Loper Bright Enterprises, Major Questions Doctrine, the Non-Delegation Doctrine, the Administrative Procedure Act, and Partnership Rules and Regulations

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§1.1 Marbury v. Madison (1803): The Province and Duty of the Judicial Department To Say What the Law Is. 35

§1.2 Legislative and Interpretive Regulations. 36

§1.3 Administrative Procedure Act (1946). 51

§1.4 Chevron v. Natural Resources Defense Council (1984): Deference To Agency Interpretations. 59

§1.5 Loper Bright Enterprises v. Raimondo: Overruling Chevron.(2024) 66

§1.6 Some General Comments on the Future of Loper Bright Enterprises 93

§1.7 Tax Planning After Loper Bright Enterprises. 102

§1.8 Situations to Consider. 104

[1] Tribune Media Company (2021). 104

[a] Whether the Subordinated Debt is Equity for Federal Income Tax Purposes. 118

[b] Whether The Special Distribution Received By Tribune Media Company Should Be Treated As Consideration For A Disguised Sale Under Treasury Regulations Section 1.707-5(B)(1). 121

[c] Government Argument that the Substance over Form Doctrine Applies to Recast the Transaction as a Sale of 95% of the Chicago Cubs Assets. 144

[d] Summary of Government Arguments on Appeal. 146

[e] Summary of Taxpayer Arguments on Appeal. 154

[f] Taxpayer Discussion of Loper Bright. 156

[g] Internal Revenue Service Discussion of Loper Bright. 157

[2] Who Is A Limited Partner For Purposes Of SECA? 158

[a] Renkemeyer, Campbell & Weaver, LLP v. Commissioner (2011): Who Is a Limited Partner for purposes of Self-Employment Income? 163

[b] Soroban Capital Partners LP (2023): Are Limited Partners of a Limited Partnership Limited Partners for purposes of Social Security? 167

[c] Sirius Solutions LLLP v. Commissioner (2024): Are Limited Partners of a Limited Partnership Subject to Self-Employment Tax? 173

[d] Denham Capital Management LP v. Commissioner (2024): Who Is A Limited Partner For Purposes Of Self-Employment Tax? 177

[3] Partnership Basis Shifting Transactions. 191

[a] Press Release, IR-2023-176: Basis Adjusting Transactions. 194

[b] Fact Sheet FS-2024-21 (June 17, 2024): Basis Adjusting Transactions. 195

[c] Notice 2024-54: Basis Adjusting Transactions. 196

[d] Revenue Ruling 2024-14: Basis Disparity Transactions and Economic Substance. 197

[i] Situation 1. 215

[ii] Situation 2. 224

[iii] Situation 3. 230

[e] Reportable Transaction Disclosure Statement. 259

[f] Proposed Regulations On Disclosure Of Basis Shifting Transactions. 260

[g] Itemized Statement Component of Advisee List. 261

[h] Treasury Regulations on Reportable Basis Shifting Transactions. 261

[i] Example of Partnership Related-Party Basis Adjustment Transaction under Proposed Section 1.6011-18(c)(1)(i). 308

[ii] Example Of A Partnership Related-Party Basis Adjustment Transaction Under Proposed Treasury Regulations 1.6011-18(C)(1)(ii). 311

[iii] Example Of A Partnership Related-Party Basis Adjustment Transaction Under Proposed Section 1.6011-18(C)(1)(iii). 312

[iv] Example Of A Partnership Related-Party Basis Adjustment Transaction Under Proposed Treasury Regulations Section 1.6011-18(C)(2). 314

[i] Biden Revenue Proposals on Basis Shifting Transactions 319

[4] Temporary Rules and Regulations. 325

[5] Profits Interest. 327

[a] Revenue Procedure 93-27: Profits Interest in Partnership for Services. 327

[b] Revenue Procedure 2001-43: Restricted Profits Partnership Interest for Services. 331

[c] ES NPA Holding, LLC v. Commissioner: Taxation of Remote Profits Interests Received as Consideration for Services (2023). 332

[6] Section 701: Partnership Antiabuse. 342

[a] Choice Of Entity; Avoidance Of Entity-Level Tax; Use Of Partnership Consistent With The Intent Of Subchapter K. 346

[b] Choice Of Entity; Avoidance Of Subchapter S Shareholder Requirements; Use Of Partnership Consistent With The Intent Of Subchapter K. 347

[c] Choice Of Entity; Avoidance Of More Restrictive Foreign Tax Credit Limitation; Use Of Partnership Consistent With The Intent Of Subchapter K. 348

[d] Choice Of Entity; Avoidance Of Gain Recognition Under Sections 351(E) And 357(C); Use Of Partnership Consistent With The Intent Of Subchapter K. 349

[e] Special Allocations; Dividends Received Deductions; Use Of Partnership Consistent With The Intent Of Subchapter K. 352

[f] Special Allocations; Nonrecourse Financing; Low-Income Housing Credit; Use Of Partnership Consistent With The Intent Of Subchapter K. 354

[g] Partner With Nominal Interest; Temporary Partner; Use Of Partnership Not Consistent With The Intent Of Subchapter K. 358

[h] Plan To Duplicate Losses Through Absence Of Section 754 Election; Use Of Partnership Not Consistent With The Intent Of Subchapter K. 359

[i] Absence Of Section 754 Election; Use Of Partnership Consistent With The Intent Of Subchapter K. 366

[j] Basis Adjustments Under Section 732; Use Of Partnership Consistent With The Intent Of Subchapter K. 371

[k] Basis Adjustments Under Section 732; Plan Or Arrangement To Distort Basis Allocations Artificially; Use Of Partnership Not Consistent With The Intent Of Subchapter K. 376

[7] Section 704: Partnership Allocation Regulations. 380

[8] Section 705: Basis. 384

[9] Section 706: Taxable Year Of A Partnership. 384

[10] Section 707: Disguised Sale and Guaranteed Payments. 384

[11] Section 708: Continuation of a Partnership. 385
[12] Section 709: Organizational and Syndication Fees. 386
[13] Section 721: Contributions. 386
[14] Section 722: Basis of Contributing Partner's Interest. 386
[15] Section 723: Basis of property contributed to a partnership. 392
[16] Section 724: Character of gain or loss on contributed unrealized receivables, inventory items, and capital loss property. 392
[17] Section 731: Extent Of Recognition Of Gain Or Loss On Distribution. 392
[18] Section 732: Basis Of Distributed Property Other Than Money. 394
[19] Section 733: Basis Of Distributee Partner's Interest. 395
[20] Section 734: Adjustment To Basis Of Undistributed Partnership Property. 395
[21] Section 735: Character Of Gain Or Loss On Disposition Of Distributed Property 395
[22] Section 736: Payments To A Retiring Partner Or A Deceased Partner's Successor In Interest. 395
[23] Section 737: Recognition Of Precontribution Gain In Case Of Certain Distributions To Contributing Partner 396
[24] Section 741: Recognition And Character Of Gain Or Loss On Sale Or Exchange. 396
[25] Section 742: Basis Of Transferee Partner's Interest. 396
[26] Section 743: Special Rules Where Section 754 Election Or Substantial Built-In Loss. 396
[27] Section 751: Unrealized Receivables And Inventory Items. 397
[28] Section 752: Treatment Of Certain Liabilities 397
[29] Section 753: Partner Receiving Income In Respect Of Decedent. 399
[30] Section 754: Manner Of Electing Optional Adjustment To Basis Of Partnership Property. 400
[31] Section 755: Rules For Allocation Of Basis. 400
[32] Section 761: Terms Defined. 400
[33] Revenue Ruling 84-53: Concept of Unitary Partnership Interest. 401
[34] Revenue Ruling 99-5: Conversion of Disregarded LLC to Recognized Tax Partnership. 404

[35] Revenue Ruling 99-6: Acquisition of All Interests in LLC and Termination of the LLC. 409

[36] Check The Box Regulations. 414

[37] Bipartisan Budget Act Partnership Audit Rules 418

[38] Non-Income Adjustment Rule 418

[39] Statute of Limitations Exception. 437

§1.9 Pre-Chevron Authorities. 451

[1] Skidmore v. Swift and Co. (1944): Correctness Of Agency Rules Is Determined Based On The Persuasiveness Of The Agency Arguments Supporting The Rules. 451

[2] National Labor Relations Board V. Hearst Publications (1944): It Is Not The Court's Function To Substitute Its Own Inferences Of Fact For The Board's, When The Latter Have Support In The Record. 453

[3] United States v. Morton Salt Co. (1950): Agency Determinations Of Fact Are Binding On The Courts, Provided That There Is Evidence To Support The Findings. 456

[4] Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council (1978): Courts Do Not Have The Authority To Require For Agency Rulemaking Additional Procedures In Addition To The Procedures Set Forth In The Administrative Procedure Act. 458

[5] National Muffler Dealers Association v. United States (1979): Courts Should Defer To Administrative Interpretations Of Statutes Only If The Administrative Interpretations Properly Implement A Congressional Mandate And Harmonize With The Plain Language Of The Statute, Its Origin, And Purpose. 477

[6] Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Auto Insurance Co. (1983): Discussion of Arbitrary and Capricious Standard. 480

§1.10 Post-Chevron Authorities. 487

[1] Auer v Robbins (1997): Administrative Interpretation Of Agency Regulation is Controlling Unless Plainly Erroneous Or Inconsistent With The Regulation. 487

[2] United States v. Mead Corporation (2001): No Chevron Deference to Informal Agency Guidance Not Subject to Notice and Comment. 488

[3] City of Arlington, Texas v. Federal Communications Commission (May 2013): Deferral To Agency In Interpreting Jurisdiction Of Agency To Adopt Rule. 494

[4] Treasury Policy Statement On The Tax Regulatory Process (2019). 507

[5] Kisor v Wilkie (2019): Deference to Agency Interpretations of Its Regulations. 510

[6] Mayo Foundation for Medical Education and Research v. United States (2021): Applied Chevron Deference to Interpretive Regulations. 518

[7] Mann Construction, Inc. v. United States (2022): Internal Revenue Service Is Generally Subject To Notice And Comment Requirements of the Administrative Procedure Act. 526

§1.11 Post Loper Bright Enterprises Authorities. 533

[1] Tennessee v. Beccera (July 2024): Recognizing and Deferring to Pre-Loper Bright Authorities under Stare Decisis. 533

[2] Restaurant Law Center v. United States Department of Labor (August 2024): No Deferral to Agency Interpretation Unless Statute is Ambiguous. 543

[3] Varian Medical Systems, Inc. v. Commissioner (August 2024): Close Reading of the Statute and Employing Conventional Rules of Statutory Interpretation, Particularly Plain Meaning Analysis. 545

[4] United States ex rel. Kyer v. Thomas Health System, Inc. (September 2024): District Court Ordered Briefing On The Effects Of Loper Bright Enterprises.. 561

[5] In re MCP No. 185: Loper Bright Enterprises Appied to Federal Communications Commission Net Neutrality Rules. 564

§1.12 Statute of Limitations under Administrative Procedure Act. 581

[1] Corner Post v. Board of Governors of the Federal Reserve System (July 2024): Statute of Limitations for Bringing Actions under Administrative Procedure Act. 581

§1.13 Failure to Provide Notice and Comment. 583

[1] Green Rock LLC v. Internal Revenue Service (June 2024): Internal Revenue Service Violated Administrative Procedure Act in Issuing Notice 2017-10 Without Public Notice And Comment. 583

§1.14 Failure to Explain Reasons or Answer Comments in Regulatory Process. 588

[1] Oakbrook Land Holdings, LLC v. Commissioner (2020): Consideration of Public Comments to Proposed Regulations 588

[2] Good Fortune Shipping S.A. Shipping (2018): Failure to Explain Reason for Distinction in Regulation Between Treatment of Bearer Shares and Nominee Shares Resulted in Invalidity of Regulation. 593

[3] Altera Corporation v. Commissioner (2019): Agency Must Examine The Relevant Data And Articulate A Satisfactory Explanation For Its Action Including A Rational Connection Between The Facts Found And The Choice Made. 600

[4] 3M Company V. Commissioner (2023): Failure Of Preamble To Explain Regulation. 618

[5] Valley Park Ranch v. Commissioner (March 2024): Contribution of Conservation Easement; Regulation Invalid For Failure To Respond To Significant Comments. 628

[6] Ohio v. Environmental Protection Agency (July 2024): Invalidity Based On Failure Adequately To Respond To Comments During Notice And Comment Process. 633

[7] Teche Vermilion Sugar Cane Growers Association Inc., v. Su (September 2024): Agency Failure To Examine Relevant Data And Articulate Satisfactory Explanation For Its Action. 638

§1.15 Right to Jury Trial. 655

[1] Securities and Exchange Commission v. Jarkesy (June 2024): Seventh Amendment Gives Citizens A Right To Jury Trial In All Statutory Actions That Are Legal In Nature. 655

§1.16 Major Questions. 668

[1] Mayes V. Biden (April 2023): Executive Order Did Not Violate Major Questions Doctrine. 668

[2] West Virginia v. Environmental Protection Agency (2022): Major Questions Doctrine. 681

[3] Biden V. Nebraska (June 2024): Major Questions Doctrine. 695

[4] Swisher International, Inc., V. United States Food And Drug Administration (September 2024): Major Questions Doctrine. 695

[5] State Of Nebraska V. Su (November 2024): Executive Order Did Not Violate Major Questions Doctrine But Department Of Labor Acted Arbitrarily And Capriciously. 706

§1.17 Non-Delegation. 721

[1] Gundy v. United States (2019): Nondelegation Doctrine. 721

[2] Ryan LLC v. Federal Trade Commission (August 2024): Nondelegation Doctrine. 744

[3] Mayfield v. United States Department of Labor (September 2024): Nondelegation. 751

§1.18 Anti-Injunction Act. 760

[1] CIC Services v. Internal Revenue Service (2021): Anti-Injunction Act Did Not Prohibit Material Advisor's Suit To Enjoin The IRS Notice 2016-66 Concerning Micro-Captive Insurance Transactions as Tax Shelters, Even Though A Violation Of The Notice Might Result In A Tax Penalty. 760

This is an article about secondary effects of *Clupea harengus* on income taxation. This is an article about commercial herring fishing and its effect on the tax system. That effect has been profound.

Atlantic herring are in the family *Clupeidae*. They are of the genus *Clupea* and species *harengus*.

Atlantic herring are silvery in color. The herring are bluish or greenish-blue back. Herring can grow up to 14 inches. Herring can live up to 15 years.

Atlantic herring will migrate in schools to areas where they feed, spawn, and spend the winter. Atlantic herring spawn as early as August in Nova Scotia and eastern Maine and from October through November in the southern Gulf of Maine, Georges Bank, and Nantucket Shoals. Female herring can produce 30,000 to 200,000 eggs. Female herring deposit their eggs on rock, gravel, or sand ocean bottom. The eggs usually hatch in 7 to 10 days, depending on temperature.

By late spring, herring larvae grow into juvenile herring. The herring form large schools in coastal waters during the summer. Atlantic herring feed on zooplankton (tiny floating animals), krill, and fish larvae.

Atlantic herring are found on both sides of the North Atlantic. In the western North Atlantic, Atlantic herring are found from Labrador to Cape Hatteras, North Carolina. Atlantic herring are found in coastal and continental shelf waters.

United States wild-caught Atlantic herring are managed and harvested under United States regulations of the National Oceanic and Atmospheric Administration Fisheries. National Oceanic and Atmospheric Administration Fisheries provides professionally trained

biological technicians as observers of herring fishing.[1] The government observers gather first-hand data on what is caught and what is discarded by United States commercial fishing vessels. Data that the National Oceanic and Atmospheric Administration Fisheries observers collect is used to monitor federal fisheries, to assess fish populations, to set fishing quotas and to ensure that fish and fishermen have a future.

In 2020, NOAA Fisheries published a final rule implementing the New England Industry-Funded Monitoring (Industry Funded Monitoring) Omnibus Amendment. The Amendment established a new Industry Funded Monitoring program in the herring fishery when federal funding is available to cover NOAA Fisheries cost responsibilities above the costs for Standardized Bycatch Reporting Methodology coverage. Under the herring fishery Industry Funded Monitoring program, vessels issued a herring permit for Category A (All Areas) or Category B (Areas 2/3) must secure at-sea monitoring coverage from a NOAA Fisheries-approved service provider on declared herring trips that are selected for Industry Funded Monitoring coverage. The coverage target is 50 percent of declared herring trips, and is calculated by combining Industry Funded Monitoring and Standardized Bycatch Reporting Methodology coverage. Costs associated with the Industry Funded Monitoring program are split into two categories: NOAA Fisheries administrative costs; and industry sampling costs. NOAA Fisheries began selecting declared herring trips for Industry Funded Monitoring coverage on July 1, 2021.[2]

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[1] Directed from the Regional Office in Gloucester, Massachusetts, Greater Atlantic Regional Fisheries Office of the National Oceanic and Atmospheric Administration Fisheries has four field offices in the Greater Atlantic region: Orono, Maine; Sandy Hook, New Jersey; Annapolis, Maryland; and Gloucester Point, Virginia. National Oceanic and Atmospheric Administration Fisheries has port agents and other industry liaison staff in Sedgewick, Maine; Portland, Maine; Gloucester, Massachusetts; New Bedford, Massachusetts; Point Judith, Rhode Island; Saunderstown, Rhode Island; East Hampton, New York; Toms River, New Jersey; Northfield, New Jersey; Belle Haven, Virginia; and Hampton, Virginia.

[2] When there is no Federal funding available to cover NOAA Fisheries cost responsibilities above Standardized Bycatch Reporting Methodology coverage costs in a given year, then no Industry Funded Monitoring program operates during that year. NOAA Fisheries does not have a permanent source of federal funding to cover the agency's administrative costs associated with the herring Industry Funded Monitoring program in 2023. The program was suspended in 2023 until funding is available. Herring vessels will still need to comply with the notification and reporting requirements for the fishery, and the need to carry a Northeast Fishery Observer Program (NEFOP) observer when selected for Standardized Bycatch Reporting Methodology coverage, while the Industry Funded Monitoring program is suspended. Industry-funded observer programs were created as early as 1990 and managers have continued to create these programs under the Magnuson-Stevens Act in the more than 30 years since.

The New England Fishery Management Council's observer program for the herring fishery follows the course set by regional fishery management councils over decades. The herring fishery has collapsed before and is now in a delicate state. The Atlantic herring stock crashed again in 2018, it is currently overfished, and fishing for them also results in incidental catch of haddock, river herring and

The National Marine Fisheries Service required herring fishermen to pay roughly $710 per day for the cost of carrying observers aboard herring fishing boats. The National Marine Fisheries Service reimbursed fishermen for the costs of the observers while the monitoring program was active. The monitoring was stopped in 2023 for lack of federal funds.

The *Loper Bright Enterprises*[3] case was brought by a group of herring fishermen from Cape May, New Jersey. These fishermen felt threatened by government regulation. These fishermen were concerned that the cost of this regulation could put the fishermen out of the herring business.

For 30 years, the Magnuson-Stevens Act gave the National Oceanic and Atmospheric Administration authority to require monitors on commercial fishing boats. The role of these monitors was to ensure "ethical" fishing practices, as determined by the National Oceanic and Atmospheric Administration.

The Magnuson-Stevens Act required the owners of certain classes of fishing boats to pay for their own monitors. The Magnuson-Stevens Act, however, did not expressly address who is responsible for paying the cost of the monitors on the herring boats used by the fishermen. For many years, the National Oceanic and Atmospheric Administration paid for the herring boat monitors. The National Oceanic and Atmospheric Administration finally ran out of money to pay for certain at-sea monitoring programs.

The National Oceanic and Atmospheric Administration promulgated rules that required that the herring fishermen pay for the cost of third-party monitors on their own fishing boats. Monitors are paid more than $700 per day per ship, which was generous compensation in the herring fishing industry.

A group of herring fishermen brought the *Loper Bright Enterprises* case to seek relief from the cost of the monitors.

The *Loper Bright Enterprises* case is significant to herring fishermen in relieving them of the burden of charges for government monitors. The *Loper Bright Enterprises* case is significant to others in overturning *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*[4] deference to administrative agencies in interpreting federal statutes with the jurisdiction of the administrative agencies.

The *Loper Bright Enterprises* case was based on a Supreme Court interpretation of the Administrative Procedure Act.

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shad. Reliable data collected by on-board observers is essential for effective fishery management and ensuring that this stock of fish can be rebuilt to sustainable levels.

[33] *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024).

[4] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

Loper Bright Enterprises challenges the competence to practice of all tax professionals. Most will be found wanting. Tax practitioners need to be competent in administrative law in order to be competent in practicing tax law. Few tax professionals are well versed in administrative law. Most tax professionals are comfortable simply relying on Internal Revenue Service rules and regulations and give little thought to the validity of the rules and regulations. Most tax professionals give advice based on regulations without the tax professionals worrying about whether the regulations are interpretive or legislative regulations – or whether the regulations are valid or invalid.

Loper Bright Enterprises and the Administrative Procedure Act provide a foundation for questioning the validity of many Treasury and Internal Revenue Service rules and regulations. This does not mean that these rules and regulations are invalid, but merely that their validity can be questioned. Few taxpayers, however, may be sufficiently well funded to be able to challenge these rules and regulations effectively. Challenging rules and regulations effectively is not easy or inexpensive.

The Supreme Court in *Loper Bright Enterprises* instructed:

> *The APA codifies for agency cases the unremarkable, yet elemental proposition reflected by judicial practice dating back to Marbury: that courts decide legal questions by applying their own judgment. It specifies that courts, not agencies, will decide "all relevant questions of law" arising on review of agency action, § 706 (emphasis added)—even those involving ambiguous laws—and set aside any such action inconsistent with the law as they interpret it. And it prescribes no deferential standard for courts to employ in answering those legal questions. That omission is telling, because Section 706 does mandate that judicial review of agency policymaking and factfinding be deferential.* [5]

The major questions doctrine [6] and the non-delegation doctrine, [7] also discussed in this article, similarly provide additional bases for challenging the validity of some Treasury and Internal Revenue Service rules and regulations.

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[5] *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244, 2261 (2024).

[6] *MCI Telecommunications Corp. v. American Telephone & Telegraph Co.*, 512 U.S. 218 (1994); *Gundy v. United States*, 139 S. Ct. 2116, 2141-42 (2019) (Gorsuch, J., dissenting); *West Virginia v. Environmental Protection Agency,* 142 S. Ct. 2587 (2022).

[7] *See Brown v Maryland,* 25 U.S. 419, 441-42 (1827) (states may not tax goods in interstate or foreign commerce while the goods remained in their original packages and had yet to become incorporated and mixed up within the mass of property in the country); *Michelin Tire Corp v Wages,* 423 US 276, 282-83 (1976) (rejecting the "original package" doctrine as a substantive rule); *J.W Hampton, Jr., & Co v United States*, 276 US 394, 409 (1928) (Congressional delegation of to an administrative agency of the power to adjust the import tariff rates failed to provide an "intelligible principle" the agency provided that tariff rates could be adjusted within a range of values in order to "equalize the . . . differences in costs of production in the United States and the principal competing country." *Id.*. at 401, *quoting* § 315(a) of Title 6 of the Tariff Act of September 21, 1922, 42 Stat 858; "'The Congress may not delegate its purely legislative power to a commission, but, having laid down the general rules of action under which a commission shall proceed, it may require of that commission

the application of such rules to particular situations and the investigation of facts, with a view to making orders in a particular matter within the rules laid down by the Congress.'" (*quoting Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U. S. 194, 214 (1912)); *Marshall Field & Co v. Clark*, 143 U.S. 649, 692 (1892) (Congressional delegation to the President under Act of Congress, Oct. 1, 1890, § 3, authorizing the president to suspend, "for such time as he shall deem just," the provisions of that act allowing the free importation of sugars, molasses, coffee, tea, and hides, as to any countries which impose upon the products of the United States duties which he "may deem to be reciprocally unequal and unjust," cannot be considered a delegation of legislative or treaty-making power; especially in view of the fact that, from the foundation of the government, Congress has frequently invested the president with similar discretion; delegation is not invalid; Act of Cong. Oct. 1, 1890, § 3, authorizing the president to suspend, "for such time as he shall deem just," the provisions of that act allowing the free importation of sugars, molasses, coffee, tea, and hides, as to any countries which impose upon the products of the United States duties which he "may deem to be reciprocally unequal and unjust," cannot be considered a delegation of legislative or treaty-making power; especially in view of the fact that, from the foundation of the government, Congress has frequently invested the president with similar discretion."; "The plaintiffs in error contend that this section, so far as it authorizes the president to suspend the provisions of the act relating to the free introduction of sugar, molasses, coffee, tea, and hides, is unconstitutional, as delegating to him both legislative and treaty-making powers, and, being an essential part of the system established by Congress, the entire act must be declared null and void. On behalf of the United States it is insisted that legislation of this character is sustained by an early decision of this court and by the practice of the government for nearly a century, and that, even if the third section were unconstitutional, the remaining parts of the act would stand."); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935) (invalidating § 9 (c) hot oil provisions of the National Industrial Recovery Act, authorizing President to prohibit transportation in interstate and foreign commerce of petroleum and petroleum products produced or withdrawn from storage in excess of the amounts permitted by state authority; delegation is void because the power sought to be delegated is legislative power, yet nowhere in the statute has Congress declared or indicated any policy or standard to guide or limit the President when acting under this delegation; Congress may lay down its policies and establish its standards and leave to selected instrumentalities the making of subordinate rules, within prescribed limits, and the determination of facts to which the policy, as declared by Congress, shall apply, but the constant recognition of the necessity and validity of such provisions, and the wide range of administrative authority which has been developed by means of them, cannot be allowed to obscure the limitations of the authority to delegate, if our constitutional system is to be maintained; if citizen is to be punished for violating a legislative order of an executive officer, board or commission, due process of law requires that it shall appear that the order is within the authority of the officer, board or commission, and if that authority depends on determinations of fact, those determinations must be shown; when the President is invested with legislative authority as the delegate of Congress in carrying out a declared policy, he necessarily acts under the constitutional restriction applicable to the delegation); *Association of American Railroads v. Department of Transportation*, 721 F.3d 666, 677 (D.C. Cir. 2013) (§ 207 of the Passenger Railroad Investment and Improvement Act of 2008 constitutes an unlawful delegation of regulatory power to AMTRAC; case involved three metrics formulated to measure on-time performance: "effective speed" (the ratio of route's distance to the average time required to travel it), "endpoint on-time performance" (the portion of a route's trains that arrive on schedule), and "all-stations on-time performance" (the degree to which trains arrive on time at each station along the route); "Federal lawmakers cannot delegate regulatory authority to a private entity. To do so would be 'legislative delegation in its most obnoxious form.' *Carter v. Carter Coal Co.*, 298 U.S. 238, 311, 56 S.Ct. 855, 80 L.Ed. 1160 (1936). This constitutional prohibition is the

The Administrative Procedure Act requires courts to exercise independent judgment in deciding whether an agency has acted within its statutory authority. The courts may not defer to an agency interpretation of the law simply because a statute is ambiguous. The Administrative Procedure Act requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority.

The Supreme Court, in *Loper Bright Enterprises v. Raimondo*,[8] recently held that courts may not defer to an agency interpretation of the law simply because a statute is ambiguous. *Loper Bright Enterprises* requires courts to seek the best reading of the statute when they are working with interpretive rules regulations. *Loper Bright Enterprises* overrules *Chevron v. Natural*

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lesser-known cousin of the doctrine that Congress cannot delegate its legislative function to an agency of the Executive Branch. See U.S. CONST. art. I, § 1 ('All legislative Powers herein granted shall be vested in a Congress of the United States')"); *National Cable Television Association v. United States*, 415 U.S. 352, 353 (1974) ("Congress, of course, does delegate powers to agencies, setting standards to guide their determination. Thus, in *Hampton & Co. v. United States*, 276 U.S. 394, 48 S.Ct. 348, 72 L.Ed. 624, Congress enacted a flexible tariff law which authorized the imposition of customs duties on articles imported which equaled the difference between the cost of producing them in a foreign country and of selling them here and the cost of producing and selling like or similar articles in the United States. Provision was made for the investigation and determination of these differences by the Tariff Commission which reported to the President who increased or decreased the duty accordingly. The Court in sustaining that system said: 'If Congress shall lay down by legislative act an intelligible principle to which the person or body authorized to fix such rates is directed to conform, such legislative action is not a forbidden delegation of legislative power.' *Id.*, at 409, 48 S.Ct. at 352."); *American Trucking Association v. Environmental Protection Agency*, 175 F.3d (D.C. Cir. 1999) (considering final rule of Environmental Protection Agency revising primary and secondary National Ambient Air Quality Standards for ozone; Environmental Protection Agency relied on unconstitutional delegation of legislative power under Clean Air Act). On non-delegation generally, see Patrick W. Duff & Horace E. Whiteside, *Delegata Potestas Non Potest Delegari: A Maxim of American Constitutional Law*, 14 Cornell L. Q. 168 (1928); Kenneth Culp Davis, 1 *Administrative Law Treatise* § 2 at 76-81 (West 1st ed. 1958); Peter H. Aranson et al., *A Theory of Legislative Delegation*, 68 Cornell L. Rev. 1 (1982); Cass R. Sunstein, *Constitutionalism After the New Deal*, 101 Harvard L. Rev. 421 (1987) ("[a] general revival of the nondelegation doctrine would also be a mistake in range of considerations,"); David Schoenbrod, *The Delegation Doctrine: Could the Court Give It Substance?*, 83 Mich. L. Rev. 1223, 1249-74 (1985); Harold J. Krent, *Delegation and Its Discontents*, 94 Colum L. Rev. 710 (1994); Gary Lawson, *The Rise and Rise of the Administrative State*, 107 Harv. L. Rev. 1231 (1994); Jerry Mashaw, *Greed, Chaos, and Governance: Using Public Choice to Improve Public Law* (Yale 1997); Peter Schuck, *Delegation and Democracy: Comments on David Schoenbrod*, 20 Cardozo L. Rev. 775 (1999); David Epstein & Sharyn O'Halloran, *The Nondelegation Doctrine and the Separation of Powers: A Political Science Approach*, 20 Cardozo L. Rev. 947 (1999); David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 Geogia L.J. 97 (2000); Cass R. Sunstein, *Nondelegation Canons*, 67 U. Chicago L. Rev. 315, 321-22 (2000); Daniel A. Farber & Philip P. Frickey, *Law and Public Choice: A Critical Introduction* 81-82 (Chicago 1991); Eric A. Posner & Adrian Vermeule, *Interring the Nondelegation Doctrine*, 49 U. Chicago L. Rev. 1721-62 (2002); Gary Lawson, *Delegation and Original Meaning*, 88 Va. L Rev. 327 (2002); Whittington & Iuliano, *The Myth of the Nondelegation Doctrine*, 165 U. Pennsylvania L. Rev. 379-431 (2017).

[8] 603 U.S. __, 144 S. Ct. 2244 (2024).

Resources Defense Council. *Loper Bright Enterprises*[9] invalidated regulations that required herring fishermen to pay for the cost of carrying federal observers aboard herring fishing boats.

Loper Bright Enterprises substantially diminishes the authority of federal agencies to interpret statutory law. *Loper Bright Enterprises* correspondingly substantially increases the authority of the courts to interpret statutory law.

Loper Bright Enterprises directs courts to rely on their own best interpretations of ambiguous statutes.

Loper Bright Enterprises may bring increasing uncertainty concerning the validity of agency interpretations and may increase the likelihood of taxpayer challenges to agency regulations.

Loper Bright Enterprises marks a major shift of power from the executive branch to the judiciary.

Loper Bright Enterprises cuts across all federal statutory law and all federal agencies. *Loper Bright Enterprises* does not overrule the many cases that relied on *Chevron*. Nevertheless, *Loper Bright* does call into question the reliability of their holdings.

The Supreme Court in *Loper Bright Enterprises* found that there is a "best reading" of each statute. This "best reading" is the "one the court, after applying all relevant interpretative tools, concludes is best."[10] The court's authority, however, is inhibited when "a particular statute delegates authority to an agency consistent with constitutional limits." Then, "courts must respect the delegation, while ensuring that the agency acts within it."[11] The Court's emphasis of Constitutional limits on delegation of authority could prove important in future cases. This indicates that the ability of Congress to delegate legislative authority to an administrative agency is not unlimited. A delegation might fail, and a consequent agency regulation, might be invalid on account of Congress exceeding Constitutional limits in delegating authority to an agency.

Loper Bright Enterprises acknowledges that many statutes contain an express delegation of power to make rules and regulations to an executive agency. *Loper Bright Enterprises* generally defers to these delegations of legislative power.

Legislative regulations still can be challenged on procedural grounds, particularly for failure comply with the notice and comment and other requirements of the Administrative Procedure Act.[12]

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[9] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[10] 142 S.Ct. at 2266.

[11] 142 S.Ct. at 2273.

[12] *Good Fortune Shipping S.A. Shipping SA v. Commissioner,* 897 F.3d 256 (D.C. Cir., 2018); *Altera Corporation v. Commissioner,* 941 F.3d. 1200 (9th Cir. 2019); *Oakbrook Land Holdings, LLC v. Commissioner*,

The general holding of *Loper Bright Enterprises* is limited by the doctrine of separation of powers between branches of government. Congress is Constitutionally limited in the legislative power that Congress can delegate to an executive agency. In appropriate circumstances, taxpayers can challenge rules and regulations under the nondelegation doctrine.[13]

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154 T.C. 180 (2020), *aff'd*, 28 F.4th 700 (6th Cir. 2022), *cert. denied*, 143 S. Ct. 626 (2023); *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022); *Valley Park Ranch v. Commissioner*, 62 T.C. No. 6 (2024); *Green Rock LLC v. Internal Revenue Service*, 104 F.4th 220 (11th Cir. 2024); *Ohio v. Environmental Protection Agency*, 603 U.S. 279 (2024), *Teche Vermilion Sugar Cane Growers Association Inc., v. Su*, 2024 W.L. 4246272 (W.D. Louisiana, September 18, 2024).

[13] *See Gundy v. United States*, 139 S. Ct. 2115 (2019). *See, also Oklahoma v. United States*, 62 F.4th 221, 228–29 (6th Cir. 2023), *cert. denied*, 144 S. Ct. 2679 (2024); *Ryan LLC v. Federal Trade Commission,* __ F. Supp. 3d __ 2024 W.L. 3879954(2024); *National Horsemen's Benevolent & Protective Association v. Black*, 107 F.4th 415 (5th Cir. 2024), *stay granted sub nom Horseracing Integrity and Safety Authority, Incorporated v. National Horsemen's Benevolent and Protective Association*, 2024 W.L. 4589181 (2024); *Alvarez v. NES Global LLC*, 2024 W.L. 4309989 (S.D. Tex., September 26, 2024) (trade association of owners and trainers of race horses and its affiliate organizations brought action against Federal Trade Commission alleging that Horseracing Integrity and Safety Act's regulatory scheme facially violated private nondelegation doctrine, Appointments Clause, Tenth Amendment, and due process; Horseracing Integrity and Safety Act's delegation of authority to Authority did not violate private nondelegation doctrine; Horseracing Integrity and Safety Act's limitation on Federal Trade Commission's ability to draft interim final rules without proposal from Authority did not violate private nondelegation doctrine; "Specifically, after remand, the original plaintiffs continue to claim that [Horseracing Integrity and Safety Act] violates the private-nondelegation doctrine under Article I and the Due Process Clause. Dkt. No. 116. Texas and the Texas Racing Commission, as intervenor-plaintiffs, raise the same arguments. Dkt. No. 155 at 22 – 25. Additionally, also after remand, another court transferred a related case to this Court. *Gulf Coast Racing LLC v. Horseracing Integrity & Safety Authority*, No. 2:22-CV-146-Z (N.D. Tex.), Dkt. No. 53. Those plaintiffs make the same private-nondelegation claim, but only as an alternative to their primary claim that [Horseracing Integrity and Safety Act] violates Article II's Appointments Clause and Article I's Vesting Clause. Dkt. No. 136. In their view, the private entity at issue—the Horseracing Integrity and Safety Authority—is, in reality, a public entity subject to the same requirements applicable to all public officers. No. 5:23-CV-077, Dkt. No. 36 at 33. They also allege, albeit briefly, that [Horseracing Integrity and Safety Act] violates the Tenth Amendment's anti-commandeering principles by requiring Texas to do the federal government's bidding. *Id.*. at 57. ¶ In light of Congress's amendment to [Horseracing Integrity and Safety Act] and the undisputed evidence following a bench trial, each of these arguments falls short. First, the plaintiffs' private-nondelegation argument reveals too much and is barred by precedent. Previously, the plaintiffs argued that '[Horseracing Integrity and Safety Act] violates the private nondelegation doctrine because the [Federal Trade Commission] cannot modify the Authority's rules.' Dkt. No. 38 at 26. Now that Congress expressly authorizes the [Federal Trade Commission] to modify the Authority's rules, the plaintiffs retreat and admit their true view: that there is nothing Congress could do to bring the [Horseracing Integrity and Safety Act] – Authority arrangement within constitutional bounds. Dkt. No. 182 at 31 – 33, 37 – 38. But this argument ignores the long history of the executive branch leveraging—with court approval—expertise from private industry so long as the industry remains subordinate to a supervisory federal agency. *E.g., Sunshine Anthracite Coal Co. v. Adkins*,

310 U.S. 381, 388, 399, 60 S.Ct. 907, 84 L.Ed. 1263 (1940) (allowing private parties to participate in price setting because the private entities 'function[ed] subordinately to the Commission' and because the Commission retained 'pervasive surveillance and authority' over the activities of the private parties); *see also Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 386 – 90, 115 S.Ct. 961, 130 L.Ed.2d 902 (1995) (detailing the 'long history of corporations created and participated in by the United States for the achievement of governmental objectives' beginning in the 18th Century). The Court understands the plaintiffs' concerns with these arrangements, especially given how long horseracing has been regulated at the local level. But because Congress brought [Horseracing Integrity and Safety Act] within the Constitution's limits as defined by the Fifth Circuit, the Court concludes that [Horseracing Integrity and Safety Act] does not violate the private non-delegation doctrine.'; 'Finally, the Fifth Circuit noted that [Horseracing Integrity and Safety Act]'s [Federal Trade Commission]-Authority relationship was materially different from the Maloney Act's SEC – FINRA model, which has consistently withstood non-delegation challenges. *Id.*. at 887. Although FINRA, like the Authority, 'is a private entity empowered to draft and propose regulations' to a federal agency, there was 'a key distinction' between the two. *Id.*. 'Unlike [Horseracing Integrity and Safety Act], the Maloney Act empowers the SEC to 'abrogate, add to, and delete from' FINRA rules 'as the [SEC] deems necessary or appropriate[.]'" *Id.., quoting* 15 U.S.C. § 78s(c) and *citing Aslin v. Fin. Indus. Regulatory Auth., Inc.*, 704 F.3d 475, 476 (7th Cir. 2013) (observing that the SEC 'may abrogate, add to, and delete from all FINRA rules as it deems necessary'). The SEC's rulemaking power, the court explained, 'meaningfully distinguishes the SEC-FINRA relationship from the [Federal Trade Commission]-Authority relationship.' *Id.*. The court recognized that while 'FINRA plays an important role in formulating securities industry rules, its role is ultimately 'in aid of' the SEC, which has the final word on the substance of the rules.' *Id.*. The Authority, in contrast, has the final word on formulating and proposing rules because of 'the limits built into the [Federal Trade Commission]'s oversight.' *Id.*. Thus, the Fifth Circuit held that 'the [Federal Trade Commission]'s power to recommend modifications is not equivalent to the power to require modifications.' *Id.*. at 888. ¶ These reasons—combined with the Fifth Circuit's view that precedent did not require affirmance—led the Court to hold that the Authority was not subordinate to the [Federal Trade Commission] and, thus, the [Federal Trade Commission]-Authority structure violated the Constitution's guarantee against private nondelegation. *Id.*. at 890."); *Daisey Trust v. Federal Housing Finance Agency*, 2024 W.L. 4267792 (D. Nev., September 20, 2024) (class action against the Federal Housing Finance Authority asserting that the way the Federal Housing Finance Authority is funded violates the Constitution's Appropriations Clause and the non-delegation doctrine; plaintiffs thus contend that the Federal Housing Finance Authority lacks authority to foreclose on their properties because it cannot constitutionally take any action unless the alleged constitutional defects are corrected; "2. Non-delegation Doctrine ¶ The defendants argue that the plaintiffs' non-delegation doctrine claim fails because that doctrine requires only that Congress set out an 'intelligible principle to guide the delegee's exercise of authority.' ECF No. 36 at 29 (quotation omitted). The defendants argue this standard is satisfied because the [Federal Housing Finance Agency]'s director may collect assessments annually 'in an amount not exceeding the amount sufficient to provide for' the agency's 'reasonable costs and expenses.' *Id.*. (quotation omitted). The defendants contend that [the Housing and Economic Recovery Act] also provides examples of reasonable costs, such as expenses incurred in conducting examinations, credit assessments, and an amount to maintain a working capital fund. They contend that other similar, or even more broadly worded, statutes have passed scrutiny under the doctrine. The plaintiffs respond that allowing the [Federal Housing Finance Agency]'s director the discretion to determine what is reasonable is an illusory limit governed only by the director's determination of what is reasonable. They argue there are no factors for the director, Congress, or the public to apply to determine when the [Federal Housing Finance Agency] has

collected too much because there is no limit to how much it can raise and it does not have to return any surplus to the Treasury. They thus contend that allowing the [Federal Housing Finance Agency] the ability to raise and spend unlimited funds without any checks on those powers violates the separation of powers and the non-delegation doctrine. Congress 'may not transfer to another branch powers which are strictly and exclusively legislative.' *Gundy v. United States*, 588 U.S. 128, 135 (2019) (quotation omitted). However, Congress 'may confer substantial discretion on executive agencies to implement and enforce the laws.' *Id.*. That is so because 'in our increasingly complex society, replete with ever changing and more technical problems,' the Supreme Court 'has understood that Congress simply cannot do its job absent an ability to delegate power under broad general directives.' *Id.*. (simplified). Consequently, 'a statutory delegation is constitutional as long as Congress lays down by legislative act an intelligible principle to which the person or body authorized to exercise the delegated authority is directed to conform.' *Id.*. (simplified). I determine whether Congress has provided an intelligible principle by examining the relevant statute's language. *Id.*. ¶ [The Housing and Economic Recovery Act] allows the [Federal Housing Finance Agency] to collect assessments 'in an amount not exceeding the amount sufficient to provide for [the Federal Housing Finance Agency's] reasonable costs' along with an amount the director 'deem[s] necessary to maintain a working capital fund.' 12 U.S.C. §§ 4516(a), (a)(3), (e). It also identifies categories of costs the [Federal Housing Finance Agency] can incur in carrying out its statutory duties, including compensating the director and other [Federal Housing Finance Agency] employees, expenses for examinations, obtaining reviews and credit assessments, and winding up affairs of certain entities. *Id.*. §§ 4516(a)(1)-(4), 4516(f)(4). The Supreme Court has found similar (or even broader) descriptions of delegated power to be intelligible principles.[12] [[12] *See, e.g., Lichter v. United States*, 334 U.S. 742, 785-86 (1948) (upholding delegation of authority to determine 'excessive profits'); *American Power & Light Co. v. SEC*, 329 U.S. 90, 104-05 (1946) (upholding delegation of authority to Securities and Exchange Commission to prevent unfair or inequitable distribution of voting power among security holders); *Yakus v. United States*, 321 U.S. 414, 420, 426 (1944) (upholding delegation to Price Administrator to promulgate regulations fixing commodity prices that, 'in his judgment will be fair and equitable and will effectuate' the relevant statute's purposes); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 600 (1944) (upholding delegation to Federal Power Commission to determine 'just and reasonable' rates); *Nat'l Broad. Co. v. United States*, 319 U.S. 190, 214, 225-26, (1943) (upholding delegation to Federal Communications Commission to regulate broadcast licensing 'as public convenience, interest, or necessity' require).] ¶ The plaintiffs argue, however, that this case is more akin to one of the few cases in which the Supreme Court has found a violation of the non-delegation doctrine: *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). In *Schechter*, the President approved a 'Live Poultry Code' under the National Industrial Recovery Act. 295 U.S. at 522-23. That Act provided, in relevant part, that upon application by a trade or industrial group, the President 'may approve a code or codes of fair competition for the trade or industry.' 45 Stat. 195, 196 (June 16, 1933). Once the President approved a code, that code set the relevant industry's 'standards of fair competition,' the violation of which would constitute unfair competition under the Federal Trade Commission Act. *Id.*. The Live Poultry Code's purpose was to establish 'a code for fair competition for the live poultry industry' in the New York City metropolitan area and included various specified unfair trade practices. *Schecter*, 295 U.S. at 522-25 (quotation omitted). ¶ The Supreme Court held that this arrangement violated the non-delegation doctrine because the trade groups could propose any code provisions so long as the code was not monopolistic. *Id.*. at 538. The President could then 'approve or disapprove their proposals as he may see fit,' as well as impose his own conditions, so long as the President found that the code would promote trade or industry. *Id.*. The Act therefore 'supplie[d] no standards for any trade, industry, or activity,' did 'not undertake to prescribe rules of conduct to be applied to particular states

of fact determined by appropriate administrative procedure,' and instead authorized that codes be made without legislatively setting standards 'aside from the statement of the general aims of rehabilitation, correction, and expansion' of the industry. *Id.*. at 541. The Court stated that '[i]n view of the scope of that broad declaration and of the nature of the few restrictions that are imposed, the [President's] discretion in approving or prescribing codes, and thus enacting laws for the government of trade and industry throughout the country, is virtually unfettered.' *Id.*. at 541-42. The Supreme Court thus held that the Act's delegation of 'code-making authority' to the President was unconstitutional. *Id.*. at 542. ¶ The [Federal Housing Finance Agency]'s statutory language bears no resemblance to the National Industrial Recovery Act. It does not delegate standardless authority to the [Federal Housing Finance Agency]. Rather, the [Federal Housing Finance Agency] is directed to spend its funds for reasonable expenses and to maintain a working capital fund to carry out the [Federal Housing Finance Agency]'s statutorily prescribed duties. Although the plaintiffs contend that 'reasonable' is whatever the [Federal Housing Finance Agency]'s director says it is, and that could theoretically allow the [Federal Housing Finance Agency] to purchase gold staplers and the like, that very example defeats the plaintiffs' argument. No one would argue that gold staplers are reasonable, nor have the plaintiffs pointed to a closer question of something the [Federal Housing Finance Agency] has actually expended funds on that would arguably be unreasonable. Reasonableness is an intelligible principle, particularly in light of the fact that the [Federal Housing Finance Agency] must annually report its operations to Congress and is subject to annual and spot audits by the Comptroller General, who must report the findings of those audits to Congress. *See Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 600 (1944) (upholding delegation to Federal Power Commission to determine 'just and reasonable' rates). The plaintiffs' non-delegation doctrine claim therefore fails as a matter of law."); *Walmsley v. Federal Trade Commission*, 117 F.4th 1032 (8th Cir. 2024) ("Walmsley contends that the Authority's rulemaking power violates the private nondelegation doctrine. Congress may not delegate its legislative power to a private entity. *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 537, 55 S.Ct. 837, 79 L.Ed. 1570 (1935). Where a private entity is subordinate to a governmental body, however, Congress may assign certain tasks to the entity. *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 397-99, 60 S.Ct. 907, 84 L.Ed. 1263 (1940); *Oklahoma v. United States*, 62 F.4th 221, 229 (6th Cir. 2023), *cert. denied*, – – – U.S. – – – – , 144 S.Ct. 2679, – – – – , – – – L.Ed.2d – – – – (2024). ¶ We agree with the Sixth and Fifth Circuits that the Act's rulemaking structure does not violate the private nondelegation doctrine. Section 3053(e) as amended gives the Commission 'ultimate discretion over the content of the rules that govern the horseracing industry.' *Oklahoma*, 62 F.4th at 230. If the Commission disagrees with policies reflected in the Authority's rules, then the Commission may change them under its power to 'abrogate, add to, and modify' the rules. *Nat'l Horsemen's Benevolent & Prot. Ass'n v. Black* (*NHBPA II*), 107 F.4th 415, 424 (5th Cir. 2024); 15 U.S.C. § 3053(e). As such, the statute 'makes the [Federal Trade Commission] the primary rule-maker, and leaves the Authority as the secondary, the inferior, the subordinate one.' *Oklahoma*, 62 F.4th at 230."); *Mayfield v. Department of Labor*, 117 F.4th 611 (5th Cir. 2024) ("Finally, we consider Mayfield's argument that the EAP Exemption, when interpreted to grant DOL the authority to issue the 2019 Minimum Salary Rule, violates the nondelegation doctrine because it lacks an intelligible principle to guide DOL's power to define and delimit the EAP Exemption's terms. As currently constituted,[7] [[7] The current formulation of the nondelegation doctrine has been called into serious question. In *Gundy v. United States*, three justices wrote that the intelligible-principle test, as applied by the Court, 'has no basis in the original meaning of the Constitution, in history, or even in the decision from which it was plucked.' 588 U.S. 128, 164, 139 S.Ct. 2116, 204 L.Ed.2d 522 (2019) (Gorsuch, J., joined by Roberts, C.J., and Thomas, J., dissenting). Justice Alito noted in his concurrence that he agreed that the Court should reconsider the doctrine, *id.* at 148 – 49, 139 S.Ct. 2116 (Alito, J., concurring), and Justice Kavanaugh,

who had not joined the Court when Gundy was decided, indicated in a subsequent writing that he too would reconsider the doctrine, *Paul v. United States*, – – – U.S. – – – – , 140 S. Ct. 342, 205 L.Ed.2d 368 (2019) (Kavanaugh, J., respecting the denial of certiorari). On the *Gundy* dissent's view, the test should be whether the statute only assigns the executive fact-finding duties, makes clear the facts to be considered and the criteria against which to evaluate them, and leaves all policy judgments to Congress, not the executive branch. *Gundy*, 588 U.S. at 166, 139 S.Ct. 2116 (Gorsuch, J., dissenting). Of course, it is not our prerogative to decide cases based on what the Supreme Court might do. *Agostini v. Felton*, 521 U.S. 203, 237, 117 S.Ct. 1997, 138 L.Ed.2d 391 (1997).] the intelligible-principle test requires Congress to set out guidance that 'delineates the general policy, the public agency which is to apply it, and the boundaries of this delegated authority.' *Mistretta v. United States*, 488 U.S. 361, 372 – 73, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989) (*quoting Am. Power & Light Co. v. SEC*, 329 U.S. 90, 105, 67 S.Ct. 133, 91 L.Ed. 103 (1946)). As the Supreme Court recently explained, '[t]hose standards . . . are not demanding,' and the Supreme Court has only twice found an excessive delegation of power, doing so in each case because 'Congress had failed to articulate any policy or standard to confine discretion.' *Gundy*, 588 U.S. at 146, 139 S.Ct. 2116 (internal quotations omitted); *see also Jarkesy v. SEC*, 34 F.4th 446, 462 (5th Cir. 2022) (holding a delegation unconstitutional because Congress provided 'no guidance whatsoever'), *aff'd*, – – – U.S. – – – – , 144 S. Ct. 2117, 219 L.Ed.2d 650 (2024). Of course, 'that does not mean we must rubber-stamp all delegations of legislative power.' *Consumers' Rsch. v. FCC*, 109 F.4th 743, 759 (5th Cir. 2024) (alterations adopted) (*quoting Big Time Vapes, Inc. v. FDA*, 963 F.3d 436, 443 (5th Cir. 2020)). To do so would be to 'shy away from our judicial duty to invalidate unconstitutional delegations.' *Id.*. (alterations adopted) (*quoting Big Time Vapes*, 963 F.3d at 443)). [Footnote omitted.] ¶ Here, as the district court correctly noted, there are at least two principles that guide and confine the authority delegated to DOL: the FLSA's statutory directive to eliminate substandard labor conditions that are detrimental to the health, efficiency, and general wellbeing of workers, 29 U.S.C. § 202(a), (b), and the text of the Exemption itself, *id.* § 213(a)(1). The guidance provided by these provisions is admittedly not straightforward, and the boundaries it delineates are neither clear nor uncontroversial. But as the Supreme Court has said, the existing standard is not demanding. *Gundy*, 588 U.S. at 146, 139 S.Ct. 2116. Under that standard, both the FLSA's purpose and the text of the Exemption itself provide at least some guidance for how DOL can exercise its authority. Therefore, they are each independently sufficient to satisfy the nondelegation doctrine's requirements. ¶ True, the Minimum Salary Rule determines which workers are protected by the FLSA. By contrast, the FLSA's purpose speaks to what workers should be protected from. But it nevertheless provides guidance. DOL can look to whether a particular group of workers is subject to the very problems the Act seeks to remedy to determine whether the Exemption should be clarified to include or exclude that group of workers.[8] [[8] The ability to effectuate the FLSA's purpose by determining which workers are and are not exempt from its protections may seem like a broad grant of authority, but it fits comfortably within a long line of cases blessing similarly broad intelligible principles that entrust the agency with effectuating a statutory purpose. *See Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 474 – 75, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) (collecting examples).] *Cf. Hewitt*, 15 F.4th at 305 (Jones, J., dissenting). DOL is also constrained by the qualification that the FLSA should improve working conditions 'without substantially curtailing employment or earning power.' 29 U.S.C. § 202(b). So while the FLSA's purpose speaks to what workers should be protected from, it nevertheless guides and limits DOL's authority to enact a rule determining which workers require protection. ¶ So too with the text of the Exemption itself. The words 'executive,' 'administrative,' and 'professional' each have meaning. That meaning both guides and limits DOL's power to 'define[ ] and delimit[ ]' them. DOL can enact rules that clarify the meaning of those terms or, as in the case of the

Minimum Salary Rule, impose some limitations on their scope. By contrast, DOL cannot enact rules that replace or swallow the meaning those terms have. It is true that the Exemption's text does not provide a precise line for what is permissible and what is not. As we have discussed, a rule that uses a proxy to determine whether something falls within the Exemption poses the difficult question of how accurate the proxy must be to be permissible. And a rule imposing a new characteristic raises the question of whether that characteristic is sufficiently connected to the existing definition. But an intelligible principle is a guide, not a definitive guide, to what can and cannot be done. As such, the Exemption itself provides an intelligible principle for the power to define and delimit its terms. ¶ The lack of clarity in both intelligible principles raises reasonable concerns, but they are concerns that are only legally relevant under a test that has been floated but never grounded in law. To require more is to ask for a level of specificity that the law does not currently demand. Thus, we join two of our sister circuits in finding that, under the existing test, DOL's authority to define and delimit the terms of the EAP Exemption is guided by an intelligible principle. *See Fanelli*, 141 F.2d at 218; *Walling*, 140 F.2d at 832 – 33."); *Novo Nordisk Inc. v. Becerra*, 2024 W.L. 3594413 (D.N.J., July 31. 2024) ("Plaintiffs' Separation of Powers claim is largely premised on the nondelegation doctrine. Plaintiffs argue that the IRA violates the nondelegation doctrine because when Congress enacted the IRA, it failed to articulate an 'intelligible principle to which' CMS 'is directed to conform.' (Plfs.' Moving Br. at 39 (quoting Touby v. United States, 500 U.S. 160, 165 (1991)). Plaintiffs recognize that the IRA defines maximum fair price and that it provides a list of factors that CMS must consider in reaching the maximum fair price, but they argue that the IRA does not explain how CMS should determine the prices or how to weigh and consider each factor. (*Id.* at 41.) Further, Plaintiffs argue that nondelegation concerns are heightened by 'Congress's decision to withdraw judicial review of CMS's price-setting decisions' because the IRA's price-setting scheme lacks a standard mechanism of ensuring accountability. (*Id.* at 42.) Along these lines, Plaintiffs suggest that the IRA is 'unlike any price-setting scheme Congress has ever created.' (*Id.* at 51.) They claim that the IRA confers 'virtually unfettered' discretion on CMS to 'control large parts of the economy' and argue that it should be invalidated. (*Id.* at 53 (*citing A.L.A Schechter Poultry Corp. v. United States*, 295 U.S. 495, 542 (1935))). ¶ Here, the Court disagrees and concludes that Plaintiffs' arguments, and the IRA generally, does not run afoul of the nondelegation doctrine for the reasons set forth below. ¶ Article I of the Constitution provides that '[a]ll legislative Powers herein granted shall be vested in a Congress of the United States' and '[a]ccompanying that assignment of power to Congress is a bar on its further delegation.' *Gundy v. United States*, 558 U.S. 128, 135 (2019) (plurality opinion). Though Congress may not transfer to the Executive or Judicial branch 'powers which are strictly and exclusively legislative,' *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 42 – 43 (1825), the Constitution permits Congress the 'necessary resources of flexibility and practicality to perform its function.' *Yakus v. United States*, 321 U.S. 414, 425 (1944) (internal quotation marks omitted). To that end, 'Congress may 'obtain the assistance of its coordinate Branches'—and in particular, may confer substantial discretion on executive agencies to implement and enforce the laws." *Gundy*, 588 U.S. at 135 (plurality opinion) (quoting Mistretta v. United States, 488 U.S. 361, 372 (1989)). The Supreme Court has 'held, time and again, that a statutory delegation is constitutional as long as congress 'lay[s] down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform." *Id.*. (*quoting Mistretta*, 488 U.S. at 372). ¶ The Supreme Court has consistently explained that the standards to satisfy an intelligible principle to guide an agency's exercise of authority 'are not demanding.' *Id.*. at 146 (plurality opinion). It is well accepted that it is 'constitutionally sufficient if Congress clearly delineates the general policy, the public agency which is to apply it, and the boundaries of this delegated authority.' *Am. Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946). Accordingly, to determine whether Congress has articulated an intelligible principle to CMS, the Court must review the statutory language of the IRA to determine

'what task it delegates and what instructions it provides.' *Gundy*, 588 U.S. at 135 – 36 (plurality opinion). '[O]nce a court interprets the statute, it may find that the constitutional question all but answers itself.' *Id.*. at 136. ¶ The Court rejects Plaintiffs' position that the IRA fails to articulate an intelligible principle and that it lacks necessary safeguards that leaves CMS with unfettered power. The IRA is a statute that directs the Secretary of HHS, acting through CMS, to establish the Program. 42 U.S.C. § 1320f(a). The IRA then describes the core functions and elements of the Program, including instructing CMS to: (1) publish a list of selected drugs; (2) enter into agreements with the manufacturers of the selected drugs; and (3) negotiate and renegotiate maximum fair prices for the selected drugs. § 1320f(a)(1) – (3). Arguably, the Court could find that Congress satisfied the constitutional standard setting forth an intelligible principle to CMS within just the first subsection of the IRA. *See Am. Power & Light Co.*, 329 U.S. at 105. ¶ However, a review of the IRA reveals that the statute provides significantly much more guidance than Plaintiffs claim. In particular, § 1320f-3 focuses on the 'negotiation and renegotiation process.' Specifically, § 1320f-3(c) explains how CMS shall determine the ceiling for the maximum fair price and § 1320f-3(e) sets forth specific criteria that CMS 'shall consider . . . as the basis for determining the offers and counteroffers' for the maximum fair price of a selected drug. There are two categories of factors. The first category of factors covers 'manufacturer-specific data' for a particular drug, including research and development costs, production and developments costs, patent application data, market data, revenue, and sales volume data. § 1320f-3(e)(1). The second category of factors covers 'evidence about alternative treatments' and includes evidence such as whether a selected drug 'represents a therapeutic advance as compared to existing therapeutic alternatives,' FDA approved prescribing information for the selected drug and its therapeutic alternatives, and the comparative effectiveness of the selected drug and its therapeutic alternatives. § 1320f-3(e)(2). Having considered and reviewed the statute, the Court finds that Congress's delegation in the IRA easily passes constitutional muster because it articulates an 'intelligible principle' to guide CMS during the negotiation process. The IRA conveys a specific, delineated task to CMS, and it explains the scope and parameters of the delegation throughout the statute. The statute sets forth a broad delegation to CMS to negotiate maximum fair prices for selected drugs, but it also narrowly defines relevant terms, sets forth the timelines for the various applicability periods, and provides CMS with guidance during the price negotiation phase. ¶ It is undisputed that since 1935, the Supreme Court 'has uniformly rejected nondelegation arguments and has upheld provisions that authorized agencies to adopt important rules pursuant to extraordinarily capacious standards.' *Gundy*, 588 U.S. at 148 – 49 (Alito, J., concurring). Notably, the Supreme Court has found a delegation to be excessive in only two cases, both in 1935, where 'Congress had failed to articulate any policy or standard' to confine discretion. *Mistretta*, 488 U.S. at 373 n.7 (emphasis added); *see Schechter*, 295 U.S. 495 (1935); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935). Given the various directions and considerations set forth in the IRA, it certainly cannot be said that Congress failed to articulate any intelligible principle in the IRA and Plaintiffs' attempts to compare the IRA to the delegations in Schechter or Panama Refining are not successful. Finding that the IRA fails to delegate an intelligible principle to CMS would disturb nearly century-long precedent upholding very broad delegations to agencies to regulate 'in the public interest' and to '"set fair and equitable" prices and 'just and reasonable' rates.' *See Gundy*, 588 U.S. at 146 (plurality opinion) (first quoting *Nat'l Broad. Co. v. United States*, 319, U.S. 190, 216 (1943); then quoting *Yakus*, 321 U.S. at 427). ¶ Further, Plaintiffs' argument that the nondelegation doctrine is violated because CMS's decisions are not subject to judicial review is misplaced. The Court agrees with Defendants that the preclusion of judicial review is not related to the nondelegation doctrine. (Defs.' Cross-Br. at 67.) As Defendants note, the nondelegation doctrine focuses on 'the power Congress has delegated to the Executive Branch, on the front end—not whether the exercise of that power is subject to otherwise-unrelated constraints,

on the back end.' (*Id.*) (emphasis added). Plaintiffs do not cite to any authority that stands for the proposition that Congress's decision to preclude judicial review triggers a violation of the nondelegation doctrine issue. [Footnote omitted.] In fact, courts have consistently considered statutes that preclude judicial review and have not indicated that such preclusion violates the nondelegation doctrine. *See, e.g., Heckler v. Chaney*, 470 U.S. 821 (1985) (discussing that the APA precludes judicial review of certain decisions); *United States v. Erika, Inc.*, 456 U.S. 201, 208 (1982) (discussing that Medicare precludes judicial review of certain determinations and claims); *Yale New Haven Hosp. v. Becerra*, 56 F.4th 9 (2d Cir. 2022) (same). Given the Court does not find that the IRA violates the nondelegation doctrine under the traditional intelligible doctrine test, the Court declines to extend the nondelegation doctrine to find that the IRA's lack of judicial review creates a nondelegation doctrine violation. Accordingly, for the reasons provided, the Court concludes that the IRA does not violate the nondelegation doctrine and it does not violate separation of powers."); *Consumer's Research v. Federal Communications Commission*, 109 F.4th 743 (5th Cir. 2024) ("The Supreme Court has held Congress has broad discretion to empower executive agencies to 'execute' the law. *See City of Arlington v. FCC*, 569 U.S. 290, 304 n.4, 133 S.Ct. 1863, 185 L.Ed.2d 941 (2013). 'When it comes to private entities, however, there is not even a fig leaf of constitutional justification. Private entities are not vested with legislative Powers. Nor are they vested with the executive Power, which belongs to the President.' *Amtrak II*, 575 U.S. at 62, 135 S.Ct. 1225 (Alito, J., concurring) (quotation and citations omitted). So it is clear that delegations to private entities raise constitutional concerns entirely distinct from delegations to the executive. ¶ Only four times has the Supreme Court considered whether a delegation to private entities violates Article I's Vesting Clause. [Footnote omitted.] ¶ First, in *Schechter Poultry*, the Court considered a constitutional challenge to the National Industrial Recovery Act ('NIRA') of 1933, 48 Stat. 195. See 295 U.S. at 519 – 21, 55 S.Ct. 837. That statute delegated to trade or industrial groups the authority to develop codes defining 'unfair method[s] of competition.' *Id.*. at 521 n.4, 55 S.Ct. 837 (quotation omitted). If the codes were approved by the President, they were to become law under 'such exceptions to and exemptions from the provisions of such code, as the President in his discretion deem[ed] necessary to effectuate the policy' of the NIRA. *Ibid.* The Court held that the statute was unconstitutional. In part, it reasoned the idea that 'Congress could delegate its legislative authority to trade or industrial associations or groups so as to empower them to enact the laws they deem to be wise and beneficent for the rehabilitation and expansion of their trade or industries,' or that 'trade or industrial associations or groups be constituted legislative bodies for that purpose because such associations or groups are familiar with the problems of their enterprises' was 'utterly inconsistent with the constitutional prerogatives and duties of Congress.' *Id.*. at 537, 55 S.Ct. 837. ¶ The next year, in *Carter v. Carter Coal Company*, 298 U.S. 238, 278, 56 S.Ct. 855, 80 L.Ed. 1160 (1936), the Court considered a delegation challenge to the Bituminous Coal Conservation Act of 1935, 49 Stat. 991 (repealed 1937). That statute authorized the district board in local coal districts (the 'code authority') to adopt a code that included agreed-upon minimum prices for coal. *Carter Coal*, 298 U.S. at 282 – 83, 56 S.Ct. 855. It also allowed an agreement between producers of more than two-thirds of the annual tonnage of coal and a majority of mine workers to set industry-wide minimum wage and maximum working-hour agreements. *Id.*. at 283 – 84, 56 S.Ct. 855. Both the minimum price codes and the labor codes bound producers—i.e., obtained legal force—without approval by any federal official. *Id.*. at 282, 284, 56 S.Ct. 855. The Court explained the statute amounted to 'delegation in its most obnoxious form' because it purported to delegate regulatory power not 'to an official or an official body, presumptively disinterested,' but rather 'to private persons whose interests . . . often are adverse' to those whom the statute authorized them to regulate. *Id.*. at 311, 56 S.Ct. 855. That, the Court held, was 'an intolerable and unconstitutional interference with personal liberty and private property.' *Ibid.* [Footnote omitted.] ¶ In *Currin v. Wallace*, 306 U.S. 1, 5 – 6, 59 S.Ct. 379, 83 L.Ed. 441

(1939), the Court considered a delegation challenge to the Tobacco Inspection Act of 1935, 49 Stat. 731 which authorized the Secretary of Agriculture to designate markets in which no tobacco could be sold unless it had 'been inspected and certified by an authorized representative of the Secretary according to the established standards.' One of the bases for the challenge was that the Secretary could not designate a market unless two-thirds of the growers voting at a prescribed referendum favored the designation. *See Currin*, 306 U.S. at 6, 15, 59 S.Ct. 379. But the producers had no power to designate the markets in which classification would be required; only the Secretary could do that. Nor did the statute even provide that the producers would help craft regulations. So unlike the private bodies in *Carter Coal*, the tobacco producers had no power to 'make the law and force it upon a minority.' *Id.*. at 15 – 16, 59 S.Ct. 379 (citation omitted). Congress merely gave them the ability to prevent certain regulations from taking effect. *See ibid.* The Court accordingly rejected the challenge on the ground that the statute did not delegate any legislative power to private entities. *Id.*. ¶ Finally, in *Sunshine Anthracite Coal Company v. Adkins*, 310 U.S. 381, 387, 60 S.Ct. 907, 84 L.Ed. 1263 (1940), the Court considered a private delegation challenge to The Bituminous Coal Act of 1937, 50 Stat. 72 (repealed 1966), a revised version of the statute the Court held unlawful in Carter Coal. Congress's most important revision was to relegate the code authorities from lawmakers to 'aid[s]' subject to the 'pervasive surveillance and authority' of the National Bituminous Coal Commission. *Sunshine Anthracite*, 310 U.S. at 388, 60 S.Ct. 907. Under the revised statute, code authorities could 'propose' minimum prices, but their proposals were legal nullities until they were expressly 'approved, disapproved, or modified' by the Coal Commission. *Ibid.* Thus, the Court concluded that the Commission, 'not the code authorities, determine[d] [coal] prices,' *Id.*. at 399, 60 S.Ct. 907, and it therefore held that the statute did not unconstitutionally delegate government power to private entities. ¶ Lower courts have discerned from these cases the 'cardinal constitutional principle [ ] that federal power can be wielded only by the federal government.' *Black*, 53 F.4th at 872. Private delegations are thus constitutional only on three conditions. First, government officials must have final decision-making authority. See Larkin, *The Private Delegation Doctrine, supra*, at 50 – 51 (noting that in every case in which the Supreme Court has upheld a private delegation, 'the law[ ] at issue . . . left final decision-making authority in the hands of a government official'). Second, agencies must actually exercise their authority rather than 'reflexively rubber stamp [work product] prepared by others.' *Sierra Club v. Lynn*, 502 F.2d 43, 59 (5th Cir. 1974); *see State v. Rettig*, 987 F.3d 518, 531 (5th Cir. 2021), *cert. denied, Tex. v. Comm'r of Internal Revenue*, – – – U.S. – – – – , 142 S. Ct. 1308, 212 L.Ed.2d 413 (2022) ('A federal agency may not abdicate its statutory duties by delegating them to a private entity.' (quotation and citation omitted)). [Footnote omitted.] And third, the private actors must always remain subject to the 'pervasive surveillance and authority' of some person or entity lawfully vested with government power. *Sunshine Anthracite*, 310 U.S. at 388, 60 S.Ct. 907. ¶ In light of these strictures on private delegations, we held unconstitutional a statute that vested a private entity with the power to make rules regulating an industry where those rules were subject only to limited agency review. *See Black*, 53 F.4th at 884 – 89. And the D.C. Circuit similarly held unconstitutional a statute that empowered Amtrak to work jointly with the Federal Railroad Administration to develop binding railroad performance standards because the statute did not vest FRA with complete regulatory control. *See Amtrak I*, 721 F.3d at 670 – 74, *vacated and remanded sub nom. Amtrak II*, 575 U.S. 43, 135 S.Ct. 1225; *see also Black*, 53 F.4th at 889 – 90 (relying on *Amtrak I*)."); *White v. Environmental Protection Agency*, 2024 W.L. 3049581 (E.D.N.C.. June 18, 2024) (case about "adjacent" wetlands and their place within the "waters of the United States" as those terms are understood in the Clean Water Act, 33 U.S.C. § 1251 *et seq.*; "Second, he argues that the Amended Rule engenders serious doubts as to its constitutionality because of the nondelegation and due process concerns. Constitutional avoidance kicks in 'where an otherwise acceptable construction of a statute would raise serious constitutional problems, [leading]

[federal courts] [to] construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.' *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. and Const. Trades Council*, 485 U.S. 568, 575, 108 S.Ct. 1392, 99 L.Ed.2d 645 (1988); *see also Williams v. Kincaid*, 45 F.4th 759, 772 (4th Cir. 2022). The doctrine of constitutional avoidance is thus an interpretative tool available when a court confronts ambiguity and alternative interpretations, and thus it is inapplicable where there is no room for ambiguity because precedent precludes interpretation. *United States v. Wass*, 954 F.3d 184, 193 – 94 (4th Cir. 2020). For that reason, constitutional avoidance has no role to play here. As discussed above, the Amended Rule faithfully conforms to Sackett's interpretation of the 'waters of the United States.' ¶ Still, going through the exercise does not change the bottom line—the Amended Rule suffers no constitutional infirmity either from the due process clause or federalism. How Sackett used these background interpretative principles is dispositive of White's argument here. That is, the Court used the federalism canon and due process concerns to reject the EPA's interpretation after it had already defined the 'waters of the United States' to include only those wetlands with a 'continuous surface connection.' *See Sackett*, 598 U.S. at 679 – 81, 143 S.Ct. 1322. It would be a strange turn of events if the Court's interpretation was susceptible to the same faults. Thus, White's attempt to wield the federalism canon and due process against the regulations that faithfully embody that test is unavailing.7 ¶ Concerning nondelegation, there is no reason to doubt either *Sackett* or the Amended Rule on nondelegation grounds. 'The nondelegation doctrine bars Congress from transferring its legislative power to another branch of Government.' *Granados v. Garland*, 17 F.4th 475, 480 (4th Cir. 2021) (citation and internal quotation marks omitted) Yet not all delegations are constitutionally impermissible. '[A] delegation is constitutional so long as Congress has set out an 'intelligible principle' to guide the delegee's exercise of authority.' *Gundy v. United States*, 588 U.S. 128, 145 – 46, 139 S.Ct. 2116, 204 L.Ed.2d 522 (2019) (plurality opinion) (quoting J.W. Hampton, Jr. & Co. v. United States, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624 (1928)). Put differently, 'a delegation is permissible if Congress has made clear to the delegee the 'general policy' [it] must pursue and the 'boundaries of [its] authority.' *Gundy*, 588 U.S. at 146, 139 S.Ct. 2116 (plurality opinion) (*quoting American Power & Light v. SEC*, 329 U.S. 90, 105, 67 S.Ct. 133, 91 L.Ed. 103 (1946)). ¶ White's nondelegation challenge is unpersuasive. The general policy of the CWA is to 'restore and maintain the chemical, physical, and biological integrity of the Nation's waters' while balancing 'the primary responsibilities and rights of States to prevent, reduce, and eliminate pollution.' 33 U.S.C. § 1251(a) – (b). That is, to be sure, a broad policy. But a broad policy in line with Congress's view of the CWA as a 'self-consciously comprehensive' statutory scheme that effected a 'total structuring and complete rewriting of the existing water pollution legislation' *Milwaukee v. Illinois*, 451 U.S. 304, 317 – 19, 101 S.Ct. 1784, 68 L.Ed.2d 114 (1981). Congress has clearly outlined the policies the Agencies must pursue: 'The [EPA] is authorized to prescribe such regulation as are necessary to carry out [its] functions' under the Act. § 1361(a); *see also Service Oil, Inc. v. EPA*, 590 F.3d 545, 549 (8th Cir. 2009) (describing EPA's rule-making authority as 'broad'). The Corps is authorized to oversee permitting and to investigate and impose penalties on those who violate the CWA. §§ 1344, 1319(g)(1). Congress, moreover, has clearly defined the 'boundaries of [the Agencies'] authority' through § 1362(7). ¶ What's more, the Supreme Court's treatment of the CWA provides all the more reason to reject White's nondelegation arguments. The Court has never questioned whether Congress included an 'intelligible principle' in the CWA, even where the Agencies have exceeded their statutory authority. *See SWANCC*, 531 U.S. at 172 – 74, 121 S.Ct. 675 (reading the CWA 'to avoid significant constitutional and federalism questions' raised by an administrative interpretation at 'the outer limits of Congress' power' but never questioning delegation of authority to agency); *Cf. Rapanos*, 547 U.S. at 758, 126 S.Ct. 2208 (Roberts, C.J., concurring) ('Given the broad, somewhat ambiguous, but nonetheless clearly limiting terms, Congress employed in the CWA, the Corps and the EPA would

have plenty of room to operate.' (emphasis added))"); *Bradford v Department of Labor*, 101 F.4th 797 (10th Cir. 2024) ("Finally, Appellants argue that we must read FPASA narrowly to avoid the constitutional question of whether the statute impermissibly delegates legislative authority. See Aplts.' Opening Br. at 34 – 38. More specifically, Appellants claim that 'an interpretation of the Procurement Act that allowed the President to unilaterally displace existing minimum wage rules for employers who merely have a special use permit' would raise a nondelegation concern. *Id.*. at 35 (emphasis omitted). We conclude that no such concerns arise here. ¶ '[W]here an otherwise acceptable construction of a statute would raise serious constitutional problems,' we must 'construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.' *Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Const. Trades Council*, 485 U.S. 568, 575, 108 S.Ct. 1392, 99 L.Ed.2d 645 (1988). Under the 'nondelegation doctrine,' which is 'rooted in the principle of separation of powers that underlies our tripartite system of Government[,] . . . Congress generally cannot delegate its legislative power to another Branch.' *Mistretta v. United States*, 488 U.S. 361, 371 – 72, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989). We therefore must interpret FPASA in a manner that does not 'raise serious' questions under the nondelegation doctrine. *DeBartolo*, 485 U.S. at 575, 108 S.Ct. 1392. ¶ '[A] delegation is constitutional so long as Congress has set out an "intelligible principle" to guide the delegee's exercise of authority.' *Gundy v. United States*, 588 U.S. 128, 139 S. Ct. 2116, 2129, 204 L.Ed.2d 522 (2019) (plurality opinion) (*quoting J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624 (1928)). The Supreme Court '[has] "almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law." *Whitman*, 531 U.S. at 474 – 75, 121 S.Ct. 903 (*quoting Mistretta*, 488 U.S. at 416, 109 S.Ct. 647 (Scalia, J., dissenting)). It has struck down statutory provisions under the nondelegation doctrine '[o]nly twice in this country's history[,] . . . in each case because "Congress had failed to articulate any policy or standard" to confine discretion.' *Gundy*, 139 S. Ct. at 2129 (*quoting Mistretta*, 488 U.S. at 373 n.7, 109 S.Ct. 647); *see also United States v. Rickett*, 535 F. App'x 668, 674 – 75 (10th Cir. 2013) (explaining that '[b]etween 1789 and 1935—a period spanning 146 years of constitutional history—the Supreme Court "never struck down a challenged statute on delegation grounds,"' and that it has done so only twice since, both times in 1935 (*quoting Mistretta*, 488 U.S. at 373, 109 S.Ct. 647)). [Footnote omitted.] And the Court has approved at least arguably broad delegations requiring agencies to regulate in the 'public interest,' *Nat'l Broad. Co. v. United States*, 319 U.S. 190, 216, 63 S.Ct. 997, 87 L.Ed. 1344 (1943), to set prices that in an agency administrator's 'judgment will be generally fair and equitable,' *Yakus v. United States*, 321 U.S. 414, 421 – 22, 427, 64 S.Ct. 660, 88 L.Ed. 834 (1944), and to set air quality standards that are 'requisite to protect the public health," *Whitman*, 531 U.S. at 472, 121 S.Ct. 903 (*quoting* 42 U.S.C. § 7409(b)(1)). ¶ Appellants' nondelegation challenge is untenable under these precedents. For example, in *Whitman*, a provision of the CAA provided an intelligible principle by merely delegating authority to set air quality standards that, 'in the judgment of the [EPA] Administrator' and in conformity with certain statutory criteria, 'are requisite to protect the public health.' 531 U.S. at 472, 121 S.Ct. 903 (emphasis added) (*quoting* 42 U.S.C. § 7409(b)(1)). The term 'requisite' channeled agency discretion because the term authorized only actions taken to protect public health that are 'sufficient, but not more than necessary.' *Id.*. at 473, 121 S.Ct. 903. Similarly, FPASA only authorizes executive orders that 'the President considers necessary' to promote an 'economical' and 'efficient' system for procuring and supplying goods and services. *See City of Albuquerque*, 379 F.3d at 914 n.6. These italicized terms likewise channel executive discretion because they encompass only actions that the President considers necessary to increase productivity or quality of service in procurement and supply with little or no waste. ¶ This analysis is also consistent with our precedent. In *City of Albuquerque*, a city brought a challenge under the Administrative Procedure Act arguing that the Department of Interior violated an executive order issued pursuant to FPASA by

selecting office space in a manner that conflicted with procedures dictated under the order. See 379 F.3d at 904 – 05, 913. To establish prudential standing, the city had to demonstrate that it was 'within the "zone of interests" of a statute supporting standing under the [APA].' *Id.*. at 913. [Footnote omitted.] Because neither the executive order nor FPASA provided an explicit right of action, the city needed to establish that the executive order had a 'statutory foundation,' in which case 'it is given the effect of a congressional statute.' *Id.*. (*quoting City of Carmel-by-the-Sea v. United States Dep't of Transp.*, 123 F.3d 1142, 1166 (9th Cir. 1997)). ¶ We concluded that FPASA 'provide[d] a sufficient statutory foundation for [the executive order].' *Id.*. at 914. As we explained, 'Congress may delegate responsibility to the executive branch so long as Congress provides an 'intelligible principle' to guide the exercise of the power.' *Id.*. (*quoting J.W. Hampton*, 276 U.S. at 409, 48 S.Ct. 348). We recognized that Congress used 'a relatively broad delegation of authority in [FPASA],' but we explained that Congress 'instruct[ed] the President's exercise of authority should establish "an economical and efficient system for . . . the procurement and supply" of property.' *Id.*. (*quoting* 40 U.S.C. § 471 (2000), *currently codified at* 40 U.S.C. § 101). And we concluded that directions in the executive order 'concerning the consideration of locations within [a] central business area are sufficiently related to [FPASA] to be a valid exercise of the Act's delegated authority.' *Id.*. In so holding, we recognized that FPASA provides an 'intelligible principle' by only authorizing actions that promote economy and efficiency in procurement and supply. *See id.* at 914 – 15.9 ¶ Thus, given the clear guidance of our precedent, we must conclude that the rule at issue here does not present any nondelegation concerns."); *United States v. Shvartsman*, 722 F.Supp.3d 276 (S.D.N.Y 2024) ("I. M. Shvartsman's Motion to Dismiss Pursuant to Article I of the Constitution ¶ M. Shvartsman's first argument is his most ambitious. He asserts that criminal prohibitions on insider trading constitute 'criminal law made by judges' in violation of Article I of the United States Constitution and the non-delegation doctrine. Dkt. No. 56 at 16. Thus, M. Shvartsman asks the Court to invalidate all criminal insider trading jurisprudence as contrary to the separation of powers. The Government retorts that M. Shvartsman's argument 'flies in the face of statutory and case law and is meritless.' Dkt. No. 66 at 3. ¶ Section 1 of Article I of the Constitution provides that '[a]ll legislative Powers herein granted shall be vested in a Congress of the United States.' U.S. Const. art. I, § 1. 'Accompanying that assignment of power to Congress is a bar on its further delegation. Congress, this Court explained early on, may not transfer to another branch powers which are strictly and exclusively legislative.' *Gundy v. United States*, 588 U.S. 128, 139 S. Ct. 2116, 2123, 204 L.Ed.2d 522 (2019) (plurality) (internal quotation marks omitted); *see also Whitman v. Am. Trucking Assocs.*, 531 U.S. 457, 472, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001). To ensure Congress does not 'unconstitutionally divest[ ] itself of its legislative responsibilities,' courts developed the non-delegation doctrine. *Gundy*, 139 S. Ct. at 2135 (Gorsuch, J., dissenting). But courts fashioned that doctrine when resolving challenges to congressional delegations to executive agencies, not the judiciary. In those non-delegation cases, courts 'repeatedly have said that when Congress confers decisionmaking authority upon agencies Congress must 'lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform."[Footnote omitted.] *Whitman*, 531 U.S. at 472, 121 S.Ct. 903 (*quoting J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624 (1928)) (emphasis omitted). '[T]he Supreme Court has found an improper delegation only twice – in *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 55 S.Ct. 837, 79 L.Ed. 1570 (1935), and in *Panama Refining Co. v. Ryan*, 293 U.S. 388, 55 S.Ct. 241, 79 L.Ed. 446 (1935).' *CFPB v. L. Offs. of Crystal Moroney, P.C.*, 63 F.4th 174, 184 n.1 (2d Cir. 2023). And 'since 1935, the Court has uniformly rejected nondelegation arguments and has upheld provisions that authorized agencies to adopt important rules pursuant to extraordinarily capacious standards.' *Gundy*, 139 S. Ct. at 2130 – 31 (Alito, J., concurring). ¶ I.M. Shvartsman's non-delegation challenge, however, opposes a purported judicial exercise of legislative power. Although not entirely unknown,[3] [[3] *See United States*

v. Buntyn, 2020 W.L. 7342688, at *4 (D.N.M. Dec. 14, 2020) (rejecting such a challenge); *United States v. Hudson*, 414 F.3d 931, 936 (8th Cir. 2005) (same); *Ugland v. United States*, 596 F. Supp. 156, 158 – 59 (D.N.J. 1984) (same).] non-delegation challenges to the judiciary's activities have largely remained a subject of academic debate,[4] [[4]*See, e.g.*, Alexander Volokh, *Judicial Non-Delegation, the Inherent-Powers Corollary, and Federal Common Law*, 66 Emory L.J. 1391 (2017); Margaret H. Lemos, *The Other Delegate: Judicially Administered Statutes and the Nondelegation Doctrine*, 81 S. Cal. L. Rev. 405 (2008).] rather than judicial precedent. Yet the judiciary is not immune from the separation of powers concerns that animate the non-delegation doctrine. Montesquieu recognized that 'there is no liberty, if the judiciary power be not separated from the legislative and executive. Were it joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control; for the judge would be then the legislator.' 1 Baron de Montesquieu, *The Spirit of Laws*, bk. XI, ch. 6, at 173 (Thomas Nugent trans., Batoche Books 2001); *accord* 1 William Blackstone, Commentaries *259 ('Were [the judicial power] joined with the legislative, the life, liberty, and property, of the subject would be in the hands of arbitrary judges, whose decisions would be then regulated only by their own opinions, and not by any fundamental principles of law.'). Chief Justice Marshall likewise warned that courts cannot exercise legislative power: 'It will not be contended that Congress can delegate to the Courts, or to any other tribunals, powers which are strictly and exclusively legislative.' *Wayman v. Southard*, 23 U.S. 1, 42, 10 Wheat. 1, 6 L.Ed. 253 (1825) (Marshall, C.J.). ¶ Only Congress can enact federal crimes. *See United States v. Hudson*, 11 U.S. 32, 34, 7 Cranch 32, 11 U.S. 32, 3 L.Ed. 259 (1812) ('The legislative authority of the Union must first make an act a crime, affix a punishment to it, and declare the Court that shall have jurisdiction of the offence.'); *see also United States v. Lanier*, 520 U.S. 259, 267 n.6, 117 S.Ct. 1219, 137 L.Ed.2d 432 (1997). Because 'the power of punishment is vested in the legislative, not in the judicial department[, i]t is the legislature, not the Court, which is to define a crime, and ordain its punishment.' *United States v. Wiltberger*, 18 U.S. 76, 95, 5 Wheat. 76, 18 U.S. 76, 5 L.Ed. 37 (1820) (Marshall, C.J.); *see also Whalen v. United States*, 445 U.S. 684, 689, 100 S.Ct. 1432, 63 L.Ed.2d 715 (1980) ('[T]he power to define criminal offenses and to prescribe the punishments to be imposed upon those found guilty of them, resides wholly with the Congress.'). ¶ According to M. Shvartsman, criminal prohibitions on insider trading transgress this fundamental division of authority between the legislative and judicial branches. Dkt. No. 56 at 6. But courts did not create insider trading doctrine *ex nihilo*. To the contrary, they have developed that doctrine as an interpretation of the anti-fraud provisions of duly enacted statutes. 18 U.S.C. § 1348 (stating that it is a crime to 'to defraud any person' in connection with certain securities or 'to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property' in connection with the purchase or sale of certain securities); 15 U.S.C. §§ 78j(b) (forbidding the use of 'any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe' in connection with the purchase or sale of securities), 78ff(a) (criminalizing willful violations of Section 78j); see 17 C.F.R. § 240.10b-5 (prohibiting any person from 'employ[ing] any device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security'); *see also Salman v. United States*, 580 U.S. 39, 41, 137 S.Ct. 420, 196 L.Ed.2d 351 (2016) ('Section 10(b) of the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b – 5 prohibit undisclosed trading on inside corporate information by individuals who are under a duty of trust and confidence that prohibits them from secretly using such information for their personal advantage.'); *United States v. Blaszczak*, 56 F.4th 230, 248 & n.20 (2d Cir. 2022) (Walker, J., concurring). ¶ 4M. Shvartsman objects that insider trading prohibitions do not appear on the face of these statutory provisions. See Dkt. No. 56 at 6. While neither 18 U.S.C. § 1348 nor 15 U.S.C. § 78j 'expressly mentions insider trading,' it does not follow that insider trading therefore falls beyond their 'broad[ ] prohibit[ions on] schemes or artifices to defraud in connection with the securities market.' *Blaszczak*,

56 F.4th at 248 (Walker, J., concurring). 'Broadly worded constitutional and statutory provisions necessarily have been given concrete meaning and application by a process of case-by-case judicial decision in the common-law tradition.' *Nw. Airlines, Inc. v. Transp. Workers Union of Am.*, AFL-CIO, 451 U.S. 77, 95, 101 S.Ct. 1571, 67 L.Ed.2d 750 (1981). Indeed, '[i]n almost any statutory scheme, there may be a need for judicial interpretation of ambiguous or incomplete provisions. But the authority to construe a statute is fundamentally different from the authority to fashion a new rule or to provide a new remedy which Congress has decided not to adopt.' *Id.*. at 97, 101 S.Ct. 1571; *see also Mistretta v. United States*, 488 U.S. 361, 417, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989) (Scalia, J., dissenting) ('The whole theory of lawful congressional 'delegation' is not that Congress is sometimes too busy or too divided and can therefore assign its responsibility of making law to someone else; but rather that a certain degree of discretion, and thus of lawmaking, inheres in most executive or judicial action, and it is up to Congress, by the relative specificity or generality of its statutory commands, to determine—up to a point—how small or how large that degree shall be.'). ¶ The judiciary has performed its constitutional duty to interpret broadly worded criminal statutes since the Founding. Congress's first criminal enactment—the Crimes Act of 1790—penalized a variety of offenses on the high seas and in federal enclaves. See 1 Stat. 112 (1790). 'The offenses, however, were merely identified and not defined by the statutory text.' Dan M. Kahan, *Lenity and Federal Common Law Crimes*, 1994 Sup. Ct. Rev. 345, 371. As a result, federal courts struggled to elucidate those offenses and even expressed concerns that 'it seemed to us too much like legislating to give a definition of our own.' *United States v. Kelly*, 26 F. Cas. 700, 701 (C.C.E.D. Pa. 1825). Yet the Supreme Court roundly rejected the notion that the Crimes Act's lack of specificity required the judiciary to exceed its constitutional role: 'This Court is of opinion, that although the act of Congress does not define this offence, it is, nevertheless, competent to the Court to give a judicial definition of it.' *United States v. Kelly*, 24 U.S. 417, 418, 11 Wheat. 417, 24 U.S. 417, 6 L.Ed. 508 (1826). ¶ Similar challenges to the judiciary's authority to interpret broad statutes arose nearly a century later, following the enactment of the 'Magna Carta of free enterprise': the Sherman Antitrust Act. *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 610, 92 S.Ct. 1126, 31 L.Ed.2d 515 (1972). The Act's laconic prohibition on '[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade,' 15 U.S.C. § 1, led critics of the statute to contend that it unconstitutionally delegated legislative power to the judiciary. For example, Standard Oil argued that the Act was 'not susceptible of being enforced by the courts because it cannot be carried out without a judicial exertion of legislative power.' *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 69, 31 S.Ct. 502, 55 L.Ed. 619 (1911). But the Supreme Court held that argument was 'clearly unsound.' *Id.*. Although the Court acknowledged that the Sherman Act 'generically enumerates the character of acts which it prohibits,' the Court rejected the proposition that 'it never can be left to the judiciary to decide whether, in a given case, particular acts come within a generic statutory provision,' as that legal principle would 'deny the existence of essential legislative authority, and challenge the right of the judiciary to perform duties which that department of the government has exerted from the beginning.' *Id.*. at 69 – 70, 31 S.Ct. 502. In reciting 'obvious examples' of judicial applications of generic provisions, the Court stated: 'Take questions of fraud.' *Id.*. at 70, 31 S.Ct. 502. Two years later, the Supreme Court upheld a criminal conviction under the Sherman Act, despite the defendant's similar objection 'that the crime thus defined by the statute contains in its definition an element of degree as to which estimates may differ.' *Nash v. United States*, 229 U.S. 373, 376, 33 S.Ct. 780, 57 L.Ed. 1232 (1913). Writing for the Court, Justice Holmes emphasized that the Sherman Act built on 'the common law as to the restraint of trade,' and that the criminal law 'is full of instances where a man's fate depends on his estimating rightly . . . some matter of degree.' *Id.*. at 377, 33 S.Ct. 780. ¶ Like the Crimes Act and the Sherman Act, the securities laws include broad proscriptions that cannot be mechanically applied in a given case. Consequently, when faced with a securities fraud case, the court must engage

in the quintessential judicial act of interpretation. *See Marbury v. Madison*, 5 U.S. 137, 177, 1 Cranch 137, 2 L.Ed. 60 (1803) ('It is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule.'); *see also Anspec Co. v. Johnson Controls, Inc.*, 922 F.2d 1240, 1245 (6th Cir. 1991) ('The authority to construe a statute lies at the very heart of judicial power.'). In applying the anti-fraud provisions of the securities laws to insider trading, courts have hewed closely to their traditional role by construing fraud—one of the most ancient and venerable doctrines of our legal tradition—in light of other common-law concepts. *See, e.g., Chiarella v. United States*, 445 U.S. 222, 227 – 28, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980) (fiduciary duties); *Dirks v. SEC*, 463 U.S. 646, 661 n.20, 103 S.Ct. 3255, 77 L.Ed.2d 911 (1983) (restitution and agency); *United States v. O'Hagan*, 521 U.S. 642, 654, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997) (embezzlement). ¶ The judiciary's resort to longstanding doctrines in expounding the meaning of securities fraud undermines the notion that insider trading doctrine has crossed the boundary from legal interpretation to outright legislation. Indeed, the division of authority between Congress and the courts in contemporary insider trading jurisprudence reflects fraud's inherently open-textured nature. It is impossible to anticipate in advance the precise manner in which one person might seek to defraud another. See 1 *J. Story, Equity Jurisprudence* § 189 163 – 64 (1839) ('Fraud, then, being so various in its nature, and so extensive in its application to human concerns, it would be difficult to enumerate all the instances in which courts . . . will grant relief under this head.'). Consequently, any attempt to exhaustively list and detail every possible fraudulent scheme by legislation would not only be futile but also enable a creative criminal to engage in wrongdoing the legislature sought to prohibit by designing a scheme that fell just outside the letter of the law. *See McAleer v. Horsey*, 35 Md. 439, 452 (1872) ('[F]or as it is the very nature and essence of fraud to elude all laws in fact, without appearing to break them in form, a technical definition of fraud, making everything come within the scope of its words before the law could deal with it as such, would be in effect telling to the crafty precisely how to avoid the grasp of the law.'). Thus, it is little surprise that our constitutional order has long permitted the Congress to legislate in broad strokes leaving room for interpretation by the courts in applying Congress's language to specific concrete cases. *See Standard Oil Co.*, 221 U.S. at 70, 31 S.Ct. 502; *see also McNally v. United States*, 483 U.S. 350, 372 – 73, 107 S.Ct. 2875, 97 L.Ed.2d 292 (1987) (Stevens, J., dissenting). M. Shvartsman may disagree with the Supreme Court's interpretation of the securities laws as forbidding insider trading. But '[w]hatever the merits of that interpretation, it is undoubtedly an interpretation of the [securities] fraud statute[s]: an attempt to 'giv[e] effect to the will of the Legislature." *United States v. Holden*, 908 F.3d 395, 401 (9th Cir. 2018) (*quoting* Osborn v. Bank of U.S., 22 U.S. (9 Wheat.) 738, 866, 6 L.Ed. 204 (1824) (Marshall, C.J.)).") ¶ *Meta Platforms, Inc. v. Federal Trade Commission*, 723 F.Supp.3d 64 (D.D.C. 2024) ("6. Nondelegation Doctrine ¶ Meta's final constitutional challenge is premised on the nondelegation doctrine. 'The nondelegation doctrine is rooted in the principle of separation of powers' and the related precept that the legislative power is vested exclusively in the Congress. *Mistretta v. United States*, 488 U.S. 361, 371 – 72, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989). 'Congress . . . may not transfer to another branch "powers which are strictly and exclusively legislative,"' *Gundy v. United States*, 588 U.S. 128, 139 S. Ct. 2116, 2123, 204 L.Ed.2d 522 (2019) (plurality) (*quoting Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 42 – 43, 6 L.Ed. 253 (1825)), although it can 'obtain[ ] the assistance of its coordinate Branches' *Id.*. (*quoting Mistretta v. United States*, 488 U.S. 361, 371 – 72, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989)), by 'confer[ring] substantial discretion on executive agencies to implement and enforce the laws,' *Id.*. When it 'confers decisionmaking authority upon agencies[,] Congress must "lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform."' *Whitman v. Am. Trucking Associations*, 531 U.S. 457, 472, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) (*quoting J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624

(1928)). ¶ Meta argues that the OTSC process is unconstitutional because the [Federal Trade Commission] had discretion to decide whether to enforce a cease-and-desist order by modifying the order under Section 5(b) of the [Federal Trade Commission] Act or by referring the matter to the Attorney General, who can file suit under Section 5(l) of the Act. Dkt. 4-1 at 24. This discretion violates the separation of powers in Meta's view, because the [Federal Trade Commission] Act contains no 'intelligible principle' to guide the [Federal Trade Commission] in deciding which enforcement path to pursue. *Id.*. But Meta's argument misapprehends the nondelegation doctrine. 'In a delegation challenge, the constitutional question is whether the statute has delegated legislative power to the agency.' *Whitman*, 531 U.S. at 472, 121 S.Ct. 903 (emphasis added). The decision that *Meta* challenges, however, constitutes an exercise of executive authority. The Supreme Court has long held that '[l]egislative power, as distinguished from executive power, is the authority to make laws, but not to enforce them.' *Springer v. Gov't of Philippine Islands*, 277 U.S. 189, 202, 48 S.Ct. 480, 72 L.Ed. 845 (1928). '[T]he choice of how to prioritize and how aggressively to pursue legal actions against defendants who violate the law falls within the discretion of the Executive Branch.' *TransUnion LLC v. Ramirez*, 594 U.S. 413, 429, 141 S.Ct. 2190, 210 L.Ed.2d 568 (2021). ¶ To take just one of the hundreds of examples that leap to mind, a criminal defendant's right to waive a jury trial requires the government's consent. See Fed. R. Crim. P. 23(a)(2). No statute or rule tells the government whether and when to withhold such consent, but no one would seriously maintain that granting the government the discretion to make that decision runs afoul of the nondelegation doctrine. Because the decision of how to enforce the law is a quintessential exercise of executive authority, see U.S. Const., Art. II, § 3 (The President 'shall take care that the laws be faithfully executed.' (capitalization altered)); *Buckley v. Valeo*, 424 U.S. 1, 138, 96 S.Ct. 612, 46 L.Ed.2d 659 (1976) ('[E]nforcement power [is] exemplified by its discretionary power to seek judicial relief.'), Congress cannot have impermissibly delegated its legislative power when it gave the [Federal Trade Commission] a choice of two different mechanisms, one administrative and the other judicial, to enforce its cease-and-desist orders. [Footnote omitted.] ¶ Meta attempts to avoid this conclusion by distinguishing between '(i) the legislative choice to assign a dispute to administrative adjudication rather than seek judicial relief, which is at issue here,' and '(ii) the discretionary power to seek judicial relief' by filing a lawsuit which is an exercise of executive authority.' Dkt. 31 at 30 – 31 (quotation marks and alterations omitted). But even with that (modest) limitation, Meta's argument still proves way too much. For example, under Meta's theory, virtually every decision by an administrative agency to proceed by adjudication as opposed to rulemaking would violate the nondelegation doctrine. Or an agency's decision to invoke one enforcement authority in lieu of another would lie outside the executive sphere. That is not the law. In *United States v. Batchelder*, 442 U.S. 114, 124, 99 S.Ct. 2198, 60 L.Ed.2d 755 (1979), the Supreme Court considered whether Congress's enactment of two federal criminal statutes that assessed different maximum penalties for the same prohibited conduct 'constitute[d] an impermissible delegation of congressional authority,' *id.* at 116 – 17, 123, 99 S.Ct. 2198. The defendant there argued that these laws were unconstitutional because the prosecutor could effectively 'fix' the criminal penalty, and thereby exercise legislative power, by deciding which of the two statutes to charge the defendant under, *id.* at 124 – 25, 99 S.Ct. 2198. The Supreme Court rejected this argument, finding that the statutes 'at issue plainly demarcate the range of penalties that prosecutors . . . may seek' and any discretion that a prosecutor exercises in picking between the two statutes was 'no broader than the authority they routinely exercise in enforcing the criminal laws.' *Id.*. ¶ There is no reason to reach a different conclusion here: Congress conferred executive discretion on the Commission to seek to modify an existing cease-and-desist order administratively or by filing a case in federal court. *Cf. Heckler v. Chaney*, 470 U.S. 821, 832, 105 S.Ct. 1649, 84 L.Ed.2d 714 (1985) ('[A]n agency's refusal to institute proceedings shares to some extent the characteristics of the decision of a prosecutor in the Executive

Branch not to indict—a decision which has long been regarded as the special province of the Executive Branch.'). How the [Federal Trade Commission] goes about striking the 'complicated balance[e] of a number of factors which are peculiarly within its expertise' and, based on that assessment, decides which of the enforcement authorities that Congress granted it to invoke, lies soundly within the Commission's executive discretion. Chaney, 470 U.S. at 831, 105 S.Ct. 1649. The exercise of that enforcement authority does not usurp any legislative power.'') ¶ *Tennessee v. United States Department of Health and Human Services*, 720 F.Supp.3d 564 (E.D. Tenn., 2024) ("Each grant had an average value of $3 million. *Id.*. This relatively modest grant-making power is far from the type of administrative power that the Supreme Court has held to violate the nondelegation doctrine. *See Util. Air Regul. Grp. v. E.P.A.*, 573 U.S. 302, 322, 134 S.Ct. 2427, 189 L.Ed.2d 372 (2014) (finding a nondelegation issue when 'newly [regulated] sources would face permitting costs of $147 billion'); *Brown & Williamson*, 529 U.S. at 159, 120 S.Ct. 1291 (finding a nondelegation issue when 'the FDA has now asserted jurisdiction to regulate an industry constituting a significant portion of the American economy.').''); *Alpine Securities Corporation v. National Securities Clearing Corporation*, 2024 W.L. 1011863 (D. Utah, March 8, 2024) ("B. Nondelegation ¶ Alpine's third claim is pleaded under the nondelegation doctrine. The non-delegation doctrine arises from Article I of the Constitution, which provides that '[a]ll legislative Powers herein granted shall be vested in a Congress of the United States.' U.S. Const. art I., § 1. Alpine argues that Defendants' exercise of authority violates the nondelegation doctrine whether or not Defendants are considered part of the government for purposes of its structural-constitutional claims. ¶ i) Interbranch delegation ¶ First, even if, arguendo, Defendants are properly considered part of the government, Alpine has failed to show any likelihood of success on its argument that Defendants wield legislative authority in excess of nondelegation principles. [Footnote omitted.] It is in this context of delegations of legislative authority between parts of the government that the nondelegation doctrine typically arises: 'The non-delegation doctrine provides 'that Congress may not constitutionally delegate its legislative power to another branch of government.'" *United States v. Brown*, 348 F.3d 1200, 1216 (10th Cir. 2003) (*quoting Touby v. United States*, 500 U.S. 160, 165, 111 S.Ct. 1752, 114 L.Ed.2d 219 (1991)). ¶ But delegation, by itself, is not suspect under existing precedent. In fact, most such delegations of authority are upheld. See *Gundy v. United States*, ––– U.S. –––– , 139 S. Ct. 2116, 212, 204 L.Ed.2d 522 (2019) (*quoting Mistretta v. United States*, 488 U.S. 361, 373 n.7, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989)) ('Only twice in this country's history (and that in a single year) have we found a delegation excessive—in each case because Congress had failed to articulate any policy or standard to confine discretion. By contrast, we have over and over upheld even very broad delegations.') (quotation omitted). '[T]he Constitution does not deny[ ] to the Congress the necessary resources of flexibility and practicality [that enable it] to perform its function[s].' *Gundy*, 139 S. Ct at 2123 (*quoting Yakus v. United States*, 321 U.S. 414, 425, 64 S.Ct. 660, 88 L.Ed. 834 (1944)). ¶ The nondelegation test is thus limited to a search for an 'intelligible principle' laid down by Congress guiding agency enforcement and interpretation. *See Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 472-73, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001). As black-letter law now stands, the nondelegation doctrine is a tremendously low hurdle for Congress to clear. The Supreme Court has approved delegations to 'regulate in the public interest,' 'set fair and reasonable prices,' 'set just and equitable rates,' and 'issue whatever air quality standards are requisite to protect the public health.' *Gundy*, 139 S. Ct at 2123 (cleaned up) (collecting cases). ¶ The court is satisfied that, for the purposes of a probabilistic determination under Rule 65, the Exchange Act lays down an intelligible principle guiding agency enforcement and interpretation. ¶ ii) Private delegation ¶ In the event that Defendants are not part of the government, Alpine argues that a nondelegation problem arises under the so-called private nondelegation doctrine. That doctrine 'addresses the Constitution's bar on the government's delegation of unchecked legislative power to private entities.' *Consumers' Rsch. v. FCC*, 63 F.4th 441,

450 (5th Cir. 2023) (cleaned up); *accord Consumers' Rsch. v. FCC*, 88 F.4th 917, 925 (11th Cir. 2023). ¶ Delegations of authority to private entities are lawful where the private entity 'function[s] subordinately to' the agency while aiding the agency and the agency 'has authority and surveillance over the activities of' the private entity. *See Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 388, 399, 60 S.Ct. 907, 84 L.Ed. 1263 (1940); *Texas v. Rettig*, 987 F.3d 518, 532 (5th Cir. 2021), *cert. denied sub nom. Texas v. Comm'r*, – – – U.S. – – – – , 142 S. Ct. 1308, 212 L.Ed.2d 413 (2022); *Consumers' Rsch.*, 88 F.4th at 925-26. ¶ While Alpine's Motion concedes that Defendants' 'combined functions are subject to SEC oversight,' it nonetheless argues that Defendants' determination that Alpine 'clears for others' lacks sufficient SEC oversight. Mot. at 30. But Defendants' classification decision is, in fact, subject to review by the SEC through the adjudicatory appeal process outlined above. The supposed lack of oversight that Alpine complains of is a function of time: Alpine will be able to submit any sanctions imposed by Defendants to SEC review and oversight. The fact that it hasn't yet been able to do so does not give rise to a private nondelegation problem. *See Oklahoma v. United States*, 62 F.4th 221, 243 (6th Cir. 2023) (Cole, J., concurring) (*citing Sartain v. SEC*, 601 F.2d 1366, 1371 n.2 (9th Cir. 1979), and *Sorrell v. SEC*, 679 F.2d 1323, 1326 (9th Cir. 1982)). Further, as addressed above, Alpine can move to stay any sanctions imposed by Defendants pending review by both the SEC and the United States Court of Appeals. ¶ The public-private regulatory regime created by the Exchange Act has repeatedly been upheld against private nondelegation challenges and elsewhere cited as an example of a constitutionally permissible arrangement. 'In case after case, the courts have upheld this arrangement, reasoning that the SEC's ultimate control over the rules and their enforcement makes the SROs permissible aides and advisors.' *Oklahoma*, 62 F.4th at 229 (*citing R.H. Johnson & Co. v. SEC*, 198 F.2d 690, 695 (2d Cir. 1952); *Todd & Co. v. SEC*, 557 F.2d 1008, 1012-13 (3d Cir. 1977); *First Jersey Secs., Inc. v. Bergen*, 605 F.2d 690, 697 (3d Cir. 1979); *Sorrell v. SEC*, 679 F.2d 1323, 1325-26 (9th Cir. 1982); *see also Ass'n of Am. R.R. v. United States DOT*, 721 F.3d 666, 671 n.5 (D.C. Cir. 2013) (describing the SROs' role as 'purely advisory or ministerial')); *accord Gen. Bond & Share Co. v. SEC*, 39 F.3d 1451, 1453 (10th Cir. 1994); *Calif. Pub. Emples.' Ret. Sys. v. N.Y. Stock Exch., Inc.* (*In re NYSE Specialists Sec. Litig.*), 503 F.3d 89, 102 (2d Cir. 2007); *Aslin v. Fin. Indus. Regulatory Auth., Inc.*, 704 F.3d 475, 476 (7th Cir. 2013). ¶ Alpine fails to meaningfully argue that the SEC lacks ongoing authority and surveillance over Defendants' activities and has therefore failed to demonstrate a likelihood of success on its private nondelegation argument."); *United States v. Stratics Networks Inc.*, 721 F.Supp.3d 1080 (S.D. Cal. 2024) ("Under Article I of the Constitution, '[a]ll legislative Powers herein granted shall be vested in a Congress of the United States.' U.S. Const. art. I, § 1. The non-delegation doctrine extends from this provision such that Congress 'may not transfer to another branch powers which are strictly and exclusively legislative.' *Gundy v. United States*, – – – U.S. – – – – , 139 S. Ct. 2116, 2123, 204 L.Ed.2d 522 (2019). Over time, however, Congress has delegated its power to executive agencies in order to effectuate its legislative goals and principles. This sort of 'statutory delegation is constitutional as long as Congress 'lay[s] down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform." *Id.*. at 2123 (*quoting Mistretta v. United States*, 488 U.S. 361, 372, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989)). A delegation is permissible so long as 'Congress has made clear to the delegee 'the general policy' he must pursue and the 'boundaries of [his] authority." *Id.*. at 2129 (*quoting Am. Power & Light Co. v. SEC*, 329 U.S. 90, 105, 67 S.Ct. 133, 91 L.Ed. 103 (1946)). This standard is 'not demanding' and '[p]revailing on a non-delegation challenge is thus a tall order.' *United States v. Melgar-Diaz*, 2 F.4th 1263, 1266 – 67 (9th Cir. 2021). ¶ The [Federal Trade Commission] Act and Telemarketing Act contain intelligible principles to direct the [Federal Trade Commission]'s action. The [Federal Trade Commission] Act provides that the Commission has authority to declare acts or practices unlawful as 'unfair' or 'deceptive.' 15 U.S.C. § 45(a). The [Federal Trade Commission] Act, however, also clarifies that an act or practice cannot be deemed unfair 'unless

Loper Bright Enterprises is further limited by the major issues doctrine as articulated in *West Virginia v. Environmental Protection Agency.*[14] The major questions doctrine in extraordinary cases can provide a basis for challenging a rule or regulations where the history and the breadth of the authority that the agency has asserted and the economic and political significance of that assertion, provide a reason to hesitate before concluding that Congress meant to confer this authority. A major issue implicates regulation of "a significant portion of the American economy" or seems to "intrude into an area that is the domain of state law."[15] So far, the major questions doctrine has not been useful in most tax cases, but it may have potential.

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the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.' 15 U.S.C. § 45(n). This direction is sufficient to avoid offending the Constitution."); *Watterson v. Bureau of Alcohol, Tobacco, Firearms and Explosives* , 2024 W.L. 897595 (E.D. Teas March 1, 2924); *DACO Investments, LLC v. United States Small Business Administration*, 2024 W.L. 750594 (W.D. La. 2024) ("Plaintiffs next argue that, to the extent the CARES Act authorizes the SBA to adopt eligibility restrictions, the Act violates the 'nondelegation doctrine.' The nondelegation doctrine is grounded on the principle that Article I of the Constitution vests legislative power in Congress, and that Congress may not then constitutionally delegate that power to another branch. [Footnote omitted.] Here, plaintiffs contend that the CARES Act unconstitutionally delegates legislative power to the SBA, an executive branch agency. Not all delegations of legislative power are unconstitutional. A delegation of legislative power to an executive agency is constitutional if Congress incorporates in the statute 'an intelligible principle' to guide the agency's actions under that statute. [Footnote omitted.] The Supreme Court has held that it is 'constitutionally sufficient if Congress clearly delineates the general policy, the public agency which is to apply it, and the boundaries of the delegated authority.' [Footnote omitted.] Accordingly, a court must construe 'the challenged statute to figure out what task it delegates and what instructions it provides.' [Footnote omitted.]"); *Britto v. Bureau of Alcohol, Tobacco, Firearms & Explosives*, No. 2:23-CV-019-Z, 2023 W.L. 7418291 (N.D. Tex. Nov. 8, 2023); *Mock v. Garland*, 75 F.4th 563 (5th Cir. 2023). *See, also, Cargo of the Brig Aurora v. United States*, 11 U.S. (7 Cranch) 382 (1813); *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1 (1825); *Field v. Clark*, 143 U.S. 649 (1892); *In re Kollock*, 165 U.S. 526, 533 (1897); *Buttfield v. Stranahan*, 192 U.S. 470, 489 (1904); *United States v. Grimaud*, 220 U.S. 506, 509, 516 (1911); *Union Bridge Co. v. United States*, 204 U.S. 364, 386 (1907); *Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U.S. 194 (1912); *Mutual Film Corp. v. Industrial Commission of Ohio*, 236 U.S. 230, 245 (1915); *Mahler v. Eby*, 264 U.S. 32, 36-37, 40 (1924); *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394 (1928); *Shreveport Grain & Elevator Co.*, 287 U.S. 77, 85 (1932); *Federal Radio Commission v. Nelson Brothers Bond & Mortgage Co.*, 289 U.S. 266, 276 (1933); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Wickard v. Filburn*, 317 U.S. 111, 125 (1942); *National Labor Relations Board v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 37 (1937); *Currin v. Wallace*, 306 U.S. 1 (1939); *Yakus v. United States*, 321 U.S. 414, 426 (1944); *Lichter v. United States*, 334 U.S. 742, 785 (1948); *Department of Transportation v. Association of American Railroads*, 575 U.S. 43, 61 (2015); *Currin v. Wallace*, 306 U.S. 1, 6 (1939); *Amalgamated Meat Cutters & Butcher Workmen of North America v. Connally*, 337 F. Supp. 737, 762 (D.D.C. 1971); *Mistretta v. United States*, 488 U.S. 361 (1989); *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 214 (1989); *Whitman v. American Trucking Associations*, 531 U.S. 457 (2001).

[14] 142 S. Ct. 2587 (2022).

[15] 142 S. Ct. at 2620-2621.

Chevron[16] may have produced complacency at Treasury and the Internal Revenue Service. Many interpretive regulations were drafted as if the Internal Revenue Service had authority to expand the statute through interpretive regulations rather than merely the authority to interpret the statute. The Internal Revenue Service often published detailed rules that went far beyond what an independent third party would have expected as a mere interpretation of the statute. *Loper Bright Enterprises* throws into question the validity of interpretive regulations that expand a statute or modify a statute or otherwise do not merely represent the best reading of the statute. *Loper Bright Enterprises* also should affect the manner in which regulations are drafted so that new regulation will reflect the limitations imposed by *Loper Bright Enterprises*.

§1.1 Marbury v. Madison (1803): The Province and Duty of the Judicial Department To Say What the Law Is.

Chief Justice Marshall wrote in *Marbury v. Madison*,[17] "[i]t is emphatically the province and duty of the judicial department to say what the law is."[18] When the meaning of a statute

[16] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[17] 1 Cranch 137, 177 (1803). *Marbury v. Madison* established the doctrine of judicial review. *Marbury v. Madison* established the authority of the courts to review and to interpret the law, when necessary, and to disapprove legislation passed by Congress as unconstitutional. *Marbury v. Madison* established that the Supreme Court of the United States is ultimate agency to interpret the Constitution, to determine the constitutionality and validity of Congressional legislation, and to determine the validity of the acts of Congress and the Executive. In *Marbury v. Madison*, the Supreme Court, invalidate an act of Congress as unconstitutional. President Adams appointed William Marbury as a justice of the peace. The appointment was confirmed on March 3. President Jefferson took office a President the next day. Mr. Marbury's judicial commission was not delivered before President Jefferson took office. The new Secretary of State James Madison under President Thomas Jefferson refused to deliver Mr. Marbury's commission. Mr. Marbury sued in the Supreme Court seeking a writ of mandamus ordering Secretary Madison to deliver the commission. The Supreme Court concluded that Mr. Marbury did have a right to the commission. The Supreme Court found that that if an Executive branch duty is established by the Constitution or federal law, then the Judiciary could enforce that Executive branch duty. The Supreme Court concluded that it did not have jurisdiction to issue a writ of mandamus as an original action – as provided for in Section 13 of the Judiciary Act. Issuing the writ would violate Section III of the Constitution. The Supreme Court held that the relevant provision in the Judiciary Act of 1789 was unconstitutional. This case marked the first time the Supreme Court declared a federal law unconstitutional. *Marbury v. Madison* established the power of judicial review. *Marbury v. Madison* established the principle that that a law in conflict with the Constitution is not valid. *Marbury v. Madison* also held that the Supreme Court had the power to invalidate or to disregard such a law. *Marbury v. Madison* established the legal principle that the Constitution is the law superior to any enacted by Congress. The courts must follow the Constitution rather than any inconsistent provisions of federal legislation.

