Kluwer International Tax Blog

How May the Supreme Court Overturning of Chevron Deference Impact International Tax Regulations and Pending Cases?

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On Friday, the U.S. Supreme Court issued its expected overruling of the Chevron doctrine, which has been relied upon in 70 past Supreme Court decisions and approximately 17,000 in the Appellate and District courts.[1]

I was reminded of a discussion about Chevron's deference at the ABA Tax Section Transfer Pricing committee meeting at the mid-year January 2023 conference, wherein I argued that the New Jersey 'fisheries' case would be the one chosen to overturn Chevron. But that tax administration would not come crashing down without Chevron. After all, before 2011, the tax court, district courts, and appellate courts disagreed on whether Treasury's tax regulations were eligible for Chevron deference. Some courts afforded Treasury tax regulations deference as comporting to the specific statutory authority underlying them. Other courts did not provide such deference and instead undertook a rigorous statutory interpretation analysis to measure a regulation.

In this pre-Chevron world, for some judicial fora, Treasury regulations were challenged, and in general, the regulations stood. Regardless, in 2011, the Supreme Court resolved in favor of the Treasury the issue of whether Chevron applied to Treasury tax regulations in its seminal decision *Mayo Foundation for Medical Education and Research v. United States*.[2] Of course, *Mayo* is now irrelevant without the underlying Chevron doctrine upon which the decision is based.

Brief Overview of the Chevron Doctrine

In a landmark unanimous decision in 1984, the Supreme Court established the Chevron doctrine. Only six justices participated due to the recusal of Justices Rehnquist, O'Connor, and Marshall.[3] The case, *Chevron U. S. A. v. Natural Resources Defense Council*, concerned whether a regulation issued by President Ronald Reagan's administration's EPA that, in the perspective of environmental groups, watered down the requirements of the Clean Air Act Amendments of 1977, permissibly defined a statutory term. The previous administration's EPA regulation defined the term differently and had the support of environmental groups.

The Supreme Court began its analysis to establish the new doctrine of agency deference by stating when the issue of deference does not arise: if Congress' statutory intent is clear, then the court, as well as the agency, must give effect to the unambiguously expressed intent.[4] But when a court

determines that Congress has not spoken directly on a statutory issue (the first step of Chevron's analysis), then the second step is for a court to discern if Congress has explicitly left a gap for the agency to fill. The Court continued that if a statute is silent or ambiguous concerning a specific issue, the question for the court is whether the agency's answer is based on a *permissible* construction of the statute.[5]

If Congress has provided express or implicit delegation of authority to the agency to elucidate a specific provision of the statute by regulation, then the Chevron doctrine established a ***threshold of deference*** in favor of an executive branch agency's regulatory choices, subject to three provisos: (a) the regulatory scheme is technical and complex, (b) the agency considered the matter in a detailed and reasoned fashion, and (c) the decision involves reconciling conflicting policies.[6] Deference was stated to mean 'controlling weight' unless the Agency's regulations are *arbitrary, capricious, or manifestly contrary to the statute*."[7]

The Supreme Court, analyzing the statute's language in *Chevron*, ascertained that Congress did not intend a particular regulatory definition and instead intended to grant the EPA broad scope to effectuate the policies of the Clean Air Act.[8] The Supreme Court held that policy arguments regarding regulatory choices "are more properly addressed to legislators or administrators, not to judges."[9]

The Decision Overruling the Chevron Doctrine

On June 28, 2024, the Supreme Court published its decision for Loper Bright Enterprises v. Raimondo, Secretary of Commerce, known colloquially as the 'New Jersey Fisheries case'.[10] A six-justice majority held that the Administrative Procedure Act requires courts to exercise their *independent judgment* in deciding whether an agency has acted within its statutory authority, and thus, courts may not defer to an agency's interpretation of the law simply because a statute is ambiguous.[11] A three-justice dissent defended the Chevron doctrine's allocation of deference to the executive branch based on the presumption that Congress favors an agency exercising the discretion allowed by a statute rather than the courts.[12]

In 1976, Congress promulgated the Magnuson-Stevens Fishery Conservation and Management Act (the "MSA") to address overfishing in U.S.-controlled waters.[13] The MSA established eight regional fishery management councils with each comprised of members of the regional fishing industry, the regional states, and the federal regulatory agency National Marine Fisheries Service ("NMFS").[14] The MSA requires that fishing businesses allow an observer on fishing voyages to collect data necessary for the conservation and management of the fishery. The MSA specifies three industry groups that must cover the costs of the observer program, of which only one is a regional fishery management council (North Pacific).

