The Scope of the Treasury's Power to Issue Nonretroactive Regulations

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When a Supreme Court decision or administrative ruling changes a previously prevailing interpretation of an Internal Revenue Code section, it often is undesirable and unfair to apply the completely new standards to taxpayers who have closed transactions in reliance upon prior regulations and decisions. This unfairness can be eliminated by limiting the application of the new interpretation to situations arising after the decision or ruling has been issued. Realizing that there is considerable hardship involved in retroactive judicial and administrative decisions in such a rapidly changing field of law as taxation, Congress has enacted legislation resulting in Internal Revenue Code Section 3791(b), authorizing the Treasury to grant relief. This section provides:

The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury decision, relating to the internal revenue laws, shall be applied without retroactive effect.

*This comment will discuss the history and background of Section 3791(b), the extent of nonretroactivity allowed, the questions of validity raised thereby, the nonretroactive regulations which have been issued, and their judicial acceptance.

History of Section 3791(b)

The history of Section 3791(b) began with the Revenue Act of 1921, adopted when there was a backlog of tax cases after the first World War. In handling this great volume of tax business, the Treasury Department found it impossible to attain consistency in all of its rulings. If each change in the Treasury decisions were applied retroactively, the agents and taxpayers could not rely on the regulations and confusion would reign. To remedy the situation, Section 1314 of the 1921 Act\(^1\) was passed, providing that if a regulation or Treasury decision was reversed by a subsequent regulation or Treasury decision, and this reversal was not the direct result of a court decision, the Commissioner, with the approval of the Secretary, might, by issu-

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\(^1\) 42 Stat. 227, 314 (1921).
ing a ruling, apply the new regulation or Treasury decision without retroactive effect.

This policy was extended in Section 605\(^2\) of the Revenue Act of 1928 to cover (1) cases where the new regulation or Treasury decision was occasioned by a court decision, and (2) cases where the new regulation or Treasury decision amended (even though it did not reverse) the prior regulation or Treasury decision.\(^3\)

The present language of Section 3791(b) was adopted in Section 506 of the Revenue Act of 1934.\(^4\) It broadened the provision in three respects: (1) to cover rulings as well as regulations and Treasury decisions; (2) to cover any ruling, regulation, or Treasury decision even though it did not amend one previously issued, and (3) to allow the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which the ruling, or regulation, or Treasury decision should be applied without retroactive effect, thus introducing flexibility and permitting partial retroactive application.\(^5\)

The committee reports accompanying the stages of legislation leading to the present Section 3791(b) indicate that there were two main purposes underlying the statute: (1) facilitation of the administration of the internal revenue laws by making it unnecessary to reopen thousands of cases,\(^6\) and (2) granting relief to taxpayers who had relied on the existing regulations and court decisions.\(^7\)

### The “Extent” of Nonretroactivity Allowed by Section 3791(b)

The section states that the Treasury may prescribe the “extent” to which the regulation will be applied without retroactive effect. Prospectively, any new Treasury decision is to be given full application. However, there are several possible interpretations as to the “extent” of nonretroactivity allowed by Section 3791(b).\(^8\) The question is, from what date can the Treasury make a regulation nonretro-

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\(^2\) 45 Stat. 791, 874 (1928).


active? For example, can a nonretroactive regulation render a decision such as Comm'r v. Estate of Church applicable only to decedents dying (1) after the date of the Church decision, (2) after the date of the regulation, (3) some other date.

One interpretation of "extent of nonretroactivity" would restrict nonretroactive application from the date of the court decision rather than the date of the regulation embodying the case. The basis of this view is the 1928 amendment, which for the first time broadened the authority to include regulations occasioned by a court decision. The purpose of this amendment was to permit the Treasury to avoid, in appropriate cases, the effects of the theory that a judicial decision announced what the law had been from the beginning. Under this interpretation, a regulation would cause a case such as Church to have an impact only on decedents dying after the date of the decision.

Another interpretation would permit a nonretroactive regulation to render a court decision inapplicable from the date the subsequent regulation embodying the decision is issued. This interpretation is compatible with the wording of the section. Nonapplication of cases such as Church could, by means of such a nonretroactive regulation, give relief to estates of decedents dying before or after the decision but before the issuance of the regulation.

A more difficult question is whether judicial decisions could be made nonapplicable to decedents dying after the issuance of the regulation. The issue is whether "retroactive" as used in 3791(b) may have reference to the date of transactions determining the extent of taxability upon a future taxable event as well as to the date of that event itself. This problem frequently arises in the estate and gift tax field where the tax base may include property dispositions made many years prior to death.

9 Nonretroactive regulations have two parts. One part sets out the new interpretation of an I. R. C. code section; the other part renders the new interpretation nonretroactive by making it apply only to taxpayers after a certain date. A nonretroactive regulation reversing a previous regulation renders the new interpretation applicable to future taxable events, and retains the old interpretation for past taxable events.

A nonretroactive regulation embodying a court decision reversing a previous line of cases renders the new rule applicable to future taxable events and retains the rule in force before the reversing court decision for those taxpayers who had relied on the previous interpretation. This type of nonretroactive regulation is in a sense thus actually retroactive as respects that group of taxpayers who are granted relief under the regulation in that it retroactively sets aside the rule applicable to them under the new court decision and substitutes the previously applicable rule which the decision discarded.

