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Taxpayer Beware: A Jurisdictional Examination of Deference Owed to Revenue Rulings and the Case for Congressional Action

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TAXPAYER BEWARE: A JURISDICTIONAL EXAMINATION OF DEFERENCE OWED TO REVENUE RULINGS AND THE CASE FOR CONGRESSIONAL ACTION*

INTRODUCTION

For taxpayers and tax practitioners alike, the world of tax law is a unique moving target, subject to congressional politics and frequent revision.[1] The ever-evolving body of tax law consists of administrative rulings, regulations, statutes, and procedures, along with decisions from trial and appellate venues.[2] The intersection of administrative guidance provided by revenue rulings, revenue regulations, treasury rulings, and the judicial tax venues is a regular subject of debate.[3] Part of this controversy arises from taxpayers' reliance on the administrative guidance provided by the Internal Revenue Service ("IRS").[4] Taxpayers who inappropriately rely upon the IRS' administrative guidance can subject themselves to audits, tax levys, and other forms of prosecution.[5] Those taxpayers wishing to challenge their tax liabilities face difficult strategic choices as to selection of litigation venue.[6] Outstanding questions with respect to the IRS' ability to

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[1] *See* Michael Livingston, *Practical Reason, "Purposivism," and the Interpretation of Tax Statutes*, 51 TAX. L. REV. 677, 678 (1996) (acknowledging unique qualities of tax law including high level of detail and frequent revision).

[2] *See* Martin J. McMahon, Jr., Ira B. Shepard, Daniel L. Simmons, *Recent Developments in Federal Income Taxation: 2012,* 13 FLA. TAX REV. 503, 503 (2013) (acknowledging importance and utility of administrative rulings and regulations relative to Internal Revenue Code amendments).

[3] *See* Linda Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 OHIO ST. L.J. 1037, 1040 (1995) (advocating for judicial or legislative intervention to prevent unreasoned deference to revenue rulings). *But see;* Paul L. Caron, Symposium; *Tax Myopia Meets Tax Hyperopia: The Unproven Case Of Increased Judicial Deference to Revenue Rulings*, 57 OHIO ST. L.J. 637, 639-41 (1996) (criticizing Professor Galler's prior commentary concerning judicial deference to revenue rulings).

[4] *See* Benjamin J. Cohen & Catherine A. Harrington, *Is the Internal Revenue Service Bound by Its Own Regulations and Rulings*, 51 TAX LAW. 675, 681 (1998) (observing conflict arising from taxpayer's reliance upon revenue rulings arguably invalidated by retroactive administrative action).

[5] *See* Treas. Reg. § 601.104(c) (2013) (explaining means of IRS enforcement procedures including levys, liens, and penalties).

[6] *See* Linda Galler, *Emerging Standards For Judicial Review of IRS Revenue Rulings* 72

retroactively invalidate or amend revenue rulings may give taxpayers pause about relying upon the IRS' administrative guidance.[7] Additional questions exist as to whether a revenue ruling issued contrary to existing law may be used to the detriment of the taxpayer.[8] Revenue Ruling 2009-9[9] is an example of such a ruling, the invalidation of which may expose already aggrieved taxpayers to greater tax liabilities.[10] In the wake of the Bernard Madoff scandal, the IRS issued a revenue ruling in an apparent attempt to offer relief to those affected by the scandal.[11] This ruling allowed aggrieved parties to deduct the financial losses from the scheme as "theft losses" under I.R.C. § 165(e) despite having recorded the illusory gains associated with these investments as capital gains under I.R.C. § 1221.[12] This note will highlight difficulties faced by tax law litigators who utilize revenue rulings in litigation.[13] Following an overview of the sources of tax law, this note will provide an analysis of the historic relationship between

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B.U. L. REV. 841, 852-57 (1992) (providing overview of deference based upon IRS agency expertise); *see also* Galler, *supra* note 3 at 1039 (discussing varied deference given to administrative guidance by Tax Court and circuit courts of appeal).

[7] *See* 138 Cong. Rec. S1894-02, at *S1914 (daily ed. Feb. 20, 1992) (statement of Sen. Boren) (explaining difficulty faced by taxpayers if and when IRS may retroactively invalidate administrative guidance).

[8] *See* Dixon v. United States, 381 U.S. 68, 72 (1965) (theorizing IRS's erroneous ruling cannot prevent collection of tax liabilities due).

[9] Rev. Rul. 2009-9, 2009-14 I.R.B. 735 [*hereinafter Rev. Rul. 2009-9*].

[10] *See Rev. Rul. 2009-9*, 2009-1 C.B. 735 (providing taxpayers aggrieved by financial fraud relief from tax liabilities arising from illusory income.)

[11] *See id.* (recognizing tax liabilities created by illusory income from financial pyramid scheme). Although revenue rulings will not explicitly disclose what specific event, if any, gave rise to the ruling, every ruling presents a specific set of redacted facts which describe the circumstances under which taxpayers may utilize the rulings. *Id.*; *see also Understanding IRS Guidance-A Brief Primer*, IRS.GOV, http://www.irs.gov/uac/Understanding-IRS-Guidance---A-Brief-Primer (last visited November 3, 2012) (defining various regulations and rulings issued by the IRS). The tax law community widely understands this ruling to have been issued in direct response to the Madoff scandal, despite the lack of explicit references to Madoff within the ruling. *See* Jeffrey P. Coleman & Jennifer Newsom, *Can an Investment Become a Theft for Tax Purposes*, 84 FLA. BAR J. 27 (2010) (addressing circumstances surrounding IRS'S publication of *Rev. Rul. 2009-9*).

[12] *See Rev. Rul. 2009-9* (directing taxpayers to classify deductions as "theft losses"); *see also infra* note 152 and accompanying text (discussing significance of *Arrowsmith* ruling with respect to matching rule).

[13] *See infra* notes 33-43 and accompanying text (observing differences between three tax litigation venues and treatment of revenue rulings); *see also* Chevron v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) (observing history of judicial deference given to executive department administration of statutory authority through regulations). The *Chevron* Court recognized two-step analyses for courts reviewing an agency's regulation or other administration of statutory authority: determine whether Congress has "directly spoken to the precise question at issue" and if not, determine "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 842-43.

the courts and the IRS.[14] By using the so-called, "Madoff Ruling" this note will demonstrate the risks and strategic decisions faced in tax litigation in light of the ever-evolving standards of review afforded to the IRS' administrative guidance.[15] Tax practitioners and litigants must consider the varied levels of deference offered to revenue rulings when considering the proper venue for a refund or deficiency action. This note concludes by recommending that congress mandate the IRS follow the Administrative Procedures Act when issuing revenue rulings and procedures.

PART I: SOURCES OF TAX LAW

The primary source of tax law is found within the Internal Revenue Code.[16] Title Twenty-Six of the United States Code contains the codification of the Internal Revenue Code of 1986.[17] Similar to other statutory titles, the Internal Revenue Code contains a number of vague provisions, which Congress has delegated authority to the Treasury Department and the Internal Revenue Service to clarify.[18] Unlike many other areas, the Internal Revenue Code is subject to continuous redevelopment and political influence.[19] This continuous redevelopment is due, in part, to the actions of the Treasury Department and the IRS.[20] Despite being part of the execu-

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[14] *See* Christopher M. Pietruszkiewicz, *Discarded Deference: Judicial Independence In Informal Agency Guidance*, 74 TENN. L. REV. 1, 2-6 (2006) (discussing sliding scale of judicial deference to informal administrative guidance).

[15] *See id.* at 29-30 (reviewing two-prong *Chevron* test for determining level of deference afforded to administrative guidance).

[16] *See* 26 U.S.C. §§ 1-9834 (setting forth Internal Revenue Code).

[17] *See* I.R.C. § 7805(a) (authorizing Treasury Department to promulgate rules and regulations for enforcement of Internal Revenue Code).

[18] *See* I.R.C. § 7805(a) (discussing IRS's authority to administer the Internal Revenue Code).

[19] *See* Livingston, *supra* note 1, at 678 (acknowledging the complexity of tax law); *see also* Galler, *supra* note 6 at 841-42 (observing frequent and expeditious promulgation of revenue rulings); Galler, *supra* note 3 at 1088 (1995) (crediting "procedural ease" of issuance of revenue rulings with frequent and prompt publication by IRS).

[20] *See* I.R.C. § 7805(a) (authorizing Treasury Department to proscribe rules and regulations for enforcement of Internal Revenue Code); *see also* Bingler v. Johnson, 394 U.S. 741, 749-51 (1969) (acknowledging authority of Treasury to properly administer tax code); United States v. Moore, 95 U.S. 760, 763 (1877) (holding authoritative statutory construction is "always entitled to the *most* respectful consideration") (emphasis added). *Bingler* further recognized that treasury regulations must be sustained unless "unreasonable and plainly inconsistent with revenue statutes" and that they "should not be overruled except for weighty reasons." *Bingler*, 394 U.S. at 750 (quoting Comm'r v. South Tx. Lumber Co., 333 U.S. 496, 501 (1948)); *see also* Burnet v. S. & L. Bldg. Corp., 288 U.S. 406, 415 (1933) (holding Treasury Regulations were not "contrary to any positive provisions of the statute . . . [and] were both equitably and legally sound") (internal quotations omitted). While the Internal Revenue Code provides authority to the Treasury Department, it does not explicitly provide authority to the Internal Revenue Service as an agency of the Treasury Department for the proscription of such authoritative guidance. *See* I.R.C. §

tive branch, the Treasury Department's regulations and rulings are susceptible to congressional influence.[21] Treasury regulations are issued by the Secretary of the Treasury in order to clarify the statutory language and provide guidance to taxpayers in response to new legislation or recent judicial decisions.[22]

Revenue rulings and procedures are issued by the Internal Revenue Service in order to accomplish a similar goal, to respond to the facts posed within the ruling as a reflection of a current or anticipated issue pertaining to tax law.[23] Whereas revenue rulings provide an official interpretation of applicable tax law, revenue procedures provide guidance on how taxpayers may act on a ruling.[24] Among the greatest differences between treasury regulations and revenue rulings and procedures is their relative weight of authority; with treasury regulations being afforded greater authoritative weight.[25] The relative authority of the Treasury Department Regulations and IRS Revenue Rulings are reflected in the procedures necessary for their publication.[26]

7805(a).

[21] *See* Rev. Rul. 89-14, 1989-6 I.R.B. 6 (discussing weight given to Treasury regulations). As the agency responsible for the administration of the Internal Revenue Code, the Internal Revenue Service has the authority to promulgate regulations, rulings, and procedures in order to clarify the service's interpretation of the internal revenue code and related regulations and statutes. *See id.*; *see also* Karla W. Simon, *Congress and Taxes: A Separation of Powers Analysis*, 45 U. MIAMI L. REV. 1005, 1045-46 (1991) (discussing effect of congressional politics and exercise of power over Treasury and IRS).

[22] *See* I.R.C. § 7805(a) (authorizing Treasury Department to prescribe all needful rules and regulations for enforcement of internal revenue code).

[23] *See* Treas. Reg. § 601.601(d)(2)(v)(a) (2012) (stating revenue rulings will be directly responsive to "pivotal facts" as stated in ruling).

[24] *See* Treas. Reg. § 601.601(d)(2)(i) & (vi) (2012) (defining revenue procedures' role in providing guidance to taxpayers).

[25] *Compare* Treas. Reg. § 601.601(d)(2)(v)(d) (2012) (limiting force of revenue procedures to provide precedent for disposition of other cases), *with* I.R.C., Chapter I, Subchapter H, Part 601, *Statement Of Procedural Rules* (Feb. 23, 1976), *available at* 1973 WL 173329 ("Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations.").

[26] *See* 5 U.S.C. § 533(a), (c) (requiring rulemaking agencies to follow public notice procedures). The Treasury Department is bound by the Administrative Procedures Act to provide advance notice to the public and solicit comments before issuing any regulations. 5 U.S.C. § 553(a), (c). The public is, however, largely shielded from the promulgation of revenue rulings and procedures as review of proposed rulings and procedures takes place within the confines of the Internal Revenue Service. Treas. Reg. § 601.601(a) (1987); *see also* Revenue Ruling 2, 1953-1 C.B. 484 ¶ 6 (1953) (outlining internal procedure for publication of revenue rulings and procedures). *See also* Galler, *supra* note 6 at 842 (1992) (observing differences between publication requirements of revenue rulings, revenue procedures, and Treasury Department regulations). *But see* 5 U.S.C. § 801 (requiring submission of agency rulings to Comptroller General and Congress prior to receiving authoritative effect). Professor Galler posits that the standards of judicial review utilized in *Chevron* and *Davis*, discussed *infra*, should not be applied to revenue rulings and

Revenue Rulings have also evolved since their inception in the mid-1950s.[27] In addition to the IRS' authority to issue revenue rulings and procedures, it may also issue private letter rulings upon the request of a taxpayer.[28] These private letter rulings are not binding upon the IRS or the courts; however, they do represent the position of the IRS on a specific issue and are very useful for taxpayers who are willing to pay the price to elicit a private letter ruling.[29]

Venue is yet another critical point of consideration for a taxpayer in anticipation of litigation.[30] In addition to the aforementioned statutory and regulatory sources of tax law, there are numerous judicial venues rendering decisions that affect the ever evolving body of tax law.[31]

The three federal courts with jurisdiction over issues of tax law are: United States Tax Court, United States Court of Federal Claims, and United States District Court.[32] Of particular importance to this analysis is the level of deference, if any, these venues offer to revenue rulings.[33] The nature of the action is determinative of what type of forum may or should be chosen.[34]

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procedures because to do so would obviate the need for compliance with the Administrative Procedures Act and presupposes that Congress will act to correct a statutory ambiguity when a court offers deference to an agency opinion, such as a revenue ruling. *See* Galler, *supra* note 6 at 891-92.

[27] *See* Rev. Rul. 212, 1953-2 C.B. 449 (expanding publication of revenue rulings to include *inter alia* procedures affecting taxpayers' rights or duties).

[28] *See* Treas. Reg. §601.201(a)(2) (2002) (allowing for IRS issuance of private letter rulings).

[29] *See* Robert S. Schwartz, *What You Should Know About Obtaining IRS Private Letter Rulings*, 17 No. 1 PRAC. TAX. LAW. 49, 52 (2002) (observing approximate $6,000 cost of a private letter ruling).

