Horsing Around with *Dobson* and *Chevron*: Tax Deference in *Roberts v. Commissioner*

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INTRODUCTION

In April of 2016, the United States Court of Appeals for the Seventh Circuit reversed an opinion by the United States Tax Court in Roberts v. Commissioner.\(^1\) The reversal has been called “an embarrassment not only for the Internal Revenue Service (“IRS”), but for the Tax Court judge in the case.”\(^2\) The Seventh Circuit’s opinion is rife with patronizing language, arguing “[w]e mustn’t be too hard on the Tax Court,” and referring to certain IRS regulations as “goofy.”\(^3\)

In Dobson v. Commissioner, the United States Supreme Court severely restricted appellate review of Tax Court decisions by circuit courts, essentially forbidding reversal without a “clear-cut mistake of
law. The “Dobson rule” has since fallen out of favor, but has had a lasting impact on deference issues in the Tax Court context.

The United States Supreme Court again changed the landscape of deference in *Chevron U.S.A., Inc. v. National Resource Defense Council, Inc.*\(^5\) The *Chevron* decision stands for the principle that agency expertise should be granted a certain amount of deference in the interpretation of statutes.\(^6\) In *Mayo Foundation for Medical Education and Research v. United States*, the Supreme Court definitively determined that *Chevron* deference should apply to regulations promulgated by the United States Treasury Department.\(^7\)

This article will discuss the impact and enduring effect of both the *Dobson* and *Chevron* decisions on federal tax litigation. It will also discuss the impact these decisions have, or should have had, on the Seventh Circuit’s decision in *Roberts v. Commissioner*. Finally, it will address how the courts and the Department of the Treasury and IRS might act in an attempt to clarify what deference should look like in the tax world going forward.

I. DEFERENCE ISSUES IN TAX

The United States Tax Court is a federal trial court established by the United States Congress under Article I of the United States Constitution.\(^8\) Its first incarnation was as the Board of Tax Appeals, which was established by Congress through the Revenue Act of 1924.\(^9\) The Board of Tax Appeals was an independent agency within the executive branch.\(^10\) In 1929, the Supreme Court’s decision in *Old Colony Trust Co. v. Commissioner* definitively established that the

\(^4\) 320 U.S. 489, 502 (1943).
\(^6\) Id. at 844.
\(^7\) See 562 U.S. 44, 55-56 (2011).
\(^8\) 26 U.S.C. § 7441 (establishing the Tax Court as an Article I court).
\(^10\) Id.
Board was “not a court,” but rather “an executive or administrative board.”\textsuperscript{11} Congress changed the Board’s name to the “The Tax Court of the United States” in 1942\textsuperscript{12} and again to “The United States Tax Court” in 1969.\textsuperscript{13} At this point, the status of the Tax Court changed from an administrative board within the executive branch to a purely judicial court.\textsuperscript{14} In \textit{Freytag v. Commissioner}, the Supreme Court asserted “[t]he Tax Court exercises judicial power to the exclusion of any other functions.”\textsuperscript{15}

For several reasons, the Tax Court is the forum of choice for up to 97 percent of federal tax litigation.\textsuperscript{16} The most common reason taxpayers choose to litigate in the Tax Court, rather than in federal district court, is the ability to avoid paying the tax in question before contesting.\textsuperscript{17}

When taxpayers receive an unfavorable ruling from the Tax Court, those decisions are appealable to the federal courts of appeal.\textsuperscript{18} The Tax Court is in a unique position as a court outside of the judicial branch whose appeals are heard by judicial branch courts.\textsuperscript{19} The question of appropriate standard of review for Tax Court decisions, therefore, has been heavily contested since the Tax Court’s inception.\textsuperscript{20}

\textsuperscript{11} 279 U.S. 716, 725.
\textsuperscript{12} Revenue Act of 1942, Pub. L. No. 77–753, § 504(a), 56 Stat. 798, 957.
\textsuperscript{14} See \textit{Freytag v. Comm'r}, 501 U.S. 868, 891 (1991) (“[The Tax Court’s] function and role in the federal judicial scheme closely resemble those of the federal district courts, which indisputably are ‘Courts of Law.’”).
\textsuperscript{15} Id.
\textsuperscript{17} See Kaffenberger v. United States, 314 F.3d 944, 958 (8th Cir. 2003) (“Full payment of a tax assessment is a prerequisite to suit in federal district court; taxpayers may bring prepayment suits only in United States Tax Court.”).
\textsuperscript{18} See 26 U.S.C. § 7482.
\textsuperscript{19} 26 U.S.C. §§ 7441, 7482.
\textsuperscript{20} See \textit{Dobson}, supra note 9, at 472-474.
A. Dobson v. Commissioner and Deference to the Tax Court

Dobson v. Commissioner was brought before the Supreme Court in 1943.\(^\text{21}\) The case raised the issue of a doctrine known as the “tax benefit rule.”\(^\text{22}\) It consisted of a consolidation of four petitions by the Commissioner wherein the Court of Appeals had reversed Tax Court decisions.\(^\text{23}\) The facts of one case defined the common issue.\(^\text{24}\)

The taxpayer in question, James N. Collins, had sold certain shares at a loss in tax years 1930 and 1931 and claimed those losses as deductions on his tax returns.\(^\text{25}\) In 1936, Collins learned that the stocks had not been appropriately registered in compliance with certain state laws.\(^\text{26}\) He sued the seller of the stocks for fraud and failure to register, asking for rescission of his entire purchase.\(^\text{27}\) The suit was settled in 1939 and Collins netted a recovery of $45,150.63.\(^\text{28}\) Collins, however, did not report any part of his recovery, including that which was allocable to his previously claimed losses, as income on his 1939 tax return.\(^\text{29}\) Adjustment of his 1930 and 1931 tax liability was barred by the statute of limitations during the 1939 tax year.\(^\text{30}\)

The Commissioner adjusted Collins’ gross income for the 1930 tax year by adding the recovery attributable to the sold shares as ordinary gain.\(^\text{31}\) Collins sought redetermination by the Board of Tax Appeals (now the Tax Court).\(^\text{32}\) He argued that he recognized no gain or income as he had received no tax benefit from his 1930 and 1931 loss

\(^{21}\) Dobson v. Comm’r of Internal Revenue, 320 U.S. 489 (1943).

