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The False Promise of Presidential Indexation

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The False Promise of Presidential Indexation

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The Trump Administration faces mounting pressure from conservative thinkers and activists—including calls from its own National Economic Council director—to promulgate a U.S. Treasury Department regulation that indexes capital gains for inflation. Proponents of such a move—which is sometimes called "presidential indexation"—make three principal arguments in favor of the proposal: (1) that inflation indexing would be an economic boon; (2) that the President and his Treasury Department have legal authority to implement inflation indexing without further congressional authorization; and (3) that in any event, it is unlikely that anyone would have standing to challenge such an action in court. This Article evaluates the proponents' three arguments and concludes that all are faulty. First, whatever the merits of comprehensive legislation that adjusts the taxation of capital gains and various other elements of the Internal Revenue Code for inflation, rifle-shot regulatory action that targets only the capital gains tax would be costly and regressive, would open a number of large loopholes that allow for rampant tax arbitrage, and would be unlikely to significantly enhance growth. Second, the legal authority for presidential indexation simply does not exist. The Justice Department under the first President Bush reached the conclusion in 1992 that the Executive Branch cannot implement inflation indexing unilaterally, and doctrinal developments in the last quarter century have—if anything—strengthened that conclusion. Third, a number of potential plaintiffs—including a Democrat-controlled House of Representatives, certain states, brokers subject to statutory basis reporting requirements, and investment funds whose tax liability could rise as a result of the regulation—would likely have standing to challenge presidential indexation in federal court. In sum, the promise of presidential indexation turns out too hollow, and calls for unilateral action should be spurned.

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Introduction

Prominent conservative activists and commentators have pressed the Trump Administration in recent months to index the capital gains tax for inflation via executive action—a move sometimes called "presidential indexation."[1] In August 2017, then-CNBC commentator Larry Kudlow urged President Trump to "take matters into his own hands by issuing an executive order to index capital gains for inflation."[2] The next month, Kudlow and two dozen other conservative leaders sent an open letter calling on President Trump to index capital gains for inflation unilaterally.[3] Those same leaders joined forces again in January 2018 to urge Treasury Secretary Steven Mnuchin to promulgate a regulation that indexes capital gains for inflation.[4] The push for presidential

1. *See* Editorial, *Presidential Indexation*, WALL ST. J., Jan. 28, 1992, at A14 [hereinafter "Editorial, *Presidential Indexation*"]. To be more precise, these proposals would involve indexing "basis" for inflation. The Internal Revenue Code's definition of "basis" applies both to capital and ordinary assets. *See* I.R.C. § 1012(a) (2018). We use "capital gains indexing" as a shorthand referring to indexing basis for both capital and ordinary assets, which would reduce the gains on both. In dollar terms, most of the effect would likely be on capital gains. In 2015, there were $725 billion of net capital gains reported as compared to $12 billion of gains on "ordinary" property. *See* IRS, STATISTICS OF INCOME DIV., *Individual Income Tax Returns Publication 1304* (Sept. 2017), https://www.irs.gov/pub/irs-soi/15in13ms.xls [https://perma.cc/9RED-SPXW]. As noted below, indexing basis for inflation would also have a number of implications beyond the capital gains tax context, including for depreciation and amortization. *See infra* note 49.

2. Larry Kudlow, *Index Capital Gains for Inflation, Mr. President*, CNBC: KUDLOW'S CORNER (Aug. 11, 2017, 6:17 PM), https://www.cnbc.com/2017/08/11/index-capital-gains-for-inflation-mr-president.html [https://perma.cc/6L5Q-5NBM].

3. *See* Rachel Slobodien, *Club for Growth Leads Coalition Urging Trump to End Taxation of "Phantom Income;" Encourages Executive Order*, CLUB FOR GROWTH (Sept. 26, 2017), https://www.clubforgrowth.org/taxes/club-for-growth-leads-coalition-urging-trump-to-end-taxation-of-phantom-income-encourages-executive-order [https://perma.cc/CA6U-J5WC].

4. Letter from Grover G. Norquist, Pres., Americans for Tax Reform, to Steven T. Mnuchin, Sec'y, U.S. Dep't of the Treas. (Jan. 23, 2018), https://www.atr.org/sites/default/files/assets/ATR%20letter%20to%20Treasury%20on%20Indexing%20Capital%20Gains%20to%20Inflation.pdf [https://perma.cc/2YVY-AFSE].

indexation gathered even more momentum in March 2018, when President Trump named Kudlow to be the next director of the National Economic Council.[5] Since then, opinion-shapers in the right-leaning media have joined the chorus.[6] Kevin Brady, former chairman and now ranking Republican for the House Ways and Means Committee, has also backed the proposal,[7] and the President has asked the Treasury Department to look into the idea.[8] "I'm thinking about it very strongly," Trump told reporters as the summer of 2018 drew to an end.[9] With a new Democratic House majority poised to block any tax-slashing legislation, the indexing idea may prove even more attractive to a President who still seeks further cuts.[10]

This is not the first time that a Republican president has faced calls from leading conservative thinkers and activists—including members of his own Administration—to index capital gains for inflation unilaterally. Tax lawyers with long memories may recall a similar effort during the last year of the first Bush Administration,[11] when the President and his Treasury Secretary faced a drumbeat of demands for unilateral action on indexing. Paul Craig Roberts, who served as an Assistant Secretary of the Treasury under President Reagan, wrote in the *Washington Times* in January 1992 that President Bush "can cut the capital gains tax unilaterally" and "would be derelict not to do so."[12] That same month, the *Wall Street Journal* editorial board enthusiastically endorsed the plan, which it described as a "bold move" that "would benefit both the economy and Mr.

5. *See* Ryan Ellis, *Larry Kudlow Should Get President Trump to Index Capital Gains to Inflation*, FORBES (Mar. 14, 2018, 3:15 PM), https://www.forbes.com/sites/ryanellis/2018/03/14/larry-kudlow-should-get-president-trump-to-index-capital-gains-to-inflation/#2e89e0243514 [https://perma.cc/5JZ7-QCUP]; Richard Rubin, *How Lawrence Kudlow's Rise Breathes New Life into Indexing Capital Gains to Inflation*, WALL ST. J. (Mar. 20, 2018, 6:00 AM), https://blogs.wsj.com/economics/2018/03/20/how-lawrence-kudlows-rise-breathes-new-life-into-indexing-capital-gains-to-inflation [https://perma.cc/FW9G-2D6D].

6. *See* Editorial, *Death to the Inflation Tax*, WASH. TIMES (Apr. 22, 2018), https://www.washingtontimes.com/news/2018/apr/22/editorial-theres-evidence-that-trump-can-strike-th [https://perma.cc/2E49-R9J8]; Kimberley A. Strassel, Opinion, *Trump Alone Can Cut Taxes*, WALL ST. J. (July 12, 2018, 7:02 PM), https://www.wsj.com/articles/trump-alone-can-cut-taxes-1531436546 [https://perma.cc/4ZKU-E2HT].

7. *See* Alan Rappeport & Jim Tankersley, *Trump Administration Mulls a Unilateral Tax Cut for the Rich*, N.Y. TIMES (July 30, 2018), https://www.nytimes.com/2018/07/30/us/politics/trump-tax-cuts-rich.html [https://perma.cc/4YX4-UPWW].

8. Phil Mattingly (@Phil_Mattingly), TWITTER (Aug. 1, 2018, 2:51 PM), https://twitter.com/Phil_Mattingly/status/1024714248503615488 [https://perma.cc/F4Z9-P2NE].

9. John Micklethwait, Margaret Talev & Jennifer Jacobs, *Trump Says He's Thinking About Indexing Capital Gains to Inflation*, BLOOMBERG (Aug. 30, 2018, 4:22 PM), https://www.bloomberg.com/news/articles/2018-08-30/trump-says-thinking-about-indexing-capital-gains-to-inflation.

10. *Cf.* Joshua Gallu, Justin Sink & Sahil Kapur, *Trump's Pre-Election Tax-Cut Promise Leaves GOP Leaders Baffled*, BLOOMBERG (Oct. 20, 2018, 4:48 PM), https://www.bloomberg.com/news/articles/2018-10-20/trump-says-new-tax-cut-plan-may-come-days-before-november-vote (discussing Trump's still ill-formed plans for further tax reductions).

11. Our tax law memories do not extend that far back. Both of us were in grade school at the time of the 1992 debate.

12. Paul Craig Roberts, Commentary, *Instant Way to Cut Capital Gains Tax?*, WASH. TIMES, Jan. 22, 1992, at F1.

Bush."[13] Several other prominent Reagan Administration veterans sent a letter to President Bush in March of that year urging him to direct his Treasury Secretary to take immediate action.[14] One outspoken member of President Bush's Cabinet, Secretary of Housing and Urban Development Jack Kemp, backed the idea as well.[15]

The intellectual foundation of the 1992 push for presidential indexing was a ninety-two-page memorandum produced for the National Taxpayers Union and the National Chamber Foundation by three conservative attorneys at a prominent law firm in Washington, D.C., including two partners who had held high posts in the Reagan Administration Justice Department.[16] To readers familiar with the U.S. system of separation of powers, the memorandum's claim that the President could—through his Treasury Secretary—radically alter the tax treatment of capital gains might have seemed surprising. After all, the Constitution allocates the taxing power to Congress.[17] And, more specifically, the Constitution requires that revenue-related legislation originate in the House of Representatives.[18] But the 1992 memorandum concluded that "a regulation indexing capital gains for inflation should and would be upheld judicially as a valid exercise of the Treasury's interpretive discretion" under the Internal Revenue Code.[19] Central to the authors' argument was Section 1012 of the Code, which provides that—as a general rule—"[t]he basis of property shall be the cost of such property."[20] The memorandum's authors contended that the Treasury Secretary could promulgate a regulation interpreting "cost" to mean cost in "real" (i.e., inflation-adjusted), as opposed to "nominal," terms. Because the gain on an undepreciated capital asset generally is calculated by subtracting the basis from the sale price,[21]

13. Editorial, *Presidential Indexation*, *supra* note 1, at A14.

14. *See* Letter from Gary L. Bauer et al. to George H.W. Bush, President of the United States (Mar. 19, 1992), *reprinted in* Letter, *What Bush Must Do After His Deadline*, WALL ST. J., Mar. 20, 1992, at A12. Signatories of the letter included former Secretary of Transportation James H. Burnley IV, former Office and Management and Budget Director James C. Miller III, and former Assistant Attorney General Theodore B. Olson, among others. *See id*.

15. *See* Joanna Richardson, *Treasury Empowered to Index Capital Gains Through Regulation, Study Finds*, 56 TAX NOTES 1123 (Aug. 31, 1992).

16. Memorandum from Charles J. Cooper, Michael A. Carvin & Vincent J. Colatriano to Dr. Lawrence A. Hunter, Exec. Vice Pres., Nat'l Chamber Found. 1 (Aug. 17, 1992), https://www.atr.org/sites/default/files/assets/shaw%20pittman%20potts.pdf [https://perma.cc/N6JW-SDGW] [hereinafter "Cooper Memorandum"].

17. *See* U.S. CONST. art. I, § 8, cl. 1 ("The Congress shall have Power To lay and collect Taxes . . . .").

18. *See* U.S. CONST. art. I, § 7, cl. 1 ("All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills."). Courts uniformly have interpreted the Origination Clause to apply to bills that raise *and lower* taxes. *See* Armstrong v. United States, 759 F.2d 1378, 1381 (9th Cir. 1985) ("We . . . conclude . . . that in adopting [the Origination Clause], the framers of the Constitution intended that all legislation relating to taxes (and not just bills raising taxes) must be initiated in the House."); Wardell v. United States, 757 F.2d 203, 205 (8th Cir. 1985) (per curiam) ("We cannot agree that 'revenue-raising' means only bills that increase taxes.").

19. Cooper Memorandum at 1.

20. I.R.C. § 1012(a) (2018).

21. *See* I.R.C. § 1001(a) (2018).

the proposed reinterpretation would have the effect of incorporating an inflation adjustment into the taxation of capital gains.[22]

The 1992 push for presidential indexation lost momentum after the Treasury Department's General Counsel and the Justice Department's Office of Legal Counsel both concluded that Treasury did not, in fact, have the legal authority to index basis for inflation via regulatory action.[23] Still, the idea has continued to resurface since. Republican presidential candidate Bob Dole pledged on the campaign trail in 1996 that he would implement indexing via executive action in his first year in the Oval Office.[24] The *Wall Street Journal* Editorial Board briefly resurrected the idea during the second President Bush's second term.[25] Two of the three authors of the ninety-two-page 1992 memorandum published a "sequel" to their earlier analysis in 2012 in a law journal,[26] when the upcoming election presented the possibility of a change in administration. Presidential indexation has proven to be an idea that will not die. Now, it is back, and supporters are especially emboldened by Kudlow's sudden ascent.

Over the years, the case for presidential indexation, as framed by its proponents, has been based on three core claims. First, advocates say that it would be good policy—it would encourage capital formation and enhance economic efficiency.[27] Second, as noted above, advocates argue that Treasury has the legal authority to index basis for inflation on its own, without further congressional action. And third, some proponents of presidential indexation say that it is "unlikely that anyone would have standing to sue to block indexing." In other words, whether or not presidential indexation is lawful, it probably could not be stopped.[28]

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22. In fact, because gains from the disposition of all assets are determined under these same rules, the plan would seemingly apply to gains from the sale of ordinary assets as well. *See* Memorandum from John A. Corry, Chair, Tax Section, N.Y. State Bar Ass'n, Capital Gains Indexation by Regulation (Sept. 1, 1992) (accessed from Tax Notes database, Document 92-8222, Electronic Citation 92 TNT 179-45) [hereinafter "NYSBA Memorandum"].

