THE U.S. APPROACH TO SEPARATION OF POWERS IN TAX MATTERS

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1. Relationship between the Parliament and the Tax Authorities: The influence of the tax authorities on tax legislation

The United States Constitution confers governmental powers on three branches of government, the legislature or Congress, which is composed of the House of Representatives and the Senate, the President (or Executive Branch), and the courts.[1] Much of the work of the Executive Branch is presently carried out by administrative agencies. Tax laws are administered by the Department of the Treasury, supervised by the Secretary. Most of this responsibility has been delegated to the Internal Revenue Service, a branch of the Department of the Treasury, which is led by the Commissioner of Internal Revenue.

1.1. Does your Government have legislative competence on tax matters?

Assuming that the term government refers solely to the tax administration or Executive Branch of government, the answer is no. The United States Constitution vests all legislative powers in Congress.[2] The Constitution specifically empowers Congress to lay and collect Taxes, Duties, Imports and Excises.[3] The Sixteenth Amendment to the Constitution grants Congress the power to impose an income tax.[4]

1.2. Does your Government draft tax bills proposals and present them to Parliament?

[*] I would like to express special thanks to Victor T. Thuronyi, who provided helpful comments and critical insights in the preparation of this paper.

[1] This work deals exclusively with the administration of tax laws at the level of the national government and does not deal with these issues at the state government level. The United States is a federal system established by the U.S. Constitution comprised of federal or national government and fifty subordinate semi-sovereign states. State governments are competent to legislate on tax matters within their boundaries.

[2] U.S. CONST. Art. I, § 1.

[3] *Id.*, § 8.

[4] U.S. CONST., 16th Amend.

Yes. Presidents often propose tax legislation. Both President Clinton and President Bush proposed several major tax plans to Congress. President Obama has posted his Administration's tax plan on the White House website.[5] Tax legislation proposed by the Executive Branch normally originates with the Secretary of the Treasury whose principle advisor is the Assistant Secretary for Tax Policy. The Assistant Secretary heads up the Office of Tax Legislative Counsel.[6]

It should be noted, however, that what is typically proposed is not a draft law, but rather a policy proposal. The drafting work is actually done by the House Legislative Counsel and the Senate Legislative Counsel.

1.3. In case your answer to 1.1. and 1.2. is positive:

1.3.1 Does your Government usually exercise that competence?

Yes. The legislature will always review proposals presented by the President or the Department of the Treasury. There is no automatic acceptance, however. The usual practice is for Congress to draft a bill, to hold its own hearings, and to subject the proposal to substantial analysis, debate, and revision before submitting a bill to the floor of Congress for voting.

1.3.2 Does your Parliament passively accept the draft bills provided by tax authorities or does it discuss them in detail and introduce changes to them?

Certainly tax authorities have significant input into tax legislation. As pointed out before, often the President or the agency propose legislation. Finally, as with all legislation, the

[5] http://www.whitehouse.gov/infocus/taxes/.
[6] *See* MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE, ¶ 1.02(1) (2nd ed. Warren Gorham & Lamont).

President of the United States may veto tax legislation, which veto may only be overruled and the legislation made law by a vote of 2/3 of each house (House and Senate).[7]

The U.S. Congress, however, is quite independent of the Executive Branch of government. Each House has standing committees on tax legislation, the House Ways and Means and the Senate Finance Committee. A third committee, the Joint Committee on Taxation, is essentially a formal committee with a professional staff that provides support to both houses. These three committees are well-staffed and bear the major role in developing tax legislation.

1.4. How does the literature in your country and your domestic Courts interpret the situation as you described it in 1.3. ?

Though the Constitution of the United States never uses the words separation of powers,[8] it is often thought that the concept is implicit in the American form of constitutional government. Under the Constitution, the national government is a government of delegated powers. One can correctly speak of separation of powers in terms of the application of the structural limits or checks on the power of the three branches of government set forth in the Constitution. The Constitution explicitly delegates the authority for making law exclusively to Congress. Congressional lawmaking is subject to the veto power of the President, however, which veto can be overruled by a supermajority of both houses.

2. The meaning of legal indeterminacy in tax matters

[7] U.S. Const. Art. I, § 7.
[8] The framers of the U.S. Constitution twice rejected proposals for a separation of powers clause in the Constitution. *See* Casper, *An Essay in Separation of Powers: Some Early Versions and Practice*, 30 WM. & MARY L. REV. 211, 221 (1989).

2.1. Is your domestic tax legislation vague, when defining the tax object, tax subject and/or tax base, leaving a large margin for discretion, or, is it, on the contrary, very detailed, avoiding indeterminate concepts?

The first income tax act passed after the adoption of the Sixteenth Amendment was a model of simplicity.[9] The entire act was less than 16 pages and the substantive provisions that imposed the tax were only two pages in length. The initial law relied primarily on concepts, standards and principles rather than rules.[10] This necessarily imposed on the administration and the courts the obligation to develop the tax law over the years.[11] For example, the Code provides that "gross income means all income from whatever source derived."[12] As recently as 1955, the U.S. Supreme Court refused to limit the concept of income by a precise definition, where Congress had not.[13] Clearly, it was through this process undertaken by the courts in the context of particular taxpayer disputes, instigated by the administration's elaboration of the legislative scheme as it sought to enforce the legislation, that led to the development of many of the most important principles of income taxation in the United States.[14]

However, as time passed, U.S. tax legislation has become more detailed and thus more rule-oriented. Though detailed rules present a plethora of interpretive issues for courts and administrators leading to considerable administrative guidance and litigation, their interpretation generally lacks the global impact that the interpretation of concepts and standards have.