\(^{22}\) See id. at 492.

\(^{23}\) Id. at 490.

\(^{24}\) Id.

\(^{25}\) Id. at 491.

\(^{26}\) Id.

\(^{27}\) Id.

\(^{28}\) Id.

\(^{29}\) Id.

\(^{30}\) Id.

\(^{31}\) Id.

\(^{32}\) Id. at 492.
deductions.\textsuperscript{33} The Tax Court agreed with Collins and concluded that he had no taxable gain.\textsuperscript{34}

The Court of Appeals for the Eighth Circuit held that the Tax Court had overstepped its bounds in applying the “tax benefit theory.”\textsuperscript{35} The Eighth Circuit argued that the “tax benefit theory” was an equitable one, without root in statute or regulation.\textsuperscript{36} Therefore, the Tax Court used it inappropriately to determine whether Collins had recognized taxable gain.\textsuperscript{37} The Supreme Court granted certiorari, determining that “questions important to tax administration were involved” in the underlying case.\textsuperscript{38}

Justice Robert H. Jackson wrote for a unanimous Court.\textsuperscript{39} Justice Jackson had a particularly unique perspective on the substance of the Dobson case. Early in his career, he served as Chief Counsel for the U.S. Treasury Department’s Bureau of Internal Revenue,\textsuperscript{40} known today as the Internal Revenue Service.\textsuperscript{41} Some have speculated that Justice Jackson considered much of the appellate review of Tax Court decisions unnecessarily complex.\textsuperscript{42} Accordingly, he intentionally wrote the Dobson opinion to limit such review.\textsuperscript{43}

The Court reversed the decision below, rejecting the Commissioner’s argument and reinstating the decision of the Tax

\begin{footnotesize}
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\item \textsuperscript{33} Id.
\item \textsuperscript{34} Id.
\item \textsuperscript{35} Id.
\item \textsuperscript{36} Id.
\item \textsuperscript{37} Id.
\item \textsuperscript{38} Id.
\item \textsuperscript{39} Id. at 490.
\item \textsuperscript{40} See Kirk J. Stark, The Unfulfilled Tax Legacy of Justice Robert H. Jackson, 54 TAX L. REV. 171, 173 (2000).
\item \textsuperscript{41} Brief History of the IRS, IRS.GOV, https://www.irs.gov/uac/brief-history-of-irs (last updated September 28, 2016).
\item \textsuperscript{42} See Stark, supra note 40, at 221 (“If the Tax Court were given the final say on a broader range of disputed tax questions, Jackson believed, much of the complexity arising out of excessive appellate litigation could be curbed.”).
\item \textsuperscript{43} See id.
\end{itemize}
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Court. The opinion emphasized that appellate courts should defer to Tax Court findings absent “a clear-cut mistake of law.” Several reasons are given for this proposition, including the unique expertise of the Tax Court and the advantage of uniformity in tax law application. The guiding principle that Tax Court decisions should be given a heightened amount of deference became known as the “Dobson rule.”

B. After Dobson

Legal scholars and commentators swiftly criticized the Dobson decision. Critics took particular issue with the opinion’s confusing and unclear distinction between the reviewability of legal and factual findings. The courts were equally frustrated with Dobson. The Court of Appeals for the First Circuit wrote that the decision raised “a question which will no doubt perplex the circuit courts of appeals until

44 See Dobson, 320 U.S. at 507.
45 Id. at 502.
46 Id.
47 See e.g., Leandra Lederman, (Un)appealing Deference to the Tax Court, 63 DUKE L.J. 1835, 1867 (2014).
48 See e.g., Randolph E. Paul, Dobson v. Commissioner: The Strange Ways of Law and Fact, 57 HARV. L. REV. 753 (1944) (“The Supreme Court in the Dobson Decision leaves an impression that difficulty in answering a question may excuse a failure to answer it.”); Louis Eisenstein, Some Iconoclastic Reflections on Tax Administration, 58 HARV. L. REV. 477 (1945) (“The Dobson decision is a poorly disguised effort to rescue the Supreme Court from the growing demands of tax litigation and, at the same time, augment the scope of administrative finality.”); Erwin N. Griswold, The Need for a Court of Tax Appeals, 57 HARV. L. REV. 1153, 1170-73 (1944) (“[T]here is almost certain to be more litigation as to the applicability of the Dobson rule than there was as to the basic tax questions themselves.”).
49 See e.g., DUBROFF, supra note 9, at 807; Ralph S. Rice, Law, Fact, and Taxes: Review of Tax Court Decisions Under Section 1141 of the Internal Revenue Code, COLUM. L. REV. 439 (1951) (“In the entire course of the doctrine’s reign, the court never revealed the criteria by which a clear-cut question of law might be distinguished from other questions.”); Eisenstein, supra note 48, at 540.