23. *See* Bruce Bartlett, *Indexing Capital Gains by Fiat*, 135 TAX NOTES 883, 884 (May 14, 2012); Memorandum Op. for the Gen. Counsel, Dep't Treas., 16 Op. O.L.C. 136 (1992) [hereinafter "Op. O.L.C."]. Other tax scholars who engaged in the debate at the time agreed that Treasury lacked authority to index the capital gains tax via executive action. *See* Linda Galler, Chevron *and the Administrative Regulation of Indexation: Challenging the Cooper Memorandum*, 56 TAX NOTES 1791 (1992); Lawrence Zelenak, *Does Treasury Have Authority to Index Basis for Inflation*, 55 TAX NOTES 841 (1992).

24. *See* Richard W. Stevenson, *Dole Tax Plan Would Shelter Some Gains*, N.Y. TIMES (Oct. 23, 1996), https://www.nytimes.com/1996/10/23/us/dole-tax-plan-would-shelter-some-gains.html [https://perma.cc/EF6V-VUUZ].

25. Review & Outlook, *Counting Capital Gains*, WALL ST. J. (Oct. 3, 2006, 12:01 AM), https://www.wsj.com/articles/SB115983941679680708 [https://perma.cc/63F2-NL8E].

26. *See* Charles J. Cooper & Vincent Colatriano, *The Regulatory Authority of the Treasury Department to Index Capital Gains for Inflation: A Sequel*, 35 HARV. J. L. & PUB. POL'Y 487 (2012).

27. *See, e.g.*, Kudlow, *supra* note 2 (claiming that inflation indexing "would spark a wave of prosperity").

28. *See* Editorial, *Presidential Indexation*, *supra* note 1.

All three of these claims were the subject of extensive discussion in 1992.[29] Yet legislative and doctrinal developments in the past quarter century have altered the terms of the debate in important ways. Proponents of the proposal believe that these changes strengthen the legal case for presidential indexation.[30] But closer inspection reveals precisely the opposite. The policy arguments for presidential indexation remain weak, the legal foundations are even shakier than they were in 1992, and it is even more likely that challengers could show that they have standing to bring a lawsuit that stops Treasury from implementing such a regulation.

This Article seeks to puncture the myth and mystique that have come to surround the ill-considered notion of presidential indexation. Our analysis proceeds in three parts. Part I reviews the policy arguments around inflation indexing. While legislative action that takes a comprehensive approach to inflation throughout the Internal Revenue Code might have merit, regulatory action that targets only the tax treatment of capital gains would open a wide door to tax arbitrage. Part II considers whether Treasury has the legal authority to implement indexing via regulation. The Office of Legal Counsel (OLC) roundly rejected this proposition in 1992, and that conclusion is even more emphatic today in light of *Chevron*-related doctrinal developments over the last quarter-century. Part III asks who would have standing to challenge such a regulation. We identify a number of potential plaintiffs—including a Democrat-controlled House, certain states, securities brokers subject to statutory basis reporting rules, and taxpayers whose liability would rise as a result of indexing—who would likely satisfy the standing requirements. In short, the administration prudentially ought not and legally cannot index basis for inflation without an act of Congress. If it attempts to do so via regulation, its action likely will not stand for long.

I. Inflation Indexing: Policy Considerations

The basic policy argument for indexing basis to inflation is easily stated: without any adjustment for inflation, capital gains taxes will impose burdens on investors that are disproportionate to their real returns. To illustrate: imagine that an individual purchased a share of Company C stock for $100 when the first President Bush took office, and that the individual sells the stock for $200 in February 2019. The individual would pay tax on the $100 capital gain—a $20 tax at the top statutory rate.[31] But based on the consumer price index, $100 in January 1989 has the same buying power as $208.73 in February 2019.[32] In

29. *See* Galler, *supra* note 23; Zelenak, *supra* note 23; NYSBA Memorandum, *supra* note 22.

30. *See* Cooper & Colatriano, *supra* note 26.

31. For arithmetic ease, the calculation excludes the 3.8% net investment income tax as well as state income taxes.

32. U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, *CPI Inflation Calculator*, https://www.bls.gov/data/inflation_calculator.htm [https://perma.cc/6ZWB-YR5A]. Some proponents of

inflation-adjusted terms, the individual has suffered a $8.73 loss, not a $100 gain. The fact that basis is not adjusted for inflation causes capital gains taxes to fall on "phantom" gains.

Indexing basis for inflation would eliminate the phantom gains tax. In the example above, an individual who bought stock for $100 in January 1989 would have basis in February 2019 of $208.73. Sale of the stock would thus generate a $8.73 capital loss instead of a $100 gain. The tax treatment of the transaction would reflect the real economic consequences of the transaction.

As a policy matter, the case for indexing basis to inflation is considerably stronger if it is accomplished as part of a comprehensive reform package that addresses and eliminates potential loopholes that indexing otherwise would open. Legislative indexing, moreover, could be coupled with other changes to the Code that offset the revenue and distributional effects of inflation adjustments. Even then, however, the case is not a clear one. More importantly for present purposes, the policy case for indexing collapses if indexing is done via rifle-shot regulatory action, which would generate opportunities for tax arbitrage, reduce revenue significantly, and deliver benefits almost exclusively to those at the top of the income distribution.

A. Inflation Indexing via Comprehensive Legislative Reform

Proposals for inflation indexing via comprehensive legislative reform—specifically trading off higher statutory rates for inflation adjustments—have sparked insightful analyses from scholars and commentators on both sides of the indexing debate.[33] If a shift toward indexing is coupled with an increase in statutory rates applied to the remaining gains, it can be revenue-neutral (or even revenue-positive) and distributionally neutral, as well. Inflation indexing via regulatory action would have none of those characteristics. The case for inflation indexing as part of a comprehensive legislative reform package like this does not translate into an argument for Treasury to go it alone.

Importantly, a number of legislative proposals for inflation indexing lack the above-mentioned characteristics, too. For example, the Capital Gains Inflation Relief Act of 2018, introduced by Senators Ted Cruz and Jim Inhofe

indexing have suggested that the Consumer Price Index (CPI) would be the appropriate measure for calculating inflation. Following the adoption of chained CPI as the relevant inflation metric for most inflation-indexed thresholds as part of the December 2017 tax law, see Pub. L. No. 115-97, § 11002, 131 Stat. 2054 (2017), reliance on unchained CPI for purposes of the capital gains tax would be difficult to defend. Because unchained CPI generally increases at a faster rate than chained CPI, the use of unchained CPI for capital gains tax purposes would effectively mean that wealthier taxpayers get a more favorable inflation metric than working families. On the implications of chained CPI for working families, see Chuck Marr, *Instead of Boosting Working-Family Tax Credit, GOP Tax Bill Erodes It Over Time*, CTR. FOR BUDGET & POL'Y PRIORITIES (Dec. 21, 2017, 10:15 AM), https://www.cbpp.org/blog/instead-of-boosting-working-family-tax-credit-gop-tax-bill-erodes-it-over-time [https://perma.cc/62LH-EDQD].

33. *Compare, e.g.*, Reed Shuldiner, *Indexing the Code*, 48 TAX L. REV. 538 (1993) (pro-indexing), *with* N.Y. STATE BAR ASS'N, TAX SECTION, AD HOC COMM. ON INDEXATION OF BASIS, *Report on Inflation Adjustments to the Basis of Capital Assets* (1990), *reprinted in* 48 TAX NOTES 759 (1990).

this past April, would index basis for inflation but would not apply to interest income and expense.[34] Thus, the arbitrage opportunities described in Section I.B would be possible under the Cruz-Inhofe legislation, as well. Moreover, the Cruz-Inhofe legislation would not raise statutory rates to offset the revenue and distributional effects of inflation indexing. Thus, the main arguments for inflation indexing via comprehensive legislative reform discussed in this Section do not necessarily apply to bills such as the Cruz-Inhofe proposal. Instead, the economic trade-offs can be similar to that for executive action discussed in the next Section.

The primary arguments in favor of inflation indexing in exchange for an increase in tax rates are (1) that it leads to more accurate measurement of income;[35] (2) that—when coupled with an increase in statutory rates on capital gains—it appropriately shifts the tax burden from the "normal" return on capital to the "abnormal" or "extraordinary" return; and (3) that it smooths the taxation of capital income over time.

Start with the first claim: that indexing would lead to a more accurate measurement of income. Imagine that the inflation rate is 10% per year, that the tax rate is 20%, and that *A* and *B* both sell assets for $100 that they bought for $75. Imagine as well that *A* has held his asset for three years and that *B* has held her asset for one year. Without indexing, *A* and *B* each would pay a $5 tax (i.e., 20% x ($100 – $75)). However, all but around $0.18 of *A*'s gain is attributable to inflation,[36] while $7.50 of *B*'s gain is attributable to inflation and the remaining $17.50 of her gain is a real economic return.[37] Taxing *A* the same as *B* arguably represents a mismeasurement of income because *A*'s real income is less than *B*'s. Indexing basis for inflation would ensure that *A*, whose real income on the transaction is close to zero, pays no tax, and that *B* is taxed only on the portion of her gain that reflects a real return.

The second argument for inflation indexing—and, specifically, for indexing basis for inflation while also increasing the statutory rate on capital gains—is that such a shift would lead to the more appropriate tax treatment of abnormal or extraordinary returns (what in finance is sometimes referred to as "alpha"[38]). More of the tax burden would be borne by such extraordinary returns, which should tend to enhance both efficiency and fairness.

Briefly, returns on capital investment can be disaggregated into four elements: (i) the effect of inflation, (ii) the real risk-free return on capital investment, (iii) the risk-based return on capital investment, and (iv) the abnormal or extraordinary return. There are a number of plausible reasons to

34. Capital Gains Inflation Relief Act of 2018, S. 2688, 115th Cong. (2d Sess. 2018).

35. *See* Shuldiner, *supra* note 33, at 548-52.

36. The real gain is calculated as follows: 100 – ($75 x $(1.1)^3$) = $0.18.

37. The real gain is calculated as follows: 100 – ($75 x 1.1) = $17.50.

38. *See* Steven M. Davidoff, *Black Market Capital*, 2008 COLUM. BUS. L. REV. 172, 188 (2008) (defining alpha); Victor Fleischer, *Alpha: Labor Is the New Capital* (2016) (unpublished manuscript) (on file with authors).

conclude that the fourth element—the abnormal return—should bear the brunt of the capital tax burden.[39] First, taxation of abnormal returns will not distort investment decisions because the return represents—by hypothesis—an amount over and above the opportunity cost of capital. As long as the rate on abnormal returns is one-hundred percent or less, an investment generating such a return should still be attractive to the taxpayer. Second, some or all of these abnormal returns on capital may in fact be disguised returns to labor (e.g., returns on startup founders' stock or the carried interest income of private equity and venture capital fund managers). There are both fairness and efficiency benefits to treating this disguised labor income more like other labor income with which it should be categorized. Third, insofar as abnormal returns represent economic rents (e.g., monopoly or oligopoly profits), then a tax on abnormal returns potentially deters socially wasteful rent-seeking behavior.[40]

Indexing basis for inflation and then raising the rates on other returns to capital shifts the tax burden from the inflationary component to the other components. However, the risk-free return appears to have been shrinking and close to zero in recent years. Thus, the additional burden on the risk-free return is probably small.[41] Moreover, taxpayers can—at least under certain conditions—eliminate the burden on the risk-based return through borrowing and hedging.[42] Thus, in significant part, a revenue-neutral combination of

39. There is some evidence that abnormal or extraordinary returns have been increasing relative to normal returns, which makes trading inflation adjustments for higher statutory rates more attractive. This is because taxation of extraordinary returns would then finance more of the inflation adjustment. For instance, looking at corporations, Treasury Department economists have estimated that the risk-free return comprised only twenty-five percent of the total return from capital in 2003-2013, down from forty percent from 1992-2002. *See* Laura Power & Austin Frick, *Have Excess Returns to Corporations Been Increasing over Time?*, U.S. DEP'T OF TREASURY, OFFICE OF TAX ANALYSIS 12 (Nov. 2016), https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-111.pdf [https://perma.cc/CU9M-DQH2] ("Overall, the risk-free return fraction based on economic depreciation averages forty percent during the first half of the analysis and around 25 percent in the second half."). Based on this, the Treasury economists conclude that "excess returns" have been increasing as a share of profits. *Id.* at 7.

40. For important treatments of the taxation of capital, see, among others, Joseph Bankman & Thomas Griffith, *Is the Debate Between an Income Tax and a Consumption Tax a Debate About Risk? Does It Matter?*, 47 TAX L. REV. 377 (1992); Noel B. Cunningham, *The Taxation of Capital Income and the Choice of Tax Base*, 52 TAX L. REV. 17 (1996); Louis Kaplow, *Taxation and Risk Taking: A General Equilibrium Perspective*, 47 NAT'L TAX J. 789 (1994); Deborah H. Schenk, *Saving the Income Tax with a Wealth Tax*, 53 TAX L. REV. 423 (2000); Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax Is Exempt Under a Cash Flow Tax*, 52 TAX L. REV. 1 (1996); and David A. Weisbach, *The (Non)Taxation of Risk*, 58 TAX L. REV. 1, 2-3, 24-25 (2004).

