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**NOTE**

**THE REGULATORY AUTHORITY OF THE TREASURY  
DEPARTMENT TO INDEX CAPITAL GAINS FOR  
INFLATION: A SEQUEL**

CHARLES J. COOPER\* & VINCENT COLATRIANO\*\*

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\* Founding partner and chairman of Cooper & Kirk, PLLC, in Washington, D.C.

\*\* Partner, Cooper & Kirk, PLLC, in Washington, D.C.

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#### INTRODUCTION\*\*\*

The 1992 election witnessed the revival of one of the periodically recurring debates in the field of tax policy—whether the determination of taxable gain from the sale or exchange of a capital asset should be “indexed” to reflect the effect of inflation on the taxpayer’s investment. What distinguished that debate from virtually all previous capital gains indexation debates was the overlay of a complex legal question on top of the usual economic and political considerations. Although the indexation debate previously focused almost exclusively on the wisdom of amending the Internal Revenue Code (the Code or I.R.C.) to require indexation, the 1992 debate introduced the legal issue of whether such a statutory amendment was even necessary. Could the Treasury Department (Treasury) simply adopt regulations allowing for capital gains indexation? Consideration of this legal issue obviously implicated intricate questions concerning the meaning of the Code’s capital gains provisions and the deference to which any administrative reinterpretation of those provisions would be entitled in a court challenge.

During the summer of 1992, we were asked by the National Chamber Foundation, an affiliate of the United States Chamber of Commerce, to examine this legal issue. After conducting a comprehensive analysis of the Code and its legislative history, as well as of relevant principles of administrative law—with particular emphasis on the “*Chevron* doctrine”—we concluded that the Treasury would have the regulatory authority to index capital gains without an amendment to the Code. The principal foundation of our analysis was our conclusion that the term “cost” as used in the Code’s capital gains provisions was ambiguous and was not plainly limited to historical cost—that is, the price originally paid for a capital asset. We also concluded that Congress’s failure to enact various proposals that would

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\*\*\* Although the views expressed herein are solely those of the authors, the authors gratefully acknowledge the assistance of Michael Morley in the preparation of this article.

have amended the Code to provide for indexation, as well as its enactment over the years of various other kinds of capital gains preferences, did not eliminate the ambiguity in the meaning of the pivotal term "cost" in the Code, nor did it otherwise foreclose the Treasury's ability to provide for indexation through the adoption of regulations. Our memorandum discussing the details of our legal analysis subsequently formed the basis of a law review article on the subject of administrative indexation of capital gains.<sup>1</sup> Though we direct the reader to the *VTR* article for the details of our comprehensive analysis, we provide a summary of that analysis in Part I of this Article.

We acknowledged in our 1992 analysis that the arguments against the Treasury's authority to reinterpret the Code to allow for indexation were substantial and that the legal question was a close and difficult one. As it turned out, the Department of Justice under the administration of President George H.W. Bush concluded that those arguments were not only substantial but insurmountable. In September 1992, the Office of Legal Counsel (OLC) prepared an opinion examining our analysis and concluding that the Code precludes administrative indexation (OLC opinion).<sup>2</sup> Shortly thereafter, and presumably on the basis of the OLC opinion (as well as a similar legal analysis undertaken by Treasury), President Bush decided against ordering administrative indexation. In our *VTR* article, which appends the OLC opinion in full,<sup>3</sup> we addressed the OLC opinion and explained why we believed the OLC's analysis was flawed and ultimately incorrect.

This Article is a sequel to our *VTR* article; its purpose is to identify any relevant legislative and jurisprudential developments that have taken place over the last twenty years and to assess their impact, if any, on the conclusions we reached in 1992. As discussed in Part II below, although the question remains a close one, it is not as close as it was in 1992. Post-1992

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1. See Charles J. Cooper et al., *The Legal Authority of the Department of the Treasury to Promulgate a Regulation Providing for Indexation of Capital Gains*, 12 VA. TAX REV. 631 (1993) [hereinafter Cooper et al., *Legal Authority*].

2. Memorandum for Jeanne S. Archibald Re: Legal Authority of the Department of the Treasury to Issue Regulations Indexing Capital Gains for Inflation, 16 Op. O.L.C. 145 (1992), reprinted in Cooper et al., *Legal Authority*, supra note 1, app. at 704-32; see also William P. Barr, *Attorney General's Remarks*, Benjamin N. Cardozo School of Law, November 15, 1992, 15 CARDOZO L. REV. 31, 35 (1993).

3. See Cooper et al., *Legal Authority*, supra note 1, app. at 704-32.

developments have substantially strengthened our original 1992 conclusions that the Code's capital gains provisions do not foreclose the Treasury from providing by regulation for the indexation of capital gains and that any such regulation would be entitled to deference under *Chevron* and analogous legal principles as a valid exercise of the Treasury's interpretative discretion. Moreover, although over the past twenty years Congress failed to enact bills providing for indexation and successfully enacted other types of capital gains "preferences," these legislative developments are no different in kind from similar pre-1992 developments and thus do not repeal or otherwise eliminate Treasury's discretion under the Code to provide for indexation by regulation.

Subsequent legal developments have strengthened support for our original conclusions in at least three respects. First, the Supreme Court, in *Mayo Foundation for Medical Education and Research v. United States*, recently confirmed that the *Chevron* doctrine applies to Treasury regulations interpreting the Code.<sup>4</sup> Second, in *Verizon Communications Inc. v. FCC*, the Court ruled (albeit in a different statutory context) that the meaning of the term "cost" is not at all plain and unambiguous and therefore can be reasonably interpreted to include costs other than historical cost.<sup>5</sup> In this regard, the Court's analysis in *Verizon* both tracks quite closely with our VTR article's examination of the meaning of the term "cost" in the Code and flatly rejects the central premise underlying the analysis in the OLC opinion. Finally, in *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, the Court made clear that a previous court decision interpreting a statutory provision operates to deprive an agency of discretion to interpret the provision differently only if the judicial decision finds the provision to be unambiguous.<sup>6</sup> Because no previous judicial decisions conclusively hold that the term "cost" unambiguously precludes indexation, *Brand X* confirms that a Treasury reinterpretation of cost to provide for indexation would be entitled to *Chevron* deference notwithstanding prior lower court decisions adopting the historical "purchase price" interpretation of cost.

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4. See 131 S. Ct. 704, 713 (2011).

5. See 535 U.S. 467, 497 (2002).

6. See 545 U.S. 967, 982 (2005).

Eefore addressing in Part II these post-1992 developments in detail, we provide in Part I a brief sketch of the salient features of our 1992 analysis.

## I. SUMMARY OF 1992 ANALYSIS

### A. *The Chevron Analytical Framework*

At the outset of our 1992 analysis, we stressed that any challenge to a Treasury regulation providing for the indexation of capital gains would depend heavily on the standard of judicial review that would apply to such a regulation.<sup>7</sup> Modern administrative law doctrine makes clear that the legal question is not whether a court, were it reviewing the relevant provisions of the Code de novo, would conclude that indexation of capital gains is *required* under the statute or is even the best reading of the statute.<sup>8</sup> Rather, the question is whether a Treasury regulation indexing capital gains is based upon a *permissible* reading of the statute.<sup>9</sup> Obviously, an agency's statutory construction cannot be sustained if Congress has directly and unambiguously addressed the precise question at issue in a manner that forecloses the agency's interpretation.<sup>10</sup> Apart from this obvious constraint on an administrative agency's interpretive discretion, however, a court must defer to the agency's reading if it is a plausible and reasonable reading of the statute, even if the court's own de novo construction of the statute would differ from the agency's.<sup>11</sup>

The modern framework governing judicial examination of an agency's interpretation of its organic statute was established in *Chevron U.S.A. Inc. v. Natural Resources Defense Council*.<sup>12</sup> *Chevron's* familiar two-step inquiry is worth repeating:

First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court deter-

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7. See Cooper et al., *Legal Authority*, *supra* note 1, at 633.

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. 467 U.S. 837 (1984).

mines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.<sup>13</sup>

Thus, "[t]he 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."<sup>14</sup>

The *Chevron* doctrine is premised on the notion that the agency, rather than a court, is the appropriate body to "fill any gap left, implicitly or explicitly, by Congress."<sup>15</sup> Significantly, this is true even when the agency interpretation reflects a change in the agency's views.<sup>16</sup> This conclusion follows from one of the central premises of the Court's analysis—namely, that the popularly elected Executive (or his designate) may adopt and implement reasonable policy choices within the discretion the statute entrusts to him.<sup>17</sup> Changes in such policy choices are the natural and predictable outgrowth of the political process, and the judiciary is not authorized to interfere with such discretionary policy decisions.<sup>18</sup>

At the time of our 1992 analysis, the Supreme Court had not squarely addressed whether judicial challenges to Treasury regulations and decisions interpreting the Code were to be analyzed under *Chevron*. Because we could discern no reason in law or policy to suppose that the general principles of judicial deference explicated in *Chevron* would be held inapplicable in the context of such Treasury interpretations, we were confident that *Chevron's* analysis would be held to apply fully to any Treasury regulation providing for indexation of capital gains.<sup>19</sup>

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13. *Id.* at 842-43.

14. *Id.* at 843 n.11.

15. *Id.* at 843 (quoting *Morton v. Ruiz*, 415 U.S. 199, 231 (1974)).

16. *See id.* at 863-64.

17. *See id.* at 844-45 (citing *United States v. Shimer*, 367 U.S. 374, 382-83 (1961)).

18. *See id.* at 865-66.

19. Cooper et al., *Legal Authority*, *supra* note 1, at 644-45.

As discussed in Part II.A below, the Supreme Court has now resolved this issue as predicted.

B. *The Chevron "Step One" Analysis*

1. *The Statutory Text and the Meaning of "Cost"*

The Code provides that "[t]he gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis . . . ."<sup>20</sup> The "basis" of property, in turn, is defined generally as "the cost of such property . . . ."<sup>21</sup> The Code expressly provides for a number of adjustments to basis for items such as depletion, depreciation, amortization, and certain expenses.<sup>22</sup> This basic structure for the determination of gain or loss on the sale of property has not materially changed since 1918.