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[9] Act of Oct. 3, 1913, ch. 16, § II(B), 38 Stat. 114, 167.
[10] *See, e.g.*, Victor Thuronyi, *The Concept of Income*, 46 TAX. L. REV. 45 (1990).
[11] Richard Haig criticized the income tax's lack of a definition of income as follows: "Viewed from the vantage point of the present, the federal income tax law of 1913 seems an incredibly naïve document. Today it seems astonishing that so many fundamental issues should have been so slightly considered or so blithely ignored. The law contained no precise and comprehensive description of the tax base." Rittaig, *Forward to* MAGILL, TAXABLE INCOME at iii (1936).
[12] Internal Revenue Code of 1954 [hereinafter IRC] § 61.
[13] Commissioner v. Glenshaw Glass, 348 U.S. 426 (1955).
[14] For an account of this early jurisprudence, *see* William B. Barker, Statutory Interpretation, Comparative Law and Economic Theory: Discovering the Grund of Income Taxation, 40 SAN DIEGO L. REV. 821, 832-65 (2003).

2.2. How do you/does the literature in your country evaluate the use of both techniques in tax legislation?

Though the incredible volume of legislative rules indicate quite strongly that the power of Congress and the rule-based approach to tax law dominates current tax law, there are still significant areas which depend on broad judicial and administrative discretion. A principal area involves anti-avoidance principles developed by courts like assignment of income, substance over form, sham, and economic substance. Other provisions, like the U.S. transfer pricing legislation[15] and the accounting legislation that requires that a taxpayer's method of accounting must "clearly reflect income,"[16] grant considerable discretion to the administration. Administrative discretion is always subject to review by the courts.[17] The literature in the United States on administrative and judicial discretion is voluminous.[18]

2.3. Are there independent domestic Courts obliged to control the constitutionality of tax legislation?

The United States Constitution establishes the judicial power of the courts[19] which extends to "all cases [and controversies] in Law and Equity, arising under the Constitution, and the laws and treaties of the United States."[20] All legislation must comply with the requirements

[15] IRC § 482.
[16] *Id*., § 446(b).
[17] For example, the Secretary's authority under IRC § 446(b) is subject to the abuse of discretion standard of review. The Administrative Procedure Act, 5 U.S.C. § 706(2)(A).

Recently, there has been a movement to codify the economic substance requirement in order to make it more effective in preventing tax abuse. This is a controversial measure which has not yet been enacted.
[18] *See, e.g.*, Lawrence Zelenak, *Thinking About Nonliteral Interpretation of the Internal Revenue Code*, 64 N.C. L. REV. 623 (1986); Deborah A. Geier, *Interpreting Tax Legislation: The Role of Purpose*, 2 FLA. TAX REV. 492 (1995). For a thorough account of American administrative law principles and separation of powers, see KENNETH C. DAVIS AND RICHARD J. PIERCE, ADMINISTRATIVE LAW TREATISE, Ch. 2 (3rd ed. 1994). For a critical account of excessive delegation of powers to administrative agencies, see *A Symposium on Administrative Law: "The Uneasy Constitutional Status of the Administrative Agencies," April 4, 1986, Part I, Delegation of Powers to Administrative Agencies: Principle Paper: Two Roads to Serfdom, Liberalism, Conservatism and Administrative Power*, 30 AM. U. L. REV. 295 (1987).

of the Constitution. Early in the history of the United States, the U.S. Supreme Court in *Marbury v. Madison* concluded that "An act of Congress repugnant to the constitution cannot become a law."[21] In that case the Court established the principle that the question of the constitutionality of legislation is properly subject to judicial review. Consequently, courts of the United States may determine the constitutionality of legislation within the confines of cases and controversies and make final determinations resolving the parties' dispute.

Decisions invalidating federal income tax legislation are extremely rare in the United States. Although there were cases in the past,[22] such an outcome would be very surprising today.[23] In cases of taxes other than income taxes, the Constitution is more restrictive, however.[24] By contrast, federal courts routinely rule that state taxes are unconstitutional usually on grounds that they violate principles of federalism.

The court system in the United States that has jurisdiction over tax matters is both complicated and diverse, and is based on historical accident rather than logic. Briefly summarizing this structure here will aid in one's understanding some of the responses below. There are three courts of original jurisdiction in tax matters, the United States District Courts, which are courts of general jurisdiction spread across the United States; the Court of Federal Claims, which is a national court of limited jurisdiction, that has jurisdiction over claims mainly

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[19] U.S. CONST., Art. III, § 1.
[20] *Id*., § 2.
[21] 1 Cranch 137, 138 (1803).
[22] The most famous case was Pollock v. Farmer's Loan and Trust Co., *supra* note 4, which invalidated the income tax. A more recent case was *Eisner v. Macomber*, which declared Congresses' inclusion of stock dividends (in kind) in income was unconstitutional because it defined income beyond the scope of the Sixteenth Amendment. 252 U.S. 189 (1920). The Court's reasoning has been significantly eroded by later cases. *See Commissioner v. Glenshaw Glass*, *supra* note 12.
[23] In Murphy v. Commissioner, 460 F.3d 79 (D.C. Cir. 2006), the court of appeals initially held that the statute could not tax damages received by an employee from her employer under a whistleblower statute because such damages were not income within the meaning of the Sixteenth Amendment. The court later vacated and reversed this decision. 493 F.3d 170 (D.C. Cir. 2007).
[24] *See* United States v. United States Shoe Corp., 523 U.S. 360 (1998) (Harbor Tax was a tax, not a user fee, which was in an amount disproportionate to the benefit conferred and thus violated the Export Clause of the Constitution).

for money damages brought against the United States government; and the Tax Court, a national court whose jurisdiction is solely limited to tax cases. The primary distinction between the jurisdiction of the Tax Court and the District and Federal Claims Courts in taxation is that the Tax Court's jurisdiction extends to tax deficiencies[25] (where the taxpayer has not paid) and the District and Claims Courts' jurisdiction extends to tax refund suits (where the taxpayer asserts an overpayment of tax and seeks a refund).[26] Appeals from decisions of the Tax Court and District Court go to one of the twelve regional Courts of Appeals; decisions of the Federal Claims Court are appealed to the Federal Circuit Court of Appeals.

2.4. Is legal indeterminacy considered to be unconstitutional/has a tax rule ever been declared unconstitutional due to legal indeterminacy?

