The Fall of Chevron Deference and the Rise of Taxpayer Engagement

This column provides an informal exchange of ideas, questions, and comments arising in everyday tax practice. The author of this column is Daniel F. Cullen, Partner, Baker & McKenzie, Chicago, Illinois. Readers are invited to write to the editors: Richard M. Lipton, Senior Counsel, Baker McKenzie, Dallas, Texas, richard.lipton@bakermckenzie.com; Samuel P. Grilli, Partner, Baker & McKenzie, Chicago, Illinois, samuel.grilli@bakermckenzie.com; and Daniel F. Cullen, Partner, Baker & McKenzie, Chicago, Illinois, daniel.cullen@bakermckenzie.com.

As predicted, *Chevron*[1] deference is dead.[2] In *Loper Bright*, the Supreme Court overruled the—at times "dizzying"[3]—*Chevron* two-step analytical framework and instructed courts to independently determine the best meaning of a statute without deference to interpretations adopted by federal agencies. Previously, for the past 40 years under *Chevron*, a court interpreting a federal agency's action had to defer to the agency's reasonable interpretation of an ambiguous statute. Now, going forward under *Loper Bright*, federal courts are not required to defer to agency interpretations of an ambiguous statute, and instead must determine the "best interpretation of a statute by exhausting the traditional tools of statutory construction."[4]

Chief Justice Roberts, writing for the majority, declared that "*Chevron* has proved to be fundamentally misguided" and that "[e]xperience has ... shown that *Chevron* is unworkable." In particular, *Chevron* failed to grapple with the Administrative Procedure Act ("APA"), the statute that lays out how judicial review of agency action works:

> The APA, in short, incorporates the traditional understanding of the judicial function, under which courts must exercise independent judgment in determining the meaning of statutory provisions. In exercising such judgment, though, courts may—as they have from the start—seek aid from the interpretations of those responsible for implementing particular statutes. Such interpretations 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance' consistent with the APA.[5]

The Supreme Court in *Loper Bright* concluded that "*Chevron* defies the command of the APA that 'the reviewing court'—not the agency whose action it reviews—is to 'decide all relevant questions of law' and 'interpret . . . statutory provisions.'"[6] Accordingly, going forward, under *Loper Bright*, when a statute is ambiguous, the judicial branch will determine the best interpretation, with agency expertise remaining relevant, albeit under a framework like that set forth in *Skidmore*.

The holding in *Loper Bright* creates a sea change relating to a taxpayer's ability to challenge the validity of an overreaching rule promulgated by Treasury and the IRS. In this new world, how should taxpayers and their advisors approach the opportunities and challenges created in the wake of *Loper Bright?* How might we address the often burdensome, and at times simply inappropriate, tax rules proposed by Treasury? Your author and editors believe *Loper Bright* should kick off an increased level of and enhanced system for taxpayer empowerment and engagement—in both the legislative and regulatory processes, as well as during audits, at Appeals and, when needed, at the courthouse door.

First, our legislative process for creating and amending the tax laws is ripe for improvement. Taxpayers, their advisors, industry organizations and Congress (especially senior tax policy staff members) have a unique and refreshed opportunity to join together in collaboration during the legislative process to ensure that statutory provisions are clear and that grants of rulemaking authority are precise and carefully tailored to specific problems. Your author recognizes this is a high and lofty goal and that, despite best efforts, it may not be achieved. Yet, at the same time, "[n]othing worth having comes easy."[7]

Second, active participation in Treasury's rulemaking process will be more important than ever. The views of taxpayers, expressed in comment letters (directly or through industry associations) are now "at least as important as the views of Treasury and the IRS."[8] Taxpayers should leverage their deep industry knowledge and hands-on tax expertise to actively engage with Treasury and the IRS through comment letters—and by testifying when possible—to shape the interpretation of tax provisions and how they will be reflected in the regulations. Active participation in the rulemaking process by key industry organizations should be strongly supported—by volunteering time and providing financial support. There are many industry organizations capable of making high-impact contributions to Treasury's rulemaking process. In your author's areas of specialty, the Real Estate Roundtable (RER), National Association of Real Estate Investment Trusts (NAREIT) and the Institute for Portfolio Alternatives (IPA) are noteworthy examples. The views expressed by taxpayers and their industries will now matter more (in comparison to the dynamic at play under *Chevron*)—the Court in *Loper Bright* made it clear that a court's view of the meaning of a statute is informed not only by the agency's view, but also by the disputing parties and *amicus curiae* (impartial third parties providing informed views on the interpretive issues at hand).

