Loper Bright Upends Judicial Deference: Implications for the IRS, Treasury, and Taxpayers

A Practical Guidance® Article by
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On June 28, 2024, the U.S. Supreme Court decided *Loper Bright Enterprises v. Raimondo and Relentless, Inc. v. Department of Commerce*, which ended the era of judicial deference to agencies' interpretations of federal law, as expressed in formal rules and regulations. The decision will have far-reaching impacts on all federal agencies, including the US Department of the Treasury and Internal Revenue Service, as well as for taxpayers.

In *Loper Bright and Relentless*, [1] the Court expressly overruled *Chevron U.S.A. v. National Resources Defense Council, Inc.*, [2] which had required federal courts to defer to reasonable regulatory interpretations of ambiguous statutory provisions. Going forward, courts addressing challenges to agency interpretations "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority" and "may not defer" to the agency's interpretation, regardless of any ambiguities or gaps in the statutory provision being interpreted. [3]

We cover below the following topics to help taxpayers evaluate how Loper Bright will affect them and what steps they can take to protect potential claims and positively influence the development of future rules:

- Prior standards for judicial review of tax regulations
- The impact of *Loper Bright* on the review of tax regulations
- Opportunities and next steps for taxpayers
- How to stay informed

HISTORICAL STANDARDS FOR JUDICIAL REVIEW OF TAX REGULATIONS

Historically, the U.S. Supreme Court and lower federal courts gave different degrees of deference to agency interpretive rules based on a variety of factors described in the Court's 1944 decision in *Skidmore v. Swift*. [4] Those factors included the degree of formality embodied in the process through which a rule was made, the "specialized experience" and "broader" knowledge of the agency making the rule, the public interest in consistency between the enforcement standards applied by the agency and the standards to be applied by the courts in disputes among private parties, and the persuasive force of the interpretation, as driven by, among other things, "the thoroughness evident in its consideration, the validity of its reasoning, [and] its consistency with earlier and later pronouncements." [5]

In tax cases, the *Skidmore* factors typically resulted in deference, although that was not always the case. In *National Muffler Dealers Association v. United States*, the Supreme Court explained that it had "customarily" deferred to Treasury regulations "if found to implement the congressional mandate in some reasonable manner." [6] The Court gave a number of reasons for a special degree of deference in tax matters, including (1) the U.S. Congress's explicit delegation of regulatory authority to Treasury in I.R.C. § 7805(a); (2) the fact that tax law provisions are often applied across a wide variety of factual circumstances, and in that context specific rules and regulations can promote consistency in application; and (3) the "master[y]" of technical tax law that the IRS and Treasury bring to statutory interpretation.

Nevertheless, in *National Muffler* the Court continued to rely on multiple factors to determine whether Treasury had acted in a reasonable manner: (1) "whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose"; (2) whether the regulation was promulgated "substantially contemporaneous[ly]" with enactment of a statute (in which case the IRS and Treasury could be "presumed to have been aware of congressional intent"); and (3) whether the administrative interpretation was consistent and longstanding and the subject of taxpayer reliance. [7]

In *Chevron*, the Court adopted a more rigid two-step approach to judicial review of agency interpretations of law. [8] In step one, the court considered whether the language of the statute directly addressed the precise question at issue. If so, the court was required to "give effect to the unambiguously expressed intent of Congress." [9] If Congress had not directly addressed the issue in the statutory language, *Chevron*'s second step required the court to analyze whether the agency's rule was a "permissible construction of the statute." If found permissible, the court would uphold the agency's interpretation rather than interpreting the statute itself. [10]

Impact of Loper Bright on Review of Tax Regulations

In *Loper Bright*, the Court abandoned both the methodology set out in *Chevron* and the practice of courts deferring to agencies on what the law means. The decision will pave important new avenues for taxpayers to challenge the interpretations of federal tax law in Treasury regulations. [11] When an interpretive regulation is challenged, courts will be required to apply traditional canons of statutory construction to arrive at their own interpretations of the underlying provisions of the Internal Revenue Code (Code) rather than deferring to the judgment reflected in the regulation. In defending the regulation, the IRS will have to demonstrate that Treasury's interpretation of the statute is objectively correct, not just one among a number of plausible interpretations.