[18] 1 Cranch 137, 177 (1803).

was at issue, the judicial role was to "interpret the act of Congress, in order to ascertain the rights of the parties."[19] Exercising independent judgment often includes according due respect to Executive Branch interpretations of federal statutes. This respect was thought especially warranted when an agency interpretation was issued roughly contemporaneously with enactment of the statute and remained consistent over time. The theory was that "[t]he officers concerned [were] usually able men, and masters of the subject," who may well have drafted the laws at issue.[20] The views of the agency could inform the judgment of the Judiciary, but did not supersede it. "[I]n cases where [a court's] own judgment . . . differ[ed] from that of other high functionaries," the court was "not at liberty to surrender, or to waive it."[21]

§1.2 Legislative and Interpretive Regulations.

A government agency does not have intrinsic power to issue regulations. The agency's power to issue regulations may come from either of two sources. A statute may contain a special provision that directs a government agency to publish needful rules and regulations to interpret the statute. "[A]mbiguous grants of rulemaking authority should be construed to give agencies the broadest possible powers, so that they will have flexibility in determining how to effectuate their statutory mandates."[22] In the absence of this specific grant of limited legislative

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[19] *Decatur v. Paulding*, 14 Pet. 497, 515.

[20] *United States v. Moore*, 95 U.S. 760, 763.

[21] *United States v. Dickson*, 15 Pet. 141, 162.

[22] Merrill & Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 Harv. L. Rev. 467, 492 (2002). *See National Petroleum Refiners Associations v. Federal Trade Commission*, 482 F.2d 672 (D.C. Cir. 1973) ("There is little disagreement that the Commission will be able to proceed more expeditiously, give greater certainty to businesses subject to the Act, and deploy its internal resources more efficiently with a mixed system of rule-making and adjudication than with adjudication alone. With the issues in I.R.C. § 5 proceedings reduced by the existence of a rule delineating what is a violation of the statute or what presumptions the Commission proposes to rely upon, proceedings will be speeded up. For example, in an adjudication proceeding based on a violation of the octane rating rule at issue here, the central question to be decided will be whether or not pumps owned by a given refiner are properly marked. [Citation omitted.] Without the rule, the Commission might well be obliged to prove and argue that the absence of the rating markers in each particular case was likely to have injurious and unfair effects on consumers or competition. [Footnote omitted.] Since this laborious process might well have to be repeated every time the Commission chose to proceed subsequently against another defendant on the same ground, the difference in administrative efficiency between the two kinds of proceedings is obvious. Furthermore, rules, as contrasted with the holdings reached by case-by-case adjudication, are more specific as to their scope, and industry compliance is more likely simply because each company is on clearer notice whether or not specific rules apply to it. ¶ Moreover, when delay in agency proceedings is minimized by using rules, those violating the statutory standard lose an opportunity to turn litigation into a profitable and lengthy game of postponing the effect of the rule on their current practice. [Footnote omitted.] As a result, substantive rules will protect the companies which willingly comply with the law against what amounts to the unfair competition of those who would profit from delayed enforcement as to them. This, too, will

authority to a government agency, Section 7805(a) provides a general grant of authority to the Internal Revenue Service to publish interpretive rules and regulations. Other agencies receive general interpretive power under other statutes. These sources of authority create an important distinction in regulations.[23]

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minimize useless litigation and is likely to assist the Commission in more effectively allocating its resources. In addition, whatever form rules take, whether bright-line standards or presumptions that are rebuttable, they are likely to decrease the current uncertainty many businesses are said to feel over the current scope and applicability of I.R.C. § 5.25. But the important point here is not that rule-making is assuredly going to solve the Commission's problems. It is rather than recognition and use of rule-making by the Commission is convincingly linked to the goals of agency expedition, efficiency, and certainty of regulatory standards that loomed in the background of the 1914 passage of the Federal Trade Commission Act. ¶ This relationship between rule-making's probable benefits and the broad concerns evident when the [Federal Trade Commission] was created, together with the express language of I.R.C. § 6(g), help persuade us that any purported ambiguity of the statute be resolved in favor of the Commission's claim. 'In a case much more clouded with doubts than this one, we held that we would not 'in the absence of compelling evidence that such was Congress' intention . prohibit administrative action imperative for the achievement of an agency's ultimate purposes.' *Permian Basin Area Rate Cases*, 390 U.S. 747, 780, 88 S.Ct. 1344, 1367, 20 L.Ed.2d 312.' *Weinberger v. Bentex Pharmaceuticals, Inc., supra*, 412 U.S. at 653, 93 S.Ct. at 2494. ¶ V ¶ Despite the import of I.R.C. § 6(g)'s plain language, the overwhelming judicial support given to expansive agency readings of statutory rule-making authorizations that are not flatly inconsistent with other statutory provisions, and the incontestable relationship between the broad policies behind the 1914 Act and the utility of substantive rule-making power, appellees argue that substantive rule-making represents a sufficiently important innovation in Commission practice for us to balk at authorizing its use on the basis of an arguably ambiguous statute in the absence of very firm indications of affirmative and specific legislative intent. Indeed, courts have assumed such a stance toward novel assertions of agency powers. This court did so in *Textile and Apparel Group v. [Federal Trade Commission]*, *supra*, where we reviewed an agency rule allowing for *ex parte* seizure of imports at Customs and a procedure for testing goods prior to entry, both without provision for the Trade Commission's normal enforcement procedure of adversary cease-and-desist proceedings and judicial review. Because this procedure entirely dispensed with a hearing and because it varied so sharply from the Commission's customary mode of proceeding against possible wrongdoers, we structured our review to 'look for some fairly strong indication, backed by sound policy, that Congress meant for the Commission to act in this way.' 133 U.S.App.D.C. at 356, 410 F.2d at 1055. *See also FMC v. Anglo-Canadian Shipping Co.*, 9 Cir., 335 F.2d 255, 258-259 (1964) (involving agency use of prehearing discovery procedures).")

[23] Whether a regulation is a legislative regulation that is subject to the Administrative Procedure Act's rulemaking requirements or an interpretative regulation that is exempt from Administrative Procedure Act procedural requirements usually depends on whether the regulation was promulgated pursuant to a specific statutory grant of authority (a legislative regulation) or issued under the power to make all needful rules and regulations under Section 7805(a) (an interpretative regulation). See ., *Rowan Cos. v. United States*, 452 US 247 (1981). The distinction is based on the nondelegation doctrine. *Mayo Foundation* led to challenges to regulations based on whether regulations had met th procedural requirements of the Administrative Procedure Act, particularly the notice and comment requirements. Internal Revenue Manual 32.1.1.2.6 (09-23-2011) advises:

Interpretative Regulations

The Administrative Procedure Act (APA) exempts interpretative rules from the APA's notice and comment requirements. Generally, rules or statements issued by an agency to advise the public of the agency's construction of the statutes it administers are considered interpretative. Most IRS/Treasury regulations are considered interpretative because the underlying statute implemented by the regulation contains the necessary legal authority for the action taken and any effect of the regulation flows directly from that statute. See CCDM 32.1.1.2.7 and CCDM 32.1.1.2.8, below, and CCDM 32.1.5.4.7.5.1(2), Administrative Procedure Act, for further discussion on whether a regulation is interpretive or legislative.

32.1.1.2.7 (08-02-2018)

Legislative Regulations

Regulations required to follow the APA's notice and comment procedure are referred to as legislative rules or substantive rules. Legislative rules are required when Congress simply provided an end result, without any guidance as to how to achieve the desired result or when a statutory provision does not provide adequate authority for the regulatory action taken.

32.1.1.2.8 (08-02-2018)

How to Determine If a Rule Is Interpretative or Legislative

Whether a regulation is promulgated under a specific grant of authority in the Internal Revenue Code does not govern whether the regulation is interpretative or legislative.

If Congress simply provided an end result, without any guidance as to how to achieve the desired result, then regulations promulgated to achieve that result are considered to be legislative.

If Congress provided specific rules and merely left gaps for the Secretary to fill, regulations filling those gaps are considered interpretative.

If the regulation repeats law subsumed in the underlying legislation, then the regulation is considered interpretative.

See Altera Corporation v. Commissioner, 145 T.C. 91 (2015), *rev'd.,* 926 F.3d 1061 (9th Cir. 2019) (I.R.C. § 482 regulation was legislative regulation, subject to notice and comment under the Administrative Procedure Act. "Generally, interpretive rules merely explain preexisting substantive law. *See Hemp Indus. Ass'n v. DEA*, 333 F.3d 1082, 1087 (9th Cir.2003). Substantive (or legislative) rules by contrast, 'create rights, impose obligations, or effect a change in existing law'. *Id.*. Stated simply, 'legislative rules, unlike interpretive rules, have the "force of law."' *Id.*. (*quoting Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C.Cir.1993)); *see also Chrysler Corp. v. Brown*, 441 U.S. 281, 301 – 302, 99 S.Ct. 1705, 60 L.Ed.2d 208 (1979). ¶ A rule has the force of law 'only if Congress has delegated legislative power to the agency and if the agency intended to exercise that power in promulgating the rule.' *Am. Mining Cong.*, 995 F.2d at 1109 (*citing Am. Postal Workers Union v. USPS*, 707 F.2d 548, 558 (D.C.Cir.1983)). The U.S. Court of Appeals for the Ninth Circuit, to which an appeal in these cases appears to lie absent a stipulation to the contrary, see sec. 7482(b)(1)(B), (2), has held that we can infer that an agency intends for a rule to have the force of law in any of the following circumstances: '(1) when, in the absence of the rule, there would not be an adequate legislative basis for enforcement action; (2) when the agency has explicitly invoked its general legislative authority; or (3) when the rule effectively amends a prior legislative rule,' *Hemp Indus.*, 333 F.3d at 1087 (*citing Am. Mining Cong.*, 995 F.2d 1106), or "'effect[s] a change in existing law or policy"', *D.H. Blattner & Sons, Inc. v. Sec'y of Labor, Mine Safety & Health Admin.*, 152 F.3d 1102, 1109 (9th Cir.1998) (alteration in original) (*quoting Powderly v. Schweiker*, 704 F.2d 1092, 1098 (9th Cir.1983)). In determining whether a rule is interpretive or legislative we 'need not accept the agency characterization at face value.' *Hemp Indus.*, 333 F.3d at 1087 (*citing Gunderson v. Hood*, 268 F.3d 1149, 1154 n. 27 (9th Cir. 2001)). ¶ The notice and comment requirements of APA sec. 553 'are intended to assist judicial review as well as to

provide fair treatment for persons affected by a rule.' *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 (D.C.Cir.1977). Accordingly, 'there must be an exchange of views, information, and criticism between interested persons and the agency.' *Id.*. Additionally, because 'the opportunity to comment is meaningless unless the agency responds to significant points raised by the public', an agency is required to respond to significant comments.[11] [[11] "[O]nly comments which, if true, raise points relevant to the agency's decision and which, if adopted, would require a change in an agency's proposed rule cast doubt on the reasonableness of a position taken by the agency. Moreover, comments which themselves are purely speculative and do not disclose the factual or policy basis on which they rest require no response." *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 n. 58 (D.C.Cir.1977); *see also Am. Mining Cong. v. EPA*, 965 F.2d 759, 771 (9th Cir.1992) (*citing Home Box Office*, 567 F.2d at 35 & n. 58).] *Id.*. at 35 – 36. However, "[t]he failure to respond to comments is significant only insofar as it demonstrates that the agency's decision was not based on a consideration of the relevant factors." *Sherley v. Sebelius*, 689 F.3d 776, 784 (D.C.Cir.2012) (*quoting Covad Commc'ns v. FCC*, 450 F.3d 528, 550 (D.C.Cir.2006)).''); *Oakbrook Land Holdings v. Commissioner*, 154 T.C. 180 (2020) (examining whether Treas. Reg. § 1.170A-14(g)(6) concerning "protected in perpetuity" requirement for charitable donation of conservation easement was legislative or interpretive regulation; Treas. Reg. § 1.170A-14(g)(6) was legislative regulation rather than interpretive regulation; Treas. Reg. § 1.170A-14(g)(6) had force of law; Department of Treasury did not act arbitrarily, capriciously, abuse its discretion under Administrative Procedure Act in issuing Treas. Reg. § 1.170A-14(g)(6); Treas. Reg. § 1.170A-14(g)(6) was reasonable interpretation; "1. Legislative vs. Interpretive Rules ¶ Administrative law distinguishes between interpretive and legislative agency rules. 'An interpretive rule merely clarifies or explains preexisting substantive law or regulations.' *SIH Partners LLLP v. Commissioner*, 150 T.C. 28, 40 (2018) (*citing Elizabeth Blackwell Health Ctr. for Women v. Knoll*, 61 F.3d 170, 181 (3d Cir. 1995)), *aff'd*, 923 F.3d 296 (3d Cir. 2019); *see Tenn. Hosp. Ass'n v. Azar*, 908 F.3d 1029, 1042 (6th Cir. 2018). A legislative rule, on the other hand, 'creates rights, assigns duties, or imposes obligations, the basic tenor of which is not already outlined in the law itself.' *SIH Partners*, 150 T.C. at 40 (*quoting Dia Navigation Co. v. Pomeroy*, 34 F.3d 1255, 1264 (3d Cir. 1994)); *see Tenn. Hosp. Ass'n*, 908 F.3d at 1042. Legislative rules have 'the force and effect of law.' *Chrysler Corp. v. Brown*, 441 U.S. 281, 303, 99 S.Ct. 1705, 60 L.Ed.2d 208 (1979) (*quoting Batterton v. Francis*, 432 U.S. 419, 425 n.9 (1977)). ¶ Section 170(h)(5)(A) requires that the conservation purpose underlying the easement be 'protected in perpetuity.' But the statute does not indicate how (or whether) this requirement could be deemed satisfied given the possibility that the easement might later be extinguished. The regulation specifies the circumstances in which 'the conservation purpose can nonetheless be treated as protected in perpetuity.' Sec. 1.170A-14(g)(6)(i), Income Tax Regs. ¶ To secure this treatment the regulation requires that the donor agree, at the time of the gift, to a specified division of proceeds in the event the property is sold following judicial extinguishment of the easement. *Ibid.* The required division of proceeds is set forth in subparagraph (6)(ii). Because the regulation imposes a requirement not explicitly set forth in the statute, it is appropriately treated as a legislative rule. *Cf. SIH Partners*, 150 T.C. at 40 – 41. ¶ 2. Procedural Requirements for Legislative Rules ¶ Legislative rules are subject to APA notice-and-comment rulemaking procedures. *See* 5 U.S.C. sec. 553(b); *Tenn. Hosp. Ass'n*, 908 F.3d at 1042. To issue a legislative regulation consistently with the APA an agency must: (1) publish a notice of proposed rulemaking in the Federal Register; (2) provide 'interested persons an opportunity to participate *** through submission of written data, views, or arguments'; and (3) '[a]fter consideration of the relevant matter presented, *** incorporate in the rules adopted a concise general statement of their basis and purpose.' *See* 5 U.S.C. sec. 553(b) and (c). ¶ The administrative record for T.D. 8069 shows (and petitioner does not dispute) that Treasury satisfied the first two requirements.

Petitioner contends that Treasury failed to consider a 'relevant matter presented' to it and failed to include in the final regulations a 'concise general statement of their basis and purpose.' ¶ The APA provides that a reviewing court shall set aside agency action that is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' 5 U.S.C. sec. 706(2)(a). The scope of our review 'is a narrow one' because '[t]he court is not empowered to substitute its judgment for that of the agency.' *Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 285, 95 S.Ct. 438, 42 L.Ed.2d 447 (1974) (*quoting Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416, 91 S.Ct. 814, 28 L.Ed.2d 136 (1971)). We consider only whether the agency 'articulate[d] a satisfactory explanation for its action.' *Motor Vehicle Mfrs. Ass'n, Inc. v. State Farm Mut. Auto. Ins. Co.* (*State Farm*), 463 U.S. 29, 43, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983). ¶ While we cannot provide a reasoned basis for agency action that the agency itself did not supply, we will 'uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.' *Bowman Transp., Inc.*, 419 U.S. at 285 – 286, 95 S.Ct. 438. 'So long as an agency's rationale can reasonably be discerned and that rationale coincides with the agency's authority and obligations under the relevant statute, a reviewing court may not 'broadly require an agency to consider all policy alternatives in reaching decision." *SIH Partners*, 150 T.C. at 47 (*quoting State Farm*, 463 U.S. at 51, 103 S.Ct. 2856). Indeed, 'regulations with no statement of basis and purpose have been upheld where the basis and purpose w[ere] considered obvious.' *Cal-Almond, Inc. v. U.S. Dep't of Agric.*, 14 F.3d 429, 443 (9th Cir. 1993) (*citing Citizens to Save Spencer Cty. v. EPA*, 600 F.2d 844, 884 (D.C. Cir. 1979)). [Footnote omitted.] ¶ The preamble to the final regulations explains that they were being promulgated to 'provide necessary guidance to the public for compliance with the law,' as recently amended by Congress, 'relating to contributions *** of partial interests in property for conservation purposes.' T.D. 8069, 1986-1 C.B. at 89. The preamble to the proposed regulations supplied extensive background about the legislative history, explaining that '[t]he regulations reflect the major policy decisions made by the Congress and expressed in the[ ] committee reports.' 48 Fed. Reg. at 22940. Treasury noted that '[t]he most difficult problem posed in this regulation was how to provide a workable framework for donors, donees, and the *** [IRS] to judge the deductibility of open space easements,' inviting public comments on this and other points. *Ibid.* ¶ In response to this request Treasury received comments from 90 organizations and individuals who supplied voluminous commentary on many aspects of the proposed regulations. Treasury considered these comments and made numerous changes throughout, highlighting the most important revisions in a two-page 'Summary of Comments.' T.D. 8069, 1986-1 C.B. at 90 – 91. The preamble to the final regulations states that, '[a]fter consideration of all comments regarding the proposed amendments ***, those amendments are adopted as revised by this Treasury decision.' *Id.*. at 90. This Court has found a similar statement, coupled with the administrative record, sufficient to find that Treasury had considered the relevant matter presented to it. *See Wing v. Commissioner*, 81 T.C. 17, 31 – 32 (1983) (upholding a regulation whose preamble stated that, '[a]fter consideration of all comments regarding the proposed amendments, this Treasury Decision is adopted' (*quoting* T.D. 7523, 42 Fed. Reg. 63640 (Dec. 19, 1977))). ¶ The preamble to the final regulations discusses seven major groups of comments and the changes Treasury made in response to them. But an agency cannot reasonably be expected to address every comment it received. The APA 'has never been interpreted to require the agency to respond to every comment, or to analyze every issue or alternative raised by the comments, no matter how insubstantial.' *Thompson v. Clark*, 741 F.2d 401, 408 (D.C. Cir. 1984). 'We do not expect the agency to discuss every item of fact or opinion included in the submissions made to it.' *Simms v. Nat'l Highway Traffic Safety Admin.*, 45 F.3d 999, 1005 (6th Cir. 1995) (*quoting Auto. Parts & Accessories Ass'n, Inc. v. Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968)); *see Action on Smoking & Health v. Civil Aeronautics Bd.*, 699 F.2d 1209, 1216 (D.C. Cir. 1983) ('An agency need not respond to every comment.'). ¶ The two aspects of the 'judicial extinguishment' rule to which petitioner objects are the requirement that the donee

receive a proportional share of the proceeds and the fact that the 'proportionate share' formula does not account for the possibility of donor improvements. Treasury clearly considered the comments it received on the first point because it substantially revised the text of section 1.170A-14(g)(6)(ii), Income Tax Regs., in response to those comments. [Citation omitted.] ¶ Only one of the 90 commenters mentioned donor improvements, and it devoted exactly one paragraph to this subject. That commenter, NYLC, was concerned about facade easements on historic structures, as opposed to 'perpetual open space easements,' with which Treasury was chiefly concerned. See 48 Fed. Reg. at 22940. And NYLC mentioned this point to support its belief that donors of facade easements 'are likely to be discouraged from making a donation,' a supposition that Treasury may reasonably have discounted. ¶ In any event, '[t]he administrative record reflects that no substantive alternatives to the final rules were presented for Treasury's consideration.' *SIH Partners*, 150 T.C. at 44; see dissenting op. p. 102 ('A comment is *** more likely to be significant if the commenter suggests a remedy for the purported problem it identifies.'). NYLC offered no suggestion about how the subject of donor improvements might be handled; it simply recommended 'deletion of the entire extinguishment provision.' Only one other commenter of the 13 mentioning judicial extinguishment voiced that recommendation. [Footnote omitted.] The APA requires 'consideration of the relevant matter presented' during the rulemaking process. 5 U.S.C. sec. 553(c). Our review of the administrative record leaves us with no doubt that Treasury considered the relevant matter presented to it. See *Wing*, 81 T.C. at 33. And we find equally little merit in petitioner's assertion that Treasury failed to 'incorporate in the rules adopted a concise general statement of their basis and purpose.' *See* 5 U.S.C. sec. 553(c). ¶ The preamble to the final regulations explains that they were being promulgated to 'provide necessary guidance to the public for compliance with the law,' as recently amended by Congress, 'relating to contributions ***of partial interests in property for conservation purposes.' T.D. 8069, 1986-1 C.B. at 89. The preamble to the proposed regulations emphasized the requirement that conservation easements 'be perpetual in order to qualify for a deduction.' 48 Fed. Reg. 22940. The purpose of the 'judicial extinguishment' rule is plain on its face – to provide a mechanism to ensure that the conservation purpose can be deemed 'protected in perpetuity' notwithstanding the possibility that the easement might later be extinguished. Sec. 1.170A-14(g)(6)(i), Income Tax Regs. Even where a regulation contains no statement of basis and purpose whatsoever, it may be upheld 'where the basis and purpose *** [are] considered obvious.' *Cal-Almond, Inc.*, 14 F.3d at 443. ¶ Petitioner insists that Treasury failed to comply with the APA because the preamble to the final regulations did not discuss the 'basis and purpose' of the judicial extinguishment provision specifically. But this provision represented one subparagraph of a regulation project consisting of 10 paragraphs, 23 subparagraphs, 30 subdivisions, and 21 examples. No court has ever construed the APA to mandate that an agency explain the basis and purpose of each individual component of a regulation separately. '[T]he detail required in a statement of basis and purpose depends on the subject of the regulation and the nature of the comments received.' *Reytblatt v. U.S. Nuclear Regulatory Comm'n*, 105 F.3d 715, 722 (D.C. Cir. 1997) (*quoting Action on Smoking & Health*, 699 F.2d at 1216). This statement need only 'contain sufficient information to allow a court to exercise judicial review.' *United States v. Garner*, 767 F.2d 104, 117 (5th Cir. 1985); *see Simms*, 45 F.3d at 1005 (*quoting Auto. Parts & Accessories Ass'n, Inc.*, 407 F.2d at 338). ¶ The broad statements of purpose contained in the preambles to the final and proposed regulations, coupled with obvious inferences drawn from the regulations themselves, are more than adequate to enable us to perform judicial review. We find that Treasury's rationale for the judicial extinguishment rule 'can reasonably be discerned and *** coincides with the agency's authority and obligations under the relevant statute.' *SIH Partners*, 150 T.C. at 47. We accordingly hold that Treasury satisfied all applicable APA requirements when promulgating this rule. [Footnote omitted.]").

In the future, the Internal Revenue Service may argue that Section 7805(a) does provide Treasury and the Internal Revenue Service with a sufficient delegation of authority that all Treasury Regulations are legislative regulations. That should make for an interesting Supreme Court case. One could be skeptical of such a broad claim.

Regulations published pursuant to a specific grant of authority in a statute, often called "legislative regulations", are entitled to a high degree of deference by the courts. Legislative regulations derive their authorization from the specific grant of power in a statute. A legislative regulation must be within the grant of power and also must comply with the Administrative Procedure Act. Properly reasoned legislative regulations essentially have the force of law.

There developed a distinction between legislative and interpretive rules. Legislative rules are made pursuant to a specific delegation of legislative authority. Legislative regulations have the force of law. Interpretive rules do not have a specific delegation of legislative authority. Interpretive rules do not have the force of law. Interpretive rules will receive varying degrees of deference from the courts.

Interpretive regulations are much easier to challenge than legislative regulations, unless there are procedural deficiencies in the adoption of the legislative regulations.

As a practical matter, even interpretive rules and regulations can have substantial coercive force. There usually is a strong incentive for parties to comply with even interpretive rules and regulations.

Legislative rules and regulations are subject to Administrative Procedure Act notice-and-comment rulemaking procedures. An agency must:

- publish a notice of proposed rulemaking in the Federal Register;
- provide "interested persons an opportunity to participate . . . through submission of written data, views, or arguments"; and
- "[a]fter consideration of the relevant matter presented, . incorporate in the rules adopted a concise general statement of their basis and purpose."[24]

The grant of legislative authority may use different language. Section 1502, for example, directs that "[t]he Secretary shall prescribe such regulations as he may deem necessary." and Section 269B(b) requires that "[t]he Secretary shall prescribe such regulations as may be necessary" in a more absolute sense. Other provisions may use other formulations of the delegation.

Interpretive tax regulations and other interpretive authority published under the authority of Section 7805(a) are not entitled to the same high degree of deference that legislative regulations receive. The basic standard for legislative regulations provided by the Administrative Procedure Act is to require deference to interpretations by administrative

[24] See 5 U.S.C. § 553(b), (c).

agencies unless their interpretations of statutes were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"[25] or otherwise failed to comply with the Administrative Procedure Act. Agency interpretations could be set aside because these interpretations violated the Constitution or exceeded the statutory grant of interpretive authority. Agency interpretations also could be set aside because the interpretations failed to follow the procedures mandated in the Administrative Procedure Act for the promulgation of rules and regulations. This standard substantially gave properly adopted legislative rules and regulations the force of law. Under *Loper Bright Enterprises*, interpretive regulations and rules are not clearly entitled to much deference beyond the soundness of the arguments on which the interpretive regulations are based. The strength of interpretive regulations under *Loper Bright Enterprises* may not be greater than the strength of a government brief in a Tax Court case. Interpretative regulations are not subject to the notice and comment requirements of the Administrative Procedure Act. Interpretive rules and regulations do not particularly bind the courts after *Loper Bright Enterprises*. Interpretive rules and regulations after *Loper Bright Enterprises* are perhaps more advisory than binding. A court should exercise independent judgement in considering whether interpretive rules and regulations provide the best interpretation of the statute under *Loper Bright Enterprises*.

The Internal Revenue Service has increasingly used notices to publish additions to the list of reportable transactions. This strategy avoided the notice and comment process under the Administrative Procedure Act. This particularly initiative has proven unsuccessful. One example was Notice 2007-83 ("Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits.").[26]

The Sixth Circuit in *Mann Construction, Inc. v. United States*, determined that Notice 2007-83 was a legislative rule. As such, Notice 2007-83 was subject to the notice and comment requirements of the Administrative Procedure Act. The Internal Revenue Service had not complied with notice and comment. *Mann Construction* found that Notice 2007-83 was a legislative rule because Notice 2007-83 "impose[s] new rights or duties and change[s] the legal status of regulated parties." Based on this failure, the Sixth Circuit found Notice 2007-83 invalid.[27]

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[25] 5 U.S.C. § 706(2)(A).

[26] 2007-2 C.B. 960.

[27] *Mann Construction v. United States*, 27 F.4th 1138 (6th Cir. 2022) ("Note to begin the absence of any express variation of the APA's notice-and-comment procedures. The statutes do not say anything, expressly or otherwise, that modifies the baseline procedure for rulemaking established by the APA. *Id.*. §§ 6011, 6707A. Nor did Congress expressly displace those requirements by creating a new procedure for these regulations. The statutes do not provide any 'express direction to the' agency 'regarding its procedure' for identifying reportable and listed transactions, let alone procedures 'that cannot be reconciled with' notice-and-comment requirements or any other indication within the statutory text that 'plainly expresses a congressional intent to depart from' the normal APA procedures. *Asiana Airlines*, 134 F.3d at 398. The statutes merely establish a disclosure and penalty

regime for the IRS to administer. As to the statutory text, Congress did not change the background procedural requirements of the APA or otherwise indicate an exemption from those requirements in a 'clear' or 'plain' way that would make the APA's procedures inapplicable to the IRS. *See Lockhart*, 546 U.S. at 145 – 46, 126 S.Ct. 699. ¶ Not true, the government pushes back. It starts by pointing to the cross-reference language in the reportable transaction definition, which describes such transactions as those 'determined under regulations prescribed under section 6011.' 26 U.S.C. § 6707A(c)(1). It then adds that, at the time Congress enacted § 6707A, one such regulation provided that the IRS could identify reportable and listed transactions by 'notice, regulation, or other form of published guidance.' 26 C.F.R. § 1.6011-4(b)(1) – (2) (2003). Because a 'notice' is the type of IRS action at issue, it claims that the statute contains an express exception from the APA's notice-and-comment process. ¶ But the agency's reference to its apparent rules of process, without more, does not show that Congress exempted Notice 2007-83 from notice-and-comment rulemaking. The question is whether Congress amended the APA's prerequisites, not whether the IRS did. While the cross-reference is probative of whether Congress was aware of the IRS's transaction-listing procedures, it does not alone suffice to show an express exemption from the APA procedures. Even on its own terms, moreover, the argument falls short. Section 6707A deals with penalties for not reporting certain transactions to the IRS. The statute's key feature is to describe the 'type[s]' of 'transaction[s]' subject to penalties for non-reporting, namely the ones 'determined' by 'the Secretary' 'because' they have a 'potential for tax avoidance or evasion.' 26 U.S.C. § 6707A(c)(1). The statute thus addresses a 'which transactions' question, not a 'what process' question. That does not suffice to create an express modification of the APA's background assumption that rulemaking will go through the notice-and-comment requirements. ¶ Statutory context reinforces the point. The cross-reference featured in § 6707A appears in the 'definitions' portion of the statute and appears there only to show reportable transactions, not listed transactions. Compare *id.*, with *id.* § 6707A(c)(2). The 'regulations prescribed under section 6011,' *id.* § 6707A(c)(1), contain all information that taxpayers must report, see *id.* § 6011. One way or another, Congress had to cross-reference those regulations—to incorporate the list of covered transactions—undermining the idea that the cross-reference somehow expressly changes the procedure for issuing legislative rules. ¶ The driving inquiry is whether Congress 'clearly' departed from the APA's baseline rule. *Lockhart*, 546 U.S. at 145, 126 S.Ct. 699; *see also Ass'n of Data Processing*, 745 F.2d at 685 – 86. Potential inferences layered on top of conjectural implications do not suffice. The government, notably, has not identified any case in which Congress exempted an agency from the APA's requirements via such a winding and elaborate route. Accepting the government's approach 'would require us to create § 559 precedent that itself could prove disruptive by too readily permitting other agencies to depart from uniform APA requirements.' *Dickinson*, 527 U.S. at 162, 119 S.Ct. 1816. ¶ The government separately argues that Congress ratified by inaction the IRS's nonconformance with the APA. Congress, it is true, sometimes may be deemed to 'ratify acts which it might have authorized and give the force of law to official action unauthorized when taken.' *Swayne & Hoyt v. United States*, 300 U.S. 297, 301 – 02, 57 S.Ct. 478, 81 L.Ed. 659 (1937). But this argument faces a lot of yellow lights. Inaction may, but does not always, mean ratification. And it rarely suffices to show express modification of the APA's bedrock procedural guarantees given the raft of potential explanations for inaction on Capitol Hill. The government identifies nothing beyond Congress's 'mere acquiescence' to the IRS's non-conforming practices over the years, which does not suffice. *Hannah v. Larche*, 363 U.S. 420, 438 – 39, 80 S.Ct. 1502, 4 L.Ed.2d 1307 (1960). ¶ Implied ratification also would be odd in this context. It may be the case in some settings that Congress is 'presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.' *Lorillard v. Pons*, 434 U.S. 575, 580, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978); *cf. Boeing Co. v. United States*, 537 U.S. 437, 457, 123 S.Ct. 1099, 155 L.Ed.2d 17 (2003). But

Case occasionally considers the status of revenue procedures under the Administrative Procedure Act. *Bullock v. Internal Revenue Service*[28] is an action against the Internal Revenue

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Congress presumably is equally aware of the APA's requirement that it must 'expressly' override the normal notice-and-comment rules. 5 U.S.C. § 559. It takes far more than the clanging silence we have here to infer that Congress has expressly altered the prerequisites for creating a rule that imposes financial and criminal penalties. ¶ Last of all, the government invokes legislative history. It notes that tax shelters have been a rampant problem that the IRS needs to address promptly, all without the procedural burdens that the APA imposes, and the legislative history shows as much. A representative of the IRS testifying in Congress, for example, noted that prior to § 6707A's enactment 'the best tool we have in dealing with [abusive transactions] is early identification.' Hearing Before S. Comm. on Fin., 107th Cong. 8 (2002). The IRS, he added, had to be able to '[i]dentify[ ] questionable transactions early . . . and issue guidance, in some cases before the transactions even show up on tax returns.' *Id.*. But the U.S. Supreme Court has already rejected the idea that tax law deserves special treatment under the APA. In its words, 'we are not inclined to carve out an approach to administrative review good for tax law only.' *Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55, 131 S.Ct. 704, 178 L.Ed.2d 588 (2011). ¶ Also problematic is that legislative history standing alone cannot supply the 'express,' 'plain,' or 'clear' direction needed to show that Congress modified the APA's procedures in this area. 'Legislative history, for those who take it into account, is meant to clear up ambiguity, not create it.' *Milner v. Dep't of Navy*, 562 U.S. 562, 574, 131 S.Ct. 1259, 179 L.Ed.2d 268 (2011). A congressional ambiguity does not a clear statement make. In the last analysis, if the IRS 'doesn't like Congress's notice-and-comment policy choices, it must take its complaints there.' *Azar*, 139 S. Ct. at 1815. Any exceptions to the sturdy protections established by the APA's notice-and-comment requirements must come from Congress, not us and not the IRS. ¶ *** ¶ Because the IRS's process for issuing Notice 2007-83 did not satisfy the notice-and-comment procedures for promulgating legislative rules under the APA, we must set it aside."). *See also Green Valley Investors v. Commissioner*, 159 T.C. 80 (2002) ("The act of identifying a transaction as a listed transaction by the IRS, by its very nature, is the creation of a substantive (*i.e.*, legislative) rule and not merely an interpretative rule. [Footnote omitted.] See 5 U.S.C. § 553. Identifying a transaction as a listed transaction does not merely provide the IRS's interpretation of the law or remind taxpayers of preexisting duties. Rather, and as we will detail below, identifying a transaction as a listed transaction imposes new duties in the form of reporting obligations and recordkeeping requirements on both taxpayers and their advisors. Notice 2017-10 exposes these individuals to additional reporting obligations and penalties to which they would not otherwise be exposed but for the notice. Creating new substantive duties and exposing taxpayers to penalties for noncompliance 'are hallmarks of a legislative, not an interpretive, rule.' *Mann Constr., Inc.*, 27 F.4th at 1144.")

[28] 401 F.Supp. 1144 (D. Mont. 2019) ("C. Agency Discretion ¶ Defendants claim that this Court cannot review the IRS's promulgation of Revenue Procedure 2018-38. The IRS Commissioner possesses broad discretion to 'relieve any organization or class of organizations . . . from filing, in whole or in part the annual return required . . . where he determines that such returns are not necessary for the efficient administration of the internal revenue laws.' 26 U.S.C. § 1.6033-2(g)(6). The IRS Commissioner exercised this discretion and determined that tax-exempt organizations need not file substantial-contributor information as previously required. This discretion, according to Defendants, evades any meaningful standard that a court could apply in judging the IRS Commissioner's decision to relieve the exempt organizations of the reporting requirement. ¶ A meaningful standard does exist. '[T]he mere fact that a statute contains discretionary language does not make agency action unreviewable.' *Pinnacle Armor, Inc. v. United States*, 648 F.3d 708, 719 (9th Cir. 2011). A court possesses

the ability to review agency action 'even where the substance or result of a decision is committed fully to an agency's discretion.' *Drakes Bay Oyster Co. v. Jewell*, 747 F.3d 1073, 1082 (9th Cir. 2014). The IRS stands correct that the substance of its ultimate decision remains subject to the Commissioner's discretion. A court may review, however, 'whether the Secretary followed whatever legal restrictions applied to his decision-making process.' *Id.*. at 1083. ¶ The APA's rulemaking processes remain the legal restrictions at issue here. Plaintiffs do not ask this Court to review the substance of the IRS's decision or whether substantial-contributor information must be disclosed. Plaintiffs challenge instead the IRS's alleged failure to follow the required notice-and-comment procedures before the promulgation of Revenue Procedure 2018-38. Amend. Compl. ¶¶ 81-89. Plaintiffs possess statutory standing to pursue this claim."; "C. Discussion ¶ The APA requires courts to 'hold unlawful and set aside agency action' promulgated 'without the observance of procedure required by law.' 5 U.S.C. § 706(2)(D). The APA requires that agencies advise the public through a notice in the Federal Register of the terms or substance of a proposed legislative rule and allow the public a period of time to comment. *Erringer v. Thompson*, 371 F.3d 625, 629 (2004). 'This is termed the notice-and-comment requirement of the APA.' *Id.*; *see* 5 U.S.C. § 553(b), (c). The APA's notice-and-comment requirement grants interested persons, organizations, and entities 'an opportunity to participate in the rulemaking process' by submitting written data, opposing views, or arguments. *Erringer*, 371 F.3d at 629 (*quoting Chief Prob. Officers of California v. Shalala*, 118 F.3d 1327, 1329 (9th Cir. 1997)); 5 U.S.C. § 553(c). This procedural gate holds government agencies accountable and ensures that these agencies issue reasoned decisions. *Sequoia Orange Co. v. Yeutter*, 973 F.2d 752, 758 (9th Cir. 1992). ¶ The APA's rule-making procedures, including the notice-and-comment period, do not apply 'to interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice . . . or when the agency for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest.' 5 U.S.C. § 553(b)(3)(A). An interpretive rule simply 'advise[s] the public of the agency's construction of the statutes and rules which it administers.' *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 88, 115 S.Ct. 1232, 131 L.Ed.2d 106 (1995). Interpretive rules 'merely explain, but do not add to, the substantive law that already exists in the form of a statute or legislative rule.' *Hemp Indus. Ass'n v. DEA*, 333 F.3d 1082, 1087 (9th Cir. 2003) ('Hemp Industries'). ¶ 'Interpretive rules instruct as to what an agency thinks a statute or regulation means.' *Reno-Sparks Indian Colony v. U.S. E.P.A.*, 336 F.3d 899, 909 (9th Cir. 2003). The Ninth Circuit in *Reno-Sparks Indian Colony* considered whether a rule purporting to 'clarify' certain determinations pursuant to the Clean Air Act ('CAA') stood as interpretive rather than legislative. *Id.*. at 902. The Environmental Protection Agency ('EPA') issued a rule that it claimed simply clarified 'that, in the table listing Nevada's Clean Air Act designations for various pollutants . . . the terms 'rest of state' and 'entire state' d[id] not refer to a single baseline area.' *Id.*. The EPA explained specifically that the terms 'rest of state' and 'entire state' actually referred 'to more than 250 distinct hydrographic areas, each of which constitute[d] its own separate baseline area' for CAA determinations. *Id.*. ¶ . . . . ¶ An agency must follow the requisite notice-and-comment procedures if the rule 'effect[s] a change in existing law or policy' that 'impos[es] general, extra-statutory obligations.' *Id.*. (*quoting Powderly v. Schweiker*, 704 F.2d 1092, 1098 (9th Cir. 1983); *Alcaraz v. Block*, 746 F.2d 593, 613 (9th Cir. 1984)). The Ninth Circuit determined, however, that the EPA's rule proved interpretive and not subject to the APA's notice-and-comment procedures because it failed to change existing law. *Reno-Sparks Indian Colony*, 336 F.3d at 909. The Ninth Circuit explained that 'the terms 'rest of state' and 'entire state' carr[ied] the same meaning' with or without 'the EPA's explanation of what the pre-existing substantive law mean[t].' *Id.*. at 910; *see also JEM Broadcasting Co., Inc. v. F.C.C.*, 22 F.3d 320, 327 (D.C. Cir. 1994) (upholding the FCC's adoption of 'hard look' rules regarding review of broadcast license applications without public notice-and-comment as rules that 'fall comfortably within the realm of the 'procedural' '). ¶ 'Legislative rules, on the other hand, create

rights, impose obligations, or effect change in existing law pursuant to authority delegated by Congress.' *Hemp Industries*, 333 F.3d at 1087. The Ninth Circuit in Hemp Industries considered the validity of a rule issued by the Drug Enforcement Agency ('DEA'). *Id.*. at 1082. The DEA claimed that its rule simply interpreted both the Controlled Substances Act ('CSA') and DEA regulations in an effort to ban all naturally occurring Tetrahydrocannabinols ('THC'). *Id.*. at 1085. THC constitutes the active chemical in marijuana. *Id.*. The DEA's ban on THC, however, effectively banned hemp seed and hemp oil labeled THC-free. *Id.*. at 1085. Both hemp seed and oil naturally contain miniscule trace amounts of THC. *Id.*. ¶ Companies that manufactured, purchased, or sold consumable products containing THC-free sterilized hemp seed and oil challenged the validity of the rule. *Id.*. The companies argued that the DEA's alleged interpretive rule represented an invalid legislative rule 'promulgated without observance of the procedures required by the APA.' *Id.*. at 1086. The Ninth Circuit adopted the D.C. Circuit's framework for distinguishing legislative rules from interpretive rules. ¶ This framework acknowledges that legislative rules, unlike interpretive rules, possess the 'force of law.' *Id.*. at 1087. Three circumstances exist in which a rule possesses the 'force of law.' *Id.*. First, a rule possesses the force of law 'when, in the absence of the rule, there would not be an adequate legislative basis for enforcement action.' *Id.*. The second circumstance occurs when the agency 'explicitly invoke[s] its general legislative authority.' *Id.*. The final circumstance arises 'when the rule effectively amends a prior legislative rule.' *Id.*. The Ninth Circuit determined that 'the third criterion appears to be the primary source of contention' in evaluating the DEA's promulgation of its THC ban. *Id.*. at 1088. ¶ The Ninth Circuit looked to the status of the law before the issuance of the DEA's new rule. The CSA previously considered marijuana and THC separately from one another. The CSA classifies marijuana to be 'all parts of the plant Cannabis sativa L., whether growing or not,' but excludes 'mature stalks of such plant, fiber produced from such stalks, oil or cake made from the seeds of such plant . . . or the sterilized seed of such plant[.]' *Id.*; 21 U.S.C. § 802(16)(A), (B)(ii). The CSA explicitly exempted the companies' products – hemp oil and sterilized seed – from marijuana's definition. *Id.*. The DEA's new rule combined marijuana and THC by banning all products containing even trace amounts of THC. The rule changed an existing law and effectively amended its previously understood terms. ¶ The Ninth Circuit concluded that the DEA's revised approach rose to the level of a legislative rule subject to the public notice-and-comment period. To interpret a regulation, a rule must remain consistent with the substance of the regulation. *Id.*. at 1090. The DEA's new rule repealed existing classifications and rendered 'superfluous the separate listing of marijuana.' *Id.*. Moreover, the DEA's new rule nullified 'the explicit exemption of hemp seed and oil from the coverage of marijuana.' *Id.*. The Ninth Circuit declared that the DEA's promulgation of its new rule represented a 'disingenuous interpretation' in an attempt 'to evade the time-consuming procedures of the APA' by changing an existing regulation retroactively. *Id.*. at 1091. ¶ The IRS's promulgation of Revenue Procedure 2018-38 appears to represent a similar attempt to 'evade the time-consuming procedures of the APA.' *Id.*. Unlike the rule in *Reno-Sparks*, the IRS regulation would not retain the same meaning 'with or without' the IRS's amendment. *Reno-Sparks Indian Colony*, 336 F.3d at 910. The IRS has required tax-exempt organizations for nearly five decades to 'file an annual information return' that furnishes '[t]he total of the contributions, gifts, grants and similar amounts received . . . and the names and addresses of all persons who contributed, bequeathed, or devised $5,000 or more . . . .' 26 C.F.R. § 1.6033-2(a)(ii)(f). Revenue Procedure 2018-38 explicitly upends this fifty-year practice and 'effectively amends' this existing rule. *Hemp Industries*, 333 F.3d at 1087. Revenue Procedure 2018-38 directs tax-exempt organizations to forego existing policy and informs these organizations that they 'are no longer required to report the names and addresses of their contributors' as previously required. Rev. Proc. 2018-38 at 1. ¶ Defendants claim that Revenue Procedure 2018-38 remains an interpretive rule despite its clear conflict with existing law. Defendants seek to classify Revenue Procedure 2018-

Service seeking to invalidate Revenue Procedure 2018-38.[29] This revenue procedure considered the information to be reported to the Internal Revenue Service by organizations exempt from tax under Section 501(a). The action sought to require to force the Internal Revenue Service to follow the procedural rules under the Administrative Procedure Act. The court denied the defendant's motion to dismiss and held that "[t]he IRS must follow the proper notice-and-comment procedures pursuant to the APA if it seeks to adopt a similar rule."[30]

Section 7805(a) provides broad authority to Treasury to publish interpretive rules and regulations:

Sec. 7805 Rules and regulations

(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

38 as 'an interpretive rule because it interprets and clarifies the 'other information' that § 6033(a)(1) allows the IRS to require.' Revenue Procedure 2018-38, according to Defendants, simply specifies the type of information that certain organizations need to provide. *Id.*. at 31. It may be true that the IRS lawfully can determine what information that it requires from exempt organizations pursuant to § 6033. The IRS cannot escape, however, the procedural demands of the APA. ¶ The APA requires federal agencies to follow the notice-and-comment rulemaking procedures before it creates or amends legislative rules and regulations. 5 U.S.C. § 553(b). An interpretive rule remains consistent with the regulation that it seeks to interpret. *Hemp Industries*, 333 F.3d at 1090. A legislative rule 'effectively amends a prior legislative rule.' *Id.*. at 1087. Revenue Procedure 2018-38 effectively amends the previous rule that required tax-exempt organizations to file substantial-contributor information annually. See 26 C.F.R. § 1.6033-2(a)(ii)(f). Revenue Procedure 2018-38, as a legislative rule, requires the IRS to follow the notice-and-comment procedures pursuant to the APA. *Hemp Industries*, 333 F.3d at 1091. The IRS's admitted failure to follow the APA's public notice-and-comment procedure warrants summary judgment in favor of Plaintiffs on Count One of the Amended Complaint. ¶ The IRS must enforce and administer the Internal Revenue Code 'with integrity and fairness to all.' The IRS Missions and Statutory Authority, https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority (last visited July 10, 2019). The scope of this responsibility provides sufficient reason for the IRS to seek external information and opposing opinions before it promulgates an amendment to a legislative rule, such as Revenue Procedure 2018-38. The Court recognizes that tax-exempt organizations may not receive tax-exempt status if any part of their earnings or income 'inures to the benefit of any private shareholder or individual.' *See* 26 U.S.C. § 501(c)(4)(B). Plaintiffs contend that a state-tax agency may need to rely on substantial-contributor information to determine whether that organization has violated this prohibition on private inurement. Plaintiffs further suggest that information concerning the identity of exempt organizations' contributors remains critical for enforcing limits on political activity. *Id.*. The Court agrees that these purposes support the need for the IRS to comply with the APA's notice-and-comment provision when it amends a long-standing regulation that implicates the collection and sharing of this information.").

[29] 2018-31 I.R.B. 280.

[30] 401 F.Supp.3d at 1159.

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.

Section 7805(a) grants Treasury broad interpretative authority, but that authority is limited. Courts, particularly *Loper Bright Enterprises v. Raimondo*,[31] have profoundly limited the scope of the authority of Treasury to publish interpretive regulations under Section 7805(a).

Chevron v. Natural Resources Defense Council[32] provided substantial deference to agency regulations interpreting statutes. *Chevron* taught that, if Congress has not addressed the question at the center of a dispute, a court must accept the agency's reasonable interpretation of the statute. An "arbitrary and capricious" interpretation, however, did not bind the courts. *Chevron* guided administrative law for 40 years.

Loper Bright Enterprises instead directs courts to rely on their own interpretations of ambiguous statutes without deferring to agency interpretations. *Loper Bright Enterprises* found that there is a "best reading" of each statute. This "best reading" is the "one the court, after applying all relevant interpretative tools, concludes is best." The court should follow the best reading of the statute without deference to agency interpretations in interpretive regulations.

Section 7805(b) considers retroactivity of regulations. In general, regulations are prospective rather than retroactive, at least in theory. Many regulations nevertheless may have retroactive effects.

(b) Retroactivity of regulations.

(1) In general. Except as otherwise provided in this subsection, no temporary, proposed, or final regulation relating to the internal revenue laws shall apply to any taxable period ending before the earliest of the following dates:

(A) The date on which such regulation is filed with the Federal Register.

(B) In the case of any final regulation, the date on which any proposed or temporary regulation to which such final regulation relates was filed with the Federal Register.

(C) The date on which any notice substantially describing the expected contents of any temporary, proposed, or final regulation is issued to the public.

(2) Exception for promptly issued regulations. Paragraph (1) shall not apply to regulations filed or issued within 18 months of the date of the enactment of the statutory provision to which the regulation relates.

(3) Prevention of abuse. The Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse.

[31] 603 U.S. __, 144 S. Ct. 2244 (2024).

[32] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

(4) Correction of procedural defects. The Secretary may provide that any regulation may apply retroactively to correct a procedural defect in the issuance of any prior regulation.

(5) Internal regulations. The limitation of paragraph (1) shall not apply to any regulation relating to internal Treasury Department policies, practices, or procedures.

(6) Congressional authorization. The limitation of paragraph (1) may be superseded by a legislative grant from Congress authorizing the Secretary to prescribe the effective date with respect to any regulation.

(7) Election to apply retroactively. The Secretary may provide for any taxpayer to elect to apply any regulation before the dates specified in paragraph (1).

(8) Application to rulings. The Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.

Section 7805(c) addresses temporary regulations and contains a special three-year sunset provision.

(e) Temporary regulations.

(1) Issuance. Any temporary regulation issued by the Secretary shall also be issued as a proposed regulation.

(2) 3-year duration. Any temporary regulation shall expire within 3 years after the date of issuance of such regulation.

Proposed and temporary regulations are submitted to the Small Business Administration for comment on impact on small business under Section 7805(a):

(f) Review of impact of regulations on small business.

(1) Submissions to Small Business Administration. After publication of any proposed or temporary regulation by the Secretary, the Secretary shall submit such regulation to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact of such regulation on small business. Not later than the date 4 weeks after the date of such submission, the Chief Counsel for Advocacy shall submit comments on such regulation to the Secretary.

(2) Consideration of comments. In prescribing any final regulation which supersedes a proposed or temporary regulation which had been submitted under this subsection to the Chief Counsel for Advocacy of the Small Business Administration–

(A) the Secretary shall consider the comments of the Chief Counsel for Advocacy on such proposed or temporary regulation, and

(B) the Secretary shall discuss any response to such comments in the preamble of such final regulation.

(3) Submission of certain final regulations. In the case of the promulgation by the Secretary of any final regulation (other than a temporary regulation) which does not supersede a proposed regulation, the requirements of paragraphs (1) and (2) shall apply; except that–

(A) the submission under paragraph (1) shall be made at least 4 weeks before the date of such promulgation, and

(B) the consideration (and discussion) required under paragraph (2) shall be made in connection with the promulgation of such final regulation.

§1.3 Administrative Procedure Act (1946).

Administrative agencies do not have inherent power to publish binding rules and regulations. Administrative agencies do not have inherent regulatory authority. Regulatory must be delegated by Congress in order for a regulatory agency to adopt binding rules and regulations. Congress, however, frequently has explicitly granted administrative agencies regulatory authority. For rules and regulations to be valid, regulatory agencies must demonstrate that they Congress has delegated to them regulatory authority. Congress has delegated significant rulemaking to executive agencies since the beginning of the United States. An early statute required traders to obey "in all things touching . . . trade and intercourse" with Indian tribes "such rules and regulations as the President shall prescribe."[33] With the enormous expansion of government activities over time, there has been an enormous expansion in executive agency rules and regulations. Congress often would delegate specific rulemaking power to executive agencies.[34]

The Administrative Procedure Act, enacted June 11, 1946,[35] prescribes procedures for agency action and delineates the basic contours of judicial review of this action. The Administrative Procedure Act codifies for agency cases the proposition that courts decide legal questions by applying their own judgment.

The Administrative Procedure Act reflected a reaction to the dramatic expansion of government agencies and their interpretations of legislation during the New Deal. The Administrative Procedure Act set forth consistent procedures for administrative agencies to make rules. The Administrative Procedure Act also set forth consistent restrictions on administrative guidance and bases for invalidation of administrative agency rulemaking. The basic standard was that, for legislative regulations, the Administrative Procedure Act provided

[33] Act of July 22, 1790, 1 Stat. 137.

[34] *But see Gundy v. United States*, 139 S. Ct. 2116, (2019) (accompanying the Constitution's "assignment of power to Congress is a bar on its further delegation. Congress, this Court explained early on, may not transfer to another branch 'powers which are strictly and exclusively legislative.'") (*quoting Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 42–43, (1825)).

[35] Ch. 324, 60 Stat. 237 (June 11, 1946).

deference to administrative agencies unless their interpretations of statutes were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[36] Agency interpretations could be set aside because these interpretations violated the Constitution or exceeded the statutory grant of interpretive authority. Agency interpretations also could be set aside because the interpretations failed to follow the procedures mandated in the Administrative Procedure Act for the promulgation of rules and regulations. This standard substantially gave properly adopted rules and regulations the force of law.

> *There shall be no presumption that any rule or regulation of any agency is valid, and whenever the validity of any such rule or regulation is drawn in question in any court of the United States or of any State, the court shall not uphold the validity of such challenged rule or regulation unless such validity is established by a preponderance of the evidence shown. Provided, however. That if any rule or regulation is set up as a defense to any criminal prosecution or action for civil penalty, such rule or regulation shall be presumed valid until the party initiating the criminal prosecution or action for civil penalty shall have sustained the burden of proof normally applicable in such actions. the reviewing court shall de novo decide all relevant questions of law, [and] interpret constitutional and statutory provisions."*[37]

An important lesson for tax lawyers is that the Administrative Procedure Act is of general application. The Administrative Procedure Act applies as much to guidance and rules from Treasury and the Internal Revenue Service as the Administrative Procedure Act does to guidance and rules from all other governmental agencies. Guidance by Treasury and the Internal Revenue Service is limited by the Administrative Procedure Act. Cases on the Administrative Procedure Act outside of the tax area are just as applicable to guidance and rules issued by Treasury and the Internal Revenue Service as are cases involving Federal income tax issues. Counsel working with tax cases need to consult authorities both within and without the tax area properly to understand the operation of the Administrative Procedure Act to tax guidance. Too many tax attorneys limit their inquiry into the Administrative Procedure Act to tax authorities and cases.

Treasury and the Internal Revenue Service have an unfortunate history in dealing with and complying with the Administrative Procedure Act. The Internal Revenue Service at times has been profligate in promulgating temporary regulations without relying on notice and comment. Treasury and the Internal Revenue Service sometimes have been expansive in interpreting their power to interpret some statutes where the statutes contain a special grant of interpretative authority. Treasury and the Internal Revenue Service sometimes have been sparse in their responses to taxpayer comments. Treasury and the Internal Revenue Service often have been creative and expansive in their interpretations of statutes contained in interpretive regulations and other guidance. Interpretative regulations and some other Internal Revenue Service guidance often look much more like legislative regulations than interpretive

[36] 5 U.S.C. § 706(2)(A).

[37] 125 Cong. Rec. S12145 (daily ed. Sept. 7, 1979).

regulations. These regulations and guidance often reach interpretations of the underlying statutes that a court would be unlikely to reach.

There also is a substantial body of interpretive regulations, rulings, and other authorities in the tax area that, if promulgated after *Loper Bright Enterprises*, might well be met with skepticism by a court that exercised its independent judgment in interpreting the underlying statute. The status of these existing regulations, rulings, and other authorities determined under *Chevron v. Natural Resources Defense Council*[38] is uncertain after *Loper Bright Enterprises*. In other cases, existing interpreting regulations, rulings, and other authorities represent sound interpretations of the underlying statute and should easily survive challenge under *Loper Bright Enterprises*. *Loper Bright Enterprises* requires an extensive reevaluation of all regulations and other administrative authorities in the tax area. *Loper Bright Enterprises* reemphasizes the overriding importance of the Administrative Procedure Act.

The Administrative Procedure Act specifies that courts, not agencies, will decide "all relevant questions of law" arising on review of agency action[39] —even those involving ambiguous laws. The Administrative Procedure Act does not prescribe a deferential standard for courts to employ in answering legal questions, despite mandating deferential judicial review of agency policymaking and factfinding.[40] By directing courts to "interpret constitutional and statutory provisions" without differentiating between the two,[41] the Administrative Procedure Act clarifies that agency interpretations of statutes are not generally entitled to deference.

The Administrative Procedure Act[42] provides rules that govern the process by which federal agencies develop and issue regulations. The Administrative Procedure Act requires that

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[38] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024). 467 U.S. 837 (1984).

[39] 5 U. S. C. § 706.

[40] See 5 U. S. C. § 706(2)(A), (E).

[41] 5 U.S.C. § 706.

[42] Pub. L. No. 79-404, 60 Stat. 237, ch. 324, §§ 1–12 (June 11, 19465), *codified at* U.S.C. §§ 551–559, 701–706, 1305, 3105, 3344, 5372, 7521 (2012); originally enacted by the Administrative Procedure Act, as originally enacted was repealed by Pub. L. No. 89-554, 80 Stat. 381 (Sept. 6, 1966), as part of the general revision of title 5 of the United States Code. The provisions of the Administrative Procedure Act were incorporated into title 5 of the United States Code. 5 U.S.C. § 552 (Freedom of Information Act) has been revised significantly since 1946. 5 U.S.C. § 552a (the Privacy Act) was added to the Administrative Procedure Act in 1974. I.R.C. § 552 has been amended several times. 5 U.S.C. § 552b (the Government in the Sunshine Act) was added in 1976 and amended once. The Administrative Dispute Resolution Act (5 U.S.C. §§ 571–584) and the Negotiated Rulemaking Act (5 U.S.C. §§ 561–570) were enacted in 1990. The committee reports on the APA are S. Rep. No. 752 (1945) and H.R. Rep. No. 1980 (1946). The Senate and House debates and the documents mentioned in the preceding paragraph, other than the Final Report of the Attorney General's Committee, are compiled in S. Doc. No. 248, Administrative Procedure Act—Legislative History 1944-46 (1946). The Final Report was published as S. Doc. No. 8 (1941). The *Attorney General's Manual on the Administrative Procedure Act* (1947) is a contemporaneous interpretive guide to the original language of the

agencies that adopt regulations (at least, legislative regulations entitled to full deference) must publishing notices of proposed and final rulemaking in the Federal Register. The Administrative Procedure Act also provides the public with the opportunity to comment on notices of proposed rulemaking. Treasury and the Internal Revenue Service will publish a written summary response to these comments. Most rules are subject to a 30-day delayed effective date. Notice and comment encourages public deliberation of agency rules. Notice and comment encourages accountability of government agencies to the public. Notice and comment exposes government regulations to the test of public inspection. The public may have important insights that government rule makers may have missed. The public may find errors in regulations. The public may help regulators to balance considerations in rulemaking. The public also may be able to provide specialized expertise that can affect the outcome of rulemaking.

A government agency issues a legislative rule under a delegation of authority by statute. This delegation can provide for a broad delegation or a very specific delegation.

The Administrative Procedure Act sets forth the basic requirements for notice and comment rulemaking, the process generally used by agencies to issue legislative rules. Other statutes, executive orders, or agency rules impose additional requirements.

The notice and comment requirements for rulemaking requires a Federal agency –

- first to issue a notice of proposed rulemaking and
- additionally to provide the public with an opportunity for public comment on the proposal before the agency can issue a final rule.

The Administrative Procedure Act allows limited exceptions to the requirement for notice and comment. Notice and comment may be waived for "good cause" for emergencies.

The notice of proposed rulemaking explains –

- the need,
- the source of authority, and
- the reasons

for the proposed rules.

The notice of proposed rulemaking is required to set forth either –

- the text of a proposed rule or
- a description of the subjects and issues involved in the rule.

Administrative Procedure Act. The *Attorney General's Manual on the Administrative Procedure Act*, published in 1947, is the principal guide to the Administrative Procedure Act.

The notice of proposed rulemaking also includes –

- the deadline for public comments,
- how and where to file comments, and
- people to contact for further information about the proposal.

The agency's notice of proposed rulemaking usually is published in the Federal Register.

The typical comment period is at least 30 days. This period provides an opportunity for the Federal agency to file comments on a notice of proposed rulemaking.

The notice and comment process is designed to "provide an accurate picture of the reasoning that has led the agency to the proposed rule."[43] The notice and comment process is supposed to ensure reasoned decision making by Federal agencies. The record in notice and comment also provides a basis for judicial review of administrative rules.

The Administrative Procedure Act requires that agency's final rules are required to be reasonable. The publishing agency must state the basis for its decision on comments. The publishing agency also must show how its final rule will achieve its purpose. Changes from the initially proposed rule to the final rule must be of a type that could have been reasonably anticipated by the public. A change that is not a logical outgrowth of the proposal in the notice of proposed rulemaking will require the agency to provide the public with a further opportunity for public comment.

An agency publishing a final rule must conclude that this rule accomplishes the identified goals. The adopting agency may publish a proposed rule to address issues raised during the notice and comment process. The agency also may change the proposed rule prior to issuing a final rule and without issuing a new notice of proposed rulemaking. The agency may avoid a new round of notice and comment only to the extent that changes between the proposed and final rules are "logical outgrowth" of the initially proposed rule. If the final rule is a "logical outgrowth" of the rulemaking proposal, then no additional notice and comment is required. The Administrative Procedure Act does not require that the final rule is the same as the proposed rule. The Administrative Procedure Act requires that the preamble discussed the subjects and issues that led to the final rule.

Agencies typically permit oral and written presentations to agency decision makers.

The agency adopting new rules must maintain a public docket of public comments.

The Administrative Procedure Act requires that the final rule contain –

- an explanatory preamble and

[43] *Connecticut Light & Power Co. v. Nuclear Regulatory Commission*, 673 F.2d 525, 530 (D.C. Cir.), *cert. denied*, 459 U.S. 835 (1982).

- the text of the new rule.

The Administrative Procedure Act requires that preamble includes –

- a response to the significant, relevant issues raised in public comments,
- a statement providing the basis and the purpose of the rule,
- a recitation of the facts and data relied on by the agency in promulgating the rule, and
- responses to major public comments.

The final rule normally will be published in the Federal Register.

Legislative rules generally will be effective at least 30 days after the rules are published in the Federal Register.

The Administrative Procedure Act was enacted on June 11, 1946.

The purpose of the Administrative Procedure Act is:

- To require agencies to keep the public currently informed of their organization, procedures, and rules,
- To provide for public participation in the rulemaking process,
- To prescribe uniform standards for the conduct of formal rulemaking and adjudicatory proceedings (*i.e.*, proceedings required by statute to be made on the record after opportunity for an agency hearing), and
- To restate the law of judicial review.

The Administrative Procedure Act distinguishes between agency rulemaking and agency adjudication. Rulemaking is agency action that regulates the future conduct of persons through the formulation and issuance of an agency statement designed to implement, interpret, or prescribe law or policy. This rulemaking is essentially legislative. Adjudication is concerned with determination of past and present rights and liabilities. Agencies use rulemaking to formulate future policy. Agencies use a combination of rulemaking and adjudication.

The Administrative Procedure Act prescribes procedures for both formal rulemaking and formal adjudication.

Section 553 of the Administrative Procedure Act requires for rulemaking:

- notice of proposed rulemaking in the Federal Register,[44] followed by

[44] 5 U.S.C. § 553(b).

- an opportunity for some level of participation by interested persons by written or oral comments,[45] and finally
- publication of the rule, in most instances at least 30 days before the rule becomes effective.[46]
- Inclusion of a general statement of basis and purpose in the published notice finalizing the regulation, including consideration and response to public objections and suggestions.[47]

The Administrative Procedure Act provides an opportunity for public participation in rulemaking. The Administrative Procedure Act is designed to foster the fair and informed exercise of agency authority.

When Congress enacted the Administrative Procedure Act, Congress encouraged agencies to use the notice-and-comment procedure in some excepted cases, and many agencies routinely do so in making certain kinds of exempted rules.

Most rulemaking proceedings involve informal rulemaking. The Administrative Procedure Act then requires for public participation is an opportunity to submit written data, views, or arguments. The agency also may permit oral presentations. The published rule must incorporate a concise general statement of its basis and purpose. The Supreme Court held that where rulemaking is governed by the (informal) requirements of Section 553, as in the case of the Nuclear Regulatory Commission's regulation of nuclear power plants, the courts may not require additional procedures.[48]

The Administrative Procedure Act also provides for formal rulemaking. Formal rulemaking is required when rules are required by statute to be made on the record after an opportunity for an agency hearing. Formal rulemaking under Sections 556 and 557 under the Administrative Procedure Act is usually reserved for adjudicatory orders. Formal rulemaking is required only where the statute involved specifically requires an "on the record" hearing.[49] Formal rulemaking is used infrequently. Many "hybrid rulemaking" statutes require some specific procedures beyond the basic notice-and-comment elements of informal rulemaking.

Formal adjudication (cases for which an adjudicatory proceeding is required by statute to be determined on the record after the opportunity for an agency hearing) is governed by Sections 554, 556, and 557 of the Administrative Procedure Act. These sections apply to proceedings by certain agencies seeking to impose civil money penalties as part of a regulatory enforcement program.

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[45] 5 U.S.C. § 554(c).
[46] 5 U.S.C. § 553(c).
[47] 5 U.S.C. § 553(c).
[48] *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978).
[49] *United States v. Florida East Coast Railway Co.*, 410 U.S. 224 (1973).

Section 554(b) of the Administrative Procedure Act specifies notice requirements.

Section 554(c) of the Administrative Procedure Act provides for an opportunity for submission and consideration of facts, arguments, and informal settlements where practicable.

Section 555 of the Administrative Procedure Act states various procedural rights of private parties, which may be incidental to rulemaking, adjudication, or the exercise of any other agency authority.

Section 555(b) of the Administrative Procedure Act addresses appearances in agency proceedings by parties, counsel, and other interested persons.

Section 555(c) of the Administrative Procedure Act provides that a person compelled to submit data or evidence is entitled to a copy or transcript, except that in nonpublic investigations this may be limited to a right to inspect the official transcript.

The basic rule making requirements of the Administrative Procedure Act are set forth in Section 553 of the Administrative Procedure Act:

§553. Rule making

(a) This section applies, according to the provisions thereof, except to the extent that there is involved-

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include-

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed;

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved; and

(4) the Internet address of a summary of not more than 100 words in length of the proposed rule, in plain language, that shall be posted on the Internet website under section 206(d) of the E-Government Act of 2002 (44 U.S.C. 3501 note) (commonly known as regulations.gov).

Except when notice or hearing is required by statute, this subsection does not apply –

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except-

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

Section 706(2)(A) of the Administrative Procedure Act provides for the invalidity of agency rules that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Hewitt v. Commissioner*,[50] held that Treasury Regulations Section 1.170A-14(g)(6)(ii) is procedurally invalid under the Administrative Procedure Act. Charitable contribution deeds do not have to qualify under this regulation. The Eleventh Circuit held that "the Commissioner's interpretation of §1.170A-14(g)(6)(ii), to disallow the subtraction of the value of post-donation improvements . . . is arbitrary and capricious and therefore invalid under the [Administrative Procedure Act]'s procedural requirements."[51] *Hewitt* held that the regulation was "arbitrary and capricious and therefore invalid under the [Administrative Procedure Act] 's procedural requirements."

§1.4 Chevron v. Natural Resources Defense Council (1984): Deference To Agency Interpretations.

Loper Bright Enterprises represents a major departure from the prior teaching of *Chevron v. Natural Resources Defense Council.*[52] *Chevron* taught that, if Congress has not addressed the

[50] 21 F.4th 1336 (11th Cir. 2021),

[51] *Hewitt v. Commissioner*, 21 F.4th 1336, 1353 (11th Cir. 2021), *rev'g and remanding* T.C. Memo. 2020-89.

[52] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024). 467 U.S. 837 (1984).

question at the center of a dispute, a court must accept the agency's reasonable interpretation of the statute. *Chevron* was grounded on the implicit assumption that Congress intended administrative agencies to provide administrative guidance to clarify ambiguities in the statute and to fill gaps in the statute. *Chevron* embraced broad agency discretion in rulemaking.

Loper Bright Enterprises explicitly overrules *Chevron*. *Loper Bright Enterprises* represents a potential tsunami change in tax law. *Loper Bright Enterprises* eliminates the presumption of validity in favor of interpretations contained in interpretive Treasury Regulations. In litigation, the Internal Revenue Service must justify the interpretations contained in interpretive regulations. The Internal Revenue Service must show that the regulations contain the best interpretation of the statute.

Loper Bright Enterprises throws into some doubt the validity of many interpretive Treasury Regulations. This observation does not mean that these regulations are invalid, but this observation does create a basis for a taxpayer challenging the regulations if the taxpayer feels that he has a better interpretation of statutory provisions. *Loper Bright Enterprises* articulates support for *stare decisis*, but *Loper Bright Enterprises* also provides the ground work for a determination that cases determined under a *Chevron* standard may not be properly decided on account of *Chevron* not requiring that courts determine the best meaning of the statute. The law has yet to clarify old cases determined under *Chevron* will fare under *Loper Bright Enterprises*.

Taxpayers also can use the nondelegation doctrine to challenge Treasury Regulations. The nondelegation doctrine addresses whether there has been a proper delegation of authority to Treasury and the Internal Revenue Service to draft regulations.

Chevron considered whether the Clean Air Act required that Environmental Protection Agency regulations should apply separately to emissions from each individual smokestack or whether regulations should address emissions from an entire plant taken as a whole (an approach that the industry commonly referred to as the "bubble" approach). *Chevron* most importantly established a new two-step analysis for the validity of administrative regulations. The Administrative Procedure Act provides that: "To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action."[53] Courts should invalidate agency action that the court found to be in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.[54] Further, courts should hold unlawful and set aside administrative agency decisions and actions that are "arbitrary, capricious, [or] an abuse of discretion."[55] The Administrative Procedure Act directed courts to set aside administrative agency rules and actions only if those rules and

[53] 5 U.S.C. § 706.
[54] 5 U.S.C. § 706(2)(C).
[55] 5 U.S.C. § 706(a)(A).

actions were not supported by substantial evidence.[56] A reviewing court was substantially limited to determining the reasonable of the administrative agency's exercise of discretion and to ensure that the agency's determinations were not arbitrary, capricious, or an abuse of discretion. Nevertheless, "the reviewing court shall decide all relevant questions of law [and] interpret constitutional and statutory provisions."[57] In a footnote, the *Chevron* court observed:

> *The court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding . . . .*[58]

The result of *Chevron* was a high degree of judicial deference to administrative agency acts, rules, and regulations.

The *Chevron* Court did observe in a footnote that:

> *The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear Congressional intent . . . . If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect."*[59]

Under *Chevron*, where Congressional intent in a statute was clear, a court was required to follow that intent concerning the meaning of a statute. Administrative interpretations inconsistent with clear Congressional intent would not be respected. Where the statute was either silent or ambiguous, *Chevron* required a court to defer to administrative agency interpretations of a statute. The court was required to defer to the administrative agency interpretation even where the administrative agency interpretation was different from how the court otherwise would have interpreted the statute, provided that the administrative agency interpretation was a rational interpretation of the statute. *Chevron* had guided administrative law for 40 years. *Chevron* was one of the most important cases on administrative law prior to *Loper Bright Enterprises*.

Chevron also accepted implicit legislative delegation to administrative agencies: "[s]ometimes the legislative delegation to an agency on a particular question is implicit rather than explicit.[60]

Chevron followed and expanded on the principle of *United States v. Moore*,[61] which opined that "The construction given to a statute by those charged with the duty of executing it is always entitled to the most respectful consideration, and ought not to be overruled without

[56] 5 U.S.C. § 706(2)(E).
[57] 5 U.S.C. § 706.
[58] 467 U.S. at 842n.11.
[59] 467 U.S. at 843n.9
[60] *Chevron* at 467 U.S. at 844.
[61] 95 U.S. 760 (1877).

cogent reasons. [Citation omitted.] The officers concerned are usually able men, and masters of the subject. Not unfrequently they are the draftsmen of the laws they are afterwards called upon to interpret."[62]

Chevron stood in contrast to the Administrative Procedure Act, which directed that the "reviewing court shall decide all relevant questions of law, [and] interpret . . . statutory provisions.[63]

Many authorities argued that *Chevron* has led to too great an expansion of the administrative state. *Chevron* certainly has been followed by an enormous outpouring of regulations and other advice from administrative agencies. This expansion, the authorities argued, undermined the authority of both Congress and the courts.

Chevron v. Natural Resources Defense Council[64] sustained an Environmental Protection Agency's interpretation of the Clean Air Act. The case Environmental Protection Agency had defined the term "stationary source" in the Clean Air Act to permit owners of polluting facilities to treat all emitting devices as if the emitting devices were under a single "bubble". This treatment minimized compliance costs with the Clean Air Act emissions requirements.[65]

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[62] *Id.*. at 763. Robert Stern wrote in 1944:

The duty of the courts in reviewing the administrative decision for error of law is to see that the agency has stayed within the bounds for the exercise of discretion fixed by Congress, and that it has applied the statutory standards and no others. As long as the agency does so, the courts are not to substitute their judgment . . [T]he function of the reviewing court in determining the "law" in this field is to search for legislative intention, which of course would include an intention to vest the administrator with discretionary power, and then to decide whether the administrative ruling is consistent with it.

Robert Stern, *Review of Findings of Administrators, Judges and Juries: A Comparative Analysis*, 58 Harv. L. Rev. 70, 106-07 (1944). This compares with the view of Justice Brandeis: "the function of the courts is not one of review but essentially of control-the function of keeping agencies within their statutory authority." *Crowell v. Benson*, 285 U.S. 22, 89 (1932) (Brandeis, J., dissenting) (footnote omitted). *See NLRB v. Hearst Publications*, 322 U.S. 111 (1944). See Hart & Wechsler, Hart, *The Power of Congress to Limit the Jurisdiction of Federal Courts: An Exercise in Dialectic*, 66 Harv. L. Rev. 1362 (1953) ("In recent years we've recognized increasingly a permissible range of administrative discretion in the shaping of judicially enforceable duties. How wide that discretion should be, and what are the appropriate ways to control it, are crucial questions in administrative law. But so long as the courts sit to answer the questions, the spirit of Brandeis' statement is maintained. And, since discretion by hypothesis is not law, the letter of it is not in question.") (citations omitted) (footnote omitted).

[63] 5 U.S.C. §706 (2000).

[64] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[65] The Clean Air Act Amendments of 1977 imposed certain requirements on States that have not achieved the national air quality standards established by the Environmental Protection Agency pursuant to earlier legislation. This included the requirement that such "nonattainment" States establish a permit program regulating "new or modified major stationary sources" of air pollution. Generally, a permit may not be issued for such sources unless stringent conditions are met.

Environmental Protection Agency regulations promulgated in 1981 to implement the permit requirement allowed a State to adopt a plantwide definition of the term "stationary source." Under this plantwide definition, an existing plant that contains several pollution-emitting devices may install or modify one piece of equipment without meeting the permit conditions if the alteration will not increase the total emissions from the plant. This allowed State to treat all of the pollution-emitting devices within the same industrial grouping as though they were encased within a single "bubble." Respondents filed a petition for review in the Court of Appeals, which set aside the regulations embodying the "bubble concept" as contrary to law. Although recognizing that the amended Clean Air Act does not explicitly define what Congress envisioned as a "stationary source" to which the permit program should apply, and that the issue was not squarely addressed in the legislative history, the court concluded that, in view of the purpose of the nonattainment program to improve, rather than merely maintain, air quality, a plantwide definition was "inappropriate," while stating it was mandatory in programs designed to maintain existing air quality. The court held that the Environmental Protection Agency's plantwide definition is a permissible construction of the statutory term "stationary source." With regard to judicial review of an agency's construction of the statute which it administers, if Congress has not directly spoken to the precise question at issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute. The legislation and its history supported the Court of Appeals' conclusion that Congress did not have a specific intention as to the applicability of the "bubble concept" in these cases. The legislative history of the portion of the 1977 Amendments dealing with nonattainment areas plainly disclosed that, in the permit program, Congress sought to accommodate the conflict between the economic interest in permitting capital improvements to continue and the environmental interest in improving air quality. Prior to the 1977 Amendments, the Environmental Protection Agency had used a plantwide definition of the term "source." In 1980, the Environmental Protection Agency adopted a regulation that precluded use of the "bubble concept" in nonattainment States' programs designed to enhance air quality. When a new administration took office in 1981, the Environmental Protection Agency, in promulgating the regulations involved in the *Chevron* case, reevaluated the various arguments that had been advanced in connection with the proper definition of the term "source" and concluded that the term should be given the plantwide definition in nonattainment areas. Parsing the general terms in the text of the amended Clean Air Act did not reveal any actual intent of Congress as to the issue in the case. To the extent any Congressional "intent" can be discerned from the statutory language, it would appear that the listing of overlapping, illustrative terms was intended to enlarge, rather than to confine, the scope of the Environmental Protection Agency's power to regulate particular sources in order to effectuate the policies of the Clean Air Act. Similarly, the legislative history is consistent with the view that the Environmental Protection Agency should have broad discretion in implementing the policies of the 1977 Amendments. The plantwide definition is fully consistent with the policy of allowing reasonable economic growth. The Environmental Protection Agency advanced a reasonable explanation for its conclusion that the regulations serve environmental objectives as well. The fact that the Environmental Protection Agency has from time to time changed its interpretation of the term "source" does not lead to the conclusion that no deference should be accorded the Environmental Protection Agency's interpretation of the statute. An agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis. Policy arguments concerning the "bubble concept" should be addressed to legislators or administrators, not to judges. The Environmental Protection Agency's interpretation of the statute here represents a reasonable accommodation of manifestly competing interests, and is entitled to deference.

Chevron emphasized the expertise of administrative agencies concerning subject matter. *Chevron* basically addressed cases where a statute was ambiguous and the interpretation by a relevant government agency differed from the court's best interpretation of the statute. *Chevron* directed in these circumstances that the court should defer to the administrative agency interpretation if the agency interpretation were a rational interpretation consistent with the statute.

Chevron established the principle that courts will accept a federal agency's reasonable interpretation of the ambiguous terms of a statute that falls under the jurisdiction of the agency.[66] *Chevron* dealt with the deference to agency interpretations in a two-step process:

> *First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.*[67]

Ambiguities in statutes often resulted from one of two cases. In one case, Congress intended a particular result, but was unclear in expressing the result that Congress intended. In the other case, Congress had no particular intent concerning the resolution of the issue, but instead Congress intended to leave the resolution of the issue to the agency having jurisdiction over the issue. In many cases, however, Congress may not have perceived the ambiguity in a

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[66] For a discussion of prior law, see Thomas W. Merrill, *Judicial Deference To Executive Precedent*, 101 Yale Law Journal 969 (March 1992). Prior to *Chevron*, there was a wide range in court deference to administrative rules. The court might pay little attention to agency pronouncements. The court might pay great deference to agency pronouncements. The court might apply a standard somewhere in between these poles. Also, a court might follow an agency interpretation based on traditional rules of statutory interpretation. This might involve a determination that the agency pronouncement was supported by the plain language of the statute. The court might accept an agency pronouncement based on consistency of the agency pronouncement with legislative history of the statute. The court might accept an agency pronouncement as a long-standing administrative interpretation. Agency interpretations typically received much greater deference if the interpretations were directed by a specific delegation of Congressional authority. Courts often deferred to special expertise of the agency. This view, however, ignores that the taxpayer and the taxpayer's counsel might well have greater special expertise than government counsel or other government personnel involved in the case. The courts also could be persuaded by the agency's reasoned analysis supporting its interpretation. A court's deference to administrative interpretation might be based on "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944). Older cases often emphasized the power of "a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion." *Norwegian Nitrogen Co. v. United States*, 288 U.S. 294, 315 (1933). Some courts have suggested that agency interpretations have been ratified by Congress through reenactment of the provision. *See, e.g.*, *NLRB v. Hendricks County Rural Electrical Corp.*, 454 U.S. 170, 177 (1981); *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 275 (1974); *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969); *Securities and Exchange Commission v. Sloan*, 436 U.S. 103 (1978).

[67] *Id.*. at 842-43 (footnote omitted).

statute, had no particular intent concerning the correct interpretation, and had given no thought to leaving interpretation of the ambiguity to the agency having jurisdiction.

If the court found that the Congressional intent was not clear, the court was instructed to proceed to step 2:

> *If, however, the court determines that Congress has not dressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.* [68]

Chevron granted great difference to administrative agency interpretations of statutes within their jurisdiction. Agency interpretations were to be reversed only if the administrative interpretations did not have a rational basis. This practically imposed a sanity test on agency interpretations of statutes within their jurisdiction. Courts were required to follow the agency interpretation unless agency interpretation was insane or, more formally, did not have a rational basis.

The *Chevron* rule substantially diminished the role of the courts in interpreting ambiguous statutes. The deference granted by *Chevron* seems inconsistent with the holding of the Supreme Court in *Marbury v. Madison* [69]: "[i]t is emphatically the province and duty of the judicial department to say what the law is." [70] The judgment of the court itself concerning the best interpretation was ignored in favor of the agency interpretation unless the agency interpretation was without a rational basis. This *Chevron* approach made executive agencies rather than the courts the final arbiters of the interpretation of ambiguous statutes. This shifted the balance of interpretative power from the courts to the executive. *Chevron* left to the courts the determination of whether the statute was ambiguous. This was the courts' sole role if the statute was ambiguous and the agency had provided its interpretation.

Among other things, *Chevron* was a rule of efficiency and economy. There is an enormous burden of statutes. In a modern world, statutes are often ambiguous. Agencies are more efficient in interpreting statutes than courts are. Agencies are much better staffed than the courts. Administrative interpretation is much less costly than interpretation by litigation. While administrative interpretations may infringe on due process rights, administrative interpretations are generally considerably less costly and more efficient than interpretation through litigation.

There still remained some enthusiasm in the courts for applying "traditional tools of statutory construction" to overrule a government agency's interpretation of Congressional

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[68] *Id.*. at 843 (footnote omitted),

[69] 1 Cranch 137, 177 (1803).

[70] *Id.*

intent.[71] Further, courts could still determine whether an agency's interpretation is permissible.[72] That agency interpretation is not permissible if the interpretation is contrary to clearly expressed Congressional intent.[73] Courts also, through the application of tools of statutory construction, could conclude that, in proper context, the statute was not ambiguous at all.

Congress in 1946 enacted the Administrative Procedure Act "as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices."[74] The Administrative Procedure Act prescribes procedures for agency action and delineates the basic contours of judicial review of the agency action. The Administrative Procedure Act was supposed to serve as "as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices."[75]

§1.5 Loper Bright Enterprises v. Raimondo: Overruling Chevron.(2024)

The Supreme Court decided *Loper Bright Enterprises v. Raimondo*,[76] and its companion case, *Relentless, Inc. v. Department of Commerce* in 2024. *Loper Bright Enterprises* overruled *Chevron*

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[71] *See, e.g., INS v. Cardoza-Fonseca*, 480 U.S. 421 (1987); *NLRB v. United Food & Commercial Workers Local 23*, 108 S. Ct. 413 (1988).

[72] *NLRB v. United Food & Commercial Workers*, 108 S. Ct. 413, 426 (1988).

[73] *Chemical Manufacturers Association v. NRDC*, 470 U.S. 116, 125 (1985) ("Of course, if Congress has clearly expressed an intent contrary to that of that of the Agency, our duty is to enforce the will of Congress.").

[74] *Morton Salt*, 338 U. S., at 644.

[75] *United States v. Morton Salt Co.*, 338 U. S. 632, 644.

[76] 603 U.S. __, 144 S. Ct. 2244 (2024). *See, also, Ogier as trustee for Estate of Bosley v. International Follies, Inc.*, 2024 W.L. 4664441 (11th Cir. 2024) (vacating and remanding for consideration of the effects of *Loper Bright Enterprises* in the context of the proper interpretation of 29 U.S.C. § 203(m)(2)(B) (Fair Labor Standards Act); *Van Loon v. Department of the Treasury*, --- F.4th ----, 2024 W.L. 4891474 (5th Cir. 2024) (considering self-executing crypto-mixing smart contracts providing through open-source software by cryptocurrency transaction project, which were added to Specially Designated Nationals and Blocked Persons (SDN) list by Department of the Treasury's Office of Foreign Assets Control (OFAC) pursuant to the International Emergency Economic Powers Act (IEEPA) and the North Korea Sanctions and Policy Enhancement Act; "When "Congress has clearly delegated discretionary authority to an agency, we discharge our duty by 'independently interpret[ing] the statute and effectuat[ing] the will of Congress subject to constitutional limits.'"[Footnote omitted.] In effect, the Supreme Court has instructed that we must "independently identify and respect [constitutional] delegations of authority, police the outer statutory boundaries of those delegations, and ensure that agencies exercise their discretion consistent with" the Administrative Procedure Act or have engaged in reasoned decisionmaking within those boundaries. [Footnote omitted.] To do so, we must "determine the 'best' reading of a statute; a merely 'permissible' reading is not enough." [Footnote

omitted.]); *Mayfield v. Department of Labor*, 117 F.4th 611 (5th Cir. 2024) (considering Department of Labor rule that raised from $455 per week to $684 per week the minimum salary required to qualify for the so-called "White Collar Exemption," which exempted executive, administrative, or professional employees from the Fair Labor Standards Act's minimum wage and overtime requirements, exceeded the Department's statutorily conferred authority and violated the nondelegation doctrine); . *Lopez v. Garland*, 116 F.4th 1032 (9th Cir. 2024) (petition for review of order of Board of Immigration Appeals that affirmed immigration judge's denial of applications for asylum, for withholding of removal, and for relief under Convention Against Torture; "after *Loper Bright Enterprises*, we may look to agency interpretations for guidance, but do not defer to the agency. 144 S. Ct. at 2266–67; *see Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944) (explaining that, while an agency's interpretation is "not controlling," it may still have "power to persuade" based on "the thoroughness evident in its consideration, the validity of its reasoning, [and] its consistency with earlier and later pronouncements"). We review factual findings, including those that underlie eligibility determinations for asylum and related relief, under the substantial evidence standard. *Rodriguez Tornes v. Garland*, 993 F.3d 743, 750 (9th Cir. 2021)."; "Because we have not previously addressed the meaning of pardon waiver in this context, we undertake the statutory analysis independently, giving proper respect but not controlling deference to the views of the BIA. *Loper Bright Enter.*, 144 S. Ct. at 2269–70."); *Utah v. Su*, 109 F.4th 313 2024 (5th Cir. 2024) (action challenging final rule promulgated by United States Department of Labor allowing Employee Retirement Income Security Act fiduciaries to consider environmental, social, and governance (ESG) objectives when making investment decisions on behalf of pension plans in certain situations, which plaintiffs contended was inconsistent with ERISA and was arbitrary and capricious under Administrative Procedure Act; case remanded to District Court for reconsideration in the light of *Loper Bright Enterprises*); *United States v. Peralta*, 2024 W.L. 4603297 (11th Cir. 2024) ("Peralta suggests that we should stay the case pending the outcome of *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024), in which, Peralta says, the Supreme Court was 'considering overruling the *Kisor* test for deference.' '*Kisor* deference' formed the basis of our conclusion in *Dupree* – that we should defer to the Sentencing Guidelines commentary when a Guideline is 'genuinely ambiguous,' 57 F.4th at 1275 (*quoting Kisor v. Wilkie*, 588 U.S. 558, 574 (2019)) – and controls our decision in this case. The Supreme Court has now decided *Loper Bright*, and Peralta has not made any filing arguing that the Supreme Court in fact decided to overrule *Kisor*, so we need not resolve the issue. *Sapuppo*, 739 F.3d at 681. It's worth noting, however, that while the Supreme Court mentioned *Kisor* several times in *Loper Bright*, it never said it had overruled it, which is unsurprising since the two cases involve different types of deference – *Loper Bright* addressed agency interpretation of statutes, whereas *Kisor* involved agency interpretation of its own regulations. See *United States v. Boler*, 115 F.4th 316, 322 n.4 (4th Cir. 2024) (persuasive authority) ('Since *Loper Bright* dealt specifically with ambiguities in statutory directives to agencies and did not address the issue of agency interpretations of their own regulations, we will apply the Supreme Court's recent guidance in Kisor to address the issue before us today.')."); *Tennessee v. Becerra*, 117 F.4th 348 (6th Cir. 2024) (case concerning complaint against Department of Health and Human Services (HHS), seeking declaratory judgment that HHS's termination of federal funding for state's Title X projects violated the Spending Clause and the Administrative Procedure Act (APA); appeal of denial of state's motion for preliminary injunction; "Since our decision in *Ohio* [*v. Becerra*, 87 F.4th 759 (6th Cir. 2023)], *Chevron* deference has fallen. *See Loper Bright Enters. v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 2273, – – – L.Ed.2d – – – – (2024). Consequently, given *Rust*'s [*Rust v. Sullivan*, 500 U.S. 173 (1991)] and *Ohio*'s application of *Chevron* deference to HHS's actions relating to the provisions of neutral, nondirective counseling [footnote omitted] and referrals in those cases, Tennessee challenges their precedential effect. However, the extent to which *Loper Bright* undermines the validity of prior cases

that were decided using *Chevron* deference depends on several factors not addressed by the parties in their briefing. In its guidance to lower courts, the Court broadly stated that it 'do[es] not call into question prior cases that relied on the *Chevron* framework.' *Id.*. And it further explained that '[t]he holdings of those cases that specific agency actions are lawful . . . are still subject to statutory *stare decisis* despite [its] change in interpretive methodology.' *Id.*. (citing *CBOCS West, Inc. v. Humphries*, 553 U.S. 442, 457, 128 S.Ct. 1951, 170 L.Ed.2d 864 (2008)). So, while *Loper Bright* opens the door to new challenges based on new agency actions interpreting statutes, it forecloses new challenges based on specific agency actions that were already resolved via *Chevron* deference analysis. *See id.* Unremarked upon was whether statutory *stare decisis* includes Circuit court precedent. *See id.*; [citation omitted]. . . . We have held that we are bound by precedent 'unless a Supreme Court decision 'mandates modification' of our precedent.' *RLR Investments, LLC v. City of Pigeon Forge, Tenn.*, 4 F.4th 380, 390 (6th Cir. 2021) (*quoting United States v. Moody*, 206 F.3d 609, 615 (6th Cir. 2000)). . . . The Supreme Court cautioned litigants hoping to rehash or relitigate previously settled issues decided on *Chevron* that '[m]ere reliance on *Chevron* cannot constitute a special justification for overruling such a holding.' *Loper Bright*, 144 S. Ct. at 2273 (*quoting Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 266, 134 S.Ct. 2398, 189 L.Ed.2d 339 (2014) (cleaned up)). To argue as much, the Court continued, would 'at best,' be 'just an argument that the precedent was wrongly decided.' *Id.*. And this, as the majority concluded, is 'not enough to justify overruling a statutory precedent.' *Id.*"); *Avon Nursing and Rehabilitation v. Becerra*, 119 F.4th 286 (2d Cir. 2024) (participants in Medicaid program brought action against the Secretary of the United States Department of Health and Human Services under the Administrative Procedure Act concerning final rule promulgated by the Centers for Medicare and Medicaid Services permitting investigative surveys of facilities for purposes of investigation of complaints and monitoring nursing facility compliance to be conducted without a registered nurse; "Uncertainty about whether investigations under § 1396(g)(4) should be considered surveys may have arisen from the terminology used in HHS's implementing regulations. Rather than referring to these investigatory and enforcement activities using the terms employed by the statute, the regulations refer to this type of inspection as a 'complaint survey.' See 42 C.F.R. § 488.30 (defining 'complaint surveys'); see also 42 C.F.R. § 488.301 (defining 'abbreviated standard survey' to include, among other things, information gathering 'premised on complaints received'). Especially in light of Loper Bright, however, our interpretation of the statute should not rest on the taxonomy developed by the agency. The registered nurse requirement only extends to surveys as that term is used in the statute, regardless of the terminology used by the agency. The regulation's use of the term 'survey' to refer to this type of inspection does not affect the meaning of the word 'survey' within the universe of the statute itself. Allowing the agency's terminology to control our interpretation of the statute would be an abdication of our duty to interpret the statute independently. See Loper Bright, 144 S. Ct. at 2261 ('Under the [Administrative Procedure Act], it thus remains the responsibility of the court to decide whether the law means what the agency says.' (internal quotation marks and citation omitted)). [Footnote omitted.]"); *United States v. Trumbull*, 114 F.4th 1114 (9th Cir. 2024) (considering sentencing guidelines related to use of a "large capacity magazine"; "The Supreme Court has said that the commentary to the Guidelines 'is akin to an agency's interpretation of its own legislative rules.' *Stinson v. United States*, 508 U.S. 36, 45, 113 S.Ct. 1913, 123 L.Ed.2d 598 (1993). As a result, we apply *Kisor v. Wilkie*, 588 U.S. 558, 139 S.Ct. 2400, 204 L.Ed.2d 841 (2019), to determine whether to defer to the commentary's interpretation of a Guideline. *Castillo*, 69 F.4th at 655 – 56."); *Texas Medical Association v. United States Department of Health and Human Services*, 110 F.4th 762 110 F.4th 762 (5th Cir. 2024) (action by healthcare and air ambulance service providers under Administrative Procedure Act against Departments of Health and Human Services, Labor, and Treasury challenging final rule governing arbitration process for resolving payment disputes between out-of-network providers and health insurers, alleging rule

was arbitrary and capricious and exceeded and conflicted with the No Surprises Act by limiting arbitrators' discretion in considering statutory factors and by making qualifying payment amount *de facto* benchmark for out-of-network reimbursement; "The Administrative Procedure Act requires a reviewing court to 'hold unlawful and set aside' agency action that is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' 5 U.S.C. § 706(2)(A). Where a statute delegates authority to an agency, 'the role of the reviewing court under the APA is' to ' 'fix[ ] the boundaries of [the] delegated authority' and ensur[e] the agency has engaged in ' 'reasoned decisionmaking' ' within those boundaries.' *Loper Bright Enters. v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 2263, – – – L.Ed.2d – – – – (2024) (citation omitted) (*quoting* Henry P. Monaghan, *Marbury and the Administrative State*, 83 Colum. L. Rev. 1, 27 (1983), *and then quoting Michigan v. EPA*, 576 U.S. 743, 750, 135 S. Ct. 2699, 2706, 192 L.Ed.2d 674 (2015)). [Footnote omitted.]"; "Of course, Congress may so draft statutes as to 'confer discretionary authority on agencies.' *Loper Bright*, 144 S. Ct. at 2268. But courts have 'obligations under the APA' to 'police the outer statutory boundaries of those delegations, and ensure that agencies exercise their discretion consistent with the APA.' *Id.*'"; "With these regulations, the Departments exceeded their authority by infringing on arbitrators' discretion to balance the statutory factors. Congress has provided that it is not the Departments, but the arbitrator, who 'shall consider' how to balance the factors under the statute. See 42 U.S.C. § 300gg-111(c)(5)(C)(i). By taking this discretion away from the Departments and giving it to the arbitrator, Congress created an 'outer statutory boundary' beyond which the Departments were not authorized to stray. *See Loper Bright*, 144 S. Ct. at 2268."); *Transcontinental Gas Pipe Line Company, LLC v. Beckman*, 2024 W.L. 4661593 (2024) (gas line company sought to abandon some of its pipelines and expand others. To do that, it needs permits from state and federal agencies; gas line company received these permits and environmental advocates administratively appealed the issuance of the state permits to the Pennsylvania Environmental Hearing Board; gas line company sought an injunction preventing the administrative appeal in the United States District Court; "In its supplemental brief, Transco argues that we should reach a different conclusion than that reached in Transcon. I due to the Supreme Court's decision in *Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244 (2024). Transco Supp. Br. 1 – 2. Transco argues that our analysis in Transcon. I was flawed because, by discussing the history of the Administrative Procedure Act in its decision, the Supreme Court signaled that we should afford more weight to legislative history. Transco Supp. Br. 1 – 2. We disagree. Instead, the Supreme Court clarified that, when interpreting the meaning of a statute's text, a court need not defer to an agency's interpretation. *See Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright*, 144 S. Ct. 2244. Like the Court in *Loper Bright*, we rested our interpretation of the relevant statute on the plain meaning of the statutory text. *See Loper Bright*, 144 S. Ct. at 2262 ('The text of the APA means what it says.'); *see, e.g., Transcon. I*, 108 F.4th at 151 – 53. We reject the idea that the Supreme Court in *Loper Bright* implicitly required more."); *Restaurant Law Center v. United States Department of Labor*, 120 F.4th 163 (5th Cir. 2024) (public policy organization and restaurant trade organization brought action against the Department of Labor and Department of Labor officials, seeking to permanently enjoin Department of Labor's enforcement of final rule that stated that an employer could only take a tip credit against the federal minimum wage for work performed by a tipped employee that was part of the employee's tipped occupation; "Following the Supreme Court's instructions, and without the guidance of *Chevron*, we turn now to our task. While the district court was of course correct to apply the *Chevron* framework at the time of its decision, the Supreme Court's intervening opinion in *Loper Bright* requires us to depart from the district court's analysis at the very start. We must parse the text of the FLSA using the traditional tools of statutory interpretation. As the district court correctly put it, '[t]he dispute in this case turns on the meaning of the statutory phrase 'engaged in an occupation' and the term 'occupation,' both of which are used in the definition of 'tipped employee' but are

undefined in the FLSA.'"; "We pause to note that, even in the absence of *Chevron*, courts are well-advised to consider agency 'interpretations issued contemporaneously with the statute at issue, and which have remained consistent over time.' *Loper Bright*, 144 S. Ct. at 2262. As DOL points out, the 80/20 standard (but not the 30-minute requirement) is indeed of some vintage, having been applied with brief interregna since at least 1988. But while longstanding agency practice might have the 'power to persuade,' it has never had the 'power to control.' *See Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944). Nor can we permit agency practice to 'defeat a statute's text by 'adverse possession." *Airlines for Am. v. Dep't of Transp.*, 110 F.4th 672, 676 (5th Cir. 2024) (*quoting Rapanos v. United States*, 547 U.S. 715, 752, 126 S.Ct. 2208, 165 L.Ed.2d 159 (2006)). We are not persuaded that the 80/20 standard, however longstanding, can defeat the FLSA's plain text. [Footnote omitted.]"); *Relentless, Inc. v. United States Department of Commerce*, 120 F.4th 163 (5th Cir. 2024) (owners of fishing vessel that harvested Atlantic herring brought action challenging National Marine Fisheries Service final rule implementing industry-funded monitoring for Atlantic herring fishery); *Allen v. United States*, 2024 W.L. 4002305 (Fed. Cir. 2024) ("In light of the Supreme Court's decisions in *Loper Bright Enterprises v. Raimondo*, No. 22-451, and *Relentless, Inc. v. Department of Commerce*, No. 22-1219, the parties 'agree that the Court should remand this case to the [United States] Court of Federal Claims but do not agree on whether this Court should vacate the judgment of the Court of Federal Claims.' ECF No. 15 at 2."; "But *Chevron* has been overruled. The Supreme Court has now instructed that courts must 'exercise their independent judgment in deciding whether an agency has acted within its statutory authority' and 'may not defer to an agency interpretation of the law simply because a statute is ambiguous.' *Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244, 2273 (2024). And the Court made clear that the law does not demand that courts 'mechanically afford binding deference to agency interpretations' 'when a preexisting judicial precedent holds that the statute means something else.' *Id.*. at 2265. ¶ Because the Court of Federal Claims's decision was predicated on since overruled precedent, we vacate the judgment and remand for further proceedings. *See Utah v. Su*, 109 F.4th 313, 319 n.10 (5th Cir. 2024) (vacating and remanding under the same circumstances and collecting cases supporting vacatur as the general approach)."); *Pacific Gas and Electric Company v. Federal Energy Regulatory Commission*, 113 F.4th 943 (D.C. Cir. 2024) (investor-owned utility that provided electricity to most consumers in city petitioned for review of orders of the Federal Energy Regulatory Commission ("FERC"), with respect to utility's obligations under a tariff to transmit, or wheel, over its network electricity produced by a public utility with some customers in city; "FERC's primary argument is that it adhered to its Suffolk County orders, and the class-based interpretation of 'ultimate consumer' in those orders is compatible with the statutory text. But we must seek the 'single, best meaning' of a statute, not just permissible interpretations. *Loper Bright*, 144 S. Ct. at 2266. And FERC's class-based reasoning is unpersuasive as a matter of statutory interpretation. FERC did not analyze the text of section 824k(h)(2), but instead relied on the Suffolk County orders' interpretation of the provision. [Citation omitted.] Contrary to FERC's assertions before this court, FERC's reasoning in those orders was not based on the statutory text."); *NextEra Energy Resources, LLC v. Federal Energy Regulatory Commission*, 118 F.4th 361 (D.C. Cir. 2024) (electricity generator whose facility was connected to regional transmission grid, petitioned under the Administrative Procedure Act for review of Federal Energy Regulatory Commission (FERC) orders concluding that generator was required to upgrade facility's circuit breaker under terms of applicable standard Large Generator Interconnection Agreement so that competitor electricity generator could connect to regional grid, and that, although competitor generator was required to pay direct cost of upgrade, it was not required to reimburse generator for claimed lost profits and legal expenses; "Under the Administrative Procedure Act, we 'decide all relevant questions of law.' 5 U.S.C. § 706. We interpret FERC tariffs like contracts and 'must enforce unambiguous tariff language.' *Long Island Power Auth. v. FERC*, 27 F.4th 705, 716 (D.C.

Cir. 2022). Because contract interpretation is a question of law, we do not defer to agencies.1 [Footnote omitted.] *See Loper Bright Enters. v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 2265, 219 L.Ed.2d 832 (2024). Our task is not to interpret with an eye to policy, but simply to 'determine the plain meaning of' the tariff. *Ameren Servs. Co. v. FERC*, 330 F.3d 494, 499 (D.C. Cir. 2003); *see also Idaho Power Co. v. FERC*, 312 F.3d 454, 462 (D.C. Cir. 2002) ('The fact that FERC's order[ ] directly conflict[s] with the plain meaning of the tariff alone merits a reversal.').."); *United States v. Boler*, 519 U.S. 452, 461, (1997) ("The Supreme Court's recent ruling in *Loper Bright Enterprises v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 219 L.Ed.2d 832 (2024), calls into question the viability of *Auer* deference. In *Loper Bright*, the Court rejected the long-standing notion that 'ambiguities' in statutory language act as 'implicit delegations to agencies.' *Id.*. at 2265. Since *Loper Bright* dealt specifically with ambiguities in statutory directives to agencies and did not address the issue of agency interpretations of their own regulations, we will apply the Supreme Court's recent guidance in *Kisor* to address the issue before us today."); *Seldon v. Garland*, 120 F.4th 527 (6th Cir 2024) ("Where, as here, 'the BIA reviews the [IJ]'s decision and issues a separate opinion, rather than summarily affirming the [IJ]'s decision, we review the BIA's decision as the final agency determination.' *Khalili v. Holder*, 557 F.3d 429, 435 (6th Cir. 2009). We review the BIA's factual findings under the substantial evidence standard and treat them as 'conclusive unless any reasonable adjudicator would be compelled to conclude to the contrary.' *Ben Hamida v. Gonzales*, 478 F.3d 734, 736 (6th Cir. 2007) (*quoting* 8 U.S.C. § 1252(b)(4)(B)). We review the BIA's legal conclusions, including questions of statutory interpretation, *de novo*. *Khalili*, 557 F.3d at 435. Prior to *Loper Bright Enterprises v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 219 L.Ed.2d 832 (2024), and *Kisor v. Wilkie*, 588 U.S. 558, 139 S.Ct. 2400, 204 L.Ed.2d 841 (2019), we would give 'substantial deference' to the agency's interpretations of the INA and accompanying regulations. *Khalili*, 557 F.3d at 435. After *Loper Bright*, 'we may look to agency interpretations [of the INA] for guidance, but do not defer to the agency.' *Lopez v. Garland*, 116 F.4th 1032, 1036 (9th Cir. 2024). While the BIA's interpretations are 'not controlling,' they may still have 'power to persuade' based on 'the thoroughness evident in [their] consideration, the validity of [their] reasoning, [and their] consistency with earlier and later pronouncements.' *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944); see *Loper Bright*, 144 S. Ct. at 2267. As to agency regulations, we must thoroughly evaluate an agency's interpretation of an ambiguous regulation before giving any deference. *Kisor*, 588 U.S. at 574 – 78, 139 S.Ct. 2400."). ¶ *Marin Audubon Society v. Federal Aviation Administration*, 121 F.4th 902 (D.C. Cir. 2024) (environmental organizations petitioned for review of Federal Aviation Administration's and National Park Service's approval of air travel management plan governing commercial tourist flights over four national parks without environmental analysis under National Environmental Policy Act; Council on Environmental Quality regulations implementing NEPA were ultra vires and thus invalid; agencies' treatment of existing level of flights under interim operating authority as baseline for NEPA analysis was arbitrary and capricious; agencies' mere change of original decision to prepare environmental assessment was not arbitrary and capricious; preparation of environmental assessments for other parks did not make lack of one for parks in issue arbitrary and capricious; "No statute confers rulemaking authority on CEQ. President Carter's Executive Order cited section 309 of the Clean Air Act. 42 Fed. Reg. 26,967 (May 25, 1977). Under this provision, the Administrator of the Environmental Protection Agency reviews the environmental impact of other federal agencies' proposed actions. 42 U.S.C. § 7609(a). If the EPA Administrator finds that the proposed action is 'unsatisfactory' from an environmental-quality standpoint, he must 'publish his determination' and refer the matter to CEQ. *Id.*. § 7609(b). That provision is consistent with CEQ's advisory role; it says nothing about CEQ's rulemaking authority. The Executive Order also cites the Environmental Quality Improvement Act of 1970, which established an Office of Environmental Quality headed by the chairman of CEQ. 42 U.S.C. § 4372(a).

Even as the director of that Office, however, CEQ's chairman only has the authority to 'assist[ ]' other federal agencies. *Id.* § 4372(d)(2), (5), (6). The Chairman may 'promulgate regulations' but only related to a fund used to finance the Office's projects and research studies. [Footnote omitted.] *Id.*. § 4375. ¶ The Supreme Court's pronouncements in this area cannot rescue CEQ's regulations. The Court once wrote that CEQ's regulations under NEPA are 'entitled to substantial deference.' *Andrus v. Sierra Club*, 442 U.S. 347, 358, 99 S.Ct. 2335, 60 L.Ed.2d 943 (1979). But that *Chevron*-like statement did not result from an examination of CEQ's authority to issue judicially enforceable regulations and cannot be credited in light of the Supreme Court's ruling in *Loper Bright Enterprises v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 219 L.Ed.2d 832 (2024). In another case, the Supreme Court stated that CEQ was 'established by NEPA with authority to issue regulations interpreting it.' *Pub. Citizen*, 541 U.S. at 757, 124 S.Ct. 2204. The statement appeared without any accompanying legal analysis. We must obey 'carefully considered language of the Supreme Court, even if technically dictum.' *Winslow v. FERC*, 587 F.3d 1133, 1135 (D.C. Cir. 2009) (*quoting United States v. Dorcely*, 454 F.3d 366, 375 (D.C. Cir. 2006)). But we are not bound by every stray remark on an issue the parties neither raised nor discussed in any meaningful way. *See Webster v. Fall*, 266 U.S. 507, 511, 45 S.Ct. 148, 69 L.Ed. 411 (1925); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 399 – 400, 5 L.Ed. 257 (1821) (Marshall, C.J.). ¶ The CEQ regulations are by no means a mere delegation of the President's authority under the Take Care Clause. See U.S. Const. art. II, § 3; 3 U.S.C. § 301; *see also Whitney, supra*, at 91. Executive Orders focused solely on the internal management of the Executive Branch create no private rights and are not judicially reviewable. *California v. EPA*, 72 F.4th at 318. NEPA, by contrast, 'imposes statutory obligations that agencies must execute consistent with the requirements of the APA,' and affect private parties who may seek judicial review of agencies' compliance. *Id.*. (*citing Cmtys. Against Runway Expansion, Inc. v. FAA*, 355 F.3d 678, 689 (D.C. Cir. 2004)). [Citation omitted.] If all federal agencies are bound by the CEQ regulations and must follow them in carrying out their obligations under NEPA, and if the regulations are enforceable by courts, then those regulations cannot be justified solely as an exercise in a President's oversight of his Administration. ¶ Besides, upholding the CEQ regulations on the theory that these amount to Presidential oversight would raise additional problems. The regulations 'replace[d]' the rules of some seventy federal agencies, 43 Fed. Reg. at 55,978, and limited the agencies' role to supplementing CEQ's work with 'implementing procedures,' 40 C.F.R. § 1507.3(a) (1978). Once the CEQ rules went into effect, they served as binding regulations across the whole of government. And yet Supreme Court decisions hold that the Take Care Clause cannot be used to bypass agencies' limited status as 'creatures of statute,' 'possess[ing] only the authority that Congress has provided them.' *Nat'l Fed'n of Indep. Bus. v. OSHA*, 595 U.S. 109, 117, 142 S.Ct. 661, 211 L.Ed.2d 448 (2022). To repeat, the Constitution does not permit the President to seize for himself the 'law-making power of Congress' by issuing an order that, 'like a statute, authorizes a government official to promulgate . . . rules and regulations.' *Youngstown*, 343 U.S. at 588, 72 S.Ct. 863 (1952); *see also Whitney*, *supra*, at 92 – 94.7. ¶ CEQ therefore had no lawful authority to promulgate these regulations. One wrinkle remains. Many agencies, including the parent departments of the agencies here (the Department of the Interior, for the Park Service, and the Department of Transportation, for the FAA), have issued their own NEPA regulations. If an agency adopts CEQ's rules or incorporates them by reference into its NEPA regulations, would that be a permissible exercise of its own rulemaking authority? [Citation omitted.] The question is a good one, but it does not describe this case. ¶ CEQ's regulations, as mentioned, instruct agencies to 'confine themselves' to issuing only 'implementing procedures' that 'comply with [CEQ's] regulations.' 40 C.F.R. § 1507.3(a) – (b) (1978). The implementing procedures 'shall not paraphrase' CEQ's rules. *Id.*. So the CEQ regulations represent the framework for all agencies' compliance with NEPA, leaving the agencies to fill in certain details specific to their programs. ¶ As a result, the Agencies here have neither adopted the content of the

CEQ regulations nor incorporated those rules by reference. Instead, they obeyed CEQ's command and accepted the CEQ regulations as a stand-alone body of law that they must obey and the courts must enforce. The Department of the Interior's NEPA rules, for example, are meant to be used 'for compliance with' the CEQ regulations. 43 C.F.R. § 46.10(a)(2). Interior's regulations 'supplement, and [are] to be used in conjunction with, the CEQ regulations.' *Id.*. § 46.20(a). And although the Department of the Interior once stated that it was 'incorporat[ing]' certain CEQ guidance documents, it never said the same of the regulations. 73 Fed. Reg. 61,292, 61,292, 61,298 (Oct. 15, 2008). The Department of Transportation's rules are similar: they are 'not a substitute for' the CEQ regulations; do not 'repeat or paraphrase the language of those regulations'; and merely 'supplement[ ] the CEQ regulations by applying them to DOT programs.' Dep't of Transp., Order 5610.1C, at 2 (July 30, 1985)."); *Solar Energy Industries Association v. United States*, 111 F.4th 1349 (Fed. Cir. 2024) (solar-energy trade association and renewable-energy companies sued government, challenging validity of Presidential Proclamation that subjected bifacial solar panels to import duties from which they had previously been excluded and seeking declaratory and injunctive relief; Court of International Trade granted summary judgment to plaintiffs, enjoining enforcement of the challenged Proclamation; the President's power to grant a "modification" of an existing import-related safeguard includes the authority to make trade-restrictive changes and is not limited to making trade-liberalizing changes; the President is authorized to order a reduction, modification, or termination of an import-related safeguard based on a determination by the President that the applicable domestic industry has begun to make a positive adjustment to import competition; the President is not required to reweigh costs and benefits when modifying an import-related safeguard); *National Labor Relations Board v. Macomb*, 2024 L 4240545 (6th Cir. 2024) ("We apply *de novo* review to the NLRB's interpretation of the NLRA, though we pay "'careful attention" to the judgment of the agency to inform that inquiry.' Rieth-Riley Constr. Co., Inc. v. NLRB, – – – F.4th – – – – , No. 23-1899, 2024 W.L. 3811837, at *3 (6th Cir. Aug. 14, 2024) (*quoting Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244, 2273 (2024)). Although we are 'slow to overturn an administrative decision,' *NLRB v. Babcock & Wilcox Co.*, 351 U.S. 105, 112 (1956), we may not simply 'rubberstamp' an administrative decision that is 'inconsistent with a statutory mandate or that frustrate[s] the congressional policy underlying a statute.' *NLRB v. Brown*, 380 U.S. 278, 291 (1965)."); *Kentucky v. Environmental Protection Agency*, __ F.4th __ (2024 W.L. 5001991 (6th Cir. 2024) (State of Kentucky petitioned for review of Environmental Protection Agency's final rule that disapproved Kentucky's state plan implementing new air-quality standard for ozone, and the EPA moved to transfer case to District of Columbia Circuit; 6th Circuit held that: disapproval of plan was arbitrary and capricious under Administrative Procedure Act (APA), and disapproval of plan was not harmless; "The EPA also claims that we should use a 'deferential standard' to review whether an agency action rests on 'a determination of nationwide scope or effect' under § 7607(b)(1). Respondents' Br. 46. But the Supreme Court has recently told courts that we should no longer defer to an agency's answers to legal questions. *See Loper Bright*, 144 S. Ct. at 2273. And the EPA resolves a pure question of law when it interprets the key terms in § 7607(b)(1) (such as 'nationally applicable' or 'determination'). After *Loper Bright*, we must review (and correct) the agency's mistaken interpretation of those terms without giving it deference."'); *Quito-Guachichulca v. Garland*, __ F. 4th __ 2024 W.L. 5037033 (8th Cir. 2024) ("As applied here, the question is whether everything that could have led to a conviction, including 'the least of the acts criminalized,' qualifies as rape. *Esquivel-Quintana*, 581 U.S. at 390, 137 S.Ct. 1562. Answering it requires the use of 'traditional tools of statutory construction' to 'determine the best reading of [each] statute.' *Loper Bright Enters. v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 2266, 219 L.Ed.2d 832 (2024); *see Esquivel-Quintana*, 581 U.S. at 391, 137 S.Ct. 1562 (explaining that we interpret undefined terms in the list of aggravated felonies 'using the normal tools of statutory interpretation'). Our review is *de novo*, see *Huynh v. Garland*, 102 F.4th

943, 944 (8th Cir. 2024), and we no longer treat the government's views as controlling or even 'especially informative.' *Loper Bright*, 144 S. Ct. at 2267. Deference to the Board, in other words, is now a relic of the past. [Footnote omitted.]"); *Alaris Health at Boulevard East v. National Labor Relations Board*, __ F.4th __, 2024 W.L. 5037163 (3rd Cir. 2024) ("The Board also determined the bonuses were 'a form of hazard pay, which is a mandatory subject of bargaining.' App. 2. No decision of the Board to our knowledge has ever recognized 'hazard pay' as part of the 'terms and conditions of employment' under the Act. [Footnote omitted.] 'We recognize that classification of bargaining subjects as terms and conditions of employment is a matter concerning which the Board has special expertise.' *Allied Chem. & Alkali Workers of Am. v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 182, 92 S.Ct. 383, 30 L.Ed.2d 341 (1971) (quotation marks and parentheses omitted). Accordingly, we have traditionally deferred to the Board's interpretations of the Act so long as they are 'reasonable.' *See, e.g., MCPC, Inc. v. NLRB*, 813 F.3d 475, 482 (3d Cir. 2016); *see also Ford Motor Co. v. NLRB*, 441 U.S. 488, 497, 99 S.Ct. 1842, 60 L.Ed.2d 420 (1979) (holding the Board's interpretation of the Act should be enforced so long as it is 'reasonably defensible,' and refusing to enforce the Board's interpretation only when it has 'no reasonable basis in law,' is 'fundamentally inconsistent with the structure of the Act and an attempt to usurp major policy decisions properly made by Congress,' or 'mov[es] into a new area of regulation which Congress has not committed to it' (citations and quotation marks omitted)). ¶ Whether this deference survives the Supreme Court's recent decision in *Loper Bright Enterprises v. Raimondo*, – – – U.S. – – – – , 144 S. Ct. 2244, 219 L.Ed.2d 832 (2024), which overruled *Chevron* deference, is somewhat of an open question. It would appear to us, however, that judicial deference to the Board's classifications of the 'terms and conditions of employment' under the Act is distinct from *Chevron* deference, as the Supreme Court's decisions developing that deference to the Board predate *Chevron v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). *See, e.g., Ford Motor Co.*, 441 U.S. at 496-97, 99 S.Ct. 1842 (collecting cases). In fact, the Court in *Loper Bright* distinguished *Chevron* deference from prior cases where it deferred to the Board's interpretation of the Act, reasoning '[t]he Act had, in the Court's judgment, assigned primarily to the Board the task of marking a definitive limitation around the [relevant statutory] term' and so 'application of [the] statutory term was sufficiently intertwined with the agency's factfinding' that deference to the Board's interpretation was warranted. 144 S. Ct. at 2259-60 (citations and quotation marks omitted); *see also Ford Motor Co.*, 441 U.S. at 496, 99 S.Ct. 1842 (noting 'Congress made a conscious decision to continue its delegation to the Board of the primary responsibility of marking out the scope of the statutory language and the statutory duty to bargain'). *But see, e.g., Allegheny Ludlum Corp. v. NLRB*, 301 F.3d 167, 174-75 (3d Cir. 2002) (reciting our deferential standard to the Board's interpretations of the Act but noting '[o]ur standard is governed by the test articulated in Chevron'); *Stardyne, Inc. v. NLRB*, 41 F.3d 141, 147 (3d Cir. 1994) (Alito, J.) (similar). ¶ Ultimately, we need not decide whether deference to the Board's designation of mandatory bargaining subjects under the Act survives the Supreme Court's rejection of *Chevron* deference in *Loper Bright*. Even on *de novo* review, we reach the same conclusion as the Board—that hazard pay is appropriately considered the 'terms and conditions of employment' and thus subject to mandatory bargaining under the Act. The Department of Labor defines hazard pay as 'additional pay for performing hazardous duty or work involving physical hardship.' *Hazard Pay, U.S. Dep't of Labor* (last visited Aug. 14, 2024), https://www.dol.gov/general/topic/wages/hazardpay. And in the federal employee context, Congress has authorized the Office of Personnel Management 'to provide additional compensation at fixed rates (pay differentials) to salaried, General Schedule employees for duty involving unusual physical hardship or hazard,' or 'for duty involving unusually severe working conditions or unusually severe hazards.' *Adams v. United States*, 59 F.4th 1349, 1351-52 (Fed. Cir. 2023) (*en banc*) (quotation marks omitted); see 5 U.S.C. §§ 5543(c)(4), 5545(d). . . .'").

deference to administrative agency interpretation of ambiguous statutes that are "'silent or ambiguous with respect to the specific issue' at hand." *Chevron* had applied a two-step analysis to the authority of administrative agency interpretations of federal statutes within the agency jurisdiction. Step 1: Is the statute ambiguous on the precise question at issue? If the statute is unambiguous, a court must follow the statute and not the administrative agency's conflicting interpretation. Step 2: If the statute is ambiguous, is the agency's interpretation of the statute reasonable? If the agency's interpretation is reasonable, then *Chevron* required that a court defer to the regulation, even if the court feels that the administrative agency interpretation differs from the best interpretation of the regulation. The court had to put aside its better judgement in favor of the administrative agency interpretation.