[30] *See* Gerald A. Kafka & Rita A. Cavanaugh, *Available Forums For Tax Litigation*, LITIGATION OF FEDERAL CIVIL TAX CONTROVERSIES ¶ 1.01 (arguing tax cases present important judgmental decisions for litigant, including forum).

[31] *See* TAX CT. R. 13 (stating jurisdiction limited to taxpayers issued deficiency notice from Commissioner of Revenue).

[32] *See id.* (outlining judicial forums with jurisdiction over tax law issues). Implicit in the Tax Court's rule conferring jurisdiction and standing upon litigants is the requirement that a taxpaying litigant not have paid her outstanding tax liability before challenging it in the Tax Court; *see also* I.R.C. § 6213 (providing statutory authority for taxpayers to challenge deficiency notices in the Tax court); I.R.C. § 7422 (1998) (defining basis for standing before district court and United States Court of Federal Claims). Taxpayers seeking to challenge a deficiency assessment must decide whether to pay the deficiency and bring their case before a jury in a trial court or refuse payment and depend upon the tax expertise of the United States Tax Court judges. Galler, *supra* note 6, at 886 (explaining difficulty faced by taxpayer challenging revenue ruling).

[33] *See* Vons Cos., Inc. v. United States, 51 Fed. Cl. 1, 7-9 (2001) (reviewing spectrum of deference offered by tax litigation venues to revenue rulings); *see also* Galler, *supra* note 3 at 1038 (observing varied levels of authority offered to revenue rulings).

[34] *See* Gerald A. Kafka, *Choice of Forum In Federal Civil Tax Litigation (Part 1)*, 25 No. 2 PRAC. TAX. LAW. 55, 56 (2011) (describing two classes of tax litigation: deficiency and refund).

PART II: TAX LITIGATION VENUES AND LEVELS OF REVIEW

The Tax Court has jurisdiction over deficiency actions where the litigant taxpayer has yet to fulfill his alleged tax liability and wishes to contest it after receiving a deficiency notice.[35] The Court of Federal Claims and the U.S. District Courts have jurisdiction over refund actions only where the petitioner taxpayer is attempting to collect a disputed tax refund.[36] In addition to the particular jurisdictional requirements for practice before the tax court and the decisions that must be made with respect to the payment of alleged tax liability, there are other strategic considerations for a tax litigant considering a deficiency action.[37]

In order for the Tax Court to have and continue to retain jurisdiction over the litigant's case, the IRS must have issued the taxpayer a deficiency notice.[38] The Tax Court may gain jurisdiction over a case if the taxpayer litigant files a petition for redetermination within ninety days of the mailing of the deficiency notice.[39] The tax deficiency must remain unresolved in order for the Tax Court to retain jurisdiction, however interest penalties will continue to accrue while the Tax Court litigation progresses.[40] The nature of proceedings before the Tax Court represents another

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Deficiency actions occur when the IRS issues a notice of deficiency to the taxpayer. If the taxpayer has paid his tax liability, but later wishes to dispute it and obtain a refund, he may do so before the United States District Court or the United States Court of Federal Claims. *Id.* at 60-61.

[35] *See* TAX CT. R. 13(a), (b) (establishing jurisdictional requirements for tax court litigants).

[36] *See* Kafka, *supra* note 34 at 56-59 (describing jurisdictional requirements of the United States Court of Federal Claims and District Courts).

[37] *See* Comm'r v. Sunnen, 333 U.S. 591, 598 (1948) (holding subsequent tax litigation on similar issues for different tax year not limited by estoppel). Due to the annual nature of tax liability and the methods of litigation, doctrines of res judicata and collateral estoppel are somewhat limited. *Id.*; *see also* Gerald A. Kafka & Rita A. Cavanaugh, *Res Judicata and Collateral Estoppel in Civil Tax Litigation*, LIT. FED. CIV. TAX CONTROVERSIES ¶ 22.01 (discussing unique aspects of tax litigation and issue and claim preclusion).

[38] *See* I.R.C. § 6212(a) (providing Secretary of Treasury authority to issue taxpayers notices of deficiency of tax payment). The opportunity for litigation before the Tax Court opens upon the mailing of the notice. I.R.C. § 6213(a).

[39] *See* I.R.C. § 6213(a) (describing filing requirements for Tax Court petitions); *see also* Kafka, *supra* note 34, at 61-62 (describing implications of missing the filing deadline). The Tax Court has no authority to extend the filing deadline. Joannou v. Comm'r, 33 T.C. 868, 869 (1960); *see also*, Kafka, *supra* note 34, at 61-62 (discussing harsh consequences of missing filing deadline).

[40] *See* Kafka, *supra* note 34, at 61 (describing issues regarding interest accrual during pendency of Tax Court litigation). The IRS issued a revenue procedure addressing interest accrual and providing guidelines under which taxpayer litigants may place a deposit down in lieu of the payment of the disputed tax. *See* Rev. Proc. 2005-18, 2005-1 C.B. 798. By providing a deposit while not satisfying the disputed tax, the Tax Court will retain jurisdiction and the interest accrual will be mitigated. *Id.*

significant difference between the three tax litigation forums.[41]

In deficiency matters where the amount in dispute is $50,000 or less, litigants may elect to have their case docketed and tried as a "small tax case."[42] Depending upon the nature and strength of the case, litigants who qualify for small tax case litigation may enjoy the informal nature of the proceedings and the relaxed rules of evidence.[43] Small tax case litigants face the possibility of having an unfavorable judgment entered, which is not subject to any subsequent judicial review.[44] In addition to the restrictions on judicial review, the Tax Court judges who sit before a small tax case are restricted in their ability to re-determine the litigant's tax liability beyond the amount placed in controversy before the court.[45] Outside of the small tax case scenario, tax court judges may issue findings and judgments that increase the petitioner's tax liability beyond the amount in controversy at the inception of the case.[46]

Unlike the federal judges presiding over the District Courts, the judges who preside over the Tax Court are the sole fact finders, as a jury does not sit during cases before this court.[47] Tax Court judges are well informed to be the sole finder of facts because all judges are former tax practitioners.[48] A Tax Court judge's specialized knowledge of the tax law may

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[41] *See* I.R.C. § 7463(c) (providing procedures for tax litigants where amount in controversy less than $50,000). These proceedings, known as small tax cases take a slightly different form than other proceedings before the Tax Court. *Id.*

[42] *See* TAX CT. R. 171 (allowing litigant election of "small tax case" status under certain circumstances).

[43] *See* TAX CT. R. 174(b) (stating small tax court litigation be as informal as possible with relaxed rules of evidence). The Tax Court rules provide for less stringent rules governing the admissibility of evidence with admissibility contingent upon the court's determination of probative value. *Id. Contra* TAX CT. R. 143(a) (stating evidentiary rules for other tax court cases governed by federal rules of evidence).

[44] *See* I.R.C. § 7463(b) (stating decision rendered by Tax Court judges are not subject to any judicial review).

[45] *See* I.R.C. § 7463(c) (describing restrictions placed upon a judge presiding over a small tax case). This section of the Code illustrates an important distinction between the authority of a small tax case judge and other Tax Court judges. *Id.*

[46] *See* I.R.C. § 6214(a) (allowing for a redetermination of tax liability in excess of initial amount in controversy). Despite the Tax Court's authority to redetermine the petitioner's tax liability in light of other tax years not at issue, the court does not have the authority to determine whether the petitioner's tax liability for other years was overpaid or underpaid. *Id.*

[47] *See* Wickwire v. Reinecke, 275 U.S. 101, 105 (1927) (observing jury trial in tax cases not guaranteed by Constitution); *see also* Phillips v. Comm'r, 283 US. 589, 599 n.9 (recognizing *Wickwire* ruling). The *Wickwire* Court held that the unavailability of a jury trial in proceedings intended to recover disputed property does not violate the taxpayer's due process rights. *Wickwire*, 275 U.S. at 106.

[48] *See About the Court,* USTAXCOURT.GOV, (last updated May 25, 2011) http://www.ustaxcourt.gov/about.htm. The United States Tax Court's official website makes clear that, the Tax Court judges, "apply [their expertise] in a manner to ensure that taxpayers are

provide litigants with a significant advantage but also stands to deprive litigants the benefit of theater as the tax judges will not be swayed in the same way as jurors.[49] The tax court also represents one extreme end of the spectrum of deference described by Professor Galler and recognized by the Court of Federal Claims in *Vons Companies Inc. v. United States*.[50] The *Vons Companies Inc.,* court cited a line of cases arising from the Tax Court wherein trial and appellate judges have opined that a revenue ruling is no more than the opinion of one litigant and thus entitled to no special deference.[51] Although commentary and dicta regarding tax court jurisprudence suggests the court has little regard for revenue rulings, the decisions of these courts are decidedly inconsistent.[52] These unique substantive and procedural characteristics inform a particular practitioner's decision as to which forum is most proper and preferable for her client's case.[53] Although the majority of tax law cases are heard before the U.S. Tax Court,

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assessed only what they owe, and no more." *Id.*; *see also* Robert E. McKenzie, Jeffry J. Erney, Thomas J. Callahan & Gregory J. Gawlik, *Deciding to Litigate in Tax Court*, REPRESENTATION BEFORE THE UNITED STATES TAX COURT § 1:4 (observing Tax Court Judges' prior experience with tax practice).

[49] *See* McKenzie, Erney, Callahan & Gawlik, *supra* note 48 (outlining disadvantages posed by lack of jury trials). In addition to the uselessness of theatric strategy before the Tax Court, the Tax Court's reliance and use of legal precedent is another distinguishing factor. *Id.* Although the Tax Court is not bound by decisions of the U.S. District Court or the U.S. Court of Federal Claims, it is bound by prior decisions of the full U.S. Tax Court, "T.C." opinions. *Id.*

[50] *See* Vons Co., Inc. v. United States, 51 Fed. Cl. 1, 7 (2008) (observing Tax Court occupies extreme end of Professor Galler's spectrum, according revenue rulings little weight).

[51] *See id.* ("[T]he Tax Court[…]has historically held that revenue rulings merely [] represent the position of one of the parties.") (internal quotation omitted). In support of its assertion that the tax court is disinclined to defer to revenue rulings, the *Vons Companies Inc.* court relied upon a number of prior cases. *See id.* (citing Estate of Kosow v Comm'r, 45 F.3d 1524, 1529 (11th Cir. 1995) (finding taxpayers may rely defensively upon revenue rulings but not with legal force and effect); Stubbs, Overbeck,& Assoc., Inc. v. United States, 445 F.2d 1142, 1146-47 (5th Cir. 1971) (disagreeing with government by finding revenue ruling mere opinion of agency attorney); and Brown v. Comm'r, 73 T.C. 723 (1980) (Hall, J. Concurring) (refusing to credit IRS position expressed in revenue ruling with force of law)). *But see* Tedoken v. Comm'r, 84 T.C.M. (CCH) 657, at *4 -*5 (2002) (relying on *Mead* to hold that revenue ruling in question "commands" deference); *see also* AM. BAR ASS'N, *ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 TAX LAW. 717, 770 (2004) (arguing Tax Court's approach to revenue rulings appears affected by *Mead*).

[52] *Compare*, *Tedoken*, 84 T.C.M. (CCH) 657, at *4 -*5 (finding revenue ruling "commanded deference"), *with* Trinova Corp. and Subsidiaries v. Comm'r, 108 T.C. 68 (1997) (disagreeing with Second and Ninth Circuits' level of deference to revenue rulings), *rev'd sub nom.* Aeroquip-Vickers Inc., v. Comm'r, 347 F.3d 173 (6th Cir. 2003). The Sixth Circuit Court's decision in *Aeroquip-Vickers* acknowledged the change in direction taken upon reversing the Tax Court's ruling and finding that, in light of recent Supreme Court jurisprudence, revenue rulings should be afforded some degree of deference. *Id.* at 180.

[53] *See supra* notes 38-42 and accompanying text (discussing unique procedural and substantive aspects of the Tax Court); *see also Wickwire*, 275 U.S. at 105 (discussing lack of jury trial rights before Tax Court).

the U.S. District Courts and the U.S. Court of Federal Claims offers litigants certain procedural and substantive advantages unavailable to tax court litigants.[54] However, as outlined above, a litigant's opportunity to appear before the Court of Federal Claims or the U.S. District Court depends upon his ability and willingness to pay the deficiency.[55]

The Court of Federal Claims offers another forum for tax litigation.[56] In contrast to the Tax Court, the U.S. Court of Federal Claims has jurisdiction over tax refund cases.[57] If a taxpayer is able to pay the disputed tax liability and file a petition for refund in the U.S. Court of Federal Claims, the attorneys of the Department of Justice undertake the defense of the IRS' position.[58] Prior to the litigant's petition to the U.S. Court of Federal Claims, the IRS had primary responsibility over discovery and the administrative proceedings.[59] The *de novo* nature of the proceedings before the Claims Court presents litigants with the burden of effectively retrying their case against different attorneys from the Department of Justice.[60] Just as the Tax Court has unique procedural rules, practice before the U.S. Court of Federal Claims is governed by statute and the rules of procedure

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[54] *See* Kafka, *supra* note 34, at 57 (2011) (providing data for 2007 regarding distribution of cases over three tax forums).

[55] *Id.* (explaining strategic considerations for Tax Court litigation including continuous accrual of interest on deficiency). It is suggested that the taxpayer litigant who wishes to proceed but avoid the interest accrual could attempt to make a deposit in order to suspend the accrual of interest while their litigation proceeds. Rev. Proc. 2005-18, 2005 I.R.B. 798; *see also infra* note 101 (reviewing Tax Court decisions addressing deference afforded to revenue rulings). In addition to considering the proper trial venue for a refund action, a taxpayer litigant should consider the governing law of the federal circuit in which she is choosing to litigate, which is a practicable undertaking because the Tax Court is bound by the precedent of the federal circuit in which the taxpayer resides when the case is filed. *See* I.R.C. 7482(b).

[56] *See* Kafka, *supra* note 34, at 56 (explaining Court of Federal Claims' ability to hear tax cases).