10 335 U.S. 632 (1949). This case overruled May v. Heiner, 281 U.S. 238 (1930) and held that the reservation of a life estate renders even pre-1931 transfers taxable under 811(c) as transfers intended to take effect in possession or enjoyment after death. (Similar post-1931 transfers were expressly made taxable by a Joint Resolution of Congress on March 3, 1931, c. 454, 46 Stat. 1516; see 49 Col. L. Rev. 437 (1949); 58 Yale L. J. 825 (1949).

By taking the date of the decedent's death as the significant date, the application is "prospective," but if the date of the transfer is used as the significant date, the application is "retroactive." If the Treasury is empowered to make significant the date of transfer, it can completely eliminate the applicability of decisions such as *Church*, whose sole impact is on past transfers. But if the date of death must be used as the significant date, nonapplication must be limited to estates of decedents dying before the issuance of the regulations.

Since one purpose of Section 3791(b) is to give relief to taxpayers who have made transactions in reliance on previous cases and regulations, the most reasonable interpretation is that this section allows the Treasury to make the date of the transaction the significant date if the administrative conclusion is that certain future decedents need relief. Thus, if two decedents died on the same day, the nonretroactive regulation could provide relief for the decedent who made his transaction before the court decision in reliance on previous regulations and cases, but not for the decedent who made his transfer after the decision of the crucial case.\(^2\)

It is noteworthy that in a number of instances in which Section 3791(b) has been applied to estate tax cases, tax relief for estates of future decedents has been preserved as regards past transactions.\(^13\) It may be concluded among these three possible interpretations of 3791(b) that the Treasury has authority to apply nonretroactivity at whatever significant date it thinks desirable in keeping with the broad relief contemplated.

However, Section 811(h) of the Internal Revenue Code may compel the date of death to be taken as the significant date. This section declares that the taxability of property arrangements or dispositions made by the decedent during his lifetime is to be determined

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12 Congress could constitutionally grant such relief. See Technical Changes Act of 1949 (P. L. 378, 81st Cong.) amending sec. 7 of I. R. C. § 811(c).

13 E.g.: T. D. 5038, 1940-2 Cum. Bull. 286 (1940), which amended Article 17 of U. S. Treas. Reg. 80 (now Reg. 105) to conform with the Hallock decision (taxing inter vivos transfers retaining a reversionary interest), provided that transfers made between November 11, 1935 (the date of the St. Louis Union Trust Co. decisions) and January 29, 1940 (the date of the Hallock decision), which were determined by the Commissioner to be similar to those involved in the St. Louis decisions, should not be included in the gross estate of any decedent (past or future); T. D. 5032, 1941-1 Cum. Bull. 427 (1941), which amended U. S. Treas. Reg. 80, Art. 27, to provide that insurance purchased by the decedent upon his life and payable to beneficiaries other than his estate is includible in his gross estate even though he possesses none of the legal incidents of ownership in the policy, made the new rule inapplicable to insurance purchased (by future decedents) prior to the date of its issuance if the decedent possessed none of the legal incidents of ownership in the policy at any time after such date; T. D. 5042, 1941-1 Cum. Bull. 424 (1941), which amended U. S. Treas. Reg. 80, Art. 13, to provide that United States bonds beneficially owned by a nonresident alien should be included in his gross estate, made the new rule inapplicable (even with respect to future decedents) to United States bonds issued prior to the date of the Treasury decision.
under the estate tax provisions in effect at his death even though differ- 
ing from the provisions in effect when the arrangements or dispo-
sitions were made. It might be argued that, in deciding the scope of 
Section 3791(b) in these situations, the principle of Section 811(h) 
would furnish trustworthy guidance. If this principle were thus to 
provide the yardstick requiring the estate tax to operate equally upon 
the estates of persons dying within the same period, it could be 
urged that promulgations such as Treasury Decisions 5008, 5032, and 
5042, which made crucial the date of transfer, were out of harmony 
with Congressional policy as declared in Section 811(h).

It is submitted that, in passing Section 3791(b), Congress has 
provided for administrative exceptions to be made to the general rule 
of Section 811(h), and that relief may be extended to all future de-
cedents as regards past transactions without exceeding the limits of 
either Section 3791(b) or Section 811(h).

Is a Nonretroactive Regulation Constitutional?

It may be argued that a nonretroactive regulation issued under 
Section 3791(b) is discriminatory and thus a violation of Fifth 
Amendment due process. As an illustration, consider Treasury De-
cision 5741. This Treasury decision is nonretroactive in that it ren-
ders Church applicable only to estates of decedents who died after 
January 17, 1949, the date of the decision of the Church case. The 
argument of discrimination is that all estates of decedents who died 
before January 17, 1949 and have retained only a life estate, except 
one, are given relief under the new regulation. The one exception is 
the Church estate. Thus, the one taxpayer whose case has been de-
cided is in a class of his own. Does this make the entire principle of 
the nonretroactive regulation discriminatory and thus a violation of 
due process?

