After Chevron: Uniform Tax Law Interpretation Not Guaranteed

By **Michelle Levin and Carneil Wilson** (July 9, 2024)

On June 28, the U.S. Supreme Court overturned a decades-old precedent, known as Chevron deference, that favored federal agencies' rulemaking interpretations. In this Expert Analysis series, attorneys discuss the decision's likely impact on rulemaking and litigation across practice areas.

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This article will explore the potential ramifications of the U.S. Supreme Court's Loper Bright Enterprises v. Raimondo decision,[1] and the loss of deference in agency rulemaking, in the area of tax law. We will analyze what paths the IRS may or may not take when issuing guidance to taxpayers, and the impacts of those different paths.

While Chevron no longer provides deference to agency interpretations, both the Administrative Procedure Act and the Supreme Court's 1983 decision in Motor Vehicle Manufacturers Association of the U.S. Inc. v. State Farm Mutual Automobile Insurance Co.[2] still provide a framework against which agency rules can be judged, along with established rules of statutory construction utilized by courts to interpret the laws.

The post-Chevron era will not necessarily doom all agency rules or guarantee a taxpayer victory when regulations are challenged. Instead, using the framework in the APA and State Farm, agency rules will withstand scrutiny if they are consistent with the authority delegated to them by Congress, and if the agency provides an explanation for how it derived the rule based on the facts before it.

In the tax area, as in Loper, rules often deviated from the plain language of the statute, with little explanation for how a particular rule was chosen. The U.S. Department of the Treasury would then rely on Chevron deference to justify its decision.

There are two recent examples of the Treasury utilizing Chevron deference to withstand judicial scrutiny, even though the regulation at issue had lacked rational or empirical support.

In 2022, the U.S. Court of Appeals for the Sixth Circuit in Oakbrook Land Holdings LLC v. Commissioner of Internal Revenue[3] upheld a Treasury regulation, along with the Treasury's interpretation of the same, that imposed a requirement on donors of conservation easements to include a specific allocation of post-extinguishment proceeds. The Sixth Circuit found this requirement passed muster under Chevron because "the section is silent on what should happen if an easement is extinguished by judicial proceedings."

In 2019, the U.S. Court of Appeals for the Ninth Circuit in Altera Corp. v. Commissioner of Internal Revenue[4] upheld the Treasury's regulation requiring the allocation of costs from qualified stock compensation between controlled corporations in transfer pricing

computations, even though such allocation was inconsistent with the long-standing comparable transaction method contemplated by the statute.

In overturning the Tax Court's decision that the regulation was invalid, the Ninth Circuit explained that "while interpreting the statute to do away with reliance on comparables may not have been 'the only possible interpretation' of Congress's intent, it provides a reasonable one," quoting its 2009 decision in Entergy Corp. v. Riverkeeper Inc.

Using a swimming analogy, under Chevron, agencies could promulgate rules or regulations without delving too deeply into their reasoning, as their statutory interpretations were given deference. Chevron acted like floaties for these agencies, providing aid to the novice swimmers by helping them to float.

Without Chevron, agency rules or regulations must now swim on their own, something agencies can easily accomplish by showing a strong connection between the facts found and the decisions made. Rather than undermining the agency's rules, the loss of the Chevron crutch will help to make agency rules stronger.

Is a Rule Reasonable?

Courts will still need to determine whether a rule is permissible or not. Chevron was established to provide a framework for determining whether an agency rule is a permissible interpretation of a statute. That need persists even without Chevron. The courts will have many other methods to determine if a rule is reasonable.

As a starting point, the courts will look to the APA. Under the APA, new rules must undergo a notice-and-comment process. Agencies shall provide a general notice of the rule in the Federal Register, followed by an opportunity for interested parties to submit written or oral data, views, or arguments.[5] Courts use the record developed during notice and comment to assess the reasonableness of a rule. Under the APA, an agency rule is valid so long as it is not "arbitrary, capricious, an abuse of discretion, or not otherwise in accordance of the law" or "in excess of statutory jurisdiction, authority, or limitations."[6]

Agencies can also expect the framework set forth in State Farm will be used by the courts to determine whether the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for [their] action."[7] Under State Farm, agencies can ensure that their rules will withstand APA scrutiny by demonstrating the rational relationship between the facts found and the decision made.

Finally, the legislative branch might also respond to the Chevron decision by revisiting and potentially revising the APA.

How Will the IRS React to a Post-Chevron World?