[57] *See Jurisdiction of U.S. Court Of Federal Claims In Refund Cases*, FED. TAX COORDINATOR U-6004 (2d.) (explaining Court of Federal Claims jurisdiction). The jurisdiction of the Court of Federal Claims is governed in part by the "*flora*." *Id.* This rule arose from the case of Flora v. United States, 357 U.S. 63, 75-76 (1958), *reh'g denied* 362 U.S. 972 (1960) (agreeing with Congressional study regarding utility of Tax Court vis-à-vis Court of Federal Claims).

[58] *See* Int'l Paper Co. v. United States, 36 Fed. Cl. 313, 322 (1996) (observing tax litigation before Court of Federal Claims is *de novo* proceeding).

[59] *See id.* (observing Claims Court tax litigation is not akin to a quasi-appellate venue). The *International Paper* court also noted that because of the *de novo* nature of the proceedings, litigants may not rely upon admissions or fruits of administrative discovery with the IRS prior to the inception of the Claims Court Case. *Id.*

[60] *See id.* (suggesting pre litigation agreements, stipulations, or admissions by the IRS are nonbinding on the government). Further, the *International Paper* Court states that in addition to being non-binding, admissions by the IRS may be wholly irrelevant.

slightly different from the Federal Rules of Civil Procedure.[61]

In order to bring a refund action against the IRS in the US Court of Federal Claims, the litigant must have paid the outstanding contested tax.[62] The taxpayer litigant must also file a claim for refund with the Secretary of the Treasury prior to filing suit.[63] The Treasury Department has also issued a regulation requiring the taxpayer litigant to provide sufficient facts justifying she claim for a refund.[64] The claim is subject to a three year statute of limitations, which begins to run upon the filing of the contested return.[65] Once the notice requirements are satisfied, the case is commenced through the same procedure in other civil venues; through filing a complaint.[66]

Refund litigation is also available to litigants before the U.S. District Courts, and the procedure before these courts is governed by the Federal Rules of Civil Procedure.[67] The U.S. District Court hears the least amount of refund cases of the three available tax litigation forums.[68] Of the few tax cases pending before the U.S. District Court, even fewer proceed to a trial.[69]

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[61] *See* 28 U.S.C. §§ 1491-1509 (establishing jurisdiction of the U.S. Court of Federal Claims and rules of procedure).

[62] *See* Waltner v. United States, 98 Fed. Cl. 737, 752 (2011) (observing legitimacy of "flora rule" in partially granting government's motion to dismiss); Flora v. United States, 357 U.S. 63, 72-73 (1958), *aff'd on reh'g* 362 U.S. 145 (1960) (holding jurisdiction of Court of Federal Claims dependent upon full payment of tax liability).

[63] *See* I.R.C. § 7422(a) (requiring taxpayers file claim with IRS prior to commencing refund suit).

[64] *See* Treas. Reg. § 301.6402-2(b)(1) (1967) (requiring notice set forth specific facts and grounds sufficient to describe exact basis of claim). The sufficiency of detail also extends to the original tax filing itself. *See* Waltner v. United States, 98 Fed. Cl. 737, 760 (2011) (observing tax returns claiming zero wages on 1040 insufficient for purposes of establishing claim).

[65] *See* I.R.C. § 6511(a) (providing three-year window during which a refund claim may be filed). The statute also provides for limitations on the amount of a refund by prohibiting the refund from exceeding the portion of the tax paid within that three-year period. *Id.* at § 6511(b)(1). This statute of limitations applies to all refund actions brought before the Court of Federal Claims and the United States District Courts. *Id.* at § 6511(a).

[66] *See* FED. R. C. CT. 3, *available at* http://www.uscfc.uscourts.gov/sites/default/files/court_info/20130813_rules/13.08.30%20Final%20Version%20of%20Rules.pdf (allowing an action to commence through filing a complaint).

[67] *See* Gerald A. Kafka, *Choice of Forum in Federal Civil Tax Litigation (Part 2)*, 25 No. 3 PRAC. TAX LAW. 51, 52-59 (2011) (comparing three tax litigation forums).

[68] *See* Kafka, *supra* note 34, at 60 (displaying chart describing caseload of tax litigation forums in 2007). While the Tax Court handled 29,040 tax cases with $23.5 billion in controversy in 2007, the amount in controversy before the U.S. District Courts combined was only $5.5 billion among 219 cases. *Id.* The Court of Federal Claims handled even fewer cases with only ninety-six cases filed in 2007 and $2.7 billion in controversy. *Id.*

[69] *See id.* (observing dearth of tax cases proceeding to trial).

PART III: DEGREES OF DEFERENCE

Before considering the avenues of relief for aggrieved taxpayers it is important to recognize the varied levels of deference offered to revenue rulings.[70] Although the Supreme Court has yet to rule on whether revenue rulings, in particular, are afforded any level of judicial deference; the Court has offered guidance as to how courts should interpret and defer to administrative rulings, generally.[71] Most recently in *United States v. Mead Corp*,[72] the Court reviewed and reaffirmed the means of judicial review offered by the Court in both *Skidmore v. Swift & Co.*[73] and *Chevron v. Natural Res. Def. Council, Inc.*[74] In order to fully appreciate the significance of the *Mead* ruling, it is necessary to first step back and examine its predecessors; beginning with *Skidmore*.[75]

In *Skidmore,* the Court examined the weight of an administrative interpretation published by the administrator of the Fair Labor Standards Act.[76] At issue in the lower court was the definition of "hours worked" under the Fair Labor Standards Act.[77] The Administrator's interpretation of this definition was significant because it determined whether the petitioners

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[70] *See* AMER. BAR ASS'N, *supra* note 51, at 768-71 (reviewing varied levels of deference afforded by tax litigation venues).

[71] *See* O'Shaughnessy v. Comm'r. of Internal Revenue, 332 F.3d 1125, 1130 (8th Cir. 2003) (observing Supreme Court's reluctance to decide if revenue rulings entitled to judicial deference). The Eighth Circuit relied upon *Cleveland Indians Baseball Co.* wherein the Supreme Court explicitly declined to decide whether revenue rulings are entitled to deference. *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001). The *Cleveland* Court determined that the revenue ruling in question was entitled to substantial judicial deference due to the reasonableness of its interpretation. *Id.*

[72] 533 U.S. 218 (2001).

[73] 323 U.S. 134 (1944).

[74] 467 U.S. 837 (1984).

[75] *See Skidmore*, 323 U.S. at 140 (holding deference owed to administrative decisions rulings and interpretations dependent upon individualized factors). The *Skidmore* Court concluded that parties may rely upon administrative rulings, interpretations, and opinions and the extent of their persuasive value would depend upon "thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade." *Id.*; *c.f. Chevron*, 467 U.S. at 842-44 (holding when Congress has not spoken directly on issue, courts defer to permissible agency interpretations), Davis v. United States, 495 U.S. 472, 484 (1990) (stating Service's interpretative rulings owed "considerable weight" where they involve contemporaneous statutory construction.); United States v. Mead Corp., 533 U.S. 218, 238 (2001) (holding judicial review of administrative actions must continue on a spectrum between *Chevron* and *Skidmore*).

[76] *See Skidmore,* 323 U.S. at 139 (reviewing authority of Secretary of Labor to implement Fair Labor Standards Act). Similar to the role of the IRS in issuing interpretive opinions like revenue rulings, the Administrator publishes the Interpretive Bulletin. *Id.* at 137-38.

[77] *Id.* at 138-39 (explaining Administrator's reasoning in holding that "hours worked" includes all time given to employer).

could sustain a cause of action under the Act.[78] Although the Court recognized that the Administrator's interpretations and conclusions did not arise from any adversary proceeding, it also recognized that the Administrator's policies deserve some level of respect.[79] Based upon the experience and apparent expertise of the Administrator, the Court concluded that the "[R]ulings, interpretations and opinions of the Administrator under [the] Act . . . do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance."[80]

The Court next undertook an analysis of a similar issue approximately forty years later in *Chevron*.[81] *Chevron* concerned the Environmental Protection Agency's definition of "stationary source" within the context to the Clean Air Act and its 1977 amendments.[82] The *Chevron* Court's analysis of the EPA's definition rested upon the Court's earlier finding that the latitude of an administrative agency to promulgate regulations and rules depends upon the nature of regulatory gaps left by Congress.[83] The *Chevron* Court recognized Congress' ability to implicitly or explicitly leave gaps in legislation and a court's review of an administrative agency's inter-

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[78] *Id.* (summarizing trial court's conclusion that "hours worked" did not include time alleged as overtime).

[79] *Id.* at 140 (recognizing weight previously given to Treasury Regulations and other non-adversarial regulations and interpretations). The Court also recognized the Administrator's acquisition of knowledge of labor and employment issues through the execution of congressionally mandated responsibilities. *Id.*

[80] *See id.* (observing that administrative interpretation's thorough nature, consistency and valid reasoning give interpretation persuasive effect). The Administrator's ability to formulate policies based upon specialized experience and broader investigation and information was contrasted with the ability of a court to make factual findings based upon an adversary proceeding. *Skidmore*, 323 U.S. at 140. In addition to highlighting the utility of the Administrators interpretations, the Court emphasized that the interpretations, rulings and opinions do not bind the courts to any particular position. *Id.*

[81] 467 U.S. 837 (1984).

[82] *Id.* at 840 (outlining requirements under amended Clean Air Act for "non-attainment" States to establish regulatory framework). "Non-attainment" states were those that had not met the national air quality standards as defined under the Act before it was amended in 1977. *Id.* at 839-40. The litigation giving rise to the Supreme Court's consideration of this issue was the Environmental Protection Agency's ("EPA") interpretative definition of "stationary source" as referenced in the Clean Air Act. *Id.* at 841. The Circuit Court of Appeals for the District of Columbia Circuit ruled in favor of the industry respondents based upon its finding that the "bubble concept" to which the "stationary source" definition applied, was not applicable to the programs designed to improve air quality. *Id.* Upon granting the petition for review, the Supreme Court concluded the D.C. Circuit erroneously adopted a definition of "stationary source" separate from the EPA definition. *Id.* at 842. Essential to this error was the D.C. Circuit's finding that Congress had not instructed the EPA to provide a definition of "stationary source" and thus the application of their definition was an error. *Id.* at 841-42.

[83] *See* Morton v. Ruiz, 415 U.S. 199, 231 (1974) (holding administrative agency's power includes rule and policy making).

pretative authority.[84] *Chevron* conducted an examination of the relevant legislative history leading to the amendments of the Clean Air Act and the EPA's interpretative rulings.[85] Based upon its examination, the Court concluded that the legislative history was not enlightening and found that "stationary source" was.[86] The Court further observed the EPA's ability to modify its interpretation of the definition, and expressed approval of the EPA's reinterpretation of "stationary source" to be the same regardless of whether it is applied to "non-attainment" states or the prevention of serious deterioration in areas already in compliance with the Act.[87]

The Court undertook a similar but separate analytical approach when examining the meaning of the phrase "for the use of" as used in a treasury regulation.[88] *Davis* was yet another tax case wherein the Court determined that the Service's administrative guidance is owed a certain level of deference.[89] The petitioners in this case attempted to make a charitable deduction of certain amounts they provided to their children in connection with missionary work undertaken by their church.[90] The petitioners had taken the charitable deduction for these donations on an amended tax return

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[84] *See* Chevron v. Natural Res. Def. Counsel, 467 U.S. 837, 843-44 (1984) (recognizing Congress's ability to expressly or implicitly delegate authority to administer statutes). Administrative regulations promulgated to fill a statutory gap, purposefully left open by Congress, have authoritative weight *unless* "arbitrary, capricious or manifestly contrary" in relation to the statute it is meant to give effect to. *Id.* If a court finds that Congress has implicitly left a gap in authority granting legislation, a court is prohibited from substituting its own interpretation of statutory construction in place of a reasonable administrative interpretation. *Id.* at 844.

[85] *See id.* at 848-59 (examining legislative history and highlighting EPA's regulatory interpretation in response to Congressional action). The industry respondent essentially argued that the EPA's definition of "stationary source" was contrary to the statute authorizing such rulemaking. *See id.* at 859.

[86] *See id.* at 862 (recognizing Congressional intent to expand the scope of the EPA's regulatory power).

[87] *See id.* at 863-64 (concluding that agency's adoption of different definitions of certain statutory phrases supports definition's flexibility). The Court further observed that the EPA was motivated by a desire to balance the interest of industry members and environmental advocates when it provided its interpretation of the statutory language. *Id.* at 865. The Court also recognized the EPA's expertise in the area of environmental protection and in turn, the judiciary's lack of such expertise. *Id.*

[88] *See* Davis v. United States, 495 U.S. 472, 476-77 (1990) (reviewing petitioner's argument concerning meaning of "for the use of" relative to donations to son).

[89] *See id.* at 484-85 (holding administrative rulings are owed *considerable* weight under certain circumstances).

[90] *See id.* at 474-75 (detailing the missionary work undertaken by the petitioner's church). As members of the Church of Jesus Christ of Latter-day Saints, the petitioners were instructed to provide their children with a designated amount of money, which was deemed necessary for the missionary work performed by the children through the Church. *Id.* at 474. This money was used directly by the children and was not held by the Church. *Id.*

under the charitable deduction rules under the Internal Revenue Code.[91] The Court's review of the Ninth Circuit's decision in *Davis* rested upon the definition of the word "use" and the numerous enactments and reenactments of the Internal Revenue Code as well as the administrative interpretations provided by the IRS.[92] Central to subsequent revenue rulings and judicial decisions was the idea that a qualified recipient of a deductible donation must have a certain amount of control over the ultimate disposition of the donated funds.[93] The *Davis* Court ultimately relied upon the contemporaneous nature of the IRS' interpretations relative to congressional amendments of the Internal Revenue Code in order to find in favor of the IRS.[94] Rather than relying on its decision in *Chevron*, the *Davis* Court created a new but similar path; finding that timing and consistency of administrative rulings warrants an award of considerable weight.[95]

United States v. Mead appeared to have further clarified the *Chev-*

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[91] *See* I.R.C. § 170(c)(2)(B) (allowing deductions of amounts given for church's use, among other approved recipients). The IRS refused to issue a refund based upon the amended returns and the petitioners filed a lawsuit in the United States District Court for the District of Idaho. *Davis*, 495 U.S. at 477. The District Court granted the government's motion for summary judgment, a decision that was affirmed by the Ninth Circuit Court of Appeals. *Id.*; *see also* Davis v. United States, 861 F.2d 558, 565 (9th Cir. 1988) (affirming judgment of district court).

