Settling with the IRS in Appeals: The New Importance of the APA

*By Elizabeth Nelson**

Elizabeth Nelson shares lessons learned through her own efforts in achieving settlements by raising the issue of whether a regulation is in compliance with the APA. Included in her article, are the steps necessary to determine if the regulation is susceptible to attack and an analysis of what defects render a regulation invalid.

I. Overview

In the wake of the many recent taxpayer Administrative Procedure Act ("APA") cases within the district courts,[1] Court of Federal Claims,[2] Tax Court,[3] Courts of Appeals,[4] and the U.S. Supreme Court,[5] one may think of the APA solely as a litigation tactic. However, utilizing the APA is now a valuable strategy in settling with the IRS, after Exam, within the 30-day letter Appeals process.[6]

Recently, within the Appeals process, the author queried the validity of Reg. §53.4959-1 (the "Regulation"), a recently enacted excise tax penalty against Code Sec. 501(c)(3) hospitals under the Affordable Care Act.[7] We argued that the Regulation should be invalidated and the proposed penalties against the tax exempt hospital[8] should be withdrawn because Treasury gave defective Notice under the APA.[9] Taxpayer hospital also argued that whether the Regulation is valid is an issue that is ripe for Appeals analysis, that its resolution would greatly simplify the issues to be decided at trial, and that it is a case of first impression. The tax-exempt hospital received a settlement of 25% of the proposed assessment, utilizing a Qualified Offer,[10] APA "hazards of litigation" and Executive Order dated January 20, 2017.[11] The result was "justice in the system for both the IRS and the Taxpayer," Nathan Hockman, UCLA 2017 Annual Tax Controversy Institute.[12]

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The author initiated this strategy of reviewing a regulation within Appeals for defects under the APA, after settlement of a 2015 multi-million-dollar tax refund case within the U.S. Court of Federal Claims ("Federal Claims").[13] In the Federal Claims case, we argued that Treasury gave defective Notice under the APA when it enacted Reg. §1.1001-1(g)(1), ["this Regulation"] and that this Regulation, thus, could not be applied against plaintiffs in a land investments case.

Due to the increasing role of the APA within tax controversy litigation, research of a regulation's enactment to confirm it meets the APA's requirements should now be the first step in defense of your client within Appeals.

Part A, below, delineates the steps necessary to determine if the regulation is susceptible to attack at the Appeals level for defective notice under the APA. Part B, below, concludes with an analysis of what defects render a regulation invalid. Both sections utilize examples and analysis from cases the author settled with the IRS within both Appeals and the U.S. Court of Federal Claims.[14]

A. Researching Treasury Regulations for APA Defects

Due to the increasing role of the APA within tax controversy litigation, research of a regulation's enactment to confirm it meets the APA's requirements should now be the first step in defense of your client within Appeals.[15] Therefore, after determining that a regulation is at issue, review its enactment for defects under the APA.[16]

In reviewing the enactment of Treasury regulations, tax controversy and tax litigation attorneys must now become APA experts.[17] Taxpayer victories involve scrutiny of regulations under the APA, within both non-tax administrative law cases[18]and tax law cases.[19]

1. Review Final Treasury Decisions and Proposed Regulations

Certainly, researching for APA discrepancies is not for the fainthearted. First, it entails a review of the many iterations[20] of each final Treasury Decisions ("TD") listed at the bottom of each regulation, to determine the first citing of the regulation at issue. The second step comprises slogging through each TD to identify any prior proposed regulations and to review the many iterations[21] of each proposed regulation to determine the first citing of the regulation.[22] At the same time, it may be necessary to secure Public Law[23] and Legislative histories,[24] with dates prior to the dates of publication within database research libraries. Inevitably, research in a law school or other research library will be required.[25]

2. Review for Changes in the Proposed and Final Regulations

The next step involves an analysis of the regulation at issue to determine if the final regulation was contained within any prior proposed regulation,[26] or if the proposed regulation was changed in its final enactment. This was the case with Reg. §53.4959-1, enacted under the Affordable Care Act.[27] The Taxpayer hospital contended that it was not subject to the excise tax imposed under Code Sec. 4959, due to the failure of Treasury to follow the APA in enacting the Final Regulations. There is a significant difference between the 2013 Proposed Regulations[28] and the Final Regulations[29] adopted under Code Sec. 4959.

The 2013 Proposed Regulations, within Reg. §53.4959-1(b)(1), stated that this excise tax "may be imposed for each taxable year that a hospital facility fails to meet the requirements of section 501(r)(3)."[30] However, the Final Regulations deleted "may" in its entirety. The Final Regulation, Reg. §53.4959-1(b)(1), provides that a hospital facility failing to meet the CHNA requirements "will" (rather that "may" in the discretion of the IRS) be subject to an excise tax under Code Sec. 4959. The final regulation reads as follows: "[F]ailure to meet the requirements of section 501(r) will result in a tax being imposed."[31] The Taxpayer hospital argued that the failure by Treasury to follow the APA in enacting the changes within the Final Regulations invalidated the regulation, making it inapplicable to the Taxpayer hospital.