In 2020, the NMFS published a final rule initiated by the New England Fishery Management Council ("NE-FMC")that required New England-based fishing businesses to cover the costs of monitoring the Atlantic herring fishery when the NMFS elected not to do so.[15] The NMFS estimated that such costs would be approximately $710 per day, reducing annual returns to the vessel owner by up to 20 percent.[16] The New Jersey Fisheries case involved herring fishing family businesses who argued the NMFS is not authorized by the MSA to impose these costs upon them because their businesses fall within the non-specified NE-FMC.

The majority opinion provides an overview of the history of judicial interpretation, beginning with

the seminal *Marbury* case, continuing through the New Deal period, the 1946 enactment of the Administrative Procedures Act, and ending with the present line of Chevron cases.[17] A foretelling statement regarding deference is made in its overview:

> "Respect," though, was just that. The views of the Executive Branch could inform the judgment of the Judiciary, but did not supersede it.[18]

The majority noted that the APA explicitly directs a reviewing court to decide all relevant questions of law, interpret constitutional and statutory provisions, determine the meaning or applicability of terms of an agency's actions, and set aside agency action, findings, and conclusions not per a statute.[19] The majority concludes: "The deference that Chevron requires of courts reviewing agency action cannot be squared with the APA."[20]

The majority decision was thus that: "Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority, as the APA requires. Careful attention to the judgment of the Executive Branch may help inform that inquiry. And when a particular statute delegates authority to an agency consistent with constitutional limits, courts must respect the delegation, while ensuring that the agency acts within it. But courts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous."[21]

Impact on Treasury/IRS Regulations?

On April 8, 2024, the Congressional Research Service (the "CRS") published an In Focus article regarding "The Possible Elimination of Chevron Deference: Potential Implications for Tax Revenue and Administration".[22] The most telling statement of the CRS is that without Chevron deference, Treasury may draft more taxpayer-friendly regulations. Why? CRS states that a survey found that:

> 88 percent of agency rule drafters either "agreed" or "somewhat agreed" that Chevron made them more willing to adopt "a more aggressive interpretation."

The CRS stated that without Chevron's deference, the 2019 Altera regarding the regulations for cost-sharing arrangements may have been decided in favor of the taxpayer.[23] You may find my previous Kluwer Tax Blog articles about the Altera decision by linking here and my 2017 article about Treasury regulation jurisprudence for cost-sharing arrangements in light of the Amazon decision by linking here.

Impact on Cases Involving the Validity of IRS Regulations?

The 3M Blocked Income Appeal

The 2023 *3M v. Commissioner* Tax Court nine-to-eight split decision is currently under appeal at the Eighth Circuit.[24] The significant issue of 3M is the validity of the blocked income regulations.[25] In this context, both the majority and dissent analyzed Treasury's issuance of the blocked income regulations from a *Chevron* deference perspective. Without the context of *Chevron*

deference, it is certainly possible that this decision could have gone the other way.

The 3M decision required six years to be finalized after the end of its trial procedures and included six opinions over 346 pages. Nine justices formed the majority but with only a seven-judge plurality opinion.[26] Two additional majority judges concurred in the result but not the plurality opinion. Different groupings from the majority signed onto two additional concurring opinions, one responding to the dissent and the other supporting a different analysis. Eight judges dissented in three opinions. The first two dissenting opinions addressed the substantive validity of the regulations and were signed by five judges each. The final dissent, issued by four judges, included detailed arguments that the blocked income regulations are invalid procedurally pursuant to the Administrative Procedures Act and Supreme Court jurisprudence regarding the validity of actions by administrative agencies.

Judge Toro, the author of the third dissenting opinion, analyzed the Treasury's issuance of the blocked income regulations in light of the Administrative Procedure Act ("APA").[27] Citing *Chevron*, these dissenting judges challenged whether Treasury should be afforded deference regarding the regulation because deference is not warranted where the regulation is procedurally defective.[28] In promulgating the blocked income regulation, the Treasury stated that it was not required to adhere to the APA regarding its notice and comment period. Judge Toro points out that the majority acknowledges that the blocked income regulation was a departure from the Treasury's previous 1968 taxpayer-friendly regulation on the same issue. He responds that "when an agency changes an existing policy, the APA requires that it must at least 'display awareness that it is changing position' and 'show that there are good reasons for the new policy.'"[29] Moreover, Judge Toro wrote that the 1983 *State Farm**[30]*** Supreme Court decision disallows a reviewing court to divine an administrative agency's rationale after the fact. A telling sign of the importance of *Chevron* deference for the majority is that the majority's response to this dissenting opinion is that, without *Chevron*, administrative agencies and the court system would be hamstrung by the undoing of years of regulatory promulgation, creating uncertainty for taxpayers and the Treasury.[31]

Coca-Cola

If the Eighth Circuit overturns the 3M Tax Court decision (whether issuing its own analysis and judgment or remanding the case to the Tax Court in light of the demise of *Chevron*), then the last part of the *Coca-Cola*[32] Tax Court decision addressing the same blocked income regulations may also require remand (because *Coca-Cola* decision relied specifically on the outcome of *3M* decision).