[92] *See Davis*, 495 U.S. at 477-79 (reviewing common definitions of "for the use of"). *Compare* Revenue Act of 1921, H.R. 4285, 67th Cong. (1st Sess. 1921) (including "for the use of" language relative to the deductibility of charitable donations) *and* I.R.C. § 170(c) (containing language of amended Internal Revenue Act and "for the use of" language), *with* Rev. Rul. 55-275, 1955-1 C.B. 295 (defining "for the use of" as similar to "in trust for") *and* Rev. Rul. 194, 1953-2 C.B. 128 (also relying upon "in trust" analogy in defining "for the use of").

[93] *See Davis*, 495 U.S. at 483 (acknowledging IRS argument in favor of "for the use of" accounts for significant legislative history). The IRS interpretation of "for the use of" statutory language was credited for being contemporaneous to Congress' amendment of the Internal Revenue Act of 1921 to include such charitable donations as deductions in order to encourage charitable donations. *See id.* at 483-84. The *Davis* Court further observed that Congress' subsequent 1964 amendment to I.R.C. § 170 was intended to ensure that deductible donations were actually made *to* a charity instead of to a "trust" that may or may not ensure a charitable disposition of donated funds. *Id.* at 484; s*ee also* S. REP. No. 88-830, at 59-60 (1964) (discussing prevalence of delay of charitable donations reaching intended charity).

[94] *See* Davis v. United States, 495 U.S. 472, 485 (observing consistency with congressional intent and statutory language legitimizes IRS's interpretation). The Court further observed that the IRS interpretative rulings bear the same considerable weight despite the IRS's ability to adopt other contrary interpretations in the future. *See id.*

[95] *See id.* at 484-85 (discussing significance of contemporaneous issuance of revenue rulings relative to underlying statute); *see also* Galler, *supra* note 3, at 1073-74 (questioning utility of "longstanding" as quality of revenue ruling due considerable weight). Professor Galler interpreted the various methodologies outlined in her article as a sign that federal courts are generally searching for the best means to defer to the IRS's various interpretative rulings. *Id.* at 1074. Professor Galler further argues that the Tax Court is less deferential to IRS administrative rulings and interpretations due to the unique expertise of tax court judges. *See id.* at 1074-75.

ron position.[96] The *Skidmore* decision was later highlighted by the *Mead* Court as representing one end of the spectrum of judicial deference offered to administrative rulings.[97] According to *Mead*, the level of judicial deference may fall within a broad spectrum ranging from *Chevron* to *Skidmore*.[98] *Mead*, however, did not alleviate the confusion among the lower courts as to what level of deference and review, if any, should be applied to revenue rulings.[99] The varied levels of deference and review applied by the lower courts should force to tax practitioners to proceed with caution when evaluating the various venues available to their clients.[100] These approaches to judicial deference will be utilized in light of the Madoff Ruling discussed in Part V.

Despite the acknowledged difference between treasury regulations and revenue rulings, the amount of deference offered to treasury regula-

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[96] *See* United States v. Mead Corp., 533 U.S. 218, 237-38 (2001) (holding *Chevron* did not change *Skidmore* and equating instant case to *Christensen*); *see also* Christensen v. Harris Cnty., 529 U.S. 576, 588 (2000) (holding agency interpretation not entitled to deference unless underlying regulation is ambiguous).

[97] *See Mead*, 533 U.S. at 237-38 (recognizing a spectrum of judicial deference exists between *Skidmore* and *Mead*). The *Mead* Court concluded that courts must continue to recognize the necessity of *Skidmore* analysis. *See id.*; *see also* Ryan C. Morris, comment, *Substantially Deferring to Revenue Rulings After Mead*, 2005 BYU L. REV. 999, 1045 (2005) (arguing consideration of *Skidmore* ruling alone substantially defeats utility of revenue rulings). *But see* Galler, *supra* note 3, at 1038-39 (1995) (recognizing circuit courts application of three new levels of increased deference to revenue rulings); *cf.* Caron, *supra* note 3, at 662 (criticizing Professor Galler for failing to recognize difference between judicial decision-making and decision justifying). The essence of Caron's argument and criticism is that most relevant tax cases are decided on grounds unrelated to revenue rulings and the presence of revenue ruling as supplementary authority is mistaken for judicial reliance. *See id.* at 662-64.

[98] *See Mead*, 538 U.S. at 236-37 (implying approval for broad spectrum of judicial deference to administrative interpretations and rulings). The *Mead* court recognized the necessity for a broad range of judicial deference, arguing that Congress did not intend to restrict a spectrum of possible deference to administrative action, requiring either *Chevron* or none at all. *See id.* at 236.

[99] *See* AMER. BAR ASS'N, *supra* note 51, at 718 (recognizing "post-*Mead*" confusion regarding application of *Chevron*). The American Bar Association created the Task Force on Judicial Deference in 2000 to examine the issue of judicial deference to administrative interpretations and rulings of the Treasury Department and the IRS. *Id.*

[100] *Compare* Omohundro v. United States, 300 F.3d 1065, 1068 (9th Cir. 2002) (finding revenue ruling "commands deference" due to valid reasoning and legislative history), and Tedokon *v.* Comm'r, 84 T.C.M (CCH) 657, at *5 (2002) (relying upon *Omohundro*, finding revenue ruling in question also commands deference), *and* Vons Cos, Inc. v. United States, 51 Fed. Cl. 1, 11 (2001), *abrogated by* Alphi I, L.P. *ex rel. Sands* v. United States, 83 Fed. Cl. 279, (2008) (holding revenue rulings not binding precedent but entitled to some weight), *and* O'Shaughnessy v. Comm'r, 332 F.3d 1125, 1131 (8th Cir. 2003) (concluding revenue not entitled to persuasive authority due to drastic change in applicable statute), *with* Lunsford v. Comm'r, 117 T.C. 159, 174 n.3 (2001) (Halpern, J. concurring) (equating revenue rulings as the mere position of a litigant, not entitled to deference), *and* Federal Nat'l Mortgage Ass'n v. United States, 379 F.3d 1303, 1307-08 (Fed. Cir. 2004) (holding revenue procedure not entitled to *Chevron* deference).

tions remains instructive.[101] The Supreme Court has long held that agencies charged with the administration of a statute are owed great deference in the issuance of interpretative regulations and rulings.[102] Commentary regarding the difference between revenue rulings and treasury regulations has recognized one of the principle differences between the two is the notice and comment procedures followed during the issuance of treasury regulations, which is not followed when the IRS issues revenue rulings.[103] Despite the disputed weight previously afforded to revenue rulings, they have continually been recognized for their utility.[104]

Professor Linda Galler argues that the administrative guidance provided by the IRS is not only beneficial to the taxpayer because of its informative nature but also because it is one of the sources of authority, which taxpayers may utilize to avoid or reduce a tax penalty.[105] As Profes-

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[101] *See* PBS Holdings, Inc. v. Comm'r, 129 T.C. 131, 142 (2007) (holding revenue ruling only entitled to consideration of Tax Court, not given weight of regulation); Med. Emergency Care Assocs., S.C. v. Comm'r, 120 T.C. 436, 445 (2003) (declining to defer to revenue ruling due to IRS's questionable reasoning and thoroughness of review); *see also* Galler, *supra* note 3, at 1043-46 (distinguishing between treasury regulations and revenue rulings according to compliance with Administrative Procedure Act). The Administrative Procedure Act ("APA") is voluntarily followed by the Department of Treasury when issuing treasury regulations. *See id.* at 1044. Compliance with the APA provisions requires the agency issuing regulations to provide the public notice of the proposed regulation and allow for submission of public commentary and suggestion. *See id.* at 1043; 5 U.S.C. §§ 533(b), 533(c).

[102] *See* United States v. Moore, 95 U.S. 760, 763 (1877) (observing statutory construction provided by statutorily responsible agency owed "most respectful consideration"). The *Moore* Court continued to explain that the regulation should not be overruled except for "cogent reasons". *See id.*; *see also* Bingler v. Johnson, 394 U.S. 741, 749-50 (1969) (recognizing "fundamental" principle of deference to revenue regulations absent finding of unreasonable or inconsistent interpretation); Comm'r v. S. Tex. Lumber Co., 333 U.S. 496, 501 (1948) (recognizing longstanding deference to treasury regulations citing *Fawcus Machine Co.*); Burnet v. S. & L. Bldg. Corp., 288 U.S. 406, 415 (1933) (looking to statute for examination of treasury regulation and concluding regulation not contrary to statute); Fawcus Mach. Co. v. United States, 282 U.S. 375, 378 (1931) (relying in part on *Moore* to affirm treasury regulation pertaining to taxpayer calculation of profits).

[103] *See* Galler, *supra* note 6, at 842 (highlighting voluntary compliance with APA notice and comment rules when issuing treasury regulations); *see also* Morris, *supra* note 97, at 1002 (recognizing historic significance of notice and comment procedure with respect to weight of revenue rulings).

[104] *See* Rev. Proc. 89-14, 1989-1 C.B. 814 (1989) (allowing taxpayers to rely upon revenue rulings and procedures). The IRS also cautioned taxpayers to ensure that they are not relying upon a revenue ruling or procedure which has been modified, distinguished, clarified or otherwise overruled. *Id.*; *c.f.* Rev. Proc. 89-14(6), 1989-1 C.B. 814. This revenue procedure further cautions taxpayers against relying upon conclusions contained in revenue rulings that are based upon nontax law. *Id.*; *see infra* note 190 and accompanying text (observing caution provided by Revenue Ruling 89-14).

[105] *See* Galler, *supra* note 6, at 846-47 (explaining revenue rulings are among authorities listed in Treasury Reg. § 1.6662-4). Treasury Regulation § 1.6662-4 imposes penalties on taxpayers who take positions contrary to published revenue rulings. *Id.*

sor Galler recognizes, taxpayers reliance and compliance with revenue rulings and procedures comes at a certain cost.[106] The risk of coming under scrutiny for violating Treasury Regulation § 1.6662-4 by taking a position contrary to a published revenue ruling will inform a litigant's decision regarding her chosen venue.[107]

Tax law practitioners and commentators, such as Professor Linda Galler, have attempted to reconcile the many attempts by the Supreme Court and lower courts to take a position on the official weight of revenue rulings and other administrative interpretations.[108] Professor Galler's examination of tax law jurisprudence pertaining to revenue rulings gave rise to her determination that in the years leading up to 1995, federal courts have sought ways to afford revenue rulings unprecedented levels of deference.[109] Professor Galler's analysis leads her to recognize three tiers of deference offered by the various tax court venues and federal courts of appeal: deference based upon an analysis of whether the revenue ruling is "reasonable and consistent with underlying statute"; deference because of the IRS' authority to administer the tax code; and traditional deference under *Chevron U.S.A., Inc. v. Natural Resources Def Council, Inc.*[110] Each of these three approaches warrant explanation as they offer some clarity as to the position taken by each tax law venue.[111]

According to Professor Galler's analysis, the Tax Court traditionally afforded revenue rulings no authoritative weight; viewing a revenue ruling as the mere position of one litigant.[112] Galler postulates that the court's reluctance to defer to revenue rulings may be due to the specialized training and knowledge of the Tax Court judges.[113] The tax court's reluctance to

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[106] *See* Galler, *supra* note 6, at 847 (arguing that taxpayers invite audit by disclosing questionable transactions to the IRS). By disclosing the arguably questionable transaction to the IRS, taxpayers may then challenge the IRS determination before one of the various tax venues. *See id.*

[107] *See infra* note 230 and accompanying text (discussing choice of venue in tax litigation).

[108] *See* Galler, *supra* note 6, at 857-60 (attempting to elucidate routes of judicial deference offered by Supreme Court and lower courts). *But see* Morris, *supra* note 97, at 1013 n.75 (criticizing Professor Galler's position on significance of revenue rulings).

[109] *See* Galler, *supra* note 3, at 1038 (observing federal courts' desire to afford revenue rulings "considerable, if not controlling, weight").

[110] *See* Galler, *supra* note 3, at 1038-39 (arguing increased deference comes in form of three distinct approaches). The three approaches advocated by Professor Galler include: a "reasonable and consistent" approach, deference to administrative advice, and traditional *Chevron* deference." *See id.*

[111] *See id.* at 1039 (observing consequences of splits among circuits and trial courts on revenue ruling weight).

[112] *See* Galler, *supra* note 3, at 1039 (commenting on Tax Court's reluctance to afford revenue rulings weight contradictory to circuit court of appeals).

[113] *See* Galler, *supra* note 3, at 1075 (crediting Tax Court judges' specialized training for their reluctance to afford deference to revenue rulings).

defer to the IRS position as illustrated by a revenue ruling stands in stark contrast to the approach taken by the circuit courts of appeals.[114]

A. REASONABLE AND CONSISTENT

Five of the Circuit Courts of Appeals apply what Professor Galler has described as the "reasonable and consistent" standard of review for revenue rulings.[115] Despite what may appear to be uniformity among those five circuits under Professor Galler tiered structure, the "reasonable and consistent" approach is a mere consistent theme among those circuits.[116] The determination of whether a revenue ruling is reasonable and consistent turns on an evaluation of the applicable provision(s) of the internal revenue code, which the revenue ruling is interpreting.[117]

The second circuit court of appeals has also conducted an extensive analysis under Geller's reasonable and consistent paradigm in *Salomon Inc. v. U.S.*[118] This case was not included in Galler's review of the approach

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[114] *See* Galler, *supra* note 3, at 1061-68 (describing how second, third, fifth, sixth and ninth circuits apply the "reasonable and consistent" standard).

[115] *See* Galler, *supra* note 3, at 1063-64 (explaining that reasonable and consistent standard emerged in Dunn v. United States, 468 F. Supp. 991, 993 (S.D.N.Y. 1979)). The *Dunn* court recognized that revenue rulings "have the force of legal precedents unless unreasonable or inconsistent with provisions of the Internal Revenue Code." *Dunn*, 468 F. Supp. at 993.