While Chevron has been in place for four decades, it has only applied to IRS rules for about a third of that time. Treasury regulations did not receive Chevron deference until the 2011 Supreme Court decision in Mayo Foundation for Medical Education and Research v. U.S.[8]

Just four years later, the Supreme Court started to walk back the Chevron deference it gave to the IRS when faced with a Treasury regulation concerning health insurance exchanges under the Affordable Care Act. The Supreme Court concluded in its 2015 King v. Burwell decision that Chevron deference does not apply to these particular regulations: "It is especially unlikely that Congress would have delegated this decision to the IRS, which has

no expertise in crafting healthcare policy of this sort."[9]

But most tax regulations involve subject matters outside the IRS' expertise, such as electric vehicles, opportunity zones, cryptocurrency and even conservation. It seemed as though Chevron deference to IRS regulations was doomed from the start.

Taxpayers who lost their desired tax treatment by unintentionally running afoul of IRS regulations are likely cheering the fall of Chevron.[10] However, the fallout from this decision may leave the taxpayers with less certainty about how our country's byzantine tax laws should be applied and may drive more disputes into court.

Theoretically, the IRS will take steps to ensure its regulatory process complies with the APA, as the Treasury promised to do when it issued a policy statement on the tax regulatory process in 2019.[11] This could lead to a more robust and carefully considered body of Treasury regulations, which could come at the cost of speed and efficiency.

The IRS may also take steps to familiarize itself with the rules of statutory construction utilized by the courts. This would assist the IRS in both understanding how the courts will interpret the statutes written by Congress and the regulations written by the IRS to elucidate those rules.

The IRS may also decide to skip the notice-and-comment process in certain circumstances. The notice-and-comment process is extremely time-consuming, particularly for an under-resourced agency that is easily inundated with comments in the age of modern technology.

Having lost the deference it was receiving after following the notice and comment, the IRS may begin using more subregulatory guidance, such as notices, revenue rulings and announcements. In fact, we have already seen this shift in the employee retention credit and crypto spaces, and may see it in others.[12]

Of course, skipping the APA notice-and-comment process altogether could significantly undermine IRS rules.

In 2021, the Sixth Circuit was asked in Mann Construction Inc. v. U.S. to determine the validity of a listing notice issued by the IRS without notice and comment, which imposed an obligation on taxpayers to report certain transactions to the IRS or face significant penalties. In 2022, the Sixth Circuit held that the listing notice was invalid because the IRS failed to comply with the notice-and-comment process under the APA.[13]

Later that year, the Tax Court followed the Sixth Circuit's lead, holding in Green Valley Investors LLC v. Commissioner that a different listing notice was invalid due to the IRS' failure to utilize the notice-and-comment process.[14] The U.S. Court of Appeals for the Eleventh Circuit also took the same approach when faced with Notice 2017-10 in Green Rock LLC v. IRS last month.[15]

Further, if the IRS does not develop a record through public comment, it will have much more difficulty convincing a court that it examined relevant data or that its decision is rationally related to the facts found.

Another option for the IRS would be to skip issuing guidance altogether, and instead let the courts decide what is or is not permissible under the statute. Here too, this would not be ideal.

In the conservation easement space, both taxpayers and the national taxpayer advocate complained about the "let the courts decide" strategy employed by the IRS when it came to language in conservation easement deeds.[16] The complaints grew so loud that in 2022, when Congress amended the Consolidated Appropriations Act that governs conservation easements, it instructed the IRS to produce safe harbor language that taxpayers could utilize in their easement deeds going forward.[17]

And while the IRS' role in elucidating the tax law in a post-Chevron world may become more limited, placing greater weight on the statutory language utilized by Congress could have negative impacts for taxpayers. Changes to the tax code are often part of massive legislative projects, where the impacts of new tax provisions are not fully vetted or considered by Congress.

Many times, taxpayers turn to the IRS for regulations, particularly when a statute is unclear or appears to conflict with congressional intent, as they did after the Tax Cuts and Jobs Act inadvertently excluded qualified improvement property from the list of items subject to 15-year depreciation.[18]

Congress' failure to understand the distinction between an IRS determination and assessment led to conflicting case law on the applicability of Internal Revenue Code Section 6751(b). By using the term "assessment" as interpreted by the courts, Congress completely undermined its goal in passing that statute.[19] Under Chevron, IRS rules clarifying poorly written statutes provided taxpayers with better guidance.

In sum, a post-Chevron world forces taxpayers to go to Congress when a tax provision, as passed, is not working. The IRS' limited ability to clarify or assist through the regulatory process may cause the IRS to forego that process altogether and shift that responsibility to the courts. Taxpayers will have to hold Congress, not the IRS, accountable for poorly written tax laws.

The Future Without Chevron

With the elimination of Chevron deference, courts are now able to interpret statutes independently. Judges will need to delve deeper into legislative history, context, the plain meaning of statutory text and the many canons of statutory interpretation.

