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Increasing Participation in the Rulemaking Process

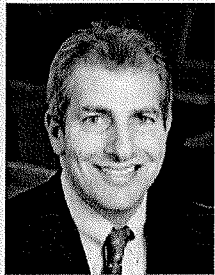
Leslie Book



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Increasing Participation in the Rulemaking Process

By Leslie Book



Leslie Book

Leslie Book is a professor and director of the graduate tax program at the Villanova University School of Law. He is the successor author of the treatise *IRS Practice and Procedure*, originally written by Michael Saltzman. Book is grateful for the research assistance of Villanova Law students Kristen Allen and

Adam Cole. He also received helpful comments and suggestions from Bryan Camp, Keith Fogg, Dick Harvey, Leandra Lederman, Nina Olson, Eric San Juan, and Carlton Smith.

In this article, which is a condensed and modified version of a coming article in the *Florida Tax Review*, Book argues that the Administrative Procedure Act's notice and comment rulemaking does not provide the tax bar the legal certainty it needs, and he suggests the IRS seek input from those who have information and expertise more relevant for administering provisions like equitable relief from joint and several liability and collection alternatives.

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A. Introduction

The Administrative Procedure Act's (APA) paradigm of notice and comment rulemaking does not provide the tax bar with the legal certainty it needs. Moreover, it is insufficient to provide both input to the IRS and legitimacy to its actions when the IRS issues guidance that touches on topics that are germane to lower-income or disadvantaged taxpayers.

As an alternative paradigm, I suggest that the IRS assertively seek (1) input from groups and individuals who are likely to have information and expertise most relevant for administering provisions like equitable relief from joint and several liability and collection alternatives and (2) input when guidance has a significant effect on low-

income taxpayers, or those without access to representation or a voice in the rulemaking process. Even with an IRS determined to seek input from groups underrepresented in the political process, however, the lack of resources available to those groups is likely to result in a shortage of meaningful feedback from them. Accordingly, I propose an approach that would ensure that organized third parties (such as the Taxpayer Advocate Service (TAS) and tax clinics) are encouraged and incentivized to contribute to the IRS's formation of rules. My idea is not novel; scholars outside the tax area have long noted how poorer Americans are underrepresented in the political process and that agencies often need to interact with organized intermediaries or proxies that can advance the interest of people the agencies regulate.¹ Although few have considered those issues in the tax context, this article offers specific suggestions to improve the rulemaking process.

Too often, the IRS tends to issue guidance that no matter how well intentioned, does not reflect meaningful input from those who are best able to provide a perspective on the lives most directly touched by those provisions. One example is the IRS's adoption of a two-year limitations period on filing claims for equitable relief under section 6015(f). Despite seeking input before final adoption, the IRS received no comments (that I am aware of) on that topic before the fact. After adoption there was significant controversy, and although the IRS eventually changed

¹See, e.g., Arthur Earl Bonfield, "Representation for the Poor in Federal Rulemaking," 67 *Mich. L. Rev.* 511 (1968-1969) (urging "the sound operation of the federal administrative rulemaking system demands that all relevant interests and viewpoints be considered prior to the formulation and promulgation of its product"). Bonfield asserts that agency rulemaking is more representative of middle- and upper-income Americans who either directly or indirectly monitor agency activities, to the detriment of those who lack the resources to keep themselves informed. *Id.* at 511-512. See also Simon Lazarus and Joseph Onek, "The Regulators and the People," 57 *Va. L. Rev.* 1069 (1971) (stating the central problem with regulatory agencies is their unresponsiveness to public concerns). Lazarus and Onek posit that "the mere fact that agencies perform efficiently does not insure that the agencies are properly fulfilling their functions." *Id.* at 1071.

its position, many taxpayers were adversely affected (with serious and at times devastating consequences) and substantial institutional resources focused on the issue.²

As Congress has increasingly called on the IRS to administer provisions that are outside the experience and expertise of the agency's employees, it becomes increasingly likely that mere knowledge of substantive tax law (daunting in and of itself, given the law's complexity) is an insufficient training ground for proper tax administration.