Most authorities agree that *Loper Bright Enterprises* represents a major development in administrative law. *Chevron* had considerably restricted the role of the judiciary in interpreting administrative regulations and rulings. *Loper Bright Enterprises* overruled *Chevron* and restored the role of the judiciary in interpreting statutes as that judiciary role existed prior to *Chevron*. *Loper Bright Enterprises*.

The overall importance of *Loper Bright Enterprises* in administrative law is not yet altogether clear. Initially, *Loper Bright Enterprises* seems to be exceedingly important in administrative law. *Loper Bright Enterprises'* analysis must be developed by the courts in the future. Courts may be aggressive in disregarding administrative interpretations in interpreting statutes. Even after *Loper Bright Enterprises*, courts perhaps will be heavily reliant on administrative interpretations, even though the courts are directed to apply their independent judgement to interpreting regulations. Different courts and perhaps also different circuits perhaps will follow different paths in interpreting statutes and dealing with administrative interpretations after *Loper Bright Enterprises*. *Loper Bright Enterprises* may have must less of an impact on the status of interpretive regulations than many will suppose or perhaps *Loper Bright Enterprises* will have a much greater impact of the status of interpretative regulations than many others suppose.

Loper Bright Enterprises was based both on the obligation of the courts under Article III of the Constitution to determine the law and a consideration of the requirements of the Administrative Procedure Act. Administrative Procedure Act Section 706 provides that a "reviewing court shall decide all relevant questions of law, [and] interpret constitutional and statutory provisions."

Loper Bright Enterprises holds that courts reviewing agency interpretations of statutes "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority."

Loper Bright Enterprises is expected by many authorities to have an important impact on administrative law, both within and without the tax law, although other caution that court still

will have substantial deference to administrative agency interpretations of statutes where there are specific grants of interpretative power in the statute.

Loper Bright Enterprises also does not undermine the traditional role of administrative agencies as fact finders in formal agency proceedings.

Loper Bright Enterprises does not represent a broad overthrow of all Internal Revenue Service regulations.

Loper Bright Enterprises does not necessarily disrupt the holdings of prior cases, to which the doctrine of *stare decisis* may apply. The Supreme Court in *Loper Bright Enterprises* advised: "we do not call into question prior cases that relied on the Chevron framework. The holdings of those cases that specific agency actions are lawful—including the Clean Air Act holding of Chevron itself—are still subject to statutory *stare decisis* despite our change in interpretive methodology."

Loper Bright Enterprises does not overturn every case that relied on *Chevron*. The status of these older cases is uncertain. *Stare decisis* may prevail. Courts also may still permit taxpayers to relitigate issues under *Loper Bright Enterprises* that were determined under regulations that were accepted under *Chevron* deference but that would not be accepted under the principles of *Loper Bright Enterprises*. The Supreme Court may have merely intended to indicate that these cases are not automatically reversed, but the interpretations advanced in these cases may be vulnerable[77] to future challenge. Most regulations are interpretive rather than legislative. Whether these regulations represent the best reading of the statute often could be disputed. *Loper Bright Enterprises* may be an invitation to relitigate many established regulations.

Many taxpayers may not be adequately funded to challenge regulations under *Loper Bright Enterprises*. Not every taxpayer is financially equipped to challenge Treasury Regulations in litigation. Courts may still defer to the expertise of the Internal Revenue Service and also may be inclined to follow longstanding interpretive regulations. We will still have to see what the long-term effect of *Loper Bright Enterprises* will be, particularly in the partnership tax area.

The challenge of tax regulations under *Loper Bright Enterprises* may evolve over time. Not every tax regulation will be challenged immediately. Some existing tax regulations and future regulations could be challenged over time. It may take a considerable time before we know whether a particular regulation will stand a *Loper Bright Enterprises* challenge.

Loper Bright Enterprises also may indicate a current attitude of Supreme Court that is much less sanguine to aggressive tax regulations. This may lead to cases challenging even legislative regulations based on theory that the regulations constitute unconstitutional

[77] This paper uses "vulnerable" in the sense that a credible case can be made for challenging the validity of a rule or regulation. The Internal Revenue Service also may have credible arguments in support of the interpretation offered by the rule or regulation. This paper expresses no view on the outcome of a taxpayer challenge in court to the validity of the Internal Revenue Service interpretation.

delegations of legislative power to administrative agencies. *Loper Bright Enterprises* could be a harbinger of things to come.[78]

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[78] But see *Gundy v. United States*, 139 S. Ct. 2116 (2019) ("Subsection (d), in other words, focuses on individuals convicted of a sex offense before SORNA's enactment—a group we will call pre-Act offenders. Many of these individuals were unregistered at the time of SORNA's enactment, either because pre-existing law did not cover them or because they had successfully evaded that law (so were 'lost' to the system). See supra, at 2121 2122. And of those potential new registrants, many or most could not comply with subsection (b)'s registration rule because they had already completed their prison sentences. For the entire group of pre-Act offenders, once again, the Attorney General 'shall have the authority' to 'specify the applicability' of SORNA's registration requirements and 'to prescribe rules for [their] registration.' ¶ Under that delegated authority, the Attorney General issued an interim rule in February 2007, specifying that SORNA's registration requirements apply in full to 'sex offenders convicted of the offense for which registration is required prior to the enactment of that Act.' 72 Fed. Reg. 8897. The final rule, issued in December 2010, reiterated that SORNA applies to all pre-Act offenders. 75 Fed. Reg. 81850. That rule has remained the same to this day. ¶ Petitioner Herman Gundy is a pre-Act offender. The year before SORNA's enactment, he pleaded guilty under Maryland law for sexually assaulting a minor. After his release from prison in 2012, Gundy came to live in New York. But he never registered there as a sex offender. A few years later, he was convicted for failing to register, in violation of § 2250. He argued below (among other things) that Congress unconstitutionally delegated legislative power when it authorized the Attorney General to 'specify the applicability' of SORNA's registration requirements to pre-Act offenders. § 20913(d). The District Court and Court of Appeals for the Second Circuit rejected that claim, see 695 Fed.Appx. 639 (2017), as had every other court (including eleven Courts of Appeals) to consider the issue. We nonetheless granted certiorari. 583 U.S. , 138 S.Ct. 1260, 200 L.Ed.2d 416 (2018). Today, we join the consensus and affirm. ¶ II ¶ Article I of the Constitution provides that '[a]ll legislative Powers herein granted shall be vested in a Congress of the United States.' § 1. Accompanying that assignment of power to Congress is a bar on its further delegation. Congress, this Court explained early on, may not transfer to another branch 'powers which are strictly and exclusively legislative.' *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1, 42 43, 6 L.Ed. 253 (1825). But the Constitution does not 'deny[ ] to the Congress the necessary resources of flexibility and practicality [that enable it] to perform its function[s].' *Yakus v. United States*, 321 U.S. 414, 425, 64 S.Ct. 660, 88 L.Ed. 834 (1944) (internal quotation marks omitted). Congress may 'obtain[ ] the assistance of its coordinate Branches'—and in particular, may confer substantial discretion on executive agencies to implement and enforce the laws. *Mistretta v. United States*, 488 U.S. 361, 372, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989). '[I]n our increasingly complex society, replete with ever changing and more technical problems,' this Court has understood that 'Congress simply cannot do its job absent an ability to delegate power under broad general directives.' *Ibid.* So we have held, time and again, that a statutory delegation is constitutional as long as Congress 'lay[s] down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform.' *Ibid.* (*quoting J. W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624 (1928); brackets in original). ¶ Given that standard, a nondelegation inquiry always begins (and often almost ends) with statutory interpretation. The constitutional question is whether Congress has supplied an intelligible principle to guide the delegee's use of discretion. So the answer requires construing the challenged statute to figure out what task it delegates and what instructions it provides. *See, e.g., Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 473, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) (construing the text of a delegation to place constitutionally adequate 'limits on the Environmental Protection Agency's discretion'); *American*

Power & Light Co. v. SEC, 329 U.S. 90, 104 105, 67 S.Ct. 133, 91 L.Ed. 103 (1946) (interpreting a statutory delegation, in light of its 'purpose[,] factual background[, and] context,' to provide sufficiently 'definite' standards). Only after a court has determined a challenged statute's meaning can it decide whether the law sufficiently guides executive discretion to accord with Article I. And indeed, once a court interprets the statute, it may find that the constitutional question all but answers itself. ¶ That is the case here, because § 20913(d) does not give the Attorney General anything like the 'unguided' and 'unchecked' authority that Gundy says. Brief for Petitioner 37, 45. The provision, in Gundy's view, 'grants the Attorney General plenary power to determine SORNA's applicability to pre-Act offenders—to require them to register, or not, as she sees fit, and to change her policy for any reason and at any time.' *Id.*, at 42. If that were so, we would face a nondelegation question. But it is not. This Court has already interpreted § 20913(d) to say something different—to require the Attorney General to apply SORNA to all pre-Act offenders as soon as feasible. *See Reynolds*, 565 U.S. at 442 443, 132 S.Ct. 975. And revisiting that issue yet more fully today, we reach the same conclusion. The text, considered alongside its context, purpose, and history, makes clear that the Attorney General's discretion extends only to considering and addressing feasibility issues. Given that statutory meaning, Gundy's constitutional claim must fail. Section 20913(d)'s delegation falls well within permissible bounds."). *See also Whitman v. American Trucking Associations Inc.*, 531 U.S. 457 (2001); *Toughby v. United States*, 500 U.S. 160 (1991) ("The Constitution provides that '[a]ll legislative Powers herein granted shall be vested in a Congress of the United States.' U.S. Const., Art. I, § 1. From this language the Court has derived the nondelegation doctrine: that Congress may not constitutionally delegate its legislative power to another branch of Government. 'The nondelegation doctrine is rooted in the principle of separation of powers that underlies our tripartite system of Government.' *Mistretta v. United States*, 488 U.S. 361, 371, 109 S.Ct. 647, 654, 102 L.Ed.2d 714 (1989). ¶ We have long recognized that the nondelegation doctrine does not prevent Congress from seeking assistance, within proper limits, from its coordinate Branches. *Id.*, at 372, 109 S.Ct., at 654. Thus, Congress does not violate the Constitution merely because it legislates in broad terms, leaving a certain degree of discretion to executive or judicial actors. So long as Congress 'lay [s] down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform, such legislative action is not a forbidden delegation of legislative power.' *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409, 48 S.Ct. 348, 352, 72 L.Ed. 624 (1928). Petitioners wisely concede that Congress has set forth in § 201(h) an 'intelligible principle' to constrain the Attorney General's discretion to schedule controlled substances on a temporary basis. We have upheld as providing sufficient guidance statutes authorizing the War Department to recover 'excessive profits' earned on military contracts, *see Lichter v. United States*, 334 U.S. 742, 778-786, 68 S.Ct. 1294, 1313-1317, 92 L.Ed. 1694 (1948); authorizing the Price Administrator to fix 'fair and equitable' commodities prices, *see Yakus v. United States*, 321 U.S. 414, 426-427, 64 S.Ct. 660, 668-669, 88 L.Ed. 834 (1944); and authorizing the Federal Communications Commission to regulate broadcast licensing in the 'public interest,' *see National Broadcasting Co. v. United States*, 319 U.S. 190, 225-226, 63 S.Ct. 997, 1013-1014, 87 L.Ed. 1344 (1943). In light of these precedents, one cannot plausibly argue that § 201(h)'s 'imminent hazard to the public safety' standard is not an intelligible principle. ¶ Petitioners suggest, however, that something more than an 'intelligible principle' is required when Congress authorizes another Branch to promulgate regulations that contemplate criminal sanctions. They contend that regulations of this sort pose a heightened risk to individual liberty and that Congress must therefore provide more specific guidance. Our cases are not entirely clear as to whether more specific guidance is in fact required. *Compare Fahey v. Mallonee*, 332 U.S. 245, 249-250, 67 S.Ct. 1552, 1553-1554, 91 L.Ed. 2030 (1947), *cited in Mistretta, supra*, 488 U.S., at 373, n. 7, 109 S.Ct., at 655, n. 7, *with Yakus, supra*, 321 U.S.,

The basic question in *Loper Bright Enterprises* was a challenge to a rule promulgated by the National Marine Fisheries Service pursuant to the Magnuson-Stevens Act,[79] which incorporates the Administrative Procedure Act.[80] The Supreme Court determined that the Administrative Procedure Act requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority. Courts may not defer to an agency interpretation of the law simply because a statute is ambiguous. The Supreme Court overruled *Chevron*.

In overruling *Chevron*, the Supreme Court in *Loper Bright Enterprises* reasoned that the Constitution assigns to the judiciary the obligation to adjudicate cases and controversies. *Loper Bright Enterprises* also left interpretation of statutes to the courts.

Article III of the Constitution assigns to the Federal Judiciary the responsibility and power to adjudicate "Cases" and "Controversies"—concrete disputes with consequences for the parties involved. The

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at 423-427, 64 S.Ct., at 666-669, and *United States v. Grimaud*, 220 U.S. 506, 518, 521, 31 S.Ct. 480, 483, 484, 55 L.Ed. 563 (1911). We need not resolve the issue today. We conclude that § 201(h) passes muster even if greater Congressional specificity is required in the criminal context. ¶ Although it features fewer procedural requirements than the permanent scheduling statute, § 201(h) meaningfully constrains the Attorney General's discretion to define criminal conduct. To schedule a drug temporarily, the Attorney General must find that doing so is 'necessary to avoid an imminent hazard to the public safety.' § 201(h)(1), 21 U.S.C. § 811(h)(1). In making this determination, he is 'required to consider' three factors: the drug's 'history and current pattern of abuse'; '[t]he scope, duration, and significance of abuse'; and '[w]hat, if any, risk there is to the public health.' §§ 201(c)(4)-(6), 201(h)(3), 21 U.S.C. §§ 811(c)(4)-(6), 811(h)(3). Included within these factors are three other factors on which the statute places a special emphasis: 'actual abuse, diversion from legitimate channels, and clandestine importation, manufacture, or distribution.' § 201(h)(3), 21 U.S.C. § 811(h)(3). The Attorney General also must publish 30-day notice of the proposed scheduling in the Federal Register, transmit notice to the Secretary of HHS, and 'take into consideration any comments submitted by the Secretary in response.' §§ 201(h)(1), 201(h)(4), 21 U.S.C. §§ 811(h)(1), 811(h)(4). ¶ In addition to satisfying the numerous requirements of § 201(h), the Attorney General must satisfy the requirements of § 202(b), 21 U.S.C. § 812(b). This section identifies the criteria for adding a substance to each of the five schedules. As the United States acknowledges in its brief, § 202(b) speaks in mandatory terms, drawing no distinction between permanent and temporary scheduling. With exceptions not pertinent here, it states that 'a drug or other substance may not be placed in any schedule unless the findings required for such schedule are made with respect to such drug or other substance.' § 202(b), 21 U.S.C. § 812(b). Thus, apart from the 'imminent hazard' determination required by § 201(h), the Attorney General, if he wishes to add temporarily a drug to schedule I, must find that it 'has a high potential for abuse,' that it 'has no currently accepted medical use in treatment in the United States,' and that '[t]here is a lack of accepted safety for use of the drug . under medical supervision.' § 202(b)(1), 21 U.S.C. § 812(b)(1). ¶ It is clear that in §§ 201(h) and 202(b) Congress has placed multiple specific restrictions on the Attorney General's discretion to define criminal conduct. These restrictions satisfy the constitutional requirements of the nondelegation doctrine.").

[79] 16 U. S. C. §1801 *et seq.*

[80] 5 U. S. C. §551 *et seq.*

Framers appreciated that the laws judges would necessarily apply in resolving those disputes would not always be clear. Cognizant of the limits of human language and foresight, they anticipated that "[a]ll new laws, though penned with the greatest technical skill, and passed on the fullest and most mature deliberation," would be "more or less obscure and equivocal, until their meaning" was settled "by a series of particular discussions and adjudications." The Federalist No. 37, p. 236 (J. Cooke ed. 1961) (J. Madison).

The Framers also envisioned that the final "interpretation of the laws" would be "the proper and peculiar province of the courts." Id., No. 78, at 525 (A. Hamilton). Unlike the political branches, the courts would by design exercise "neither Force nor Will, but merely judgment." Id., at 523. To ensure the "steady, upright and impartial administration of the laws," the Framers structured the Constitution to allow judges to exercise that judgment independent of influence from the political branches. [Citation omitted.][81]

Marbury v. Madison[82] clarified that the province of the courts to say what the law is:

This Court embraced the Framers' understanding of the judicial function early on. In the foundational decision of Marbury v. Madison, Chief Justice Marshall famously declared that "[i]t is emphatically the province and duty of the judicial department to say what the law is." [Citation omitted.] And in the following decades, the Court understood "interpret[ing] the laws, in the last resort," to be a "solemn duty" of the Judiciary. [Citation omitted.] When the meaning of a statute was at issue, the judicial role was to "interpret the act of Congress, in order to ascertain the rights of the parties." [Citation omitted.][83]

The Court provided respect for agency interpretation particularly when the interpretation was issued roughly contemporaneously with enactment of the statute:

The Court also recognized from the outset, though, that exercising independent judgment often included according due respect to Executive Branch interpretations of federal statutes. For example, [citation omitted], the Court explained that "[i]n the construction of a doubtful and ambiguous law, the contemporaneous construction of those who were called upon to act under the law, and were appointed to carry its provisions into effect, is entitled to very great respect." [Citation omitted.]

Such respect was thought especially warranted when an Executive Branch interpretation was issued roughly contemporaneously with enactment of the statute and remained consistent over time. [Citation omitted.] That is because "the longstanding 'practice of the government'"—like any other interpretive aid—"can inform [a court's] determination of 'what the law is.'" [Citation omitted.][84]

Respect for agency interpretations would inform the courts, but not supersede their judgement.

"Respect," though, was just that. The views of the Executive Branch could inform the judgment of the Judiciary, but did not supersede it. Whatever respect an Executive Branch interpretation was due, a judge

[81] 244 S.Ct. at 2257.
[82] 5 U.S. 137 (1803).
[83] 244 S.Ct. at 2257.
[84] 244 S.Ct. at 2247.

"certainly would not be bound to adopt the construction given by the head of a department." [Citation omitted.] Otherwise, judicial judgment would not be independent at all. As Justice Story put it, "in cases where [a court's] own judgment . . . differ[ed] from that of other high functionaries," the court was "not at liberty to surrender, or to waive it." [Citation omitted.][85]

Through the New Deal, courts continued to rule that questions of law were for the courts to determine:

The New Deal ushered in a "rapid expansion of the administrative process." [Citation omitted.] But as new agencies with new powers proliferated, the Court continued to adhere to the traditional understanding that questions of law were for courts to decide, exercising independent judgment.

During this period, the Court often treated agency determinations of fact as binding on the courts, provided that there was "evidence to support the findings." [Citation omitted.] "When the legislature itself acts within the broad field of legislative discretion," the Court reasoned, "its determinations are conclusive." [Citation omitted.] Congress could therefore "appoint[ ] an agent to act within that sphere of legislative authority" and "endow the agent with power to make findings of fact which are conclusive, provided the requirements of due process which are specially applicable to such an agency are met, as in according a fair hearing and acting upon evidence and not arbitrarily." [Citation omitted.]

But the Court did not extend similar deference to agency resolutions of questions of law. It instead made clear, repeatedly, that "[t]he interpretation of the meaning of statutes, as applied to justiciable controversies," was "exclusively a judicial function." [Citation omitted.] The Court understood, in the words of Justice Brandeis, that "[t]he supremacy of law demands that there shall be opportunity to have some court decide whether an erroneous rule of law was applied." [Citation omitted.] It also continued to note, as it long had, that the informed judgment of the Executive Branch—especially in the form of an interpretation issued contemporaneously with the enactment of the statute—could be entitled to "great weight." [Citation omitted.][86]

In *Skidmore v. Swift & Co.*,[87] the court agreed the court could resort to interpretations by the relevant agency based on specialized experience. The weight given to agency interpretations would "depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." The courts would defer to agencies for "factbound determinations":

Perhaps most notably along those lines, in Skidmore v. Swift & Co., 323 U.S. 134, 65 S.Ct. 161, 89 L.Ed. 124 (1944), the Court explained that the "interpretations and opinions" of the relevant agency, "made in pursuance of official duty" and "based upon . . . specialized experience," "constitute[d] a body of experience and informed judgment to which courts and litigants [could] properly resort for guidance," even on legal questions. [Citation omitted.] "The weight of such a judgment in a particular case," the Court observed,

[85] 244 S.Ct. at 2247.
[86] 144 S. Ct. at 2258.
[87] 323 U.S. 134 (1944).

would "depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." [Citation omitted.]

On occasion, to be sure, the Court applied deferential review upon concluding that a particular statute empowered an agency to decide how a broad statutory term applied to specific facts found by the agency . . . .

Such deferential review, though, was cabined to factbound determinations . . [I]n Hearst, the Court proclaimed that "[u]ndoubtedly questions of statutory interpretation . . . are for the courts to resolve, giving appropriate weight to the judgment of those whose special duty is to administer the questioned statute." [Citation omitted.] At least with respect to questions it regarded as involving "statutory interpretation," the Court thus did not disturb the traditional rule. It merely thought that a different approach should apply where application of a statutory term was sufficiently intertwined with the agency's factfinding. [88]

The Administrative Procedure Act was enacted to protect the country from overzealous administrators:

Congress in 1946 enacted the APA "as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices." [Citation omitted.] It was the culmination of a "comprehensive rethinking of the place of administrative agencies in a regime of separate and divided powers." [Citation omitted.]

In addition to prescribing procedures for agency action, the APA delineates the basic contours of judicial review of such action. As relevant here, Section 706 directs that "[t]o the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action." 5 U.S.C. § 706. It further requires courts to "hold unlawful and set aside agency action, findings, and conclusions found to be . . . not in accordance with law." § 706(2)(A).

The APA thus codifies for agency cases the unremarkable, yet elemental proposition reflected by judicial practice dating back to Marbury: that courts decide legal questions by applying their own judgment. It specifies that courts, not agencies, will decide "all relevant questions of law" arising on review of agency action, § 706 (emphasis added)—even those involving ambiguous laws—and set aside any such action inconsistent with the law as they interpret it. And it prescribes no deferential standard for courts to employ in answering those legal questions. That omission is telling, because Section 706 does mandate that judicial review of agency policymaking and factfinding be deferential. See § 706(2)(A) (agency action to be set aside if "arbitrary, capricious, [or] an abuse of discretion"); § 706(2)(E) (agency factfinding in formal proceedings to be set aside if "unsupported by substantial evidence"). [89]

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[88] 144 S. Ct. at 2259. *Hearst* considered an order published by an administrative agency and not a regulations.

[89] 144 S. Ct. at 2257. *But see Volkswagenwerk Aktiengesellschaft v. FMC*, 390 U.S. 261 (1968) "The construction put on a statute by the agency charged with administering it is entitled to deference by the courts, and ordinarily that construction will be affirmed if it has a 'reasonable basis in law.' *NLRB*

V. Hearst Publications, 322 U.S. 111, 131; *Unemployment Commission v. Aragon*, 329 U.S. 143, 153-154. But the courts are the final authorities on issues of statutory construction, *FTC v. Colgate Palmolive Co.*, 380 U.S. 374, 385, and 'are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the Congressional policy underlying a statute.' *NLRB v. Brown*, 380 U.S. 278, 291. 'The deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia . ." *American Ship Building Co. v. NLRB*, 380 U.S. 300, 318."). Courts often tended to defer to an administrative interpretation that the administrative agency has followed since the adoption of the statute. *See, e.g.*, *Sunray Mid-Continent Oil Co. v. Federal Power Commission*, 364 U.S. 137 (1960) (independent natural gas producer contracted to sell gas to an interstate pipeline company at specified prices for a term of 20 years, applied to the Federal Power Commission under the Natural Gas Act for a certificate of convenience and necessity authorizing sales for only 20 years; Federal Power Commission issued a certificate without any time limitation); *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294 (1933) (right of foreign producer to examine confidential information provided to Tariff Commission by domestic competitor; right of hearing did not include the right to examine the statement of costs which the domestic producer furnished the Tariff Commission in confidence, or the right to inspect data, gathered confidentially by the Tariff Commission, or the right to examine the domestic producer's officers and the Federal Power Commission's agents). Deference often was especially likely in circumstances in which the staff of the administrative agency participated in drafting the statute. *See. e.g.. Miller v. Youakim*, 440 U.S. 125 (1979) (Department of Health, Education, and Welfare has interpreted the federal statute to require that states provide AFDC-FC benefits "regardless of whether the . foster family home in which a child is placed is operated by a relative"; Illinois refused to make AFDC-FC payments on behalf of children because they were related to their foster parents); *Shapiro v. United States*, 335 U.S. 1, 12n.13 (1948) (recordkeeping and inspection provisions related to Emergency Price Control Act); *United States v. American Trucking Associations*, 310 U.S. 534, 549 (1940) (construction of Motor Carrier Act by Interstate Commerce Commission). There often was deference to longstanding administrative interpretations. *See, e.g.. United States v. National Association of Securities Dealers, Inc.*, 422 U.S. 694, 719 (1975) (considering price maintenance mandate of Section 22(d) of the Investment Company Act of 1940); *National Labor Relations Board v. Boeing Co.*, 412 U.S. 67, 74-75 (1973) (considering unfair labor practice under Section 8(b)(1)(A) of the National Labor Relations Act and disciplinary fine levied by the union against a member). Deference was considerably less likely in circumstances in which the administrative agency advancing the interpretation was not the administrative agency that was charged with administering the interpreted statute. *Alaska S.S. Co. v. United States*, 290 U.S. 256, 261-64 (1933) (compensation for transporting crew of destitute seamen from Ketchikan to Seattle after their ship was wrecked); *United States v. Florida East Coast Ry.*, 410 U.S. 224 (1973) (Interstate Commerce Commission *per diem* rates for freight card). Courts often would infer Congressional approval of an intervening administrative interpretation where the statute was reenacted without change by Congress subsequent to the administrative agency interpretation (reenactment doctrine). *See United States v. Rutherford*, 99 S. Ct. 2470 (1979) (injunction action against government to prevent it from interfering with the interstate shipment and sale of Laetrile under Section 505 of the Federal Food, Drug, and Cosmetic Act); *Red Lion Broadcasting Co. v. Federal Communications Commission*, 395 U.S. 367 (1969) (Federal Communication Commission's fairness doctrine); *United States v. Correll*, 389 U.S. 299, 305-06 (1967) (Internal Revenue Service ruled concerning travelling expenses incurred while away from home under I.R.C. § 162(a)(2)); *Power Reactor Development Co. v. International Union of Electrical Workers*, 367 U.S. 396 (1961) (provisional license issued by Atomic Energy Commission for construction permit for fast-neutron breeder reactor for generation of electrical power). See, generally, Gardner, *Federal Courts and Agencies: An Audit of the Partnership Books*, 75 Columbia L. Rev. 800 (1975).

Congress would have clearly articulated a standard requiring deference to administrative agencies if that is what Congress intended. Agency interpretations of statutes (other than where there is an express delegation of legislative authority to the administrative agency) are not entitled to deference:

> *In a statute designed to "serve as the fundamental charter of the administrative state," [citation omitted], Congress surely would have articulated a similarly deferential standard applicable to questions of law had it intended to depart from the settled pre-APA understanding that deciding such questions was "exclusively a judicial function," [Citation omitted.] But nothing in the APA hints at such a dramatic departure. On the contrary, by directing courts to "interpret constitutional and statutory provisions" without differentiating between the two, Section 706 makes clear that agency interpretations of statutes—like agency interpretations of the Constitution—are not entitled to deference. Under the APA, it thus "remains the responsibility of the court to decide whether the law means what the agency says." [Citation omitted.]*[90]

The Administrative Procedure Act provides that questions of law are for courts to decide:

> *The text of the APA means what it says. And a look at its history if anything only underscores that plain meaning. According to both the House and Senate Reports on the legislation, Section 706 "provide[d] that questions of law are for courts rather than agencies to decide in the last analysis." [Citation omitted.] Some of the legislation's most prominent supporters articulated the same view. [Citation omitted.] . .*
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> *The Administrative Procedure Act incorporates the rule that "courts must exercise independent judgment in determining the meaning of statutory provisions."*
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> *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. [Citation omitted.] And interpretations issued contemporaneously with the statute at issue, and which have remained consistent over time, may be especially useful in determining the statute's meaning. [Citation omitted.]*[91]

Congress can still expressly delegate authority to an administrative agency to define a particular statutory term or to fill in details of a statute:

> *In a case involving an agency, of course, the statute's meaning may well be that the agency is authorized to exercise a degree of discretion. Congress has often enacted such statutes. For example, some statutes "expressly delegate[ ]" to an agency the authority to give meaning to a particular statutory term. [Citation omitted.] Others*

[90] 144 S. Ct. at 2261

[91] 144 S. Ct. at 2262.

empower an agency to prescribe rules to "fill up the details" of a statutory scheme, [citation omitted], or to regulate subject to the limits imposed by a term or phrase that "leaves agencies with flexibility," [citation omitted], such as "appropriate" or "reasonable."[Footnote omitted.][92]

When the statute delegates special discretion to an agency, the court is limited to ensuring that the agency is engaging in "reasoned decisionmaking":

When the best reading of a statute is that it delegates discretionary authority to an agency, the role of the reviewing court under the APA is, as always, to independently interpret the statute and effectuate the will of Congress subject to constitutional limits. The court fulfills that role by recognizing constitutional delegations, "fix[ing] the boundaries of [the] delegated authority," [citation omitted], and ensuring the agency has engaged in "'reasoned decisionmaking'" within those boundaries, [citation omitted]. By doing so, a court upholds the traditional conception of the judicial function that the APA adopts.

Chevron deference is inconsistent with the Administrative Procedure Act and is inconsistent with the traditional approach to interpreting statutes:

The deference that Chevron requires of courts reviewing agency action cannot be squared with the APA.

. .

In the decades between the enactment of the APA and this Court's decision in Chevron, courts generally continued to review agency interpretations of the statutes they administer by independently examining each statute to determine its meaning. [Citation omitted.] As an early proponent (and later critic) of Chevron recounted, courts during this period thus identified delegations of discretionary authority to agencies on a "statute-by-statute basis." [Citation omitted.]

Chevron, decided in 1984 by a bare quorum of six Justices, triggered a marked departure from the traditional approach. The question in the case was whether an EPA regulation "allow[ing] States to treat all of the pollution-emitting devices within the same industrial grouping as though they were encased within a single 'bubble' was consistent with the term "stationary source" as used in the Clean Air Act. [Citation omitted.] To answer that question of statutory interpretation, the Court articulated and employed a now familiar two-step approach broadly applicable to review of agency action.[93]

Chevron adopted a two-step analysis:

The first step was to discern "whether Congress ha[d] directly spoken to the precise question at issue." [Citation omitted.] The Court explained that "[i]f the intent of Congress is clear, that is the end of the matter," ibid., and courts were therefore to "reject administrative constructions which are contrary to clear Congressional intent," [Citation omitted.] To discern such intent, the Court noted, a reviewing court was to "employ[ ] traditional tools of statutory construction." [Citation omitted.]

[92] 144 S. Ct. at 2263.

[93] 144 S. Ct. at 2263.

Without mentioning the APA, or acknowledging any doctrinal shift, the Court articulated a second step applicable when "Congress ha[d] not directly addressed the precise question at issue." [Citation omitted.] In such a case—that is, a case in which "the statute [was] silent or ambiguous with respect to the specific issue" at hand—a reviewing court could not "simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation." [Citation omitted.] A court instead had to set aside the traditional interpretive tools and defer to the agency if it had offered "a permissible construction of the statute," [citation omitted], even if not "the reading the court would have reached if the question initially had arisen in a judicial proceeding," [citation omitted]. That directive was justified, according to the Court, by the understanding that administering statutes "requires the formulation of policy" to fill statutory "gap[s]"; by the long judicial tradition of according "considerable weight" to Executive Branch interpretations; and by a host of other considerations, including the complexity of the regulatory scheme, EPA's "detailed and reasoned" consideration, the policy-laden nature of the judgment supposedly required, and the agency's indirect accountability to the people through the President. [Citation omitted.][94]

The *Chevron* court did not reconcile its holding with the Administrative Procedure Act:

Neither Chevron nor any subsequent decision of this Court attempted to reconcile its framework with the APA. The "law of deference" that this Court has built on the foundation laid in Chevron has instead been "[h]eedless of the original design" of the APA. Perez, 575 U.S. at 109, 135 S.Ct. 1199 (Scalia, J., concurring in judgment).

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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." [Citation omitted.] It requires a court to ignore, not follow, "the reading the court would have reached" had it exercised its independent judgment as required by the APA. [Citation omitted.] And although exercising independent judgment is consistent with the "respect" historically given to Executive Branch interpretations, [citation omitted], Chevron insists on much more. It demands that courts mechanically afford binding deference to agency interpretations, including those that have been inconsistent over time. [Citation omitted.] Still worse, it forces courts to do so even when a pre-existing judicial precedent holds that the statute means something else—unless the prior court happened to also say that the statute is "unambiguous." [Citation omitted.] That regime is the antithesis of the time honored approach the APA prescribes. In fretting over the prospect of "allow[ing]" a judicial interpretation of a statute "to override an agency's" in a dispute before a court, ibid., Chevron turns the statutory scheme for judicial review of agency action upside down.

Chevron cannot be reconciled with the APA, as the Government and the dissent contend, by presuming that statutory ambiguities are implicit delegations to agencies. [Citation omitted.] Presumptions have their place in statutory interpretation, but only to the extent that they approximate reality. Chevron's presumption does not, because "[a]n ambiguity is simply not a delegation of law-interpreting power. Chevron confuses the two." [Citation omitted.] As Chevron itself noted, ambiguities may result from an inability on the part of Congress

[94] 144 S. Ct. at 2264.

to squarely answer the question at hand, or from a failure to even "consider the question" with the requisite precision. [Citation omitted.] In neither case does an ambiguity necessarily reflect a Congressional intent that an agency, as opposed to a court, resolve the resulting interpretive question. And many or perhaps most statutory ambiguities may be unintentional. As the Framers recognized, ambiguities will inevitably follow from "the complexity of objects, . the imperfection of the human faculties," and the simple fact that "no language is so copious as to supply words and phrases for every complex idea." [Citation omitted.][95]

The court should follow the best interpretation or best reading of a statute, not merely a permissible interpretation of a statute:

In an agency case as in any other, though, even if some judges might (or might not) consider the statute ambiguous, there is a best reading all the same—"the reading the court would have reached" if no agency were involved. [Citation omitted.] It therefore makes no sense to speak of a "permissible" interpretation that is not the one the court, after applying all relevant interpretive tools, concludes is best. In the business of statutory interpretation, if it is not the best, it is not permissible.[96]

Agencies do not have special competence in resolving statutory ambiguities. Courts have special competence in resolving statutory ambiguities.

Perhaps most fundamentally, Chevron's presumption is misguided because agencies have no special competence in resolving statutory ambiguities. Courts do. The Framers, as noted, anticipated that courts would often confront statutory ambiguities and expected that courts would resolve them by exercising independent legal judgment. And even Chevron itself reaffirmed that "[t]he judiciary is the final authority on issues of statutory construction" and recognized that "in the absence of an administrative interpretation," it is "necessary" for a court to "impose its own construction on the statute." [Citation omitted.] Chevron gravely erred, though, in concluding that the inquiry is fundamentally different just because an administrative interpretation is in play. The very point of the traditional tools of statutory construction—the tools courts use every day—is to resolve statutory ambiguities. That is no less true when the ambiguity is about the scope of an agency's own power—perhaps the occasion on which abdication in favor of the agency is least appropriate.[97]

Agencies may have subject matter expertise regarding the statutes they administer. Referring to agencies purportedly promotes the uniform construction of federal law. Resolving statutory ambiguities can involve policymaking best left to political actors, rather than courts. These considerations do not justify a presumption that Congress intends to leave statutory interpretation to government agencies.

The Government responds that Congress must generally intend for agencies to resolve statutory ambiguities because agencies have subject matter expertise regarding the statutes they administer; because deferring to agencies purportedly promotes the uniform construction of federal law; and because resolving statutory ambiguities can involve policymaking best left to political actors, rather than courts. [Citation omitted.] The

[95] 144 S. Ct. at 2265.
[96] 144 S. Ct. at 2264.
[97] 144 S. Ct. at 2266.

dissent offers more of the same. [Citation omitted.] But none of these considerations justifies Chevron's sweeping presumption of Congressional intent. [98]

Interpretive issues often fall more naturally in the judged bailiwick than an agency's bailiwick.

Beginning with expertise, we recently noted that interpretive issues arising in connection with a regulatory scheme often "may fall more naturally into a judge's bailiwick" than an agency's. [Citation omitted.] We thus observed that "[w]hen the agency has no comparative expertise in resolving a regulatory ambiguity, Congress presumably would not grant it that authority." [Citation omitted.] Chevron's broad rule of deference, though, demands that courts presume just the opposite. Under that rule, ambiguities of all stripes trigger deference. Indeed, the Government and, seemingly, the dissent continue to defend the proposition that Chevron applies even in cases having little to do with an agency's technical subject matter expertise. [Citation omitted.] [99]

Congress expects courts to handle technical statutory issues.

But even when an ambiguity happens to implicate a technical matter, it does not follow that Congress has taken the power to authoritatively interpret the statute from the courts and given it to the agency. Congress expects courts to handle technical statutory questions. "[M]any statutory cases" call upon "courts [to] interpret the mass of technical detail that is the ordinary diet of the law," [citation omitted], and courts did so without issue in agency cases before Chevron, [citation omitted]. Courts, after all, do not decide such questions blindly. The parties and amici in such cases are steeped in the subject matter, and reviewing courts have the benefit of their perspectives. In an agency case in particular, the court will go about its task with the agency's "body of experience and informed judgment," among other information, at its disposal. [Citation omitted.] And although an agency's interpretation of a statute "cannot bind a court," it may be especially informative "to the extent it rests on factual premises within [the agency's] expertise." [Citation omitted.] Such expertise has always been one of the factors which may give an Executive Branch interpretation particular "power to persuade, if lacking power to control." [Citation omitted.] [100]

Delegation of interpretive power to agencies is not necessary to resolve statutory ambiguities.

For those reasons, delegating ultimate interpretive authority to agencies is simply not necessary to ensure that the resolution of statutory ambiguities is well informed by subject matter expertise. The better presumption is therefore that Congress expects courts to do their ordinary job of interpreting statutes, with due respect for the views of the Executive Branch. And to the extent that Congress and the Executive Branch may disagree with how the courts have performed that job in a particular case, they are of course always free to act by revising the statute. [101]

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[98] 144 S. Ct. at 2266.
[99] 144 S. Ct. at 2266.
[100] 144 S. Ct. at 2266.
[101] 144 S. Ct. at 2267.

Uniform construction of federal law does not justify *Chevron* deference to agency interpretations.

> *Nor does a desire for the uniform construction of federal law justify Chevron. Given inconsistencies in how judges apply Chevron, [citation omitted], it is unclear how much the doctrine as a whole (as opposed to its highly deferential second step) actually promotes such uniformity. In any event, there is little value in imposing a uniform interpretation of a statute if that interpretation is wrong. We see no reason to presume that Congress prefers uniformity for uniformity's sake over the correct interpretation of the laws it enacts.* [102]

The view that interpretation of ambiguous statutes amounts to policymaking does not justify deference to agency interpretations. Interpretation of ambiguous statutes is not policymaking.

> *The view that interpretation of ambiguous statutory provisions amounts to policymaking suited for political actors rather than courts is especially mistaken, for it rests on a profound misconception of the judicial role. It is reasonable to assume that Congress intends to leave policymaking to political actors. But resolution of statutory ambiguities involves legal interpretation. That task does not suddenly become policymaking just because a court has an "agency to fall back on." [Citation omitted.] Courts interpret statutes, no matter the context, based on the traditional tools of statutory construction, not individual policy preferences. Indeed, the Framers crafted the Constitution to ensure that federal judges could exercise judgment free from the influence of the political branches. [Citation omitted.] They were to construe the law with "[c]lear heads . . . and honest hearts," not with an eye to policy preferences that had not made it into the statute. [Citation omitted.] Congress can confer discretionary authority (generally to be distinguished from authority to interpret statutes) on government agencies.*
>
> *That is not to say that Congress cannot or does not confer discretionary authority on agencies. Congress may do so, subject to constitutional limits, and it often has. But to stay out of discretionary policymaking left to the political branches, judges need only fulfill their obligations under the APA to independently identify and respect such delegations of authority, police the outer statutory boundaries of those delegations, and ensure that agencies exercise their discretion consistent with the APA. By forcing courts to instead pretend that ambiguities are necessarily delegations, Chevron does not prevent judges from making policy. It prevents them from judging.*
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> *In truth, Chevron's justifying presumption is, as Members of this Court have often recognized, a fiction.* . [103]

Chevron did not apply to questions of "deep 'economic and political significance'":

> *Even where those procedural hurdles are cleared, substantive ones remain. Most notably, Chevron does not apply if the question at issue is one of "deep 'economic and political significance.' [Citation omitted.] We have instead expected Congress to delegate such authority "expressly" if at all, [citation omitted], for "[e]xtraordinary grants of regulatory authority are rarely accomplished through 'modest words,' 'vague terms,' or 'subtle device[s],' [Citation omitted.] Nor have we applied Chevron to agency interpretations of judicial*

[102] 144 S. Ct. at 2267.

[103] 144 S. Ct. at 2268.

review provisions, [citation omitted], or to statutory schemes not administered by the agency seeking deference, [citation omitted]. And we have sent mixed signals on whether Chevron applies when a statute has criminal applications. [Citation omitted.] [104]

Chevron distracts from the question that matters: Does the statute authorize the challenged agency action?

The experience of the last 40 years has thus done little to rehabilitate Chevron. It has only made clear that Chevron's fictional presumption of Congressional intent was always unmoored from the APA's demand that courts exercise independent judgment in construing statutes administered by agencies. At best, our intricate Chevron doctrine has been nothing more than a distraction from the question that matters: Does the statute authorize the challenged agency action? And at worst, it has required courts to violate the APA by yielding to an agency the express responsibility, vested in "the reviewing court," to "decide all relevant questions of law" and "interpret . . . statutory provisions." § 706 (emphasis added). [105]

Stare decisis does not require adherence to *Chevron*.

The only question left is whether stare decisis, the doctrine governing judicial adherence to precedent, requires us to persist in the Chevron project. It does not. Stare decisis is not an "inexorable command," [citation omitted], and the stare decisis considerations most relevant here—"the quality of [the precedent's] reasoning, the workability of the rule it established, . and reliance on the decision," [citation omitted] —all weigh in favor of letting Chevron go. [106]

Chevron failed to grapple with the Administrative Procedure Act. The Supreme Court has continually limited its application. The Supreme Court has long questioned its premises.

Chevron has proved to be fundamentally misguided. Despite reshaping judicial review of agency action, neither it nor any case of ours applying it grappled with the APA—the statute that lays out how such review works. Its flaws were nonetheless apparent from the start, prompting this Court to revise its foundations and continually limit its application. It has launched and sustained a cottage industry of scholars attempting to decipher its basis and meaning. And Members of this Court have long questioned its premises. [Citation omitted.] Even Justice Scalia, an early champion of Chevron, came to seriously doubt whether it could be reconciled with the APA. [Citation omitted.] For its entire existence, Chevron has been a "rule in search of a justification," [citation omitted], if it was ever coherent enough to be called a rule at all. [107]

Chevron is unworkable, according to the Supreme Court in *Loper Bright Enterprises*.

Experience has also shown that Chevron is unworkable. The defining feature of its framework is the identification of statutory ambiguity, which requires deference at the doctrine's second step. But the concept of

[104] 144 S. Ct. at 2269.
[105] 144 S. Ct. at 2269.
[106] 144 S. Ct. at 2270.
[107] 144 S. Ct. at 2270.

ambiguity has always evaded meaningful definition. As Justice Scalia put the dilemma just five years after Chevron was decided: "How clear is clear?" [Citation omitted.][108]

Chevron is an impediment to saying what the law is, according to the Supreme Court in *Loper Bright Enterprises*.

> *Four decades after its inception, Chevron has thus become an impediment, rather than an aid, to accomplishing the basic judicial task of "say[ing] what the law is." [Citation omitted.] And its continuing import is far from clear. Courts have often declined to engage with the doctrine, saying it makes no difference. [Citation omitted.] And as noted, we have avoided deferring under Chevron since 2016. That trend is nothing new; for decades, we have often declined to invoke Chevron even in those cases where it might appear to be applicable. [Citation omitted.] At this point, all that remains of Chevron is a decaying husk with bold pretensions.*[109]

Chevron destroys reliance interests, according to the Supreme Court in *Loper Bright Enterprises*.

> *Rather than safeguarding reliance interests, Chevron affirmatively destroys them. Under Chevron, a statutory ambiguity, no matter why it is there, becomes a license authorizing an agency to change positions as much as it likes, with "[u]nexplained inconsistency" being "at most . . . a reason for holding an interpretation to be . . . arbitrary and capricious." [Citation omitted.] But statutory ambiguity, as we have explained, is not a reliable indicator of actual delegation of discretionary authority to agencies. Chevron thus allows agencies to change course even when Congress has given them no power to do so. By its sheer breadth, Chevron fosters unwarranted instability in the law, leaving those attempting to plan around agency action in an eternal fog of uncertainty.*
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> . . . .
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> *This is one of those cases. Chevron was a judicial invention that required judges to disregard their statutory duties. And the only way to "ensure that the law will not merely change erratically, but will develop in a principled and intelligible fashion," [citation omitted], is for us to leave Chevron behind.*[110]

In overruling *Chevron*, the Supreme Court in *Loper Bright Enterprises* says that it does not call into question prior cases that relied on *Chevron*.

> *By doing so, however, we do not call into question prior cases that relied on the Chevron framework. The holdings of those cases that specific agency actions are lawful—including the Clean Air Act holding of Chevron itself—are still subject to statutory stare decisis despite our change in interpretive methodology. [Citation omitted.] Mere reliance on Chevron cannot constitute a "'special justification'" for overruling such a*

[108] 144 S. Ct. at 2270.
[109] 144 S. Ct. at 2271
[110] 144 S. Ct. at __ 2272

holding, because to say a precedent relied on Chevron is, at best, "just an argument that the precedent was wrongly decided." [Citation omitted.] That is not enough to justify overruling a statutory precedent. [111]

This does not say that that *stare decisis* will automatically apply to these cases. The Supreme Court in *Loper Bright Enterprises* is not clear on whether a current court can review earlier decisions decided under a *Chevron* analysis and reevaluate these cases under *Loper Bright Enterprises* or whether *stare decisis* will apply.

The Supreme Court finally holds that *Chevron* is overrules and that courts must exercise independent judgment in deciding whether an agency has acted within statutory authority in interpreting a statute. However, when a statute delegates authority to an agency within constitutional limits, a court must defer to the agency.

Chevron is overruled. 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. [112]

Loper Bright Enterprises did not defer to the supposed special expertise of administrative agencies. *Loper Bright Enterprises* looks to the traditional role, the Constitutional role, of courts rather than administrative agencies in interpreting ambiguous statutes. The role of the courts is to determine matters of law. *Loper Bright Enterprises* thus emphasized that: "Courts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority." This follows the direction in the Administrative Procedure Act for a court to "'decide all relevant questions of law" and to "interpret . . . statutory provisions."'

Loper Bright Enterprises recognizes that there is a "best reading" of even ambiguous statutes. The court must adopt that "best reading" of the statute, regardless of a contrary administrative interpretation. In reaching the "best reading" of the statute, the court should employ all relevant interpretative tools.

An issue that is not clearly dealt with in *Loper Bright Enterprises* is the degree to which Congress can delegate legislative authority to administrative agencies. It is possible that, in appropriate circumstances, the Supreme Court or another court will hold that a delegation of legislative authority to an administrative authority exceeds Constitutional limitations and therefore the administrative interpretation is invalid.

[111] 144 S. Ct. at 2272.
[112] 144 S. Ct. at 2273.

In appropriate circumstances, a court might hold that the nature of the administrative guidance deprives the taxpayer of Due Process by improperly relying on subjective judgements of an administrative agency without proper guidelines.

Perhaps a taxpayer will be able to challenge the imposition of penalties by the Tax Court as violating a taxpayer's right to jury trial.

Taxpayers may seek declaratory judgements to test the validity of regulations, although courts often are not sanguine to declaratory judgements in federal tax matters on account of the Anti-Injunction Act.[113] The Anti-Injunction Act provides generally that "A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." Courts generally interpret the Anti-Injunction Act as not permitting declaratory judgments or other pre-enforcement review of regulations and other sub-regulatory guidance.

§1.6 Some General Comments on the Future of Loper Bright Enterprises

We are left to speculate on the long-term effects of *Loper Bright Enterprises* and the overturning of *Chevron* deference.[114] Some authorities expect a dramatic impact. Other authorities believe that *Loper Bright Enterprises* will have be much more of a small, quiet splash than a giant tsunami. Some believe that the practical impact of *Loper Bright Enterprises* may vary from court to court. Although the mandate of the Supreme Court in *Loper Bright Enterprises* seems clear, different courts will follow different paths in finding the best interpretation of the statute. Some courts may be more influenced by interpretation of the statute by administrative agencies than other courts. Some courts may have different reasons to accept administrative interpretations than other courts.

Loper Bright Enterprises may show an increasing concern in the Supreme Court concerning the increasing rise of the administrative state, in which there is more and more government by regulations promulgated by administrative agencies. It is impossible to know how this concern might be expressive in future Supreme Court opinions and other court opinions. At the least, it appears that the current Supreme Court is proactive and willing to set new directions in administrative law than were followed immediately after *Chevron*.

Many regulations could be perceived as taxpayer favorable. These regulations are less likely than others to be challenged by taxpayers. Even regulations identified as taxpayer favorable may be challenged by some taxpayer in the future. A regulation that appears taxpayer

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[113] 28 U.S.C. § 2283.

[114] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

favorable to taxpayers generally may be perceived as unfavorable to a particular taxpayer in proper circumstances.

So far, *Loper Bright Enterprises* is being cited by trial and appellate courts on a daily basis. Initially, there seems to be an increased interest in the courts in pursuing careful textual analysis of statutes. *Loper Bright Enterprises* is well on its way to being a heavily cited case.[115] It may take

[115] *See, e.g., Laska v. McDonough*, 2024 W.L. 4096538 (September 6, 2024) (appeal of decision that denied entitlement to special monthly compensation for traumatic brain injury under 38 U.S.C. § 1114(t)) ("In determining the meaning of a statutory provision, "'we look first to its language, giving the words used their ordinary meaning.'"[Citation omitted.] Additionally, "'the plain meaning of any statutory provision must be determined in light of the statutory scheme as a whole, the specific context in which the word or provision at issue is used, and the broader context of the statute as a whole'"[Citation omitted.] Finally, legislative history may help clarify or confirm the meaning of statutory provisions. [Citation omitted.]"); *United States v. Deleon* __F. 4th. __ (11th Cir. 2024) (applying a two-level enhancement for an armed robbery, "if any person was physically restrained to facilitate commission of the offense or to facilitate escape.") ("*Dupree*, 57 F.4th 1269, sets forth the process for interpreting the Guidelines. It relied on the deferential scheme afforded to agency interpretations of their own legislative rules when those rules are truly ambiguous. *Id.*. at 1275–77. Recently, the Supreme Court held that, where Congress has not conferred discretionary authority on an agency to interpret a federal statute, the Administrative Procedure Act, 5 U.S.C. § 706, does not permit courts to "defer to an agency interpretation of the law simply because a statute is ambiguous." *Loper Bright Enters. v. Raimondo*, __U.S. __, 144 S. Ct. 2244, 2263, 2268, 2273, __ L.Ed.2d __ (2024). To be sure, that is not squarely on point with *Dupree*, which addressed the proper interpretation of the Sentencing Guidelines and their commentary and application notes, or the cases *Dupree* relied on. But to the extent *Loper Bright* casts any doubt on *Dupree*'s methodology, that may be another good reason for us to consider rehearing this case *en banc*."); *Anderson v. Diamondback Investment Group*, __ F.4th __ (4th Cir. 2024) (disability discrimination for discharge for using purportedly lawful hemp-derived products containing delta-9-tetrahydrocannabinol to treat anxiety and muscle spasms during nonworking hours) ("Though we "may . seek aid from the interpretations of [the agencies] responsible for implementing particular statutes," *Loper Bright*, 144 S.Ct. at 2262 (emphasis added), we find that the DEA's interpretation here lacks the "power to persuade," *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944)."); *United States Sugar Corporation v. Environmental Protection Agency,* __ F.4th __ (D.C. Cir. 2024) (review of Environmental Protection Agency rule that classified some industrial boilers as new sources of hazardous air pollutants, which were subject to stricter standards under the Clean Air Act than the required standards for existing sources, even though they were built before the new emission standards were proposed) ("*Loper Bright* held that the Administrative Procedure Act requires courts to construe statutes *de novo*, without deference to the views of agencies entrusted to administer the statutes. *See* 144 S. Ct. at 2261 & n.4. That analysis controls the Environmental Protection Agency interpretations of the Clean Air Act reviewed under its judicial-review provision, 42 U.S.C. § 7607(d)(9), because judicial review under the Clean Air Act is "essentially the same" as judicial review under the APA, *see Ethyl Corp. v. Environmental Protection Agency*, 51 F.3d 1053, 1064 (D.C. Cir. 1995)."); *Lake Region Healthcare Corporation v. Becerra* __ F.4th __ (D.C. Cir. 2024) (determining reimbursed fixed costs for purposes of computing volume-decrease adjustment for qualifying hospitals that treat Medicare patients) ("This case turns on a question of statutory construction—whether CMS's total-fixed method for calculating volume-decrease adjustments is consistent with the statutory command to "fully compensate" qualifying hospitals for their "fixed costs." 42 U.S.C. § 1395ww(d)(5)(D)(ii). The district court

long for many regulations and other administrative rules to be tested in the courts under a *Loper Bright Enterprises* standard. Many regulations and other administrative rules may never be tested in the courts under a *Loper Bright Enterprises* standard.

Chevron never forced the trial court to say that an administrative agency interpretation was the best interpretation of the statute. Now, the court has to say that its interpretation is the best interpretation of the statute. *Loper Bright Enterprises* requires more work from a court. *Chevron* made the lower court's job easier because the lower court could simply defer to administrative agency interpretations and invoke the talisman of *Chevron*. *Loper Bright Enterprises* forces the court to conduct a more wide-ranging investigation in order to determine the best interpretation of an interpretive regulation. Now courts will have to go through more thorough analysis if they had not been doing so through analysis before.

By denying administrative agency *Chevron* deference, *Loper Bright Enterprises* makes it much easier to challenge administrative agency interpretations of the statute. *Loper Bright Enterprises* makes it much easier to overturn administrative agency regulations. That does not necessarily make it easy to challenge administrative agency regulations in court. The process of challenging regulations in court is expensive.

If you have a trial judge who is inclined to defer to an administrative agency interpretation, *Loper Bright Enterprises* provides some basis for the judge creatively to defer to the administrative agency. A lazy trial judge often can still uphold a regulation based on an administrative interpretation that the court would not have reached without the regulation and that may not really be the best interpretation of a statute.

Loper Bright Enterprises explained that it did "not call into question prior cases" decided under *Chevron*. *Loper Bright Enterprises* also asserted a commitment to *stare decisis*. What this means in practice will be important for the future development of administrative law. The injunction not to call into question prior cases is ambiguous. The precise role of *stare decisis* under *Loper Bright Enterprises* is uncertain. How *stare decisis* will be applied in light of *Loper Bright Enterprises* is a matter that the future will reveal. Many past cases determined under *Chevron* deference might have reached different results if *Loper Bright Enterprises* had been applied to those cases. It is not clear how *stare decisis* will apply to these cases. The Supreme Court in *Loper Bright Enterprises* is not clear on whether a current court can review earlier decisions made under a *Chevron* analysis and independently determine the bet interpretation of the statute that

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deferred to HHS's reading of the statute under *Chevron*. *See Lake Region III*, 2022 W.L. 9936856, at 9–10. Other courts have done the same. *See, e.g., Unity HealthCare v. Azar*, 918 F.3d 571, 577–78 (8th Cir. 2019); *Stephens Cnty. Hosp. v. Becerra*, No. 19-cv-3020, 2021 W.L. 4502068, 9–10 (D.D.C. Sept. 30, 2021). But *Chevron* has now been overruled, so we must "exercise independent judgment" in construing the Medicare statute. *Loper Bright*, 144 S. Ct. at 2262. ¶ We hold that HHS's fixed-total approach does not afford the requisite full compensation for fixed costs . .").

conflicts with earlier interpretations of the statute deferring to an administrative interpretation under the more relaxed *Chevron* standard.

Courts also may be more receptive to challenges of regulations where the regulations provide legal interpretations. Treasury Regulations frequently provide legal interpretations. A court is more likely to rely on its own judgements of statutory interpretation than to rely on administrative agency interpretation of a statute. Courts also may be less likely to rely on interpretations by administrative agencies when Constitutional issues are involved.

Loper Bright Enterprises requires "courts to do their ordinary job" to determine the "best reading" of a statute. In this regard, the courts will apply traditional rules of statutory construction. This includes "due respect" to agency determinations. What that means, however, could be debated. It may mean nothing more than the court should consider agency interpretations, as the court would consider any other evidence or argument presented to the court.

Loper Bright Enterprises elevates pre-*Chevron* cases concerning statutory interpretation. This particularly includes *Skidmore v. Swift and Co.*[116]*Skidmore v. Swift & Co.* instructed courts to consider the thoroughness, reasoning, and consistency of an agency's view and "all those factors which give it power to persuade, if lacking power to control."

Loper Bright Enterprises is expected by many to have an important impact on administrative law, both within and without the tax law. Some advisors and perhaps also some government agencies apparently do not believe that *Loper Bright Enterprises* will have a dramatic impact on the development of the law. A court still will have substantial deference to administrative agency interpretations of statutes where there are specific grants of interpretative power in the statute. *Loper Bright Enterprises* apparently provides for little, if any, deference to administrative interpretations, although courts still may cite special expertise of administrative agencies and longstanding, consistent interpretations of the statute given by regulations. Courts also may cite the effect of reenactment of the statute.

Loper Bright Enterprises breathes new life into *Skidmore v. Swift and Co.*[117] *Skidmore* apparently will become the standard for interpreting interpretive rules and regulations (as opposed to legislative rules and regulations). Courts still may follow agency rules and determinations based on the persuasiveness of the agency arguments supporting the rules. This puts the Internal Revenue Service to the test in justifying its interpretive regulations and other interpretations. Internal Revenue Service interpretive rules and regulations will not be automatically accepted by the courts. Internal Revenue Service interpretive rules and regulations may be more like government arguments in briefs filed with the court. The arguments will be considered, but the court will also consider arguments in opposing briefs. Whether a court will agree with an agency's interpretation of a state depends on "the

[116] 323 U.S. 134 (1944).
[117] 323 U.S. 134 (1944).

thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."[118] While administrative interpretations are not binding on the courts, administrative interpretations do constitute a body of experience and informed judgment.

One of the most important aspects of *Loper Bright Enterprises* is that it mandates deference to government agencies when statutes contain a special grant of interpretative or rule making authority. This grant is subject to limitation by the Constitution and particularly Constitutional Due Process and the Constitutional roles of the executive, legislative and judicial branches. This grant also is limited by the requirement for strict compliance with the Administrative Procedure Act, including its requirements for notice and comment. Some regulations and other interpretations might be challenged as unconstitutional delegations to the executive branch or otherwise unconstitutional in substance. Even where rules and regulations are mandated by a specific Congressional grant of rule making discretion or interpretation, administrative agency interpretations must have a rational basis. Administrative agencies must comply with procedural aspects of the Administrative Procedure Act in adopting legislative rules and regulations. The Administrative Procedure Act provided for deference to legislative rules and regulations unless their interpretations of statutes were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[119] Agency interpretations can be set aside because these interpretations violated the Constitution or exceeded the statutory grant of interpretive authority. Agency interpretations also could be set aside because the interpretations failed to follow the procedures mandated in the Administrative Procedure Act for the promulgation of rules and regulations.

Delegations of authority must be consistent with Constitutional limits. It is clear that Congress has considerable power to delegate interpretive authority to administrative agencies.[120] That power, however, it limited. In appropriate circumstances (which will presumably be extraordinary circumstances) a court may find that the delegation of authority to an administrative agency exceeds Constitutional limitations. A delegation might fail, and a consequent agency regulation, might be invalid on account of Congress exceeding Constitutional limits in delegating authority to an agency.

Some authorities have suggested that the future will see a much more consistent and specific grant of discretion and interpretation to administrative agencies. Others are skeptical.

Confronted by legislative regulations, courts still must interpret that the rules are rational, that they are within the scope of the legislative grant of discretion, and that the grant and the rules are Constitutional. Courts also will scrutinize compliance with the Administrative

[118] 323 U.S. at 140.

[119] 5 U.S.C. § 706(2)(A).

[120] See *Gundy v. United States*, 139 S. Ct. 2115 (2019).

Procedure Act. At least some courts may look more closely at whether legislative regulations are rational, whether they are within the scope of the legislative grant of discretion, and whether the grant and the rules are Constitutional.

Loper Bright Enterprises may evince a greater skepticism of the administrative state and agency regulations that could cause the courts and particularly the Supreme Court to look more skeptically at Internal Revenue Service legislative regulations. *Loper Bright Enterprises* also may be accompanied by an inclination of some courts to emphasize plain meaning of statutes.

For interpretive rules and regulations, *Loper Bright Enterprises* holds that reviewing courts "must exercise their independent judgment in deciding whether an agency has acted within its statutory authority."

One might infer from *Loper Bright Enterprises* that courts will be more aggressive in examining whether agencies have acted within their statutory authority. There also may be an increased literalism in the Supreme Court in looking for "plain meaning".

Some courts still may find it appropriate to defer to the judgement of administrative agencies on the basis of the administrative agency's supposed experience and technical competence. This could be particularly the case when nonlegal issues are involved. Court may find it easy to defer to longstanding regulations. Also, it is easy for a court to defer to an agency interpretation of a statute. Courts may be less likely to defer to agency interpretations in the case of purely legal interpretation. Courts also may defer to some regulations through inertia: it is much easier for a court to apply an interpretive regulation than to find the regulation invalid.

Courts may defer to longstanding interpretations.

Courts also may be persuaded to see and to combat the types of abuse that the Internal Revenue Service perceived when it promulgated interpretive regulations.

The Internal Revenue Service also may have a greater burden to explain why it has adopted particular positions in regulations. [121]

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[121] See, e.g., *Burlington Truck Lines v. United States*, 371 U.S., at 167 ("There are no findings and no analysis here to justify the choice made, no indication of the basis on which the [agency] exercised its expert discretion. We are not prepared to and the Administrative Procedure Act will not permit us to accept such . practice. . Expert discretion is the lifeblood of the administrative process, but 'unless we make the requirements for administrative action strict and demanding, expertise, the strength of modern government, can become a monster which rules with no practical limits on its discretion.' *New York v. United States*, 342 U.S. 882, 884 [72 S.Ct. 152, 153, 96 L.Ed. 662] (dissenting opinion).' (footnote omitted)."); *Atchison, T & S.F.R. Co. v. Wichita Bd. of Trade*, 412 U.S. 800, 806, (1973) ("But the District Court held that the Commission had not adequately justified its failure to follow 'its long established rule that it will not allow a separate charge for an accessorial service previously performed as part of the line-haul rates without substantial evidence that such an additional charge is justified measured against the overall services rendered and the overall reasonableness of the increased line-

Loper Bright Enterprises does not undermine the traditional role of administrative agencies as fact finders in formal agency proceedings.

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haul rate resulting therefrom.' 352 F.Supp. 365, 368. The Commission, although it analyzed the cost of each in-transit inspection, had made no attempt to consider the reasonableness of continuing the existing line-haul rate, which included some charge for in-transit inspections. Instead, the Commission had attempted to distinguish this case from prior cases in which the rule was invoked, but the District Court, relying on *Secretary of Agriculture v. United States*, 347 U.S. 645, 74 S.Ct. 826, 98 L.Ed. 1015 (1954), was 'not convinced that the instant proceeding can be 'distinguished' as the Commission has indicated.' 352 F.Supp., at 369. ¶ Although the Commission must be given some leeway to re-examine and reinterpret its prior holdings, it is not sufficiently clear from its opinion that it has done so in this case. A reviewing court must be able to discern in the Commission's actions the policy it is now pursuing, so that it may complete the task of judicial review—in this regard, to determine whether the Commission's policies are consistent with its mandate from Congress. Since we cannot tell from the Commission's opinions what those policies are, we therefore agree with the District Court that the Commission's order finding the rates just and reasonable cannot be sustained."); *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 249 (1972) ("Our view is that 'the considerations urged here in support of the Commission's order were not those upon which its action was based.' *SEC v. Chenery Corp.*, 318 U.S. 80, 92, 63 S.Ct. 454, 461, 87 L.Ed. 626 (1943). At the least the Commission has failed to 'articulate any rational connection between the facts found and the choice made.' *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168, 83 S.Ct. 239, 246, 9 L.Ed.2d 207 (1962). ¶ The Commission's action being flawed in this respect, we cannot sustain its order. '(T)he orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained.' *Chenery, supra*, 318 U.S., at 94, 63 S.Ct., at 462; *Burlington Truck Lines, supra*, 371 U.S., at 169, 83 S.Ct., at 246. A court cannot label a practice 'unfair' under 15 U.S.C. s 45(a)(1). It can only affirm or vacate an agency's judgment to that effect. 'If an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service for an administrative judgment.' *Chenery, supra*, 318 U.S., at 88, 63 S.Ct., at 459."); *NLRB v. Metropolitan Ins. Co.*, 380 U.S. 438 443 (1965) ("On the other hand, due to the Board's lack of articulated reasons for the decisions in and distinctions among these cases,5 the Board's action here cannot be properly reviewed. When the Board so exercises the discretion given to it by Congress, it must 'disclose the basis of its order' and 'give clear indication that it has exercised the discretion with which Congress has empowered it.' [Footnote omitted.] *Phelps Dodge Corp. v. National Labor Relations Board*, 313 U.S. 177, 197, 61 S.Ct. 845, 854, 85 L.Ed. 1271. *See Burlington Truck Lines v. United States*, 371 U.S. 156, 167—169, 83 S.Ct. 239, 245-246, 9 L.Ed.2d 207; *Interstate Commerce Comm'n v. J—T Transport Co.*, 368 U.S. 81, 93, 82 S.Ct. 204, 211, 7 L.Ed.2d 147. Although Board counsel in his brief and argument before this Court has rationalized the different unit determinations in the variant factual situations of these cases on criteria other than a controlling effect being given to the extent of organization, the integrity of the administration process requires that 'courts may not accept appellate counsel's *post hoc* rationalizations for agency action * * *.' *Burlington Truck Lines v. United States, supra*, 371 U.S. at 168, 83 S.Ct. at 246; see *Securities & Exchange Comm'n v. Chenery Corp.*, 332 U.S. 194, 196, 67 S.Ct. 1575, 1577, 91 L.Ed. 1995. For reviewing courts to substitute counsel's rationale or their discretion for that of the Board is incompatible with the orderly function of the process of judicial review. Such action would not vindicate, but would deprecate the administrative process for it would 'propel the court into the domain which Congress has set aside exclusively for the administrative agency.' *Securities & Exchange Comm'n v. Chenery Corp., supra*, at 196, 67 S.Ct. at 1577.").

Loper Bright Enterprises also does not address an administrative agency's interpretation of its own regulations. *Kisor v. Wilkie*[122] suggests that courts may still defer to administrative agencies in interpreting their own regulations (*Auer* deference).[123] *Loper Bright Enterprises* dealt with ambiguities in statutory directives to agencies. *Loper Bright Enterprises* did not address the issue of agency interpretations of their own regulations.

Those who see *Loper Bright Enterprises* as an administrative law tsunami should consider that *Loper Bright Enterprises* was substantially limited to interpretive rules and regulations. *Loper Bright Enterprises* respected substantial deference to interpretive guidance from administrative agencies pursuant to specific grant of administrative authority.

Loper Bright Enterprises does not automatically reject administrative agency interpretations of a statute. *Loper Bright Enterprises* merely requires that the court exercise its independent judgment in interpreting the statute, untethered to administrative interpretations. This is the classic role of the courts to interpret statutory law. A court applying *Loper Bright Enterprises* will follow administrative interpretations where the court agrees that the administrative interpretation is the best reading of the statute. Language in *Loper Bright Enterprises* also may bring comfort to longstanding administrative interpretations of statutes.

Loper Bright Enterprises does not clarify the future role of *stare decisis* with respect to the vast body of nonlegislative administrative rules and regulations that precede *Loper Bright Enterprises* and that were approved under *Chevron* after deference to administrative agency interpretations. *Loper Bright Enterprises* does not automatically overturn the earlier approval of administrative agency interpretations under *Chevron*. *Loper Bright Enterprises* also does not seem automatically to accept these earlier nonlegislative administrative interpretations that have been previously approved by the courts under *Chevron*. The future should see how *Loper Bright Enterprises* affects these prior nonlegislative rules and regulations and previously were approved by courts under *Chevron* deference. This may create a future battleground for disputes between taxpayers and the Internal Revenue Service. Perhaps any nonlegislative rule and regulation that was approved under *Chevron* deference may be a potential litigation target after *Loper Bright Enterprises*.

That nevertheless does not mean that these nonlegislative rules and regulations necessarily are vulnerable to challenge.[124] These rules and regulations may provide the best interpretation of the statute, and therefore should be approved by a court after *Loper Bright Enterprises*. Courts as a matter of practice may have an unwritten and unstated inclination to follow administrative interpretations, particularly administrative interpretations that have been longstanding, even when not challenged in the courts.

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[122] 588 U.S. 558 (2019).

[123] *Auer v. Robbins*, 519 U.S. 452 (1997).

[124] See note 58.

Also, administrative interpretations by the Internal Revenue Service in nonlegislative rules and regulations often have not been tested in the courts, even when those interpretations have been longstanding. The nonlegislative interpretive rules and regulations often read like legislative regulations, with rules and regulations adopting detailed tests or procedures or methodologies that a court well might have prescribed from its own reading of the statute. In the tax field, there is a massive amount of nonlegislative rules and regulations finalized prior to *Loper Bright Enterprises* that have not been litigated and interpreted in the courts. The status of these prior untested nonlegislative rules and regulations under *Loper Bright Enterprises* is uncertain. These rules and regulations may be vulnerable[125] in future tax litigation.

Loper Bright Enterprises does not represent a broad overthrow of all Internal Revenue Service regulations. *Loper Bright Enterprises* does not overturn every case that relied on *Chevron*. *Loper Bright Enterprises* does not necessarily disrupt the holdings of prior cases, to which the doctrine of *stare decisis* may apply. The future role of *stare decisis* in connection with regulations approved in the past under *Chevron* is unclear. It seems likely that some taxpayers will use *Loper Bright Enterprises* to challenge both new and old regulations.

Many taxpayers may not be adequately funded to challenge regulations under *Loper Bright Enterprises*. The Internal Revenue Service presumably will follow its rules and regulations at the audit level. It will be difficult to convince an Internal Revenue Service examiner at the audit level not to follow an Internal Revenue Service regulation unless that regulation has been expressly overturned by a court. The Internal Revenue Service may defend a regulation in audit unless the regulation has been overturned by a court of appeals in the same circuit. The taxpayer may have a somewhat better change of disputing a regulation at the administrative appellate level, but it may well be very difficult to convince an audit conferee not to apply and to follow a regulation unless that regulation has been expressly overturned by an appellate court in the same circuit.

This means that a taxpayer may not have a realistic chance of challenging a regulation in litigation until the case reaches the Tax Court, the District Court of the Court of Federal Claims. Tax litigations will all make their own judgements, but they may find that the Tax Court is not an especially sanguine forum for challenging Internal Revenue Service regulations.

This may mean that the taxpayer who chooses a Tax Court route may not have good chances of a successful challenge to a regulation before his case reaches the Court of Appeals. Taking a case through examination, appellate, and the Tax Court is expensive and slow. Many taxpayers will be unprepared for both the expense and the delay in reaching a final resolution of their tax liabilities.

District Courts and the Court of Federal Claims may prove more receptive to arguments that regulations are invalid under *Loper Bright Enterprises*. Some taxpayers will prefer to bring their cases before the District Court or Court of Federal Claims to litigation in Tax

[125] See note 77.

Court. Nevertheless, bringing a tax case through audit, appellate and then either the District Court or Court of Federal Claims is expensive and slow. Depending on the circumstances, the Internal Revenue Service may appeal an adverse ruling in District Court of the Court of Federal Claims to the court of appeals. This will add additional taxpayer expense and delay.

Realistically, many taxpayers will not be able to afford the process of challenging even regulations that they feel are invalid under *Loper Bright Enterprises*.

Most tax planners are highly reluctant to plan transactions under the assumption that a regulation will be found to be invalid. Few tax planners deliberately plan into situations that they feel the Internal Revenue Service is likely to challenge in audit, particularly when it is may be unlikely that the Internal Revenue Service will concede its position at the administrative level.

The cost of challenging Internal Revenue Service regulations, requiring funding of litigation that may go to the Court of Appeal is substantial. Challenging Internal Revenue Service regulations is a long, strenuous, and expansive path. Few taxpayers will have the appetite for the difficulty and expense of challenging Internal Revenue Service regulations in court.

By contrast, the Internal Revenue Service may be strongly inclined to protect and to defend its regulations and rulings and willing to devote substantial litigation resources to defending those regulations and rulings. This may also distract the Internal Revenue Service from the possibility that Treasury and the Internal Revenue Service should be approaching Congress to amend the Code where defects that lead to abuses are detected.

Courts may still defer to the expertise of the Internal Revenue Service and also may be inclined to follow longstanding interpretive regulations.

We will still have to see what the long-term effect of *Loper Bright Enterprises* will be, particularly in the partnership tax area.

§1.7 Tax Planning After Loper Bright Enterprises.

The tax planner may react differently from the tax litigator. *Loper Bright Enterprises* may have little impact on the tax planner until a regulation or other administrative authority has been invalidated by a court, perhaps even an appellate court or perhaps even an appellate court in the circuit in which the taxpayer lives. Few tax planners will want to take a planning position contrary to either a legislative regulation or an interpretative regulation. Contesting a regulation is an invitation to a tax deficiency, penalties, and interest. That is not good for tax planners, even when they believe that the case against a regulation is a strong case. The planner usually must assume for planning purposes that all regulations are valid, until invalidated by a court.

The cost of contesting a regulation is a high bar. The tax planner usually is unwilling to plan into a situation in which his client will be forced to contest a regulation or other Internal Revenue Service authorities in litigation.

A contest over the validity of a regulations is difficult or impossible for a taxpayer to win in an Internal Revenue Service examination. A regulation contest will be difficult or impossible for the taxpayer to win at the appellate level. An Internal Revenue Service examiner will be forced to defend an Internal Revenue Service regulation unless the regulation has been declared invalid by a court. The same is likely true of the appellate conferee. The Internal Revenue Service is likely to defend a regulation in other circuits even if the regulation has been found invalid in one circuit. Tax litigation is not fun for most taxpayers. Taxpayers will be unlikely to desire to risk deficiencies, interest, and possible penalties if they plan transactions based on the supposed invalidity of a regulation or other Internal Revenue Service authority.

A taxpayer who has lost at the appellate level of the Internal Revenue Service has a difficult decision. The Tax Court may be an inhospitable forum in which to contest an Internal Revenue Service final regulation, especially a legislative regulation. A litigator may be more comfortable with the United States District Court or the Court of Federal Claims as a forum in which to contest an Internal Revenue Service regulation.

Several considerations may inhibit the taxpayer from bringing a case in court to contest a regulation. Tax litigation is extremely expensive. To file a case in the United States District Court or the Court of Federal Claims requires the taxpayer to pay the assessed tax deficiency and to sue for a refund. This can amount to a considerable expense, particularly since the course of tax litigation often is slow. Assessment of the question of where to litigate a case can be sensitive to where the taxpayer lives. Some districts can be more taxpayer friendly than other districts.

Further, the Internal Revenue Service may be inclined to defend a regulation that has been found invalid in a trial court in an appeal to the Court of Appeals. This subjects the taxpayer to the appreciable cost of legal fees for appellate counsel. This also will subject the taxpayer to the risk of further interest expense. Also, whether the taxpayer wins or loses in the Court of Appeals, the taxpayer is exposed to the inconvenience and possible embarrassment of being in protracted litigation.

The tax litigator may face some similar concerns. The expense and inconvenience of protracted tax litigation is considerable. Many taxpayers will be unwilling to underwrite the expense of a protracted litigation. Litigation over a final regulation usually will be expensive. Tax litigation seeking to invalidate a final regulation is a matter for a select client or group of clients who have an adequate amount at stake to make the expense of protracted litigation worthwhile and the ability to fund protracted litigation.

Section 702 of the Administrative Procedure Act provides: "A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within

the meaning of a relevant statute, is entitled to judicial review thereof." Some taxpayers may wish to seek injunctions against the enforcement of a tax regulation or declaratory judgments concerning the correct interpretation of a tax regulation. The action must survive the Anti-Injunction Act.[126] The Anti-Injunction Act provides generally that "A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." Courts generally interpret the Anti-Injunction Act as not permitting declaratory judgments or other pre-enforcement review of regulations and other sub-regulatory guidance.

§1.8 Situations to Consider.

This summarizes some areas in which the interpretation of partnership tax code provisions may be subject to controversy. This is merely a quick overview and does not consider possible defects in the adoption of legislative regulations under the Administrative Procedure Act (such as failure to respond to comments in the notice and comment process).

[1] Tribune Media Company (2021).

Tribune Media Company v. Commissioner[127] involved a complex, highly tax-structured transaction designed to minimize taxable gain on the sale of the Chicago Cubs. The disposition was handled through contributions to a partnership and distributions of cash to one partner that were designed to be nontaxable. The transaction was carefully structured by highly experienced tax advisors based on a careful reading of Section 752 regulations and disguised sale regulations. *Tribune Media Company* also is especially fact rich.

Some will compare *Tribune Media Company* to playing a card game with some young children. The rules keep changing as the game progresses. In *Tribune Media Company,* the Internal Revenue Service seemed uncomfortable with rules published by Treasury and the Internal Revenue Service for liability sharing among partners and for disguised sales.

Tribune Media Company is an unusual case in which the language and rules of Treasury Regulations seemed to bring more comfort to the taxpayers than this language and these rules were to the Internal Revenue Service. The *Tribune Media Company* apparently was structured by highly experienced tax professionals who had a deep knowledge of Subchapter K and its regulations. The advisors clearly read the applicable regulations carefully.

The Internal Revenue Service apparently felt that the transaction was abusive, but had some difficulty making its case on the basis of substantive Treasury Regulations. Some

[126] 28 U.S.C. § 2283.

[127] T.C. Memo. 2021-122

advisors have observed that the disguised sale Treasury Regulations concerning leveraged distributions to contributing partners invite abuse or arguable abuse. The Internal Revenue Service may have been uncomfortable with some of the language of its Treasury Regulations under Section 752.

Not finding its litigating position well supported by the literal application of substantive regulations for allocating partnership liabilities and for disguised sales, the Internal Revenue Service turned to judicial doctrines and antiabuse regulations. As a result, in *Tribune Media Company*, the Internal Revenue Service was particularly reliant on antiabuse regulations, particularly the general antiabuse regulation in Treasury Regulations Section 1.701-2 and the more limited anti-abuse regulation for sharing partnership liabilities.

In *Tribune Media Company,* the Internal Revenue Service sought to apply the general partnership antiabuse rule in Treasury Regulations Section 1.704-2 to disregard a senior debt guaranty on account of the barriers to enforcement of the senior guaranty and the unlikelihood that the guaranty ever would be called. As the senior guaranty was structured, the guaranty was unlikely to be called. The senior guaranty, if valid, would allocate partnership debt to the taxpayer and avoid gain under partnership disguised sale rules.

The Tax Court held that the senior guaranty should be respected for tax purposes and did reallocate substantial amounts of partnership debt to the taxpayer. This reduced the taxpayer's disguised sale gain on the transaction substantially. The Tax Court characterized other debt as partnership equity.

Tribune Media Company may prove to be a critical case in the Internal Revenue Service's defense of the general partnership antiabuse regulation in Section 1.702-2. That regulation, an interpretive regulation published under the authority of Section 7805(a) should not be invested with a presumption of correctness on account of *Loper Bright Enterprises*.

The Tax Court in *Tribune Media Company* determined that –

- Tribune Media Company's 2009 disposition of the Chicago Cubs was a disguised sale to the newly formed partnership Chicago Baseball Holdings, LLC.
- The advance characterized as subordinated debt was equity for tax purposes, and the portion of the distribution attributable to the subordinated debt cannot offset Tribune's recognized gains from the disguised sale.
- The senior debt guaranty was *bona fide*,
- The portion of the distribution attributable to the senior debt guaranty is a nontaxable debt-financed distribution.

Tribune Media Company is now on appeal to the Seventh Circuit Court of Appeals.

In 1847, Tribune Media Company began publishing the Chicago Tribune Media Company newspaper.

Tribune Media Company went public in 1983.

In 1981, Tribune Media Company acquired the Chicago Cubs, a major league baseball team, the Wrigley Field stadium, and other Cubs-related assets (the "Chicago Cubs Assets") for $20.5 million.

At the time, Tribune Media Company was a publicly traded C corporation.

In 2007, investor Mr. Samuel Zell led a leveraged buyout of Tribune Media Company stock. Mr. Zell structured the new company as an S corporation wholly-owned by an ESOP.

On the effective date of the S election, January 1, 2008, Tribune Media Company converted from a C to an S corporation with an unrealized built-in gain of $612 million attributable to the Chicago Cubs Assets. Disposing of any of its built-in gain assets, including the Chicago Cubs Assets within a ten year period beginning January 1, 2008, would subject Tribune Media Company to an entity level tax under Section 1374(a) on any net realized built-in gain.

In connection with the leveraged buy-out, Tribune Media Company took on $8.4 billion in new debt, increasing its total outstanding liabilities to $14.4 billion.

Mr. Zell had planned on selling the Chicago Cubs Assets even before the leveraged restructuring of Tribune Media Company was completed in December 2007.

The Cubs transaction arose from Tribune Media Company's desire to dispose of the Cubs assets, to focus on its core businesses, and to obtain cash to pay off other debts. The Cubs assets had significantly appreciated. An outright sale would have generated considerable gain recognition. To maximize its after-tax proceeds, Tribune Media Company sought to structure the disposition of the Cubs assets in a tax-favored way.

Tribune Media Company structured the disposition of the Cubs assets to fit into an exception to the partnership disguised sale rule that would allow for nonrecognition of gain from the special distribution of borrowed funds.

Tribune Media Company contributed the Cubs assets to a newly formed partnership, Chicago Baseball Holdings, LLC, in exchange for a 5% interest.

Chicago Baseball Holdings, LLC borrowed money.

Tribune Media Company guaranteed collection of the debt.

Then, Chicago Baseball Holdings, LLC made the special distribution to Tribune Media Company as part of the transaction.

Tribune Media Company reported the transaction on its 2009 return as a disguised sale. Tribune Media Company intended to limit its recognized gain to the proceeds that exceeded the debt-financed distribution.

The Internal Revenue Service argued that the subordinated debt and the guaranties were not *bona fide*.

To sell the Chicago Cubs Assets, Tribune Media Company engaged JP Morgan to facilitate the bidding process. In advance of the bidding, Tribune Media Company's advisors prepared a descriptive memorandum outlining Tribune Media Company's preferred transaction; the key aspects of the structure included –

- a debt-financed purchase of the Chicago Cubs Assets by a partnership,
- guarantee of the debt by Tribune Media Company,
- a special cash distribution to Tribune Media Company equal to 95% of the value of the Chicago Cubs Assets, and
- an agreement by the parties not to sell the Chicago Cubs Assets prior to January 1, 2018.

Tribune Media Company accepted the offer tendered by the Ricketts family, which included a retained interest in the partnership and lower value for the assets, but had higher projected after-tax proceeds.

During the bidding process, Tribune Media Company, on December 8, 2008, filed a petition for Chapter 11 bankruptcy relief and reported $14.4 billion in debt.

Just over a month later, in January 2008, Tribune Media Company announced its plans to sell the Chicago Cubs Assets to the Ricketts family. The deal closed in October 2009.

The Ricketts family structured their winning bid in accordance with the descriptive memorandum. The transaction allowed Tribune Media Company to dispose of 95 percent of its interest in the Chicago Cubs Assets in exchange for $713.5 million in cash.

If allowed, Tribune Media Company achieved the economic equivalent of a tax-free sale of the Chicago Cubs Assets through a debt financed distribution to Tribune Media Company equivalent to the fair market value of Tribune Media Company's 95 percent interest in the Chicago Cubs Assets.

- The Ricketts family, through affiliated entities, contributed $150 million in cash to Chicago Baseball Holdings LLC for a 95 percent interest and beneficial use and control of the Chicago Cubs Assets.
- Chicago Baseball Holdings LLC took on $674 million in senior and purported subordinated debt.

- Tribune Media Company collected $713.5 million in cash and attempted to avoid payment of $181 million in built-in gain tax under Section 1374.
- Tribune Media Company contributed the assets and liabilities of its Chicago Cubs business, with a fair market value of approximately $845 million, to newly formed Chicago Baseball Holdings LLC, which is treated as a partnership for tax purposes.
- The Ricketts family provided the funds:
    - Ricketts Acquisition LLC ("Ricketts Acquisition LLC") contributed $150 million in cash to Chicago Baseball Holdings LLC,
    - Chicago Baseball Holdings LLC obtained the senior debt financing ("Senior Debt"),
    - arranged subordinated debt through a Ricketts affiliate ("Subordinated Debt"),
    - as was a $35 million revolving operational support fund (the "Operational Support Fund").
- Tribune Media Company then received a $713.5 million special distribution.
- To obtain the necessary cash to achieve Tribune Media Company's transaction goal of receiving a debt-financed cash distribution,
    - Chicago Baseball Holdings LLC borrowed the Senior Debt of $425 million
    - with a $25 million revolving credit facility

  from a consortium of banks led by JPMorgan Chase Bank (the "Senior Lenders").
- To ensure sufficient funds to service the Senior Debt, Chicago Baseball Holdings LLC agreed to establish a cash collateral account into which Chicago Baseball Holdings LLC agreed to deposit all amounts received at any time (less certain excluded revenues such as loans received under the Operational Support Fund).
- Payments from the cash collateral account
    - were paid first to service the Senior Debt,

    - with any excess distributed in accordance with a waterfall provision in the Cash Collateral Agreement.[128]
- Payment on the Subordinated Debt was fourth (and last) in priority under this waterfall provision.
- Chicago Baseball Holdings LLC borrowed the Subordinated Debt of $248.8 million from Marlene Ricketts through her indirect interest in RAC Education Trust Finance LLC, an entity owned by MMR Investors, LLC.
- Marlene Ricketts, the matriarch of the Ricketts family and mother of Thomas Ricketts, was the sole member of MMR Investors, LLC.
- The sole manager of RAC Education Trust Finance LLC was Ricketts Acquisition LLC.
- Under the terms of the Subordinated Promissory Note,
    - Chicago Baseball Holdings LLC must pay the accrued interest on the Subordinated Debt at the end of each year,

      but only if

      - Chicago Baseball Holdings LLC determines that there is cash available under the payment waterfall and
      - the payment is allowable under the Cash Collateral Agreement and a Subordination Agreement.
- Accrued but unpaid interest is added to the principal balance of the Subordinated Debt as paid in kind interest.
- Chicago Baseball Holdings LLC may not prepay any amount of principal on the Subordinated Debt for the first five years

[128] As part of the Cubs transaction, J.P. Morgan, as collateral agent, and Chicago Baseball Holdings, LLC entered into a cash collateral agreement. This agreement governed the flow of cash entering into Chicago Baseball Holdings, LLC to create the cash waterfall. In Chicago Baseball Holdings, LLC's cash waterfall, revenues related to certain Cubs assets, such as gate receipts, local media revenue, and MLB Central Fund distributions, would be deposited into the cash waterfall revenue account. Under the cash collateral agreement, after revenues in excess of roughly $50 million are transferred to a separate account to pay the Cubs' operating expenses, the remaining funds are to be applied to the cash waterfall in the following order: First and second to accounts to service the senior debt; third to accounts to pay fees and other obligations; and fourth to the distribution account. Funds in the distribution account are then applied in the following order: First for specified capital contributions; second to pay principal and interest on operating support agreement loans; third to discretionary capital expenditures; and fourth (and last) to pay the subordinated debt. The subordinated debt is paid only if revenue remains after every previous obligation is met through the cash waterfall.

unless

- the sum of –
    - the outstanding principal on the Senior Debt and
    - the Subordinated Debt (including any interest that has been added to principal)

exceeds

- $700 million.

- It was contemplated that Chicago Baseball Holdings LLC would issue Subordinated Promissory Notes to outside investors
    - in addition to or as a substitute for
        - a portion of the $248.8 million funded by Marlene Ricketts and
- A Confidential Private Placement Memorandum was drafted for this purpose.
- Under the terms of the Subscription Agreement, which was required to be executed by any potential note holder,
    - the form of any Subordinated Promissory Note would be exactly the same as that agreed to by the subordinated lender.
- Thus, any outside note holders would be subject to the same limitations on receipt of payments, paid in kind interest, and loan acceleration.
- Subordinated promissory notes were never issued to outside investors and Marlene Ricketts remained the sole subordinated lender.
- Operating Support Agreement
    - In transactions involving the transfer of a controlling interest in one of its clubs, Major League Baseball must certify that
        - the level of debt undertaken in connection with the transfer

          will not create

        - a persistent inability of the club to comply with Major League Baseball's debt service rule.
    - The Major League Baseball debt service rule restricts
        - the amount of debt a team can carry

          based on

- how much debt can reasonably be supported by the team's earnings.

- In a letter dated October 7, 2009 to Mr. Ricketts, Major League Baseball expressed concern about the level of debt to be taken on by the new partnership.
- The Operating Support Agreement was established as a separate evergreen reserve fund in connection with the Major League Baseball approval.
- In a letter dated October 27, 2009, Mr. Ricketts, on behalf of the Ricketts entities, agreed

  to form

  - an Operating Support Agreement Entity

    to provide

    - Chicago Baseball Holdings LLC an available funding source of

      no less than

      - $35 million for operational support.
- The agreement anticipated
  - the Operating Support Agreement Entity would fund Chicago Baseball Holdings LLC

    through

    - unsecured, subordinated loans, if needed,
      - to meet ongoing operational expenses and
      - to satisfy Major League Baseball's debt service rule.
- Should the total net worth of the Operating Support Agreement entity fall below $35 million,
  - the agreement obligates the Ricketts family to make an additional capital contribution or escrow deposit equal to the short-fall.
- The Operating Support Agreement does not cap the total amount the Ricketts family may be required to contribute.
- The Senior Lenders relied on the Operating Support Agreement.

- The fifth whereas clause of the Operating Support Agreement provides, in part, that the Senior Lenders' obligation to make loans is conditioned upon the execution and delivery of the Operating Support Agreement.
- The Credit Agreement makes it a specific event of default

  if

  - the Operating Support Agreement Entity shall fail to make any payment due to the Borrower, Chicago Baseball Holdings LLC under the Operating Support Agreement Commitment [Subordinated Loan Commitment Agreement] as and when due, or
  - any other default shall occur under
    - the Operating Support Agreement Commitment or
    - the Operating Support Agreement, or
  - the failure of the Operating Support Agreement Entity to fund an Operating Support Agreement loan as required under the Operating Support Agreement.
- Several documents state that the Operating Support Agreement Entity's obligations are not intended to be, directly or indirectly, a guarantee of the Senior Debt
- The parties, including Major League Baseball, intended the Operating Support Agreement Entity to help ensure that –
  - Chicago Baseball Holdings LLC operations maintain liquidity and
  - the Cubs organization remains properly funded.

- Tribune Media Company's Guarantees of Collection
  - Tribune Media Company needed to sell the Chicago Cubs Assets to pay its bankruptcy creditors.
  - Tribune Media Company was still a debtor-in possession at the time the transaction closed.
  - To maximize the cash from the sale and obtain a tax-free debt-financed distribution,

- Tribune Media Company required that Tribune Media Company Media Company provide guarantees for the debt incurred by Chicago Baseball Holdings LLC;
    - guarantees that neither the Ricketts family nor the Senior Lenders required.
- Tribune Media Company contended that,
    - by providing the guarantees,
        - Tribune Media Company received basis under Section 752 and,
        - thus, the special distribution of $713.5 million is tax-free under the debt-financed distribution exception to the disguised sale rules under Treasury Regulations Section 1.707-5 as "borrowing through the partnership."
- Both guarantees cap Tribune Media Company's potential liability to the original principal amount plus any unpaid interest and premium.
- The guarantees explicitly state that
    - these are collection guarantees and not guarantees of payment, and
    - the lenders must first exhaust all their remedies against Chicago Baseball Holdings LLC, the collateral and other guarantors before collecting on the guarantees.
- In a Tribune Media Company memorandum, dated October 27, 2009,
    - Nick Chakiris, Tribune Media Company's Assistant Controller, explains that
        - in order to trigger the Tribune Media Company guarantees,
            - the "lines of credit supplied by the $25 million revolver and the $35 million Operating Support Agreement would need to be exhausted and the [Ricketts family] would need to refuse to contribute additional funds."
            - the $25 million revolver and the $35 million Operating Support Agreement ensure that the repayment of the Senior Debt Financing facilities

and the Subordinated Debt Financing facilities are not solely dependent on successful operations of the Cubs Business.

- Although the Company [Tribune Media Company] is the guarantor on the debt, the guaranties
  - are insignificant to the overall transaction and
  - are not a continued necessity for the successful operations of Chicago Baseball Holdings LLC.

- In rating the risk of the transaction Fitch, Standard & Poor's and JPMorgan did not decrease the risk of the transaction as a result of Tribune Media Company's collection guarantees.
  - Any mention of the guarantees was brief and not included in the overall analysis of the transaction.
  - The three rating statements did, however, address the importance of the Operating Support Agreement.
  - Mr. Chakiris concluded that Tribune Media Company would not record a liability related to its collection guarantees for accounting purposes.
    - Tribune Media Company has no credit rating as it is currently operating as a debtor in possession under the Chapter 11 proceedings.
    - Without an approved plan of reorganization in place when the guaranties were signed, the lending parties had no insight into the Tribune Media Company's future financial position.
    - Ricketts family has net worth of $1 billion as listed in a 2008 Forbes Magazine report.
    - Ricketts has ample resources absent the Tribune Media Company's guaranty.
    - It is unlikely that the amount or the terms of the Senior Debt Financing facility were enhanced as a result of the guaranty.
    - Tribune Media Company's sensitivity analysis determined that "there is no value to the contingent liability associated

with the guaranties as the likelihood of performance is remote."

- Tribune Media Company did not record the guarantees as liabilities and determined it was instead required to make off-balance sheet disclosures related to these guarantees because "it is not currently likely that the guaranties will have a material impact on the Company's operations, cash flows or liquidity."

- Prior to its bankruptcy filing,
  - Tribune Media Company entered into a financing arrangement with Barclays Capital

    in which

  - Tribune Media Company granted Barclays a security interest in Tribune Media Company's accounts receivables.
  - When Tribune Media Company filed for bankruptcy,
    - this borrowing was converted into an interim debtor-in-possession financing.
  - A side letter was signed at closing of the interim Debtor in Possession debt that allowed "tax advantaged debt" defined as Permitted Disposition Transaction debt to be incurred by Tribune Media Company,

    but only if –

    - the interim Debtor in Possession debt was repaid in full.
  - This debt was defined as Permitted Disposition Transaction debt.
  - Tribune Media Company sought to amend the side letter to allow for
    - the Permitted Disposition Transaction debt to be incurred

      without

    - accelerating the interim Debtor in Possession debt facility.
  - The negotiations with respect to the Permitted Disposition Transaction debt in connection with the proposed Cubs transaction indicate that the risk of the guarantees being called upon was remote.

- Tribune Media Company's Book Treatment
    - In a memorandum, Nicholas Chakiris, Former Assistant Controller, Tribune Media Company, stated "the purpose of this [transaction] was to transfer operational control of the Cubs Businesses to [Chicago Baseball Holdings LLC] thereby monetizing the assets for [Tribune Media Company]."
        - For book purposes, Tribune Media Company reported the transaction as a sale.
        - An independent auditor's report from Deloitte, also considers the transaction a sale.
        - Deloitte states "[i]n exchange for its sale of the Chicago Cubs baseball team and related assets, Tribune Media Company and Tribune Media Company affiliated companies received cash consideration and a 5% equity interest in [Chicago Baseball Holdings LLC]."
        - On Tribune Media Company's balance sheet, the Chicago Cubs Assets are "held for disposition."
        - After the transaction, Tribune Media Company's "residual 5% equity stake in [Chicago Baseball Holdings LLC] is so minor that [Tribune Media Company] has virtually no influence over [Chicago Baseball Holdings LLC's] operating and financial policies."

Citing the anti-abuse rules under Section 701 and the substance-over-form doctrine, the Internal Revenue Service determined that:

- Tribune Media Company's guaranties were not valid and
- the disguised sale of the Cubs was taxable. [129]

The Internal Revenue Service, on audit,

- reduced Tribune Media Company's reported capital contribution from $715,503,405 to $20 million.
- reduced Tribune Media Company's reported allocable share of recourse liabilities from $673,750,000 to zero.

[129] The Internal Revenue Service calculated that Tribune Media Company realized $739,509,665 of built-in gain on the sale of the Cubs, $705,679,530 more than Tribune Media Company reported on its return.

- increased Tribune Media Company's share of nonrecourse liabilities from $6,143,915 to $27,393,915.
- imposed a 40% gross valuation misstatement penalty of $72,664,732[130] and a 20% accuracy-related penalty.[131]

When a C corporation converts to an S corporation, a corporate-level tax applies to any net recognized built-in gain during the recognition period. The recognition period generally extends for 10 years from the date of conversion. This corporate-level tax applies to transactions treated as completed sales for Federal income tax purposes. The Cubs transaction occurred within 10 years of when Tribune Media Company converted from a C corporation to an S corporation in 2007. When Tribune Media Company completed the Cubs transaction in 2009, it could be taxed on built-in gain at the corporate level. What is in dispute is the extent to which Tribune Media Company had net recognized built-in gain. The answer to this question turns on the disguised sale rules.

Petitioners argued that –

- the Cubs transaction is a disguised sale
    - but that the distribution to Tribune Media Company is not taxable

      because

[130] Under I.R.C. § 6662(h).

[131] Under I.R.C. § 6662(a), (b)(1), (2), and (3), (c), (d). At trial, both sides presented several expert witnesses. Among petitioners' experts was Ron Kahn, managing director at Lincoln International, LLC, and head of its debt advisory group. Mr. Kahn prepared a rebuttal report to findings of Howard Gellis, an expert hired by the Internal Revenue Service. Mr. Kahn testified that the subordinated debt's terms were commercially reasonable and that the guaranties served a valid business purpose and had value. Likewise, William Chambers, an associate professor of finance at Boston University's Metropolitan College, testified that the terms of the subordinated debt were reasonable. Professor Shaked also testified on petitioners' behalf. Professor Shaked is a professor of finance and economics at Boston University's Questrom School of Business and the managing director of the Michel-Shaked Group, a firm that provides corporate finance and business consulting to private and public entities. In his report, Professor Shaked analyzed Chicago Baseball Holdings, LLC's financial position and concluded that the company was creditworthy and adequately capitalized. Merle Erickson also testified for petitioners. An accounting professor at the University of Chicago Booth School of Business, Professor Erickson provided testimony on the differences between GAAP accounting and tax accounting, specifically regarding Tribune Media Company's financial reporting of the guaranties.

The Internal Revenue Service also relied on several experts in presenting his case. Among those experts was Mr. Gellis, former senior managing director of the Blackstone Group. Mr. Gellis analyzed the commercial reasonableness of the subordinated debt and the guaranties, concluding that neither the guaranties nor the subordinated debt was commercially reasonable. Dr. Skinner, an accounting professor and faculty dean at the University of Chicago Booth School of Business, also opined on the guaranties and whether they created a material risk for Tribune Media Company.

- the transaction was a debt-financed distribution.

- the Internal Revenue Service erred when it invalidated the guaranties, recharacterized the liabilities, and designated the subordinated debt as equity.

The Internal Revenue Service agreed that the Cubs transaction was structured as a disguised sale, but it argued that the distribution to Tribune Media Company is taxable.

The Internal Revenue Service claims that –

- the guaranties promise repayment in name only,
- the senior debt is nonrecourse, and
- the subordinated debt is not *bona fide* debt.

The Internal Revenue Service argued in the alternative that various doctrines should be applied to recast the Cubs transaction as an outright sale.

[a] Whether the Subordinated Debt is Equity for Federal Income Tax Purposes.

Chicago Baseball Holdings LLC issued $248.8 million of Subordinated Promissory Notes to RAC Finance, an entity owned by MMR Investors, LLC, which is in turn wholly owned by Marlene Ricketts.

Marlene Ricketts funded the $248.8 million of purported Subordinated Debt of Chicago Baseball Holdings LLC. This loan was financed through her disregarded entities.

According to the Tax Court, any reasonable analysis of the debt-equity factors must conclude that the Subordinated Debt is equity for federal income tax purposes. Consequently, the Subordinated Debt cannot be allocated under Treasury Regulations Section 1.752-2. The Tax Court undertook a classic debt-equity analysis that did not depend on any special presumption in favor of the government's characterization of the debt. This analysis should not be affected by *Loper Bright Enterprises*.

Tribune Media Company is not entitled to claim basis with respect to the Subordinated Debt in the amount of $248.8 million.

The debt versus equity inquiry generally focuses on –

- whether there was intent to create a debt with a reasonable expectation of repayment and,
- if so, whether the intent comports with the economic reality of creating a debtor-creditor relationship.[132]

[132] *Fin Hay Realty Co. v. United States*, 398 F.2d 694, 697 (3d Cir. 1968); *Litton Bus. Sys., Inc. v. Commissioner*, 61 T.C. 367, 377 (1973).

The key is discerning the taxpayer's actual intent. This actual intent is evidenced by the particular circumstances of the transfer.[133] A list of 13 factors is used for consideration in the debt versus equity analysis.[134]

Factors include –

- the names given to the certificates evidencing purported indebtedness;
- the presence or absence of a fixed maturity date;
- the present or absence of a fixed or determinable rate of interest or dividends to be paid to the holder;
- the source of payments;
- the right to enforce payment of principal and interest;
- participation in management flowing from the instrument;
- the status of the contribution in relation to regular corporate creditors; (viii) the intent of the parties;
- the adequacy of the capital structure of the issuer;
- the identity of the interest between creditors and shareholders;
- the ability of the corporation to obtain loans from outside lending institutions; and
- the extent to which the advance was used to acquire capital assets.[135]

An analysis of the transaction as a whole and of the factors independently clearly demonstrates that the Subordinated Debt is equity, albeit equity carefully structured to resemble debt.

In the present case all the formal indicia of an obligation were meticulously made to appear. The corporation, however, was the complete creature of the two shareholders who had the power to create whatever appearance would be of tax benefit to them despite the economic reality of the transaction.[136] The transaction structure was dictated in advance by Tribune Media Company. The transaction structure required that a newly created partnership have a sufficient amount of debt to enable the special distribution to flow to Tribune Media Company tax free. The transaction structure and the level of debt were dictated by Tribune

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[133] *A.R. Lantz Co. v. U.S.*, 424 F.2d 1330, 1333 (9th Cir. 1970); *U.S. v. Uneco, Inc.*, 532 F.2d 1209.

[134] *Dixie Dairies Corp. v. Commissioner*, 74 T.C. 476, 493 (1980); *see also* Notice 94-47, 1994-1 C.B. 357. The same debt-equity factors that apply in the corporate context are equally applicable to partners and partnerships. *Hambeuchen v. Commissioner*, 43 T.C. 90 (1964).

[135] *Dixie Dairies*, 74 T.C. at 493.

[136] *Fin Hay Realty v. United States*, 398 F.2d 694, 697 (3rd Cir 1968).

Media Company.[137] In addition, the Ricketts family preferred not to use subordinated debt instead of equity. Subordinated debt was chosen as a source of capital in favor of equity, in large part to meet the tax strategies of the seller.

In form, the Subordinated Debt reflects the classic features of debt: an apparently enforceable right to a sum certain on maturity, including fixed interest, regardless of the income of Chicago Baseball Holdings LLC. This does not reflect the economic reality of the arrangement.[138]

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[137] The Major League Baseball Commissioner stated in an October 7, 2008 letter that the structure of the transaction and the level of debt in particular were driven by Tribune Media Company.

[138] The interest rate on the Subordinated Debt is 6.5%. This is lower than the 6.79% 7.17% interest rate range on the three private placement notes constituting $250 million of the Senior Debt, which is secured by Chicago Baseball Holdings LLC's assets. Annual accrued interest on the Subordinated Debt may not be paid unless Chicago Baseball Holdings LLC determined that there was cash available under the payment waterfalls. Chicago Baseball Holdings LLC cannot make this determination if it owes Tribune Media Company any money under the Tax Matters Agreement. If the lender receives a cash interest payment despite Chicago Baseball Holdings LLC having an obligation to Tribune Media Company under the Tax Matters Agreement, the lender must hold the cash in trust for Tribune Media Company and pay it over upon written request. Accrued interest that is not paid each year is added to the principal balance of the loan as paid in kind interest, which is not due until 2024. Interest is added to principal on the annual payment date. The Subordinated Debt is not due for 15 years. All interest is deferred for the life of the purported debt. The Subordinated Debt permits Marlene Ricketts the right to receive a tax distribution for the accrued and unpaid interest. The right to a tax distribution is a hallmark of equity. The right to a tax distribution is never available on a debt instrument. Thomas Ricketts, the member of the Ricketts family that controls RA LLC, the 95% owner of Chicago Baseball Holdings LLC, made the election to defer payment of interest on the Subordinated Debt until maturity and to only take a tax distribution. The individual controlling 95% of the borrowing is making decisions on behalf of the lender. The "events of default" under the Subordinated Debt are very weak. A default cannot occur as a result of nonpayment of principal or interest when due until the maturity date in 15 years. The other two events of default are tied to conditions of the Senior Debt. The subordinated loan documentation was wholly inadequate to protect the interests of any lender. Any potential investor in the Subordinated Debt was obligated to accept the exact same terms as the Ricketts family without negotiation. The Subordinated Debt is held by Marlene Ricketts, the matriarch of the Ricketts family. The Ricketts family controls RA LLC, which as the majority owner of Chicago Baseball Holdings LLC possesses nearly exclusive management rights in Chicago Baseball Holdings LLC. RA LLC is the sole manager of RAC Finance, the lender of the Subordinated Debt. Those rights should be treated as held by Ms. Ricketts based upon her relationship as holder of the Subordinated Debt and RA LLC. It is highly unlikely that Ms. Ricketts would sue her son to enforce payment of the Subordinated Debt. The identity of interest between Ms. Ricketts and RA LLC supports treatment of the Subordinated Debt as equity for tax purposes. Many of the special benefits provided to Ms. Ricketts under the agreement — premium seating, clubhouse access, annual road trips — are of the type provided to owners and non-owners alike (such as retired athletes and contest winners). There is no support for treating such special benefits as equivalent to the rights of a creditor.

Major League Baseball did not consider the Subordinated Debt to be true debt under its Debt Service Rule. Major League Baseball does not consider related party debt to be true debt of a team unless the debt is secured by team assets.

The Ricketts family considered selling a portion of the Subordinated Debt in a private placement. However, the Subordinated Debt was never sold in the debt market. No one appeared to be interested. The inability of the Ricketts to sell the Subordinated Debt is definitive, objective proof that the terms of the Subordinated Debt were far more speculative than any outside investor was willing to accept. The Subordinated Debt is Ricketts' equity and cannot result in a share of liabilities under Section 752.

[b] Whether The Special Distribution Received By Tribune Media Company Should Be Treated As Consideration For A Disguised Sale Under Treasury Regulations Section 1.707-5(B)(1).

Tribune Media Company realized built-in gains of approximately $739 million on the disguised sale of the Chicago Cubs Assets in 2009. The Internal Revenue Code provides generally for the tax-free contribution of capital to partnerships [139] as well as the tax-free return of money to a partner not exceeding a partner's adjusted basis in the partnership [140] Congress recognized that taxpayers could devise "disguised sale" schemes to avoid reporting taxable gains on sales and dispositions of property by disguising transactions as combinations of otherwise non-taxable contributions and distributions through partnership structures. [141]

Tribune Media Company sought a tax-free return on the sale of Chicago Cubs Assets, Tribune Media Company exchanged

- the Chicago Cubs Assets and liabilities

for

- a special distribution of cash through Chicago Baseball Holdings LLC, according to the Tax Court analysis.

The transfer may be treated as a sale under disguised sale rules –

if

- a partner transfers property to a partnership and
- receives a related transfer of money. [142]

[139] I.R.C. § 721.
[140] I.R.C. § 731.
[141] See I.R.C. § 707(a)(2)(B).
[142] Under I.R.C. § 707(a)(2)(B). Treas. Reg. § 1.707-3(a)(1).

The transfers constitute a sale under disguised sale rules –

only if

- based on all the facts and circumstances,
  - the transfer of money would not have been made

    but for
    - the transfer of property; and
  - in cases in which the transfers are not made simultaneously,
    - the subsequent transfer is not

      dependent on
    - the entrepreneurial risks of partnership operations.[143]

Transfers that occur within a two-year period –

are presumed to be

- a sale of the property to the partnership

  unless
- the facts and circumstances

  clearly establish that
- the transfers do not constitute a sale.[144]

Section 752 regulations provide a "debt-financed distribution" exception if –

- a partner transfers property to a partnership, and
- the partnership incurs a liability and
- all or a portion of the proceeds of that liability are allocable to –
  - a transfer of money to the partner

    made within
  - 90 days of incurring the liability.[145]

The transfer of money is taken into account in the disguised sale transaction –

only to the extent that

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[143] Treas. Reg. § 1.707-3(b)(1).
[144] Treas. Reg. § 1.707-3(c)(1).

[145] Treas. Reg. § 1.707-5(b)(1).

- the amount of money transferred

  exceeds

- that partner's allocable share of the partnership liability.

For the debt-financed distribution exception to apply,

- Tribune Media Company's guarantees must be respected and treated as an obligation

  such that

- Tribune Media Company is allocated
  - the Senior Debt and,
  - to the extent respected as *bona fide* debt,
    - the Subordinated Debt under Section 752.

Section 752 and the regulations thereunder apply in determining a partner's share of a partnership liability for purposes of the debt-financed distribution exception.[146]

A partner's share of recourse liability equals the portion of that liability, if any, for which the partner bears the economic risk of loss.[147]

A partner bears the economic risk of loss for a partnership liability –

to the extent that,

- if the partnership constructively liquidated,
- the partner would be obligated to make a payment to any person (or a contribution to the partnership)

  because

  - that liability becomes due and payable and
  - the partner would not be entitled to reimbursement from another partner.[148]

For purposes of determining whether a partner is obligated to make a payment, contractual obligations such as guarantees are taken into account.[149]

It is assumed,

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[146] Treas. Reg. § 1.707-5(a)(2).
[147] Treas. Reg. § 1.752-2(a).
[148] Treas. Reg. § 1.752-2(b)(1).
[149] Treas. Reg. § 1.752-2(b)(3)(i).