41. One indication of the real risk-free return is the yield on ten-year U.S. Treasury inflation-indexed securities. That figure was less than one percent from April 2011 through September 2018, and below zero for a year-long period in 2012-2013. *See* FED. RESERVE BANK OF ST. LOUIS, *FRED Economic Data: 10-Year Treasury Inflation-Indexed Security, Constant Maturity* (Dec. 17, 2018), https://fred.stlouisfed.org/series/DFII10 [https://perma.cc/M9D7-U6UH]. There is some reason to believe that the long-term drop in the real risk-free rate of return to very low levels may be a continuing phenomenon in the United States and other advanced economies. *See, e.g.*, Lawrence H. Summers, *Reflections on the New Secular Stagnation*, VOXEU (Oct. 30, 2014), https://voxeu.org/article/larry-summers-secular-stagnation [https://perma.cc/G3C3-YSAP].

42. This conclusion tends to be associated with Evsey Domar and Richard Musgrave and their ground-breaking article exploring taxation of risk. *See* Evsey D. Domar & Richard A. Musgrave,

inflation indexing and rate adjustments shifts the tax burden on capital from the inflationary component to the abnormal return, which—as discussed above—appears to be a desirable result.[43]

A final argument for inflation indexing is that it will lead to the more equal tax treatment of the real return to capital investment over time. By contrast, in a system that is not adjusted for inflation, the tax rate on the real return to capital investment will fluctuate with the inflation rate. In general, variance in the tax rate around a mean generates greater distortions than simply maintaining a constant tax rate at the mean.[44] For the most part, this claim holds true across time periods, as well as across taxpayers within the same time period.[45] This argument is tempered by the reality that, with or without inflation indexing, tax rates on capital investment will likely vary over time as the government's revenue needs fluctuate and political conditions change.

These benefits from indexing for inflation are potentially significant, but the case for legislative indexing is not overwhelming. There are some plausible reasons to favor a system with a lower statutory tax rate and no inflation adjustment, as opposed to a system with a higher statutory rate and an inflation adjustment. First, the nonindexation of basis potentially serves as a macroeconomic stabilizer, as it leads to higher effective tax rates when the economy is overheated (and, likewise, lower rates in deflationary environments,

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Proportional Income Taxation and Risk-Taking, 58 Q.J. ECON. 388 (1944). The Domar-Musgrave result is based on the assumptions that the tax rate is flat, losses are fully and immediately deductible, and taxpayers can scale up their investments costlessly. For an extension to environments with multiple tax rates, see David A. Weisbach, *Taxation and Risk-Taking with Multiple Tax Rates*, 57 NAT'L TAX J. 229 (2004).

43. To illustrate how an inflation-adjusted capital gains tax shifts the burden from inflationary returns to extraordinary returns: imagine that the inflation rate is 10%, that the real risk-free and risk-based returns are zero, and that the tax rate on ordinary income is 40%. Further, assume that *A* invests $100 and earns $10, all of which is attributable to inflation, while *B* invests $100 and earns $30, $10 of which is attributable to inflation and $20 of which is attributable to economic rents or disguised labor income.

Now imagine first that capital gains are taxed at a preferential 20% rate and that basis is not indexed. Thus, *A* will pay a tax of 20% x $10 = $2, and *B* will pay a tax of 20% x $30 = $6, for total revenue of $8. If instead we index basis for inflation and eliminate the preferential tax on capital gains (such that gains are now taxed at the 40% ordinary rate), then *A* will pay no tax and *B* will pay a tax of 40% x $20, for total revenue of $8. The second arrangement is likely preferable to the first arrangement on efficiency grounds (because it eliminates the tax disincentive for saving) and on equity grounds (because it eliminates the difficult-to-defend tax preference for economic rents and disguised labor income).

44. This is because the "excess burden" associated with taxation (the loss in welfare in addition to revenue raised) is in proportion to the square of the tax rate. *See* Harry Watson, *Excess Burden*, *in* THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 121 (Joseph J. Cordes et al. eds., 2005). As a result, a capital gains tax system that varies the effective marginal tax rate based on inflation should produce greater excess burden than a system with the same *average* tax rate (and producing the same amount of revenue across time) but without variation based on the rate of inflation. All of the relevant distortions on which tax scholars focus—for instance, the distortion of the consumption-vs.-saving decision and the "lock-in" effect—should be larger in the system without the inflation adjustment.

45. For an illustration in an analogous context, see Ian Ayres & Paul Klemperer, *Limiting Patentees' Market Power Without Reducing Innovation Incentives: The Perverse Benefits of Uncertainty and Non-Injunctive Remedies*, 97 MICH. L. REV. 985, 989-93 (1999).

which often correspond to recessions). Note that this argument is nearly the opposite of the third argument in indexing's favor: the fact that nonindexation leads to differential tax rates over time is potentially a feature and not a bug. But this argument also assumes a correspondence between the inflation rate and the rate of economic growth—a correlation that does not hold in all periods (e.g., the "stagflation" era of the 1970s).

Second, and perhaps most significantly, indexing basis for inflation would raise administrative and compliance costs for taxpayers.[46] This increase in administrative and compliance costs would take several forms. Most basically, indexing basis for inflation would add further steps to the computation of capital gains, as taxpayers or their preparers would have to calculate the percentage change in the relevant inflation index from the date of acquisition to the date of disposition and then multiply basis by that amount—with calculation becoming particularly complicated when costs associated with investments are incurred over time such as via improvements to property.[47] Indexing also would require taxpayers to keep careful track of the date on which they acquired or improved an asset, as the extent of the basis adjustment depends upon the precise holding period. As a New York Bar Association report predicted in 1990, this would likely lead to an increase in disputes between taxpayers and the IRS regarding the precise dates upon which assets were acquired and sold.[48] And, adding to the headache, adjusting basis for inflation would considerably complicate the calculation of deductions for depreciation and amortization, which depend on the basis of the relevant capital asset and would thus fluctuate year to year and month to month depending on the inflation rate.[49]

In light of these complexities, there is perhaps something to be said for our current approach, which affords a lower statutory rate for capital gains as a sort of "rough justice" that partially accounts for inflation while avoiding some of the administrative and compliance costs that the previous paragraph highlights. Whether or not to change the status quo through legislation that indexes basis for inflation and raises the tax rate on capital gains is thus a difficult question. But it is an entirely different policy question than whether inflation indexing should be accomplished via executive action.

46. *See* Leonard E. Burman, *Should Treasury Index Capital Gains?*, TAXVOX (May 10, 2018), https://www.taxpolicycenter.org/taxvox/should-treasury-index-capital-gains [https://perma.cc/8KL3-CFY7].

47. *See id*.

48. *See* NYSBA Report, *supra* note 33.

49. *See* I.R.C. § 167(c) (2018) (linking basis for depreciation purposes to "adjusted basis" in I.R.C. § 1011); I.R.C. § 197 (2018) (amortization); *see also* I.R.C. § 1011(a) (2018) (linking "adjusted basis" to definition of basis in I.R.C. § 1012).

B. Inflation Indexing via Executive Action

The uncertain policy case for indexing basis to inflation falls apart entirely if it only involves adding inflation indexing for capital (and other) gains without any other changes to the tax system. This would be the result if indexing were implemented via executive action rather than legislation. Thus, indexing via executive action—or legislation that made a similar "rifle-shot" change—would be an invitation to arbitrage and would have negative implications for economic efficiency and tax equity.

Proponents of executive indexing echo many of the policy arguments for reducing capital gains rates through rifle-shot, deficit-increasing capital gains tax cuts. First, they argue that capital gains taxes—including taxation of phantom gains—distort the consumption-savings decision. Second, and relatedly, they argue that the taxation of phantom gains discourages capital formation when the inflation rate is positive. Third, they say that the taxation of phantom gains exacerbates the capital gains tax's lock-in effect.

However, reductions in the capital gains taxes, especially via unilateral executive action, come with a set of overwhelming downsides. First, indexing basis without indexing other elements of the Code would generate widespread opportunities for arbitrage. To illustrate one potential arbitrage strategy: Imagine that a taxpayer buys an asset for $100 that is fully financed by a loan. Assume that the real interest rate is zero, that the inflation rate is 10%, and that the nominal interest rate on the loan is 10% as well. One year later, assuming no change in the real value of the asset, the asset will be worth $110 on account of inflation. If basis is indexed for inflation, the taxpayer can sell the asset for $110 and recognize no taxable gain. Assuming that the interest is properly allocable to a trade or business, the taxpayer can claim an interest deduction of $10 with no offsetting gain, despite the fact that the taxpayer is in the same pre-tax position as previously.[50] Put differently, the effort to eliminate the taxation of phantom gains leads to opportunities for the creation of phantom losses.

The phantom loss in the previous example might be offset by a phantom gain for the lender, which realizes income of $10 even though it has gained nothing in real terms. Yet the arrangement still might be advantageous if the lender's tax rate is lower than the borrower's (and especially if the lender is a tax-exempt entity). Similar arbitrage opportunities exist under the current Code because of the preferential tax rate on long-term capital gains, but indexing basis for inflation exacerbates the current Code's flaws.

Arbitrage opportunities involving debt financing might be mitigated through legislation that adopts a comprehensive approach to indexing. For example, if the inflation component of interest were neither deductible to the borrower nor includible to the lender, the arbitrage opportunity laid out above would go away. But no one, to our knowledge, has suggested that Treasury has

50. The text builds on an example in Shuldiner, *supra* note 33, at 643.

the legal authority to implement indexing for interest income and deductions via executive action. And the critical provisions governing the tax treatment of interest do not depend upon the definition of basis in Section 1012.[51] The inevitably partial nature of regulatory indexing provides one powerful reason for Treasury to wait for legislative action rather than attempting to implement indexing unilaterally.

Second, and relatedly, indexing basis for inflation via executive action would add significantly to the federal deficit. According to an estimate based on the Penn Wharton Budget Model, indexing would reduce federal revenues by $102 billion over a decade, before accounting for potential behavioral responses (including the arbitrage opportunities discussed above).[52] Similarly, Leonard Burman at the Tax Policy Center estimates that indexing capital gains would cost in the range of $10 to $20 billion per year, after accounting for behavioral effects.[53] The revenue loss conceivably could be offset by other changes to the Code as part of a broader legislative reform, but indexing basis for inflation via executive action likely would not be coupled with comprehensive changes elsewhere.

Third, indexing basis for inflation via executive action would exacerbate already-widening wealth inequalities. According to the Penn Wharton Budget Model estimate, 86.1% of the tax benefits from indexing would flow to households in the top percentile of the income distribution, and 97.5% of the benefits would flow to households in the top decile.[54] And, as before, these figures do not account for behavioral changes. As a result, the Penn Wharton estimates likely understate the regressivity of the indexing proposal because the arbitrage opportunities are greatest for taxpayers with the highest marginal rates (who also tend to be the taxpayers with the highest incomes).

Fourth, any executive action to index basis for inflation almost certainly would apply to old investments as well as new investments. Insofar as the benefits of indexing flow to taxpayers who already have invested in stock, real estate, and other capital assets, indexing amounts to a windfall based on past decisions rather than an incentive for capital formation.[55] And since the revenue loss today likely would lead to higher distortionary taxes in the future, the net effect is not merely a transfer to the owners of old capital but a reduction in economic efficiency overall.

51. *See, e.g.*, I.R.C. § 61(a) (2018) ("Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited) to . . . [i]nterest . . . ."); *Id.* § 163(a) ("There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness [subject to specific limitations] . . . .").

52. *See* John Ricco, *Indexing Capital Gains to Inflation*, PENN WHARTON BUDGET MODEL (Mar. 23, 2018), http://budgetmodel.wharton.upenn.edu/economic-matters/2018/3/23/indexing-capital-gains-to-inflation [https://perma.cc/K5L8-CKLT].

53. Burman, *supra* note 46.

54. *See* Ricco, *supra* note 52.

55. *See* JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 289 (3d ed. 2004).

Fifth, indexing basis for inflation via executive action would do little to foster capital investment and economic growth—and, in fact, could do the opposite. Even if indexing were accomplished through a permanent legislative fix, it would—at most—result in a modest reduction in the cost of capital.[56] Some or all of that impact would be offset by the "crowding out" of capital investment that would result from an increase in the national debt.[57] And if indexing were accomplished via executive action, it is unlikely that investors would perceive the change to be permanent. A future Democratic administration could easily reverse the move, and—as discussed below—a court might set aside any regulation that allows for indexing. Accordingly, individuals and firms making capital investment decisions today would discount the expected after-tax benefits from indexation by the probability that the regulation would be rescinded by the time they realized gains. Thus, not only would indexing via executive action amount to a windfall for old capital, but it would do little to encourage new capital formation as long as the duration of the policy remained highly uncertain.

Finally, implementing indexing via executive action would effectively "double compensate" investors for inflation. We already have made an adjustment—admittedly, a crude adjustment—to account for phantom gains in the form of the preferential long-term capital gains rate. Indexing basis for inflation while keeping the long-term capital gains tax rate where it is would arguably over-adjust for inflation's effects.

For all these reasons, we think that the policy case for indexing basis to inflation via executive action is quite weak. There is a stronger argument for indexing as part of a revenue-neutral or revenue-positive reform effort that also addresses arbitrage opportunities, incorporates changes elsewhere to offset the regressive distributional effects, and limits the benefit of indexing to new investment. But advocates of regulatory indexing cannot free-ride on the policy arguments for legislative indexing, because comprehensive legislative indexing is a fundamentally different proposition than regulatory indexing. And whatever one thinks of legislative indexing, regulatory indexing is—in our view—irresponsible tax policy.

II. The Flawed Legal Case for Indexing via Executive Action

We have argued that the Treasury Department *ought not* seek to index the capital gains tax via regulatory action. But if Treasury disregards our policy advice, does it have the legal authority to accomplish indexing via regulation? This Part considers the legal foundation for indexing via executive action. We conclude that the Treasury and Justice Departments under the first President

56. Jane G. Gravelle, *Indexing Capital Gains Taxes for Inflation*, CONG. RESEARCH SERV. 14-15 (July 24, 2018), https://fas.org/sgp/crs/misc/R45229.pdf [https://perma.cc/7SMG-QW8Q] (estimating that indexing would reduce the cost of capital net of depreciation by 0.06% to 0.07%, or 6 to 7 basis points).