Provisions such as refundable credits based on income or family status, equitable relief innocent spouse³ and collection due process⁴ requires an agency nimble in the ways of taxpayers whose interests are not traditionally championed by industry associations, institutional constituencies, or the professional bar, and whose circumstances may differ widely from even the best-intentioned and trained IRS employee. The interests of taxpayers affected by those provisions are significant, with emotional and financial consequences weighing heavily on those whom the rules are meant to address. As the tax system has evolved into a complex dynamic with functions that extend far beyond revenue collection, the need for heightened expedience that often accompanies agencies wishing to bypass procedural checks is less compelling.⁵

B. Administrative Law to the Rescue?

1. The theory underlying notice and comment. The APA notice and comment rulemaking mechanism is a way to ensure input in federal agencies' deliberative rulemaking process.⁶ Professor Kristin Hickman and others have suggested that the IRS's failure to follow notice and comment rulemaking under the

APA is inconsistent with general administrative law norms.⁷ The IRS has pushed back, claiming that its regulatory process is consistent with the APA. While courts likely will have occasion to consider that further, whatever the legal outcome, it is likely that the IRS will take APA notice and comment more seriously in determining the process that will attach to its rulemaking choices.⁸

The outcome of the current debate is unclear; administrative law on the topic is vague, and scholars and courts have been wrestling with adopting a workable frame for decades.⁹ After surveying the relevant literature and cases, I have come to two broad conclusions: (1) Courts and scholars are uncertain where the line should be drawn between rulemaking that requires notice and comment and rulemaking that need not go through the process and (2) there are good reasons not to require all agency rulemaking to engage in notice and comment. I do not propose a meaningful resolution of the issue; my project takes a step back and inquires more broadly as to the underlying concerns for participation in the regulatory process.

One particularly perceptive scholar frames the issue as follows:

How can courts strike the best balance between administrative efficiency and broad public participation in agency policymaking? Interpret the exemptions from notice and comment too narrowly, and you drive agencies into a purely adjudicative mode that offers less notice and less opportunity for widespread participation. Interpret them too broadly, and

²In my law review article, I contrast the input the IRS received in connection with its adoption of rules requiring corporate disclosure of uncertain tax positions in Schedule UTP, in which informal and formal lobbying and comments, as well as an elaborate give and take on the IRS's part, reflected an agency that responded to and considered a variety of institutional and individual interests. See Leslie Book, "A New Paradigm for IRS Guidance: Ensuring Input and Enhancing Participation," *Fla. Tax Rev.* (forthcoming 2012).

³See section 6015(b) (outlining the elements of an innocent spouse claim).

⁴See sections 6320 and 6330.

⁵Administrative law scholars have long noted deep-seated and at times contradictory impulses in administrative law between efficiency and participatory values. See Gordon G. Young, "Judicial Review of Informal Agency Action on the Fiftieth Anniversary of the APA: The Alleged Demise and Actual Status of *Overton Park's* Requirement of Judicial Review 'On the Record,'" 10 *Admin. L.J. Am. U.* 179, 181 (1996).

⁶See 5 U.S.C. section 553(b) and (c) (discussing the requirements for issuance of notice and acceptance of public comments in administrative rulemaking).

⁷See Kristin E. Hickman, "A Problem of Remedy: Responding to Treasury's (Lack of) Compliance With Administrative Procedure Act Rulemaking Requirements," 76 *Geo. Wash. L. Rev.* 1153, 1158 (2008).