In general, all legislation is subject to the Due Process Clause of the Constitution.[27] An act will not be enforced if it is so unclear as to be arbitrary. In other areas, this is referred to as the void for vagueness doctrine.[28] This requirement was described by the Tenth Circuit Court of Appeals as follows: "A taxing statute must describe with some certainty the ... object to be taxed, and in the typical situation it is construed against the government."[29] Research has not disclosed any case that has struck down an income tax statute for vagueness. In practice, courts use legislative history, regulations, administrative guidance, judicial decisions, or general principles of statutory construction to give meaning to statutes which on their face may appear to be vague.

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[25] IRC § 7442.
[26] *See, e.g., id*., § 7422.
[27] U.S. CONST., Vth Amend., ("No person shall. . . be deprived of property without due process of law. . .").
[28] *See, e.g*., Colautti v. Franklin, 439 U.S. 379 (1979).
[29] United States v. Community TV, Inc., 327 F.2d 797, 800 (1964).

3. The consequences of legal indeterminacy in tax matters

3.1. In case of legal indeterminacy not considered to be unconstitutional, who has the final word regarding the interpretation of the rule – the tax authorities or the domestic Courts?

Decisions of the courts in tax matters are final. Thus, the courts have the final word regarding the interpretation of tax statutes with respect to the case before them. In other words, the decision is final with respect to the parties and the dispute before the court. As to future cases, a court's interpretation of the tax law only serves as precedent, and precedent only binds inferior courts whose decisions must be appealed to that forum. Courts, however, only rarely overrule their own precedents. Consequently, only the decisions of the U.S. Supreme Court constitute binding precedent for all courts in the United States.

A decision of the Supreme Court which determines the validity of tax law tested by the Constitution binds all branches of government as to future cases and cannot be changed by Congress. It can, however, be overruled by the Supreme Court itself.[30]

3.2. Is there a constitutional basis for either the tax authorities or the domestic Courts having the final word on interpretation of indeterminate legal rules?

As pointed out in Section 3.1, the Constitution assigns to the courts the final word on the interpretation of tax statutes in the case immediately before them. Their decisions are precedents that only bind the courts under the principles outlined in Section 3.1.

[30] *See* James v. United States, 366 U.S. 213 (1961) (prior interpretation that embezzlement gains were not income within the meaning of the 16th Amendment was overruled).

3.3 Is legal indeterminacy normally fulfilled by regulations, administrative rulings and/or case law?

The Internal Revenue Code of 1986 (as amended), which deals with federal taxes (individual and corporate income taxation, estate and gift taxation, excises, Social Security tax, and others) is unquestionably a complex and complicated legislative scheme. It is composed of thousands of sections covering hundreds of pages of text. Guidance to taxpayers on the meaning of tax legislation is supplied through voluminous case decisions and administrative pronouncements. This guidance includes six volumes of Treasury Regulations, Internal Revenue Service Revenue Rulings published in over 100 volumes, and other types of published materials, including specific advice to individual taxpayers published as Private Letter Rulings. In many cases, understanding the way tax legislation applies to individual circumstances is determined by administrative or judicial work product.

3.4 Are administrative rulings binding to the taxpayer and/or the Courts?

Regulations are promulgated by the Department of the Treasury. Under the Administrative Procedure Act, these Rules are "an agency statement of general or particular applicability and future effect designed to implement, interpret or prescribe law or policy. . . ."[31] In the U.S., a Revenue Ruling is a statement of law or policy adopted by the IRS that, much like a court case, gives advice on the application of the law to a particular set of facts. Regulations and Rulings are accorded different status as sources of law by U.S. courts.

There are two kinds of regulations, legislative or substantive regulations, and interpretive regulations. Legislative regulations are those that are promulgated under a specific statute whereby Congress makes a specific delegation of rulemaking authority. Legislative regulations

[31] 5 U.S.C. § 551(4).

are said to have the force and effect of legislation.[32] For example, Section 1501 of the Code[33] grants to an affiliated group of companies the privilege of filing a consolidated income tax return in very general terms. Section 1502 grants to the Secretary of the Treasury vast rulemaking authority to determine the manner in which affiliated corporations comply. Thus, the consolidated return regulations are, essentially, the consolidated income tax return laws.

A particular broad delegation of legislative power was considered in the case of *Skinner v. Mid-American Pipeline Co.*[34] There, Congress had authorized the Secretary of the Department of Transportation to calculate and impose a tax on the operation of pipelines based on volume-miles, miles, revenues, or an appropriate combination thereof. The Supreme Court unanimously upheld the delegation of Congress' taxing power, finding that the taxing power was no different than any other legislative power.

All regulations are subject to judicial control, however. Legislative regulations have been invalidated when they conflict with the statute[35] because that would exceed the agency's delegated power.[36]

The second category of regulations is known as interpretive regulations. These regulations are promulgated under the general authority of Section 7805(a) to "prescribe all needful rules and regulations for the enforcement of" internal revenue laws.[37] Their purpose is to give guidance to taxpayers by explaining the meaning of legislative provisions. Interpretive regulations are not always binding on the courts, but they must be followed if they present a

[32] Union Elect. Co. v. United States, 305 F.2d 850, 854 (Ct. Cl. 1962).
[33] I.R.C. § 1501.
[34] 490 U.S. 212 (1989).
[35] City of Tucson v. Commissioner, 820 F.2d 1283 (D.C. Cir. 1987).
[36] American Standard Inc. v. United States, 602 F.2d 256 (Ct. Cl. 1979) (consolidated return regulation unreasonable and invalid because it "changed the conceptual base upon which Congress permitted the Sec. 922 deduction and defeats the congressional purpose that WHTC's products and services are competitively priced in Western Hemisphere trade.")
[37] I.R.C. § 7805(a).

reasonable interpretation of the statute. It is the administration's prerogative, not the court's, to choose among reasonable interpretations. An interpretation is not reasonable, however, unless it is in harmony with the statute's purpose.[38]

Revenue rulings are the IRS's interpretation of the revenue laws. Traditionally, they have not been considered to be binding on taxpayers or the courts.[39] Practically speaking, however, they are generally followed by Service personnel in the administrative stage.