312
further light is shed.\textsuperscript{50} Judge Learned Hand, writing for the Second Circuit Court of Appeals, criticized \textit{Dobson} on multiple occasions.\textsuperscript{51} The Supreme Court itself applied the \textit{Dobson} rule unevenly, to the further frustration of the courts of appeals.\textsuperscript{52} Even those who agreed with \textit{Dobson}’s reasoning—that the Tax Court had specialized expertise in tax law—acknowledged that the jurisdictional framework under \textit{Dobson} was untenable.\textsuperscript{53}

In 1948, Congress attempted to quell the controversy surrounding \textit{Dobson} by amending the Internal Revenue Code.\textsuperscript{54} As enacted, the statute now dictates the courts of Appeals have “jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury.”\textsuperscript{55} According to the Federal Rules of Civil Procedure, this means that the Tax Court’s findings of fact “must not be set aside unless clearly erroneous.”\textsuperscript{56} The Tax Court’s legal

\textsuperscript{50} Denholm & McKay Realty Co. v. Comm’r, 139 F.2d 545, 550 (1944).
\textsuperscript{51} See Comm’r v. Nat’l Carbide Corp, 167 F.2d 304, 307 (1948) (“There remains only the vexed question whether we should yield our own judgment to that of the Tax Court.”); Brooklyn Nat’l Corp. v. Comm’r, 157 F.2d 450, 452-53 (1946) (“Why . . . we – or indeed, even the Supreme Court itself – should be competent to fix the measure of the Tax Court’s competence, and why we should ever declare that it is wrong is indeed an interesting inquiry, which happily it is not necessary for us to pursue).
\textsuperscript{52} See e.g., John Kelley Co. v. Comm’r, 326 U.S. 521, 530 (1946) (concluding that the Tax Court’s findings must be dispositive as the terms in question were well understood); Bingham’s Trust v. Comm’r, 325 U.S. 365, 384 (1945) (refusing to apply the \textit{Dobson} rule to the facts at hand).
\textsuperscript{53} See e.g., \textit{Bingham’s Trust}, 325 U.S. at 384 (Frankfurter, J., concurring) (“The fact that the district courts continue to have vestigial jurisdiction may call for a scientific revamping of jurisdiction in tax cases. It does not counsel against giving the fullest efficacy to Tax Court decisions consonant with its special responsibility.”).
\textsuperscript{54} See 26 U.S.C. § 7482(a)(1).
\textsuperscript{55} \textit{Id.}
\textsuperscript{56} \textit{See} \textit{Fed. R. Civ. P. 52(a)(6).}
findings should be reviewed *de novo*. Some courts and scholars have interpreted this congressional action as an overruling of *Dobson*—the effective end of the *Dobson* rule. However, the “end” of *Dobson* was not so cut-and-dry, and its shadow continues to linger around the topic of Tax Court appellate review.

In the first place, Congress did not replace the original language of the statute, which outlined the appropriate standard of review. To this day, subsection (c)(1) of Section 7482 states that the courts of appeals “shall have the power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision . . . as justice may require.” This is the same language that Justice Jackson used to formulate the *Dobson* rule in the first place.

Some scholars have called into question whether Congress intended to overrule *Dobson* in its entirety, or simply to ensure that it did not apply to questions of fact. Regardless of Congress’s intent, it seems well established among courts, including the Supreme Court, that the *Dobson* rule, however interpreted, is no longer binding precedent.

Even though the *Dobson* rule has been effectively overruled, its enduring effect is undeniable; several federal courts have

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57 See e.g., Griffin v. Camp 40 F.3d 170, 172 (7th Cir. 1994) (“We subject the district court’s findings of law and mixed findings of law and fact to *de novo* review” (citing Brewer v. Aiken, 935 F.2d 850, 855 (7th Cir. 1991))).

58 See Dubroff, supra note 9, at 811-12 (“The overruling of the *Dobson* rule was, at that point, so uncontroversial that it was accomplished in a bill, the movement of which through Congress depended on its acceptability to all.”).

59 See Lederman, supra note 47, at 1867-74.


62 See Lederman, supra note 47, at 1855-56; David F. Shores, *Deferential Review of Tax Court Decisions: Dobson Revisited*, 49 TAX LAW 629, 673 (1996) (That Congress intended to modify rather than overrule *Dobson* when it amended subsection (a) in 1948 is made plain by the retention of subsection (c)).

63 See, e.g. Freytag v. Comm’r, 501 U.S. 868, 912 (1991); Comm’r v. Idaho Power Co., 418 U.S. 1, 19 (1974) (Douglas, J., dissenting) (“Dobson was short-lived, as Congress made clear its purpose that we were to continue on our leaden-footed pursuit of law and justice.”); Vukasovich v. Comm’r, 790 F.2d 1409, 1412-13 (9th Cir. 1986).
maintained the idea that the Tax Court’s decisions deserve a special level of deference. The Ninth Circuit in particular has a long history of acknowledging the Tax Court’s specialized expertise. In 2012, the Ninth Circuit heard an appeal from the Tax Court regarding pass-through loss from foreign currency transactions. The taxpayers, a married couple, argued that the Tax Court lacked jurisdiction, which was denied by the Tax Court judge. The taxpayers appealed. In the same breathe that the Ninth Circuit insisted it would “not give the Tax Court special deference in a de novo review,” it acknowledged, “the Tax Court has special expertise in the field” and “its opinions bearing on the Internal Revenue Code are entitled to respect.” The decision of the Tax Court was affirmed.

Several other Ninth Circuit opinions have expressed the same sentiment. For example, in United States v. Hinkson, the court found that in order to reverse the Tax Court, it would have to find the Tax Court’s conclusions “illogical,” “implausible,” or “without support in inferences that may be drawn from facts in the record.” In Sibla v. Commissioner, the Ninth Circuit acquiesced to the Tax Court, stating that the Tax Court had “exercised that degree of special expertise which Congress has intended . . . and that this court should not overrule that body, unless some unmistakable question of law mandates such a decision.”