At the heart of the indexation inquiry, then, is the meaning of the word cost as that term is used in Section 1012. Congress has never defined the term cost, and the regulations issued under the Code did not define it until 1957. The Treasury Regulations issued in 1957 defined cost as "the amount paid for . . . property in cash or other property."<sup>23</sup> This regulatory definition remains in place today. Thus, Treasury interpreted the cost of a capital asset to mean the asset's original purchase price—its historical cost—and measured the gain on the asset's sale as the difference (with certain adjustments not relevant here) between its purchase price and its selling price.

Again, under the analytical framework dictated by *Chevron*, the relevant inquiry is whether the Treasury's "purchase price" understanding of cost is *required*—that is, whether it is the *only* permissible means of measuring capital gains income consistent with the Code.<sup>24</sup> If not, the question becomes whether there is a reasoned and lawful basis for Treasury to reinterpret cost to reflect the effect of inflation.<sup>25</sup> These questions guided our

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20. I.R.C. § 1001(a) (2006).

21. I.R.C. § 1012(a) (2006 & Supp. 2010).

22. *See, e.g.*, I.R.C. § 1016(a)(1)–(2) (2006).

23. Treas. Reg. § 1.1012-1(a) (1957).

24. *See Chevron U.S.A. Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 842–43 (1984).

25. *See id.* at 843–44.

review of the text, structure, and legislative history of the Code's provisions governing the treatment of capital gains.

With respect to the statutory text, we concluded that the term cost was subject to more than one reasonable interpretation and was readily amenable to a construction that took inflation into account.<sup>26</sup> An interpretation of cost, pursuant to Treasury's administrative discretion under the Code, to refer to the true economic consequences of a taxpayer's investment—that is, the taxpayer's gain or loss of *real* income or spending power—was plausible and reasonable, just as was Treasury's long-standing interpretation limiting that term to only the *nominal* dollars expended to purchase the asset.<sup>27</sup> In an important sense, the only difference between the two definitions was that the former measured cost at the time the capital asset was sold, whereas the latter measured cost at the time the asset was purchased.<sup>28</sup>

## 2. *The Legislative History*

Just as the text of the Code did not indicate a clear legislative intent to limit the meaning of cost under Section 1012 to original purchase price, neither did the legislative history of the relevant Code provisions.<sup>29</sup> The history of the Code's capital gains provisions contained little if any persuasive evidence that Congress clearly spoke to the "precise question at issue,"<sup>30</sup> denying Treasury any interpretative discretion to take account of economic considerations other than original purchase price in calculating cost for purposes of determining capital gains. The strongest argument for limiting the meaning of cost was that both at the time that Congress passed the predecessor to Section 1012 and in subsequent years, some members of Congress assumed that capital gains would be calculated by reference to the original purchase price paid for an asset.<sup>31</sup> Nonetheless, these isolated statements did not demonstrate that Congress had left no discretion to Treasury to interpret the Code's capital gains provisions in such a way as to account for the effect of inflation on the true economic value of capital assets.

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26. Cooper et al., *Legal Authority*, *supra* note 1, at 633–34.

27. *Id.* at 649.

28. *Id.* at 649–50.

29. *Id.* at 662–84.

30. *Chevron*, 467 U.S. at 842.

31. See Cooper et al., *Legal Authority*, *supra* note 1, at 672.

To the contrary, from the beginning Treasury exercised, without objection from Congress, regulatory discretion in applying the cost concept. The earliest regulations the Treasury promulgated under the Revenue Act of 1918—which first incorporated the term cost in the capital gains provisions—adopted a flexible approach to interpreting “basis” and “cost” and provided for the regulatory adjustment of the purchase price, or historical cost, of an item to measure accurately the income of the taxpayer.<sup>32</sup> Perhaps most significantly, Treasury’s 1913 regulations provided that an asset’s cost was not its original purchase price but rather was its purchase price less the amount of any depreciation or depletion taken by the taxpayer prior to its sale.<sup>33</sup> Also notable was the 1918 regulations’ treatment of property acquired by gift or bequest; the basis for such property would be its fair market value as of the date of acquisition, rather than the price paid or historical cost.<sup>34</sup> Similarly, the regulations provided that in certain situations, a partner’s cost in his partnership interest would include not only the original cost of the partner’s share in the partnership but also his share in undistributed taxed partnership net income.<sup>35</sup>

Thus, in its original 1918 regulations interpreting the Code, Treasury interpreted cost as *not* limited to the original purchase price. This meant that other measures of cost—in particular, adjustments made to reflect the asset’s value at the time of sale rather than at the time of purchase—could be used if justified by sound economic and tax considerations.<sup>36</sup>

The legislative history of the Code’s capital gains provisions also included several unsuccessful attempts in Congress, primarily in the 1970s, 1980s, and early 1990s, to legislatively require indexation of capital gains for inflation.<sup>37</sup> We rejected the notion that the failure of these attempts signified congressional “acquiescence” in Treasury’s “purchase price” interpretation of

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32. *Id.* at 662–74.

33. *See, e.g.*, T.D. 2831, 21 *Treas. Dec. Int. Rev.* 170, 392, art. 1561 (1919).

34. *Id.* at 393, art. 1562. A later version of this regulation explicitly tied this basis rule to the Treasury’s conception of the meaning of cost. T.D. 3206, 23 *Treas. Dec. Int. Rev.* 763, 770, art. 1562 (1921) (“The cost of . . . property [acquired by gift or bequest] to the person making the sale or other disposition thereof is the fair market value of the property at the date of acquisition . . .”).

35. T.D. 2831, 21 *Treas. Dec. Int. Rev.* 170, 396, art. 1570 (1919).

36. Cooper et al., *Legal Authority*, *supra* note 1, at 666–67.

37. *See id.* at 697–98.

"cost" and thus foreclosed Treasury from reinterpreting that term.<sup>38</sup> Even leaving aside the legislative history revealing that Congress favored the concept of indexing capital gains (indexation measures had actually passed in recent sessions of both the Senate and the House<sup>39</sup>), there is no warrant, in law or logic, for interpreting a later Congress's *failure* to enact legislation as effectively amending an existing statute so as to remove an agency's regulatory discretion to interpret statutory terms.<sup>40</sup>

Nor did we find merit in the argument that Congress's periodic reenactment of the Code somehow had the effect of freezing in place Treasury's original construction of "cost."<sup>41</sup> Although such a "reenactment doctrine" sometimes has been invoked as a shield to prevent the invalidation of Treasury regulations that were in place at the time of reenactment, the doctrine could not be utilized, in any principled manner, as a sword to invalidate what would otherwise be a reasonable exercise by Treasury of its statutorily-granted interpretive discretion.<sup>42</sup> The reenactment doctrine "does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers . . ."<sup>43</sup> In short, neither the language nor the legislative history of the Code definitively and explicitly defined the term *cost* or otherwise evidenced an unambiguous intent to limit its meaning to original purchase price.

### 3. *Relevant Caselaw*

Review of relevant judicial precedent likewise confirmed to us that the meaning of cost is ambiguous and that Treasury has administrative discretion to reinterpret the term in a manner that better reflects economic reality and accords with the principles underlying the taxation of income.<sup>44</sup> Decisions recognizing Treasury's interpretive discretion regarding other, similarly

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38. *See id.* at 698-701.

39. *See id.* at 699-700.

40. *See id.* at 698-701.

41. *See id.* at 695-97.

42. *Id.* at 695.

43. *Id.* at 695-96 (quoting *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 100 (1939)).

44. *See Cooper et al., Legal Authority, supra* note 1, at 685-86.

ambiguous Code provisions supported Treasury's interpretive discretion concerning income taxation.<sup>45</sup> In addition, ample Supreme Court precedent, even outside the standard *Chevron* framework, supported Treasury's regulatory discretion to change its interpretation of Code provisions.<sup>46</sup> And although several lower court cases held, in keeping with the existing regulatory definition, that the cost of property for tax basis purposes is the amount paid for the property, none of these decisions addressed whether Treasury retained discretion to *reinterpret* cost to account for inflation.<sup>47</sup>

### C. *The Chevron "Step Two" Analysis*

Proceeding to *Chevron* "step two," which examines whether an agency interpretation of ambiguous statutory language "is based on a permissible construction of the statute,"<sup>48</sup> our 1992 analysis concluded that the second *Chevron* prong was easily satisfied.<sup>49</sup> Treasury clearly would have reasoned support for reinterpreting the term cost to permit the indexing of capital gains to account for the illusory gain attributable to inflation.<sup>50</sup> A tax imposed on a "gain" attributable to inflation is a tax on a gain that does not truly increase the taxpayer's purchasing power. By more accurately assessing the actual increase in a person's wealth or purchasing power, capital gains indexation would run truer to the principles underlying federal income taxation.<sup>51</sup>

## II. DEVELOPMENTS SINCE THE 1992 ANALYSIS

In updating our 1992 analysis, we concentrated primarily on developments in the Supreme Court jurisprudence that bear upon the main building blocks of our analysis and on developments in Congress that bear upon the tax treatment of capital gains. The bottom line is that the pertinent legal landscape has changed over the last two decades in ways that only strengthen the support for our conclusions.

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45. *See id.* at 689-91.

46. *See id.* at 686-88.

47. *See id.* at 688 n.193 & 691-94.

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

49. *See Cooper et al., Legal Authority*, *supra* note 1, at 659.

50. *Id.* at 701.

51. *See id.* at 701-03.

Notwithstanding several additional unsuccessful attempts in Congress during this period to amend the Code to provide for indexation, the basic statutory and regulatory regime governing the determination of capital gains that existed in 1992 remains largely in place. Cost is still the operative term in the definition of the basis of a capital asset, and Treasury continues to define cost by reference to the asset's original purchase price. Recent attempts to amend the Code to provide for indexation are no different in kind from those that preceded 1992. Finally, the *Chevron* doctrine continues to govern the basic legal regime under which any effort by Treasury to redefine cost to allow for indexation would be reviewed by the courts.

Important developments in Supreme Court jurisprudence, however, bear directly on two critical components of our *Chevron* step one analysis and confirm our original views on the applicability of that analysis to Treasury interpretations of the Code and on the inherent ambiguity of the meaning of the term cost. We now turn to a discussion of these, and other, developments.