3. Review for Basis and Purpose Statements in the Preamble[32] to the Final Regulations

If there is a significant change from the proposed to the final regulations, or from a statute's clear meaning to a momentous statute altering regulation,[33] then the APA additionally requires an agency (such as Treasury) to provide a concise general statement of the rule's basis and purpose in the adopted rule.[34] We argued that with regard to the Regulation, §53.4959-1, that Treasury violated the APA in that proposed versions of the Regulation failed to properly delineate a concise general statement of the basis and purpose for substantively changing the final regulation from the proposed regulation, from *May* to *Will* in the imposition of the excise tax.

It is necessary to go through about 60 to 100 pages of the Preamble to a regulation to see if Treasury provided a basis and purpose for the adoption of a final regulation, which differs markedly from its proposed regulation. We reviewed the Regulation and argued that Treasury also gave defective Notice under the APA in that, without explanation, the final rule as adopted in the Regulation differed markedly from the prior proposed version of the Regulation.[35] Treasury merely stated what some commentators suggested for the application of the excise tax, as follows:

> The 2013 proposed regulations stated that a hospital facility may, in the discretion of the IRS, be subject to an excise tax under section 4959 for a failure to meet the CHNA requirements. … Although some commentators did not think that the excise tax should apply upon correction and disclosure … one commentator suggested that the full $50,000 excise tax should apply only in instances were a hospital facility fails to conduct a CHNA altogether, with a sliding scale of tax applied to organizations that conduct a CHNA but fail to comply with all of the CHNA requirements … *[T]he final regulations do not adopt these commentators' suggestions* … [T]he final regulations under section 4959 provide that a hospital facility failing to meet the CHNA requirements "will" (rather than "may" in the discretion of the IRS) be subject to an excise tax under 4959. Final Regulations, *Summary of Comments and Explanation of Revisions,* section 9. *Excise Tax on Failure to Meet CHNA Requirements*, p. 78995. [Emphasis added.]

Merely stating within section 9 of the final regulations, that the final regulations do not adopt these commentator's suggestions, does not provide the *basis and purpose* for enacting such a change, as required under APA section 553(c). Further, Treasury failed to comply with the Notice and Comment section under APA section 553(b) in enacting this change. Thus, we argued that the change from "may" to "will" is invalid, because Treasury failed to follow APA sections 533(b) and 533(c) in enacting the Regulation.

Lastly, it is apparent that even in 2014, Treasury failed to consider the Supreme Court in *Mayo,* by stating, that section 553(b) of the APA does not apply to the final regulations.

> **Special Analysis.** It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to the final regulations. Special Analysis section of the Final Regulations, 79 FR 78954-01, 78995[36] [emphasis added].

The Regulation at issue is a substantive regulation, as it "affects individual rights and obligations," *delineating new rules that are "binding" or have the "force of law."*[37] The Supreme Court mandates that *substantive regulations cannot be afforded the* "force and effect of law," *if not promulgated in accordance with the law delineated within Section 553 of the APA.*[38]

B. What Defects Render a Regulation Invalid?

How does one determine whether an enacted Treasury regulation is valid or invalid? To answer this question, the validity of two aspects of a regulation must be determined: "the substantive rule imposed by the regulation, and the procedure whereby the regulation was issued. If either one of these is not valid, then the regulation is invalid."[39]

Put more succinctly, the substantive rule looks at whether the regulation is a reasonable interpretation of the statute to which it relates. If the regulation does not purport to reasonably interpret the statute, the regulation is invalid. The procedural rule focuses on the required procedures of the APA, which must be followed in issuing the regulation. If Treasury failed to follow the procedures mandated by the APA, the regulation is invalid. "Each of these failures represents a separate and wholly sufficient basis" for presenting an argument within Appeals, and later in litigation, that the regulation is invalid.[40] Under U.S. Supreme Court precedent, a Treasury regulation is valid only if it is a reasonable interpretation of the statute to which it relates.[41]

1. Is the Regulation Invalid Because It Fails to Be a Reasonable Interpretation of the Statute, Which Is the Will of Congress?

"In *Chevron,* the U.S. Supreme Court mandated that in reviewing whether an agency reasonably interpreted a statute which it administers, a court must undertake a two-step inquiry, as follows:

> First, always, is the question whether Congress has directly spoken to the precise question at issue. *If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.* If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent

> or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute."[42]

Further, in analyzing Treasury's interpretation, the focus must solely be on the basis articulated by Treasury at the time of the regulation's enactment. Such a precedent was enunciated by the U.S. Supreme Court in *State Farm*, wherein the Court held: "the courts may not accept appellate counsel's *post hoc*rationalizations for agency actions ... It is well-established that an agency's [e.g., Treasury's] action must be upheld, if at all, on the basis articulated by the agency itself."[43]

If the regulation is invalid, this stops all further inquiry. By applying this analysis at the Appeals level, there exists the ability and possibility to settle with the IRS at an earlier point in time—with a result that is "justice in the system for both the IRS and the Taxpayer."