International Tax Regulation Cases Employing Chevron Deference

Besides the cases mentioned above, I provide three examples of cases decided after *Mayo* in which a taxpayer challenged the validity of an international tax regulation, for which a Chevron analysis was applied, and the taxpayer lost. While I am not a controversy (litigation) expert, I think these three cases would have been decided favorably for the IRS without the need for Chevron's deference.

In the 2019 Third Circuit decision *SIH Partners*, the taxpayer lost a challenge of two IRS regulations promulgated nearly fifty years earlier in 1964 that defined when a CFC's pledge or guarantee would result in the CFC being deemed the holder of the loan, and if a loan, how much of

the loan is attributed to the pledgor or guarantor.[33] The Tax Court and Third Circuit applied Chevron's deference, albeit the Third Circuit added that the Chevron analysis cannot be made in hindsight.[34] That is, the Court must apply the Chevron analysis to the record when the regulations were promulgated without consideration of evidence after that promulgation.

In the 2017 Tax Court decision *Good Fortune Shipping*, the taxpayer challenged the I.R.C. section 883 regulations.[35] For the issue in the case, the regulations established that bearer shares do not constitute ownership of stock of a foreign corporation for the purpose of the foreign corporation qualifying for the exclusion from gross income and the exemption from U.S. taxation under I.R.C. section 883(a)(1) [Ships operated by certain foreign corporations].[36] The Tax Court employed the Chevron analysis to determine the regulation's validity. Regardless, the regulations at issue were replaced for the year of the controversy but took effect for years after that.

In the 2015 Tax Court decision of *McDonald v. Comm'r*, the taxpayer argued that the IRS' one-year filing limitation for a late return to elect the foreign earned income exclusion limitation was arbitrary because the statute did not contain such a time frame.[37] The Tax Court applied the Chevron doctrine and found that the IRS may generally establish filing deadlines and may do so specifically for the purpose of I.R.C. section 911 [foreign earned income exclusion].

Domestic Tax Regulation Validity Cases Citing Chevron and/or Mayo

While readers of the Kluwer International Tax blog, like me, are most interested in regulations impacting international investments and transactions, all international tax regulations combined are a small slice of the tax regulation portfolio the IRS must draft and manage. I undertook a general legal case database search of federal cases citing *Mayo* because these cases may have the validity of a tax regulation at issue. My search resulted in 285 federal cases since 2011 when *Mayo* was decided. I briefly scanned the summary of 50 cases and noticed that sometimes Mayo is cited without regard to a tax dispute, much less the validity of an IRS regulation. When a tax regulation's validity is challenged, at least for the first 50, the court upheld the validity.

Then, I undertook a Boolean search for all the federal cases between January 1, 1985, and June 30, 2011, citing Chevron and including all the terms: tax, regulation, and validity. 863 cases resulted, of which my review of the first 30 starting from 1985 to the last 30 starting from 2011 found nearly, but not quite, two-thirds included an argument about the validity of a tax regulation. None of the tax regulations mentioned in the cases were found invalid. Granted, my general search and survey of some case results are not a deep dive. When I undertake an academic literature review later this week, I suspect that if there are relevant journal articles to find about the necessity of Chevron to the IRS winning regulation validity cases, then I will learn that cases citing Chevron would, for the most part, still result in an IRS win without Chevron deference.

I doubt that Chevron's overruling will lead to an explosion of new taxpayer cases challenging Treasury regulations. Post-Chevron, the court will still afford "careful attention to the judgment" of the Treasury to inform its inquiry.[38] To enunciate its judgment, I think that Treasury regulations will provide more preamble analysis explaining underlying Internal Revenue Code sections and the choices made in drafting the regulations. From my academic perspective, this is a positive outcome. However, drafting time and payroll costs per regulation will increase to generate such considerations and explanations of choices made. Industry and taxpayers, in general, should support Congress in providing the additional funding necessary for the Treasury to build capacity among its regulatory drafting counsel and professionals because regulations provide, whether a

taxpayer agrees with the choices made, certainty of the IRS perspective for its implementation of an underlying Code section.