It is probable that no taxpayer would challenge or have standing 
to challenge the constitutionality of the nonretroactive regulation on 
this ground. Only an estate which is harmed by the regulation would 
have standing to sue. The Church estate could not raise the issue 
because there is no procedure allowing refunds in a case that has been

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14 The Supreme Court has made an exception to this rule of uniformity by en-
croaching on 811(h) in Helvering v. Helmholtz, 296 U.S. 93 (1935).
15 Supra note 13.
16 Congress has also made an exception to § 811(h) in passing the Technical Changes 
Act of 1949 (P. L. 378, 81st Cong.).
17 1949 INT. REV. BULL. No. 20 at 10 (1949). In the case of a decedent who died 
on or before January 17, 1949, the date of the decision of the U.S. Supreme Court in 
Church, property transferred by the decedent is not included in his gross estate under 
this section if the decedent's only right or interest in the property consisted of an estate 
for his life. This T.D. was superseded by the Technical Changes Act of 1949, supra 
note 16.
adjudicated by the Supreme Court, and it is unlikely that any other estate would be harmed by the application of such a regulation.

Even if the issue were litigated, it is extremely doubtful that the court would be swayed by a taxpayer's contention that the entire doctrine of nonretroactive regulations is unconstitutional because it is discriminatory to the previously adjudicated Church estate. Aside from the fact that there is no arbitrary discrimination as regards any litigating taxpayer other than the one whose liability has been adjudicated, it is most probable that the court would consider such a classification a reasonable one even as to the latter. Further, where there has been detrimental reliance on former court decisions and regulations, the desirability of relief as respects other taxpayers would appeal strongly to the court. A more reasonable method of changing the regulations and still protecting taxpayers would be difficult to find. In some cases, the courts themselves have realized that the hardship caused by overruled decisions has been intolerable and have rendered nonretroactive decisions.

Moreover, recent trends indicate that the particular taxpayer who has been whipping boy of the nonretroactive regulations can get relief through legislation; for example, the Technical Changes Act of 1949, which amended Section 811(c), permitted the Spiegel estate to get a refund. This further decreases the likelihood that the constitutionality of 3791(b) or of regulations issued thereunder will be litigated.

18 There is no express provision in the Internal Revenue Code or Treasury regulations providing for such a situation. The legislative solution is aptly illustrated by the Technical Changes Act of 1949 permitting the Spiegel estate, 335 U.S. 701 (1949), to get a refund. An example of the legislative policy is expressed in I.R.C. § 3774 and § 3775 prohibiting refunds and credits after periods of limitations. Cf. I.R.C. Sec. 321 providing credit for overpayment of installment.

Quaere whether the whole problem of discrimination and necessity of reliance upon legislative relief could be eliminated by a nonretroactive regulation issued under 3791(b) allowing Church relief along with the rest of the class of estates which fit his case and are covered by the regulation. Such a Treasury decision seems to be authorized by the literal words of the section. However, because of lack of administrative procedure and precedent the Commissioner probably would be reluctant to exercise his power under 3791(b) in these situations.


20 Fed. Power Comm'n v. Pipeline Co., 315 U.S. 575 (1942). The Supreme Court in cases of economic due process applies a strong presumption of validity. An almost insuperable burden of proof falls on the party attacking the statute. Given a reasonable basis for such a regulation, the court will hold it constitutional. See also note 18 supra. 

21 See CARDOZO, NATURE OF THE JUDICIAL PROCESS 147 (1921). 

22 State v. Haid, 327 Mo. 567, 38 S.W. 2d 44 (1931); Gelpcke v. City of Dubuque, 1 Wall. 175 (U.S. 1864).

23 P.L. 378, 81st Cong.

24 For the argument of unconstitutionality based on unlawful delegation of legislative power, see PAUL, SELECTED STUDIES IN FEDERAL TAXATION, SECOND SERIES 82 (1938). His conclusion is that "the courts should, and in all likelihood, would" declare the nonretroactive regulations constitutional.
Can the Treasury Attach a Condition to a Nonretroactive Regulation Issued under the Authority of Section 3791(b)?

In order to facilitate the administration of the internal revenue laws by not having to litigate whether the taxpayer's case comes within the relief granted in the regulation, the Treasury has attempted to attach conditions to nonretroactive regulations. The question of the validity of such conditions has not been before the courts. The Treasury's first condition appeared in Treasury Decision 5008, which provided equitable treatment for transfers in trust made in reliance upon the St. Louis Union Trust Company cases as follows:

Where the Commissioner, whose determination therein shall be conclusive, determines that such transfer is classifiable with the transfers involved in such two cases..., then the property so transferred shall not be included in the decedent's gross estate under the provisions of this article....

By conditioning relief on a conclusive classification to be made by himself, the Commissioner reserved the power to determine whether or not a particular taxpayer's case came within the relief provided, thus greatly facilitating administration.

No taxpayer has challenged the Treasury's power to issue and apply Treasury Decision 5008 with the condition (italicized above). However, when the Treasury attempted to attach a condition to the proposed but never adopted regulation amending the existing regulations in order to conform to the decision of the Supreme Court in Church, it ran into taxpayer opposition. The proposed regulation would have relieved those taxpayers who had relied on the decisions previous to Church, but it attached a condition to the granting of such relief. It provided:

In the case of a decedent who died on or before January 17, 1949, the date of the decision of the U. S. Supreme Court in Commissioner v. Church, property transferred before 10:30 p.m., Eastern Standard Time, March 3, 1931, shall not be included in the gross estate under this section if the Commissioner, whose determination shall be conclusive, shall determine that the decedent's only right or interest in the property consisted of an estate for his life.