⁸Steve R. Johnson, "Understanding *Mayo*: What the Law Has Been, What It Is Now, and What It Should Be," Mar. 1, 2012, available at <http://www.american taxpolicyinstitute.org/pdf/Johnson-3-1.pdf>. For an excellent description of the historical distinction between legislative and interpretative rules in the context of tax regulations, see Leandra Lederman, "The Fight Over Fighting Regs and Judicial Deference in Tax Litigation," 92 *B.U. Law Rev.* 643 (2012).

⁹Generally, legislative rules are derived from a statutory authority to implement the law, while interpretive rules inform the public of an existing statutory authority and how the agency will exercise its power. See David L. Franklin, "Legislative Rules, Nonlegislative Rules, and the Perils of the Short Cut," 120 *Yale L.J.* 276, 278 (2010). As Franklin identifies, the three main benefits for agencies to engage in rulemaking outside of notice and comment, all of which concern administrative efficiency, are (1) providing swift and accurate notice to the public; (2) informing lower-level agency employees about changes or views to ensure bureaucratic uniformity; and (3) avoiding opportunity costs by freeing up agency resources away from the notice and comment process. *Id.* at 303-304.

you allow agencies to dispense with public input at the pre-promulgation stage as a matter of course.¹⁰

APA section 553 is meant to provide a mechanism for public participation. An agency must publish advance notice and take comments before finalizing a rule. Courts impose a general obligation on agencies to explain their reasoning when they reject significant comments. Agency actions that are not reasoned or are arbitrary or capricious face the possibility that judges will vacate them. Administrative law scholars have noted that notice and comment requirements ensure that agencies remain "accountable for following the law (including implementing any critical value choices Congress may have made in the authorizing statute) and for acting in a non-arbitrary fashion."¹¹

The notice and comment regime reflects the quasi-legislative role that agencies play and attempts to inject democratic responsiveness and accountability in actions that unelected agency officials take when promulgating general rules. A foundational aspect of rulemaking under the APA is that agency guidance having the force of law must be subject to notice and comment rulemaking. That right of public participation reflects a delicate legislative balance whereby state agencies with expertise promulgate rules of general application but ensure input that contributes to collective wisdom and enhances legitimacy of state actions.

In theory, the APA allows for direct involvement in agency process, and agency explanation satisfies both a pluralist and civic republican view of democratic accountability. From a pluralist perspective, an agency decision is democratic "to the extent the agency hears directly from and considers a wide variety of interests."¹² The APA requirements allowing for access to the agency, as well as the backstop of the right to challenge agency actions in court, is a mechanism to allow individuals to provide input and ensure that agencies remain accountable for their actions. From a civic republican perspective, legitimacy of agency actions in a democratic state is grounded in agencies contributing to a dialogue in which citizens provide their views and agencies and citizens alike are deliberative and open to considering differing perspectives. The APA's participation requirements and judicial requirements

that agencies explain their actions contribute to accountability in a civic republican sense.

2. The practical limitations on participation for those without resources. Federal agency rulemaking has an enormous impact on the lives of Americans. Administrative law scholars like Cynthia Farina and others have commented on the paradox of agency rulemaking. On the one hand, rulemaking's impact is enormous, and the APA provides the opportunity for participation and transparency. On the other hand, few citizens actually know about rulemaking, and fewer participate and exercise their right to engage the agency and have their views heard. The Obama administration has called on agencies to use social media and other technologies, following up on the E-Government Act of 2002 which required agencies (including the IRS) to move much of its rulemaking process to the web. In future articles, I intend to discuss what some scholars are calling Rulemaking 2.0, that is, the future of technology-supported rulemaking. While technology holds great promise for opening rulemaking, in practice, observers of agencies generally have noted that there is a skewing of participation in the process toward business interests and away from a diffuse class of regulated beneficiaries.¹³ The main reason for that is because it takes "resources to uncover the existence of a rulemaking, to understand the issues at stake, and to prepare persuasive comments."¹⁴ Compounding the issue is the collective action problem, meaning there are challenges associated with organizing those whose interests are widely diffused as compared with matters that relate to more concentrated groups.¹⁵

