No. 11-139

In The
Supreme Court of the United States

UNITED STATES OF AMERICA,

Petitioner,

v.

HOME CONCRETE & SUPPLY, LLC, *et al.*,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF *AMICI CURIAE* OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS SMALL BUSINESS LEGAL CENTER AND CATO INSTITUTE IN SUPPORT OF RESPONDENTS

Elizabeth Milito
Counsel of Record
Karen R. Harned
Katherine A. Isard
NATIONAL FEDERATION OF INDEPENDENT BUSINESS SMALL BUSINESS LEGAL CENTER
1201 F Street, N.W., Suite 200
Washington, DC 20004
(202) 406-4443
elizabeth.milito@nfib.org

Ilya Shapiro
CATO INSTITUTE
1000 Mass. Ave., N.W.
Washington, D.C. 20001
(202) 842-0200
ishapiro@cato.org

Counsel for Amici Curiae

Dated: December 22, 2011

THE LEX GROUP[DC] ♦ 1825 K Street, N.W. ♦ Suite 103 ♦ Washington, D.C. 20006
(202) 955-0001 ♦ (800) 856-4419 ♦ Fax: (202) 955-0022 ♦ www.thelexgroup.com

QUESTION PRESENTED

Whether an administrative agency can change—retroactively at that—the law that Congress enacted and the Supreme Court has interpreted.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

REGULATION

IDENTITY AND INTEREST OF *AMICI CURIAE*

The National Federation of Independent Business Small Business Legal Center (NFIB Legal Center)[1] is a nonprofit, public interest law firm established to provide legal resources and be the voice for small businesses in the nation's courts through representation on issues of public interest affecting small businesses. The National Federation of Independent Business (NFIB) is the nation's leading small business advocacy association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents about 350,000 independent business owners who are located throughout the United States. The NFIB Legal Center frequently files amicus briefs in cases that will affect small businesses.

NFIB's membership includes small businesses that would be adversely affected if judicial deference is granted to a final regulation promulgated by the United States Department of the Treasury (Treasury), where the regulation is contrary to Supreme Court precedent, and was drafted during the pendency of litigation solely to revive a failing

---

[1] In accordance with Rule 37.6, *amici* state that no counsel for any party has authored this brief in whole or in part, and no person or entity, other than *amici* and its counsel has made a monetary contribution to the preparation or submission of this brief. In accordance with Rule 37.3(a), *amici* state that all parties consented to the filing of this brief. All letters of consent are on file with the Clerk.

legal position in litigation between the Internal Revenue Service (IRS) and the taxpayer. Granting deference here would severely undermine NFIB's small business members' ability to operate, in so far as they could no longer plan a regular course of business based on the consistency of the myriad of regulations applicable to each taxpayer, or rely on a fair application of current regulations or Court precedents.

The Cato Institute was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1989 to promote the principles of limited constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences, produces the annual Cato Supreme Court Review, and files amicus briefs. The present case centrally concerns Cato because the sort of ad hoc rule-making at issue here implicates constitutional separation of powers and basic rule of law principles.

SUMMARY OF THE ARGUMENT

Where Congress has not seen fit to change the meaning of a statute that has been interpreted by this Court and found to have an unambiguous meaning, it is not the role of an agency to issue a regulation purporting to change that meaning. The regulation issued here contains a directly contrary definition of a statute previously interpreted by this Court, an interpretation that has been left unchanged by Congress in the intervening decades.

The government's position is that this regulation is due judicial deference, but accepting that argument would not only contradict this Court's precedent, it would sanction an attempt to issue a new regulation *during litigation* for the purpose of reviving a failed litigation position. This argument was rejected by the lower court and if approved here would upend the constitutional balance of powers between an agency on the one hand and Congress and the Supreme Court on the other. In expounding on the deference afforded agencies pursuant to *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), and its progeny, this Court surely never intended to undermine the very structure of the Republic.

ARGUMENT

I. THE TREASURY REGULATION IS NOT ENTITLED TO *CHEVRON* DEFERENCE

There is no dispute that at the outset of this litigation, in December 2006, the three-year statute of limitations found in I.R.C. § 6501(a) applied with respect to the overstatement of basis in the 1999 tax return, timely filed by Home Concrete & Supply, LLP in April 2000. The IRS failed to act during the three-year limitations period, however, instead initiating its investigation in June 2003 and issuing a Final Partnership Administrative Adjustment (FPAA) in September 2006. The IRS similarly failed to act within the three-year time period as to several other taxpayers who had engaged in similar overstatements of basis. In each of these cases, the IRS was forced to argue for the application of the six-year statute of limitations found in § 6501(e)(1)(A),

which is applicable to situations where a taxpayer "omits from gross income" items properly included therein that constitute more than 25 percent of the gross income in the taxpayer's return.