A. *Chevron Applies to Treasury Interpretations of the Code: Mayo Foundation*

We noted in our 1992 analysis that Treasury regulations interpreting Code provisions would presumably be entitled to *Chevron* deference but that the Supreme Court had not yet weighed in on the issue.<sup>52</sup> Just last Term, however, the Court made clear that the *Chevron* analysis fully applies to Treasury regulations, and it reiterated that *Chevron* mandates deference even to agency constructions that represent a change in position.<sup>53</sup>

The petitioner in *Mayo Foundation* challenged the validity of Treasury's new interpretation of certain provisions of the Federal Insurance Contributions Act (FICA).<sup>54</sup> The Court rejected the petitioner's argument that the multifactor test of *National Muffler Dealers Ass'n v. United States* should govern judicial evaluation of the Treasury's interpretation, instead clarifying that *Chevron's* rule of deference applies.<sup>55</sup>

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52. *See id.* at 644-45.

53. *See Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704, 712-714 (2011).

54. *Id.* at 706.

55. *See id.* at 712 (citing *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979)).

In *National Muffler*, decided five years before *Chevron*, the Court held that a regulation "may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent," but that "[i]f the regulation date[d] from a later period, the manner in which it evolved merits inquiry."<sup>56</sup> In that latter circumstance, relevant considerations for a reviewing court included "the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute."<sup>57</sup>

The Court in *Mayo Foundation* acknowledged that it had applied *National Muffler* to post-*Chevron* challenges to Treasury tax regulations but that in other cases it had applied the *Chevron* framework.<sup>58</sup> The Court explained, however, that its more recent decisions had rejected the premises of *National Muffler*, holding both that "[a]gency inconsistency is not a basis for declining to analyze the agency's interpretation under the *Chevron* framework,"<sup>59</sup> and that "neither antiquity nor contemporaneity with [a] statute is a condition of [a regulation's] validity."<sup>60</sup> Accordingly, the Court held that "[t]he principles underlying our decision in *Chevron* apply with full force in the tax context."<sup>61</sup> "Filling gaps in the . . . Code," the Court said, "plainly requires the Treasury Department to make interpretive choices for statutory implementation at least as complex as the ones other agencies must make in administering their statutes."<sup>62</sup> The Court therefore saw no reason judicial "review of

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56. 440 U.S. at 477.

57. *Id.*

58. See *Mayo Found.*, 131 S. Ct. at 712.

59. *Id.* (quoting *Nat'l Cable Telecomm. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 981 (2005)); accord *United States v. Eurodif S.A.*, 129 S. Ct. 878, 887 (2009); *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 156-57 (2000) (holding that under *Chevron*, an agency's "initial interpretation of a statute that it is charged with administering is not 'carved in stone'" (quoting *Chevron U.S.A. Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 863 (1984))); *Smiley v. Citibank (S.D.)*, N.A., 517 U.S. 735, 742 (1996) (similar).

60. *Mayo Foundatcn*, 131 S. Ct. at 712 (quoting *Smiley*, 517 U.S. at 740).

61. *Id.* at 713; see also *id.* ("Aside from our past citation of *National Muffler*, *Mayo* has not advanced any justification for applying a less deferential standard of review to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only.").

62. *Id.*

tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as our review of other regulations."<sup>63</sup> Applying *Chevron*, the Court concluded that Treasury's interpretation of FICA, as reflected in its final rule adopted pursuant to notice-and-comment rulemaking, was a reasonable construction of the statute.<sup>64</sup>

Thus, *Mayo Foundation* removes any doubt as to the applicability of *Chevron* to judicial review of Treasury regulations interpreting the Code.

## B. *Developments Affecting Application of the Chevron Test*

### 1. *The Meaning of Cost: Verizon Communications*

As noted above, in applying the first prong of the *Chevron* framework to a Treasury regulation providing for capital gains indexation, the pivotal issue is whether the meaning of the term cost in Section 1012 is unambiguous and therefore can only be construed to refer to original purchase price.<sup>65</sup> Our 1992 analysis concluded that "the meaning of 'cost' is sufficiently ambiguous to permit the exercise of administrative discretion" in interpreting the term to take account of inflation and that such an interpretation would be entitled to judicial deference under *Chevron*.<sup>66</sup>

The OLC rejected our analysis, concluding that cost is not ambiguous and can mean only "purchase price" under the Code.<sup>67</sup> Relying on the "well-established rule of construction that statutes must be accorded their plain and commonly understood meaning,"<sup>68</sup> the OLC analysis rested primarily on the finding that in a variety of respected dictionaries, including Black's Law Dictionary, "the first and most common meaning of the term [cost] is the price paid."<sup>69</sup> The OLC illustrated its point by explaining that if "one were asked 'How much did your car cost?' " the answer would invariably be an "approximate

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63. *Id.*

64. *Id.* at 714.

65. See *supra* Part I.B.1.

66. See Cooper et al., *Legal Authority*, *supra* note 1, at 649-54.

67. See *id.* at app. at 709.

68. *Id.* at 708.

69. *Id.* at 712.

ration of the actual price paid at the time of purchase."<sup>70</sup> This "price paid" meaning of cost is confirmed, according to the OLC, by the structure of the Code, which contains numerous other provisions, such as those relating to the deduction for depreciation that make sense only if the cost of the asset is measured at the time it is purchased.<sup>71</sup> The Supreme Court, however, in *Verizon Communications Inc. v. FCC*, unanimously rejected strikingly similar arguments in closely analogous circumstances.<sup>72</sup>

In *Verizon*, the Court reviewed challenges to FCC regulations interpreting and implementing certain rate-setting provisions in the Telecommunications Act of 1996 (TCA). At issue was

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<sup>70</sup> *Id.* For our answer to this "plain meaning" argument, see Cooper et al., *Legal Authority*, *supra* note 1, at 652-60.

<sup>71</sup> Specifically, the OLC argued that because "the adjusted basis of an asset is determined by [s]ection 1012, which uses the term 'cost,'" in taking a deduction for depreciation, "the cost of an asset must be known in every year in which the taxpayer would take a depreciation deduction." Cooper et al., *Legal Authority*, *supra* note 1, app. at 717. But if the cost of the asset, according to the OLC, is adjusted to account for inflation at the time of the asset's sale, "the taxpayer (and Treasury) would have no basis on which to calculate the proper deduction." *Id.* This is a non sequitur, as we noted in our 1992 analysis. *See id.* at 650 n.62. With respect to the OLC's specific example of a depreciation deduction, the cost of the asset would be adjusted at the time of the deduction to account for inflation, and the amount of the depreciation would then be deducted from the inflation-adjusted cost. Indeed, each deduction taken for depreciation can be viewed essentially as a sale of a corresponding percentage of the asset itself. As the Supreme Court noted: "The theory underlying this allowance for depreciation is that by using up the [asset], a gradual sale is made of it. The depreciation charged is the measure of the cost of the part which has been sold." *United States v. Ludey*, 274 U.S. 295, 301 (1927); accord Cooper et al., *Legal Authority*, *supra* note 1, at 685-87.

In a related argument, the OLC noted that Section 1016 of the Code contains twenty-five specific items of adjustment to the basis, or cost of property, but does not specifically include an inflation adjustment. Cooper et al., *Legal Authority*, *supra* note 1, app. at 718. According to the OLC, "one would rationally expect that if Congress intended to provide such an adjustment in the Code, the adjustment would appear in [s]ection 1016" or elsewhere in the Code. *Id.* Similarly, given that Section 1016 sets forth certain specific adjustments to account for the impact of inflation, the OLC "would expect that if Congress intended that asset costs be indexed for the calculation of capital gains, it would have done so explicitly . . ." *Id.* at 719. The OLC's point is valid as far as it goes. But it does not go to the relevant point here. True, if Congress had intended to mandate an inflation adjustment for calculating capital gains, it presumably would have done so explicitly in the manner suggested by the OLC. But if Congress had not intended to mandate such an adjustment in the Code, but rather had intended to allow Treasury regulatory discretion, based on its expertise and experience in administering the tax system, to determine whether an asset's basis should be measured from an historical perspective at the time of purchase or, rather, from a current perspective at the time of sale, it would have defined "basis" using an ambiguous term such as cost.

<sup>72</sup> 535 U.S. 467 (2002)

whether the term cost, as used in the TCA's rate-setting provision,<sup>73</sup> is ambiguous and, if so, whether the FCC's interpretation of the term was reasonable.<sup>74</sup> Section 252(d)(1) dictated that the rate an incumbent local exchange carrier charged to a competing local exchange carrier for a network element must "be . . . based on the cost . . . of providing the . . . network element . . ."<sup>75</sup> In applying this provision, the FCC required rates to be set by reference to hypothetical "forward looking" costs rather than to the actual historical acquisition cost of the "element" at issue.<sup>76</sup>

The petitioners in *Verizon*, incumbent local exchange carriers, argued that the term cost plainly and unambiguously meant the "historical" cost—the amount "in fact paid for something."<sup>77</sup> Relying on standard reference works such as Black's Law Dictionary, petitioners argued that "[t]he plain, dictionary meaning of the word 'cost' includes the entire amount paid for any particular item or service."<sup>78</sup> The petitioners also argued that the "price paid" meaning of "cost" in the TCA was confirmed by the structure of the Act, which included, for example, an interrelated provision recognizing in the rate-setting formula an allowance for a "reasonable profit"—a concept that is by definition measured as revenue in excess of historical costs.<sup>79</sup>

The *Verizon* Court flatly and unanimously rejected petitioners' dictionary-driven interpretation of cost and deferred to the agency under *Chevron*. Far from plain and unambiguous, the *Verizon* Court held, the term cost is "protean," "a chameleon," and "virtually meaningless."<sup>80</sup> According to the Court, petitioners' argument "boils down to the proposition that 'the cost of providing the network element' can only mean, in plain language and in this particular technical context, the past cost to an incumbent of furnishing the specific network element actu-

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73. 47 U.S.C. § 252(d)(1) (2006).

74. *Verizon*, 535 U.S. at 497–98.

75. 47 U.S.C. § 252(d)(1) (2006).

