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In this article, Sykes examines *Loper Bright* and *Relentless* and predicts that the Supreme Court will modify *Chevron*, strengthening the hands of taxpayers involved in disputes with the IRS over the meaning and effect of Treasury regulations.

Loper Bright and *Relentless*

On October 13 the Supreme Court granted certiorari in *Relentless*.[1] In its order, the Court also directed that a briefing schedule be established to allow the case to be argued in tandem with *Loper Bright* in January 2024.[2] Both cases involve a challenge to a cost-shifting regulation issued by the Commerce Department under the Magnuson-Stevens Act, which governs commercial fishing. The cases arose from the First and D.C. circuits, respectively. Both courts upheld a federal regulation shifting the cost of federal monitors present on fishing boats to the boat owners, despite the lack of statutory authorization for that shift and even though the statute did authorize certain other specified costs to be shifted. The petitions each presented two questions but in each case, the Court granted certiorari on only one, which was stated identically in both petitions:

> Whether the Court should overrule *Chevron* or at least clarify that statutory silence concerning controversial powers expressly but narrowly granted elsewhere in the statute does not constitute an ambiguity requiring deference to the agency.

Certiorari in *Loper Bright* was granted May 1 and Justice Ketanji Brown Jackson recused herself, seemingly because she had been a member of the D.C. Circuit when it rendered that opinion. The grant of certiorari in *Loper Bright* immediately received considerable attention from commentators, for obvious reasons. That is, a Court opinion overruling or clarifying *Chevron* would have vast ramifications for the way in which (1) lower courts review the rules and regulations of federal agencies, and (2) federal agencies handle their regulatory duties. Some administrative law practitioners promptly questioned whether *Loper Bright* was a good vehicle for the regulatory question presented.[3] Over 60 amicus briefs were filed in *Loper Bright*, suggesting the importance, difficulty, and contentiousness of the issue.

The First Circuit's *Relentless* opinion came out March 16. The October grant of certiorari and the Supreme Court's unusual order that it be quickly

[1] *Relentless Inc. v. U.S. Department of Commerce*, No. 22-1219 (U.S. 2023).

[2] *Loper Bright Enterprises v. Raimondo*, No. 22-451 (U.S. 2023).

[3] *See, e.g.*, Tyler Scandalios, "*Loper Bright Enterprises v. Raimondo* — Perhaps Not the Best Vessel to Help Clarify Application of *Chevron*," Notice & Comment blog, Yale Journal on Regulation and ABA Section of Administrative Law & Regulatory Practice, June 30, 2023.

briefed and argued in tandem with *Loper Bright* (coupled with Jackson's non-recusal in *Relentless*) immediately generated commentary from practitioners and journalists.[4]

The grant of certiorari in *Relentless* suggests that the Court is striving to position itself to address, if not revise, the contours of *Chevron*, decided 40 years ago.[5] Reconsideration of *Chevron* at this point would not be premature because there appears to be ample need for clarification. In a 2020 law review article, *Chevron* was described as ubiquitous, ambiguous, and controversial[6]:

> Decades after the Supreme Court decided *Chevron*, courts and commentators continue to disagree over how *Chevron* works and what it requires courts to do. How ambiguous must a statute be before courts shift into a deferential posture, and what makes an interpretation reasonable, and thus worthy of deference? On its face, *Chevron* has two steps, but some argue the two steps are really one, plus the Court added a step zero many years ago, leading still others to contend we should add even more steps, or maybe already have.

Chevron's Massive Significance

Section 7805(a), authorizing Treasury to issue regulations interpreting virtually the entire code, provides:

> (a) Authorization
>
> Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

The Supreme Court has viewed *Chevron* as a gloss on this statute. In *Mayo*,[7] the Court held that a FICA tax regulation issued under section 7805(a) would be held invalid if it either (1) was inconsistent with the plain meaning of a statute; or (2) reflected an unreasonable interpretation of the statute — the two-step test derived from *Chevron*. Applying this test, *Mayo* upheld a regulation that prospectively reversed the uniformly favorable results obtained earlier by teaching hospitals in five courts of appeals. As *Mayo* illustrates, *Chevron* sometimes plays a pivotal role in the judicial review of Treasury regulations.