a) Chevron Step One: Is the Statute Unambiguous. Is the intent of Congress made crystal clear within the statute? If so, under *Chevron* Step One, *"the law mandates that the Court's inquiry stops here."*[44]Additionally, "when determining Congress's intent, *Chevron* instructs that courts should utilize 'traditional tools of statutory construction' as found within legislative history."[45] "Clearly, the ruling in *Chevron* relied heavily on legislative history."[46]

b) Chevron Step Two: Is the Regulation a Reasonable/Permissible Construction of the Statute? In evaluating a regulation, *Chevron* Step Two determines whether a regulation is a reasonable/permissible construction of a statute if Congress's intention is ambiguous. Under Chevron Step Two, a regulation is held invalid where it is not a reasonable interpretation of the statute and must fail as being contrary to the will of Congress.

2. Is the Regulation Invalid Because It Was Issued in Violation of the APA's Procedural Requirements?

In *Mayo,* the Supreme Court stated that Treasury regulations are subject to the APA:

> *We are not inclined to carve out an approach to administrative review good for tax law only.* To the contrary, we have expressly "recogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action."[47]

The APA imposes important procedural requirements upon federal agencies engaged in rulemaking. "The issuance of all regulations by federal agencies is governed by 5 USC §553 ("Section 553") (entitled "Rule making"), subject to certain exceptions as otherwise provided in Section 553."[48]

a) Is the Regulation Invalid Because Treasury Failed to Comply with the APA's Notice and Comment Requirements? The APA requires that, prior to issuing a regulation, an agency (such as Treasury) must publish a notice of proposed rulemaking ("Notice") and provide an opportunity for the public to participate in the rulemaking process. With regard to a regulation, Treasury violates the APA if it fails to publish a Notice and provide an opportunity for the public to participate in the rulemaking process. The Treasury also gives a defective Notice under the APA if the final regulation, as adopted, differs markedly from the prior proposed regulation.[49]

In the *Hlavacek* matter, "Treasury never provided an effective opportunity for the public to comment on the Regulation, prior to its initial adoption, because no one was put on effective notice that Code Sec. 1001(b) was the subject of either the 1986 Proposal or the 1992 Notice."[50] "Neither of these documents, in their Background section, referred to Code Sec. 1001(b)."[51] "This failure to properly put the public on notice of the substantive change relative to IRC §1001(b) (a change which amounted to overruling this code section) is a blatant failure to follow the APA which failure should invalidate the Regulation."[52]

b) Is the Regulation Invalid Because Treasury Failed to Provide APA Section 553's Required Statement of Basis and Purpose? The APA requires an agency (such as Treasury) to provide a concise general statement of the rule's basis and purpose in the adopted rule.[53] Section 553(c) requires that, after such notice, the public must be given "an opportunity to participate in the rule making through submission of written data, views, or arguments" and further requires that "the agency shall incorporate in the rules adopted a *concise general statement of their basis and purpose*."[54] *See* section A, part 3 *supra*, for our argument of violations of the basis and purpose APA requirements under Reg. §53.4959-1.

In *Hlavacek*, "Treasury failed to provide, within the prior announcements of the adoption of the Regulation, a concise general statement of the Regulation's *basis and*

purpose relative to absolutely contradicting Code Sec. 1001(b), thereby usurping the power of Congress. As this Court has stated:

> *The APA also requires that when a rule is adopted, a statement of its basis and purpose shall accompany its publication.* 5 U.S.C. §553(c). No such statement accompanied the promulgation of Treas.Reg. §1.1502-25. Plaintiff contends that *the regulation is thus invalid. See National Welfare Rights Organization v. Mathews,* 174 U.S.App.D.C. 410,533 F.2d 637 (1976). *The purpose of requiring a statement of the basis and purpose is to enable courts, which have the duty to exercise review, to be aware of the legal and factual framework underlying the agency's action. See SEC v. Chenery Corp.,* 318 U.S. 80, 94, 63 S.Ct. 454, 87 L.Ed. 626 (1943); Wright, The Courts and the Rulemaking Process: The Limits of Judicial Review, 59 Cornell L.Rev. 375, 395 (1974), quoted in *National Welfare Rights Organization v. Mathews, supra,* 174 U.S.App.D.C. at 422, 533 F.2d at 649. … *The reason the lack of a rationale renders a regulation invalid is that a court cannot evaluate the reasonableness of a regulation without a statement of the purpose and basis.*"[55]

We argued that "Treasury could hardly have had a proper basis for, or purpose in, overturning an act of Congress. *Treasury's failure to provide its statement of basis and purpose relative to the Regulation renders the Regulation invalid.*"[56]

c) Is the Regulation Invalid Because Treasury Violated the APA's "Excess of Statutory Jurisdiction" Standard? The APA forbids agency action "in excess of statutory jurisdiction authority, or limitations."[57] In the *Hlavacek* case, we concurrently argued that *American Standard* applies to the Regulation in another important way, as well:

> The *American Standard* Court also found that the regulation was invalid, because Treasury exceeded the delegation of rule making power granted to Treasury in promulgating the regulation. *American Standard,* 602 F.2d at 265, 269. "In our view, there is no requirement that a taxpayer acquiesce in a regulation promulgated outside the authority delegated by Congress. *The 'bitter with the sweet' does not include the invalid." Rite Aid Corp. v. United States,* 46 Fed. Cl. 500 (2000) *rev'd,* 255 F.3d 1357, 1360 (2001) [emphasis added].[58]

Treasury failed to cite to *any*specific authority for contradicting the express language of Code Sec. 1001(b). "In exercising its authority relative to issuing regulations interpreting statutory language concerning original issue discount and the imputation of interest on deferred payments, Treasury was most expressly *not* empowered to alter Code Sec. 1001(b). In promulgating the Regulation, Treasury imposed tax liability that Code Sec. 1001(b) does not impose."[59] We argued that such action by Treasury was in excess of statutory jurisdiction authority, or limitations, and hence invalid.

d) Is the Regulation Invalid Because Treasury Violated the APA's "Arbitrary and Capricious" Standard? A regulation should be accorded no deference if it was promulgated in violation of the APA's arbitrary and capricious standard as set forth in Section 706(2)(A). "The reviewing court shall … hold unlawful and set aside agency action, findings, and conclusions found to be … *arbitrary, capricious*, an abuse of discretion, or otherwise not in accordance with law."[60]

The leading Supreme Court decision interpreting this arbitrary, capricious standard is *State Farm,* with numerous subsequent decisions applying its principles. "Under *State Farm,* for agency action to satisfy the arbitrary and capricious standard, the agency must examine the relevant data and *articulate a satisfactory explanation for its action* including a 'rational connection between the facts found and the choice made.' *Burlington Truck Lines, Inc. v. United States,* 371 U.S. 156, 168 (1962)."[61] "The *State Farm* Court also stated: 'We have frequently reiterated that an agency must cogently explain why it has exercised its discretion in a given manner, ... and we reaffirm this principle again today.'"[62]

We argued in *Hlavacek* that the prior "announcements of the adopted final Regulation provided no explanation whatsoever as to why Treasury issued a Regulation which absolutely contradicts Code Sec. 1001(b). [Further, we opined that] [b]ecause Treasury has not given any such explanation for the Regulation, the Regulation was issued in violation of the APA's arbitrary and capricious standard and should be invalidated."[63]

Numerous decisions by the federal Courts of Appeals, in non-tax cases, have held agency actions invalid under the APA's arbitrary and capricious standard for which the agency failed to provide an adequate explanation.[64]

However, it seems that the analysis under the arbitrary and capricious standard is a greater obstacle for taxpayers to meet, within tax cases, than in other agency non-tax cases.[65] The recent *Chamber of Commerce* case held:

> The court has reviewed the full analysis by which the Agencies determined the Rule is necessary to achieve the goals of the Internal Revenue Code. The court concludes the Agencies did not rely on factors that Congress did not intend for them to consider or fail

to consider an important aspect of the issue before them. *Motor Vehicle Mfrs.,* 463 U.S. at 43. The Agencies offered a plausible explanation for the Rule that does not run counter to the evidence before them. *See id*. Accordingly, the court concludes the Agencies did not engage in an arbitrary and capricious rulemaking in issuing the Rule.[66]

The *Chamber of Commerce* court did not invalidate the regulation under the APA's rule of being arbitrary, capricious, or *manifestly contrary* to the statute.[67] Rather, the *Chamber of Commerce* court invalidated the Rule because Treasury failed to complete the notice-and-comment procedure:

The court concludes that the Rule was unlawfully issued without adherence to the APA's notice-and-comment requirements. When a reviewing court finds an agency action to have been carried out "without observance of procedure required by law," the court shall "hold unlawful and set aside" the action. 5 U.S.C. § 706. Accordingly, the court will grant summary judgment in favor of Plaintiffs on their claim that Defendants failed to complete the notice-and-comment procedure required by the APA and set aside the Rule.[68]

II. Conclusion

The significance of reviewing a regulation for compliance under the APA within Appeals is that it may provide a defensive tool at the initial point of the IRS examination. If the regulation is invalid, this stops all further inquiry. By applying this analysis at the Appeals level, there exists the ability and possibility to settle with the IRS at an earlier point in time—with a result that is "justice in the system for both the IRS and the Taxpayer."[69]

ENDNOTES

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1 *Chamber of Commerce of the United States of America et al.*, No. 1:16-CV-00944 (W.C Tex. 2017) ("*Chamber of Commerce*"). The U.S. District Court for the Western District of Texas granted summary judgment for the plaintiffs on September 29, 2017; Amended Order, dated October 6, 2017, which held that Treasury's temporary regulation 26 CFR §1.7874-8T (the "Rule") failed to complete the notice-and-comment procedure and set aside the Rule:

> Accordingly, the court will grant summary judgment in favor of Plaintiffs on their claim that Defendants failed to complete the notice-and-comment procedure required by the APA and set aside the Rule. *Id.* at *15.

On November 27, 2017, U.S. Department of the Treasury and the IRS filed "Defendants' Joint Notice of Appeal."