- for purposes of determining the extent to which a partner has a payment obligation and economic risk of loss,

  that

  - all partners who have obligations to make payments actually perform those obligations, irrespective of their actual net worth,

    unless

  - the facts and circumstances indicate a plan to circumvent or avoid the obligation.[150]

According to the Internal Revenue Service,

- Tribune Media Company's guarantees of collection

  do not provide

  - Tribune Media Company with

    - an economic risk of loss on the Chicago Baseball Holdings LLC debt and

  - should be disregarded.[151]

- Rather, the Ricketts family bears the economic risk of loss for the liabilities under the Section 752 anti-abuse rule.[152]

Where the facts and circumstances indicate

- a plan to circumvent or to avoid the obligation attributed to the partner under the constructive liquidation test,[153]

- the Section 752 anti-abuse provision[154] applies.

An obligation of a partner to make a payment may be disregarded or treated as an obligation of another person –

if

- the facts and circumstances indicate that –

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[150] Treas. Reg. § 1.752-2(b)(6).

[151] It is appropriate to disregard a guarantee if the guarantee is nothing more than a "guise to cloak" a partner "with an obligation for which it bore no actual economic risk of loss." *Canal Corp. v. Commissioner*, 135 T.C. at 213.

[152] See Treas. Reg. § 1.752-2(j).

[153] Treas. Reg. § 1.752-2(b)(6).

[154] Under Treas. Reg. § 1.752-2(j)(1).

- a ***principal purpose*** of the arrangement between the parties is –
  - to eliminate the partner's economic risk of loss

    with respect to

    - that obligation or
  - to create the appearance of the partner bearing the economic risk of loss
    - when, in fact, the substance of the arrangement is otherwise.[155]

An obligation of a partner to make a payment is not recognized –

if

- the facts and circumstances indicate
  - a plan to circumvent or avoid the obligation.[156]

Under the debt-financed distribution rule,

- a partner's allocable share of a partnership liability is
  - the partnership's share of the liability under normal rules for allocation of partnership liabilities,

    multiplied by

  - the percentage of the liability used to fund the distribution.

The allocation of partnership liabilities among partners depends on whether the liability is a recourse liability or a nonrecourse liability.

A recourse liability is a liability for which "any partner or related person bears the economic risk of loss."

A nonrecourse liability is one for which "no partner or related person bears the economic risk of loss."

Whether a transaction is abusive can depend on whether a partner bears the economic risk of loss. In attempting to distinguish between abusive and nonabusive transactions, Congress recognized that debt frequently plays a valid role in both sale and business formation transactions and thus did not intend to limit its legitimate use.[157]

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[155] Under Treas. Reg. § 1.752-2(j)(1).

[156] Treas. Reg. § 1.752-2(j)(3).

[157] The report of the Joint Committee on Taxation explains that a nonabusive use of debt occurs when:

An abusive situation occurs when:

> the transferor partner receives the proceeds of a loan related to the property and responsibility for the repayment of the loan rests, directly or indirectly, with the partnership (or its assets) or the other partners. [158]

The distinction is whether the contributing partner is still economically liable for the debt.

The parties agreed that the special distribution was a debt-financed distribution; but they disputed how much debt was properly allocated to Tribune Media Company for the purpose of applying the disguised sale rule.

Tribune Media Company argued –

- Tribune Media Company was entitled to offset any gain recognized on the Cubs transaction by $673,750,000, the amount of the senior debt and subordinated debt combined.
- Tribune Media Company bore the economic risk of loss for those debts through the guaranties.

The Internal Revenue Service disagreed.

First, the Internal Revenue Service argued that –

- the subordinated debt was not *bona fide* debt
- the subordinated debt was a disguised equity contribution.

Second, the Internal Revenue Service argued that –

- Tribune Media Company's guaranties of the senior debt and subordinated debt did not have economic substance

  such that

  - Tribune Media Company was responsible for repayment of the debts.

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a partner contributes property to a partnership and that property is borrowed against, pledged as collateral for a loan, or otherwise refinanced, and the proceeds of the loan are distributed to the contributing partner, there is not a disguised sale to the extent the distributed proceeds are attributable to indebtedness properly allocable to the contributing partner under the rules of section 752 (*i.e.*, to the extent the contributing partner is considered to retain substantive liability for repayment of the borrowed amounts), since, in effect, the partner in this case has simply borrowed through the partnership . .

Staff of J. Comm. on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 232 (J. Comm. Print 1985).

[158] General Explanation at 232.

Tribune Media Company's guarantees share several similarities with the WISCO indemnity disregarded by the Court in *Canal Corp.*[159]

In both cases,

- neither the lender nor the guarantors required the guarantees.
- both
  - Tribune Media Company and Chesapeake
  - insisted on the debt as a prerequisite to the transaction.

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[159] In *Canal Corp. v. Commissioner*, T.C. Memo. 2021-122, the Tax Court considered the application of the I.R.C. § 752 antiabuse rule to an indemnity agreement. Treas. Reg. § 1.752-2(j). WISCO, a wholly-owned subsidiary of Chesapeake (the predecessor of Canal Corporation) transferred assets worth $775 million to a new partnership (Georgia-Pacific Tissue LLC) in exchange for a 5 percent partnership interest. Chesapeake wanted to sell a portion of its business but had a low basis in the assets. Georgia Pacific transferred property worth $376.4 million to Georgia-Pacific Tissue LLC in exchange for a 95 percent partnership interest. Georgia Pacific had no interest in Chesapeake's tax deferral but was willing to "buy" at a lower "price" because of the deferral benefit. Subsequently, Georgia-Pacific Tissue LLC borrowed $755.2 million from a third party lender, all of which was immediately distributed to WISCO in a special distribution. Georgia Pacific served as the guarantor on the principal amount of the loan. WISCO agreed to indemnify Georgia Pacific for any principal payments Georgia Pacific was required to make under its guarantee. Neither Georgia Pacific nor the third party lender required the indemnity. The indemnity agreement was significant in several respects: (1) the indemnification only covered the principal of the debt; (2) the indemnification required Georgia Pacific to proceed against the assets of Georgia-Pacific Tissue LLC before demanding indemnification; and (3) the indemnification provided that WISCO's interest in Georgia-Pacific Tissue LLC would increase should WISCO make an indemnification payment. WISCO was not required to maintain a certain net worth (WISCO's net worth of $157 million represented approximately 21 percent of the indemnification exposure). The economic risk of loss of Chesapeake was limited to WISCO's assets, the most valuable of which was an intercompany note that Chesapeake could cancel at any time. Georgia Pacific knew that WISCO's assets were limited at the time of the transfers. Like Tribune Media Company, WISCO claimed that no disguised sale had occurred because WISCO satisfied the literal requirements for the debt-financed distribution exception. Treas. Reg. § 1.707-5(b)(1). The Tax Court considered the purpose of the indemnity agreement and whether WISCO had sufficient assets to cover the indemnity agreement. The Tax Court found that the purpose of the agreement was to limit any potential liability of WISCO's assets. The Tax Court took into account the following facts: (1) Georgia Pacific did not require the indemnification; (2) the indemnification did not require WISCO to maintain a certain net worth; (3) WISCO provided the indemnification purposely to achieve tax deferral; (4) the indemnification only covered the principal of the loan; and (5) WISCO stood to receive an increased interest in Georgia-Pacific Tissue LLC if required to make indemnification payments. The Tax Court found that WISCO's agreement to indemnify Georgia Pacific lacked economic substance and provided Georgia Pacific no real protection because WISCO's primary asset was an intercompany note that could be cancelled at any time and the indemnity did not require WISCO to retain this note or any other asset (WISCO was severely undercapitalized vis-à-vis the indemnification exposure).

- the lenders imposed no net worth maintenance requirement on Tribune Media Company.

Which partner is allocated a liability –

depends on

- whether the partners are general or limited partners and
- whether the liability is recourse or nonrecourse.

In a general partnership, the general partner is allocated liabilities. Chicago Baseball Holdings, LLC is a limited liability company. Chicago Baseball Holdings, LLC has no general partners.

Tribune Media Company is not a general partner. Tribune Media Company guaranteed collection of the debt. A partner's "guarantee of an otherwise nonrecourse note places each guaranteeing partner in an economic position indistinguishable from that of a general partner with liability under a recourse note — except that the guaranteeing partner's liability is limited to the amount guaranteed."[160]

If –

- Tribune Media Company's senior debt guaranty is valid,
    - the senior debt is a recourse liability allocated to Tribune Media Company.

If –

- Tribune Media Company's senior debt guaranty is not valid,
    - the senior debt is a nonrecourse liability.

Tribune Media Company argued that –

- Tribune Media Company is allocated the entire liability

  because

- Tribune Media Company bears the economic risk of loss through its senior debt guaranty.

The Internal Revenue Service disagreed. The Internal Revenue Service argued that –

- the senior debt guaranty does not sufficiently obligate Tribune Media Company under the constructive liquidation test.
- the ***principal purpose*** of the senior debt guaranty was

[160] *Abramson v. Commissioner*, 86 T.C. 360, 374 (1986).

- to create an illusion of economic risk for Tribune Media Company

  without

- creating any real risk for Tribune Media Company.

The cash distribution Tribune Media Company received is taxable as sale proceeds under the disguised sale rules of Section 707(a)(2)

if

- its guarantees are disregarded

  for purposes of

  - determining Tribune Media Company's share of recourse liabilities.

The anti-abuse regulation was included to prevent exactly the type of transaction that Tribune Media Company engaged in, according to the Internal Revenue Service:

- one where the form seems to obligate the taxpayer

  but

- where the obligation was cleverly structured to avoid true economic risk.

Tribune Media Company intended to sell the Chicago Cubs Assets and obtain "true sale" treatment for financial reporting purposes. The public believed that the Ricketts family purchased the Chicago Cubs Assets. The tax results are no different.

Tribune Media Company used several techniques to reduce the risk of its collection guarantees.

First, Tribune Media Company was in the middle of a bankruptcy restructuring under Chapter 11 when the guarantees were executed.

- No lender would give any credence or rely in any way upon a guarantee of a bankrupt obligor. [161]

[161] Lenders generally avoid dealing with bankrupt companies, with the notable exception of Debtor in Possession financing. Tribune Media Company fashioned the guarantee with an administrative priority. There is no evidence that the lenders relied on Tribune Media Company's guarantee. The guarantees were structured and entered into solely for Tribune Media Company's benefit. Further, it is extremely unlikely that the guarantees would have ever become payable to the lenders because they are guarantees of collection, not payment, and there are many conditions precedent in the guarantees that must occur before the guarantees become payable. Administrative priority of payment is of no practical consequence to a lender until the guarantees become payable. If the guarantees are not payable to the lenders, the guarantees will not be able to compete for payment from the bankruptcy estate vis-à-vis other claims against the bankruptcy estate. In the meantime, other administrative claims, whether superior or in pari passu in the order of payment to the guarantees, and

- The guarantees were structured and entered into solely for Tribune Media Company's benefit, according to the Internal Revenue Service.
- It is extremely unlikely that the guarantees would have ever become payable to the lenders, according to the Internal Revenue Service,

  because

  - the guarantees are guarantees of collection, not payment, and
  - there are many conditions precedent in the guarantees that must occur before the guarantees become payable.

Second, the guarantees were not commercially common guarantees.[162] The guarantees were guarantees of collection and not of payment.

Third, the structure of the transaction ensured that the Ricketts family would be responsible for the Chicago Baseball Holdings LLC debt, according to the Internal Revenue Service. Major League Baseball did not look to the guarantees of the bankrupt Tribune Media Company.[163]

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even unsecured priority claims (by definition a lower than administrative claim priority), that have become payable, may be paid out by the bankruptcy estate.

[162] They were highly unusual, arcane guarantees of collection, and not of payment. The guarantees also had monetary carve-outs for expenses and costs. The guarantees cannot be enforced until the borrower (a) shall have failed to make a payment due to the lenders in respect of the guaranteed obligation and the loan shall have been accelerated, (b) the lenders shall have exhausted all "Lender Remedies" and (c) the lenders shall have failed to collect the full amount of the guaranteed obligations. The guarantee agreement provides that the term "Lender Remedy" shall mean "all rights and remedies at law and in equity that the [lenders] may have against any Borrower Party, the Collateral. . or any other Person that has provided credit support in respect of the applicable Guaranteed obligations, to collect, or obtain payment of, the Guaranteed obligation, including, without limitation, foreclosure or similar proceedings, litigation and collection of all applicable insurance policies, and termination of all commitments to advance additional funds to [Borrower] under the Loan Documents. For the avoidance of doubt, Lender Remedies shall not have been exhausted with respect to any Collateral which has been foreclosed on by the [lenders], the value thereof has been included. . Effectively, the lenders are required to foreclose on the Chicago Cubs Assets, but the guarantee of collection still does not trigger until the lenders actually sell the collateral, which requires the consent of Major League Baseball. Further, the definition of "Lender Remedy" also requires a lender to exhaust their rights under the Operating Support Agreement, as well as the loan agreements, as rights regarding the collateral. The guarantee of collection presents no real economic risk to Tribune Media Company, as the guarantor.

[163] Instead, the Ricketts family was required to maintain an Operating Support Agreement with an evergreen cash escrow of $35 million to be used to fund any shortfalls in the operations of the business, such as baseball salaries, rent and franchise expenses. While debt service is excluded from the Operating Support Agreement, cash is fungible and Operating Support Agreement proceeds used for Chicago Baseball Holdings LLC operations would free up cash to service the debt. Further, if the Tribune Media Company guarantees of collection had provided any assurance, Major League Baseball

The Internal Revenue Service argued that –

- Tribune Media Company did not bear the risk of economic loss under the constructive liquidation test.
- The senior debt guaranty was not due and payable upon the constructive liquidation of Chicago Baseball Holdings, LLC.
- Tribune Media Company's obligation to pay under the guarantee was insulated by
    - requiring a series of complex lawsuits to exhaust all remedies in law and in equity,

      after which
    - Tribune Media Company could have sued Chicago Baseball Holdings, LLC's lenders for not fully exhausting those remedies.

Petitioners responded that the Internal Revenue Service was not properly applying the constructive liquidation test.

The Tax Court agreed with the petitioners. The tax respected the senior debt guaranty.

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would not have required the Ricketts family to maintain $35 million in the Operating Support Agreement. Additionally, under the letter agreement, dated October 27, 2009, between Major League Baseball, Chicago Baseball Holdings LLC and certain Ricketts family affiliates, Major League Baseball may require the Ricketts to make either equity contributions or "subordinated loans" under the Subordinated Loan Commitment Agreement.3 The Letter agreement states that Major League Baseball may "at any time and from time to time" direct that the Ricketts transfer funds to the team. In an October 7, 2009 letter from the Major League Baseball commissioner to Thomas Ricketts, the Major League Baseball commissioner indicates that he will require contributions to an escrow account if the Operating Support Agreement Entity's liquid assets fall below $35 million and "then current Club EBITDA, financial performance and financial projections indicate additional funding is needed as a remedial measure. . If the Cubs fall out of compliance with the Debt Service Rule, "[the Major League Baseball commissioner] will require that such amounts from the Operating Support Agreement Entity or the Operating Support Agreement Escrow Account as [the Major League Baseball commissioner] deem[s] necessary to achieve compliance be used in the DCR calculations to further supplement the Club's EBITDA in support of the Club's Debt Service Rule obligations." Moreover, per the Basic Agreement, the Major League Baseball commissioner has 16 specifically enumerated remedial measures that he can take against a team, team owners, and team executives if the team violates the Debt Service Rule, which are intended to force teams to get back into compliance with the Debt Service Rule. If the Ricketts do not perform under the letter agreement or the Operating Support Agreement, Major League Baseball has remedies against the Ricketts family, but not Tribune Media Company. The principle purpose of the transaction, and specifically the collection guarantees, was to create the appearance of Tribune Media Company bearing the economic risk of loss for the Chicago Baseball Holdings LLC debt when, in fact, the substance of the arrangement was otherwise.

Under the constructive liquidation test, Tribune Media Company bears the risk of economic loss for the senior debt.

Under the Tribune Media Company's guaranty of the senior debt, Tribune Media Company was obligated to pay when –

- Chicago Baseball Holdings, LLC fails to make a payment and the debt is accelerated,
- the creditors have exhausted their remedies, and
- the creditors have failed to collect the full amount of the debt.

In a constructive liquidation,

- the partnership fails to pay the debt,
- the debt comes due,
- the partnership assets are depleted, and
- the debt remains outstanding.

Under the senior debt guaranty, Tribune Media Company would be required to pay in this circumstance.

The test is whether Tribune Media Company must repay the senior debt creditors in a worst-case scenario.

No other party was liable for the debt.

No partnership assets secured the loans.

If the debt were due in full in the world of a constructive liquidation, the senior debt creditors would seek repayment from Tribune Media Company and no other party.

The Internal Revenue Service argued that –

- the senior debt guaranty does not pass the constructive liquidation test

  because

- the senior debt guaranty creates a *contingent obligation* for Tribune Media Company.

A *contingent obligation* is an obligation that "is subject to contingencies that make it unlikely that the obligation will ever be discharged."

The Internal Revenue Service claimed that –

- the requirement that creditors exhaust legal remedies before seeking repayment from Tribune Media Company

- make it unlikely that
    - the obligation will ever be discharged and
    - that it is far from clear that the creditors would be capable of exhausting these legal remedies.

This, according to the Internal Revenue Service, makes Tribune Media Company's collection obligation contingent.

The Tax Court found that the fact that the senior debt guaranty is a collection guaranty does not negate Tribune Media Company's ultimate obligation.[164]

- The requirements in the senior debt guaranty that lenders exhaust their remedies
    - are not a contingency under Treasury Regulations Section 1.752-2(b)(4).

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[164] The government argued on brief on appeal:

2. The Commissioner's interpretation of I.R.C. § 1.752-2(j) is consistent with Congressional intent

The Tax Court failed to apply I.R.C. § 1.752-2's plain text, and thus there is no need to examine the legislative history for related statutes. That history, however, is consistent with the Commissioner's interpretation of I.R.C. § 1.752-2. (Br.51-52.) Petitioners argue that Congress generally intended that partnership debt could be allocated to a guaranteeing partner. (Pet.Br.33-34, 47.) They point to 1984 legislation directing that I.R.C. § 752 and related regulations "be applied without regard to the result reached" in *Raphan v. United States*, 3 Cl. Ct. 457 (1983), *rev'd in part*, 759 F.2d 879, 885-86 (Fed. Cir. 1985). See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 79, 98 Stat. 494, 597 (1984). But in sharp contrast to Tribune's Senior Guarantee (see Br.18-19), the unconditional *Raphan* guarantee allowed creditors to proceed against the guarantor before exercising any creditor remedies, and that guarantee also "was a prerequisite to obtaining the loan which, in turn, was sine qua non of the deal." 3 Cl. Ct. at 465; 759 F.2d at 886 n.3. The Claims Court in *Raphan* nonetheless disregarded the guarantee. See 3 Cl. Ct. at 465-66.

Concerned about that outcome, Congress directed Treasury to "prescribe regulations [under I.R.C. § 752] relating to liabilities, including the treatment of guarantees. . Deficit Reduction Act of 1984, 98 Stat. at 597. The regulations that Treasury promulgated provide that obligations that are generally "taken into account" under the constructive-liquidation test include "guarantees." Treas. Reg. § 1.752-2(b)(3)(i). But additional rules otherwise provided in I.R.C. § 1.752-2, including paragraph (j)'s anti-abuse rule, ensure that the allocation of liabilities among partners reflects the manner, if any, in which a guaranteeing partner "share[s] the economic risk of loss," as Congress intended. H.R. Rep. No. 98-861, at 869 (1984) (Conf. Rep.).

Congress legislatively overruled *Raphan* in 1984 against a backdrop of nearly fifty years of judicial anti-abuse tax doctrines, see *supra* at 9-10, and there is no hint that Congress wanted to exempt a partner's guarantee from regulatory or judicial scrutiny for tax abuse. In more recent years, moreover, Congress has only increased legislative efforts to combat tax abuse, including by codifying the economic-substance doctrine. I.R.C. § 7701(o); Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409(a), 124 Stat. 1029, 1067-70 (2010).[6] [[6]I.R.C. § 7701(o) does not apply here because it was enacted in 2010 and took effect after the Cubs Transaction in 2009.]

- If the requirements in the senior debt guaranty that lenders exhaust their remedies were a contingency,
    - most if not all collection guaranties would be disregarded as conferring an obligation under the constructive liquidation test.
- Regulations clearly intend to treat guaranties — including collection guaranties — as obligations.
- The requirement that the creditors exhaust other legal remedies before turning to Tribune Media Company
    - does not vitiate Tribune Media Company's ultimate obligation to pay.

The constructive liquidation test is subject to an anti-abuse rule in Section 752 regulations.[165]

The anti-abuse rule –

- disregards the payment obligation or
- treats the payment obligation
- as the obligation of another person

if

- the payment obligation creates
- an illusion of the partner's economic risk of loss

  without

- actually subjecting the partner to real financial risk.

Treasury Regulations provide that –

- the obligation *may be disregarded*

if

- facts and circumstances
    - indicate that
        - a ***principal purpose*** of the arrangement between the parties is
            - to eliminate the partner's economic risk of loss

              with respect to

                - that obligation or

[165] I.R.C. § 1.752-2(j).

- to create the appearance of the partner or related person
    - bearing the economic risk of loss

    when, in fact,

    - the substance of the arrangement is otherwise."[166]

The Internal Revenue Service sought to apply the anti-abuse rule to the senior guaranty.

The Internal Revenue Service believed that –

- the possibility that the senior debt guaranty would ever be called
- was so remote that
- Tribune Media Company did not bear the risk of economic loss.

The Internal Revenue Service claimed numerous "buffers" made it unlikely the senior debt guaranty would be called.[167]

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[166] Treas. Reg. § 1.752-2(j)(1).

[167] One of these buffers is that Tribune Media Company did not bear the risk of loss because the Ricketts family "was the true guarantor." The Internal Revenue Service focused on the Ricketts family's ownership of the Cubs as an intergenerational trophy asset. Under the Internal Revenue Service view, because the Ricketts family committed to the Cubs as a long-term investment, the family was the "real guarantor." The Internal Revenue Service did not address the fact that in a constructive liquidation, the Cubs would be deemed worthless and the Ricketts family would lack an incentive to preserve its investment. Further, the Ricketts family was not a partner in Chicago Baseball Holdings, LLC. Transaction documents obligated Ricketts Acquisition LLC to pay the senior debt in a constructive liquidation. A recourse debt must be allocated to a partner. There was no evidence that Ricketts Acquisition LLC was that partner. Another buffer cited by the Internal Revenue Service is the operating support agreement. The Internal Revenue Service argued that the operating support agreement, which memorialized the Ricketts' family's agreement to place $35 million in an escrow account to fund Cubs operating expenses as needed, is the "real guarantee." Chicago Baseball Holdings, LLC could not use these escrowed funds to pay its debt. The escrow account was established so that the Cubs could continue to operate if its cash flow decreased significantly. This was a genuine concern because anything that stopped games from being played, such as a players' strike, would dramatically decrease the team's cash flow. The Internal Revenue Service presented no persuasive evidence that the operating support agreement served the alternative purpose of guaranteeing the senior debt, particularly when the agreement already served a crucial function. In a constructive liquidation where Chicago Baseball Holdings, LLC could pay neither its debts nor its operating expenses, Chicago Baseball Holdings, LLC's creditors would not look to the Ricketts family for payment under the operating support agreement, they would look to Tribune Media Company for payment of the debt. Many of the Internal Revenue Service's additional "buffers" resembled common lender protections. The existence of oversight and protections to prevent a doomsday scenario does not render the senior debt guaranty illusory. The Internal Revenue Service's argument that the senior debt guaranty was unlikely to be called is without merit. By relying on the unlikeliness, the Internal Revenue Service conceded the possibility that the debt would be called.

According to the Tax Court,

- The constructive liquidation test does not posit an expected occurrence.
- The constructive liquidation test tests the worst-case scenario, going so far as to assume that even cash is rendered worthless.

The probability of Tribune Media Company's fulfillment of its promise in the senior debt guaranty is irrelevant.

- If Chicago Baseball Holdings, LLC could not pay its senior debt, Tribune Media Company would have to do so.
- The anti-abuse rule does not apply here.

While

- Tribune Media Company was bankrupt when it executed the senior debt guaranty,
- Tribune Media Company had sufficient assets to pay the senior debt guaranty upon execution and
- expected its net worth to increase.

The Internal Revenue Service argued that,

even if

  - the Subordinated Debt is respected and
  - the guarantees of collection by Tribune Media Company are also respected,

    then

  - Tribune Media Company does not have a "payment obligation" on its collection guarantees.

- Tribune Media Company
  - does not bear the economic risk of loss
  - under its collection guarantees of the Chicago Baseball Holdings LLC debt
  - in a constructive liquidation of the partnership. [168]

[168] Under Treas. Reg. § 1.752-2(b)(1). Under the regulation, the following steps are considered to occur in a hypothetical sale transaction:

1. All of the partnership's obligations become due and payable

The Internal Revenue Service argued that the anti-abuse rule of Treasury Regulations Section 1.701-2 applies to invalidate the senior debt guaranty:

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2. All of the partnership's assets, except certain assets that secure partnership obligations, become worthless and are sold for zero consideration

3. The partnership allocates the loss associated with such sale of its assets among the partners, and

4. The partnership liquidates in accordance with the partners' capital account balances.

Tribune Media Company structured its guarantees so that numerous additional steps must be considered as occurring before Tribune Media Company, as the guarantor of collection, would have such a payment obligation. These additional steps would not be required if Tribune Media Company had provided a standard guarantee of payment. Under a payment guarantee, a creditor could proceed directly against the guarantor when the obligation becomes due and payable. Instead, under Tribune Media Company's guarantee of collection, once the debt becomes due and payable, the borrower first must fail to satisfy the obligation, then the lender must exhaust its legal remedies under both law and equity against the borrower, including suing the borrower for repayment, receiving a judgment against the borrower, then seeking to enforce the judgment, selling the collateral, and suing under the Operating Support Agreement, only to have the execution of these various judgments returned unsatisfied. These additional steps were not contemplated by the regulations in determining if a partner has a payment obligation, according to the Internal Revenue Service.

As a technical matter, after applying all of the steps in the hypothetical sale and liquidation of the partnership under Treas. Reg. § 1.752-2(b), the guarantee of collection fails to trigger a payment obligation, according to the Internal Revenue Service argument. Tribune Media Company intentionally placed many difficult hurdles in front of its guarantees, Those hurdles apply equally in the hypothetical sale, according to the Internal Revenue Service, such that no payment obligation arises on the default and acceleration of the loans. Therefore, according to the Internal Revenue Service, Tribune Media Company is not treated as having any share of recourse liability.

Even if a payment obligation is considered to arise under the terms of the collection guarantee, it would not arise until after such additional steps were taken by the lenders to enforce their claims. A payment obligation is not considered to arise until after the occurrence of certain future events in a situation in which the obligation is considered to be contingent on the occurrence of such future events, and the likelihood that those events will occur is not reasonably certain. Treas. Reg. § 1.752-2(b)(4). The many vague conditions that must occur in order to collect on Tribune Media Company's collection guarantees are extremely unlikely to occur. Tribune Media Company knew they would not occur when it structured the guarantees, a fact that is demonstrated by Tribune Media Company establishing no reserve for the liability on the books, according to the Internal Revenue Service. Tribune Media Company intentionally structured the collection guarantees to effectively negate any chance that it would ever have a payment obligation under the guarantees, but then claimed to possess a real economic risk of loss under the same guarantees in a constructive liquidation of the partnership under Treas. Reg. § 1.752-2(b)(1), according to the Internal Revenue Service. Tribune Media Company cannot have it both ways. Unless and until the lenders take the series of steps necessary to create a payment obligation, Tribune Media Company bears no economic risk of loss under its collection guarantees of the Chicago Baseball Holdings LLC debt in a constructive liquidation of the partnership under Treas. Reg. § 1.752-2(b)(1), according to the Internal Revenue Service. Accordingly, the entire special distribution is treated as consideration for a disguised sale under Treas. Reg. § 1.707-5(b)(1), according to the Internal Revenue Service.

- The regulation "requires that each component of a partnership transaction have a substantial business purpose."
- the senior debt guaranty lacks a ***substantial business purpose***.
- the senior debt guaranty therefore violates the general anti-abuse rule.

To support this assertion, the Internal Revenue Service emphasized the benefits lacking in the senior debt guaranty:

- The senior debt guarantee did not improve Tribune Media Company's credit or decrease interest rates on the loans.
- Tribune Media Company did not receive payment to issue the senior debt guaranty.
- The senior creditors did not request that Tribune Media Company guarantee the loans.
- As further evidence of the senior debt guaranty's lack of ***business purpose***, the credit rating agencies "gave little or no credence" to the senior debt guaranty.
- Tribune Media Company itself did not recognize the senior debt guaranty in its financial statements under the GAAP requirements.
- Because the senior debt guaranty lacked a ***business purpose***, according to the Internal Revenue Service,
    - the senior debt guaranty served only to lessen Tribune Media Company's tax liability and
    - failed the general anti-abuse rule.

Petitioners disputed the Internal Revenue Service's interpretation of the antiabuse rules of Section 1.701-2:

- the Internal Revenue Service inaccurately construed the regulation to require a ***business purpose*** for "each component" of a transaction instead of the transaction as a whole.
- petitioners pointed to the examples in the regulation and courts' application of the regulation to support their contention.

The Tax Court agreed with petitioners.

- The examples in the antiabuse regulation establish that
    - a partnership must have a genuine ***business purpose*** for forming the partnership,

not that

- every component of the partnership's formation have a separate ***business purpose***.

- The examples illustrate that –
  - a partnership passes the anti-abuse rule when it is formed to "conduct a *bona fide* business,"

    such as

    - real estate management,
    - making joint investments, and
    - owning and operating a building.
- A partnership *does not* have a ***business purpose***

  when

  - the partners lack the intent to genuinely pursue a venture under the partnership.
- In such a situation,
  - the transactions did not have a ***business purpose***

    because

    - "any purported business purpose for the transaction is insignificant in comparison to the tax benefits" enjoyed by the partners if the partnership form were respected.
- Accordingly, the transactions lacked a ***business purpose*** and should be disregarded.

This ***business purpose*** requirement is a broad provision applying to the function of the partnership as a whole, according to the Tax Court:

- The ***business purpose*** requirement is not intended to apply to every agreement into which the partnership or its partners enter.
- The courts have interpreted ***business purpose*** requirements to apply to whether
  - the entities engaged in the transaction are genuine and profit-motivated or
  - whether the ultimate intent of the transaction had a nontax purpose.

- In determining whether a transaction has a nontax motive, the court assesses whether the transaction alters the taxpayer's economic position.
- Chicago Baseball Holdings, LLC had a *bona fide* ***business purpose***.
- Tribune Media Company and Ricketts Acquisition LLC created Chicago Baseball Holdings, LLC to hold and to operate the Cubs, an endeavor which Chicago Baseball Holdings, LLC pursued.
- The transaction
  - was not a sham and
  - resulted in significant economic outcomes to Tribune Media Company and Ricketts Acquisition LLC.
- No evidence shows that Chicago Baseball Holdings, LLC lacked a ***business purpose***.

Even if the ***business purpose*** requirement did not apply to the Cubs transaction as a whole, the Internal Revenue Service's attempt to discredit the senior debt guaranty is unpersuasive, according to the Tax Court:

- The purpose of a guaranty is to provide an ultimate payor on a loan if the original obligor is unable to pay.
- A valid guaranty ensures that the guarantor will shoulder the ultimate economic burden of a debt.
- Because a guaranty certifies that a debt will be paid,
  - The guaranty may convey additional benefits to the parties,

    such as

    - a favorable interest rate,
    - an improved credit standing, and
    - a payment from the creditor to the guarantor.
- The Internal Revenue Service cited these benefits as proof of a guaranty's "***business purpose***," and insisted that

  because

    - the senior debt guaranty lacked these enhancements,
    - the senior debt guaranty is not a valid guaranty.
  - A guaranty does not require a separate purpose other than pledging ultimate payment for a loan.

        - Additional perks may be desired but are not the purpose of the guaranty.
        - Conditioning the validity of a guaranty on its provision of additional extrinsic benefits overlooks its essential function.
        - The Internal Revenue Service's position is an incorrect analysis of the circumstances under which we will honor a guaranty.
    - The Tax Court respects a guaranty if the guarantor has ultimate economic responsibility for the loan.
    - Tribune Media Company bore ultimate responsibility for the senior debt.

The Tax Court determined that the Internal Revenue Service's claim that the senior debt guaranty had no real-world consequences is similarly false.

- The Internal Revenue Service argued that –
    - the senior debt guaranty lacked substance

      because
    - Tribune Media Company did not report the senior guarantee
        - on Tribune Media Company's financial statements per GAAP guidelines.
- Tribune Media Company properly followed these guidelines
    - when it reported
        - the guaranties had no contingent or noncontingent value but
    - disclosed
        - its economic exposure from the guaranties.
- An expert for the Internal Revenue Service
    - affirmed that
        - Tribune Media Company accurately represented the guaranties on its financial statements, and
    - testified that
        - the "GAAP value does not equate to the economic value"

          because
        - the GAAP calculation measures the likelihood of payment,
            - not the economic value of a guaranty.

    - seemed to agree when
        - the Internal Revenue Service calculated the economic value of the guaranties at $6,120,000 to $18,860,000.
- The Internal Revenue Service's claim that Tribune Media Company's GAAP reporting

  reflects

    - the guaranties' true lack of substance
    - is thus inaccurate.
- The reporting indicates Tribune Media Company's assessment that
    - the likelihood Tribune Media Company would be called to service the guaranties
    - was remote.
- A remote possibility that a guaranty will be called is still a possibility and
    - does not invalidate a guaranty.
- The guaranties had economic value.
- The senior debt guaranty is not a sham or an illusory agreement created solely for tax purposes.

The guaranties affected Tribune Media Company's credit rating.

The Internal Revenue Service claimed that the credit agencies gave the guaranties "little or no credence," but that is not true.

In its credit rating analyses of Tribune Media Company, S&P accounted for the guaranties when calculating Tribune Media Company's leverage and risk.

In its 2016 credit report, S&P attributed $100 million of Chicago Baseball Holdings, LLC's debt to Tribune Media Company as a result of the guaranties. This additional $100 million of attributable debt affected Tribune Media Company's credit rating by increasing its debt to earnings ratio by 0.4. Not only did S&P give more than "a little" credence to the guaranties, but the guaranties had a real-world effect on Tribune Media Company's credit rating. The senior debt guaranty had genuine consequences outside of its tax benefits.

The Internal Revenue Service made two other arguments as to why the senior debt guaranty failed the general anti-abuse rule.

- First, the Internal Revenue Service's claim that the senior debt guaranty was
    - a phony guaranty that

        - was "trumped by the cash-backed competing guarantee of the Ricketts family". the operating support agreement.
    - The operating support agreement did not guarantee the senior debt and was established to fund necessary Cubs operating costs.
        - The operating support agreement expressly prohibited Chicago Baseball Holdings, LLC from using the operating support agreement funds to satisfy debts.
        - This argument is not persuasive to the Tax Court.
- Second, the Internal Revenue Service stated that
    - the senior debt guaranty's status as a collection guaranty
        - made the likelihood of Tribune Media Company's ultimate payment too attenuated.
    - The Internal Revenue Service cited the protections embedded in the senior debt guaranty requiring the lenders to exhaust other legal remedies before seeking payment from Tribune Media Company and the protections in the debt structure that minimized the risk of the senior debt guaranty's being called.
    - According to the Tax Court,
        - Collection guaranties are valid guaranties.
        - The regulations in fact provide an example where the partner who has a guaranty of collection is allocated the debt as a recourse liability.
        - The Tax Court would not invalidate a collection guaranty simply because the lenders must seek payment from other potential sources before turning to the guarantor.
        - The Tax Court would not invalidate a guaranty because the borrowing entity structured its debt to mitigate the risk of default.
        - An entity may (and is perhaps encouraged to) create a debt structure that maximizes its ability to satisfy the terms of its debt agreements.
        - Tribune Media Company's foresight on this issue does not invalidate the senior debt guaranty.

[c] Government Argument that the Substance over Form Doctrine Applies to Recast the Transaction as a Sale of 95% of the Chicago Cubs Assets.

The Internal Revenue Service argued before the Tax Court that

- Section 1.701-2(b) and the common law doctrine of substance over form *apply to invalidate*
  - the Cubs transaction and
  - the nontax treatment of the special distribution.
- Section 1.701-2(b), which establishes a general anti-abuse rule for partnerships, and the doctrine of substance over form are coextensive and function together when necessary.

According to the Tax Court, neither the general anti-abuse rule nor the substance over form doctrine applies to the Cubs transaction.

The Joint Committee on Taxation described substance over form:

> *The concept of the substance over form doctrine is that the tax results of an arrangement are better determined based on the underlying substance rather than an evaluation of the mere formal steps by which the arrangement was undertaken. For instance, two transactions that achieve the same underlying result should not be taxed differently simply because they are achieved through different legal steps. The Supreme Court has found that a "given result at the end of a straight path is not made a different result because reached by following a devious path."*[169]

In *Gregory v. Helvering*, the Supreme Court considered a transaction that complied with the text of the Code, but not its intended purpose:

> *The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.* [170]

The test of substance over form is "whether what was done, apart from the tax motive, was the thing which the statute intended." [171]

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[169] Staff of Joint Committee on Taxation, Study of Present-Law Penalty and Interest Provisions as Required by I.R.C. § 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Including Provisions Relating to Corporate Tax Shelters) (Vol. I), at 195 (J. Comm. Print 1999) (*quoting Minn. Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938).

[170] *Gregory v. Helvering*, 293 U.S. at 470.

[171] *Gregory v. Helvering*, 293 U.S. at 469.

The courts use the doctrine of substance over form to "determine the true nature of a transaction and appropriately recast it for Federal income tax purposes." [172]

The courts apply these principles "only when warranted and generally respect the form of a transaction." [173]

Form will be respected when form and substance align, even when the transaction involved consciously pursuing tax benefits.

If the form does not coincide with the transaction's substance, the fact that it was negotiated at arm's length by unrelated taxpayers does not protect it against attack. [174]

Petitioners argued that –

- substance over form should not apply because they complied with the disguised sale rules.
- the question posed by the doctrine of substance over form is whether the steps of the transaction substantively took place.
- the substance over form doctrine does not apply "where a taxpayer has dutifully structured a transaction in compliance with a detailed regulatory regime that implements Congress' intent."
- Tribune Media Company may reap the tax benefits of the disguised sales rules if:
    - the parties actually contributed their respective assets to form a *bona fide* partnership,
    - the partnership in fact borrowed the Senior and Subordinated Debt;
    - the Subordinated Debt in fact constitutes true debt for tax purposes, and
    - Tribune Media Company provided guarantees of the Senior and Subordinated Debt that qualify as valid guarantees under Section 752

    because

    - Tribune Media Company followed — in substance as well as form — the prescribed steps of a disguised sale, the transaction should be respected.

The Internal Revenue Service argued in the alternative that –

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[172] *Exelon Corp. v. Commissioner*, 147 T.C. 230, 299 (2016), *aff'd*, 906 F.3d 513 (7th Cir. 2018).

[173] *Gregory v. Helvering*, 293 U.S. at 469.

[174] Boris Bittker & Lawrence Lokken, Federal Taxation of Income, Estates and Gifts, para. 4.3.3, at 4-40 (3d ed. 1999).

- the court should recast the Cubs transaction as an outright sale under the substance over form doctrine.
- in substance the Cubs transaction was a sale of 95% of the team's assets.
- in substance the Cubs transaction was "orchestrated as a partnership contribution in form solely to avoid the payment of income tax."
- "[f]rom the outset, all parties knew the transaction was in substance a sale, that Tribune wanted to part with the Cubs, that the transaction had to be structured in a certain manner, and that the structure existed to provided Tribune tax benefits."

The Tax Court that –

- the Cubs transaction was a disguised sale in both form and substance.
- the economic reality of this transaction lies squarely within the intent of the disguised sale statute.
- the parties to the transaction formed a *bona fide* partnership that operates the Cubs franchise with assets contributed by Tribune Media Company.
- the partnership in fact distributed cash to Tribune Media Company.
- this transaction also substantively fits into the debt-financed distribution exception for a disguised sale, receiving the distribution tax free up to the amount of the senior debt guaranteed by Tribune Media Company.
- Chicago Baseball Holdings, LLC borrowed the senior debt.
- Tribune Media Company guaranteed the senior debt.
- Then, such a transaction is explicitly provided for by Congress and followed by a taxpayer in both substance and form, the court will not recharacterize it.
- the doctrine of substance over form is applied to prevent taxpayers from mislabeling transactions to achieve a desired tax consequence.
- Petitioners did not mislabel the transaction.
- the economic substance of the Cubs transaction is a disguised sale with a debt-financed distribution, a structure contemplated by both the statute and the regulations.

[d] Summary of Government Arguments on Appeal.

On brief on appeal, the government argued:

Tribune Media Company wanted to avoid prodigious built-in gains tax from its disguised sale of the Cubs Assets to Chicago Baseball Holdings ("CBH"). [Footnote omitted.] To do so, Tribune designed the Cubs Transaction in an attempt to meet the technical requirements for the debt-financed exception to the disguised-sale rules. To qualify for that exception, Tribune had to bear real economic risk for real debt that CBH borrowed to pay Tribune for the Cubs Assets. To meet Tribune's demands that the deal include maximum debt (to generate maximum tax benefits), CBH used debt to fund the lion's share of its $714 million payment to Tribune for the Cubs Assets: $425 million in Senior Debt from outside lenders, and $248.75 million in purported Subordinated Debt funded by the Ricketts family. To create the appearance that Tribune was at risk for that debt, the parties executed Tribune's collection guarantees for both tranches of debt.

Tribune's goal for the parties' complex arrangements was tax avoidance and not, as Tribune repeatedly asserts, tax deferral. [Citation omitted.] Even if deferral was the goal, unwarranted tax deferral also hurts the public fisc by delaying collection and enabling potential avoidance in future years. But the analysis here focuses on the 2009 timeframe of the Cubs Transaction, [footnote omitted] when Tribune recently had changed from a C Corporation (which pays entity-level income taxes) to a pass-through S Corporation (which generally does not) owned by a tax-exempt entity. [Citation omitted.] That change in corporate status kicked off a ten-year recognition period for built-in gains tax. (Id.) To avoid built-in gains tax during that ten-year period, Tribune structured the Cubs Transaction to avoid recognizing its gain until 2018. [Citation omitted.] Petitioners admit that Tribune avoided that tax during the several years that it maintained the corporate structure it had in 2009. [Citation omitted.] Tribune began paying that tax only because, in 2012, it unexpectedly converted back to a C Corporation — a fact that is irrelevant to determining petitioners' 2009 tax issues, which are at issue here. The IRS correctly rejected Tribune's attempt to avoid taxes by shoehorning the Senior Guarantee into the debt-financed distribution exception to the disguised-sale rules. That maneuver was abusive and counter to the purposes of the Internal Revenue Code's partnership provisions.

The Tax Court, however, erroneously concluded that the Senior Guarantee supported petitioners' claims under the debt-financed distribution exception. In reaching that conclusion, the court misinterpreted and misapplied the plain text of two independent anti-abuse regulations: Treas. Reg. §§ 1.752-2(j) and 1.701-2. Regarding Section 1.752-2(j), the Tax Court erroneously ignored the real-world facts and circumstances surrounding the Cubs Transaction. Although the parties' complex arrangements made it appear as though Tribune had risk for the Senior Debt, the substance of the arrangements was otherwise because Tribune had — at most — de minimis risk under the Senior Guarantee. Petitioners' own expert calculated Tribune's risk from the Senior Guarantee as ranging from zero to a maximum 0.43% of the total Senior Debt. [Footnote omitted.] The substance of the parties' arrangements thus departed from the appearances those arrangements created, violating Section 1.752-2(j). Applying Section 1.701-2, the court failed to focus on whether the Senior Guarantee had a "business purpose." Tribune guaranteed CBH's debt for one reason: minimizing taxes. That is not a "business purpose" under federal tax law. The Commissioner asks this Court to reverse the Tax Court's decision as to the Senior Debt or, at a minimum, to vacate and remand that portion of the decision to the Tax Court for application of the correct legal standards.

The Tax Court correctly found that the Subordinated Debt was equity, and not bona fide debt, for federal tax purposes — and that the related portion of CBH's payment to Tribune thus was not a debt-

financed distribution. The Subordinated Debt was advanced from one Ricketts-controlled entity to another on terms that a third party would not accept. Thomas Ricketts singlehandedly determined those terms with no negotiation. These and other facts amply support the Tax Court's overall finding, reviewed for clear error, that the Subordinated Debt was equity. The Commissioner asks this Court to affirm the Tax Court's decision as to the Subordinated Debt.

With respect to the general partnership antiabuse regulations, the government argued on brief on appeal:

B. The partnership anti-abuse rule in Treas. Reg. § 1.701-2 separately bars the tax benefits claimed from the Senior Guarantee

The Senior Guarantee also fails the general partnership (Subchapter K) anti-abuse rule in Treas. Reg. § 1.701-2. [Citation omitted.] Petitioners contend that this regulation is invalid. [Citation omitted.] But I.R.C. § 7805(a) granted the Treasury Department authority to promulgate Section 1.701-2, which is consistent with Congressional intent and case law.

In upholding petitioners' treatment of the Senior Debt under Section 1.701-2, the Tax Court misinterpreted the regulation and relied on irrelevant and unreliable evidence. [Citation omitted.] The record here supports a ruling in the Commissioner's favor under Section 1.701-2. But like Section 1.752-2, the Tax Court's legal errors regarding Section 1.701-2 require, at a minimum, vacatur and remand for application of the correct standard. [Citation omitted.]

1. I.R.C. § 7805(a) granted authority to promulgate Section 1.701-2

Building on decades of judicial anti-abuse tax doctrines, the Treasury Department promulgated Section 1.701-2 under the broad regulatory authority Congress granted in I.R.C. § 7805(a). Subchapter K Anti-Abuse Rule, 60 Fed. Reg. 23, 27 (Jan. 3, 1995). Section 7805(a) not only authorizes but directs the Secretary of the Treasury to "prescribe all needful rules and regulations for the enforcement of this title" i.e., the Internal Revenue Code (Title 26, U.S.C.). Congress has granted similarly broad regulatory authority since the Revenue Act of 1918. [Citation omitted.] Section 7805(a) is "essential to efficient and fair administration of the tax laws" because the tax system is "complex" and the Treasury Department "must be able to exercise its authority to meet changing conditions and new problems." [Citation omitted.]

The Internal Revenue Code of 1954 enacted Subchapter K's partnership tax provisions and included the substantively unchanged text of Section 7805(a). [Citation omitted.] There is no reason to think — and petitioners have offered none — that Congress intended to exempt Subchapter K from Section 7805(a) or otherwise narrow Treasury's authority to promulgate regulations preventing partnership tax abuse. Petitioners argue that Congress withheld specific authority to promulgate rules preventing tax abuse in partnership arrangements [citation omitted], but Congress granted that authority in Section 7805(a). And the fact that Congress sometimes has specifically required Treasury to promulgate regulations [citation omitted] does not narrow Section 7805(a)'s sweep. Petitioners do not even attempt to show that Section 1.701-2 is outside of Congress' broad grant of authority in Section 7805(a), which they cite once [citation omitted] and then ignore.

Congress enacted Subchapter K and Section 7805(a), moreover, against a backdrop of well-established judicial doctrines foreclosing abuse of the federal tax system. Nearly twenty years before the Internal Revenue Code of 1954, and sixty years before Treasury promulgated Section 1.701-2, the Supreme Court decided Gregory v. Helvering, 293 U.S. 465 (1935). Petitioners cite Gregory for the idea that a tax-reduction motive "'will not alter the result or make unlawful what the statute allows.'" [Citation omitted.] But that significantly shortchanges Gregory's import. Gregory concerned the federal tax consequences of an arrangement (specifically, a corporate reorganization) that met relevant statutory requirements, which the Commissioner nonetheless concluded "was without substance and must be disregarded." [Citation omitted.] The Court looked beyond the technical requirements to inquire "whether what was done, apart from the tax motive, was the thing which the statute intended." [Citation omitted.] Gregory upheld the Commissioner's determination because the transaction was "outside the plain intent of the statute." [Citation omitted.]

Petitioners complain [citation omitted] that Section 1.701-2 allows the Commissioner to adjust or modify claimed tax treatment "to achieve tax results that are consistent with the intent of Subchapter K" even where "the transaction may fall within the literal words of a particular statutory or regulatory provision." Treas. Reg. 1.701-2(b). But that aspect of Section 1.701-2 is directly traceable to the reasoning in Gregory that petitioners ignore, which courts continue to apply today. [Citation omitted.]

The Commissioner's appeal focuses on the business-purpose requirement in Section 1.701-2(a)(1) [citation omitted], which also is directly traceable to longstanding caselaw. To apply "the doctrine of Gregory," courts examine the motives behind a transaction and consider whether it was "entered upon for commercial or industrial purposes" and whether there was "no other motive but to escape taxation." [Citation omitted.] The business-purpose requirement in Section 1.701-2 also is consistent with Congress' more recent codification of the judicial economic-substance doctrine, including the business-purpose requirement. [Citation omitted.]

The business-purpose requirement is "essential" because "[e]ven the smartest drafters of legislation and regulation cannot be expected to anticipate every device" that "clever individuals in the private sector" may use in an attempt "to game the system." [Citation omitted.] It is neither surprising nor relevant, therefore, that some have "widely condemned" Section 1.701-2 "from the beginning," as petitioners claim. [Citation omitted.]

Section 1.701-2 is within the authority Congress granted the Treasury Department in Section 7805(a). The regulation is consistent with decades of caselaw, as well as with Congress' embrace of anti-abuse doctrines, and also gives taxpayers guidance regarding how the IRS will apply such concepts in the partnership context. District courts have enforced Section 1.701-2 without questioning its validity. [Citation omitted.] Congress may, moreover, legislatively overrule regulations it deems improper, but Section 1.701-2 was promulgated nearly thirty years ago and is "deemed to have received Congressional approval and have the effect of law." [Citation omitted.]

2. The Commissioner may rely on both the Section 1.752-2(j) and Section 1.701-2 anti-abuse rules

The Commissioner relies on two independent anti-abuse regulations to disallow the benefits generated by the Senior Guarantee: Section 1.752-2(j) and Section 1.701-2. Consistent with Gregory, a transaction that passes muster under "the literal words" of Section 1.752-2 nevertheless could be abusive under

Section 1.701-2. [Citation omitted.] The regulations thus complement each other and are not, as petitioners suggest, in conflict. [Citation omitted.] Petitioners also assert that applying Section 1.701-2 here "violates the 'elementary tenet' that 'a specific [provision] will not be controlled or nullified by a general one.'" [Citation omitted.] But from their Guidry quote, petitioners omit that this tenet of textual interpretation applies only "[w]here there is no clear intention otherwise." [Citation omitted.] This omitted language is important here, for Section 1.701-2(b) does state a "clear intention" that Section 1.701-2 still applies where tax claims meet other "particular statutory or regulatory provision[s]."

In any event, the Commissioner may argue that both anti-abuse regulations apply here. Like Federal Rule of Civil Procedure 8(d)(3), Tax Court Rule 31(c) allows parties to make alternative claims, "regardless of consistency." [Citation omitted.]

3. The Tax Court erroneously interpreted and applied Section 1.701-2

a. The business-purpose requirement applies to each transaction, not "to the function of the partnership as a whole"

Under Section 1.701-2(a)(1), a "partnership must be bona fide and each partnership transaction or series of related transactions (individually or collectively, the transaction) must be entered into for a substantial business purpose." (Emphasis added.) As indicated by the word "and," the bona fide partnership requirement and business-purpose requirement are separate mandates. In conflict with that plain text, the Tax Court erroneously held that the regulation's business-purpose requirement broadly applies "to the function of the partnership as a whole" and not "to every agreement." [Citation omitted.]

If left undisturbed, the Tax Court's interpretation could eviscerate Section 1.701-2 because a partnership with an overall bona fide "function" could, without running afoul of Section 1.701-2, freely engage in tax abuse through transactions with no business purpose. [Citation omitted.] Petitioners do not even attempt to defend this aspect of the Tax Court's ruling and have forfeited the opportunity to do so. [Citation omitted.] The Tax Court's erroneous interpretation of Section 1.701-2(a)(1) should be reversed.

b. The Tax Court failed to focus the business-purpose inquiry on the Senior Guarantee

The Tax Court also erroneously failed to analyze whether the Senior Guarantee was "entered into for a substantial business purpose," as Section 1.701-2(a)(1) requires. (Br.65-68.) The court instead briefly discussed whether the Cubs Transaction, as a whole, was a sham. [Citation omitted.] Under that approach, as long as Tribune actually carried out the disguised sale of the Cubs Assets to CBH, the parties could avoid scrutiny under Section 1.701-2 while engaging in utter chicanery to avoid tax for Tribune on hundreds of millions of dollars in gains on the Cubs Assets. That is not, and cannot be, the law.

The text of the regulation, moreover, confirms that its business-purpose analysis focuses on the Senior Guarantee. [Citation omitted.] For example, the facts-and-circumstances test requires identifying "the transaction" that generated "the claimed tax benefits" and then comparing such benefits with the purported business purpose for that transaction. Treas. Reg. § 1.701-2(c). [Citation omitted.] Petitioners argue that the business-purpose analysis could focus on either a single "transaction" or a "series of related transactions," relying on the parenthetical in Section 1.701-2(a)(1). [Citation omitted.] To be sure, in other circumstances,

tax benefits could be generated by a series of transactions. But the claimed tax benefits at issue here — i.e., Tribune's tax-free claim to the $425 million funded by the Senior Debt — resulted from the Senior Guarantee, and that transaction is the correct focus for the business-purpose inquiry under Section 1.701-2. [Citation omitted.]

Petitioners contend that the business-purpose analysis considers "the entire Cubs transaction" because all parts of the transaction were necessary to generate the tax benefits, including "forming the partnership, taking out the loans, and distributing the proceeds to Tribune." [Citation omitted.] But if the parties had taken those steps without the Senior Guarantee, that would have been a straightforward disguised sale in which CBH borrowed money to pay Tribune for the Cubs Assets, and Tribune would have been subject to built-in gains tax on the $425 million funded by the Senior Debt. That portion of CBH's payment to Tribune could escape tax under the debt-financed exception only if Tribune had economic risk for the Senior Debt under Treas. Reg. § 1.752-2, and the only source of that purported economic risk was the Senior Guarantee. Section 1.701-2 thus requires a comparison of the claimed tax benefits — tax-free treatment of $425 million — with the purported business purpose for the Senior Guarantee.

Focusing on the transaction (or portion thereof) that generated the tax benefits is consistent with cases applying the economic-substance doctrine, as Treasury intended when it promulgated Section 1.701-2. [Citation omitted.] For example, in GSS Holdings (Liberty) Inc. v. United States — the subject of petitioners' October 9, 2023 letter to this Court — the Federal Circuit explained that the economic-substance doctrine "focus[es] solely on 'the transaction . . . that gave rise to the alleged tax benefit.'" [Citation omitted.] The Federal Circuit held that this approach should not be applied under the step-transaction doctrine, [citation omitted], but that does not affect this case, which does not involve the step-transaction doctrine.

Petitioners also posit that, to show business purpose, they need only describe what the Senior Guarantee did, and that there is no need to probe why Tribune executed the Senior Guarantee. [Citation omitted.] But that is exactly what the business-purpose inquiry involves — examining the reasons behind a transaction to determine the presence (or absence) of objective, non-tax reasons for it. In Gregory, for example, the Supreme Court considered the reasons motivating the corporate reorganization at issue and found a lack of "business or corporate purpose." [Citation omitted.] In Frank Lyon Co. v. United States, the Court also examined why the parties engaged in the transaction under scrutiny and found, inter alia, that it was "imbued with tax-independent considerations." [Citation omitted.] The business-purpose analysis, whether under Section 1.701-2 or judicial doctrines, necessarily examines why parties entered a transaction. [Footnote omitted.]

c. Tribune had no business purpose for the Senior Guarantee

Petitioners have never identified a plausible non-tax business purpose for the Senior Guarantee. They assert that Tribune sought "to ensure the ultimate repayment of CBH's loans" by bearing the ultimate burden of those debts. [Citation omitted.] But except for avoiding taxes, it made no sense for Tribune to relinquish 95% of its ownership over the Cubs Assets, while guaranteeing the Senior Debt funding CBH's payment to Tribune for the Cubs Assets. For very good reasons, everyone involved was confident that CBH would pay its debts. And given the parties' arrangements and the Senior Debt's overcollateralization, Tribune had no more than a de minimis (zero to 0.43%) risk on the Senior Debt.

There is no evidence, moreover, that the Senior Guarantee had any effect on the terms or amount of the Senior Debt, and petitioners do not claim otherwise. [Citation omitted.] There was, for example, no evidence that a lender offered CBH a lower interest rate, a larger loan, or any more favorable terms than it would have without the Senior Guarantee. Tribune itself concluded that it was "unlikely" that the Senior Guarantee "enhanced" the Senior Debt's amount or terms. (Br.32, 69; A.1000.) If the Senior Guarantee caused any such enhancement, moreover, that would have benefited CBH and the Rickettses, as CBH's 95% owners — not only the senior lenders, as petitioners claim [Citation omitted.] Tribune determined, however, that "the Rickettses received "no perceived benefit" from the Senior Guarantee. [Citation omitted.] Tribune viewed its guarantees as "insignificant to the overall transaction" and "not a continued necessity" for CBH's successful operations. [Citation omitted.] Petitioners also point out that the senior lenders negotiated the terms of Tribune's guarantees. [Citation omitted.] This does nothing to show a business purpose for Tribune to guarantee the funds CBH used to pay Tribune for the Cubs Assets, and it is hardly surprising that sophisticated banks and institutions loaning $425 million would take an interest in the terms of guarantees Tribune insisted on providing.

The evidence shows that Tribune had no business purpose for the Senior Guarantee, which existed only to support outsized tax benefits. The Tax Court thus erred in concluding that petitioners' treatment of the Senior Debt passed muster under Section 1.701-2.

d. The Tax Court also erroneously relied on irrelevant and unreliable evidence

The Tax Court's alternative rejection of the Commissioner's view of the Senior Guarantee (SA.110-14) proceeded through multiple legal errors and relied on irrelevant and unreliable evidence (Br.68-73). Petitioners assert that the court properly relied on the total valuation of both guarantees (for the Senior Debt and Subordinated Debt). (Pet.Br.72.) But that was inconsistent with the Tax Court's correct conclusion that the Subordinated Debt was not debt, for federal tax purposes. The court should not have used Tribune's risk on that separate non-debt to boost petitioners' claim that Tribune had risk for the Senior Debt. (Br.70-71; see supra at 15-16.) Petitioners also defend the Tax Court's reliance on S&P estimates, prepared from 2012 to 2016, of Tribune's risk under both guarantees. (Pet.Br.73.) The Tax Court should not have placed any weight on those documents, which were prepared years after the Cubs Transaction by an analyst who lumped together the purported risk on both guarantees and lacked basic knowledge about the elements of the deal. (Br.71-73; see infra at 57-58.)

As with Section 1.752-2(j), the Tax Court committed multiple legal errors in its analysis of Section 1.701-2, and it compounded those errors by relying on irrelevant and unreliable evidence. (Br. 61-73.) The Tax Court's decision, at a minimum, should be vacated as to its analysis of the Senior Guarantee under Section 1.701-2, and the case remanded for application of the correct legal framework to relevant facts.

On brief on appeal, the government argued:

In upholding petitioners' treatment of the Senior Debt, the Tax Court misinterpreted two anti-abuse regulations

A. The Tax Court failed to apply the plain text of Treas. Reg. § 1.752-2

1. The Section 1.752-2(j) anti-abuse rule analyzes real facts, circumstances, and substance

2. The Commissioner's interpretation of Section 1.752-2(j) is consistent with Congressional intent

3. Judicial doctrines underlying Section 1.752-2(j) support the Commissioner's interpretation

4. The parties' arrangements made it appear as though Tribune bore risk for the Senior Debt, but the substance of the arrangements was otherwise

B. The partnership anti-abuse rule in Treas. Reg. § 1.701-2 separately bars the tax benefits claimed from the Senior Guarantee

1. I.R.C. § 7805(a) granted authority to promulgate Section 1.701-2

2. The Commissioner may rely on both the Section 1.752-2(j) and Section 1.701-2 anti-abuse rules

3. The Tax Court erroneously interpreted and applied Section 1.701-2

a. The business-purpose requirement applies to each transaction, not "to the function of the partnership as a whole"

b. The Tax Court failed to focus the business-purpose inquiry on the Senior Guarantee

c. Tribune had no business purpose for the Senior Guarantee

d. The Tax Court also erroneously relied on irrelevant and unreliable evidence

Part II. Answering brief of the Commissioner as cross-appellee

Statement of the issue

Statement of the case

A. Supplemental facts regarding the Subordinated Debt

B. The Tax Court found that the Subordinated Debt was equity

Summary of argument

Argument:

The Tax Court correctly held that the Subordinated Debt was equity for federal tax purposes.

Standard of review

A. Legal framework

B. The Subordinated Debt was equity, and not bona fide debt, for federal tax purposes

1. The Rickettses funded the Subordinated Debt and controlled both lender and borrower

2. CBH used the Subordinated Debt to acquire capital assets

3. Especially given Tribune's tax-avoidance aims, it matters little how the parties labeled or categorized the Subordinated Debt

4. The Subordinated Debt effectively lacked a fixed maturity date

5. With no meaningful enforcement rights, and no chance any rights would actually be enforced, the risk in advancing the Subordinated Debt resembled equity, not debt

6. A third party would not have accepted the Subordinated Debt terms

7. The record supports the Tax Court's findings that several factors were neutral

C. The Tax Court correctly found that the Subordinated Debt was equity, and not bona fide debt

[e] Summary of Taxpayer Arguments on Appeal.

On brief on appeal, taxpayers argued:

This case involves Tribune Media Company's transfer of the Chicago Cubs baseball team to a partnership it formed with the Ricketts family. Tribune used a well-established and thoroughly regulated type of partnership transaction, and it followed an on-point tax regulation to the letter. It paid $149 million in tax on the transaction. But the government wants more tax, so it cast aside its own regulation and asserted sweeping authority to invalidate Tribune's tax treatment under two anti-abuse rules. The Tax Court correctly rejected that approach.

In the transaction at issue, Tribune formed a partnership with Ricketts Acquisition LLC (RAC). The partnership was called Chicago Baseball Holdings, LLC (CBH). Tribune contributed the Cubs and related assets, and RAC contributed money. The partnership took out two loans, and Tribune guaranteed their collection. The partnership then used the loan proceeds to pay Tribune. Under longstanding tax regulations, the money paid to Tribune was a "debt-financed distribution," rather than proceeds from a sale, because Tribune's guarantees made it liable for the loans. Importantly, the regulations allowed Tribune only to defer the tax and pay it over a period of years, not to avoid paying tax entirely.

The government seeks to disregard Tribune's guarantees because in its view, the likelihood Tribune would ever have to pay on the guarantees was remote. If the government can disregard the guarantees, the government can treat all of the money the partnership paid Tribune as proceeds from a sale and tax it in the year of the transaction.

The Tax Court correctly held that no basis exists for disregarding Tribune's guarantees. The Treasury Department's own regulation sets out the test for determining whether Tribune ultimately was liable for the partnership's loans because of the guarantees. That test, called the constructive-liquidation test, asks whether Tribune would have to repay the loans in the worst-case scenario where all liabilities come due and the partnership has no ability to pay. The test does not consider the likelihood of that scenario occurring. The Tax

Court applied that test and held that Tribune would have to pay in that scenario, so the government cannot disregard the guarantees, and the money paid to Tribune is a debt-financed distribution.

On appeal, the government casts aside its own constructive-liquidation test and argues it can use two anti-abuse rules to disregard the guarantees. But the Treasury Department chose the constructive-liquidation test for this precise situation, and it cannot simply abandon that test when the taxpayer wins under it. Further, by their terms, the anti-abuse rules apply only in narrow circumstances not present here. And even if the government were correct on the law, the government would lose on the facts, because the Tax Court found that the guarantees had real economic value. The Court therefore should affirm on the government's appeal.

The issue on cross-appeal is whether part of the money that the partnership borrowed should be considered equity, rather than debt, for tax purposes. The partnership took out two types of loans — the senior debt (loans from various banks that would be repaid first) and the subordinated debt (loans from a separate company that would be repaid after the senior debt). Everyone agreed that the senior debt qualifies as debt for tax purposes. But the Tax Court treated the subordinated debt as equity. If the subordinated debt is equity, then the portion of the distribution to Tribune funded by that debt does not qualify as a debt-financed distribution.

The key question is whether the parties intended for the investment to be equity, with repayment depending on the success of the venture, or debt, where the funds would be repaid no matter what. Here, the parties' intent is clear: They called the subordinated debt "debt"; issued it as debt; and treated it as debt. The debt instrument required the loan to be paid back regardless of the partnership's success. If the partnership did not repay the loan, the debtholder would have the same right to repayment as the partnership's other unsecured creditors, ahead of the equity holders. All interested third parties treated the subordinated debt as debt. The lenders of the senior debt entered into binding contracts on that basis. Major League Baseball (MLB) and Standard & Poor's (S&P) both considered the subordinated debt to be debt when they analyzed the Cubs transaction to understand its effect on Tribune's and the partnership's financial positions.

The Tax Court reached the wrong result because it failed to focus on the ultimate question: the parties' intent. It mechanically applied a thirteen-factor test instead of evaluating what the factors show about the parties' intent. It also relied on standard features of subordinated debt to show equity, even though subordinated debt is a common form of financing that is widely understood to be debt. And it completely disregarded the evidence of how the interested third parties treated the subordinated debt. This Court therefore should reverse on the cross-appeal.

On brief the taxpayers argued on appeal:

I. Tribune and CBH Correctly Reported the Debt-Financed Distribution

Standard of Review

A. Tribune Was Liable for Repaying CBH's Loans Because of Its Guarantees

1. The Constructive-Liquidation Test Provides the Governing Rule Here

2. Tribune Bore the Economic Risk of Loss for the Loans Under the Constructive-Liquidation Test

B. The Specific Anti-Abuse Rule Is Inapplicable

1. The Text of the Rule Provides No Basis to Disregard Tribune's Guarantees

2. Nothing Else Supports the Government's Interpretation of the Specific Anti-Abuse Rule

3. Tribune Bore a Meaningful Risk of Loss on Its Guarantees

C. The General Anti-Abuse Rule Is Inapplicable

1. The General Anti-Abuse Rule Is Invalid

2. The General Anti-Abuse Rule Applies to the Cubs Transaction as a Whole, Not to Each Guarantee

3. The Transaction Had a Substantial Business Purpose Under Any Standard

II. The Subordinated Debt Was Debt, Not Equity

Standard of Review

A. The Parties Intended the Subordinated Debt to Be Debt

1. Whether an Investment Is Debt or Equity Depends on the Parties' Intent

2. The Parties Intended for CBH to Repay the Subordinated Debt Regardless of CBH's Success

3. Interested Third Parties All Understood the Subordinated Debt to Be Debt

B. Each of the Factors Considered by the Tax Court Showed That the Subordinated Debt Was Debt

1. The Parties Treated the Subordinated Debt as Debt

2. CBH's Obligations and Performance Favored Debt

3. The Lender's Rights Favored Debt

4. The Risks of the Subordinated Debt Favored Debt

C. The Tax Court's Flawed Analysis Should Be Reversed

[f] Taxpayer Discussion of Loper Bright.

Taxpayer's counsel wrote the clerk of the Seventh Circuit Court of Appeals, dated July 3, 2024, Re: *Tribune Media Company v. CIR*, Nos. 23-1135, -1136, -1242, & -1243, concerning the potential application of *Loper Bright Enterprises* to the appeal of *Tribune Media Company*.

I write to advise the Court of the decision in Loper Bright Enterprises v. Raimondo, Nos. 22-451 & 22-1219 (U.S. June 28, 2024). That decision is relevant to the arguments about the validity of the general anti-abuse rule, 26 C.F.R. §1.701-2. [Citation omitted.]

Petitioners have argued that the general anti-abuse rule is invalid because it exceeds the Treasury Department's authority. [Citation omitted.] In Loper Bright, the Supreme Court overruled Chevron, holding that courts should not defer to an agency's interpretation of an ambiguous statute that the agency administers. Slip Op. 35. The Court made clear that courts should "exercise independent judgment" to ensure that agencies do not act outside of their delegated authority. Id. at 17-18.

Here, the government does not make an express claim of Chevron deference. See Gov't Response-Reply Br. 22-27. But it argues that the Treasury Department had the authority to promulgate the general anti-abuse rule, because Congress in 26 U.S.C. §7805(a) gave the agency the general authority to "prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code]." Id. (quoting 26 U.S.C. §7805(a)).

The general anti-abuse rule is an extraordinarily broad assertion of agency authority; the agency even contends that it can invalidate a transaction that follows "the literal words" of a statute that Congress enacted. [Citation omitted.] Loper Bright confirms that this Court should scrutinize that assertion of authority carefully to ensure that the agency stayed within permissible statutory bounds. [Citation omitted.]

[g] Internal Revenue Service Discussion of Loper Bright.

In a letter to the clerk of the Court of Appeals for the Seventh Circuit, dated July 10, 2023, Re: *Tribune Media Co., et al. v. Commissioner of Internal Revenue* (7th Cir.__ Nos. 23-1135, 23-1136, 23-1242, 23-1243), the Justice Department argued:

The Commissioner responds to petitioners' letter concerning Loper Bright Enterprises v. Raimondo, — S. Ct. —, 2024 WL 3208360 (2024). Loper Bright overruled Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). But as petitioners acknowledge, the Commissioner has not relied on Chevron to establish the validity of the partnership anti-abuse rule in Treas. Reg. §1.701-2. (See Commissioner Reply-Ans. Br. 21-27.)

Petitioners challenge the Commissioner's authority to issue the regulation. But the partnership anti-abuse rule targeted by petitioners is rooted in well-established caselaw combating tax abuse. (Id.) Nearly 60 years before §1.701-2 was promulgated, the Supreme Court upheld the Commissioner's determination that a corporate reorganization, which met technical statutory requirements, nonetheless "was without substance and must be disregarded" for federal tax purposes. Gregory v. Helvering, 293 U.S. 465, 467-70 (1935). The §1.701-2 anti-abuse rule is directly traceable to Gregory and its progeny. (Commissioner Reply-Ans. Br. 24-27.) And the business-purpose requirement in §1.701-2(a)(1), on which the Commissioner's appeal focuses, also is consistent with Congress' more recent codification of the judicial economic-substance doctrine, I.R.C. §7701(o). (Id. 25-26.)

The partnership anti-abuse rule, moreover, comfortably fits within the regulatory authority (now codified at I.R.C. §7805(a)) that Congress has granted in the tax arena since the Revenue Act of 1918 — and petitioners have not argued otherwise. (Id. 22-24.) Section 7805(a) is "essential to efficient and fair administration of the tax laws" because the tax system is "complex," and the IRS "must be able to exercise its authority to meet changing conditions and new problems." Bob Jones Univ. v. United States, 461 U.S. 574, 596 (1983).

Tribune created such problems by attempting to abuse federal tax rules to avoid a prodigious tax bill when it sold the Chicago Cubs and related assets. That ran afoul of, among other things, the §1.701-2 partnership anti-abuse rule. And that rule is supported by a long and unbroken history of judicial doctrines and Congressional enactments empowering the IRS to combat the kind of chicanery attempted here.

[2] Who Is A Limited Partner For Purposes Of SECA?

Section 1402(a)(13) excludes from net self-employment earnings under the Self-Employment Contributions Act (SECA) tax limited partner's distributive share of income or loss. The problem is to determine who is a "limited partner" for this purpose. The Internal Revenue Service is considering proposing regulations, but, as this is written, there are no current proposed regulations. Earlier proposed regulations were issued in 1997.

Compensation earned by individual taxpayers ordinarily is subject to employment taxes. Sole proprietors, independent contractors, and partners are subject to Self-Employment Contributions Act taxes. Self-Employment Contributions Act taxes is imposed on "net earnings from self-employment".

Self-Employment Contributions Act taxes start in 1950. Section 1401 taxes self-employment income of individuals. Section 1401 imposed a hospital insurance tax currently at the rate of 2.9% of self-employment income. Section 1402 also imposes old-age, survivors, and disability tax at the rate of 12.4% of self-employment income (subject to an income cap). Distributive shares of income of all partners, both general and limited, were initially subject to Self-Employment Contributions Act taxes. In 1977, Congress enacted the predecessor to Section 1402(a)(13).[175] Section 1402(a)(13) states: "[T]here shall be excluded the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in Section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services." Guaranteed payments made to limited partners for services are subject to Self-Employment Contributions Act taxes.

Congress was concerned about limited partnership interests that produced income subject to Self-Employment Contributions Act. This entitled the limited partners to Social Security benefits on retirement. The Ways and Means Committee felt that this eligibility was

[175] Social Security Financing Amendments of 1977, Pub. L. No. 95-216, 91 Stat. 1509.

"inconsistent with the of the [Self-Employment Contributions Act] program that benefits are designed to p lost earnings from work."[176]

The Internal Revenue Service issued proposed regulations in in 1994 on account of the challenges of LLC's under the Self-Employment Contributions Act rules. A member of a limited liability company would be treated as a "limited partner"[177] if –

- the member was not a limited liability company manager and,
- the LLC could have been formed as a limited partnership in the state and if the LLC had been formed as a limited partnership, the member could have qualified as a limited partner.

The proposed regulations were designed to "to ensure that both a member of a limited liability company and a limited partner in a limited partnership who participate in the management or control of the entity to the same extent are treated in the same manner for self-employment tax purposes."[178] The proposed regulations were never finalized. The Internal Revenue Service withdrew the proposed regulations.

In 1997, the Internal Revenue Service proposed new regulations. New proposed regulations addressed limited partnerships, limited liability companies, limited liability partnerships, and other similar entities. The new proposed regulations define "limited partner" required that a limited partner not have any of these characteristics:

- the partner was personally liable for the liabilities of the partnership based on his status as a partner, or
- the partner had authority under state law to contract for the partnership, or
- the partner participated in the partnership's business more than 500 hours during a partnership taxable year.[179]

The second proposed regulation adopted a functional approach to determining whether a state law limited partner or member of a limited liability company is a limited partner for purposes of Section 1402(a)(13): "Thus, even in the case of a state law limited partnership, a functional approach is necessary to ensure that the self-employment tax consequences to

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[176] H.R. Rep. No. 95-702. The House Ways and Means Committee explained.:

The advertising [of limited partnership interests] injures the Social Security program in the public view and causes resentment on the part of the vast majority of workers whose employment is compulsorily covered under [Social Security], as well as those people without work income who would like to be able to become insured under the [Social Security] program but cannot afford to invest in limited partnerships.

H. R. Rep. No. 95-702, at 13. *Cf. Estate of Ellsasser v. Commissioner*, 61 T.C. 241 (1973).

[177] For purposes of I.R.C. § 1402(a)(13).

[178] Notice 45-94, 1995-1 C.B. 853.

[179] Prop. Treas. Reg. § 1.1402(a)-2(h)(2), 62 Fed. Reg. 1702-01 (1997).

similarly situated taxpayers do not differ depending upon where the partnership is organized."[180] Under the second proposed regulations, a service partner in a service partnership was not a limited partner. A "service partner" provided services either to a partnership or on behalf of its trade or business. A "service partnership" was a partnership substantially all of whose activities involved the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, or consulting.

The Biden Administration revenue proposals for 2022[181] mention problems under Section 1402(a)(13) because Section 1402(a)(13) only refers to limited partners.[182] The

[180] Notice 45-94, 1995-1 C.B. 853.

[181] See United States Treasury Department, General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals (May 2021) ("Revenue Proposals").

[182] The Revenue Proposals discuss this state of the law and reasons for change:

RATIONALIZE NET INVESTMENT INCOME AND SELF-EMPLOYMENT CONTRIBUTIONS ACT TAXES

Current Law

Individuals with incomes over a threshold amount are subject to a 3.8 percent tax on net investment income. The threshold is $200,000 for single and head of household returns and $250,000 for joint returns. Net investment income generally includes: (1) interest, dividends, rents, annuities, and royalties, other than such income derived in the ordinary course of a trade or business; (2) income derived from a trade or business in which the taxpayer does not materially participate; (3) income from a business of trading in financial instruments or commodities; and (4) net gain from the disposition of property other than property held in a trade or business in which the taxpayer materially participates. The net investment income tax (NIIT) does not apply to self-employment earnings. Proceeds from the NIIT flow into the General Fund of the Treasury. Self-employment earnings and wages are subject to employment taxes under either the Self Employment Contributions Act (SECA) or the Federal Insurance Contributions Act (FICA), respectively. Both SECA and FICA taxes apply at a rate of 12.4 percent for social security tax on employment earnings (capped at $142,800 in 2021) and at a rate of 2.9 percent for Medicare tax on all employment earnings (not subject to a cap). An additional 0.9 percent Medicare tax is imposed on self-employment earnings and wages of high-income taxpayers, above the same NIIT thresholds of $200,000 for single and head of household filers and $250,000 for joint filers. The SECA and FICA taxes flow into the Social Security and Hospital Insurance Trust Funds. General partners and sole proprietors pay SECA tax on the full amount of their net trade or business income, subject to certain exceptions. I.R.C. § 1402(a)(13) of the Internal Revenue Code provides that limited partners are statutorily excluded from paying SECA tax with respect to their distributive shares of partnership income or loss, although they are subject to SECA tax on their section 707(c) guaranteed payments from the partnership that are for services they provide to, or on behalf of, the partnership. Because the statutory exclusion only refers to limited partners, questions have arisen as to the meaning of this term and whether the limited partner exclusion might be applicable to limited liability company (LLC) members. Some partners who might more accurately be considered general partners and some LLC members avoid SECA by claiming the treatment of limited partners. S corporation shareholders are not subject to SECA tax. However, tax law requires that owner employees pay themselves "reasonable compensation" for services provided, on which they pay FICA tax like any other employee. Nonwage distributions to shareholders of S corporations are not subject to either FICA or SECA taxes.

Reason for Change

proposals included legislation that would impose Self-Employment Contributions Act tax on limited partners and members who "materially participate" in a business.[183]

Active owners of pass-through businesses are treated differently for purposes of the NIIT and SECA tax according to the legal form of their ownership and the legal form of the payment that they receive. While general partners and sole proprietors pay SECA tax on earnings from their businesses, S corporation owner-employees and limited partners (their counterparts and sometimes competitors) pay employment taxes on only a portion of their earnings. LLC members often pay little or no SECA tax at all. Although the NIIT reflects an intention to impose the 3.8 percent tax on both earned and unearned income of high-income taxpayers, certain income escapes both SECA tax and the NIIT, including the distributive shares of S corporation shareholder-employees, limited partners, and LLC members who claim the statutory exclusion for limited partners. Different treatment is unfair, inefficient, distorts choice of organizational form, and provides tax planning opportunities for business owners, particularly those with high incomes, to avoid paying their fair share of taxes. The current system is also a challenge for the Internal Revenue Service (IRS) to administer. The determination of "reasonable compensation" of S corporation owners generally depends on facts and circumstances and requires a valuation analysis, which is expensive, and which can be contested by the taxpayer, adding to the cost of administration and enforcement. Uncertainty surrounding the treatment of limited partners and LLC members who materially participate in their businesses undermines the IRS's ability to ensure payment of SECA tax and the NIIT. In addition, proceeds from the NIIT are paid into the General Fund of the Treasury, while the Medicare portion of FICA and SECA taxes are paid into the Hospital Insurance Trust Fund. This treatment of the taxes is inconsistent with the fact that the taxes are intended for the same purpose.

[183] The Revenue Proposals provide:

Proposal

The proposal would (i) ensure that all pass-through business income of high-income taxpayers is subject to either the NIIT or SECA tax, (ii) redirect NIIT funds to the Hospital Insurance Trust Fund, (iii) make the application of SECA to partnership and LLC income more consistent for high-income taxpayers, and (iv) apply SECA to the ordinary business income of high-income nonpassive S corporation owners. First, the proposal would ensure that all trade or business income of high-income taxpayers is subject to the 3.8-percent Medicare tax, either through the NIIT or SECA tax. In particular, for taxpayers with adjusted gross income in excess of $400,000, the definition of net investment tax would be amended to include gross income and gain from any trades or businesses that is not otherwise subject to employment taxes. Second, all of the revenue from the NIIT (that raised under current law and that which would be raised by the proposed expansion) would be directed to the Hospital Insurance Trust Fund, just as is the revenue from the 3.8 percent tax under FICA and SECA. Third, limited partners and LLC members who provide services and materially participate in their partnerships and LLCs would be subject to SECA tax on their distributive shares of partnership or LLC income to the extent that this income exceeds certain threshold amounts. The exemptions from SECA tax provided under current law for certain types of partnership income (e.g., rents, dividends, capital gains, and certain retired partner income) would continue to apply to these types of income.

Fourth, S corporation owners who materially participate in the trade or business would be subject to SECA taxes on their distributive shares of the business' income to the extent that this income exceeds certain threshold amounts. The exemptions from SECA tax provided under current law for certain types of S corporation income (e.g., rents, dividends, and capital

In addition to the tax activity concerning Self-Employment Contributions Act, the laws concerning limited partners have changed appreciably in some states since the enactment of the limited partner exception. Under some current state partnership laws, limited partners may be permitted to participate in the management and control of the partnership without incurring personal liability for the liabilities of the partnership. In some states, a limited partner may consult with or advise a general partner, cause the general partner to take a specific action, act as a surety for the partnership, elect or remove a general partner, terminate the partnership, amend the partnership agreement, act as an employee, or propose or vote with respect to various partnership matters related to the business of the partnership.

Limited liability companies were introduced in Wyoming in 1977 and spread to most other states. Limited liability companies provided liability protection for all partners.

Limited liability partnerships were introduced in Texas in 1991. They have spread to many other states.

Limited liability companies and limited liability partnerships provide limited liability for members or partners, even though the partners are actively involved in the business and even though the partners may manage the business.

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gains) would continue to apply to these types of income. In order to determine the amount of partnership income and S corporation income that would be subject to SECA tax under the proposal, the taxpayer would sum (a) ordinary business income derived from S corporations for which the owner materially participates in the trade or business, and (b) ordinary business income derived from either limited partnership interests or interests in LLCs that are classified as partnerships to the extent a limited partner or LLC member materially participates in its partnership's or LLC's trade or business (this sum referred to as the "potential SECA income"). Beginning in 2022, the additional income that would be subject to SECA tax would be the lesser of (i) the potential SECA income, and (ii) the excess over $400,000 of the sum of the potential SECA income, wage income subject to FICA under current law, and 92.35 percent of self-employment income subject to SECA tax under current law. The $400,000 threshold amount would not be indexed for inflation.

Material participation standards would apply to individuals who participate in a business in which they have a direct or indirect ownership interest. Taxpayers are usually considered to materially participate in a business if they are involved in it in a regular, continuous, and substantial way. Often this means they work for the business for at least 500 hours per year. The statutory exception to SECA tax for limited partners would not exempt a limited partner from SECA tax if the limited partner otherwise materially participated. The proposal would be effective for taxable years beginning after December 31, 2021.

Revenue Proposals at 66-67.

[a] *Renkemeyer, Campbell & Weaver, LLP v. Commissioner (2011): Who Is a Limited Partner for purposes of Self-Employment Income?*

In *Renkemeyer, Campbell & Weaver, LLP v. Commissioner*,[184] the taxpayers, three attorney partners, formed a Kansas limited liability partnership. The limited liability partnership operated a law firm practice. The law firm practiced Federal income tax law.

The limited liability partnership had three individual partners. A fourth partner was an S corporation.

The S corporation was owned by an ESOP.

The Internal Revenue Service audited the LLP. The Internal Revenue Service disallowed a special allocation and recharacterized the distributive shares as net earnings from self-employment.

For tax year ended April 30, 2004, the law firm limited liability partnership in *Renkemeyer, Campbell & Weaver, LLP* allocated 87.557 percent of its net business income to the

[184] 136 T.C. 137 (2011). "In *Soroban Capital Partners v. Commissioner*, 161 T.C. No. 12 (2023), the Tax Court addressed the scope of the section 1402(a)(13) exclusion for "a limited partner, as such" in a state-law limited partnership. The issue was whether the limited partner's distributive share of the partnership's ordinary business income could be excluded. The Tax Court applied a "functional analysis," and held that the exclusion does not apply to a partner who is limited in name only. Rather, the limited partner must be functioning as a passive investor for the exclusion to apply. In *Renkemeyer, Campbell, & Weaver, LLP, v. Commissioner*, 136 T.C. 137, 150 (2011), the Tax Court held that distributive shares of limited partners in a law firm that was an LLP (limited liability partnership under applicable State law) of partnership income "arising from the legal services they performed in their capacity as partners in the law firm are subject to self-employment tax" in the years at issue. See also Amy S. Elliott, "Tax Court Decision Could Reignite Debate Over Partnerships and Employment Taxes," Tax Notes, vol. 130, March 11, 2011, p. 1244. See also *Howell v. Commissioner*, T.C. Memo. 2012-303 (2012) in which the Tax Court concluded that a member of a state-law limited liability company (treated as a partnership for tax purposes) who received guaranteed payments had performed services for the partnership and therefore was required to include the payments in net earnings from self-employment; and *Riether v. U.S.*, 919 F.Supp. 2d 1140 (D.C. N.M., 2012) in which the District Court held that the two members of a diagnostic imaging LLC should have treated all their income from the LLC as self-employment income because they participated in the partnership business. In 1997, the Treasury Department issued proposed regulations defining a limited partner for purposes of the self-employment tax rules. Prop. Treas. Reg. sec. 1.1402(a)-2 (January 13, 1997). These regulations provided, among other things, that an individual is not a limited partner if the individual participates in the partnership business for more than 500 hours during the taxable year. However, in the Taxpayer Relief Act of 1997, the Congress imposed a moratorium on regulations regarding employment taxes of limited partners. The moratorium provided that any regulations relating to the definition of a limited partner for self-employment tax purposes could not be issued or effective before July 1, 1998. No regulations have been issued to date. Staff of the Joint Committee on Taxation, *Description of the Revenue Provisions Contained in the President's Fiscal Year 2025 Budget Proposal* (JCS-1-24), 188n.780, 118th Congress, 2nd Session (November 2024)

S corporation. The Internal Revenue Service disallowed the special allocation. The Internal Revenue Service also determined that the three attorney partners' distributive shares of the law firm's net business income were net earnings from self-employment subject to Self-Employment Contributions Act tax on self-employment income.

Section 1401(a) imposes a tax on the self-employment income of every individual for a taxable year. Self-employment income is defined as "the net earnings from self-employment derived by an individual . . . during any taxable year" excluding (1) the portion in excess of the Social Security wage base limitation for the year as well as (2) all earnings from self-employment if the total amount of the individual's net earnings from self-employment for the taxable year is less than $400.[185] A partner must include his distributive share of partnership income in calculating his net earnings from self-employment. Fees for services, like those generated by a law partnership, are part of the partners' distributive shares under Section 702(a)(8).

Section 1402(a)(13) provides:

> *there shall be excluded the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in Section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services . . . .*

Taxpayers in *Renkemeyer, Campbell & Weaver, LLP* argued that the three individual law firm partners should be considered limited partners in a limited partnership for purposes of Section 1402(a)(13). They emphasized that their respective interests in the law firm share characteristics of those of a limited partner in a limited partnership because:

- their interests are designated as limited partnership interests in the law firm's organizational documents, and
- the individual interests in the law firm enjoy limited liability pursuant to Kansas law.

The court in *Renkemeyer, Campbell & Weaver, LLP* found that:

- all partners of an L.L.P. enjoy limited liability protection and may have management powers.
- in essence, an L.L.P. is a general partnership that affords a form of limited liability protection for all its partners by filing a statement of qualification with the appropriate state authorities.

[185] I.R.C. § 1402(b).

- a Kansas partnership that elects to become an L.L.P. "continues to be the same entity that existed before the filing of a statement of qualification under K.S.A. 56a–1001."[186]

A limited partnership has two fundamental classes of partners, general and limited. General partners typically have management power, General partners typically have unlimited personal liability. Limited partners lack management powers but enjoy immunity from liability for debts of the partnership. The court observed that it is generally understood that a limited partner could lose his limited liability protection were he to engage in the business operations of the partnership.[187]The court observed that "the interest of a limited partner in a limited partnership is generally akin to that of a passive investor."

All partners of a limited liability partnership enjoy limited liability protection and may have management powers. An L.L.P. is a general partnership that affords a form of limited liability protection for all its partners by filing a statement of qualification with the appropriate state authorities.

The court in *Renkemeyer, Campbell & Weaver, LLP* observed:

Section 1402(a)(13) was originally enacted as section 1402(a)(12) at a time (1977) before entities such as L.L.P.s were contemplated, [citation omitted] and the applicable statute did not, and still does not, define a "limited partner". When L.L.P.s (and limited liability companies) began to be frequently used, it was determined that there needed to be a definition of "limited partner" for purposes of the self-employment tax. In 1997 the Secretary issued proposed regulations which were intended to do just that. See sec. 1 .1402(a)–2, Proposed Income Tax Regs., 62 Fed.Reg. 1704 (Jan. 13, 1997). The proposed regulations ignited controversy. As a result, Congress enacted legislation which provided that "No temporary or final regulation with respect to the definition of a limited partner under section 1402(a)(13) of the Internal Revenue Code of 1986 may be issued or made effective before July 1, 1998." Taxpayer Relief Act of 1997, Pub.L. 105–34, sec. 935, 111 Stat. 882. Indeed, a Sense of the Senate resolution with respect to this provision stated:

SEC. 734. SENSE OF THE SENATE WITH RESPECT TO SELF–EMPLOYMENT TAX OF LIMITED PARTNERS.

(a) Findings.—The Senate finds that—

* * *

(4) certain types of entities, such as limited liability companies and limited liability partnerships, were not widely used at the time the present rule relating to limited partners was enacted, and that the proposed regulations attempt to address owners of such entities;

[186] Kan. Stat. Ann. sec. 56a–201(b) (2005).

[187] This may not be the case under state law.

(5) the Senate is concerned that the proposed change in the treatment of individuals who are limited partners under applicable State law exceeds the regulatory authority of the Treasury Department and would effectively change the law administratively without Congressional action; and

(6) the proposed regulations address and raise significant policy issues and the proposed definition of a limited partner may have a substantial impact on the tax liability of certain individuals and may also affect individuals' entitlement to social security benefits.

(b) Sense of Senate.—It is the sense of the Senate that—

(1) the Department of the Treasury and the Internal Revenue Service should withdraw Proposed Regulation 1.1402(a)–2 which imposes a tax on limited partners; and

(2) Congress, not the Department of the Treasury or the Internal Revenue Service, should determine the tax law governing self-employment for limited partners. [188]

143 Cong. Rec. 13297 (1997). [Footnote omitted.]

As of 2005 Congress had not issued any other pronouncements with respect to the definition of a limited partner for purposes of the self-employment tax, nor had the Secretary. We therefore are left to interpret the statute without elaboration. [189]

The court in *Renkemeyer, Campbell & Weaver, LLP* looked to plain meaning of "limited partner" and to legislative history. [190]

"Limited partner" is a technical term which has become obscured over time because of the increasing complexity of partnerships and other flowthrough entities as well as the history of section 1402(a)(13). We therefore must look to the legislative history for guidance.

Section 1402(a)(13) was enacted by the Social Security Amendments of 1977. [191]

The relevant legislative history provides insight with respect to Congress' intent:

Under present law each partner's share of partnership income is includable in his net earnings from self-employment for social security purposes, irrespective of the nature of his membership in the partnership. The bill would exclude from social security coverage, the distributive share of income or loss received by a limited partner from the trade or business of a limited partnership. This is to exclude for coverage purposes certain earnings which are basically of an investment nature. However, the exclusion from coverage would not extend

[188] 136 T.C. at 149.

[189] 136 T.C. at 149.

[190] "Since section 1402(a)(13) does not define "limited partner", we apply accepted principles of statutory construction to ascertain Congress' intent. It is a well-established rule of construction that if a statute does not define a term, the term is to be given its ordinary meaning. *Gates v. Commissioner*, 135 T.C. 1, 6, (2010); *see Perrin v. United States*, 444 U.S. 37, 42, 100 S.Ct. 311, 62 L.Ed.2d 199 (1979). And we look to the legislative history to ascertain Congress' intent if the statutory purpose is obscured by ambiguity. *See Burlington N. R.R. v. Okla. Tax Commn.*, 481 U.S. 454, 461, 107 S.Ct. 1855, 95 L.Ed.2d 404 (1987)." 136 T.C. at 149.

[191] Pub. L. 95–216, sec. 313(b), 91 Stat. 1536.

to guaranteed payments (as described in 707(c) of the Internal Revenue Code), such as salary and professional fees, received for services actually performed by the limited partner for the partnership [192]

The Tax Court in *Renkemeyer, Campbell & Weaver, LLP* read the legislative history as revealing an intent of the limited partner exception was to ensure that individuals who merely invested in a partnership and who were not actively participating in the partnership's business operations would not receive credits toward Social Security coverage.

The insight provided reveals that the intent of section 1402(a)(13) was to ensure that individuals who merely invested in a partnership and who were not actively participating in the partnership's business operations (which was the archetype of limited partners at the time) would not receive credits toward Social Security coverage. The legislative history of section 1402(a)(13) does not support a holding that Congress contemplated excluding partners who performed services for a partnership in their capacity as partners (i.e., acting in the manner of self-employed persons), from liability for self-employment taxes.

Aside from a nominal amount of income arising from recognition of certain pass-through income from RCGW, all of the law firm's revenues were derived from legal services performed by petitioner and Messrs. Campbell, and Weaver in their capacities as partners. Petitioner and Messrs. Campbell, and Weaver each contributed a nominal amount ($110) for their respective partnership units. Thus it is clear that the partners' distributive shares of the law firm's income did not arise as a return on the partners' investment and were not "earnings which are basically of an investment nature." Instead, the attorney partners' distributive shares arose from legal services they performed on behalf of the law firm.

To conclude, we hold that the respective distributive shares of petitioner and Messrs. Campbell, and Weaver arising from the legal services they performed in their capacity as partners in the law firm are subject to self-employment taxes for the 2004 and 2005 tax years. [193]

[b] Soroban Capital Partners LP (2023): Are Limited Partners of a Limited Partnership Limited Partners for purposes of Social Security?

Soroban Capital Partners LP v. Commissioner[194] held that state law classifications of limited partners are not controlling for purposes of Section 1402(a)(13) ("exclud[ing] from net earnings from self-employment the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in Section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services"). Applying a plain meaning analysis, the Tax Court in *Soroban Capital Partners LP* found that "limited

[192] H. Rept. 95–702 (Part 1), at 11 (1977).
[193] 136 T.C. at 149 at 150.
[194] 161 T.C. 12 (2023).

partner" under state law does not mean "limited partner, as such" and that limited partners are not *per se* limited partners for purposes of Section 1402(a)(13).

Soroban Capital Partners LP was an investment firm organized as a Delaware limited partnership. Soroban Capital originally was organized as a limited liability company. Soroban Capital converted to a Delaware limited partnership.

The Notices of Final Partnership Administrative Adjustment in *Soroban Capital Partners LP* asserted that income allocated to the limited partners constituted earnings from self-employment. The notices took this position, notwithstanding that the limited partners were limited partners under Delaware law. The taxpayer, in response, argued in *Soroban Capital Partners LP* that the limited partner income was explicitly exempted from net earnings from self-employment by Section 1402(a)(13). The language of that statute is clear. A limited partner's income cannot constitute net earnings from self-employment under the specific language of the statute (except for guaranteed payment income). The focus of in *Soroban Capital Partners LP* was the term "limited partner" under the Section 1402(a)(13) exclusion. This term is not explicitly defined in the Code. The taxpayer in in *Soroban Capital Partners LP* asserted that the court should look to state law in interpreting "limited partner," and that this state treatment should be dispositive. Further, the term "limited partner" has an accepted meaning as a person who was a limited partner under state law. The taxpayer emphasized that Section 1402 had been reenacted many times since 1977, and that Congress had not enacted a more limiting definition of "limited partner."

The taxpayer in in *Soroban Capital Partners LP* also stressed that Congress had imposed an explicit moratorium from finalizing 1997 proposed regulations under which the Internal Revenue Service sought to define "limited partner" under a functional analysis.

The 1997 proposed regulations rejected treating all state law limited partners as "limited partners" under the self-employment tax. The proposed regulations provided that an individual is not a "limited partner" if

- the individual has personal liability for partnership debts,
- the individual has authority to contract on behalf of the partnership, or
- the individual participates in the partnership's trade or business for more than 500 hours during the taxable year.

A Senate resolution expressed concern that the proposed regulations changed and did not interpret the statute. The Senate was concerned that a limited partner's income could be taxed to a passive investor under the self-employment tax. A passive investor could be taxable under the self-employment tax if the partnership had liability for partnership debts.

In 2011, the Tax Court considered a similar question with respect to a limited liability partnership in Renkemeyer v. Commissioner (136 T.C. 137). In Renkemeyer, the Tax Court applied a functional analysis test to an LLP that considered the functions and roles performed by the limited partners to determine whether the limited partners were passive investors or were actively participating in the operations of the partnership. In the Soroban case, the Tax Court denied the summary judgement motion by Soroban's GP and held that a functional analysis must be performed in the case of limited partners in a state law limited partnership without defining what should be included in such an analysis.

The taxpayer in in *Soroban Capital Partners LP* argued that the functional test should not apply to partners who were explicitly limited partners under state law.

The Internal Revenue Service in in *Soroban Capital Partners LP* argued for the application of the functional test of *Renkemeyer, Campbell & Weaver, LLP*.

The Tax Court in *Soroban Capital Partners LP* applied a functional analysis to determine whether a partner was a limited partner for purposes of Section 1402(a)(13).[195] Soroban's general partnership argued that its positions was supported by the plain language of the statute and the legislative history of the statute. The statute literally applied the limited partner exclusion to all partners who were limited partners under state law. The Tax Court found that the self-employment tax should be applied to limited partners who were functionally the equivalent of general partners. The Tax Court held that the limited partner exception does not apply to a limited partner who was not functionally a limited partner. The Tax Court in *Soroban Capital Partners LP* observed: "We find that the limited partner exception does not apply to a partner who is limited in name only. If Congress had intended that limited partners be automatically excluded, it could have simply said "limited partner." By adding "as such," according to the Tax Court in *Soroban Capital Partners LP,* Congress made clear that the limited partner exception applies only to a limited partner who is functioning as a limited partner."

Whether this issue can be considered in a BBA partnership audit, however, is uncertain. Section 6241(9)(A) provides that the audit rules to not apply to a chapter 2 tax, such as the Self-Employment Contributions Act tax.

The Tax Court in *Soroban Capital Partners LP* did not explore the grammatical usage of "as such" in Section 1402(a)(13). "[A] such" is apparently a reference to "limited partner", its antecedent. More literally applies, "limited partner, as such" in Section 1402(a)(13) refers to limited partner, as a limited partner. This perhaps is a reference to the possibility that a single

[195] *Cf.* REG-209824-96 (Jan. 10, 1997) (proposed amendments to regulations on self-employment taxes imposed under I.R.C. § 1402; individual treated as a limited partner unless he (1) has personal liability for the debts of or claims against the partnership because he is a partner; (2) has authority to contract on behalf of the partnership; (3) participates in the partnership's trade or business for more than 500 hours during the tax year.).

partner could be both a limited partner and a general partner, and that the exception referred to income as a limited partner.

Section 1402(a)(13) does not define the phrase "limited partner." The Tax Court in *Soroban Capital Partners LP* looked to legislative history and case law for insight on Congress' intended meaning. The limited partner exception was enacted in 1977 to "exclude from social security coverage, the distributive share of income or loss received by a limited partner from the trade or business of a limited partnership."[196] The limited partner exception should exclude earnings that are of an investment nature.[197]

In 1997, Treasury issued a proposed regulation seeking to define the scope of the limited partner exception.[198] The proposed regulation provided that an individual would not be treated as a limited partner if –

- the individual had personal liability for partnership debts,
- had authority to contract on behalf of the partnership, or
- participated in the partnership's trade or business for more than 500 hours during the partnership's taxable year.

Congress issued a moratorium prohibiting Treasury from issuing any temporary or final regulation with respect to the definition of a limited partner under Section 1402(a)(13) until July 1, 1998.[199] Congress' reasoning was that "the Senate [was] concerned that the proposed change in the treatment of individuals who are limited partners under applicable State law exceeds the regulatory authority of the Treasury Department and would effectively change the law administratively without Congressional action."[200]

Since the moratorium,

- Congress has briefly discussed the definition of limited partner but has not defined it.[201]

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[196] H.R. Rep. No. 95-702, pt. 1, at 11, *as reprinted in* 1977 U.S.C.C.A.N. at 4168.

[197] H.R. Rep. No. 95-702, pt. 1, at 11, *as reprinted in* 1977 U.S.C.C.A.N. at 4168.

[198] See Prop. Treas. Reg. § 1.1402(a)-2.

[199] Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 935, 111 Stat. 788, 882.

[200] Revenue Reconciliation Act of 1997, H.R. 2014, 105th Cong., 143 Cong. Rec. S6694, S6774, S6819 (1997).

[201] See, e.g., Staff of J. Comm. on Tax'n, 110th Cong., Present Law and Analysis Relating to Tax Treatment of Partnership Carried Interests and Related Issues, Part I, JCX-62-07, at 35 n.64 (J. Comm. Print 2007) ("[L]imited partner status is determined under State law. Issues have arisen under present law as to the proper [self-employment] tax treatment of individuals who may be limited partners under State law but who participate in the management and operation of the partnership.").

- Treasury has yet to issue any final or temporary regulation defining "limited partner" under Section 1402(a)(13).

In 2011, the Tax Court applied statutory construction principles to determine whether partners in a limited liability partnership should be considered limited partners under Section 1402(a)(13).[202] In *Renkemeyer, Campbell & Weaver, LLP*,[203] the Tax Court analyzed the legislative history of Section 1402(a)(13) and concluded that its intent "was to ensure that individuals who merely invested in a partnership and who were not actively participating in the partnership's business operations . . . would not receive credits towards Social Security coverage." The Tax Court found that "[t]he legislative history . . . does not support a holding that Congress contemplated excluding partners who performed services for a partnership in their capacity as partners (*i.e.*, acting in the manner of self-employed persons), from liability for self-employment taxes."[204]

The Tax Court in *Renkemeyer, Campbell & Weaver, LLP* also held that the partners in that case were not limited partners for purposes of Section 1402(a)(13) because their "distributive shares arose from legal services . . . performed on behalf of the law firm" and not "as a return on the partners' investments."[205]

Renkemeyer, Campbell & Weaver, LLP applied a functional analysis test to determine whether the limited partner exception applied. *Renkemeyer, Campbell & Weaver, LLP* dealt with a limited liability partnership and not a limited partnership. While there have been subsequent opinions applying *Renkemeyer, Campbell & Weaver, LLP* to determine whether taxpayers in passthrough entities are limited partners under Section 1402(a)(13), the Tax Court had not addressed whether a limited partner in a state law limited partnership must satisfy a functional analysis test to be entitled to the limited partner exception.[206]

Petitioner in *Renkemeyer, Campbell & Weaver, LLP* contended that three individuals involved as partners are state law limited partners and therefore their distributive shares of income are excluded from net earnings from self-employment.[207] Petitioner argued that because Soroban is a state law limited partnership and its Limited Partnership Agreement identified the three individuals as limited partners, Section 1402(a)(13) is satisfied.

The Internal Revenue Service argued that the distributive shares of income of limited partners in state law limited partnerships are not automatically exempt from self-employment

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[202] See *Renkemeyer*, 136 T.C. 137.

[203] 136 T.C. at 150.

[204] *Renkemeyer*, 136 T.C. at 150.

[205] *Renkemeyer*, 136 T.C. at 150.

[206] *See, e.g., Castigliola v. Commissioner*, T.C. Memo. 2017-62, at 7–14 (finding professional LLC members not limited partners for purposes of I.R.C. § 1402(a)(13)); *Joseph v. Commissioner*, T.C. Memo. 2020-65, at 60 n.9 (Tax Court declined to answer whether a *de jure* limited partner must satisfy *Renkemeyer*'s functional analysis test to be entitled to the limited partner exclusion).

[207] Under I.R.C. § 1402(a)(13).

income. Instead, the Tax Court must apply a functional analysis test, similar to the test outlined in *Renkemeyer, Campbell & Weaver, LLP* to determine whether individuals are limited partners pursuant to Section 1402(a)(13). The Tax Court in *Soroban Capital Partners LP* agreed with the Internal Revenue Service.

The Tax Court in *Soroban Capital Partners LP* found that the limited partner exception does not apply to a partner who is limited in name only. The Tax Court found that this view was supported by the plain meaning of the statute.

> *If Congress had intended that limited partners be automatically excluded [from Self-Employment Contributions Act], it could have simply said "limited partner." By adding "as such," Congress made clear that the limited partner exception applies only to a limited partner who is functioning as a limited partner.* [208]

According to the Tax Court in *Soroban Capital Partners LP*, Congress used "limited partners, as such" in Section 1402(a)(13) to refer to passive investors. The Tax Court did not explain why Congress did not use the term "passive investors" if it meant passive investors. Congress intended Section 1402(a)(13) to apply to partners that are passive investors.

The taxpayer in *Soroban Capital Partners LP* cited the Sense of the Senate Resolution for support. Through that resolution, the Senate expressed its view that Treasury's attempt to define "limited partner" exceeded its authority. The Tax Court in *Soroban Capital Partners LP* found that the Senate's concern was "that an individual meeting any one of these three criteria will be treated as a general partner." [209] The Tax Court found that Senate's concern about the criteria set forth in Treasury's proposed regulation does not override the plain text of the statute.

The taxpayer in *Soroban Capital Partners LP* also cited a Joint Committee on Taxation report that states: "A special rule applies for limited partners of a partnership." [210] In a footnote, that report explains that "limited partner status is determined under State law." [211] The Tax Court found this unpersuasive. The report addresses only the meaning of the words "limited partner" and not the phrase "limited partner, as such." The Tax Court in *Soroban Capital Partners LP* found that those latter words that narrow the scope of the limited partner exception, which the Joint Committee Report does not address. The Tax Court observed that, to the extent one might read the Joint Committee on Taxation Report more broadly, the report does not constitute legislative history and carries no more weight than a law review article. [212]

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[208] 161 T,C, at 320.

[209] H.R. 2014, 105th Cong., 143 Cong. Rec. S6694, S6774, S6819.

[210] Staff of J. Comm. on Tax'n, 110th Cong., Present Law and Analysis Relating to Tax Treatment of Partnership Carried Interests and Related Issues, Part I, JCX-62-07, at 35.

[211] *Id.*. at 35 n.64.

[212] *Gregory*, 149 T.C. at 55.

Thus, applying a plain meaning analysis, the Tax Court in *Soroban Capital Partners LP* found that "limited partner" for state law purposes does not mean "limited partner, as such" and that limited partners are not *per se* limited partners for purposes of Section 1402(a)(13).

Soroban Capital Partners LP undertook a scheme of analysis that is consistent with the directives of *Loper Bright Enterprises,* although one might disagree with the conclusion of the Tax Court that under a plain mean interpretation "limited partner" does not mean "limited partner". *Soroban Capital Partners LP* reaches a plain meaning conclusion that most readers could regard as surprising. Whether a court after *Loper Bright Enterprises* would agree with the Tax Court's plain meaning interpretation of "limited partner as such" is a matter than must be left for the future.

[c] Sirius Solutions LLLP v. Commissioner (2024): Are Limited Partners of a Limited Partnership Subject to Self-Employment Tax?

In *Sirius Solutions LLLP v. Commissioner*,[213] a limited partnership argued that Section 1402(a)(13) should exclude state law limited partners from net self-employment earnings under the Self-Employment Contributions Act tax on a limited partner's distributive share of income or loss. *Sirius Solutions* was summarily dealt with by the Tax Court, and a judgement was entered in favor of the government on the basis of *Soroban Capital Partners LP* and *stare decisis*.

Sirius Solutions is a Delaware limited liability limited partnership that is treated as a limited partnership for all purposes of the laws of the State of Delaware. The parties have also stipulated that its limited partners are limited partners under Delaware state law. Sirius Solutions is a business-consulting firm. During 2014, Sirius Solutions was owned by nine limited partners and a general partner: Sirius GP. Sirius Solutions was owned by five limited partners and Sirius GP. All the limited partners were limited partners under Delaware law and had limited liability. The limited partners were allocated a share of Sirius Solutions' income or loss in tax years 2014-2016.

Sirius Solutions excluded the limited partners' distributive shares of partnership income from net earnings from self-employment under the limited partner exception of Section 1402(a)(13) and the instructions to the partnership income tax return. Those instructions provided:

> *Generally, a limited partner's share of partnership income (loss) is not included in net earnings (loss) from self-employment. Limited partners treat as self-employment earnings only guaranteed payments for services they actually rendered to, or on behalf of, the partnership to the extent that those payments are payment for those services.*

[213] No. 11587-20 (2024).

Form 1065 instructions defined a "limited partner" as a "partner in a partnership formed under a state limited partnership law, whose personal liability for partnership debts is limited to the amount of money or other property that the partner contributed or is required to contribute to the partnership." Form 1065 instructions for the years at issue defined a "limited partnership" as a partnership that "is formed under a state limited partnership law and composed of at least one general partner and one or more limited partners."

Sirius Solutions' limited partners are limited partners in a state-law limited partnership with limited liability. Sirius Solutions followed the return instructions and excluded the limited partners' shares of Sirius Solutions' income or loss from net earnings from self-employment on its 2014-2016 returns.

The Internal Revenue Service audited Sirius Solutions' 2014-2016 tax returns and determined that the limited partners were not "limited partners" for purposes of the exception in Section 1402(a)(13). The Internal Revenue Service included the limited partners' shares of partnership income or loss in net earnings from self-employment.

By stipulation before the Tax Court, Sirius Solutions and the Internal Revenue Service agreed that the *Soroban Capital Partners LP* opinion applied to determine the tax liability of Sirius Solutions for tax years 2014 through 2016. This permitted an expedited appeal by Sirius Solutions. The Tax Court applied its decision in *Soroban Capital Partners LP* and entered its decision in favor of the Internal Revenue Service.

The taxpayer in *Sirius Solutions LLLP v. Commissioner* argued on brief:

> *This Court should reverse the Tax Court and hold that "limited partner" in section 1402(a)(13) has its ordinary meaning of a state-law limited partner. Dictionary definitions and contemporaneous and long-held guidance from the IRS and Social Security Administration all confirm that the ordinary meaning of the term "limited partner" is a state-law limited partner. Congress rejected the Treasury Department's later attempt to define "limited partner" as something other than a state-law limited partner. This Court should likewise reject the Tax Court's interpretation. It disregards the ordinary meaning of both "limited partner" and "as such," violates a fundamental canon of statutory construction by rendering the carve-out for "guaranteed payments" meaningless, erroneously relies on legislative history, and applies irrelevant case law involving non-state law limited partners.*

The taxpayer in *Sirius Solutions LLLP v. Commissioner* argued on brief:

- The term "limited partner" in Section 1402(a)(13) must be given its ordinary meaning of a state-law limited partner for at least four reasons.
- First, dictionary definitions at the time of enactment confirm that the ordinary meaning of the term "limited partner" is a partner with limited liability — *i.e.*, a state-law limited partner.

- Second, a contemporaneous interpretation by the Internal Revenue Service in 1978 also defined "limited partner" as a partner with limited liability.
- Third, contemporaneous regulations for the companion provision in the Social Security Act also define the term "limited partner" as a partner with limited liability.
    - The Internal Revenue Service and Social Security Administration's interpretation of the term "limited partner" has remained consistent for decades.
    - An agency's interpretation of a statutory term that was "issued contemporaneously with the statute at issue, and [that has] remained consistent over time" is "especially useful" in determining the statute's meaning.[214]
- Fourth, in 1997, when the Internal Revenue Service issued proposed regulations attempting to define "limited partner" as something other than a state-law limited partner, Congress swiftly issued a moratorium prohibiting the Internal Revenue Service from finalizing the proposed regulations.
    - Congress proposed this moratorium because "the proposed change in the treatment of individuals who are limited partners under applicable State law exceeds the regulatory authority of the United States Department of Treasury and would effectively change the law administratively without Congressional action."[215]
    - Congress has made clear that "limited partner" means a state-law limited partner and has reconfirmed this understanding repeatedly in steadfastly refusing to amend the statute since its enactment almost 50 years ago.
- The Tax Court erred in interpreting "limited partner, as such," to mean a passive investor.
    - First, the Tax Court misinterpreted the phrase "as such."
        - Contrary to the Tax Court's analysis, a "limited partner, as such," means "a limited partner, as a limited partner."
        - "As such" clarifies that, if a partner is both a general partner and a limited partner (a dual-status partner), the partner's distributive

[214] *Loper Bright Enters. v. Raimondo,* 144 S. Ct. 2244, 2262 (2024).
[215] 143 Cong. Record S6774 (June 27, 1997).

share received as a limited partner is subject to the exception, whereas the distributive share received as a general partner is not.

    - The addition of "as such" after "limited partner" does not change the ordinary meaning of the term "limited partner" to passive investor.

- Second, the Tax Court's interpretation is directly refuted by the statute's carve-out of guaranteed payments.
    - Congress was aware that limited partners may provide services to the partnership but chose to subject only guaranteed payments for services to self-employment taxes.
    - The Tax Court's interpretation of "limited partner" as a "passive investor" renders the carve-out for "guaranteed payments" meaningless.
    - Under that interpretation, any partner who provides services to the partnership would not qualify for the exception in the first place.
    - Making the carve-out meaningless violates a fundamental canon of statutory construction that all words be given meaning.
- Third, the Tax Court erred in considering legislative history because the term "limited partner" is unambiguous.
    - Moreover, even if legislative history could be considered, it would support interpreting "limited partner" consistent with its ordinary meaning.
    - The legislative history confirms that "as such" addresses dual-status partners — *i.e.*, partners that are both general partners and limited partners.
    - Further, the legislative history reveals that the "limited partner" exception is an anti-abuse provision enacted to prevent limited partners from qualifying for Social Security.
    - Therefore, it is unsurprising that Congress broadly drafted the provision to apply to all state-law limited partners.
- Fourth, the Tax Court erred in applying its earlier cases involving non-state law limited partners.
    - That case law has no bearing here, where the partner is a state-law limited partner and therefore qualifies for the exception in

Section 1402(a)(13) under the ordinary meaning of the term "limited partner."

An additional interesting characteristic is that the Internal Revenue Service proposal (functional analysis) is more difficult to apply than the taxpayer's proposal (a limited partner is a limited partner). The Internal Revenue Service proposal requires a separate functional analysis for every partner. The taxpayer proposal is a bright line test for limited partnerships: all limited partners of limited partnerships are treated as limited partners for purposes of Self-Employment Contributions Act.

[d] Denham Capital Management LP v. Commissioner (2024): Who Is A Limited Partner For Purposes Of Self-Employment Tax?

Denham Capital Management LP v. Commissioner[216] considered whether the limited partner exception to self-employment tax applied to limited partners of a limited partnership. members of a limited liability company.

Denham Capital Management LP Capital Management LP is docketed as a TEFRA partnership audit case before the Tax Court to consider who is a limited partner for purposes of self-employment tax. *Denham Capital Management LP* concerns whether five individuals who were limited partners of a Delaware limited partnership qualify as "limited partners" for self-employment tax purposes. The dispute lies in the proper interpretation of the term "limited partner" and whether the limited partners at issue fall within that definition. Petitioner, Denham Capital Management LP Capital Management GP LLC, is the Tax Matters Partner and General Partner of Denham Capital Management LP Capital Management LP. Denham Capital Management LP Capital Management GP LLC is a Delaware limited partnership with five limited partners during the tax years at issue (2016 and 2017) and is classified as a partnership for federal income tax purposes. Denham Capital Management LP Capital Management GP LLC's principal business is to provide investment management services to several global equity investment vehicles ("Funds"), which during the relevant time period invested across the energy and commodities sectors, including oil and gas, mining, and international power. By 2017, Denham Capital Management LP Capital Management GP LLC advised seven active Funds with $8.3 billion in committed capital, of which $6.9 billion had been invested. During 2016 and 2017, Denham Capital Management LP made guaranteed payments to five individual limited partners for services they provided to Denham Capital Management LP. These payments were compensation for services. These payments did not depend on Denham Capital Management LP's income. All partners of Denham Capital Management LP, including those five, were also allocated a share of Denham Capital Management LP's income. The main issue in *Denham Capital Management LP* is what should be

[216] *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114.

included in those five limited partners' "net earnings from self-employment," under the Social Security Act and the Internal Revenue Code. A person's net earnings from self-employment are used to determine their social security eligibility and coverage, as well as their self-employment tax.