That argument proved to be a loser for the IRS in *Bakersfield Energy Partners, LP*, 568 F.3d 767 (9th Cir. 2009) and *Salaman Ranch Ltd.*, 573 F.3d 1362 (Fed. Cir. 2009), where the Ninth and Federal Circuits applied this Court's decision in *Colony, Inc., v. Commissioner*, 357 U.S. 28, 78 S. Ct. 1033 (1958). In *Colony*, this Court interpreted the substantively identical predecessor to § 6501(e)(1)(A) to mean that an overstatement of basis was not properly included in the definition of "omits from gross income" and therefore not subject to the extended six-year statute of limitations. Although the Ninth Circuit applied *Colony* against the IRS in *Bakersfield*, it suggested that the IRS may be able, pursuant to the Court's decision in *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005) (*Brand* X), to overturn the unfavorable (to the IRS) precedent by promulgating a new regulation containing an interpretation of § 6501(e)(1)(A) that was contrary to the Court's finding in *Colony*.

The IRS quickly employed the Ninth Circuit's suggestion, issuing Proposed and Temporary Regulations on September 24, 2009, which became final Treas. Reg. § 301.6501(e)-1 on December 14, 2010 (the "Regulation"). The Regulation states, in part, that an overstatement of basis constitutes an omission from gross income for the purposes of § 6501(e)(1)(A). Though the Treasury claimed in the preamble to the Regulation, and in its arguments in this litigation, that the new regulation merely "clarifies" the meaning of § 6501(e)(1)(A), the

Regulation is a blatant attempt to overturn *Colony* and create a new statute of limitations applicable to the very litigation that prompted the Regulation.

On its face, even the six-year statute of limitations that the government argues is applicable forecloses the action taken by the IRS where, as here, more than six years have elapsed since Home Concrete filed its 1999 tax return. Therefore, beyond arguing that its regulation should receive judicial deference and overturn this Court's precedent, the IRS seeks to preserve its untimely assessment through the language added to the Regulation's preamble, which states that the six-year limitations period remains open for any litigation that was pending at the time the Regulation was promulgated. Accepting the government's arguments would effectively grant the IRS unprecedented discretion to legislate while litigating, after which a taxpayer would be subject to retroactive laws drafted by its litigation opponent and applied by courts as that opponent sees fit.

A. THE COURT IN *COLONY* FOUND THE STATUTE TO BE UNAMBIGUOUS

In *Chevron*, this Court created a two-step process for judicial review of an agency's construction of a statute that the agency is charged with administering. The first step is to determine whether the meaning of the statute is unambiguous, "for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id*. at 842-43. Where Congress has spoken directly to the precise question at issue, "that is the end of the matter." *Id*. at 842. Under step two, if the

statute is ambiguous a court is to defer to an agency's "permissible construction of the statute." *Id.* at 843.

In *Colony*, this Court concluded that an overstatement of basis did not constitute an omission from gross income, and that this conclusion was "in harmony with the unambiguous language of section § 6501(e)(1)(A)." 357 U.S. at 37. Although *Colony* was decided pre-*Chevron*, it is possible to analyze that decision under the *Chevron* framework. In doing so, courts, including the circuit court here, have correctly determined that *Colony* was decided under *Chevron*'s step one. *See Burks v. United States*, 633 F.3d 347, 360 (5th Cir. 2011) (unambiguous at *Chevron* step one); *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249, 257 (4th Cir. 2011) (citing *Colony*, and stating, "The Supreme Court's reference to 'the *unambiguous* language of section 6501(e)(1)(A)' cannot be ignored."). The *Colony* Court analyzed the statute using traditional means of statutory construction, looking to the plain language of the statute and legislative history. After doing so, and finding the statute to have an unambiguous meaning, that pre-*Chevron* Court effectively completed the analysis under a *Chevron* framework. Accordingly, the contrary construction set forth in the Regulation here is not entitled to deference.

The government argues that the Court in *Colony* in fact found the language "omits from gross income" to be "ambiguous" and, in support of this argument, cites the Court's statement that "it cannot be said that the [relevant] language is unambiguous." Pet'r's Br. 48, 50 (citing *Colony*, 357 U.S. at 33). The Court in *Colony* authored its

opinion 26 years before *Chevron* was decided, however, and its use of the term "ambiguous" must be taken in context. To focus on this phrase in *Colony* ignores the Court's next step, which was to review the plain language and legislative history of the statute—the same steps it would undertake today under *Chevron* step one. The *Colony* Court then concluded that based on the statutes' plain meaning, and Congressional intent, there was only one clear meaning of the term "omits from gross income." 357 U.S. at 33-35. In a post-*Chevron* world, this conclusion would end the statutory interpretation at step one, with a determination that the statute is unambiguous. Significantly, the clear meaning of the statute found by the *Colony* court is one that, in the intervening decades since the *Colony* decision, Congress has not attempted to alter.