There is a growing trend among courts of appeal to allow some deference to revenue rulings.[40] Though the Supreme Court has declined to determine whether revenue rulings are generally entitled to deference, it did conclude that where the rulings represent the IRS's longstanding interpretation of the tax code and such statutes are not amended or substantially reenacted, the rulings "are deemed to have received congressional approval and have the effect of law."[41]

Though taxpayers may generally rely on the regulations and rulings of the Treasury and IRS,[42] the government is not always bound by its own pronouncements. Treasury Regulations are binding unless they have been revoked, or unless they are not a valid interpretation of the statute. Revenue rulings can usually be repudiated by the Service. In general, the courts will not bind the government where the administration's pronouncements reflect mistaken law.[43]

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[38] United States v. South Texas Lumber Co., 333 U.S. 496 (1948).
[39] Stubbs, Overbeck & Assocs. v. United States, 445 F.2d 1142, 1146-47 (5th Cir. 1971) (a revenue ruling "is merely the opinion of a lawyer in the agency. . . .").
[40] *See* Benjamin J. Cohen & Catherine A. Harrington, *Is the Internal Revenue Service Bound by its Own Regulations and Rulings*, 51 TAX LAWYER, 675, 687 n.73 (cases cited therein).
[41] United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 212 (2001).
[42] Treas. Reg. §§ 601, 601(d)(2)((v)(e).
[43] Manhattan General Equipment Co. v. Commissioner, 297 U.S. 129 (1936) (general rule that the government may revoke retroactively erroneous regulations and rulings). *See also* Dixon v. United States, 381 U.S. 68, 75 (1965), (the government may correct a mistake of law even where the taxpayer has acted in reliance on the government's interpretation).

4. Relationship between the Tax Administration and the Domestic Tax Courts:

4.1. Do your domestic Courts control application of tax law by your Tax Administration?

As explained in sections 3.1 and 3.2, taxpayers have full access to courts to resolve their tax liability. The court's decisions in tax cases control the application of the tax law in regard to the taxpayer's liability.

4.2. Do your domestic Courts, in their case law, take into account rulings and binding information emerging from your Tax Administration?

As described in sections 3.3 and 3.4, the courts are bound by legislative regulations, which have the force of law, as long as the administration's actions are in accordance with the enabling statute. Interpretive regulations are entitled to great weight. They are followed by the courts as long as they adopt a reasonable interpretation of the legislation (even though the court, if free to do so, would adopt another interpretation). Revenue rulings traditionally were viewed as notice of the litigating position of the Internal Revenue Service and were accorded no weight. The trend is growing among U.S. Courts of Appeal to accord deference to revenue rulings. Courts in general, however, always give serious consideration to administrative materials.

4.3. Does your Tax Administration take into account the domestic courts case law and/or the ECJ case law when applying the law?

In the United States, much of what the tax law is today is the result of the interpretations made by courts in implementing the tax law.[44] Administrative authorities take court cases into account all the time in applying the law. As outlined in more detail in sections 4.5 and 4.6,

[44] *See* Section 2.1, *supra*.

however, administrative authorities are not generally bound by court decisions as to the future interpretation of the law. In cases of disagreement, the IRS has a procedure for notifying the public and administrative personnel as to its position as to the validity or applicability of court cases.[45]

4.4. Is there a principle of reciprocal observation of the interpretation of tax law by the Tax Administration and domestic Courts?

Though not all tax controversies are litigated, it is natural and expected in the United States for unresolved tax controversies to be litigated. For this reason, courts in the United States are significant players in controlling the substance of tax law as administratively practiced. Juxtaposed to this is the role of the administration that makes the initial determination as to a taxpayer's liability and is directly involved in setting the agenda for the courts.

In the U.S., we do not speak of a principle of reciprocal observation. That, of course, does not mean that the principle does not operate in the tax world. The concept, however, conveys the concept of two systems that are operatively closed but cognitively open to the other. Though it would be inaccurate to conclude that the court system is closed to the administration, since the administration is always a necessary player in the judicial process, it would be accurate to conclude that courts and administration are structurally coupled, allowing for simultaneous reciprocal observation between them. Thus law and enforcement, courts and administration, interrelate in a way that reflects this dynamic interchange. The United States Supreme Court once summarized the relationship among the three Branches of government by relating that the

[45] *See* Sections II, 3.3, 3.4, 3.5.

Constitution created a governmental structure that "imposes on the Branches a degree of overlapping responsibility, a duty of interdependence, as well as independence.[46]

4.5. Is your Tax Administration legally bound to the decisions of supreme courts and/or the ECJ?

First, it must be recognized that once a court decision is final, it resolves the tax controversy between the parties and both the government and taxpayer are bound. As to the question of whether the Service is bound to follow the court's interpretation of the tax law in other cases, the answer is that if the interpretation is made by the U.S. Supreme Court, the administration is bound. Otherwise, the administration is not bound by the court's determination and is free to relitigate the issue in any forum.[47] Even where the decision is that of the Supreme Court, the administration may relitigate the issue with the objective of seeking a redetermination by the Supreme Court.[48] In addition, the Service may also litigate the question of the scope and meaning of a Supreme Court interpretation of tax law.

4.6. Does your Tax Administration circumvent your domestic courts' case law?

In regard to lower court determinations, the Service often relitigates the same issues in other forums. Taxpayers, moreover, do likewise. It is also not uncommon for subsequent courts to disagree with the interpretations reached in earlier decisions. This is an expected part of the U.S. system which is looked upon by most as an appropriate way to allow for the best development of the tax law through consideration in multiple forums. One ground for review by

[46] Mistretta v. United States, 488 U.S. 361 (1989).
[47] The Supreme Court has not ruled on this agency practice. For an excellent article generally treating this subject, see Estreicher and Revesz, *Nonacquiescence by Federal Agencies*, 98 YALE L.J. 679 (1989).
[48] *See* James v. United States, *supra*, note 26, where the administration successfully advanced the argument that embezzled gain was income contrary to the Supreme Court's prior decision that it was not.

the U.S. Supreme Court (by writ of certiorari) is a conflict between or among circuit courts of appeal. The Supreme Court is not required, however, to grant certiorari. Consequently, as tax law develops through a process of continuous consideration and reconsideration by the administration and the courts, it can be interpreted and applied differently in different parts of the country. Though these cases are not common, they are significant enough to be a defining element in the enforcement and interpretation of U.S. tax law.

