As a result, taxpayers are required to clearly show that the Commissioner's action was arbitrary, capricious, or without sound basis in fact. Knight-Ridder

deference under an abuse of discretion standard is broad, it is not unlimited[219] and permits needed flexibility.[220]

The Sixth Circuit, while indicating that there is no magical formula to define abuse of discretion, described review under an abuse of discretion standard in the following manner:

> "Abuse of discretion" is a phrase which sounds worse than it really is. All it need mean is that, when judicial action is taken in a discretionary manner, such action cannot be set aside by a reviewing court unless it has a definite and firm conviction that the court below committed a clear error in judgment in the conclusion it reached upon a weighing of the relevant factors . . . [and] the inquiry is confined to whether such situation and circumstances clearly show an abuse of discretion, that is, arbitrary action not justifiable in view of such situation and circumstances.[221]

Congress clearly vested the Commissioner with the discretion to limit the retroactive application of any ruling, regulation, or Treasury decision when necessary to avoid inequities to and among taxpayers. Therefore, under current law, when a court reviews the legislative grant of authority to the Commissioner to limit retroactive application, the court's duty is simply to determine whether the IRS acted within its delegated authority.[222]

Arguments of consistency do not address the correct application of tax law to a particular set of facts, but instead insist on an ideal system of taxation that disregards the legislative powers conferred on Congress.[223] More specifically, Congress made the legislative choice to

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Newspapers v. United States, 743 F.2d 781, 788 (11th Cir. 1984); *Mailman*, 91 T.C. at 1084; Drazen v. Comm'r, 34 T.C. 1070, 1076 (1960).

219. Babai v. INS, 985 F.2d 252, 255 (6th Cir. 1993) (quoting Mejia-Carrillo v. INS, 656 F.2d 520, 522 (9th Cir. 1991)).

220. Pierce v. Underwood, 487 U.S. 552, 562 (1988).

221. *Balani*, 669 F.2d at 1160–61. *See* United States v. Finley, 301 F.3d 1000, 1007 (9th Cir. 2002) (applying abuse of discretion standard based on determination of "a definite and firm conviction" of error of judgment); United States v. Benavidez-Benavidez, 217 F.3d 720, 723 (9th Cir. 2000) (same); Gonzalez v. INS, 996 F.2d 804, 808 (6th Cir. 1993) (holding abuse of discretion to be an arbitrary action not justifiable in light of the facts and circumstances presented in the record); NLRB v. Guernsey-Muskingum Elec. Co-op., Inc., 285 F.2d 8, 11 (6th Cir. 1960) (same). The Ninth Circuit has articulated the standard in slightly different language. *See* Harman v. Apfel, 211 F.3d 1172, 1175 (9th Cir. 2000) (noting reversal under the abuse of discretion standard is possible only "when the appellate court is convinced firmly that the reviewed decision lies beyond the pale of reasonable justification under the circumstances.").

222. Galler, *supra* note 62, at 1049. *See* Schweiker v. Gray Panthers, 453 U.S. 34, 44 (1981); Henry P. Monaghan, *Marbury and the Administrative State*, 83 COLUM. L. REV. 1, 6 (1983) ("The court's interpretational task is . . . to determine the boundaries of delegated authority.").

223. *See* Richard M. Ireland, Jr., *Retroactivity and IRC § 7805—A Plea to the IRS to Exercise its Discretion to Limit its Discretion*, 28 LOY. L. REV. 483, 513 (1982) ("It is difficult to see how a taxpayer can maintain respect for a government or a judicial process when he is told that the reason the IRS can

grant discretion to the Secretary to apply rulings prospectively.[224] The question, therefore, is whether the agency—in this case the IRS—abused the discretion conferred by Congress.

F. Abuse of Discretion Standard Promotes More Uniformity than a Duty of Consistency

A common refrain in addressing matters relating to tax law is that "uniformity often trumps decisional methodology."[225] A difference exists, however, between uniformity (or consistency) by the IRS in the implementation of tax law and the uniformity (or consistency) of the courts in reviewing what the IRS has done administratively. In the former, the IRS applies the rule with uniformity as a goal. In the latter, courts have diverged in their reviews of administrative determinations, creating less uniformity.