The proposed regulation was challenged in Commissioner v. Estate of Schroeder. The Tax Court held previously that the trust corpus was not includible in the decedent's gross estate on the ground that

25 Supra note 13.
27 See Estate of Sinclair v. Commissioner, 6 T. C. 1080 (1946); Thomas v. Graham, 158 F. 2d 561 (1946) where the courts apparently questioned but expressly did not pass on the Commissioner's power to alleviate a Hallock type case.
28 14 Fed. Reg. 1824 (Filed April 14, 1949). (Emphasis added.)
there was no possibility of reverter. The Commissioner appealed the case, and it was pending before the Second Circuit when Church was decided. Although Schroeder had been taken to the court on the question of whether the decedent had reserved a possibility of reverter, the Second Circuit completely avoided this issue and taxed the estate on the authority of Church because the deceased had reserved a life estate.

On April 14, 1949, the Commissioner gave notice of the proposed nonretroactive regulation quoted above, which would have given relief to Schroeder had it not been conditioned by the Commissioner’s “conclusive” power to determine whether or not the taxpayer had made the transfer reserving a reversionary interest.

On June 6, 1949, Schroeder’s estate filed a petition for certiorari in the Supreme Court, asking for relief under the proposed regulation expected to be in effect at the time of the decision but arguing that the condition attached to this proposed regulation was invalid. The argument was based on the doctrine of separation of powers. Because of opposition of the tax bar or because he wanted to avoid the impending decision on review in the Supreme Court, the Commissioner issued Treasury Decision 5741, amending his proposed regulation, leaving out the proposed condition of determination of the reversionary interest. Thus, the question of the validity of such a condition was not decided.

In determining the validity of a nonretroactive regulation which contains a condition of conclusive determination by the Commissioner of its applicability, two issues arise: does Section 3791(b) grant such authority, and, if so, is such an attempt by the Commissioner a violation of due process?

A regulation which cuts off judicial review can be held valid only if Section 3791(b) gives the Treasury the power required by Section

29 6 T. C. M. 568 (1947).
31 Apparently Schroeder assumed that since the Commissioner had previously determined a reversionary interest he would do it again for purposes of applying the new regulation. The Treasury might have been willing to reconsider the question.
32 Petition for Writ of Certiorari for Appellees, p. 7. “The asserted power of the Commissioner of Internal Revenue to reserve to himself alone final authority to decide questions of law which may arise under the proposed Treasury regulations is presumptively in violation of the doctrine of separation of powers and illegally encroaches on the constitutional functions of the court.” A due process argument would have been stronger. But see text at note 38 infra.
33 Pavenstedt, Congress Deactivates Another Bombshell: The Mitigation of Church and Spiegel, 5 Tax L. Rev. 309, 326 (1950).
34 Supra note 17.
35 For disposition of the Schroeder case, see note 71 infra.
10 of the Administrative Procedure Act.\(^3\) This section requires that there must be judicial review “except so far as . . . agency action is by law committed to agency discretion.” In some cases, Congress gives such discretion expressly.\(^3\) It may be argued that the words of Section 3791(b) “the Commissioner . . . may prescribe the extent, if any, to which any ruling . . . shall be applied without retroactive effect” gives rise to a strong implication that such discretion is given to the Commissioner.

To meet the attack of unconstitutionality, the regulation in question might be brought into the line of cases in which the Supreme Court has held that conclusive administrative decisions of questions of law are not unconstitutional because they involve a “question of privilege or benefit” rather than a “question of legal right.”\(^3\) In the instant situation, the taxpayer would be taxed because of the adverse court decision changing the interpretation of the statute on which he had relied. The nonretroactive regulation gives “relief” if the Commissioner determines that it applies. Thus, it can be argued that the regulation involves a “benefit” by relieving the taxpayer from the effect of an adverse court decision where the taxpayer has made transactions in reliance on previous decisions and regulations.

Even if these are not “benefit” regulations and are subject to more critical court review than administrative action conferring a benefit, the Commissioner’s determination still could not be attacked if the action under the power is exercised in a consistently nonarbitrary and nondiscriminatory manner.\(^3\)

Nonretroactive Regulations Issued

Section 3791(b) has possibilities for wide use in income tax cases where the Commissioner realizes that the past decisions and regulations do not reflect the correct interpretation of the Internal Revenue Code but is reluctant to change the rule because of reliance on the part of the taxpayer. For example, nonretroactive regulations have


\(^{37}\) E.g., First Moon v. Whitetail, 270 U.S. 243 (1926) construing 36 Stat. 855 (1910); Crane v. Hahlo, 258 U.S. 142 (1922) construing Laws of New York, 1918 c. 519 (1918); (in both statutes the words “final and conclusive” were used.)