5. Relationship between different legal sources (legal pluralism):

5.1. How do your Parliament, Tax Administration and Courts react before the different legal sources in tax matters (tax treaties and other treaties, EC Treaty, secondary law and soft law)?

5.2. How is the hierarchy of different tax legal sources recognized by the constitution and the different domestic powers (Parliament, Tax Administration and Courts)?

The U.S. Constitution provides that the Constitution, the laws of the United States, and treaties made under the authority of the United States, shall be the supreme law of the land.[49] Article II, Section 2 empowers the President, with the advice and consent of the Senate (providing two-thirds of those present concur), to make treaties.[50] The U.S. Constitution is the law upon which all others are based, and all laws or treaties inconsistent with the Constitution are invalid.[51] "An act of Congress, repugnant to the constitution, cannot become a law."[52] An interpretation by the U.S. Supreme Court as to the constitutional validity of an act of Congress or treaty is binding on all courts and Congress. Only the Supreme Court can overrule its own

[49] U.S. CONST., Art. III, § 3.
[50] *Id*. Art. II, § 2.
[51] *Marbury v. Madison, supra* note 19.
[52] *Id*. at 138.

interpretation as to the Constitution. Though this hierarchy of legal sources was established solely by one branch of government—the courts—it is an established principle of the U.S. concept of the rule of law and the principle of separation of powers.

Among acts of Congress and treaties, the general principle is whichever is more recent will be controlling if there is a conflict between them.[53] However, if both treaty and congressional law can be understood to both apply, both will apply.[54] Although treaty override is possible in the U.S., it is not favored. Courts will interpret a statute as overriding a treaty only if there is a fairly clear Congressional intention to do so.

5.3. Does the taxpayer have access to different legal remedies that assure him/her effective protection of his/her rights granted by tax treaties, EC law and domestic law, or are those legal remedies in fact limited to protection of rights granted by domestic law?

As noted in Section 5.1 and 5.2, the Constitution, legislation, and treaties are the "supreme law of the land."[55] The Constitution also provides that the judicial power shall extend to all cases arising under the Constitution, the laws and treaties of the United States.[56] Rights afforded by the Constitution, legislation or treaties are enforceable in the context of a judicial proceeding involving the proper tax liability of a taxpayer. As outline in more detail in Section 2.3, a taxpayer may bring a tax claim in three courts of original jurisdiction: the district courts, the tax court, and the federal claims court. Both the taxpayer and the administration have the right to appeal an adverse decision to the appropriate court of appeals. Unless a tax case

[53] Ward v. Race Horse, 163 U.S. 504, 511 (1896).
[54] *Id.*
[55] U.S. CONST., Art. III, § 3.
[56] *Id.*, Art. III, § 2.

involves an adverse determination of the constitutional validity of law, review by the Supreme Court of lower court decisions can only be obtained by application for a writ of certiorari, the grant of which is a matter of complete discretion with the Supreme Court.

II

Please answer the following questionnaire, which aims at confirming your answers in I

1. Relationship between the Parliament and the Tax Authorities: The influence of the tax authorities on tax legislation

1.1. Does your Parliament control tax authorities in an efficient way? yes – no

Congress controls the actions of the Department of the Treasury and the Internal Revenue Service in various ways. Congress, through legislation, grants to an agency the power to act. Congress always has the power to change the authority upon which an agency acts; Congress can also override a specific agency decision.[57] Moreover, pursuant to Congress' power over appropriations,[58] Congress can limit an agency's funds and can even deny money for a particular agency program.[59] In addition, Congress must consent to the appointment by the President of the Secretary of the Treasury, the Commissioner of Internal Revenue and the Assistant Secretary of the Treasury for Tax Policy.

Congress also performs its oversight function of tax administration through the Congress' Joint Committee on Internal Revenue Taxation.[60] This committee exercises considerable

[57] *See* MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE at I-26.
[58] U.S. CONST., Art. I, § 9.
[59] *See* Pub. L. No. 96-74, §§ 614, 615, 93 Stat. 576 (1979), where Congress mandated to the IRS that no portion of any appropriation be used to enforce rules dealing with the tax exempt status of segregated schools.
[60] IRC §§ 8001-8005.

authority over IRS actions and procedures. The Committee reviews all compromised tax refunds over $200,000,[61] has the power to examine tax returns, and can subpoena witnesses.[62]

1.2. Do tax authorities influence tax legislation to a major degree? <u>yes</u> - no

As pointed out in Section I, 1.1, the Executive Branch is a source of significant input affecting tax legislation.

1.3. Does your Parliament a) usually accept the bills provided by tax authorities? yes – no

Though Congress usually accepts a presidential plan for consideration, this does not guarantee its eventual adoption. Tax bills go through a rigorous process of consideration by the committees of both houses. These include the House Ways and Means Committee, the Senate Finance Committee, and the Joint Committee on Taxation. To say that the bills are usually improved by this process is a matter of opinion; to say that they are often changed is true as a matter of fact.

b) refuse the bills provided by tax authorities? never - sometimes - often

Sometimes

c) improve the bills provided by tax authorities? never - sometimes – often

Often

1.4. Is your Parliament able to discuss the bills thoroughly? <u>yes</u> – no

Congressional committees control the nature of the legislation presented to the House and Senate for final vote. Once legislation is presented, the process formally begins in the House

[61] *Id*. § 6015(b).
[62] *Id*. § 8021.

Committee. If approved, the bill is then sent to the floor of the House for a vote, if approved by the House it is sent to the Senate Committee, then to the floor of the Senate for a vote. At this point, the two versions are sent to a conference committee to reconcile the differences. There can be considerable debate by members of Congress at these various stages. Debate and the possibility of offering amendments are usually more extensive in the Senate, due to the difference in procedural rules in each chamber.