57. *Id.* at 15.

Bush correctly determined that the legal authority for regulatory indexation simply does not exist. Developments since 1992 have only bolstered that conclusion.

A. Round One: The 1992 Debate

We start by articulating the argument *for* the proposition that Treasury has the legal authority to index basis for inflation via regulation. Section 1012 of the Code, first enacted as part of the Revenue Act of 1918, says that in general, "[t]he basis of property shall be the cost of such property."[58] "Cost," at least according to the proponents of presidential indexation, is an ambiguous term. The *Chevron* doctrine generally applies to agency interpretations of ambiguous statutory language.[59] Courts reviewing agency interpretations under *Chevron* apply a two-step analysis. At step one, courts ask whether the statute is indeed "silent or ambiguous with respect to the specific issue."[60] If the statute speaks clearly, then "that is the end of the matter" under *Chevron*, "for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[61] But if the statute is ambiguous, the court then moves to *Chevron* step two and asks whether the agency's interpretation is "based on a permissible construction of the statute."[62] If so, the court will defer to the agency's view. A Treasury regulation that interpreted "cost" in Section 1012 to mean cost in real terms (i.e., after adjusting for inflation) would be a "permissible construction" and thus would—according to the proponents—pass muster under *Chevron*.

This was the argument that advocates of presidential indexation made during the first Bush Administration,[63] and this is the argument that OLC roundly rejected.[64] OLC's analysis started with the "fundamental canon of statutory construction" that unless otherwise defined, the words of a statute take on their "ordinary, contemporary, common meaning."[65] OLC consulted dictionaries from the time of the Revenue Act of 1918 as well as more recent editions and observed that the first and most common meaning" of the term "cost" is "price paid."[66] In "normal usage," according to OLC, "price paid" means price in nominal—as opposed to inflation-adjusted—terms.[67]

OLC's analysis did not rest entirely—or even primarily—on dictionary definitions of "cost." OLC also looked to contemporaneous Treasury pronouncements, subsequent court decisions, other Internal Revenue Code

58. I.R.C. § 1012(a) (2018).
59. Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984).
60. *Id*. at 843.
61. *Id*. at 842-43.
62. *Id*. at 843.
63. *See* Cooper Memorandum, *supra* note 16.
64. Op. O.L.C., *supra* note 23.
65. *Id*. at 140 (quoting Perrin v. United States, 444 U.S. 37, 42 (1979)).
66. *Id*. at 141-43.
67. *Id*. at 143.

provisions, interpretive canons, and legislative history to support its conclusion that Treasury lacks the authority to index basis for inflation via executive action. As for the contemporaneous Treasury pronouncements, OLC noted that Treasury regulations pursuant to the Revenue Act of 1913 had interpreted the term "cost" to mean "actual price paid."[68] Congress in 1918 legislated against that regulatory background and, as OLC noted, has continued to reenact the tax laws "without disturbing Treasury's interpretation of 'cost.'"[69] OLC also pointed to a long line of court decisions interpreting the word "cost" to mean the amount paid, without adjustment for inflation.[70] OLC further observed that Section 1016 of the Code includes more than two dozen specific adjustments to basis, but no adjustment for inflation. Further, under a common canon of interpretation, OLC noted, "the expression of one thing is the exclusion of another."[71] Relatedly, OLC emphasized that Congress has enacted specific provisions elsewhere in the Code that provide for inflation adjustments in other contexts (e.g., indexing the bracket thresholds, the amount of the standard deduction, and the amount of personal exemptions).[72] "Again," according to OLC, "we would expect that if Congress intended that asset costs be indexed for the calculation of capital gains, it would have done so explicitly and in the same manner as these many other indexing provisions."[73]

As for the legislative history of the capital gains provisions, OLC noted that Congress in 1918 "must have been extremely well aware of the problems of inflation when it adopted the Act" because the inflation rate at the time was eighteen percent.[74] Lawmakers at the time recognized that the capital gains tax would burden taxpayers who held assets that had appreciated in nominal but not real terms. Nonetheless, Congress rejected proposals that would have offset this burden by limiting the capital gains tax.[75] In subsequent legislation, Congress set the tax rate on capital gains below the tax rate on other items of income precisely because lawmakers recognized that some capital gains reflected phantom gains due to inflation.[76] Moreover, Congress repeatedly reenacted the tax laws without overriding Treasury's interpretation of "cost"—a fact that, in light of the familiar

68. Op. O.L.C., *supra* note 23, at 144 (quoting T.D. 2005, 16 Treas. Dec. Int. Rev. Ill, 112 (1914), restated, T.D. 2090, 16 Treas. Dec. Int. Rev. 259, 272-73 (1914)).

69. *Id*. at 144 n.16.

70. *See id.* at 144-46 (collecting sources).

71. *Id*. at 147. This is known as the *expressio unius* canon of interpretation, and it represents "the principle that when a statutory provision explicitly expresses or includes particular things, other things are implicitly excluded." JOHN F. MANNING & MATTHEW C. STEPHENSON, LEGISLATION AND REGULATION: CASES AND MATERIALS 279 (3d ed. 2017).

72. *See id*. at 147-48 (citing, inter alia, I.R.C. §§ 1(f), 63(c)(4), 151(d)(4)).

73. *Id.* at 148.

74. *Id*. at 152-53.

75. *See id*.

76. *See id*. at 155-56 (citing, inter alia, S. Rep. No. 1263, 95th Cong., 2d Sess. 192 (1978)).

legislative reenactment doctrine, served to bolster OLC's conclusion.[77] For these reasons and others, OLC concluded that "the term 'cost' as used in section 1012 is not ambiguous" and that it unambiguously disallows indexing basis for inflation.[78]

B. Round Two

OLC's opinion did not settle the indexing question, however. In 2012, two of the three authors of the 1992 memo that prompted the initial OLC opinion, Charles Cooper and Vincent Colatriano, published a "sequel" in which they recapitulated their earlier argument.[79] Cooper and Colatriano pointed to three developments that, in their view, "have strengthened support" for the proposition that Treasury has the legal authority to index basis for inflation via regulatory action.[80]

1. *Verizon Communications* and the Meaning of "Cost"

The first of these developments, chronologically, was the Supreme Court's 2002 decision in a non-tax case, *Verizon Communications, Inc. v. Federal Communications Commission*.[81] That case involved the FCC's interpretation of the Telecommunications Act of 1996, which allowed new entrants to pay "just and reasonable" rates for access to local telephone networks controlled by incumbent Bell System companies. Section 252(d)(1) of the 1996 law mandates that "the just and reasonable rate . . . shall be . . . based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element."[82] The FCC, in a 1997 rule, interpreted the term "cost" to mean the "forward-looking economic cost" to the Bell System company, rather than the "historical" cost incurred by the company.[83] Verizon and other Bell System carriers challenged the FCC's interpretation as an unreasonable reading of the new Section 252(d)(1).

The Supreme Court, in an opinion by Justice Souter, rejected Verizon's argument. That opinion is potentially relevant to the controversy over indexing because of Justice Souter's extensive discussion of the meaning of the word "cost" in the Telecommunications Act's "just and reasonable rate" provision. Central to Justice Souter's analysis is a 1944 Supreme Court decision, *Federal Power Commission v. Hope Natural Gas Co.*,[84] which involved the interpretation

77. *See id*. at 144 n.16 (citing, inter alia, Cottage Sav. Ass'n v. Comm'r, 499 U.S. 554, 560-62 (1991)).
78. Op. O.L.C., *supra* note 23, at 158.
79. *See* Cooper & Colatriano, *supra* note 26.
80. *Id.* at 490.
81. 535 U.S. 467 (2002).
82. 47 U.S.C. § 252(d)(1) (2018).
83. *Verizon Communications*, 535 U.S. at 495-96.
84. 320 U.S. 591 (1944).

of similar "just and reasonable" rate language in the Natural Gas Act. The Court in *Hope Natural Gas* held that "the fixing of 'just and reasonable' rates . . . involves a balancing of the investor and consumer interests"[85] and need not be tethered to the "original cost" incurred by a utility.[86]

We quote Justice Souter's opinion at length because of the significance that indexing proponents assert that it holds in the latest round of the indexing debate. According to Justice Souter:

> The incumbents . . . contend that "cost" in the statute refers to "historical" cost, which they define as "what was in fact paid" for a capital asset . . . . The incumbents 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 . . . .
>
> What is equally important is that the incumbents' plain-meaning argument ignores the statutory setting in which the mandate to use "cost" in valuing network elements occurs. First, the Act uses "cost" as an intermediate term in the calculation of "just and reasonable rates," and it was the very point of *Hope Natural Gas* that regulatory bodies required to set rates expressed in these terms have ample discretion to choose methodology. Second, it would have been passing strange to think Congress tied "cost" to historical cost without a more specific indication, when the very same sentence that requires "cost" pricing also prohibits any reference to a "rate-of-return or other rate-based proceeding," each of which has been identified with historical cost ever since *Hope Natural Gas* was decided.
>
> 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 . . . . Words like "cost" give rate setting commissions broad methodological leeway; they say little about the method employed to determine a particular rate. We accordingly reach the conclusion . . . that nothing in § 252(d)(1) plainly requires reference to historical investment when pegging rates to forward-looking "cost."[87]

Cooper and Colatriano argue that *Verizon Communications* provides a powerful boost to the argument that Treasury has the legal authority to index the capital gains tax via regulation. In their view, "the Court's decision wholly eliminates the fundamental premise of the OLC's dictionary-driven 'plain-meaning' analysis in its 1992 opinion."[88] On further reflection, however, *Verizon*

85. *Id.* at 603.

86. *See id*. at 596-600, 605-07.

87. *Verizon Communications*, 535 U.S. at 497-501 (citations and some internal quotation marks omitted).

88. Cooper & Colatriano, *supra* note 26, at 504.

Communications does little to advance the argument in favor of presidential indexation for two reasons.

First, while *Verizon Communications* confirms that the dictionary definition of "cost" is not controlling, that proposition does little to disturb OLC's analysis, which was not (contra Cooper and Colatriano) "dictionary-driven." Dictionaries—contemporaneous and current—were only one among the many categories of sources that OLC consulted in concluding that "cost" in Section 1012 does not mean inflation-adjusted price. As noted above, OLC's analysis rested as well on contemporaneous Treasury regulations, subsequent court decisions, interpretive canons, and legislative history, all of which bolstered OLC's determination that Section 1012 does not allow for inflation indexing.

Second, the Court's opinion in *Verizon Communications* is entirely consistent with—and, indeed, supportive of—OLC's view that the meaning of a statutory provision depends upon context above all else. Indeed, the Court in *Verizon Communications* said that the "statutory setting" is "equally important" as common usage in understanding the meaning of the term "cost."[89] And the statutory settings of the term "cost" in Section 1012 of the Internal Revenue Code and Section 252(d)(1) of the Telecommunications Act could not be more different. As for the former, the term "cost" in Section 1012 is part of a statute that provides dozens of specific adjustments to basis (but no adjustment for inflation) as well as several inflation-indexing provisions (but no inflation-indexing provision for basis). As for the latter, the term "cost" in Section 252(d)(1) is part of the definition of a statutory term that had long been understood to mean something *other* than historical cost. While Cooper and Colatriano repeatedly quote Justice Souter's statement that "cost" is a "chameleon,"[90] they overlook the fact that chameleons change their colors based on their environment, and the words "cost" in Sections 1012 and 252(d)(1) have very different statutory backgrounds.

To the extent that *Verizon Communications* stands for the proposition that "cost" does not always mean "price paid," the proposition is itself banal. When Blaise Pascal said that "[k]ind words do not cost much, yet they accomplish much,"[91] he of course was not referring to the cost of kind words in historical dollars (or francs). So, too, when W.E.B. Du Bois said that "[t]he cost of liberty is less than the price of repression,"[92] and when Winston Churchill said that "[w]e shall defend our island, whatever the cost may be."[93] Insofar as *Verizon Communications* confirms that the meaning of "cost" is contextual, it confirms what was already known. And, as the OLC memo explained in detail, the context

89. *Verizon Communications*, 535 U.S. at 499.

90. *See* Cooper & Colatriano, *supra* note 26, at 502-03, 523.

91. BLAGO KIROV, BLAISE PASCAL: QUOTES & FACTS 27 (2016).

92. WILLIAM EDWARD BURGHARDT DU BOIS, JOHN BROWN 383 (1909).

93. THE WORLD'S GREAT SPEECHES 439 (Lewis Copeland et al. eds., 1999) (quoting a speech delivered by Winston Churchill on June 4, 1940).

surrounding the word "cost" in Section 1012 suggests that no inflation adjustment is permitted.

2. *Brand X* and the Implications of Precedent

A second development that Cooper and Colatriano argue is significant is the Supreme Court's 2005 decision in *National Cable & Telecommunications Association v. Brand X Internet Services*, a case that—like *Verizon Communications*—involved the FCC's interpretation of the Telecommunications Act of 1996.[94] Another provision of that law subjects providers of "telecommunications services" to common carrier regulations.[95] At issue in *Brand X* was whether cable modem services fall within the statutory definition of "telecommunications services." In a 2000 decision, the Ninth Circuit had answered that question in the affirmative.[96] In 2002, however, the FCC ruled that cable modem services are not "telecommunications services" within the meaning of the statute. The Ninth Circuit thereafter declined to apply *Chevron* deference to the agency's interpretation and struck down the 2002 FCC ruling. One of the questions before the Supreme Court was whether the Ninth Circuit should have reviewed the FCC's 2002 ruling under the *Chevron* framework notwithstanding the fact that the agency ruling contravened the Ninth Circuit's prior statutory interpretation.[97]

The Supreme Court said that the Ninth Circuit should have given *Chevron* deference to the FCC. Justice Thomas, who wrote the majority opinion, announced what has since become known as the *Brand X* doctrine: "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."[98] In other words, if a court at time 1 says that a statute means *P* and an agency at time 2 says that the statute means *Q*, a court at time 3 should defer to the agency's interpretation (assuming that the interpretation is otherwise *Chevron*-eligible) unless the court at time 1 had said that the statute *unambiguously* means *P*.