[116] *See* Gillis v. Hoechst Celanese Corp., 4 F.3d 1137, 1145 (3d Cir. 1993) (affording revenue rulings weight so long as not unreasonable or inconsistent); Walt Disney v. Comm'r, 4 F.3d 735, 740 (9th Cir. 1993) (evaluating revenue rulings consistency to determine proper weight); Foil v. Comm'r, 920 F.2d 1196, 1201 (5th Cir. 1990) (offering consistent and reasonable revenue rulings special consideration); Threlkeld v. Comm'r, 848 F.2d 81, 84 (6th Cir. 1988) (allowing courts to disregard unreasonable and inconsistent revenue rulings), *superseded by statute*, Omnibus Budget Reconciliation Act Of 1989, Pub.L. 101-239, Title VII, § 7641(a), *as recognized in* O'Gilvie v. United States, 66 F.3d 1550, 1559 (10th Cir. 1995); Amato v. Western Union Int'l, 773 F.2d 1402, 1411-12 (2d Cir. 1985) (revenue rulings owed great deference and force of legal precedent unless unreasonable or inconsistent); *see also* Certified Stainless Servs., Inc. v. United States, 736 F.2d 1383, 1386 (evaluating weight of revenue rulings with respect to commissioner's congressional mandate); Estate of Lang v. Comm'r, 613 F.2d 770, 776 (9th Cir. 1980) (providing extra weight to revenue rulings that are longstanding), Galler, *supra* note 3, at 1064-68 (describing various approaches to "reasonable and consistent" analysis). The variety included: the Second Circuit's approach, applying great deference and legal precedents unless unreasonable or inconsistent (2nd Circuit); simple weight (3rd Circuit); and "special or respectful consideration" so long as not "unreasonable or inconsistent with legislative history" (5th Circuit). *Id.* The Ninth Circuit adopted the Second Circuit's approach whereas the Sixth Circuit has yet to articulate how it approaches the test. *Id.* at 1067-68.

[117] *See* Galler, *supra* note 3, at 1062 (explaining basic concept of "reasonable and consistent" analysis involves consideration of underlying statute).

[118] *See* 976 F.2d 837, 841-43 (2nd Cir. 1992) (evaluating applicable revenue ruling in light of its consistency with prevailing law). The *Salomon* Court compared the revenue ruling to the underlying provision of the Internal Revenue Code to determine that the IRS's interpretation as expressed in the revenue ruling is consistent with the applicable IRC provisions. *Id.*

taken by the second circuit as modern second circuit jurisprudence and appears to be governed by the second tier analysis, affording deference based upon the agency's authority to administer the Internal Revenue Code.[119]

B. AUTHORITY TO ADMINISTER INTERNAL REVENUE CODE

The second part of Galler's tiered paradigm recognizes the evaluation of revenue rulings based on the IRS' congressionally delegated authority to administer the code and the IRS' specialized expertise in the area of tax law.[120] Under this tier, Galler observes that courts have seldom explained why the administrative functions of the IRS should grant revenue rulings enhanced deference.[121] In addition to considerations of whether revenue rulings are validly afforded deference due to the IRS' authority to "administer the code," Galler is critical of affording revenue rulings greater deference because the IRS is well positioned to craft interpretive rulings due to its expertise.[122] As part of her criticism, Galler argues the IRS is more likely to craft revenue rulings its own favor and in favor of promoting tax collection.[123] The third tier in Galler's paradigm is the traditional analysis under *Chevron*.[124]

C. CHEVERON DEFERENCE

Professor Galler's review of the *Chevron* progeny specifically relevant to revenue rulings was limited to two sixth circuit cases, which at the time constituted the only circuit court analysis of a revenue ruling.[125] The

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[119] *See* Galler, *supra* note 3, at 1068-69 (recognizing approach taken in Second, Fourth, Fifth, Sixth and Eleventh Circuits). Galler notes that the Sixth Circuit appears to have adopted all three approaches during the period between 1990 and 1995. *Id.* at 1069.

[120] *See* Galler, *supra* note 3, at 1062 (observing special weight afforded to revenue rulings based on IRS's authority to administer tax code).

[121] *See* Galler, *supra* note 3, at 1069 (recognizing legal commentary surrounding issue of whether revenue rulings' authority properly derived from IRS's authority).

[122] *See* Galler, *supra* note 3, at 1069-71(arguing IRS tax expertise no greater than tax practitioners who include former IRS attorneys).

[123] *See* Galler, *supra* note 3, at 1070-72 ("As the nation's revenue collector . . . the IRS should be expected to construe statutes in a light most favorable to the collection of tax dollars.").

[124] *See* Chevron v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) (recognizing weight afforded to agency rulings unless, "arbitrary, capricious, or manifestly contrary to statute").

[125] *See* CenTra, Inc. v. United States, 953 F.2d 1051, 1056 (6th Cir. 1992), *abrogated by* Aeroquip-Vickers, Inc. v. Comm'r, 347 F.3d 173 (6th Cir. 2003) (applying the *Chevron* analysis solely to revenue ruling finding ruling consistent with vague statutory scheme); *see also* Johnson Cty. Med. Ctr. v. United States, 999 F.2d 973, 977 (6th Cir. 1993) (recognizing *Chevron* as proper means of analysis); *see also* Galler, *supra* note 3, at 1072 (reviewing *Chevron* analysis in *Cen-*

three tiered paradigm set forth in her analysis suggests that revenue rulings seldom afforded *Chevron* deference, and further illustrates the need for clarity among tax litigation venues.[126]

Galler's perspective is based on the premise that tax litigants will be disadvantaged by a revenue ruling and should base litigation decisions upon which venue will afford the revenue ruling the least weight.[127] Although Galler's analysis deserves credit for highlighting the various approaches to afford revenue rulings weight, her analysis appears to overlook the possibility that revenue rulings are useful to tax litigants. Litigation venue decisions should be based upon the taxpayer's individual choice, not simply avoiding venues that give revenue rulings greater weight.[128] Professor Galler's approach is sharply criticized by another legal scholar, Professor Paul Caron, whose perspective is dismissive of the significance of *Chevron* and illustrates the unsettled nature of tax litigation and revenue rulings.[129]

Professor Caron relies upon an empirical analysis of tax litigation cases both before and after *Chevron* to support his argument that judicial deference to revenue rulings is left unaffected after *Chevron*.[130] Instead of highlighting the language and analytical approach of tax law judges in their analyses of revenue rulings, Caron studied the outcome of each case cited by Professor Galler.[131] Despite the pointed criticism and apparent contradictions between the two scholars' theories, the increase in taxpayer success rates in litigation during the years cited by Professor Galler suggests

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Tra). *But see* Johnson Cty. Med. Ctr. at 980-81 (Batchelder, J., dissenting) (recognizing *Skidmore* as proper frame of analysis of revenue rulings).

[126] *See* Galler, *supra* note 3, at 1073-74 (recognizing difficulty posed to future litigants by lack of judicial clarity).

[127] *See* Galler, *supra* note 3, at 1094 (equating success with court's determination that revenue ruling is owed least amount of deference). Galler relies on a wealth of authority from the Tax Court in the 1990s in support of her assertion that tax litigants who are fighting the applicability of a revenue ruling are best positioned before the Tax court. *Id.* at 1059 n.113-114.

[128] *See* Galler, *supra* note 3, at 1059 nn.113-114 (endorsing Tax Court approach of offering no deference to revenue rulings).

[129] *See* Paul L. Caron, *Tax Myopia Meets Tax Hyperopia: The Unproven Case of Increased Judicial Deference to Revenue Rulings*, 57 OHIO ST. L.J. 637, 638-39 (1996) (criticizing Galler's proposed paradigm as failing to recognize true implications of revenue rulings).

[130] *See id.* at 655-56 (arguing *Chevron* has had little impact on deference offered to agency interpretations and administrative guidance).

[131] *See id.* at 646-49. Of the pre-*Chevron* cases cited by Professor Galler, the court of appeals accepted the revenue ruling ninety-two percent of the time following *Chevron*, circuit courts of appeal accepted the ruling seventy-one percent of the time. *Id.* at 646. Professor Caron further observes that the data indicates an increase in taxpayer success rates in the years following 1990. *Id.* at 648-49.

that taxpayers may be relying on the revenue rulings to a greater extent.[132] Taken together, the studies appear to show encouraging support for litigants wishing to rely on a revenue ruling in support of their claim. Taxpayer litigants should be cautioned in light of uncertainty as to whether the IRS is bound by unfavorable rulings.[133] Although the aforementioned judicial venues allow taxpayers to challenge the Service's determination and assessment of a tax liability, they are relatively powerless to challenge the applicability of a revenue ruling that is not being used against them.[134] In addition to the problems faced by litigants seeking to challenge a revenue ruling or procedure, the IRS is able to retroactively void a revenue ruling or procedure under certain circumstances.[135]

In *Manhattan Gen. Equip. Co. v. Comm'r*,[136] the Supreme Court held that the IRS could amend revenue rulings with retroactive affect without concluding that the amendment's themselves were retroactive.[137] *Manhattan General* arose from a corporation's sale of stock and claim of a loss.[138] The IRS challenged the amount of the loss.[139] The case turned on whether or not the applicable revenue ruling or its amendment was applicable.[140] The Supreme Court held that, because the original regulation was contrary to the statute the ruling was meant to administer, it was invalid since its inception.[141]

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[132] *See* Caron, *supra* note 129, at 649-50 (illustrating increase in taxpayer success rates before federal circuit between 1980 and 1990). The data indicates that taxpayer success rates increased to twenty percent in 1990, and this was their highest in the intervening years. *See id.*

[133] *See* Cohen & Harrington, *supra* note 4, at 688 (recognizing IRS's authority to retroactively revoke revenue rulings).

[134] *See* Galler, *supra* note 6, at 885-86 (arguing taxpayer must invite an audit to challenge revenue ruling). Professor Galler highlighted the difficulties faced by taxpayers seeking to challenge revenue rulings in support of her argument that revenue rulings should not be afforded any deference under the *Chevron* standard, but rather should simply be considered the position of one litigant—presumably the Service—upon coming under judicial review. *Id.* at 884-86.

[135] *See* Cohen & Harrington, *supra* note 4, at 678 (observing *Manhattan General* ruling that apparent retroactive amendment of IRS rulings is *not* retroactivity).

[136] 297 U.S. 129 (1936).

[137] *See id.* at 134-35 (distinguishing between retroactive amendment and nullity). The *Manhattan General* Court held that, because law making is the unique province of Congress, agencies charged with the administration of a statute, such as the IRS, cannot retroactively "amend" a regulation if it is contrary to law; the regulation would simply be void from the beginning. *Id.*

[138] *See id.* at 131-33. The petitioners relied on a treasury regulation in deciding the categorization of the resulting loss. *Id.* The treasury regulation was subsequently amended to bring it into conformance with the underlying statute. *Id.*

[139] *Id.* (recognizing Commissioner's authority to amend rulings based on error of law).

[140] *See id.* at 133-34 ("Without pursuing the matter in further detail, it is enough to say that the case turns entirely upon the question whether the loss was to be determined in accordance with the original or the amended regulation.").

[141] *See Manhattan General*, 297 U.S. at 134 (holding regulations failing to conform to under-

Manhattan General established what is referred to as the "nullity" theory.[142] Under the *Manhattan General* nullity theory, an invalid or "null" revenue ruling would be considered a declaration by the Commissioner of Internal Revenue that he/she is choosing not to enforce the tax laws.[143] The Supreme Court has continued to observe the *Manhattan General* nullity rule in subsequent decisions wherein the Court has reaffirmed the validity of the nullity rule and its implications for taxpayers.[144] An overview of the relevant statutory tax law is necessary before considering the validity and utility of the Madoff Ruling.[145]

PART IV: RELEVANT DEFINITIONS OF INCOME

According to the Revenue Act of 1921, a capital asset includes property acquired and held by the taxpayer for profit or investment, subject to exceptions.[146] Those exceptions include: stock held by the taxpayer in a business he owns, or other property that is otherwise classified as business inventory.[147] Of particular significance, for the purposes of the Madoff Ruling, is the capital asset category.[148] Although an individual taxpayer would prefer that his income generating assets be listed as ordinary income and not capital, it is generally accepted an individual's asset is a capital asset unless otherwise categorized.[149] Although specific rates of taxation are

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lying statute null).

[142] *See* Cohen & Harrington, *supra* note 4, at 678 (opining *Manhattan General* nullity theory continues to be utilized despite disagreement over terminology). Cohen argues that, in terms of a treasury regulation, a modern court would not treat the functional retroactivity as "disqualifying," but rather subject to judicial review. *Id.*

[143] *Compare Manhattan General*, 297 U.S. at 134 (discussing nullity theory), *with* Dixon v. United States, 381 U.S. 68, 72-73 (1965) (discussing effect of *Manhattan General* on IRS's ability to abstain from tax collection). The *Dixon* Court observed that if the IRS issues an acquiescence, which is later determined to be incorrect, this does not bar the IRS from subsequently seeking collection of the tax. *Dixon* 381 U.S. at 73.

[144] *See* Comm'r v. Schleier, 515 U.S. 323, 336 n.8 (1995) (noting IRS's interpretative rulings do not have force and effect of regulations); *see also Dixon*, 381 U.S. at 73 (ruling taxpayer's detrimental reliance on an invalid revenue ruling cannot preclude tax collection); Automobile Club of Mich. v. Comm'r, 353 U.S. 180, 183 (1957) (reiterating *Manhattan General* language, and observing earlier IRS rulings based upon mistakes of law).

[145] *See Rev. Rul. 2009-9* (describing circumstances under which taxpayers may classify illusory income as theft losses).

[146] *See* I.R.C. § 1221(a) (defining capital asset by providing list of items not classified as capital assets).

[147] *See id.* (expanding exclusions to include copyrights, works of art or letters or similar property).

[148] *See id.* (defining capital asset by listing exclusions to general rule that all assets are capital).