The code includes many provisions that expressly or implicitly authorize regulations that are specific to a particular provision, using text that does not necessarily mirror that found in section 7805(a).[8]

Accumulated over the last 100 years, Treasury regulations now occupy tens of thousands of pages of fine print in title 26 of the Code of Federal Regulations; and the regulations pertaining to other federal departments, agencies, and bureaus span millions of additional pages. It is safe to say that these regulations, written by non-elected federal officials, and the underlying authorization statutes, display endless variety and complexity, and they touch virtually every corner of American life, sometimes positively and sometimes negatively. The justices' task of reaching a consensus in *Loper Bright* and *Relentless* would seem challenging.

Chevron's Recurring Flaws

Given the vastness of the statutory and regulatory landscape, it would be my guess that

[4] *See* Eli Nachmany, "With a Cert Grant in *Relentless, Inc. v. Department of Commerce*, *Loper Bright* Gets Some Company," Notice & Comment blog, Yale Journal on Regulation and ABA Section of Administrative Law & Regulatory Practice, Oct. 13, 2023; Donald L.R. Goodson, "Nine Justices Should — and Now Can — Decide the Fate of *Chevron* Deference," Notice & Comment blog, Oct. 13, 2023; Elizabeth Kolbert, "The Supreme Court Looks Set to Deliver Another Blow to the Environment," *The New Yorker*, Oct. 20, 2023.

[5] *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

[6] Kristin E. Hickman and R. David Hahn, "Categorizing *Chevron*," 81 *Ohio St. L.J.* 611, at 613-614 (2020) (footnotes omitted). Several justices have been publicly critical of *Chevron*.

[7] *Mayo Foundation for Medical Education & Research v. United States*, 562 U.S. 44, 52 (2011).

[8] *See, e.g.*, section 483(f) (authorizing regulations that are "necessary or appropriate to carry out the purposes" of section 483 (respecting the accounting for interest on some deferred payments)); section 482 (conferring broad authority on Treasury to "distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among . . . organizations, trades, or businesses" that are "owned or controlled directly or indirectly by the same interests").

the majority opinion from the Supreme Court will not overturn *Chevron*, but instead will give firm instruction refining *Chevron* to the federal agencies and lower courts. One scholar has called this approach "domesticating *Chevron*."[9]

Practicing tax law in the federal courts on both sides for four decades, I have been struck by two recurring thoughts when handling disputes involving federal regulations being reviewed under *Chevron*'s two-step test.

First, Treasury seems far too willing to move forward with proposed regulations that are inconsistent with the statute they purport to interpret, in contravention of *Chevron*'s step 1.

One recent example comes from the Corporate Transparency Act, passed by Congress in January 2021. That statutory regime imposes sweeping reporting rules that apply to the nation's 30 million small businesses, many of them owned by immigrants, undercapitalized, or both.[10] In prop. reg. section 1010.380(a)(2), Treasury required that the updating of beneficial ownership information previously reported occur within 30 days after the change. The statute, however, had more generously and unambiguously provided that the updating should be done "in a timely manner, and not later than 1 year after the date on which there is a change."[11]

Obviously, a foreshortened deadline is a trap for millions of small business owners just trying to stay afloat who perhaps have contact with professional advisers only infrequently. A common example of a reportable change would be when the original owner takes on, say, her cousin as a partner. Congress was aware of the burdens imposed on the unwary by the requirement that ownership information be updated; 31 U.S.C. section 5336(b)(1)(E) directed the Treasury secretary to file a report with Congress about this "sensitive" issue. Still, this dubious proposed regulation with a short deadline conflicting with a more generous deadline set out in the statute was adopted without change (despite my emphasis on the point in my timely *Tax Notes* article).[12]