According to Cooper and Colatriano, "*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."[99] That conclusion is dubious for two reasons. First, the Supreme Court at least arguably *has* held that Section 1012 is unambiguous. Second, even if the Supreme Court had not addressed the

94. 545 U.S. 967 (2005).
95. 47 U.S.C. § 153(44) (2018).
96. *See* AT&T Corp. v. Portland, 216 F.3d 871, 877-80 (9th Cir. 2000).
97. Brand X Internet Serv. v. F.C.C., 345 F.3d 1120 (9th Cir. 2003).
98. *Brand X Internet Serv.*, 545 U.S. at 982.
99. Cooper & Colatriano, *supra* note 26, at 490.

question, that fact alone would not allow Treasury to claim *Chevron* deference for the novel interpretation of Section 1012 that Cooper and Colatriano urge Treasury to adopt.

On the first point, the most relevant Supreme Court case construing Section 1012 is *Koshland v. Helvering*, a 1936 decision.[100] The taxpayer in *Koshland* bought preferred stock in Columbia Steel Corporation in the mid-1920s for roughly $91 per share. For several years, Columbia Steel paid a dividend to its shareholders in the form of common stock. Then, in 1930, Columbia Steel redeemed the preferred stock for $105 per share. The taxpayer took the position that he had a gain of approximately $14 per share ($105 minus $91). The Commissioner, citing Treasury regulations, argued the taxpayer's basis in the preferred stock should be reduced by the value of the common stock that he received as a dividend, such that the gain per share would be greater than $14.[101]

The Supreme Court, in an opinion by Justice Owen Roberts, rejected the Commissioner's position and ruled for the taxpayer. Again, the Supreme Court's specific language is relevant, so we quote it at length:

> The property disposed of was the petitioner's preferred stock. In plain terms the statute directs the subtraction of its cost from the proceeds of its redemption, if the latter sum be the greater. But we are told that Treasury Regulations long in force require an allocation of the original cost between the preferred stock purchased and the common stock received as dividend. And it is said that while no provision of the statute authorizes a specific regulation respecting this matter, the general power conferred by the law to make appropriate regulations comprehends the subject. Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts . . . . *But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation.* Congress having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost.[102]

Concededly, *Koshland* does not address inflation specifically. But it does say that the predecessor to Section 1012 is "unambiguous," that its instructions are "plain," and that Treasury has "no power to amend it by regulation."[103] These statements arguably could support the conclusion that even after *Brand X*, Section 1012 is an instance in which the agency is hemmed in by judicial

100. 298 U.S. 441 (1936). The relevant provision at the time was Section 113(a) of the Revenue Act of 1928, which for all intents and purposes is identical to the current Section 1012(a).

101. *See* Comm'r v. Koshland, 81 F.2d 641, 641-42 (9th Cir. 1936), rev'd, 298 U.S. 441.

102. 298 U.S. at 446-47 (emphasis added).

103. *Koshland*, 298 U.S. at 446-47.

precedent. They certainly undermine any claim based on *Verizon Communications* that "cost" in Section 1012 is an infinitely elastic term.

Other cases provide additional support for the view that Treasury's hands are tied. The Seventh Circuit said in a 1939 case that it "must follow" from statutory language and Supreme Court precedent that gain from the sale of securities should be calculated based on the "number of dollars," notwithstanding changes in the gold content of U.S. currency.[104] The Fifth Circuit, for its part, has said that it is "frivolous" to argue that inflationary gain can be excluded from income, though it said that in the context of interest income rather than the sale of a capital asset.[105] And the Ninth Circuit has held (albeit in a nonprecedential opinion) that the claim that the capital gains provisions allow for inflation indexing is "meritless."[106]

An even more fundamental flaw in Cooper and Colatriano's interpretation of *Brand X* is that *Brand X* nowhere says what they want it to say: that "[b]ecause no previous judicial decisions conclusively hold that the term 'cost' unambiguously precludes indexation, . . . a Treasury reinterpretation of cost to provide for indexation would be entitled to *Chevron* deference."[107] All that *Brand X* establishes is that a prior judicial interpretation of the statute in question does not preclude *Chevron* deference unless the court holds that the statute is unambiguous; there remains the question of whether the agency is entitled to *Chevron* deference in the first instance. Put differently, even if no court has held that the statute unambiguously means *P*, an agency interpretation of the statute to mean *Q* will not receive *Chevron* deference if, in fact, the statute unambiguously means *P*.

Thus, if OLC's analysis was correct in 1992 (as we believe it was), *Brand X* changes nothing. In fact, the OLC opinion relied on legal arguments entirely consistent with the holding in *Brand X*, and it did not argue that the longstanding interpretation was unchangeable simply because it was longstanding. If anything, *Brand X* provides an additional argument in favor of OLC's conclusion that OLC itself did not make[108]: that under the *Brand X* standard, the Court's decision in *Koshland* removes the interpretation of "cost" in Section 1012 from Treasury's discretion.

104. Bates v. United States, 108 F.2d 407, 411 (7th Cir. 1939).

105. *See* Stelly v. Comm'r, 804 F.2d 868, 870 (5th Cir. 1986).

106. *See* Oswald v. IRS, No. 88-6153, 1989 U.S. App. LEXIS 23686, at *1 (9th Cir. Oct. 11, 1989) (describing as "meritless" the claim that the capital gains provisions allow for inflation adjustment).

107. Cooper & Colatriano, *supra* note 26, at 490.

108. OLC, in fact, never cited *Koshland* in its 1992 opinion—a fact to which we attach little significance other than that the Office was synthesizing an extraordinary amount of legal material under time pressure.

3. *Mayo Foundation* and the Evolution of *Chevron*

The third development highlighted by Cooper and Colatriano is the Supreme Court's 2012 decision in *Mayo Foundation for Medical Education & Research v. United States*.[109] In *Mayo Foundation*, the Court cleared away lingering confusion as to whether the *Chevron* framework applies to tax regulations. It does. "The principles underlying our decision in *Chevron* apply with full force in the tax context," Chief Justice Roberts wrote for a unanimous Court.[110] But OLC assumed in its 1992 opinion that *Chevron* applies to tax; *Mayo Foundation* simply confirms what OLC took for granted.

The "principles underlying . . . *Chevron*," moreover, do not command application of the two-step *Chevron* framework in all cases involving agency interpretations of statutes. Over the last quarter-century, the Court has retreated from *Chevron* in important respects. This retreat began with the Court's 1994 decision in *MCI Telecommunications Corp. v. AT&T Co.*[111] and culminated in its 2015 decision in *King v. Burwell*,[112] with several other significant steps along the way. The basic idea across this line of cases is that linguistic ambiguity on its own does not trigger *Chevron* deference. Instead, courts must consult contextual clues and common sense before concluding that Congress has delegated a decision of "vast economic and political significance" to an agency.[113]

Start with *MCI*. The case involved Section 203 of the Communications Act of 1934, which requires communications common carriers to file tariffs (i.e., price schedules) with the FCC and allows the FCC to "modify" any tariff filing requirement "for good cause shown."[114] In 1992, the FCC issued an order exempting all long-distance carriers other than AT&T from the tariff filing requirements. The question before the Supreme Court was whether the FCC's statutory authority to "modify" tariff filing requirements allowed the Commission to exempt a large category of carriers from those requirements altogether. The Court concluded that the FCC had exceeded the statute's bounds, rebuffing the Commission's request for *Chevron* deference. As Justice Scalia wrote for a majority of the Court:

> Rate filings are, in fact, the essential characteristic of a rate-regulated industry. It is highly unlikely that Congress would leave the determination of whether an industry will be entirely, or even substantially, rate-regulated to agency discretion—and even more unlikely that it would achieve that through such a subtle device as permission to 'modify' rate-filing requirements . . . . What we

109. 562 U.S. 44 (2012).
110. *Id*. at 55.
111. 512 U.S. 218 (1994).
112. 135 S. Ct. 2480 (2015).
113. *See* Util. Air Regulatory Grp. v. EPA, 134 S. Ct. 2427, 2444 (2014).
114. 47 U.S.C. § 203(a)-(b) (2018).

> have here, in reality, is a fundamental revision of the statute . . . . That may be a good idea, but it was not the idea Congress enacted into law in 1934.[115]

The key word in *MCI*—"modify"—is, of course, not the same as the contested term "cost" in Section 1012. Nonetheless, much of Justice Scalia's analysis in *MCI* can be applied to the indexing debate. Whether to adjust basis for inflation is no doubt an "essential characteristic" of a capital gains tax, and it seems highly unlikely that Congress would have delegated the decision of whether or not to index to the Treasury Department with such a subtle device as the word "cost." Insofar as *MCI* indicates a reluctance on the part of courts to accord *Chevron* deference to regulations that make a "fundamental revision to the statute," *MCI* suggests that Treasury would face an uphill battle in securing *Chevron* deference for a regulation that indexes basis for inflation.

MCI's suggestion that some questions are simply too fundamental to the statutory scheme to merit *Chevron* deference drew further support six years later in *Brown & Williamson*. The question in that case was whether the Food, Drug, and Cosmetic Act, which authorizes the FDA to regulate "drugs," thereby gives the agency authority over tobacco products.[116] The FDA claimed that it did and argued that its 1996 regulations restricting the sale and distribution of tobacco products were entitled to *Chevron* deference. The Supreme Court rejected that argument for a number of reasons, one of which was the sheer significance of the prospect of FDA regulation of tobacco. As Justice O'Connor wrote for a sharply divided Court, "we must be guided to a degree by common sense as to the manner in which Congress is likely to delegate a policy decision of such economic and political magnitude to an administrative agency."[117] She went on to say that "[a]s in *MCI*, we are confident that Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion."[118]

Following *MCI* and *Brown & Williamson*, scholars of administrative law—led by Cass Sunstein—recognized these cases as articulating what would come to be known as the "major questions" doctrine.[119] And the Supreme Court, for its part, continued to rely on the "major questions" rationale in a series of decisions denying *Chevron* deference to agency interpretations. In the 2006 case *Gonzales v. Oregon*,[120] the Court considered the Attorney General's attempt to "deregister" physicians who participated in a state-sanctioned physician-assisted

115. *MCI*, 512 U.S. at 231-32.

116. 21 U.S.C. § 321(g). Also at issue was whether the FDCA authorizes the FDA to regulate cigarettes and smokeless tobacco as drug delivery "devices."

117. FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000).

118. *Id.* at 160.

119. *See* Cass R. Sunstein, Chevron *Step Zero*, 92 VA. L. REV. 187, 236-42 (2006); *see also* Abigail R. Moncrieff, *Reincarnating the "Major Questions" Exception to* Chevron *Deference as a Doctrine of Noninterference (or Why* Massachusetts v. EPA *Got It Wrong)*, 60 ADMIN. L. REV. 593 (2008) (elaborating on the major questions doctrine).

120. 546 U.S. 243 (2006).

suicide program. While the Controlled Substances Act gives the Attorney General the power to revoke a physician's registration if the Attorney General determines that the physician's registration is "inconsistent with the public interest,"[121] the Court concluded that the Attorney General's actions exceeded the scope of his statutory ambit. Citing *Brown & Williamson*, Justice Kennedy wrote for a majority of the Court that "[t]he idea that Congress gave the Attorney General such broad and unusual authority through an implicit delegation in the CSA's registration provision is not sustainable."[122] He went on to say that "[t]he importance of the issue of physician-assisted suicide . . . makes the oblique form of the claimed delegation all the more suspect."[123]

The "major questions" rationale returned eight years later in *Utility Air Regulatory Group v. EPA*.[124] Among the issues in *Utility Air Regulatory Group* was whether the Clean Air Act allows EPA to regulate greenhouse gas emissions from "millions of small sources—including retail stores, offices, apartment buildings, shopping centers, schools, and churches."[125] The Court declined to accord *Chevron* deference to the agency's assertion of regulatory authority over these small sources. "When an agency claims to discover in a long-extant statute an unheralded power to regulate a significant portion of the American economy," Justice Scalia wrote for the majority, "we typically greet its announcement with a measure of skepticism."[126] Citing *Brown & Williamson*, he added: "We expect Congress to speak clearly if it wishes to assign to an agency decisions of vast economic and political significance."[127]

Most recently, in *King v. Burwell*,[128] the Court invoked the "major questions" doctrine in deciding whether taxpayers were entitled to premium assistance credits for purchasing health insurance on federally established exchanges under the Affordable Care Act. Although the Court ultimately sided with the government's argument, it declined to accord *Chevron* deference to Treasury's regulation on point. As Chief Justice Roberts wrote for the majority:

> When analyzing an agency's interpretation of a statute, we often apply the two-step framework announced in *Chevron* . . . . This approach is premised on the theory that a statute's ambiguity constitutes an implicit delegation from Congress to the agency to fill in the statutory gaps. In extraordinary cases, however, there may be reason to hesitate before concluding that Congress has intended such an implicit delegation. This is one of those cases. The tax credits are among the Act's key reforms, involving billions of dollars in spending each year and affecting the price of health insurance for millions of people. Whether those credits are

121. 21 U.S.C. § 824(a)(4) (2018).
122. *Gonzales*, 546 U.S. at 267.
123. *Id*.
124. 134 S. Ct. 2427 (2014).
125. *Id*. at 2446.
126. *Id*. at 2444 (internal quotation marks omitted).
127. *Id*. (internal quotation marks omitted).
128. 135 S. Ct. 2480 (2015).