\(^{36}\) Dorsheimer v. United States, 74 U.S. 166 (1868). (No judicial review when administrative action concerns remission of a penalty); Williamsport Co. v. United States, 277 U.S. 551 (1928); Heiner v. Diamond Alkali Co., 288 U.S. 502 (1933) (no review of administrative determination of special relief against hardship in computing excess profits taxes); Spaulding v. Douglas Aircraft Co., 154 F. 2d 419, 427 (9th Cir. 1946) (nonreviewability of renegotiation contracts); see Tollefson, Administrative Fiduciary, 29 Mich. L. Rev. 839 (1931).

\(^{39}\) Markall v. Bowles, 58 Fed. Supp. 463 (N.D. Cal. 1944), where it was said that the statutory word “discretion” would allow the OPA to act without judicial review unless the action is “capricious and arbitrary.”
been issued where a court decision or administrative ruling has changed the prevailing interpretation of a Code Section in the following cases: requirement for filing statements of deductions for distributions to employees' retirement funds,\(^{40}\) taxation of stock options granted to employees,\(^{42}\) taxation of income of Clifford type trusts,\(^{43}\) taxation of compensation for personal services,\(^{44}\) determination of the amount of gain or loss on charges incurred.\(^{44}\)

Where drastic changes have been made in the interpretation of the Code Sections concerning estate tax, the nonretroactive regulation is very appropriate to the extent that estate planning is done with reliance upon existing regulations and decisions.\(^{45}\)

The Commissioner has also utilized Section 3791(b) by issuing nonretroactive administrative rulings other than Treasury decisions. Such rulings relate to income tax,\(^{46}\) miscellaneous excise taxes,\(^{47}\) and

\(^{40}\) T. D. 5666, 1948–2 CUM. BULL. 34 (1948), next to last sentence of the second paragraph of U. S. Treas. Reg. 111, § 29.23(1)–3.

\(^{41}\) T. D. 5507, 1946–1 CUM. BULL. 18 (1946), conforming U. S. Treas. Reg. 111, § 29.22(a)–1 to the decision in Commissioner v. Smith, 324 U. S. 177 (1945), was made applicable only to stock options granted to employees on or after February 26, 1945, the date of that decision.


\(^{43}\) T. D. 5151, 1942–1 CUM. BULL. 34 (1942), amending the second paragraph of Treas. Reg. 103, § 19.22(a)–2 relative to compensation for personal services, was made applicable only to agreements entered into on or before the date of its approval.

\(^{44}\) T. D. 4321, X–2 CUM. BULL. 169 (1931), amending U. S. Treas. Reg. 74, Art. 561, relative to determination of the amount of gain or loss, was made inapplicable to certain charges paid or incurred prior to the date of its approval. See Jackson v. Commissioner, 9 T. C. 307 (1947).

\(^{45}\) E.g., T. D. 5741, 1949 INT. REV. BULL. No. 20 at 10, § 1(E) (1949), conforming U. S. Reg. 105 to the decision in Comm'r v. Estate of Church, 335 U. S. 632 (1949), was made inapplicable to estates of decedents who died on or before January 17, 1949, the date of the decision; T. D. 5042, 1941–1 CUM. BULL. 424 (1941), last paragraph of U. S. Treas. Reg. 105, § 81.13, amending U. S. Treas. Reg. 80, Art. 13 (1937), relative to United States bonds beneficially held by nonresident aliens, was made applicable only to bonds issued on or after the date of its approval; T. D. 5032, 1941–1 CUM. BULL. 427 (1941), first paragraph of U. S. Treas. Reg. 105, § 81.27 prior to its amendment by T. D. 523 (1943), amending U. S. Treas. Reg. 80 (1937) relative to proceeds of insurance upon the decedent's life, was made inapplicable to certain insurance taken out on or before the date of its approval; T. D. 5068, supra note 13.

\(^{46}\) I. T. 3954, 1949 INT. REV. BULL. No. 11 at 4 (1949) relating to holding period of commodity received under futures contract; I. T. 3950, 1949 INT. REV. BULL. No. 9 at 3, relating to method of accounting for bad debt reserves by banks; Misc. 6367, 1949 INT. REV. BULL. No. 6 at 2 (1949), relating to deductibility of Federal stamp taxes paid on the issuance of corporate bonds; I. T. 3935, 1949 INT. REV. BULL. No. 2 at 2 (1949), relating to donative assignments of short-lived in-oil payment rights; I. T. 3930 and 3933, 1948–2 CUM. BULL. 126 and 130 (1948), relating to oil and gas joint operating agreements; I. T. 3669, 1943 CUM. BULL. 505, relating to the application of the rule of Helvering v. Stuart, 317 U. S. 154 (1942); I. T. 3979, 1949 INT. REV. BULL. No. 24 at 5, relating to capital gains of finance companies who have foreclosed on real estate and sold it.

\(^{47}\) M. T. 32, 1948–2 CUM. BULL. 160, relating to the application of the decision in
Applications of the doctrine have likewise been effected in gift tax and alcohol tax.

Judicial Attitude toward Nonretroactive Regulations

Because nonretroactive administrative decisions seem to conflict with the generally prevailing theory that the law stated by a court decision has existed from the beginning, regulations issued under Section 3791(b) have encountered some judicial opposition.