The Court of Appeals for the District of Columbia, in an appeal from a Tax Court decision, wrote, “we are aware that the Tax Court deserves some deference for its significant expertise on what bare

64 Meruelo v. Comm’r, 691 F.3d 1108, 1111 (2012).
65 Id. at 1113 (citing Meruelo v. Comm’r, 132 T.C. 355 (2009)).
66 Meruelo, 691 F.3d at 1119.
67 Id. at 1114 (quoting Merkel v. Comm’r, 192 F.3d 844, 847-48 (9th Cir. 1999)).
68 Meruelo, 691 F.3d at 1119.
69 585 F.3d 1247, 1262 (2009) (citing to Anderson v. City of Bessemer City, N.C., 470 S.C. 564, 577 (1985)).
70 611 F.2d 1260, 1262 (1980).
bones allegations are essential . . . in tax deficiency cases.” In 2011, a United States District Court seated in Massachusetts cited to Dobson in asserting that “[w]hile decisions by the Tax Court are not binding, ‘uniform administration would be promoted by conforming to them where possible.'” The Second Circuit did not acknowledge the idea that Tax Court decisions should be treated with the same level of deference as district court decisions until 2013.

C. Chevron Deference and Tax

The Supreme Court case Chevron U.S.A., Inc. v. Natural Resource Defense Council, Inc. stands for the principle that courts should defer to agency interpretations of statutes where those interpretations are reasonable. The 1984 decision upheld an Environmental Protection Agency (EPA) regulation. The regulation allowed existing plants to purchase new equipment that did not meet standards set forth by the Clean Air Act of 1977, so long as the total emissions from those plants did not increase.

The decision to uphold the regulation and defer to the EPA’s authority rested largely on the concept that Congress charged the agency with the administration of the Act and that its expertise on its subject matter should be afforded a level of heightened deference.

73 See Diebold Foundation, Inc. v. Commissioner, 736 F.3d 172, 174 (2d Cir. 2013) (“[W]e conclude that the standard of review for mixed questions of law and fact in a case on review from the Tax Court is the same as that for a case on review after a bench trial from the district court: de novo to the extent that the alleged error is in the misunderstanding of a legal standard and clear error to the extent the alleged error is in a factual determination.”). For further discussion of the Dobson rule and its continued implications, see Lederman, supra note 47, at 1841-74.
74 497 U.S. at 844.
75 Id. at 866.
76 Id. at 840.
77 See id. at 865.
Chevron created a two-step test in determining whether courts should defer to an agency’s statutory interpretation. First, the court must ask whether the statute in question is ambiguous. If Congress’s intent is clear, the matter is closed. If the intent is unclear, the court must then ask whether the agency’s interpretation is reasonable—that is, “based on a permissible construction of the statute.”

Later Supreme Court jurisprudence clarified that Chevron deference does not necessarily apply to any and all actions taken by an agency in the administration of a statute. In United States v. Mead Corp., the Mead Corporation challenged a ruling by the United States Customs Service. Mead imported day planners. The Customs Service imposed a tariff on “diaries, notebooks, and address books,” but until 1993 had not classified Mead’s day planners as such. In January of 1993, Customs changed its position and determined that the day planners should, in fact, be subject to tariff. Mead objected and the case eventually made its way to the Supreme Court. The issue at hand was whether the Customs Service ruling should be granted Chevron deference. The Court determined that an agency’s statutory interpretation should only be afforded Chevron deference “when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.”

78 Id. at 842.
79 Id. at 842.
80 Id. at 842-43.
81 Id. at 843.
83 Id. at 225-26.
84 Id. at 224.
85 Id.
86 Id.
87 Id. at 226-27.
88 Id. at 226.
89 Id. at 226-27.

317
In *Mayo Foundation for Medical Education & Research v. United States*, the Supreme Court affirmed that *Chevron* deference applies to interpretations of the Internal Revenue Code by the United States Treasury Department (of which the IRS is a part). The *Mayo* dispute arose over a disagreement between the IRS and the medical community as to whether residents are “students” who are exempt from FICA taxes.

Internal Revenue Code Section 3121(b) states that “employment,” for the purposes of FICA tax, does not include employment by a university “if such service is performed by a student who is enrolled and regularly attending classes.” In 2004, the Treasury Department issued a regulation setting forth a rule that full time employees cannot qualify for the student FICA exemption, thereby subjecting wages earned by most, if not all, medical residents to FICA taxes. The Mayo Foundation brought suit arguing that the regulation was invalid and that its residents should be exempt. A District Court in Minnesota agreed with Mayo and proclaimed the regulation invalid. When the Government appealed, the Court of Appeals for the Eighth Circuit reversed, finding that *Chevron* applied, that the statute was “silent or ambiguous on the question whether a medical resident working for the school full-time is a ‘student’” and that the regulation in question was “a permissible interpretation” of § 3121(b).

The Supreme Court granted certiorari and affirmed the Eighth Circuit’s decision. The Court began its analysis under the two-part

90 562 U.S. 44, 55-56 (2011) (“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.”).
91 See id. at 49.
93 Mayo, 562 U.S. at 51.
96 Mayo, 562 U.S. at 51, 60.
Chevron test. It determined that “the plain text of the statute . . . [does not] speak with the precision necessary to say definitively whether [it] applies to’ medical residents.” The first step of Chevron was, therefore, satisfied. The Court went on to say that “[t]he full time employee rule easily satisfies the second step of Chevron, which asks whether the Department’s rule is a ‘reasonable interpretation’ of the enacted text.” Therefore, the decision of the Eighth Circuit below was affirmed and the regulation was upheld.

In its analysis, the Court also concluded that the regulation satisfied the requirements set forth by Mead. It wrote that the Department of the Treasury had “explicit authorization to `prescribe all needful rules and regulations for the enforcement’ of the Internal Revenue Code.” This particular pronouncement is significant because it indicates the Mead and Chevron standards apply to both general authority and specific authority regulations. However, where a pronouncement by an agency is less than a formal regulation, it appears settled that Chevron deference does not apply.