Courts can still give persuasive weight to tax interpretations based on how thoroughly the IRS and Treasury considered the issue, the extent to which resolving the issue requires technical tax expertise, and the validity of the agency's reasoning. [12] In addition, Congress can still delegate to Treasury the discretionary authority to prescribe particular tax rules via regulation—as it did, for instance, in I.R.C. § 1502, which authorizes the consolidated return regulations. Courts will respect such delegations but will review the resulting regulations to ensure that Treasury has acted reasonably and within the strict scope of the delegation. [13]

The heightened standard of review under *Loper Bright* will increase the scrutiny applied to Treasury regulations and should increase the frequency of successful challenges. The decision comes at a time when Treasury and the IRS continue to issue a large number of important proposed and final regulations. [14]

Among the wide range of subjects to be addressed in anticipated or recently proposed or finalized regulations are the following:

- Interpretation of recently enacted laws, such as the Inflation Reduction Act, the CHIPS Act, and even some provisions of the Tax Cuts and Jobs Act;
- Attempts to resolve ongoing disputes that the IRS has been fighting for years, such as those around supervisory approvals for the application of penalties and the definition of a state law limited partner in the application of self-employment tax;
- Rules curbing transactions that the IRS perceives as abusive, such as basis-shifting transactions involving partnerships and syndicated conservation easements;
- Regulations reflecting new policy positions, such as the look-through of domestic pass-through entities in applying the subpart F rules, the look-through of certain corporate shareholders in applying the domestically controlled qualified investment entity (REIT or RIC) test, and the scope of income taxes eligible for the foreign tax credit; and
- New regulations regarding broker information reporting, the determination of amount realized and basis, and backup withholding for certain digital asset sales and exchanges.

We expect that *Loper Bright* will influence the substance, trajectory, and timeline of these proposed and anticipated regulations—as well as the parameters under which taxpayers may bring challenges to final regulations. Courts

will no longer simply defer to interpretations by the IRS and Treasury, but instead will give weight to each particular regulatory interpretation depending upon (among other things) the thoroughness evident in its consideration and the validity of its reasoning. As a result, the IRS and Treasury are likely to take even greater care than they already do to spell out their reasoning in regulatory preambles and to emphasize the degree to which their interpretations rely on their "body of experience and informed judgment."

Opportunities and Next Steps for Taxpayers

Loper Bright opens the door for further and more effective challenges to federal regulations, including those promulgated by the IRS and Treasury. Taxpayers should consider the resulting opportunities carefully in consultation with counsel. Where appropriate, taxpayers should consider taking steps to pursue these opportunities, including securing appropriate support for future return positions that may be inconsistent with IRS/Treasury guidance, and filing protective refund claims where existing or anticipated challenges present the opportunity to do so cost-effectively.

Assess the Impact/ Opportunities

The first step for taxpayers is to review their existing and anticipated tax positions that are affected by regulatory guidance presently being challenged or subject to future challenge, whether in the taxpayer's circuit or another circuit. There are a number of tax regulations currently being challenged in litigation:

- Transfer Pricing Blocked Income Regulation (Treas. Reg. § 1.482-1(h)(2)) [15]
- Denial of FTC on "Offset Earnings" (Treas. Reg. § 1.965-5(c)(1)(ii))[16]
- SALT Cap Charitable Deduction Workaround (Treas. Reg. § 1.170A-1(h)(3)(i))[17]
- I.R.C. § 245AEffective Date "Doughnut Hole" (Temp. Reg. § 1.245A-5T) [18]
- Conservation Easement "Enforceable in Perpetuity" Regulation (Treas. Reg. § 1.170A-14(g)(6)(ii))[19]
- Denial of I.R.C. § 245A Deduction for Foreign Tax Gross-Up (Treas. Reg. § 1.78-1(a)) [20]
- Split Dollar Life Insurance Regulations (Treas. Reg. § 1.61-22) [21]

In addition, Treasury has issued, and continues to issue, numerous proposed regulations interpreting significant provisions of the Inflation Reduction Act, including the corporate alternative minimum tax, the I.R.C. § 4501 tax on stock buybacks, and the law's many energy-related tax credit provisions. Both the economic significance of these provisions and the extensive public comments submitted suggest that there will be taxpayer challenges to many of the final regulations, and *Loper Bright* improves the prospects for those challenges.