That the Tax Court has evidenced some lack of understanding is illustrated in Estate of Stockstrom v. Commissioner, which held the income from the Stockstrom trusts taxable under Helvering v. Clifford for the years 1938-1941. The court of appeals affirmed the Tax Court on all issues which the Tax Court decided, but because of new evidence the decision was reversed for such proceedings as would be necessary to dispose of the issue. Upon rehearing before the Tax Court, that court received an order from the court of appeals requesting it to consider the question of Stockstrom's liability in light


48 T. D. 5041, 1941-1 Cum. Bull. 438 (1941), first section of U.S. Treas. Reg. 108, § 86.2, amending U.S. Treas. Reg. 79, Art. 2 (1936) relative to United States bonds beneficially held by nonresident aliens, was made applicable only to bonds issued on or after the date of its approval; T. D. 5010, 1940-2 Cum. Bull. 293 (1940), last paragraph of U.S. Treas. Reg. 108, § 86.3 prior to its amendment by T. D. 5366 (1944), conforming U.S. Treas. Reg. 79, Art. 3 (1936) to the decision in Estate of Sanford v. Comm'r, 308 U.S. 39 (1939) was made inapplicable to certain transfers made prior to the calendar year 1939.

49 T. D. 5694, 1949 Int. Rev. Bull. No. 8 at 19 (1949), amending U.S. Treas. Reg. 21 relative to rates of tax applicable to liquors, etc., was made effective on May 1, 1946.

50 Supra note 11.

51 3 T. C. 255 (1944).

52 309 U. S. 331 (1940).


54 Estate of Stockstrom v. Commissioner, 7 T. C. 251 (1946).
of Treasury Decision 5488 and Mimeograph 5968 which had been issued by the Commissioner under authority of Section 3791(b) after the court of appeals had reviewed Stockstrom.

In this proceeding, the petitioner argued that these new regulations constituted "controlling authority" and required a conclusion on the part of the Tax Court that none of the income of the trusts in question was taxable to the grantor in 1938-1941 because the new nonretroactive regulations set up tests of nontaxability within which the taxpayer claimed he came. The Commissioner agreed that such new standard was applicable but disagreed on its interpretation, contending that Stockstrom was taxable even under the new standard.

The Tax Court failed to pass on the interpretation of the Treasury decision and mimeograph, which should have been the main issue before it, but rather held the income taxable on its interpretation of Clifford. It said that the regulations did not have the force and effect of law, and that it was unnecessary for the court to consider whether the new regulations covered the income in question.

In a later opinion in the case, the Tax Court gave its reasons for not applying the regulations. Rather than considering the Treasury decision and the mimeograph as one regulation promulgated to carry out the purposes of 3791(b), that court disposed of each ruling separately, stating that the Treasury decision was by its terms inapplicable to the tax years in question, and that the mimeograph merely set out the policy of the Bureau and was of no concern to the court:

The Commissioner himself issues as a caveat on the flyleaf of every Internal Revenue Bulletin that "rulings other than Treasury decisions have none of the force or effect of Treasury decisions and do not commit the department to any interpretation of the law which has

66 T. D. 5488, 1946–1 CUM. BULL. 19, 22 (1945). This T. D. amending U. S. Treas. Reg. 111, § 29.22(2)–21 et seq. is known as the "Clifford Regulation." The Secretary, under authority of I. R. C. § 3791(b), prescribed the Treasury decision to be prospective in effect.

67 Mim. 5968, 1946–1 CUM. BULL. 25 (1946). "Reference is made to Treasury Decision 5488 . . . . The Treasury decision provides that § 22(a) of the Code shall be applied in determining the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to the amendment to the regulations made by the Treasury decision. However, in cases not yet finally determined for such taxable years, it will be the policy of the Bureau, where no inconsistent claims prejudicial to the Government are asserted by trustees or beneficiaries, not to assert liability to the grantor under the general provisions of § 22(a) of the Code, if the trust income would not be taxable to the grantor under the amendment to the regulations."

68 Estate of Stockstrom v. Commissioner, 7 T. C. 251 (1946). Stockstrom's petition to the Tax Court for rehearing was denied, but the Tax Court issued a Memorandum Sur Order "for the purpose of making more explicit (its) Supplemental Findings of Fact and Opinions . . . .” (Estate of Stockstrom v. Commissioner, 6 T. C. M. 268) (1947).
not been formally approved and promulgated by the Secretary of the Treasury."

This argument disposing of the mimeograph appears to be invalid, however, because the Commissioner, in order to comply with Section 3791(b), obtained the signature of the Secretary on the mimeograph, thus giving the mimeograph "Treasury decision" status, having been "approved and promulgated" by the Secretary.

The texts of the mimeograph and the Treasury decision indicate that the Commissioner intended the two rulings as one regulation issued under the authority of Section 3791(b). Had they been read together as one regulation, the Tax Court could not have disposed of the Treasury decision by stating that it was by its terms inapplicable, as the mimeograph clearly rendered it applicable to the tax years in question.

By holding against the taxpayer without reference to the regulations, the Tax Court by implication found that the taxpayer could not win even if he proved himself to be within their terms. Is it within the court's discretion thus to invalidate such regulations?