[149] *See id.* (explaining income is categorized as capital asset by default); *see also* I.R.C. § 65

subject to continuous change, capital gains are traditionally subject to a lower rate of taxation than ordinary gains.[150] Capital gains are currently subdivided into long-term capital gains and short-term capital gains.[151] Equally important as the categorization of gains is how individuals are allowed to categorize losses.[152]

The Internal Revenue Code allows an individual taxpayer to claim a deduction for losses certain limited circumstances.[153] Unlike businesses, which may claim a deduction for any type of loss sustained within the relevant taxable year, individuals are only eligible to claim losses in the following categories: losses sustained in connection with a trade or business; losses from any transaction entered into for profit but not connected with a trade or business; losses of property resulting from fire, shipwreck, or other causality or losses arising from theft.[154] For the purposes of the analysis to follow, the extent to which an individual may take a theft loss is significant.[155] Losses that are classified as ordinary business losses are entitled to a deduction of 100% of the amount of the loss.[156]

Individual taxpayers attempting to claim one of the aforementioned losses are required to follow the rule established by *Arrowsmith v. Comm'r of Internal Revenue*.[157] The issue before the *Arrowsmith* Court was whether individual taxpayers were entitled to treat losses arising from payment of

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(defining ordinary loss as any loss realized from noncapital asset or property not found in I.R.C. § 1231(b)). Ordinary asset categorization is preferable to taxpayers because it allows for a greater deduction for losses whereas the lower capital income tax rates do not allow for as generous a deduction for losses. *See* I.R.C. §§ 64-65.

[150] *See* I.R.C. § 1(h) (defining maximum rates of capital gains tax).

[151] *See* I.R.C. § 1222(2) (defining short term capital gain as one from asset held for less than one year). The Internal Revenue Code also defines long term capital gains as those arising from capital assets held for more than one year. *See* I.R.C. § 1222(3).

[152] *See* Arrowsmith v. Comm'r, 344 U.S. 6, 10 (1952) (holding taxpayer must offset capital gains with capital losses).

[153] *Compare* I.R.C. § 165(a) (allowing for deduction for losses sustained and not compensated by insurance), *with* I.R.C. § 165(c) (limiting losses claimed by individuals to certain limited categories); *see also* I.R.C. § 1231(a)(3)(B) (defining "1231 loss" to include capital assets subject to involuntary conversion).

[154] *See* I.R.C. § 165(c) (limiting individual loss deduction).

[155] *See* I.R.C. § 165(e) (allowing taxpayers to take losses arising from theft during taxable year when the loss is discovered). *See also* I.R.C. § 1341 (discussing tax implications of taxpayer's realization of gains or losses based upon prior fraudulent transaction). I.R.C. § 1341 discusses what is commonly known as the claim of right doctrine. *Id.* The claim of right doctrine is applicable when a taxpayer discovers that his or her prior acquisition of an asset was the product of a fraudulent transaction, such as the sale or disposition of stolen property. *Id.* at § (a). *See* sources cited *infra* note 189.

[156] *See* I.R.C. §§ 165(a), (b) (allowing for deductions for losses in accordance with I.R.C. § 1011); *see also* I.R.C. § 1011(a) (defining adjusted basis for purposes of determining loss).

[157] 344 U.S. 6 (1952)

a judgment against a liquidated business as an ordinary business loss instead of a capital business loss.[158] The Supreme Court affirmed the judgment of the Circuit Court of Appeals, finding that categorization of the losses as ordinary business losses would effectively allow for unique and preferential treatment of the taxpayers.[159] The *Arrowsmith* rule and the cases that follow have been subject to criticism, arguing that they fail to account for modern day financial transactions, including hedging.[160] Despite *Arrowsmith* allowing taxpayers the benefit of hindsight, a taxpayer's motivation when conducting a transaction has no bearing on the categorization of the resulting gain or loss according to the Court's opinion in *Ark. Best Corp. v. Comm'r.*,[161] which addressed the taxpayer's motivation when determining income and loss categorization.[162] Income categorization is an issue central to the tax implications of *Rev. Rul. 2009-9*.[163]

PART V: THE MADOFF SCANDAL AND ALLEGED TAXPAYER RELIEF

When Bernard Madoff executed one of the largest Ponzi schemes of his time, the government, aided by private law firms, began the difficult task of unwinding the transactions, that gave rise to the scheme's downfall.[164] The transactions involved in the Madoff Scheme are not the focus

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[158] *See id.* at 7-8 (summarizing history of events leading to liquidation of petitioner's business). The Tax Court found in favor of the taxpayer and classified the loss as an ordinary business loss. *Id.* at 8-9. The Court recognized that taxpayers were seeking preferential treatment of their loss, which, if categorized as an ordinary business loss, would have entitled them to a 100% deduction when the capital gain they claimed in connection with their dividends entitled them to a lower tax liability. *Id.*

[159] *See Arrowsmith*, 344 U.S. at 9 (finding no justification for providing taxpayers a preferential tax position); *see also* Yaron Z. Reich, *The Case for A "Super-Matching" Rule*, 65 TAX. L. REV. 241, 241-48 (2012) (recognizing *Arrowsmith* rule as vestige of Revenue Act of 1924).

[160] *See* Reich, *supra* note 159, at 246 (describing problems created by *Arrowsmith* matching rule).

[161] 485 U.S. 212, 223 (1988) (holding taxpayer's motivation irrelevant for purposes of asset categorization). *Arkansas Best* concerned the petitioner's purchase and subsequent sale of a majority of shares of certain bank stock. *Id.* at 213-14. The purchase of this stock was motivated by the bank's need for capital. *Id.* In 1975, the petitioner sold the majority of its shares following another decline in the bank's financial health, and declared the resulting loss as an ordinary loss on its 1975 tax returns. *Id.*

[162] *See id.* at 217 (highlighting contradiction between definition of capital asset and consideration of taxpayer's motivation). The Court explained that if a taxpayer's motivation in purchasing an asset was a material point of consideration, it would require the removal of the phrase "whether or not connected with his trade or business" from I.R.C. § 1221. *Id.*

[163] *See Rev. Rul. 2009-9* (allowing for the categorization of illusory income as a theft loss).

[164] *See generally* MADOFF RECOVERY INITIATIVE, *Frequently Asked Questions*, http://www.madofftrustee.com/facts-08.html (last visited Nov. 24, 2012) (outlining recovery ef-

of this note; however, it is important to appreciate how the Madoff Scheme generally operated in order to understand the significance of the IRS' subsequent revenue ruling.[165] Bernard Madoff operated a limited liability corporation, Bernard L. Madoff Investment Securities, LLC ("BLMIS").[166] BLMIS solicited investors with promises of success now understood to have been characteristic of Ponzi schemes.[167] As part of the scheme and in order to maintain the façade of a legitimate investment company, BLMIS issued its clients standard IRS tax forms demonstrating earnings and losses on an annual basis.[168] Relying on those tax statements, the Madoff investors filed individual and corporate tax returns in accordance with the relevant tax law of the time.[169] Before the scheme was uncovered, certain investors decided to "cash out" and withdraw their funds based on the earnings statements they received.[170] BLMIS was forced to make payments consistent with the false earning statements.[171] In certain circumstances, those earnings were greater than or less than the principle investments made. [172] In response to tax questions raised by the prior payment of capital gains tax, paid on gains which were illusory, the IRS issued *Rev. Rul. 2009-9*.[173] Consistent with the generally recognized formats for revenue rulings, *Rev. Rul. 2009-9* begins by setting forth a number of issues which are addressed by the revenue ruling.[174]

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forts and providing answers to certain frequently asked questions). It is interesting to note that the frequently asked question regarding tax implications of the Madoff Scheme does not refer inquiring parties to *Rev. Rul. 2009-9*. *See id.*

[165] *See* SECURITIES AND EXCHANGE COMMISSION, *What is a Ponzi Scheme*, http://www.sec.gov/answers/ponzi.htm, (last accessed March 31, 2013) (defining Ponzi scheme).

[166] *See* MADOFF RECOVERY INITIATIVE, *Timeline*, http://www.madofftrustee.com/timeline-31.html (last visited March 31, 2013) (providing detailed timeline of Madoff fraud).

[167] *See supra* note 165 (describing characteristics of a Ponzi scheme).

[168] *See Rev. Rul. 2009-9* (describing, in redacted version, tax implication portions of Madoff scandal).

[169] *See id.* (describing circumstances potentially faced by taxpayers and victims of Madoff scandal). The exact tax guidance and circumstances of the individual investors is beyond the scope of this note.

[170] *See generally* MADOFF RECOVERY INITIATIVE, *supra* note 164 (recognizing certain investors who withdrew portions of or their entire principle).

[171] *See* MADOFF RECOVERY INITIATIVE, *supra* note 164, at *What Happened to BLMIS Customers' Original Deposits* (explaining all funds withdrawn from BLMIS belonged to other BLMIS customers).

[172] *See id.* (addressing issues pertaining to net equity and investors relative economic positions).

[173] *See Rev. Rul. 2009-9* (offering resolution to defrauded investors who have paid taxes on illusory capital gains). Although the revenue ruling does not disclose that it was issued in response to the Madoff scandal, the language and issue addressed in the ruling have been widely recognized as having been issued in direct response to the scandal. *Id.*

[174] *See Rev. Rul. 2009-9* (outlining seven issues addressed by ruling). The revenue ruling addresses the following issues: (1) whether or not a loss from fraud or embezzlement in a for-

Generally speaking, *Rev. Rul. 2009-9* allows aggrieved, qualified taxpayers to claim losses they experienced in connection with BLMIS as theft losses.[175] The revenue rulings set forth a nondescript set of circumstances that perfectly describe the BLMIS scheme and make it clear that the "qualified investor" is one who suffered a loss from a scheme fitting the description therein.[176] The Ruling allows the qualified investor to claim a theft loss under I.R.C § 165(h) for the year the loss was discovered, so long as the loss was demonstrated to have been caused by a scheme fitting the description provided within the ruling.[177] If an individual is determined to be a qualified investor, he or she is allowed to claim her losses as theft losses under I.R.C. § 165(h), regardless of the nature of the initial investment made.[178] The IRS also issued a revenue procedure, which provides guidance to tax payers on the filing of a return intending to take advantage of the Revenue Ruling.[179] The IRS states that qualified investors may seek "safe harbor" from being required to amend past returns in order to accu-

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profit transaction is a "theft" or capital loss under I.R.C. § 165; (2) whether the loss subject to the personal loss limitations in I.R.C. § 165(h) or limits found within I.R.C. §§ 67, 68; (3) when an aggrieved taxpayer can claim the losses; (4) how a taxpayer determines the amount of the loss; (5) if the loss can create or increase a net operating loss under I.R.C. § 172; (6) whether the loss qualifies for restoration under claim of right doctrine under I.R.C. § 1341; and (7) whether the loss qualifies for the application of I.R.C. §§ 1311-1314 to adjust liability otherwise barred by the statute of limitations under I.R.C. § 6511. *Id.*

[175] *See id.* (stating ruling addresses tax treatment of losses from "ponzi" schemes). Although the revenue ruling never directly mentions BLMIS, it is generally accepted and known that the ruling was issued in response to the actions of Bernard Madoff and BLMIS. *See e.g.* Jerald David August & Ricardo A. Antaramian, *Reporting Madoff Investor Losses*, 11 No.2 BUSENT 36, 44-46 (2009) (explaining utility of *Rev. Rul. 2009-9* with respect to claiming losses from BLMIS); George J. Blaine, IRS Information Letters, IRS INFO 2009-064, 2009 WL 1833388 (March 20, 2009) (explaining purposes and effect of *Rev. Rul. 2009-9* and Revenue Procedure 2009-20); Jeffrey P. Coleman & Jennifer Newsom, *Can an Investment Become a Theft for Tax Purposes*?, 84 FLA. BAR J. 27 (2010) (commenting on *Rev. Rul. 2009-9* in connection with the BLMIS scheme). The IRS Information Letters are authored by IRS Chief Counsel members and in this instance are directed to members of the U.S. House of Representatives. Blaine, *supra.* Despite the failure of the revenue ruling to mention the BLMIS scheme, the IRS Chief Counsel clearly states the purpose of the revenue ruling was to provide relief to the victims of BLMIS. *Id.*

[176] *See Rev. Rul. 2009-9* (explaining "facts" as they relate to the BLMIS Scheme). The Ruling sets forth a detailed set of facts describing the circumstances surrounding the BLMIS scheme. *Id.*; *see also* Rev. Proc. 2009-20, 2009-14 I.R.B. 749 [*hereinafter Rev. Proc. 2009-20*] (explaining how a qualified investor can utilize *Rev. Rul. 2009-9*).

[177] *See Rev. Rul. 2009-9* (requiring taxpayers to prove loss resulted from "taking of property that was illegal"). The Ruling carefully states that the taxpayer is not required to show the thief or perpetrator was convicted in order to take advantage of this ruling. *Id.*

[178] *See id.* (discussing irrelevance of differentiating capital investment from ordinary investment).

[179] *See Rev. Proc. 2009-20* (addressing taxpayer's anticipated procedural questions with respect to taking advantage of revenue ruling)

rately account for illusory capital gains and ordinary income.[180]

PART VI: ANALYSIS

Rev. Rul. 2009-9 and *Rev. Proc. 2009-20* appear to provide a benefit to taxpayers aggrieved by the BLMIS scheme.[181] Given the large amounts of losses most investors experiences, both institutional and individual, the revenue ruling provides great relief for those individuals who are already under a great amount of financial stress.[182] The ruling, however, does pose problems in light of the aforementioned Supreme Court precedent with respect to income matching.[183]

Individuals who invested money with BLMIS were able to claim those illusory gains as capital gains during the years the scheme went undiscovered.[184] Investors who withdrew their funds from BLMIS with a net loss prior to the discovery of the fraud had the benefit of only being liable for capital gains during the years in which they were reported, and were required to offset those gains with capital losses during the appropriate years.[185] Under this scenario, if the taxpayer were to utilize *Rev. Proc. 2009-20* as a "qualified investor," she would be able to offset her gains during the intervening years with a loss of ninety-five percent of her principle investment through BLMIS.[186] By not taking into account the character of investors' initial investments and the character of any subsequent offsetting losses, the Revenue Ruling and procedure stand in conflict with *Ar-*

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[180] *See id.* at § 8 (describing obligation of taxpayers who choose not to take advantage of "safe harbor" provisions). The revenue procedure states that a taxpayer who wishes to file amended returns in order to eliminate the illusory gains and reduce her subsequent taxable income will be bound by all the requirements of the deductibility of losses under I.R.C. § 165. *Id.*

[181] *See* Coleman & Newsom, *supra* note 175, at 27 (commenting on benefits provided by *Rev. Rul. 2009-9* to investors defrauded by "ponzi" schemes). Coleman and Newsom continue on to say that victims of other types of investment losses unrelated to the circumstances specified in the revenue ruling do not enjoy the same benefits. *Id.*

[182] *See* MADOFF RECOVERY INITIATIVE, *supra* note 166 (describing financial implications of BLMIS scheme and actions taken to recover victims' funds).