Ask Your Advisors These Questions

Taxpayers should review their tax positions that are affected by regulations currently under review by a federal court, regulations that may likely be challenged in the future, and regulations that the taxpayer may wish to challenge.

For each of those tax positions, the taxpayer should consult with advisors to consider:

- If the position on a prior return could change for the better as a result of an existing or anticipated challenge, should a protective refund claim be filed?
- If the sustainability of a position on a prior return could change as a result of an existing or anticipated challenge, should an associated financial statement reserve be adjusted?
- If prior support for a filing position or financial statement accrual may have assumed that a regulatory position would be sustained, does the overruling of Chevron require revision of an opinion or other supporting document?
- How should existing or anticipated challenges affect the taxpayer's filing position on future returns? What support would be necessary for a change in filing position, and what disclosure and financial statement implications would follow?

Consider Avenues for Challenge

Taxpayers who may wish to challenge a regulation—or simply to preserve their rights in the event others successfully challenge it—should consult with counsel to understand the process, their available options, and the timeline associated with each approach.

The typical route for challenge is either a petition in the US Tax Court for redetermination of a tax deficiency or a tax refund suit in US District Court or the US Court of Federal Claims. A Tax Court petition requires first filing a return inconsistent with the regulation and then waiting for the IRS

to examine the return and assert a tax deficiency (and likely penalties). A refund suit requires first paying the tax (or, in the case of a divisible tax, a divisible portion of the tax), then filing a refund claim and waiting at least six months for the IRS to act on the claim.

In special cases, it may be possible to bring a challenge by suing for a declaratory judgment on the validity of a regulation or an injunction against its enforcement. In most cases, declaratory or injunctive relief will be precluded by the Anti-Injunction Act (AIA), [22] which with narrow exception bars any "suit for the purpose of restraining the assessment or collection" of a tax. However, the AIA may not bar pre-enforcement challenges to information reporting and other ancillary tax rules that are not part of the process of determining or collecting a tax.

Engage in the Regulatory Process

Recent criticisms of Treasury regulations and the associated rulemaking process have caused the IRS and Treasury to publish increasingly longer preambles that address drafting considerations and taxpayer comments in an effort to comply with the Administrative Procedure Act. *Loper Bright* will likely accentuate that trend, adding even more time and deliberation to an already lengthy process.

Taxpayers with an interest in the outcome of a particular anticipated or proposed regulation can take advantage of any expanded opportunities for or increased consideration of input in the tax rulemaking process.

Some of the many points at which taxpayers may get involved in the regulatory process include the following:

- Providing written feedback to the IRS with respect to items identified on its Priority Guidance Plan. The Priority Guidance Plan is used by Treasury's Office of Tax Policy and the IRS to identify and prioritize the tax issues that should be addressed through regulations and other administrative guidance.
- Providing written comments when the IRS and Treasury solicit feedback on anticipated published guidance. The IRS recently published Notice 2024-54 announcing the intent to publish proposed regulations addressing certain partnership basis-shifting transactions and soliciting comments with respect to certain aspects of the anticipated guidance. Issuing a notice inviting initial feedback prior to publishing proposed regulations is not customary or required in the rulemaking process. However, given *Loper Bright* and other recent regulatory challenges, it is likely that the IRS and Treasury will continue to seek public engagement earlier in the rulemaking process.
- Providing written comments to the IRS and Treasury during the notice and comment period for proposed regulations.
- Providing oral testimony during public hearings offered by the IRS and Treasury on proposed regulations.

Taxpayers should consult counsel regarding these and other possible options as soon as they become aware of a regulatory project of importance to them or anticipate that one should be or will be undertaken by the IRS and Treasury. Our Morgan Lewis Tax team stands by ready to assist.