Another example of Treasury's willingness to take aggressive positions regarding a regulation that conflicts with lines drawn in a statute concerns section 1061, focusing on the long-running dispute over the tax treatment of carried interest.[13] After years of lobbying and highly visible public debate, the Tax Cuts and Jobs Act somewhat trimmed — but surely did not eliminate — the tax benefits available for carried interest. The statute drew lines. In section 1061(c)(4)(A), the new statute carved out an exception for interests held by a "corporation." Reg. section 1.1061-3(b)(2)(i), however, views and treats that statutory "corporation" exception as not encompassing an S corporation.

Treasury's casual attitude toward the text of section 1061(c)(4)(A) appears to ignore well-established law. Beginning in 1997, a code-wide definitional provision of the check-the-box regulations defined "corporation" in a way that encompasses S corporations.[14] Under the doctrine of legislative reenactment, reg. section 301.7701(a)(3)-2(b)(7) was entitled to be given the force of law — and the 2017 Congress, enacting section 1061, (1) was presumably aware of the decades-old, code-wide definitional provision, and (2) easily could have had the section 1061(c)(4)(A) exception refer to a "C corporation" if that was truly its intent. "The evident intention of Congress [is] to be collected from the words it employed."[15] "We are not at liberty to rewrite the statute passed by Congress and signed by the President."[16] "We must interpret the statute as written."[17] Much more could be said, and has, about reg. section 1.1061-3(b)(2)(i).[18]

[9] Cass R. Sunstein, "*Chevron* as Law," 107 *Geo. L.J.* 1613, 1672 (2019).

[10] *See generally* Thomas D. Sykes, "New FinCEN Reporting Will Challenge Small Companies," *Tax Notes Federal*, Jan. 10, 2022, p. 191.

[11] 31 U.S.C. section 5336(b)(1)(D).

[12] 31 C.F.R. section 1010.380(a)(2), (b)(3); Sykes, *supra* note 10.

[13] The regulatory situation in *Loper Bright* and *Relentless* is found in reg. section 1.1061-3(b)(2)(i), T.D. 9945, purportedly interpreting section 1061(c)(4)(A).

[14] Reg. section 301.7701(a)(3)-2(b)(7). See section 1374, requiring S corporations to pay income tax on built-in gains, and referring to C corporations.

[15] *United States v. Rodgers*, 150 U.S. 249, 276 (1893).

[16] *Henry Schein Inc. v. Archer & White Sales Inc.*, 139 S. Ct. 524, 528 (2019) (Kavanaugh, J., writing for a unanimous court).

[17] *Id.* at 529.

[18] *See* Sykes, "The 'Corporation' Exception to Carried Interest: A Litigator's View," *Tax Notes Federal*, Nov. 2, 2020, p. 769.

Similarly, commentators have repeatedly observed that federal courts seem too willing to gloss over the requirements of *Chevron* step 1, instead leaping (prematurely) to the inquiry under *Chevron* step 2. The courts' failure to apply step 1 rigorously likely contributes to a situation in which agencies take a casual approach toward step 1, and then move forward to step 2 with a focus on whether, from a policy standpoint, the regulation should be drafted in a way that the agency prefers. Of course, that casual approach to step 1 ignores that it is Congress's role to write the text of the law.

