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NOTE

Not So Special After All: How *Mayo* Granted the Treasury Unfettered Rule-Making Discretion

Mayo Foundation for Medical Education and Research v. United States,
131 S. Ct. 704 (2011).

DANIEL W. GRAVES*

I. INTRODUCTION

The ability of executive agencies to promulgate rules is an important and vital function in American government. Due to the sheer complexity of so many regulatory issues, it would be impracticable for Congress to legislate, much less anticipate, every possible detail that might arise in a statutory scheme. The often slow pace of legislative approval also can hinder Congressional attempts to respond to changing circumstances. To avoid any problems that might arise from these difficulties, Congress frequently gives the executive branch rulemaking authority via statute.¹ This ability of executive departments to promulgate rules thus fills in the gaps left by Congress.

Often, however, these regulations go much further than merely clarifying details around a framework provided by Congress, and instead address areas to which Congress has not directly spoken at all.² When such regulations create undesirable results, Congress can either amend the statute to reverse the agency's position,³ or a court can overturn the regulation by finding it to be an impermissible interpretation of the underlying statute.⁴

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1. *Background on the Rulemaking Process*, OMB WATCH REG. RES. CTR., 5, <http://www.ombwatch.org/files/regs/rcenter/backgroundpdfs/1.-V..pdf> (last visited Jan. 29, 2012) [hereinafter OMB WATCH].

2. See J.P. Finet & Peyton M. Sturges, *U.S. Supreme Court Upholds Treasury Rule That Medical Residents Subject to FICA Tax*, 8 Daily Tax Rep. (BNA), Jan. 12, 2011, at GG-1, available at 2011 WL 81377.

3. See Einer Elhauge, *Preference-Estimating Statutory Default Rules*, 102 COLUM. L. REV. 2027, 2112-13 (2002).

4. See *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 710 (2011).

Under the *Chevron* framework of analysis provided by the Supreme Court of the United States in 1984,⁵ a regulation will be overturned only if (1) Congress has either failed to directly address the issue at hand or has left ambiguity in the statute, and (2) the agency's resolution of that omission or ambiguity is "arbitrary or capricious in substance, or manifestly contrary to the statute."⁶ Tax regulations promulgated by the Treasury Department, however, are viewed as having something of a "special place" in administrative law, with a less deferential standard for testing those regulations, i.e., the *National Muffler* framework.⁷ Prior to 2011, the Supreme Court of the United States had not distinguished between these competing standards for review of the Treasury Department regulations, and indeed had often cited conflicting doctrines in prior cases.⁸ This situation "plagued lower courts for decades,"⁹ and led to a protracted struggle, particularly in the United States Tax Court, to resolve the conflicting rulings.¹⁰

On January 11, 2011, the Supreme Court decided *Mayo Foundation for Medical Education and Research v. United States*, in which it definitively settled on the more deferential *Chevron* standard for analyzing Treasury Department regulations, finding no justification in treating them differently from regulations of other agencies.¹¹ In doing so, the Court has given the Treasury Department virtually free rein in crafting new regulations and amending those regulations already in existence. Because taxpayer lawsuits were one of the few ways in which Treasury regulations could be overturned, by instructing

5. *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

6. *Mayo*, 131 S. Ct. at 711 (quoting *Household Credit Servs., Inc. v. Pfennig*, 541 U.S. 232, 242 (2004)).

7. See *Finet & Sturges*, *supra* note 2.

8. See *Mayo*, 131 S. Ct. at 712.

9. Jeremiah Coder, *The State of Tax Guidance After Mayo*, Tax Notes Today (Tax Analysts), Feb. 7, 2011, available at LEXIS 2011 TNT 25-1.

10. See Mark E. Berg, *Judicial Deference to Tax Regulations: A Reconsideration in Light of National Cable, Swallows Holding, and Other Developments*, 61 TAX LAW. 481, 498-523 (2008); see also, e.g., *Swallows Holding, Ltd. v. Comm'r*, 126 T.C. 96, 164 (2006) ("This case may therefore be a good vehicle for appellate guidance on whether *National Muffler* continues to be in good working order after *Chevron*, *Mead*, and *Brand X*"), vacated, 515 F.3d 162 (3d Cir. 2008); *Walton v. Comm'r*, 115 T.C. 589, 598 (2000) ("[T]he opinion of the Supreme Court in *Chevron* failed to cite *National Muffler* and may have established a different formulation of the standard of review." (citing *Central Pa. Sav. Ass'n & Subsidiaries v. Comm'r*, 104 T.C. 384, 390-91 (1995))); *Cent. Pa. Sav. Ass'n*, 104 T.C. at 390-91 ("[T]he Supreme Court [opinion] in *Chevron*, which failed to cite *National Muffler* . . . appear[s] to establish a different formulation of the standard of review . . . [of] an agency's construction of [a] statute which it administers *Chevron* has had a checkered career in the tax arena.")

(internal quotation marks omitted)).

11. *Mayo*, 131 S. Ct. at 713.

the lower courts to give such regulations the heightened degree of deference that *Chevron* prescribes, the Court has greatly reduced the likelihood that these taxpayer suits will be successful.¹²

Although *Mayo* brings a great degree of clarity to the arena of Treasury regulations, this clarity comes at a price – any given regulation will now be more difficult to counter. Before *Mayo*, lower courts, and even the Supreme Court, considered a broad array of factors, including consistency with prior regulations and reliance interests, in determining whether a Treasury regulation was a reasonable interpretation of the underlying statute.¹³ By removing the courts' ability to consider such factors, *Mayo* could lead to an emboldened Treasury Department adopting more and broader regulations, all with only a hamstrung judicial check on that power. Because of the broad implications that Treasury regulations carry, Congress should consider amending the Internal Revenue Code to ensure that in deciding the reasonableness of a regulation, courts can consider other important factors beyond merely whether Congress has already addressed the issue and whether the regulation is inconsistent with the statute.