> available on Federal Exchanges is thus a question of deep economic and political significance that is central to this statutory scheme; had Congress wished to assign that question to an agency, it surely would have done so expressly.[129]

In our view, the advent of the major questions doctrine is the most significant post-1992 doctrinal development bearing upon the legality of the presidential indexation proposal. And it does not bode well for the idea. While the exact boundaries of the major questions doctrine remain unclear, there are compelling arguments that the decision to index basis for inflation or not should qualify as a major question. This adds yet another reason to believe that Treasury does not have discretion to choose to index basis for inflation.

First, the sheer magnitude of the change counsels against *Chevron* deference. While the major questions doctrine turns on more than dollars and cents, the fact that the change would potentially come with a price tag of $10 billion to $20 billion per year, according to analysts at Penn Wharton and the Tax Policy Center, strengthens the case that this question is "major."[130] Another way to look at this is in terms of the change in the tax rate on gains. Analyzing IRS data from 2012, Leonard Burman at the Tax Policy Center estimates that one-third of gains that year represented "inflationary" gains. Thus, if gains had been indexed to inflation, the effective tax rate would have been cut by one-third that year.[131]

The oblique nature of the putative delegation offers a second argument against *Chevron* deference. Application of the major questions doctrine depends not only on the magnitude of the issue but also on the words that Congress uses. Where the language that supposedly delegates vast authority to the agency is "subtle" or "cryptic,"[132] courts hesitate before concluding that those words effect an extraordinary transfer of power. As Justice Scalia wrote for the Court in *Whitman v. American Trucking Association*, citing to both *MCI* and *Brown & Williamson*: "Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms . . . . [I]t does not, one might say, hide elephants in mouseholes."[133] And as we have emphasized, indexing basis for inflation would indeed be an elephant.

Third, the "common sense" approach to *Chevron* deference adopted by the majority in *Brown & Williamson* cuts against claims made by presidential indexation's proponents.[134] It simply belies common sense to conclude that Congress would delegate to Treasury what is essentially[135] a binary choice: cut

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129. *Id*. at 2488-89 (citations and internal quotation marks omitted).

130. *See supra* notes 52-53 and accompanying text.

131. Burman, *supra* note 46.

132. *See* MCI Telecomm. Corp. v. AT&T Co., 512 U.S. 218, 231-32 (1994); FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000).

133. 531 U.S. 457, 468 (2001).

134. *Brown & Williamson*, 529 U.S. at 133.

135. Treasury presumably would—in the view of the pro-presidential indexation camp—have some leeway to choose among possible inflation measures. *See supra* note 32. Still, its choice

the effective tax rate on capital gains by one-third or not at all. And it especially strains credulity to think that Congress would want Treasury to have this choice with respect to capital gains but not to interest, given the gaming opportunities that emerge when indexing applies to one and not the other.

Finally, it is worth noting that the Court's "major questions" precedents all pre-date the retirement of Justice Anthony Kennedy and the confirmation of Brett Kavanaugh to the bench. And Kavanaugh, as a D.C. Circuit judge, embraced an especially robust view of the major questions doctrine.[136] In a dissent from the denial of rehearing en banc in a case involving the FCC's net neutrality order, then-Judge Kavanaugh argued that the major questions (or "major rules") doctrine should operate as a limit not only on *Chevron* deference but on agency rulemaking authority. In his view, "while the *Chevron* doctrine *allows* an agency to rely on statutory ambiguity to issue ordinary rules, the major rules doctrine *prevents* an agency from relying on statutory ambiguity to issue major rules."[137]

The difference between the Court's articulation of the "major questions" doctrine in the line of cases culminating in *King* and Kavanaugh's "major rules" variant is subtle but significant. Applied to inflation indexing, the Supreme Court's major questions doctrine suggests that Treasury would not receive *Chevron* deference for its interpretation of Section 1012 if inflation indexing is "a question of deep economic and political significance that is central to th[e] statutory scheme."[138] But Treasury still might argue for a lesser level of deference,[139] or might argue that its reading of the statute is simply the best interpretation of the language. Then-Judge Kavanaugh's framing of the "major rules" doctrine suggests that Treasury would have to surmount a higher hurdle: it would have to show not only that its interpretation of Section 1012 is the best, but also that Congress has "*clearly* authorize[d] the agency" to implement inflation indexing.[140]

Kavanaugh, to be sure, is only one Justice on a nine-member Court. But he is not the only one of the nine to advocate for a narrow view of *Chevron*'s scope.

set would be severely limited to the status quo of non-indexation and a number of indexing alternatives clustered quite close to each other.

136. *See* Jeffrey Pojanowski, *Cabining the* Chevron *Doctrine the Kavanaugh Way*, LAW & LIBERTY (June 12, 2017), https://www.lawliberty.org/2017/06/12/cabining-the-chevron-doctrine-the-kavanaugh-way [https://perma.cc/MP93-LS9F]; Christopher Walker, *Judge Kavanaugh on Administrative Law and the Separation of Powers*, SCOTUSBLOG (July 26, 2018), http://www.scotusblog.com/2018/07/kavanaugh-on-administrative-law-and-separation-of-powers [https://perma.cc/FP3S-DJM4].

137. U.S. Telecomms. Ass'n v. FCC, 855 F.3d 381, 419 (D.C. Cir. 2017) (Kavanaugh, J., dissenting from denial of reh'g en banc) (emphasis in original).

138. *King*, 135 S. Ct. at 2488-89 (citation omitted).

139. *Cf.* Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944) (stating that an agency's interpretations, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance," with the "weight" of the agency's view based on "all those factors which give it power to persuade").

140. U.S. Telecomms. Ass'n, 855 F.3d at 419 (Kavanaugh, J., dissenting from denial of reh'g en banc).

Justice Thomas has complained of the Executive Branch "exploit[ing] our practice of deferring to agency interpretations of statutes."[141] Justice Gorsuch, while a Tenth Circuit judge, warned that *Chevron* could "permit executive bureaucracies to swallow huge amounts of core judicial and legislative power and concentrate federal power in a way that seems more than a little difficult to square with the Constitution of the framers' design."[142] Chief Justice Roberts, though slightly more muted in his criticism of *Chevron*, has expressed concern over "the danger posed by the growing power of the administrative state."[143] Justice Breyer has been a *Chevron* skeptic from the start, writing more than thirty years ago (while he was still a First Circuit judge) that "[i]f taken literally," *Chevron* "suggests a greater abdication of judicial responsibility to interpret the law than seems wise."[144]

In sum, the argument that an inflation indexing regulation would receive *Chevron* deference is not only at odds with existing doctrine but also in tension with the judicial zeitgeist—which at the moment is decidedly anti-*Chevron*. Even Justices who might be ideologically sympathetic to inflation indexing are likely to greet Treasury's assertion of interpretive authority with skepticism. While Cooper and Colatriano write that post-1992 judicial developments "remove[] any doubt as to the application of *Chevron* to judicial review of Treasury regulations interpreting the Code," we believe that Treasury's potential bid for *Chevron* deference to an inflation indexing regulation is, if anything, even more of a long shot today than it was a quarter century ago.[145]

III. Standing to Challenge an Inflation Indexing Regulation

The analysis above leads us to conclude that Treasury lacks the legal authority to index the capital gains tax for inflation via regulatory action. But what if it tried? Would anyone have standing to challenge Treasury's regulation in court?

Commentators considered this question during the 1992 debate and—for the most part—answered it in the negative. The *Wall Street Journal* editorial board, in advocating for the proposal, said that it was "unlikely that anyone would have standing to sue to block indexing."[146] Lawrence Zelenak, though sharply critical of the idea, acknowledged that "[d]espite the invalidity of regulatory indexing, indexing would probably be immune from judicial

141. Michigan v. EPA, 135 S. Ct. 2699, 2713 n.1 (2015) (Thomas, J., concurring).

142. Gutierrez-Brizuela v. Lynch, 834 F.3d 1142, 1149 (10th Cir. 2016) (Gorsuch, J., concurring).

143. City of Arlington v. FCC, 569 U.S. 290, 315 (2013) (Roberts, C.J., dissenting).

144. Stephen Breyer, *Judicial Review of Questions of Law and Policy*, 38 ADMIN. L. REV. 363, 381 (1986).

145. Cooper & Colatriano, *supra* note 26, at 500.

146. *See* Editorial, *Presidential Indexation*, *supra* note 1, at A14.

challenge."[147] He reasoned that "[a]bsent deflation, indexing could work only to the advantage of particular taxpayers, and without a disadvantaged taxpayer there would almost certainly be no one with standing to challenge the new regulation."[148] Harry Gourevitch of the Congressional Research Service similarly concluded that "it is doubtful a private plaintiff would be able to gain access to a Federal court to challenge the lawfulness of the regulation," though Gourevitch noted the possibility that a member of Congress might have standing to sue on the theory that the executive action "nullified his voting power."[149]

Even absent standing to challenge, Treasury would be acting contrary to statute if it were to unilaterally index basis to inflation, and that should be reason alone for Treasury not to pursue this course. In addition, we are more sanguine about the possibility of a successful challenge in court. At least four types of plaintiffs plausibly have standing to sue in the event that Treasury tried to implement inflation indexing via executive action. First, House Democrats could potentially claim legislative standing based on recent Supreme Court and D.C. federal district court decisions recognizing the right of lawmaking bodies to sue for certain separation-of-powers violations. Second, states that have tied their own income taxes to the federal income tax might have standing to challenge a hypothetical Treasury action. Third, brokers subject to basis reporting requirements could credibly claim injury on account of indexing. Fourth, a small set of taxpayers whose liability would potentially rise as a result of inflation indexing could challenge the regulation in a Tax Court petition or refund suit. And in addition to the above-mentioned plaintiffs, organizations that can receive tax-deductible contributions might be able to make out a colorable argument for standing—though this theory of standing is rather less certain than the others.

A. Legislative Standing

The case law on legislative standing, as one commentator has observed, "contains various inconsistent pronouncements, rendering it difficult or impossible to discern a coherent doctrine."[150] The Supreme Court's most recent pronouncement on the subject came in a 2015 case that pitted the Arizona Legislature against the state's Independent Redistricting Commission. There, the Legislature challenged a state law that authorized an independent commission to draw congressional district lines after the decennial census—arguably in contravention of the federal Constitution's Elections Clause, which provides that

147. Zelenak, *supra* note 23.

148. *Id.*; *see also* Lawrence Zelenak, *Radical Tax Reform, the Constitution, and the Conscientious Legislator*, 99 COLUM. L. REV. 833, 837 n.29 (1999).

149. HARRY G. GOUREVITCH, CONG. RESEARCH SERV., THE QUESTION OF INDEXING CAPITAL GAINS BY REGULATION (1992) (accessed from Tax Notes database, Document 92-8298, Electronic Citation 92 TNT 182-185).

150. *See* Matthew I. Hall, *Making Sense of Legislative Standing*, 90 SO. CAL. L. REV. 1, 3 (2016).

"[t]he Times, Place and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof."[151] The Supreme Court, by a 5-4 vote, upheld the state's redistricting procedure, but only after the majority concluded that the state Legislature had standing to bring the challenge.

In reaching that conclusion, the majority—in an opinion by Justice Ginsburg—applied a rule derived from earlier cases that "legislators whose votes would have been sufficient to defeat (or enact) a specific legislative Act have standing to sue if that legislative action goes into effect (or does not go into effect), on the ground that their votes have been completely nullified."[152] The Court distinguished the Arizona Legislature's lawsuit from earlier cases brought by individual members of Congress challenging alleged institutional injuries.

The Chief Justice and Justices Scalia, Thomas, and Alito dissented, but only Scalia and Thomas said that the Legislature lacked standing in the case.[153] The silence of Roberts and Alito on the standing question arguably suggests that they agreed with the majority's view, which—in any event—is now binding precedent.[154]

Legislative standing returned to the limelight later that same year in a case involving the Affordable Care Act.[155] After a Republican-controlled House refused to appropriate funds for certain "cost-sharing" subsidies to insurers, the Obama Administration disbursed the monies anyway, claiming that it had statutory authority notwithstanding congressional opposition. The House voted 225-201 to authorize legal action against the President and other executive branch officials to stop the payment of the subsidies.[156] The House then filed a suit against Health and Human Services Secretary Sylvia Burwell in federal district court in Washington, D.C., teeing up the legislative standing issue.

The district court concluded that the House did indeed have standing to challenge the cost-sharing subsidies. As Judge Rosemary Collyer wrote:

> The Congress (of which the House and Senate are equal) is the only body empowered by the Constitution to adopt laws directing monies to be spent from the U.S. Treasury. Yet this constitutional structure would collapse, and the role of the House would be meaningless, if the Executive could circumvent the appropriations process and spend funds however it pleases. If such actions are

151. Ariz. State Legis. v. Ariz. Indep. Redistricting Comm'n, 135 S. Ct. 2652 (2015).

152. *Id*. at 2655 (quoting Raines v. Byrd, 521 U.S. 811, 823 (1997)).

153. *See id*. at 2677 (Roberts, C.J., dissenting); *id*. at 2694 (Scalia, J., dissenting).

154. Justice Alito, for his part, had indicated in a solo dissent two years earlier that a single House would have standing to defend an act of Congress from constitutional attack. United States v. Windsor, 570 U.S. 744, 803-07 (2013) (Alito, J., dissenting).