97 Id. at 52.
98 Id. at 53.
99 See id.
101 Mayo, 562 U.S. at 60.
102 Id. at 57.
103 Id. (citing 26 U.S.C. § 7805(a)).
105 See Christensen v. Harris County, 529 U.S. 576, 587 (2000) (“Interpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant Chevron-style deference.”); see, e.g., Voss v. Comm’r, 796 F.3d 1051, 1066 (9th Cir. 2015) (“[T]he IRS’s Chief Counsel Advice is only entitled to the ‘measure of deference proportional to the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade.’” (quoting Christopher v. SmithKline Beecham Corp., 132 S.Ct. 2156, 2168-69 (2012))).
Some scholars have asserted that *Chevron* deference should also apply to the Tax Court.\(^{106}\) This argument rests on the fact that the Tax Court originated as the Board of Tax Appeals, which was an independent agency within the executive branch.\(^{107}\) If it had remained as such, Professor David Shores argues, its interpretive rulings would have been afforded *Chevron* deference.\(^{108}\) By Professor Shores’s logic, it makes little sense that the Tax Court’s legal interpretations should be reviewed de novo simply because its status has since been converted to that of a judicial court.\(^{109}\)

However, the Tax Court is not an agency. The Tax Court is a “court of record” and only has judicial functions and power.\(^{110}\) It is generally agreed upon that the notion of *Chevron* deference as it applies to the Tax Court was settled by the Supreme Court’s decision in *Freytag*.\(^{111}\) The *Freytag* decision held that “the Tax Court is not a ‘Department’ like the Treasury, but rather is a ‘Court of Law.’”\(^{112}\) It is clear that *Chevron* deference will apply to regulations promulgated by the Department of Treasury and the IRS,\(^{113}\) but the decisions of the Tax Court hold no such weight.\(^{114}\)

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\(^{106}\) See, e.g., Shores, *supra* note 62, at 669.
\(^{107}\) See *Dubroff*, *supra* note 9, at 1.
\(^{108}\) See Shores, *supra* note 82, at 669.
\(^{109}\) *Id*. (Shores does acknowledge that “[i]t would be a stretch to claim that review of Tax Court decisions falls within the four corners of *Chevron* [as *Chevron* involved a classic administrative agency . . . with rulemaking as well as adjudicative powers].”)
\(^{110}\) See I.R.C. § 7441 (establishing the Tax Court under Article I as a “court of record”).
The application of *Chevron* to tax cases has been rocky in the wake of *Mayo*. Professor Steve Johnson discussed this rocky history in depth and argued that “[p]art of the confusion is the persistent use of ‘deference’ to refer to both force-of-law regulations and mere non-binding guidance documents.” Professor Johnson went on to discuss several cases in which *Chevron* is either completely ignored where logic dictates it would apply or “converting [Chevron] from a shield to protect agency actions into a sword with which to assail them.” Many recent cases, according to Johnson, point to the fall of *Chevron*, both in the tax context and generally.

One of the strongest cases indicating the fall of *Chevron* in tax is the 2015 Supreme Court decision in *King v. Burwell*. *King* concerned the interpretation of certain provisions of the Patient Protection and Affordable Care Act (“ACA”). The ACA allowed for subsidies on healthcare exchanges established by the states. A regulation implemented by the IRS as a part of the ACA allowed for subsidies on both state and federally-run exchanges. The petitioners in *King* argued that the regulation exceeded the authority granted to it by Congress. The Court ultimately determined that the regulation did not warrant *Chevron* deference, carving out two additional exceptions to *Chevron* in the process. First, the IRS lacked expertise

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116 Id. at 26.
119 Id. at 26–31.
120 135 S. Ct. 2480.
121 Id. at 2485.
122 Id. at 2486.
123 Id. at 2488.
124 Id.
125 Id. at 2489.
in the particular area of law, and second, the statute itself did not clearly delegate the authority to the IRS to make decisions of “deep ‘economic and political significance.’”

II. ROBERTS v. COMMISSIONER

A. The Facts of Roberts

Taxpayer Merrill C. Roberts, a successful Indiana businessman and restaurateur, bought his first two racehorses in 1999. The same year, he built a horse track on his Indianapolis land. Within three years, he owned ten racehorses and a breeding stallion and obtained an Indiana horse-training license.

By 2005, Roberts was comfortable enough with his horse racing, breeding, and training that he decided to build his own horse training facility. He purchased a 180-acre parcel of land in Mooresville, Indiana, in 2006, where he began construction. The facility, which included a track, horse stalls, rehabilitation equipment, specialized training areas, and living space for employees, was completed in 2007.

From 2005 to 2008, Roberts participated in various aspects of the horse racing industry including the boarding, breeding, and training of racehorses. He hired a full-time assistant trainer and spent substantial time keeping up the condition of his training facility and studying horse racing strategy. During that time period, he also

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126 Id.
127 Roberts v. C.I.R., 820 F.3d 247, 248 (7th Cir. 2016).
128 Id.
129 Id.
130 Id.
131 Id. at 248–49.
133 Id.
134 Id. at 4-5.
joined several professional horse racing organizations and served on the board of two of them.\textsuperscript{135}

During those same years, Roberts suffered numerous misfortunes and setbacks.\textsuperscript{136} Several of his horses were injured or killed in lightning strikes and in-race accidents.\textsuperscript{137} These mishaps contributed to losses he deducted for tax years 2005 through 2008.\textsuperscript{138} He also deducted other “ordinary and necessary expenses” related to his racehorse activities.\textsuperscript{139} The Internal Revenue Code allows such deductions for “expenses paid or incurred . . . in carrying on any trade or business.”\textsuperscript{140}

On March 1, 2011, the Commissioner of the Internal Revenue Service (Commissioner) issued a notice of deficiency to Roberts.\textsuperscript{141} Commissioner contended that Roberts was liable for taxes and penalties for tax years 2005 through 2008.\textsuperscript{142} Commissioner’s argument rested on the proposition that Roberts was engaged in his racehorse activities as a hobby and not as a business.\textsuperscript{143} Therefore, his deductions for losses related to those activities were erroneous and disallowed.\textsuperscript{144}