2 *American Standard, Inc.*, 220 Ct.Cls. 411, 79-2 USTC ¶9417, 602 F2d 256, (1979)("*American Standard*"); *Dominion Resources, Inc.*, FedCl, 2011-1 USTC ¶50,248, 97 FedCl 239, *rev'd*, CA-FC, 2012-1 USTC ¶50,372, 681 F3d 1313 ("*Dominion Resources*"); *Murfam Farms, LLC*, 88 FedCl 516 (2009) ("*Murfam*"); *CNG Transmission Management VEBA v. U.S.*, 84 Fed.Cl. 327 (2008); *aff'd, CNG Transmission Management VEBA v. U.S.,* 588 F3d 1376 (2009) ("*CNG*").

3 *Altera Corp.*, 145 TC 3 (2015) ("*Altera*"); *Xilinx, Inc.*, 125 TC 37, Dec. 56,129 (2005), *rev'd* CA-9, 2009-1 USTC ¶50,405, 567 F3d 482, *withdrawn* (9th Cir.2010), *aff'd*, CA-9, 2010-1 USTC ¶50,302, 598 F3d 1191.

4 *Florida Bankers Ass'n v. U.S. Dep't of the Treasury,* CA-DC, 2015-2 USTC ¶50,436, 799 F3d 1065 ("*Florida Bankers*"); *Dominion Resources, Inc.*, CA-FC, 2012-1 USTC ¶50,372, 681 F3d 1313 ("*Dominion Resources*"); *N. Cohen*, CA-DC, 2011-2 USTC ¶50,481, 650 F3d 717 ("*Cohen*").

5 *Mayo Found. for Med. Ed. & Research*, SCt, 2011-1 USTC ¶50,143, 131 SCt 704 ("*Mayo*"); *Home Concrete & Supply, LLC*, 132 SCt 1836 (2012) ("*Home Concrete*").

6 Donald Korb, former Chief Counsel of the IRS, 2004–2008, partner Sullivan & Cromwell, "Using the Administrative Procedure Act to Challenge IRS Guidance and Other IRS Administrative Actions," NYU Graduate Tax Program, 2016 ("Korb").

7 Patient Protection and Affordable Care Act ("Affordable Care Act") (P.L. 111-148), 124 Stat. 119, enacted March 23, 2010; "Section 9007 of the Affordable Care Act added section 501(r) and 4959 to the Code and amended Section 6033(b) ... Section 501(r)(7) provides that the Secretary shall issue such regulations and guidance as may be necessary to carry out the provisions of section 501(r)." Notice 2011-52.

8 The hospital was issued an audit notice after review by the national IRS Affordable Care Act ("ACA") 501(r) Issue Examination, Project Code 8015, whereby Code Sec. 501(c)(3) hospitals were referred to exam based upon certain issues as follows: "The issues focus on noncompliance related to Section 501(r) of the Public Law 111-148 (Patient Protection and Affordable Care Act) Section 9007(c) Additional Requirements for Charitable Hospitals. This case file contains information secured from an in-depth review of the health care organization's web site, Form 990 and other research supporting the issues(s) being referred...please contact one of the Triage members listed below for further guidance." EOCA Form 17-ACA 501(r) Examination Form, Page 1 of 2, Revised August 24, 2015.

9 "The APA requires that, prior to issuing a regulation, an agency (such as Treasury) must publish a notice of proposed rulemaking ('Notice') and provide an opportunity for the public to participate in the rulemaking process." Treasury also gives defective Notice under the APA if the final regulation, as adopted, differs markedly from the prior proposed regulation. The final Regulation as adopted, differed markedly from the prior proposed Regulation. In *American Standard*, 602 F2d at 265, 269, the "Court invalidated a regulation, where Treasury ... diametrically changed its substantive approach from the first proposal to the final regulation, [thus failing] to comply with the APA's notice rules." *Lubor Hlavacek, et al.*, 1:09-cv-00752 (settled Fed. Cl. July 15, 2015) Status Report Order, filed Nov. 6, 2014; Joint Status Report, filed Nov. 25, 2014. Stipulation of Dismissal, July 15, 2015. This case may not be cited for precedential purposes; *Plaintiffs' Memorandum in Support of Their Motion for Partial Summary Judgment as to the Validity of Treasury Regulation §1.1001-1(g)(1),* dated August 17, 2011 ("*Hlavacek*"), at 2; *Id*., note 39.

10 Currently, Section 7430(a), the primary Code section for obtaining administrative costs, provides the following: "In any administrative or court proceeding which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party may

be awarded a judgment or a settlement for—(1) reasonable administrative costs incurred in connection with such administrative proceeding within the IRS, and (2) reasonable litigation costs incurred in connection with such court proceeding."

[11] Executive Order dated January 20, 2017, Order Minimizing the Economic Burden of the Patient Protection and Affordable Care Act Pending Repeal, mandates that Treasury, as an agency with "authorities and responsibilities under the Act … exercise all authority and discretion available to them to waive, defer, grant exemptions from or delay the implementation of any provision or requirement of the Act that would impose a … tax, penalty or regulatory burden on … healthcare providers."