Accordingly, *Chevron* step one requires that this Court give effect to Congress's clear intent, as determined by its own precedent, and refuse the contrary interpretation of the statute promulgated by the government.

B. THE IRS DOES NOT HAVE THE AUTHORITY TO OVERRULE SUPREME COURT PRECEDENT

The government can cite no authority for the proposition that this Court must give controlling deference to Treasury regulations in direct conflict with Court precedent—much less where that precedent determined the plain meaning of a statute. In fact, under *Chevron*, when the Court has previously determined that the statute has an unambiguous meaning, it does not consider any

contrary interpretations advocated by an agency, much less a so-called "clarification" that effectively overturns established Court precedent. Despite this lack of authority, the IRS has continued to assert that the Regulation interpreting the phrase "omits from gross income" to include overstatements of basis—the opposite of the conclusion reached by this Court in *Colony*—is entitled to judicial deference.

In this case, and in previous cases addressing the new regulation, the government relies in part on *Brand X* to justify deference to its new regulation. Pet'r's Br. 37; *see also*, *Carpenter Family Investments, LLC*, 136 TC No. 17 ("We think that it is reasonably clear from the preamble to the final regulations that the Secretary believes that, relying on *Brand X*, he can come to a different conclusion as to the meaning of section 6501 than the Supreme Court did in *Colony*."). The government argues that only where a judicial precedent has held that a statute unambiguously forecloses an agency's interpretation does precedent displace a conflicting agency construction. That, however, was not the holding of *Brand X*. The Court in *Brand X* concluded that the Ninth Circuit should have applied *Chevron* and deferred to the FCC's interpretation of the statute, rather than follow its own precedent, in which it had adopted a conflicting statutory construction. 545 U.S. at 1003. The Court held that "[a] court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Id.* at 982.

The *Brand X* Court also stated, however, that where a court has previously found a statute to be unambiguous, precedent forecloses a contrary agency construction. *Brand X*, 545 U.S. at 984 (citing *Neal v. United States*, 516 U.S. 284 (1996)). Moreover, *Brand X* did not address this Court's previous rulings and, in his *Brand X* concurrence, Justice Stevens noted that the Court's analysis "would not necessarily be applicable to a decision by this Court that would presumably remove any pre-existing ambiguity." *Brand X*, 545 U.S. at 1003. Where the instructions of Congress are considered by the Supreme Court to be unambiguous, the Treasury is not left with an interpretative or advisory role, or with the authority to issue a contrary interpretation, even when issued as a regulation. To find otherwise would be to grant to an agency more legislative power than Congress itself wields.

In his *Brand X* dissent, Justice Scalia raised a hypothetical future agency action, which unfortunately parallels the actions of the agency here. He posed a circumstance in which the agency itself was a party to the case in which the Court construes a statute, and the agency then disregards that construction and seeks *Chevron* deference for its own contrary construction the "next time around." *Id.* at 1017 (Scalia, J., dissenting). He then correctly posited that this overturning of Court precedent by agency rulemaking is "bizarre" and "probably unconstitutional." *Id.* (citing *Chicago & Southern Air Lines, Inc. v. Waterman S.S. Corp.*, 333 U.S. 103, 113 (1948) ("Judgments within the powers vested in courts by the Judiciary Article of the Constitution may not lawfully be revised, overturned or refused faith and credit by another Department of

Government.")). Justice Scalia was correct in both his prediction of the manner in which an agency would hope to apply the Court's decision in *Brand X*, and the characterization of the result.

As in Justice Scalia's *Brand X* dissent, his dissent in *United States v. Mead Corp.*, in which the Court examined the deference to be given to an agency regulation, raised another hypothetical that predicted the IRS's actions here. 533 U.S. 218, 247-48 (2001). In that hypothetical an agency readopts an interpretation of a regulation previously rejected by a court by repromulgating it through a *Chevron*-eligible procedural format—in other words, precisely what the Petitioner seeks to do here. Justice Scalia stated that approving this procedure would be "a landmark abdication of judicial power" and "worlds apart from *Chevron* proper." *Id.* (Scalia, J., dissenting). Indeed, for the Court to approve that procedure as urged by the government would both be a radical departure from the current *Chevron* framework and an abdication of judicial power that, as Justice Scalia suggested in *Brand X*, would be both bizarre and likely unconstitutional. Though both hypotheticals were raised in dissents, neither reflected the result of the actual holdings in either *Mead* or *Brand X*.