155. U.S. House of Representatives v. Burwell, 130 F. Supp. 3d 53 (D.D.C. 2015).

156. H.R. Res. 676, 113th Cong. (2014).

> taken, in contravention of the specific proscription in [the Appropriations Clause], the House as an institution has standing to sue.[157]

One can imagine an analogous argument in the inflation indexing context. Say that Treasury takes regulatory action to index basis for inflation. The Democrat-controlled House could and likely would argue—just as the Republican-led House did in the cost-sharing case—that the regulation encroaches upon its institutional authority. Judge Collyer's logic would seem to apply four-square: Congress is the only body empowered by the Constitution's Origination and Taxing Clauses to adopt laws raising or lowering taxes;[158] if the executive could circumvent that legislative process, "the constitutional structure would collapse;" and thus if the executive circumvents that process, either the House or the Senate as an institution would have standing to sue. To use the language from the Arizona redistricting case: legislators whose votes would have been sufficient to defeat indexing by statute would have standing to sue if indexing goes into effect, on the grounds that their votes have been completely nullified by the Administration's decision to proceed without congressional approval.

While the House's case would be strong, it is not open-and-shut. For one, the Arizona redistricting case involved both houses of the state legislature authorizing a suit; with Republicans a majority in the Senate until at least 2021, this hypothetical lawsuit would almost certainly have to come from the Democrat-controlled House alone. And while the cost-sharing case involved a single chamber of Congress, that case was settled on terms that made the district court's holding nonprecedential.[159] In any event, a decision by a federal district court does not bind other federal courts—nor does it even bind other judges in the same district. Also, while the Court's logic in the Arizona redistricting case would point toward the House having standing, the Court, in a cryptic footnote, suggested that its decision on state legislative standing may not fully translate into the federal context.[160]

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157. *House of Representatives*, 130 F. Supp. 3d at 71 (citations omitted).

158. *See* U.S. CONST. art. I, § 7, cl. 1 ("All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills."); art. I, § 8, cl. 1 ("The Congress shall have Power To lay and collect Taxes . . . ."). Note that courts have interpreted the Origination Clause to apply to bills that raise *and lower* taxes. *See* Armstrong v. United States, 759 F.2d 1378, 1381 (9th Cir. 1985) ("We . . . conclude . . . that in adopting [the Origination Clause], the framers of the Constitution intended that all legislation relating to taxes (and not just bills raising taxes) must be initiated in the House."); Wardell v. United States, 757 F.2d 203, 205 (8th Cir. 1985) (per curiam) ("We cannot agree that 'revenue-raising' means only bills that increase taxes.").

159. Settlement Agreement, U.S. House of Representatives v. Hargan, No. 16-5202 (D.C. Cir. Dec. 15, 2017).

160. The majority wrote that "[t]he case before us does not touch or concern the question whether Congress has standing to bring a suit against the President," and noted that such a case "would raise would raise separation-of-powers concerns absent here." Ariz. State Legis. v. Ariz. Indep. Redistricting Comm'n, 135 S. Ct. 2652, 2665 n.12 (2015).

In sum, the Supreme Court's decision in the Arizona redistricting litigation and the D.C. federal district court's cost-sharing ruling suggest that a Democrat-controlled House would have a plausible argument for standing to challenge a Treasury regulation that indexes basis for inflation. Still, complete confidence in the House's success on the standing issue would be misplaced.

B. States

The states are a second set of potential plaintiffs in a legal challenge to presidential indexation.

The crux of the states' case for standing would be as follows: Most states tie their definition of income for state income tax purposes to the federal definition.[161] For instance, many states simply start their tax calculation with federal adjusted gross income or taxable income—either of which automatically would include the effects of presidential indexation.[162] Indexing basis for inflation via regulation would reduce the federal adjusted gross income and taxable income of taxpayers with capital gains, so it would reduce the amount those taxpayers pay to their states as well. As a result, presidential indexation would lead to revenue losses for the states. Undoing this would require the states to both change their laws and increase their (and their taxpayers') administrative costs, as taxpayers would need to separately report capital gains to state authorities (using a different definition than at the federal level).

Until relatively recently, the notion that a state might have standing to challenge a federal tax change because of its incidental effect on state tax revenues might have seemed like a nonstarter under longstanding precedent. In the 1927 case *Florida v. Mellon*, the Supreme Court considered a superficially similar challenge by the State of Florida to a provision of the federal estate tax.[163] The challenged provision allowed a credit against the federal estate tax for inheritance taxes paid to the states, up to eighty percent of the amount of the federal tax.[164] Florida, which had no inheritance tax, argued that the provision "constitute[d] an invasion of the sovereign rights of the state and a direct effort

161. *See, e.g.*, 3 ILL. COMP. STAT. 203(e)(1) (2018); *see also* Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 DUKE L.J. 1267, 1275 (2013) ("Thirty-five of the forty-one states with broad-based income taxes use federal definitions of income as the starting point for calculating residents' taxable income.").

162. *See* Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUND. 16 (2016), https://files.taxfoundation.org/20170316133143/Tax-Foundation-FF543.pdf [https://perma.cc/YW2V-M4JP] (cataloguing linkages between state and federal income tax systems). In some cases, the state codes conform on a rolling basis, automatically incorporating statutory changes at the federal level as they occur; in other cases, they conform to the federal code as of a specific date. *Id.* Even states that conform to the code as of a specific, prior date would likely be affected by presidential indexation because the definition of basis in Section 1012, which presidential indexation would reinterpret by fiat, is a longstanding feature of federal tax law.

163. 273 U.S. 12 (1927).

164. *See id*. at 15 (citing Revenue Act of 1926, ch. 27, § 301, 44 Stat. 9, 69-70).

on the part of Congress to coerce the state into imposing an inheritance tax."[165] Florida also claimed that it would be injured because the estate tax "will result in the withdrawal from Florida of several million dollars per annum and thus diminish the revenues of the state derived largely from taxation of property therein."[166]

Rather than reaching the merits of Florida's coercion claim, the Court dismissed the state's challenge on standing grounds. As Justice Sutherland wrote for the Court, "[i]f, as alleged, the supposed withdrawal of property will diminish the revenues of the state, *non constat* [(i.e., it is doubtful)] that the deficiency cannot readily be made up by an increased rate of taxation."[167] In other words, the potential reduction in state revenue as a result of the federal estate tax was not enough to establish state standing when the state could make up for the shortfall through other means.

And so things stood for the next half century. In a 1976 case, the Supreme Court held that Pennsylvania lacked standing to challenge a New Jersey tax on nonresidents (including Pennsylvania residents) on grounds that the tax violated the Constitution's Privileges and Immunities and Equal Protection Clauses.[168] Pennsylvania claimed that it was harmed by the New Jersey tax because Pennsylvania provides its residents a credit against state income taxes for taxes paid to other states; thus, the fact that Pennsylvania residents paid more to New Jersey meant that they paid less to Pennsylvania. The Supreme Court rejected Pennsylvania's argument based on logic similar to its *Florida v. Mellon* holding. "[N]othing prevents Pennsylvania from withdrawing that credit for taxes paid to New Jersey," the Court noted, adding that "[n]o State can be heard to complain about damage inflicted by its own hand."[169]

But the tide would soon turn. First, in 1992, the Supreme Court considered Wyoming's challenge to an Oklahoma law that required coal plants in the Sooner State to rely on in-state sources for at least ten percent of their coal.[170] Wyoming, a coal-producing state, imposes a severance tax on coal extracted within its borders, and the fact that Oklahoma utilities would have to buy more Oklahoma coal likely meant that they would purchase less from Wyoming. The Supreme Court held that Wyoming had standing "where its severance tax revenues are directly linked to the extraction and sale of coal" and "have been demonstrably affected" by the Oklahoma law.[171] The fact that Wyoming could have replaced its coal severance tax revenues with higher taxes on other commodities did not enter into the Court's analysis.

165. *Id*. at 16.
166. *Id*. at 15-16.
167. *Id*. at 18.
168. Pennsylvania v. New Jersey, 426 U.S. 660, 662-63 (1976).
169. *Id*. at 664.
170. *See* Wyoming v. Oklahoma, 502 U.S. 437, 440-41 (1992).
171. *Id*. at 450.

The Court took a further step toward broadening state standing fifteen years later. In 2007, it held that Massachusetts had standing to challenge the EPA's rejection of a rulemaking petition that asked the agency to regulate greenhouse gases under the Clean Air Act. Justice Kennedy, writing for the majority, observed that Massachusetts had a "well-founded desire to preserve its sovereign territory" in the face of global warming and rising sea levels.[172] He also noted that Massachusetts owns "a great deal" of land that could be affected by global warming, and that the Clean Air Act allows parties (including states) to challenge the rejection of rulemaking petitions.[173] In a line that would be widely repeated and dissected in the years to come, Justice Kennedy concluded, "Given that procedural right and Massachusetts' stake in protecting its quasi-sovereign interests, the Commonwealth is entitled to special solicitude in our standing analysis."[174]

This new "special solicitude" for the states has been a subject of extensive scholarly commentary[175]—and, increasingly, a subject of litigation. One of the most significant lower court cases on state standing in the last decade involved the Obama Administration's Deferred Action for Parents of Americans (DAPA) program. In 2014, the Department of Homeland Security announced that parents of U.S. citizens and Green Card holders who met certain criteria could apply for two-year "deferred action" status, which would—among other potential benefits—allow those individuals to obtain work authorization.[176] Texas and twenty-five other states sued to stop DAPA from taking effect, alleging that the program was fatally flawed on procedural, statutory, and constitutional grounds.[177]

One of the many questions in the DAPA case was whether the states had standing to sue. The Fifth Circuit concluded that at least one state—Texas—did. The court began its analysis by invoking the "special solicitude" line from *Massachusetts v. EPA*.[178] It then noted that under current Texas law, the state would be obligated to issue drivers' licenses at a discount to individuals with deferred action status under DAPA, leading to a revenue loss of several million dollars.[179] The court acknowledged the Obama Administration's argument that Texas might be able to change its law so that individuals with deferred action

172. Massachusetts v. EPA, 549 U.S. 497, 519 (2007).

173. *See id*. at 519-20.

174. *Id*. at 520.

175. For discussions of this subject, see, for example, Jonathan H. Adler, *Standing Still in the Roberts Court*, 59 CASE W. RES. L. REV. 1061, 1071-78 (2009); and Dru Stevenson, *Special Solicitude for State Standing:* Massachusetts v. EPA, 112 PENN ST. L. REV. 1 (2007).

176. Memorandum from Jeh Johnson, Sec'y, Dep't of Homeland Sec., to Leon Rodriguez, Dir., USCIS (Nov. 20, 2014), https://www.dhs.gov/sites/default/files/publications/14_1120_memo_deferred_action_2.pdf [https://perma.cc/24W5-4LXP].

177. Texas v. United States, 809 F.3d 134, 149-50 (5th Cir. 2015), *aff'd by an equally divided Court*, 136 S. Ct. 2271 (2016).

178. *Id*. at 151 (quoting Massachusetts v. EPA, 549 U.S. at 520).

179. *See id*. at 155.

status would not be eligible for a driver's license discount. But the court went on to say that "[a]lthough Texas could avoid financial loss by requiring applicants to pay the full costs of licenses, it could not avoid injury altogether," adding that "[s]tates have a sovereign interest in the power to create and enforce a legal code."[180]

The Fifth Circuit then sought to reconcile the Supreme Court's holding in *Pennsylvania v. New Jersey* with its holding in *Wyoming v. Oklahoma*. It noted two relevant distinctions. First, Wyoming sued in response to a "major" change in Oklahoma's policy, whereas Pennsylvania was not responding to a significant shift in New Jersey's tax laws.[181] Second, Wyoming had "limited" options for responding to the Oklahoma in-state purchasing requirement, whereas Pennsylvania could have achieved its revenue-raising goals in "myriad ways."[182] The Fifth Circuit concluded that Texas's case more closely resembled Wyoming's than Pennsylvania's.

Our own interest, for present purposes, is not to critique the Fifth Circuit's analysis but to imagine how it might apply to a state seeking to block Treasury from indexing the capital gains tax via regulation. The state would argue that, like Texas's revenue loss from issuing discounted drivers' licenses, it will lose revenue because its residents will report less income. While a state could avert this outcome by de-linking its own definition of income from the federal definition, that alternative would require state residents to bear the additional compliance cost of recalculating their capital gains (and would likely require state tax officials to bear additional administrative costs as well). Moreover, presidential indexation would be a sudden and major change, and states that wanted to avert revenue losses without incurring additional administrative costs or imposing additional compliance costs on their residents would have limited options. The case for state standing under *Texas v. United States* thus seems strong.

Importantly, *Texas v. United States* is not a nationally binding precedent. While the Supreme Court took up the DAPA case, it ultimately split 4-4 and affirmed the Fifth Circuit's decision without an opinion of its own.[183] Thus the Fifth Circuit's decision does not bind beyond the Fifth Circuit states of Louisiana, Mississippi, and Texas—none of which are especially likely to bring an action against a hypothetical Trump Administration regulatory indexing policy.[184] Even so, *Texas v. United States* constitutes persuasive authority

180. *Id*. at 156 (internal quotation marks omitted).

181. *See id*. at 158.

182. *Id*.

183. United States v. Texas, 136 S. Ct. 2271 (2016).

184. Mississippi has a Democratic Attorney General who is facing reelection in 2019 and reportedly considering a run for Governor. *See GOP Rep. Mark Baker Running for Attorney General; Hood Undecided*, MISS. BUS. J. (May 1, 2018), http://msbusiness.com/2018/05/gop-rep-mark-baker-running-for-mississippi-attorney-general [https://perma.cc/3M9P-S2YB]. Louisiana has a Democratic Governor. If either asked us for political advice, we would have to tell them that filing a lawsuit against a

outside the Fifth Circuit,[185] and we expect that other courts would at least look to the Fifth Circuit's analysis in adjudicating a state challenge to presidential indexation. While the ideological valence of the *Texas* case is obviously quite different, *Texas* provides solid support for the proposition that if Treasury sought to index the capital gains tax via executive action, states with income taxes tied to the federal definition of income would have standing to sue.