[12] Nathan Hockman, partner, Morgan, Lewis & Bockius LLP, UCLA Tax Controversy Institute, 2017 ("Hockman").

[13] *Hlavacek, supra* note 9.

[14] *Id.;* Reg. §53.4959-1, Appeals case settled September 6, 2017.

[15] Korb, *supra* note 6 and accompanying text.

[16] *Id*.

[17] David B. Blair, Esq. and David J. Fisher, Esq., Crowell & Moring LLP, BNA Tax Management Memo on *Altera*, 145 TC No. 3 (July 27, 2015), at 2.

[18] *Motor Vehicle Manufacturers Ass'n Inc. v. State Farm Mutual Automobile Insurance Co*., SCt, 463 US 29 (1983) ("State Farm"); *Chevron, U.S.A. Inc. v. Natural Res. Def. Council, Inc.,* SCt, 467 US 837, 844 (1984) ("Chevron"); *Morton v. Ruiz,* SCt, 415 US 199 (1974); *Greater Boston Television Corp. v. FCC*, 444 F2d 841, 852 (1970); *Judulang v. Holder*, 132 SCt 476 (2011).

[19] *See supra* notes 1–5 and accompanying text.

[20] Reg. §53.4959-1: T.D. 9708, 79 FR 79015, Dec. 31, 2014; 80 FR 12762, March 11, 2015; T.D. 8084, 51 FR 16303, May 2, 1986; T.D. 9407, 73 FR 37369, July 1, 2008; T.D. 9436, 73 FR 78457, Dec. 22, 2008; 74 FR 5106, Jan. 29, 2009, unless otherwise noted.Reg 1.1001-1(g): T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 7142, 36 FR 18950, Sept. 24, 1971; T.D. 7207, 37 FR 20797, Oct. 5, 1972; T.D. 7213, 37 FR 21992, Oct. 18, 1972; T.D. 8517, 59 FR 4807, Feb. 2, 1994; T.D. 8674, 61 FR 30139, June 14, 1996; T.D. 9348, 72 FR 42293, Aug. 2, 2007; T.D. 9729, 80 FR 48250, Aug. 12, 2015; 80 FR 55543, Sept. 16, 2015; T.D. 9811, 82 FR 6240, Jan. 19, 2017.

[21] 37 FR 21,992 (Oct. 18, 1972); 54 FR 37,125 (Sept. 7, 1989); 56 FR 21,112 (May 7, 1991); 56 FR 31,887 (July 12, 1991); 56 FR 8,308 (Feb. 28, 1991); 59 FR 4, 799; 59 FR 64,884 (Dec. 16, 1994). *Hlavacek*, at v. and vi.

[22] "Thereafter, from 1986 until 1991, Treasury issued four additional Notices of proposed regulations, which did not contain the Regulation. 54 Fed. Reg. 37,125 (Sept. 7, 1989); 56 Fed. Reg. 8,308 (Feb. 28, 1991); 56 Fed. Reg. 21,112 (May 7, 1991); 56 Fed. Reg. 31,887 (July 12, 1991)." *Hlavacek*, at 11.

[23] P.L. 98-369; Revenue Act of 1918, P.L. 65-254, Ch. 18, 40 Stat. 1057; Act Sec. 202(c) of the Revenue Act of 1921 (P.L. 67-98), Ch. 136, 42 Stat. 230; Act Sec. 202(c) of the Revenue Act of 1924 (P.L. 68-176), 43 Stat. 253 (1924). *Hlavacek,* at iv and v.

[24] H.R. Rep. No. 65-1037 (1918), reproduced at 1939-1 CB (Part 2) 89; S. Rep. No. 65-617 (1918), reproduced at 1939-1 CB (Part 2) 120S. Rep. No. 67-275 (1921), reproduced at 1939-1 CB (Part 2) 188; S. Rep. No. 68-398, (1924), reproduced at 1939-1 CB (Part 2) 266; S. Rep. No. 69-52 (1926), reproduced at 1939-1 CB (Part 2) 328. *Hlavacek,* at v.

[25] "In 1928, §202(c) was renumbered §111(c). J.S. Seidman, Legislative History of Federal Income Tax Laws 1113 (1938); *Helvering v. Walbridge*, 70 F.2d 683, 684 (2d Cir. 1934); 68 S. Rep. No. 69-52 (1926), reproduced at 1939-1 C.B. (Part 2) 328." *Hlavacek*, at 23, notes 66 and 67.

[26] "Thereafter, from 1986 until 1991, Treasury issued four additional Notices of proposed regulations, which did not contain the Regulation. 54 Fed. Reg. 37,125 (Sept. 7, 1989); 56 Fed. Reg. 8,308 (Feb. 28, 1991); 56 Fed. Reg. 21,112 (May 7, 1991); 56 Fed. Reg. 31,887 (July 12, 1991)." *Hlavacek*, at 11, note 33.

[27] *See supra* notes 7 to 11 and accompanying text.