II. FACTS AND HOLDING

The Mayo Foundation for Medical Education and Research, the Mayo Clinic, and the Regents of the University of Minnesota (*Mayo*), offer medical residency programs to medical school graduates.¹⁴ These programs afford an opportunity for such graduates to pursue additional education and training in a medical specialty, which is a requirement in order to become board certified to practice in that field.¹⁵ *Mayo's* residency programs typically last between three and five years.¹⁶ In that time, residents are trained primarily through hands-on experience obtained through direct patient care, generally working between fifty and eighty hours a week.¹⁷ Although residents execute tasks commonly performed by fully licensed physicians,¹⁸ they are supervised during their residency by more senior residents and by faculty members known as attending physicians.¹⁹

12. See Alison Bennett, "Mayo" Ruling Raises Bar for Challenges to Tax Regulations, *Practitioners Say*, 30 Daily Tax Report (BNA), Feb. 14, 2011, at GG-1, available at 2011 WL 480142.

13. See *id.*; see generally Finet & Sturges, *supra* note 2.

14. *Mayo*, 131 S. Ct. at 708.

15. *Id.*

16. *Id.*

17. *Id.*

18. The Supreme Court specifically noted that residents examine and diagnose patients, prescribe medications, recommend treatment plans, and perform some medical procedures. *Id.*

19. *Id.*

In addition to these on-the-job training avenues, residents also take part in a more traditional, structured education program.²⁰ They are required to read textbooks and journal articles, attend lectures and conferences, and take written exams.²¹ However, residents spend the majority of their time caring for patients, rather than learning in a classroom.²² During their participation in the program, Mayo's residents receive annual stipends,²³ as well as health insurance, malpractice insurance, and paid vacation time.²⁴

Beginning in 1951, the United States Department of the Treasury exempted from Federal Insurance Contributions Act (hereinafter "FICA" or "social security") taxation "students who work for their schools as an 'incident to and for the purpose of pursuing a course of study' there."²⁵ Under this rubric, the Treasury Department determined whether an employee's work was incident to his or her studies on a case-by-case basis, with the primary factors in the analysis being the number of hours the employee worked and the weight of his or her course load.²⁶ The Social Security Administration also used a case-by-case approach to the question but had determined as a blanket rule that medical residents did not qualify as students.²⁷ As a result, Mayo withheld FICA taxes from its residents' stipends.²⁸

In 1998, the Court of Appeals for the Eighth Circuit held that it was improper for the Social Security Administration to "categorically exclude [medical] residents from student status, given that its regulations provided for a case-by-case approach."²⁹ That decision led to the filing of more than seven thousand claims seeking FICA tax refunds with the Internal Revenue Service, asserting that medical residents qualified as students and so were exempt from FICA taxes.³⁰ This flood of claims prompted the Treasury Department to adopt an amended rule,³¹ addressing whether employees who were also students were exempted from FICA taxes levied on those employees and their employers.³²

20. *Id.*

21. *Id.* at 708-09.

22. *Id.* at 709.

23. Mayo's stipend range was between \$41,000 and \$56,000 in 2005. *Id.* at 708.

24. *Id.*

25. *Id.* at 709 (quoting 16 Fed. Reg. 12474 (1951)).

26. *Id.*

27. *Id.*

28. *See id.* at 710.

29. *Id.* at 709 (citing *Minnesota v. Apfel*, 151 F.3d 742, 747-78 (8th Cir. 1998)).

30. *Id.*

31. Treas. Reg. § 31.3121(b)(10)-2(d)(3)(i)-(iii) (as amended in 2004).

32. *Mayo*, 131 S. Ct. at 709-10; *see also* Treas. Reg. § 31.3121(b)(10)-2(d)(3)(i)-(iii). Congress "exclude[s] from [FICA] taxation 'service performed in the employ of . . . a school, college, or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university.'" *Id.* at 709 (quoting I.R.C. § 3121(b)(10) (2006)).

The new rule modified the determination of when an employee's service is "incident to" his or her studies, and thus exempt from FICA taxation, by stating that the educational aspect of the relationship between the employee and the employer had to predominate over the service aspect of that relationship in order to qualify for the exemption.³³ Moreover, the rule unconditionally stated that services of a full-time employee would never qualify as being incident to pursuing a course of study, even noting that such a determination "is not affected by the fact that the services performed . . . may have an educational, instructional, or training aspect."³⁴ Finally, the rule provided as an example of the new provision a medical resident employed by a university for forty hours or more per week, stating that the employee's services "are not incident to and for the purpose of pursuing a course of study [and] there is no need to consider other relevant factors."³⁵

On December 22, 2006, Mayo filed a complaint against the United States in the United States District Court for the District of Minnesota, seeking recovery of nearly \$1.7 million in FICA taxes that it had withheld and paid to the Treasury Department on stipends paid to residents in the second quarter of 2005.³⁶ Mayo argued that the Treasury Department's amended rule was invalid because it was inconsistent with the text of section 3121 and averred that its residents were exempt from FICA taxes.³⁷ The district court agreed with Mayo and granted its motion for summary judgment.³⁸ The court held that the amended regulation conflicted with the text of the relevant statutes, which it understood to state that any employee, regardless of the number of hours worked, is considered a student as long as the educational aspect of his or her employment predominates over the service aspect.³⁹ Importantly, the district court used the standards set forth in *National Muffler Dealers Ass'n v. United States* in finding the rule improper,⁴⁰ stating that "[a]n inter-

33. *Id.* at 710 (internal quotation marks omitted); *see also* Treas. Reg. § 31.3121(b)(10)-2(d)(3)(i).

34. *Mayo*, 131 S. Ct. at 710 (quoting Treas. Reg. § 31.3121(b)(10)-2(d)(3)(iii)). The new rule noted that the designation of what constitutes a full-time employee could be based on the employer's "standards and practices," but that an employee whose normal work schedule required at least forty hours of service per week would be considered full-time regardless of the employer's standards. Treas. Reg. § 31.3121(b)(10)-2(d)(3)(iii).