C. Brokers

Brokers are a third potential category of plaintiffs in a legal challenge to presidential indexation. The argument for broker standing draws force from the basis reporting provisions adopted by Congress in 2008.[186] The 2008 law generally requires brokers to report to the IRS the adjusted basis of securities sold by their customers.[187] The law applies only to stock acquired after 2010 (with later onset dates for other securities),[188] but the basis reporting regime is now approaching full steam and applies to a significant number of brokers and transactions.[189]

Any one of the thousands of brokers in the United States thus could challenge presidential indexation in court. The broker's argument would be that indexing—combined with the statutory basis reporting provisions—requires the broker to bear additional costs in calculating and reporting basis to customers and the IRS. The costs may be modest, but as one scholar has observed and the Supreme Court has repeated, "an identifiable trifle is enough for standing."[190] Treasury might try to preempt a broker suit by granting regulatory exemptions from the basis reporting requirements, though those exemptions might be challenged as well (either by customers or by states).

D. Taxpayers Who Are Harmed

A fourth set of potential challengers to presidential indexation encompasses taxpayers who could be harmed by the change. This situation would be relatively unusual since taxpayers, if affected, would normally see a tax cut from

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Trump Administration policy that reduces taxes for their constituents is not an electorally wise strategy in states that Donald Trump won by double digits in 2016.

185. *See* Otter v. Jewell, 227 F. Supp. 3d 117, 124 (D.D.C. 2017) (noting that "*Texas v. United States* . . . constitutes persuasive authority for this Court").

186. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 403(a), 122 Stat. 3584 (codified at I.R.C. § 6045(g)-(h) (2018)).

187. *Id*.

188. I.R.C. § 6045(g)(3)(C) (2018).

189. *See* Tara Siegel Bernard, *New Laws Take Guesswork Out of Investment Tax Liability*, N.Y. TIMES (Mar. 15, 2013), https://www.nytimes.com/2013/03/16/your-money/new-tax-laws-cover-cost-basis-of-investments.html [https://perma.cc/68EY-SDQM].

190. United States v. Students Challenging Regulatory Agency Procedures, 412 U.S. 669, 689 n.14 (1973) (quoting Kenneth Culp Davis, *Standing: Taxpayers and Others*, 35 U. CHI. L. REV. 601, 613 (1968)).

presidential indexation. But a small set of taxpayers would potentially face greater liability as a result of indexation, and these taxpayers would have a straightforward standing claim.

One relatively clear way in which indexation might hurt a taxpayer is if the taxpayer runs up against the charitable contribution deduction caps in Section 170.[191] For example, imagine a single taxpayer in the 35% ordinary income tax bracket and the 15% capital gains bracket who starts out with adjusted gross income of $600,000 and contributes well over $400,000 to charity.[192] Under current law, the taxpayer's charitable contribution deduction is capped at 60 percent of adjusted gross income—$360,000 in this example.[193] Now imagine that the same taxpayer sells a capital asset which she has held for more than one year that has nominally risen $10,000 in value—but the entire gain is attributable to inflation. Without indexing, the taxpayer pays an additional $1,880 in long-term capital gains and net investment income taxes[194] but is eligible to claim an additional $6,000 charitable contribution deduction, which on its own reduces her tax liability by $2,100. The net effect of the tax on the gain and the benefit from the deduction is a $220 reduction in tax liability. With indexing, the taxpayer neither has to pay tax on the gain nor receives the benefit of the additional charitable contribution deduction—and is, on net, worse off as a result.[195]

Another circumstance in which presidential indexation might lead to an increase in liability involves real estate investment trusts (REITs). A REIT is an entity that generally must derive at least 95% of its gross income from dividends, interest, rents from real property, gains from the sale of certain capital assets, and a number of other specific sources.[196] For an entity near the 95% threshold, inflation indexing could reduce its gain from the sale of capital assets and thus cause it to fail the REIT qualification test.[197] A similar situation exists for regulated investment companies (RICs), which must derive at least 90% of their income from dividends, interest, gains from the sale of stock and securities, and

191. *See* I.R.C. § 170(b)(1) (2018) (prescribing instances in which charitable contribution deductions are capped at twenty percent, thirty percent, and sixty percent of adjusted gross income).

192. A single individual would find herself in this position if she had taxable income of $204,100 to $434,550. *See* Rev. Proc. 2018-57, 2018-49 I.R.B. 827.

193. *See* I.R.C. § 170(b)(1)(G) (2018) (capping the deduction for cash contributions to public charities at sixty percent from 2018 to 2025).

194. This figure accounts for 3.8% net investment income tax, which applies to married couples filing jointly if adjusted gross income exceeds $250,000. *See* I.R.C. § 1411 (2018).

195. A similar example is noted in Peter J. Reilly, *Treasury Capital Gain Indexing: Who Can Sue?*, FORBES (Aug. 26, 2018), https://www.forbes.com/sites/peterjreilly/2018/08/26/treasury-capital-gain-indexing-who-can-sue/#4256965c42b9 [https://perma.cc/N9SA-ZGPY] (quoting Email from Daniel Hemel to David Kamin & Peter Reilly (Aug. 26, 2018; 4:23 PM)).

196. I.R.C. § 856(c)(2) (2018).

197. This possibility is mentioned in passing in the NYSBA Memorandum, *supra* note 22, at n.6.

several other sources.[198] In either case, the tax consequences of losing REIT or RIC status would likely exceed the tax savings from any reduction in gross income attributable to basis indexing.

There are still additional conceivable circumstances—identified by other commentators—in which indexing basis for inflation could potentially redound to a taxpayer's detriment.[199] If one of these individuals or entities were to challenge her tax liability, a court could decide, on the merits, whether presidential indexation is legal. In a country with more than 150 million taxpayers filing returns each year,[200] it seems quite likely that at least a few would emerge as potential petitioners or refund claimants.

E. Charitable Organizations

Charitable organizations exempt from federal income tax under Section 501(c)(3) constitute a final set of potential plaintiffs in a legal challenge to presidential indexation. The argument for charity standing is colorable though far from certain. It arises from the fact that Section 170 allows taxpayers to claim a charitable contribution deduction for the fair market value of property such as stock that is donated to a public charity, provided that any gain from the sale of the stock would be long-term capital gain.[201] This rule strengthens the tax incentive for charitable giving. To illustrate: imagine again that the ordinary income tax rate is 40% and the long-term capital gains rate is 20%. Taxpayer *T* buys stock for $50 more than a year ago that is worth $100 today. The taxpayer either can (a) sell the stock and pay tax of 20% x ($100 sale price – $50 basis) = $10, or (b) donate the stock to charity and claim a charitable contribution deduction worth 40% x $100 = $40. The delta between (a) and (b)—i.e., the tax incentive to give to charity—is $50.

Now imagine that presidential indexation raises *T*'s basis in the stock from $50 to $60. Option (b) remains the same—donating the stock generates a charitable contribution deduction worth $40—but option (a) has changed. With indexing, *T* can sell the stock and pay a tax of 20% x ($100 sale price – $60 basis) = $8, rather than $10 as before. The delta between (a) and (b)—the tax incentive to give to charity—has fallen from $50 to $48. The change may seem slight, but in some cases it may be quite substantial. If all of the long-term capital gain with respect to an asset is inflationary gain, then indexing eliminates the

198. *See* I.R.C. § 851(a) (2018); NYSBA Report, *supra* note 33, at n.6.

199. For other circumstances in which having *less* income might lead to the payment of more tax, see NYSBA Memorandum, *supra* note 22, at n.6. *See also* Reilly, *supra* note 195 (giving example of gains that unlock two different forms of accrued losses—capital losses and passive losses—and that, if reduced by indexation, could increase tax liability).

200. *See* INTERNAL REVENUE SERV., STATISTICS OF INCOME DIV., INDIVIDUAL INCOME TAX RETURNS 2016, 6 tbl.A (revised Sept. 2018), https://www.irs.gov/pub/irs-pdf/p1304.pdf [https://perma.cc/8LKM-LADD].

201. *See* I.R.C. § 170(e)(1)(A) (2018). Contributions of stock to a private foundation also may be deducted at fair market value under certain circumstances. *See* § 170(e)(5).

additional tax incentive for charitable contributions of appreciated assets (over and above the incentive for cash gifts).

Can a charity go to court to challenge a regulation that does not raise the charity's tax bill but makes contributions to the charity less attractive? Perhaps the strongest support for that proposition is a case involving a state plaintiff: *South Carolina v. Regan*.[202] That case involved a statutory change to Section 103, the provision allowing an exemption for interest on (some) state and local bonds.[203] Specifically, Congress in 1982 eliminated the exemption for interest on bonds issued in bearer form. South Carolina, which issued bearer bonds, challenged the new law as a violation of the Tenth Amendment and the doctrine of intergovernmental tax immunity.[204]

The new bearer-bond law did not require South Carolina to pay additional tax. The law did, however, make it less attractive for investors to give their money to South Carolina in exchange for bearer bonds, because the interest earned by the investor now would be subject to federal tax. That was enough to convince the Court to reach the merits. And while the Court's decision focuses on the Tax Anti-Injunction Act rather than standing, *South Carolina v. Regan* is illustrative of the proposition that when a tax law change makes it less attractive for taxpayers to give money to an entity, the entity has standing to sue.[205]

Concededly, the argument for charity standing might be criticized on the grounds that it proves too much. If charities have standing to challenge regulatory action that lowers the capital gains tax (and thus makes contributions to charities less attractive), then why can't charities challenge any regulatory action that reduces marginal rates? Or, beyond that, why can't charities challenge any regulatory action that affects whether taxpayers claim the standard deduction or itemize (on the grounds that itemizers have a stronger tax incentive for charitable giving). One response is that the "causation" element of the standing rubric alleviates these concerns somewhat: to establish standing, a charity will still have to show that it suffers an injury that is "fairly traceable" to the action in question.[206] Whether this response will convince a court remains to be seen. What we can say for now is that charities have a colorable claim to standing that, at the very least, could allow them to prevail before a sympathetic court.

202. 465 U.S. 367 (1984).

203. I.R.C. § 103 (2018).

204. *Regan*, 465 U.S. at 370.

205. The Court in *Regan* also noted "the serious magnitude of the federalism concerns at issue." *Id*. at 401 (internal quotation marks omitted). That might be grounds for distinguishing a challenge brought by nongovernmental charities from South Carolina's case. But opponents of presidential indexation could eliminate this distinction if they persuaded a state-affiliated recipient of charitable contributions—e.g., a public university—to join the suit, in which case the plaintiffs could appeal to federalism concerns, too.

206. Allen v. Wright, 468 U.S. 737, 751 (1984).

F. Role of the Anti-Injunction Act

Looming over any challenge to presidential indexation is an 1867 federal law known as the Tax Anti-Injunction Act, which provides (with exceptions not applicable here) that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."[207] We discuss the Anti-Injunction Act only briefly because its implications for the indexing debate are slight, except when it comes to taxpayers like those described in Section III.D who are directly harmed by the regulation and have a greater liability as a result.

As a textual matter, most legal challenges to indexing—all of those described above except the circumstances involving direct taxpayer harm—would not seem to fall within the Anti-Injunction Act's ambit. That is because they would not be suits "for the purpose of restraining the assessment or collection of any tax"—the goal would be to get the IRS to assess and collect *more* tax.[208] More importantly, the Supreme Court held in *South Carolina v. Regan* that the Anti-Injunction Act "was intended to apply only when Congress has provided an alternative avenue for an aggrieved party to litigate its claims on its own behalf."[209] If lawmakers, states, charities, and brokers aggrieved by presidential indexation would have no other avenue to challenge Treasury's action, then the Anti-Injunction Act does not appear to bar their suit. For other potential plaintiffs—such as taxpayers who unlock additional charitable contribution deductions with higher adjusted gross income, or REITs or RICs that potentially flunk the relevant qualification tests due to inflation indexing—a challenge to the indexing regulation might have to await a Tax Court petition or a refund claim. Regardless, the breadth of potential plaintiffs suggests that a regulation indexing basis for inflation could not escape legal challenge forever. Proponents of presidential indexation who believe that executive action would be immune from judicial review are, we think, quite likely to be disappointed.

Conclusion

While the prospect of presidential indexation may continue to generate enthusiasm, we think that the proposal's promise is—excuse the pun—wildly inflated. As a policy matter, indexing basis for inflation via regulatory action would be a recipe for arbitrage, revenue losses, and even wider wealth inequality. As a legal matter, the same arguments that led officials in the first Bush Administration to reject the idea in 1992 are applicable today. These arguments are bolstered by the advent of the "major questions" exception under *Chevron*.

207. I.R.C. § 7421(a) (2018).

208. For an analogous Anti-Injunction Act argument in a different context, see Daniel J. Hemel, *How to Reach the Constitutional Question in the Health Care Cases*, 64 STAN. L. REV. ONLINE 39, 41 (2012).

209. 465 U.S. at 381.

And opponents of presidential indexation also can rely on judicial and legislative developments that expand the pool of potential plaintiffs who can challenge an indexing rule. In sum, the Trump Administration ought to resist calls for it to assert its putative authority to implement indexing unilaterally. And if it succumbs to the pressure, we think that courts ought to and likely will restore the century-old interpretation of "cost" in the Code.