Adopting a uniform abuse of discretion standard in cases falling within the parameters of § 7805(b) promotes more uniformity than the duty of consistency imposed on the IRS by a few courts. A duty of consistency, premised on *IBM*, invites courts to create law that is not grounded in substance but in the admirable goal of consistency.[226] Application of the abuse of discretion standard under § 7805(b) permits review of a decision of the agency charged by Congress with the administration of tax law and the court's determination is not predicated on the substantive issue before the court. In other words, an analysis under § 7805(b), whether correct or not, is grounded in a court's affirmative duty, premised on an act of Congress, to review decisions of

change its mind years after the taxpayer relied on its published announcement of what the law means is that the IRS does not make law.").

224. *See* I.R.C. § 7805(b)(8) (1996). *See also* § 7805 CCH Explanation ¶ 44282.0122 ("The law establishes a presumption of retroactive application of a temporary regulation unless retroactivity would be an abuse of the IRS's discretion or the IRS specifically states otherwise.").

225. Galler, *supra* note 62, at 1094. *See* Griswold, *supra* note 62, at 1159–60. *See also* Burnet v. Coronado Oil & Gas Co., 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting) ("[I]t is more important that the applicable rule of law be settled than that it be settled right.").

226. Many courts, not choosing to follow *IBM*, simply state that *IBM* has been strictly limited to its particular circumstances. It should be. However, these courts address this limitation in the duty of consistency area. That is incorrect. *IBM* did not create a duty of consistency and those courts attempting to distinguish it as a duty of consistency case begin their analysis with the wrong premise. Collins Music Co. v. United States, 21 F.3d 1330, 1336, 1337 n.12 (4th Cir. 1994) (questioning soundness of *IBM*); Diebold, Inc. v. United States, 16 Cl. Ct. 193, 213 (Cl. Ct.) ("*IBM* has been strictly limited to its particular circumstances."), *aff'd*, 891 F.2d 1579 (Fed. Cir. 1989); Carpenter v. United States, 7 Cl. Ct. 732, 739 (Cl. Ct. 1985) ("The Court of Claims subsequently restricted [*IBM*] to the particular circumstances of that case."), *aff'd*, 790 F.2d 91 (Fed. Cir. 1986); Bookwalter v. Brecklein, 357 F.2d 78, 84 (8th Cir. 1966) ("*IBM* was "not intended to be a blanket ruling" . . . .").

the IRS on an abuse of discretion basis. The abuse of discretion standard does not permit courts to create new law.[227] Moreover, the abuse of discretion standard is not a grant of equity jurisdiction that allows a court to substitute its judgment for that of the Secretary and does not give a court carte blanche authority to compel the IRS to be fair. Abuse of discretion review is simply a meaningful review of agency determinations.

V. CONCLUSION

Congress should amend § 7805(b) to broaden the scope of review of discretionary determinations by the Secretary. This amendment should permit courts to review decisions of the IRS under an abuse of discretion standard not only for applying a ruling "without retroactive effect," but also to permit review of the Secretary's decisions to apply a ruling retroactively. Such an amendment would eliminate an archaic remnant of the law and would remove the retroactive-prospective distinction with respect to private letter rulings, similar to the manner in which Congress removed the distinction with respect to regulations. Such an amendment would expand judicial review and, combined with adopting a uniform standard of abuse of discretion under § 7805(b), would produce greater uniformity in the treatment of similarly situated taxpayers, an aspiration lacking under a sporadically applied duty of consistency theory.

227. *See* Boys Mkts., Inc. v. Retail Clerks Union, Local 770, 398 U.S. 235, 258 (1970) (Black, J., dissenting) (arguing that the Court "should . . . interject itself as little as possible into the law-making and law-changing process"); Stockstrom v. Comm'r, 190 F.2d 283, 289 (D.C. Cir. 1951) (Prettyman, J., dissenting) ("I reluctantly dissent from the judgment of my brethren in this case. I wish the law were as they find it to be . . . ."). *See also* Amy Coney Barrett, *Statutory Stare Decisis in the Courts of Appeals*, 73 GEO. WASH. L. REV. 317, 340 (2005).