Business groups and others with significant resources tend to dominate the rulemaking process. For example, studies of agencies tend to show that regulated entities as contrasted with regulated beneficiaries predominantly provide comments to agencies.¹⁶ As a counterweight to business interests,

¹³See Mendelson, *supra* note 11, at 1357-1358 (stating that one reason big business groups dominate rulemaking participation is their availability of financial resources to do so); Wendy Wagner, "Administrative Law, Filter Failure, and Information Capture," 59 *Duke L.J.* 1321, 1382 (2010) (asserting pre-NPRM interest group communication is also likely to be extensive and influential); Jason Webb Yackee and Susan Webb Yackee, "A Bias Towards Business? Assessing Interest Group Influence on the U.S. Bureaucracy," 68 *J. Pol.* 128, 133 (2006) (stating that rulemaking costs remain so high that individuals and public interest groups are disadvantaged).

¹⁴See Mendelson, *supra* note 11, at 1357-1358.

¹⁵*Id.* at 1358 (explaining that because of a free rider problem, groups with diffused interests have greater challenges organizing as opposed to small concentrated groups).

¹⁶See Wagner, *supra* note 13, at 1334 n.40 (quoting Colin S. Diver, "The Optimal Precision of Administrative Rules," 93 *Yale*

(Footnote continued on next page.)

¹⁰*Id.* at 306-307.

¹¹Nina A. Mendelson, "Rulemaking, Democracy, and Torrents of E-Mail," 79 *Geo. Wash. L. Rev.* 1343, 1356 (2011).

¹²*Id.* at 1350. See also Richard Stewart, "The Reformation of American Administrative Law," 88 *Harv. L. Rev.* 1669, 1679, 1683 (1975) (stating that courts have asserted that agencies must consider "all of the various interests affected by their decisions as an essential predicate" to determining the public interest).

with many matters that are the subject of agency rulemaking (such as environmental issues) there are significant public interest organizations that do participate in the process and help redress the imbalance. Yet, the balance is still skewed toward business interests in the process generally. Professor Wendy Wagner has observed that public interest groups face barriers to entry when pluralistic processes are undermined by a system that becomes oblivious to the costs imposed on participants in a meaningful way. Groups that already struggle against organizational and related collective action impediments to represent the public interest cannot keep up. Wagner argues that resource-rich participants engage in information capture by providing agencies with excess information that stretches and overwhelms agency staff. Moreover, she claims that limits on time, resources, and expertise blunt the effectiveness of public interest groups, especially when regulated entities overwhelm the process.

While administrative law scholars have spent considerable time exploring the balance between efficiency and participation in rulemaking,¹⁷ a substantial amount of scholarship considers the formidable barriers to participation in the rulemaking process that individuals, especially those with lower incomes, face. Effective and informed participation requires parties to have both the required background knowledge to make meaningful comments and the financial and technical resources to do so.

The importance of both access and opportunity to participate is thus fundamentally tied to broader issues of legitimacy of agency action. As professor Jessica Mantel has said:

The success of our social contract depends first on those entrusted with governmental powers exercising their discretion for the benefit of “we the people,” and second on citizens’ acceptance of and obedience to the state’s rules for organizing societal functioning and its allocation of public resources. Process plays a fundamental role in reinforcing both obliga-

tions. In shaping agencies’ decisionmaking, procedures promote the legitimacy of administrative policies and protect against violations of the public trust by agency officials. Social psychology also has shown that fair procedures that reinforce the legitimacy of the administrative state strengthen individuals’ normative commitment to obey the law.¹⁸