35. Treas. Reg. § 31.3121(b)(10)-2(e) ex. 4.

36. *Mayo*, 131 S. Ct. at 710; *see also* Complaint at 5, *Mayo Found. for Med. Educ. & Research v. United States*, 503 F. Supp. 2d 1164 (D. Minn. 2007) (No. 06-5059 RHK/JSM), 2006 WL 4025589.

37. *Mayo*, 131 S. Ct. at 710.

38. *Id.*

39. *Id.*

40. *Id.*

pretive tax regulation is reasonable only if it ‘harmonizes with the plain language of the statute, its origin, and its purpose.’”⁴¹

The United States appealed, and the Court of Appeals for the Eighth Circuit reversed the district court.⁴² The Eighth Circuit used the standards set forth in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.* in finding the regulation proper,⁴³ stating that “‘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.’”⁴⁴ The court concluded that the statute did not directly address the question of when an employee no longer qualifies as a student, and the amended rule “‘harmonize[d]’ . . . with the plain language of the statute,” noting that the courts should “‘defer to a Treasury Regulation so long as it is reasonable.’”⁴⁵

The Supreme Court of the United States upheld the ruling of the Eighth Circuit, agreeing that the *Chevron* analysis applied to the question.⁴⁶ The Court decided that the statute provides no definition of the term “student” and also does not directly resolve the question of whether a medical resident is subject to FICA taxation.⁴⁷ Thus, under the deferential *Chevron* analysis, the Court held that using the number of hours worked in a week was a “perfectly sensible way” of “distinguish[ing] between workers who study and students who work” and was a “reasonable construction” of the statute exempting students from FICA taxation.⁴⁸

III. LEGAL BACKGROUND

Executive departments and administrative agencies often find it necessary to adopt rules and regulations to implement or interpret statutes passed by Congress, and Congress often explicitly gives these agencies such authority.⁴⁹ This delegation of authority helps ensure that similar cases will be treated similarly and that the governing rules “will be written by ‘masters of the subject.’”⁵⁰ Oftentimes, however, the judiciary is called on to determine

41. *Mayo Found. for Med. Educ. & Research v. United States*, 503 F. Supp. 2d 1164, 1170 (D. Minn. 2007) (quoting *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 477 (1979)), *rev’d*, 568 F.3d 675 (8th Cir. 2009), *aff’d*, 131 S. Ct. 704.

42. *Mayo*, 131 S. Ct. at 710.

43. *Id.*

44. *Mayo*, 568 F.3d at 679 (quoting *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984)).

45. *Id.* at 680-81; *see also Mayo*, 131 S. Ct. at 710.

46. *Mayo*, 131 S. Ct. at 711.

47. *Id.*

48. *Id.* at 715-16.

49. *See OMB WATCH*, *supra* note 1, at 1, 5.

50. *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 477 (1979) (quoting *United States v. Moore*, 95 U.S. 760, 763 (1877)).

whether a regulation “harmonizes with the plain language of the statute, its origin, and its purpose.”⁵¹

A. National Muffler’s Factor-Based Standard

In 1979, the Supreme Court of the United States was asked in *National Muffler* to determine the propriety of a Treasury regulation defining the term “business league.”⁵² Statutes in effect at the time exempted business leagues from federal income tax but provided no definition of the term.⁵³ The National Muffler Dealers Association, a non-industry-wide trade organization, sought the exemption, but the Internal Revenue Service denied its application, finding that the statute, as interpreted by the regulation, did not include in the definition of “business league” organizations that were not industry-wide.⁵⁴

The Supreme Court began its analysis of the case by noting that the term “‘business league’ has no well-defined meaning or common usage outside the perimeters of [the Tax Code].”⁵⁵ The Court noted that in such situations, it typically defers to the regulation, provided that it implements the congressional mandate in a reasonable manner.⁵⁶ The Court stated that this presumption is especially strong if the regulation was adopted at substantially the same time as the statute and was written by people presumed to be aware of congressional intent.⁵⁷

If the regulation arose substantially after adoption of the statute, the Court noted that the judiciary should consider the evolution of the regulation in order to determine its reasonableness.⁵⁸ The Court listed several factors that should be used in this analysis: how long the regulation has been in effect, whether parties have relied substantially on its existence, the consistency

51. *Id.*

52. *See generally id.* at 477-78. The regulation defined the term as: an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. . . . [I]ts activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Id. at 474 n.3 (quoting Treas. Reg. § 1.501(c)(6)-1 (1978)).

53. *See id.* at 473-75. The statutes noted only that a “business league” could not be organized for profit, and that no part of its net earnings could inure to the benefit of any private shareholder or individual. *Id.* (citing I.R.C. § 501(c)(6) (1954)) (The Court cites the 1954 version, in effect at that time, but the section has been amended numerous times since 1954, as recently as 2010. H.R. Res. 4872, 111th Cong. (2010) (enacted)).

54. *Id.* at 473-74.

55. *Id.* at 476.

56. *Id.*

57. *Id.* at 477.

58. *Id.*

of the relevant agency's interpretation of the statute through regulations, and how Congress has responded to the existence of any regulations in subsequent reenactments of the relevant statute.⁵⁹

After surveying the history of the regulation defining "business league" and analyzing the factors listed above, the Court upheld the Treasury's regulation, noting that where a statute is ambiguous, "[t]he choice among reasonable interpretations is for the Commissioner [of the Internal Revenue Service], not the courts."⁶⁰ The Court held that a regulation need only have a reasonable basis in the statutory history and that the "logical force" of a taxpayer's contrary argument is insufficient to overturn a regulation.⁶¹ Therefore, the Court found that National Muffler had failed to show that either the regulation itself or the Commissioner's interpretation of it was an unreasonable implementation of the underlying statute, and thus denied National Muffler's claimed exemption.⁶²

B. Chevron's "Permissible Construction" Standard

The Supreme Court again had the opportunity to review an agency's regulation in the 1984 case of *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*⁶³ The Environmental Protection Agency (EPA) promulgated regulations pursuant to the Clean Air Act allowing states to adopt a plant-wide definition of the term "stationary source."⁶⁴ The Natural Resources Defense Council (NRDC) challenged the regulations in the United States Court of Appeals for the District of Columbia Circuit.⁶⁵ The court of appeals vacated the regulations, agreeing that the Act did not speak to the concept of plant-wide sources, but finding the EPA's permitted definition contrary to the purpose of the Act and thus impermissible.⁶⁶

59. *Id.*

60. *Id.* at 488.