Normally, the court need not apply regulations which it finds incorrect under their underlying statutes and may invalidate them expressly or by implication. However, it is in the nature of the problem which Section 3791(b) is supposed to solve that regulations adopted under it will perpetuate for some taxpayers regulations found to be not in accord with their statutes. It may thus be said that Section 3791(b) necessarily gives the Treasury power to make regulations, valid for limited periods, beyond the scope of its normal power to interpret Internal Revenue Code sections correctly.

In refusing to apply a regulation adopted as part of a plan under Section 3791(b) to effect an orderly transition in the law on the ground that the regulations were not in accordance with their under-

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60 A clear example of § 3791(b) perpetuating for some taxpayers a regulation not in accord with its underlying statute appears when a Supreme Court decision overrules a line of cases on which taxpayers have relied. In such a case the regulation which embodied the previous overruled cases is not a correct interpretation of its I.R.C. section. Under § 3791(b) the Treasury at its discretion may issue a new regulation embodying the reversing decision to operate "nonretroactively," thus applying the old regulation, even though it is an invalid interpretation, to taxpayers who have relied upon it. The same effect is present when the Treasury issues a new regulation, not occasioned by court decision, overruling a prior regulation which had been relied upon by taxpayers. The Treasury may make the new regulation nonretroactive and thus perpetuate the prior regulation, although it is not the correct interpretation of the code section, for taxpayers relying on it.
lying statute, and in ignoring the question of whether the particular regulations were a valid exercise of the power granted by Section 3791(b), the Tax Court indicated an insufficient appreciation of the full scope of the discretion granted the Treasury to give taxpayers relief by regulations under that section.61

Stockstrom did not appeal from his denial for rehearing and the issue of the effect of the Treasury decision and mimeograph promulgated under Section 3791(b) did not arise again until Shapero v. Commissioner.62 The petitioner in this case argued that his trusts were not taxable under the Clifford doctrine for the years 1940 and 1941 on the basis that Treasury Decision 5488 and Mimeograph 5968 were applicable and, under the new standards therein provided, he was not taxable. The Commissioner disagreed on the petitioner's interpretation of the standards therein contained. The Tax Court, however, again rejected the real issue (i.e., interpretation of the Treasury decision and Mimeograph) with one sentence on the authority of the Stockstrom case and held the trusts taxable under the Clifford principle.

Shapero appealed to the Sixth Circuit. This was the first time that a court of appeals had been faced with the issue of applying a regulation issued under 3791(b). The court in plain words stated that the Tax Court was in error in relying on the Stockstrom case and not deciding whether the Regulation and Mimeograph as a matter of law applied to the tax years prior to their promulgation. It then proceeded to apply the Treasury decision and Mimeograph and, holding that the Shapero trusts were taxable thereunder, decided that it would be unnecessary to remand the case to the Tax Court.63

The Tax Court has had no further chance to react on this issue.64 The Fifth Circuit has indicated an awareness of the "nonretroactive effect" of the Clifford regulations,65 and the Third Circuit applied 61 It must be remembered that this problem arises only where the Tax Court refuses to litigate a question under a regulation favorable to the taxpayer. The taxpayer may of course always challenge an unfavorable regulation as being beyond the terms of the underlying I.R.C. section. In other words the Commissioner, by § 3791(b), may not retroactively force an otherwise challengeable regulation adverse to the particular taxpayer.
62 8 T. C. 104 (1947).
64 In Tobin v. Commissioner, 11 T. C. 928 (1948), the petitioner did not urge the application of the Treasury decision and Mimeograph. The Tax Court apparently questioned the Treasury's power to alleviate the hardship of a Hallock type case; Arthur Sinclair Estate, 6 T.C. 1080. Goodan v. Commissioner, 12 T.C. 817, No. 110 (1949), would have furnished a testing ground to observe whether or not the Tax Court had changed its attitude toward the nonretroactive regulations since Shapero, but the case was decided on another issue.
65 Farkas v. Commissioner, 170 F. 2d 201; 1948-2 USTC 9394 (1948), Hutcheson concurring: "To the reasons given in the majority opinion for reversing the decision of the Tax Court, I add one other. This is that, though Treasury Regulations 111, Sec. 29.22..."
the Commissioner's new nonretroactive rulings in *Kay v. Commissioner*.66

Until recently, some Supreme Court decisions indicated a lack of awareness of the full scope and possibilities of 3791(b).68 One of the purposes of 3791(b) was to provide relief from hardship which would result in overturning a previous line of cases, thus allowing the courts to base their current decisions on interpretation of the statute without regard to the effect on taxpayers who have relied on a prior interpretation. But Mr. Justice Frankfurter, dissenting in *Church*,69 stated that "The Government at the bar of this Court suggested that hardships could be alleviated by a regulation relieving of a tax those estates which could show such reliance. The very suggestion involves a confession that the decision urged upon the Court would be unfair." Mr. Justice Jackson has indicated the same attitude in *Helvering v. Griffiths*.70 Nevertheless, the Supreme Court's per curiam opinion

as added by Treasury Decision 5488 and 5567, apply authoritatively only to years beginning after Dec. 21, 1945, and are, therefore, not controlling here but merely informative, they furnish, I think, conclusive support to the 'judicial determination' we have made that the income from the assigned trust interest is not taxable to the grantor."