[I updated this article Monday afternoon to include my Chevron and Mayo search results in the final part.]

[1] Adam Liptak, Supreme Court Imperils an Array of Federal Rules, NY Times, June 28, 2024. See https://www.nytimes.com/live/2024/06/28/us/supreme-court-chevron/heres-the-latest-on-the-decision?

[2] Mayo Found. for Med. Educ. & Research v. United States, 562 U.S. 44, 131 S. Ct. 704 (2011).

[3] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 104 S. Ct. 2778 (1984).

[4] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 842-43, 104 S. Ct. 2778, 2781 (1984).

[5] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 843, 104 S. Ct. 2778, 2782 (1984).

[6] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 865, 104 S. Ct. 2778, 2792-93 (1984).

[7] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 843-44, 104 S. Ct. 2778, 2782 (1984).

[8] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 839, 104 S. Ct. 2778, 2780 (1984).

[9] Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 864, 104 S. Ct. 2778, 2792 (1984).

[10] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882 (June 28, 2024).

[11] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *1 (June 28, 2024).

[12] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *114 (June 28, 2024).

[13] Pub. L. 94-265 (1976), 90 Stat. 331.

[14] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *18 (June 28, 2024).

[15] 85 FR 7414, 7414.

[16] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *20-21 (June 28, 2024).

[17] Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803); The Administrative Procedure Act (APA), Pub. L. 79–404 (1946), 60 Stat. 237.

[18] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *26 (June 28, 2024).

[19] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *32-33 (June 28, 2024).

[20] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *38 (June 28, 2024).

[21] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *61-62 (June 28, 2024).

[22] *See* https://crsreports.congress.gov/product/pdf/IF/IF12630/2.

[23] See William Byrnes, An 'arm's length result is not simply any result that maximizes one's tax obligations', Kluwer International Tax Blog (June 14, 2019), https://kluwertaxblog.com/2019/06/14/an-arms-length-result-is-not-simply-any-result-that-maximizes-ones-tax-obligations/.

[24] 3M Co. & Subsidiaries v. Commissioner, No. 5816-13, 2023 U.S. Tax Ct. LEXIS 704 (T.C. Feb. 9, 2023). Appeal: Case No. 23-3772 (8th Cir.).

[25] Treas. Reg. § 1.482-1(h).

[26] William Byrnes, *The 3M Decision: Did Treasury or Congress Overturn Past Jurisprudence*?, Kluwer International Tax Blog, Feb. 11. 2023, https://kluwertaxblog.com/2023/02/11/the-3m-decision-did-treasury-or-congress-overturn-past-jurisprudence/.

[27] Administrative Procedures Act, 5 U.S.C. §§?551–559.

[28] *3M Co. & Subsidiaries v. Comm'r*, No. 5816-13, 2023 U.S. Tax Ct. LEXIS 704, at *442 (T.C. Feb. 9, 2023).

[29] Citing *Encino Motorcars, LLC*, 579 U.S. at 221 (quoting *Fox Television Stations, Inc*., 556 U.S. at 515).

[30] *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 103 S. Ct. 2856 (1983).

[31] *3M v Comm'r*, 2023 US Tax Ct LEXIS 704 160 TC No 3 at 280 (Feb. 9, 2023).

[32] *Coca-Cola Co. v. Comm'r*, No. 31183-15, 2023 Tax Ct. Memo LEXIS 138 (T.C. Nov. 8, 2023). *See* initial disposition: *Coca-Cola Co. v Comm'r*, 155 T.C. 145, 2020 US Tax Ct LEXIS 27 (Nov 18, 2020).

[33] SIH Partners LLLP v. Commissioner, 923 F.3d 296, 2019 U.S. App. LEXIS 13612 (3d Cir. 2019). The two regulations are Treas. Reg. §§ 1.956-1(e)(2) and1.956-2(c)(1).

[34] SIH Partners LLLP v. Commissioner, 923 F.3d 296, 302 (3d Cir. 2019).

[35] Good Fortune Shipping SA v. Commissioner, 148 T.C. 262, 2017 U.S. Tax Ct. LEXIS 11 (2017).

[36] I.R.C. § 883(a)(1) excludes from a foreign corporation's gross income derived from the international operation of a ship or ships if such foreign country grants an equivalent exemption to corporations organized in the United States.

[37] McDonald v. Commissioner, No. 21543-13, 2015 Tax Ct. Memo LEXIS 169 (T.C. Aug. 25, 2015). Treas. Reg. § 1.911-7(a)(2).

[38] Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882, at *61-62 (June 28, 2024).

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