Stay Informed

For the latest on evolving developments around the Chevron decision and its impact on companies, subscribe to our Chevron Doctrine mailing list.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please reach out to any member of our Chevron Task Force.

[1] The two cases were argued in tandem and the Court issued a single decision, with *Loper Bright* as the lead case. Our subsequent references are to "*Loper Bright*."

[2] 467 U.S. 837 (1984).

[3] *Loper Bright*, slip op. at 35.

[4] 323 U.S. 134.

[5] Id. at 139-40.

[6] 440 U.S. 472, 476-77 (1979).

[7] Id. at 477.

[8] [For many years after *Chevron* was decided courts were inconsistent in the standard of review they applied to tax regulations, with some applying *Chevron* but many others applying the more complicated reasonableness factors under *National Muffler*. The Court eventually stepped in to make clear that *Chevron* applied with full force to tax regulations. Mayo Found. for Med. Educ. & Rsch. v. United States, 562 U.S. 44, 57 (2011).

[9] 467 U.S. at 842-43.

[10] Id. at 843.

[11] Before *Loper Bright*, Treasury regulations had to clear two hurdles: (1) validity under the Administrative

Procedure Act, which examines the steps Treasury took in promulgating the regulations, explanations it gave, and responses made to substantial taxpayer comments, and (2) eligibility for deference under *Chevron*. Treasury regulations could be struck down for failing to clear either hurdle. *Loper Bright* should have no effect on the APA hurdle, which will remain.

[12] *Loper Bright*, slip op. at 10, 16-17.

[13] *Id.* at 17-18, 35.

[14] *Id.* at 16.

[15] *See* 3M Co. v. Comm'r, 160 T.C. No. 3 (2023) (reviewed) (9-8) (upholding regulation, applying Chevron), on appeal, No. 23-3772 (8th Cir.).

[16] *See* FedEx Corp. v. United States (W.D. Tenn. No. 20-CV-2794, order dated Mar. 31, 2023) (striking down regulation at Chevron step 1).

[17] *See* New Jersey v. Mnuchin, No. 19 Civ. 6642 (S.D.N.Y. Mar. 30, 2024) (upholding regulation, applying Chevron), on appeal, No. 24-1503 (2nd Cir.).

[18] *See* Liberty Glob. v. United States, No. 20-CV-03501-RBJ (D. Colo. Oct. 31, 2023) (striking down regulation on APA grounds), on appeal, No. 23-1410 (10th Cir.).

[19] *See* Valley Park Ranch, LLC v. Comm'r, 162 T.C. No. 6 (Mar. 28, 2024) (reviewed) (striking down regulation on APA grounds) (Rule 155 computations pending).

[20] Challenges to this regulation are pending in Varian Med. Sys., Inc. v. Comm'r, No. 8435-23 (U.S. Tax Ct.), and Sysco Corp. v. Comm'r, No. 5728-23 (U.S. Tax Ct.), and the Tax Court has requested supplemental briefing to address the new standard of review under *Loper Bright*.

[21] *See* McGowan v. United States, No. 3:19 Civ. 1073 (N.D. Ohio Mar. 13, 2024), on appeal, No. 24-3228 (6th Cir.).

[22] IRC § 7421.

Related Content

Cases

- Loper Bright Enters. v. Raimondo, Nos. 22-451, 22-1219, 2024 U.S. LEXIS 2882 (June 28, 2024)
- Loper Bright Enters. v. Raimondo, 458 U.S. App. D.C. 600, 45 F.4th 359 (2022)
- Relentless, Inc. v. Dept. of Commerce, No. 22-1219, 2023 U.S. LEXIS 4146 (Oct. 13, 2023)
- 3M Co. & Subsidiaries v. Commissioner, No. 5816-13, 2023 U.S. Tax Ct. LEXIS 704 (T.C. 2023)
- Mayo Found. for Med. Educ. & Research v. United States, 562 U.S. 44, 131 S. Ct. 704 (2011)
- Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837 (1984)
- Skidmore v. Swift & Co., 323 U.S. 134, 65 S. Ct. 161 (1944)

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