66 Since the time of promulgation of T. D. 5488 and Mimeo. 5968, the Commissioner has issued current nonretroactive Treasury decisions and Mimeographs amending the prior ones; T. D. 5567 1947-2 CUM. BULL. 9 (1947). This Treasury decision further amended § 29.22(a)-21 et seq., and like Treasury Decision 5488, was issued under authority of § 3791(b) to be prospective in effect. "... § 29.22(a)-21 as amended shall be applicable to taxable years beginning after Dec. 31, 1945 ..."; Mimeo. 6071, 1946-2 CUM. BULL. 31 (1946). This mimeograph, like Mimeo. 5968, applied to Treasury Decision 5488, giving it added prospective limitations. "... in many instances grantors who are taxable under the provisions of Treasury Decision 5488 upon the income of trusts created prior to January 1, 1946, may desire to terminate their substantial ownership of the trust income through termination of control over such trusts.

"It will, therefore, be the policy of the Bureau where the grantor's control over a trust created prior to January 1, 1946, is terminated at any time during the calendar year 1946, with the result that the trust income on the last day of such calendar year is no longer taxable, to assert liability of the grantor under the provisions of T. D. 5488 for any part of the calendar year in 1946. The Bureau may, however, assert liability of the grantor in such a case under § 22(a) of the Internal Revenue Code without reference to T. D. 5488 for that part of the calendar year 1946 preceding the termination of the grantor's control over the trust"; Mimeo. 6156, 1947-2 CUM. BULL. 13 (1947). This mimeograph applied to T. D. 5567 in much the same respects that Mimeo. 5968 and Mimeo. 6071 applied to T. D. 5488.

67 178 F.2d 772 (3rd Cir. 1950), affg. 11 T. C. 471 (1948). The dictum indicated that the court complied with the mimeograph because it was a desirable policy and not because it was bound to follow the mimeograph.

68 E.g., Comm'r v. Estate of Church, 335 U. S. 632 (1949); Helvering v. Griffiths, 318 U. S. 371 (1943).

69 Ibid. at footnote 14 of the opinion. Counsel for the Commissioner, in urging inclusion of the transferred property in the gross estate, pointed out to the court that taxpayers who had relied on previous decisions of the Commissioner and courts, had set up such trusts, and would be taxed under the result, could be relieved of their burden by applying a nonretroactive regulation by authority of § 3791(b).

70 Supra note 68.
granting certiorari in *Schroeder v. Commissioner*\(^7\) strongly indicates that the Commissioner’s nonretroactive regulations are binding on the courts. The *Schroeder* case,\(^2\) discussed above, concerned the issue of whether or not property transferred in trust was includible in the decedent’s estate under the provisions of the Internal Revenue Code Section 811(c). While the case was pending, *Church* was decided, so the Court of Appeals in the Second Circuit\(^3\) held the transfer taxable by reason of the reservation of a life estate, following *Church*. After the decision, the Commissioner issued Treasury Decision 5741,\(^4\) a nonretroactive regulation, excluding trusts with reservation of life estate only from estates of decedents dying before January 17, 1949, the date of the *Church* case.

The Schroeder estate appealed from the Court of Appeals decision, on the ground that Treasury decision 5741, if modified as the taxpayer contended, gave it relief.\(^5\) Thus, for the first time the Supreme Court was in a position to disclose its attitude toward the question of the force and effect of a nonretroactive regulation. The Supreme Court, on certiorari, pronounced: “The judgment of the Court of Appeals is vacated and the case remanded to that court for further consideration in the light of Treasury Decision 5741.”\(^6\)

In addition to being a strong indication by that Court that the Treasury decisions promulgated under Section 3791(b) are to be recognized and given effect by the courts, *Schroeder* apparently indicates that a nonretroactive regulation may supersede a Supreme Court decision, here the *Church* case.

In summation, there would appear to be no legal barrier preventing the Treasury from making a broad use of 3791(b) in keeping with the extensive relief intended by Congress. The impact of the attitude of the Supreme Court and the Courts of Appeal should be felt by the Tax Court the next time it meets the issue of the force and effect of the nonretroactive regulations. In view of the great need and desirability of such an administrative device as Section 3791(b), in view of the very frequent occasions for granting relief in the tax field with

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\(^7\) Supreme Court of the United States, No. 103 October term, 1949. October 10, 1949, Per Curiam: The petition for writ of certiorari is granted. The judgment of the Court of Appeals is vacated and the case is remanded to that court for further consideration in light of Treasury Decision 5741, 14 Fed. Reg. 5536, and Comm’r v. Estate of Church, 335 U.S. 632, and Estate of Spiegel v. Comm’r, 335 U.S. 701.

\(^2\) 6 T. C. M. 568 (1947).

\(^3\) Commissioner v. Estate of Schroeder, 172 F. 2d 864 (1949).

\(^4\) *Supra* note 17.

\(^5\) *Supra* note 34 *supra*.

\(^6\) *Supra* note 71. It is to be noted, however, that the Technical Changes Act of 1949 (P. L. 378, 81st Cong.) amending § 7 of I.R.C. § 811(c) supersedes T. D. 5741. Thus, the Second Circuit decided the case on the basis of the 1949 legislation and gave the Schroeder estate relief.