76. *Verizon*, 535 U.S. at 495.

77. Brief for Petitioners at 19, *Verizon*, 535 U.S. at 467 (No. 00-511), 2001 WL 883672, at \*19.

78. *Id.*

79. *Id.* at 20–21.

80. *Verizon*, 535 U.S. at 500–01.

ally, physically, to be provided."<sup>81</sup> Turning first to the term's ordinary, plain language meaning, the Court observed:

The [petitioners] have picked an uphill battle. *At the most basic level of common usage, "cost" has no such clear implication.* A merchant who is asked about "the cost of providing the goods" he sells may reasonably quote their current wholesale market price, not the cost of the particular items he happens to have on his shelves, which may have been bought at higher or lower prices.<sup>82</sup>

Petitioners' argument fared no better when examined from specialized perspectives rather than ordinary usage: "When the reference shifts from common speech into the technical realm, the incumbents still have to attack uphill."<sup>83</sup> In particular, with regard to the meaning of cost as an economic term of art, the Court rejected the argument that cost must be read "to mean past incurred cost."<sup>84</sup> The Court cited several economic definitions of cost, noting that although "sunk costs" are prior costs, "practically every other sort of economic 'cost' is forward looking, or can be either historical or forward looking."<sup>85</sup> Nor was the meaning of cost made unambiguous by its close structural relationship to the term "profit," for the latter term "may also mean 'normal' profit, which is the total revenue required to cover all of the costs of a firm, including its opportunity cost."<sup>86</sup>

The Court then summarized why the term cost is ambiguous and cannot, in and of itself, be read to refer only to historical cost:

The fact is that without any better indication of meaning than the unadorned term, the word "cost" in § 252(d)(1), as in accounting generally, is "a chameleon," a "virtually meaningless" term. As JUSTICE BREYER put it . . . words like "cost" "give resetting commissions broad methodological leeway; they say little about the 'method employed' to determine a particular rate."<sup>87</sup>

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§1. *Id.* at 498.

§2. *Id.* (emphasis added).

§3. *Id.*

§4. *Id.* at 499 n.17.

§5. *Id.*

§6. *Id.* at 500 n.19 (internal quotation marks omitted).

§7. *Id.* at 500-01 (internal citations omitted).

Accordingly, the Court concluded that nothing in Section 252(d)(1) "plainly require[d]" the FCC to refer to historical cost when setting rates.<sup>88</sup>

The Court's decision in *Verizon*, of course, is not directly controlling with respect to the meaning of cost as used in Section 1012 of the Code. Still, the Court unambiguously and forcefully rejected the notion that the term cost, either as a matter of common usage or as an economic term of art, unambiguously means only the historical price actually paid for an asset.<sup>89</sup> The dictionary-driven "plain meaning" argument did not attract a single vote. Thus, the Court's decision wholly eliminates the fundamental premise of the OLC's dictionary-driven "plain meaning" analysis in its 1992 opinion. If the issue of Treasury's authority to provide for indexing capital gains for inflation should arise in some future administration, the OLC would therefore be obliged to reconsider the question from scratch.

## 2. Legislative Developments

Efforts in Congress to require indexation through legislation have continued, unsuccessfully, since 1992. The 1994–2000 period was especially active in this regard, with both the House and Senate enacting some form of capital gains indexation legislation. Indeed, in both 1995 and 1999, indexation bills actually passed both Houses and were presented to, and promptly vetoed by, President Clinton. Thus, just as during the pre-1992 period, the post-1992 efforts to amend the Code failed. We summarize below the pertinent legislative developments, and then briefly discuss how, if at all, these developments impact our analysis of the legal issues pertaining to the Treasury's authority to provide for indexation by regulation.

### a. 1993–1994

Throughout the 103rd Congress, numerous bills were introduced that would have allowed for indexing, but all died in committee, most without any discussion on the floor or even a hearing.<sup>90</sup> The indexing provisions of almost all of these bills

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88. *Id.* at 501.

89. Compare *id.* at 498–501, with Cooper et al., *Legal Authority*, *supra* note 1, at 649–60.

90. See, e.g., H.R. 4099, 103d Cong. § 1 (1994) (adding I.R.C. §1022) (sponsored by Rep. Moran; referred to House Ways & Means Comm.); Senior Citizen Capital

were identical. The most prominent of these measures was the Family, Investment, Retirement, Savings, and Tax Fairness Act of 1993, introduced concurrently in the House and Senate.<sup>91</sup> It was co-sponsored by the Republican leadership in both chambers, as well as more than eighty Representatives and Senators, but did not progress past committee. Few of the indexing bills were mentioned on the floor, and no hearings were held on any of these measures.

*b. 1995–1996*

The Contract with America was the centerpiece of the Republicans' 1994 campaign for the House of Representatives. One of the components of the Contract was a promise to have the House vote on the Job Creation and Wage Enhancement Act, which provided, among other things, for indexing of capital gains.<sup>92</sup> More than 110 Representatives, including the Republican House leadership, co-sponsored the Act, introducing it in January 1995 as H.R. 9.<sup>93</sup> Representative Bill Archer explained that, under the bill, "capital assets would be indexed for inflation, ending the unfair practice of taxing gains due to inflation."<sup>94</sup> The Senate Finance Committee<sup>95</sup> and the House

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Gair's Rate Reduction Act of 1993, H.R. 854, 103d Cong. § 4 (1993) (adding I.R.C. § 1012; limited to retirement assets for senior citizens) (sponsored by Reps. Myers, Rohrabacher, Dornan, Doolittle, Gallegly, and Lightfoot; referred to House Ways & Means Comm.); H.R. 777, 103d Cong. § 5 (1993) (adding I.R.C. § 1022) (sponsored by Rep. Kolbe; referred to House Ways & Means Comm.); H.R. 151, 103d Cong. § 4 (1993) (adding I.R.C. § 1022) (sponsored by Reps. Crane and Shays; referred to House Ways & Means Comm.).

91 H.R. 3645, 103d Cong. § 204 (1993) (adding I.R.C. § 1022) (sponsored by Rep. Granas, Gingrich, Armev, Delay, Boehner, Inhofe, and seventy-one other Representatives; referred to House Ways & Means Comm., Government Operations Comm., and Rules Comm.); *see also* S. 1576, 103d Cong. § 204 (1993) (sponsored by Sen. Coats and nine other Senators; referred to Senate Finance Comm.).

92 *See* Contract with America, <http://www.house.gov/house/Contract/CONTRACT.html> (last visited Jan. 28, 2012); *see also* Job Creation and Wage Enhancement Act Highlights, <http://www.house.gov/house/Contract/cre8jobsd.txt> (last visited Jan. 28, 2012).

93 Job Creation and Wage Enhancement Act of 1995, H.R. 9, 104th Cong. § 10(2) (1995) (adding I.R.C. § 1022) (sponsored by Rep. Archer and 115 other Representatives).

94 141 CONG. REC. 631 (1995) (statement of Rep. Archer); *see also* 141 CONG. REC. 2264 (1995) (statement of Rep. Archer) (reiterating, verbatim, Archer's explanation and defense of the indexing provisions in the Capital Formation and Jobs Creation Act of 1994).

Ways and Means and Small Business Committees<sup>96</sup> held hearings focusing on indexation, and other committees also heard testimony in favor of indexation. None of the testimony concerned whether the Treasury already had authority to index.

On March 3, 1995, during floor debate on H.R. 9, House Majority Leader Tom DeLay, without explanation, moved to strike the text of the bill and replace it with the contents of four other bills that the House previously had enacted, none of which spoke to the capital gains indexation issue.<sup>97</sup> The House approved that amendment without a recorded vote and passed the amended bill, stripped of its indexing provisions.<sup>98</sup> The amended bill died in the Senate Government Affairs Committee.<sup>99</sup>

Numerous other bills providing for indexing also were introduced in this Congress.<sup>100</sup> The most notable of these was H.R. 1215, the Contract with America Tax Relief Act of 1995, which Representative Archer introduced in mid-March 1995, shortly after H.R. 9's indexing provision was dropped.<sup>101</sup> Section 6302 of the bill provided for the indexation of long-term

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95. See, e.g., *Indexation of Assets: Hearing Before the S. Comm. on Finance*, 104th Cong. 7-10 (1995) (testimony of Alan Reynolds); *id.* at 4-6 (testimony of Christopher H. Dent, Price Waterhouse LLP); *Tax Treatment of Capital Gains: Hearing Before the S. Comm. on Finance*, 104th Cong. 4-7 (1995) (testimony of Henry J. Aaron).

96. See, e.g., *Capital Gains Tax Cut Provision in the Contract With America: Hearing Before the H. Ways & Means Comm.*, 104th Cong. (1995) (testimony of Sydney Hoff-Hay; Karen Kerrigan, President, Small Business Survival Comm.); *Capital Gains Taxes and the Investment Impact on Small Business: Hearing Before H. Comm. on Small Business*, 104th Cong. (1995) (testimony of J.D. Foster, Executive Director and Chief Economist, Tax Foundation; Richard W. Rahm, Small Business Survival Comm.; and Henry J. Aaron); see also *Capital Gains Tax Cut Provision in the Contract With America: Hearing Before the H. Ways & Means Comm.*, 104th Cong. (1995) (statement of Assistant Secretary of the Treasury for Tax Policy Leslie B. Samuels).

97. 141 CONG. REC. H2623 (daily ed. Mar. 3, 1995).

98. *Id.* at H2629.

99. 141 CONG. REC. 7,369 (1995).

100. See, e.g., Family, Investment, Retirement Savings and Tax Fairness Act of 1995, S. 568, 104th Cong. (1995) (sponsored by Sen. Coats and nine other Senators; referred to Senate Finance Comm.); H.R. 213, 104th Cong. § 4 (1995) (adding I.R.C. § 1022) (sponsored by Rep. Crane; referred to House Ways and Means Comm.); Capital Formation and Jobs Creation Act of 1995, H.R. 56, 104th Cong. § 3 (1995) (adding I.R.C. § 1022) (sponsored by Rep. Archer and fifty other Representatives; referred to House Ways & Means Comm.).