\subsection*{B. Roberts in the Tax Court}

The Tax Court heard Roberts’s case on April 29, 2014.\textsuperscript{145} The Tax Court began its analysis by noting that a notice of deficiency by the Commissioner is “presumed correct, and the taxpayer generally

\begin{itemize}
\item[\textsuperscript{135}] Id. at 5.
\item[\textsuperscript{136}] Id.
\item[\textsuperscript{137}] Id.
\item[\textsuperscript{138}] Id. at 6.
\item[\textsuperscript{139}] Id.
\item[\textsuperscript{140}] See 26 U.S.C. § 162(a).
\item[\textsuperscript{141}] Roberts, 2014 WL 1688127 at *1.
\item[\textsuperscript{142}] Id.
\item[\textsuperscript{143}] Id.
\item[\textsuperscript{144}] Id.
\item[\textsuperscript{145}] Id.
\end{itemize}
bears the burden of proving that the determinations are in error.”

A taxpayer also bears the burden of proof when he claims entitlement to any deduction.

Under section 183(a) of the Internal Revenue Code (“Code”), a deduction attributable to an activity not engaged in for profit will not be allowed. Section 183(c) defines “activity not engaged in for profit” as any activity other than an activity for which deductions are allowable under section 162 or section 212 of the Code. Deductions are allowed under these sections where “the taxpayer is engaged in the activity with the actual and honest objective of making a profit.”

The taxpayer has the burden of proving that actual and honest objective, but need not establish that any expectation of profit was reasonable.

In its analysis of whether Roberts demonstrated the requisite intent and profit objective, the Tax Court gave more weight to the objective facts than to Roberts's actual statement of his intent to make profit. Reviewing the facts, the Tax Court relied on a series of factors set forth in Treasury Regulation Sec. 1.183-2. The factors are:

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146 Id. at *7 (citing Welch v. Helvering, 290 U.S. 111, 115 (1933)).
148 Id. (“[E]xcept to the extent provided by section 183(b) . . . [which] allows for those deductions that would have been allowable had the activity been engaged in for profit only to the extent of gross income derived from the activity, reduced by deductions attributable to the activity that are allowable without regard to whether the activity was engaged in for profit.”).
149 Id. at *8.
150 Id. (citing Dreicer v. Comm’r, 78 T.C. 642, 645 (1982)).
151 Id. (citing Golanty v. Comm’r 72 T.C. 411, 425-26 (1979), aff’d without published opinion, 647 F.2d 170 (9th Cir. 1981)).
152 See id. (citing Elliott v. Comm’r, 84 T.C. 227, 236-37 (1985)).
153 Id.
(1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisers; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that the assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer’s history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation associated with the activity.154

The factors are non-exhaustive and “no one factor is determinative.”155 The Tax Court weighed each of the nine factors individually.156

Regarding the manner in which Roberts carried on his horseracing activities, it determined that Roberts “significantly changed his business model” in 2007 when he moved to the larger property and hired an assistant trainer.157 The Tax Court found the “significant changes in operating methods suggest[ed] [Roberts] engaged in horse racing activity for profit once his new facility was placed in service starting in the 2007 tax year.”158 It also rejected the Commissioner’s argument that Roberts’s “rudimentary” accounting method was an indicator that his activities were not businesslike.159 Rather, it determined that Roberts’s recordkeeping system “allowed him to make informed business decisions,” which appears to be the threshold.160

154 Id.; Treas. Reg. § 1.183-2(b).
155 Treas. Reg. § 1.183-2(b).
156 See Roberts, 2014 WL 1688127 at *8–18.
157 Id. at *9 (citing Phillips v. Comm’r, T.C. Memo. 1997-128 (explaining a business plan could be evidenced by actions rather than a written document)).
158 Id.
159 Id.
160 See id.
As to the expertise of Roberts or his advisors, the Tax Court found that Roberts “immersed himself in all aspects of the horse racing business, becoming an expert in his own right.” Roberts also participated in trade associations, in which he eventually took on leadership roles. The Tax Court accepted Roberts’s testimony as credible and believed that he had spent significant time and effort to developing expertise in boarding, breeding, and training, as well as in the financial aspects of the horseracing business, concluding that this factor weighed in his favor for all the years at issue. The Tax Court came to a similar conclusion regarding the “time and effort” factor.

The Tax Court went on to analyze whether Roberts appeared to expect that the assets used in his horseracing venture would appreciate in value. It separated the assets associated with the activities into two types: the horses themselves, and the real property and capital improvements on it. The Tax Court determined that Roberts did not buy the land where he built his first horse track specifically for that purpose and, by his own admission, did not expect the land to appreciate for any reason other than regular real estate appreciation. On the other hand, when Roberts bought the larger property, his specific intent was to use it as a “premier horse training facility.” Therefore, the Tax Court again concluded that Roberts did not manifest intent to profit from his horse racing activities until tax year 2007 when he bought the larger property.

The Tax Court next considered Roberts’s success in carrying on other activities and quickly found his previous entrepreneurial

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161 Id. at *10.
162 Id.
163 Id. at *10–11.
164 Id. at *11–12 ("[B]y tax year 2005 petitioner devoted time and effort appropriate to demonstrate a profit objective for all the tax years in issue.")
165 Id. *12.
166 Id.
167 Id. at *13.
168 Id.
169 Id.
successes weighed the factor in his favor. When considering Roberts’s history of income and losses associated with his horseracing activities, the Tax Court noted that a portion of his losses were attributable to “a series of unfortunate events beyond his control.” These unfortunate events, coupled with the fact that Roberts’s horseracing venture was in its “startup stage” during the years at issue balanced against the substantial losses he asserted. This factor was “neutral.”