Active participation by taxpayers, their advisors, and industry organizations will help induce Treasury and the IRS to adopt statutory interpretations that best follow the text of the tax provisions at issue. If Treasury adopts an interpretation contrary to the views outlined by taxpayers, their advisors, and industry organizations, Treasury will need to specifically memorialize and defend the reasons its interpretation of the statute is better. The administrative record developed together will be highly relevant to a reviewing court exercising its independent evaluation of the best interpretation of the statute as required by *Loper Bright*. If the reviewing court finds the interpretation and reasoning offered by Treasury to be lacking, under the *Skidmore* framework and *Loper Bright*, the views of taxpayers, as documented in the rulemaking process, could

ultimately be adopted. To achieve these results, active participation in the rulemaking process will be critical going forward.

Third, taxpayers should develop a greater level of comfort challenging inappropriate tax regulations—during audit, at Appeals, and in federal court. For the past several years, "Treasury has become increasingly aggressive in their rulemaking, issuing regulations that purport to override or rewrite clear statutory text regardless of whether Treasury and the IRS claim to be acting pursuant to a specific grant of rulemaking authority or the more general grant under section 7805."[9] In recent years, many of us have informed Treasury that certain regulations were contrary to statutory language, or exceeded Treasury's rulemaking authority. The response from Treasury often has been lacking. Taxpayers should closely monitor these regulations.

Recently, your author and editors have called out (directly or in connection with others) several regulations subject to challenge in our view—including, but not limited to, (i) the recently published final regulations defining domestically controlled qualified investment entities ("QIE") under Treas. Reg. 1.897-1(c)(3), (ii) the general partnership anti-abuse rule under Treas. Reg. 1.701-2 (the validity of which is at issue in the *Tribune Media* case), and (iii) the forthcoming proposed regulations announced in Notice 2024-54, which purport to override the Code's long-standing mechanical basis-allocation rules in certain partnership transactions involving related parties, as well as the related proposed regulations that would identify such transactions and substantially similar transactions as transactions of interest (a type of reportable transaction) with far-reaching retroactive effect. The IRS wants to change the partnership basis rules in certain cases that the IRS, without clear statutory authority, has now decided it considers inappropriate. The proposed rules and onerous reporting requirements are particularly capricious as they are excessively retroactive, purporting to compel taxpayers and their advisors to report routine past transactions from potentially decades ago. These new rules and regulations arbitrarily propose to override decades-long settled law to impose a massive, harsh compliance and tax burden on partnerships and their partners, and thus, appear to be especially vulnerable following the *Loper Bright* ruling.

Similarly, our colleagues recently published a lengthier list of tax regulations that may be ripe for successful challenge by taxpayers.[10]

- The section 965 regulations that purport to disallow credits for foreign taxes paid on section 965(b) previously taxed earnings and profits (a.k.a. Offset Earnings);
- The section 78 regulations that purport to disallow a section 245A dividends-received deduction for certain section 78 dividends that arise in connection with a taxpayer's section 965 inclusion;
- The section 245A regulations that purport to disallow dividends-received deductions for, or limit the applicability of, section 954(c)(6) to distributions of earnings and profits in relation to what the IRS refers to as "extraordinary disposition" or "extraordinary reduction" transactions;
- The section 951A regulations that purport to allocate a deduction or loss attributable to what the IRS calls the "disqualified basis" in a CFC's intangible property solely to "residual CFC gross income" and not to income that is factually related to the deduction; and
- The proposed stock-buyback excise tax regulations, which invent a "funding rule" found nowhere in section 4501.

In addition to the reset analytical framework provided by *Loper Bright*, the Supreme Court recently kept open the runway to the courthouse steps for taxpayers looking to challenge agency actions. In *Corner Post*,[11] the court held that that the statute of limitations for challenging agency action and rulemaking under the APA begins when a plaintiff suffers injury caused by final agency action, not when the agency action becomes final.[12] Thus, a taxpayer's ability to challenge a regulation ripens when the taxpayer experiences a "complete and present cause of action." The Supreme Court's holding in *Corner Post* allows taxpayers to challenge Treasury's actions even if the injuries occur many years after the date Treasury regulations are finalized.