101. H.R. 1215, 104th Cong. § 6302 (1995) (adding I.R.C. § 1022) (sponsored by Rep. Archer) (as introduced in the House).

capital gains for taxpayers other than "C" corporations.<sup>102</sup> The committee report for the bill explained:

Under present law, gain or loss from the disposition of any asset generally is the sales price of the asset . . . reduced by the taxpayer's adjusted basis in that asset. The taxpayer's adjusted basis generally is the taxpayer's cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflation.

Because a taxpayer's adjusted basis for tax purposes is determined by historical cost, a taxpayer can have gains for tax purposes even though the real value of the assets (i.e., adjusted for inflation) has not increased. Even at modest inflation rates of three percent per year for five years, an investor's adjusted basis will under-represent his real purchasing power by 16 percent over five years. . . . For this reason, the Committee believes it is appropriate to provide for inflation adjustments to a taxpayer's adjusted basis in certain assets (held for more than three years) for purposes of determining gain on their disposition.<sup>103</sup>

Several members entered remarks into the *Congressional Record*, specifically debating the indexation provisions.<sup>104</sup> Indexing also came up several times during the floor debates on the bill.<sup>105</sup> Notably, some of those who spoke against the bill supported the concept of indexing but were concerned that the legislation did not adequately pay for it.<sup>106</sup> Again, none of these discussions related to the scope of the Treasury's existing authority to index capital gains.

After H.R. 1215 was reported from committee, on March 28, 1995, Representative John Kasich introduced H.R. 1327, the Tax Fairness and Deficit Reduction Act of 1995, which contained H.R. 1215's full text—including its indexation provision, as Section

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102. *Id.*

103. H.R. REP. NO. 104-84, at 37-38 (1995).

104. *See, e.g.*, 141 CONG. REC. 10560 (1995) (statement of Rep. Cardin) (opposing indexing because it adds to complexity and could lead to tax shelter activities).

105. *Compare* 141 CONG. REC. 10,508-10, 10,548-49, 10,555, 10,611-12 (1995) (statements of Reps. Crane, Bereuter, Frelinghuysen, and Gingrich, supporting indexing), *with* 141 CONG. REC. at 10,531-32, 10,544-45, 10,552-53 (1995) (statements of Reps. Moran, Beilenson, and Bentsen opposing indexing proposal).

106. *See, e.g.*, 141 CONG. REC. 10,552-54 (1995) (statements of Reps. Bentsen and Foemer).

6302.<sup>107</sup> The House then voted in favor of an amendment in the nature of a substitute, replacing the original name and text of H.R. 1215 with that of H.R. 1327.<sup>108</sup> The House voted 246 to 188 to pass the bill,<sup>109</sup> as modified.<sup>110</sup> The bill was referred to the Senate Finance Committee,<sup>111</sup> but did not make any further progress.

Later that year, H.R. 1215's indexation provision reappeared, with slight revisions, as Section 11022 of the Balanced Budget Act of 1995 (originally called the Seven-Year Balanced Budget Reconciliation Act of 1995), introduced by Representative Kasich on October 17, 1995.<sup>112</sup> Congress enacted the Balanced Budget Act, but President Clinton vetoed it, and Congress failed to override the veto.<sup>113</sup> The President's veto message did not specifically address indexing, but did state that the bill "provide[d] a huge tax cut whose benefits would flow disproportionately to those who are already the most well-off."<sup>114</sup>

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107. See 141 CONG. REC. 9,548 (1995).

108. 141 CONG. REC. 10,505, 10,560, 10,609 (1995) (floor vote).

109. 141 CONG. REC. 10,616 (1995) (final passage in House).

110. Tax Fairness and Deficit Reduction Act of 1995, H.R. 1215, 104th Cong. § 6302 (1995) (adding I.R.C. § 1022) (sponsored by Rep. Archer) (as engrossed in the House and referred in the Senate).

111. 141 CONG. REC. S5403 (daily ed. Apr. 6, 1995).

112. Seven-Year Balanced Budget Reconciliation Act of 1995, H.R. 2491, 104th Cong. § 11022 (1995) (adding I.R.C. § 1022) (sponsored by Rep. Kasich). The Balanced Budget Act's version applied only to assets acquired after December 31, 2000, while H.R. 1215's indexing provision would have applied to assets acquired after December 31, 1994.

113. 141 CONG. REC. 35,656-57 (1995).

114. *Id.* at 35,656. It should be noted, however, that even though the President's veto statements did not explicitly mention indexation, earlier statements from the White House indicated that President Clinton did not support the capital gains indexation provisions. The closest thing to an express veto threat directly from the President was made in a June 30, 1997, statement in which he indicated that he was "worried" about capital gains indexing but did not want to get into veto threats at that time. Bill Clinton, President of the U.S., Remarks Upon Departure (June 30, 1997), in U.S. NEWSWIRE, Oct. 1998, available in LEXIS, News Library, PR Newswire File. A few days earlier, White House spokesman Mike McCurry gave a White House briefing that many subsequent media reports took as a veto threat from President Clinton. Michael McCurry, White House Regular Briefing, in FED. NEWS SERV., June 27, 1997, at 6, 9. When a reporter asked about a potential veto of the tax bill, McCurry replied that indexing capital gains was "clearly" the "most problematic" provision. *Id.* at 6. A month earlier, Gene Sperling, Director of the National Economic Council, when asked a question about indexation, responded somewhat cryptically that "we would be willing to veto a bill that was not consistent with the bipartisan balanced budget agreement." *One of President Clinton's Top Negotiators of the New Budget Agreement, Gene Sperling, Speaks Out*, Evans &

## c. 1997-1998

During the 1996 presidential campaign, Republican candidates Robert Dole and Jack Kemp repeatedly mentioned indexation of capital gains as part of their platform, but without referencing whether the Treasury Department had (or lacked) authority to index such taxes by regulation.<sup>115</sup> Throughout 1997, as in prior years, numerous bills concerning indexation were introduced, but no substantial action was taken.<sup>116</sup>

In March 1997, the Senate Finance and Agriculture Committees<sup>117</sup> held hearings on indexation, but, as with prior hearings, no witnesses or members addressed whether the Treasury Department had the regulatory power to provide for indexation. That month, Senator Connie Mack III introduced into the *Congressional Record* a report from the Joint Economic Committee about "[t]he importance of indexation."<sup>118</sup> The report concluded, "[R]educing the effective tax rate on capital gains would kill two birds with one stone: It would both ease the tax burden and make it easier to balance the budget," and it explained why capital gains could be indexed, even if debt was not.<sup>119</sup>

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Novak (CNN television broadcast May 10, 1997) (transcript available at LEXIS # 97051000V38).

115. Jack Kemp, Remarks at a Meeting of the Society for a Better New York (Oct. 18, 1996), in FDCH POLITICAL TRANS.; Jack Kemp, Remarks at a Meeting of the National Association of Manufacturers (Sept. 21, 1996), in FDCH POLITICAL TRANS.; see also Patrick Buchanan, News Conference to Discuss the Republican Platform, (July 31, 1996) in FDCH POLITICAL TRANS..

116. See, e.g., Return Capital to the American People Act, S. 501, 105th Cong. § 5 (1997) (sponsored by Sen. Mack; referred to Senate Finance Comm.); Tax Freedom for Families Act of 1997, H.R. 1584, 105th Cong. § 102 (1997) (adding I.R.C. § 1022) (sponsored by Rep. Johnson and eleven other Representatives; referred to the House Ways and Means Comm.); American Family Tax Relief Act, S. 2, 105th Cong. § 202 (1997) (adding I.R.C. § 1022) (sponsored by Sen. Roth and thirty-one other Senators; referred to the Senate Finance Comm.); S. 1635, 105th Cong. § 2 (1998) (adding I.R.C. § 1022) (sponsored by Sen. Allard; referred to Senate Finance Comm.); see also 143 CONG. REC. 537-38 (1997) (summary of S. 2 prepared by the Joint Committee of Taxation).

117. See *Tax Treatment of Capital Gains and Losses: Hearing Before the S. Comm. on Finance*, 105th Cong. 31-33 (1997) (statement of Prof. Alan Auerbach, opposing indexing); *id.* at 28-31 (testimony of Allen Sinai, CEO, Primark Decision Econ., Inc. supporting indexing); *id.* at 14-28 (testimony of Jack Kemp, co-director of Empower America); *The Economic Impact of Capital Gains Taxes: Hearing Before the S. Comm. on Agric., Nutrition, and Forestry*, 105th Cong. (1997) (testimony of Jack Kemp in support of indexation).

118. 143 CONG. REC. 4,564-65 (1997) (statement of Sen. Mack).

119. *Id.* at 4,565, reprinting ROBERT STEIN, JOINT ECON. COMM., INDEXING CAPITAL GAINS (1997).

Indexing became one of the main flash points in the debates over the budget reconciliation bill, H.R. 2014.<sup>120</sup> Several Members opposed indexing because H.R. 2014 also would reduce the capital gains tax rate. Representative Ben Cardin, for example, argued, that "the Republican bill allows people to sell and buy back their assets to get a lower capital gains rate and then to be able to take advantage of indexing. They get it twice."<sup>121</sup> Representative Gerald Kleckza echoed this sentiment, stating:

I believe we should give the American people capital gains tax relief, but this bill clearly provides more than is reasonable. It both cuts the capital gains rates as well as indexes the values of assets for inflation. I am all for providing relief, but considering the huge potential revenue loss of these combined provisions 10, 15, or 20 years from now, we should pare down the capital gains cuts to a more reasonable size. After all, as the bill stands today, the capital gains cuts lead to a loss of \$36 billion in 2003 through 2007 alone. This bill should either cut the capital gains rate or index assets, but not both.<sup>122</sup>

Despite this opposition, the House passed H.R. 2014 with its indexing provisions intact.<sup>123</sup>

The Senate version of the bill, however, lacked indexing provisions. On June 27, 1997, Senator Wayne Allard introduced an amendment to add them.<sup>124</sup> Senator William Roth spoke in opposition to the measure, pointing out that President Clinton had announced that he would veto any tax bill that included capital gains indexation provisions.<sup>125</sup> Noting that the Senate had "a historic opportunity today to deliver badly needed tax cuts to Americans," Senator Roth argued that although he "would like to provide greater tax relief . . . we cannot, and 'half a loaf' is better than 'no loaf.'"<sup>126</sup>

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120. Taxpayer Relief Act of 1997, H.R. 2014, 105th Cong. § 312 (1997) (adding I.R.C. § 1022); *see also, e.g.*, 143 CONG. REC. 13,979-80, 13,984 (1997) (statement of Rep. Crane in support of indexation) (debate on instructions for House conferees); *id.* at 8,949 (1997) (statement of Rep. Saxton in support of indexation); *id.* at 12,682, 12,689, 12,700-01, 12,706-07, 12,826-27 (1997) (statements of Reps. Bonior, Cardin, Rangel, Coyne, and Peterson opposing indexing).