When analyzing the “amount of occasional profits” factor, the Tax Court acknowledged that “[h]orse racing can be very speculative, and the expectation of profit may be very small.” It determined that Roberts’s expectation of future profits was reasonable and “consistent with the existence of a profit objective for all the tax years in issue” because he had initial success with the first two horses he purchased and his later successes indicated that “his horses [had] the potential to race at a very high level and possibly earn significant profit.”

As to Roberts’s financial status, the Tax Court noted that “[s]ubstantial income from sources other than the activity, particularly if the losses from the activity generate substantial tax benefits, may indicate that the activity is not engaged in for profit, especially if personal or recreational elements are involved.” Whereas, Roberts did have income from other sources and the losses he claimed reduced

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170 Id. at *13–14 (Listing Roberts’s various business successes and concluding “[h]e worked hard and showed initiative, foresight, and other qualities that led to success in his other business activities, and he had reason to expect eventual success in his horse-related activities.”).
171 Id. at *14 (“These events include the untimely death of several racing and breeding prospects, an unfortunate quarantine during racing season, a contractor’s building a shoddy fence that factored into the accidental death of two stallions, and the need to hire and fire several different trainers.”).
172 Id.
173 Id.
174 Id. at *15.
175 Id.
176 Id.
his overall taxable income. The Tax Court weighed this factor in favor of the Commissioner.

Finally, the Tax Court considered the “elements of personal pleasure or recreation” involved in Roberts’s horse-racing activities. It found Roberts initially began his activities as a result of social meetings and gatherings. During tax years 2005 and 2006, Roberts took equal part in the business and social aspects of the horse track. However, in 2007 he hired an assistant trainer who attended to more of the social obligations, freeing Roberts up to attend to the business side of things. Therefore, the Tax Court again drew a distinction between Roberts’s activities during 2005 and 2006 and his activities beginning in 2007 and moving forward.

Conclusively, after examining the factors individually, the Tax Court weighed them together. It ruled that Roberts did demonstrate a profit objective for the 2007 and 2008 tax years. However, the Tax Court also found that for 2005 and 2006, the activities were engaged in primarily for “personal pleasure or recreation,” and therefore the losses related therewith could not be deducted.

C. Roberts in the Seventh Circuit

Roberts appealed to the Seventh Circuit and Judge Posner wrote for a unanimous court. The Seventh Circuit held that Roberts’ activities were a business and not a hobby for all years in question.

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177 Id. at *16.
178 Id.
179 Id.
180 Id.
181 Id. at *1–17.
182 Id. at *17.
183 Id.
184 Id.
185 Id.
186 Id. at *16–17.
187 See Roberts v. C.I.R., 820 F.3d 247, 248 (7th Cir. 2016).
including 2005 and 2006, overturning the Tax Court’s decision. The Seventh Circuit, after discussing the Tax Court’s findings, began its analysis saying, “We mustn’t be too hard on the Tax Court . . . It felt itself imprisoned by a goofy regulation”—referring to Reg. Sec. 1.183-2. The rest of the analysis hinges on that “goofy regulation.” The Seventh Circuit found that the regulation’s factors “overwhelmingly favor[ed] Roberts’ claim that even in 2005 and 2006, his horse-racing enterprise was a business.”

The opinion goes on to acknowledge that, indeed, the horseracing industry attracts hobbyists, but that just because the activities in question were “fun,” did not mean they were not a business. The Seventh Circuit concluded by suggesting that the Tax Court, rather than considering the factors set forth by the IRS regulations, would be better off listening to the taxpayer’s protestations.

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188 Id. at 254.
189 Id. at 250.
190 See id. at 252.
191 Id. (“He conducted it in a businesslike way (factor 1). He prepared by extensive study (to obtain a training license) (factor 2). He largely withdrew from his previous businesses in order to devote ‘most of his energies’ to his horse-racing enterprise (factor 3). He expected to derive an eventual profit from the enterprise, including profit in the form of appreciation of the value of the land and buildings used in the enterprise (factor 4)—it’s not as if he were a billionaire indifferent to the modest profit that probably was all he could expect from horse racing. Entering the restaurant business on a small scale in his twenties, Roberts had suffered setbacks that prevented his business from being an immediate success—indeed his first restaurant burned down and the insurance settlement was too small to enable him to rebuild it as a full-service establishment. Yet he ‘grew’ the business to large dimensions over time, a pattern consistent with his attempting to repeat the process in his horse-racing venture in 2005 and 2006 (factor 5). ‘A series of losses during the initial or start-up stage of the activity may not necessarily be an indication that the activity is not engaged in for profit’ (factor 6)—that’s this case, all right. A ‘substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit’ (factor 7).”).
192 See id. at 254.
193 See id. at 253–54.
194 Id. at 254.
D. Deference Issues in Roberts

The Seventh Circuit’s opinion is particularly dismissive of the Tax Court, its opinion on Reg. Sec. 1.183-2, and the regulation itself. To begin, the Seventh Circuit makes no mention of the applicable standard of review it should give to the Tax Court’s decision.\textsuperscript{195} At this point, as this article has discussed, it is well established that courts of appeals owe little to no deference to the Tax Court’s findings of law and should review them de novo.\textsuperscript{196} Here, that seems to simply be taken for granted.