61. *See id.*

62. *Id.* at 488-89.

63. 467 U.S. 837 (1984).

64. *Id.* at 840 (citing 40 C.F.R. § 51.18(j)(1)(i)-(ii) (1983)). In essence, the regulation allowed states to define the term such that a pollution-emitting plant could avoid the Clean Air Act's permitting requirements subsequent to new construction or substantial modifications of sources of pollution if the plant contained several pollution-emitting devices and installed or modified equipment that did not increase the plant's overall emissions total. *Id.*

65. *Id.* at 841. Federal law mandates that petitions for review of actions by the EPA Administrator regarding certain air quality rule promulgations be filed in the United States Court of Appeals for the District of Columbia Circuit, rather than a district court. 42 U.S.C. § 7607(b)(1) (2006).

66. *See Chevron*, 467 U.S. at 841. The court of appeals found that the regulation's permitted plant-wide definition of a stationary source would only serve to maintain air quality, while the Act's purpose was to improve it. *Id.* at 841-42.

On appeal, the Supreme Court reversed, finding that the court of appeals erred in “adopt[ing] a static judicial definition of the term ‘stationary source’ when . . . Congress itself had not commanded that definition.”⁶⁷ The Court explained that when a court is asked to review an executive or administrative agency’s interpretation of a statute, there are two issues that must be addressed.⁶⁸ First, the court must consider whether Congress has explicitly addressed the matter at hand.⁶⁹ The Court noted that if congressional intent is clear, the judiciary and the relevant agency must abide by Congress’s explicitly stated intent.⁷⁰

If the intent of Congress is not clear, however, the Court stated that it is not the purview of the judiciary to draft its own interpretation of the statute, but rather to decide “whether the agency’s answer is based on a permissible construction of the statute.”⁷¹ The Court noted that where Congress explicitly leaves a gap in the law for an agency to fill, any resulting regulations are honored unless they are “arbitrary, capricious, or manifestly contrary to the statute.”⁷² Where the authority to fill such a gap is implicit,⁷³ the Court stated that the judiciary may not subvert a “reasonable interpretation” made by the relevant agency.⁷⁴

In determining whether an agency has made such a reasonable interpretation, the Court noted that deference is traditionally afforded to executive and administrative decisions.⁷⁵ This deference is not generally disturbed “unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.”⁷⁶ The Supreme Court held that the court of appeals erred when, after finding that Congress had expressed no intent regarding the plant-wide definition of a stationary source, it decided on its own that the EPA’s interpretation of the term was

67. *Id.* at 842.

68. *Id.*

69. *Id.*

70. *Id.* at 842-43. “If a court . . . ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.” *Id.* at 843 n.9.

71. *Id.* at 843.

72. *Id.* at 843-44. “The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.” *Id.* at 843 n.11.

73. The Court noted that “[s]ometimes the legislative delegation to an agency on a particular question is implicit rather than explicit.” *Id.* at 844.

74. *Id.*

75. *Id.* (“We have long recognized that considerable weight should be accorded to an executive department’s construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations.” (footnote omitted)).

76. *Id.* at 845 (quoting *United States v. Shimer*, 367 U.S. 374, 383 (1961)).

inappropriate.⁷⁷ Instead, the Supreme Court noted that the Court of Appeals should have considered only whether the EPA's regulations were appropriate in the context of the Act itself.⁷⁸

In its review of whether the regulations were sufficiently appropriate, the Court examined the legislative history of the Act, noting that while Congress intended the federal government to have greater authority and responsibility over air quality, primary responsibility for it explicitly remained with the states.⁷⁹ Furthermore, the Court noted that the legislative history indicated two motives behind the 1977 amendments to the Act: “to allow reasonable economic growth to continue in an area while making reasonable further progress to assure attainment of the standards . . . [and] to allow States greater flexibility for [that] purpose than EPA's present interpretative regulations afford.”⁸⁰

Reflecting on this and other legislative history, the Court reasoned that the intent of the Act and its amendments was “to enlarge, rather than to confine, the scope of the [EPA's] power to regulate particular sources in order to effectuate the policies of the Act.”⁸¹ The Court thus held that the EPA's regulations should be upheld, finding them to be a reasonable attempt to accommodate Congress's twin goals of reducing air pollution while encouraging economic growth.⁸² In finding the regulations reasonable, and therefore entitled to deference, the Court noted “the regulatory scheme is technical and complex, the agency considered the matter in a detailed and reasoned fashion, and the decision involves reconciling conflicting policies.”⁸³ In summary, the Court stated that, where a challenge to a regulation focuses on the wisdom of the regulation itself, rather than on whether the choice of interpretation was reasonable, “the challenge must fail.”⁸⁴

77. *See id.*

78. *Id.*

79. *Id.* at 845-46.

80. *Id.* at 851-52 (quoting H.R. REP. NO. 95-294, pt. 2, at 211 (1977)).

81. *Id.* at 862.

82. *Id.* at 863-64, 866.

[T]he Court of Appeals misconceived the nature of its role in reviewing the regulations at issue. Once it determined . . . that Congress did not actually have an intent regarding [this concept addressed by the regulation], the question before it was not whether in [the court's] view the concept is “inappropriate” . . . but whether the Administrator's view that it is appropriate in the context of this particular program is a reasonable one.
Id. at 845.