121. 143 CONG. REC. 12,689 (1997) (statement of Rep. Cardin).

122. *Id.* at 12,705 (statement of Rep. Kleckza).

123. *Id.* at 12,828-29 (vote on final passage).

124. 143 CONG. REC. 13,169-70 (1997) (statement of Sen. Allard).

125. *Id.* at 13,170 (statement of Sen. Roth).

126. *Id.*

The opponents of indexation prevailed, as the Senate passed the bill without the indexing provisions.<sup>127</sup> In conference, the House's indexation provision was removed. The conference report explained that the House bill contained indexing provisions, that the Senate bill lacked them, and that the conference agreement did not include the House bill's provision.<sup>128</sup>

As the foregoing discussion suggests, President Clinton in large measure opposed including capital gains indexation provisions in the reconciliation bill (which ultimately was enacted as the Taxpayer Relief Act of 1997) precisely because those provisions, in his view, would provide double benefits to certain taxpayers. Treasury Secretary Robert Rubin explained:

We have always had very serious reservations about indexing partly because with indexing and lowering the top rates, you're providing an enormous set of benefits to people with large capital gains, partly because of complexity and in the case of the indexing, because of the impacts it could have on the deficit in outer years.<sup>129</sup>

*d. 1999–2000.*

In July 1999, both the House and Senate passed tax bills that lacked any provision mandating indexation.<sup>130</sup> The bill reported out by the ensuing conference committee nevertheless included a provision allowing for indexation, by taxpayers other than "C" corporations, of capital gains realized on certain assets held for more than one year.<sup>131</sup> The new indexing provisions were mentioned only a few times during subsequent floor de-

127. *Id.* at 13,193.

128. See 143 CONG. REC. 16,983 (1997) (statement of Rep. Cardin) (floor debate on conference report).

129. Press Release, The White House, Office of the Press Sec'y, Press Briefing by Secretary of Treasury Bob Rubin and Director of the National Economic Council Gene Sperling (June 9, 1997), available at <http://clinton6.nara.gov/1997/06/1997-06-10-sec-rubin-and-gene-sperling-briefing.html>.

130. See 145 CONG. REC. 18,835 (1999) (passing S. 1429, Taxpayer Refund Act of 1999); 145 CONG. REC. 17,259–61 (1999) (passing H.R. 2488, the Financial Freedom Act of 1999).

131. Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. § 202 (1999) (adding I.R.C. § 1022) (sponsored by Rep. Archer and eight other Representatives); see also Conference Report to Accompany H.R. 2488, H.R. REP. NO. 106-289, at 234 (1999) (describing operation of indexation provision).

bate on the conference report.<sup>132</sup> Both houses agreed to the compromise bill,<sup>133</sup> but, as in 1995, President Clinton vetoed the bill.<sup>134</sup> As with his 1995 veto, the President's veto message did not mention the indexation provision. However, it did object, among other things, that "[t]he bill as a whole would disproportionately benefit the wealthiest Americans by, for example, lowering capital gains rates, repealing the estate and gift tax, increasing maximum IRA and retirement plan contribution limits, and weakening pension anti-discrimination protections for moderate- and lower-income workers."<sup>135</sup> Indexation provisions were not included in subsequent versions of the bill.

*e. 2000–Present*

Various other indexing measures have been introduced in subsequent years, but none has progressed past committee, and virtually none were the subject of a floor speech or debate or committee report.<sup>136</sup> One of the only extended discussions of an indexing proposal was offered by Senator Inhofe, when he introduced the Capital Gains Inflation Relief Act of 2007:<sup>137</sup>

[C]urrent tax policy taxes the capital asset holder not only on real gains, but also on gains due to inflation. This creates a situation that is patently unfair to the American taxpayer. . . . Why should an American taxpayer, who invested in a capital asset in his youth, be forced to pay capital gains taxes, on what can only be viewed as a loss, in his later years? . . .

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132. See 145 CONG. REC. 19,779, 19,789 (1999) (statements of Sens. Moynihan and Nickles); *id.* at 20,040, 20,053 (statements of Reps. Dreier and Crane)

133. 145 CONG. REC. 20,056 (1999); *id.* at 19,826.

134. *Id.* at 22,481.

135. *Id.*

136. See, e.g., Fair and Simple Tax Act of 2009, H.R. 99, 111th Cong. § 7 (2009) (sponsored by Rep. Dreier; referred to House Ways and Means Comm.); Investment Tax Incentive Act of 2003, H.R. 44, 108th Cong. § 3 (2003) (adding I.R.C. § 1023) (sponsored by Rep. Dreier and seven other Representatives; referred to House Ways and Means Comm.); S. 1635, 105th Cong. § 2 (1998) (adding I.R.C. § 1022) (sponsored by Rep. Allard; referred to Senate Comm. on Finance); see also Rep. Chaka Fattah, *Déjà vu All Over Again: Reexamining Fundamental Tax Reform and Evaluating the Feasibility of a Transaction Tax in the 111th Congress*, 47 HARV. J. ON LEGIS. 327, 348 (2010).

137. S. 892, 110th Cong. § 2 (2007) (adding I.R.C. § 1023) (sponsored by Sen. Inhofe; referred to Senate Comm. on Finance).

Inflation indexing would instantly increase the net return on capital investment and consequently encourage more of it. Inflation indexing would also restore core principles of sound tax policy such as "horizontal equity," wherein two taxpayers in identical situations are treated identically by the tax system. Indexing capital gains would improve the basic fairness of the tax code with only a minor increase in administrative costs and a single step of simple multiplication for taxpayer compliance.<sup>138</sup>

In February 2007 testimony before the Senate Banking Committee, Federal Reserve Chairman Alan Greenspan stated that in his view "the appropriate capital gains tax rate was zero. And short of that, any cuts and especially indexing would, in my judgment, be an act that would be appropriate policy for this Congress."<sup>139</sup>

*f. Capital Gains "Preferences"*

Over the two decades since our 1992 analysis, Congress continued to provide for various capital gains "preferences," which typically take the form of a lower tax rate than the rate applicable to "ordinary" income. At the time of our 1992 analysis, that preference was minimal.<sup>140</sup>

The Tax Reform Act of 1986 established a maximum capital gains tax rate of 28%.<sup>141</sup> This rate was maintained until 1997,<sup>142</sup> when it was lowered to 20%, with a lower rate for taxpayers in the bottom brackets.<sup>143</sup> In 2003, the tax rate for long-term capital gains was reduced to 15%, and to 5% for taxpayers in the lowest two income brackets.<sup>144</sup> This reduced rate was set to expire in 2008, but

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138. 153 CONG. REC. 6,542 (2007) (statement of Sen. Inhofe).

139. 143 CONG. REC. 7,078 (1997) (Rep. Dreier quoting Fed. Reserve Chairman Alan Greenspan).

140. See Cooper et al., *Legal Authority*, *supra* note 1, at 681 n.164 (describing "preference" as of 1992).

141. See Tax Reform Act of 1986, Pub. L. No. 99-514, § 302, 100 Stat. 2085, 2218 (1986); see also Cooper et al., *Legal Authority*, *supra* note 1, at 681 n.164.

142. See, e.g., Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11101(c), 104 Stat. 1388, 1388-404 to 1388-405 (1990).

143. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 311, 111 Stat. 788, 832 (1997).

144. See Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, § 301, 117 Stat. 752, 758 (2003).

it was extended twice, first through 2010 and then through 2012, with additional adjustments to the rates for the lowest brackets.<sup>145</sup>

*g. Implications of Legislative Developments*

As the above discussion demonstrates, the post-1992 developments in Congress track quite closely the pre-1992 developments discussed at length in our original analysis and article. If anything, indexation was viewed more favorably in Congress after 1992 than it was before, as Congress twice passed bills that included indexation (even though both bills were later vetoed). The point for present purposes is that the relevant legislative developments since 1992 are materially indistinguishable from those that preceded our original analysis and therefore do not have a significant impact on our legal conclusions.<sup>146</sup>

Likewise, post-1992 legislative developments have not disturbed our view that Congress's unsuccessful attempts to enact legislation explicitly providing for indexation of capital gains cannot reasonably be read to signify, for purposes of the *Chevron* step one analysis, that Congress has directly spoken to the indexation issue in such a manner as to deprive the Treasury of the authority to provide administratively for indexation:

As a theory of statutory construction, however, the legislative acquiescence doctrine . . . is virtually blind to the simple truth that legislative proposals are rejected for an infinite variety of reasons, many having nothing to do with Congress' views concerning their merits. Allowing Congress' failure to enact a measure to have controlling interpretive significance over the enactments of a previous Congress not only ignores the realities of the legislative process, but comes perilously close to transferring Congress' exclusive constitutional law-making power to executive agencies [who had construed the earlier enactment before the failure of the subsequent legislation]. As Professor Tribe has noted, "justifying an interpretation of a prior enactment by pointing to what a *subsequent*

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145. See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 102(a), 124 Stat. 3296, 3298; Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, § 102, 120 Stat. 345, 346 (2006). See generally *Trends in Federal Tax Revenues and Rates: Hearing Before the S. Comm. on Finance, 111th Cong. 9, ex. 4* (2010) (Statement of Douglas W. Elmendorf, Director, Cong. Budget Office); TAX FOUND., FED. CAPITAL GAINS TAX RATES 1988-2011 (2010), [http://www.taxfoundation.org/files/fed\\_capgains\\_taxrates-20100830.pdf](http://www.taxfoundation.org/files/fed_capgains_taxrates-20100830.pdf).