Finally, when appropriate, Taxpayers should continue to question if Treasury has actual authority over a specific issue at hand—asking not if the statute is being interpreted correctly, but rather if the proposed rule itself is within the ambit of the statute. This line of questioning is often cast under the "major questions doctrine" ("MQD"), whereby "...the Supreme Court has rejected agency claims of regulatory authority when (1) the underlying claim of authority concerns an issue of "vast 'economic and political significance,' and (2) Congress has not clearly empowered the agency with authority over the issue."[13] The MQD's precise relationship to the *Chevron* doctrine has been uncertain. The Court has "arguably applied the [MQD] in the *Chevron* context in an unclear, ad hoc manner."[14] The MQD's scope in the *Loper Bright* landscape is yet to be considered; however, the MQD may continue to play an important role in challenging flawed agency rulemaking efforts.

Your author and editors strenuously urge sufficient taxpayer engagement so that we make the most of the post-*Loper Bright* opportunities available for a better federal tax system. In the days ahead we anticipate seeing taxpayers and Congress actively collaborating in the legislative process towards a clearer US tax code. Taxpayers, their advisors, and industry organizations robustly engaging in the agency rulemaking process will lead to sounder rule of law in the federal tax sphere and an improved outcome for all stakeholders. And, when necessary, taxpayers should carefully and comfortably consider raising regulatory validity challenges at all stages of a tax dispute—at audit, Appeals, and in the courts—whenever suffering under flawed regulatory interpretations by Treasury. As always, we welcome our readers' comments, particularly additional thoughts and ideas for taxpayer engagement after the fall of *Chevron* deference.

End Notes

[1] *Chevron U.S.A. v Natural Resources Defense Counsel, Inc*. 467 U.S. 837 (1984) ("*Chevron*") (the landmark decision creating a two-step legal framework requiring federal courts to defer to government agency's interpretations of a statute).

[2] The Supreme Court overturned *Chevron* on June 28, 2024, in a 6-3 decision, in a pair of related cases - *Loper Bright Enterprises v. Raimondo*, No. 22-451 (June 28, 2024) and *Relentless, Inc. v. Department of Commerce*, No. 22–1219 (June 28, 2024), *available at https://www.supremecourt.gov/opinions/23pdf/22-451_7m58.pdf*. The Supreme Court heard oral arguments this past January in the two conjoined cases, each involving small fishing companies challenging an agency rule requiring payment for a government observer on their boats.

[3] *Loper Bright* at No. 22-451, slip op. at 32.

[4] *See* Judkins, Patel and Balasubramaniam, "No more dizzying breakdancing", Baker & McKenzie, Tax News and Developments, July 2024 (hereinafter "Tax News and Developments, July 2024"), *available at* https://insightplus.bakermckenzie.com/bm/tax/united-states-no-more-dizzying-breakdancing.

[5] *Loper Bright* at No. 22-451, slip op. at 16 (*citing Skidmore v. Swift & Co.*, 323 U. S. 134, 140 (1944)).

[6] *Loper Bright* at No. 22-451, slip op. at 21 (*citing* 5 U. S. C. §706).

[7] Often credited to Theodore Roosevelt.

[8] Tax News and Developments, July 2024.

[9] *Id*.

[10] *Id*.

[11] *Corner Post, Inc. v. Bd. of Governors of Fed. Rsrv. Sys.*, No. 22-1008 (July 1, 2024).

[12] *See* Patel, Judkins and Leng "Supreme Court opens door to challenges of old agency guidance", Baker & McKenzie: Tax News and Developments, July 2024, *available at* https://insightplus.bakermckenzie.com/bm/tax/united-states-supreme-court-opens-door-to-challenges-of-old-agency-guidance.

[13] *Util. Air Regul. Grp. (UARG) v. EPA*, 573 U.S. 302, 324 (2014).

[14] *See* Congressional Research Service, In Focus, "The Major Questions Doctrine," Updated Nov. 2, 2022.