83. *Id.* at 865 (footnotes omitted).

84. *Id.* at 866. As part of its justification for this holding, the Court noted that “Judges are not experts in [this] field The responsibilities for assessing the wisdom of such policy choices . . . are not judicial ones” *Id.* at 865-66.

C. *Seeking a Standard: National Muffler or Chevron*

The Supreme Court in *Chevron* established a significantly more deferential standard of review for agency rules and regulations than existed under *National Muffler*. Using *National Muffler*, the judiciary could view an otherwise reasonable interpretation of an ambiguous statute “with heightened skepticism,” based on the factors given in that case – the length of time between passage of the statute and adoption of the regulation, the consistency of the agency’s interpretation of the statute via regulation, or the manner in which the regulation evolved.⁸⁵ Under *Chevron*, however, “deference to an agency’s interpretation of an ambiguous statute does not turn on such considerations.”⁸⁶

In 2001, the Supreme Court revisited the issue in *United States v. Mead*.⁸⁷ In that decision, the Court, citing *Chevron*, noted that where Congress explicitly leaves a statutory gap for an executive agency to fill, the agency has an express delegation of authority to fill that gap.⁸⁸ In *Mead*, the Court affirmed that “any ensuing regulation is binding in the courts unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute.”⁸⁹ The Court further noted that this express authority can be implied if it is “apparent from the agency’s generally conferred authority and other statutory circumstances” that Congress intended the agency to have specific authority to fill statutory gaps.⁹⁰ As with affirmatively expressed authority, “a reviewing court has no business rejecting an agency’s exercise of its generally conferred authority . . . [and] is obliged to accept the agency’s position if Congress has not previously spoken to the point at issue and the agency’s interpretation is reasonable.”⁹¹

But where there is no such express delegation of authority, the Court in *Mead* noted that not all subsequent regulations bind the courts.⁹² The Court stated that it is proper for the judiciary to give “considerable weight” to “well-reasoned” agency regulations, but it explained that the level of deference the courts should afford these regulations can vary with the circumstances surrounding the case.⁹³ The Court recognized that this leads to a

85. *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 712 (2011) (citing *Nat’l Muffler Dealers Ass’n v. United States*, 440 U.S. 472, 477 (1979)).

86. *Id.*

87. *See* 533 U.S. 218, 221 (2001).

88. *Id.* at 227.

89. *Id.*

90. *Id.* at 229.

91. *Id.* The Court again stated that a regulation is reasonable unless “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” *Id.* (quoting 5 U.S.C. § 706(2) (2006)).

92. *Id.* at 227.

93. *Id.* at 227-28.

“spectrum of judicial responses, from great respect at one end to near indifference at the other,” with such factors as the thoroughness of the agency’s consideration of the issue and the consistency with other regulations guiding the courts in affording the proper measure of deference.⁹⁴ Finally, the Court specifically noted that *Chevron* was not meant to eliminate the judiciary’s ability to consider various justifications in deciding whether to afford more or less deference.⁹⁵

Prior to 2011, the Supreme Court had not explicitly addressed the question of whether the *Chevron* standard, the *National Muffler* standard, or some individualized approach of the type countenanced in *Mead* should apply to regulations promulgated by the Department of the Treasury. In fact, the Court at times varied its approach to the issue, citing *Chevron* in a 1985 opinion,⁹⁶ *National Muffler* in a 2001 opinion,⁹⁷ and referencing both doctrines in a 1993 ruling.⁹⁸ Thus, when the controversy in *Mayo* arose, the Supreme Court definitively resolved the question of which of the competing standards should apply.⁹⁹

IV. THE INSTANT DECISION

The Supreme Court began its analysis of the controversy in *Mayo* by asking the first question required under both *National Muffler* and *Chevron* – whether Congress had explicitly answered the question of whether a medical resident qualifies for the FICA tax exemption.¹⁰⁰ The Court agreed with the Eighth Circuit that Congress had not done so, noting that the statute in question neither defines the term “student” nor otherwise addresses the specific inquiry of whether medical residents are subject to FICA taxation.¹⁰¹

94. *Id.* at 228 (citations omitted).

95. *Id.* at 237.

96. *United States v. Boyle*, 469 U.S. 241, 246 n.4 (1985).

97. *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 218-19 (2001).

98. *Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 575-76 (1993).

99. The Supreme Court specifically noted that, prior to the decision in *Mayo*, it had not yet distinguished between *National Muffler* and *Chevron* when considering a Treasury regulation. *See Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 712-13 (2011).

100. *See id.* at 711.

101. *Id.* Not all agree that the regulation in question passes the first step of *Chevron* analysis. *See generally* Thomas D. Sykes, *Tax Regulations: The “Mayo” Decision’s Problematic Tax Analysis*, 52 *Daily Tax Rep. (BNA)*, Mar. 17, 2011, at J-1, available at LEXIS 52 DTR J-1 (arguing that Congress spoke directly to the issue in I.R.C. § 3121(b)(10)).