1.5. Is there sufficient knowledge of tax law in Parliament? <u>yes</u> - no

As outlined above, the Congressional Committees on taxation have large professional staffs to aid the members of those Committees in considering tax legislation. Members of these Committees tend to develop a certain expertise over time. Since the members of Congress are confronted with an enormous variety of issues, they must necessarily rely on their staffs for expertise in tax matters. Since taxation in America is an issue of enormous political importance, tax bills receive considerable attention from members of Congress.

1.6. Are tax rules often so vague, that tax authorities have to fill the gaps themselves by administrative regulations? never - sometimes - often

See Section 1.7, *infra*

1.7. Have tax authorities the competence to typify and fill out the legal gaps without control by the Parliament? never - sometimes - often

The concept of gap filling, or prolongation of statutes, though not unknown in American jurisprudence, is one which is typically considered to go beyond the mandate of the courts which

instead is to implement the legislation that Congress enacted. The effect of this viewpoint must be examined, however, in light of two important aspects of American tax law.

First the initial income tax act was very brief (less than 16 pages in total and less than two pages of substantive provisions) and it relied on concepts, standards and principles. The history of income taxation was dominated for many years by courts developing these concepts. Though U.S. tax legislation has become more technical and more rule-based over the years, the expansive judicial role is still a factor in the interpretation of tax laws. Second, it is not misleading that the Americans called their tax law the Internal Revenue *Code*. The Code is viewed not simply as a digest of tax laws, but as an integrated whole. Thus, in interpreting individual provisions one must view their place in the whole of tax law assuming, unless there were an indication otherwise, that Congress intended a meaning consistent with other provisions. When resolving ambiguous legislation, judicial interpretation is designed to implement the policy that Congress has adopted. Resolving ambiguity, however, can require choices among policies.

Second, as outlined in Section I(3), Congress has delegated considerable rulemaking power to the tax authorities. Clearly, legislative regulations, which have the force and effect of law as long as they are not inconsistent with the statute, are a broad grant of legislative power to administrators authorizing agency policymaking. Thus, there is broad power conferred on tax administrators to implement broad congressional policies with more particularized rules. This is gap filling and policymaking by administrative regulation.[63]

Interpretive regulations and other rulings may have a similar, if not as dramatic, effect. Where Congress has unambiguously expressed itself, the agency, as well as the courts, must give

[63] The Supreme Court stated, "The power of an administrative agency to administer a congressionally created. . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." Chevron v. National Resources Defense Council, 467 U.S. 837, 843 (1984).

expression to that intent.[64] Where, however, legislation is ambiguous, or silent as to the precise question at issue, tax authorities may supply a reasonable answer.

2. Relationship between the Parliament and the Domestic Tax Courts

2.1. Are there independent (Tax) Courts in your country entitled to control legislation?

As set forth above, taxpayers have free access to several different courts to settle their tax controversies. Since courts make final determinations in tax controversies, one might say that in this way courts "control" legislation.

The courts' role, however, is not to control legislation but to apply it to the facts before it. That is, its job is to implement the congressional design. In doing so, courts interpret the legislation, and in that way courts determine legislation's scope and effect. Congress can always overrule a court's legal determination as it applies to other taxpayers, unless that determination is that Congress lacks the constitutional power to act in that fashion.

The question also speaks to the question of the independence of the courts. Two of the courts of original jurisdiction are the Tax Court and the Court of Federal Claims.[65] These are known as Article I courts (Article I of the U.S. Constitution) or legislatively authorized courts. Judges on these courts are appointed by the President[66] for a period of 15 years[67] with the salary of district court judges.[68] They can only be removed for cause.[69] All appeals in tax matters are to the courts of appeal which, like the district courts, are article III courts, authorized by the

[64] See i*d.*
[65] I.R.C. § 7441 (establishes the Tax Court pursuant to Article I of the Constitution). The Court of Federal Claims follows the same pattern. *See* 28 U.S.C. § 1346.
[66] I.R.C. § 7443(b).
[67] I.R.C. § 7443(e).
[68] I.R.C. § 7443(c).
[69] I.R.C. § 7443(f).

Constitution, where judges enjoy lifetime appointments with no possibility of pay decreases.[70] Article III judges may be impeached by Congress and, thus, removed for cause.[71]

2.2. If "yes", do they control tax legislation: 0 ex ante or 0 ex post?

Ex post

2.3. Are Courts competent to clarify whether a specific written tax rule is compatible with constitutional standards? yes - no

Yes.

2.4. If a high Court is convinced that a specific tax law violates constitutional standards, is the court in this case allowed to ignore the law? yes - no

Yes.

3. Relationship between the Tax Administration and the Domestic Tax Courts

3. 1. Are there independent (Tax) Courts in your country, obliged to control your Tax Administration?

Yes. See Section II, 2.1.

3.2. Are your domestic Courts bound to administrative regulations/orders/rulings, which are issued by tax authorities? yes - no

If "no", do the courts follow them in fact? never - sometimes – often - very often

[70] I.R.C. § 7482.
[71] The Constitution provides that judges "shall hold their Offices during good behavior." U.S. Const., Art. III, ¶1.

Yes, in some cases. See discussion in Section I, 3.3, 3.4.

3.3. Are first instance Court decisions on a tax case, normally accepted by the Tax Administration (i.e. do they not try to appeal against the decision)? never - sometimes - often - very often

Often.