The Tax Court clearly went to great pains in this case to examine each of the factors set forth in the Treasury Regulation in depth and to apply the facts at hand, taking the better part of ten pages to do so.\textsuperscript{197} The Seventh Circuit managed the same analysis in little more than a paragraph.\textsuperscript{198}

One of the most unusual things about the Tax Court’s opinion is that, as painstakingly as it applies Reg. Sec. 1.183-2(b) it makes no mention of Reg. Sec. 1.183-2(c).\textsuperscript{199} Part (c) of the regulation comprises examples to illustrate its provisions\textsuperscript{200} and the third example provided by the Department of the Treasury matches the facts of the Roberts dispute, particularly during 2005 and 2006, almost to a T.\textsuperscript{201}

\textsuperscript{195} See generally, id.
\textsuperscript{196} See, e.g., Freytag v. Comm’r, 501 U.S. 868, 891 (1991) (“[The Tax Court’s] function and role in the federal judicial scheme closely resemble those of the federal district courts, which indisputably are ‘Courts of Law.’”); Diebold, 736 F.3d 174 (“[T]he standard of review for mixed questions of law and fact in a case on review from the Tax Court is the same as that for a case on review after a bench trial from the district court: de novo to the extent that the alleged error is in the misunderstanding of a legal standard and clear error to the extent the alleged error is in a factual determination.”).
\textsuperscript{197} See Roberts v. Comm’r, 2014 WL 1688127 at *7–18.
\textsuperscript{198} See Roberts, 820 F.3d at 252–53.
\textsuperscript{199} See generally, Roberts, 2014 WL 1688127.
\textsuperscript{200} Treas. Reg. §1.183-2(c).
\textsuperscript{201} See id.
Example 3 of Treas. Reg. 1.183-2(c) describes a hypothetical taxpayer who is a successful businessman and who has taken up the hobby of raising and racing thoroughbred horses.\textsuperscript{202} The taxpayer has suffered increasing losses over the years as a result of his horse racing and breeding activities and has never seen a profit as a result.\textsuperscript{203} His horse racing activities are combined with social and recreational ones.\textsuperscript{204} He conducts the activities on a large residential property where he resides with his family.\textsuperscript{205} “Since (i) the activity of raising . . . and racing the horses is of a sporting and recreational nature, (ii) the taxpayer has substantial income from his [other] business activities . . . , (iii) the horse . . . operations are not conducted in a businesslike manner, and (iv) such operations have a continuous record of losses, it could be determined that the horse . . . activities of the taxpayer are not engaged in for profit.”\textsuperscript{206}

Clearly this regulation is not a particularly rigid one, as the Seventh Circuit points out.\textsuperscript{207} It should be noted that neither the Tax Court nor the Seventh Circuit mention Chevron in their opinions.\textsuperscript{208} However, it seems apparent that the Tax Court must have taken into consideration the example in part (c), as the facts of the case were so glaringly similar. It is not a great leap in logic to think that the authors of the regulation, given the example put forth, would have found Roberts’ horse racing activities during the 2005 and 2006 tax years to have been “not engaged in for profit.” And the Tax Court appeared to

\textsuperscript{202} Id.  
\textsuperscript{203} Id.  
\textsuperscript{204} Id.  
\textsuperscript{205} Id.  
\textsuperscript{206} Id.  
\textsuperscript{207} See Roberts v. C.I.R., 820 F.3d 247, 252 (7th Cir. 2016) (“[T]he test is open-ended – which means that the Tax Court was not actually required to apply all of those factors to Roberts’ horse-racing enterprise. It could have devised its own test, with its own factors, as long as it explained why the factors that should ‘normally be taken into account’ were insufficient.”).  
\textsuperscript{208} See generally, Roberts, 820 F.3d at 247; Roberts, 2014 WL 1688127.
have afforded the deference required by *Chevron* to the Treasury Departments guidance as set forth in the regulation.\(^{209}\)

Technically, the Seventh Circuit also deferred to the regulation and found that the factors set forth therein supported the position that Roberts was conducting a business in 2005 and 2006.\(^{210}\) However, the opinion appears to stand for the proposition that neither the Seventh Circuit nor the Tax Court is bound to give any sort of deference to the regulation.\(^{211}\) It is true that the regulation itself concedes “no one factor is determinative,” and not “only the factors described . . . are to be taken into account.”\(^{212}\) However, the principles of *Chevron* lie largely on the concept of agency expertise in a given area of law.\(^{213}\) With this in mind, does it truly stand to reason that any time a regulation uses a “may” rather than a “shall,” it should be tossed out the window? Surely this cannot be the case, even where a court finds a regulation “goofy.”

It is clear that deferential treatment to the Tax Court is dead. However, the Seventh Circuit’s apparent defiance of the Treasury Regulation’s authority as well as it and the Tax Court’s failure to mention *Chevron* deference at all may be one of many signals that *Chevron* in tax is dying. As it stands, the level of deference a court of appeals will give to either the Tax Court’s logic or to a Treasury Regulation appears largely unpredictable. Perhaps the decision is an indication that the Treasury Department and the IRS should reevaluate the manner in which they draft regulatory language. Would a “shall” inserted somewhere into Reg. Sec. 1.183-2 have forced the Seventh Circuit to defer to it? If regulations like this one are so easily brushed off by courts, it seems a waste of agency resources to even bother issuing them. If the Treasury Department were to use more assertive and authoritative language in its regulations and courts continued to

\(^{209}\) See generally, Roberts, 2014 WL 1688127.

\(^{210}\) See Roberts, 820 F.3d at 252.

\(^{211}\) See id.

\(^{212}\) Treas. Reg. §1.183-2(c).

dismiss them (the way the Seventh Circuit did in Roberts) the Supreme Court or Congress would have an opportunity to again evaluate the proper role (if there is one) of deference, Chevron or otherwise, in tax.

CONCLUSION

The jurisprudential landscape of deference in tax continues to be ever-changing. Dobson, though incredibly unpopular, would have put to bed many of the inconsistencies we are presented with today by simply deferring to the expertise of the Tax Court, which handles an overwhelming majority of federal tax litigation. But, as it happens, Dobson was short-lived, and deference in the tax world has been a messy affair since its death.

Although technically Chevron deference applies to Treasury Regulations, Chevron itself is applied so haphazardly that it hardly provides clarity in the already complex field of tax litigation. Accordingly, the Department of the Treasury and the IRS should take a harder line when issuing regulatory guidance. If these agencies are more insistent that their interpretations of the Internal Revenue Code should be adhered to, they will provide more certainty to tax litigators.