The Supreme Court rejected Mayo's argument that the dictionary definition of "student"¹⁰² should control in this context.¹⁰³ Mayo had asserted that medical residents should not be excluded from the dictionary definition, because the only limit placed on the term "students" by Congress was that they be enrolled in and regularly attending classes at a school.¹⁰⁴ In rejecting that argument, the Court reasoned that Mayo's reading of the statute does not eliminate the inherent ambiguity of the term "student" in examining working professionals.¹⁰⁵ The Court pointed out that Mayo conceded that a full-time professor taking evening classes could legitimately be subject to FICA taxation because he or she would not primarily be a student, and the Court concluded that medical residents could be excluded using the same logic.¹⁰⁶

Having decided that Congress had not directly addressed the issue at hand, the Court noted that the parties disagreed over "the proper framework for evaluating an ambiguous provision of the Internal Revenue Code," with Mayo asserting that *National Muffler* governed, and the government contending that *National Muffler* was superseded by *Chevron*.¹⁰⁷ The Court reflected on the importance of the distinction, stating that, under *Chevron*, the only question remaining for a court would be "whether the agency's [regulation] is based on a permissible construction of the statute,"¹⁰⁸ while under *National Muffler*, a court would also be required to consider factors relating to the evolution and history of the regulation, regardless of whether it was reasonable.¹⁰⁹ The Court highlighted the significance of the differing approaches in pointing out that the district court had cited the factors in *National Muffler* in overturning the regulation in question.¹¹⁰

The Court pointed out that *Chevron* applies to reviews of regulations from all other agencies, and that Mayo did not advance any justification for

102. Mayo offered as the dictionary definition of student "one who engages in study by applying the mind to the acquisition of learning, whether by means of books, observation, or experiment." *Mayo*, 131 S. Ct. at 711 (internal quotation marks omitted).

103. *See id.*

104. *Id.* (citing I.R.C. § 3121(b)(10) (2006)).

105. *Id.*

106. *Id.*

107. *Id.* at 712. The Court also admitted that it "ha[d] not thus far distinguished between *National Muffler* and *Chevron*." *Id.*

108. *Id.* (quoting *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984)).

109. *See id.* (citing *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979)). For a more detailed discussion of the *National Muffler* factors, see *supra* notes 58-59 and accompanying text.

110. *Mayo*, 131 S. Ct. at 712. The *National Muffler* standard of deference is not wholly inapplicable to Treasury Department actions. *See* J.P. Finet, *Tax Administration: Despite Supreme Court's "Mayo" Ruling, Practitioners Say "National Muffler" Not Dead*, 43 Daily Tax Rep. (BNA), Mar. 4, 2011, at K-3, available at LEXIS 43 DTR K-3.

applying the less deferential standard of *National Muffler* to Treasury Department regulations.¹¹¹ The Court stated that, without such a justification, it is preferential to maintain a “uniform approach to judicial review of administrative action.”¹¹² The Court noted that filling gaps in the Internal Revenue Code requires the Treasury Department to make interpretative decisions at least as complex as those made by other administrative agencies, and that the Treasury Department needs to be able to meet changing conditions and newly arising problems.¹¹³ Therefore, the Court saw no reason to scrutinize Treasury regulations differently than those from other agencies and held that the principles of *Chevron* “apply with full force in the tax context.”¹¹⁴

Having decided on the proper framework of analysis, the Court found that the full-time employee rule met the second step of the *Chevron* analysis, which requires that the regulation be a reasonable construction of the underlying statute.¹¹⁵ The Court held that to focus on the number of hours an employee works in a week is a “perfectly sensible way” to “distinguish between workers who study and students who work.”¹¹⁶ The Court found it reasonable for the Treasury Department to presume that an individual’s performance at work and his or her course of study are separate activities, and that one who works enough hours to qualify as a full-time employee has filled his or her time on the job with working, rather than studying.¹¹⁷ The Court decided that this approach was a reasonable way to distinguish education from service, without labeling clinical training as being unrelated to education.¹¹⁸

The Court also agreed with the Treasury Department that the regulation’s reasonableness was enhanced by its likelihood of improving administration of FICA taxation, and avoiding the “wasteful litigation and continuing uncertainty that would inevitably accompany any purely case-by-case approach.”¹¹⁹ The Court also pointed out that the Social Security Act has been understood by the judiciary to apply broadly, that medical residents share many similar characteristics with full-time workers who Congress

111. *Mayo*, 131 S. Ct. at 713.

112. *Id.* (quoting *Dickinson v. Zurko*, 527 U.S. 150, 154 (1999)). “In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only.” *Id.*

113. *See id.*

114. *Id.* “We see no reason why our review of tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as our review of other regulations.” *Id.*

115. *Id.* at 714.

116. *Id.* at 715.

117. *Id.*

118. *See id.*

119. *Id.* (quoting *United States v. Correll*, 389 U.S. 299, 302 (1967)). In further support of the regulation’s reasonableness, the Court explained that it would also further the purpose of the Social Security Act. *Id.*

clearly intended to fall within the scope of FICA taxation, and that exemptions from taxation are typically construed narrowly.¹²⁰

Thus, by holding that *Chevron's* more deferential standard superseded *National Muffler's* factor-based approach in establishing the proper framework for analyzing Treasury regulations, the Court concluded that once it is determined that Congress has not already answered the question addressed by the regulation, the only consideration for the judiciary is whether the regulation is reasonable under the statute.¹²¹ In the absence of a statutory definition of "student," the Court found that using the number of hours worked in a week was a sensible means of distinguishing between "workers who study and students who work"¹²² and unanimously upheld the regulation as a reasonable exercise of the authority of the Treasury Department.¹²³

V. COMMENT

In *Mayo*, the Supreme Court of the United States provided some "much needed clarity" to the question of how much deference the judiciary should give to Treasury regulations.¹²⁴ The benefit of this clarity, however, could come at taxpayers' expense in two ways – by reducing the chance that a taxpayer can successfully challenge a Treasury regulation, and by emboldening the Treasury Department to draft more aggressive regulations that come closer to making law than interpreting and explaining existing law.

120. *Id.*; see also *United States v. Burke*, 504 U.S. 229, 248 (1992) ("[T]he default rule of statutory interpretation [is] that exclusions from income must be narrowly construed.").

121. See *Mayo*, 131 S. Ct. at 712.

122. *Id.* at 715-16.

123. The majority opinion was joined by all eight participating Justices. *Id.* at 708. Justice Kagan recused herself from the case because she had worked on it as United States Solicitor General. Adam Liptak, *Court Rules on Debtors and Doctors in Training*, N.Y. TIMES, Jan. 12, 2011, at A12.