Petitioner in *Denham Capital Management LP* is the tax matters partner and state law general partner of Denham Capital Management LP. Petitioner is a Delaware limited liability company and elected to be treated as a partnership for federal income tax purposes.

Denham Capital Management LP is organized as a limited partnership under Delaware law and offers investment advisory and management services to affiliated private equity funds that invest in the energy sector − specifically oil and gas, mining, and power. Under investment advisory agreements between Denham Capital Management LP and each fund, Denham Capital Management LP was expected to furnish investment advice, negotiate terms of investments, monitor the health of the investments, and complete the day-to-day administrative tasks associated with managing the funds.

In addition to petitioner, Denham Capital Management LP had five limited partners during the years in issue. These individuals were Stuart Porter, Scott Mackin, Carl Tricoli, Riaz Siddiqi, and Jordan Marye (collectively, Partners). The Partners functioned similarly to and were subject to the same general policies and procedures as Denham Capital Management LP's employees.

Denham Capital Management LP's Fifth Amended and Restated Limited Partnership Agreement, effective May 1, 2014, governed the obligations and authority of Denham Capital Management LP's partners for the years in issue. Under the Restated Limited Partnership Agreement, petitioner, as general partner of Denham Capital Management LP, had "unlimited liability" for Denham Capital Management LP's debts. Partners enjoyed limited liability. Partners could be held personally liable for the debts and obligations of Denham Capital Management LP only to the extent, if any, of capital contributions they made to Denham Capital Management LP.

The Restated Limited Partnership Agreement vested all management authority exclusively in petitioner. Mr. Porter owned 100% of the equity of petitioner. All of the Partners were voting members of petitioner throughout the years in issue. Denham Capital Management LP's limited partners had authority to the extent petitioner delegated authority to them. Acting in his authority as managing member of petitioner, Mr. Porter authorized via written resolution Messrs. Tricoli, Mackin, and Siddiqi, along with Denham Capital Management LP's chief financial officer, director of tax, general counsel, and associate general counsel, to negotiate and to execute any type of agreement or document on petitioner's behalf. The resolution also authorized Kelly Henry to execute any federal or state tax return. Denham Capital Management LP's Restated Limited Partnership Agreement also required that each

partner, except for Mr. Porter, "devote substantially all of his or her business time and attention to the affairs of [Denham Capital Management LP] and its affiliates."[217]

[217] Messrs. Porter, Siddiqi, and Tricoli were Denham Capital Management LP's founding partners. Mr. Porter contributed approximately $8 million in exchange for his limited partner interest. Other than Mr. Porter's initial contribution, no other capital contributions were made to Denham Capital Management LP by any of the partners. Messrs. Tricoli, Siddiqi, Mackin, and Marye received their limited partner interests in Denham Capital Management LP through grants of profits interests at various times ranging from April 2008 to May 2014.

Denham Capital Management LP's Partners had the authority to remove partners by consensus. The Partners voted informally to decide whether to expel an underperforming partner. Partner removal occurred according to written agreements under which the exiting partner disassociated simultaneously from all Denham Capital Management LP-related entities.

Two partners exited Denham Capital Management LP in this fashion before the years in issue. Mr. Siddiqi began phasing out of Denham Capital Management LP by the end of 2017.

The Partners held various roles and responsibilities not explicitly outlined in the Restated Limited Partnership Agreement. Mr. Porter oversaw Denham Capital Management LP's investment strategy from a macroeconomic perspective through managing the risk group, which performed risk analyses of transactions and Denham Capital Management LP's portfolios and provided its recommendations to the appropriate investment committee. Denham Capital Management LP carried total life insurance coverage on Mr. Porter of $90 million in 2016 and $30 million in 2017. Mr. Porter also spent a considerable amount of his time meeting with lower level Denham Capital Management LP employees to discuss career development and their ongoing work.

Messrs. Tricoli, Mackin, and Marye each held the title of managing partner and led deal teams within their respective sectors. Messrs. Tricoli and Mackin also held the title of copresident. Mr. Tricoli led oil and gas and mining deal teams. Mr. Mackin joined Denham Capital Management LP as a managing director before becoming partner in 2010. During the years in issue Mr. Mackin led deal teams in the power sector. Mr. Marye was promoted to partner in 2014, and he also led oil and gas sector deal teams.

Mr. Siddiqi served as managing partner and led the portfolio services group during the years in issue. The portfolio services group was an internal Denham Capital Management LP team which monitored and reported on the status of the investments Denham Capital Management LP managed. The group conducted extensive due diligence and intervened where a company a Denham Capital Management LP fund had invested in, called a portfolio company, did not meet expectations. Intervention typically involved forming and implementing a business plan, hiring or replacing management, or exiting the investment early. Mr. Siddiqi was personally involved with Denham Capital Management LP's rehabilitation of at least two portfolio companies.

The Partners' role with Denham Capital Management LP was so fundamental to the firm's operation that investors had the right to withdraw their investments early if one or more of the Partners died, became disabled, or could no longer devote substantially all business time to the funds. Each fund's key person provision referred to Mr. Porter, but all five Partners were considered a key person by at least one of the funds active during the years in issue.

In addition to their specific titles and roles, certain responsibilities were handled by all the Partners. Each of the Partners served on some or all of Denham Capital Management LP's management, valuation, and/or investment committees. Excluding Mr. Porter, the Partners frequently served on boards of directors of portfolio companies. A Denham Capital Management LP partner or employee was not compensated for serving on a portfolio company's board of directors. The Partners

Denham Capital Management LP managed five active funds in 2016 and seven active funds in 2017, under which it had $7.5 billion and $8.3 billion of assets under management, respectively.[218]

Each fund is a separate entity formed as a limited partnership with another limited partnership as its general partner. [219]

Each fund paid Denham Capital Management LP quarterly management fees in exchange for its advisory services.[220]

Denham Capital Management LP's funds generally followed a specific process in making their investments. At the outset Denham Capital Management LP established the

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often discussed their decision making in their director roles with other Denham Capital Management LP Partners but observed that they owed fiduciary duties to the portfolio companies' other shareholders.

Messrs. Porter, Mackin, and Marye were actively engaged in fostering and attracting investor relationships. They frequently traveled to meet with potential and current investors for fundraising. When the Partners traveled, travel reimbursements were provided by Denham Capital Management LP, not petitioner.

The Partners made most business decisions affecting Denham Capital Management LP's internal operation through the management committee. Petitioner established the management committee. In 2016 and 2017 Messrs. Porter, Tricoli, and Mackin were the sole members of the management committee. The management committee discussed issues such as, but not limited to, budgeting, significant employee hirings or departures, and the expansion of the number of offices.

[218] Messrs. Porter, Siddiqi, and at least one other of Denham Capital Management LP's Partners were directly involved with each fund. Each partner is referenced in every private placement memorandum (PPM), and each investment committee had Mr. Porter, Mr. Siddiqi, and at least one more. Denham Capital Management LP had approximately 80 employees during the years in issue. In 2017 Denham Capital Management LP's compensation per employee ranged from approximately $61,000 to $1,200,000. Denham Capital Management LP was scheduled to pay approximately $21,302,203 in total employee compensation in 2017. With the exception of Mr. Siddiqi, who had begun to phase out, each of the Partners was scheduled to receive a salary of $325,000 and no bonus. Twenty-three of Denham Capital Management LP's employees were scheduled to receive total compensation exceeding the Partners' salaries.

[219] The partners of the limited partnerships that served as the funds' general partners were generally partners and/or employees of Denham Capital Management LP. Each fund's general partner had the authority to make all investment decisions for the respective fund, and its investors, primarily institutional, purchased limited partner interests in the fund entities to make their investments. Fund investors had no decision-making authority as part of their limited partnership stake.

[220] Management fee terms varied by fund but typically ranged between 0.75% and 1.75% of capital committed by investors. Denham Capital Management LP generated $69,903,232 and $61,280,194 in total revenue for 2016 and 2017, respectively, all of which was derived from fees collected in exchange for its investment management services.

fund's legal structure, and the Partners collectively determined the fund's fundraising target, or the "top target capital raise," based on market factors. [221]

According to Denham Capital Management LP's recommendations, the funds used the committed capital to acquire equity interests, typically controlling interests, in portfolio companies Denham Capital Management LP viewed as being fit for investment, held them for a period, and then "exited" the investments by selling the equity they had acquired and returning capital to investors.[222]

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[221] To aid the Partners in soliciting capital commitments, Denham Capital Management LP hired outside counsel to prepare PPMs to inform potential investors of the details of each fund. Denham Capital Management LP's general counsel and the Partners reviewed the PPMs before they were circulated to potential investors. The PPMs informed investors about the fund's objectives, its strategies, and the Denham Capital Management LP team overseeing the fund, including a professional biography of each Partner and the senior-level employees that supported that respective sector.

[222] Denham Capital Management LP's method of providing advice to the funds involved multiple internal Denham Capital Management LP teams, such as each fund's deal team, investment committee, and valuation committee. Deal teams consisted of sector-specific groups of investment professionals under the supervision of a Partner or a managing director. Voting members of the investment committees typically included one or more of Denham Capital Management LP's Partners and other senior professionals. In 2016 and 2017 Messrs. Porter, Tricoli, and Siddiqi served on the investment committee for every fund Denham Capital Management LP managed. Also during the years in issue, Mr. Mackin served on the committees for the commingled commodity funds and Mr. Marye served on the oil and gas fund's investment committee. [Footnote omitted.]

Each fund's deal team was responsible for generating and analyzing investment proposals and presenting them to that fund's investment committee. Investment committees met weekly to consider and vote on potential new investments and significant decisions relating to existing investments. For the committee to adopt an investment recommendation, the vote needed to be unanimous. As a result, each of the Partners, while having no affirmative authority to do so, could effectively reject an investment proposal unilaterally. The respective fund's deal team executed recommendations approved by the investment committee and monitored portfolio companies.

The investment committees closely scrutinized each recommendation. Deal teams circulated memoranda explaining the details of investment proposals, followed by a presentation of the same to the investment committee. Voting members of the respective investment committee debated the proposal before voting. Partners, even when discussing a proposal before a committee they were not a voting member of, were encouraged to use their specialized knowledge of finance and the commodities industry to provide feedback on the proposal being discussed. The deal teams and investment committees worked closely with other Denham Capital Management LP teams such as the risk group and the portfolio services group throughout the process.

Denham Capital Management LP's valuation committees reviewed, discussed, and approved recommendations with respect to valuations prepared by the deal teams. Valuation recommendations were made quarterly on a company-by-company basis and were necessary for accurate financial reporting to regulators and fund investors. The valuation committee's role was advisory as it did not have the authority to obligate a fund to accept or reject a valuation.

In *Soroban Capital Partners LP v. Commissioner*,[223] the Tax Court determined that the limited partner exception does not automatically apply to a limited partner "in name only." The Court in Soroban ultimately denied the petitioner's motion for summary judgment and ruled that factual determinations were necessary because "[t]he court must apply a functional analysis test to determine whether a partner in a state law limited partnership is a 'limited partner, as such' for purposes of section 1402(a)(13)." The opinion does not otherwise describe the "functional analysis test"—guidance is limited to the advice that. in making that determination, only that such test must be "similar to the test outlined in *Renkemeyer, Campbell & Weaver, LLP* and subsequent cases."

The Taxpayer in *Denham Capital Management* argued that the Tax Court does not need to reach the functional analysis test, though, because a crucial interpretive error in *Soroban* regarding the phrase "limited partner, as such" provides at least a "special justification" for overturning the opinion. Taxpayer argued that the *Soroban Court* incorrectly interpreted this phrase "as such" to require a functional analysis.

The phrase "as such," however, simply clarifies the tax treatment of dual status partners. This misinterpretation not only contradicts the plain meaning of the statutory text but also disregards the legislative history, which aimed to broadly exclude limited partners from social security coverage to prevent abuse schemes.

Most portfolio companies were not traded on public markets, and consequently the valuation process involved benchmarking investments against comparable public market investments or other ventures Denham Capital Management LP had engaged in. Denham Capital Management LP's accounting team refined the valuations it proposed in response to valuation committee members' critical evaluation and inquiries into the assumptions and methodologies used to reach their conclusion. Once all disagreements were resolved, the valuations were presented for a vote.

In 2016 and 2017 the valuation committees included a broad group of Denham Capital Management LP personnel, such as the chief financial officer, the general counsel, and other senior professionals, including all five of the Partners. As with Denham Capital Management LP's investment committees, approval of a valuation recommendation required a unanimous vote from the valuation committee, and thus one voting member could effectively reject a recommendation.

A fund's decision to initiate, alter, or exit an investment was made according to recommendations given to it by Denham Capital Management LP. The recommendations were reviewed, scrutinized, and revised at the direction of the Partners that were voting members of the respective investment committee. Each fund's general partner had the authority to reject a recommendation that was approved by an investment committee, but that never actually occurred.

Denham Capital Management LP's PPMs frequently represented to potential investors that "[t]he overall direction of the firm is guided by its partners." Further, the Partners' experience and expertise was an influential consideration to potential investors. In contrast to the employees who provided support, Denham Capital Management LP's Partners used their experience and expertise to make the strategic decisions related to Denham Capital Management LP's provision of investment advisory services in three distinct areas. The Partners (1) managed investor relations and fundraising; (2) made fundamental business decisions by serving as voting members of one or more of Denham Capital Management LP's management, valuation, and investment committees, and (3) managed their sector's deal teams, including making personnel decisions.

[223] 161 T.C. No. 12 (2023).

By misinterpreting the phrase, Soroban effectively renders the guaranteed payment carve-out meaningless, a violation of the canon against surplusage. Rectifying this error is essential to align the interpretation with Congressional intent and statutory language, and provides the special justification needed to overturn Soroban.

But if the Court were to apply a functional analysis test, this Court will need to decide what baseline standard Denham's Limited Partners should be compared against. Petitioner and Respondent offer competing versions of that baseline. Petitioner's position is that the Court should examine the roles and functions of the limited partners to determine whether they were bona fide limited partners with liability protection under applicable state law. Respondent's position is that the Court should examine the roles and functions of the limited partners to determine whether they functioned as passive investors or employees. A core problem with Respondent's version of the test is that at the time the limited partner exception was enacted, Congress understood that limited partners could function as employees.

Should this Court decide it must apply a functional test, the Court should be guided by RULPA and Delaware law, and examine the permissible functions and roles of a limited partner. This Court should also apply a test that is consistent with Respondent's own guidance and the SSA's regulation that seeks to determine whether, as a result of the individual partner's roles and functions within the partnership, that limited partner's financial liability for the obligations of the partnership is limited to the amount of their financial investment in the partnership. By adopting and utilizing this test, which essentially asks whether the limited partner is a bona fide limited partner of a limited partnership, the Court will align the application of section 1402(a)(13) with the statute's text, its legislative history, longstanding definitions used by the IRS, and the 1980 regulations issued by the SSA. Only Petitioner's proposed functional test is compatible with the SSA's regulation and accurately reflects the statute's text.

The evidence presented at trial confirmed that Denham's limited partners satisfy this functional test because they were bona fide limited partners and did not engage in any activities that caused them to lose their limited liability protection. The evidence showed that Denham's limited partners acknowledged and meticulously adhered to their limited partner roles in accordance with state law and, more broadly, RULPA. The witnesses at trial testified that the limited partners consistently complied with Delaware limited partnership law and never unlawfully exercised management authority or falsely claimed the authority to make binding decisions for Denham in their capacities as limited partners. Ultimately, the evidence established that there is no legitimate ground for Respondent to question the status of Denham's limited partners as bona fide limited partners.

In service of a vague, poorly defined, impractical, and erroneous "passive investor" test, Respondent presumably will point to uncontested evidence showing that the five individual limited partners at issue functioned, in part, as employees and provided services to Denham. Denham's Limited Partners were actively involved in analyzing investments, served as board members of portfolio companies, and collaborated on making investment recommendations to the investment funds. They were also members of Denham's general partner, DCM GP. But this evidence misses the point and supports Petitioner's position. Both at the time Congress enacted the limited partner exception and today, limited partners were permitted to engage in all of these roles and activities, including working as employees of the limited partnership. Indeed, the limited partner exception itself contains an exception — for guaranteed payments for services — that addresses how and when payments

to limited partners for these sorts of activities are creditable for social security purposes and subject to self-employment tax. The only thing that matters is whether Denham's limited partners functioned as bona fide limited partners with limited liability for Denham's financial obligations. They did, and the evidence presented at trial proved as much.[224]

Section 1402(a) provides a list of exclusions from net earnings from self-employment. Section 1402(a)(13) excludes an individual's:

distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration of those services. . . .[225]

Section 1402(a)(13) is commonly referred to as the limited partner exception. Resolution of this case depends on our classification of Denham's partners under the limited partner exception.

The court previously held in *Soroban Capital Partners LP v. Commissioner*[226] that the court has jurisdiction to determine a state law limited partner's status for the purpose of determining applicability of the limited partner exception in partnership level proceedings pursuant to the Tax Equity and Fiscal Responsibility Act of 1982.[227] The *Soroban* court held that such determinations require a functional analysis inquiry to ascertain the roles and responsibilities of partners to determine their status for tax purposes.[228] Petitioner in *Denham Capital Management LP* challenges both of *Soroban*'s holdings.

Petitioner in *Denham Capital Management LP* contended that *Soroban* missed the mark because the court did not consider a third element of the definition of partnership items — that the item must affect the entire partnership, not just the partners individually. According to the Tax Court in *Denham Capital Management LP*, the court adheres to the doctrine of *stare decisis*. The court affords precedential weight to its prior reviewed and division opinions.[229] The court will revisit prior decisions only when presented with a special justification to do so.[230] The Tax Court in *Denham Capital Management LP* said that it saw no special justification to revisit *Soroban*'s reasoning. According to the Tax Court in *Denham Capital Management LP*, determination of the applicability of the limited partner exception is a partnership item over which the court has jurisdiction. Determinations under Section 1402(a)(13) require a functional analysis inquiry to ascertain the Partners' roles and responsibilities for tax purposes, according to the Tax Court in *Denham Capital Management LP*.

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[224] __ T.C. __ (2024).
[225] I.R.C. § 1402(a)(13).
[226] 161 T.C. 310 (2023).
[227] Pub. L. No. 97-248, 96 Stat. 324, *Soroban*, 161 T.C. at 325.
[228] *Soroban*, 161 T.C. at 319.
[229] *E.g., Analog Devices, Inc. & Subs. v. Commissioner*, 147 T.C. 429, 443 (2016).
[230] *Sec. State Bank v. Commissioner*, 111 T.C. 210, 213 (1998), *aff'd*, 214 F.3d 1254 (10th Cir. 2000).

The self-employment tax imposes a tax on every individual's self-employment income for a taxable year.[231] With minor exceptions not, self-employment income is equivalent to the net earnings from self-employment derived by an individual during the taxable year.[232]

The limited partner exception excludes from net earnings from self-employment –

- an individual's distributive share of any item of income or loss of a "limited partner, as such,"
- other than guaranteed payments[233]
- to the extent
- the payments are in the nature of remuneration of services actually rendered to or on behalf of the partnership.[234]

The Tax Court construes exceptions to net earnings from self-employment narrowly to achieve the congressional policy that the optimum number of potentially eligible persons will be provided for under the Social Security framework.[235]

In *Soroban*,[236] the Court held "that the limited partner exception does not apply to a partner who is limited in name only" and that "Congress intended section 1402(a)(13) to apply to partners that are passive investors."

Before *Soroban*, in *Renkemeyer, Campbell & Weaver, LLP v. Commissioner*,[237] the Tax Court applied a functional analysis test to determine whether the lawyer-partners of a Kansas limited liability partnership were limited partners under section 1402(a)(13).

The Court in *Renkemeyer, Campbell & Weaver, LLP* looked to the legislative history to provide insight with respect to Congress's intent.[238] The Tax Court held that "the intent of section 1402(a)(13) was to ensure that individuals who merely invested in a partnership and who were not actively participating in the partnership's business operations (which was the archetype of limited partners at the time) would not receive credits toward Social Security coverage."[239] Furthermore, the legislative history does not support the conclusion that Congress intended to exclude partners who performed services for a partnership in their

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[231] I.R.C. § 1401(a), (b).

[232] I.R.C. § 1402(b).

[233] Described in I.R.C. § 707(c).

[234] I.R.C. § 1402(a)(13).

[235] *Stevenson v. Commissioner*, T.C. Memo. 1989-357, 57 T.C.M. (CCH) 1032, 1034, *citing Johnson v. Commissioner*, 60 T.C. 829, 833 (1973).

[236] 161 T.C. at 320−31.

[237] 136 T.C. 137 (2011),

[238] *Renkemeyer*, 136 T.C. at 150.

[239] *Id.*

capacity as partners (*i.e.*, acting in the manner of self-employed persons) from liability for self-employment taxes.[240]

The parties disagreed on whether the Partners are limited partners for purposes of the limited partner exception.[241] Petitioner contends that a functional analysis test in the context of a limited partnership should inquire whether the partners have maintained their limited liability status under state law or the Revised Uniform Limited Partnership Act. As part of its analysis in *Renkemeyer, Campbell & Weaver, LLP*, the Tax Court held that a partner's having limited liability was not enough for the partner to qualify for the limited partner exception.[242] The Court concluded that the interest of a limited partner in a limited partnership is similar to the interest of a passive investor.[243]

In Renkemeyer, Campbell & Weaver, LLP the Court focused on how partnership income was derived and found that it was received in exchange for legal services performed by the partners. Id. at 150. Each of those partners participated in management of the firm and contributed only a nominal amount of capital for his respective partnership units. Id. at 141. Those facts led the Court to conclude that the partners' distributive shares of income were not a return on the partners' investments, but rather earned from the provision of legal services performed by the partners on behalf of the law firm. Id. at 150. Renkemeyer, Campbell & Weaver, LLP's conclusion was not affected by the fact that the partners failed to comply with formalities prescribed by state partnership law. Id.

Since *Renkemeyer, Campbell & Weaver, LLP*, the Court has continued to use a to use functional analysis to determine whether state-law partners of passthrough entities are limited partners for the purpose of the limited partner exception. In *Castigliola v. Commissioner*,[244], the Court used the Renkemeyer, Campbell & Weaver, LLP analysis to conclude that the members of a professional limited liability company were not limited partners because they were involved in the management of the business.

The Court has also applied the Renkemeyer, Campbell & Weaver, LLP functional analysis test to determine whether a partner is a "limited partner, as such" under the limited partner exception. In *Hardy v. Commissioner*,[245] the court concluded that a surgeon who held a minority interest in a partnership that operated a surgery center was a limited partner for purposes of the limited partner exception. The surgeon performed some of his surgeries at the center, but he had no day-to-day or management responsibilities with respect to the partnership; and patients paid separate fees to the partnership for the use of the surgery

[240] *Id.*
[241] I.R.C. § 1402(a)(13).
[242] *Renkemeyer*, 136 T.C. at 147.
[243] *Id.*. at 147-48.
[244] T.C. Memo. 2017-62, at *12.
[245] T.C. Memo. 2017-16.

centers.[246] The number of surgeries that the surgeon performed at the center did not affect his distributive share. The Tax Court concluded that the surgeon received a distribution based on the fees that patients paid to use the surgery centers. Consequently, the surgeon's distributive share was not subject to the self-employment tax. The surgeon received his distributive share in his capacity as an investor.[247]

In *Hardy*, the functional inquiry was focused on the efforts and responsibilities borne by the partner and whether his business arrangement with the partnership in question was more akin to one of employment or one of a passive investment.

Petitioner in *Denham Capital Management LP* argued that the pre-*Soroban* cases are inapplicable because they concerned taxpayers who owned interests in entities other than a state law limited partnership. According to the Tax Court, this argument fails because it ignores that *Soroban* expressly condoned the Commissioner's position that "the Court must apply a functional analysis test, similar to the test outlined in *Renkemeyer* and subsequent cases."[248] The petitioner in *Denham Capital Management LP* is correct that those cases involved entities other than limited partnerships. Nevertheless, the Court's opinion in *Soroban* considered and resolved the question that petitioner's argument attempts to answer. The Tax Court in *Denham Capital Management LP* found *Renkemeyer, Campbell & Weaver, LLP* and the subsequent cases instructive in applying a functional analysis test applicable to state law limited partnerships.

In addition to disregarding settled precedent, according to the Tax Court, petitioner's position in *Denham Capital Management LP* violated the maxim that federal law, not state law, prescribes classification of individuals and organizations for federal tax purposes.[249] Caselaw has continuously held that determinations under the limited partner exception require a factual inquiry into how the partnership generated the income in question and the partners' roles and responsibilities in doing so. Petitioner's position that the Partners are eligible for the limited partnership exception merely because the Partners complied with formalities prescribed by state partnership law does not comport with caselaw, according to the tax law.[250]

Petitioner in *Denham Capital Management LP* alternatively contended that a passive investor standard violates the canon against surplusage because it renders meaningless the final

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[246] *Hardy*, T.C. Memo. 2017-16, at *7.

[247] *Id.*. at *32.

[248] *Soroban*, 161 T.C. at 319.

[249] *See, e.g.,* Treas. Reg. §301.7701-1(a); *see also Kraatz & Craig Surveying Inc. v. Commissioner*, 134 T.C. 167, 180 (2010) ("The meaning of the words or the legal status of circumstances for federal tax purposes need not be identical to their meaning or their legal effect under state law." (*quoting Estate of Steffke v. Commissioner*, 538 F.2d 730, 732 (7th Cir. 1976), *aff'g* 64 T.C. 530 (1975))).

[250] *See Renkemeyer*, 136 T.C. at 150; *Castigliola*, T.C. Memo. 2017-62, at *7-14; *Hardy*, T.C. Memo. 2017-16, at *29-32.

clause of the limited partner exception, also known as the guaranteed payment carveout.[251] Petitioner suggested that because passive investors never receive guaranteed payments, the clause will never be invoked under a passive investor standard. The Tax Court disagreed.

The Tax Court in *Denham Capital Management LP* undertook a comprehensive inquiry to determine, on account of the pertinent facts and circumstances, whether the Partners were "generally akin" to passive investors.[252] This standard does not preclude a partner from qualifying for the limited partner exception with respect to his distributive share of partnership income despite receiving a guaranteed payment for services actually rendered, as long as other circumstances of the partner's economic relationship with the partnership sufficiently indicate it is generally one of passive investment.

To determine Denham's net earnings from self-employment, the Tax Court analyzed the Partners' roles and responsibilities to ascertain whether their relationships with Denham were more akin to those of passive investors or employees. Petitioner bears the burden of establishing that the Partners' distributive shares represented income of an investment nature. The *Denham* court reviewed –

- the sources of Denham's income for the years in issue,
- the Partners' role in generating this income, and
- the relationship between the Partners' distributive shares and any capital contributions they made to the partnership.[253]

When the size of a partner's investment is relatively small in comparison to the income the partnership earned for the services the partners provided, the small investment is not sufficient to classify the partner's distributive share as a return on investment.[254]Considering that the Partners, except Mr. Porter, paid nothing for their partnership interests, it cannot be said that such large portions of the Partners' distributive shares in 2016 and 2017 were returns on investments. Even though Mr. Porter made a capital contribution, he cannot be considered a passive investor in view of

- the relative size of his investment compared to the substantial fees received by Denham,
- the central role that he played in generating them, and

[251] *See Growmark, Inc. & Subs. v. Commissioner*, 160 T.C. 475, 486 (2023) ("When construing a statute, the Court must interpret it 'so as to avoid rendering any part of the statute meaningless surplusage.'"(*quoting 15 W. 17th St. LLC v. Commissioner*, 147 T.C. 557, 586 (2016))).

[252] *See Renkemeyer*, 136 T.C. at 147-48.

[253] *See Renkemeyer*, 136 T.C. at 150.

[254] *See Renkemeyer*, 136 T.C. at 150.

- the fact that Denham carried a key person life insurance policy on him during the years in issue.

In addition, all of Denham's Partners, except for Mr. Porter, were required to "devote substantially all of [their] business time and attention to the affairs of the [p]artnership and its affiliates." The Partners, in fact, did each devote substantially all of their time to Denham. The Partners treated their work for Denham as their full-time employment. Each of the Partners participated in the management of Denham in some way. Messrs. Porter, Tricoli, and Siddiqi made up Denham's management committee. All five served on the firm's investment and valuation committees. When not acting by committee the Partners exercised authority delegated to them by petitioner to negotiate and execute any agreement or document to conduct Denham's business. These facts further support that the Partners were crucial and active parts of Denham's business.

The Partners were active in Denham's day-to-day business:

- The Partners' expertise and judgment were a significant draw for fund investors, who bargained for the Partners' oversight and could withdraw their investments if certain partners could no longer participate.
- Fund marketing materials made clear that the Partners had a significant role in Denham's operation.
- The Partners solicited capital commitments.
- Fund PPMs explained that investment decisions for the funds would be made by that fund's investment committee, which included the Partners.
- The Partners each exercised significant control over personnel decisions.
- Through the management committee, and occasionally unilateral action, the Partners decided who to invite to be a new partner and who to hire and fire as employees, and they determined compensation packages.
- Criteria for hiring and promotion at Denham included strong financial analysis skills and a solid track record in investing.
- The Partners had control over Denham's personnel decisions.
- Denham planned to spend over $23 million in employee compensation for 2017. Such a large payroll indicates a substantial and active business operation, which included the Partners.
- A sizable number of Denham employees were scheduled to receive total compensation exceeding the Partners' guaranteed payments that petitioner alleges represented their market-level salary indicates that the guaranteed

payments were not designed to adequately compensate the Partners for the value of their services.

- Denham does not exist without the Partners.
- Their directional and strategic guidance is what drew investors to Denham in the first place and is the reason Denham has maintained its success.
- None of the Partners' investment recommendations were refused in practice.
- Denham's employees filled the ranks and provided support to effect the Partners' guidance.
- Employees made up the deal teams that analyzed and executed transactions and completed the day-to-day tasks of monitoring the funds.
- No employee of Denham had authority to make investment decisions for the funds.

The Partners' control over Denham's personnel decisions is further evidence that the Partners were active and fundamental contributors to Denham's operation.

Individuals that serve roles as integral to their partnerships as those the Partners served for Denham cannot be said to be merely passive investors.

The Tax Court in *Denham Capital Management LP* found that Petitioner's positions unpersuasive for three reasons.

First, petitioner's reliance on the prior cases of *Joseph v. Commissioner*[255] and *Duffy v. Commissioner*[256] is misplaced. In neither case did the Court address the issue of the applicability of the *Renkemeyer, Campbell & Weaver, LLP* functional analysis test to a state law limited partner. The facts and issues of both cases were sufficiently distinct from the current case that the court did not consider dicta in those cases to be persuasive here. In any event, they support our conclusion that state partnership law is not determinative.[257]

Second, the record supports the conclusion that the Partners were operating Denham's business as self-employed persons, rather than acting as limited partners as that term would have been understood when Congress enacted the limited partner exception. Denham's chief operation was providing investment management services to the funds. The Partners

[255] T.C. Memo. 2020-65.

[256] T.C. Memo. 2020-108.

[257] *See Duffy*, T.C. Memo. 2020-108, at *50 n.16 ("In [*Renkemeyer*], 136 T.C. at 147, however, we concluded that an owner's protection from claims against an entity is not enough to qualify the owner as a limited partner for purposes of [section] 1402(a)(13)."); *Joseph*, T.C. Memo. 2020-65, at *59 (acknowledging that the evolution of state law limited liability entities forced the Court in *Renkemeyer* to adopt a functional analysis inquiry seeking to determine whether interest-holders are passive investors).

controlled nearly every aspect of the provision of the services. Petitioner's contentions rest upon changes made to state law after the enactment of the limited partner exception. These changes cannot be considered to affect the statute's interpretation.

Third, petitioner's attempt to characterize the Partners' involvement in Denham's operation as carrying out their roles as members of petitioner does not comport with the fact that the Partners were focused on deriving financial benefit to and were compensated by Denham, not petitioner. Mr. Porter's testimony that his roles as a member of petitioner and an adviser to the funds were entirely different confirms that the Partners were providing services to the funds in their capacity as partners of Denham.

The Tax Court in *Denham Capital Management LP* found that the Partners were not "limited partners, as such" under the limited partner exception and that Denham may not exclude the Partners' distributive shares from its net earnings from self-employment by way of the limited partner exception.

[3] Partnership Basis Shifting Transactions.

Like Dr. Seuss, I do not like green eggs and ham. I do not like them in a house. I do not like them with a mouse. I do not like them here or there. I do not like them anywhere. I do not like green eggs and ham. The Internal Revenue Service does not like partnership basis shifting transactions.

Basis adjustments are explained in the Preamble to REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40:

> *B. Basis Adjustments Under Section 732*
>
> *Section 732 governs a distributee partner's basis in distributed property other than money. In the case of a current distribution, and except as provided under section 732(a)(1) and (2) provides that the distributee partner's basis in distributed property (other than money) is equal to the partnership's adjusted basis in the distributed property immediately before the distribution. Under section 732(a)(2), however, a distributee partner's basis in distributed property is limited to the adjusted basis of the distributee partner's partnership interest reduced by any money distributed to such partner in the same transaction.*
>
> *In the case of a liquidating distribution, section 732(b) provides that the distributee partner's basis in distributed property (other than money) is equal to the adjusted basis of the distributee partner's partnership interest reduced by any money distributed to such partner in the same transaction.*
>
> *In the case of a distribution of more than one property from a partnership, the basis of the distributed properties to which section 732(a)(2) and (b) apply must be allocated among the distributed properties under the rules of section 732(c) and the regulations thereunder.*
>
> *C. Basis Adjustments Under Section 734*

In the case of a distribution of property by a partnership with a section 754 election in effect, and for which either the distributee partner recognizes gain or loss on the distribution, or for which the basis of the distributed property in the distributee partner's hands, as determined under section 732, differs from the partnership's adjusted basis in the distributed property immediately before the distribution, section 734(b) requires the partnership to increase or decrease (as applicable) the basis of its remaining partnership property. Also, in the case of a distribution of property by a partnership that results in a substantial basis reduction under section 734(d), the basis of remaining partnership property must be adjusted under section 734(b), even if the partnership does not have a section 754 election in effect.

Section 734(b)(1) requires a partnership to increase the basis of its remaining partnership property if a distribution of partnership property by the partnership results in the distributee partner recognizing gain under section 731(a)(1) of the Code, or if property (other than money) to which section 732(a)(2) or (b) applies is distributed to the distributee partner and the property's adjusted basis to the partnership immediately before the distribution is greater than the distributee partner's basis in the distributed property as determined under section 732. Section 731(a)(1) requires a distributee partner to recognize gain in a current or liquidating distribution to the extent that any money distributed to that partner in the distribution exceeds the adjusted basis of that partner's partnership interest immediately before the distribution. The amount of the basis increase to the partnership's remaining property under section 734(b)(1) following a distribution of partnership property to a partner is equal to the amount of gain recognized by the distributee partner in the distribution under section 731(a)(1) and the excess of the partnership's adjusted basis in the distributed property immediately before the distribution over the distributee partner's basis in the distributed property as determined under section 732.

Section 734(b)(2) requires a partnership to decrease the basis of its remaining property if a distribution of property by the partnership results in the distributee partner recognizing loss under section 731(a)(2), or if property (other than money) is distributed to the distributee partner in a distribution to which section 732(b) applies and the property's adjusted basis to the partnership immediately before the distribution is less than the distributee partner's basis in the distributed property as determined under section 732. Under section 731(a)(2), a distributee partner may recognize a loss in a liquidating distribution of that partner's interest in the partnership to the extent that such partner received only money, unrealized receivables described in section 751(c), or inventory items described in section 751(d) of the Code in the distribution. In such a case, the distributee partner is required to recognize a loss to the extent that such partner's adjusted basis in the partnership interest exceeds the sum of any money distributed to that partner in the distribution and the basis to the distributee partner (determined under section 732) of any unrealized receivables or inventory received by that partner in the distribution. The amount of the basis decrease to the partnership's remaining property under section 734(b)(2) following a distribution of partnership property to a partner is equal to the amount of loss recognized by the distributee partner in the distribution under section 731(a)(2) and the excess of the distributee partner's basis in the distributed property as determined under section 732 over the partnership's adjusted basis in the distributed property immediately before the distribution.

A partnership without a section 754 election in effect is subject to a mandatory basis adjustment under section 734(b)(2) if there is a substantial basis reduction with respect to a distribution of partnership property. Under section 734(d), a substantial basis reduction with respect to a distribution of partnership property occurs

if the sum of the amount of loss recognized to the distributee partner on the distribution, plus any increase in basis in the distributed property to the distributee partner under section 732(b), exceeds $250,000.

D. Basis Adjustments Under Section 743(b)

Generally, if a partnership interest is transferred in a sale or exchange or on the death of a partner, the transferee partner's basis in the transferred partnership interest is determined under section 742 of the Code and the basis of partnership property is determined under section 743(a). Section 742 provides that the transferee partner's basis in a partnership interest acquired other than by contribution is determined under part II of subchapter O of chapter 1 of the Code, beginning at section 1011 of the Code and following. Thus, for example, a transferee partner's basis in a partnership interest acquired by purchase generally is cost basis under section 1012 of the Code. Section 743(a) provides that, in the case of a transfer of a partnership interest by sale or exchange or on the death of a partner, the basis of partnership property is not adjusted unless either the partnership has a section 754 election in effect or the partnership has a substantial built-in loss with respect to the transfer of the partnership interest.

Under section 743(b), in the case of a transfer of a partnership interest by sale or exchange or on the death of a partner, a partnership with a section 754 election in effect or that has a substantial built-in loss with respect to the transfer of the partnership interest must increase or decrease (as applicable) the adjusted basis of partnership property with respect to the transferee partner.

Section 743(b)(1) provides that the adjusted basis of partnership property is increased by the excess of the transferee partner's basis in the transferred partnership interest over the transferee partner's proportionate share of the adjusted basis of partnership property.

Section 743(b)(2) provides that the adjusted basis of partnership property is decreased by the excess of the transferee partner's proportionate share of the adjusted basis of partnership property over the transferee partner's basis in the transferred partnership interest.

A partnership without a section 754 election is subject to a mandatory basis adjustment under section 743(b) with respect to a transfer of a partnership interest if the partnership has a substantial built-in loss with respect to the transfer of the partnership interest. Under section 743(d)(1), a partnership has a substantial built-in loss with respect to a transfer of an interest in the partnership if either the partnership's adjusted basis in its property exceeds the fair market value of such property by more than $250,000, or the transferee partner would be allocated a loss of more than $250,000 if the partnership assets were sold for cash equal to their fair market value immediately after the transfer.

Under regulations prescribed by the Secretary, a basis adjustment under section 743(b) is an adjustment to the basis of partnership property with respect to the transferee partner only. The transferee partner's proportionate share of the partnership's adjusted basis in its property generally is determined in accordance with the transferee partner's interest in the partnership's previously taxed capital (including the transferee partner's share of partnership liabilities) under regulations prescribed by the Secretary.

In the case of a transferee partner who acquired all or part of its partnership interest by a transfer to which no section 754 election was in effect, and to whom a distribution of property (other than money) is made

with respect to the transferred interest within two years, section 732(d) and the regulations thereunder allow the partner to make an election to treat as the adjusted basis of the distributed property the adjusted basis such property would have if the adjustment under section 743(b) were in effect with respect to the partnership property.

Under § 1.732-1(d)(4), the special basis adjustment under section 732(d) is required to apply to a distribution of property to a partner who acquired all or part of its interest by a transfer from a partnership without a section 754 election in effect for the taxable year of such transfer, whether or not the distribution is made within two years of such transfer, if at the time the partnership interest was transferred, (i) the fair market value of all partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership, (ii) an allocation of basis under section 732(c) upon a liquidation of the transferee partner's interest in the partnership immediately after the transfer of such interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization to property subject to such an allowance, and (iii) a basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

E. Allocation of Basis Adjustments Under Sections 734 and 743

Section 734(c) states that a basis adjustment under section 734(b) is allocated among partnership properties under the rules of section 755 of the Code. Section 743(c) states that a basis adjustment under section 743(b) is allocated among partnership properties under the rules of section 755.

Section 755(a) generally requires basis adjustments under section 734(b) or section 743(b) to be allocated in a manner that has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties or in any other manner permitted by regulations. In addition, section 755(b) requires these basis adjustments to be allocated to partnership property of a like character or to subsequently acquired partnership property of a like character if such property is not available or has insufficient basis at the time of the basis adjustment (because a decrease in the adjusted basis of the property would reduce the basis of such property below zero). Section 755(c) provides a special rule that prohibits allocating a basis decrease under section 734(b) to the stock of a corporation that is a partner of the partnership (or to any related partner in the partnership within the meaning of section 267(b) of the Code or section 707(b)(1) of the Code).

F. Common Terminology for Bases With Respect to a Partnership Interest

A partner's adjusted basis in its partnership interest commonly is referred to as the partner's "outside basis" in its partnership interest. A partnership's adjusted basis in its property commonly is referred to as the "inside basis" of the partnership's property. Each partner has a share of inside basis. For ease of explanation, this terminology is used in part IV of this Background section.

[a] Press Release, IR-2023-176: Basis Adjusting Transactions.

Press Release IR-2023-176 (June 17, 2024) announces steps to combat abusive use of partnerships. Internal Revenue Service compliance work continues to accelerate in this complex area of law.

The Internal Revenue Service announced a new dedicated group in the Office of Chief Counsel specifically focused on developing guidance on partnerships, including closing loopholes. The office will work closely with a new passthrough work group being established in the Internal Revenue Service Large and Business International division.

The release also announced new guidance is designed to stop the use of "basis shifting" transactions that use related-party partnerships to avoid taxes. "In these complex moves. high-income taxpayers and corporations strip basis from assets they own where the basis is not generating tax benefits and then move the basis to assets they own where it will generate tax benefits without causing any meaningful change to the economics of their businesses."

"These basis shifting transactions allow closely related parties to avoid taxes." Commissioner Danny Werfel commented: "This announcement signals the IRS is accelerating our work in the partnership arena, which has been overlooked for more than a decade and allowed tax abuse to go on for far too long. We are building teams and adding expertise inside the agency so we can reverse long-term compliance declines that have allowed high-income taxpayers and corporations to hide behind complexity to avoid paying taxes. Billions are at stake here." The Internal Revenue Service is increasing audits on complex partnerships and the issues covered in this guidance will emerge as an important focus area. "In essence, basis shifting amounts to a shell game where sophisticated tax maneuvers take place by shifting the basis of assets between closely related entities, ultimately allowing these complex partnership arrangements to hide from a tax bill," Werfel said "These complicated maneuvers take time and resources for the IRS to uncover. The new guidance is aimed at telling promoters that the IRS considers these transactions inappropriate, and we are bringing new Inflation Reduction Act resources into play to beef up our compliance work in the overlooked partnerships and passthroughs area."

[b] Fact Sheet FS-2024-21 (June 17, 2024): Basis Adjusting Transactions.

Fact Sheet FS-2024-21 (June 17, 2024) announces concurrently released and future guidance intended to crack down on partnership basis-shifting transactions[258] which the Internal Revenue Service believes generate inappropriate tax benefits by stripping tax basis over a period of years using sophisticated tax strategies and technology. The crackdown targets three types of transactions: the transfer of a partnership interest to a related party, the distribution of property to a related party, and the liquidation of a related partnership or partner.

[258] REG-124593-23, Rev. Rul. 2024-14, Notice 2024-54.

[c] Notice 2024-54: Basis Adjusting Transactions.

Notice 2024-54[259] previews two sets of proposed regulations that will address basis shifting transactions involving partnerships and related persons. This notice announces that the Treasury Department and the Internal Revenue Service intend to publish two sets of forthcoming proposed regulations that would address certain basis-shifting transactions involving partnerships and related parties. These "covered transactions" –

- involve partners in a partnership and their related parties,
- result in increases to the basis of property under Section 732, Section 734(b), or Section 743(b), and
- generate increased cost recovery allowances or reduced gain (or increased loss) upon the sale or other disposition of the basis-adjusted property.

The new regulations will be interpretive regulations. This may create a particular challenge for the Internal Revenue Service under *Loper Bright Enterprises*, which provides considerably diminished deference to interpretive regulations by comparison to the situation under *Chevron*.

The Treasury Department and the Internal Revenue Service intend to propose regulations under Sections 732, 734(b), 743(b) and 755 that would –

- provide the required method of recovering adjustments to the bases of property held by a partnership, property distributed by a partnership, or both, arising from the covered transactions,
- provide rules governing the determination of gain or loss on the disposition of the basis-adjusted property, and
- include similar transactions involving tax-indifferent parties (for example, certain foreign persons, a tax-exempt organization, or a party with tax attributes that make it tax-indifferent) rather than related parties.

The Treasury Department and the Internal Revenue Service intend to propose regulations under Section 1502 (forthcoming Proposed Consolidated Return Regulations) to clearly reflect the taxable income and tax liability of a consolidated group whose members own interests in a partnership.

The forthcoming Proposed Consolidated Return Regulations would provide for

- single-entity treatment of members that are partners in a partnership,

so that

[259] 2024-28 I.R.B. 24.

- covered transactions cannot shift basis among group members and distort group income.

These regulations, when promulgated, presumably will be legislative regulations and entitled to a high degree of deference under *Loper Bright Enterprises*. Provided that the regulations are rational as an interpretation of the statute and provided that the Internal Revenue Service follows all of the requirements of the Administrative Procedure Act, unless the final regulations are "irrational", the consolidated return regulations could be difficult to challenge on account of the high level of deference to legislative regulations.

[d] Revenue Ruling 2024-14: Basis Disparity Transactions and Economic Substance.

Revenue Ruling 2024-14[260] advises that the Internal Revenue Service will challenge three types of partnership related-party transactions as lacking economic substance under Section 7701(o).

The Internal Revenue Service intends to disregard the basis adjustments.

Revenue Ruling 2024-14 presents three situations involving partnership basis adjustments.

The first situation involves Section 743(b) basis adjustments that result from a sale or exchange of a partnership interest.

The second situation involves Section 734(b) basis adjustments resulting from a distribution of partnership property.

The third situation involves Section 732(b) basis adjustments on account of a distribution of partnership property on the liquidation of the partnership.

Revenue Ruling 2024-14 asserts that the transactions lack economic substance under Section 7701(o). The Internal Revenue Service disallows the basis adjustments, but did not disallow any of the steps of any of the transactions. This seems to be an aberrational application of economic substance, which usually recharacterizes steps of a transaction.

In reading Revenue Ruling 2024-14, it is important that it constitutes subregulatory guidance that presumably does not constitute a legislative rule and that is not entitled to deference under *Loper Bright Enterprises*, except perhaps in accordance with the reasoning of *Skidmore v. Swift and Co.*[261] Subregulatory guidance (such as revenue rulings, revenue procedures, and notices) perhaps can be legislative rules that are subject to the notice and comment procedures of the Administrative Procedure Act.

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[260] 2024-28 IRB 18.

[261] 323 U.S. 134 (1944). *See also E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244 (1991).

Revenue Ruling 2024-14 illustrates how important economic substance and ***business purpose*** are in tax planning transactions. Revenue Ruling 2024-14 also illustrates the complications that can result from related part transactions that produce tax benefits.

The transactions –

- create basis disparities;
- involve
    - transferring a partnership interest in a nonrecognition transaction or
    - making a current or liquidating distribution of partnership property to a partner; and
- claim a basis adjustment under Sections 732(b), 734(b), or 743(b),
    - generating increased cost recovery deductions or reducing gain on sale.

Revenue Ruling 2024-14 concludes that the transactions fail economic substance under Section 7701(o)(1).

Significantly,

- All of the three transactions in Revenue Ruling 2024-14 are related-party transactions.

    [This does not immunize transactions with unrelated parties. Nevertheless, it suggests that there is something different with transactions with unrelated parties.]

- There is an evil intent in all of the transactions exploiting inside/outside basis disparities to create artificial depreciation.

    [An evil taxpayer intent may be an indispensable element in the application of the economic substance doctrine. Courts may regard testimony of taxpayers with skepticism.]

- Each transaction has a fragile and perhaps questionable ***business purpose***.

    [In defense, taxpayers with similar transactions will endeavor to show substantial business purpose (tax-independent business purpose). Substantial business purpose may be the taxpayer's best defense. Many taxpayers, however, may argue the validity of contrived business purposes proposed by tax counsel. A tax case may probe who is was what suggested the business purpose for a transaction.]

Substantially identical transactions apparently could be treated differently depending on the psychological state of the taxpayer.

Perhaps seemingly identical transactions might be treated differently depending on the involvement or lack of involvement of related parties.

Identical transactions might be treated differently depending on the presence or absence of a legitimate ***business purpose***.

The Internal Revenue Service asserts in Revenue Ruling 2024-14 that the three transactions in Revenue Ruling 2024-14 lack economic substance under Section 7701(o). Section 7701(o) provides:

(o) Clarification of economic substance doctrine.

(1) Application of doctrine. In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if--

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

(2) Special rule where taxpayer relies on profit potential.

(A) In general. The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.

(B) Treatment of fees and foreign taxes. Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

(3) State and local tax benefits. For purposes of paragraph (1), any State or local income tax effect which is related to a Federal income tax effect shall be treated in the same manner as a Federal income tax effect.

(4) Financial accounting benefits. For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax.

(5) Definitions and special rules. For purposes of this subsection--

(A) Economic substance doctrine. The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) Exception for personal transactions of individuals. In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(C) Determination of application of doctrine not affected. The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.

(D) Transaction. The term "transaction" includes a series of transactions.

The first situation involves Section 743(b) basis adjustments that result from a sale or exchange of a partnership interest.

The second situation involves Section 734(b) basis adjustments resulting from a distribution of partnership property.

The third situation involves Section 732(b) basis adjustments on account of a distribution of partnership property on the liquidation of the partnership.

The transactions are entirely within commonly owned entities.

The Internal Revenue Service also may apply –

- the substance-over-form doctrine and
- step-transaction doctrine.

A transaction (or series of transactions) has economic substance (and thus satisfies the economic substance doctrine)

only if –

- the taxpayer establishes that –
  - the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and
  - the taxpayer has a *substantial non-Federal-tax purpose* for entering into the transaction.

The provision provides a uniform definition of economic substance, but does not alter the flexibility of the courts in other respects.

The Senate Finance Committee explained the statutory economic substance provision:

ECONOMIC SUBSTANCE DOCTRINE

1. Clarification of the economic substance doctrine

Present Law

In general

The Code provides detailed rules specifying the computation of taxable income, including the amount, timing, source, and character of items of income, gain, loss, and deduction. These rules permit both taxpayers and the government to compute taxable income with reasonable accuracy and predictability. Taxpayers generally

may plan their transactions in reliance on these rules to determine the federal income tax consequences arising from the transactions.

In addition to the statutory provisions, courts have developed several doctrines that can be applied to deny the tax benefits of tax motivated transactions, notwithstanding that the transaction may satisfy the literal requirements of a specific tax provision. The common-law doctrines are not entirely distinguishable, and their application to a given set of facts is often blurred by the courts and the IRS. Although these doctrines serve an important role in the administration of the tax system, they can be seen as at odds with an objective, "rule-based" system of taxation.

A common-law doctrine applied with increasing frequency is the "economic substance" doctrine. In general, this doctrine denies tax benefits arising from transactions that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax.[1] [[1]See, e.g., ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), aff'g 73 T.C.M. (CCH) 2189 (1997), cert. denied 526 U.S. 1017 (1999). Closely related doctrines also applied by the courts (sometimes interchangeable with the economic substance doctrine) include the "sham transaction doctrine" and the "business purpose doctrine." See, e.g., Knetsch v. United States, 364 U.S. 361 (1960) (denying interest deductions on a "sham transaction" whose only purpose was to create the deductions). Certain "substance over form" cases involving tax-indifferent parties, in which courts have found that the substance of the transaction did not comport with the form asserted by the taxpayer, have also involved examination of whether the change in economic position that occurred, if any, was consistent with the form asserted, and whether the claimed business purpose supported the particular tax benefits that were claimed. See, e.g., Klamath Strategic Investment Fund, LLC v. United States, 472 F. Supp. 2d 885 (E.D. Texas 2007); TIFD-III-E, Inc. v. United States, 459 F. 3d 220 (2d Cir. 2006); BB&T Corporation v. United States, __F. Supp. 2d __, 2007-1 USTC P 50,130 (M.D.N.C. 2007).]

Economic substance doctrine

Courts generally deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations? notwithstanding that the purported activity actually occurred. The Tax Court has described the doctrine as follows:

The tax law . . . requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings.[2] [[2]ACM Partnership v. Commissioner, 73 T.C.M. at 2215.]

Business purpose doctrine

A common law doctrine that often is considered together with the economic substance doctrine is the business purpose doctrine. The business purpose doctrine involves a subjective inquiry into the motives of the taxpayer? that is, whether the taxpayer intended the transaction to serve some useful non-tax purpose. In making this determination, some courts have bifurcated a transaction in which independent activities with non-

tax objectives have been combined with an unrelated item having only tax-avoidance objectives in order to disallow the tax benefits of the overall transaction.[3] [[3]See, ACM Partnership v. Commissioner, 157 F.3d at 256 n.48.]

Application by the courts

Elements of the doctrine

There is a lack of uniformity regarding the proper application of the economic substance doctrine.[4] [[4] "The casebooks are glutted with [economic substance] tests. Many such tests proliferate because they give the comforting illusion of consistency and precision. They often obscure rather than clarify." Collins v. Commissioner, 857 F.2d 1383, 1386 (9th Cir. 1988).] Some courts apply a conjunctive test that requires a taxpayer to establish the presence of both economic substance (i.e., the objective component) and business purpose (i.e., the subjective component) in order for the transaction to survive judicial scrutiny.[5] [[5]See, e.g., Pasternak v. Commissioner, 990 F.2d 893, 898 (6th Cir. 1993) ("The threshold question is whether the transaction has economic substance. If the answer is yes, the question becomes whether the taxpayer was motivated by profit to participate in the transaction.").] A narrower approach used by some courts is to conclude that either a business purpose or economic substance is sufficient to respect the transaction.[6] [[6]See, e.g., Rice's Toyota World v. Commissioner, 752 F.2d 89, 91-92 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and, second, that the transaction has no economic substance because no reasonable possibility of a profit exists."); IES Industries v. United States, 253 F.3d 350, 358 (8th Cir. 2001) ("In determining whether a transaction is a sham for tax purposes [under the Eighth Circuit test], a transaction will be characterized as a sham if it is not motivated by any economic purpose out of tax considerations (the business purpose test), and if it is without economic substance because no real potential for profit exists (the economic substance test)."). As noted earlier, the economic substance doctrine and the sham transaction doctrine are similar and sometimes are applied interchangeably. For a more detailed discussion of the sham transaction doctrine, see, e.g., Joint Committee on Taxation, Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998 (including Provisions Relating to Corporate Tax Shelters) (JCS-3-99) at 182.] A third approach regards economic substance and business purpose as "simply more precise factors to consider" in determining whether a transaction has any practical economic effects other than the creation of tax benefits.[7] [[7]See, e.g., ACM Partnership v. Commissioner, 157 F.3d at 247; James v. Commissioner, 899 F.2d 905, 908 (10th Cir. 1995); Sacks v. Commissioner, 69 F.3d 982, 985 (9th Cir. 1995) ("Instead, the consideration of business purpose and economic substance are simply more precise factors to consider . . . We have repeatedly and carefully noted that this formulation cannot be used as a 'rigid two-step analysis'.").]

Recently, the Court of Federal Claims questioned the continuing viability of the doctrine. That court also stated that "the use of the 'economic substance' doctrine to trump 'mere compliance with the Code' would violate the separation of powers" though that court also found that the particular case did not lack economic substance. The Court of Appeals for the Federal Circuit ("Federal Circuit Court") overruled the Court of Federal Claims decision, reiterating the viability of the economic substance doctrine and concluding that the

transaction in question violated that doctrine.[8] [[8]Coltec Industries, Inc. v. United States, 62 Fed. Cl. 716 (2004) (slip opinion at 123-124, 128); vacated and remanded, 454 F.3d 1340 (Fed. Cir. 2006), cert. denied, 127 S. Ct. 1261 (Mem.) (2007).] The Federal Circuit Court stated that "[w]hile the doctrine may well also apply if the taxpayer's sole subjective motivation is tax avoidance even if the transaction has economic substance, [footnote omitted], a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance."[9] [[9] The Federal Circuit Court stated that "when the taxpayer claims a deduction, it is the taxpayer who bears the burden of proving that the transaction has economic substance." The Federal Circuit Court quoted a decision of its predecessor court, stating that "Gregory v. Helvering requires that a taxpayer carry an unusually heavy burden when he attempts to demonstrate that Congress intended to give favorable tax treatment to the kind of transaction that would never occur absent the motive of tax avoidance." The Court also stated that "while the taxpayer's subjective motivation may be pertinent to the existence of a tax avoidance purpose, all courts have looked to the objective reality of a transaction in assessing its economic substance." Coltec Industries, Inc. v. United States, 454 F.3d at 1355, 1356.]

Nontax economic benefits

There also is a lack of uniformity regarding the type of non-tax economic benefit a taxpayer must establish in order to satisfy economic substance. Some courts have denied tax benefits on the grounds that a stated business benefit of a particular structure was not in fact obtained by that structure.[10] [[10]See, e.g., Coltec Industries v. United States, 454 F.3d 1340 (Fed. Cir. 2006). The court analyzed the transfer to a subsidiary of a note purporting to provide high stock basis in exchange for a purported assumption of liabilities, and held these transactions unnecessary to accomplish any business purpose of using a subsidiary to manage asbestos liabilities. The court also held that the purported business purpose of adding a barrier to veil-piercing claims by third parties was not accomplished by the transaction. 454 F.3d at 1358-1360 (Fed. Cir. 2006).] Several courts have denied tax benefits on the grounds that the subject transactions lacked profit potential.[11] [[11]See, e.g., Knetsch, 364 U.S. at 361; Goldstein v. Commissioner, 364 F.2d 734 (2d Cir. 1966) (holding that an unprofitable, leveraged acquisition of Treasury bills, and accompanying prepaid interest deduction, lacked economic substance).] In addition, some courts have applied the economic substance doctrine to disallow tax benefits in transactions in which a taxpayer was exposed to risk and the transaction had a profit potential, but the court concluded that the economic risks and profit potential were insignificant when compared to the tax benefits.[12] [[12]See, e.g., Goldstein v. Commissioner, 364 F.2d at 739-40 (disallowing deduction even though taxpayer had a possibility of small gain or loss by owning Treasury bills); Sheldon v. Commissioner, 94 T.C. 738, 768 (1990) (stating that "potential for gain . . . is infinitesimally nominal and vastly insignificant when considered in comparison with the claimed deductions").] Under this analysis, the taxpayer's profit potential must be more than nominal. Conversely, other courts view the application of the economic substance doctrine as requiring an objective determination of whether a "reasonable possibility of profit" from the transaction existed apart from the tax benefits.[13] [[13]See, e.g., Rice's Toyota World v. Commissioner, 752 F. 2d 89, 94 (4th Cir. 1985) (the economic substance inquiry requires an objective determination of whether a reasonable possibility of profit from the transaction existed apart from tax benefits); Compaq Computer Corp. v. Commissioner, 277 F.3d 778, 781 (5th Cir. 2001)(applied the same test, citing Rice's Toyota World); IES Industries v. United States, 253 F.3d 350, 354 (8th Cir. 2001).] In these cases, in assessing whether a reasonable

possibility of profit exists, it may be sufficient if there is a nominal amount of pre-tax profit as measured against expected net tax benefits.

Financial accounting benefits

In determining whether a taxpayer had a valid business purpose for entering into a transaction, at least one court has concluded that financial accounting benefits arising from tax savings do not qualify as a non-tax business purpose.[14] [[14]See American Electric Power, Inc. v. United States, 136 F. Supp. 2d 762, 791-92 (S.D. Ohio 2001); aff'd 326 F.3d.737 (6th Cir. 2003).] However, based on court decisions that recognize the importance of financial accounting treatment, taxpayers have asserted that financial accounting benefits arising from tax savings can satisfy the business purpose test.[15] [15See, e.g., Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JSC-303) February, 2003 ("Enron Report"), Volume III at C-93, 289. Enron Corporation relied on Frank Lyon Co. v. United States, 435 U.S. 561, 577-78 (1978), and Newman v. Commissioner, 902 F.2d 159, 163 (2d Cir. 1990), to argue that financial accounting benefits arising from tax savings constitute a good business purpose.]

Tax-indifferent parties

A number of cases have involved transactions structured to allocate income for Federal tax purposes to a tax-indifferent party, with a corresponding deduction, or favorable basis result, to a taxable person. The income allocated to the tax-indifferent party for tax purposes was structured to exceed any actual economic income to be received by the tax indifferent party from the transaction. Courts have sometimes concluded that a particular type of transaction did not satisfy the economic substance doctrine.[16] [[16]See, e.g., ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998), aff'g 73 T.C.M. (CCH) 2189 (1997), cert. denied 526 U.S. 1017 (1999).] In other cases, courts have indicated that the substance of the transaction did not support the form of income allocations asserted by the taxpayer, and have questioned whether asserted business purpose or other standards were met.[17] [[17]See, e.g., TIFD- III-E, Inc. v. United States, 459 F.3d 220 (2d Cir. 2006).]

Description of Proposal

The provision clarifies and enhances the application of the economic substance doctrine. Under the provision, in a case in which a court determines that the economic substance doctrine is relevant to a transaction (or a series of transactions), such transaction (or series of transactions) has economic substance (and thus satisfies the economic substance doctrine) only if the taxpayer establishes that (1) the transaction changes in a meaningful way (apart from Federal income tax consequences) the taxpayer's economic position, and (2) the taxpayer has a substantial non-Federal-tax purpose for entering into such transaction. The provision provides a uniform definition of economic substance, but does not alter the flexibility of the courts in other respects.

If the tax benefits are clearly consistent with all applicable provisions of the Code and the purposes of such provisions, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine as defined in this provision. Thus, the provision does not change current law standards used by courts in determining when to utilize an economic substance analysis.[18]

[[18]See, e.g., Treas. Reg. sec. 1.269-2, stating that characteristic of circumstances in which a deduction otherwise allowed will be disallowed are those in which the effect of the deduction, credit, or other allowance would be to distort the liability of the particular taxpayer when the essential nature of the transaction or situation is examined in the light of the basic purpose or plan which the deduction, credit, or other allowance was designed by the Congress to effectuate.]

The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages. Among[19] [[19]The examples are illustrative and not exclusive.] these basic decisions are (1) the choice between capitalizing a business enterprise with debt or equity; (2) the choice between foreign corporations and domestic corporations; (3) the treatment of a transaction or series of transactions as a corporate organization or reorganization under subchapter C; and (4) the ability to respect a transaction between related parties provided that the arm's length standard of section 482 is satisfied. Leasing transactions, like all other types of transactions, will continue to be analyzed in light of all the facts and circumstances.[20] [[20]See, e.g., Frank Lyon v. Commissioner, 435 U.S. 561 (1978); Coltec Industries v. United States, 454 F.3d 1340 (Fed. Cir. 2006), cert. denied 127 S. Ct. 1261 (Mem) (2007).] As under present law, whether a particular transaction meets the requirements for specific treatment under any of these provisions can be a question of facts and circumstances. Also, the fact that a transaction does meet the requirements for specific treatment under any provision of the Code is not determinative of whether a transaction or series of transactions of which it is a part has economic substance.

The provision does not alter the court's ability to aggregate, disaggregate, or otherwise recharacterize a transaction when applying the doctrine. For example, the provision reiterates the present-law ability of the courts to bifurcate a transaction in which independent activities with non- tax objectives are combined with an unrelated item having only tax- avoidance objectives in order to disallow those tax motivated benefits.[21] [[21]See, e.g., Coltec Industries, Inc. v. United States, 454 F.3d 1340 (Fed. Cir. 2006), cert. denied 127 S. Ct. 1261 (Mem.) (2007) ("the first asserted business purpose focuses on the wrong transaction--the creation of Garrison as a separate subsidiary to manage asbestos liabilities. . [W]e must focus on the transaction that gave the taxpayer a high basis in the stock and thus gave rise to the alleged benefit upon sale . .") 454 F.3d 1340, 1358 (Fed. Cir. 2006). See also ACM Partnership v. Commissioner, 157 F.3d at 256 n.48; Minnesota Tea Co. v. Helvering, 302 U.S. 609, 613 (1938) ("A given result at the end of a straight path is not made a different result because reached by following a devious path.").]

Conjunctive analysis

The provision clarifies that the economic substance doctrine involves a conjunctive analysis? there must be a judicial inquiry regarding the objective effects of the transaction on the taxpayer's economic position as well as an inquiry regarding the taxpayer's subjective motives for engaging in the transaction. Under the provision, a transaction must satisfy both tests, i.e., the transaction must change in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and the taxpayer must have a substantial non-Federal-tax purpose[22] [[22] A purpose of reducing non-Federal taxes is not a non-Federal-tax business purpose if (i) the transaction will effect a reduction in both Federal and non-Federal taxes because of similarities between Federal

tax law and the law of the other jurisdiction and (ii) the reduction of Federal taxes is greater than or substantially coextensive with the reduction of non-Federal taxes.] for entering into such transaction, in order to satisfy the economic substance doctrine. This clarification eliminates the disparity that exists among the circuits regarding the application of the doctrine, and modifies its application in those circuits in which either a change in economic position or a non-tax business purpose (without having both) is sufficient to satisfy the economic substance doctrine.

Non-Federal-tax business purpose

Under the provision, a taxpayer's non-Federal-tax purpose for entering into a transaction (the second prong in the analysis) must be "substantial."[23] [[23] See, e.g., Treas. Reg. sec. 1.269-2(b) (stating that a distortion of tax liability indicating the principal purpose of tax evasion or avoidance might be evidenced by the fact that "the transaction was not undertaken for reasons germane to the conduct of the business of the taxpayer"). Similarly, in ACM Partnership v. Commissioner, 73 T.C.M. (CCH) 2189 (1997), the court stated: Key to [the determination of whether a transaction has economic substance] is that the transaction must be rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. Both the utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry. A rational relationship between purpose and means ordinarily will not be found unless there was a reasonable expectation that the nontax benefits would be at least commensurate with the transaction costs. [citations omitted]

An objective of achieving a favorable accounting treatment for financial reporting purposes will not itself be treated as a substantial non-Federal-tax purpose if the origin of such financial accounting benefit is a reduction of Federal income tax.[24] [[24] However, if the tax benefits are clearly contemplated and expected by the language and purpose of the relevant authority, such tax benefits should not be disallowed solely because the transaction results in a favorable accounting treatment. An example is the repealed foreign sales corporation rules.] For example, a transaction that is expected to increase financial accounting income as a result of generating tax deductions or losses without a corresponding financial accounting charge (i.e., a permanent book-tax difference)[25] [[25] This includes tax deductions or losses that are anticipated to be recognized in a period subsequent to the period the financial accounting benefit is recognized. For example, FAS 109 in some cases permits the recognition of financial accounting benefits prior to the period in which the tax benefits are recognized for income tax purposes.] should not be considered to have a substantial non-Federal-tax purpose unless a substantial non-Federal-tax purpose exists apart from the financial accounting benefits.[26] [[26] Claiming that a financial accounting benefit constitutes a substantial non-tax purpose fails to consider the origin of the accounting benefit (i.e., reduction of taxes) and significantly diminishes the purpose for having a substantial non-tax purpose requirement. See, e.g., American Electric Power, Inc. v. United States, 136 F. Supp. 2d 762, 791-92 (S.D. Ohio 2001) ("AEP's intended use of the cash flows generated by the [corporate-owned life insurance] plan is irrelevant to the subjective prong of the economic substance analysis. If a legitimate business purpose for the use of the tax savings 'were sufficient to breathe substance into a transaction whose only purpose was to reduce taxes, [then] every sham tax-shelter device might succeed,'") (citing Winn-Dixie v. Commissioner, 113 T.C. 254, 287 (1999)); aff'd, 326 F3d 737 (6th Cir. 2003).]

Profit potential

Under the provision, a taxpayer may rely on factors other than profit potential to demonstrate that a transaction results in a meaningful change in the taxpayer's economic position or that the taxpayer has a substantial non-Federal-tax purpose for entering into such transaction. The provision does not require or establish a specified minimum return that will satisfy the profit potential test. However, if a taxpayer relies on a profit potential, the present value of the reasonably expected pre- Federal tax profit must be substantial in relation to the present value of the expected net Federal tax benefits that would be allowed if the transaction were respected.[27] [[27] Thus, a "reasonable possibility of profit" alone will not be sufficient to establish that a transaction has economic substance.] In addition, in determining pre-Federal-tax profit, foreign taxes are treated as expenses to the extent provided in regulations.[28] [[28] There is no intention to restrict the ability of the courts to consider the appropriate treatment of foreign taxes in particular cases, as under present law. However, the Treasury Department may, in addition, choose to require treatment of foreign taxes as expenses as provided in regulations.]

Other rules

The Secretary may prescribe regulations that provide (1) exemptions from the application of the provision, and (2) other rules as may be necessary or appropriate to carry out the purposes of the provision.

No inference is intended as to the proper application of the economic substance doctrine under present law. In addition, the provision shall not be construed as altering or supplanting any other common law doctrine; and the provision shall be construed as being additive to any such other doctrine.

Effective Date

The provision applies to transactions entered into after the date of enactment.

2. Penalty for understatements attributable to transactions lacking economic substance, etc.

Present Law

General accuracy-related penalty

An accuracy-related penalty under section 6662 applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement. If the correct income tax liability exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 (or, in the case of corporations, by the lesser of (a) 10 percent of the correct tax (or $10,000 if greater) or (b) $10 million), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement.[29] [[29] Sec. 6662.] Except in the case of tax shelters,30 the amount of any understatement is reduced by any portion attributable to an item if (1) the treatment of the item is supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed and there was a reasonable basis for its tax treatment. The Treasury Secretary may prescribe a list of positions which the Secretary believes do not meet the requirements for substantial authority under this provision.

The section 6662 penalty generally is abated (even with respect to tax shelters) in cases in which the taxpayer can demonstrate that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.[31] [[31] Sec. 6664(c).] The relevant regulations provide that reasonable cause exists where the taxpayer "reasonably relies in good faith on an opinion based on a professional tax advisor's analysis of the pertinent facts and authorities [that] . unambiguously concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged" by the IRS.[32] [[32] Treas. Reg. sec. 1.6662-4(g)(4)(i)(B); Treas. Reg. sec. 1.6664-4(c).]

Listed transactions and reportable avoidance transactions

In general

A separate accuracy-related penalty under section 6662A applies to "listed transactions" and to other "reportable transactions" with a significant tax avoidance purpose (hereinafter referred to as a "reportable avoidance transaction"). The penalty rate and defenses available to avoid the penalty vary depending on whether the transaction was adequately disclosed.

Both listed transactions and reportable transactions are allowed to be described by the Treasury department under section 6707A(c), which imposes a penalty for failure adequately to report such transactions under section 6011. A reportable transaction is defined as one that the Treasury Secretary determines is required to be disclosed because it is determined to have a potential for tax avoidance or evasion.[33] [[33] Sec. 6707A(c)(1).] A listed transaction is defined as a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of the reporting disclosure requirements.[34] [[34] Sec. 6707A(c)(2).]

Disclosed transactions

In general, a 20-percent accuracy-related penalty is imposed on any understatement attributable to an adequately disclosed listed transaction or reportable avoidance transaction.[35] [[35] Sec. 6662A(a).] The only exception to the penalty is if the taxpayer satisfies a more stringent reasonable cause and good faith exception (hereinafter referred to as the "strengthened reasonable cause exception"), which is described below. The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

Undisclosed transactions

If the taxpayer does not adequately disclose the transaction, the strengthened reasonable cause exception is not available (i.e., a strict-liability penalty generally applies), and the taxpayer is subject to an increased penalty equal to 30 percent of the understatement.[36] [[36] Sec. 6662A(c).] However, a taxpayer will be treated as having adequately disclosed a transaction for this purpose if the IRS Commissioner has separately rescinded the separate penalty under section 6707A for failure to disclose a reportable transaction.[37] [[37] Sec. 6664(d).] The IRS Commissioner is authorized to do this only if the failure does not relate to a listed transaction and only if rescinding the penalty would promote compliance and effective tax administration.[38] [[38] Sec. 6707A(d).]

A public entity that is required to pay a penalty for an undisclosed listed or reportable transaction must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).[39] [[39] Sec. 6707A(e).]

Determination of the understatement amount

The penalty is applied to the amount of any understatement attributable to the listed or reportable avoidance transaction without regard to other items on the tax return. For purposes of this provision, the amount of the understatement is determined as the sum of: (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return);[40] [[40] For this purpose, any reduction in the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income. Sec. 6662A(b).] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item.

Except as provided in regulations, a taxpayer's treatment of an item shall not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of when the taxpayer is first contacted regarding an examination of the return or such other date as specified by the Secretary.[41] [[41] Sec. 6662A(e)(3).]

Strengthened reasonable cause exception

A penalty is not imposed with respect to any portion of an understatement if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith. Such a showing requires: (1) adequate disclosure of the facts affecting the transaction in accordance with the regulations under section 6011;42 (2) that there is or was substantial authority for such treatment; and (3) that the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. For this purpose, a taxpayer will be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief: (1) is based on the facts and law that exist at the time the tax return (that includes the item) is filed; and (2) relates solely to the taxpayer's chances of success on the merits and does not take into account the possibility that (a) a return will not be audited, (b) the treatment will not be raised on audit, or (c) the treatment will be resolved through settlement if raised. [Footnote omitted.]

A taxpayer may (but is not required to) rely on an opinion of a tax advisor in establishing its reasonable belief with respect to the tax treatment of the item. However, a taxpayer may not rely on an opinion of a tax advisor for this purpose if the opinion (1) is provided by a "disqualified tax advisor" or (2) is a "disqualified opinion."

Disqualified tax advisor

A disqualified tax advisor is any advisor who: (1) is a material advisor44 and who participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates; (2) is compensated directly or indirectly45 by a material advisor with respect to the transaction; (3) has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained; or (4) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.

A material advisor is considered as participating in the "organization" of a transaction if the advisor performs acts relating to the development of the transaction. This may include, for example, preparing documents: (1) establishing a structure used in connection with the transaction (such as a partnership agreement); (2) describing the transaction (such as an offering memorandum or other statement describing the transaction); or (3) relating to the registration of the transaction with any federal, state, or local government body.46 [Citation omitted.] Participation in the "management" of a transaction means involvement in the decision-making process regarding any business activity with respect to the transaction. Participation in the "promotion or sale" of a transaction means involvement in the marketing or solicitation of the transaction to others. Thus, an advisor who provides information about the transaction to a potential participant is involved in the promotion or sale of a transaction, as is any advisor who recommends the transaction to a potential participant.

Disqualified opinion

An opinion may not be relied upon if the opinion: (1) is based on unreasonable factual or legal assumptions (including assumptions as to future events); (2) unreasonably relies upon representations, statements, finding or agreements of the taxpayer or any other person; (3) does not identify and consider all relevant facts; or (4) fails to meet any other requirement prescribed by the Secretary.

Coordination with other penalties

To the extent a penalty on an understatement is imposed under section 6662A, that same amount of understatement is not also subject to the accuracy-related penalty under section 6662(a) or to the valuation misstatement penalties under section 6662(e) or 6662(h). However, such amount of understatement is included for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1) and for purposes of identifying an underpayment under the section 6663 fraud penalty.

The penalty imposed under section 6662A does not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.

Description of Proposal

The provision imposes a new, stronger penalty for an understatement attributable to any transaction that lacks economic substance (referred to in the statute as a "noneconomic substance transaction understatement").47 The penalty rate is 30 percent (reduced to 20 percent if the taxpayer adequately discloses

the relevant facts in accordance with regulations prescribed under section 6011). No exceptions (including the reasonable cause or rescission rules) to the penalty are available (i.e., the penalty is a strict-liability penalty). Under the provision, outside opinions or in- house analysis would not protect a taxpayer from imposition of a penalty if it is determined that the transaction lacks economic substance or is not respected as described below.

A "noneconomic substance transaction" means any transaction if (1) the transaction lacks economic substance (as defined in the provision regarding the clarification of the economic substance doctrine). [Footnote omitted.] For this purpose, a transaction is one that lacks economic substance if it is disregarded as a result of the application of the same factors and analysis that is required under the provision for an economic substance analysis, even if a court uses a different term to describe the doctrine.

For purposes of the bill, the calculation of an "understatement" is made in the same manner as in the present law provision relating to accuracy-related penalties for listed and reportable avoidance transactions (sec. 6662A). Thus, the amount of the understatement under the provision would be determined as the sum of (1) the product of the highest corporate or individual tax rate (as appropriate) and the increase in taxable income resulting from the difference between the taxpayer's treatment of the item and the proper treatment of the item (without regard to other items on the tax return), [footnote omitted] and (2) the amount of any decrease in the aggregate amount of credits which results from a difference between the taxpayer's treatment of an item and the proper tax treatment of such item. In essence, the penalty will apply to the amount of any understatement attributable solely to a non-economic substance transaction.

As in the case of the understatement penalty for reportable and listed transactions under present law section 6662A(e)(3), except as provided in regulations, the taxpayer's treatment of an item will not take into account any amendment or supplement to a return if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted regarding an examination of such return or such other date as specified by the Secretary.

As in the case of the understatement penalty for undisclosed reportable transactions under present law section 6707A, a public entity that is required to pay a penalty under the provision (but in this case, regardless of whether the transaction was disclosed) must disclose the imposition of the penalty in reports to the SEC for such periods as the Secretary shall specify. The disclosure to the SEC applies without regard to whether the taxpayer determines the amount of the penalty to be material to the reports in which the penalty must appear, and any failure to disclose such penalty in the reports is treated as a failure to disclose a listed transaction. A taxpayer must disclose a penalty in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid).

Regardless of whether the transaction was disclosed, a penalty under the provision cannot be asserted until there has been a review and approval by the Chief Counsel of the Internal Revenue Service (or, if so delegated, a branch chief within the office of Chief Counsel) and the taxpayer has had the opportunity to submit a written statement in connection with that review. Once the penalty has been asserted following such National Office review, the penalty cannot be compromised for purposes of a settlement without approval of the Chief Counsel (or, if so delegated, a branch chief within the office of Chief Counsel). The penalty can be compromised in such event only to the extent the underlying understatement with respect to which it was asserted is also

compromised. Furthermore, the IRS is required to keep records summarizing the application of this penalty and providing a description of each penalty compromised under the provision and the reasons for the compromise. If a final adjudication of a court determines that the economic substance doctrine does not apply, then a noneconomic substance penalty asserted by the IRS in that case would not apply.

Any understatement on which a penalty is imposed under the provision will not be subject to the accuracy-related penalty under section 6662 or under 6662A (accuracy-related penalties for listed and reportable avoidance transactions). However, an understatement under the provision is taken into account for purposes of determining whether any understatement (as defined in sec. 6662(d)(2)) is a substantial understatement as defined under section 6662(d)(1). The penalty imposed under the provision will not apply to any portion of an understatement to which a fraud penalty is applied under section 6663.[262]

The federal tax effects of the transactions must be disregarded, according to Revenue Ruling 2024-14. Revenue Ruling 2024-14 ignores only certain basis adjustments rather than ignoring steps of the transaction. Ignoring a particular tax effect (basis adjustment) but not recharacterizing the transaction in a manner that has economic substance is an idiosyncratic attempted application of the economic substance doctrine.

It is difficult to know what to make of Revenue Ruling 2024-14's application of related parties. This suggests that perhaps a different tax result would be reached if the parties were unrelated. The stress of Revenue Ruling 2024-14 on related party transactions may be taken by many as an approval of basis adjusting transactions undertaken where related parties are not involve.

Revenue Ruling 2024-14 adjusts basis consequences of the basis adjusting transactions but does not disregard any steps in the transactions. This seems to be a departure from the normal application of the economic substance doctrine, which normally ignores either steps in a transaction or an entire transaction.

Revenue Ruling 2024-14 does not examine any of the transactions that created inside-outside basis disparities. Revenue Ruling 2024-14 asserts that those earlier transactions are part of the overall plan. The earlier transactions that create inside-outside basis disparities appear to happen magically off stage. These transactions are not explained at all. Revenue Ruling 2024-14 does not consider whether those earlier transactions that created the inside-outside basis disparities should be disregarded.

Revenue Ruling 2024-14 apparently disregards various Code sections and regulations. Revenue Ruling 2024-14 appears to turn off Sections 734, 743, and 755. Revenue Ruling 2024-14 selectively ignores certain tax aspects of transactions, but does not ignore the transactions themselves. This does not seem consistent with the history of the economic substance doctrine, which normally disregards steps in a transaction rather than nullifies isolated tax benefits.

[262] See Doc 2007-22524, 2007 TNT 195-59 (Oct. 4, 2007).

Revenue Ruling 2024-14 assumes evil intent on the part of the taxpayer with respect to the entire transaction. That makes its conclusion considerably easier. Similar transactions may be undertaken by taxpayers without evil intent. The status of these other transactions is uncertain in the light of Revenue Ruling 2024-14.

The Internal Revenue Service has chosen not to impose a minimum size for transactions covered by Revenue Ruling 2024-14.

Undertaking partnership basis adjusting transactions could prove expensive for taxpayers in litigation expenses, even if the tax benefits of those transactions ultimately are approved by the courts.

An implicit bias the underlies Revenue Ruling 2024-14. The Internal Revenue Service apparently believes that if a transaction is identified as the Internal Revenue Service as "abusive", the Internal Revenue Service should win in tax litigation. Revenue Ruling 2024-14 apparently infers that, if Congress did not consider a particular tax consequence of a transaction and that tax consequence if favorable to a taxpayer, the Internal Revenue Service can disregard that particular tax consequence.

Revenue Ruling 2024-14 is a bold assertion of the breadth of the Internal Revenue Service authority under the economic substance doctrine, particularly since the Internal Revenue Service appears willing to respect all of the steps in the transaction in Revenue Ruling 2024-14.

Revenue Ruling 2024-14 is not being used to delete or reorder steps, but rather to delete specific tax benefits in this case adjustments to tax basis. Revenue Ruling 2024-14 takes the position that, in appropriate circumstances in which the Internal Revenue Service does not like a particular tax result, the Internal Revenue Service can simply disregard that tax result rather than recharacterize the transaction.

Courts still may find themselves constrained by the language of the Code and Treasury Regulations. While judicial doctrines such as economic substance, step transaction, and sham can be used to overcome the form of the transaction, these doctrines are applied by the court only with considerable care and analysis. Characterization of a transaction as "abusive" does not necessarily mean that the tax benefits of the transaction can be disallowed by the Internal Revenue Service.

Economic substance is normally used

- to correct transactions that do not have economic substance and
- to recharacterize them in a manner that have economic substance.

Revenue Ruling 2024-14 does not do that. Revenue Ruling 2024-14 does not recharacterize the transaction. Revenue Ruling 2024-14 merely disallows basis adjustment benefits without recharacterizing the underlying transactions.

It perhaps would have been more productive for the Internal Revenue Service to seek relief in Congress rather than publishing Revenue Ruling 2024-14. The Internal Revenue Service still may seek relief in Congress.

Revenue Ruling 2024-14 nevertheless may have an appreciable *in terrorem* effect on taxpayers.

Revenue Ruling 2024-14 should be viewed against the background that the partnership basis adjustment rules can produce anomalous results.

The question in Revenue Ruling 2024-14 is:

> *Does the economic substance doctrine apply to disallow tax benefits associated with a series of transactions involving a related-party partnership, through which the parties first generate a disparity between inside basis and outside basis and then trigger a basis adjustment to property under Section 732(b), Section 734(b), or Section 743(b), which generates increased cost recovery deductions with respect to the property or reduced gain (or increased loss) upon a sale of the property?*

These are the general facts:

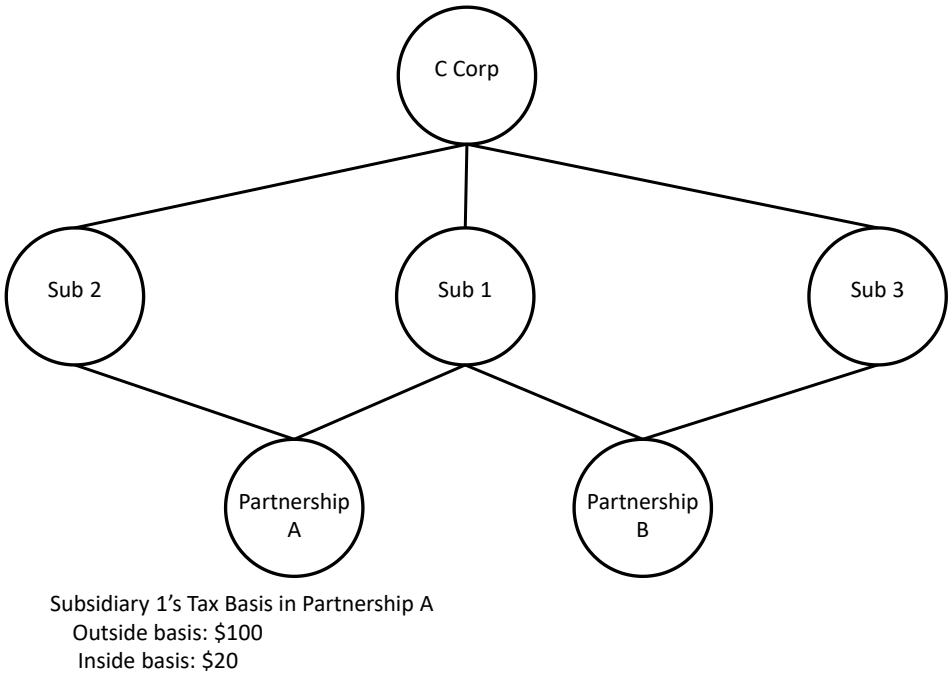
- C is a domestic corporation engaged in operating a trade or business, including
  - through several subsidiary entities
    - commonly managed by C or
    - in which C directly or indirectly holds controlling financial interests (C Subsidiaries) such that C is related to each of the C Subsidiaries.[263]
- The C Subsidiaries include, among other entities,
  - Sub 1, Sub 2, Sub 3,
  - Partnership A, Partnership B, Partnership C, and Partnership D,
  - each of which is indirectly owned by C through one or more C Subsidiaries.
- The C Subsidiaries
  - own various depreciable or amortizable assets used in the conduct of C's trade or business., and
  - have incurred various liabilities as part of the conduct of C's trade or business.

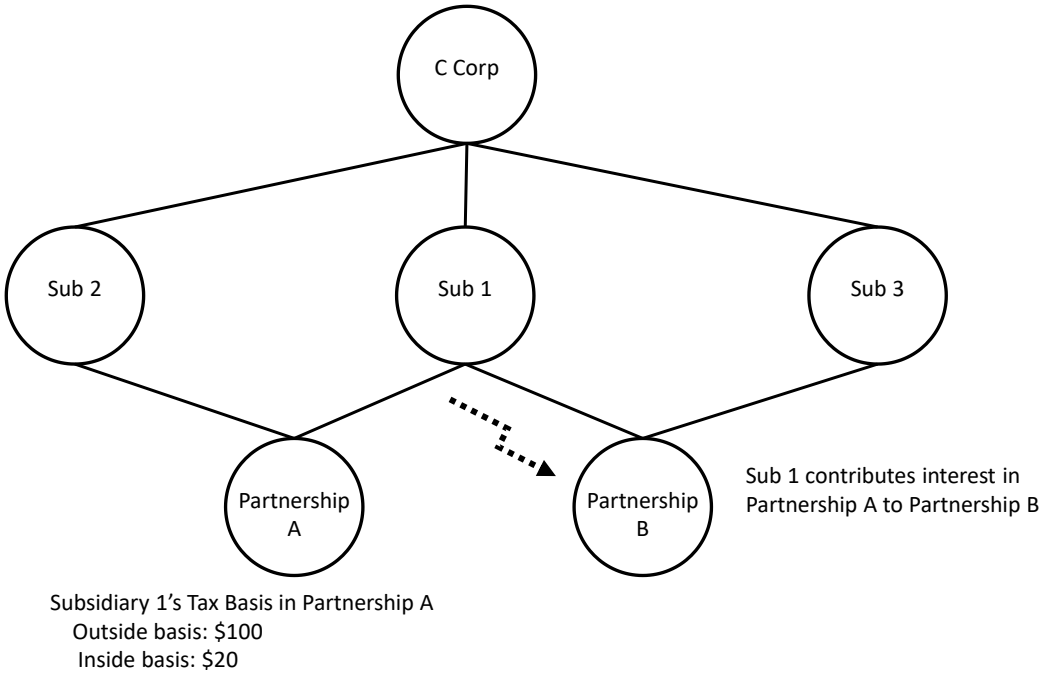
[263] Under I.R.C. § 267(b) or I.R.C. § 707(b)(1).

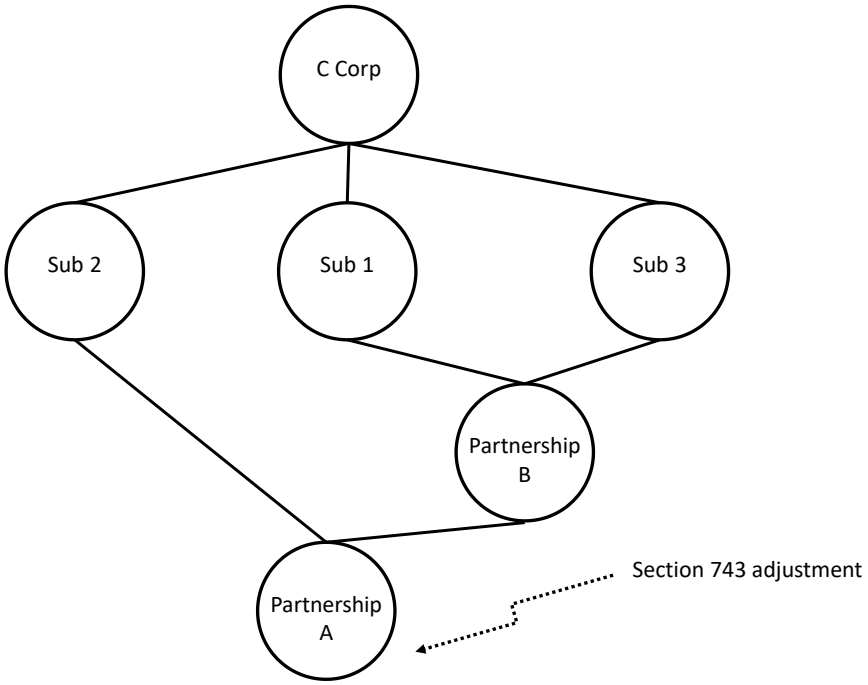
- C issues financial statements for its trade or business that report these assets and liabilities of the C Subsidiaries (C Financial Statements).

[i] Situation 1.

Thee diagrams show the transaction in Situation 1:







In Situation 1.

- C indirectly owns more than 50 percent of the stock of each of Sub 1, Sub 2, and Sub 3, all domestic corporations.

[Apparently, there may be outside ownership of Sub 1, Sub 2, and Sub 3. Revenue Ruling 2024-14 does not adequately consider these other owners, if there are any.]

- Sub 1 and Sub 2 are the only partners in Partnership A with
  - each holding a 50 percent interest in the capital, profits, and losses of Partnership A.
- Sub 1 and Sub 3 are the only partners in Partnership B
  - with each holding a 50 percent interest in the capital, profits, and losses of Partnership B.
- Prior to Date 1, Partnership A had a valid election in place under Section 754.
- Also prior to Date 1,
  - Sub 1's share of the adjusted tax basis of Partnership A's property
    - (that is, Sub 1's share of Partnership A's inside basis)
    - was equal to $20x and
  - the adjusted tax basis of Sub 1's interest in Partnership A
    - (that is, Sub 1's outside basis)
    - was $100x.
- This $80x disparity between Sub 1's share of Partnership A's inside basis and Sub 1's outside basis in Partnership A prior to Date 1 resulted from –
  - both –
    - Sub 1 and Sub 2 making contributions to Partnership A, and
    - Partnership A making distributions to Sub 1 and Sub 2,

    of property with specific Federal income tax attributes, and

    [These earlier transactions are assumed to be part of the abusive plan, but they are not discussed in Revenue Ruling 2024-14.]
  - the allocation of Federal income tax items in accordance with Section704(b) and (c).

    [Revenue Ruling 2024-14 does not describe precisely these prior transactions. Revenue Ruling 2024-14 does not engage the issue of whether prior allocations of federal income tax items should have been disallowed. Revenue Ruling 2024-14 does not describe how these various prior transactions produced the inside-outside basis disparity. The lack of detail makes the example considerably more difficult to understand. So far as the reader is concerned, the inside-outside basis disparity seems

to have been created by some form of black magic. It appears to be critical to the analysis of Revenue Ruling 2024-14 that the creation of the inside-outside basis disparity was part of the integrated plan. A transaction where the creation of the inside-outside basis disparity was independent of the exploitation of the basis disparity apparently would not be subject to the economic substance doctrine under Revenue Ruling 2024-14.]

- The contributions, distributions, and allocations were undertaken −

  with a view to −

  - creating a disparity between −
    - Sub 1's share of Partnership A's inside basis and
    - Sub 1's outside basis in Partnership A.

[The example does not detail how this conclusion was reached, except by assumption. The example does not indicate the size of the basis disparity. The "set up" of the basis adjusting transaction in creating the transaction seems to be an indispensable part of the plan.]

- On Date 1,
  - Sub 1 transfers its interest in Partnership A to Partnership B in a contribution −
    - that qualifies for nonrecognition of gain or loss under Section 721(a) (Sub 1 Contribution).

      [The contribution creates a potential Section 743 adjustment in the assets of Partnership A for the benefit of Sub 1 on account of the inside-outside basis disparity. The example does not explore why this transfer occurred.]

- The stated ***business purpose*** for the Sub 1 Contribution is –
  - to achieve cost savings for C and the C Subsidiaries by −
    - cleaning up intercompany accounts,
    - reducing administrative complexity, and
    - achieving other administrative efficiencies.

      [Revenue Ruling 2024-14 chooses a transaction with particularly anemic ***business purpose****s. A taxpayer might fare better if the taxpayer had more* ***substantial business purpose****s. The example does not seem particularly impressed with the assigned business purposes. The example might well reach a different result if there were substantial business purposes.]*

- Immediately after the Sub 1 Contribution,
  - Partnership B's outside basis in its interest in Partnership A is $100x[264]

    while
  - its share of Partnership A's inside basis is $20x (without regard to Section 743(b)).

    [This inside-outside basis disparity appear to be an indispensable part of the example.]
- As a result,
  - Partnership A increases the adjusted basis of its property by $80x with respect to Partnership B only. This is the excess of –
    - Partnership B's $100x outside basis

      over
    - its $20x proportionate share of inside basis)[265]
  - Partnership A allocates substantially all of this $80x basis increase to its depreciable or amortizable property (Basis-Adjusted Property)[266]

    [The example fails to mention that this allocation apparently is required by Treasury Regulations and that the partnership has no options under the Treasury Regulations.]
- The Sub 1 Contribution on Date 1 was undertaken with a view to –

  exploiting
  - the disparity between
    - Sub 1's share of Partnership A's inside basis and
    - Sub 1's outside basis in Partnership A created before Date 1 and

  increasing
  - Partnership B's share of Partnership A's inside basis in the depreciable or amortizable property.

    [The example assumes an evil purpose for the contribution.]
- The cost savings resulting from the Sub 1 Contribution are *insubstantial* –

[264] Under I.R.C. § 723.
[265] Under I.R.C. § 743(b).
[266] Under I.R.C. § 755 and I.R.C. § 1.755-1(b)(5).

in relation to

- the reduction in the aggregate Federal income tax liability of the C Subsidiaries

  resulting from

  - the $80x increase in Partnership A's basis in the Basis-Adjusted Property,

  which results in

  - Partnership B being allocated increased amounts of deductions for depreciation or amortization or
  - reduced amounts of gain (or increased amounts of loss) upon the sale of the Basis-Adjusted Property.

    [This compares the cost savings from the contribution to the tax benefits from the basis adjustment.]

- C reports the relatively small cost savings in the C Financial Statements.

The basis adjustment rules under Section 732(b), 734(b), and 743(b) are intended to –

- reduce disparities between inside and outside basis
- that would otherwise result from a distribution of property or transfer of a partnership interest.[267]

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[267] Revenue Ruling 2024-14 summarizes the basis adjustment law:

I.R.C. § 267(a) generally disallows deductions in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of I.R.C. § 267(b), other than any loss of a distributing corporation (or the distributee) in the case of a distribution in complete liquidation. I.R.C. § 267(b)(3) provides that two corporations that are members of the same controlled group (as defined in I.R.C. § 267(f)) have a relationship referred to in I.R.C. § 267(a). I.R.C. § 267(f)(1) provides that a controlled group has the meaning given by I.R.C. § 1563(a), except that "more than 50 percent" is substituted for "at least 80 percent" each place it appears in I.R.C. § 1563(a), and the determination is made without regard to I.R.C. § 1563(a)(4) and (e)(3)(C). In addition, I.R.C. § 267(b)(10) provides that a corporation and a partnership owned by the same persons have a relationship referred to in I.R.C. § 267(a) if the same persons own more than 50 percent of both the value of the outstanding stock of the corporation and the capital interest, or the profits interest, in the partnership.

I.R.C. § 707(b)(1)(A) disallows any deduction for losses from sales or exchanges of property (other than an interest in the partnership) directly or indirectly, between a partnership and a partner owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership. I.R.C. § 707(b)(1)(B) disallows any deduction for losses from sales or exchanges of property (other than an interest in the partnership) directly or indirectly, between two partnerships in

which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

I.R.C. § 721(a) provides that no gain or loss is recognized to a partnership or to any of its partners on the contribution of property to the partnership in exchange for an interest in the partnership. I.R.C. § 723 provides that the basis of property contributed to a partnership by a partner is the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount of gain (if any) recognized under I.R.C. § 721(b) to the contributing partner at such time.

I.R.C. § 731(b) provides that no gain or loss is recognized to a partnership on the distribution to a partner of property, including money. I.R.C. § 732(a)(1) generally provides that the basis of property (other than money) distributed by a partnership to a partner other than in liquidation of the partner's interest is its adjusted basis to the partnership immediately before the distribution. However, I.R.C. § 732(a)(2) limits the basis to the distributee partner to the adjusted basis of that partner's interest in the partnership reduced by any money distributed in the same transaction. I.R.C. § 732(b) provides that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest equals the adjusted basis of the partner's interest in the partnership reduced by any money distributed in the same transaction. I.R.C. § 732(c) provides rules for the allocation of basis among properties received in a distribution to which I.R.C. § 732(a)(2) or I.R.C. § 732(b) applies.

I.R.C. § 733 provides that the adjusted basis of a distributee partner's interest in a partnership following a non-liquidating distribution is reduced (but not below zero) by (1) the amount of any money distributed to the partner, and (2) the adjusted basis of distributed property (other than money), as determined under I.R.C. § 732.

I.R.C. § 734(a) provides that the basis of partnership property is not adjusted as the result of a distribution of property to a partner unless an election provided in I.R.C. § 754 is in effect or there is a substantial basis reduction (as defined in I.R.C. § 734(d)) with respect to such distribution. I.R.C. § 734(b) provides that a partnership, with respect to which an election provided in I.R.C. § 754 is in effect or with respect to which there is a substantial basis reduction, increases or decreases the adjusted basis of partnership property to take into account the gain or loss recognized by a distributee partner under I.R.C. § 731(a) or changes in the basis of distributed property under I.R.C. § 732. Under I.R.C. § 734(b)(1)(B), in the case of distributed property to which I.R.C. § 732(a)(2) applies, the amount of increase includes the excess of the adjusted basis of the distributed property immediately before the distribution over the basis of the distributed property to the distributee. If I.R.C. § 734(b) is applicable, I.R.C. § 734(c) provides that the allocation of basis among partnership properties is made in accordance with the rules provided in I.R.C. § 755. I.R.C. § 734(d) provides that there is a substantial basis reduction with respect to a distribution if, had an election provided in I.R.C. § 754 been in effect, there would be a negative net basis adjustment to partnership property of more than $250,000.

I.R.C. § 743(a) provides that the basis of partnership property is not adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner unless an election provided in I.R.C. § 754 is in effect or there is a substantial built-in loss (as defined in I.R.C. § 743(d)) immediately after such transfer. I.R.C. § 743(b) provides that, in the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which an election provided in I.R.C. § 754 is in effect or a partnership that has a substantial built-in loss immediately after such transfer, increases the adjusted basis of the partnership property by the excess of the basis to the transferee partner of the transferee partner's interest in the partnership over such partner's proportionate share of the adjusted basis of the partnership property, or decreases the

[The basis adjustment rules apparently did precisely this in the example. They reduced disparities between inside and outside basis.]

In each of Situations 1-3,

- the parties engaged in a concerted effort

  [The collaboration is not altogether clear. Revenue Ruling 2024-14 should at least identify which parties were acting in concert.]

- to create disparities between inside and outside basis
- through various methods, such as
  - the contribution or distribution of property with specific Federal income tax attributes or
  - the allocation of Federal income tax items in accordance with Section 704(b) and (c).

    [Revenue Ruling 2024-14 does not identify the facts of this "concerted effort". It is not clear what the parties did or that what they did was improper. The example does not clarify how the contribution or distribution of property and the allocation of Federal income tax items in this case worked. The example does not

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adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of such partner's interest in the partnership. I.R.C. § 743(b) further provides that, under regulations prescribed by the Secretary of the Treasury or her delegate (Secretary), such increase or decrease constitutes an adjustment to the basis of partnership property with respect to the transferee partner only. If I.R.C. § 743(b) is applicable, I.R.C. § 743(c) provides that the allocation of basis among partnership properties is made in accordance with the rules provided in I.R.C. § 755.

I.R.C. § 754 provides, in part, that if a partnership files an election, in accordance with the regulations prescribed by the Secretary, the basis of partnership property is adjusted, in the case of a distribution of property, in the manner provided in I.R.C. § 734, and, in the case of a transfer of a partnership interest, in the manner provided in I.R.C. § 743. A I.R.C. § 754 election applies with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which the election was filed and all subsequent taxable years.

I.R.C. § 755(a) provides that a basis adjustment under I.R.C. § 734(b) or I.R.C. § 743(b) is allocated among partnership properties in a manner that reduces the difference between the fair market values and adjusted bases of those properties or in any other manner permitted by the regulations prescribed by the Secretary. I.R.C. § 755(b) provides that in applying the allocation rules of I.R.C. § 755(a), increases or decreases in the adjusted basis of partnership property arising from a distribution of, or a transfer of an interest attributable to, capital assets and property described in I.R.C. § 1231(b), or any other property of the partnership, are allocated to partnership property of like character. The allocation of basis adjustments under I.R.C. § 743(b) and 734(b) among partnership property is provided in I.R.C. § 1.755-1(b) and (c), respectively.

consider the possibility that the Treasury Regulations somehow do not work properly in this context, and that the real problem may be a deficiency in the Code or in Treasury Regulations. The example also does not consider what would have occurred if the same facts presented themselves, but there never was a concerted effort to create an inside-outside basis disparity. The example does not clarify why the effect of the application of antiabuse rules was not to prevent the inside-outside basis disparity if that was the particular evil perceived in the transaction.]

They then exploited the created disparities by –

- engaging in transfers resulting in basis adjustments
  - under the mechanical rules of Sections 732(b), 734(b), or 743(b)
- to inappropriately reduce taxable income through increased deductions or reduced gain (or increased loss).

[The example does not explain why the parties inappropriately reduced taxable income or whether the parties merely followed the Code and Treasury Regulations. The example does not explain why the reduction in taxable income was inappropriate if the parties merely followed the Code and Regulations. The example does not engage the possibility that, if there was a problem, the problem resided in the Code and regulations. The example does not engage the fact that Treasury and the Internal Revenue Service have published highly detailed comprehensive regulations that were applied {apparently correctly} by the taxpayers in the transaction. Revenue Ruling 2024-14 does not properly explain why the transaction "inappropriately reduce[d] taxable income through increased deductions or reduced gain (or increased loss)." The parties appear not to have done anything that the Code and Treasury Regulations did not clearly mandate. It could be argued that Revenue Ruling 2024-14 endeavors to repair defects in the Code and regulations with an anti-abuse rule that never was considered by Congress and that never was subject to notice and public comment. Had Revenue Ruling 2024-14 been a legislative regulation, it would have been subject to notice and public comment requirements under the Administrative Procedure Act. It could be argued that Revenue Ruling 2024-14 does the same thing that the Internal Revenue Service might have been able to do through legislative regulations if there had been am express delegation of legislative authority to promulgate legislative regulations. By choosing to publish subregulatory guidance through Revenue Ruling 2024-14, the Internal Revenue Service effectively has taken an end-run around the notice and comment requirements of the Administrative Procedure Act. Even if Revenue Ruling 2024-14 had been subject to notice and comment and Revenue Ruling 2024-14 had been published as an interpretive regulation, under Loper Bright Enterprises, the Internal Revenue Service would have been put to the test of whether Revenue Ruling 2024-14 expressed the best reading of the statute, using traditional standards of interpretation. The Internal Revenue Service may have to rely on traditional judicial doctrines, such as economic substance, ***business purpose****, and step transaction, as the sole authority*

for Revenue Ruling 2024-14. The question then becomes whether Revenue Ruling 2024-14 correctly applies these traditional judicial doctrines. What is not clear is whether, as a matter of substance, the Internal Revenue Service's litigating position is stronger after the publication of Revenue Ruling 2024-14 than it was before the publication of Revenue Ruling 2024-14.]

In Situation 1,

- the actions of the parties creating a disparity between Sub 1's outside basis and share of Partnership A's inside basis,
- the transfer of Sub 1's interest in Partnership A to Partnership B in the Sub 1 Contribution, and
- the resulting positive basis adjustment to Partnership B's share of inside basis of Partnership A's property under Section 743(b)

were undertaken with a view to

- increasing Partnership B's share of Partnership A's inside basis in depreciable or amortizable property by $80x

while

- avoiding recognition of gain or loss under Section 721(a) through a nonrecognition transaction.

[The example fails to mention that the parties apparently applied the Code and Treasury Regulations rigorously and correctly as the applicable provisions are written.]

Additionally, the $80x basis increase was

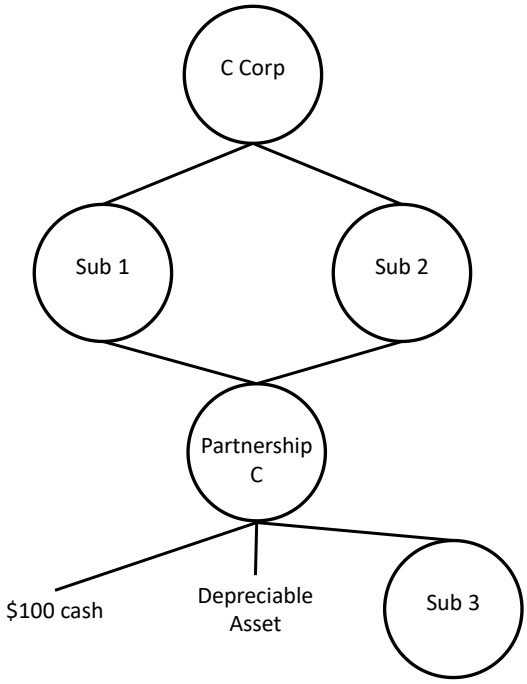
- relatively large in amount

compared to

- the cost savings to C and the C Subsidiaries.

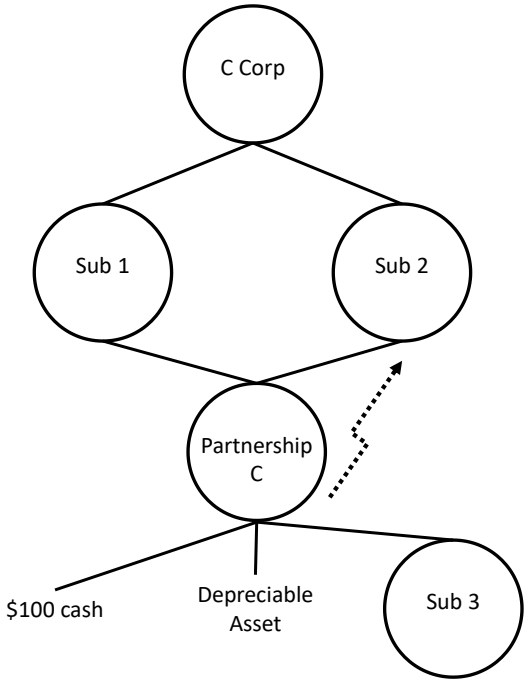
[ii] Situation 2.

These are diagrams for Situation 2:

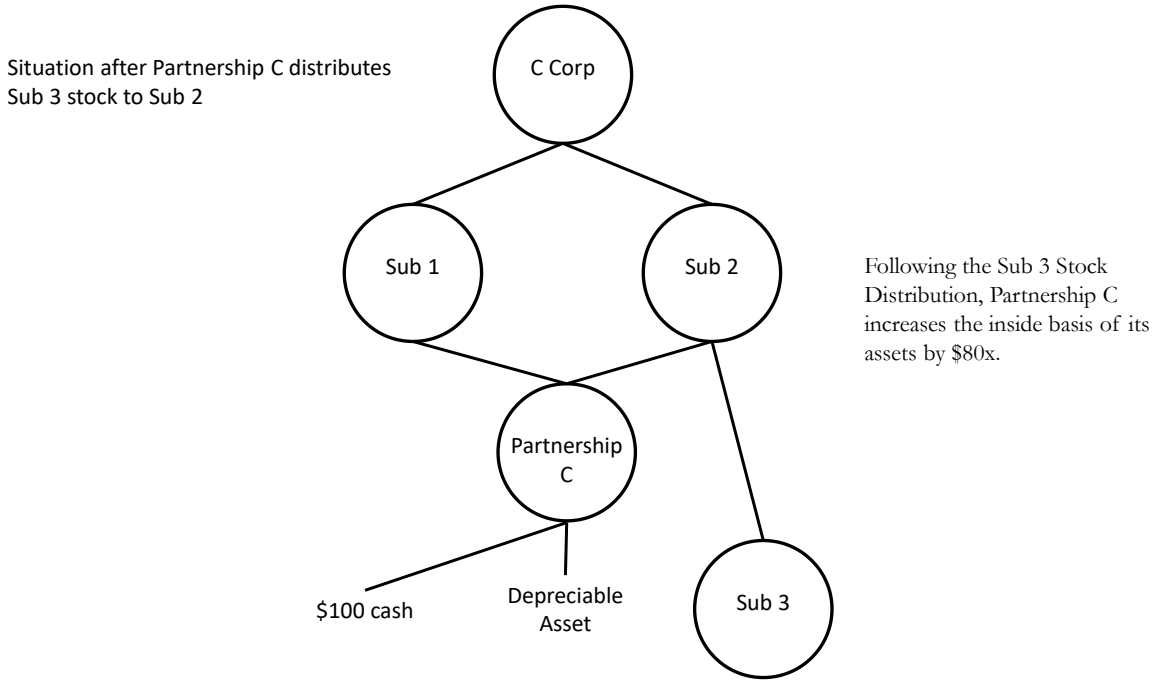


- Partnership C held the Sub 3 stock with
  - an adjusted basis of $90x and
  - fair market value of $100x and
- held the depreciable asset with
  - an adjusted basis of $10x and
  - fair market value of $100x.

Partnership C distributes stock in Sub 3 to Sub 2



- Partnership C held the Sub 3 stock with
  - an adjusted basis of $90x and
  - fair market value of $100x and
- held the depreciable asset with
  - an adjusted basis of $10x and
  - fair market value of $100x.



In Situation 2,

- C indirectly owns more than 50 percent of the stock of Sub 1 and Sub 2, both domestic corporations.
- Sub 1 and Sub 2 are the only partners in Partnership C with each having a 50 percent interest in the capital, profits, and losses of Partnership C.
- Partnership C owns –
    - 100 percent of the stock of Sub 3, a domestic corporation,
    - a depreciable asset, and
    - $100x of money deposited in a bank account.
- Prior to Date 2, Partnership had a valid election in place under Section 754.
- Also prior to Date 2,
    - Partnership C held the Sub 3 stock with
        - an adjusted basis of $90x and
        - fair market value of $100x and
    - Partnership C held the depreciable asset with
        - an adjusted basis of $10x and
        - fair market value of $100x.

- Sub 1's outside basis in Partnership C was $100x.
- Sub 2's outside basis in Partnership C was $10x

  as a result of

  - Sub 1 and Sub 2 making contributions to Partnership C, and
  - Partnership C making distributions to Sub 1 and Sub 2, of property with specific Federal income tax attributes, and
  - the allocation of Federal income tax items in accordance with Section 704(b) and (c).

    [We again are confronted with a magical inside-outside basis disparity. The example does not provide the precise details of how this inside-outside basis disparity was produced.]

- The contributions, distributions, and allocations were undertaken

  with a view to

  - creating a disparity between
    - Sub 2's outside basis and
    - Partnership C's inside basis in the Sub 3 stock.

      [The assertion that the parties did something evil is made, but what the parties did that was evil to create the inside basis disparity is not explained properly. This leaves open questions concerning what the result might if only part of the inside-outside basis disparity were due to transaction undertaken with a view to creating the inside-outside basis disparity. Assuming the validity of Revenue Ruling 2024-14, as it is written, Revenue Ruling 2024-14 may require showing that the basis disparity was created with an evil intent or at least that the transactions creating the basis disparity were planned with an intent to create the basis disparity.]

- On Date 2,
  - Partnership C distributes all of the Sub 3 stock to Sub 2

    other than in liquidation of

  - Sub 2's interest in Partnership C (Sub 3 Stock Distribution).
- The stated ***business purpose*** for the Sub 3 Stock Distribution is –
  - to achieve costs savings for C and the C Subsidiaries by
    - cleaning up intercompany accounts,

- reducing administrative complexity, and
- achieving other administrative efficiencies.

[The example implicitly assumes that there was no other ***business purpose****. The stated* ***business purpose****s appear to be particularly anemic in Revenue Ruling 2024-14. The taxpayers might have fared better if they had mustered a more convincing business purpose for the transaction. It is interesting that Revenue Ruling 2024-14 refers to "stated business purpose."]*

- Immediately after the Sub 3 Stock Distribution,
  - Sub 2's adjusted basis in the Sub 3 stock is
    - $10x,[268]
      - the same as Sub 2's outside basis in Partnership C prior to the Sub 3 Stock Distribution.
- In addition,
  - the Sub 3 Stock Distribution

    reduces
  - Sub 2's outside basis in Partnership C
    - from $10x
    - to zero.[269]

[The transaction would not be particularly interesting if x = 1. As Revenue Ruling 2024-14 is drafted, it apparently applies as much if x = 1 as it would apply if x = $100 million.]

- Following the Sub 3 Stock Distribution, Partnership C increases the inside basis of its assets by $80x.[270]
- Partnership C increases the adjusted basis of its remaining depreciable asset from $10x to $90x.[271]
- The Sub 3 stock Distribution on Date 2 was undertaken with a view to –
  - exploiting the disparity between –

[268] Under I.R.C. § 732(a)(2).
[269] Under I.R.C. § 733(2).
[270] Under I.R.C. § 734(b)(1)(B).
[271] Under I.R.C. § 755 and I.R.C. § 1.755-1(c)(2)(i).