Indeed, the majority in *Brand X*, when addressing Justice Scalia's concerns, does not contemplate that its holding could be used to advance the type of abuse of authority the IRS engaged in here. *See* 545 U.S. 967, 982-84. Similarly, in *Mead*, while the majority does give deference to the agency choice, it does so under circumstances where there was a lack of indication by Congress as to whether or not it intended to

delegate rulemaking authority to the agency. 533 U.S. 218, 237. The *Mead* holding does not tread upon the dangerous idea of allowing an agency to change or promulgate rules that directly contradict Supreme Court precedent in order to put itself in a better position for litigation. The Court should not extend both precedents to reach the action taken by the IRS here.

C. DEFERENCE SHOULD NOT BE EXTENDED TO THE REGULATION UNDER *CHEVRON* STEP TWO

Even assuming the language of § 6501(e)(1)(A) is ambiguous, *Chevron*'s step two does not justify deference to the unreasonable Regulation. The second step of *Chevron* requires that, if the statute is "silent or ambiguous," the court will defer to an agency's "permissible construction of the statute." *Chevron*, 467 U.S. at 843, 104 S. Ct. 2778.

In *Mayo Foundation for Medical Education and Research v. United States*, 131 S. Ct. 704 (2011), the Court recently revisited *Chevron* in the context of an IRS Treasury Regulation, holding *Chevron* is to be applied in the tax context. There are limits to *Chevron* deference, however, even in step two. In *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213, 109 S. Ct. 468 (1988), the Court recognized one such limit, stating that "[d]eference to what appears to be nothing more than an agency's convenient litigating position" is "entirely inappropriate." Citing *Bowen* when analyzing the Regulation at issue here, the Fifth Circuit in *Burks v. United States*, noted that even if *Chevron* step two were applied, it was at best "unclear" whether the Regulation would be subject to *Chevron* deference, where the Treasury had during

the "pendency of litigation" promulgated "determinative, retroactive regulations following prior adverse judicial decision on the identical legal issue." 633 F.3d 347, n.9 (5th Cir. 2011) (citing *Chock Full O'Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1971) ("The Commissioner may not take advantage of his power to promulgate retroactive regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations.").

If the Regulation is retroactively applied to Home Concrete's 1999 tax return, the IRS will have successfully avoided the running of both the three-year statute of limitations applicable when the lawsuit began, and the six-year statute of limitations the IRS created during the litigation. Moreover, Home Concrete will be found liable for unpaid taxes for the 1999 tax year, the liability for which was not created by the IRS until 2009. The ability of an agency to change the laws governing ongoing litigation in which it is embroiled, and to receive judicial deference of its interpretations of those laws, will give the agency the ability to create liability tailored to each of its opponents.

Extending judicial deference and the force of law to what amounts to simple gamesmanship by a litigation opponent to secure a victory, would amount to a major departure from the framework of *Chevron* deference. Following such a decision, the IRS would exercise unprecedented discretion to legislate while litigating, after which a taxpayer finding itself facing the IRS in litigation would be subject to retroactive laws drafted by its litigation opponent and applied by the court according to the

instruction of that same opponent. That represents a breakdown in "conventional" litigation and, more broadly, a subversion of the rule of law.

CONCLUSION

This Court has consistently held that, where a statute has an unambiguous meaning, an agency's contrary interpretation is not entitled to deference.

Under the government's proposed framework, IRS officials, not the tax code, would rule taxpayers, and litigants would be unable to rely on the Court's precedent. Taxpayers would be unable to assess liability at the time it was incurred or anticipate what rules would be applied to them at a later date. The ability for an agency to legislate laws tailored to the litigation in which it is currently engaged would alter basic rule-of-law assumptions regarding the fairness and reliability of laws and their application by the courts.

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

DATED: December 22, 2011.

Respectfully submitted,

Elizabeth Milito
Counsel of Record
Karen R. Harned
Katherine A. Isard
NATIONAL FEDERATION OF
INDEPENDENT BUSINESS
SMALL BUSINESS
LEGAL CENTER
1201 F Street, N.W., Suite 200
Washington, DC 20004
elizabeth.milito@nfib.org
(202) 406-4443

Counsel for Amicus Curiae
National Federation of
Independent Business Small
Business Legal Center

Ilya Shapiro
Counsel of Record
CATO INSTITUTE
1000 Mass. Ave., N.W.
Washington, D.C. 20001
(202) 842-0200
ishapiro@cato.org

Counsel for Amicus Curiae
Cato Institute