3. Bringing it back to the tax system. The IRS can do more to seek out the voice of the underrepresented in the rulemaking process. I suggest that it more assertively seek input if the guidance has significant impact on low-income taxpayers or those without access to representation or a voice in the rulemaking process. However, it is still likely that there would be a shortage of meaningful input from those groups due to their lack of resources. Accordingly, I propose an approach that would require the IRS to reach out to seek input and would ensure that organized third parties are encouraged and incentivized to contribute to the IRS’s formation of rules. As noted, my idea is not novel. Below are my ideas for the TAS, which were echoed in National Taxpayer Advocate Nina Olson’s recent legislative recommendation to Congress.¹⁹

a. The role of institutional intermediaries. Other scholars and advocates have considered using advocate agencies and ombudsmen to represent the interests of low-income or otherwise underrepresented parties.²⁰ For example, in a recent essay, professors Brett McDonnell and Daniel Schwarcz explore the role that regulatory contrarians can play, with a focus on ensuring a more adaptive and responsive financial regulatory process.²¹ Describing TAS as “perhaps the most well-known ombudsman contrarian,” McDonnell and Schwarcz refer to its ability to improve the IRS’s relationship through persuasive force and soft powers, such as its congressional reporting power and its participation

¹⁸Jessica Mantel, “Procedural Safeguards for Agency Guidance: A Source of Legitimacy for the Administrative State,” 61 *Admin. L. Rev.* 343, 346-347 (2009).

¹⁹See National Taxpayer Advocate Nina Olson, “2011 Annual Report to Congress,” at 573 (2011), *Doc 2012-588, 2012 TNT 8-16* (Legislative Recommendations: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*).

²⁰See Wagner, *supra* note 13, at 1414 (proposing that government intermediaries such as agency selected ombudsmen, advocates, and advisory groups, stand in for underrepresented interest groups to redress pluralistic imbalances in rulemaking); Stewart, *supra* note 12, at 1723, 1748 (asserting that specialized advocacy in the form of high-level government advocates may be a potential way to ensure diffused interests are represented in policy formation).

²¹See generally Brett McDonnell and Daniel Schwarcz, “Regulatory Contrarians,” 89 *N.C. L. Rev.* 1629 (2011).

L.J. 65, 99 (1983) (stating “widely dispersed costs or benefits are less effectively represented in policymaking than concentrated costs or benefits. Thus we would expect error-correction to favor interests championed by enforcers and regulated firms and to undervalue interests of unorganized beneficiaries of government programs”).

¹⁷Tax law scholars have been taking up some questions presented by the tension between the values of efficiency and participation of tax administration. See Bryan T. Camp, “Theory and Practice in Tax Administration,” 29 *Va. Tax Rev.* 227, 275 (2009); T. Keith Fogg, “Systemic Problems With Low-Dollar Lien Filing,” *Tax Notes*, Oct. 3, 2011, p. 88, *Doc 2011-18595*, or 2011 *TNT* 194-9.

within the academy (such as in research colloquia and conferences).²² TAS also has the ability to “continually present the taxpayer point of view to other subcomponents within the agency as a balance, counterweight, or check to insular thinking and the enforcement mentality that often pervades inquisitorial systems.”²³

Also, Wagner has called for the deployment of government intermediaries to redress a pluralistic imbalance that she believes is exacerbated by the ability of larger, better-financed parties to engage in information capture, or the “excessive use of information costs as a means of gaining control over regulatory decision making in informal rulemakings.”²⁴ Wagner writes mostly about the potential for capture in the context of environmental rulemaking, in which, unlike in many of the tax issues concerning lower-income taxpayers, there is a possibility that larger, better-financed voices can crowd out less powerful voices on particularized matters. In those matters, an agency such as the EPA balances differing interests of the regulated parties. Wagner’s (and others’) concern is that powerful parties can control or capture the agency through, for example, the allure of employment prospects for agency employees or the ability to overload the agency with information in a way that distorts the process.²⁵