- Sub 2's outside basis in Partnership C and
- Partnership C's inside basis in the Sub 3 stock created before Date 2 and

- transferring basis from nondepreciable Sub 3 stock to Partnership C's remaining depreciable asset.

[This admits the possibility that the transaction would have been respected if the parties had never planned the tax consequences. The analysis of the ruling seems to be situated to situations where the taxpayer has the evil view of securing a basis adjustment.]

- The cost savings resulting from the Sub 3 Stock Distribution are −

insubstantial in relation to

- the reduction in the aggregate Federal income tax liability of the C Subsidiaries resulting from the $80x increase in Partnership C's inside basis in the remaining depreciable asset,

which results in

- Sub 1 and Sub 2 being allocated increased amounts of deductions for depreciation or reduced amounts of gain (or increased amounts of loss) upon the sale of Partnership C's remaining depreciable asset.

[This creates an interesting question of what the results would be if the business purpose for the transaction were sufficiently substantial that the transaction would be undertaken in the absence of the tax purposes, but the tax purposes are substantially greater than the business purposes.]

- C reports the relatively small cost savings in the C Financial Statements.

In Situation 2,

- the actions of the parties creating a disparity between Sub 2's outside basis and Partnership C's inside basis in the Sub 3 stock,
- the distribution of −
  - Sub 3 stock (a high-inside basis asset) to −
  - Sub 2 (a partner with a low outside basis in its partnership interest) and
- the resulting adjustment to the inside basis of Partnership C's remaining property

were undertaken with a view to−

- transfer $80x of basis

  from

  - nondepreciable Sub 3 stock

    to

  - Partnership C's remaining depreciable asset

  while

- avoiding recognition of gain or loss under Section 731 through a nonrecognition distribution.

  [In other words, there was a structured transaction. If the transaction had been undertaken without the evil intent or knowledge of the tax consequences, the result might have been different. Revenue Ruling 2024-14 seems to have established a standard that would substantially expand the scope of the economic substance doctrine and that would wind up in sweeping in many legitimate transactions. Revenue Ruling 2024-14 could potentially apply to many legitimate transactions. There is substantial doubt that a court would sustain Revenue Ruling 2024-14 as a legitimate interpretation of the Code and regulations, particularly under the standards of Loper Bright Enterprises.

  [It appears that if a naïve taxpayer structured the transaction without knowledge of the tax consequences, the transaction would be respected.]

Additionally,

- the $80x basis increase was

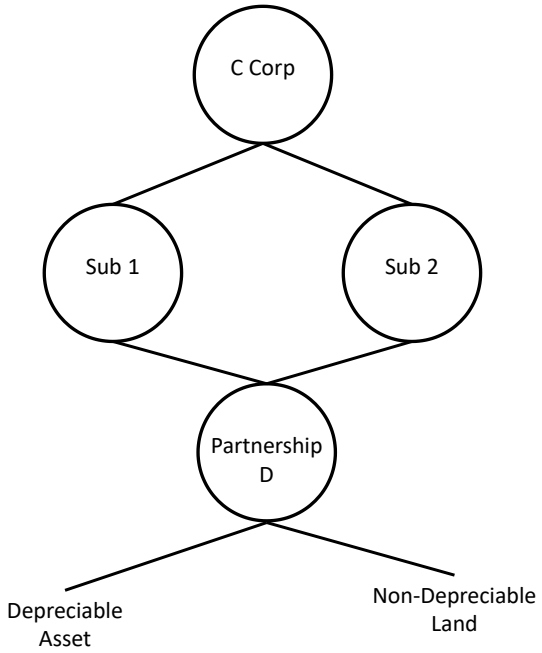
  - relatively large in amount

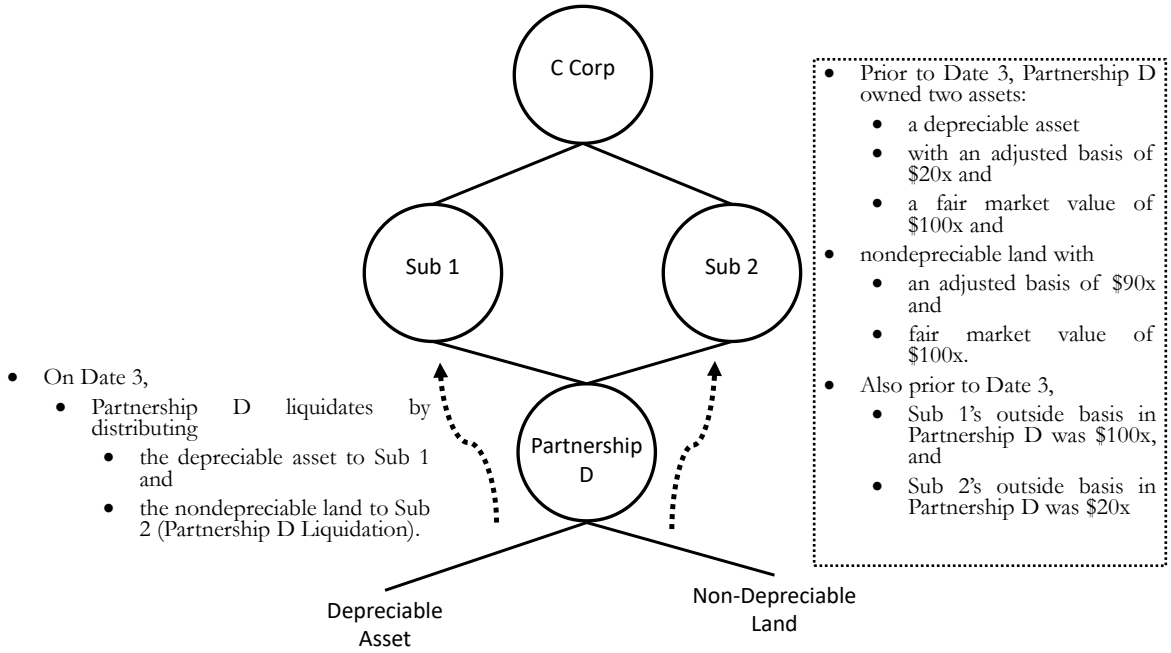
    compared to the cost savings.

    [It is curious that Revenue Ruling 2024-14 looks to the aggregate amount of the basis increase rather than to the present value of the resulting tax benefits. The Internal Revenue Service appears to accept the principal that tax benefits are enough by itself for a court to apply the economic substance doctrine. The mere fact that a transaction provides tax benefits should not be enough to apply the economic substance doctrine.]

[iii] Situation 3.

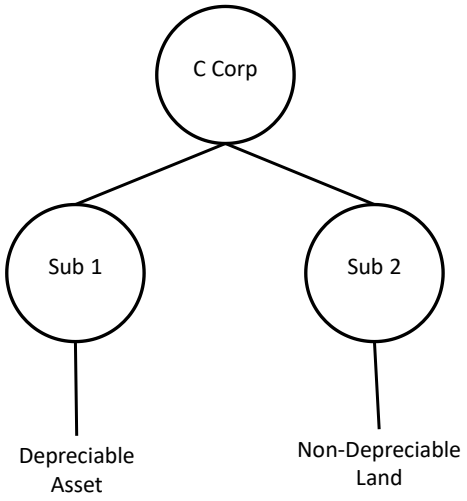
These charts show Situation 3:


C Corp
Sub 1
Sub 2
Partnership D
Depreciable Asset
Non-Depreciable Land



Situation after Partnership D liquidates. Partnership D distributes Depreciable Asset to Sub 1 and Non-Depreciable Land to Sub 2

- Immediately after the Partnership D Liquidation,
  - Sub 1's adjusted basis in the depreciable asset is $100x ,
    - the same as Sub 1's outside basis in Partnership D prior to the Partnership D Liquidation,
    - reflecting an increase of $80x to the adjusted basis of the depreciable asset in the hands of Sub 1.
- Also immediately after the Partnership D Liquidation,
  - Sub 2's adjusted basis in the nondepreciable land is $20x ,
    - the same as Sub 2's outside basis in Partnership D prior to the Partnership D Liquidation,
    - reflecting a decrease of $70x to the adjusted basis of the nondepreciable land in the hands of Sub 2.



Situation 3.

- C indirectly owns more than 50 percent of the stock of Sub 1 and Sub 2, both domestic corporations.

- Sub 1 and Sub 2 are the only partners in Partnership D
  - with each having a 50 percent interest in the capital, profits, and losses of Partnership D.
- Prior to Date 3, Partnership D owned two assets:
  - a depreciable asset
    - with an adjusted basis of $20x and
    - a fair market value of $100x and
  - nondepreciable land with
    - an adjusted basis of $90x and
    - fair market value of $100x.
- Also prior to Date 3,
  - Sub 1's outside basis in Partnership D was $100x, and Sub 2's outside basis in Partnership D was $20x

    as a result of
    - Sub 1 and Sub 2 making contributions to Partnership D, and
    - Partnership D making distributions to Sub 1 and Sub 2,
    - of property with specific Federal income tax attributes, and
    - the allocation of Federal income tax items in accordance with Section 704(b) and (c).
- The contributions, distributions, and allocations were undertaken

  with a view to
  - creating a disparity between Partnership D's inside basis in the depreciable asset and Sub 1's outside basis in Partnership D.

    [This evil view appears to be an indispensable part of the analysis.]
- On Date 3,
  - Partnership D liquidates by distributing
    - the depreciable asset to Sub 1 and
    - the nondepreciable land to Sub 2 (Partnership D Liquidation).
- The stated ***business purpose*** for the Partnership D Liquidation is
  - to achieve cost savings for C and the C Subsidiaries by −

- cleaning up intercompany accounts,
- reducing administrative complexity, and
- achieving other administrative efficiencies.

[The comparative lack of business purpose – or, at least, the soft business purpose, seems to be an indispensable part of the transaction. The transaction might work if the taxpayer had a substantial, tax-independent business purpose.]

- Immediately after the Partnership D Liquidation,
  - Sub 1's adjusted basis in the depreciable asset is $100x [272],
  - the same as Sub 1's outside basis in Partnership D prior to the Partnership D Liquidation,
  - reflecting an *increase* of $80x to the adjusted basis of the depreciable asset in the hands of Sub 1.
- Also immediately after the Partnership D Liquidation,
  - Sub 2's adjusted basis in the nondepreciable land is $20x [273],
    - the same as Sub 2's outside basis in Partnership D prior to the Partnership D Liquidation,
  - reflecting a *decrease* of $70x to the adjusted basis of the nondepreciable land in the hands of Sub 2.

[This could be considered a classic "basis strip" technique – lowering the adjusted basis of land, while in effect transferring basis to a depreciable asset of an asset soon to be sold.]

- The distribution of the depreciable asset to Sub 1 as part of the Partnership D Liquidation on Date 3 was undertaken

  with a view to

  - exploiting the disparity between
    - Partnership D's inside basis in the depreciable asset and
    - Sub 1's outside basis in Partnership D created before Date 3 and
  - transferring basis from nondepreciable land distributed to Sub 2 to the depreciable asset distributed to Sub 1.

[272] Under I.R.C. § 732(b).
[273] Under I.R.C. § 732(b).

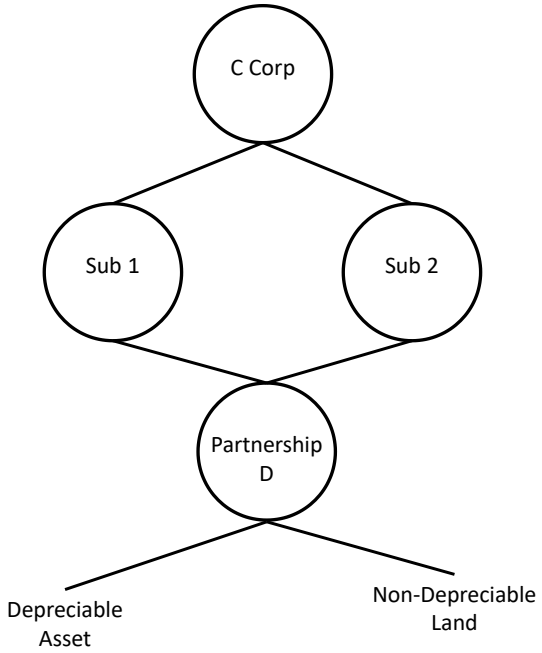
- The cost savings resulting from the Partnership D Liquidation are –
  - insubstantial

    in relation to
  - the reduction in the aggregate Federal income tax liability of the C Subsidiaries resulting from
    - the $80x increase in Sub 1's adjusted basis in the depreciable asset,
      - which results in increased deductions for depreciation or
      - reduced amounts of gain (or increased amounts of loss) upon the sale of the depreciable asset for Sub 1.

        [This attacks the validity of the purported business purpose. The business purpose of the transaction is insubstantial.]
- C reports the relatively small cost savings in the C Financial Statements.

Situation 3.

This is the situation after the transaction in Situation 3:



In Situation 3,

- the actions of the parties creating a disparity between
  - Sub 1's outside basis and

    - Partnership D's adjusted basis in the depreciable asset,
- the liquidating distribution of
    - the depreciable asset (a low-inside basis asset)

      to

    - Sub 1 (a partner with a high outside basis in its partnership interest) in the Partnership D Liquidation and
- the resulting adjustment to the adjusted basis of the depreciable asset to Sub 1[274]

were undertaken with a view to

- transferring basis from nondepreciable land distributed to Sub 2 to
- the depreciable asset distributed to Sub 1

  while

- avoiding recognition of gain or loss under §731 through a nonrecognition distribution.
- Additionally, the $80x basis increase was relatively large in amount

  compared to

- the cost savings to C and the C Subsidiaries.

The statutory economic substance doctrine of Section 7701(o)(1) provides that,

- in the case of any transaction to which the economic substance doctrine is relevant,
- the transaction is treated as having economic substance only if
    - the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and
    - the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

For this purpose,

- achieving a financial accounting benefit
- is not taken into account as
- a purpose for entering into a transaction

[274] Under I.R.C. § 732(b).

if

- the origin of the financial accounting benefit is
- a reduction of Federal income tax. Section 7701(o)(4).

The "economic substance doctrine" means –

- the common law doctrine under which
- tax benefits under subtitle A of the Code

with respect to

- a transaction
- are not allowable

if

- the transaction either
  - does not have economic substance or
  - lacks a ***business purpose***.[275]

The determination of whether the economic substance doctrine –

- is relevant to a transaction
- is made in the same manner

as if

- Section 7701(o) had never been enacted.[276]

"Transaction" includes a series of transactions.[277]

If a taxpayer relies on profit potential–

to help prove that

- a transaction has economic substance,

then

- profit potential will only be taken into account

if

- the present value of –

[275] I.R.C. § 7701(o)(5)(A).
[276] I.R.C. § 7701(o)(5)(C).
[277] I.R.C. § 7701(o)(5)(D).

- the reasonably-expected pretax profit of that transaction

- is substantial

  in relation to

- the present value of –

  - the expected net tax benefits of the transaction that would be allowed

    if

    - the Federal income tax effects of the transaction were not disregarded.[278]

      [No guidance is provided concerning what discount rate is used to compute present value. There can be some question concerning how to compute the "reasonably-expected pretax profit" of the transaction.]

Revenue Ruling 2024-14 holds –

- The series of transactions in Situations 1-3 lack economic substance under Section 7701(o).
- The transactions did not change the economic position of C or the C Subsidiaries in a meaningful way (aside from the Federal income tax effects).
- Neither C nor the C Subsidiaries had a substantial purpose for entering the transactions (aside from Federal income tax effects).
- In Situation 1,

  - the basis adjustment under Section 743(b) is disregarded.

    [Note that Revenue Ruling 2024-14 disallows the Section 743(b) basis adjustment in the transaction. Revenue Ruling 2024-14 does not recharacterize or disallow any of the steps in the transaction. Revenue Ruling 2024-14 also leave open the possibility of future basis adjustments.]

  - As a result,

    - Partnership B is not entitled to an increase of $80x in its share of the inside basis of Partnership A's assets, and
    - Partnership B's share of the inside basis of Partnership A's assets remains $20x.

[278] I.R.C. § 7701(o)(2)(A).

[Revenue Ruling 2024-14 fails to discuss the other tax effects of the transaction, if any.]

- In Situation 2,
  - the basis adjustment under Section 734(b) is disregarded.

    [Note that Revenue Ruling 2024-14 disallows the Section 743(b) basis adjustment in the transaction. Revenue Ruling 2024-14 does not recharacterize or disallow any of the steps in the transaction. Revenue Ruling 2024-14 also leave open the possibility of future basis adjustments.]
  - As a result,
    - Partnership C is not entitled to an increase of $80x to the inside basis of the remaining depreciable asset, and
    - the inside basis of the depreciable asset remains $10x.

    [Revenue Ruling 2024-14 fails to discuss the other tax effects of the transaction.]
- In Situation 3,
  - the basis adjustment to Sub 1 under Section 732(b) is disregarded.

    [Note that Revenue Ruling 2024-14 disallows the Section 743(b) basis adjustment in the transaction. Revenue Ruling 2024-14 does not recharacterize or disallow any of the steps in the transaction. Revenue Ruling 2024-14 also leave open the possibility of future basis adjustments.]
  - As a result,
    - Sub 1 is not entitled to an increase of $80x to the adjusted basis of the depreciable asset, and
    - the adjusted basis of Sub 1's depreciable asset remains $20x.

    [Revenue Ruling 2024-14 fails to discuss the other tax effects of the transaction.]
- C and/or the C Subsidiaries, as applicable, are subject to –
  - the 20 percent penalty under Section 6662(b)(6) or
  - the 40 percent penalty under Section 6662(i) for a nondisclosed noneconomic substance transaction, as applicable.

Section 7701(o) provides:

> *(o) Clarification of economic substance doctrine.*
>
> *(1) Application of doctrine. In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if–*

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

(2) Special rule where taxpayer relies on profit potential.

(A) In general. The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected.

(B) Treatment of fees and foreign taxes. Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases.

(3) State and local tax benefits. For purposes of paragraph (1), any State or local income tax effect which is related to a Federal income tax effect shall be treated in the same manner as a Federal income tax effect.

(4) Financial accounting benefits. For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax.

(5) Definitions and special rules. For purposes of this subsection–

(A) Economic substance doctrine. The term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

(B) Exception for personal transactions of individuals. In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income.

(C) Determination of application of doctrine not affected. The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted.

(D) Transaction. The term "transaction" includes a series of transactions.[279]

A 20 percent penalty applies to –

- an underpayment attributable to

[279] See note 301.

- a transaction lacking economic substance[280] or
- failing to meet the requirements of any similar rule of law.[281]

The penalty is increased to –

- 40 percent or
- any portion of an underpayment that is attributable to one or more nondisclosed noneconomic substance transactions.[282]

There is no reasonable cause exception to the penalties described in Section 6662(b)(6) or (i).[283]

The analysis stresses that Situations 1-3 all involve persons related to each other.[284]

- A transaction among related parties to avoid Federal income tax by generating inflated basis adjustments falls outside the plain intent of Section 732(b), 734(b), 743(b), and 754.
- While the differing economic interests of unrelated parties generally make it less likely that unrelated partners will engage in transactions such as those in Situations 1-3, partnerships composed of related partners have no such disincentive.
- Congress intended that the provisions of Subchapter K apply to transactions between partnerships and their partners to preserve parity between inside and outside basis "so as to prevent any unintended tax benefit or detriment to the partners."[285]

  [Section 743 is elective. The application of 743 is not automatic, but is limited to "sale or exchange" transactions.]

- Congress also expressed its desire to prevent related parties from exploiting the rules of Subchapter K to avoid tax "through the realization of fictitious losses or increasing the basis of property for purposes of depreciation."[286]

  [Section 754 elections are elective. A variety of situations can create inside-outside basis disparities. Subchapter K seems to favor inside-outside basis discrepancies, since Section 734 and Section 743 are elective provisions. Section 734 and Section 743 apply in

[280] Under I.R.C. § 7701(o).
[281] I.R.C. § 6662(b)(6).
[282] Under I.R.C. § 6662(i).
[283] Under I.R.C. § 6664(c)(2).
[284] Under I.R.C. § 267(b) or I.R.C. § 707(b)(1).
[285] H.R. Rep. No. 1337, 83d Cong., 2d Sess. A225 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 384 (1954).
[286] H.R. Rep. No. 1337, at A226; S. Rep. No. 1622, at 386-87.

limited circumstances. There are a variety of circumstances in which inside-outside basis disparities can exist.]

- Congress did not intend that taxpayers be able to avoid or indefinitely defer taxation altogether by creating basis disparities through –
  - contributions or distributions of property or
  - allocations of tax items by reason of a Section 743(b) basis adjustment after a nonrecognition transaction, such as the Sub 1 Contribution in Situation 1;
  - by reason of a Section 734(b) basis adjustment after distribution of property, such as the Sub 3 Stock Distribution in Situation 2; or
  - by reason of a Section 732(b) basis adjustment after a liquidating distribution of property, such as the Partnership D Liquidation in Situation 3.

[This is an uncited and unsupported comment. The Code and the Treasury Regulations say what they say and apparently a straight-forward application of the rules in the Code and Treasury Regulations produces the results to which Revenue Ruling 2024-14 objects. Beyond that, the default is that Section 734 and Section 743 seem to favor basis disparities when a Section 754 basis election is not made. Revenue Ruling 2024-14 asserts an interpretation of Code provisions and Treasury Regulations that is novel. Revenue Ruling 2024-14 represents a significant departure from the language of the partnership basis adjustment provisions. One might conclude that Congress intended that the provisions of the various Code provisions involved in Revenue Ruling 2024-14 should be interpreted in accordance with their plain meaning. Congress has never moved to amend the partnership basis rules in the many years in which they have been in place. Revenue Ruling 2024-14 represents a fundamental change in the law. Congress might appropriately amend the partnership basis rules; the Internal Revenue Service does not have the authority to amend the rules through Revenue Ruling 2024-14. There is some question whether there was an abusive application of the Code and Treasury Regulations or whether there were merely defects in the Code and Treasury Regulations that admitted the results. The Internal Revenue Service seems to focus more on the result than analysis of the process by which the result was obtained. By attacking these transactions through Revenue Ruling 2024-14, the Internal Revenue Service avoids notice and comment that otherwise might be required. By attacking these transactions through economic substance, the Internal Revenue Service avoids putting the Section 701 regulations into issue. The validity of the Section 701 regulations after Loper Bright Enterprises is uncertain.]

- The shared economic interests of related parties make them more likely than unrelated parties to attempt to generate such tax benefits in a manner not intended by Congress by entering into transactions with no meaningful economic change.

  [It appears that the involvement of related parties is critical to Revenue Ruling 2024-14 (or, at least, very important to Revenue Ruling 2024-14) and that the tax results of the transaction would have been respected if related parties were materially involved.]

- Unless a "meaning plainly appears" that Congress intended a provision to grant a tax benefit to transactions without economic substance or business purpose, such an intent "will not [be] attribute[d] to Congress."[287]

  [The key to this statement is "without economic substance or business purpose." Contributions to partnerships and distributions of property by partnerships, without more, are generally respected. One could argue that the statutes involved in this case are clear, and that the taxpayers applied those statutes in accordance with their terms. One could argue that the taxpayers' transaction in fact did have economic substance. "The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages. Among [footnote omitted] these basic transactions are (1) the choice between capitalizing a business enterprise with debt or equity; [footnote omitted] (2) a U.S. person's choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment; [footnote omitted] (3) the choice to enter a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C; [footnote omitted] and (4) the choice to utilize a related-party entity in a transaction, provided that the arm's length standard of section 482 and other applicable concepts are satisfied. [Footnote omitted.] Leasing transactions, like all other types of transactions, will continue to be analyzed in light of all the facts and circumstances. [Footnote omitted.] As under present law, whether a particular transaction meets the requirements for specific treatment under any of these provisions can be a question of facts and circumstances. Also, the fact that a transaction does meet the requirements for specific treatment under any provision of the Code is not determinative of whether a transaction or series of transactions of which it is a part has economic substance." The situations in Revenue Ruling 2024-14 do not necessarily lend themselves to an economic substance attack. Revenue Ruling 2024-14 seems to assume that the transactions do not have economic substance. In any real world situation, the Internal Revenue Service would have to prove lack of economic substance based on established standards of the economic substance doctrine. Revenue Ruling 2024-14 seems to assume that, if the result is favorable to the taxpayer and the result was not expressly endorsed by Congress, the transaction does not have

[287] *Knetsch v. United States*, 364 U.S. 361, 367-69 (1960).

economic substance or, at least, that the Internal Revenue Service can deny a selected tax benefit of the transaction. Revenue Ruling 2024-14 should not be subject to a presumption of correctness under Loper Bright Enterprises. That, of course, does not mean that a court would automatically reject the analysis of Revenue Ruling 2024-14. The Internal Revenue Service should be required to show that this is the best reading of the statute and the result most in accordance with established judicial doctrines. Revenue Ruling 2024-14 reaches an interpretation of the Code that is not particularly straight forward. The interpretation perhaps can be endorsed as a matter of policy (the tax effects of the transaction may be favorable to the taxpayer), but it is more difficult to reach the result of Revenue Ruling 2024-14 as a matter of textual interpretation. The subject of Revenue Ruling 2024-14 might be more appropriate for legislative regulations that are entitled to strong deference. The Internal Revenue Service clearly does not like the result from a clear application of the Code and regulations in these examples. Considering the transactions undertaken, the Code and regulations did not leave the taxpayers with any discretion. Also, transactions like a contribution to a partnership have not traditionally been subject to economic substance attack. There are no connected transactions that undermine the economics of the transactions and that make it clear than the form of the transactions is inconsistent with their substance. Economic substance would normally set aside an entire transaction rather than cherry-pick particular tax benefits. Revenue Ruling 2024-14 cherry picks tax benefits and does not disregard the entire transaction. It is curious that the Internal Revenue Service relies on economic substance rather than the Section 701 antiabuse regulations. This may indicate a lack of confidence in the Section 701 regulations.]

- The economic substance doctrine is intended to apply "despite literal compliance with the statute."[288]

  [The Internal Revenue Service still needs to show that the transaction does not have economic substance. Other than the involvement of related parties, nothing special (particularly incidental side agreements) apparently was involved in the transactions in Revenue Ruling 2024-14 that deprived the transactions of economic substance. While the transactions involved related parties, the involvement of related parties does not normally by itself deprive transactions of economic substance.]

- The economic substance doctrine was developed to address transactions such as these, which follow the literal words of the Code but lie outside of Congress' plain intent.[289]

  [It is questionable that Congress had much intent at all concerning the subtleties of the operation of the partnership basis adjustment rules. Revenue Ruling 2024-14 suggests that anything outside of Congress' plain intent is subject to the economic substance doctrine.

[288] *Coltec Indus., Inc. v. United States*, 454 F.3d 1340, 1354 (Fed. Cir. 2006); *see Gregory v. Helvering*, 293 U.S. 465, 470 (1935).

[289] *Gregory*, 293 U.S. at 469-470.

There are a broad range of transactions that Congress never considered and on which Congress never expressed an intent. The position of Revenue Ruling 2024-14 apparently is that all of these transactions are subject to the economic substance doctrine if the Internal Revenue Service does not like the result. It perhaps is more likely that economic substance should apply when a transaction is fundamentally lacking in true economic substance (making a difference or potential difference for the various participants) and Congress has expressed a view that the tax benefits of the transaction should be disallowed. The default rule, in the absence of a clear expression of Congressional purpose, should be applying the statute in accordance with its terms, rather than being creative and speculating on how Congress would have resolved the issues if Congress had considered the issues.]

- Each series of transactions described in Situations 1-3 lacks economic substance.

  [The transactions appear to lack economic substance principally because they produce a tax benefit to taxpayers and involve related parties.]

- In each of those situations, the economic substance doctrine is applied to basis adjustments generated by the following series of connected transactions involving related parties, which may occur over the course of several taxable years:
  - the parties generate basis disparities through various methods, such as contributions of property with specific Federal income tax attributes to the partnership, the allocation of Federal income tax items in accordance with Section 704(b) and (c), or distributions of property with specific attributes to the partners, and
  - either –
    - a partner transfers its partnership interest in a nonrecognition transaction while there exists an inside/outside basis disparity, or
    - the partnership distributes property with specific Federal income tax attributes (for example, high inside basis) to one or more partners with specific Federal income tax attributes (for example, low outside basis) in a current or liquidating distribution.

[Section 7701(i) provides: "In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if–(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction." Revenue Ruling 2024-14 follows this language literally by disallowing certain tax effects of a transaction, while respecting the steps. Revenue Ruling 2024-14 appears based on the premise that the Internal Revenue Service can selectively delete tax benefits on a benefit by benefit basis when the economic substance doctrine applies. He

history of the economic substance doctrine suggests that it is limited to disallowing and recharacterizing steps of a transaction and not selectively disallowing tax benefits of a transaction.]

- The resulting basis adjustments, if allowed, would permit the parties to shift basis in a manner that enables the parties to claim increased cost recovery deductions or reduced gain (or increased loss) upon the sale of the basis-adjusted property.
- In applying the conjunctive test of Section 7701(o)(1), each of two prongs must be met for the transactions described in Situations 1-3 to have economic substance.
  - First, under Section 7701(o)(1)(A), the transaction must change in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position.
  - Second, under Section 7701(o)(1)(B), the taxpayer must have had a substantial purpose (apart from Federal income tax effects) for entering into the transaction.
- With respect to the first prong under Section 7701(o)(1)(A),
  - the transactions in Situations 1-3 have a negligible effect on C's economic position

    because

    - the transactions shift ownership of property among commonly controlled entities

      without

    - "effect[ing] any real change in the 'flow of economic benefits,' or provid[ing] any real 'opportunity to make a profit'. .[290]

      [The transaction presumably would have been respected if either "(A) the transaction change[d] in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer ha[d] a substantial purpose (apart from Federal income tax effects) for entering into such transaction."]
  - The transactions fail to "appreciably affect the [taxpayer's] beneficial interest except to reduce . . . tax"; that is, the transactions do not appreciably affect C's beneficial interests in the C Subsidiaries or their

[290] *Coltec*, 454 F.3d at 1360; *see Reddam v. Commissioner*, 755 F.3d 1051, 1060-62 (9th Cir. 2014).

assets, except to reduce the aggregate Federal income tax liability of the related persons involved.[291]

- The only potential economic gains are derived from
  - purported cost savings from
    - cleaning up intercompany accounts between the C Subsidiaries,
    - reducing administrative complexity, and
    - achieving administrative efficiencies.

      [The Internal Revenue Service apparently chose an example with especially anemic ***business purpose****s. This suggests the possibility of a different result when more tangible* ***business purpose****s are apparent.]*
- However,
  - any such cost savings
  - do not change C and the C Subsidiaries' economic position
- in a meaningful way

  because
  - any economic benefits attributable to purported cost savings (apart from the Federal income tax effects)

    are insubstantial compared to
  - the $80x in Federal income tax benefits from the basis adjustments attributable to these transactions.

- The basis increases –
  - of $80x resulting from the transactions in Situations 1-3
  - can be used to reduce taxable income of the C Subsidiaries through
    - depreciation,
    - amortization, or
    - other deductions or
  - reduce gain recognized upon the sale of the property.

[291] *Knetsch*, 364 U.S. at 366 (*quoting Gilbert v. Commissioner*, 248 F.2d 399, 411 (2d Cir. 1957) (Learned Hand, J., dissenting)) (emphasis added).

[It also is possible that the basis adjustments will not be recognized for 20 to 30 years on the sale of the property if the property is not depreciable.]

- The transactions were "designed to generate" basis increases, and
- Those basis increases "would always .have overshadowed" the economic gain, including gain derived from cost savings.[292]

[The transactions were "structured transactions" designed to obtain tax benefits. The transactions apparently were motivated to achieve designed tax benefits.]

- Even if there had been "some prospect of profit"

from

  - transferring a partnership interest or partnership property among related parties,
  - the calculable Federal income tax benefits would have
    - "far exceeded any independent potential for economic return."[293]
- Any change in economic position –
  - (apart from the Federal income tax effects)
  - in the transactions described in Situations 1-3
  - is not meaningful.[294]

[The same could be said about a contribution to a wholly owned corporation, a contribution to a wholly owned limited liability company, a partnership between two wholly owned entities, a distribution by a wholly owned limited liability company etc. These transactions, however, are normally respected.]

- With respect to the second prong of the conjunctive test under Section 7701(o)(1)(B), the transactions described in Situations 1-3 demonstrate a lack of any substantial purpose (apart from Federal income tax effects) to enter into these transactions.

[It appears that the deck was stacked by the Internal Revenue Service. Revenue Ruling 2024-14 assumes that there is no material ***business purpose****.]*

- The stated ***business purpose*** of achieving cost savings from cleaning up intercompany accounts between the C Subsidiaries, reducing administrative

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[292] *Reddam*, 755 F.3d at 1061-62.

[293] *Bank of New York Mellon Corp. v. Commissioner*, 801 F.3d 104, 117-18, 120 (2d Cir. 2015); *Salem Fin., Inc. v. United States*, 786 F.3d 932, 949 (Fed. Cir. 2015), *citing Knetsch*, 364 U.S. at 365-66.

[294] Within the meaning of I.R.C. § 7701(o)(1)(A).

complexity, and achieving administrative efficiencies may be a legitimate nontax economic purpose.

- Any such ***business purpose*** is not substantial compared to the Federal income tax purposes the transactions were designed to carry out. [295]

  [This seems to be an assumption of the example, not a clear inference from the facts. The facts do not permit a clear evaluation to be made.]

- Many of the facts in these transactions
  - demonstrating a lack of meaningful change in economic position (apart from Federal income tax effects)
  - also demonstrate a lack of substantial purpose (apart from Federal income tax effects) for these related parties to enter into these transactions.
- Reasonable inferences into a taxpayer's purpose for entering a transaction can be drawn from
  - the facts and circumstances surrounding such transaction,

    including

    - results from a transaction that the taxpayer could have reasonably anticipated

      as well as

    - results from a transaction that were by design.
- The fact
  - that the cost savings were insubstantial compared to relatively large basis increases of $80x,
  - that there was no appreciable effect on the parties' economic ownership of the property allocated the basis increases, and
  - that the transactions were structured to guarantee basis increases of $80x to depreciable or amortizable property
    - while
      - carrying a *de minimis* risk of economic loss
      - compared to the designed Federal income tax benefit, [296]

[295] *See Reddam*, 755 F.3d at 1061.
[296] *Altria Grp.*, 658 F.3d at 290-91

"indicate[ ] that the taxpayer's true motivation for the transaction is tax avoidance."[297]

- C lacked a substantial purpose (apart from Federal income tax effects) for causing its subsidiaries to enter into the transactions described in Situations 1-3.[298]

- If a transaction or series of transactions lacks economic substance,
  - it may be disregarded for Federal income tax purposes.[299]

  [This refers to disregarding the transaction rather than disallowing selected tax benefits, as is theme of Revenue Ruling 2024-14.]

- While a transaction might meet the literal requirements of the Code, courts will not recognize a transaction that is not within the intent of the Code.[300]

- The series of transactions described in Situations 1-3 —
  - related-party
    - contributions or distributions of property or
    - allocations of tax items and
  - the subsequent
    - transfer of a partnership interest or
    - distribution of property
    - to generate a basis adjustment to property that is eligible for cost recovery (or is held for future sale) —

  failed both prongs under Section 7701(o)(1) and, therefore, lack economic substance.[301]

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[297] *See Bank of New York Mellon Corp. v. United States*, 140 T.C. 15, 38 (2013).

[298] Within the meaning of I.R.C. § 7701(o)(1)(B).

[299] See *Gregory*, 293 U.S. 465; *Coltec*, 454 F.3d at 1352; *ACM P'ship v. Commissioner*, 157 F.3d 231, 247-48 (3d Cir. 1998).

[300] *Gregory*, 293 U.S. at 469-70.

[301] I.R.C. § 7701(o) ("(o) Clarification of economic substance doctrine. (1) Application of doctrine. In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction. (2) Special rule where taxpayer relies on profit potential. (A) In general. The potential for profit of a transaction shall be taken into account in determining whether the requirements of subparagraphs (A) and (B) of paragraph (1) are met with respect to the transaction only if the present

value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected. (B) Treatment of fees and foreign taxes. Fees and other transaction expenses shall be taken into account as expenses in determining pre-tax profit under subparagraph (A). The Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases. (3) State and local tax benefits. For purposes of paragraph (1), any State or local income tax effect which is related to a Federal income tax effect shall be treated in the same manner as a Federal income tax effect. (4) Financial accounting benefits. For purposes of paragraph (1)(B), achieving a financial accounting benefit shall not be taken into account as a purpose for entering into a transaction if the origin of such financial accounting benefit is a reduction of Federal income tax. (5) Definitions and special rules. For purposes of this subsection (A) Economic substance doctrine. The term 'economic substance doctrine' means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose. (B) Exception for personal transactions of individuals. In the case of an individual, paragraph (1) shall apply only to transactions entered into in connection with a trade or business or an activity engaged in for the production of income. (C) Determination of application of doctrine not affected. The determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if this subsection had never been enacted. (D) Transaction. The term 'transaction' includes a series of transactions.")

See Notice 2010-62, 2010-40 I.R.B. 411:

PURPOSE

This notice provides interim guidance regarding the codification of the economic substance doctrine under section 7701(o) and the related amendments to the penalties under sections 6662, 6662A, 6664, and 6676 by section 1409 of the Health Care and Education Reconciliation Act of 2010 (Act), Pub. L. No. 111-152. The notice applies with respect to transactions entered into on or after March 31, 2010, which is the effective date for the amendments made by section 1409 of the Act.

BACKGROUND

I.R.C. § 1409 of the Act added new section 7701(o) to the Code. I.R.C. § 7701(o)(1) provides that, in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if (i) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (ii) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into the transaction. I.R.C. § 7701(o)(5)(A) states that the term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

I.R.C. § 7701(o)(5)(C) states that the determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if section 7701(o) had never been enacted. With respect to individuals, however, section 7701(o)(5)(B) states that the two-prong analysis in section 7701(o)(1) shall apply only to a transaction entered into in connection with a trade or business or an activity engaged in for the production of income. In addition, section 7701(o)(5)(D) states that the term "transaction" as used in section 7701(o) includes a series of transactions.

I.R.C. § 7701(o)(2)(A) provides that a transaction's potential for profit shall be taken into account in determining whether the requirements of section 7701(o)(1) are met only if the present value of the reasonably expected pre-tax profit is substantial in relation to the

present value of the claimed net tax benefits. For purposes of computing pre-tax profit, section 7701(o)(2)(B) provides that the Secretary shall issue regulations treating foreign taxes as a pre-tax expense in appropriate cases.

The Act also added section 6662(b)(6), which provides that the accuracy-related penalty imposed under section 6662(a) applies to any underpayment attributable to any disallowance of a claimed tax benefit because of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet any similar rule of law (collectively a section 6662(b)(6) transaction). The Act also added section 6662(i), which increases the accuracy-related penalty from 20 to 40 percent for any portion of an underpayment attributable to one or more section 6662(b)(6) transactions with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return or in a statement attached to the return. Furthermore, new section 6662(i)(3) provides that certain amended returns or any supplement to a return shall not be taken into consideration for purposes of section 6662(i).

The Act amended section 6664(c) so that the reasonable cause exception for underpayments found in section 6664(c)(1) shall not apply to any portion of any underpayment attributable to a section 6662(b)(6) transaction. The Act similarly amended section 6664(d) so that the reasonable cause exception found in section 6664(d)(1) shall not apply to any reportable transaction understatement (within the meaning of section 6662A(b)) attributable to a section 6662(b)(6) transaction. The Act also amended section 6676 so that any excessive amount (within the meaning of section 6676(b)) attributable to any section 6662(b)(6) transaction shall not be treated as having a reasonable basis.

APPLICATION OF THE ECONOMIC SUBSTANCE DOCTRINE WITH RESPECT TO TRANSACTIONS ENTERED INTO AFTER THE EFFECTIVE DATE OF THE ACT

A. Application of the Conjunctive Test

For transactions entered into on or after March 31, 2010, to which the economic substance doctrine is relevant, section 7701(o)(1) mandates the use of a conjunctive two-prong test to determine whether a transaction shall be treated as having economic substance. The first prong, found in section 7701(o)(1)(A), requires that the transaction change in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position. The second prong, found in section 7701(o)(1)(B), requires that the taxpayer have a substantial purpose (apart from Federal income tax effects) for entering into the transaction.

The IRS will continue to rely on relevant case law under the common-law economic substance doctrine in applying the two-prong conjunctive test in section 7701(o)(1). Accordingly, in determining whether a transaction sufficiently affects the taxpayer's economic position to satisfy the requirements of section 7701(o)(1)(A), the IRS will apply cases under the common-law economic substance doctrine (as identified in section 7701(o)(5)(A)) pertaining to whether the tax benefits of a transaction are not allowable because the transaction does not satisfy the economic substance prong of the economic substance doctrine. Similarly, in determining whether a transaction has a sufficient nontax purpose to satisfy the requirements of section 7701(o)(1)(B), the IRS will apply cases under the common-law economic substance doctrine pertaining to whether the tax benefits of a transaction are not allowable because the transaction lacks a business purpose.

The IRS will challenge taxpayers who seek to rely on prior case law under the common-law economic substance doctrine for the proposition that a transaction will be

treated as having economic substance merely because it satisfies either section 7701(o)(1)(A) (or its common-law corollary) or section 7701(o)(1)(B) (or its common-law corollary). For all transactions subject to section 1409 of the Act that otherwise would have been subject to a common-law economic substance analysis that treated a transaction as having economic substance merely because it satisfies either section 7701(o)(1)(A) (or its common-law corollary) or section 7701(o)(1)(B) (or its common-law corollary) the IRS will apply a two-prong conjunctive test consistent with section 7701(o).

B. Determination of Economic Substance Transactions

I.R.C. § 7701(o)(5)(C) provides that the determination of whether a transaction is subject to the economic substance doctrine shall be made in the same manner as if section 7701(o) had never been enacted. In addition, section 7701(o)(1) only applies in the case of any transaction to which the economic substance doctrine is relevant. Consistent with these provisions, the IRS will continue to analyze when the economic substance doctrine will apply in the same fashion as it did prior to the enactment of section 7701(o). If authorities, prior to the enactment of section 7701(o), provided that the economic substance doctrine was not relevant to whether certain tax benefits are allowable, the IRS will continue to take the position that the economic substance doctrine is not relevant to whether those tax benefits are allowable. The IRS anticipates that the case law regarding the circumstances in which the economic substance doctrine is relevant will continue to develop. Consistent with section 7701(o)(5)(C), codification of the economic substance doctrine should not affect the ongoing development of authorities on this issue. The Treasury Department and the IRS do not intend to issue general administrative guidance regarding the types of transactions to which the economic substance doctrine either applies or does not apply.

C. Calculating Net Present Value of the Reasonably Expected Pre-tax Profit.

In determining whether the requirements of section 7701(o)(1)(A) and (B) are met, the IRS will take into account the taxpayer's profit motive only if the present value of the reasonably expected pre-tax profit is substantial in relation to the present value of the expected net tax benefits that would be allowed if the transaction were respected for Federal income tax purposes. In performing this calculation, the IRS will apply existing relevant case law and other published guidance.

D. Treatment of Foreign Taxes as Expenses in Appropriate Cases.

I.R.C. § 7701(o)(2)(B) provides that the Secretary shall issue regulations requiring foreign taxes to be treated as expenses in determining pre-tax profit in appropriate cases. The Treasury Department and the IRS intend to issue regulations pursuant to section 7701(o)(2)(B). In the interim, the enactment of the provision does not restrict the ability of the courts to consider the appropriate treatment of foreign taxes in economic substance cases.

ACCURACY-RELATED PENALTIES

Unless the transaction is a reportable transaction, as defined in Treas. Reg. § 1.6011-4(b), the adequate disclosure requirements of section 6662(i) will be satisfied if a taxpayer adequately discloses on a timely filed original return (determined with regard to extensions) or a qualified amended return (as defined under Treas. Reg. § 1.6664-2(c)(3)) the relevant facts affecting the tax treatment of the transaction. If a disclosure would be considered adequate for purposes of section 6662(d)(2)(B) (without regard to section 6662(d)(2)(C)) prior to the enactment of section 1409 of the Act, then it will be deemed to be adequate for purposes of section 6662(i). The disclosure will be considered adequate only if it is made on a Form 8275 or 8275-R, or as otherwise prescribed in forms, publications, or other guidance subsequently published by the IRS consistent with the instructions and other guidance associated with those

subsequent forms, publications, or other guidance. Disclosures made consistent with the terms of Rev. Proc. 94-69 also will be taken into account for purposes of section 6662(i). If a transaction lacking economic substance is a reportable transaction, as defined in Treas. Reg. § 1.6011-4(b), the adequate disclosure requirement under section 6662(i)(2) will be satisfied only if the taxpayer meets the disclosure requirements described earlier in this paragraph and the disclosure requirements under the section 6011 regulations. Similarly, a taxpayer will not meet the disclosure requirements for a reportable transaction under the section 6011 regulations by only attaching Form 8275 or 8275-R to an original or qualified amended return. See Notice 2014-58, 2014-44 I.R.B. 746:

PURPOSE

This notice amplifies Notice 2010-62, 2010-40 I.R.B. 411, by providing additional guidance regarding the codification of the economic substance doctrine and the related penalty amendments. Specifically, this notice provides guidance regarding: (1) the definition of "transaction" for purposes of applying the codified economic substance doctrine under section 7701(o), and (2) the meaning of "similar rule of law" as described in the accuracy-related penalty under section 6662(b)(6). This notice is also relevant with respect to the availability of the reasonable cause exceptions under sections 6664(c) and (d) and the reasonable basis exception under section 6676 because those exceptions are inapplicable to transactions described in section 6662(b)(6).

BACKGROUND

The economic substance doctrine is a judicial doctrine that was codified in section 7701(o) by section 1409 of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152. I.R.C. § 7701(o)(5)(A) defines "economic substance doctrine" as the common-law doctrine that disallows tax benefits under subtitle A of the Internal Revenue Code if the transaction that produces those benefits lacks economic substance or a business purpose. Under section 7701(o)(1), a transaction has economic substance if: (1) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position; and (2) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

I.R.C. § 7701(o)(5)(D) provides that "[t]he term 'transaction' includes a series of transactions." The legislative history explained:

The provision does not alter the court's ability to aggregate, disaggregate, or otherwise recharacterize a transaction when applying the [economic substance] doctrine. For example, the provision reiterates the present-law ability of the courts to bifurcate a transaction in which independent activities with non-tax objectives are combined with an unrelated item having only tax-avoidance objectives in order to disallow those tax-motivated benefits.

H.R. Rep. No. 111-443(I), at 296-297, P.L. 111-152, Health Care and Education Reconciliation Act of 2010. Although section 7701(o) does not provide a definition of "transaction," the term has been defined in the analogous context of reportable transactions. Specifically, Treas. Reg. § 1.6011-4(b)(1) provides that, for purposes of the reportable transaction disclosure regime, the term "transaction" includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement and also includes any series of steps carried out as part of a plan.

I.R.C. § 6662(b)(6) imposes a penalty on an underpayment attributable to tax benefits that were disallowed because a transaction lacks economic substance (within the meaning of section 7701(o)) or fails to meet the requirements of any similar rule of law. Neither section

7701(o) nor section 6662 defines "similar rule of law." However, the legislative history explained, with respect to a "similar rule of law," that the "penalty would apply to a transaction that is disregarded as a result of the application of the same factors and analysis that is required under the provision [section 7701(o)] for an economic substance analysis, even if a different term is used to describe the doctrine." H.R. Rep. 111-443(I), at 304.

I.R.C. § 6664(c)(2) and (d)(2) provide that the reasonable cause and good faith exception to a section 6662 or 6662A penalty does not apply to the portion of an underpayment or reportable transaction understatement attributable to one or more transactions described in section 6662(b)(6). For purposes of the penalty for an erroneous claim for refund or credit of an excessive amount, section 6676(c) provides that any excessive amount (within the meaning of section 6676(b)) that is attributable to any transaction described in section 6662(b)(6) is not treated as having a reasonable basis.

DISCUSSION

A. Transaction

For purposes of determining whether the codified economic substance doctrine applies, "transaction" generally includes all the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement; and any or all of the steps that are carried out as part of a plan. Facts and circumstances determine whether a plan's steps are aggregated or disaggregated when defining a transaction.

Generally, when a plan that generated a tax benefit involves a series of interconnected steps with a common objective, the "transaction" includes all of the steps taken together an aggregation approach. This means that every step in the series will be considered when analyzing whether the "transaction" as a whole lacks economic substance. However, when a series of steps includes a tax-motivated step that is not necessary to achieve a non-tax objective, an aggregation approach may not be appropriate. In that case, the "transaction" may include only the tax-motivated steps that are not necessary to accomplish the non-tax goals a disaggregation approach.

Whether the economic substance doctrine is relevant and whether a transaction should be disaggregated will be considered on a case-by-case basis, depending on the facts and circumstances of each individual case. For example, if transfers of multiple assets and liabilities occur and the transfer of a specific asset or assumption of a specific liability was tax-motivated and unnecessary to accomplish a non-tax objective, then the economic substance doctrine may be applied solely to the transfer or assumption of that specific asset or liability. Separable activities may take many forms including, for example, the use of an intermediary employed for tax benefits and whose actions or involvement was unnecessary to accomplish an overarching non-tax objective. These situations are merely examples intended to illustrate the potential application of the disaggregation approach and are not exhaustive or comprehensive.

B. Similar Rule of Law

For purposes of section 6662(b)(6), "similar rule of law" means a rule or doctrine that disallows the tax benefits under subtitle A of the Code related to a transaction because:

(1) the transaction does not change a taxpayer's economic position in a meaningful way (apart from Federal income tax effects); or

(2) the taxpayer did not have a substantial purpose (apart from Federal income tax effects) for entering into the transaction.

In other words, "similar rule of law" means a rule or doctrine that applies the same factors and analysis that is required under section 7701(o) for an economic substance analysis,

- As a result, their Federal income tax effects must be disregarded.

  [This statement in Revenue Ruling 2024-14 is ambiguous. It implies disregarding all of the federal income tax effects of the transaction. That is practically impossible. Revenue Ruling 2024-14 disregards selected federal income tax effects.]

- The transactions did not change in a meaningful way (apart from Federal income tax effects) the economic position of C or the C Subsidiaries within the meaning of Section 7701(o)(1)(A), and C lacked a substantial business or other purpose (apart from Federal income tax effects) for causing the C Subsidiaries to enter into these transactions within the meaning of Section 7701(o)(1)(B).
- In addition, under Section 6662(b)(6), the transactions described in Situations 1-3 give rise to a 20 percent penalty applicable to an underpayment attributable to a transaction lacking economic substance [302].
- The penalty is increased to 40 percent on any portion of the underpayment attributable to one or more nondisclosed noneconomic substance transactions. [303]
- A reasonable cause exception to penalties [304] may not be asserted. [305]
- The series of transactions described in Situations 1-3 may also be subject to the partnership anti-abuse rule under Section 1.701-2 or the Section 704(c) anti-abuse rule under Section 1.704-3(a)(10).
- Other anti-abuse doctrines including, but not limited to,
  - the substance-over-form doctrine and

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even if a different term or terms (for example, "sham transaction doctrine") are used to describe the rule or doctrine. See H.R. Rep. 111-443, at 304.

The IRS will not apply a penalty under section 6662(b)(6) (or otherwise argue that a transaction is described in section 6662(b)(6)) unless it also raises section 7701(o) to support the underlying adjustments. If the IRS does not raise section 7701(o) to disallow the claimed tax benefits and instead relies upon other judicial doctrines (e.g., the substance over form or step transaction doctrines) to support the underlying adjustments, the IRS will not apply a section 6662(b)(6) penalty (or otherwise argue that a transaction is described in section 6662(b)(6)) because the IRS will not treat the transaction as failing to meet the requirements of a similar rule of law. Code sections and Treasury regulations, other than section 7701(o) and the regulations under that section, that disallow tax benefits are not similar rules of law for purposes of section 6662(b)(6).

[302] Under I.R.C. § 7701(o).

[303] See I.R.C. § 6662(i).

[304] Described in I.R.C. § 6662(b)(6) and (i).

[305] Under I.R.C. § 6664(c)(2).

- step-transaction doctrine

may apply, depending on the facts and circumstances of a specific transaction or series of transactions.

- Transaction is promoted by outside tax advisors. *See, e.g. Reddam v. Commissioner*, T.C. Memo 2012-106 at 20, *aff'd*, 755 F.3d 1051 (9th Cir. 2014) (considering the involvement of an outside tax advisor who sold tax strategy products in applying the subjective prong of the economic substance doctrine).
- Transaction is highly structured. *See, e.g. Reddam*, T.C. Memo 2012-106 (considering the purposeful structuring of transactions to produce favorable tax consequences in applying the subjective prong of the economic substance doctrine, but noting that planning alone does not compel disallowance of transaction's tax effects).
- Transaction includes unnecessary steps. *See, e.g., Basic Inc. v. U.S.*, 549 F.2d 740, 745 (Ct. Cl. 1977) (reasoning that the ***business purpose*** of an ultimate sale could not be used to justify an unnecessary intercompany transfer or otherwise "all manner of intermediate transfers could lay claim to 'business purpose' simply by showing some factual connection, no matter how remote, to an otherwise legitimate transaction existing at the end of the line.").
- Transaction is not at arm's length with unrelated third parties. *See, e.g. Coltec,* 454 F.3d at 1357 (noting in its application of the economic substance doctrine, that "arrangements with subsidiaries that do not affect the economic interest of independent third parties deserve particularly close scrutiny.").
- Transaction creates no meaningful economic change on a present value basis (pre-tax). *See, e.g., ACM P'ship v. Commissioner*, 157 F.3d 231, 259 (3d Cir. 1998) (agreeing with Tax Court that in analyzing profitability under economic substance doctrine, "present value adjustments are. . an appropriate means of assessing the transaction's actual and anticipated economic effects.").
- Taxpayer's potential for gain or loss is artificially limited. See, e.g., *Yosha*, 861 F.2d at 501 ("The lack of [economic] substance lies in the fact that the investor had zero prospect of gain or loss.").
- Transaction accelerates a loss or duplicates a deduction. *See, e.g., Rice's Toyota World, Inc. v. Commissioner*, 752 F.2d 89 (4th Cir. 1985) (holding sale-leaseback transaction had no economic substance where taxpayer

entered into transaction to generate accelerated depreciation and interest expense deductions in the early years of the lease).

- Transaction generates a deduction that is not matched by an equivalent economic loss or expense (including artificial creation or increase in basis of an asset). *See, e.g., ACM P'ship*, 157 F.3d at 252 ("Tax losses such as these . . . which do not correspond to any actual economic losses, do not constitute the type of '*bona fide*' losses that are deductible under the Internal Revenue Code and regulations.").
- Taxpayer holds offsetting positions that largely reduce or eliminate the economic risk of the transaction. *See, e.g., Yosha*, 861 F.2d 494 (holding investors' purchases of offsetting tax straddles lacked economic substance).
- Transaction involves a tax-indifferent counterparty that recognizes substantial income. *See, e.g., CMA Consol.*, T.C. Memo. 2005-16 (holding that certain lease stripping transactions lacked economic substance where rental income was allocated to a tax-indifferent party).
- Transaction results in separation of income recognition from a related deduction either between different taxpayers or between the same taxpayer in different tax years. *See, e.g., Id.* (holding that certain lease stripping transactions lacked economic substance where equipment rental income was separated from related rental expenses).
- Transaction has no credible ***business purpose*** apart from federal tax benefits. *See, e.g., Bail Bonds by Marvin Nelson, Inc. v. Comm'r*, 820 F.2d 1543, 1549 (9th Cir. 1987).
- Transaction has no meaningful potential for profit apart from tax benefits. *See, e.g., Rice's Toyota World, Inc.*, 752 F.2d at 91 (4th Cir. 1985) ("To treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and that the transaction has no economic substance because no reasonable possibility of a profit exists.").
- Transaction has no significant risk of loss. *See, e.g., Yosha*, 861 F.2d at 500 ("Straddles that involve no market risks are not economically substantial straddles and hedges; they are artifices created by accomplices in tax evasion, the brokers.").
- Tax benefit is artificially generated by the transaction. *CMA Consol.*, T.C. Memo. 2005-16 ("*De minimis* or inconsequential pretax profits relative to a taxpayer's artificially and grossly inflated claim of potential tax benefits

may be insufficient to imbue an otherwise economically questionable transaction with economic substance.") (*citing ACM P'ship.*, 157 F.3d at 257 and *Sheldon v. Comm'r*, 94 T.C. 738, 767-768 (1990)).

- Transaction is outside the taxpayer's ordinary business operations. *See, e.g., ACM P'ship*, T.C. Memo. 1997-115.

[e] Reportable Transaction Disclosure Statement.

A party that has participated in one or more of the above transactions, may be required to file a Form 8886.

A ***material advisor*** is defined as:

- Anyone who provides material aid, assistance, or advice with respect to organizing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and
- Directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the Secretary) for such aid, assistance, or advice.

Threshold amounts are:

- Listed Transactions: $10,000 for a natural person and $25,000 for all other entities.
- Non-Listed Transactions: $50,000 for a natural person and $250,000 for all other entities.

A material advisor may be required to file the Form 8918, Material Advisor Disclosure Statement.

Generally, a material advisor must maintain a list identifying each entity or individual with respect to whom the advisor acted as a material advisor with respect to a reportable transaction.

A material advisor is **not** required to keep a list –

if

- the entity or individual entered into a listed transaction or transaction of interest
  - more than 6 years before
    - the transaction was identified in published guidance
    - as a listed transaction or transaction of interest.

A separate list must be prepared and maintained for each transaction or group of substantially similar transactions. This list must be maintained for 7 years following the earlier of the date on which the material advisor last made a tax statement relating to the transaction, or the date the transaction was last entered into.

[f] Proposed Regulations On Disclosure Of Basis Shifting Transactions.

The Office of Tax Shelter Analysis (OTSA) in the Large Business & International (LB&I) Division collects and analyzes information about abusive tax shelters and transactions, and coordinates LB&I's tax shelter planning and operation. A comprehensive strategy is in place to:

- Identify and deter participation and promotion of abusive tax transactions through audits, summons enforcement, litigation and alternative methods.
- Publish taxpayer guidance on abusive transactions and tax shelters.
- Promote reportable transaction disclosure filings by those who participate or promote abusive transactions.

Treasury Regulations require that certain tax shelters and transactions be registered and that lists of investors be maintained by parties who organize or sell interests in the shelter(s). Investors in certain shelters and transactions are required to disclose their participation on their tax returns.

Reportable transactions are:

- ***Listed transactions*** that are the same as or substantially similar to one of the types of transactions that the Internal Revenue Service has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.
- ***Confidential Transactions*** that are offered to a taxpayer under conditions of confidentiality and the taxpayer has paid a minimum advisor fee.
- ***Contractual Protection Transactions*** that are offered with the right to full or partial refund of fees if the Internal Revenue Service does not allow the tax benefit of the transaction.
- ***Loss transactions*** under Section 165.
- ***Transactions of interest*** (TOI) that the Internal Revenue Service and the Treasury Department believe to have the potential for tax avoidance or evasion but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction.

The proposed regulations[306] have received substantial criticism from tax advisors. Critics have been especially critical of the retroactive effect of the proposed regulations. Reporting obligations would apply to all years in which the taxpayer receives tax benefits from the transactions, even though the final regulations were not effective when the underlying transaction was undertaken.

[g] Itemized Statement Component of Advisee List.

Form 13976, Itemized Statement Component of Advisee List may be used by material advisors for the purpose of preparing and maintaining lists with respect to reportable transactions under Section 6112. This form is offered as an option for maintaining the transaction participants list.

Revenue Procedure 2008-20 –

- provides guidance relating to the obligation of material advisors to prepare and maintain lists with respect to reportable transactions under Section 6112 and
- provides that material advisors may use the Form 13976, Itemized Statement Component of Advisee List (or successor form) to maintain the itemized statement component of the list.

[h] Treasury Regulations on Reportable Basis Shifting Transactions.

REG-124593-23[307] represents a portion of full court attack on basis shifting transactions involving related parties. Proposed Treasury Regulations would identify as transactions of interest and impose disclosure requirements[308] related to the use by related

[306] REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

[307] 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40. For comments on the proposed regulations, see letter, dated August 16, 2024, from Susan D. Snyder, President, American College of Trust and Estate Counsel, to Internal Revenue Service, Re: Comments of the American College of Trust And Estate Counsel on Proposed Regulations that Would Identify Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, transmitting Comments of the American College of Trust and Estate Counsel ("ACTEC") on Proposed Regulations under Code I.R.C. § 6011 Concerning Partnership Related Party Basis Adjustment Transactions; and letter dated August 16, 2024, from Jiyeon Lee-Lim, Chair, New York State Bar Association, Tax I.R.C. § to the Honorable Aviva Aron-Dine, Acting Assistant Secretary (Tax Policy), Department of the Treasury, the Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service, and the Honorable Marjorie A. Rollinson, Chief Counsel, Internal Revenue Service, Re: NYSBA Tax I.R.C. § Report No. 1498 — Report on Proposed Regulation Regarding Partnership Basis Adjustments and Application of Notice 2024-54 to Previously Effected Transactions.

[308] See Prop. Treas. Reg. § 1.6011-18(f) ("(f) Disclosure requirements — (1) In general. Participants must provide the information required under §1.6011-4(d) and the Instructions to Form

persons of partnerships of transactions that inappropriately exploit the basis adjustment provisions of Subchapter K applicable to distributions of partnership property or transfers of

8886, Reportable Transaction Disclosure Statement (or successor form) for each taxable year in which the participant participated in a transaction described in paragraph (c) of this section as determined under paragraph (e) of this section. For all participants, describing the transaction in sufficient detail includes describing the information described in paragraphs (f)(1)(i) through (iii) of this section, as applicable, on Form 8886 (or successor form) for the taxable year of a transaction described in paragraph (c) of this section. (i) The names and identifying numbers of all participants, including the participating partnership, participating partners and any related subsequent transferees or tax-indifferent parties. (ii) All basis adjustments resulting from a transaction described in paragraph (c) of this section, and basis information, including the participating partnership's adjusted basis in the distributed property immediately before the distribution, any adjustments to basis under section 732(a)(2), (b), (d) or 734(b), any adjustments to basis under section 743(b) with respect to a participating partner that is transferred an interest in a participating partnership, and with respect to a participating partner that transfers an interest in a participating partnership, that participating partner's adjusted basis in the participating partnership interest and share of the participating partnership's adjusted basis in its property immediately before the transfer. (iii) Any Federal income tax consequences realized during the taxable year, as a result of a transaction described in paragraph (c) of this section, including cost recovery allowances attributable to an increase in basis as a result of a transaction described in paragraph (c) of this section, and taxable gain or taxable loss attributable to the disposition of property that was subject to an increase in basis as a result of a transaction described in paragraph (c) of this section. For example, in the case of a distribution of depreciable property that was subject to an increase in basis as a result of a transaction described in paragraph (c) of this section, the Federal income tax consequences realized during the taxable year include the basis increase and cost recovery allowances attributable to the basis increase during the taxable year. (2) Disposition in subsequent taxable years. If the property subject to an increase in basis as a result of a transaction described in paragraph (c) of this section is disposed of in a transaction in which gain or loss is recognized in whole or in part in a subsequent taxable year, the participant must send a copy of Form 8886 to the Office of Tax Shelter Analysis (OTSA). This requirement is in addition to the requirement that a participant send a copy of Form 8886 to OTSA for the taxable year of the basis increase.").

partnership interests. These transactions are designated as reportable transactions.[309] The proposed regulation would require tax shelter disclosure of these transactions.[310]

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[309] The preamble discusses this requirement:

V. Information Disclosure Requirements

Proposed §1.6011-18(f) would require participants to provide the information required under §1.6011-4(d) and the Instructions to Form 8886 (or successor form). For all participants, describing the transaction in sufficient detail would include (but would not be limited to) describing on Form 8886 (or successor form) an increase in basis resulting from a transaction described in proposed §1.6011-18(c) by providing the information required in proposed §1.6011-18(f)(1)(i), through (iii).

Proposed §1.6011-18(f)(1)(i) would require reporting of the names and identifying numbers (for example, social security number, employer identification number) of all participants.

Proposed §1.6011-18(f)(1)(ii) would require participants to provide all basis adjustments resulting from a transaction described in §1.6011-18(c), and basis information, including the participating partnership's adjusted basis in the distributed property immediately before the distribution, any adjustments to basis under sections 732(a)(2), (b), (d) or 734(b), any adjustments to basis under section 743(b) with respect to a participating partner that is transferred an interest in a participating partnership, and with respect to a participating partner that transfers an interest in a participating partnership, that participating partner's adjusted basis in the participating partnership interest and share of the participating partnership's adjusted basis in its property immediately before the transfer.

Proposed §1.6011-18(f)(1)(iii) would require participants to provide information on Form 8886 (or successor form) of any Federal income tax consequences realized during the taxable year as a result of a transaction described in proposed §1.6011-18(c), including cost recovery allowances attributable to an increase in basis described in proposed §1.6011-18(c) or taxable gain or loss attributable to the disposition of property that was subject to an increase in basis described in proposed §1.6011-18(c). In the case of Federal income tax consequences realized after the taxable year of a transaction described in proposed §1.6011-18(c), such as cost recovery allowances or taxable gain or loss on a disposition, a participant must provide information on the Federal income tax consequences on Form 8886 (or successor form) for the taxable year of realization.

Under proposed §1.6011-18(f)(2), if the property subject to an increase in basis as a result of a transaction described in proposed §1.6011-18(c) is disposed of in a subsequent taxable year in a transaction in which gain or loss is recognized in whole or in part, a participant must send a copy of Form 8886 to OTSA, for the taxable year of the disposition, in addition to sending a copy to OTSA in the taxable year of the basis adjustment transaction.

Proposed §1.6011-18(g) would provide examples of the participants' disclosure requirements for the taxable year in which the transaction of interest occurred and the subsequent taxable years in which a participant continued to realize the Federal income tax consequences of the transaction of interest.

VI. Effect of Transaction Becoming a Transaction of Interest

Participants required to disclose these transactions under §1.6011-4 who fail to do so would be subject to penalties under section 6707A. Material advisors required to disclose these transactions under section 6111 who fail to do so would be subject to penalties under section 6707. Material advisors required to maintain lists of investors under section 6112 who fail to

do so (or who fail to provide such lists when requested by the IRS) would be subject to penalties under section 6708(a). In addition, the IRS may impose other penalties on persons involved in these transactions or substantially similar transactions, including accuracy-related penalties under section 6662 or section 6662A, the penalty under section 6700 of the Code for promoting abusive tax shelters, and the penalty under section 6701 of the Code for aiding and abetting understatement of a tax liability.

Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

[310] The preamble REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40, advises:

I. Partnership Related-Party Basis Adjustment Transactions of Interest

Proposed §1.6011-18(a) would identify transactions that are the same as or substantially similar (within the meaning of §1.6011-4(c)(4)) to transactions described in proposed §1.6011-18(c) as transactions of interest for the purposes of §1.6011-4(b)(6). Proposed §1.6011-18(c) would include a relatedness requirement and a $5 million minimum threshold requirement. Further, proposed §1.6011-18(a) would identify transactions that are substantially similar (within the meaning of §1.6011-4(c)(4)) to the transactions described in proposed §1.6011-18(c) as including the transactions described in proposed §1.6011-18(d).

The relatedness requirement would be set forth in proposed §1.6011-18(b)(8) and (9). Proposed §1.6011-18(b)(8) would define "related" as having a relationship described in section 267(b) (without regard to section 267(c)(3)) or 707(b)(1). Proposed §1.6011-18(b)(9) would define "related partners" as partners of a partnership that are related in the following manner — (i) in a transaction described in proposed §1.6011-18(c)(1), the partnership has two or more direct or indirect partners that are related to each other within the meaning of proposed §1.6011-18(b)(8), or (ii) in a transaction described in proposed §1.6011-18(c)(2), the transferor of a partnership interest is related to the transferee, or the transferee is related to one or more of the partners in the partnership, within the meaning of proposed §1.6011-18(b)(8). The relatedness requirement may be met either immediately before or immediately after a basis adjustment transaction described in proposed §1.6011-18(c)(1) or (2).

Proposed §1.6011-18(c) would provide that a transaction of interest is a transaction the factual elements of which are described in proposed §1.6011-18(c)(1)(i) through (iii) or (c)(2). A basis adjustment transaction under proposed §1.6011-18(c)(1)(i) would occur when a partnership makes a current or liquidating distribution of property to a partner who is related to one or more partners, the partnership increases the basis of one or more of its remaining properties under section 734(b) and (c), and the $5 million threshold under proposed §1.6011-18(c)(3) is met.

A basis adjustment transaction under proposed §1.6011-18(c)(1)(ii) would occur when a partnership distributes property to a partner who is related to one or more partners in liquidation of a partnership interest (or in complete liquidation of the partnership), the basis of one or more distributed properties is increased under section 732(b) and (c), and the $5 million threshold under proposed §1.6011-18(c)(3) is met.

A basis adjustment transaction under proposed §1.6011-18(c)(1)(iii) would occur when a partnership distributes property to a partner who is related to one or more partners, the basis of one or more distributed properties is increased under section 732(d), the related partner acquired all or a part of its interest in the partnership in a transaction that would have been a transaction described in proposed §1.6011-18(c)(2) if the partnership had a section 754 election in effect for the year of transfer, and the $5 million threshold under proposed §1.6011-18(c)(3) is met.

Section 6011(a) and (b) provide:

> *(a) General rule. When required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.*

A basis adjustment transaction under proposed §1.6011-18(c)(2) would occur when a partner transfers an interest in the partnership to a related transferee or to a person who is related to one or more existing partners in a nonrecognition transaction, the basis of one or more partnership properties is increased under section 743(b)(1) and (c), and the $5 million threshold under proposed §1.6011-18(c)(3) is met. Proposed §1.6011-18(b)(2) would define nonrecognition transaction as defined in section 7701(a)(45) (other than a transfer on the death of a partner).

Proposed §1.6011-18(c)(3) would provide rules for determining the $5 million threshold. Under proposed §1.6011-18(c)(3), a basis adjustment would include basis increases from multiple transactions described in proposed §1.6011-18(c)(1) or (2) by the same partner or partnership during the taxable year that in the aggregate (without netting for any basis adjustments in the same transaction or another transaction that reduce basis) and after reducing the resulting aggregate amount by the gain recognized, if any, on which tax imposed under subtitle A of the Code (subtitle A) is required to be paid by any of the related parties to the transaction equal or exceed $5 million. Accordingly, a transaction of a partner or partnership described in proposed §1.6011-18(c)(1) or (2) that results in a basis increase of less than $5 million during the taxable year would be a transaction of interest under proposed §1.6011-18(a) if, in the same taxable year, the partner or partnership participated in another transaction or transactions described in proposed §1.6011-18(c)(1) or (2), and in the aggregate, the transactions resulted in a basis increase that equals or exceeds $5 million, without regard to any basis decrease resulting from the transactions and after reducing the resulting aggregate amount by the gain recognized, if any, on which tax imposed under subtitle A is required to be paid by any of the related parties to the transactions. A threshold of $5 million of basis increases in a taxable year to which no corresponding tax is paid should be sufficiently large to capture situations that use the provisions of Subchapter K to produce significant tax benefits with little or no economic impact.

If a basis adjustment transaction is described in proposed §1.6011-18(c)(1)(i) through (iii) or (c)(2), any basis adjustments to recoverable property must be reported in the taxable year of the basis adjustment transaction, in each taxable year there is a cost recovery allowance, and in the taxable year the recoverable property is disposed of in a transaction in which gain or loss is recognized in whole or in part. Any basis adjustments to other property must be reported in the taxable year of the basis adjustment transaction and the taxable year in which the other property is disposed of in a transaction in which gain or loss is recognized in whole or in part. See proposed §1.6011-18(e) and (f).

Proposed §1.6011-18(b)(7) would define recoverable property as property of a character subject to an allowance for depreciation, amortization, or depletion under subtitle A of the Code.

Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

(b) Identification of taxpayer. The Secretary is authorized to require such information with respect to persons subject to the taxes imposed by chapter 21 or chapter 24 as is necessary or helpful in securing proper identification of such persons. [311]

The Section 6011 regulations are legislative regulations. These regulations will be difficult to contest in tax litigation. Planners are unlikely voluntarily to take the risk of ignoring these regulations. Challenging the regulations by failing to report could turn out to be a bad gamble.

Listed transaction subject to reporting under the proposed regulations (when and if finalized) are:

- *Distribution transactions with Section 734 adjustments*. Transactions in which −
  - a partnership distributes property to a person
    - who is a related partner in a current or liquidating distribution,
  - the partnership increases the basis of one or more of its remaining properties under Section 734(b) and (c),[312] and

[311] Treas. Reg. § 1.6011-1 provides:

(a) General rule. Every person subject to any tax, or required to collect any tax, under Subtitle A of the Code, shall make such returns or statements as are required by the regulations in this chapter. The return or statement shall include therein the information required by the applicable regulations or forms.

(b) Use of prescribed forms. Copies of the prescribed return forms will so far as possible be furnished taxpayers by district directors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the district director in ample time to have their returns prepared, verified, and filed on or before the due date with the internal revenue office where such returns are required to be filed. Each taxpayer should carefully prepare his return and set forth fully and clearly the information required to be included therein. Returns which have not been so prepared will not be accepted as meeting the requirements of the Code. In the absence of a prescribed form, a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and, if filed within the prescribed time, the statement so made will relieve the taxpayer from liability for the addition to tax imposed for the delinquent filing of the return, provided that without unnecessary delay such a tentative return is supplemented by a return made on the proper form.

(c) Tax withheld on nonresident aliens and foreign corporations. For requirements respecting the return of the tax required to be withheld under Chapter 3 of the Code on nonresident aliens and foreign corporations and tax-free covenant bonds, see section 1.1461-2.

[312] I.R.C. § 734(b), (c) ("(b) Method of adjustment. In the case of a distribution of property to a partner by a partnership with respect to which the election provided in section 754 is in effect or with respect to which there is a substantial basis reduction, the partnership shall – (1) increase the adjusted basis of partnership property by – (A) the amount of any gain recognized to the distributee

- the transaction meets a $5 million threshold.[313]

- *Partnership interest transfer transactions with Section 743 adjustments*. Transactions in which −
  - a partner transfers an interest in a partnership
    - to a related partner
    - in a nonrecognition transaction,
  - the basis of one or more partnership properties is increased under Section 743(b)(1) and (c),[314] and

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partner with respect to such distribution under section 731(a)(1), and (B) in the case of distributed property to which section 732(a)(2) or (b) applies, the excess of the adjusted basis of the distributed property to the partnership immediately before the distribution (as adjusted by section 732(d)) over the basis of the distributed property to the distributee, as determined under section 732, or (2) decrease the adjusted basis of partnership property by – (A) the amount of any loss recognized to the distributee partner with respect to such distribution under section 731(a)(2), and (B) in the case of distributed property to which section 732(b) applies, the excess of the basis of the distributed property to the distributee, as determined under section 732, over the adjusted basis of the distributed property to the partnership immediately before such distribution (as adjusted by section 732(d)). Paragraph (1)(B) shall not apply to any distributed property which is an interest in another partnership with respect to which the election provided in section 754 is not in effect. (c) Allocation of basis. The allocation of basis among partnership properties where subsection (b) is applicable shall be made in accordance with the rules provided in section 755.").

[313] Prop. Treas. Reg. §1.6011-18(c)(c) ("(3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.")

[314] I.R.C. § 743(b)(1), (c) ("(b) Adjustment to basis of partnership property. In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect or which has a substantial built-in loss immediately after such transfer shall − (1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property, or . . . . Under regulations prescribed by the Secretary, such increase or decrease shall constitute an adjustment to the basis of partnership property with respect to the transferee partner only. A partner's proportionate share of the adjusted basis of partnership property shall be determined in accordance with his interest in partnership capital and, in the case of property contributed to the partnership by a partner, section 704(c) (relating to contributed property) shall apply in determining such share. In the case of an adjustment under this subsection to the basis of partnership property subject to depletion, any depletion allowable shall be determined separately for the transferee partner with respect to his interest

- the transaction meets a $5 million threshold;[315]

- *Liquidating distribution transactions*. Transactions in which –
  - a partnership distributes property to
    - a person who is a related partner
    - in liquidation of the person's partnership interest (or in complete liquidation of the partnership),
  - the basis of one or more distributed properties is increased under section 732(b) and (c),[316] and

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in such property. (c) Allocation of basis. The allocation of basis among partnership properties where subsection (b) is applicable shall be made in accordance with the rules provided in section 755.").

[315] Prop. Treas. Reg. §1.6011-18(c)(c) ("(3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.")

[316] I.R.C. § 732(b), (c) ("(b) Distributions in liquidation. The basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction. (c) Allocation of basis. (1) In general. The basis of distributed properties to which subsection (a)(2) or (b) is applicable shall be allocated – (A) (i) first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)) in an amount equal to the adjusted basis of each such property to the partnership, and (ii) if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, then, to the extent any decrease is required in order to have the adjusted bases of such properties equal the basis to be allocated, in the manner provided in paragraph (3), and (B) to the extent of any basis remaining after the allocation under subparagraph (A), to other distributed properties – (i) first by assigning to each such other property such other property's adjusted basis to the partnership, and (ii) then, to the extent any increase or decrease in basis is required in order to have the adjusted bases of such other distributed properties equal such remaining basis, in the manner provided in paragraph (2) or (3), whichever is appropriate. (2) Method of allocating increase. Any increase required under paragraph (1)(B) shall be allocated among the properties – (A) first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation), and (B) then, to the extent such increase is not allocated under subparagraph (A), in proportion to their respective fair market values. (3) Method of allocating decrease. Any decrease required under paragraph (1)(A) or (1)(B) shall be allocated – (A) first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation), and (B) then, to the extent such decrease is not allocated under subparagraph (A), in proportion to their respective adjusted bases (as adjusted under subparagraph (A)).")

- the transaction meets a $5 million threshold;[317]

- Distribution transactions with Section 732(d) adjustments.[318] Transactions in which −
  - a partnership distributes property
  - to a person who is a related partner,
  - the basis of one or more distributed properties is increased under section 732(d),[319]
  - the related partner acquired all or a part of its interest in the partnership
  - in a transaction that would have been described in Prop. Treas. Reg. §1.6011-18(c)(2)[320] (transfer of a partnership interest) −

[317] Prop. Treas. Reg. §1.6011-18(c)(c) ("(3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.")

[318] I.R.C. § 732(d) ("(d) Special partnership basis to transferee. For purposes of subsections (a), (b), and (c), a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in section 754 is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within 2 years after such transfer, may elect, under regulations prescribed by the Secretary, to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in section 743(b) were in effect with respect to the partnership property. The Secretary may by regulations require the application of this subsection in the case of a distribution to a transferee partner, whether or not made within 2 years after the transfer, if at the time of the transfer the fair market value of the partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership.").

[319] I.R.C. § 732(d) ((d) Special partnership basis to transferee. For purposes of subsections (a), (b), and (c), a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in section 754 is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within 2 years after such transfer, may elect, under regulations prescribed by the Secretary, to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in section 743(b) were in effect with respect to the partnership property. The Secretary may by regulations require the application of this subsection in the case of a distribution to a transferee partner, whether or not made within 2 years after the transfer, if at the time of the transfer the fair market value of the partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership.).

[320] Prop. Treas. Reg. §1.6011-18(c)(2) ("(2) Transfer of partnership interest. A partner transfers an interest in a partnership to a related partner in a nonrecognition transaction, the basis of one or

if

- the partnership had a section 754 election in effect for the year of the transfer, and
- the transaction meets the $5 million threshold.[321]

The Section 6011 regulations are especially controversial on account of their highly retroactive effect, although the regulations are not technically retroactive. The Section 6011

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more partnership properties is increased under section 743(b)(1) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met.").

[321] Prop. Treas. Reg. §1.6011-18(c)(c) ("(3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions."); Prop. Treas. Reg. §1.6011-18(c) ("(c) Transaction description. A transaction is described in this paragraph (c) if the factual elements of the transaction described in paragraph (c)(1)(i) through (iii) or (c)(2) of this section are met. (1) Distributions by partnership. A partnership engages in any of the transactions described in paragraphs (c)(1)(i) through (iii) of this section with one or more of the related partners: (i) The partnership distributes property to a person who is a related partner in a current or liquidating distribution, the partnership increases the basis of one or more of its remaining properties under section 734(b) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (ii) The partnership distributes property to a person who is a related partner in liquidation of the person's partnership interest (or in complete liquidation of the partnership), the basis of one or more distributed properties is increased under section 732(b) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (iii) The partnership distributes property to a person who is a related partner, the basis of one or more distributed properties is increased under section 732(d) of the Code, the related partner acquired all or a part of its interest in the partnership in a transaction that would have been a transaction described in paragraph (c)(2) of this section if the partnership had a section 754 election in effect for the year of transfer, and the $5 million threshold described in paragraph (c)(3) of this section is met. (2) Transfer of partnership interest. A partner transfers an interest in a partnership to a related partner in a nonrecognition transaction, the basis of one or more partnership properties is increased under section 743(b)(1) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.").

regulations are controversial on account of their "substantially similar" rules in Section 1.6011-4. As the American Bar Association notes in its report on the proposed regulations, "Although by their terms the disclosure requirements for both participating partners and material advisors would apply prospectively after the date the Proposed TOI Regulations are finalized, in practice the Proposed TOI Regulations would require disclosures of transactions occurring in prior years, as a result of the TOI definition, as described below. The forthcoming rules described in Notice 2024-54, 2024-28 I.R.B. 24 (the 'Notice') that relate to related-party basis adjustments, would in practice, also apply retroactively for the same reason."[322]

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[322] See letter dated November 15, 2024, from Alice G. Abreu, Chair, Section of Taxation, American Bar Association, to Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service, Re: Comments on Proposed Regulations under Section 6011, DOC 2024-33141, 2024 TNTF 222-13 (Nov. 15, 2024)

I. Retroactive Application of the Proposed TOI Regulations

A. Background on provisions

1. TOI reporting requirements for participating parties

As drafted, the Proposed TOI Regulations will be effective as of the date final regulations are published in the Federal Register.[12] [[12] Prop. Treas. Reg. §1.6011-18(h).] Once the Proposed TOI Regulations are effective, the disclosure for a TOI must be attached to the taxpayer's tax return for each taxable year in which a taxpayer participates in a TOI.[13] [[13] See Treas. Reg. §1.6011-4(e)(1). Taxpayers required to disclose TOIs must complete Form 8886, Reportable Transaction Disclosure Statement.] A taxpayer participates in a TOI if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the TOI.[14] [[14] Treas. Reg. §1.6011-4(c)(3)(i)(E).] The Proposed TOI Regulations define participant to include taxpayers that (i) engage in a TOI during the tax year; or (ii) report the tax consequences of a basis increase resulting from a TOI on their tax return.[15] [[15] See Prop. Treas. Reg. §1.6011-18(e)(1)-(5).]

If a transaction becomes a TOI after the filing of a taxpayer's tax return (including an amended return or administrative adjustment request) reflecting the taxpayer's participation in the TOI and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the TOI, then a disclosure statement must be filed with the Office of Tax Shelter Analysis – regardless of whether the taxpayer participated in the transaction in the year the transaction became a TOI – within 90 calendar days after the date on which the transaction became a TOI.[16] [[16] See Treas. Reg. §1.6011-4(e)(2)(i).]

2. TOI reporting requirements for material advisors ¶

The Preamble clarifies that material advisors would have disclosure requirements with respect to TOIs under the existing rules in sections 6011 and 6111 and the regulations under sections 6011 and 6111.[17] [[17] Preamble to Prop. Treas. Reg. §1.6011-18, 89 Fed. Reg. at 51478.] Material advisors would also have disclosure requirements for transactions occurring in prior years. The Preamble states that material advisors would be required to disclose historical transactions if they have made an oral or written tax statement that relates to a tax aspect of the transaction during the period beginning six years prior to the date of the Treasury Decision adopting the Proposed TOI Regulations as final regulations.[18] [[18] Id. at 51486.].

See, also, letter dated August 16, 2024, from Jiyeon Lee-Lim, Chair, New York State Bar Association, Tax Section, to The Honorable Aviva Aron-Dine, Acting Assistant Secretary (Tax Policy) Department of the Treasury, The Honorable Daniel I. Werfel, Commissioner, Internal Revenue

The proposed regulations provide that a transaction is "substantially similar" if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy.[323] That is a standard that could prove difficult to apply precisely in practice.

Service, and The Honorable Marjorie A. Rollinson, Chief Counsel, Internal Revenue Service, Re: NYSBA Tax Section Report No. 1498 — Report on Proposed Regulation Regarding Partnership Basis Adjustments and Application of Notice 2024-54 to Previously Effected Transactions, and enclosing Report No. 1498, DOC 2024-23768, 2024 TNTF 159-30 (Aug. 16, 2024) ("we oppose the application of such rules to basis increases arising before the date of publication of the Notice, because such application would change the tax consequences of previously consummated, non-abusive, commercial transactions that were done in complete accord with existing law. As the proposed retroactive effect specifically negates any inquiry into the bona fides of a transaction, many transactions to which the new rules could apply would involve the well-settled application, in the years in which the transactions were effected, of longstanding provisions of subchapter K of the Code. . . . ¶ However, exactly as noted with respect to the Notice, many transactions that would become TOIs under the proposed retroactive application of the Proposed TOI Regulation relied on the well-settled application, in the years in which the transactions were effected, of longstanding provisions of subchapter K of the Code. Taxpayers have prevailed in litigation when these transactions were challenged by the IRS, even when transactions were planned with an eye toward the existing rules of the Code and Regulations.24 Moreover, such transactions are often planned by taxpayers' regular tax advisors — not syndicated or marketed — and they affect real world restructurings, with real economic effects of existing bona fide business entities. Thus, they are quite different from the typically "one off" transactions that predominate on the rosters of listed transactions and transactions of interest. [Footnote omitted.] ¶ Identifying those basis adjustment transactions that arise from a TOI will entail a fact-intensive inquiry of transactions from the last many years, and taxpayers and, even more so, their advisors26 often will have no ready way of now recalling or identifying transactions that may fit within the Proposed TOI Regulation's definition but happened years ago. This will be particularly so where advisors have died or retired, firms have dissolved or merged, and so on. For example, if a transaction that resulted in a positive basis adjustment to commercial or industrial real property occurred 30 or more years ago, a participant might have to attach a Form 8886 to its tax return for any taxable years for which the period of limitations is still open when and if the Proposed TOI Regulation are finalized in the mid-2020s.").

[323] Treas. Reg. §1.6011-4(c)(4) ("(4) Substantially similar. The term substantially similar includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a listed transaction even though it involves different entities or uses different Internal Revenue Code provisions. (See for example, Notice 2003-54 (2003-2 CB 363), describing a transaction substantially similar to the transactions in Notice 2002-50 (2002-2 CB 98), and Notice 2002-65 (2002-2 CB 690).) The following examples illustrate situations where a transaction is the same as or substantially similar to a listed transaction under paragraph (b)(2) of this section. (Such transactions may also be reportable transactions under paragraphs (b)(3) through (7) of this section.) See § 601.601(d)(2)(ii)(b) of this chapter.") See letter dated November 15, 2024, from Alice G. Abreu,

Chair, Section of Taxation, American Bar Association, to Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service, Re: Comments on Proposed Regulations under Section 6011, DOC 2024-33141, 2024 TNTF 222-13 (Nov. 15, 2024):

> Because the narrow interpretation and the broad interpretation both represent plausible readings of the Substantially Similar Transaction rule, the proper interpretation should be clarified. We recommend that the re-proposed (or final) regulations adopt the narrow interpretation and clarify that the 'substantially similar' rule under Prop. Treas. Reg. §1.6011-18(d)(2) does not apply to transfers of partnership interests between persons who are not related to each other. As Section 3 of the Notice states: '[i]n most commercial transactions involving unrelated parties, the opportunity for abuse is limited because each party has separate, and often competing, economic and tax interests, and the parties transact at arm's length.' We agree with this assertion and believe that the transfer of a partnership interest in a taxable transaction between unrelated persons presents little potential for abuse. Thus, the benefits of requiring disclosure are small, especially when compared to the number of innocuous transfers that would require disclosure under the broad interpretation. We therefore recommend that the re-proposed (or final) regulations clarify that Prop. Treas. Reg. §1.6011-18(d)(2) does not apply to taxable transfers of partnership interests between unrelated persons.
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> . . . .
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> We recommend that the Substantially Similar Transaction rule relating to tax-indifferent parties under Prop. Treas. Reg. §1.6011-18(d)(1) be modified by limiting application of the rule to situations in which the taxpayer knowingly participates in the transaction in which the tax-indifferent party facilitates a basis step-up.[37] [[37] As an aside, we also recommend that the re-proposed (or final) TOI regulations clarify whether the Substantially Similar Transactions rule applies to the purchase of a partnership interest from an unrelated tax-indifferent party. By its terms, the Substantially Similar Transaction rule applies to a transaction that is described in Prop. Treas. Reg. §1.6011-18(c) except that the partners are unrelated and one or more partners is a tax-indifferent party that facilitates "by receiving a distribution of property from the partnership or otherwise" an increase in the basis of partnership property. The reference to Prop. Treas. Reg. §1.6011-18(c) encompasses both Prop. Treas. Reg. §1.6011-18(c)(1), which describes partnership distribution transactions and Prop. Treas. Reg. §1.6011-18(c)(2), which describes exchanges of partnership interest transactions. Although the Substantially Similar Transactions rule focuses on transactions involving distributions of partnership property, the catch-all language "or otherwise" suggests that taxable sales could also be swept in. Clarity on this point would be extremely helpful.]
>
> If the scope of the rule is not limited in this manner, we believe that routine business transactions will be reported prophylactically to the Service. This volume of disclosures would not help advance Treasury and the Service's goal of policing abusive transactions and would create a significant reporting burden on taxpayers and tax advisers. For example, if a partnership distributes property to a partner in liquidation of the partner's interest, the partnership generally has no way of determining whether the partner is tax-indifferent in the taxable year in question (for example, due to tax attributes). Partnerships and tax advisers likely would elect to report all distributions of cash or property to the government to avoid an inadvertent failure to report a transaction involving a tax-indifferent party. This result could be avoided if a knowledge requirement were added to the rule — in other words, if the rule were limited to situations in which a taxpayer knowingly participates in a transaction in which a tax-indifferent party facilitates a basis step-up under sections 732, 734, or 743.[38] [[38] Another

Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction.

The term "substantially similar" must be broadly construed in favor of disclosure.

Substantially Similar Transactions, include, without limitation,

- Transactions described in Section 1.6011-18(c),[324] except that –

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possible way of addressing this issue would be to clarify that the term "facilitates," as used in Prop. Treas. Reg. §1.6011-18(d)(1), contains a requirement that the parties must have knowingly and intentionally availed themselves of the tax-indifferent status of the tax-indifferent party. As written, it is not clear whether the term "facilitates," as used in Prop. Treas. Reg. §1.6011-18(d)(1), includes the elements of knowledge and intention, or merely requires that a tax-indifferent party participated in the transaction leading to the covered result. Limiting the term "facilitates" to fact patterns in which the parties knowingly and intentionally avail themselves of the tax-indifferent status of the tax-indifferent party to generate a basis step-up under sections 732, 734, or 743 without the payment of additional U.S. federal income tax would significantly reduce the overbreadth of the reporting requirements under Prop. Treas. Reg. §1.6011-18(d)(1) without frustrating the government's goal of identifying and policing abusive transactions.]

[324] Prop. Treas. Reg. §1.6011-18(c) ("(c) Transaction description. A transaction is described in this paragraph (c) if the factual elements of the transaction described in paragraph (c)(1)(i) through (iii) or (c)(2) of this section are met. (1) Distributions by partnership. A partnership engages in any of the transactions described in paragraphs (c)(1)(i) through (iii) of this section with one or more of the related partners: (i) The partnership distributes property to a person who is a related partner in a current or liquidating distribution, the partnership increases the basis of one or more of its remaining properties under section 734(b) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (ii) The partnership distributes property to a person who is a related partner in liquidation of the person's partnership interest (or in complete liquidation of the partnership), the basis of one or more distributed properties is increased under section 732(b) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (iii) The partnership distributes property to a person who is a related partner, the basis of one or more distributed properties is increased under section 732(d) of the Code, the related partner acquired all or a part of its interest in the partnership in a transaction that would have been a transaction described in paragraph (c)(2) of this section if the partnership had a section 754 election in effect for the year of transfer, and the $5 million threshold described in paragraph (c)(3) of this section is met. (2) Transfer of partnership interest. A partner transfers an interest in a partnership to a related partner in a nonrecognition transaction, the basis of one or more partnership properties is increased under section 743(b)(1) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related

- the partners of the partnership are *not related* and
- one or more partners of the partnership is a *tax-indifferent party* that facilitates, by receiving
  - a distribution of property from the partnership or otherwise,
  - an increase in the basis of partnership property or
  - an increase in the basis of property held by another partner in the partnership; and
- Transactions in which
  - a partnership distributes property
    - to a person who is a related partner
  - in a current or liquidating distribution,
  - the partnership increases the basis of one or more of its remaining properties under section 734(b) and (c), and
  - the transaction satisfies the $5 million threshold.[325]
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- Transactions in which a partner transfers an interest in a partnership to a related partner in a nonrecognition transaction, the basis of one or more partnership properties is increased under section 743(b)(1) and (c), and the $5 million threshold is met;7
- Transactions in which a partnership distributes property to a person who is a related partner in liquidation of the person's partnership interest (or in complete liquidation of the partnership), the basis of one or more distributed properties is increased under section 732(b) and (c), and the $5 million threshold is met;8

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partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.").

[325] Prop. Treas. Reg. §1.6011-18(d) ("(d) Substantially similar transaction. A transaction that is substantially similar (within the meaning of §1.6011-4(c)(4)) to a transaction described in paragraph (c) of this section includes, but is not limited to: (1) A transaction that is described in paragraph (c) of this section except that the partners of the partnership are not related and one or more partners of the partnership is a tax-indifferent party that facilitates, by receiving a distribution of property from the partnership or otherwise, an increase in the basis of partnership property or an increase in the basis of property held by another partner in the partnership; and (2) A transaction in which a partner transfers an interest in a partnership to a related partner in a recognition transaction, and the $5 million threshold described in paragraph (c)(3) of this section is met.")

- Transactions in which a partnership distributes property to a person who is a related partner, the basis of one or more distributed properties is increased under section 732(d), the related partner acquired all or a part of its interest in the partnership in a transaction that would have been described in Prop. Treas. Reg. §1.6011-18(c)(2) if the partnership had a section 754 election in effect for the year of the transfer, and the $5 million threshold is met;9
- Transactions in which a partner transfers an interest in a partnership to a related partner in a recognition transaction and the $5 million threshold is met.10

A transaction may be substantially similar to a transaction of interest even though it may involve different entities or use different Code provisions. There doubtless will be considerable soul searching among advisors and taxpayers concerning whether a transaction is "substantially similar". Advisors and taxpayers may be well advised to be expansive in their disclosure of transactions that might be found to be "substantially similar" to partnership related-party basis adjustment transactions.

[Taxpayers and advisors will be left uncertain in many situations concerning whether their transactions are "substantially similar under the regulation.]

These partnership basis shifting transactions are structured to exploit the mechanical basis adjustment provisions to produce significant tax benefits with little or no economic impact on the related parties. Proposed regulations address four variations of the transaction, which are referred to as "Partnership Related-Party Basis Adjustment Transactions." These transactions rely on the basis adjustment provisions of Sections 732(b) and (d), 734(b), and 743(b).[326]

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[326] Basis adjustments are explained in the Preamble to REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40:

B. Basis Adjustments Under Section 732

Section 732 governs a distributee partner's basis in distributed property other than money. In the case of a current distribution, and except as provided under section 732(a)(1) and (2) provides that the distributee partner's basis in distributed property (other than money) is equal to the partnership's adjusted basis in the distributed property immediately before the distribution. Under section 732(a)(2), however, a distributee partner's basis in distributed property is limited to the adjusted basis of the distributee partner's partnership interest reduced by any money distributed to such partner in the same transaction.

In the case of a liquidating distribution, section 732(b) provides that the distributee partner's basis in distributed property (other than money) is equal to the adjusted basis of the distributee partner's partnership interest reduced by any money distributed to such partner in the same transaction.

In the case of a distribution of more than one property from a partnership, the basis of the distributed properties to which section 732(a)(2) and (b) apply must be allocated among the distributed properties under the rules of section 732(c) and the regulations thereunder.

C. Basis Adjustments Under Section 734

In the case of a distribution of property by a partnership with a section 754 election in effect, and for which either the distributee partner recognizes gain or loss on the distribution, or for which the basis of the distributed property in the distributee partner's hands, as determined under section 732, differs from the partnership's adjusted basis in the distributed property immediately before the distribution, section 734(b) requires the partnership to increase or decrease (as applicable) the basis of its remaining partnership property. Also, in the case of a distribution of property by a partnership that results in a substantial basis reduction under section 734(d), the basis of remaining partnership property must be adjusted under section 734(b), even if the partnership does not have a section 754 election in effect.

Section 734(b)(1) requires a partnership to increase the basis of its remaining partnership property if a distribution of partnership property by the partnership results in the distributee partner recognizing gain under section 731(a)(1) of the Code, or if property (other than money) to which section 732(a)(2) or (b) applies is distributed to the distributee partner and the property's adjusted basis to the partnership immediately before the distribution is greater than the distributee partner's basis in the distributed property as determined under section 732. Section 731(a)(1) requires a distributee partner to recognize gain in a current or liquidating distribution to the extent that any money distributed to that partner in the distribution exceeds the adjusted basis of that partner's partnership interest immediately before the distribution. The amount of the basis increase to the partnership's remaining property under section 734(b)(1) following a distribution of partnership property to a partner is equal to the amount of gain recognized by the distributee partner in the distribution under section 731(a)(1) and the excess of the partnership's adjusted basis in the distributed property immediately before the distribution over the distributee partner's basis in the distributed property as determined under section 732.

Section 734(b)(2) requires a partnership to decrease the basis of its remaining property if a distribution of property by the partnership results in the distributee partner recognizing loss under section 731(a)(2), or if property (other than money) is distributed to the distributee partner in a distribution to which section 732(b) applies and the property's adjusted basis to the partnership immediately before the distribution is less than the distributee partner's basis in the distributed property as determined under section 732. Under section 731(a)(2), a distributee partner may recognize a loss in a liquidating distribution of that partner's interest in the partnership to the extent that such partner received only money, unrealized receivables described in section 751(c), or inventory items described in section 751(d) of the Code in the distribution. In such a case, the distributee partner is required to recognize a loss to the extent that such partner's adjusted basis in the partnership interest exceeds the sum of any money distributed to that partner in the distribution and the basis to the distributee partner (determined under section 732) of any unrealized receivables or inventory received by that partner in the distribution. The amount of the basis decrease to the partnership's remaining property under section 734(b)(2) following a distribution of partnership property to a partner is equal to the amount of loss recognized by the distributee partner in the distribution under section 731(a)(2) and the excess of the distributee partner's basis in the distributed property as determined under section 732 over the partnership's adjusted basis in the distributed property immediately before the distribution.

A partnership without a section 754 election in effect is subject to a mandatory basis adjustment under section 734(b)(2) if there is a substantial basis reduction with respect to a

distribution of partnership property. Under section 734(d), a substantial basis reduction with respect to a distribution of partnership property occurs if the sum of the amount of loss recognized to the distributee partner on the distribution, plus any increase in basis in the distributed property to the distributee partner under section 732(b), exceeds $250,000.

D. Basis Adjustments Under Section 743(b)

Generally, if a partnership interest is transferred in a sale or exchange or on the death of a partner, the transferee partner's basis in the transferred partnership interest is determined under section 742 of the Code and the basis of partnership property is determined under section 743(a). Section 742 provides that the transferee partner's basis in a partnership interest acquired other than by contribution is determined under part II of subchapter O of chapter 1 of the Code, beginning at section 1011 of the Code and following. Thus, for example, a transferee partner's basis in a partnership interest acquired by purchase generally is cost basis under section 1012 of the Code. Section 743(a) provides that, in the case of a transfer of a partnership interest by sale or exchange or on the death of a partner, the basis of partnership property is not adjusted unless either the partnership has a section 754 election in effect or the partnership has a substantial built-in loss with respect to the transfer of the partnership interest.

Under section 743(b), in the case of a transfer of a partnership interest by sale or exchange or on the death of a partner, a partnership with a section 754 election in effect or that has a substantial built-in loss with respect to the transfer of the partnership interest must increase or decrease (as applicable) the adjusted basis of partnership property with respect to the transferee partner.

Section 743(b)(1) provides that the adjusted basis of partnership property is increased by the excess of the transferee partner's basis in the transferred partnership interest over the transferee partner's proportionate share of the adjusted basis of partnership property.

Section 743(b)(2) provides that the adjusted basis of partnership property is decreased by the excess of the transferee partner's proportionate share of the adjusted basis of partnership property over the transferee partner's basis in the transferred partnership interest.

A partnership without a section 754 election is subject to a mandatory basis adjustment under section 743(b) with respect to a transfer of a partnership interest if the partnership has a substantial built-in loss with respect to the transfer of the partnership interest. Under section 743(d)(1), a partnership has a substantial built-in loss with respect to a transfer of an interest in the partnership if either the partnership's adjusted basis in its property exceeds the fair market value of such property by more than $250,000, or the transferee partner would be allocated a loss of more than $250,000 if the partnership assets were sold for cash equal to their fair market value immediately after the transfer.

Under regulations prescribed by the Secretary, a basis adjustment under section 743(b) is an adjustment to the basis of partnership property with respect to the transferee partner only. The transferee partner's proportionate share of the partnership's adjusted basis in its property generally is determined in accordance with the transferee partner's interest in the partnership's previously taxed capital (including the transferee partner's share of partnership liabilities) under regulations prescribed by the Secretary.

In the case of a transferee partner who acquired all or part of its partnership interest by a transfer to which no section 754 election was in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within two years, section 732(d) and the regulations thereunder allow the partner to make an election to treat as

If required by regulations,

- any person made liable for any tax, or with respect to the collection of the tax,
- must make a return or statement according to the forms and regulations.[327]

Every person required to make a return or statement must include in the return or statement the information required by the forms or regulations.

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the adjusted basis of the distributed property the adjusted basis such property would have if the adjustment under section 743(b) were in effect with respect to the partnership property.

Under § 1.732-1(d)(4), the special basis adjustment under section 732(d) is required to apply to a distribution of property to a partner who acquired all or part of its interest by a transfer from a partnership without a section 754 election in effect for the taxable year of such transfer, whether or not the distribution is made within two years of such transfer, if at the time the partnership interest was transferred, (i) the fair market value of all partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership, (ii) an allocation of basis under section 732(c) upon a liquidation of the transferee partner's interest in the partnership immediately after the transfer of such interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization to property subject to such an allowance, and (iii) a basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

E. Allocation of Basis Adjustments Under Sections 734 and 743

Section 734(c) states that a basis adjustment under section 734(b) is allocated among partnership properties under the rules of section 755 of the Code. Section 743(c) states that a basis adjustment under section 743(b) is allocated among partnership properties under the rules of section 755.

Section 755(a) generally requires basis adjustments under section 734(b) or section 743(b) to be allocated in a manner that has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties or in any other manner permitted by regulations. In addition, section 755(b) requires these basis adjustments to be allocated to partnership property of a like character or to subsequently acquired partnership property of a like character if such property is not available or has insufficient basis at the time of the basis adjustment (because a decrease in the adjusted basis of the property would reduce the basis of such property below zero). Section 755(c) provides a special rule that prohibits allocating a basis decrease under section 734(b) to the stock of a corporation that is a partner of the partnership (or to any related partner in the partnership within the meaning of section 267(b) of the Code or section 707(b)(1) of the Code).

F. Common Terminology for Bases With Respect to a Partnership Interest

A partner's adjusted basis in its partnership interest commonly is referred to as the partner's "outside basis" in its partnership interest. A partnership's adjusted basis in its property commonly is referred to as the "inside basis" of the partnership's property. Each partner has a share of inside basis. For ease of explanation, this terminology is used in part IV of this Background section.

[327] I.R.C. § 6011(a).

Every taxpayer that has participated in a reportable transaction[328] and who is required to file a tax return must file a disclosure statement within the time prescribed.[329]

Reportable transactions[330] include –

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[328] Within the meaning of Treas. Reg. § 1.6011-4(b).

[329] Prescribed in Treas. Reg. § 1.6011-4(e). I.R.C. § 1.6011-4(a).

[330] Identified in Treas. Reg. § 1.6011-4. See Treas. Reg. § 1.6011-4(a), (b) ("Sec. 1.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers. (a) In general. Every taxpayer that has participated, as described in paragraph (c)(3) of this section, in a reportable transaction within the meaning of paragraph (b) of this section and who is required to file a tax return must file within the time prescribed in paragraph (e) of this section a disclosure statement in the form prescribed by paragraph (d) of this section. The fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer's treatment of the transaction is proper. (b) Reportable transactions. (1) In general. A reportable transaction is a transaction described in any of the paragraphs (b)(2) through (7) of this section. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan. (2) Listed transactions. A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction. (3) Confidential transactions. (i) In general. A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee. (ii) Conditions of confidentiality. A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction. (iii) Minimum fee. For purposes of this paragraph (b)(3), the minimum fee is (A) $250,000 for a transaction if the taxpayer is a corporation; (B) $50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is $250,000. (iv) Determination of minimum fee. For purposes of this paragraph (b)(3), in determining the minimum fee, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of the facts and circumstances. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the

facts and circumstances in determining whether consideration received in connection with a confidential transaction constitutes fees. (v) Related parties. For purposes of this paragraph (b)(3), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person. (4) Transactions with contractual protection. (i) In general. A transaction with contractual protection is a transaction for which the taxpayer or a related party (as described in section 267(b) or 707(b)) has the right to a full or partial refund of fees (as described in paragraph (b)(4)(ii) of this section) if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual protection also is a transaction for which fees (as described in paragraph (b)(4)(ii) of this section) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation. (ii) Fees. Paragraph (b)(4)(i) of this section only applies with respect to fees paid by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction. (iii) Exceptions. (A) Termination of transaction. A transaction is not considered to have contractual protection solely because a party to the transaction has the right to terminate the transaction upon the happening of an event affecting the taxation of one or more parties to the transaction. (B) Previously reported transaction. If a person makes or provides a statement to a taxpayer as to the potential tax consequences that may result from a transaction only after the taxpayer has entered into the transaction and reported the consequences of the transaction on a filed tax return, and the person has not previously received fees from the taxpayer relating to the transaction, then any refundable or contingent fees are not taken into account in determining whether the transaction has contractual protection. This paragraph (b)(4) does not provide any substantive rules regarding when a person may charge refundable or contingent fees with respect to a transaction. See Circular 230, 31 CFR Part 10, for the regulations governing practice before the IRS. (5) Loss transactions. (i) In general. A loss transaction is any transaction resulting in the taxpayer claiming a loss under section 165 of at least (A) $10 million in any single taxable year or $20 million in any combination of taxable years for corporations; (B) $10 million in any single taxable year or $20 million in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners; or (C) $2 million in any single taxable year or $4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners; (D) $2 million in any single taxable year or $4 million in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or (E) $50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in section 988(c)(1) relating to foreign currency transactions). (ii) Cumulative losses. In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years as described in paragraph (b)(5)(i) of this section, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined. (iii) I.R.C. § 165 loss. (A) For purposes of this section, in determining the thresholds in paragraph (b)(5)(i) of this section, the amount of a section 165 loss is adjusted for any salvage value and for any insurance or other compensation received. See § 1.165-1(c)(4). However, a section 165 loss does not take into account offsetting gains, or other income or

- listed transactions,
- confidential transactions,
- transactions with contractual protection,
- loss transactions, and
- transactions of interest.[331]

A "transaction of interest" is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service has identified by notice, regulation, or other form of published guidance as a transaction of interest.[332]

A transaction is "substantially similar" if –

- the transaction is expected to obtain the same or similar types of tax consequences and

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limitations. For example, a section 165 loss does not take into account the limitation in section 165(d) (relating to wagering losses) or the limitations in sections 165(f), 1211, and 1212 (relating to capital losses). The full amount of a section 165 loss is taken into account for the year in which the loss is sustained, regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or a net capital loss under section 1212 that is a carryback or carryover to another year. A section 165 loss does not include any portion of a loss, attributable to a capital loss carryback or carryover from another year, that is treated as a deemed capital loss under section 1212. (B) For purposes of this section, a section 165 loss includes an amount deductible pursuant to a provision that treats a transaction as a sale or other disposition, or otherwise results in a deduction under section 165. A section 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under section 741 and a loss resulting from a section 988 transaction. (6) Transactions of interest. A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest. (7) [Reserved] (8) Exceptions. (i) In general. A transaction will not be considered a reportable transaction, or will be excluded from any individual category of reportable transaction under paragraphs (b)(3) through (7) of this section, if the Commissioner makes a determination by published guidance that the transaction is not subject to the reporting requirements of this section. The Commissioner may make a determination by individual letter ruling under paragraph (f) of this section that an individual letter ruling request on a specific transaction satisfies the reporting requirements of this section with regard to that transaction for the taxpayer who requests the individual letter ruling. (ii) Special rule for RICs. For purposes of this section, a regulated investment company (RIC) as defined in section 851 or an investment vehicle that is owned 95 percent or more by one or more RICs at all times during the course of the transaction is not required to disclose a transaction that is described in any of paragraphs (b)(3) through (5) and (b)(7) of this section unless the transaction is also a listed transaction or a transaction of interest.")

[331] Treas. Reg. § 1.6011-4(b)(2) through (6).

[332] Treas. Reg. § 1.6011-4(b)(6).

- is either factually similar or based on the same or similar tax strategy.[333]

A taxpayer has participated in a transaction of interest if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the transaction of interest.[334]

The disclosure statement, Form 8886, Reportable Transaction Disclosure Statement (or successor form), must be attached to the taxpayer's tax return for each taxable year in which a taxpayer participates in a reportable transaction.[335]

A copy of the disclosure statement must be sent to the Internal Revenue Service's Office of Tax Shelter Analysis (OTSA) at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction.

If –

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[333] Treas. Reg. § 1.6011-4(c)(4). Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. The term "substantially similar" must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a transaction of interest even though it may involve different entities or use different Code provisions.

The preamble, REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40, advises:

> III. Substantially Similar Transactions
>
> Proposed §1.6011-18(a) would provide that substantially similar transactions include, but are not limited to, the transactions described in proposed §1.6011-18(d). For purposes of proposed §1.6011-18, transactions would be "substantially similar" transactions if the transactions are substantially similar within the meaning of §1.6011-4(c)(4).
>
> Under proposed §1.6011-18(d)(1), a transaction would be substantially similar to a transaction described in proposed §1.6011-18(c) if the transaction is a basis adjustment transaction described in proposed §1.6011-18(c)(1) or (2), except that it does not involve related partners and one or more partners of the partnership is a tax-indifferent party. Under proposed §1.6011-18(b)(11), a tax-indifferent party would mean a person that is either not liable for Federal income tax because of its tax-exempt or, in certain cases, foreign status or to which gain from a transaction described in proposed §1.6011-18(c) would not result in Federal income tax liability for the person's taxable year within which such gain is recognized (for example, because the taxpayer has a net operating loss carryforward or capital loss carryforward).
>
> Under proposed §1.6011-18(d)(2), a transaction would be substantially similar to a transaction described in proposed §1.6011-18(c) in situations in which a partner transfers its partnership interest in a recognition transaction to a related transferee or to a person related to one or more existing partners, and the $5 million threshold under proposed §1.6011-18(c)(3) is met. Proposed §1.6011-18(b)(6) would define a recognition transaction as a transaction other than a nonrecognition transaction as defined in proposed §1.6011-18(b)(2).

Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

[334] Treas. Reg. § 1.6011-4(c)(3)(i)(E).

[335] Treas. Reg. § 1.6011-4(d), (e).

- a transaction becomes a transaction of interest

  after

  - the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the transaction of interest and

  before

  - the end of the period of limitations for assessment for any taxable year in which the taxpayer participated in the transaction of interest,

  then

- a disclosure statement must be filed with the Office of Tax Shelter Analysis
- within 90 calendar days

  after

- the date on which the transaction becomes a transaction of interest. [336]

This disclosure requirement extends to an amended return.

This disclosure requirement exists regardless of whether the taxpayer participated in the transaction in the year the transaction became a transaction of interest.

The Internal Revenue Service may also determine the time for disclosure of transactions of interest in the published guidance identifying the transaction.

Participants required to disclose these transactions [337] who fail to do so are subject to penalties. [338] The amount of the penalty is –

- 75 percent of
  - the decrease in tax shown on the return
  - as a result of the reportable transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes),
  - subject to minimum and maximum penalty amounts. [339]

The minimum penalty amount is –

- $5,000 in the case of a natural person and
- $10,000 in any other case.

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[336] Treas. Reg. § 1.6011-4(e)(2)(i).
[337] Under Treas. Reg. § 1.6011-4.
[338] Under I.R.C. § 6707A.
[339] I.R.C. § 6707A(b).

For a transaction of interest, the maximum penalty amount is

- $10,000 in the case of a natural person and
- $50,000 in any other case.

Additional penalties may also apply. [340]

Each material advisor with respect to any reportable transaction must make a return setting forth:

- information identifying and describing the transaction,
- information describing any potential tax benefits expected to result from the transaction, and
- such other information as the Secretary may prescribe.

The return must be filed not later than the date specified by the Secretary. [341]

Each material advisor with respect to any reportable transaction [342] must file a return. [343]

Material advisors must disclose transactions on Form 8918, Material Advisor Disclosure Statement (or successor form), as provided in §301.6111-3(d) and (e).

The material advisor's disclosure statement for a reportable transaction must be filed with the Office of Tax Shelter Analysis in the Large Business & International (LB&I) Division by

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[340] I.R.C. § 6662A imposes a 20 percent accuracy-related penalty on any understatement (as defined in section 6662A(b)(1)) attributable to an adequately disclosed reportable transaction. If the taxpayer had a requirement to disclose participation in the reportable transaction but did not adequately disclose the transaction in accordance with the regulations under I.R.C. § 6011, the taxpayer is subject to an increased penalty rate equal to 30 percent of the understatement. See I.R.C. § 6662A(c). I.R.C. § 6662A(b)(2) provides that I.R.C. § 6662A applies to any item which is attributable to any listed transaction and any reportable transaction (other than a listed transaction) if a significant purpose of the transaction is the avoidance or evasion of Federal income tax.

[341] I.R.C. § 6111(a).

[342] As defined in Treas. Reg. § 1.6011-4(b).

[343] As described in Treas. Reg. § 301.6111-3(d) by the date described in Treas. Reg. § 301.6111-3(e). Treas. Reg. § 301.6111-3(a). Treas. Reg. § 301.6111-3(b)(1) provides that a person is a material advisor with respect to a transaction if the person provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in Treas. Reg. § 301.6111-3(b)(3) for the material aid, assistance, or advice. Under Treas. Reg. § 301.6111-3(b)(2)(i) and (ii), a person provides material aid, assistance, or advice if the person provides a tax statement, which is any statement (including another person's statement), oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction as defined in Treas. Reg. § 1.6011-4(b)(2) through (7).

- the last day of the month
- that follows the end of the calendar quarter in which
- the advisor becomes a material advisor with respect to
- a reportable transaction or in which the circumstances necessitating an amended disclosure statement occur.[344]

A person may become a material advisor with respect to a transaction that is later identified as a transaction of interest.[345] The disclosure statement must be sent to the OTSA at the address provided in the instructions for Form 8918 (or successor form).

The Internal Revenue Service will issue to a material advisor a reportable transaction number with respect to the disclosed reportable transaction.[346] Receipt of a reportable transaction number does not indicate that the disclosure statement is complete, nor does it indicate that the transaction has been reviewed, examined, or approved by the Internal Revenue Service. Material advisors must provide the reportable transaction number to all taxpayers for whom the material advisor acts as a material advisor.