[28] 78 FR 20523, REG-106499-12, 2013-211 IRB 1111 ("2013 Proposed Regulations").

[29] T.D. 9708 79 FR 78954-01, Dec. 31, 2014; ("Final Regulations").[§ 53.6011–1T [Reserved by 79 FR 79015] T.D. 9708, 79 FR 79015, Dec. 31, 2014; 80 FR 12762, March 11, 2015 Pipeline Safety: Miscellaneous Changes to Pipeline Safety Regulations.]

[30] 78 FR 20523, 20544 [emphasis added].

[31] 79 FR 78954-01, 79015 [emphasis added].

[32] The Preamble to a regulation consists of many sections such as: Summary; Supplementary Information; Summary of Comments and Explanation of Revisions; Availability of IRS Documents; Effect on Other Documents; Background; Special Analyses; and Comments and Public Hearing. Many times, there will be a section entitled Preamble. However, in the Regulation at issue in the hospital case, there was no section at the beginning entitled Preamble.

[33] *Hlavacek*, *supra* note 9.

[34] 5 USC §553(c).

[35] In *American Standard, Inc.*, 220 CtCls 411, 432 (1979), the Court invalidated a regulation where Treasury diametrically changed its substantive approach from the first proposal to the final regulation.

[36] Special Analyses section of the Final Regulations, 79 FR 78954-01, 78995.

[37] Substantive rules are defined by the Supreme Court, interpreting the APA, as those "affecting individual rights and obligations." *Morton v. Ruiz*, SCt, 415 US 199, 232, 94 SCt 1055, 1073, 39 LEd2d 270 (1974). "This characteristic is an important touchstone for distinguishing those rules that may be 'binding' or have the 'force of law.' *Id*., at 235, 236, 94 SCt 1074 … Likewise, the promulgation of these regulations must conform with any procedural requirements imposed by Congress. *Id., at 232*." *Hlavacek*, note 85*;* For agency discretion is limited not only by substantive, statutory grants of authority, but also by the procedural requirements which "assure fairness and mature consideration of rules of general application." *NLRB v. Wyman-Gordon Co*., SCt, 394 US 759, 764, 89 SCt 1426, 1429, 22 LEd2d 709 (1969). [Emphasis added].

[38] "*Chrysler Corp. v Brown*, SCt, 441 US 281, 313 F.N. 31, at 303 (1979); see *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc*., SCt, 435 US 519, 546, 98 SCt 1197, 1213, 55 LEd2d 460 (1978); *Power Reactor Co. v. Electricians*, SCt, 367 US 396, 408, 81 SCt 1529, 1535, 6 LEd2d 924 (1961); Zucca, SCt, 351 US 91, 96, 76 SCt 671, 674, 100 LEd 964 (1956)" Hlavacek, at 29, note 86.

[39] *Hlavacek*, at 1; *See Murfam, supra* note 2, *Plaintiff's Memorandum in Support of its Motion for Partial Summary Judgment,* dated March 7, 2008, at 16.

[40] *Id., Murfam*.

[41] "*Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc*., 467 U.S. 837, 842-43 (1984) ('Chevron'). In *Mayo Found. v. United States*, 131 S.Ct. 704 (20 II) ('Mayo'), the Supreme Court made it clear that Treasury regulations are to be given no deference other than that given to other regulations." *Hlavacek*, note 2 and accompanying text.

[42] *Chevron,* 467 US 842–843; *Hlavacek*, at 17.

[43] *State Farm*, 463 US 50; *Hlavacek*, at 18.

[44] *Chevron*, 461 US 842; *Hlavacek*, at 19.

[45] *Chevron*, 467 US 843, n.9; *Hlavacek,* at 19.

[46] *Chevron,* 467 US 862; *Hlavacek*, at 19; *Id*., *see generally* 19 to 27 for further analysis of Chevron Steps One and Two.

[47] *Chevron,* 467 US 844. *Mayo*, 131 SCt 713 [emphasis added].

[48] "5 USC §553 (b), (c), and (d). In general, 5 USC 553(b) and (c) require agencies to publish Notices of Proposed Rulemaking ("Notice") in the Federal Register ("FR") and provide interested persons the opportunity to comment on the proposed rules before adopted as final regulations." *Hlavacek*, note 4; *Id*., at 27.

[49] "*See American Standard 602 F.2d at 267-269*, wherein the Court invalidated a regulation relative to which Treasury diametrically changed its substantive approach from the first proposed regulation to the final regulation, thus failing to comply with the APA notice rules. *See also State Farm, supra,* 463 U.S. at 57, wherein the Supreme Court stated, 'an agency changing its course *must supply a reasoned analysis'* (quoting from *Greater Boston Television Corp. v. FCC,* 444 F.2d 841,852 (1970)) [emphasis added]." *Hlavacek*, note 95.

[50] The 1989 and 1991 Notices did not contain any such effective notice, either. However, these other Notices were minor and contained no language dealing with the Reg. or Code Sec. 1001(b). *Hlavacek,* at 31.

[51] *Id*.

[52] *American Standard*, 602 F2d 267–269; *Hlavacek*, at 32.