When agencies seek to act and provide guidance in a variety of forms, parties with access and voice have opportunity to present to and persuade the agency, and those without the ability to communicate will face an agency that is unaware of their needs. Wagner suggests that agencies allow ombudsmen to participate in the formative rulemaking process so that agencies consider not just the costs of regulation but also the health benefits for vulnerable populations.²⁶ If the agency failed to consider the interests adequately in the formulation of rules, Wagner proposes that the ombudsperson be required to file comments, thus building a record for

review to be used by other regulatory participants and potentially in the context of judicial review of the agency’s rulemaking.²⁷ For rulemakings that are highly technical, Wagner suggests assembling an expert advisory committee that would allow the agency to consider issues concerning “missing affected interests” — that is, interests that the agency may not otherwise consider (or even be aware of).²⁸

Wagner’s policy prescription makes sense for the IRS, and, as McDonnell and Schwarcz identify, the IRS already has in place a strong ombudsman’s office that plays an active, although incomplete, role in representing the voices of less powerful taxpayers. In tax matters, while there may not be the same clash between, say, polluters and environmental groups that Wagner identifies, the effect may be the same. For example, the IRS may not necessarily sufficiently consider the interests of lower-income or underrepresented taxpayers in the context of rules on the delivery of benefits or to relief of liability because those taxpayers and their concerns are less germane to the agency’s core constituencies.²⁹

Currently, TAS plays a significant, although incomplete, role in the formation of administrative policy.³⁰ Nontax and tax scholars looking at TAS have praised its abilities to provide a voice for

²⁷See *id.* at 1415 (reasoning that a paper trail of comments would be beneficial to judicial review).

²⁸In addition to improving the agency’s rules *ex ante*, Wagner’s proposals have as a secondary objective creating a record so that parties challenging the agency’s rulemaking in court may be able to point to inadequacies in the process or substance of the agency’s rulemaking. As discussed in detail in my forthcoming law review article, in the tax context, limits to parties’ ability to receive pre-enforcement judicial review combined with the trend of greater deference to IRS rulemaking makes this secondary objective less relevant. Likewise, Wagner’s suggested use of administrative law judges to oversee a hybrid formal/informal rulemaking, in light of the relative absence of ALJs in the tax context, make this portion of the proposal generally inapplicable to IRS rulemaking. *Id.*

²⁹See Colin S. Diver, “Policymaking Paradigms in Administrative Law,” 95 *Harv. L. Rev.* 393 (1981); Mark Seidenfeld, “Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking,” 87 *Cornell L. Rev.* 486 (2002).

³⁰The National Commission on Restructuring the Internal Revenue Service suggested significant structural changes to TAS to “restore the public’s faith in the American tax system,” incorporate greater outside oversight, simplify the system, and strengthen TAS to allow for greater independence. National Commission on Restructuring the Internal Revenue Service, “A Vision for a New IRS,” at 5 (June 25, 1997), *Doc 97-18729*, 97 *TNT* 123-15. Specifically, it stated that “to succeed, the Advocate must be viewed, both in perception and reality, as an independent voice for the taxpayer within the IRS.” *Id.* at 48. To mitigate those concerns, the commission called on the TAS to expand its reporting obligations by identifying the 10 most litigated issues and providing solutions for mitigating disputes in those areas. See *id.* at 49. The commission also called for a more vigorous

(Footnote continued on next page.)

²²*Id.* at 1655.

²³*Id.* at 1655-1656 n.108 (citing Bryan T. Camp, “What Good Is the National Taxpayer Advocate?” *Tax Notes*, Mar. 8, 2010, p. 1243, *Doc 2010-1723*, or 2010 *TNT* 46-5).

²⁴See Wagner, *supra* note 13, at 1325, 1414.

²⁵*Id.* at 1325. Wagner also references other areas of agency regulations that have been plagued by information capture. *Id.* at n.18 (citing Pete Tridish and Danielle Redden, “Radio Controlled: A Media Activist’s Guide to the FCC!” Prometheus Radio Project, Feb. 12, 2006 (referring to information capture and excessive information in FCC rulemaking)); Troy A. Paredes, “Blinded by the Light: Information Overload and Its Consequences for Securities Regulation,” 81 *Wash. U. L.Q.* 417, 449 (2003) (arguing that increased disclosure requirements can be problematic in light of inadequate filtering of information).