[183] *See Arrowsmith*, 344 U.S. at 9 (declining to provide taxpayers with preferential treatment arising from high deductions and low tax liability). The revenue ruling and corresponding procedure allow those "qualified investors" to seek safe harbor by claiming closes discovered in the year Mr. Madoff's fraud was discovered. *See* Blaine, *supra* note 175 and accompanying text.

[184] *See* I.R.C. §§ 1221(a) (defining capital asset and corresponding tax liability).

[185] *See* Arrowsmith v. Comm'r, 344 U.S. 6, 10 (1952) (Douglas, J. dissenting) (holding taxpayer must offset capital gains with capital losses).

[186] *See Rev. Proc. 2009-20. Rev. Proc. 2009-20* allows qualified investors not seeking insurance or other reimbursement through insurance or other sources to claim ninety-five percent of their principle investment as a theft loss. *See id.*

rowsmith and its progeny.[187] The IRS' analysis section of the revenue ruling notably omits any mention of *Arrowsmith* and *Arkansas Best.*[188] The omission of this authority from administrative guidance is notable in light of the revenue rulings dealing with "revenue matching" and the "relation back" doctrine, which arise from *Arrowsmith.*[189] *Rev. Rul. 2009-9* and *Rev. Proc. 2009-20* may have been formulated in light of the complexity of the Madoff scheme, but the courts have implicitly acknowledged that the IRS cannot use erroneous rulings to insulate taxpayers from liability.[190]

Qualified investors taking advantage of the "safe haven" provided by the ruling and procedure are only required to meet a few requirements.[191] In addition to not making any attempt to reconcile the revenue ruling with *Arrowsmith* or *Arkansas Best*, the authors of this ruling have specifically prohibited investors from seeking relief under the claim of right doctrine found in I.R.C. § 1341.[192] As *Rev. Proc. 2009-20* explains,

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[187] *See Arrowsmith*, 344 U.S. at 10 (1952) (Douglas, J. dissenting) (establishing matching rule prohibiting taxpayers from taking advantage of low tax rates and high deductions).

[188] *See Rev. Rul. 2009-9* (omitting *Arkansas Best* and *Arrowsmith* analysis from determination of qualified investors); *c.f.* Ark. Best Corp. v. Comm'r, 485 U.S. 212, 222 (1988) (holding a taxpayer not entitled to benefit of hindsight when categorizing losses). The revenue ruling allows those "qualified investors" this same benefit by recognizing and utilizing a substantial offset to their income for that year, regardless of its nature. *Rev. Proc. 2009-20.* This omission is notable because the revenue ruling and corresponding procedure appear to allow investors to offset any gains they may have previously realized with theft losses on the presumption that any loss they experienced is properly characterized as theft loss. *See supra* note 179 and accompanying text (explaining procedure followed by qualifying investors).

[189] *See* Rev. Rul. 79-278, 1979 C.B. 302 (addressing income categorization, relying upon *Arrowsmith* and concluding characteristics from earlier transaction characterize subsequent transaction); Rev. Rul. 78-25, 1978-1 C.B. 270 (discussing *Arrowsmith* with respect to claim of right doctrine under I.R.C. § 1341); Rev. Rul. 72-13, 1972-1 C.B. 42 (addressing loss categorization, relying on *Arrowsmith*); Rev. Rul. 67-331, 1967-2 C.B. 290 (concluding tax loss categorization determined by reference back to earlier transaction under *Arrowsmith*).

[190] *See* Dixon v. United States, 381 U.S. 68, 73 (1965) (theorizing erroneous ruling cannot prevent IRS from collecting tax liabilities due). The *Dixon* Court held a taxpayer's detrimental reliance upon an acquiescence ruling issued prior to the inception of the transaction in question and withdrawn before the end of the tax year did not preclude collection. *Id.* The ruling's withdrawal was made in part due to a realized error of law. *Id.* The Court further observed Congress has empowered the Commissioner of Internal Revenue to retroactively correct mistakes of law in the enactment of I.R.C. § 7805(b). *Id.* at 80; *see also* Rev. Proc. 89-14, 1989-1 C.B. 814 (advising taxpayers against reliance on revenue rulings based upon nontax law).

[191] *See Rev. Proc. 2009-20* app. A (providing details for application of revenue procedure). The revenue procedure provides that qualified investors can calculate their deductible loss by simply listing the sum of their initial investment amount, any subsequent investment, and any gains; the investors then subtract withdrawals and multiply that sum by ninety-five percent in the event they do not anticipate any potential third party recovery. *Id.* If the taxpayer does not have any insurance or other means of third party recovery, she will be able to offset their ordinary income with a deduction of ninety-five percent of their principle investment amount. *Id.*

[192] *See Rev. Rul. 2009-9* (concluding defrauded investors not entitled to relief because losses do not arise from repayment obligation).

I.R.C. § 1341 provides relief to taxpayers who included items in gross income and subsequently discovered they did not have a right to those assets.[193] The circumstances giving rise to relief under I.R.C § 1341 are extremely similar if not identical to those encountered by many BLMIS investors.[194] *Rev. Proc. 2009-20* fails to take into account that investors can and will be under an obligation to repay the misappropriated and incorrectly withdrawn funds.[195] Under the authority of the Securities Investor Protection act ("SIPA"), the SIPA trustee may file suit against investors to recover funds withdrawn from the BLMIS fund.[196] Prior to filing suit, the SIPA trustee has indicated a policy of attempting to negotiate with the customers for the return of inappropriately withdrawn funds.[197] Regardless of whether the SIPA trustee files suit or is successful in negotiating the return of funds, an obligation to repay under I.R.C. § 1341 will arise.[198] In drafting *Rev. Proc. 2009-20*, the IRS did not appear to take into account the SIPA recovery effort and the size of recoveries made thus far.[199] Relief under I.R.C. § 1341 is not only appropriate for investors who have been pursued by SIPA, furthermore I.R.C. § 1341 relief does not depend violate *Arrowsmith* and *Arkansas Best*.[200] Similarly, the IRS' instructions on the revenue ruling do not take into account I.R.C. § 1341 and the SIPA/SIPC

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[193] *See id.* (describing I.R.C. § 1341's mitigatory effect on adverse tax consequence). The adverse tax consequences arise in the event that taxpayers are under an obligation to repay funds or relinquish assets that they previously included in gross income. *Id.*

[194] *See Rev. Rul. 2009-9* (providing broad overview of transactions undertaken by BLMIS investors).

[195] *See* MADOFF RECOVERY INITIATIVE, *supra* note 164, at *What is SIPC's Role in the Ongoing Madoff Liquidation Proceeding*? (explaining SIPC appointed the SIPA trustee to recover assets stolen during BLMIS scheme). Due to the BLMIS fund's lack of actual earnings, assets recovered after the scheme's discovery are entirely comprised of other investors' principle investment. *Id.*

[196] *See id.* (explaining SIPA Trustee's policy of pre-suit investor negotiation regarding return of fraudulent gains).

[197] *See id.* (stating filing suit against investors is last resort).

[198] *Compare* MADOFF RECOVERY INITIATIVE, *supra* note 164, at *What Can You Tell Us About the Status of the "Good Faith" Avoidance Actions?* (explaining policy regarding recovery of inappropriately withdrawn funds), *with Rev. Rul. 2009-9* (prohibiting BLMIS investors from seeking relief under I.R.C. § 1341). Based upon the plain language and reasoning of *Rev. Rul. 2009-9*, the only reason BLMIS investors could not claim relief under I.R.C. § 1341 is due to the alleged lack of an obligation to repay. *Id.* Investors who are pursued by the SIPA trustee and required to repay funds withdrawn are clearly under an obligation to repay. *Id.*

[199] *See* MADOFF RECOVERY INITIATIVE, *Status of Customer Fund/Recoveries & Settlement Agreement Reported as of October 30, 2013,* http://www.madofftrustee.com/recovery-chart-status-34.html (last visited Feb. 25, 2014) (tracking funds recovered from investors and calculating an approximate recovery of $9.79 billion).

[200] *See Rev. Rul. 2009-9* (explaining allowance of deduction under I.R.C. § 1341 appropriate for repaid items in excess of $3,000). In explaining § 1341, the revenue ruling states that the deduction must arise from a taxpayer's obligation to restore the inappropriately gained income. *Id.*

recoveries from taxpayers.[201] Although the revenue procedure is labeled a "safe haven" for qualified investors and requires several signatures of those claiming relief, the procedure does not state that the IRS will take applicable returns at face value.[202] The utility of *Rev. Rul. 2009-9* and *Rev. Proc. 2009-20* comes into question if the IRS decides to scrutinize a taxpayer's submission.[203]

A taxpayer utilizing *Rev. Rul. 2009-9* may find themselves at odds with the IRS, if: (1) the IRS decides to challenge the taxpayer's filing in a way that increases his tax liability at the end of the tax year; or (2) the IRS reduces the taxpayer's return.[204] The taxpayer's attorney, when retained, would then face some difficult strategic decisions with respect to choice of venue.[205] Depending upon the nature of the litigation, this choice is informed by the forum's treatment of revenue rulings.[206] An aggrieved "qualified investor" who utilizes this ruling to lessen the tax burden imposed by the prior illusory gross income and subsequently finds her tax liability to be greater than expected would most likely initiate a refund action before either the Court of Federal Claims or the United States District Court.[207] In the event the taxpayer has the ability to pay the deficiency and thus gain standing before the two courts with jurisdiction over refund actions, the law is split as to which forum may offer a greater level of deference towards the revenue ruling.[208] The utility of *Rev. Proc. 2009-20* and the proper venue to litigate is best analyzed through the paradigm offered

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[201] *See Rev. Proc. 2009-20* (highlighting implications of receiving payments from SIPA/SIPC recoveries but omitting implications of payment).

[202] *See Rev. Proc. 2009-20* § 8.03 (notifying claimants of IRS intention to examine returns submitted under this revenue procedure). *But see id.* at § 8.05 (informing taxpayers IRS will not challenge the filing so long as requirements are met). The revenue procedure does not foreclose the possibility that filings may be scrutinized and challenged, and instead declares that if party meets the requirements, he will not be subject to extra scrutiny. *Id.*

[203] *See* Galler, *supra* note 3, at 1082 (observing tax litigant success litigating revenue ruling highly dependent upon choice of forum).

[204] *See* Treasury Reg. § 601.104(c) (explaining means of IRS enforcement procedures including levys, liens, and penalties).

[205] *See* Kafka, *supra* note 34, at 56 (reviewing forums for tax litigation).

[206] *See* AMER. BAR ASS'N, *supra* note 51, at 768-69 (recognizing divergent standards of deference and methods of review for revenue rulings).

[207] *See* Kafka, *supra* note 34, at 56 (comparing refund actions and prepayment options). As discussed *supra*, in order to have standing before the Court of Federal Claims or the United States District Court for a refund action, the petitioning taxpayer must first pay the alleged tax deficiency, and then initiate his petition for refund. I.R.C. § 7422 (1998). Conversely, if the taxpayer has relied upon *Rev. Rul. 2009-9*, filed their taxes and is issued a deficiency notice, the Tax Court is the only venue initially available to the litigant. TAX CT. R. 13(a), (b).

[208] *See* Galler, *supra* note 3, at 1063 (observing varying levels of deference offered to revenue rulings).

by Professor Galler.[209]

As Professor Galler recognized, a revenue ruling that is "reasonable and consistent" with the underlying statute is more likely to be offered deference, depending upon the litigation venue.[210] As was stated above, *Rev. Rul. 2009-9* not only contradicts law established in *Arrowsmith* and *Arkansas Best*, by failing to account for revenue matching; the ruling also unlawfully prohibits aggrieved investors from seeking relief under I.R.C. § 1341.[211] As Professor Galler recognized, some jurisdictions following the reasonable and consistent standard do not have a sliding scale of deference measured by the results of the "reasonable and consistent" standard, instead may choose to disregard the ruling in its entirety.[212] Federal jurisdictions following the "reasonable and consistent" standard of review may not accord this revenue ruling any level of deference, instead choosing to disregard the ruling entirely.[213] Conversely, courts in the ninth circuit, in Galler's formulation, may accord some added weight to a revenue ruling that is well established.[214] Under this analysis, *Rev. Rul. 2009-9* is a relatively untested ruling; and not yet subject to any level of judicial review and thus unlikely to be afforded much deference before courts in the Ninth Circuit.[215] Professor Galler's second tier – deference based upon the IRS's

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[209] *See id.* (recognizing three standards of review: "reasonable and consistent," deference to administrators, and *Chevron*).

[210] *See* Dunn v. United States, 468 F. Supp. 991, 994-95 (S.D.N.Y. 1979) (holding revenue rulings have force of legal precedent unless unreasonable or inconsistent).

[211] *See supra* notes 183-84 and accompanying text (observing inconsistencies between revenue ruling and I.R.C. § 1341).

[212] *See* Foil v. Comm'r, 920 F.2d 1196, 1201 (5th Cir. 1990) (recognizing ability to disregard revenue rulings inconsistent with underlying statute or legislative history). The revenue ruling in question here, *Rev. Rul. 2009-9*, is clearly in conflict with I.R.C. § 1341 for its failure to allow BLMIS claimants relief under that provision. *Compare Rev. Rul. 2009-9*, *with* I.R.C. § 1341. Further, this ruling suggests that the IRS intends to challenge filings by BLMIS investors seeking refuge under I.R.C. § 1341. *See Rev. Rul. 2009-9.*

[213] *See Foil*, 920 F.2d at 1201 (allowing courts to disregard revenue rulings when inconsistent with legislative history or underlying statute). In Professor Galler's version of the analysis, the Fifth Circuit, under *Foil*, will disregard revenue rulings that are inconsistent and unreasonable. Galler, *supra* note 3, at 1066. *But see* Caron, *supra* note 129, at 654 (arguing "reasonable and consistent" standard has no bearing on court's decision-making).

[214] *See* Estate of Lang v. Comm'r, 613 F.2d 770, 776 (9th Cir. 1980) (refusing to afford revenue ruling greater weight because of its relative youth).