Second, regarding step 2 and based on my tax litigation experience, I hope that the Court will instruct the federal agencies and lower courts not to take administrative convenience into account in deciding whether a regulation is valid, at least in situations in which the regulation operates in a manifestly unfair way as applied to a particular party affected by the regulation. That is, a regulation that operates with manifest unfairness should not be upheld under step 2 because it promotes administrative convenience unless Congress has plainly authorized a tolerance for the manifest unfairness that appears. As stated in terms of *Chevron* step 2, a regulation designed to promote administrative convenience even when the result is manifestly unfair should not be viewed as a reasonable interpretation of the statute or statutes offered as justification unless the statutory context plainly authorizes the manifest unfairness at issue. (The agency, as the drafter of the regulation, should not, however, be permitted to invoke manifest unfairness to avoid the effect of a regulation that it drafted.) To avoid confusion at the agencies and in the lower courts, the Court perhaps should clarify that vague terms like "needful," "necessary," and "appropriate" found in an authorizing statute do not authorize manifest unfairness for the sake of administrative convenience, just as they do not authorize a disregard of statutory text that has a plain meaning.

Building these considerations into *Chevron*'s step 2 judge-made structure would be an impressive display of modesty that acknowledges that not even those who write legislation and regulations can always be expected to anticipate how the legislation and regulations will play out in a complex world. Modifying step 2 in this way would also help preserve respect for a tax-reporting system that is premised on voluntary compliance.

Next Steps for Taxpayers

It is my guess that the Supreme Court's majority opinion will make clarifying adjustments to *Chevron*'s two-step test but will not overturn the precedent. It seems unlikely that the Court, after having gone to the trouble of expediting the briefing and argument of the *Relentless* case and having agreed to receive over 60 amicus briefs in *Loper Bright*, would decide that the certiorari petitions were improvidently granted. Probably, the Court will, at a minimum, instruct the federal agencies and lower courts that *Chevron* step 1 should be applied rigorously, applying traditional rules of statutory construction, and not short-cut.

An opinion from the Supreme Court will likely arrive sometime in mid-2024. If a tax practitioner is aware of a tax dispute that involves a dubious Treasury regulation, it might make sense, depending on the amount of tax involved in open and future tax years, to preserve a client's right to make arguments or claims for refund based on any opinion delivered in *Loper Bright* and *Relentless*. A taxpayer ordinarily has three years from when a return was filed, or two years from when tax was paid, to file a timely and sufficient claim for refund, setting out in detail the facts and grounds on which the taxpayer relies.[19] Both the Internal Revenue Manual and case law provide that a taxpayer wanting to have the IRS take no action on a claim for refund that is premised on the outcome of pending litigation may file a protective claim for refund within the applicable limitations period. If the IRS has disallowed a refund claim, a taxpayer generally has two years within which to file suit in federal district court or the Court of Federal Claims,[20] unless the taxpayer previously signed a Form 2297, "Waiver of Statutory Notice of Claim Disallowance." In that case, the two years begins to run when the Form 2297 was signed. Post-

[19] Section 6511.

[20] *See* section 6501.

disallowance, a taxpayer should seek reconsideration (while meeting all prospective deadlines).

A taxpayer that has received a notice of deficiency from the IRS only has 90 days within which to file its petition in Tax Court, and that deadline may not be extended. The contingent argument, based on the possible outcome of *Loper Bright* and *Relentless*, should be fully explained in the taxpayer's petition.

Any original return, claim for refund, or similar document that is premised on a position that contradicts a Treasury regulation should be accompanied by a Form 8275-R, "Regulation Disclosure Statement," disclosing that conflict and the basis for the taxpayer's position.

Conclusion

The recent developments in *Loper Bright* and *Relentless* appear to be setting the stage for the Court to modify its *Chevron* precedent from 40 years ago. Modifications, if made, would likely strengthen the hands of taxpayers engaged in disputes with the IRS over the meaning and effect of Treasury regulations. Thus, taxpayers adversely affected by dubious regulations would be well advised to consider filing, within the applicable limitations period, protective papers preserving their position (accompanied by a Form 8275-R); and requesting that the IRS take no action on the protective submission until after the Supreme Court has ruled in *Loper Bright* and *Relentless* and they have been allowed to perfect their protective submissions with a discussion of the Court's new opinion. ■