²⁶Wagner, *supra* note 13, at 1414.

low-income individuals and for its influence on tax administration.³¹ Its reports and the testimony of Olson have had a substantial impact in terms of encouraging administrative and legislative sensitivity to issues and interests that are not necessarily championed by any organized group. It remains unclear, however, how much of TAS's influence rests with the skills of the current national taxpayer advocate, as compared with the institutional powers of its office. Further, its reporting role is directed to Congress, and while it is responsible for informing Congress, to ensure an even stronger role — and one that will last beyond the term of any one national taxpayer advocate — Congress and the IRS itself can make changes that emphasize TAS's role in assisting the IRS and Treasury develop policies before problems arise, rather than in a reactive way through IRS guidance that may adversely affect taxpayer interests.

Congress has invested the TAS with several statutorily designated hard powers and obligations, from which spring many informal soft powers.³² While those powers have led to an increased level of awareness of taxpayer issues at the IRS, they essentially center on *ex post* solutions to taxpayer problems. That is, the current TAS regime does not adequately involve the TAS in *ex ante* participation in IRS rulemaking. Congress can take specific steps to enhance the statutory powers that the TAS has in rulemaking, and, in particular, in ensuring that the IRS considers the TAS's perspective before it promulgates rules. In effect, the hard powers can help foster an environment in which there is a penumbra of soft powers.

An example of my approach is that for the guidance process, although the TAS is involved in proposing legislative changes to Congress, little explicit statutory authority exists to empower the TAS to act in the rulemaking process. To supplement the TAS's powers within the guidance process, the statute should reflect an affirmative role for commenting on proposed agency guidance as well

as reporting on the effect of its involvement in rulemaking.³³ Moreover, the structure of the office should be modified to allow a statutorily based counsel to play a formal role in the rulemaking process.

I suggest specific ways to enhance the TAS's role. First, Congress should provide a mechanism for the IRS to identify TAS comments in the notice and comment process, using section 7805(f)³⁴ as a model. Second, Congress should create an office of independent counsel that will report to the national taxpayer advocate and carve a defined role for that counsel in the rulemaking process. Third, TAS reporting obligations to Congress should be expanded to include the extent to which IRS has considered issues that TAS raises in the rulemaking process, including the extent to which the IRS has sufficiently engaged the interests of outside stakeholders and considered interests of underrepresented taxpayers.³⁵

Consider the suggestion that the IRS submit comments to a proxy that will provide meaningful input on rulemaking before the fact. Amending section 7805 to provide that the IRS is to submit regulations to the national taxpayer advocate, and likewise require the IRS to discuss those concerns, would provide a record allowing the public (and courts) to evaluate the IRS's decision-making process and further ensure that the IRS considers the interests that the TAS represents. It would increase transparency, minimize the possibility that underrepresented groups' interests are not considered in the rulemaking process, and enhance the likelihood that courts and the public accept the legitimacy of the IRS's decision in the first instance.

C. Conclusion

My article and my ongoing research calls for a consideration of the intersection of the IRS's rulemaking approach with the interests and needs of low-income and underrepresented taxpayers. While there has been increased attention to the adequacy of IRS procedures relative to general

internal role in preventing problems before they occur, emphasizing a special relationship with the IRS's outside board of directors. *Id.* While Congress adopted much of the Commission's suggestions, my proposals build on the commission's theme for *ex ante* TAS involvement.

³¹See, e.g., Camp, *supra* note 23.