[53] 5 USC §553(c).

[54] 5 USC §553(c) [emphasis added].

[55] *Hlavacek*, at 32; *Id.,* note 95.

[56] *Id*., at 33.

[57] 5 USC §706(2)(C).

[58] *Hlavacek,* note 95 and accompanying text.

[59] *Id*.

[60] 5 USC §706(2)(A) [emphasis added]; *Hlavacek*, at

33.

[61] *State Farm,* 463 US 43 [emphasis added]; *Hlavacek*, at 34.

[62] *State Farm,* 463 US 49; *Hlavacek*, at 34.

[63] *Hlavacek*, at 35.

[64] "See, e.g., *Arrington v. Daniels*, 516 F.3d 1106, 1112, 1113, 1114 (9th Cir. 2008) ('we may not "infer an agency's reasoning from mere silence" "; 'Post hoc explanations of agency action by appellate counsel cannot substitute for the agency's own articulation of the basis for its decision'; 'Here, the Bureau failed to set forth a rationale for its decision. ... This failure renders the Bureau's final rule invalid under the APA'); *Center for Biological Diversity v. Nat'l Highway Traffic Safety Admin.*, 538 F.3d 1172, 1202 (9th Cir. 2008) ('NHTSA simply did not, "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made,"' quoting *State Farm*); *Utah Envtl. Cong. v. Troyer*, 479 F.3d 1269, 1288 (10th Cir. 2007) ('consistent with ... *Chenery*, we may not affirm the project approvals on a "basis ... [not] ... set forth [in the record] with such clarity as to be understandable"' (alterations in original)); *Kentucky Waterways Alliance v. Johnson,* 540 F.3d 466, 492 (6th Cir. 2008) ('the EPA's decision document ... fails to aim its analysis at the legally operative question ... The EPA's decision document avoids answering this question, and we accordingly lack the information needed to meaningfully review the EPA's decision to approve Kentucky's regulations,' citing *State Farm*); *Citizens Awareness Network, Inc. v. United States Nuclear Regulatory Commission*, 59 F.3d 284, 291 (1st Cir. 1995) ('Courts should not attempt to supply a reasoned basis for the action that the agency itself has not given,' citing State Farm); *CBS Corp. v. FCC*, 535 F.3d 167, 183, 189 (3d Cir. 2008) ('[T]he FCC has not offered any explanation -- reasoned or otherwise -- for changing its policy'; 'Consequentially, the FCC's new policy ... is arbitrary and capricious under *State Farm* and the Administrative Procedure Act, and therefore invalid as applied to CBS'); *Yale-New Haven Hosp. v. Leavitt*, 470 F.3d 71, 85, 86 (2d Cir. 2006) ('The Secretary also fails to explain how adoption of a per se coverage standard comports with congressional purposes in enacting the Medicare Act'; 'Because the Secretary acted arbitrarily and capriciously under § 706(2)(A) in promulgating the 1986 Manual Provision, we conclude that it is invalid and unenforceable'); *Owner-Operator Independent Drivers Ass'n, Inc. v. Federal Motor Carrier Safety Administration*, 494 F3d 188, 206 (D.C. Cir. 2007) ('the agency's failure of explanation renders the restart provision arbitrary and capricious'); *Shays v. FEC*, 528 F.3d 914, 929 (D.C. Cir. 2008) ('the FEC has provided no explanation for why it believes 120 days is a sufficient time period to prevent circumvention of the Act.'); *Shays v. FEC*, 414 F.3d 76, 97, 102 (D.C. Cir. 2005) ('the FEC has given no rational justification for [the three rules], as required by the APA's arbitrary and capricious standard,' citing *State Farm*; 'Accordingly, finding the rule arbitrary and capricious under the APA, we shall affirm the district court's invalidation')." *CNG*, *supra* note 2, Plaintiff's Appellate Brief, February 6, 2009, at 25.

[65] It is this author's belief that the judiciary prefers to render a decision based upon the clear procedural requirements under the APA's Notice procedures, which are more certain and less likely to be overruled. This is solely a personal belief, based upon her clerkship with U.S. Tax Court Judge Larry L. Namaroff (retired), and what was stated to Plaintiffs' counsel within the *Hlavacek* case. The author, as one of the Plaintiffs' attorneys, recalls that Judge John P. Wiese (retired) indicated to counsel during a telephonic conference that he lacked familiarity with the statutory scheme under the Original Issue Discount rules, which is not unusual, since most federal judges are not former tax attorneys. Judge Wiese then stated that the APA Notice issues were clear, and that the Government should consider settling with the Plaintiffs.

[66] *Chamber of Commerce*, at 10. The material facts are not in dispute in this case and the court concludes Plaintiffs' arbitrary-and-capricious-rulemaking claim fails as a matter of law. The court will therefore order that Plaintiffs take nothing on their claim that Defendants violated the APA by engaging in arbitrary and capricious rulemaking. *Id.*, note 3, at 10.

[67] *Id.*, at 10.

[68] *Chamber of Commerce*, at 15.

[69] Hockman, *supra* note 12.