146. See Cooper et al., *Legal Authority*, *supra* note 1, at 683-84.

Congress did *not* enact seems incompatible with our constitutional structure."<sup>147</sup>

For these reasons, Congress's periodic consideration of indexation measures does not come close to constituting one of the quite rare occasions in which the failure to enact legislation should be viewed as essentially amending legislation in which an earlier Congress granted an agency discretion to interpret its organic statute.<sup>148</sup> Congress always retains discretion to do that which it has previously given the Executive Branch discretion to do through regulation. A decision by Congress not to exercise that ever-present discretion is in no way inconsistent with the continued existence of the regulatory discretion previously accorded to the Executive. Accordingly, a decision by Congress to refrain from exercising its own legislative discretion to index capital gains for inflation does not mean that it has decided to repeal or otherwise revoke the discretion previously given to Treasury to interpret the ambiguous term cost to include the cost of inflation. What we said in 1992 is thus no less valid today: "We are aware of no Supreme Court case that has applied the doctrine of legislative acquiescence to void an otherwise valid administrative regulation construing the agency's own statute."<sup>149</sup>

To be sure, the Supreme Court's 2000 decision in *FDA v. Brown & Williamson Tobacco Corp.*<sup>150</sup> rejected the FDA's claim of regulatory authority over tobacco products, relying in part on the failure of Congress to enact legislation that would have granted the agency such authority. The Court, applying the first prong of *Chevron*, held that Congress had "directly spoken" to the issue of the FDA's statutory authority under the Food, Drug, and Cosmetic Act (FDCA) to regulate tobacco products, and had deprived the agency of any such authority.<sup>151</sup> The Court therefore rejected the FDA's attempt, in a reversal of its long-held position, to regulate tobacco products. The majority emphasized that, given the regulatory regime enacted by Congress, if tobacco products were within FDA's jurisdiction, it would follow that such products would have to be

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147. *Id.* at 698 (quoting Lawrence Tribe, *Toward a Syntax of the Unsaid: Construing the Sounds of Congressional and Constitutional Silence*, 57 *IND. L.J.* 515, 530 (1982)).

148. *Id.* at 699-701.

149. *Id.* at 700.

150. 529 U.S. 120 (2000).

151. *Id.* at 133.

completely removed from the market, a result that no one, including the agency, could assert was intended by Congress.<sup>152</sup> Indeed, such a result would have been flatly inconsistent with other tobacco legislation *actually enacted* by Congress.<sup>153</sup>

The Court then discussed in detail six separate pieces of legislation in the field of tobacco regulation,<sup>154</sup> noting that "[i]n adopting each statute, Congress has acted against the backdrop of the FDA's consistent and repeated statements that it lacked authority under the FDCA to regulate tobacco absent claims of therapeutic benefit by the manufacturer."<sup>155</sup> It was in the context of this discussion of tobacco legislation *actually enacted* by Congress that the Court also observed that "on several occasions over this period, and after the health consequences of tobacco use and nicotine's pharmacological effects had become well known, Congress considered and rejected bills that would have granted the FDA such jurisdiction."<sup>156</sup> The Court then immediately emphasized once again that these unsuccessful bills were relevant only to the extent that they reinforced the Court's conclusions regarding the implications of the legislation actually enacted by Congress:

Under these circumstances, it is evident that Congress' tobacco-specific *statutes* have effectively ratified the FDA's long-held position that it lacks jurisdiction under the FDCA to regulate tobacco products. Congress *has created* a distinct regulatory scheme to address the problem of tobacco and health, and that scheme, as presently constructed, precludes any role for the FDA.<sup>157</sup>

*Brown & Williamson* thus offers no support to the proposition that Congress's mere failure to enact legislation explicitly granting a federal agency authority in a particular field should be read as precluding the agency from interpreting ambiguous provisions in its existing enabling legislation to provide it with such authority. Any doubt on this point was emphatically eliminated later in the Court's opinion:

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152. *Id.* at 133-39.

153. *Id.* at 137-39.

154. *See id.* at 143-55.

155. *Id.* at 144.

156. *Id.*

157. *Id.* (emphases added).

Taken together, these actions by Congress over the past 35 years preclude an interpretation of the FDCA that grants the FDA jurisdiction to regulate tobacco products. *We do not rely on Congress' failure to act—its consideration and rejection of bills that would have given the FDA this authority—in reaching this conclusion. Indeed, this is not a case of simple inaction by Congress that purportedly represents its acquiescence in an agency's position. To the contrary, Congress has enacted several statutes addressing the particular subject of tobacco and health, creating a distinct regulatory scheme for cigarettes and smokeless tobacco. . . . It has also enacted this legislation against the background of the FDA repeatedly and consistently asserting that it lacks jurisdiction under the FDCA to regulate tobacco products as customarily marketed. Further, Congress has persistently acted to preclude a meaningful role for any administrative agency in making policy on the subject of tobacco and health. Moreover, the substance of Congress' regulatory scheme is, in an important respect, incompatible with FDA jurisdiction. . . .*

Under these circumstances, it is clear that Congress' tobacco-specific legislation has effectively ratified the FDA's previous position that it lacks jurisdiction to regulate tobacco.<sup>158</sup>

The Court in *Brown & Williamson* could hardly have been clearer that its conclusion that the FDA lacked jurisdiction over tobacco products centered on Congress's enactment of subsequent statutes that were "incompatible" with the FDA having such authority.

Seven years after *Brown & Williamson*, the Supreme Court underscored the considerations that led it to reject the FDA's assertion of regulatory authority in that case. In *Massachusetts v. EPA*,<sup>159</sup> the Court held that the EPA has authority under the Clean Air Act (CAA) to regulate greenhouse gas emissions. The Court rejected the agency's argument that post-enactment developments in Congress, including the failure of a proposed amendment establishing greenhouse gas emission limits, demonstrated that EPA lacked jurisdiction under the CAA to regulate such emissions.<sup>160</sup> "Even if such postenactment legislative history could shed light on the meaning of an otherwise-unambiguous statute, EPA never identifies any action remotely

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158. *Id.* at 155–56 (emphases added) (fourth emphasis in original).

159. 549 U.S. 497 (2007).

160. *See id.* at 529–30.

suggesting that Congress meant to curtail its power to treat greenhouse gases as air pollutants."<sup>161</sup> According to the Court, the fact that "subsequent Congresses have eschewed enacting binding emissions limitations to combat global warming tells us nothing about what Congress meant when it amended" the pertinent CAA provisions at issue in the case.<sup>162</sup>

The EPA's reliance on *Brown & Williamson*, the Court held, was "misplaced."<sup>163</sup> The Court reiterated that in *Brown & Williamson*, it had "found critical at least two considerations that [had] no counterpart in this case:"

First, we thought it unlikely that Congress meant to ban tobacco products, which the FDCA would have required had [the FDA had regulatory authority over such products]. . . . Here, in contrast, EPA jurisdiction would lead to no such extreme measures. . . . However much a ban on tobacco products clashed with the "common sense" intuition that Congress never meant to remove those products from circulation, there is nothing counterintuitive to the notion that EPA can curtail the emission of substances that are putting the global climate out of kilter.

Second, in *Brown & Williamson* we pointed to an unbroken series of congressional enactments that made sense only if adopted "against the backdrop of the FDA's consistent and repeated statements that it lacked authority under the FDCA to regulate tobacco." We can point to no such enactments here: EPA has not identified any congressional action that conflicts in any way with the regulation of greenhouse gases from new motor vehicles.<sup>164</sup>

Neither of the "critical" considerations present in *Brown & Williamson* have counterparts in the history of the Code's capital gains provisions. Nothing in the history of capital gains legislation is remotely akin to the incompatibility between the FDA's assertion of jurisdiction to regulate tobacco—which, under the FDCA's scheme, would have required the agency to ban such products from the marketplace—and subsequent enactments making clear that tobacco products were not subject to such a ban. Similarly, Congress has enacted no substantive

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161. *Id.* at 529.

162. *Id.* at 529–30.

163. *Id.* at 530.

164. *Id.* at 530–31 (internal citations omitted).

measures that would make sense "only" if it is assumed that Treasury lacked regulatory authority to provide for indexation.

The most that can be said along these lines is that some members of Congress have observed at various times that in light of the reduced "preferential" rates enacted at times for some types of capital gains income, indexation of capital gains was not necessary to address the unfairness of taxing "gains" attributable to inflation. But it hardly can be asserted that capital gains indexation (whether implemented by explicit legislation or by regulation) is somehow incompatible with taxation of capital gains at preferential rates or that the former necessarily conflicts with the latter. For one thing, while taxing a "gain" wholly attributable to inflation at a lower rate might be less unfair than taxing it at a higher rate, it cannot credibly be contended that a preferential tax rate renders indexation superfluous, illogical, counterintuitive, or unnecessary. More importantly, many of the bills that Congress considered over the last twenty years (as in the previous twenty-five years) would have mandated *both* indexation and taxation at reduced rates. The fact that Congress has at times taxed (and currently taxes) capital gains at "preferential" rates cannot reasonably be characterized as incompatible with, let alone effectively repealing, any existing administrative regulatory authority under the Code to provide for indexation, or as making sense only if the Treasury lacked such authority.<sup>165</sup> The text and history of the statutory regime relating to treatment of capital gains thus bears little if any resemblance to the statutory regime held in *Brown & Williamson* to preclude FDA authority to regulate tobacco products.

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165. The OLC nonetheless attached interpretive significance to Congress's enactment of preferential tax rates for capital gains. "[I]t is obvious that to the extent Congress established a preference for capital gains in order to reduce taxation of gains that resulted merely from inflation, Congress assumed that its tax laws otherwise treated cost as nominal purchase price with no adjustment for inflation." Cooper et al., *Legal Authority*, *supra* note 1, app. at 720 n.21. But the assumption that the OLC ascribes to Congress simply does not follow. Rather, Congress might well have assumed that its tax laws treated cost as ambiguous regarding whether it should be measured as nominal purchase price or as purchase price adjusted for inflation, but that Treasury had thus far resolved that ambiguity in favor of nominal purchase price. That Congress decided to enact a preferential rate for income from capital gains is in no way inconsistent with a congressional decision to accord Treasury interpretative discretion to construe the ambiguous term cost to include the cost of inflation.