This increased responsibility may lead to more thorough judicial reviews, but it also opens the door to greater variability in statutory interpretation, as different judges may apply different methods of interpretation, canons and philosophies.

While the Tax Court is well suited to interpreting IRS rules in a uniform manner — with or without Chevron — decisions in district courts may have more variability. Even when Chevron deference was in place, we saw the Eleventh Circuit and Sixth Circuit come to opposite conclusions about the validity of a single Treasury regulation in 2021's Hewitt v. Commissioner and 2022's Oakbrook v. Commissioner, respectively.[20]

The Tax Court also found itself struggling with that same regulation, finding the regulation invalid in its Valley Park Ranch LLC v. Commissioner opinion this year, which overturned the Tax Court's decision that the regulation was valid in Oakbrook.[21]

Will the absence of Chevron change the judiciary's views on whether a rule is valid when new regulations are challenged? Or will the absence of Chevron merely shift the judiciary's reasoning to finding support, or lack thereof, in the statute, rather than in agency

deference? With or without Chevron, uniformity in judicial interpretations of statutes cannot be guaranteed.

The post-Chevron landscape will significantly alter the relationship between the courts, the IRS and Congress, and will place greater emphasis on judicial interpretation and adherence to APA procedures. This shift might lead to a more transparent and accountable rulemaking process, as agencies strive to produce well-reasoned and well-supported regulations. However, it also introduces uncertainty as courts and agencies adapt to the new legal framework.

The good news is that the branch of government vested with making the laws, Congress, still retains the ability to amend or change the statutes if it disagrees with how they are being interpreted — whether by the agencies or the courts.

In conclusion, the Supreme Court's decision to overrule the Chevron doctrine marks a significant shift in administrative law and promulgating rules. While it introduces new challenges and uncertainties, it also presents an opportunity for a more rigorous and transparent approach to rulemaking and judicial review. Courts, the IRS and taxpayers will need to navigate this new terrain carefully, balancing the need for effective regulation with the principles of fairness, accountability and clarity.

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[1] Loper Bright Enterprises v. Raimondo, 603 U. S. (2024).

[2] Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983).

[3] Oakbrook Land Holdings, LLC v. Commissioner 28 F.4th 700 (6th Cir. 2022).

[4] Altera Corp. & Subsidiaries v. Commissioner, 926 F.3d 1061 (9th Cir. 2019).

[5] Id.

[6] 5 U.S.C. § 706(2).

[7] Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

[8] Mayo Found. for Med. Educ. & Rsch. v. United States, 562 U.S. 44 (2011).

[9] King v. Burwell, 576 U.S. 473 (2015).

[10] It is worth noting that, except in rare circumstances, such as the case of Liberty Global, Inc. v. United States, No. 1:20-CV-03501-RBJ, 2022 WL 1001568 (D. Colo. Apr. 4, 2022) taxpayers do not intentionally violate Treasury Regulations, as there are enhanced penalties for doing so. I.R.C. § 6662(c). Instead, most challenges to tax regulations arise when the IRS changes its interpretation or enforcement of a regulation, or when the regulation is contrary to established law or practices of taxpayers in the industry.

[11] Department of the Treasury, Policy Statement on the Tax Regulatory Process (March 5, 2019).

[12] Stenson Tamaddon, LLC v. IRS, No. 2:24-cv-01123 (filed May 14, 2024 D. Ariz.)(challenging IRS subregulatory guidance with respect to ERC claims).

[13] Mann Construction, Inc. v. United States, 27 F.4th 1138 (6th Cir. 2022).

[14] Green Valley Investors, LLC v. Commissioner, 159 T.C. 80 (2022).

[15] Green Rock, LLC v. Internal Revenue Service, No. 23-11041 (11th Cir. June 4, 2024).

[16] National Taxpayer Advocate Annual Report to Congress 2020, Charitable Contribution Deductions Under IRS § 170.

[17] Consolidated Appropriations Act, 2023, Pub. L. No. 117-328 136 Stat. 5395 (Dec. 2022).

[18] Erica York, Tax Foundation, The Fixtures Fix: Correcting the Drafting Error Involving the Expensing of Qualified Improvement Property, (May 30, 2018).

[19] Chai v. Commissioner, 851 F.3d 190 (2d Cir. 2017); Kroner v. Commissioner, 48 F.4th 1272 (11th Cir. 2022).

[20] Hewitt v. Commissioner,, 21 F.4th 1336 (11th Cir. 2021); Oakbrook Land Holdings, LLC v. Commissioner,, 28 F.4th 700 (6th Cir. 2022).

[21] Oakbrook Land Holdings, LLC v. Commissioner, 150 T.C. 180 (2020); Valley Park Ranch, LLC v. Comm'r, 162 T.C. No. 6 (2024).