[215] *See, e.g.* Beacon Assoc. Mgnt Corp.v. Beacon Assoc., LLC., 725 F.Supp.2d 451, 455 (S.D.N.Y. 2010) (deferring to IRS interpretation of revenue ruling); Horowitz v. American Int'l. Group, Inc., 2010 WL 3825737, at *8 (relying upon revenue ruling *Rev. Rul. 2009-9* in holding plaintiffs have certain measures of recovery). These are the only judicial decisions that have referenced the revenue ruling despite the fact that the ruling is almost four years old. *Rev. Rul. 2009-9*. In addition to the dearth of judicial review, a Westlaw search of this revenue ruling reveals that IRS has issued informal guidance, which either refers to or relies upon this revenue ruling ninety-one times between 2009 and the present.

role as administrator of the Internal Revenue Code – is less encouraging and should give litigants before the Second, Fourth, Fifth, Sixth, Ninth and Eleventh pause when deciding upon the proper forum for their litigation.[216]

According to Galler's examination of six of the circuit courts of appeal, a majority of the circuits have deferred to revenue rulings based upon the perceived expertise of the IRS.[217] Courts, which appear to have deferred to the expertise of the IRS, have done so without elaborating how and why an executive branch agency deserves deference as a litigant.[218] As an executive branch agency charged with the administration of the internal revenue code, the IRS has exclusive authority to issue administrative guidance such as revenue rulings.[219] In light of the congressionally sanctioned authority, it is understandable that courts would afford some level of deference to the IRS' interpretation of the internal revenue code; however, it does not appear that this revenue ruling is deserving of such deference, in light of the aforementioned conflicts with the Internal Revenue Code and Supreme Court precedent.[220] The IRS's attempt to provide relief to BLIMS investors comes at the cost of re-characterizing the resulting loss, if any actually occurred.[221] As discussed above, taxpayers who seek to utilize this ruling are allowed to claim any funds they had left in the BLMIS fund at the time of discovery as a loss, without taking into account the character of any withdrawals and subsequent reinvestment.[222] The disregard for characterization and matching required by *Arrowsmith* and *Arkansas Best* creates a problem for litigants dependent upon *Rev. Rul. 2009-9*.[223]

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[216] *See* Galler, *supra* note 3, at 1068-71 (explaining courts in these jurisdictions have accorded revenue rulings deference based upon IRS expertise).

[217] *See* Galler, *supra* note 3, at 1068-71 (criticizing circuit courts for deferring to IRS's position based upon perception of IRS expertise).

[218] *See id.* (observing court's reluctance to explain why administration of a statute warrants deference). *See also* Merch.'s Indus. Bank v. Comm'r, 475 F.2d 1063, 1064 (10th Cir. 1973) (finding Commissioner of Internal Revenue did not abuse discretion by issuing revenue ruling).

[219] *See* I.R.C. § 7805(a) (authorizing Treasury Department to prescribe all needful rules and regulations for enforcement of internal revenue code); *see also* Treas. Reg. § 601.601(d)(2)(b)(v)(a) (2012) (stating revenue rulings will be directly responsive to "pivotal facts" as stated in ruling).

[220] *See supra* notes 192-194 and accompanying text (explaining conflict between *Rev. Rul. 2009-9* and I.R.C. § 1341).

[221] *See* Arrowsmith v. Comm'r, 344 U.S. 6, 8 (1952) (affirming judgment of 2nd Circuit by holding taxpayer cannot be granted preferential treatment for losses).

[222] *See Rev. Proc. 2009-20* § 5 (allowing qualified investors to deduct 95% of qualified investment amount as a theft loss). The procedure and ruling does not require the qualified investor to demonstrate that he actually experienced a "loss" so long as he had investment with BLMIS at the time the fraud was discovered. *Rev. Rul. 2009-9*.

[223] *See Arrowsmith*, 344 U.S. at 8-9 (observing petitioner's argument regarding "transformation" of payment made after corporation dissolved).

Under the third tier of Galler's paradigm, a limited amount of courts in the Sixth Circuit have applied *Chevron* deference to revenue ruling.[224] *Rev. Rul. 2009-9* was issued in order to address the tax consequences of the BLMIS fraud and not in response to perceived statutory vagueness.[225] The IRS' reasoning for issuance of the ruling is significant under the *Chevron* analysis because under the first prong of the *Chevron* test, the court must determine whether the underlying statute is vague so as to allow the IRS to issue guidance on the matter.[226] The claim of right doctrine under I.R.C. § 1341 offers a direct solution to the issue posed by the BLMIS scandal.[227] Under *Chevron*, *Rev. Rul. 2009-9* would likely be afforded little, if any, deference if sixth circuit courts recognized I.R.C. § 1341 as the product of Congress attempting to resolve tax issues faced by defrauded individuals.[228] In light of the varying degrees of deference offered by the circuit courts of appeal, litigants should consider the nature of their action in conjunction with the location of their chosen trial venue.[229]

Litigants must carefully consider the nature of their claim or defense before deciding upon a trial venue.[230] Former BLMIS clients may find themselves under scrutiny by the IRS in the event they choose to ignore the guidance of *Rev. Rul. 2009-9* and instead attempt to seek relief under I.R.C. § 1341.[231] Under this scenario, tax litigants may take advantage

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[224] *See* CenTra, Inc. v. United States, 953 F.2d 1051, 1056 (6th Cir. 1992) (finding *Chevron* analysis appropriate based upon the vague underlying statutory scheme), *abrogated by* Aeroquip-Vickers, Inc. v. Comm'r, 347 F.3d 173 (6th Cir. 2003); *see also* Johnson City. Med. Ctr. v. United States, 999 F.2d 973, 977 (6th Cir. 1993) (recognizing *Chevron* deference as appropriately applied to revenue rulings).

[225] *See* INTERNAL REVENUE SERVICE, *2009 Annual Report to Congress*, 2009 WL 5251017, at nn. 15-22 (Dec. 31, 2009) (explaining motivation for issuance of *Rev. Rul. 2009-9*).

[226] *See* Chevron v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) (instructing courts first look for congressional instruction on issue).

[227] *See* I.R.C. § 1341 (allowing deduction for items previously included in gross income later subject to mandatory repayment).

[228] *See Chevron*, 467 U.S. at 844 (finding when Congress has spoken to the issue, no further analysis is required); *see also* Christensen v. Harris Cnty., 529 U.S. 576, 588 (2000) (holding agency interpretation not entitled to deference unless underlying regulation is ambiguous).

[229] *See* Kafka & Cavanaugh, *supra* note 37, at ¶ 22.01 (discussing unique aspects of tax litigation and issue and claim preclusion); *see also* Kafka, *supra* note 67, at 51-60 (comparing three tax litigation forums).

[230] *See* McKenzie, Erney, Callahan & Gawlik, *supra* note 49 and accompanying text (discussing unique aspects of each tax litigation venue). When taxpayers are issued a deficiency notice they must decide whether to pay the deficiency and gain access to the Court of Federal Claims and the United States District Court or alternatively, maintain the deficiency and litigate before the Tax Court. *Id.* This decision is further complicated in light of the varying levels of deference offered in the applicable circuit courts of appeal. *See* Galler, *supra* note 3, at 1062.

[231] *Compare* I.R.C. § 1341 (allowing defrauded taxpayers who must repay unlawfully gained income to deduct repayment), *with Rev. Rul. 2009-9* (finding I.R.C. § 1341 inappropriate form of relief for BLMIS clients due to no obligation to repay). Although *Rev. Rul. 2009-9* acknowledges

of the Tax Court's lack of deference to revenue rulings in hopes that the specialized knowledge of tax court judges may find *Rev. Rul. 2009-9* invalid.[232] Conversely, in the event the taxpaying litigant chooses to utilize the revenue ruling offensively, he should carefully consider what appellate circuit the proper trial venue is located within.[233] Of the many outstanding questions with regard to this and other revenue rulings is the extent to which an adverse judicial ruling could negatively affect a taxpayer litigant.[234]

Under the "nullity" doctrine established by *Manhattan General*, a regulation or administrative interpretation that is contrary to law or contains a mistake of law is simply invalid.[235] The *Manhattan General* test operates under a consideration of whether the regulation under consideration "operates to create a rule out of harmony with the statute."[236] Under these circumstances, if an appellate court were to find Rev. Rul. 2000-09 out of harmony with either I.R.C. § 1341 or the statutes which *Arrowsmith* and *Arkansas Best* serve to interpret, the revenue ruling may be subject to nullification.[237] The implications of such nullification could include a court's determination that the taxpayer litigant is subject to an increased tax liability.[238] However, the benefits and risks of relying upon this and other

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the possibility that SIPC will make awards to defrauded clients, it fails to take into account that the recovery will cost many clients their withdrawals from the BLMIS fund. *See* MADOFF RECOVERY INITIATIVE, *Recoveries To Date*, http://www.madofftrustee.com/recoveries-04.html (last visited Feb. 25, 2014) (discussing recovery of funds from BLMIS clients reaching $9.79 billion).

[232] *See* Estate of Kosow v. Comm'r, 45 F.3d 1524, 1529 (11th Cir. 1995) (finding taxpayers may rely defensively upon revenue rulings but not with legal force and effect); Browne v. Comm'r, 73 T.C. 723, 731 (1980) (Hall, J., concurring) (refusing to credit IRS position expressed in revenue ruling with force of law). *But see* Tedoken v. Comm'r, 84 T.C.M. (CCH) 657, at *4 (2002) (relying upon *Mead*, finding the revenue ruling in question "commands" deference); Treasury Reg. § 1.6662-4 (prohibiting taxpayers from taking position contrary to established and published revenue rulings).

[233] *See* AMER. BAR ASS'N, *supra* note 51, at 751 (discussing findings of American Bar Association Taxation section study on judicial deference to administrative guidance). The American Bar Association Taxation Section study appears to credit Professor Galler's study of *Chevron's* effect on judicial deference in light of the continued rise of judicial deference to revenue rulings, albeit at varied degrees. *Id.* at 744.

[234] *See* Dixon v. United States, 381 U.S. 68, 73 (1965) (ruling taxpayer's detrimental reliance upon invalid revenue ruling cannot preclude tax collection).

[235] *See Manhattan Gen. Equip. Co. v. Comm'r*, 297 U.S. 129, 135 (1936) (discussing a "null" regulation has being incapable of addressing and properly implementing tax code).

[236] *See id.* at 134 (discussing factors contributing to a "null" regulation).

[237] *See id.* at 134 (discussing Internal Revenue Commissioner's authority to retroactively amend regulations). Although *Manhattan General* discussed a treasury regulation, the reasoning is instructive as revenue rulings still establish the rights and obligations of taxpayers under the Commissioner's interpretation of the Internal Revenue Code. *Id.*

[238] *See Dixon,* 381 U.S. at 72-73 (observing Commissioner of Internal Revenue may correct

revenue rulings do not arise solely from the opinions rendered by trial and appellate judges; the Commissioner of Internal Revenue may determine the ruling is contrary to law and must be amended or withdrawn.[239] In the event such an amendment takes place, there are mixed opinions as to whether the Commissioner would be forced to or choose to collect on the litigants new tax liability.[240] In light of the mixed levels of deference offered by the circuit courts of appeal and the reluctance of the Supreme Court to offer clarification on the subject, BLMIS investors relying upon *Rev. Rul. 2009-9* may be best situated before the Tax Court until congressional action resolves.[241]

PART VII: THE CASE FOR CONGRESSIONAL ACTION

As many commentators have noted, Supreme Court guidance and congressional intervention is increasingly important given the wide variety of judicial opinions governing the three tax litigation venues. Tax litigants have a greater opportunity than most to engage in forum shopping due to the varied jurisdictions of the United States District Court, Tax Court, and the Court of Federal Claims. Despite commentary implying revenue rulings and similar administrative guidance, represent harmless and weightless advice, the opposite appears to be true. Taxpayers who rely upon these rulings are certainly placing their confidence in the Commissioner of Internal Revenue to properly determine their rights and obligations under the Internal Revenue Code. Those same taxpayers may likely find themselves under the scrutiny for failure to appropriately apply the revenue ruling, or alternatively may seek redress from the IRS based upon the tax litigant's asserted interpretation of the tax code. When placed before the Courts, the taxpayer's ultimate relief will turn on the court's interpretation of the revenue rulings application and validity. The implication of the taxpayer's reliance on the IRS's guidance requires further attention of the Courts. In light of the current legal landscape, tax litigants should carefully consider

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mistakes of law to detriment of the taxpayer).

[239] *See id.* (reviewing authority of Commissioner of Internal Revenue to correct regulations and other administrative guidance).

[240] *See* Galler, *supra* note 3, at 1070 (opining that Commissioner of Internal Revenue would craft rulings in favor of collection). *But see supra* note 137 (discussing *Manhattan General* and nullity rule); Cohen & Harrington, *supra* note 4, at 702-03 (observing under *Manhattan General*, nullity is not akin to retroactivity).

[241] *See* Galler, *supra* note 3, at 1059 n.113-14 (arguing taxpayer litigants at odds with a revenue ruling best situated before Tax Court). The Tax Court may be an appropriate venue for litigants seeking to avoid compliance with an arguably erroneous ruling, but the litigants reliance upon *Rev. Rul. 2009-9* will likely put them at odds with both the Tax Court and the many circuit courts of appeal following the "reasonable and consistent" test. Galler, *supra* note 3, at 1062.

whether they are utilizing a revenue ruling offensively or defending against the IRS's reliance upon a given ruling. Litigants defending against the IRS's reliance upon a revenue ruling may be well situated before a Tax Court judge, so long as the litigant can afford to abstain from paying the disputed liability. Revenue rulings cannot and should not be a resource reserved for use by the IRS. Contrary to commentary such as Professor Galler's, revenue rulings should be viewed as a resource for tax litigants rather than an obstacle to be avoided during litigation.Tax litigants should be encouraged to look towards revenue rulings and procedures for guidance and persuasive support for their positions. Revenue rulings and revenue procedures offer great insight into the IRS' perspective on a pressing issues of tax law and are determinative of a taxpayer's financial obligations. In order to maintain the utility of IRS guidance while clarifying its weight, Congress should mandate the IRS issue these rulings in accordance with the Administrative Procedures Act thereby subjecting Revenue Rulings and Procedures to *Chevron* deference. In the absence of any congressional action, litigants will continue to engage in unreasonable yet necessary forum shopping.

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