The reportable transaction number must be provided at the time the transaction is entered into, or if the transaction is entered into prior to the material advisor receiving the reportable transaction number, within 60 calendar days from the date the reportable transaction number is mailed to the material advisor.

A material advisor who fails to file a timely disclosure, or files an incomplete or false disclosure statement, is subject to a penalty., the penalty for reportable transactions other than listed transactions, including transactions of interest, is $50,000.[347]

Each material advisor with respect to any reportable transaction, whether or not required to file a return[348] with respect to such transaction, must maintain a list

- identifying each person with respect to whom such advisor acted as a material advisor with respect to such transaction and
- containing such other information as the Secretary may by regulations require.[349]

Material advisors must furnish the lists to the Internal Revenue Service.[350]

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[344] Treas. Reg. § 301.6111-3(e).
[345] See Treas. Reg. § 301.6111-3(b)(4).
[346] Treas. Reg. § 301.6111-3(d)(2).
[347] Pursuant to I.R.C. § 6707(b)(1). I.R.C. § 6707(a).
[348] Under I.R.C. § 6111.
[349] I.R.C. § 6112(a).
[350] In accordance with Treas. Reg. § 301.6112-1(e).

A material advisor may be subject to a penalty under Section 6708 for failing to maintain a list[351] and failing to make the list available upon written request to the Secretary[352] within 20 business days after the date of request. The penalty is $10,000 per day for each day of the failure after the 20th day.[353] No penalty will be imposed with respect to the failure on any day if such failure is due to reasonable cause.

Participants required to disclose these transactions[354] who fail to do so would be subject to penalties under Section 6707A.

Material advisors required to disclose these transactions[355] who fail to do so would be subject to penalties[356].

Material advisors required to maintain lists of investors[357] who fail to do so (or who fail to provide such lists when requested by the Internal Revenue Service) would be subject to penalties[358].

In addition, the Internal Revenue Service may impose other penalties on persons involved in these transactions or substantially similar transactions, including –

- the accuracy-related penalties,[359]
- the penalty for promoting abusive tax shelters,[360] and
- the penalty for aiding and abetting understatement of a tax liability.[361]

Generally, in a Partnership Related-Party Basis Adjustment Transaction,

- partnership property is distributed to a partner who is related to one or more other partners, and
- that distribution results in a person related to the distributee partner, the distributee partner, or both,
- receiving all or a share of a basis increase in the distributed property or remaining partnership property under Section 732 or 734(b).

Alternatively,

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[351] Under section 6112(a).
[352] In accordance with I.R.C. § 6112(b).
[353] I.R.C. § 6708(a).
[354] Under Treas. Reg. § 1.6011-4.
[355] Under I.R.C. § 6111.
[356] Under I.R.C. § 6707.
[357] Under I.R.C. § 6112.
[358] Under I.R.C. § 6708(a)
[359] Under I.R.C. § 6662 or I.R.C. § 6662A.
[360] Under I.R.C. § 6700.
[361] Under I.R.C. § 6701.

- a partnership interest is transferred
    - between related persons or
    - to a transferee partner who is related to an existing partner in the partnership, and
- that transfer results in an increase to the inside basis in partnership property with respect to the transferee partner under Section 743(b).

The proposed Treasury Regulations include a relatedness requirement. The Proposed Treasury Regulations do not consider unrelate third-party transactions.

The proposed Treasury Regulations are subject to a $5 million minimum threshold requirement. The proposed Treasury Regulations do not apply at all to smaller transactions.

The proposed Treasury Regulations have a disclosure requirement for participants and materials advisors.

Participants required to disclose transactions who fail to do so are subject to penalties under Section 6707A.

Material advisers required to disclose transactions under Section 6111 who fail to do so are subject to penalties under Section 6707 [362] Material advisers required to maintain lists of

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[362] The Preamble to REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40, explains:

> II. Disclosure of Reportable Transactions by Material Advisors and Penalties for Failure To Disclose
>
> Section 6111(a) provides that each material advisor with respect to any reportable transaction must make a return setting forth: (1) information identifying and describing the transaction, (2) information describing any potential tax benefits expected to result from the transaction, and (3) such other information as the Secretary may prescribe. Such return must be filed not later than the date specified by the Secretary.
>
> Section 301.6111-3(a) of the Procedure and Administration Regulations (26 CFR part 301) provides that each material advisor with respect to any reportable transaction, as defined in § 1.6011-4(b), must file a return as described in § 301.6111-3(d) by the date described in § 301.6111-3(e).
>
> Section 301.6111-3(b)(1) provides that a person is a material advisor with respect to a transaction if the person provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in § 301.6111-3(b)(3) for the material aid, assistance, or advice. Under § 301.6111-3(b)(2)(i) and (ii), a person provides material aid, assistance, or advice if the person provides a tax statement, which is any statement (including another person's statement), oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction as defined in § 1.6011-4(b)(2) through (7).

investors[363] who fail to do so (or who fail to provide such lists when requested by the IRS) are subject to penalties[364].

Other penalties may all apply.[365] The Internal Revenue Service may impose other penalties on persons involved in reportable transactions or substantially similar transactions,

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Material advisors must disclose transactions on Form 8918, Material Advisor Disclosure Statement (or successor form), as provided in § 301.6111-3(d) and (e). Section 301.6111-3(e) provides that the material advisor's disclosure statement for a reportable transaction must be filed with the OTSA by the last day of the month that follows the end of the calendar quarter in which the advisor becomes a material advisor with respect to a reportable transaction or in which the circumstances necessitating an amended disclosure statement occur. A person may become a material advisor with respect to a transaction that is later identified as a transaction of interest. See § 301.6111-3(b)(4). The disclosure statement must be sent to the OTSA at the address provided in the instructions for Form 8918 (or successor form).

Section 301.6111-3(d)(2) provides that the IRS will issue to a material advisor a reportable transaction number with respect to the disclosed reportable transaction. Receipt of a reportable transaction number does not indicate that the disclosure statement is complete, nor does it indicate that the transaction has been reviewed, examined, or approved by the IRS. Material advisors must provide the reportable transaction number to all taxpayers for whom the material advisor acts as a material advisor as defined in § 301.6111-3(b). The reportable transaction number must be provided at the time the transaction is entered into, or if the transaction is entered into prior to the material advisor receiving the reportable transaction number, within 60 calendar days from the date the reportable transaction number is mailed to the material advisor.

Section 6707(a) of the Code provides that a material advisor who fails to file a timely disclosure, or files an incomplete or false disclosure statement, is subject to a penalty. Pursuant to section 6707(b)(1), the penalty for reportable transactions other than listed transactions, including transactions of interest, is $50,000.

Additionally, section 6112(a) of the Code provides that each material advisor with respect to any reportable transaction, whether or not required to file a return under section 6111 with respect to such transaction, must maintain a list (1) identifying each person with respect to whom such advisor acted as a material advisor with respect to such transaction and (2) containing such other information as the Secretary may by regulations require. Material advisors must furnish such lists to the IRS in accordance with § 301.6112-1(e).

A material advisor may be subject to a penalty under section 6708 of the Code for failing to maintain a list under section 6112(a) and failing to make the list available upon written request to the Secretary in accordance with section 6112(b) within 20 business days after the date of request. Section 6708(a) provides that the penalty is $10,000 per day for each day of the failure after the 20th day. However, no penalty will be imposed with respect to the failure on any day if such failure is due to reasonable cause.

[363] Under I.R.C. § 6112.

[364] Under I.R.C. § 6708(a).

[365] The Preamble to REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40, explains:

I. Disclosure of Reportable Transactions by Participants and Penalties for Failure To Disclose

Section 6011(a) generally provides that, if required by regulations prescribed by the Secretary of the Treasury or her delegate (Secretary), any person made liable for any tax imposed by the Code, or with respect to the collection thereof, must make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement must include therein the information required by such forms or regulations.

Section 1.6011-4(a) provides that every taxpayer that has participated in a reportable transaction within the meaning of § 1.6011-4(b) and who is required to file a tax return must file a disclosure statement within the time prescribed in § 1.6011-4(e). Reportable transactions are identified in § 1.6011-4 and include listed transactions, confidential transactions, transactions with contractual protection, loss transactions, and transactions of interest. See § 1.6011-4(b)(2) through (6). Section 1.6011-4(b)(6) defines a "transaction of interest" as a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

Section 1.6011-4(c)(4) provides that a transaction is "substantially similar" if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a transaction of interest even though it may involve different entities or use different Code provisions.

Section 1.6011-4(c)(3)(i)(E) provides that a taxpayer has participated in a transaction of interest if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the transaction of interest.

Section 1.6011-4(d) and (e) provide that the disclosure statement, Form 8886, Reportable Transaction Disclosure Statement (or successor form), must be attached to the taxpayer's tax return for each taxable year in which a taxpayer participates in a reportable transaction. A copy of the disclosure statement must be sent to the IRS's Office of Tax Shelter Analysis (OTSA) at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction.

Section 1.6011-4(e)(2)(i) provides that if a transaction becomes a transaction of interest after the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the transaction of interest and before the end of the period of limitations for assessment for any taxable year in which the taxpayer participated in the transaction of interest, then a disclosure statement must be filed with OTSA within 90 calendar days after the date on which the transaction becomes a transaction of interest. This requirement extends to an amended return and exists regardless of whether the taxpayer participated in the transaction in the year the transaction became a transaction of interest. The Commissioner of Internal Revenue (Commissioner) may also determine the time for disclosure of transactions of interest in the published guidance identifying the transaction.

Participants required to disclose these transactions under § 1.6011-4 who fail to do so are subject to penalties under section 6707A of the Code. Section 6707A(b) provides that the

including accuracy-related penalties,[366] the penalty for promoting abusive tax shelters,[367] and the penalty for aiding and abetting understatement of a tax liability.[368]

The proposed regulations[369] consider –

- partnership basis shifting transactions
- by related persons of partnerships
- to engage in transactions
- that "inappropriately exploit" the basis adjustment provisions of Subchapter K
- applicable to –
    - distributions of partnership property or
    - transfers of partnership interests.

These transactions are structured –

- to exploit mechanical basis adjustment provisions[370]
- to produce significant tax benefits
- with little or no economic impact on the related parties.

Proposed regulations address four variations of the transaction, which are referred to as "Partnership Related-Party Basis Adjustment Transactions."

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amount of the penalty is 75 percent of the decrease in tax shown on the return as a result of the reportable transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes), subject to minimum and maximum penalty amounts. The minimum penalty amount is $5,000 in the case of a natural person and $10,000 in any other case. For a transaction of interest, the maximum penalty amount is $10,000 in the case of a natural person and $50,000 in any other case.

Additional penalties may also apply. In general, section 6662A of the Code imposes a 20 percent accuracy-related penalty on any understatement (as defined in section 6662A(b)(1)) attributable to an adequately disclosed reportable transaction. If the taxpayer had a requirement to disclose participation in the reportable transaction but did not adequately disclose the transaction in accordance with the regulations under section 6011, the taxpayer is subject to an increased penalty rate equal to 30 percent of the understatement. See section 6662A(c). Section 6662A(b)(2) provides that section 6662A applies to any item which is attributable to any listed transaction and any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of Federal income tax.

[366] Under I.R.C. § 6662 or I.R.C. § 6662A.

[367] Under I.R.C. § 6700.

[368] Under I.R.C. § 6701.

[369] REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

[370] Of I.R.C. §§ 732(b), (d), 734(b), and 743(b).

These transactions rely on the basis adjustment provisions of Sections 732(b) and (d), 734(b), and 743(b).[371]

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[371] The preamble to REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40, explains:

> III. Basis Adjustments under Subchapter K
>
> A. In general
>
> Under Subchapter K of chapter 1 of the Code (Subchapter K), a distribution by a partnership of the partnership's property (partnership property) or a transfer of an interest in a partnership (partnership interest) may result in an adjustment to the basis of the distributed property, partnership property, or both.
>
> A distribution of partnership property may result in an adjustment to the basis of the distributed property under section 732(a), (b), or (d) of the Code. In the case of a distribution of partnership property to a partner by a partnership with an election under section 754 of the Code (section 754 election) in effect, or with respect to which there is a substantial basis reduction as described in section 734(d) of the Code, the distribution may also result in an adjustment to the basis of the partnership's remaining property (remaining partnership property) under section 734(b).
>
> If a partnership interest is transferred by sale or exchange or on the death of a partner, and the partnership either has a section 754 election in effect or has a substantial built-in loss with respect to the transfer of the partnership interest as described in section 743(d) of the Code, the transfer may result in an adjustment to the basis of partnership property under section 743(b) with respect to the transferee partner.
>
> I.R.C. § 754 provides that if a partnership makes an election in accordance with regulations prescribed by the Secretary, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided by section 734, and in the case of a transfer of a partnership interest, in the manner provided in section 743. Unless the election is revoked in accordance with the regulations under section 754, the section 754 election applies with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which the election was filed and all subsequent taxable years.
>
> B. Basis adjustments under section 732
>
> I.R.C. § 732 governs a distributee partner's basis in distributed property other than money. In the case of a current distribution, and except as provided under section 732(a)(2), section 732(a)(1) provides that the distributee partner's basis in distributed property (other than money) is equal to the partnership's adjusted basis in the distributed property immediately before the distribution. Under section 732(a)(2), however, a distributee partner's basis in distributed property is limited to the adjusted basis of the distributee partner's partnership interest reduced by any money distributed to such partner in the same transaction.
>
> In the case of a liquidating distribution, section 732(b) provides that the distributee partner's basis in distributed property (other than money) is equal to the adjusted basis of the distributee partner's partnership interest reduced by any money distributed to such partner in the same transaction.
>
> In the case of a distribution of more than one property from a partnership, the basis of the distributed properties to which section 732(a)(2) and (b) apply must be allocated among the distributed properties under the rules of section 732(c) and the regulations thereunder.

C. Basis adjustments under section 734

In the case of a distribution of property by a partnership with a section 754 election in effect, and for which either the distributee partner recognizes gain or loss on the distribution, or for which the basis of the distributed property in the distributee partner's hands, as determined under section 732, differs from the partnership's adjusted basis in the distributed property immediately before the distribution, section 734(b) requires the partnership to increase or decrease (as applicable) the basis of its remaining partnership property. Also, in the case of a distribution of property by a partnership that results in a substantial basis reduction under section 734(d), the basis of remaining partnership property must be adjusted under section 734(b), even if the partnership does not have a section 754 election in effect.

I.R.C. § 734(b)(1) requires a partnership to increase the basis of its remaining partnership property if a distribution of partnership property by the partnership results in the distributee partner recognizing gain under section 731(a)(1) of the Code, or if property (other than money) to which section 732(a)(2) or (b) applies is distributed to the distributee partner and the property's adjusted basis to the partnership immediately before the distribution is greater than the distributee partner's basis in the distributed property as determined under section 732. I.R.C. § 731(a)(1) requires a distributee partner to recognize gain in a current or liquidating distribution to the extent that any money distributed to that partner in the distribution exceeds the adjusted basis of that partner's partnership interest immediately before the distribution. The amount of the basis increase to the partnership's remaining property under section 734(b)(1) following a distribution of partnership property to a partner is equal to the amount of gain recognized by the distributee partner in the distribution under section 731(a)(1) and the excess of the partnership's adjusted basis in the distributed property immediately before the distribution over the distributee partner's basis in the distributed property as determined under section 732.

I.R.C. § 734(b)(2) requires a partnership to decrease the basis of its remaining property if a distribution of property by the partnership results in the distributee partner recognizing loss under section 731(a)(2), or if property (other than money) is distributed to the distributee partner in a distribution to which section 732(b) applies and the property's adjusted basis to the partnership immediately before the distribution is less than the distributee partner's basis in the distributed property as determined under section 732. Under section 731(a)(2), a distributee partner may recognize a loss in a liquidating distribution of that partner's interest in the partnership to the extent that such partner received only money, unrealized receivables described in section 751(c), or inventory items described in section 751(d) of the Code in the distribution. In such a case, the distributee partner is required to recognize a loss to the extent that such partner's adjusted basis in the partnership interest exceeds the sum of any money distributed to that partner in the distribution and the basis to the distributee partner (determined under section 732) of any unrealized receivables or inventory received by that partner in the distribution. The amount of the basis decrease to the partnership's remaining property under section 734(b)(2) following a distribution of partnership property to a partner is equal to the amount of loss recognized by the distributee partner in the distribution under section 731(a)(2) and the excess of the distributee partner's basis in the distributed property as determined under section 732 over the partnership's adjusted basis in the distributed property immediately before the distribution.

A partnership without a section 754 election in effect is subject to a mandatory basis adjustment under section 734(b)(2) if there is a substantial basis reduction with respect to a

distribution of partnership property. Under section 734(d), a substantial basis reduction with respect to a distribution of partnership property occurs if the sum of the amount of loss recognized to the distributee partner on the distribution, plus any increase in basis in the distributed property to the distributee partner under section 732(b), exceeds $250,000.

D. Basis adjustments under section 743(b)

Generally, if a partnership interest is transferred in a sale or exchange or on the death of a partner, the transferee partner's basis in the transferred partnership interest is determined under section 742 of the Code and the basis of partnership property is determined under section 743(a). I.R.C. § 742 provides that the transferee partner's basis in a partnership interest acquired other than by contribution is determined under part II of subchapter O of chapter 1 of the Code, beginning at section 1011 of the Code and following. Thus, for example, a transferee partner's basis in a partnership interest acquired by purchase generally is cost basis under section 1012 of the Code. I.R.C. § 743(a) provides that, in the case of a transfer of a partnership interest by sale or exchange or on the death of a partner, the basis of partnership property is not adjusted unless either the partnership has a section 754 election in effect or the partnership has a substantial built-in loss with respect to the transfer of the partnership interest.

Under section 743(b), in the case of a transfer of a partnership interest by sale or exchange or on the death of a partner, a partnership with a section 754 election in effect or that has a substantial built-in loss with respect to the transfer of the partnership interest must increase or decrease (as applicable) the adjusted basis of partnership property with respect to the transferee partner.

I.R.C. § 743(b)(1) provides that the adjusted basis of partnership property is increased by the excess of the transferee partner's basis in the transferred partnership interest over the transferee partner's proportionate share of the adjusted basis of partnership property.

I.R.C. § 743(b)(2) provides that the adjusted basis of partnership property is decreased by the excess of the transferee partner's proportionate share of the adjusted basis of partnership property over the transferee partner's basis in the transferred partnership interest.

A partnership without a section 754 election is subject to a mandatory basis adjustment under section 743(b) with respect to a transfer of a partnership interest if the partnership has a substantial built-in loss with respect to the transfer of the partnership interest. Under section 743(d)(1), a partnership has a substantial built-in loss with respect to a transfer of an interest in the partnership if either the partnership's adjusted basis in its property exceeds the fair market value of such property by more than $250,000, or the transferee partner would be allocated a loss of more than $250,000 if the partnership assets were sold for cash equal to their fair market value immediately after the transfer.

Under regulations prescribed by the Secretary, a basis adjustment under section 743(b) is an adjustment to the basis of partnership property with respect to the transferee partner only. The transferee partner's proportionate share of the partnership's adjusted basis in its property generally is determined in accordance with the transferee partner's interest in the partnership's previously taxed capital (including the transferee partner's share of partnership liabilities) under regulations prescribed by the Secretary.

In the case of a transferee partner who acquired all or part of its partnership interest by a transfer to which no section 754 election was in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within two years, section 732(d) and the regulations thereunder allow the partner to make an election to treat as

The proposed regulations are published pursuant to Section 7805(a), according to the preamble. The proposed regulations, in form at least, are interpretive regulations. This presumably means that the proposed regulations are not eligible for special deference. Whether the proposed regulations really are interpretive is a matter that could be debated. Some certainly could assert that the proposed regulations are extending and not merely interpreting legislation.

Section 7805(a) provides:

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the adjusted basis of the distributed property the adjusted basis such property would have if the adjustment under section 743(b) were in effect with respect to the partnership property.

Under §1.732-1(d)(4), the special basis adjustment under section 732(d) is required to apply to a distribution of property to a partner who acquired all or part of its interest by a transfer from a partnership without a section 754 election in effect for the taxable year of such transfer, whether or not the distribution is made within two years of such transfer, if at the time the partnership interest was transferred, (i) the fair market value of all partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership, (ii) an allocation of basis under section 732(c) upon a liquidation of the transferee partner's interest in the partnership immediately after the transfer of such interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization to property subject to such an allowance, and (iii) a basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

E. Allocation of basis adjustments under sections 734 and 743

I.R.C. § 734(c) states that a basis adjustment under section 734(b) is allocated among partnership properties under the rules of section 755 of the Code. I.R.C. § 743(c) states that a basis adjustment under section 743(b) is allocated among partnership properties under the rules of section 755.

I.R.C. § 755(a) generally requires basis adjustments under section 734(b) or section 743(b) to be allocated in a manner that has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties or in any other manner permitted by regulations. In addition, section 755(b) requires these basis adjustments to be allocated to partnership property of a like character or to subsequently acquired partnership property of a like character if such property is not available or has insufficient basis at the time of the basis adjustment (because a decrease in the adjusted basis of the property would reduce the basis of such property below zero). I.R.C. § 755(c) provides a special rule that prohibits allocating a basis decrease under section 734(b) to the stock of a corporation that is a partner of the partnership (or to any related partner in the partnership within the meaning of section 267(b) of the Code or section 707(b)(1) of the Code).

F. Common terminology for bases with respect to a partnership interest

A partner's adjusted basis in its partnership interest commonly is referred to as the partner's "outside basis" in its partnership interest. A partnership's adjusted basis in its property commonly is referred to as the "inside basis" of the partnership's property. Each partner has a share of inside basis. For ease of explanation, this terminology is used in part IV of this Background section.

Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.|")

(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.

(This is the classic formulation that normally results in an interpretive regulation.)

Generally, in a Partnership Related-Party Basis Adjustment Transaction,

- partnership property is distributed to a partner who is related to one or more other partners, and
- that distribution results in
- a person related to the distributee partner,[372]
- the distributee partner, or both,
- receiving all or a share of a basis increase in the distributed property or remaining partnership property.[373]

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[372] See letter dated November 15, 2024, from Alice G. Abreu, Chair, Section of Taxation, American Bar Association, to Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service, Re: Comments on Proposed Regulations under Section 6011, DOC 2024-33141, 2024 TNTF 222-13 (Nov. 15, 2024):

IV. Standard of Relatedness

A. Background on provisions

In determining relatedness, the Proposed TOI Regulations look to relationships described elsewhere in the Code41 that set a greater than 50% common ownership threshold. We expect that under attribution, a 50% threshold would classify far too many parties as "related" subjecting them to the Proposed TOI Regulations (and the Notice) unnecessarily. Given the administrative complexity of complying with the proposed rules, we believe that raising the common ownership threshold to something closer to 100% would cover the most abusive transactions without over-burdening routine business transactions with reporting. As discussed below, we propose increasing the common ownership level from 50% to at least 80% when defining related parties in these TOIs.

Further, as discussed below, the rules as outlined in the Proposed TOI Regulations and Notice do not appear to have any thresholds with respect to the relatedness of the partners to the partnership and could apply even where the related partners have a relatively small, combined ownership of the partnership. For example, a transaction entered into where the related partners combined own less than a 5% of a partnership (however that is defined) could subject the partnership, partner(s), and any subsequent transferee to the disclosure requirements outlined in the Proposed TOI Regulations. In this regard, the scope of the rules in the Proposed TOI Regulations appears overly broad.

[373] Under I.R.C. § 732 or I.R.C. § 734(b). The preamble to REG-124593-23, 89 FED. REG. 51476-51491, 2024-28 I.R.B. 40, advises:

IV. Partnership Related-Party Basis Adjustment Transactions

A. Overview

The Treasury Department and the IRS are aware of related persons using partnerships to engage in transactions that inappropriately exploit the basis adjustment provisions of Subchapter K applicable to distributions of partnership property or transfers of partnership interests discussed in part III of this Background section. This awareness results from the IRS's review of various partnership transactions involving related parties in which basis adjustments were created to artificially generate or regenerate Federal income tax benefits that resulted in significant tax savings without a corresponding economic outlay. These transactions were carefully structured to exploit the mechanical basis adjustment provisions of Subchapter K to produce significant tax benefits with little or no economic impact on the related parties, and in a manner that would not be a likely arrangement between partners negotiating at arm's-length.

Four variations of the transactions are referred to in this preamble as "Partnership Related-Party Basis Adjustment Transactions." The manner in which the transactions exploit the basis adjustment provisions of sections 732(b) and (d), 734(b), and 743(b), and the potential for tax abuse presented by the transactions are described in this part IV and part VI of this Background section.

Generally, in a Partnership Related-Party Basis Adjustment Transaction, partnership property is distributed to a partner who is related to one or more other partners, and that distribution results in a person related to the distributee partner, the distributee partner, or both, receiving all or a share of a basis increase in the distributed property or remaining partnership property under section 732 or 734(b) (as applicable); alternatively, a partnership interest is transferred between related persons or to a transferee partner who is related to an existing partner in the partnership, and that transfer results in an increase to the inside basis in partnership property with respect to the transferee partner under section 743(b).

Partnership Related-Party Basis Adjustment Transactions generally are structured so that, under the applicable allocation rules (sections 732(c), 734(c), 743(c), and 755), the basis increase is allocated to property that is eligible for cost recovery allowances (or eligible for a shorter cost recovery period) or that the partnership or the distributee partner disposes of in a taxable sale or exchange. Accordingly, the basis increase results in related partners decreasing their overall taxable income through additional or accelerated cost recovery allowances or decreasing their taxable gain or increasing their taxable loss on the subsequent taxable disposition of the property subject to the basis increase.

The related partners receive these tax benefits directly in the case of a distribution of property in which the basis of the distributed property is increased in the distributee partner's hands under section 732(b) or (d). They receive these benefits indirectly in the case of a transfer of a partnership interest in which the inside basis of partnership property is increased for the transferee partner under section 743(b) or in the case of a distribution of property that results in an increase to the common basis of partnership property under section 734(b). Whether the tax benefits are received directly or indirectly, the resulting decrease in taxable income or gain (or increase in taxable loss) benefits the related-party group as a whole. Further, because the partners are related, the distributions or transfers may have little or no effect on the overall economic ownership of the property yet produce significant tax benefits shared by the related partners.

A related partner's partnership interest must have certain characteristics to create the opportunity for a Partnership Related-Party Basis Adjustment Transaction. In general, these characteristics are (1) a partner's outside basis in its partnership interest that is low compared

to the partnership's basis in property it distributes to such partner, (2) a partner's outside basis in its partnership interest that is high compared to such partner's share of the partnership's basis in the partnership property (that is, the partner's share of inside basis), or (3) a partner's outside basis in its partnership interest that is high compared to the partnership's basis in property it distributes to such partner in liquidation of the partner's interest. Partnerships with related parties can create these characteristics through orchestrated contributions and distributions, as well as allocations under section 704(b) and (c). In most commercial transactions involving unrelated parties, the opportunity for abuse is limited because each party has separate, and often competing, economic and tax interests and the parties transact at arm's length. In contrast, for related parties, basis can be manipulated to provide a material net tax benefit to the related parties, as illustrated in part IV.B, C, D and E of this Background section.

B. Partnership Related-Party Basis Adjustment Transactions under section 734(b)

In a Partnership Related-Party Basis Adjustment Transaction under section 734(b), a partnership with a section 754 election in effect and two or more direct or indirect partners that are related to each other makes a current or liquidating distribution of partnership property to one or more of the related partners. Immediately before the distribution, the partnership's basis in the distributed partnership property exceeds the distributee partner's basis in its partnership interest (that is, the partnership distributes property with a relatively high inside basis to a distributee partner with a relatively low outside basis). Under section 732(a)(2) or (b), the low-outside basis partner takes a basis in the distributed property that is lower than the inside basis of the property immediately before the distribution.

As a result of the basis decrease to the distributed property in the hands of the distributee partner under section 732(a)(2) or (b), the partnership increases the basis of its remaining partnership properties under section 734(b) by an amount equal to the excess of the partnership's basis in the distributed property immediately before the distribution over the basis of the distributed property in the hands of the distributee partner immediately after the distribution.

As a result of the distribution, under sections 734(c) and 755, the partnership allocates the basis increase to its remaining partnership properties; these remaining partnership properties are eligible for cost recovery allowances or are disposed of by the partnership in a taxable sale or exchange. The partnership then claims increased cost recovery allowances or decreased taxable gain (or increased taxable loss) on the disposition of the partnership property with the increased basis.

Because the transaction occurs among related persons, any economic consequences inherent in distributing partnership property to a partner that will have to reduce the basis of the distributed property under section 732(a)(2) or (b) can be minimized. For example, the distributed property might be property that the distributee partner intends to hold indefinitely and that is not eligible for cost recovery allowances. Further, because the transaction occurs among related persons, the overall economic ownership of the property remains substantially the same as before the transaction.

Related parties may choose to structure a distribution of partnership property to a related partner so that gain is recognized, for example, by distributing cash or marketable securities. If the recognized gain is insignificant compared with the increase in basis obtained under section 734(b) or is offset because of a tax attribute of the distributee partner (such as

net operating losses), then the transfer may be considered a Partnership Related-Party Basis Adjustment Transaction under section 734(b).

C. Partnership Related-Party Basis Adjustment Transactions under section 743(b)

In a Partnership Related-Party Basis Adjustment Transaction under section 743(b), a partner transfers an interest in a partnership with a section 754 election in effect to a related transferee or a transferee that is related to one or more of the partners in a nonrecognition transaction within the meaning of section 7701(a)(45) of the Code, such as a transfer under section 351(a) or 721(a) of the Code. Because the transfer is accomplished through a nonrecognition transaction, the transferee's basis in the transferred partnership interest generally will be equal to the transferor partner's basis in the transferred partnership interest (that is, the transferred partnership interest will be substituted basis property within the meaning of section 7701(a)(42) of the Code, such as that provided under section 362(a) of the Code in the case of a transfer of property to a corporation in exchange for stock under section 351(a), or under section 722 of the Code in the case of a transfer of property to a partnership in exchange for a partnership interest under section 721(a)).

In order for the transfer to give rise to a basis increase under section 743(b)(1), the transferor partner must have an inside-outside basis disparity with respect to its partnership interest so that the transferor partner's basis in the partnership interest (that is, the transferor partner's outside basis that carries over to the transferee partner) is greater than the transferor partner's share of the partnership's basis in its properties (that is, the transferor partner's share of inside basis immediately prior to the transfer). Because a section 754 election is in effect for the taxable year of the transfer, section 743(b) requires a basis increase to eliminate the inside-outside basis disparity of the transferee partner. The basis increase under section 743(b)(1) is equal to the excess of the transferee partner's outside basis over its proportionate share of the inside basis.

As a result of the transfer, under sections 743(c) and 755, the partnership allocates the basis increase with respect to the transferee partner to its partnership properties; these properties are eligible for cost recovery allowances or are disposed of by the partnership in a taxable sale or exchange. The transferee partner then receives increased allocations of cost recovery allowances or lower allocations of taxable gain (or higher allocations of taxable loss) on the sale or exchange of the property by the partnership. Further, because the transaction occurs among related persons, the overall economic ownership of the partnership among the related partners remains the same as before the transaction.

Related parties may choose to structure a transfer of a partnership interest between a related transferor partner and related transferee so that gain is recognized. If the recognized gain is insignificant compared with the increase in basis obtained under section 743(b)(1) or is offset because of a tax attribute of the transferor (such as net operating losses), then the transfer may be considered a Partnership Related-Party Basis Adjustment Transaction under section 743(b).

D. Partnership Related-Party Basis Adjustment Transactions under section 732(b)

In a Partnership Related-Party Basis Adjustment Transaction under section 732(b), a partnership with two or more direct or indirect partners that are related makes a liquidating distribution of property to a related partner. Immediately before the distribution, the partnership's basis in the distributed property was relatively low and the distributee partner

had a relatively high outside basis. Under section 732(b), the distributee partner's basis in the distributed property is equal to the partner's outside basis. As a result, the distributed property's basis is increased by an amount equal to the excess of the distributee partner's outside basis over the partnership's basis in the distributed property. As part of the transaction, under section 732(b) and (c), the distributee partner allocates the basis increase to its distributed property; this property is eligible for cost recovery allowances or is property that the distributee partner disposes of in a taxable sale or exchange. Accordingly, the distributee partner receives increased cost recovery allowances or decreases its taxable gain (or increases taxable loss) on the disposition of the distributed property.

Because the transaction occurs among related parties, any economic consequences inherent in distributing partnership property that may result in tax benefits to the distributee, potentially at the expense of the remaining partners, is minimized. Further, because the transaction occurs among related persons, the overall economic ownership of the property among the related partners remains the same as before the transaction.

As a result of the basis increase to the distributed property, the partnership may be required to decrease the basis of one or more of its remaining properties under the elective or mandatory basis adjustment provisions of section 734(b)(2) or (d). The parties may plan the transaction so that this reduction in basis will not have an adverse tax effect on the related parties because the partnership can allocate the basis reduction to property the partnership intends to hold indefinitely and that is not eligible for cost recovery allowances.

The related parties may achieve similar results through a transaction in which the partnership is liquidated. In a Partnership Related-Party Basis Adjustment Transaction in which a partnership makes liquidating distributions to all partners, a partner with a high outside basis (distributee partner) receives a liquidating distribution of low-inside basis property that is eligible for cost recovery allowances or that the distributee partner disposes of in a taxable sale or exchange. The partnership also distributes property to one or more parties related to the distributee partner (related distributee partner(s)), and such distribution may require a reduction to the basis of property under section 732(b) because the related distributee partner's basis in the partnership interest at the time of liquidation may be low compared to the partnership's basis in the distributed property. Similar to the version of the transaction in which only the distributee partner's partnership interest is liquidated, the property that is subject to reduction in basis as a result of the liquidation may be property that the related distributee partner(s) intend to hold indefinitely and that is not eligible for cost recovery allowances.

E. Partnership Related-Party Basis Adjustment Transactions under section 732(d)

In a Partnership Related-Party Basis Adjustment Transaction under section 732(d), a partnership with two or more direct or indirect partners that are related makes a current or liquidating distribution of property to a related partner. Prior to the distribution, the related partner acquired all or part of its partnership interest in a transaction that would have been a Partnership Related Party Basis Adjustment Transaction under section 743(b) if the partnership had a section 754 election in effect.

The subsequent property distribution to the related transferee partner is made within two years of the transfer (in the case of an elective basis adjustment under section 732(d)) or at any time after the transfer if at the time of the transfer the fair market value of the partnership's property (other than money) exceeded 110 percent of the property's adjusted

Alternatively, a partnership interest –

- is transferred –
  - between related persons or
  - to a transferee partner who is related to an existing partner in the partnership, and
- that transfer results in an increase to the inside basis in partnership property
- with respect to the transferee partner under Section 743(b).

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basis to the partnership (in the case of a mandatory basis under section 732(d)). In either case, under section 732(d), for purposes of section 732(a), (b), and (c), the adjusted partnership basis of the distributed property is treated as equal to the adjusted basis the property would have had if the basis adjustment under section 743(b) were in effect at the time of the transfer.

As part of the transaction, the related distributee partner receives property with a higher basis than the property had before the transaction and either the property is eligible for cost recovery allowances or the distributee partner recovers the property's basis by disposing of it in a taxable sale or exchange.

Similar to a Partnership Related-Party Basis Adjustment Transaction under section 732(b), because the transaction occurs among related parties, any economic consequences inherent in distributing partnership property to a partner that, as a result of the distribution, will receive tax benefits is lessened or eliminated. Further, because the transaction occurs among related persons, the economic ownership of the property remains essentially the same as before the transaction.

V. Tax-Indifferent Parties involved in Partnership Basis Adjustment Transactions

The Treasury Department and the IRS are aware that persons using partnerships that include tax-indifferent parties as partners may undertake transactions that accomplish the same results as the Partnership Related-Party Basis Adjustment Transactions. These transactions may take the form of any of the variations of the transactions described in part IV of this Background section and produce the same tax benefits for the taxable partners, except that the partners may not be related and negative tax consequences resulting from the transactions are borne by the tax-indifferent party. For example, a partnership with a section 754 election in effect and unrelated partners, one of which is a tax-indifferent party with a low outside basis, may distribute high-basis nondepreciable property to the tax-indifferent party. Under section 732(a)(2) or (b), the distribution results in the tax-indifferent party taking a basis in the distributed property that is lower than the partnership's basis in the property immediately before the distribution. Under section 734(b), the partnership must adjust the basis of its remaining property and, as part of the transaction under sections 734(c) and 755, it increases the basis of depreciable property. Since the distributee partner is a tax-indifferent party, it does not experience any negative tax consequences from receiving property subject to a basis decrease as a result of the distribution. At the same time, the partners that are not tax-indifferent receive the tax benefit of increased cost recovery allowances through the partnership.

Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

Proposed Treasury Regulations Section 1.6011-18(a)[374] identifies transactions that are the same as or substantially similar to transactions described in proposed Treasury Regulations Section 1.6011-18(c)[375] as transactions of interest for the purposes of Section 1.6011-4(b)(6).[376]

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[374] Prop. Treas. Reg. § 1.6011-18(a) ("(a) Identification as transaction of interest. Transactions that are the same as or substantially similar (within the meaning of §1.6011-4(c)(4)) to the transactions described in paragraph (c) of this section are identified as transactions of interest for purposes of §1.6011-4(b)(6). Transactions that are substantially similar (within the meaning of §1.6011-4(c)(4)) to the transactions described in paragraph (c) of this section include, but are not limited to, transactions described in paragraph (d) of this section.").

[375] Prop. Treas. Reg. § 1.6011-18(c) ("(c) Transaction description. A transaction is described in this paragraph (c) if the factual elements of the transaction described in paragraph (c)(1)(i) through (iii) or (c)(2) of this section are met. (1) Distributions by partnership. A partnership engages in any of the transactions described in paragraphs (c)(1)(i) through (iii) of this section with one or more of the related partners: (i) The partnership distributes property to a person who is a related partner in a current or liquidating distribution, the partnership increases the basis of one or more of its remaining properties under section 734(b) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (ii) The partnership distributes property to a person who is a related partner in liquidation of the person's partnership interest (or in complete liquidation of the partnership), the basis of one or more distributed properties is increased under section 732(b) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (iii) The partnership distributes property to a person who is a related partner, the basis of one or more distributed properties is increased under section 732(d) of the Code, the related partner acquired all or a part of its interest in the partnership in a transaction that would have been a transaction described in paragraph (c)(2) of this section if the partnership had a section 754 election in effect for the year of transfer, and the $5 million threshold described in paragraph (c)(3) of this section is met. (2) Transfer of partnership interest. A partner transfers an interest in a partnership to a related partner in a nonrecognition transaction, the basis of one or more partnership properties is increased under section 743(b)(1) and (c) of the Code, and the $5 million threshold described in paragraph (c)(3) of this section is met. (3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.").

[376] See Treas. Reg. § 1.752-5(b)(1). Treas. Reg. § 1.6011-4(a), (b) ("(a) In general. Every taxpayer that has participated, as described in paragraph (c)(3) of this section, in a reportable transaction within the meaning of paragraph (b) of this section and who is required to file a tax return must file within the time prescribed in paragraph (e) of this section a disclosure statement in the form prescribed by paragraph (d) of this section. The fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer's treatment of the transaction is proper. (b) Reportable transactions. (1) In general. A reportable transaction is a transaction described in any of

the paragraphs (b)(2) through (7) of this section. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan. (2) Listed transactions. A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction. (3) Confidential transactions. (i) In general. A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee. (ii) Conditions of confidentiality. A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction. (iii) Minimum fee. For purposes of this paragraph (b)(3), the minimum fee is (A) $250,000 for a transaction if the taxpayer is a corporation; (B) $50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is $250,000. (iv) Determination of minimum fee. For purposes of this paragraph (b)(3), in determining the minimum fee, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of the facts and circumstances. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the facts and circumstances in determining whether consideration received in connection with a confidential transaction constitutes fees. (v) Related parties. For purposes of this paragraph (b)(3), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person. (4) Transactions with contractual protection. (i) In general. A transaction with contractual protection is a transaction for which the taxpayer or a related party (as described in section 267(b) or 707(b)) has the right to a full or partial refund of fees (as described in paragraph (b)(4)(ii) of this section) if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual protection also is a transaction for which fees (as described in paragraph (b)(4)(ii) of this section) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation. (ii) Fees. Paragraph (b)(4)(i) of this section only applies with respect to fees paid by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a

Proposed Treasury Regulations Section 1.6011-18(c) transactions include:

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statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction. (iii) Exceptions. (A) Termination of transaction. A transaction is not considered to have contractual protection solely because a party to the transaction has the right to terminate the transaction upon the happening of an event affecting the taxation of one or more parties to the transaction. (B) Previously reported transaction. If a person makes or provides a statement to a taxpayer as to the potential tax consequences that may result from a transaction only after the taxpayer has entered into the transaction and reported the consequences of the transaction on a filed tax return, and the person has not previously received fees from the taxpayer relating to the transaction, then any refundable or contingent fees are not taken into account in determining whether the transaction has contractual protection. This paragraph (b)(4) does not provide any substantive rules regarding when a person may charge refundable or contingent fees with respect to a transaction. See Circular 230, 31 CFR Part 10, for the regulations governing practice before the IRS. (5) Loss transactions. (i) In general. A loss transaction is any transaction resulting in the taxpayer claiming a loss under section 165 of at least (A) $10 million in any single taxable year or $20 million in any combination of taxable years for corporations; (B) $10 million in any single taxable year or $20 million in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners; or (C) $2 million in any single taxable year or $4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners; (D) $2 million in any single taxable year or $4 million in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or (E) $50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in section 988(c)(1) relating to foreign currency transactions). (ii) Cumulative losses. In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years as described in paragraph (b)(5)(i) of this section, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined. (iii) I.R.C. § 165 loss. (A) For purposes of this section, in determining the thresholds in paragraph (b)(5)(i) of this section, the amount of a section 165 loss is adjusted for any salvage value and for any insurance or other compensation received. See § 1.165-1(c)(4). However, a section 165 loss does not take into account offsetting gains, or other income or limitations. For example, a section 165 loss does not take into account the limitation in section 165(d) (relating to wagering losses) or the limitations in sections 165(f), 1211, and 1212 (relating to capital losses). The full amount of a section 165 loss is taken into account for the year in which the loss is sustained, regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or a net capital loss under section 1212 that is a carryback or carryover to another year. A section 165 loss does not include any portion of a loss, attributable to a capital loss carryback or carryover from another year, that is treated as a deemed capital loss under section 1212. (B) For purposes of this section, a section 165 loss includes an amount deductible pursuant to a provision that treats a transaction as a sale or other disposition, or otherwise results in a deduction under section 165. A section 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under section 741 and a loss resulting from a section 988 transaction. (6) Transactions of interest. A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.").

- a relatedness requirement[377] and
- a $5 million minimum threshold requirement.[378]

Proposed Treasury Regulations Section 1.6011-18(a) identifies transactions that are "substantially similar" to the transactions described in proposed Treasury Regulations Section 1.6011-18(c) as including the transactions described in proposed Treasury Regulations Section 1.6011-18(d).[379]

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[377] Prop. Treas. Reg. § 1.6011-18(b)(8) ("(8) Related means having a relationship described in section 267(b) of the Code (without regard to section 267(c)(3)) or section 707(b)(1) of the Code.")

[378] Prop. Treas. Reg. § 1.6011-18(c)(3) ("(3) $5 million threshold. For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2) of this section, the $5 million threshold is met for a taxable year if the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis) exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions.").

[379] Prop. Treas. Reg. § 1.6011-18(a) ("§1.6011-18 Certain partnership related-party basis adjustment transactions as transactions of interest. (a) Identification as transaction of interest. Transactions that are the same as or substantially similar (within the meaning of §1.6011-4(c)(4)) to the transactions described in paragraph (c) of this section are identified as transactions of interest for purposes of §1.6011-4(b)(6). Transactions that are substantially similar (within the meaning of §1.6011-4(c)(4)) to the transactions described in paragraph (c) of this section include, but are not limited to, transactions described in paragraph (d) of this section."); Prop. Treas. Reg. § 1.6011-4(c)(4) ("(4) Substantially similar. The term substantially similar includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a listed transaction even though it involves different entities or uses different Internal Revenue Code provisions. (See for example, Notice 2003-54 (2003-2 CB 363), describing a transaction substantially similar to the transactions in Notice 2002-50 (2002-2 CB 98), and Notice 2002-65 (2002-2 CB 690).) The following examples illustrate situations where a transaction is the same as or substantially similar to a listed transaction under paragraph (b)(2) of this section. (Such transactions may also be reportable transactions under paragraphs (b)(3) through (7) of this section.) See § 601.601(d)(2)(ii)(b) of this chapter. The following examples illustrate the provisions of this paragraph (c)(4): Example 1. Notice 2000-44 (2000-2 CB 255) (see § 601.601(d)(2)(ii)(b) of this chapter), sets forth a listed transaction involving offsetting options transferred to a partnership where the taxpayer claims basis in the partnership for the cost of the purchased options but does not adjust basis under section 752 as a result of the partnership's assumption of the taxpayer's obligation with respect to the options. Transactions using short sales, futures, derivatives or any other type of offsetting obligations to inflate basis in a partnership interest would be the same as or substantially similar to the transaction described in Notice 2000-44. Moreover, use of the inflated basis in the partnership interest to diminish gain that

A basis adjustment transaction under proposed Section 1.6011-18(c)(1)(ii) occurs when –

- a partnership distributes property to a partner who is related to one or more partners in liquidation of a partnership interest (or in complete liquidation of the partnership),
- the basis of one or more distributed properties is increased under Section 732(b) and (c), and
- the $5 million threshold under proposed Section 1.6011-18(c)(3) is met.

A basis adjustment transaction under proposed Treasury Regulations Section 1.6011-18(c)(1)(iii) occurs when –

- a partnership distributes property to a partner who is related to one or more partners,
- the basis of one or more distributed properties is increased under Section 732(d),
- the related partner –
  - acquires all or a part of its interest in the partnership

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would otherwise be recognized on the transfer of a partnership asset would also be the same as or substantially similar to the transaction described in Notice 2000-44. See § 601.601(d)(2)(ii)(b). Example 2. Notice 2001-16 (2001-1 CB 730) (see § 601.601(d)(2)(ii)(b) of this chapter), sets forth a listed transaction involving a seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and a buyer (Y) who desires to purchase the assets (and not the stock) of T. M agrees to facilitate the sale to prevent the recognition of the gain that T would otherwise report. Notice 2001-16 describes M as a member of a consolidated group that has a loss within the group or as a party not subject to tax. Transactions utilizing different intermediaries to prevent the recognition of gain would be the same as or substantially similar to the transaction described in Notice 2001-16. An example is a transaction in which M is a corporation that does not file a consolidated return but which buys T stock, liquidates T, sells assets of T to Y, and offsets the gain on the sale of those assets with currently generated losses. See § 601.601(d)(2)(ii)(b)."); Prop. Treas. Reg. § 1.6011-18(d) ("(d) Substantially similar transaction. A transaction that is substantially similar (within the meaning of §1.6011-4(c)(4)) to a transaction described in paragraph (c) of this section includes, but is not limited to: (1) A transaction that is described in paragraph (c) of this section except that the partners of the partnership are not related and one or more partners of the partnership is a tax-indifferent party that facilitates, by receiving a distribution of property from the partnership or otherwise, an increase in the basis of partnership property or an increase in the basis of property held by another partner in the partnership; and (2) A transaction in which a partner transfers an interest in a partnership to a related partner in a recognition transaction, and the $5 million threshold described in paragraph (c)(3) of this section is met.").

- in a transaction that would have been a transaction described in proposed Treasury Regulations Section 1.6011-18(c)(2)

  if

  - the partnership had a Section 754 election in effect for the year of transfer, and

- the $5 million threshold under proposed Treasury Regulations Section 1.6011-18(c)(3) is met.

A basis adjustment transaction under proposed Treasury Regulations Section 1.6011-18(c)(2) occurs when –

- a partner transfers an interest in the partnership to a related transferee or to a person who is related to one or more existing partners
- in a nonrecognition transaction, the basis of one or more partnership properties is increased under Section 743(b)(1) and (c), and the $5 million threshold under proposed Treasury Regulations Section 1.6011-18(c)(3) is met

If a basis adjustment transaction is described in proposed Treasury Regulations Section 1.6011-18(c)(1)(i) through (iii) or (c)(2),

- any basis adjustments to recoverable property must be reported
  - in the taxable year of the basis adjustment transaction,
  - in each taxable year there is a cost recovery allowance, and
  - in the taxable year the recoverable property is disposed of in a transaction in which gain or loss is recognized in whole or in part
- any basis adjustments to other property must be reported
  - in the taxable year of the basis adjustment transaction and
  - in the taxable year in which the other property is disposed of in a transaction in which gain or loss is recognized in whole or in part.

The proposed regulations address –

- distributions by a partnership and
- transfers of a partnership interest.

The reporting obligations of the proposed regulations apply when a partnership engages in any of the transactions described in paragraphs (c)(1)(i) through (iii).

A transaction is described in paragraph (c)(1)(i) –

if

- the partnership distributes property
- to a person who is a related partner
- in a current or liquidating distribution,
- the partnership increases the basis of one or more of its remaining properties under Section 734(b) and (c), and
- the $5 million threshold is met.

[i] Example of Partnership Related-Party Basis Adjustment Transaction under Proposed Section 1.6011-18(c)(1)(i).

Example 1. A Partnership Related-Party Basis Adjustment Transaction under proposed Section 1.6011-18(c)(1)(i).

XY Partnership is owned by partners X and Y.

The partners are related to each other within the meaning of proposed Section 1.6011-18(b)(8) and (b)(9)(i).

Each partner directly owns 50 percent of the capital and profits interests in XY Partnership and shares losses equally.

X has an outside basis of $10 million, and Y has an outside basis of $1 million.

Partner	Percentage Interest	Outside Basis
X	50%	$10 million
Y	50%	$1 million
Total	100%	$11 million

XY Partnership owns property it uses in its trade or business, including Property 1 and Property 2.

For Federal income tax purposes, Property 1 is depreciable property and Property 2 is nondepreciable property.

XY Partnership has an adjusted basis in Property 1 of zero, and an adjusted basis in Property 2 of $10 million.

Property	Type	Partnership Adjusted Basis
Property 1	Depreciable	$0
Property 2	Nondepreciable	$10 million
Total		$10 million

XY Partnership has a Section 754 election in effect for the taxable year and makes a current distribution of Property 2 to Y.

Y's basis in distributed Property 2 is limited to Y's adjusted basis in its partnership interest of $1 million.[380]

As a result of the distribution to Y,

- Property 2's adjusted basis is decreased from
  - $10 million immediately before the distribution to
  - $1 million in Y's hands.

XY Partnership must increase the basis of its remaining property.[381]

The amount of the basis increase is equal to the excess of XY Partnership's basis in Property 2 immediately before the distribution of $10 million over Y's adjusted basis in Property 2 after the distribution of $1 million, which results in an increase to the basis of XY Partnership's remaining property of $9 million.

Under Sections 734(c) and 755 and the regulations thereunder, XY Partnership allocates the basis increase of $9 million to Property 1. As a result, XY Partnership claims depreciation deductions based on an increased basis in Property 1.

A transaction is described in paragraph (c)(1)(ii)

if

- the partnership distributes property
- to a person who is a related partner
- in liquidation of the person's partnership interest (or in complete liquidation of the partnership),
- the basis of one or more distributed properties is increased under Section 732(b) and (c), and

[380] Under I.R.C. § 732(a)(2).
[381] Under I.R.C. § 734(b).

- the $5 million threshold is met.

A transaction is described in paragraph (c)(1)(iii)

if

- the partnership distributes property
- to a person who is a related partner,
- the basis of one or more distributed properties is increased under Section 732(d),
- the related partner acquired all or a part of its interest in the partnership in a transaction that would have been a transaction described in paragraph (c)(2) if the partnership had a Section 754 election in effect for the year of transfer, and
- the $5 million threshold is met.

The proposed regulations provide this analysis of Example 1:

- Partner A is a participant[382] during taxable year 1

  because

  - it is a participating partner within the meaning of paragraph (b)(3)

  since

  - it directly received a distribution of property during taxable year 1 in a transaction described in paragraph (c).

- ABC Partnership is a participant during taxable year 1 within the meaning of paragraph (e)

because

- it is a participating partnership within the meaning of paragraph (b)(4)

since

- it made a distribution of property to a participating partner during taxable year 1 in a transaction described in paragraph (c) .
- As part of its disclosure requirements under paragraph (f) and Section 1.6011-4(d) and (e), Partner A must disclose the distribution as a transaction of interest under this Section on Form 8886 (or successor form) and file the form with its tax return for taxable year 1.

[382] Within the meaning of Prop. Treas. Reg. § 1.6011-18(e) ("(e) Participation — (1) In general. Whether a taxpayer has participated in a transaction of interest described in paragraph (c) of this section during a taxable year is determined under this paragraph (e).").

- Partner A must include the information described in paragraph (f), including the amount of the deductions attributable to the $5 million increase in the basis of Property X resulting from the transaction described in paragraph (c)(1)(ii) .
- As part of its disclosure requirements under paragraph (f) and Section 1.6011-4(d) and (e), ABC Partnership must disclose the distribution as a transaction of interest under this Section on Form 8886 (or successor form) and file the form with its tax return for taxable year 1, including the information described in paragraph (f) .
- In addition, Partner A and ABC Partnership must send a copy of their respective Form 8886 (or successor form) to OTSA.

[ii] Example Of A Partnership Related-Party Basis Adjustment Transaction Under Proposed Treasury Regulations 1.6011-18(C)(1)(ii).

Example 2. A Partnership Related-Party Basis Adjustment Transaction under proposed Treasury Regulations 1.6011-18(c)(1)(ii).

DEF Partnership is owned by partners D, E and F. The partners are related to each other within the meaning of proposed Section 1.6011-18(b)(8) and (b)(9)(i).

D's outside basis is $7 million.

E and F each have an outside basis of $1 million.

DEF Partnership owns only two properties, Property 1 and Property 2, both of which it uses in its trade or business.

For Federal income tax purposes,

- Property 1 is depreciable property and
- Property 2 is nondepreciable property.

DEF Partnership has an adjusted basis in Property 1 of zero, and an adjusted basis in Property 2 is $9 million.

Property	**Type**	**Partnership Adjusted Basis**
Property 1	Depreciable property	$0
Property 2	Nondepreciable property	$9 million
Total		$10 million

DEF Partnership distributes Property 1 to D in liquidation of D's partnership interest.

D's basis in distributed Property 1 is equal to $7 million.[383] As a result, D claims depreciation deductions based on a $7 million basis in Property 1.

A transaction is described in paragraph (c)(1)(iii)

if

- a partner transfers an interest in a partnership
- to a related partner
- in a nonrecognition transaction,
- the basis of one or more partnership properties is increased under Section 743(b)(1) and (c), and
- the $5 million threshold is met.

The $5 million threshold is met for a taxable year

if

- the sum of all basis increases resulting from all such transactions of a partnership or partner during the taxable year (without netting for any basis adjustment in the same transaction or another transaction that reduces basis)

exceeds by at least $5 million

- the gain recognized from such transactions, if any,
- on which tax imposed under subtitle A
  - is required to be paid
  - by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2))
  - to the transactions.

[iii] Example Of A Partnership Related-Party Basis Adjustment Transaction Under Proposed Section 1.6011-18(C)(1)(iii).

Example 3. A Partnership Related-Party Basis Adjustment Transaction under proposed Section 1.6011-18(c)(1)(iii).

XYZ Partnership is owned by partners X, Y and Z.

The partners are related to each other within the meaning of proposed Section 1.6011-18(b)(8) and (b)(9)(i).

[383] Under I.R.C. § 732(b).

Each partner directly owns one-third of the capital and profits interests in XYZ Partnership and shares losses equally.

XYZ Partnership owns Property 1, Property 2, and Property 3.

Property 1 is depreciable property. XYZ Partnership's adjusted basis in Property 1 is zero.

Property 2 and Property 3 are nondepreciable property.

Property	Type	Partnership Adjusted Basis
Property 1	Depreciable property	$0
Property 2	Nondepreciable property	Unknown
Property 3	Nondepreciable property	Unknown

X acquired its interest in XYZ Partnership in a nonrecognition transaction from a person related to X within the meaning of proposed Section 1.6011-18(b)(8).

At the time of the transfer, XYZ Partnership did not have a Section 754 election in effect.

Immediately after the transfer, X's outside basis was $12 million and share of inside basis was $2 million.

If XYZ Partnership had a Section 754 election in effect at the time of the transfer, XYZ Partnership would have adjusted X's share of inside basis under Section 743(b).

Assume that the adjustment under Section 743(b) would have resulted in a basis increase to Property 1 of $10 million.

In a taxable year that is within two years of the transfer of the partnership interest to X, XYZ Partnership makes a current distribution of Property 1 to X.

X's adjusted basis in Property 1 is zero.[384]

X makes an election under Section 732(d) to adjust the basis of Property 1 to the adjusted basis it would have if the adjustment under Section 743(b) were in effect with respect to the partnership property at the time X acquired its interest.

As a result of the election under 732(d), because the adjusted basis of Property 1 under Section 743(b) with respect to X would have been increased by $10 million, X

- takes a basis in Property 1 equal to $10 million and
- claims depreciation deductions based on a $10 million basis in Property 1.

[384] Under I.R.C. § 732(a)(1).

A transaction is described in paragraph (c)(1)(ii)

if

- a partner transfers an interest in a partnership
- to a related partner
- in a nonrecognition transaction,
- the basis of one or more partnership properties is increased under Section 743(b)(1) and (c) of the Code, and
- the $5 million threshold described in paragraph (c)(3) is met.

[iv] Example Of A Partnership Related-Party Basis Adjustment Transaction Under Proposed Treasury Regulations Section 1.6011-18(C)(2).

Example 4. A Partnership Related-Party Basis Adjustment Transaction under proposed Treasury Regulations Section 1.6011-18(c)(2).

AB Partnership is owned by partners A and B.

A owns 95 percent of the capital and profits interests in AB Partnership and is allocated 95 percent of all losses.

B owns 5 percent of the capital and profits interests in AB Partnership and is allocated 5 percent of all losses.

A's outside basis is $6 million and share of inside basis is $1 million.

Partner	Percentage Interest	Outside Basis	Inside Basis
A	95%	$6 million	$1 million
B	5%		
Total	$100%	$6 million	$1 million

AB Partnership owns depreciable property it uses in a trade or business.

In a taxable year in which AB Partnership has a Section 754 election in effect,

- A transfers its entire partnership interest to C, a person related to A within the meaning of proposed Section 1.6011-18(b)(8) and (b)(9)(ii),
- in a nonrecognition transaction in which no gain was recognized.

AB Partnership increases the basis of the partnership property with respect to C by $5 million

because

- AB Partnership has a Section 754 election in effect for the taxable year of the transfer.[385]

Assume that under Sections 743(c) and 755, the basis increase with respect to C of $5 million is allocated to partnership property that is depreciable.

As a result, C may be allocated depreciation deductions over the recovery periods of the partnership properties equal to the amount of the basis increase under Section 743(b)(1).

For the purpose of determining whether a transaction is described in paragraph (c)(1), (c)(2), (d)(1), or (d)(2), the $5 million threshold is met for a taxable year

if

- the sum of –
  - all basis increases (without netting for any basis adjustment in the same transaction or another transaction that reduces basis)
  - resulting from all such transactions
  - of a partnership or partner during the taxable year

exceeds by at least $5 million

- the gain recognized from such transactions, if any,
  - on which tax imposed under subtitle A is required to be paid
  - by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2)) to such transactions.

Transactions that are ***the same as or substantially similar to*** the transactions described in paragraph (c) (see above) are identified as transactions of interest.[386] This potentially dramatically expands the scope of transactions of interest.

Transactions that are ***substantially similar*** to the transactions described in paragraph (c) include, but are not limited to, transactions described in paragraph (d).

A transaction that is ***substantially similar*** to a transaction described in paragraph (c) includes, but is not limited to:

- A transaction that is described in paragraph (c) except that:
  - the partners of the partnership are not related and

[385] Under I.R.C. § 743(b)(1).

[386] For purposes of Treas. Reg. § 1.6011-4(b)(6).

- one or more partners of the partnership is a tax-indifferent party[387] that
  - facilitates,
  - by receiving a distribution of property from the partnership or otherwise,
  - an increase in the basis of partnership property or an increase in the basis of property held by another partner in the partnership; and
- A transaction in which a partner transfers an interest in a partnership to a related partner in a recognition transaction, and the $5 million threshold described in paragraph (c)(3) is met.

Participants must provide the information required under Section 1.6011-4(d) and the Instructions to Form 8886, Reportable Transaction Disclosure Statement (or successor form) for each taxable year in which the participant participated in a transaction described in paragraph (c)as determined under paragraph (e).

For all participants, describing the transaction in sufficient detail includes describing the information described in paragraphs (f)(1)(i) through (iii), as applicable,

[387] Prop. Treas. Reg. § 1.6011-18 ("(11) Tax-indifferent party means a person that is either not liable for Federal income tax because of its tax-exempt or, in certain cases, foreign status or to which gain from a transaction described in paragraph (c) of this section would not result in Federal income tax liability for the person's taxable year within which such gain is recognized."). The preamble comments:

V. Tax-Indifferent Parties involved in Partnership Basis Adjustment Transactions

The Treasury Department and the IRS are aware that persons using partnerships that include tax-indifferent parties as partners may undertake transactions that accomplish the same results as the Partnership Related-Party Basis Adjustment Transactions. These transactions may take the form of any of the variations of the transactions described in part IV of this Background section and produce the same tax benefits for the taxable partners, except that the partners may not be related and negative tax consequences resulting from the transactions are borne by the tax-indifferent party. For example, a partnership with a section 754 election in effect and unrelated partners, one of which is a tax-indifferent party with a low outside basis, may distribute high-basis nondepreciable property to the tax-indifferent party. Under section 732(a)(2) or (b), the distribution results in the tax-indifferent party taking a basis in the distributed property that is lower than the partnership's basis in the property immediately before the distribution. Under section 734(b), the partnership must adjust the basis of its remaining property and, as part of the transaction under sections 734(c) and 755, it increases the basis of depreciable property. Since the distributee partner is a tax-indifferent party, it does not experience any negative tax consequences from receiving property subject to a basis decrease as a result of the distribution. At the same time, the partners that are not tax-indifferent receive the tax benefit of increased cost recovery allowances through the partnership.

Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

on Form 8886 (or successor form) for the taxable year of a transaction described in paragraph (c). This description includes:

- The names and identifying numbers of all participants, including
  - the participating partnership,
  - participating partners and
  - any related subsequent transferees or tax-indifferent parties.
- All basis adjustments resulting from a transaction described in paragraph (c), and basis information, including
  - the participating partnership's adjusted basis in the distributed property immediately before the distribution,
  - any adjustments to basis under Section 732(a)(2), (b), (d) or 734(b),
  - any adjustments to basis under Section 743(b) with respect to a participating partner that is transferred an interest in a participating partnership, and
  - with respect to a participating partner that transfers an interest in a participating partnership,
    - that participating partner's adjusted basis in the participating partnership interest and
    - share of the participating partnership's adjusted basis in its property immediately before the transfer.
- Any Federal income tax consequences realized during the taxable year, as a result of a transaction described in paragraph (c), including
  - cost recovery allowances attributable to an increase in basis as a result of a transaction described in paragraph (c), and
  - taxable gain or taxable loss attributable to the disposition of property that was subject to an increase in basis as a result of a transaction described in paragraph (c).

For example, in the case of a distribution of depreciable property that was subject to an increase in basis as a result of a transaction described in paragraph (c),

- the Federal income tax consequences realized during the taxable year include
  - the basis increase and
  - cost recovery allowances attributable to the basis increase during the taxable year.

If –

- the property subject to an increase in basis as a result of a transaction described in paragraph (c)
    - is disposed of
    - in a transaction in which gain or loss is recognized in whole or in part in a subsequent taxable year,

then

- the participant must send a copy of Form 8886 to the Office of Tax Shelter Analysis (OTSA).

This requirement is in addition to the requirement that a participant send a copy of Form 8886 to Office of Tax Shelter Analysis for the taxable year of the basis increase.

Transactions generally are structured so that, under the applicable allocation rules,[388] the basis increase is allocated to –

- property that is eligible for cost recovery allowances (or eligible for a shorter cost recovery period) or
- property that the partnership or the distributee partner disposes of in a taxable sale or exchange.

The basis increase results in related partners decreasing –

- their overall taxable income through additional or accelerated cost recovery allowances or
- their taxable gain or increasing their taxable loss on the subsequent taxable disposition of the property subject to the basis increase.

The related partners receive these tax benefits directly in the case of a distribution of property in which the basis of the distributed property is increased in the distributee partner's hands.[389]

They receive these benefits indirectly in the case of –

- a transfer of a partnership interest in which the inside basis of partnership property is increased for the transferee partner under Section 743(b) or
- a distribution of property that results in an increase to the common basis of partnership property under Section 734(b).

[388] I.R.C. §§ 732(c), 734(c), 743(c), 755.

[389] Under I.R.C. § 732(b) or (d).

Whether the tax benefits are received directly or indirectly, the resulting decrease in taxable income or gain (or increase in taxable loss) benefits the related-party group as a whole.

Partners are related. The distributions or transfers may have little or no effect on the overall economic ownership of the property yet produce significant tax benefits shared by the related partners.

A related partner's partnership interest must have certain characteristics to create the opportunity for a Partnership Related-Party Basis Adjustment Transaction.

In general, these characteristics are:

- a partner's outside basis in the partner's partnership interest that is low

compared to

- the partnership's basis in property that the partnership distributes to such partner,
- a partner's outside basis in its partnership interest that is high

compared to

- the partner's share of the partnership's basis in the partnership property (that is, the partner's share of inside basis), or
- a partner's outside basis in its partnership interest that is high compared to the partnership's basis in property it distributes to such partner in liquidation of the partner's interest.

Partnerships with related parties can create these characteristics through orchestrated contributions and distributions, as well as allocations under Section 704(b) and (c).

In most commercial transactions involving unrelated parties, according to the preamble,[390] the opportunity for abuse is limited because each party has separate, and often competing, economic and tax interests and the parties transact at arm's length.

In contrast, for related parties, basis can be manipulated to provide a material net tax benefit to the related parties.

[i] Biden Revenue Proposals on Basis Shifting Transactions

The Staff of the Joint Committee on Taxation, Description of the Revenue Provisions Contained in the President's Fiscal Year 2025 Budget Proposal, JCS-1-24 (November 2025) contains this discussion:

[390] Preamble to REG-124593-23, 89 Fed. Reg. 51476-51491, 2024-28 I.R.B. 40.

7. Prevent basis shifting by related parties through partnerships

Present Law

Basis of partner's interest and basis of partnership property

Partner's basis in partnership interest

A partner's initial basis in its partnership interest reflects the adjusted basis of property, including money, the partner contributes to the partnership, or if acquired other than by contribution, generally reflects its cost.[89] [[89] Secs. 705, 722, 742, 1011.] A partner's basis in the partnership interest is adjusted to reflect the partner's share of partnership items. In general, the adjusted basis of a partner's interest in the partnership is increased by the partner's share of taxable income and tax-exempt income of the partnership.[90] [[90] Sec. 705(a)(1)(A), (B). A partner's adjusted basis in its partnership interest is also increased by the excess of the deductions for depletion over the basis of the property subject to depletion. Sec. 705(a)(1)(C).]

The adjusted basis of a partner's interest in the partnership generally is decreased (but not below zero) by the partner's distributive share of losses of the partnership,[91] [[91] Sec. 705(a)(2)(A).] expenditures of the partnership that are not deductible and are not properly chargeable to capital account (are not capitalized), and by distributions of money or property from the partnership.[92] [92 Secs. 705(a)(2)(B), 733. A partner's adjusted basis in its partnership interest is also decreased (but not below zero) by the amount of the partner's deduction for depletion to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to the partner under section 613A(c)(7)(D).]

Partnership's basis in property

The initial basis of property contributed to a partnership by a partner is generally the adjusted basis of the property at the time of the contribution, increased by the amount (if any) of gain the partner recognizes upon the contribution.[93] [[93] Sec. 723.] The basis of partnership property acquired by purchase is generally its cost.[94] [[94] Sec. 1011.]

Adjustments to basis of partnership property

The basis of property (and of partnership interests) is adjusted upon the occurrence of certain events or transactions, including transfers of partnership interests and distributions of partnership property.

Transfer of a partnership interest

If an election under section 754 is in effect, or if the partnership has a substantial built-in loss immediately after the transfer of a partnership interest, adjustments to the basis of partnership property are made with respect to the transferee partner. These adjustments are to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest.[95] [[95] Sec. 743(b).] The adjustments are intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner.

A substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property, or the transferee partner would be allocated

a loss of more than $250,000 if the partnership assets were sold for cash equal to their fair market value immediately after such transfer.[96] [[96] Sec. 743(d). Certain securitization partnerships and electing investment partnerships are not treated as having a substantial built-in loss in certain instances, and thus are not required to make basis adjustments to partnership property. See sec. 743(e) (alternative rules for electing investment partnerships); sec. 743(f) (exception for securitization partnerships). A related rule for basis adjustments following partnership property distributions provides that a securitization partnership is not treated as having a substantial basis reduction with respect to any partnership property distribution. Sec. 734(e).]

Partnership distributions and adjustments to the basis of undistributed partnership property

Treatment of distributee partners.—In the case of a distribution in liquidation of a partner's interest, the basis of the property distributed is equal to the partner's adjusted basis in its partnership interest (reduced by any money distributed in the transaction).[97] [[97] Sec. 732(b). In a distribution other than in liquidation of a partner's interest, the distributee partner's basis in the distributed property is equal to the partnership's adjusted basis in the property immediately before the distribution, but not to exceed the partner's adjusted basis in the partnership interest (reduced by any money distributed in the same transaction).[98] [[98] Sec. 732(a).] In the event that multiple properties are distributed by a partnership, allocation rules are provided for determining their bases in the distributee partner's hands.[99] [[99] Sec. 732(c).] In some circumstances, the distributee partner may recognize gain or loss on the distribution.[100] [[100] For example, gain is recognized to the distributee partner to the extent that any money distributed exceeds the adjusted basis of the distributee partner's partnership interest immediately before the distribution. Sec. 731(a)(1). Loss is recognized to the distributee partner if no property other than money, unrealized receivables, or inventory is distributed to the partner. Sec. 731(a)(2).]

Treatment of partnership.—An adjustment to the basis of a partnership's undistributed property is required if an election under section 754 is in effect, or if the partnership has a substantial basis reduction and the distributee partner's basis in the distributed property differs from the partnership's basis, or if the distributee partner recognizes gain or loss.[101] [[101] Sec. 734(a).] A substantial basis reduction means a downward adjustment of more than $250,000 that would be made to the basis of partnership property if a section 754 election were in effect. If a partnership does not have a section 754 election in effect, and a partnership interest is transferred to a partner and there is a later distribution of partnership property to the transferee partner, a special basis rule provides for the determination of the transferee partner's basis in properties that are later distributed by the partnership as if a section 754 election had been in effect.[102] [[102] Sec. 732(d).]

Adjustments are made by a partnership to increase or decrease the basis of remaining partnership assets to reflect any increase or decrease in the adjusted basis of the distributed properties in the hands of the distributee partner (or gain or loss recognized by the distributee partner).[103] [[103] Section 734(b) provides for adjustments to the basis of partnership property in the case of distributions of property. Unlike section 743(b) (relating to transfers of partnership interests), there is no provision in section 734(b) that adjustments may be made only with respect to the relevant partner and allocations under section 704(c) are not taken into account.] Basis allocations among properties generally are made to reduce the difference between the fair market values and adjusted basis of partnership properties and by making allocations to property of a like kind among properties which are (1) capital assets and property used in a trade or business and (2) other properties.[104] [[104] Sec. 755;

Treas. Reg. sec. 1.755-1(c). Under section 755(c), no decrease in basis may be allocated to stock in a corporate partner (or related person), but must be allocated to other partnership property. Gain is recognized to the extent an amount required to be allocated to other partnership property exceeds the aggregate adjusted bases of the other property immediately before the distribution. This rule is intended to limit the ability of corporate partners to "duplicate tax deductions at no economic cost" through reducing the basis of stock in certain transactions. Conference Report to accompany S. 1637, Jumpstart our Business Strength (JOBS) Act, S. Rep. 108- 192, November 7, 2003, p. 127. See also sec. 732(f).]

Description of Proposal

The proposal creates a matching rule applicable in the case of a distribution of partnership property that results in a step-up in the basis of retained partnership property. The matching rule applies to partners in the distributing partnership. Any such partner that is related to the distributee partner is prohibited from benefitting from the partnership's basis step-up until the distributee partner recognizes all gain on the distributed property by disposing of it in a fully taxable transaction. Authority is provided under the proposal for guidance necessary to implement the matching rule for related parties.[105] [[105] Separately, the Treasury Department published proposed regulations on June 18, 2024, that would identify certain partnership related-party basis adjustment transactions and substantially similar transactions as transactions of interest, a type of reportable transaction. REG-124593-23, 89 Fed. Reg. 51476, June 18, 2024.]

Effective date.—The proposal is effective for partnership taxable years beginning after December 31, 2024.

Analysis

In general

The proposal is intended to limit the ability to shift basis among related persons through partnerships. The proposal reflects the tax policy concern that such basis shifts have no economic effect and appear to be tax-motivated transactions giving rise to economic inefficiency.

The proposal addresses basis shifts resulting from the distribution of partnership property to a partner. For example, if property is distributed to a partner, the partner takes a basis in the distributed property equal to the basis of the partner's partnership interest. If the partner's basis in its partnership interest is less than the partnership's basis in the distributed property, then the partnership allocates the amount of that difference to the basis of its retained property. The result is an immediate basis increase in the retained partnership property, with all or a portion of the tax benefit of the basis increase going to a partner related to the distributee partner. If the retained property is depreciable, larger deductions for depreciation are calculated on the stepped-up property basis. If instead of holding the retained property, the partnership sells it, the amount of taxable gain is reduced due to the increase in the property's basis.

Under the proposal's matching rule, depreciation deductions resulting from the step-up in basis of the partnership's retained property after the distribution are deferred. Only when the distributee partner is fully taxed on the built-in gain in the distributed property are those deductions allowed to the remaining partners that are related to the distributee partner. It is possible the distributee partner never is fully taxed on the built-

in gain in the distributed property, or if the distributee ever is fully taxed (e.g., upon a sale), it could be much later in time. By deferring increased depreciation deductions until the distributee partner is fully taxed on the gain, the proposal matches the timing of the benefit of the basis step-up with the timing of the connected gain recognition. This can make a basis-shifting transaction much less attractive.

Administrability

The proposal could, however, be criticized as lacking specificity. For example, the proposal does not offer a particular related party definition for determining which remaining partners are related to the distributee partner. If the related party definition is too loose, or not applicable to common fact situations, it is possible the proposal would not change the result in many, or any, transactions.

Similarly, the proposal does not explicitly require reporting to the partnership by the distributee partner, although the proposal does provide authority for guidance needed for implementation. Without a specific reporting or notice requirement, it is not clear how the partnership (or partners) would know when the distributee partner is fully taxed on gain in the distributed property, particularly if the distributee is no longer a partner. Further, administrability and enforcement issues could arise if the basis increase and the gain recognition are not reported to the IRS, and such concerns could be exacerbated in the case of tiered partnerships or foreign partners, for example. For the proposal to be administrable, reporting requirements (including with respect to tiered partnerships) and a definition of relatedness would need to be developed.

Narrow scope

Another issue is that the proposal appears to be relatively narrow in the scope of transactions it affects.

The proposal is targeted to basis shifting transactions involving related partners. However, the proposal does not address the possibility of a similar basis shift from distributed to retained partnership property that could be achieved even if the distributee partner were not related to other partners. For example, the distributee partner might be an unrelated accommodation party (whose fee might be smaller than the tax benefit of the basis shift to other partners). The proposal does not appear to address this potential workaround. Further, the proposal's disincentive effect might be circumvented if the distributee partner (even if related) were indifferent to gain recognition by reason of being tax-exempt, having offsetting losses, or not being subject to tax in the United States. However, it is possible that the proposal could be clarified to address tax-indifferent distributees and other similar circumvention techniques.

While the proposal does in concept address shifting of basis from distributed to retained partnership property by a partnership with a section 754 election in place, it does not address other potential means of basis shifting through partnerships.

For example, related partners might seek to step up the low basis of a partnership property by making a liquidating distribution of the property to a distributee with a high basis in its partnership interest. The distribution might be made by a partnership without a section 754 election in place, either because the basis step-up arises under section 732 (not 734), or because there is a substantial built-in loss that causes section 734 to apply. The absence of a section 754 election is a fact situation that is not specifically addressed by the proposal, though the proposal could be clarified to address such distributions.

The proposal does not appear to address alternative transactions that shift basis of property by other means than partnership distributions. For example, a partnership may be in a business with property whose basis is reduced by depreciation deductions or is otherwise low, though the value of the partnership is high. It may be a partnership whose interests are transferred frequently or intentionally. Transfers of partnership interests can effectively shift basis to otherwise low-basis partnership property for the transferee partners. The result may be that for those partners, depreciation deductions are increased, or gain on property dispositions is reduced. The proposal also does not specifically address basis shifting among partners not meeting the definition of relatedness, for example, using an accommodation partner or tax-indifferent partner.

The proposal applies to distributions of partnership property resulting in an increase to the basis of partnership property which benefits partners related to the distributee partner. If the proposal were enacted and that form of basis shifting transaction no longer gave rise to a basis increase in partnership property without tax, then alternative forms of basis shifting transactions might be developed by tax planners. Alternative basis shifting mechanisms may be somewhat more costly or complex than property distributions and so may not be particularly attractive today, but could become more attractive and more broadly used if a narrow basis shifting proposal were adopted. For this reason a narrow proposal might not be especially effective at limiting basis shifting through partnerships. A proposal specifically addressing not only distributions of partnership property, but also transfers of partnership interests, for example, might be more effective to prevent noneconomic basis shifting as a means of tax avoidance.

Proposed regulations[106] [[106] REG-124593-23, 89 Fed. Reg. 51476, June 18, 2024.] published June 18, 2024, provide that specified types of related party partnership basis shifting transactions as treated as transactions of interest that must be reported. The proposed regulations cover a broader spectrum of transactions than the proposal, which refers only to partnership distributions. The proposed regulations specifically define four transactions that would be affected. The transactions rely on basis adjustments made under sections 732(b) and (d), 734(b) and 743(b), and involve current and liquidating property distributions as well as transfers of partnership interests. Because the partners are related to each other outside the partnership context, the basis shift can provide a material net tax benefit to them while the overall economic ownership of the property remains the same as before the distribution.[107] [[107] See REG-124593-23, 89 Fed. Reg. 51476, Preamble (Supplementary Information), Part IV.A, June 18, 2024.] The affected transactions also include those involving a tax-indifferent party, whether or not related. A $5 million threshold requirement applies, which is met if the sum of all basis increases resulting from all relevant transactions of a partner or a partnership during the taxable year exceeds by at least $5 million the gain recognized from such transactions on which Federal income tax is imposed. The proposed regulations require that affected transactions be disclosed by a participating partnership or partner. The disclosure requirement under the proposed regulations also applies to a related subsequent transferee that (in a nonrecognition transaction) is the transferee of a partnership interest or recipient of a distribution of property that was the subject of a basis increase.

Though not a legislative proposal, the proposed regulations' definitional rules could be added to the President's Budget proposal to provide additional specificity. That is, the proposal could be expanded to apply to basis shifting transactions involving transfers of partnership interests and liquidating distributions of

partnership property. Such an approach could address the concern that the proposal might have little effect because of its narrowness.

[4] Temporary Rules and Regulations.

Temporary Regulations avoid the notice and comment requirements of the Administrative Procedure Act. Temporary regulations are treated as if they were final regulations.[391] This contrasts with proposed regulations that are entitled to little, if any, deference.[392]

The Administrative Procedure Act requires a federal agency to provide public of proposed rulemaking in the Federal Register.[393] The Administrative Procedure Act requires the publishing agency to give interested persons the opportunity to participate through submitting written comments, possibly with the opportunity for oral presentation.[394]

The publishing agency must consider and respond to public objections in its concise general statement[395]

The effective date of the agency's regulation or rule must be not less than thirty days after publication.[396]

Notice and comment is not required where the publishing agency, for good cause, determined that notice and comment procedures are impractical, unnecessary, or contrary to the public interest.[397]

Notice and comment also is not required where the regulation is an interpretive rather than a legislative regulation.

Section 7805 provides a three year sunset rule for temporary regulations:

(e) Temporary regulations.

(1) Issuance. Any temporary regulation issued by the Secretary shall also be issued as a proposed regulation.

(2) 3-year duration. Any temporary regulation shall expire within 3 years after the date of issuance of such regulation.

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[391] *Nissho Iwai American Corp. v. Commissioner*, 89 T.C. 765, 776 (1987).

[392] *Zinniel v. Commissioner*, 89 T.C. 357, 369-70 (1987).

[393] 5 U.S.C. § 553(b).

[394] 5 U.S.C. § 553(c).

[395] See *ACLU v. FCC*, 823 F.2d 1554, 1581 (D.C. Cir. 1987); *Rodway v. USDA*, 514 F.2d 809, 817 (D.C. Cir 1975).

[396] See 5 U.S.C. § 553(d).

[397] 5 U.S.C. § 553(b)(B).

This sunset rule applies only to regulations published after November 20, 1988. Some temporary regulations still exist from before this effective date. It would seem that these earlier temporary regulations are vulnerable to challenge[398] under the Administrative Procedure Act[399] The exemption from notice and comment for the three-year time period is effective for any regulation issued after November 20, 1988.

The Tax Court in *Studdy v. Commissioner*[400] considered he effective date of Section 7805(e). Taxpayer petitioned for redetermination of deficiencies arising from disallowed interest deduction, charitable contribution, and automobile expenses. The Tax Court held that

- the taxpayer may not deduct interest paid on his personal income tax liability.
- The taxpayer may not deduct charitable contributions claimed for expenditures made to his personal residence which were allocable to space used exclusively by a Section 501(c)(3) organization.
- The taxpayer may deduct at the standard mileage rate his automobile expenses connected to the determination of his personal income tax liability.

Taxpayer claimed as a sole proprietorship expense a deduction for interest that he paid with respect to his personal Federal and State income taxes. The Court of Appeals for the Ninth Circuit held in *Redlark v. Commissioner*,[401] held that this type of interest is nondeductible personal interest under Temporary Treasury Regulations Section 1.163-9T (Dec. 22, 1987). The taxpayer argued that Section 1.163-9T did not apply here and that those regulations have expired under Section 7805(e)(2).

The regulations in Section 1.163-9T are temporary regulations. Section 7805(e)(2) provides that "Any temporary regulation shall expire within 3 years after the date of issuance of such regulation", The taxpayer failed to observe that Section 7805(e)(2) applies only to regulations issued after November 20, 1988. Section 1.163-9T was issued on December 22, 1987, approximately 11 months before the effective date of Section 7805(e)(2). On the basis of Redlark v. Commissioner, and our opinion in Robinson v. Commissioner, 119 T.C. 44, the Tax Court sustained the Internal Revenue Service determination.

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[398] See note 77.

[399] See note 77.

[400] T,C, Memo 2003-232.

[401] *Redlark v. Commissioner*, 141 F.3d 936 (9th Cir.1998), *revg. and remanding* 106 T.C. 31, 1996 (1996).

[5] Profits Interest.

[a] Revenue Procedure 93-27: Profits Interest in Partnership for Services.

There is an unfortunately vast literature discussing the receipt of a profits interest in a partnership as consideration for the provision of services.

A profits interest in a partnership is the right to receive future profits in the partnership. A profits interest in a partnership does not include any right to receive money or other property upon the immediate liquidation of the partnership.

The treatment of the receipt of a profits interest in a partnership has spawned a long history of litigation between the government and profits interest partners. The government historically took the position that this transaction is taxable to the service provider under Section 83. Taxpayers argued that the transaction either was not taxable at all or that the profits interest was sufficiently contingent that it did not have any value. The bottom line is that taxpayers won essentially almost all of the cases, to the considerable embarrassment of the Internal Revenue Service. [402]

Section 83 provides that when property is transferred in connection with the performance of services, the service provider recognizes income for the taxable year in which the property is first substantially vested (*i.e.*, transferable or not subject to a substantial risk of forfeiture). The taxpayer was taxable on the excess of the fair market value of the property when it is substantially vested over the amount (if any) paid for the property. The recipient of the services generally is permitted to an equal deduction.

Property subject to a substantial risk of forfeiture and that is not transferable is "substantially nonvested." Property is subject to a substantial risk of forfeiture if the service provider's right to the property is conditioned on the future performance (or refraining from performance) of substantial services. A substantial risk of forfeiture exists if the right to the property is subject to a condition other than the performance of services, provided that the condition relates to a purpose of the transfer and there is a substantial possibility that the property will be forfeited if the condition does not occur.

A service provider receiving restricted property may make a special election [403] for the immediate inclusion of the fair market value of the property in his income, notwithstanding that the property is not substantially vested.

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[402] The Tax Court case of *Diamond v. Commissioner*, 56 T.C. 530 (1971), *aff'd* 492 F.2d 286 (7th Cir. 1974)), held that the taxpayer was taxable. *Campbell v. Commissioner*, 943 F.2d 815 (8th Cir. 1991)). See, also, *St. John v. United States*, No. 82-1134 (C.D. Ill. Nov. 16, 1983).

[403] Under I.R.C. § 83(b).

In 1993, the Internal Revenue Service issued Revenue Procedure 93-27.[404] Revenue Procedure 93-27 essentially concedes the government case concerning profits interests in

[404] 1993-2 C.B. 343. Also interesting is GCM 36346 (July 25, 1977). This reasons, in pertinent part:

As you may be aware this Office has been considering the proper treatment of the receipt of a profits interest in a partnership as compensation for services. This consideration stems from the decision in *Sol Diamond* 56 T.C. 530 (1971), *aff'd*, 492 F.2d 286 (7th Cir. 1974), holding that the fair market value of an interest in partnership profits received as compensation for services is taxable under Int. Rev. Code of 1954,section 61(a)(1) [hereinafter cited as Code]. This decision has been widely criticized as being contrary to Treas. Reg. section 1.721-1, as creating severe valuation problems and as resulting in double taxation to the recipient partner. See, e.g., A. Willis, Partnership Taxation, section 11.04 (2d ed. 1976). Previously it has been proposed that the Service not follow *Diamond* when a profits interest is received as compensation for services rendered in a capacity as partner. O.M. 18281, Receipt of a Profits Interest in a Partnership for Services Rendered: The Sol Diamond Problem, I-176-75 (Sept. 29, 1975); *amplifying* O.M. 18205, Receipt of a Partnership Interest by One Who Renders Services: The *Sol Diamond* Problem, I-190-74 (June 4, 1975). This approach was found unacceptable because it seemed to place a premium on whether the partnership is formed before or after the services are rendered.

The position of this Office is set forth in the attached proposed revenue ruling which states that the Service will not follow *Diamond* to the extent that it holds that the receipt of an interest in future partnership profits as compensation for services results in taxable income. Having conceded this question, the ruling generally preserves the result in *Diamond* by concluding that most of the interest the taxpayer received was an interest in capital, as distinguished from an interest in future profits. In addition the ruling seeks to limit the conversion of compensation into capital gain upon the receipt and sale of a profits interest by emphasizing that the renderer of services must be a partner rather than an employee or independent contractor. Whether an interest is a capital interest or an interest in future profits and whether the recipient is a partner rather than an employee or independent contractor are primarily factual questions.

Arguably the only rationale for not taxing a profits interest received as compensation is that Treas. Reg. section 1.721-1(b) was apparently designed to reach such a result. See A. Willis, *supra* at section 11.01. It is difficult to quarrel with the Tax Court's finding that such an interest is property under Treas. Reg. section 1.61-2(d)(1). When a profits interest is defined to preclude any interest in partnership assets, as is done in the proposed revenue ruling, such an interest becomes analogous to an unfunded, unsecured promise to pay deferred compensation. Such a promise is not taxable upon receipt and, in fact, is not considered to be property. See Treas. Reg. section 1.83-3(e). An analogy of a partnership profits interest to an unfunded, unsecured promise to pay deferred compensation is imperfect, however, because amounts received pursuant to or upon assignment of such a promise are taxable as compensation whereas the character of partnership profits or the character of the gain on a sale of a profits interest is determined under Code section 702(b) and Code section 741.

It must be emphasized that in holding that the receipt of a "profits" interest is not taxable, the proposed revenue ruling is limited to interests that give the holder no rights to existing partnership assets upon the liquidation of his interest. Correspondingly, a "capital" interest, which is taxable, includes an interest in earned but unrealized gains. This broad definition of a capital interest is simply an extension of the rule in Treas. Reg. section 1.61-2(d)(1) that property received as compensation is taxed at its fair market value. This rule is reflected in both Treas. Reg. section 1.704-1(e) and Treas. Reg. section 1.721-1(b)(1). In addition, support for including unrealized appreciation in partnership

partnerships received for services.[405] Under Revenue Procedure 93-27, the conclusive presumption that a profits interest has a zero value *does not apply* if:

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capital may be found in the proposed Trust and Partnership Income Tax Revision Act of 1960, H.R. 9662, 86th Cong. 2d Sess. (1960). That Act would have added a section 770 to the Code to govern the treatment of an exchange of an interest in partnership capital for services rendered to the partnership. The Senate Report states as follows:

It is important to note that the section does not deal with the transfer of a partnership interest which gives the service partner merely the right to share in appreciation in partnership assets which occurs, or in partnership profits which are earned, subsequent to the date of transfer. Thus, for example, assume that a person who has been associated with a cash basis partnership as an employee is admitted as a partner in the partnership, and acquires an interest in the appreciation then existing in partnership assets, as well as an interest in profits of the partnership which have been earned as of that time, but not yet taken into partnership income. Such preexisting appreciation and previously earned profits are considered to be an interest in partnership capital, and section 770 is applicable. However, if such service partner had acquired only an interest in the appreciation occurring subsequent to his admission and in profits of the partnership earned after such time, the rules of section 770 would have no application. S. Rep. No. 1616, 86th Cong. 2d Sess. 117 (1960).

It should be noted that unrealized accounts receivable are also considered partnership capital. This can be important for professional partnerships. Perhaps a separate revenue ruling should be published to demonstrate this point.

The partner or partnership for whom services are performed may be entitled to a deduction for the value of the capital interest transferred. Treas. Reg. section 1.721-1(b)(2); See also, Rev. Rul. 75-214, 1975-1 C.B. 185. However, if such value exceeds the basis of the interest, the transferor will be required to recognize gain. *F. C. McDougal*, 62 T.C. 704 (1974), acq. 1975-1 C.B. 2.

When a partner receives an interest in unrealized appreciation or unrealized receivables, he could be taxed not only at that time but also when appreciation or receivables are actually realized. This potential double taxation may be avoidable if the partnership elects under Code section 754 to make the optional basis adjustments provided for in Code section 743(b).

Finally, the distinction between a profits interest received as a partner rather than as an employee or independent contractor is a major issue in movie tax shelters. See, e.g., G.C.M. 36961, * * *, I- 277-76 (Dec. 21, 1976); G.C.M. 36436, * * *, I-359-73 (Sept. 25, 1975); O.M. 18034, * * *, I-514-73 (May 15, 1974). We believe that recognizing the taxpayer as a partner in the proposed revenue ruling is consistent with our position in the movie area.

[405] The Department of Treasury has issued proposed regulations concerning I.R.C. § 83 and profits interests. to the compensatory transfer of a partnership interest. See 70 Fed. Reg. 29675 (May 24, 2005). The proposed regulations confirm that a profits interest is "property" for purposes of I.R.C. § 83. A compensatory transfer of a partnership profits interest is includible in the service provider's gross income at the time that it first becomes substantially vested (or, in the case of a substantially nonvested partnership interest, at the time of grant if a I.R.C. § 83(b) election is made). The proposed regulations permit, but do not require, a partnership and a partner to elect a safe harbor under which the fair market value of a compensatory partnership interest is treated as being equal to the liquidation value of that interest. The value of a true profits interest would be zero under this approach. The grant of a substantially vested profits interest (or, if a I.R.C. § 83(b) election is made, the grant of a substantially nonvested profits interest) results in no income inclusion under I.R.C. § 83. The theory is that the fair market value of the property received by the service provider is zero. The proposed safe harbor is subject to a number of conditions. For example, the election cannot be made

- the profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease;
- within two years of receipt, the partner disposes of the profits interest; or
- the profits interest is a limited partnership interest in a publicly traded partnership.

More technically, Revenue Procedure 93-27 says that

> *Other than as provided below, if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the Internal Revenue Service will not treat the receipt of such an interest as a taxable event for the partner or the partnership.*

Revenue procedures normally are supposed to prescribe procedural rules and not substantive rules.

It is extraordinary that courts have interpreted Revenue Procedure 93-27 as setting forth substantive rules and then has used those rules against the government. The Internal Revenue Service may end up wishing that it never had published Revenue Procedure 93-27.

Revenue Procedure 93-27, to the extent that it has any substantive authority at all, is not entitled to much deference (except on account of the longevity of Revenue Procedure 93-27). One also could argue that Revenue Procedure 93-27 makes little practical sense. Profits interests certainly do have a fair market value. It seems likely that the appraisal field could express professional opinions concerning that fair market value. The tax system is able to value many contingent and economically complex rights. The real question perhaps should not be whether a profits interest has a fair market value, but whether the admission of a profits interest partner is an appropriate time to tax the profits interest partner. The question of the profits interest partner may need a legislative fix rather than a regulatory fix.

In the interim, there also is a possibility that someone will end up challenging Revenue Procedure 93-27. That challenge is unlikely to come from the Internal Revenue Service, which seems generally content not having to litigate service partner issues. The Internal Revenue Service still is worried about how it should deploy its scarce audit and litigation resources. The Internal Revenue Service is unlikely to want to use those resources on seeking to repudiate the basic rules of Revenue Procedure 93-27. The Internal Revenue Service also seems to be almost incapable of finding situations in which one of the three special limitations of Revenue Procedure 93-27 applies. The Internal Revenue Service also seems to have been reluctant to second guess taxpayers on the question of whether interests labelled as profits interests truly technically qualify as profits interests. The Internal Revenue Service has not generally

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retroactively and must apply to all compensatory partnership transfers that occur during the period that the election is in effect.

questioned partnership property valuations used to establish distribution thresholds for profits interest partners.

Partnerships also seem unlikely to want to contest the general principles of Revenue Procedure 93-27. Revenue Procedure 93-27 is generally thought to be a pro-taxpayer ruling. Tax litigation is expensive.

Nevertheless, it is significant to note that *Loper Bright Enterprises* is not entirely taxpayer friendly. *Loper Bright Enterprises* applies both to taxpayer friendly and taxpayer adverse rules and regulations. It always is possible that someday a partner or a partnership will have cause to challenge Revenue Procedure 93-27. At the least, this should make for an interesting case. The tax world doubtless will follow it closely.

[b] Revenue Procedure 2001-43: Restricted Profits Partnership Interest for Services.

Revenue Procedure 2001-43[406]. clarifies that the treatment provided in Revenue Procedure 93-27 (valuing the profits interest at zero) applies with respect to a substantially unvested profits interest

provided

- the service partner takes into income his distributive share of partnership income, and
- the partnership does not deduct any amount either on grant or on vesting of the profits interest.

A partnership capital interest received for services is includable in the partner's income under generally applicable rules relating to the receipt of property for the performance of services. A partnership capital interest for this purpose is an interest that would entitle the receiving partner to a share of the proceeds if the partnership's assets were sold at fair market value and the proceeds were distributed in liquidation. There is question concerning how this applies to a mixed capital and services interest.

Revenue Procedure 2001-43 in form is merely administrative and not substantive. To the extent that one invests Revenue Procedure 2001-43 with substance, it is difficult to make the case for Revenue Procedure 2001-43 as the best interpretation of Revenue Procedure 2001-43. Revenue Procedure 2001-43 may reach a convenient and agreeable solution, but that solution hardly reflects a plain language reading of the statutes involved, particularly Section 83. The issue, of course, is who is available to challenge Revenue Procedure 2001-43. Taxpayers generally applaud Revenue Procedure 2001-43. The Internal Revenue Service seems to be content with Revenue Procedure 2001-43 as the revenue procedure reduced Internal Revenue Service workload. If Revenue Procedure 2001-43 were challenged by someone, it

[406] 2001-2 C.B. 191.

would make an interesting case. At the least, Revenue Procedure 2001-43 should not receive a high level of deference. Revenue Procedure 2001-43 might well be vulnerable[407] in litigation, but so much of the tax world seems content with Revenue Procedure 2001-43 that the tax world may be content in the realization that perhaps no one will find it in his interest to challenge Revenue Procedure 93-27.

[c] ES NPA Holding, LLC v. Commissioner: Taxation of Remote Profits Interests Received as Consideration for Services (2023).

ES NPA Holding, LLC v. Commissioner[408] found that Revenue Procedure 93-27 was elastic. *ES NPA Holding, LLC* addressed the application of Revenue Procedure 93-27 to the receipt of a remote profits interest as consideration for the performance of services for a lower-tier partnership. *ES NPA Holding, LLC* determined that Revenue Procedure 93-27 did apply to this issuance of a remote profits interest for serviced and that the service provider did not have income. In *ES NPA Holding, LLC* the Tax Court paid little deference to the Internal Revenue Service in interpreting its own procedural rules, in this case Revenue Procedure 93-27.

ES NPA Holding, LLC Holding treated Revenue Procedure 93-27 as prescribing substantive rules rather than merely administrative guidance, notwithstanding the specific language of Revenue Procedure 93-27. The court in *ES NPA Holding, LLC v. Commissioner* never questioned the validity of Revenue Procedure 93-27 as a correct statement of principles of substantive law.

Based on the authority of Revenue Procedure 93-27 as stretched by the Tax Court, the Tax Court held that the indirect receipt of the partnership interest was a profits interest. This profits interest was not taxable to the service partner, even though the taxpayer received a remote profits interest.

National Processing of America, Inc. formed Integrated Development Solutions, LLC. and National Performance Agency, LLC.

Integrated Development Solutions, LLC issued class B and class C membership units.

National Performance Agency, LLC issued class A, B and C units.

National Processing of America, Inc. contributed substantially all its business assets to National Performance Agency, LLC. National Processing of America, Inc. received all the class A, B and C units in National Performance Agency, LLC.

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[407] See note 77.

[408] T.C. Memo. 2023-55.

Class B and class C units in Integrated Development Solutions, LLC tracked the class B and class C units that Integrated Development Solutions, LLC held in National Performance Agency, LLC (received in the transaction).

Integrated Development Solutions, LLC class C units received all of the payments received by Integrated Development Solutions, LLC from the National Performance Agency, LLC class C units.

National Processing of America, Inc. contributed the newly issued units in National Performance Agency, LLC to Integrated Development Solutions, LLC as a capital contribution.

NPA Investors acquired from Integrated Development Solutions, LLC the class A National Performance Agency, LLC units.

ES NPA Holding, LLC Holding, Inc. exercised a call option granted by National Processing of America, Inc. On exercise, ES NPA Holding, LLC Holding, Inc. acquired under the option all the Integrated Development Solutions, LLC class C units. ES NPA Holding, LLC Holding, Inc. paid to National Processing of America, Inc. cash of $100,000 and agreed to preform services to National Processing of America, Inc. The Tax Court did not especially stress that some of the profits interest was transferred as consideration for performing services for a corporation rather than a partnership. The Tax Court did not pay much attention to the fact that a portion of the profits interest was transferred for cash rather than services.

When the dust had settled,

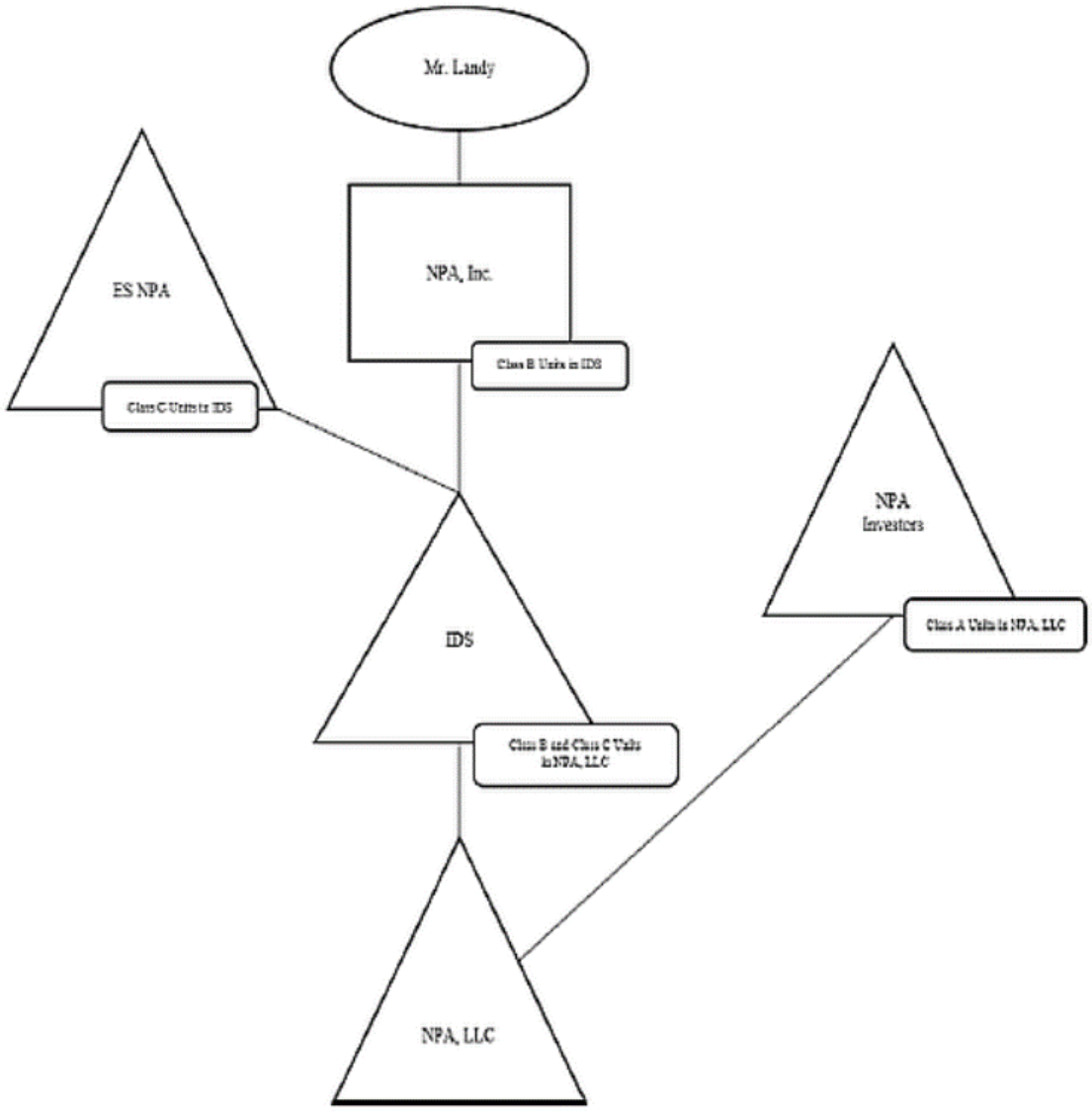
- NPA Investors held the class A units in National Performance Agency, LLC.
- Integrated Development Solutions, LLC held the class B units in National Performance Agency, LLC previously held in National Performance Agency, LLC.
- EPS NPA held the class C units in Integrated Development Solutions, LLC. The class C units in Integrated Development Solutions, LLC tracked the class C units that Integrated Development Solutions, LLC held in National Performance Agency, LLC.
- NPA, Inc held the class B units in Integrated Development Solutions, LLC. The class B units in Integrated Development Solutions, LLC track the class B units that Integrated Development Solutions, LLC previously held in National Performance Agency, LLC.

At the end of the day on October 14, 2011,

- the class A units in National Performance Agency, LLC held by NPA Investors had a capital contribution of $20,985,509,

- the class B units in National Performance Agency, LLC held by Integrated Development Solutions, LLC had a capital contribution of $8,993,790, and
- the class C units in National Performance Agency, LLC held by Integrated Development Solutions, LLC had a capital contribution of zero.

This is the final structure:



ES NPA Holding, LLC timely filed its 2011 Form 1065, U.S. Return of Partnership Income, on April 15, 2012.

On March 20, 2017, respondent issued the notice of final partnership administrative adjustment to ES NPA Holding, LLC's partners for the 2011 tax year.

Respondent determined in the FPAA that ES NPA Holding, LLC had received, but failed to report, other income of $16,106,250 for the 2011 tax year.

In the notice of final partnership administrative adjustment, respondent determined that the unreported income was attributable to ES NPA Holding, LLC's receipt of a 50% capital interest in Integrated Development Solutions, LLC.

In the alternative, according to the FPAA, respondent determined that the unreported income was attributable to ES NPA Holding, LLC's receipt of a 30% indirect capital interest in National Performance Agency, LLC (National Performance Agency, LLC).

The Internal Revenue Service issued a notice of final partnership administrative adjustment (FPAA) to ES NPA Holding, LLC through its tax matters partners. The Internal Revenue Service determined that

- ES NPA Holding, LLC had over $16 million of unreported income attributable to receiving a 50% capital interest in Integrated Development Solutions, LLC.
- In the alternative, the unreported income was attributable to ES NPA Holding, LLC receiving a 30% indirect capital interest in National Performance Agency, LLC.

On March 20, 2017, the Internal Revenue Service issued a notice of final partnership administrative adjustment (FPAA) for the tax year ending December 31, 2011, to Joseph NPA Investment, LLC, the tax matters partner for ES NPA Holding, LLC (ES NPA Holding, LLC).[409]

The issues for decision before the Tax Court were –

- whether ES NPA Holding, LLC underreported its income for the 2011 tax year and
- whether an accuracy-related penalty under Section 66621 is appropriate.

The Tax Court found for the taxpayer.

[409] ES NPA Holding, LLC timely filed its 2011 Form 1065, U.S. Return of Partnership Income, on April 15, 2012. On March 20, 2017, respondent issued the FPAA to ES NPA Holding, LLC Holding, LLC's partners for the 2011 tax year. Respondent determined in the FPAA that ES NPA Holding, LLC had received, but failed to report, other income of $16,106,250 for the 2011 tax year. In the Notice of Final Partnership Administrative Adjustment. The Internal Revenue Service determined that the unreported income was attributable to ES NPA Holding, LLC Holding, LLC's receipt of a 50% capital interest in Integrated Development Solutions, LLC. In the alternative, according to the FPAA, respondent determined that the unreported income was attributable to ES NPA Holding, LLC Holding, LLC's receipt of a 30% indirect capital interest in National Performance Agency, LLC (National Performance Agency, LLC).

ES NPA Holding, LLC contended that

- its indirect receipt of the class C units in National Performance Agency, LLC (through ES NPA Holding, LLC's receipt of the class C units in Integrated Development Solutions, LLC) was a profits interest[410]
- that was excludable from income for the tax year ending December 31, 2011. ES NPA Holding, LLC acquired the class C units in Integrated Development Solutions, LLC and
- thereby, indirectly, the class C units in National Performance Agency, LLC pursuant to a call option agreement exercised on October 14, 2011.

The initial capital account specified in the National Performance Agency, LLC operating agreement as of October 14, 2011, was as follows:

Unit Type	Number of Units	Capital Contribution	Percentage of Capital
Class A	400	$20,985,509	70%
Class B	300	8,993,790	30
Class C	300	—	—
Total	—	$29,979,299	100%

Respondent's primary argument was that –

- Revenue Procedure 93-27 is inapplicable

  because

  - ES NPA Holding, LLC did not provide services to Integrated Development Solutions, LLC.

Respondent's first alternative argument was that

- the safe harbor in Revenue Procedure in 93-27 is inapplicable

  because

  - ES NPA Holding, LLC received a taxable capital interest in Integrated Development Solutions, LLC.

Further, respondent argued that–

[410] As defined in Rev. Proc. 93-27, 1993-2 C.B. 343, and related case law,

- the fair market value of ES NPA Holding, LLC's class C units in Integrated Development Solutions, LLC was
- $12,169,000 as of October 14, 2011.

The Tax Court observed:

- The court previously held that the receipt of a profits interest in a partnership in exchange for the performance of services was a taxable event.[411]
- Then in *Campbell v. Commissioner*,[412], the Tax Court determined the receipt to be a taxable event regardless of whether the transferee partner would receive anything upon a theoretical liquidation.
- The Court of Appeals for the Eighth Circuit, however, reversed the Tax Court decision in *Campbell*.
- The Court of Appeals found that the receipt of a profits interest was not taxable since the value received was speculative.[413]5

ES NPA Holding, LLC contended that

- its indirect receipt of units in National Performance Agency, LLC (through ES NPA Holding, LLC's interest in Integrated Development Solutions, LLC)
- was a profits interest under Revenue Procedure 93-27 and,
- therefore, excludable from income for 2011.

The Internal Revenue Service contended that:

- Revenue Procedure 93-27 did not apply because ES NPA Holding, LLC did not provide services directly to Integrated Development Solutions, LLC.
- The Revenue Procedure 93-27 safe harbor did not apply because ES NPA Holding, LLC received a capital interest in Integrated Development Solutions, LLC.
- The fair market value of ES NPA Holding, LLC's interest in Integrated Development Solutions, LLC was more than ES NPA Holding, LLC claimed, which would change the outcome.

The Tax Court observed:

[411] *Diamond v. Commissioner*, 56 T.C. 530 (1971), *aff'd*, 492 F.2d 286 (7th Cir. 1974).
[412] T.C. Memo. 1990-162, *aff'd in part, rev'd in part*, 943 F.2d 815 (8th Cir. 1991).
[413] *Campbell v. Commissioner*, 943 F.2d 815.

- Section 721(a) provides that "[n]o gain or loss shall be recognized to a . . . partner[ ] in the case of a contribution of property to the partnership in exchange for an interest in the partnership."
- Where a person receives a partnership interest in exchange for a contribution of services, nonrecognition is not always guaranteed.[414]
- The "receipt of a partnership capital interest in exchange for services is taxable to the service provider."[415]
- Services are not "property" for purposes of Section 721.
- The receipt of a partnership capital interest in exchange for services does not receive Section 721 treatment.
- "To the extent that any of the partners gives up any part of his right to be repaid his contributions (as distinguished from a share in partnership profits) in favor of another partner as compensation for services (or in satisfaction of an obligation), Section 721 does not apply."[416]
- The value of an interest in partnership capital so transferred to a partner as compensation for services constitutes income to the partner under Section 61.
- The foregoing parenthetical reference to a profits interest in the above regulation has been read as intending to exempt the receipt of a profits interest for services from taxation.
- The Tax Court has held that the receipt of a profits interest in a partnership in exchange for the performance of services was a taxable event.[417]
- In *Campbell v. Commissioner*,[418] the Tax Court determined the receipt of a profits interest for services to be a taxable event regardless of whether the transferee partner would receive anything upon a theoretical liquidation.
- The Court of Appeals for the Eighth Circuit reversed the decision in *Campbell* and found that the receipt of a profits interest was not taxable since the value received was speculative.[419]

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[414] See Treas. Reg. § 1.721-1(b)(1).

[415] *Crescent Holdings, LLC*, 141 T.C. at 488; see I.R.C. §83(a) (generally dictating the recipient's tax treatment of property received in connection with services performed); Treas. Reg. § 1.61-2(d) (stating property received as compensation must be included in income).

[416] Treas. Reg. § 1.721-1(b)(1).

[417] *Diamond v. Commissioner*, 56 T.C. 530 (1971), *aff'd*, 492 F.2d 286 (7th Cir. 1974).

[418] T.C. Memo. 1990-162, *aff'd in part, rev'd in part*, 943 F.2d 815 (8th Cir. 1991).

[419] *Campbell v. Commissioner*, 943 F.2d 815.

- The Internal Revenue Service promulgated Revenue Procedure 93-27,[420] publishing guidance on the treatment of the receipt of a profits interest for services provided to or for the benefit of the partnership.
- Revenue Procedure 93-27 cites Treasury Regulation § 1.721-1(b)(1) and acknowledges that the receipt of a capital interest for services is taxable as compensation,
- Revenue Procedure 93-27 says it will not treat the receipt of a profits interest as a taxable event.
- Revenue Procedure 93-278 defines a profits interest as a partnership interest "other than a capital interest."
- Revenue Procedure 93-27 defines a capital interest as an interest that would "give the holder a share of the proceeds if the partnership's assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership."
- This theoretical liquidation is to occur "at the time of receipt of the partnership interest."
- Under Revenue Procedure 93-27, a profits interest is not treated as income upon its acquisition if a person receives it "for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner."
- ES NPA Holding, LLC provided services to NPA, Inc. in exchange for the class C units in Integrated Development Solutions, LLC.
- ES NPA Holding, LLC's interests in the class C units in Integrated Development Solutions, LLC are identical in all respects to the interests in class C units in National Performance Agency, LLC.

The parties disputed whether EX NPA satisfied Revenue Procedure 93-27.

The government contended:

- Revenue Procedure 93-27 has no application to the transaction.
- Revenue Procedure 93-27 applies only when "a partnership profits interest for services provided to or for the benefit of the partnership."
- ES NPA Holding, LLC received an interest in Integrated Development Solutions, LLC in exchange for services it provided to NPA, Inc. — not National Performance Agency, LLC.

[420] 1993-2 C.B. at 343.

The Tax Court disagreed:

- The Tax Court found this reading of this revenue procedure and views of the transaction to be unreasonably narrow.
- Revenue Procedure 93-27 states that "if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the [Internal Revenue Service] will not treat the receipt of such an interest as a taxable event for the partner or the partnership."
- The Tax Court found Revenue Procedure 93-27 §4, entitled "Application," to set the intended parameters of the revenue procedure's application.
- The government implied that Revenue Procedure 93-27 is a "safe harbor" with limited application.
- The Tax Court does not view Revenue Procedure 93-27 in such a restricted manner, but rather views Revenue Procedure 93-27 as administrative guidance on the treatment of the receipt of a partnership profits interest for services.
- Considering the text of Revenue Procedure 93-27 §4, the evidence supports a finding that ES NPA Holding, LLC directly (or through its principals), before and after formation, provided services to or for the benefit of National Performance Agency, LLC in a partner capacity or in anticipation of being a partner.
- The material assets of National Performance Agency, LLC are held in National Performance Agency, LLC, and the activities ES NPA Holding, LLC performed were to and for the benefit of the future partnership.
- It is of no material consequence that ES NPA Holding, LLC's interest in National Performance Agency, LLC is held indirectly through Integrated Development Solutions, LLC, which is a mere conduit since the liquidation rights in the class C units in both Integrated Development Solutions, LLC and National Performance Agency, LLC are identical.
- National Performance Agency, LLC came about only through ES NPA Holding, LLC and NPA, Inc.'s joint ownership of Integrated Development Solutions, LLC and their ownership interest in National Performance Agency, LLC.
- Other relevant elements here evidencing that the application of Revenue Procedure 93-27 is proper are the presence of entrepreneurial risk and the receipt of a profits interest in the capacity as a partner.

- ES NPA Holding, LLC's receipt of the class C units meets the intended parameters of Revenue Procedure 93-27 §4.
- To determine whether ES NPA Holding, LLC has received a profits interest, the court must determine whether ES NPA Holding, LLC would receive a distribution upon a hypothetical liquidation at the time of receipt.
- On October 14, 2011,
  - the class A units held by NPA Investors had a capital account of $20,985,509,
  - the class B units held by Integrated Development Solutions, LLC had a capital account of $8,993,790, and
  - the class C units held by Integrated Development Solutions, LLC had a capital account of zero.
- National Performance Agency, LLC operating agreement provides that –
  - after the payment of liabilities,
    - the National Performance Agency, LLC liquidation proceeds are to be distributed 30% to class B unit holders and 40% to class A unit holders,
    - with the remaining 30% to the members who hold class C units,

      provided, however, that
    - the sum of all distributions made to the members who hold class A units had first been satisfied.
  - In other words,
    - the class A and B unit holders have a preferred return on their capital, and
    - the class C units would receive anything in a hypothetical liquidation

      only after
      - all capital accounts were first satisfied in full.
  - The parties agree, under the terms of the operating agreement, that

    if
    - the fair market value of National Performance Agency, LLC was $29,979,299

- as reflected in National Performance Agency, LLC's capital account,

then

- there would be no distribution to the class C unit holders upon a hypothetical liquidation.

