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Tax Implications of *Chevron* Challenge

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The Supreme Court will hear *Loper Bright Enterprises v. Raimondo* in the Court's term beginning this October.[1] *Loper* concerns regulations promulgated by the National Marine Fisheries Service ("NMFS") under the 1976 Magnuson-Stevens Act ("MSA"). Some of these regulations require fishing boats to carry federal agents on board to enforce the NMFS's rules, and some even require the fishermen to pay the interloping agents' salaries.

The Court declined to address technical issues of the regulations in question and instead granted *Loper* certiorari to debate whether the NMFS's regulations should be given "*Chevron*" deference.[2] The *Chevron* doctrine directs courts to defer to the regulations issued by the agency charged with implementing the law as the "correct" interpretation of a statute which is otherwise ambiguous, even if the agency's regulation is not the "best" interpretation.

Chevron has been controversial since its inception. Because agency regulations have the force of law, *Chevron* deference shifts the law-making power from Congress to the executive branch, which many view as inconsistent with the separation of powers that is foundational to the operation of our government.

What does any of this have to do with taxes? The IRS has recently lost several strategic cases regarding its rulemaking authority.[3] The *Loper* decision will be important because it could make it more difficult for the IRS to rely on *Chevron* deference in defending its Treasury regulations.

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[1] Docket No. 22-451.
[2] *See Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).
[3] *Green Valley Invs., LLC v. Comm'r of Internal Revenue*, holding Notice 2017-10 invalid due to the IRS's failure to follow required notice and comment procedures under the Administrative Procedure Act. No. 17379-19, 2022 WL 16834499 (T.C. Nov. 9, 2022); *Green Rock, LLC v. Internal Revenue Service, et al.*, similarly

Loper will undoubtedly play an important role in cases arising from the IRS's recently published Proposed Rules for Supervisory Approval of Penalties.[4] IRC 6751(b) generally requires that the initial determination to assess a penalty be personally approved in writing by the immediate supervisor of the person making the determination. Federal district and appellate courts have ruled inconsistently on exactly when such written approvals have to be made and who has authority to make them.[5] The IRS has therefore justified the proposed regulations with the need to "address uncertainty regarding various aspects of supervisory approval of penalties that have arisen due to recent judicial decisions," and noted that, "In the absence of such regulatory standards, caselaw has developed rules for the application of section 6751(b). Such judicial holdings are subject to unanticipated but frequent change, making it difficult for IRS employees to apply them in a consistent manner."[6]

The proposed rules attempt to clarify 6751(b) by classifying penalties into three groups based on the timing of a supervisor's approval of the penalty:

1) Penalties subject to pre-assessment notice subject to review in the Tax Court (i.e., a notice of deficiency):
    a. Approval required before the IRS issues the notice.
2) Penalties raised in Tax Court (i.e., in Respondent's Answer):
    a. Approval required before Respondent requests the Court to rule.
3) Penalties not subject to pre-assessment review in Tax Court (e.g., reportable transaction penalties, and most foreign information return penalties):
    a. Approval any time before assessment.

The new rules also define the "immediate supervisor" as anyone who has responsibility to approve another person's determination of the penalty without intermediary approval, and "higher level official" as any person who has authority under the IRM or has otherwise been assigned penalty approval in their job duties. This means the immediate supervisor can be more than one person.

Conclusion

The Biden Administration urged the court not to take the *Loper* case, claiming that *Chevron* promotes national uniformity.[7] Justice Gorsuch was highly critical of *Chevron* while on the 10th Circuit.[8] Regardless of the outcome, *Loper* will undoubtedly set important administrative law precedent that will shape how the IRS promulgates and enforces its rules.

Comments on the proposed regulations are due July 10, 2023. There is no specific deadline for the IRS to issue its final rules after the close of the comment period. The IRS would likely want to know the outcome of *Loper* before issuing final rules on 6751(b), and will hopefully take seriously every comment submitted in the meantime.

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finding Notice 2017-10 to be invalid and that it must be set aside for violating the Administrative Procedure Act's notice-and-comment requirement. No. 2:21-cv-01320-ACA (N.D. Ala. Feb. 2, 2023); *Farhy v. Comm'r*, holding that I.R.C. § 6038(b) has no provision authorizing assessment, and therefore the IRS cannot assess penalties under I.R.C. § 6038(b) for failure to file Form 5471. 160 T.C. No. 6 (2023).

[4] 88 Fed. Reg. 21564 (April 11, 2023)(Proposed Rule).

[5] *See, e.g. Graev* v. *Commissioner,* 147 T.C. 460, 477–81 (2016), *superseded by* 149 T.C. 485 (2017); *Chai* v. *Commissioner,* 851 F.3d 190, 218–19 (2d Cir. 2017); *Belair Woods, LLC* v. *Commissioner,* 154 T.C. 1, 13 (2020); *Beland* v. *Commissioner,* 156 T.C. 80 (2021); *Kroner* v. *Commissioner,* T.C. Memo. 2020–73, *rev'd* 48 F. 4th 1272 (11th Cir. 2022); *Carter* v. *Commissioner,* T.C. Memo. 2020–21, *rev'd* 2022 WL 4232170 (11th Cir. Sept. 14, 2022); *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner,* 29 F.4th 1066 (9th Cir. 2022), reh'g en banc denied, No. 20–73420 (9th Cir. July 14, 2022); *Minemyer v. Commissioner,* Nos. 21–9006 & 21–9007, 2023 WL 314832 (10th Cir. Jan. 19, 2023); *Kroner v. Commissioner,* 48 F. 4th 1272 (11th Cir. 2022).

[6] *See supra* n. 5.

[7] *See supra* n. 3.

[8] *See id.*

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