³²For example, the TAS has the hard powers to intervene in an ongoing taxpayer's case before the IRS and may issue a variety of administrative measures to delay IRS actions and prompt additional agency consideration. As an outgrowth of those explicitly granted powers, as well as the skills and energy of the office, TAS has gained soft powers, such as the ability to participate in the academy and colloquia. Its prestige and influence undoubtedly contribute to the IRS's taking into account its views before promulgating guidance.

³³The 2011 Annual Report to Congress echoes specific suggestions I made in my *FTR* article. The report also requests explicit amicus powers to allow the TAS to participate directly in litigation and have its views heard in that context. See 2011 Annual Report, *supra* note 19, at 576.

³⁴Section 7805(f) provides that after publication of any proposed or temporary regulations, the IRS is to submit the regulations to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact of the regulation on small businesses.

³⁵For those interested in the proposals in detail as well as my discussion regarding the way that clinics — especially federally funded low-income taxpayer clinics — can be institutionally incentivized to participate in the process, I direct you to the whole *FTR* article.

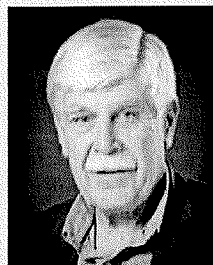
administrative law norms, the issues and implications differ when the substantive issues concern taxpayers who reside outside the mainstream of tax administration. The IRS has occasionally sought to engage that community through task forces and informal outreach. Moreover, some institutional actors participate to give lower-income taxpayers a seat at the table (for example, the American Bar Association Section of Taxation has an engaged group of clinicians and others who often advance those issues both formally and informally).

Some taxpayers may not have the resources or expertise to participate in the process, and even if they did, the IRS may not be attuned to weigh those interests properly. Yet there are ways to further institutionalize the interests of those taxpayers through proxies that can help develop the discussion and enhance the wisdom of rules before they are enacted. Further institutionalization will help ensure that input will continue beyond any one particular term of a national taxpayer advocate.

It is costly to correct unwise rules after the fact. Congress increasingly calls on the IRS to administer programs that can take into account equitable factors that are less and less technical. The provisions can affect a taxpayer's ability to meet life's basic necessities. It is time to help increase the likelihood that the IRS considers those interests fully before implementing rules that have a significant impact on people's lives.

Leverage, Taxes, and Returns

By Frank J. Jones



Frank J. Jones

Frank J. Jones is a professor in the accounting and finance department at San Jose State University College of Business and is chair of the investment committee at Private Ocean Wealth Management in San Rafael, Calif. Jones was chair and vice chair of the International Securities Exchange and executive vice president and chief investment officer of Guardian Life Insurance Co.

The tax system encourages long-term investing by imposing a lower tax rate on long-term capital gains. It is commonly believed that leveraged investing causes more volatile individual returns, including bankruptcies, and more volatile overall markets than does unleveraged investing. This article suggests a method for imposing different tax rates on unleveraged and leveraged investments by using a technique from corporate finance, the DuPont model.

A. Introduction

One of the purposes of the U.S. tax system is to encourage desired behavior. For example, to encourage long-term investment activities, the tax rate on long-term investments (one year or more) is as high as 15 percent for many taxpayers. However, to provide a disincentive to aggressive short-term trading and speculation, short-term investments (less than one year) are taxed as ordinary income, with a tax rate as high as 35 percent.

This general philosophy can also be applied to other aspects of investments. For example, leverage adds to potential return but also increases risk. Moreover, the use of leverage does not require the same skill level that fundamental investment strategies do. Anyone who qualifies for a loan based on his credit can use leverage to magnify gains and losses and increase risk for the individual investors and the overall financial system. This article examines a method for taxing leveraged investments.

It is commonly accepted that financial crises are exacerbated by leverage. For example, the 2008 crisis was amplified by borrowing and leveraging both by institutions and individuals. The tax code could be used to discourage the leveraged component of investment returns relative to the fundamental unleveraged returns. Investment professionals often refer to unlevered returns or raw returns (the amount invested before borrowing) as "real money"