When it comes to the litigation of tax cases, the U.S. has a somewhat unique set up due to the fact that two separate agencies litigate tax controversies. In the case of tax court proceedings, the administration is represented by an attorney in the Office of Chief Council of the IRS. In the case of all other tax litigation, that is refund litigation before district courts and Court of Federal Claims, and all appeals from the three courts to the courts of appeal (12 circuits and the Court of Appeals for the Federal Circuit), the United States is represented by attorneys from the U.S. Department of Justice.[72]

The tax authorities accept many decisions of the lower courts. Where it concludes the decision is in error, it considers the wisdom of an appeal. The procedure begins with the IRS's recommendation. The procedure the Service utilizes when evaluating whether to recommend an appeal to an adverse decision is contained within the Internal Revenue Manual (IRM).[73] When an adverse decision is issued against the Service, there are six guidelines which the IRS follows. First, and paramount to the inquiry of pursuing an appeal, is the legal correctness of the court decision.[74] The IRM dictates that attorneys should read the opinions of the court with an open

[72] The Tax Division of the U.S. Department of Justice is divided into sections: the District Court Sections which handle litigation before the District Courts, the Federal Claims Court Section, which handles cases before the Court of Federal Claims, the Appellate Section, which handles all appeals, and the Criminal Sections which handles criminal trials and appeals. The Appellate Section has the authority to determine whether the government will take an appeal from an adverse tax decision to the Court of Appeals.
[73] IRM § 36.2.1.1.2 (8/11/2004).
[74] IRM § 36.2.1.1 (8/11/2004)

mind and if persuaded by the court's rationale, the attorney should consider alternative measures such as acquiescence in the court's decision and a change in the IRS's position.[75]

Second, the attorney is to consider the "administrative importance" by evaluating the number of taxpayers to be affected by appeal and the adverse decision's impact on revenue.[76] Third, the attorney should consider the quality of the record and whether such record is amenable to an appeal by the Service. Fourth, the attorney is to be equitable and perhaps not appeal when public sympathies are with the taxpayer instead of the Service. Fifth, the attorney is to consider the pecuniary benefit that the government would obtain if the adverse decision were reversed. Lastly, due consideration is to be given to any alternative method for collecting funds.

Both the decision to appeal and the prosecution of the appeal are handled by attorneys in the Tax Division of the Department of Justice (DOJ). This includes decisions of the Tax Court where IRS attorneys represent the government, and decisions of the U.S. district courts and U.S. Court of Federal Claims where Justice Department attorneys represent the government. The Department of Justice has the authority to determine in what manner cases should be prosecuted, defended, compromised, or appealed when the government is a party.[77] Further, when deciding whether to appeal, the Justice Department considers the IRS's recommendation which addresses the likely effects on policy and administration if the government decides not to appeal. Nevertheless, although the Service may conclude that an appeal will achieve the optimal result, it is still left to the discretion of the Tax Division whether or not to initiate the appeal. In some cases, the Department of Justice does not follow the recommendation of the IRS. The Solicitor General's Office, a section of the Department of Justice, decides on applications for writ of certiorari or appeal to the Supreme Court. Thus, there is a practical division of powers within the

[75] *Id.*
[76] *Id.*
[77] Executive Order 6166 (June 10, 1933). *See also* IRM § 36.1.1.4 (8/11/2004)

administration of the tax laws between the IRS which carries out the day-to-day activities of tax administration and the Department of Justice which ultimately controls the effectuation of tax policy before the courts.

Alternatively, in lieu of an appeal, the Service may instead issue an Action on Decision (AOD).[78] An AOD is issued as a result of the IRS's policy to inform the public and IRS personnel as to whether the IRS will follow an adverse holding of a court. While the procedure was first designed only to express the IRS's views on tax court cases, the procedure is now used by the IRS to review adverse holdings of the tax court, district courts, federal claims court and the courts of appeals.[79] Though AODs are available to the public, the public may not rely on them as precedent.[80]

The guidance contained in an AOD is based on three different recommendations the Service takes with respect to the adverse decision: *acquiescence*, *nonacquiescence*, and *acquiescence in result only*. *Acquiescence* means that the Service accepts the holding of the adverse decision and will follow the decision when the controlling facts are the same, but the Service will not express approval or disapproval with the rationale the court employed.[81] *Acquiescence in result only* signifies that the Service accepts the holding of the adverse decision and will follow the decision where controlling facts are similar, but at the same time indicates disagreement or concern with some or all of the reasoning used by the court.[82] *Nonacquiescence* signifies that the Service does not agree with the decision and will not follow it in future cases.

[78] 1999-2 C.B. 314, 1999 IRB 1585.
[79] *Id*.
[80] *Id.*
[81] *Id*.
[82] *Id*.

Further, if the adverse decision is issued by an appellate court the Service will respect the precedential effect in that jurisdiction, but such decision will not be followed nationally.[83]

A humorous example of this process involved the interplay between the IRS and Tax Court in *Jenkins v. Commissioner*.[84] There, the taxpayer, a noted country singer, opened a chain of burger stands. To obtain capital, the taxpayer convinced seventy-five of his country music friends to invest in the chain. When the endeavor failed, the taxpayer reimbursed his friends for their losses even though he was not legally required to do so. The taxpayer argued that such expenditures were deductible under § 162 as they were necessary for his career as a country singer as to not do so would harm his reputation and, ultimately, his business as a singer. Conversely, the Service argued that such payments by the taxpayer were not deductible under § 162 as there was no legal obligation to make the payments and the expenditures were merely gratuitous. The Tax Court sided with the taxpayer and closed its opinion with a poem as follows:

> 14. We close with the following "Ode to Conway Twitty:"
>
> Twitty Burger went belly up
> But Conway remained true
> He repaid his investors, one and all
> It was the moral thing to do
>
> His fans would not have liked it
> It could have hurt his fame
> Had any investors sued him
> Like Merle Haggard or Sonny James
>
> When it was time to file taxes
> Conway thought what he would do
> Was deduct those payments as a business expense
> Under section one-sixty-two.
>
> In order to allow these deductions
> Goes the argument of the Commissioner
> The payments must be ordinary and necessary

[83] *Id*.
[84] T.C. Memo 1983-667.

To a business of the petitioner.

Had Conway not repaid the investors
His career would have been under cloud,
Under the unique facts of this case
Held: The deductions are allowed.[85]

The Service in reply issued the following AOD:

Harold Jenkins and Conway Twitty
They are both the same
But one was born
The other achieved fame.
The man is talented
And has many a friend
They opened a restaurant
His name he did lend.
They are two different things
Making burgers and song
The business went sour
It didn't take long.
He repaid his friends
Why did he act
Was it business or friendship
Which is fact?
Business the court held
It's deductible they feel
We disagree with the answer
But let's not appeal.[86]

3.4. Is a final judicial decision on a single tax case, followed by the Tax Administration not only in this case but also in all other similar cases? never - sometimes - often - very often

Sometimes. Section 3.3. outlines the procedure the IRS follows where it is dissatisfied with a court's decision, and decides not to follow it. Section 3.5 outlines the process and legal restraints on the tax authorities' ability to challenge courts' interpretations.