### 3. Judicial Decisions Construing the Code: Brand X

One final post-1992 *Chevron* precedent bears discussion. In *National Cable & Telecommunications Ass'n v. Brand X Internet Services*,<sup>166</sup> the Supreme Court addressed the role court decisions played in the first prong of the *Chevron* analysis. *Brand X* involved a challenge to an FCC order concluding that cable companies selling broadband internet service do not provide "telecommunications servic[e]" within the meaning of the Communications Act of 1934.<sup>167</sup> One of the principal questions before the Court was whether *Chevron* deference applies to the FCC's interpretation of 47 U.S.C. § 153(44) notwithstanding the Ninth Circuit's earlier decision interpreting that statutory provision as including cable modem service within the definition of telecommunications services.<sup>168</sup> The Ninth Circuit concluded that the FCC was not entitled to *Chevron* deference regardless of whether the court in its previous decision determined the statute was ambiguous.<sup>169</sup>

The Supreme Court disagreed, holding that "[a] court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."<sup>170</sup> The Court noted that this rule flowed from the very premise of *Chevron*—that when Congress leaves an ambiguity in a statute, it empowers the agency charged with administering that statute to resolve the ambiguity.<sup>171</sup> Given this premise, the Court stressed that "allowing a judicial precedent to foreclose an agency from interpreting an ambiguous statute, as the Court of Appeals assumed it could, would allow a court's interpretation to override an agency's."<sup>172</sup> Given "*Chevron's* premise . . . that it is for agencies, not courts, to fill statutory gaps," the Court held that "[o]nly a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to

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166. 545 U.S. 967 (2005).

167. *Id.* at 977–78.

168. *Id.* at 980.

169. *Id.* at 979–80 (citations omitted).

170. *Id.* at 982.

171. *Id.*

172. *Id.*

fill, displaces a conflicting agency construction."<sup>173</sup> Because nothing in the Ninth Circuit decision at issue in *Brand X* held that the Communications Act unambiguously required treating cable internet providers as providing telecommunications services, the Court held that the decision did not "trump" the agency's construction for purposes of the *Chevron* analysis.<sup>174</sup>

In light of *Brand X*, the question here becomes whether there is any judicial decision holding that the term cost as used in Section 1012 of the Code *unambiguously* means "the price paid to purchase the property." Absent such a decision, under the Court's reasoning in *Brand X*, the Treasury has regulatory discretion to give the term a reasonable construction even if it is contrary to the decision of a court.

In our 1992 analysis, we discussed a number of decisions, mostly from the Tax Court, established under Article I, equating cost for purposes of the capital gains calculation with the original purchase price.<sup>175</sup> We have found no additional published decisions addressing this issue since our original 1992 analysis. It is possible to read some of these Tax Court decisions as holding that the plain meaning of cost refers to original or historical cost.<sup>176</sup> But these decisions cannot properly be read to operate, under *Brand X*, to deprive Treasury of interpretive discretion it would otherwise have under *Chevron*.

First, while no decision directly addresses the issue, it is quite doubtful that the decisions of non-Article III courts can trump agency constructions under the rule laid down in *Brand X*. The Court in *Brand X* noted time and again that "judicial" precedents finding statutes unambiguous preclude a subsequent agency construction,<sup>177</sup> and the Court's discussion of the interplay of *Chevron* with traditional principles of stare decisis further demonstrated that the Court was concerned only with the effects of decisions by Article III courts on federal agencies'

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173. *Id.* at 982-83; accord *id.* at 984 (describing the holding of *Neal v. United States*, 516 U.S. 284 (1996) as establishing "only that a precedent holding a statute to be unambiguous forecloses a contrary agency construction"); *id.* ("[A] court's prior interpretation of a statute . . . override[s] an agency's interpretation only if the relevant court decision held the statute unambiguous.").

174. *Id.* at 984-85.

175. See Cooper et al., *Legal Authority*, *supra* note 1, at 688-89 & n.193 (discussing decisions).

176. See *id.*, app. at 715-17.

177. See, e.g., *Brand X*, 545 U.S. at 982.

latitude to interpret their organic statutes.<sup>178</sup> Certainly Justice Scalia's dissent, which focused on the constitutional problems that would be posed by a rule allowing agency decisions to overrule decisions by courts, contemplated that the majority was addressing the interplay between agency constructions and constructions by Article III courts.<sup>179</sup> In short, there is simply no reason to assume that Article I court decisions are within the Court's decision in *Brand X*, and there are powerful indications that such decisions are not.

But, even if decisions of non-Article III courts do fall within the rationale of *Brand X*, none of these Tax Court decisions squarely held that the term cost in Section 1012 of the Code unambiguously means original purchase price, such that Congress has left no room for agency discretion to define the term differently. Thus, under the Supreme Court's decision in *Brand X*, none of these Tax Court decisions operate to deprive a Treasury interpretation of cost to account for the effects of inflation of the deference it would otherwise be due under *Chevron*.

A closer question is posed by a sixty-six year old decision of the Court of Appeals for the Fifth Circuit interpreting a predecessor provision to Section 1012. *Vandenberge v. Commissioner*<sup>180</sup> addressed two income and excess profits tax questions arising from the sale of improved real estate. One of the questions related to the determination of "the unadjusted basis of the property for determining gain or loss under Section 113(a) of the Revenue Act of 1938."<sup>181</sup> The taxpayer in that case attempted to include in the property's purchase price certain valueless notes that were cancelled and returned to the seller. The Fifth Circuit held that the valueless notes were not part of the purchase price. The Court's entire analysis of the relevant legal issue can be found in three conclusory sentences: "Section 113(a) of the Revenue Act of 1938 provides that the unadjusted basis of property shall be the cost of such property. The solution to the question raised is as simple and clear as the language of the pivotal statute. The cost of the property was the price paid to acquire it."<sup>182</sup>

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178. See *id.* at 984-85.

179. *Id.* at 1017 (Scalia, J., dissenting) ("Article III courts do not sit to render decisions that can be reversed or ignored by executive officers.").

180. 147 F.2d 167 (5th Cir. 1945).

181. *Id.* at 167.

182. *Id.* at 168.

Despite the Fifth Circuit's conclusory assertion that the meaning of the term cost is "simple and clear," the case does not pose a substantial obstacle under the rule of *Brand X* to a Treasury regulation interpreting cost to allow for indexation. First, the decision is irreconcilable with the Supreme Court's 2002 ruling in *Verizon* that the meaning of cost is not simple and clear, but rather is "protean" and "a chameleon."<sup>183</sup> In any event, the court in *Vandenberg* was not called upon to decide whether the statute is unambiguous. Nor was it called upon to decide whether the Treasury could reasonably interpret the term cost to include recognized, indisputable economic costs other than original purchase price, such as the value-reducing effects of inflation or depreciation; that issue was simply not raised, let alone decided. For these reasons, the Fifth Circuit's cursory analysis in *Vandenberg* cannot reasonably be read as constituting a holding that cost *must* be read to foreclose the Treasury from providing by regulation for capital gains indexation.

But even if *Vandenberg's* cursory statutory analysis could be viewed under *Brand X* as depriving the Treasury of the authority to interpret cost to allow for indexation, that result would obtain only within the confines of the Fifth Circuit. Other circuits, and, of course, the Supreme Court, would be free to conclude that the meaning of the term cost is not so clear as to deprive the Treasury of authority to construe it. In fact, the opinions in *Brand X* themselves make this obvious point. Justice Scalia's dissent in *Brand X* chided the majority for even deciding the question of whether the Ninth Circuit's previous statutory construction decision deprived the agency of the ability to construe the statute:

*Whatever the stare decisis effect of [the Ninth Circuit's previous decision] in the Ninth Circuit, it surely does not govern this Court's decision. And—despite the Court's peculiar, self-abnegating suggestion to the contrary the Ninth Circuit would already be obliged to abandon [its earlier] holding in the face of this Court's decision that the Commission's construction of "telecommunications service" is entitled to deference and is reasonable.<sup>184</sup>*

Notably, the majority agreed with Justice Scalia that, for the reasons he described, it was "not logically necessary for us to reach the question whether the Court of Appeals misapplied

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183. *Verizon Commc'ns Inc. v. FCC*, 535 U.S. 467, 500–01 (2002).

184. *Brand X*, 545 U.S. at 1019–20 (internal citations omitted).

*Chevron* for us to decide whether the Commission acted lawfully," but it nevertheless considered and decided the question in light of the "genuine confusion in the lower courts over the interaction between the *Chevron* doctrine and stare decisis principles . . . ." <sup>185</sup>

In sum, the Supreme Court's 2005 decision in *Brand X* makes clear that none of the lower court decisions equating cost with original price paid preclude a Treasury reinterpretation of cost as including value-reducing impact of inflation.

#### CONCLUSION

Although the question remains close, it is not as close as it was almost twenty years ago. To the contrary, jurisprudential developments over the last two decades have confirmed much of our original analysis and reinforced and strengthened our original conclusion that Treasury has regulatory authority to index capital gains for inflation. In particular, the Supreme Court's decision in *Mayo Foundation* confirmed the applicability of *Chevron* deference principles to Treasury regulations interpreting the Code; the Court's decision in *Verizon* confirmed that the meaning of the term cost is ambiguous and is not plainly restricted, in common parlance or in a specialized economic usage, to historical cost or original purchase price; and the Court's decision in *Brand X* makes clear that previous court decisions interpreting ambiguous Code provisions neither deprive the Treasury of interpretive authority it would otherwise have or defeat the application of *Chevron* deference that would otherwise be applicable. And Congress's consideration over the last two decades of proposed legislation that would allow for indexation is no different in kind than the developments we considered in 1992.

In 2012, therefore, the meaning of the term cost as used in Section 1012 is still ambiguous, Treasury still has authority to interpret it to account for the cost of inflation by providing for capital gains indexation, a Treasury regulation indexing capital gains would still be entitled to judicial deference under *Chevron*, and a reviewing court should still uphold such a regulation as a reasonable interpretation of the Code.

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185. *Id.* at 985 (majority opinion).