124. *Finet & Sturges*, *supra* note 2. Precisely how much clarity *Mayo* may ultimately provide is unclear, however, as shown by at least three post-*Mayo* holdings. See *Grapevine Imports v. United States*, 636 F.3d 1368, 1376-81 (Fed. Cir. 2011) (holding that *Mayo* does mandate *Chevron* deference for Treas. Reg. § 301.6501(e)-1(e) because I.R.C. § 6501 is ambiguous and the regulation is a reasonable interpretation of the statute); *Burks v. United States*, 633 F.3d 347, 359-61 (5th Cir. 2011) (holding that I.R.C. § 6501 is unambiguous and that Treas. Reg. § 301.6501(e)-1(e) (2010) is therefore not entitled to deference); *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249, 257-58 (4th Cir. 2011) (acknowledging *Mayo* but reaching the same conclusion as *Burks*); see also Richard M. Lipton & Russell R. Young, *Courts Split on Validity of Section 6501(e)(1)(A) Regulations After Mayo Foundation*, 115 J. TAX'N 21, 24 (2011); Richard M. Lipton & Russell R. Young, *Mayo Foundation, Treasury Regulations, and the "Death" of National Muffler*, 114 J. TAX'N 206, 206 (2011); Andrew Pruitt, *Essay, Judicial Deference to Retroactive Interpretative Treasury Regulations*, 79 GEO. WASH. L. REV. 1558, 1561 & n.18 (2011).

By deciding that the more deferential *Chevron* standard applies to the review of Treasury regulations, the *Mayo* ruling makes court challenges to tax regulations much less likely to succeed.¹²⁵ In holding that *Chevron* is the appropriate standard, the Supreme Court removed any requirement that a court consider the standards set forth in *National Muffler* for determining the propriety of a Treasury regulation, such as the length of time a previous relevant regulation had been in effect, the level of reliance parties have placed on prior regulations, the consistency of the Treasury Department's regulations over time, and any subsequent Congressional action on the underlying statute.¹²⁶ Removing these considerations "shrink[s] the grounds for lawsuits,"¹²⁷ ultimately reducing the likelihood of a successful taxpayer challenge. Instead, under *Chevron*, courts will be able to overturn a Treasury regulation only if they find either that Congress specifically addressed the issue that the regulation purports to cover, or that Congress would not have sanctioned the Treasury's interpretation of the law.¹²⁸

Though *Chevron* is not an impossible hurdle to overcome, the *Mayo* ruling "'puts a pretty heavy burden on those who . . . argue that [Treasury] regulations are invalid.'"¹²⁹ Because much of the Treasury's regulatory authority comes under a broad authorization from Congress,¹³⁰ it will be nearly impossible for a taxpayer to meet the first prong of *Chevron* and show that Congress has specifically answered numerous Treasury-related questions.¹³¹ And without specific guidance from Congress on a given issue, it will be almost, if not entirely, as difficult for a taxpayer to meet the second *Chevron* prong and successfully argue that Congress would have rejected the Treasury Department's regulatory interpretation of the law.

125. See Bennett, *supra* note 12.

126. See *supra* notes 58-59 and accompanying text.

127. Bennett, *supra* note 12.

128. See *supra* notes 69-70 and accompanying text.

129. Bennett, *supra* note 12 (quoting former Commissioner of Internal Revenue Lawrence Gibbs).

130. See I.R.C. § 7805(a) (2006) (authorizing the Secretary of the Treasury to "prescribe all needful rules and regulations").

131. See Jasper L. Cummings, Jr., *Tax Regulations: "Mayo" Decision Does Not Insulate Treasury Regulations from Invalidation*, 21 Daily Tax Rep. (BNA), Feb. 1, 2011, at J-1, available at LEXIS 21 DTR J-1 (stating that Treasury regulations can now be afforded *Chevron* deference whether issued under a special grant of authority or the general grant of authority in I.R.C. § 7805 (2006)); see also *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 713-14 (2011) ("Our inquiry . . . does not turn on whether Congress's delegation of authority was general or specific."); Irving Salem, *Mayo Dissected: Some Dragons Slain, Some Still Breathing Fire*, Tax Notes Today (Tax Analysts), Mar. 14, 2011, available at LEXIS 2011 TNT 50-5 (explaining that the prior rule that regulations adopted under general grants of authority were given less deference has been reversed).

Though many commentators feel that *Mayo* will not significantly alter the Treasury's procedures in crafting regulations,¹³² it is likely that the decision will spur the Treasury to issue more guidance.¹³³ Because Treasury regulations apply more broadly and have greater weight than less formal Treasury actions, such as revenue rulings and technical advice memoranda, *Mayo* will likely give the Treasury an incentive to enshrine its stances in regulation, with less concern that these interpretations will be overturned.¹³⁴ Effectively, the *Mayo* ruling gives the Treasury "more leeway in legislating than in administering the law."¹³⁵

Another factor likely to spur the Treasury to regulate more aggressively is the current state of the national budget. In 2011, the annual United States deficit is projected to reach \$1.6 trillion,¹³⁶ and the national debt is expected to exceed \$14.3 trillion.¹³⁷ Although the *Mayo* decision directly affected only medical residents, a relatively small percentage of the United States population,¹³⁸ the ruling is expected to bring in an estimated \$700 million in annual employment taxes.¹³⁹ Although this amounts to a mere fraction of the total national deficit and debt, it is certainly plausible that the Treasury Department might begin a fervent search for other regulations that it could adopt to raise more revenue. It is also conceivable that the President and Congress might even begin pressuring the Treasury Department to find such avenues as an overall attempt to address budgetary concerns – all with minimal fear that the judiciary will overturn any resulting regulations, or that Congress or the President will have to face any political fallout from raising taxes.