[85] *Id*.
[86] A.O.D. 1984-022 (March 23, 1984).

3.5. How does the Tax Administration react when it is convinced that the final judicial decision is wrong or not "acceptable" because, e.g., it is too expensive for the public?

a) Does it accept the (from their point of view) wrong decision? never - <u>sometimes</u> - often - very often

b) Does it try in another similar case to convince the Court to decide in a different way? never - <u>sometimes</u> - often - very often

The tax administration has several choices when confronted with a decision that it perceives is wrong on the law and potentially harmful. As noted above, the administration is not bound to follow the interpretation of the law by any court other than that of the Supreme Court. Even in cases decided by the Supreme Court, the administration can litigate the scope and impact of the decision in lower courts, and can also seek a redetermination of the earlier ruling through a subsequent case.

Additionally, a court of the United States is not bound by the precedents of other courts unless appeal of its decisions lies in that other court. Thus, the tax authorities may choose to litigate the same issues in other forums in order to obtain a favorable decision. Taxpayers do the same. In this way, the tax law has developed in America through consideration by different courts of the application of the legislation to various fact scenarios. Since there are many different forums including thirteen courts of appeal, this allows for the development of tax law through a vast diversity of opinion. Rather than being considered a handicap, this system has been supported enthusiastically by both the tax administration and by the taxpaying public.[87]

[87] Proposals have been made in the past supporting the creation of a national tax court of appeals. As part of the proposal to create the U.S. Court of Appeals for the Federal Circuit (which has tax jurisdiction over appeals from the Federal Claims Court), it was initially proposed that this court be granted exclusive tax jurisdiction. This part of the proposal was dropped from the final bill. For different views of the merits of a national court of tax appeals, *see, e.g.*, Edwin N. Griswold, *The Need for a Court of Tax Appeals*, 57 HARV. L. REV. 1153 (1944); William D. Popkin, *Why A Court of Tax Appeals is So Elusive*, 47 Tax Notes 1101 (1990).

The tax authorities, have, in some cases, used anti-avoidance rules, both statutorily and judicially created, to relitigate and overrule precedents that have been around for some time.[88]

c) Does it try to influence the Parliament to change the law? never - sometimes - often - very often

The tax administration, of course, always has the option of applying to Congress for corrective legislation. Congress is constantly amending the Code to address problems arising in the tax law. Often, these amendments are the direct result of a disagreement Congress has with the holdings in tax cases often brought to Congress' attention by the tax authorities.

d) Does it make sure that the Internal Revenue Service will not follow this decision in similar cases?

never – <u>sometimes</u> - often - very often

As outlined above, the IRS publishes its acquiescence or non-acquiescence on court decisions as guidance to IRS personnel and as notice to the public.

e) Does it try "to hide" such a decision, e.g., not publishing the decision with the result that the Internal Revenue Service does not know this decision? <u>never</u> - sometimes - often - very often

The courts, not the tax authorities, control whether or not its own decisions are published. One way or another, practically all tax decisions are published.

[88] *See, e.g.*, Frank Lyon Co. v. United States, 435 U.S. 561 (1978); Newman v. Commissioner, 902 F.2d 159 (2nd Cir. 1990).

II. Statistics on Tax Cases

Unfortunately, there is no direct statistical data which analyzes the percentages of adverse decisions which the government appeals. There is some empirical data on the number of cases handled by the Tax Division of the Department of Justice, however. According to the Tax Division, 80% of their pending civil caseload is defending suits, i.e. suits brought by taxpayers against the government.[89] The civil trial sections have approximately 7,000 cases pending at any one time, with about 4,000 new cases received each year.[90] This figure only includes cases brought before the district courts and the Court of Federal Claims. About 770 civil appeals are in process at any one time, with 500 new ones received annually.[91] This figure includes appeals from all of the trial courts, the District Courts, the Court of Federal Claims and the Tax Court. In 2006, for example, the success rate of the department was 96% in the civil trial sections, 97% in appeals brought by taxpayers from decisions in favor of the government, and 78% in appeals brought by the government from adverse decisions in the Tax Court, Court of Federal Claims and the District Courts.[92]

There is hardly any data concerning Tax Court cases. The major reason for this is that the Tax Court is not required to keep records, statistical or otherwise, in the same manner as an Article III court. Indeed, there is academic commentary that the way in which the Tax Court conducts its business is so opaque that it is fundamentally unfair in our system of government.[93]

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[89] Congressional Submission for the Tax Division for Fiscal Year 2008 Performance Budget, p. 4, found at http://www.usdoj.gov/jmd/2008justification/pdf/13_tax.pdf.
[90] *Id.*
[91] *Id.*, at 5.
[92] *Id.*
[93] See "Instant Replay, Weak Teams, and Disputed Calls: An Empirical Study of Alleged Tax Court Bias," James Edward Maule, 66 Tenn. L. Rev. 351 (1999); "Tax Appeal: A proposal to Make the United States Tax Court More Judicial," Leandra Lederman, 85 Wash. U. L. Rev. 1195 (2008).

The information that we do have about the Service and the Tax Court is very general. The IRS provides data as to the caseload of the Chief Counsel.[94] While the data provides numbers for amount of Tax Court cases received, closed, and pending during the given period it does not provide information of how many of such cases were tried, settled, or otherwise. The data also includes cases that are handled by the Small Claims division which are not subject to appeal. Data also generally indicates the amount of income involved in cases during the period of the report.[95]

[94] Internal Revenue Service Data Book (2007) found at http://www.irs.gov/pub/irs-soi/07databk.pdf. The data book is available for previous years as well. The numbers for 2007 are: 29,063 cases received, 26,064 disposed, and 29,472 pending.

[95] *Id*. The numbers indicate that approximately $7 billion was involved in decided cases over the course of one year.