Although many taxpayers might not bemoan the fact that medical residents, often receiving annual salaries in excess of \$40,000 a year,¹⁴⁰ will now be required to pay FICA taxes on those wages, the true implication of *Mayo*

132. See, e.g., Bennett, *supra* note 12; Coder, *supra* note 9.

133. Coder, *supra* note 9.

134. Bennett, *supra* note 12; see also Finet, *supra* note 110 (noting that *National Muffler* scrutiny will likely survive in review of less formal Internal Revenue Service guidance, such as revenue rulings).

135. Bennett, *supra* note 12 (quoting Lawrence Hill of Dewey & LeBoeuf LLP in New York); see also Salem, *supra* note 131 (quoting associate counsel in the Treasury's Office of Tax Legislative Counsel as saying that *Mayo* gives the Treasury Department "extraordinary, powerful regulatory authority").

136. Jackie Calmes, *Obama's Budget Focuses on Path to Rein in Deficit*, N.Y. TIMES, Feb. 15, 2011, at A1.

137. See Sewell Chan, *U.S. Treasury Takes Steps to Buy Time on Debt Limit*, N.Y. TIMES, Feb. 12, 2011, at A14.

138. The National Resident Matching Program reported that 24,378 first-year medical resident positions were filled in 2010. NAT'L RESIDENT MATCHING PROGRAM, RESULTS AND DATA: 2010 MAIN RESIDENCY MATCH 1 (2010), available at <http://www.nrmp.org/data/resultsanddata2010.pdf>.

139. Finet & Sturges, *supra* note 2.

140. See *supra* note 23.

that should give citizens pause is the expansion of authority now bestowed upon the Treasury Department. Because tax-related issues affect nearly every aspect of American life, any future Treasury regulations spurred by *Mayo* could have a significant, negative impact on Americans' personal financial plans.

An example of such concerns arises when one is planning for retirement. Retirement looms over a taxpayer's entire working career, typically spanning thirty to forty years, and many retirement planning decisions are centered on tax considerations.¹⁴¹ If a new Treasury regulation affects the tax consequences of such retirement plans,¹⁴² it could alter the investment strategies of Americans for decades. Theoretically, such rulings could even negate the efforts of some citizens on the brink of retirement who have already made relevant plans in reliance on previous Treasury regulations. Because the judiciary no longer has to consider whether new Treasury regulations are inconsistent with previous regulations or to what degree parties have relied on those old regulations,¹⁴³ the Treasury would be authorized to make such changes as long as they are "reasonable," regardless of the consequences. The *Mayo* ruling severely diminishes the ability of taxpayers to challenge new regulations, removing one of the last remaining checks on the power of the Treasury to fill in statutory voids left by Congress, and leaving most of the burden of ensuring that Treasury regulations reflect Congress's goals on Congress itself.

VI. CONCLUSION

While some view *Mayo* as a positive holding because it brings more certainty to the realm of tax law,¹⁴⁴ it is important to realize that this certainty comes at a potential cost. With its authority to alter United States tax policy, the Treasury Department has the power to enact regulations that can affect nearly every aspect of American life – from massive corporations to citizens working to pay their bills and plan for retirement. Although most Treasury regulations are likely given a great deal of analysis before adoption, the current state of America's budget could spur regulations that are more aggressive in an attempt to secure more revenue. Even when such a regulation is a prod-

141. For example, consider the decision over whether to invest in tax-deferred 401k accounts or IRAs, versus their post-tax counterparts. See *Ultimate Guide to Retirement: Where Should I Save My Retirement Money?*, CNNMONEY, http://money.cnn.com/retirement/guide/basics_basics.moneymag/index2.htm (last visited Dec. 2, 2011).

142. This requires an assumption that there is no specific statute on point, such that the regulation would violate the first prong of *Chevron*. See *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 711 (2011).

143. See *supra* notes 58-59 and accompanying text.

144. See, e.g., Coder, *supra* note 9.

uct of careful analysis and reasonable policy decisions, the risk of unintended consequences, if nothing else, is always present.

When the Treasury Department adopts a regulation, the ability of a taxpayer to challenge it in court is one of the few avenues for extra-agency review and consideration of whether any inconsistencies, reliance issues, or other factors outlined in *National Muffler*¹⁴⁵ render the rule unreasonable. If a regulation stems from specific Congressional authority relevant to the issue at hand, a greater degree of judicial deference is perhaps merited, because taxpayers have a check on this power through elections of and communications with their representatives and senators. But where a regulation stems from the blanket authority given to the Treasury to adopt “all needful rules and regulations,”¹⁴⁶ that Congressional check has now been removed.¹⁴⁷ Following *Mayo*, the Treasury Department, in essence, is given nearly free rein to promulgate whatever rules it sees fit, with little accountability to United States citizens.

In light of the broad impact that Treasury regulations can have, Congress should consider codifying in statute that these regulations are subjected to less deference than the type outlined in *Chevron* and *Mayo*. The legislation could spell out several factors that courts should consider when reviewing the reasonableness of any regulations, like those outlined in *National Muffler*, or any other factors that Congress deems important, such as any pertinent legislative history.

Reinstating this higher standard for Treasury regulations will provide extra protection to taxpayers from any potential harm that might occur when the Treasury Department regulates, and in effect legislates, without specific direction from Congress. Such a standard would be similar to the rubric under which the Treasury Department has operated for decades, and so would not serve as a disincentive for the Department to continue crafting new regulations and amending existing ones. Instead, it would merely cause the Treasury Department to consider during the rulemaking process any factors outlined by Congress in order to avoid the final product being overturned by the judiciary. This framework would allow effective promulgation of rules to continue, while preserving the taxpayers’ two main mechanisms of guaranteeing that such rules are reasonable: Congress and the courts.

145. See *supra* notes 58-59 and accompanying text.

146. I.R.C. § 7805(a) (2006).

147. Congress, of course, could always adopt legislation reversing the regulation, but such a post hoc review might not prevent potential harm that could occur to taxpayers beforehand. Also, since legislation is often slow-moving, a harmful regulation could easily remain in force for years before Congress resolves the situation.