- The government contended that the fair market value of National Performance Agency, LLC as of the transaction date was $52,463,722.
- Taxpayer asserted that the fair market value of National Performance Agency, LLC was $29,979,299
- The Tax Court agreed with the taxpayer's valuation.
- The Tax Court determined that
  - ES NPA Holding, LLC's class C units are a profits interest as defined under Revenue Procedure 93-27

    since,

    - applying a fair market value of $29,979,299 to National Performance Agency, LLC at the time of receipt,
    - ES NPA Holding, LLC would not receive a share of the proceeds upon a hypothetical liquidation of the partnership.[421]
  - Any fair market value in excess of $29,979,299 is speculative.

[6] Section 701: Partnership Antiabuse.

The Section 701 partnership antiabuse rules likely will be an early target of taxpayers after *Loper Bright Enterprises*. Treasury Regulations Section 1.701-2 prescribes potentially powerful antiabuse rules that are coextensive with Subchapter K. These regulations are interpretive regulations. Treasury Regulations Section 1.701-2 states:

[421] *Cf.* In PLR 200329001 (Internal Revenue Service applied Revenue Procedure 93-27 to UP-REIT structure; REIT was a limited partner and sole general partner of operating partnership; employees of the REIT, the operating partnership, and affiliates received profits interests in the operating partnership; not all employees provided services to the operating partnership; despite not all of the employees providing services directly to the operating partnership; PLR 200329001 applied Revenue Procedure 93-27 to the profits interests). *Cf.* Prop. Treas. Reg. 1.721-1(b)(3) (limiting nonrecognition to profits interests for services provided to issuing partnership).

(a) Intent of Subchapter K. Subchapter K is intended to permit taxpayers to conduct joint business (including investment) activities through a flexible economic arrangement without incurring an entity-level tax. Implicit in the intent of Subchapter K are the following requirements --

(1) The partnership must be bona fide and each partnership transaction or series of related transactions (individually or collectively, the transaction) must be entered into for a substantial business purpose.

(2) The form of each partnership transaction must be respected under substance over form principles.

(3) Except as otherwise provided in this paragraph (a)(3), the tax consequences under Subchapter K to each partner of partnership operations and of transactions between the partner and the partnership must accurately reflect the partners' economic agreement and clearly reflect the partner's income (collectively, PROPER REFLECTION OF INCOME). However, certain provisions of Subchapter K and the regulations thereunder were adopted to promote administrative convenience and other policy objectives, with the recognition that the application of those provisions to a transaction could, in some circumstances, produce tax results that do not properly reflect income. Thus, the proper reflection of income requirement of this paragraph (a)(3) is treated as satisfied with respect to a transaction that satisfies paragraphs (a)(1) and (2) of this section to the extent that the application of such a provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision. See, for example, paragraph (d) EXAMPLE 6 of this section (relating to the value-equals-basis rule in section 1.704-1(b)(2)(iii)(c)), paragraph (d) EXAMPLE 9 of this section (relating to the election under section 754 to adjust basis in partnership property), and paragraph (d) EXAMPLES 10 AND 11 of this section (relating to the basis in property distributed by a partnership under section 732). See also, for example, sections 1.704-3(e)(1) and 1.752-2(e)(4) (providing certain de minimis exceptions).

The Section 1.701-2 regulations further provide:

(b) Application of Subchapter K rules. The provisions of Subchapter K and the regulations thereunder must be applied in a manner that is consistent with the intent of Subchapter K as set forth in paragraph (a) of this section (INTENT OF SUBCHAPTER K). Accordingly, if a partnership is formed or availed of in connection with a transaction a principal purpose of which is to reduce substantially the present value of the partners' aggregate federal tax liability in a manner that is inconsistent with the intent of Subchapter K, the Commissioner can recast the transaction for federal tax purposes, as appropriate to achieve tax results that are consistent with the intent of Subchapter K, in light of the applicable statutory and regulatory provisions and the pertinent facts and circumstances. Thus, even though the transaction may fall within the literal words of a particular statutory or regulatory provision, the Commissioner can determine, based on the particular facts and circumstances, that to achieve tax results that are consistent with the intent of Subchapter K –

(1) The purported partnership should be disregarded in whole or in part, and the partnership's assets and activities should be considered, in whole or in part, to be owned and conducted, respectively, by one or more of its purported partners;

(2) One or more of the purported partners of the partnership should not be treated as a partner;

(3) The methods of accounting used by the partnership or a partner should be adjusted to reflect clearly the partnership's or the partner's income;

(4) The partnership's items of income, gain, loss, deduction, or credit should be reallocated; or

(5) The claimed tax treatment should otherwise be adjusted or modified.

The rules are applied on the basis of a facts and circumstances analysis:

(c) Facts and circumstances analysis; factors. Whether a partnership was formed or availed of with a principal purpose to reduce substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of Subchapter K is determined based on all of the facts and circumstances, including a comparison of the purported business purpose for a transaction and the claimed tax benefits resulting from the transaction. The factors set forth below may be indicative, but do not necessarily establish, that a partnership was used in such a manner. These factors are illustrative only, and therefore may not be the only factors taken into account in making the determination under this section. Moreover, the weight given to any factor (whether specified in this paragraph or otherwise) depends on all the facts and circumstances. The presence or absence of any factor described in this paragraph does not create a presumption that a partnership was (or was not) used in such a manner. Factors include:

(1) The present value of the partners' aggregate federal tax liability is substantially less than had the partners owned the partnership's assets and conducted the partnership's activities directly;

(2) The present value of the partners' aggregate federal tax liability is substantially less than would be the case if purportedly separate transactions that are designed to achieve a particular end result are integrated and treated as steps in a single transaction. For example, this analysis may indicate that it was contemplated that a partner who was necessary to achieve the intended tax results and whose interest in the partnership was liquidated or disposed of (in whole or in part) would be a partner only temporarily in order to provide the claimed tax benefits to the remaining partners;

(3) One or more partners who are necessary to achieve the claimed tax results either have a nominal interest in the partnership, are substantially protected from any risk of loss from the partnership's activities (through distribution preferences, indemnity or loss guaranty agreements, or other arrangements), or have little or no participation in the profits from the partnership's activities other than a preferred return that is in the nature of a payment for the use of capital;

(4) Substantially all of the partners (measured by number or interests in the partnership) are related (directly or indirectly) to one another;

(5) Partnership items are allocated in compliance with the literal language of sections 1.704-1 and 1.704-2 but with results that are inconsistent with the purpose of section 704(b) and those regulations. In this regard, particular scrutiny will be paid to partnerships in which income or gain is specially

allocated to one or more partners that may be legally or effectively exempt from federal taxation (for example, a foreign person, an exempt organization, an insolvent taxpayer, or a taxpayer with unused federal tax attributes such as net operating losses, capital losses, or foreign tax credits);

(6) The benefits and burdens of ownership of property nominally contributed to the partnership are in substantial part retained (directly or indirectly) by the contributing partner (or a related party); or

(7) The benefits and burdens of ownership of partnership property are in substantial part shifted (directly or indirectly) to the distributee partner before or after the property is actually distributed to the distributee partner (or a related party).

When the Section 701-2 regulations were published, many practitioners felt that these regulations gave Internal Revenue Service examiners superpowers in auditing partnerships. The effect of the general partnership antiabuse regulations in practice has been considerably more modest. Many practitioners felt that the Section 1.701-2 regulations operated to turn off provisions of the Internal Revenue Code without any direct legislative authorization. The 1.701-2 antiabuse regulations, after all, are merely interpretive regulations. Under *Loper Bright Enterprises*, these regulations are entitled to reduced deference, if any true deference at all. The regulations may be valid only to the extent that the regulations correctly interpret statutory law and established judicial doctrines. This means that the regulations must incorporate the best reading of the statute, not merely a reasonable or plausible reading of the statute. The Internal Revenue Service seems to have been reluctant to apply the general partnership antiabuse rules whenever the Internal Revenue Service had another antiabuse weapon available.

Since the announcement of the general partnership antiabuse regulations, tax advisors have questioned the validity of the antiabuse regulations, even under *Chevron*. The partnership antiabuse regulations seemed to be an invitation to disregard clear partnership tax statutes. There is no specific partnership tax statute that provides the basis for a general partnership antiabuse rule. The general partnership antiabuse rule is not especially tied to Section 701, a short provision that provides: "A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities." This says nothing about antiabuse of Subchapter K. Section 701 says little about how partners and partnerships are to be taxed. Section 701 served merely as a convenient post from which to hang the general antiabuse regulation. The general partnership antiabuse rules seem to be grounded on all of the separate Code sections of Subchapter K, rather than merely a single provision. Indeed, the partnership antiabuse rules tend to contradict clear provisions of the partnership tax law. A court might well regard this authority as suspect. At the least, it seems likely that the general partnership antiabuse regulations would not be entitled to a high level of deference as legislative regulations. Any interpretive regulation that departs materially from a reasonable reading of

the underlying statute interpreted seems to be vulnerable[422] to taxpayer attack after *Loper Bright Enterprises*.

Time will tell whether taxpayers are successful in their arguments that the Section 1.701-2 partnership antiabuse regulation is invalid.

Much of the real detail of the general partnership antiabuse regulations is contained in the examples. Interestingly, there are embedded in these supposed antiabuse rules some structures that the Internal Revenue Service might have identified as abusive − perhaps highly abusive – but that the antiabuse rules approve. It is possible that the partnership antiabuse regulations have had more effect in protecting particular abusive structures than their effect on fighting abusive use of partnerships. These are the examples.

[a] Choice Of Entity; Avoidance Of Entity-Level Tax; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 1. Choice of entity; avoidance of entity-level tax; use of partnership consistent with the intent of Subchapter K. (i) A and B form limited partnership PRS to conduct a bona fide business. A, the corporate general partner, has a 1% partnership interest. B, the individual limited partner, has a 99% interest. PRS is properly classified as a partnership under sections 301.7701-2 and 301.7701-3. A and B chose limited partnership form as a means to provide B with limited liability without subjecting the income from the business operations to an entity-level tax.

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. Although B has retained, indirectly, substantially all of the benefits and burdens of ownership of the money or property B contributed to PRS (see paragraph (c)(6) of this section), the decision to organize and conduct business through PRS under these circumstances is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1), (2), and (3) of this section have been satisfied. The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Example 1 is a taxpayer favorable example. Example 1 tells us that the formation of a normal partnership to conduct business is usually nonabusive. Many advisors may wonder why there was enough doubt to merit this example. There is an element of "the sky is blue" about Example 1. The Internal Revenue Service is hardly making a major concession. Example 1 provides a not very interesting throwaway and is practically useless. It would have been astounding if Example 1 had reached the opposite conclusion that the transaction is abusive and should be ignored. The result would have been absolutely staggering if Example 1 had a different conclusion that found the creation of a limited partnership to create limited liability abusive. It is practically inconceivable that a court would disagree with this example.

[422] See note 77.

An unstated issue for which this example may constitute authority is whether a 99/1 partnership should be respected, or whether the minority interest is too small to be respected. Ther may well be some percentage interest of the minority partner that is too small to be respected. The Internal Revenue Service apparently conceded that a 1% minority interest should be respected.

Loper Bright Enterprises should apply as much to taxpayer-favorable rules and regulations as it does to taxpayer-unfavorable rules and regulations. Example should not be entitled to a material presumption of correctness, if any taxpayer were to try to challenge Example 1. It is not at all likely that a taxpayer would challenge Example 1. If he did, it is not likely that he would prevail. Example 1 seems to be grounded on general principles of the tax law.

[b] Choice Of Entity; Avoidance Of Subchapter S Shareholder Requirements; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 2. Choice of entity; avoidance of subchapter S shareholder requirements; use of partnership consistent with the intent of Subchapter K.

(i) A and B form partnership PRS to conduct a bona fide business. A is a corporation that has elected to be treated as an S corporation under subchapter S. B is a nonresident alien. PRS is properly classified as a partnership under sections 301.7701-2 and 301.7701-3. Because section 1361(b) prohibits B from being a shareholder in A, A and B chose partnership form, rather than admit B as a shareholder in A, as a means to retain the benefits of subchapter S treatment for A and its shareholders.

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The decision to organize and conduct business through PRS is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1), (2), and (3) of this section have been satisfied. Although it may be argued that the form of the partnership transaction should not be respected because it does not reflect its substance (inasmuch as application of the substance over form doctrine arguably could result in B being treated as a shareholder of A, thereby invalidating A's subchapter S election), the facts indicate otherwise. The shareholders of A are subject to tax on their pro rata shares of A's income (see section 1361 et seq.), and B is subject to tax on B's distributive share of partnership income (see sections 871 and 875). Thus, the form in which this arrangement is cast accurately reflects its substance as a separate partnership and S corporation. The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Example 2 is a taxpayer favorable example. The example basically says that you can have a partnership between an S corporation and a nonqualifying shareholder of the S corporation. To the extent that there is an abuse, there is an abuse of subchapter S and not particularly an abuse of Subchapter K, since arguably a partnership is being used to avoid the shareholder limitations of subchapter S. The Internal Revenue Service is hardly giving away the store from the standpoint of Subchapter K with this example.

This example nevertheless might be extended to permit a partnership structure between two or three S corporations each of which has 100 shareholders. This example could be considered an end-run around the 100 shareholder limitation of Subchapter S. This is not an abuse of partnership tax rules, but it arguably is an abuse of Subchapter S tax rules. The example appears to endorse the use of multiple S corporation partners in order to avoid the 100 shareholder requirement of Subchapter S.

Example 2 does not put any particular pressure on the general partnership antiabuse regulation, but it may place some pressure on the rules of subchapter S. In a litigation, Example 2 would not be entitled to a high level of deference.

It is not at all likely that a taxpayer would challenge Example 2. A challenge might have some chance of prevailing (arguing that a partnership between an S corporation and a disqualified shareholder is abusive). If one were to challenge this example, one might argue for an antiabuse rule for subchapter S rather than Subchapter K.

One could imagine making the Example look a little more abusive by having the partnership issue units that correspond to shares of the S corporation. The S corporation then could contribute all of its assets to the partnership. This is an Up-C structure. Example 2 could be taken as blessing the up-C structure. Thus far, the Internal Revenue Service appears to have acquiesced in up-REITs and up-C structures, but there is always the possibility with a different administration that these structures could be considered abusive. The Internal Revenue Service attack might depend more on these structures circumventing rules of subchapter C, subchapter S, or the REIT rules than on an abuse of Subchapter K.

[c] Choice Of Entity; Avoidance Of More Restrictive Foreign Tax Credit Limitation; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 3. Choice of entity; avoidance of more restrictive foreign tax credit limitation; use of partnership consistent with the intent of Subchapter K.

(i) X, a domestic corporation, and Y, a foreign corporation, form partnership PRS under the laws of foreign Country A to conduct a bona fide joint business. X and Y each owns a 50% interest in PRS. PRS is properly classified as a partnership under sections 301.7701-2 and 301.7701-3. PRS pays income taxes to Country A. X and Y chose partnership form to enable X to qualify for a direct foreign tax credit under section 901, with look-through treatment under section 1.904-5(h)(1). Conversely, if PRS were a foreign corporation for U.S. tax purposes, X would be entitled only to indirect foreign tax credits under section 902 with respect to dividend distributions from PRS. The look-through rules, however, would not apply, and pursuant to section 904(d)(1)(E) and section 1.904-4(g), the dividends and associated taxes would be subject to a separate foreign tax credit limitation for dividends from PRS, a noncontrolled section 902 corporation.

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The

decision to organize and conduct business through PRS in order to take advantage of the look- through rules for foreign tax credit purposes, thereby maximizing X's use of its proper share of foreign taxes paid by PRS, is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1), (2), and (3) of this section have been satisfied. The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Example 3 blesses forming a partnership between a corporation and an individual in order to permit the flow through of the direct foreign tax credit. The example blesses the choice of a partnership as a form of doing business, even though the partnership form creates certain tax advantage. This is not a challenging example. It would have been surprising if the Internal Revenue Service had taken the contrary position that using a partnership rather than a corporation when you want to flow through direct foreign tax credits is abusive.

[d] Choice Of Entity; Avoidance Of Gain Recognition Under Sections 351(E) And 357(C); Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 4. Choice of entity; avoidance of gain recognition under sections 351(e) and 357(c); use of partnership consistent with the intent of Subchapter K.

(i) X, ABC, and DEF form limited partnership PRS to conduct a bona fide real estate management business. PRS is properly classified as a partnership under sections 301.7701-2 and 301.7701-3. X, the general partner, is a newly formed corporation that elects to be treated as a real estate investment trust as defined in section 856. X offers its stock to the public and contributes substantially all of the proceeds from the public offering to PRS. ABC and DEF, the limited partners, are existing partnerships with substantial real estate holdings. ABC and DEF contribute all of their real property assets to PRS, subject to liabilities that exceed their respective aggregate bases in the real property contributed, and terminate under section 708(b)(1)(A). In addition, some of the former partners of ABC and DEF each have the right, beginning two years after the formation of PRS, to require the redemption of their limited partnership interests in PRS in exchange for cash or X stock (at X's option) equal to the fair market value of their respective interests in PRS at the time of the redemption. These partners are not compelled, as a legal or practical matter, to exercise their exchange rights at any time. X, ABC, and DEF chose to form a partnership rather than have ABC and DEF invest directly in X to allow ABC and DEF to avoid recognition of gain under sections 351(e) and 357(c). Because PRS would not be treated as an investment company within the meaning of section 351(e) if PRS were incorporated (so long as it did not elect under section 856), section 721(a) applies to the contribution of the real property to PRS. See section 721(b).

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The decision to organize and conduct business through PRS, thereby avoiding the tax consequences that would have resulted from contributing the existing partnerships' real estate assets to X (by applying the rules of sections 721, 731, and 752 in lieu of the rules of sections 351(e) and 357(c)), is consistent with this intent. In addition,

on these facts, the requirements of paragraphs (a)(1), (2), and (3) of this section have been satisfied. Although it may be argued that the form of the transaction should not be respected because it does not reflect its substance (inasmuch as the present value of the partners' aggregate federal tax liability is substantially less than would be the case if the transaction were integrated and treated as a contribution of the encumbered assets by ABC and DEF directly to X, see paragraph (c)(2) of this section), the facts indicate otherwise. For example, the right of some of the former ABC and DEF partners after two years to exchange their PRS interests for cash or X stock (at X's option) equal to the fair market value of their PRS interest at that time would not require that right to be considered as exercised prior to its actual exercise. Moreover, X may make other real estate investments and other business decisions, including the decision to raise additional capital for those purposes. Thus, although it may be likely that some or all of the partners with the right to do so will, at some point, exercise their exchange rights, and thereby receive either cash or X stock, the form of the transaction as a separate partnership and real estate investment trust is respected under substance over form principles (see paragraph (a)(2) of this section). The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Example 4 implicates avoidance of gain recognition under sections 351(e) and 357(c). Example 4 involves the creation of an up-REIT operating partnership. The operating partnership is a simple limited partnership that is described as conducting a *bona fide* real estate management business. That is a strange description of the activities of an up-REIT; the operating partnership is likely conducting the business of owning and renting real property. The up-REIT may manage the property incidental to its ownership of the property. The general partner, which undertake a public offering of its shares, elects to be treated as an REIT. Because the operating partnership would not be treated as an investment company within the meaning of Section 351(e) if the operating partnership were incorporated (so long as the operating partnership did not elect under Section 856), Section 721(a) applies to the contribution of the real property to the operating partnership.[423]

Example 4 seems intended to describe a classic up-REIT structure. Example 4 also may be taken as blessing the typical Up-C corporate/partnership structure. When the general partnership antiabuse regulation was published, many advisors were concerned that Example 4 would be included with the conclusion that the structure should be recharacterized under economic substance. Some people believe that both the up-REIT and up-C corporate structures are intrinsically abusive, since these structures arguably can constitute an end-run around Section 351(e) rules. The principal reason to use these structures can be to avoid Section 351(e). It was surprising that the Internal Revenue Service conceded the issue without litigation. The Internal Revenue Service may regret this concession both in the REIT area and in the Up-C corporate area. Indeed, the time may come when the Internal Revenue Service may wish that Example 4 were found invalid.

[423] See I.R.C. § 721(b).

A nuance of Example 4 is that the limited partners may require the redemption of their limited partnership interests in the partnership in exchange for cash or REIT stock (at the REIT's option) equal to the fair market value of their respective interests in the limited partnership at the time of the redemption. As a practical matter, up-REIT partnerships provide for a redemption of up-REIT units based on the trading price of the corresponding public stock (usually on a market average price basis specified in the limited partnership agreement). This may or may not be roughly the same as the fair market value of the partnership interests.[424] No attempt is typically made to assess directly the real fair market value of the up-REIT units.

Arguably, the up-REIT partnership is being used to circumvent the investment company rules of Section 351. It could be argued that the up-REIT units are sufficiently similar to the publicly traded REIT shares that the up-REIT units should be treated as stock in the REIT. It could be argued that the operating partnership in Example 4 is abusive, but the abuse is not particularly an abuse of Subchapter K. The up-REIT structure is being used to circumvent recognition rules of subchapter C. The Internal Revenue Service could have considered Example 4 abusive, the apparently the Internal Revenue Service does not (to the extent that the Internal Revenue Service has considered the issue).

Example 4 says that he Commissioner cannot use the general partnership antiabuse regulation to recast the transaction. Example 4 does not say that the Internal Revenue Service cannot use some other doctrine, such as economic substance, to recast the transaction. It nevertheless would be odd for the Internal Revenue Service to bless the transaction under Subchapter K and nevertheless to attack the transaction

Example 4 may have little continuing authority after *Loper Bright Enterprises*. The example is not a legislative regulation.

Nevertheless, it seems highly unlikely that the Internal Revenue Service will be inclined to challenge Example 4 in litigation on account of Example 4. Up-REITs are sufficiently popular that the Internal Revenue Service may well be disinclined to challenge up-REIT structures as a manner of practical politics. The existence of Example 4 would make an Internal Revenue Service challenge all the mor difficult. The Internal Revenue Service seems highly unlikely to challenge the structure on principles outside of the general partnership antiabuse regulation. It nevertheless is difficult to know what a new Administration with a strong bias against creative tax structuring and a bias against corporate tax abuse might do in tax litigation. Such a challenge, however, would greatly disrupt the up-REIT marketplace, which makes the challenge much less likely.

[424] One might make the argument that the fair market value of the units could differ materially from the fair market value of each REIT share, even though the units are convertible into REIT shares.

It currently seems highly unlikely that an up-REIT would challenge Example 4 in an Internal Revenue Service audit. The BBA partnership audit rules make it difficult for a partner of the up-REIT to challenge Example 4.

Example 4 does not discuss the possibility that the chosen structure has no ***business purpose*** and whether the structure was chosen merely to accomplish tax planning objectives. Example 4 does not discuss the possibility that, as a matter of economic substance, the partners of the operating partnership should be considered direct shareholders of the REIT. Example 4 does not discuss the possibility that the chosen structure should be treated as a sham.

Example 4 may have been outstanding for a sufficient period and up-REIT structures may be sufficiently common in the marketplace that a court would pay Example 4 deference if Example 4 were to be challenged in the courts. Beyond this, Example 4 may well constitute a correct interpretation of the law, but that is not at all a sure thing.

The bottom line is that Example 4 seems very unlikely to be tested in litigation, as long as the general partnership antiabuse regulation is outstanding. It seems that a good case can be made on general principles of tax law that Example 4 should be respected under partnership principles, but the transaction may be vulnerable[425] under economic substance principles.

A court might use one of the available doctrines to recharacterize the facts of Example 4 if the example were tested in litigation. A court, for example, might use economic substance principles to determine that the operating partnership is merely the alter ego of the REIT and therefore to treat them both as a single corporate entity for tax purposes. It nevertheless seems unlikely that this case will soon be brought before the courts.

[e] Special Allocations; Dividends Received Deductions; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 5. Special allocations; dividends received deductions; use of partnership consistent with the intent of Subchapter K.

(i) Corporations X and Y contribute equal amounts to PRS, a bona fide partnership formed to make joint investments. PRS pays $100x for a share of common stock of Z, an unrelated corporation, which has historically paid an annual dividend of $6x. PRS specially allocates the dividend income on the Z stock to X to the extent of the London Inter-Bank Offered Rate (LIBOR) on the record date, applied to X's contribution of $50x, and allocates the remainder of the dividend income to Y. All other items of partnership income and loss are allocated equally between X and Y. The allocations under the partnership agreement have substantial economic effect within the meaning of section 1.704-1(b)(2). [It appears that substantial economic effect is assumed as given. Substantial economic effect is not analyzed in the example.] In addition to avoiding

[425] See note 77.

an entity-level tax, a principal purpose for the formation of the partnership was to invest in the Z common stock and to allocate the dividend income from the stock to provide X with a floating-rate return based on LIBOR, while permitting X and Y to claim the dividends received deduction under section 243 on the dividends allocated to each of them.

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The decision to organize and conduct business through PRS is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1), (2), and (3) of this section have been satisfied. Section 704(b) and section 1.704-1(b)(2) permit income realized by the partnership to be allocated validly to the partners separate from the partners' respective ownership of the capital to which the allocations relate, provided that the allocations satisfy both the literal requirements of the statute and regulations and the purpose of those provisions (see paragraph (c)(5) of this section). [The example never undertakes a substantiality analysis. The example never considers whether the preferred return should be considered a guaranteed payment.] Section 704(e)(2) is not applicable to the facts of this example (otherwise, the allocations would be required to be proportionate to the partners' ownership of contributed capital). The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

An interesting question is why the Internal Revenue Service decided to publish Example 5. Example 5 may well be overly generous.

Example 5 considers a preferred partnership interest structure. The Internal Revenue Service someday may regret favorable authorities on preferred partnership interests.

The partnership specially allocates the dividend income to a partner to the extent of the London Inter-Bank Offered Rate (LIBOR) on the record date, applied to X's contribution of $50x, and allocates the remainder of the dividend income to the other partner. All other items of partnership income and loss are allocated equally. between X and Y. The allocations under the partnership agreement are assumed to have substantial economic effect within the meaning of Section 1.704-1(b)(2). It is possible that the conclusion of Example 5 should be limited to its specific facts. Comparatively few partnerships have allocation provisions that satisfy the technical rules of substantial economic effect. This might relegate Example 5 to the dust bin.

The preferred partnership structure would not be entitled to a high degree of *Chevron* deference under *Loper Bright Enterprises*.

The partnership in Example 5 arguably is being used to effect an assignment of income to the partner who receives the LIBOR preference. The partnership serves as an income splitter with respect to the stock of Z. The economics of the dividend income are being stripped off an allocated to one of the partners. So far as practical economics, this special allocation may be sufficiently guaranteed that perhaps the special allocation should be treated as a guaranteed payment. It may be material to Example 5 that the partnership has other stock investments and is not being used solely as an income splitter. It may be material to the analysis

of Example 5 that the partner receiving the special allocation of partnership income also receives a material participation in the other economics of the partnership. It may be material to the analysis of Example 5 that all of the partnership allocations meet the technical rules of substantial economic effect. This not only means that the allocation satisfy economic effect but also substantiality. In appropriate circumstances, the special allocation might not satisfy substantiality. A comparatively small portion of partnerships are in full compliance with the rules of substantial economic effect. Many partnerships use targeted allocations. Example 5 may not apply to partnerships with target allocations. Example 5 may not apply to special allocations that can be recharacterized as guaranteed payments.

Others may see Example 5 as providing general approval for preferred partnership interests. The Internal Revenue Service has not particularly explored preferred partnership interests in tax litigation. A skeptic might observe that preferred partnership interests can be abusive and that the Internal Revenue Service never should have provided what appears to be general approval of preferred partnership interest.

Example 5 implicitly approves that the preferred income allocation is a Section 704(b) allocation rather than a guaranteed payment. This conclusion could be questioned in appropriate circumstances.

Example 5 does not discuss whether there is a ***business purpose*** to the special allocation or whether that ***business purpose*** is relevant.

Example 5 would not be entitled to enhanced *Chevron* deference under *Loper Bright Enterprises*. The Internal Revenue Service presumably is prepared to live with a situation with the specific facts of Example 5, but it is not clear how much factual difference from the facts of Example 5 would be necessary for the Internal Revenue Service to be tempted to challenge a structure. If it did so, the Internal Revenue Service would be doing so under general tax doctrines.

Also, there may exist circumstances under which a taxpayer would challenge Example 5. The taxpayer is at a serious disadvantage under Bipartisan Budget Act of 2015 audit rules in challenging partnership positions.

[f] Special Allocations; Nonrecourse Financing; Low-Income Housing Credit; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 6. Special allocations; nonrecourse financing; low-income housing credit; use of partnership consistent with the intent of Subchapter K.

(i) A and B, high-bracket taxpayers, and X, a corporation with net operating loss carryforwards, form general partnership PRS to own and operate a building that qualifies for the low-income housing credit provided by section 42. The project is financed with both cash contributions from the partners and nonrecourse

indebtedness. The partnership agreement provides for special allocations of income and deductions, including the allocation of all depreciation deductions attributable to the building to A and B equally in a manner that is reasonably consistent with allocations that have substantial economic effect of some other significant partnership item attributable to the building. [The example does not provide a clue concerning how bottom line profits and losses are allocated other than the special allocation. The example does not provide an analysis of why the allocation of depreciation deductions satisfies substantial economic effect.] The section 42 credits are allocated to A and B in accordance with the allocation of depreciation deductions. PRS's allocations comply with all applicable regulations, including the requirements of sections 1.704-1(b)(2)(ii) (pertaining to economic effect) and 1.704-2(e) (requirements for allocations of nonrecourse deductions). The nonrecourse indebtedness is validly allocated to the partners under the rules of section 1.752-3, thereby increasing the basis of the partners' respective partnership interests. The basis increase created by the nonrecourse indebtedness enables A and B to deduct their distributive share of losses from the partnership (subject to all other applicable limitations under the Internal Revenue Code) against their nonpartnership income and to apply the credits against their tax liability.

(ii) At a time when the depreciation deductions attributable to the building are not treated as nonrecourse deductions under section 1.704-2(c) (because there is no net increase in partnership minimum gain during the year), the special allocation of depreciation deductions to A and B has substantial economic effect because of the value-equals-basis safe harbor contained in section 1.704-1(b)(2)(iii)(c) and the fact that A and B would bear the economic burden of any decline in the value of the building (to the extent of the partnership's investment in the building), notwithstanding that A and B believe it is unlikely that the building will decline in value (and, accordingly, they anticipate significant timing benefits through the special allocation). [The example nevertheless does not undertake a substantiality analysis.] Moreover, in later years, when the depreciation deductions attributable to the building are treated as nonrecourse deductions under section 1.704-2(c), the special allocation of depreciation deductions to A and B is considered to be consistent with the partners' interests in the partnership under section 1.704-2(e).

(iii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The decision to organize and conduct business through PRS is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1), (2), and (3) of this section have been satisfied. Section 704(b), section 1.704-1(b)(2), and section 1.704-2(e) allow partnership items of income, gain, loss, deduction, and credit to be allocated validly to the partners separate from the partners' respective ownership of the capital to which the allocations relate, provided that the allocations satisfy both the literal requirements of the statute and regulations and the purpose of those provisions (see paragraph (c)(5) of this section). Moreover, the application of the value-equals-basis safe harbor and the provisions of section 1.704-2(e) with respect to the allocations to A and B, and the tax results of the application of those provisions, taking into account all the facts and circumstances, are clearly contemplated. Accordingly, even if the allocations would not otherwise be considered to satisfy the proper reflection of income standard in paragraph (a)(3) of this section, that requirement will be treated as satisfied under these facts. Thus, even though the partners' aggregate federal tax liability may be substantially less than had the partners owned the partnership's assets directly (due to X's inability to use its allocable share of the partnership's losses and credits) (see paragraph (c)(1) of this section), the transaction is

not inconsistent with the intent of Subchapter K. The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Example 6 involves a low income housing credit partnership. Low income housing credits are not saleable for cash. Partnerships often are formed between developers who may not be able to use the credits and investors who can use the low income housing credits.

It seems possible that another government agency, such as the Department of Housing and Urban Development, may have been involved in the formulation of Example 6. It seems likely that the Department of Housing and Urban Development should have been pleased with the result of Example 6.

The low-income housing tax credit provides a special tax credit for investors in low-income housing. This credit acts as an incentive to invest in low income housing projects. [426] Example 6 should be understood in the context of its background in helping to effect a national housing policy. The importance of this policy may override normal tax considerations.

The partnership in Example 6 perhaps is intrinsically a tax shelter partnership, but perhaps it should be considered a "good" tax shelter partnership that the government encourages. The two individual investors are high tax bracket investors seeking tax shelter. The general partner is a corporation that does not need the credits. Example 6 never undertakes a rigorous mathematical analysis of why the allocations have substantiality. Indeed, Example 6 does not even tell us the bottom line allocations. Example 6 says that the partnership agreement provides for special allocations of income and deductions, including the allocation of all depreciation deductions attributable to the building to A and B equally in a manner that is reasonably consistent with allocations that have substantial economic effect of some other significant partnership item attributable to the building.

Perhaps significantly, Example 6 does not discuss whether there was any ***business purpose*** to the allocations in Example 6. This leaves open to the Internal Revenue Service a possible ***business purpose*** attack under the economic substance doctrine. To date, the

[426] The low income housing tax credit was established in 1986 with the enactment of I.R.C. § 42. The low income housing credit is designed to encourage development of low income housing. The credit requires that the developers of low income housing meet various eligibility requirements, plus agree to meet a tenant income test and a gross rent test. The low income tax credit can be offset to reduce the investor's tax liability, but the credit itself in not refundable or payable in cash. As a practical matter developers of low income housing will form partnerships with investors so that the credits can be allocated to the investors. These partnerships are used to aid in effecting national housing policies. Tax credits are allocated to the low income housing project on the basis of a percentage of eligible costs of the development. The credits are earned over a 10-year period. Investors receive a tax credit that equals a portion of their investment in the affordable housing project. Credits are allocated through state housing agencies. Qualifying projects must meet specified affordability and rent restriction requirements. The low income housing credit is structured as a passive investment for limited partner investors. Passive activity credits are allowable only to the extent of tax liability is attributable to passive activities for the year.

economic substance doctrine and its ***business purpose*** requirement have not been asserted by the Internal Revenue Service as a limiting factor on partnership income and loss allocations.

Example 6 assumes that the allocations pass the both the economic effect test and the substantiality test. That may be a large assumption. The example unfortunately does not show substantiality computations or show how the allocations satisfy substantial economic effect, which includes not only an economic effect test but also the more difficult to apply test of substantiality. For that matter, Example 6 does not show how income and losses (other than the special depreciation allocation) are allocated.

The requirement of satisfaction of substantial economic effect is a linchpin of Example 6 and also a substantially limiting factor in the example. The example essentially assumes its result: that everything satisfies the allocation regulations. Those allocation regulations impose an important limitation on Example 6.

Partnership agreements using target allocations apparently do not qualify to use Example 6. The partnership agreement apparently does not rely on partners' interests in the partnership.

The Section 42 credits are allocated to A and B in accordance with the allocation of depreciation deductions. PRS's allocations comply with all applicable regulations, including the requirements of sections 1.704-1(b)(2)(ii) (pertaining to economic effect) and 1.704-2(e) (requirements for allocations of nonrecourse deductions).

The nonrecourse indebtedness is validly allocated to the partners under the rules of Section 1.752-3, thereby increasing the basis of the partners' respective partnership interests.

At a time when the depreciation deductions attributable to the building are not treated as nonrecourse deductions under Section 1.704-2(c) (because there is no net increase in partnership minimum gain during the year), the special allocation of depreciation deductions to A and B has substantial economic effect because of the value-equals-basis safe harbor contained in Section 1.704-1(b)(2)(iii)(c) and the fact that A and B would bear the economic burden of any decline in the value of the building (to the extent of the partnership's investment in the building), notwithstanding that A and B believe it is unlikely that the building will decline in value (and, accordingly, they anticipate significant timing benefits through the special allocation). This comment apparently confirms that the value equals basis safe harbor is not abusive and that taxpayers can rely on this safe harbor.

This is a safe harbor is contained in an interpretative regulation, which may not be given appreciable deference under *Loper Bright Enterprises*. This regulation might be challenged by taxpayers in litigation, although it seems unlikely that the regulation would be challenged by a taxpayer in a low income housing transaction. The Section 1.704-1 regulations are merely interpretive regulations that might be challenged in part of in their entirety in a tax litigation under *Loper Bright Enterprises*.

It is not at all clear how the Section 1.704-1 regulations would fare if they were challenged. These regulations read much more like legislative regulations than interpretive regulations, but the Section 1.704-1 regulations are entitled to only the limited deference given to interpretive regulations. Also, while the Section 1.704-1 regulations were published in the 1980's and have been around for years, those regulations have been hardly tested in tax litigation, particularly a tax litigation forcing the Internal Revenue Service to establish that the Section 1.704-1 regulations constitute the best reading of the statute. It is difficult to imagine that a court would have come up with an identical interpretation as a best reading of the statute. The substantiality regulations are particularly susceptible to attack under *Loper Bright Enterprises*.

[g] Partner With Nominal Interest; Temporary Partner; Use Of Partnership Not Consistent With The Intent Of Subchapter K.

Example 7. Partner with nominal interest; temporary partner; use of partnership not consistent with the intent of Subchapter K.

(i) Pursuant to a plan a principal purpose of which is to generate artificial losses and thereby shelter from federal taxation a substantial amount of income, X (a foreign corporation), Y (a domestic corporation), and Z (a promoter) form partnership PRS by contributing $9,000x, $990x, and $10x, respectively, for proportionate interests (90.0%, 9.9%, and 0.1%, respectively) in the capital and profits of PRS. PRS purchases offshore equipment for $10,000x and validly leases the equipment offshore for a term representing most of its projected useful life. Shortly thereafter, PRS sells its rights to receive income under the lease to a third party for $9,000x, and allocates the resulting $9,000x of income $8,100x to X, $891x to Y, and $9x to Z. PRS thereafter makes a distribution of $9,000x to X in complete liquidation of its interest. Under section 1.704-1(b)(2)(iv)(f), PRS restates the partners' capital accounts immediately before making the liquidating distribution to X to reflect its assets consisting of the offshore equipment worth $1,000x and $9,000x in cash. Thus, because the capital accounts immediately before the distribution reflect assets of $19,000x (that is, the initial capital contributions of $10,000x plus the $9,000x of income realized from the sale of the lease), PRS allocates a $9,000x book loss among the partners (for capital account purposes only), resulting in restated capital accounts for X, Y, and Z of $9,000x, $990x, and $10x, respectively. Thereafter, PRS purchases real property by borrowing the $8,000x purchase price on a recourse basis, which increases Y's and Z's bases in their respective partnership interests from $1,881x and $19x, to $9,801x and $99x, respectively (reflecting Y's and Z's adjusted interests in the partnership of 99% and 1%, respectively). PRS subsequently sells the offshore equipment, subject to the lease, for $1,000x and allocates the $9,000x tax loss $8,910x to Y and $90x to Z. Y's and Z's bases in their partnership interests are therefore reduced to $891x and $9x, respectively.

(ii) On these facts, any purported business purpose for the transaction is insignificant in comparison to the tax benefits that would result if the transaction were respected for federal tax purposes (see paragraph (c) of this section). Accordingly, the transaction lacks a substantial business purpose (see paragraph (a)(1) of this

section). In addition, factors (1), (2), (3), and (5) of paragraph (c) of this section indicate that PRS was used with a principal purpose to reduce substantially the partners' tax liability in a manner inconsistent with the intent of Subchapter K. On these facts, PRS is not bona fide (see paragraph (a)(1) of this section), and the transaction is not respected under applicable substance over form principles (see paragraph (a)(2) of this section) and does not properly reflect the income of Y (see paragraph (a)(3) of this section). Thus, PRS has been formed and availed of with a principal purpose of reducing substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of Subchapter K. Therefore (in addition to possibly challenging the transaction under judicial principles or the validity of the allocations under section 1.704-1(b)(2) (see paragraph (h) of this section)), the Commissioner can recast the transaction as appropriate under paragraph (b) of this section.

Example 7 involves a plan with a partner with a nominal interest, a temporary partner, and a plan a ***principal purpose*** of which is to generate artificial losses and thereby shelter from federal taxation a substantial amount of income. One does not have to read much more than that to guess the outcome of Example 7. Example 7 is not a favorable example for the taxpayer.

The Internal Revenue Service assumes that the overall plan has a ***principal purpose*** of generating artificial losses and thereby shelter from federal taxation a substantial amount of income. This statement is an invitation to the application of substance over form and other antiabuse doctrines.

[h] Plan To Duplicate Losses Through Absence Of Section 754 Election; Use Of Partnership Not Consistent With The Intent Of Subchapter K.

Example 8 involves a loss duplication plan. These are the facts and analysis.

Example 8. Plan to duplicate losses through absence of section 754 election; use of partnership not consistent with the intent of Subchapter K.

(i) A owns land with a basis of $100x and a fair market value of $60x. A would like to sell the land to B. A and B devise a plan a principal purpose of which is to permit the duplication, for a substantial period of time, of the tax benefit of A's built-in loss in the land. To effect this plan, A, C (A's brother), and W (C's wife) form partnership PRS, to which A contributes the land, and C and W each contribute $30x. All partnership items are shared in proportion to the partners' respective contributions to PRS. PRS invests the cash in an investment asset (that is not a marketable security within the meaning of section 731(c)). PRS also leases the land to B under a three-year lease pursuant to which B has the option to purchase the land from PRS upon the expiration of the lease for an amount equal to its fair market value at that time. All lease proceeds received are immediately distributed to the partners. In year 3, at a time when the values of the partnership's assets have not materially changed, PRS agrees with A to liquidate A's interest in exchange for the investment asset held by PRS. Under section 732(b), A's basis in the asset distributed equals $100x, A's

basis in A's partnership interest immediately before the distribution. Shortly thereafter, A sells the investment asset to X, an unrelated party, recognizing a $40x loss.

(ii) PRS does not make an election under section 754. Accordingly, PRS's basis in the land contributed by A remains $100x. At the end of year 3, pursuant to the lease option, PRS sells the land to B for $60x (its fair market value). Thus, PRS recognizes a $40x loss on the sale, which is allocated equally between C and W. C's and W's bases in their partnership interests are reduced to $10x each pursuant to section 705. Their respective interests are worth $30x each. Thus, upon liquidation of PRS (or their interests therein), each of C and W will recognize $20x of gain. However, PRS's continued existence defers recognition of that gain indefinitely. Thus, if this arrangement is respected, C and W duplicate for their benefit A's built-in loss in the land prior to its contribution to PRS.

(iii) On these facts, any purported business purpose for the transaction is insignificant in comparison to the tax benefits that would result if the transaction were respected for federal tax purposes (see paragraph (c) of this section). Accordingly, the transaction lacks a substantial business purpose (see paragraph (a)(1) of this section). In addition, factors (1), (2), and (4) of paragraph (c) of this section indicate that PRS was used with a principal purpose to reduce substantially the partners' tax liability in a manner inconsistent with the intent of Subchapter K. On these facts, PRS is not bona fide (see paragraph (a)(1) of this section), and the transaction is not respected under applicable substance over form principles (see paragraph (a)(2) of this section). Further, the tax consequences to the partners do not properly reflect the partners' income; and Congress did not contemplate application of section 754 to partnerships such as PRS, which was formed for a principal purpose of producing a double tax benefit from a single economic loss (see paragraph (a)(3) of this section). Thus, PRS has been formed and availed of with a principal purpose of reducing substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of Subchapter K. Therefore (in addition to possibly challenging the transaction under judicial principles or other statutory authorities, such as the substance over form doctrine or the disguised sale rules under section 707 (see paragraph (h) of this section)), the Commissioner can recast the transaction as appropriate under paragraph (b) of this section.

Example 8 has much to criticize.

Example 8 starts out with loss property, land. Both the buyer and the seller affirmatively cooperate in a loss duplication plan. The plan has a plan a ***principal purpose*** of which is to permit the duplication, for a substantial period of time, of the tax benefit of A's built-in loss in the land.

A and B devise a plan a ***principal purpose*** of which is to permit the duplication, for a substantial period of time, of the tax benefit of A's built-in loss in the land. We are not told precisely what are the facts of the plan or the terms of the plan.

The plan introduces two related parties, C (A's brother), and W (C's wife). The loss property has a basis of $100x and a fair market value of $60x.

We are not told what A's relationships with C and W are – whether they essentially are agents of A, or whether C and W usually act at arm's-length with A. The example may imply that C and W essentially are acting as A's agents in implementing the plan.

The example does not identify whether C is cohabiting with W, although the implication is that C and W are friendly and not facing an imminent hostile divorce.

Presumably,

- A has a 50% interest in PRS and
- C and W each have a 25% interest in PRS.

The example does not identify the volatility of the loss property. This could prove an indispensable issue.

The partners make these contributions to PRS:

- A contributes the land with a loss to partnership PRS.
- C contributes $30x in cash.
- W contributes $30x in cash.

Time of contribution fair market value of the land	$60x
Time of contribution adjusted tax basis of the land	$100x

PRS invests the cash in an investment asset (that is not a marketable security).

The initial values of the investment asset are:

Initial fair market value of investment asset	$60x
Initial adjusted tax basis of investment asset	$60x

The example does not tell us anything more about the investment asset or its volatility. We are not informed why the investment in this investment asset does not give partnership PRS a ***business purpose***. We do not know the volatility of the investment asset.

PRS leases the land (contributed by A) to B (the potential buyer of the land) under a three-year lease. The example does not tell us the terms of the lease and whether the lease is either a triple net lease or a bondable net lease in which the lessee bears all expenses of the property. The lease apparently transfers the use and enjoyment of the land to B during the term of the lease.

The example does not tell us when or how often the rent is payable. The example does not tell us how the rental is determined, but apparently the rent is a fair market value rental. The example does not tell us what is the activity on the land during the term of the lease.

The lease gives B (the potential buyer of the land) the option to purchase the land from PRS upon the expiration of the lease. The purchase price under the option is "the fair market value of the land at the time of expiration of the lease".

The example is ambiguous concerning the purchase price under the option. The option might provide for appraisal of the land and determination of the purchase price at the time of exercise of the lease. The option might provide for an exercise price equal to the estimated fair market value at the time of the expiration of the lease.

All lease proceeds received are immediately distributed to the partners.

In year 3, at a time when the values of the partnership's assets have not materially changed,

- PRS agrees with A to liquidate A's interest in exchange for the investment asset held by PRS. We are not told what the fair market value of the investment asset is at the time of distribution, but the implication is that the investment asset is worth $60 at the time of distribution.
- A's basis in the asset distributed equals $100x, A's basis in A's partnership interest immediately before the distribution [427]
- Shortly thereafter, A sells the investment asset to X, an unrelated party, recognizing a $40x loss.

We do not know whether A is able to use the tax loss on the investment asset in any meaningful way in computing his tax liability.

Note that we presumably would not know at the time the lease is entered that −

- the land would not appreciate during the three year lease term.
- The investment asset would not appreciate or depreciate.

It also is not clear from the example that there was an agreement to liquidate As interest in PRS for the investment asset.

PRS does not make an election under Section 754. There is no obligation to make a Section 754 election.

PRS's basis in the land contributed by A remains $100x.

At the end of year 3,

- pursuant to the lease option, PRS sells the land to B for $60x (its fair market value).

[427] Under I.R.C. § 732(b).

- PRS recognizes a $40x loss on the sale, which is allocated equally between C and W.
- These facts have these effects:
- C's and W's bases in their partnership interests are reduced to $10x each pursuant to Section 705.
- Their respective interests are worth $30x each.
- Upon liquidation of PRS (or their interests therein), each of C and W will recognize $20x of gain.
- PRS's continued existence defers recognition of that gain indefinitely.
- If this arrangement is respected, C and W duplicate for their benefit A's built-in loss in the land prior to its contribution to PRS.

The analysis provides:

- On these facts, any purported ***business purpose*** for the transaction is insignificant in comparison to the tax benefits that would result if the transaction were respected for federal tax purposes (see paragraph (c) of this section).
    - The example more or less stipulates that the partnership has absolutely no ***business purpose*** at all. It then concludes that "any purported ***business purpose*** for the transaction is insignificant in comparison to the tax benefits that would result if the transaction were respected for federal tax purposes."
- Accordingly, the transaction lacks a ***substantial business purpose***, according to the example.
- In addition, factors (1), (2), and (4) of paragraph (c) indicate that PRS was used with a ***principal purpose*** to reduce substantially the partners' tax liability in a manner inconsistent with the intent of Subchapter K. These are those paragraphs:
    - "(1) The present value of the partners' aggregate federal tax liability is substantially less than had the partners owned the partnership's assets and conducted the partnership's activities directly."
        - The transaction presumably must be recharacterized at the time of the formation of PRS on the basis of information known then and expectations expected then (or, at the latest, as of the end of year 1 on the basis of information known at the end of year 1).

- The conclusions that "[t]he present value of the partners' aggregate federal tax liability is substantially less than had the partners owned the partnership's assets and conducted the partnership's activities directly" presumably should be reached based on reasonable expectations existing as of the time PRS was formed (and certainly no later than end of year 1).
- The actual sale prices of the investment asset and the land should be irrelevant to the analysis. What should be relevant are reasonable expectations of future values of the investment asset and the land as of the formation of PRS.
- At the formation of PRS, we do not know that "[t]he present value of the partners' aggregate federal tax liability is substantially less than had the partners owned the partnership's assets and conducted the partnership's activities directly." The example does not provide the information necessary to calculate "[t]he present value of the partners' aggregate federal tax liability" or "[t]he present value of the partners' aggregate federal tax liability . . . had the partners owned the partnership's assets and conducted the partnership's activities directly." The conclusion of reduction of tax liability is all based on implication, not facts.
- We do not have any information at the formation of PRS or at the end of year 1 concerning the likely values of the land and the investment asset.
- We do not know anything about income that might have been earned during the three year period on the investment asset. The implication may be that the investment asset did not earn any income while earned by PRS.
- We do not know anything, at the time at PRS is formed, concerning the expected volatility of the investment asset and the land. The expected volatility of these assets might have affected the analysis.
- All of the parties suffer a significant economic loss on the transaction, since they receive absolutely no return on their investments during the three year period of PRS. This significant economic loss does not seem to be considered in the analysis of the example.

        - One might argue that the example should be limited to its facts and apply only where there is a reasonable expectation that the contributed asset and the investment asset will not appreciate at all during the term of the partnership.
    - "(2) The present value of the partners' aggregate federal tax liability is substantially less than would be the case if purportedly separate transactions that are designed to achieve a particular end result are integrated and treated as steps in a single transaction. For example, this analysis may indicate that it was contemplated that a partner who was necessary to achieve the intended tax results and whose interest in the partnership was liquidated or disposed of (in whole or in part) would be a partner only temporarily in order to provide the claimed tax benefits to the remaining partners."
        - The example reaches this conclusion, but it does not provide sufficient facts, as of the time PRS is formed, to back up this conclusion.
        - The analysis does not explain the scope of "temporarily". All partners are partners only temporarily.
        - See comments above.
    - "(4) Substantially all of the partners (measured by number or interests in the partnership) are related (directly or indirectly) to one another".
        - That does seem to be true.
        - The results might be different if the parties were unrelated.
- The analysis concludes:
    - On these facts, PRS is not *bona fide*.
    - The transaction is not respected under applicable substance over form principles.
    - The tax consequences to the partners do not properly reflect the partners' income.
    - Congress did not contemplate application of Section 754 to partnerships such as PRS, which was formed for a ***principal purpose*** of producing a double tax benefit from a single economic loss.
    - PRS has been formed and availed of with a ***principal purpose*** of reducing substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of Subchapter K.

- Therefore (in addition to possibly challenging the transaction under judicial principles or other statutory authorities, such as the substance over form doctrine or the disguised sale rules under Section 707 (see paragraph (h) of this section)), the Commissioner can recast the transaction as appropriate.

The determination to disregard PRS presumably should be made based on information available at the time PRS was formed (and certainly no later than the end of the taxable year of the formation of PRS).

We can ask how the income of the partnership should have been allocated during the three year period.

We can ask what the result would have been if there had been significant reciprocal movement of the values of the land and the investment asset.

We can ask what the result would have been if, contrary to the earlier plan, the partners did not reach agreement on the liquidation of PRS and PRS never was liquidated, but continued in partnership form.

We can ask what the result would have been if, contrary to the earlier plan, PRS made a Section 754 election on the distribution of the investment asset.

[i] Absence Of Section 754 Election; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 9. Absence of section 754 election; use of partnership consistent with the intent of Subchapter K.

(i) PRS is a bona fide partnership formed to engage in investment activities with contributions of cash from each partner. Several years after joining PRS, A, a partner with a capital account balance and basis in its partnership interest of $100x, wishes to withdraw from PRS. The partnership agreement entitles A to receive the balance of A's capital account in cash or securities owned by PRS at the time of withdrawal, as mutually agreed to by A and the managing general partner, P. P and A agree to distribute to A $100x worth of non-marketable securities (see section 731(c)) in which PRS has an aggregate basis of $20x. Upon distribution, A's aggregate basis in the securities is $100x under section 732(b). PRS does not make an election to adjust the basis in its remaining assets under section 754. Thus, PRS's basis in its remaining assets is unaffected by the distribution. In contrast, if a section 754 election had been in effect for the year of the distribution, under these facts section 734(b) would have required PRS to adjust the basis in its remaining assets downward by the amount of the untaxed appreciation in the distributed property, thus reflecting that gain in PRS's retained assets. In selecting the assets to be distributed, A and P had a principal purpose to take advantage of the facts that A's basis in the securities will be determined by reference to A's basis in its partnership interest under section 732(b), and because PRS will not make an election under section 754, the

remaining partners of PRS will likely enjoy a federal tax timing advantage (i.e., from the $80x of additional basis in its assets that would have been eliminated if the section 754 election had been made) that is inconsistent with proper reflection of income under paragraph (a)(3) of this section.

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The decision to organize and conduct business through PRS is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1) and (2) of this section have been satisfied. The validity of the tax treatment of this transaction is therefore dependent upon whether the transaction satisfies (or is treated as satisfying) the proper reflection of income standard under paragraph (a)(3) of this section. A's basis in the distributed securities is properly determined under section 732(b). The benefit to the remaining partners is a result of PRS not having made an election under section 754. Subchapter K is generally intended to produce tax consequences that achieve proper reflection of income. However, paragraph (a)(3) of this section provides that if the application of a provision of Subchapter K produces tax results that do not properly reflect income, but application of that provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision (and the transaction satisfies the requirements of paragraphs (a)(1) and (2) of this section), then the application of that provision to the transaction will be treated as satisfying the proper reflection of income standard.

(iii) In general, the adjustments that would be made if an election under section 754 were in effect are necessary to minimize distortions between the partners' bases in their partnership interests and the partnership's basis in its assets following, for example, a distribution to a partner. The electively of section 754 is intended to provide administrative convenience for bona fide partnerships that are engaged in transactions for a substantial business purpose, by providing those partnerships the option of not adjusting their bases in their remaining assets following a distribution to a partner. Congress clearly recognized that if the section 754 election were not made, basis distortions may result. Taking into account all the facts and circumstances of the transaction, the electively of section 754 in the context of the distribution from PRS to A, and the ultimate tax consequences that follow from the failure to make the election with respect to the transaction, are clearly contemplated by section 754. Thus, the tax consequences of this transaction will be treated as satisfying the proper reflection of income standard under paragraph (a)(3) of this section. The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Reviewing the facts,

- PRS is a *bona fide* partnership formed to engage in investment activities with contributions of cash from each partner.
- Several years after joining PRS, A, a partner with a capital account balance and basis in its partnership interest of $100x, wishes to withdraw from PRS.
- The partnership agreement entitles A to receive the balance of A's capital account in cash or securities owned by PRS at the time of withdrawal, as mutually agreed to by A and the managing general partner, P.

- P and A agree to distribute to A $100x worth of non-marketable securities[428] in which PRS has an aggregate basis of $20x.
- Upon distribution, A's aggregate basis in the securities is $100[429].
- PRS does not make an election to adjust the basis in its remaining assets under Section 754.
- PRS's basis in its remaining assets is unaffected by the distribution.
    - In contrast,

      if
    - a Section 754 election had been in effect for the year of the distribution,

      then
    - under these facts Section 734(b) would have required PRS to adjust the basis in its remaining assets downward

      by
    - the amount of the untaxed appreciation in the distributed property,
        - thus reflecting that gain in PRS's retained assets.
- In selecting the assets to be distributed,
    - A and P had a ***principal purpose***
        - to take advantage of the facts that
            - A's basis in the securities will be determined by reference to A's basis in its partnership interest[430], and
    - because PRS will not make an election under Section 754,
    - the remaining partners of PRS will likely enjoy a federal tax timing advantage
        - (*i.e.*, from the $80x of additional basis in its assets that would have been eliminated if the Section 754 election had been made)
        - that is inconsistent with proper reflection of income.

The example adopts this analysis:

[428] See I.R.C. § 731(c).
[429] Under I.R.C. § 732(b)
[430] Under I.R.C. § 732(b).

- Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax.
- The decision to organize and conduct business through PRS is consistent with this intent.
- In addition, on these facts, the requirements of paragraphs (a)(1) and (2) of this Section have been satisfied.
    - "(1) The partnership must be *bona fide* and each partnership transaction or series of related transactions (individually or collectively, the transaction) must be entered into for a substantial business purpose."
    - "(2) The form of each partnership transaction must be respected under substance over form principles."
- The validity of the tax treatment of this transaction is therefore

  dependent upon whether

    - the transaction satisfies (or is treated as satisfying) the proper reflection of income standard under paragraph (a)(3).
        - "(3) Except as otherwise provided in this paragraph (a)(3), the tax consequences under Subchapter K to each partner of partnership operations and of transactions between the partner and the partnership must accurately reflect the partners' economic agreement and clearly reflect the partner's income (collectively, PROPER REFLECTION OF INCOME). However, certain provisions of Subchapter K and the regulations thereunder were adopted to promote administrative convenience and other policy objectives, with the recognition that the application of those provisions to a transaction could, in some circumstances, produce tax results that do not properly reflect income. Thus, the proper reflection of income requirement of this paragraph (a)(3) is treated as satisfied with respect to a transaction that satisfies paragraphs (a)(1) and (2) of this section to the extent that the application of such a provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision . . . ."
        - A's basis in the distributed securities is properly determined under Section 732(b).
- The benefit to the remaining partners is a result of PRS not having made an election under Section 754.

- Subchapter K is generally intended to produce tax consequences that achieve proper reflection of income.
- Paragraph (a)(3) provides that −

  if

  - the application of a provision of Subchapter K produces tax results that do not properly reflect income,

  but

  - application of that provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances,
    - are clearly contemplated by that provision and
    - the transaction satisfies the requirements of paragraphs (a)(1) and (2),

  then

  - the application of that provision to the transaction will be treated as satisfying the proper reflection of income standard.
- In general,
  - the adjustments that would be made

    if
  - an election under Section 754 were in effect

    are necessary
  - to minimize distortions between −
    - the partners' bases in their partnership interests and
    - the partnership's basis in its assets following, for example, a distribution to a partner.
- The electivity of Section 754 is intended to provide −
  - administrative convenience for *bona fide* partnerships that are engaged in transactions for a ***substantial business purpose***,

    by providing
  - those partnerships

- the option of not adjusting their bases in their remaining assets following a distribution to a partner.

- Congress clearly recognized that −

  if

  - the Section 754 election were not made,

  then

  - basis distortions may result.

- Taking into account all the facts and circumstances of the transaction,
  - the electively of Section 754 in the context of the distribution from PRS to A, and
  - the ultimate tax consequences that follow from the failure to make the election with respect to the transaction,
  - are clearly contemplated by Section 754.

- Thus, the tax consequences of this transaction will be treated as satisfying the proper reflection of income standard under paragraph (a)(3).

- The Commissioner therefore cannot invoke paragraph (b) to recast the transaction.

[j] Basis Adjustments Under Section 732; Use Of Partnership Consistent With The Intent Of Subchapter K.

Example 10. Basis adjustments under section 732; use of partnership consistent with the intent of Subchapter K.

(i) A, B, and C are partners in partnership PRS, which has for several years been engaged in substantial bona fide business activities. For valid business reasons, the partners agree that A's interest in PRS, which has a value and basis of $100x, will be liquidated with the following assets of PRS: a nondepreciable asset with a value of $60x and a basis to PRS of $40x, and related equipment with two years of cost recovery remaining and a value and basis to PRS of $40x. Neither asset is described in section 751 and the transaction is not described in section 732(d). Under section 732(b) and (c), A's $100x basis in A's partnership interest will be allocated between the nondepreciable asset and the equipment received in the liquidating distribution in proportion to PRS's bases in those assets, or $50x to the nondepreciable asset and $50x to the equipment. Thus, A will have a $10x built-in gain in the nondepreciable asset ($60x value less $50x basis) and a $10x built-in loss in the equipment ($50x basis less $40x value), which it expects to recover rapidly through cost recovery deductions. In selecting the assets to be distributed to A, the partners had a principal purpose to take advantage of the fact that A's basis in the assets will be determined by reference to

A's basis in A's partnership interest, thus, in effect, shifting a portion of A's basis from the nondepreciable asset to the equipment, which in turn would allow A to recover that portion of its basis more rapidly. This shift provides a federal tax timing advantage to A, with no offsetting detriment to B or C.

(ii) Subchapter K is intended to permit taxpayers to conduct joint business activity through a flexible economic arrangement without incurring an entity-level tax. See paragraph (a) of this section. The decision to organize and conduct business through PRS is consistent with this intent. In addition, on these facts, the requirements of paragraphs (a)(1) and (2) of this section have been satisfied. The validity of the tax treatment of this transaction is therefore dependent upon whether the transaction satisfies (or is treated as satisfying) the proper reflection of income standard under paragraph (a)(3) of this section. Subchapter K is generally intended to produce tax consequences that achieve proper reflection of income. However, paragraph (a)(3) of this section provides that if the application of a provision of Subchapter K produces tax results that do not properly reflect income, but the application of that provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision (and the transaction satisfies the requirements of paragraphs (a)(1) and (2) of this section), then the application of that provision to the transaction will be treated as satisfying the proper reflection of income standard.

(iii) A's basis in the assets distributed to it was determined under section 732(b) and (c). The transaction does not properly reflect A's income due to the basis distortions caused by the distribution and the shifting of basis from a nondepreciable to a depreciable asset. However, the basis rules under section 732, which in some situations can produce tax results that are inconsistent with the proper reflection of income standard (see paragraph (a)(3) of this section), are intended to provide simplifying administrative rules for bona fide partnerships that are engaged in transactions with a substantial business purpose. Taking into account all the facts and circumstances of the transaction, the application of the basis rules under section 732 to the distribution from PRS to A, and the ultimate tax consequences of the application of that provision of Subchapter K, are clearly contemplated. Thus, the application of section 732 to this transaction will be treated as satisfying the proper reflection of income standard under paragraph (a)(3) of this section. The Commissioner therefore cannot invoke paragraph (b) of this section to recast the transaction.

Example 10 considers basis adjustments under Section 732; use of partnership consistent with the intent of Subchapter K.

- A, B, and C are partners in partnership PRS.
- PRS for several years been engaged in **substantial *bona fide* business activities**.
- For valid **business reasons**,
  - the partners agree that A's interest in PRS, which has a value and basis of $100x, will be liquidated with the following assets of PRS:
    - a nondepreciable asset with

        - a value of $60x and
        - a basis to PRS of $40x, and
    - related equipment with
        - two years of cost recovery remaining and
        - a value and basis to PRS of $40x.
- Neither asset is described in Section 751.
- The transaction is not described in Section 732(d).
- A's $100x basis in A's partnership interest will be allocated between
    - the nondepreciable asset and
    - the equipment received in the liquidating distribution

    in proportion to
- PRS's bases in those assets,

    or
    - $50x to the nondepreciable asset and
    - $50x to the equipment[431]
- Thus, A will have –
    - a $10x built-in gain in the nondepreciable asset ($60x value less $50x basis) and
    - a $10x built-in loss in the equipment ($50x basis less $40x value), which it expects to recover rapidly through cost recovery deductions.
- In selecting the assets to be distributed to A,
    - the partners had a ***principal purpose***
        - to take advantage of the fact that A's basis in the assets will be determined by reference to A's basis in A's partnership interest,
            - thus, in effect, shifting a portion of A's basis from the nondepreciable asset to the equipment,
                - which in turn would allow A to recover that portion of its basis more rapidly.

[431] Under I.R.C. § 732(b), (c).

- This shift provides a federal tax timing advantage to A, with no offsetting detriment to B or C.

The example adopts this analysis:

- Subchapter K is intended to permit taxpayers
  - to conduct joint business activity
  - through a flexible economic arrangement
  - without incurring an entity-level tax.
- The decision to organize and conduct business through PRS is consistent with this intent.
- In addition, on these facts, the requirements of paragraphs (a)(1) and (2) have been satisfied.
  - "(1) The partnership must be *bona fide* and each partnership transaction or series of related transactions (individually or collectively, the transaction) must be entered into for a substantial business purpose."
  - "(2) The form of each partnership transaction must be respected under substance over form principles."
- The validity of the tax treatment of this transaction is dependent upon whether the transaction satisfies (or is treated as satisfying) the proper reflection of income standard under paragraph (a)(3).
  - "(3) Except as otherwise provided in this paragraph (a)(3), the tax consequences under Subchapter K to each partner of partnership operations and of transactions between the partner and the partnership must accurately reflect the partners' economic agreement and clearly reflect the partner's income (collectively, PROPER REFLECTION OF INCOME). However, certain provisions of Subchapter K and the regulations thereunder were adopted to promote administrative convenience and other policy objectives, with the recognition that the application of those provisions to a transaction could, in some circumstances, produce tax results that do not properly reflect income. Thus, the proper reflection of income requirement of this paragraph (a)(3) is treated as satisfied with respect to a transaction that satisfies paragraphs (a)(1) and (2) of this section to the extent that the application of such a provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision . . . ."

- Subchapter K is generally intended to produce tax consequences that achieve proper reflection of income.
- Paragraph (a)(3) provides that −

  if

  - the application of a provision of Subchapter K produces tax results that do not properly reflect income,

  but

  - the application of that provision to the transaction and the ultimate tax results, taking into account all the relevant facts and circumstances,
  - are clearly contemplated by that provision (and the transaction satisfies the requirements of paragraphs (a)(1) and (2)),

  then

  - the application of that provision to the transaction will be treated as satisfying the proper reflection of income standard.
- A's basis in the assets distributed to it was determined under Section 732(b) and (c).
- The transaction does not properly reflect A's income due to the basis distortions caused by the distribution and the shifting of basis from a nondepreciable to a depreciable asset.
- The basis rules under Section 732,
  - which in some situations can produce tax results that are inconsistent with the proper reflection of income standard,

    are intended

  - to provide simplifying administrative rules for *bona fide* partnerships
    - that are engaged in transactions with a ***substantial business purpose***.
- Taking into account all the facts and circumstances of the transaction,
  - the application of the basis rules under Section 732 to the distribution from PRS to A, and
  - the ultimate tax consequences of the application of that provision of Subchapter K,
  - are clearly contemplated.

- The application of Section 732 to this transaction will be treated as satisfying the proper reflection of income standard under paragraph (a)(3).
- The Commissioner cannot invoke paragraph (b) to recast the transaction.

[k] Basis Adjustments Under Section 732; Plan Or Arrangement To Distort Basis Allocations Artificially; Use Of Partnership Not Consistent With The Intent Of Subchapter K.

Example 11. Basis adjustments under section 732; plan or arrangement to distort basis allocations artificially; use of partnership not consistent with the intent of Subchapter K.

(i) Partnership PRS has for several years been engaged in the development and management of commercial real estate projects. X, an unrelated party, desires to acquire undeveloped land owned by PRS, which has a value of $95x and a basis of $5x. X expects to hold the land indefinitely after its acquisition. Pursuant to a plan a principal purpose of which is to permit X to acquire and hold the land but nevertheless to recover for tax purposes a substantial portion of the purchase price for the land, X contributes $100x to PRS for an interest therein. Subsequently (at a time when the value of the partnership's assets have not materially changed), PRS distributes to X in liquidation of its interest in PRS the land and another asset with a value and basis to PRS of $5x. The second asset is an insignificant part of the economic transaction but is important to achieve the desired tax results. Under section 732(b) and (c), X's $100x basis in its partnership interest is allocated between the assets distributed to it in proportion to their bases to PRS, or $50x each. Thereafter, X plans to sell the second asset for its value of $5x, recognizing a loss of $45x. In this manner, X will, in effect, recover a substantial portion of the purchase price of the land almost immediately. In selecting the assets to be distributed to X, the partners had a principal purpose to take advantage of the fact that X's basis in the assets will be determined under section 732(b) and (c), thus, in effect, shifting a portion of X's basis economically allocable to the land that X intends to retain to an inconsequential asset that X intends to dispose of quickly. This shift provides a federal tax timing advantage to X, with no offsetting detriment to any of PRS's other partners.

(ii) Although section 732 recognizes that basis distortions can occur in certain situations, which may produce tax results that do not satisfy the proper reflection of income standard of paragraph (a)(3) of this section, the provision is intended only to provide ancillary, simplifying tax results for bona fide partnership transactions that are engaged in for substantial business purposes. Section 732 is not intended to serve as the basis for plans or arrangements in which inconsequential or immaterial assets are included in the distribution with a principal purpose of obtaining substantially favorable tax results by virtue of the statute's simplifying rules. The transaction does not properly reflect X's income due to the basis distortions caused by the distribution that result in shifting a significant portion of X's basis to this inconsequential asset. Moreover, the proper reflection of income standard contained in paragraph (a)(3) of this section is not treated as satisfied, because, taking into account all the facts and circumstances, the application of section 732 to this arrangement, and the ultimate tax consequences that would thereby result, were not clearly contemplated by that provision of

Subchapter K. In addition, by using a partnership (if respected), the partners' aggregate federal tax liability would be substantially less than had they owned the partnership's assets directly (see paragraph (c)(1) of this section). On these facts, PRS has been formed and availed of with a to reduce the taxpayers' aggregate federal tax liability in a manner that is inconsistent with the intent of Subchapter K. Therefore (in addition to possibly challenging the transaction under applicable judicial principles and statutory authorities, such as the disguised sale rules under section 707, see paragraph (h) of this section), the Commissioner can recast the transaction as appropriate under paragraph (b) of this section.

The regulations advise:

(e) Abuse of entity treatment.

(1) General rule. The Commissioner can treat a partnership as an aggregate of its partners in whole or in part as appropriate to carry out the purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder.

(2) Clearly contemplated entity treatment. Paragraph (e)(1) of this section does not apply to the extent that --

(i) A provision of the Internal Revenue Code or the regulations promulgated thereunder prescribes the treatment of a partnership as an entity, in whole or in part, and

(ii) That treatment and the ultimate tax results, taking into account all the relevant facts and circumstances, are clearly contemplated by that provision.

These are the basic facts:

- Partnership PRS has for several years been engaged in the development and management of commercial real estate projects.
- X, an unrelated party, desires to acquire undeveloped land owned by PRS, which has
  - a value of $95x and
  - a basis of $5x.
- X expects to hold the land indefinitely after its acquisition.
- Pursuant to a plan –
  - a ***principal purpose*** of which is
    - to permit X to acquire and hold the land

      but
    - nevertheless to recover for tax purposes a substantial portion of the purchase price for the land,
  - X contributes $100x to PRS for an interest in PRS.

- Subsequently (at a time when the value of the partnership's assets have not materially changed),
    - PRS distributes to X in liquidation of its interest in PRS
        - the land and
        - another asset with a value and basis to PRS of $5x.
- The second asset is an insignificant part of the economic transaction but is important to achieve the desired tax results.
- X's $100x basis in its partnership interest is allocated between the assets distributed to it
    - in proportion to their bases to PRS, or $50x each [432]
- Thereafter, X plans
    - to sell the second asset for its value of $5x,
    - recognizing a loss of $45x.
- In this manner, X will, in effect, recover a substantial portion of the purchase price of the land almost immediately.
- In selecting the assets to be distributed to X,
    - the partners had a ***principal purpose*** to take advantage of the fact that
        - X's basis in the assets will be determined under Section 732(b) and (c),
            - thus, in effect, shifting a portion of X's basis economically allocable to the land that X intends to retain to an inconsequential asset that X intends to dispose of quickly.
- This shift provides a federal tax timing advantage to X, with no offsetting detriment to any of PRS's other partners.
- Although
    - Section 732 recognizes that basis distortions can occur in certain situations,
        - which may produce tax results that do not satisfy the proper reflection of income standard of paragraph (a)(3),

[432] Under I.R.C. § 732(b), (c),

    - the provision is intended only to provide ancillary, simplifying tax results for *bona fide* partnership transactions that are engaged in for ***substantial business purposes***.
- Section 732 is not intended to serve as the basis for plans or arrangements in which inconsequential or immaterial assets are included in the distribution with a ***principal purpose*** of obtaining substantially favorable tax results by virtue of the statute's simplifying rules.
- The transaction does not properly reflect X's income due to the basis distortions caused by the distribution that result in shifting a significant portion of X's basis to this inconsequential asset.
- Moreover, the proper reflection of income standard contained in paragraph (a)(3) is not treated as satisfied,

  because,

    - taking into account all the facts and circumstances,
        - the application of Section 732 to this arrangement, and
        - the ultimate tax consequences that would thereby result,
        - were not clearly contemplated by that provision of Subchapter K.
- In addition,
    - by using a partnership (if respected),
    - the partners' aggregate federal tax liability
    - would be substantially less than
    - had they owned the partnership's assets directly.
- On these facts, PRS has been formed and availed of with a ***principal purpose*** to reduce the taxpayers' aggregate federal tax liability in a manner that is inconsistent with the intent of Subchapter K.
- Therefore (in addition to possibly challenging the transaction under applicable judicial principles and statutory authorities, such as the disguised sale rules under Section 707),
    - the Commissioner can recast the transaction as appropriate under paragraph (b) of this section.

[7] Section 704: Partnership Allocation Regulations.

The Section 1.704-1 regulations under Section 704 concerning partnership allocations are clearly interpretive regulations. Those regulations had a much stronger defense under *Chevron*. The government may have a more difficult time defending its Section 704r regulations under *Loper Bright Enterprises*.

From the government's perspective, the current Section 704 regulations have the advantage that most of the regulations were published in the1980's. These regulations have been in place for a significant time period. There nevertheless have been few cases interpreting these regulations. Also, in some areas, the regulations create a minefield of confusion.

The substantiality regulations are essentially antiabuse regulations. At best, the regulations concerning substantiality can be difficult to apply in practice. The substantiality regulations appear to provide mathematical tests of partnership allocations. How to undertake these tests mathematically can be uncertain. It is also possible that the mathematical operation of these regulations is more metaphorical than objective. It is difficult to predict how the substantiality regulations will fare if they are comprehensively attacked in tax litigation. The substantiality regulations read much more like legislative regulations than interpretive regulations. It is hard to say that the substantiality regulations reflect merely a plain reading of the statute or that the substantiality regulations follow clearly from legislative history or case law.

The general rules of economic effect are defensible in terms of tax history in case law and legislative history. The general concept of capital account analysis seems to be well grounded in case law and should be defensible as a general matter. Nevertheless, the economic effect rules are highly nuanced. The economic effect rules are written as if they were legislative regulations. Many of the nuances of the economic effect rules go far beyond tax history of case law and could be challenged under *Loper Bright Enterprises*. *Corner Post* also may invite a challenge to these regulations.

The qualified income offset may invite challenge.

Partners and partnerships also might challenge the Section 704 regulations concerning "book"-up events. Few practitioners pay attention to the requirement of the regulations that "[t]he adjustments are made principally for a substantial non-tax business purpose."

The partners' interests in the partnership regulations particularly invite challenge. These regulations are imprecise and difficult to interpret. There are many unresolved questions under partners' interests in the partnership, such as the effect of a retiring partner on partners' interests in the partnership allocations, when a partnership using partners' interests in the partnership can rebook partnership assets, what happens when net income and net loss allocations do not equalize target capital accounts and adjusted capital accounts, and how

partners' interests in the partnership is generally applied to real situations. A court may have trouble applying these partners' interests in the partnership regulations to determine precise results in practical case. One question is whether the current partners' interests in the partnership relations would add very much to the analysis of a tax litigation beyond what already is present in case law. It is difficult to predict how the partners' interests in the partnership regulations will fare in litigation, but the partners' interests in the partnership regulations could be a target under *Loper Bright Enterprises* and *Corner Post* if the Internal Revenue Service ever begins challenging taxpayer positions in profit and loss allocation cases.

Taxpayers may discover that target allocation provisions do not fare well in tax litigation either under the partners' interests in the partnership regulations or under case law or legislative history. This is especially the case where the target allocation provision is applied to the liquidation of a partner's interest in the partnership. Target allocations, if controlling, depend on an interpretation of partners' interests in the partnership. The current partners' interests in the partnership regulations are difficult to apply. The partners' interests in the partnership regulations merely provide a nonexclusive list of factors and do not set forth a clear, careful analytical structure.

There is much about the Section 704(c)(1) regulations that could be questioned. These regulations are legislative regulations: "Under regulations prescribed by the Secretary". This creates a strong presumption of correctness of the regulations. They will generally be difficult to challenge in litigation.

Partners may assert that they should be entitled to aggregate assets for purposes of Section 704(c) despite the rules of the regulations to the contrary. Partners could dispute how Section 704(c) should operate in the case of the retirement of a partner. Someone could dispute what securities partnerships are permitted to aggregate assets and even whether any securities partnership should be able to aggregate assets. The general features of the traditional method under Section 704(c) should be sustainable by the Internal Revenue Service in litigation. The remedial method which depends on the generation of phantom income and loss could be a target in tax litigation if a taxpayer were to choose to challenge this method. The Internal Revenue Service might have a difficult case in tax litigation establishing the validity of remedial allocations on account of the generation of remedial income and loss, for which there is no direct approval in the Code. The traditional method with curative allocations may be easier for the Internal Revenue Service to defend in this method under Section 704(c) were attacked in litigation.

The Section 1.704-3 regulations concerning allocations with respect to contributed property contain an anti-abuse rule. The rule provides that:

> *(i) In general. An allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of*

built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. For purposes of this paragraph (a)(10), all references to the partners shall include both direct and indirect partners. [433]

This antiabuse rule is interpretive rather than legislative. The regulation depends on the evil views of taxpayers, which makes the rule more subjective than objective. It can be difficult to establish taxpayer state of mind. Nevertheless, the anti-abuse rule may be sustainable by the Internal Revenue Service in tax litigation under general tax principles without having to rely on a strong presumption in favor or Internal Revenue Service regulations. On the other hand, taxpayers might be tempted to challenge the Section 704(c) antiabuse rule under *Loper Bright Enterprises* in appropriate circumstances.

Section 704(b) has become substantially the creature of interpretive regulations. Most of these regulations are well established, but they have not been tested under *Loper Bright Enterprises*.

The most basic regulations under Section 704 are Section 1.704-1, concerning partnership allocations, Section 1.704-2 concerning nonrecourse deductions, and Section 1.704-3 concerning contributed property. These are all interpretive regulations. These regulations have generally been around for decades, although they are not frequently applied by the courts in tax litigation.

Regulations under Section 704(c)(1)(C) will be legislative regulations.

Section 704(c)(2) disguised sale regulations (Section 1.704-4) are legislative regulations.

Regulations under Section 704(c)(3) (Section 1.704-3) (concerning "contributions by a partner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items") are legislative regulations.

The Section 1.704-1 regulations concerning the limitation on allowance of partnership losses are interpretive regulations, but are not especially controversial.

The Section 1.704-1 regulations concerning recognizing a donee as a partner are interpretive regulations.

The precise tests of economic effect under Section 1.704-1 do not all automatically flow from a literal reading of Section 1.704-1. The statute refers to "substantial economic effect" in a few words, and yet the regulations expand this to a discussion that takes up many pages. These regulations read much more like legislative regulations more than simple interpretive regulations. Most of the basic concepts of economic effect are based on earlier case law. Many of the details of the Section 1.704-1 regulations might be challenged in litigation under principles of *Loper Bright Enterprises*. The regulations provide much more than a straight-forward interpretation of statutory language.

[433] Treas. Reg. § 1.704-3(a)(10).

The overall capital account analysis of the regulations is solidly grounded. The intricate detail of the rules of capital account maintenance do not automatically flow from the language of Section 704. The capital account maintenance rules in some respects expand substantially on the statute.

The "book" up rules similarly do not follow from a literal reading of the statute.

The alternative test of economic effect might be contested in tax litigation.

The economic equivalence test similarly might be contested in litigation.

The value equals "book" presumption of the regulations might fall under *Loper Bright Enterprises* if that presumption were to be contested in tax litigation.

The precise rules for deficit restoration, particularly their time periods, do not follow directly from the statute and could be questioned.

The economic equivalence test seems to be independent of case law and the language of the statute.

The rules of substantiality expand on the language of the statute and do not follow direct from case law. The substantiality rules read much more like legislative regulations, but they are not legislative regulations. This creates vulnerability in tax litigation.[434] The precise operation of the shifting tax consequences rules and transitory allocation rules similarly may go beyond a simple literal reading of the statute. These observations all create the potential for taxpayers seeking to invalidate portions of the Section 1.704-1 regulations in tax litigation.

The rules of nonrecourse deductions under Section 1.704-2 governing are highly detailed and complex. These rules hardly follow from a literal reading of Section 704. This creates vulnerability.[435] Beyond that, there are no rules provided in the regulations where allocations of losses do not have substantial economic effect.

Section 1.704-3 regulations concerning allocations with respect to contributed property are legislative regulations and are entitled to considerable deference under *Loper Bright Enterprises*. Partnerships can be loose in their compliance with these regulations, which many advisors do not understand well. The area of Section 1.704-3 can be ripe for future tax litigation, as so many taxpayer positions materially depart from the regulations.

The Internal Revenue Service, however, might receive some pressure to defend its special aggregation rules for securities from both sides. Some taxpayers might argue that they should be able to aggregate assets when the regulations do not permit aggregation. Other taxpayers might argue that securities partnerships should not be able aggregate. Parenthetically, there seems to be substantial abusive practices in the securities industry concerning using the securities aggregation rules to create special allocations to retiring partners by using "fill-up"

[434] See note 77.

[435] See note 77.

allocations to retiring partners under the premise of applying aggregation rules under Section 1.704-3.

One would imagine that, sooner or later, these practices will be challenged by the Internal Revenue Service. The Internal Revenue Service presumably will argue that stuffing allocations to retiring under the securities aggregation rules are not permitted. Thus American Revolution, the Internal Revenue Service has not shown much interest in this area.

Section 1.704-4 regulations concerning distributive shares when a partner's interest varies similarly are legislative regulations that will be difficult to invalidate under *Loper Bright Enterprises*.

[8] Section 705: Basis.

Regulations under Section 705 concerning a partner's basis in his partnership interest are interpretive regulations rather than legislative. Nevertheless, these regulations have not been particularly controversial.

The regulations fail to consider basis consequences of a sale of a portion of a partnership interest. Revenue rulings in this area have been more controversial and certainly might be challenged by taxpayers. These revenue rulings are not entitled to any special deference under *Loper Bright Enterprises*.

[9] Section 706: Taxable Year Of A Partnership.

References to regulations are spread through Section 706 concerning determining the taxable year of a partner and the effects of the change in a partner's interest in the partnership during the taxable year. Where these references exist and to the extent that these references mandate regulations, the resulting regulations should be legislative regulations and subject to a high level of deference under *Loper Bright Enterprises*.

Section 1.706-1 regulations (taxable years of partner and partnership) are generally interpretive, but not especially controversial.

Section 1.706-4 prescribes legislative regulations for determining a distributive share when a partner's interest in the partnership varies during the taxable year.

[10] Section 707: Disguised Sale and Guaranteed Payments.

Section 1.707-1 concerning transactions between a partner and his partnership is an interpretive regulation. This regulation has not been especially controversial.

The portion of 1.707-1 concerning guaranteed payments is an interpretive regulation. This regulation has not been especially controversial for the most part; however, there are substantial gaps in the regulation. A guaranteed payment is not defined with adequate precision. For example, it can be difficult to distinguish a preferred partnership interest from a guaranteed payment. The regulation does not detail the effects of the payment of a guaranteed payment with a property distribution. The regulation does not discuss conversion of rights to guaranteed payments from preferred partnership interests and the reverse. The regulation does not discuss whether a partner holding only a right to a guaranteed payment is properly treated as a partner for tax purpose. The regulation does not discuss the possible treatment of guaranteed payments as interest. Much is left to future Internal Revenue Service pronouncements or to future tax litigation.

The disguised sale rules of Section 707(a) begin with the statement "Under regulations prescribed by the Secretary . . . ." The Section 1.707-4 disguised sale regulations are clearly legislative regulations. This includes the antiabuse rule of Section 1.707-4(d)(4)(ii): "(ii) Anti-abuse rule. If capital expenditures and a qualified liability are incurred under a plan a principal purpose of which is to avoid the requirements of paragraph (d)(4)(i) of this section, the capital expenditures are deemed funded by the qualified liability." The Section 707 disguised sale regulations should be entitled to a high level of deference as legislative regulations. The regulations' status as legislative regulations provides the Internal Revenue Service with a powerful weapon in defending the validity of the regulations.

[11] Section 708: Continuation of a Partnership.

Regulations under Section 708 are interpretive rather than legislative regulations.

The problem with Section 708 regulations is not so much what the regulations say but what the regulations do not say or do not cover. The regulations do not provide details concerning what transaction it means for "no part of any business, financial operation, or venture of the partnership [to] continue[] to be carried on by any of its partners in a partnership." The regulations also do not materially discuss what is a merger or division of a partnership. The regulations do not provide a comprehensive discussion of the tax effects of a merger or division of a partnership. Any authority that the Internal Revenue Service may publish on this will be merely administrative guidance and will not be a legislative regulation. Thus far, the Internal Revenue Service has not engaged many of the real tax issues of Section 708. This makes is difficult for Internal Revenue Service auditors to audit Section 708 issues. This may make litigation on Section 708 issues difficult.

[12] Section 709: Organizational and Syndication Fees.

Regulations under Section 709(b)(1) are legislative regulations and entitled to a high degree of deference. This has not been an area of controversy.

[13] Section 721: Contributions.

Regulations under Section 721 are generally interpretive regulations. Section 721(a) regulations are not especially controversial.

Section 1.721-2 governs exercise of a noncompensatory option to acquire a partnership interest when the holder pays the exercise price with either property or cash, regardless of whether the terms of the option require or permit cash payment. These are interpretive regulations.

The extensive regulations under Section 721(c) concern transfers of property to a partnership if gain, when recognized, will be includible in the income of a non-United States person are legislative regulations entitled to a high degree of deference under *Loper Bright Enterprises*. These regulations will be a challenge for taxpayers to challenge in tax litigation. This includes the antiabuse rule of Section 1.721(c)-1(d): "If a U.S. transferor engages in a transaction (or series of transactions) or an arrangement with a principal purpose of avoiding the application of the Section 721(c) regulations, the transaction (or series of transactions) or the arrangement may be recharacterized (including by aggregating or disregarding steps or disregarding an intermediate entity) in accordance with its substance."

Regulations under Section 721(d) concerning transfers of intangibles, when published, will be legislative regulations entitled to a high degree of deference under *Loper Bright Enterprises*.

[14] Section 722: Basis of Contributing Partner's Interest.

Section 722 regulations are comparatively uncontroversial, as far as they go. There is not much about the current Section 722 regulations that seems controversial. The Section 722 regulations are solidly grounded in tax theory. These regulation are merely interpretive regulations, but these regulations represent a reasonable interpretation of Section 722.

The Section 722 regulations do not go far enough. It is not so much what the Section 722 regulations say, but more what the Section 722 regulations do not say. The Section 722 regulations are especially deficient in failing to address basis effects of transfers of

a portion of a partnership interest. The Internal Revenue Service has sought to fill in the gaps in the regulations with Revenue Ruling 84-53.[436]

The tax basis in a partnership interest must be allocated between the partnership interest that is sold and the partnership interest that is retained. Some advisors are unhappy with the advice that Revenue Ruling 2024-14 provides concerning allocating tax basis between a partnership interest that is sold and a partnership interest that is retained.

Revenue Ruling 84-53 is designed to address comparatively simple situations and does not necessarily respond well to more economically complex partnership interests. Some advisors believe that the results of Revenue Ruling 84-53 can be inappropriate in more challenging situations. Revenue Ruling 84-53 is subregulatory guidance and under *Loper Bright Enterprises* is not entitled to a high level of deference. Under *Loper Bright Enterprises*, some advisors may be tempted to challenge the analysis and the conclusions of Revenue Ruling 84-53.

A partner who holds multiple interests in a partnership is treated as holding a single unitary partnership interest. By extension of reasoning, a partner has a unitary basis in all of his interests in the partnership. This basis must be apportioned between an interest retained and an interest transferred. In doing so, it is necessary to consider basis consequences of the inclusion of partnership liabilities in basis of a partnership interest. There unfortunately is not adequate guidance concerning the apportionment of minimum gain between the interest retained and the interest that is transferred.

Under Revenue Ruling 84-53, the general rule is that, when a partner makes a taxable disposition of a portion of an interest in a partnership,

an amount which bears the same relation to

the partner's basis in the partner's entire interest as

the basis of the transferred portion of the interest

generally equals

the fair market value of the transferred portion of the interest

bears to

the fair market value of the entire interest.

[436] 1984-1 C.B. 159.

If the partnership has liabilities, special adjustments must be made to take into account the effect of those liabilities on the basis of the partner's interest.

In cases where the partner's share of all partnership liabilities does not exceed the adjusted basis of such partner's entire interest (including basis attributable to liabilities),

- the transferor partner first excludes from the adjusted basis of the partner's entire interest

  an amount equal to –

  - the partner's share of all partnership liabilities, as determined under Section 1.752-1(e).

- a part of the remaining adjusted basis (if any) is allocated to the transferred portion of the interest according to

  the ratio of –

  the fair market value of the transferred portion of the interest *to* the fair market value of the entire interest.

sum of –

adjusted basis of transferred portion of interest *equals* amount so allocated

plus

amount of partner's share of liabilities that is considered discharged on disposition of transferred portion of interest (under Section 752(d) and Section 1.1001-2)

If the partner's share of all partnership liabilities exceeds the adjusted basis of such partner's entire interest (including basis attributable to liabilities),

an amount that bears same relation to

partner's adjusted basis in entire interest as

partner's share of liabilities that is considered discharged on disposition of transferred portion of interest

adjusted basis of transferred portion of interest *equals*

bears to

partner's share of all partnership liabilities, as determined under Section 1.752-1(e).

Revenue Ruling 84-53 advises generally:

> *Under section 1.61-6(a) of the regulations, when a partner makes a taxable disposition of a portion of an interest in a partnership, the basis of the transferred portion of the interest generally equals an amount which bears the same relation to the partner's basis in the partner's entire interest as the fair market value of the transferred portion of the interest bears to the fair market value of the entire interest. However, if such partnership has liabilities, special adjustments must be made to take into account the effect of those liabilities on the basis of the partner's interest.*
>
> *In cases where the partner's share of all partnership liabilities does not exceed the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the transferor partner shall first exclude from the adjusted basis of such partner's entire interest an amount equal to such partner's share of all partnership liabilities, as determined under section 1.752-1(e) of the regulations. A part of the remaining adjusted basis (if any) shall be allocated to the transferred portion of the interest according to the ratio of the fair market value of the transferred portion of the interest to the fair market value of the entire interest. The sum of the amount so allocated plus the amount of the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest (under section 752(d) of the Code and section 1.1001-2 of the regulations) equals the adjusted basis of the transferred portion of the interest.*
>
> *On the other hand, if the partner's share of all partnership liabilities exceeds the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the adjusted basis of the transferred portion of the interest equals an amount that bears the same relation to the partner's adjusted basis in the entire interest as the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest bears to the partner's share of all partnership liabilities, as determined under section 1.752-1(e).*

This is situation 1 in Revenue Ruling 84-53:

In 1978, Y was formed as a limited partnership under the Uniform Limited Partnership Act of State N for the purpose of investing and trading in stocks and securities. Y has a calendar taxable year. A contributed $50x to Y in exchange for a general partner interest, entitling A to a 50 percent interest in all partnership distributions and in partnership income, gain, loss, and deduction. B contributed $50x to Y in exchange for a limited partner interest, entitling B to a 50 percent interest in all partnership distributions and in partnership income, gain, loss, and deduction.

On January 1, 1980, when the stock and securities of Y had decreased in value from $100x to $64x, B sold to A one half of B's limited partner interest for $16x, which interest A holds as a limited partner.

On January 1, 1982, when the stock and securities of Y has risen in value from $64x (its 1980 value) to $120x, A sold to C one-half of A's general partner interest for $30x. Immediately prior to the sale, A's entire partnership interest had a fair market value of $90x and the transferred portion of the interest had a fair market value of $30x. Since formation, the partnership has made cash distributions in an amount equal to its total income (including tax-exempt income). Assume that all partnership allocations (in all situations) are valid, and that A, B, and C are unrelated parties.

The analysis of Revenue Ruling 84-53 continues:

The tax consequences of B's sale of one-half of B's limited partner interest to A are identical to those described in Situation 1.

In 1981, A's basis in A's entire partnership interest was increased from $66x to $146x as a result of the $80x recourse borrowing (which increases only the basis of A, the sole general partner, under section 1.752-1(e) of the regulations and sections 752(a) and 722 of the Code) and was decreased to $86x as a result of the $60x loss allocated to A that year when the securities became worthless. Thus, prior to the sale of one-half of A's general partner interest to C, the adjusted basis of A's entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on A's adjusted basis, $80x (A's share of all partnership liabilities) is subtracted from $86x, leaving $6x. Because the fair market value of the transferred portion of A's interest ($10x) is one-third of the fair market value of the entire interest ($30x), $2x (½ of $6x) of the remaining adjusted basis must be allocated to the transferred portion of A's general partner interest. The sum of that amount ($2x) plus the amount of partnership liabilities from which A is discharged on the disposition of the transferred portion of A's general partner interest ($40), or $42x, equals the adjusted basis of the transferred portion of the interest. A realizes an $8x gain ($10x + $40x $42x) on the sale to C. The basis of the remainder of A's partnership interest is $44x ($86x $42x).

This is situation 2 in Revenue Ruling 84-53:

The facts are the same as in Situation 1 except that, in 1981, Y borrowed $80x recourse which was invested in securities that became worthless on December 31, 1981. Furthermore, immediately prior to A's sale to C, A's entire partnership interest had a fair market value of $30x and the transferred portion of A's interest had a fair market value of $10x.

This is the analysis that Revenue Ruling 84-53 provides:

The tax consequences of B's sale of one-half of B's limited partner interest to A are identical to those described in Situation 1.

In 1981, A's basis in A's entire partnership interest was increased from $66x to $146x as a result of the $80x recourse borrowing (which increases only the basis of A, the sole general partner, under section 1.752-1(e) of the regulations and sections 752(a) and 722 of the Code) and was decreased to $86x as a result of the $60x loss allocated to A that year when the securities became worthless. Thus, prior to the sale of one-half of A's general partner interest to C, the adjusted basis of A's entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on A's adjusted basis, $80x (A's share of all partnership liabilities) is subtracted from $86x, leaving $6x. Because the fair market value of the transferred portion of A's interest ($10x) is one-third of the fair market value of the entire interest ($30x), $2x (½ of $6x) of the remaining adjusted basis must be allocated to the transferred portion of A's general partner interest. The sum of that amount ($2x) plus the amount of partnership liabilities from which A is discharged on the disposition of the transferred portion of A's general partner interest ($40), or $42x, equals the adjusted basis of the transferred portion of the interest. A realizes an $8x gain ($10x + $40x $42x) on the sale to C. The basis of the remainder of A's partnership interest is $44x ($86x $42x).

This is situation 3 in Revenue Ruling 84-53:

The facts are the same as in Situation 2 except that, on January 1, 1982, A sold A's entire limited partner interest to C for its fair market value of $10x (rather than one-half of A's general partner interest).

This is the analysis of Revenue Ruling 84-53:

The tax consequences of B's sale of one-half of B's limited partner interest to A are identical to those described in Situation 1.

As in Situation 2, prior to the sale of A's limited partner interest to C, the adjusted basis of A's entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on A's adjusted basis, $80x (A's share of all partnership liabilities is subtracted from $86x, leaving $6x. Because of the fair market value of the transferred portion of A's limited partner interest ($10x) is one-third of the fair market value of A's entire interest ($30x), $2x (1/3 of $6x) of the remaining adjusted basis must be allocated to the transferred limited partner interest. The sum of that amount ($2x) plus the amount of partnership liabilities from which A is discharged on the disposition of the transferred limited partner interest ($0x), or $2x, equals the adjusted basis of the transferred portion of the interest. A realizes an $8x gain ($10x $2x) on the sale to C. The basis of the remainder of A's partnership interest is $84x ($86x $2x).

This is situation 4 in Revenue Ruling 84-53:

The facts are the same as in Situation 1 except that, in 1981, Y borrowed $96x recourse which is invested in securities that became worthless on December 31, 1981. Furthermore, immediately prior to A's

sale to C, A's entire partnership interest had a fair market value of $18x and the transferred portion of A's interest had a fair market value of $6x.

This is the analysis of Revenue Ruling 84-53:

The tax consequences of B's sale of one-half of B's limited partner interest was increased from $66x to $162x as a result of the $96x recourse borrowing and was decreased to $90x as a result of the $72x loss allocated to A that year when the securities became worthless. Thus, prior to the sale of one-half of A's general partner interest to C, the adjusted basis of A's entire partnership interest was $90x. In this situation, A's share of all partnership liabilities ($96x) exceeds the adjusted basis of A's entire interest ($90x). Thus, the adjusted basis of the transferred portion of A's general partner interest equals $45x, the amount which bears the same relation to A's adjusted basis in the entire interest ($90x) as the amount of partnership liabilities from which A is discharged on the disposition of the transferred portion of the general partner interest ($48x) bears to A's share of all partnership liabilities ($96x). A realizes a $9x gain ($48x + $6x $45x) on the sale of C. The basis of the remainder of A's partnership interest is $45x ($90x $45x).

[15] Section 723: Basis of property contributed to a partnership.

The Section 1.723-1 regulations are interpretive regulations. They have not been especially controversial and seem well-grounded.

[16] Section 724: Character of gain or loss on contributed unrealized receivables, inventory items, and capital loss property.

Regulations have not been proposed or finalized. Regulations will be interpretative. There may be more litigation in this area on account of the contribution of property prior to granting charitable easements. This litigation will not benefit from regulations or other interpretative authority from Treasury and the Internal Revenue Service.

[17] Section 731: Extent Of Recognition Of Gain Or Loss On Distribution.

Section 1.731-1 provides interpretive regulations concerning recognizing gain or loss on a distribution by a partnership to a partner. These regulations to not benefit from a presumption of correctness under *Loper Bright Enterprises*. These regulations, however, have not been particularly controversial.

Section 1.731-2 provides regulations concerning distributions of marketable securities. Section 731(c) is sprinkled with grants of legislative regulation authority. Section 731(c)(7)

provides a general grant of legislative authority for regulations under Section 731(c): It appears that all of the regulations under Section 731(c) are legislative.

Section 1.731-1(h) provides important antiabuse regulations concerning Section 731(c) and distributions of marketable securities:

> *The provisions of section 731(c) and this section must be applied in a manner consistent with the purpose of section 731(c) and the substance of the transaction. Accordingly, if a principal purpose of a transaction is to achieve a tax result that is inconsistent with the purpose of section 731(c) and this section, the Commissioner can recast the transaction for Federal tax purposes as appropriate to achieve tax results that are consistent with the purpose of section 731(c) and this section. Whether a tax result is inconsistent with the purpose of section 731(c) and this section must be determined based on all the facts and circumstances . . . .*

The antiabuse rules appear to be legislative regulations under the authority of Section 731(c)(7) (concerning marketable securities).

In defining "marketable securities", there are legislative grants for interests in:

> *(iv) except to the extent provided in regulations prescribed by the Secretary, any interest in a precious metal which, as of the date of the distribution, is actively traded (within the meaning of section 1092(d)(1)) unless such metal was produced, used, or held in the active conduct of a trade or business by the partnership,*
>
> *(v) except as otherwise provided in regulations prescribed by the Secretary, interests in any entity if substantially all of the assets of such entity consist (directly or indirectly) of marketable securities, money, or both, and*
>
> *(vi) to the extent provided in regulations prescribed by the Secretary, any interest in an entity not described in clause (v) but only to the extent of the value of such interest which is attributable to marketable securities, money, or both.*

Further, he marketable securities rules do not apply to a distribution of a marketable security to a partner if

> *(ii) to the extent provided in regulations prescribed by the Secretary, the property was not a marketable security when acquired by such partnership . . . . . .*

Also,

> *Under regulations prescribed by the Secretary, all marketable securities held by the partnership may be treated as marketable securities of the same class and issuer as the distributed securities.*

Section 731(c), in defining "marketable securities", contains a special grant for the Secretary to include –

> *(VII) other assets specified in regulations prescribed by the Secretary . . . .*

Section 704(c) provides a special grant of legislative authority in determining whether a partnership shall not be engaged in a trade or business by reason of –

> *(II) any other activity specified in regulations prescribed by the Secretary.*

Section 704(c) provides a special grant of regulatory for looking through tiers of partnerships:

> *(iv) Look-thru of partnership tiers. Except as otherwise provided in regulations prescribed by the Secretary--*
>
> *(I) a partnership shall be treated as engaged in any trade or business engaged in by, and as holding (instead of a partnership interest) a proportionate share of the assets of, any other partnership in which the partnership holds a partnership interest, and*
>
> *(II) a partner who contributes to a partnership an interest in another partnership shall be treated as contributing a proportionate share of the assets of the other partnership.*
>
> *If the preceding sentence does not apply under such regulations with respect to any interest held by a partnership in another partnership, the interest in such other partnership shall be treated as if it were specified in a subclause of clause (i).*

Section 731(c)(7) provides a general grant of legislative authority for regulations under Section 704(c):

> *(7) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations to prevent the avoidance of such purposes.*

[18] Section 732: Basis Of Distributed Property Other Than Money.

Regulations under Section 732 are a mix of legislative and interpretive regulations.

Regulations under Section 732(a), (b) and (c) are interpretive regulations.

Section 732(d) provides for legislative regulations:'

> *(d) Special partnership basis to transferee. For purposes of subsections (a), (b), and (c), a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in section 754 is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within 2 years after such transfer, may elect, under regulations prescribed by the Secretary, to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in section 743(b) were in effect with respect to the partnership property. The Secretary may by regulations require the application of this subsection in the case of a distribution to a transferee partner, whether or not made within 2 years after the transfer, if at the time of the transfer the fair market value of the partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership.*

Section 732(e) does not provide for legislative regulations. Section 732(e) addresses a distribution that is treated as a sale or exchange of property under Section 751(b) (relating to unrealized receivables and inventory items).

Section 732(f) considers a corresponding adjustment to the basis of assets of a distributed corporation controlled by a corporate partner. This is an anti-basis strip regulation, which deals with a limited case of basis strip transactions where corporate stock is distributed to a corporate partner. There is a special provision for legislative regulations:

> *(8) Regulations. The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations to avoid double counting and to prevent the abuse of such purposes.*

[19] Section 733: Basis Of Distributee Partner's Interest.

Regulations under Section 733 concerning basis of a distributee partner's partnership interest are interpretive regulations. Section 1733-1 provides simple guidance that is not particularly controversial.

[20] Section 734: Adjustment To Basis Of Undistributed Partnership Property.

With the exception of a special grant of regulatory authority under Section 734(d)(2) ("The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of paragraph (1) [Section 743(d) concerning substantial build-in loss] and Section 734(d), including regulations aggregating related partnerships and disregarding property acquired by the partnership in an attempt to avoid such purposes"), Section 734 regulations are interpretive regulations.

[21] Section 735: Character Of Gain Or Loss On Disposition Of Distributed Property

Section 1.735-1, concerning the character of gain or loss on disposition of distributed property, are interpretive regulations.

[22] Section 736: Payments To A Retiring Partner Or A Deceased Partner's Successor In Interest.

Section 736(a) does not provide a legislative grant. Section 736(a) regulations are interpretive regulations.

Section 736(b) provides a special grant of legislative authority: "Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments (other than payments described in paragraph (2)) are determined, ***under regulations prescribed by the Secretary***, to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under subsection (a)." [Emphasis added]

[23] Section 737: Recognition Of Precontribution Gain In Case Of Certain Distributions To Contributing Partner

Section 737 regulations are interpretive rather than legislative regulations.

Section 1.737-4 provides a nonlegislative antiabuse rule. This is an interpretive regulation. These rules may be vulnerable[437] under *Loper Bright Enterprises*.

[24] Section 741: Recognition And Character Of Gain Or Loss On Sale Or Exchange.

Regulations under Section 741 are interpretive regulations.

[25] Section 742: Basis Of Transferee Partner's Interest.

Regulations under Section 742 are interpretive regulations.

[26] Section 743: Special Rules Where Section 754 Election Or Substantial Built-In Loss.

Section 743 contains a sprinkling of grants of legislative authority.

The flush language of Section 743(b) contains this grant: "Under regulations prescribed by the Secretary, such increase or decrease shall constitute an adjustment to the basis of partnership property with respect to the transferee partner only." The scope of this grant could be debated, but perhaps it is expansive.

Section 743(d)(2) contains this grant concerning substantial built-in loss: "The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of paragraph (1) and section 734(d), including regulations aggregating related partnerships and disregarding property acquired by the partnership in an attempt to avoid such purposes."

[437] See note 77.

Section 743(d)(6) concerning alternative rules for electing investment partnerships contains this grant: "The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including regulations for applying this subsection to tiered partnerships."

[27] Section 751: Unrealized Receivables And Inventory Items.

Section 751(b) contains this grant of legislative authority: "such transactions shall, under regulations prescribed by the Secretary, be considered as a sale or exchange of such property between the distributee and the partnership (as constituted after the distribution)." This may be a very broad grant of regulatory authority.

Section 751(f) concerning tiered partnerships contain this grant of legislative authority: "Under regulations, rules similar to the rules of the preceding sentence shall also apply in the case of interests in trusts."

[28] Section 752: Treatment Of Certain Liabilities

Section 752 concerning allocating liabilities among partners does not contain a grant of legislative authority. This may create vulnerability[438] of the Section 752 regulations.

The antiabuse rule in Section 1.752-2(j) is an interpretive regulation:

(j) Anti-abuse rules.

(1) In general. An obligation of a partner or related person to make a payment may be disregarded or treated as an obligation of another person for purposes of this section if facts and circumstances indicate that a principal purpose of the arrangement between the parties is to eliminate the partner's economic risk of loss with respect to that obligation or create the appearance of the partner or related person bearing the economic risk of loss when, in fact, the substance of the arrangement is otherwise. Circumstances with respect to which a payment obligation may be disregarded include, but are not limited to, the situations described in paragraphs (j)(2) and (j)(3) of this section.

(2) Arrangements tantamount to a guarantee.

(i) In general. Irrespective of the form of a contractual obligation, a partner is considered to bear the economic risk of loss with respect to a partnership liability, or a portion thereof, to the extent that—

(A) The partner or related person undertakes one or more contractual obligations so that the partnership may obtain or retain a loan;

[438] See note 77.

(B) The contractual obligations of the partner or related person significantly reduce the risk to the lender that the partnership will not satisfy its obligations under the loan, or a portion thereof; and

(C) With respect to the contractual obligations described in paragraphs (j)(2)(i)(A) and (B) of this section—

(1) One of the principal purposes of using the contractual obligations is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests; or

(2) Another partner, or a person related to another partner, enters into a payment obligation and a principal purpose of the arrangement is to cause the payment obligation described in paragraphs (j)(2)(i)(A) and (B) of this section to be disregarded under paragraph (b)(3) of this section.

(ii) Economic risk of loss. For purposes of this paragraph (j)(2), partners are considered to bear the economic risk of loss for a liability in accordance with their relative economic burdens for the liability pursuant to the contractual obligations. For example, a lease between a partner and a partnership that is not on commercially reasonable terms may be tantamount to a guarantee by the partner of the partnership liability.

(3) Plan to circumvent or avoid an obligation.

(i) General rule. An obligation of a partner or related person to make a payment is not recognized under paragraph (b) of this section if the facts and circumstances evidence a plan to circumvent or avoid the obligation.

(ii) Factors indicating plan to circumvent or avoid an obligation. In the case of a payment obligation, other than an obligation to restore a deficit capital account upon liquidation of a partnership, paragraphs (j)(3)(ii)(A) through (G) of this section provide a non-exclusive list of factors that may indicate a plan to circumvent or avoid the payment obligation. The presence or absence of a factor is based on all of the facts and circumstances at the time the partner or related person makes the payment obligation or if the obligation is modified, at the time of the modification. For purposes of making determinations under this paragraph (j)(3), the weight to be given to any particular factor depends on the particular case and the presence or absence of a factor is not necessarily indicative of whether a payment obligation is or is not recognized under paragraph (b) of this section.

(A) The partner or related person is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, including, for example, restrictions on transfers for inadequate consideration or distributions by the partner or related person to equity owners in the partner or related person.

(B) The partner or related person is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the

partner's or related person's financial condition to the benefited party, including, for example, balance sheets and financial statements.

(C) The term of the payment obligation ends prior to the term of the partnership liability, or the partner or related person has a right to terminate its payment obligation, if the purpose of limiting the duration of the payment obligation is to terminate such payment obligation prior to the occurrence of an event or events that increase the risk of economic loss to the guarantor or benefited party (for example, termination prior to the due date of a balloon payment or a right to terminate that can be exercised because the value of loan collateral decreases). This factor typically will not be present if the termination of the obligation occurs by reason of an event or events that decrease the risk of economic loss to the guarantor or benefited party (for example, the payment obligation terminates upon the completion of a building construction project, upon the leasing of a building, or when certain income and asset coverage ratios are satisfied for a specified number of quarters).

(D) There exists a plan or arrangement in which the primary obligor or any other obligor (or a person related to the obligor) with respect to the partnership liability directly or indirectly holds money or other liquid assets in an amount that exceeds the reasonably foreseeable needs of such obligor (but not taking into account standard commercial insurance, for example, casualty insurance).

(E) The payment obligation does not permit the creditor to promptly pursue payment following a payment default on the partnership liability, or other arrangements with respect to the partnership liability or payment obligation otherwise indicate a plan to delay collection.

(F) In the case of a guarantee or similar arrangement, the terms of the partnership liability would be substantially the same had the partner or related person not agreed to provide the guarantee.

(G) The creditor or other party benefiting from the obligation did not receive executed documents with respect to the payment obligation from the partner or related person before, or within a commercially reasonable period of time after, the creation of the obligation.

Taxpayers may challenge this detailed rule, an interpretive regulation, in litigation. This antiabuse rule may have vulnerability[439] in litigation.

[29] Section 753: Partner Receiving Income In Respect Of Decedent.

Section 753 does not contain a grant of legislative authorities. Regulations under this provision are interpretive regulations.

[439] See note 77.

[30] Section 754: Manner Of Electing Optional Adjustment To Basis Of Partnership Property.

Section 754 contains a very limited grant of legislative authority: "If a partnership files an election, in accordance with regulations prescribed by the Secretary . ."

Section 754 also contains this limited grant of legislative authority: "Such election may be revoked by the partnership, subject to such limitations as may be provided by regulations prescribed by the Secretary."

Section 754 regulations otherwise would appear to be interpretive regulations.

[31] Section 755: Rules For Allocation Of Basis.

Section 755 concerning allocating basis adjustments contains two grants of legislative authority.

Section 755(a)(2) contains this grant: "in any other manner permitted by regulations prescribed by the Secretary." This seems to be a reasonably limited scope grant.

The flush language of Section 755(b) contains this grant of legislative authority: "If, in the case of a distribution, the adjustment to basis of property described in paragraph (1) or (2) is prevented by the absence of such property or by insufficient adjusted basis for such property, such adjustment shall be applied to subsequently acquired property of a like character in accordance with regulations prescribed by the Secretary."

Section 754 regulations otherwise are interpretive regulations.

[32] Section 761: Terms Defined.

Section 761 contains various grants of legislative authority.

Section 761(a) contains this grant: the term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate. Under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of . ."

Section 761(e) contains this grant: "Except as otherwise provided in regulations, for purposes of . . . ."

Section 761(e)(3) contains this grant: . "any other provision of this subchapter specified in regulations prescribed by the Secretary . . . ."

[33] Revenue Ruling 84-53: Concept of Unitary Partnership Interest.

Revenue Ruling 84-53[440] provides for single partnership interest treatment. Revenue Ruling 84-53 considers four situations:

Situation 1

In 1978, Y was formed as a limited partnership under the Uniform Limited Partnership Act of State N for the purpose of investing and trading in stocks and securities. Y has a calendar taxable year. A contributed $50x to Y in exchange for a general partner interest, entitling A to a 50 percent interest in all partnership distributions and in partnership income, gain, loss, and deduction. B contributed $50x to Y in exchange for a limited partner interest, entitling B to a 50 percent interest in all partnership distributions and in partnership income, gain, loss, and deduction.

On January 1, 1980, when the stock and securities of Y had decreased in value from $100x to $64x, B sold to A one-half of B's limited partner interest for $16x, which interest A holds as a limited partner.

On January 1, 1982, when the stock and securities of Y has risen in value from $64x (its 1980 value) to $120x, A sold to C one-half of A's general partner interest for $30x. Immediately prior to the sale, A's entire partnership interest had a fair market value of $90x and the transferred portion of the interest had a fair market value of $30x. Since formation, the partnership has made cash distributions in an amount equal to its total income (including tax-exempt income). Assume that all partnership allocations (in all situations) are valid, and that A, B, and C are unrelated parties.

Situation 2

The facts are the same as in Situation 1 except that, in 1981, Y borrowed $80x recourse which was invested in securities that became worthless on December 31, 1981. Furthermore, immediately prior to A's sale to C, A's entire partnership interest had a fair market value of $30x and the transferred portion of A's interest had a fair market value of $10x.

Situation 3

The facts are the same as in Situation 2 except that, on January 1, 1982, A sold A's entire limited partner interest to C for its fair market value of $10x (rather than one-half of A's general partner interest).

Situation 4

The facts are the same as in Situation 1 except that, in 1981, Y borrowed $96x recourse which is invested in securities that became worthless on December 31, 1981. Furthermore, immediately prior to A's sale to C, A's entire partnership interest had a fair market value of $18x and the transferred portion of A's interest had a fair market value of $6x.

These are the holdings:

[440] 1984-1 C.B. 159.

Situation 1

Prior to the sale of one-half of B's limited partner interest to A, the adjusted basis of B's entire partnership interest was $50x. Because the fair market value of the transferred portion of B's interest ($16x) is one-half of the fair market value of B's entire partnership interest ($32x), $25x (½ of $50x) of adjusted basis must be allocated to the interest transferred by B. B sustained a $9 loss ($16x $25x) on the sale to A. The adjusted basis of the remainder of B's partnership interest is $25x.

Prior to the sale of one-half of A's general partner interest to C, the adjusted basis of A's entire partnership interest was $66x. Because the fair market value of the transferred portion of A's interest ($30x) is one-third of the fair market value of A's entire partnership interest ($90x), $22x (⅓ of $66x) of the adjusted basis must be allocated to the portion of the interest transferred by A. A realizes an $8x gain ($30x $22x) on the sale to C. The basis of the remainder of A's partnership interest is $44x. The results would be the same to A if A, instead, sold to C the limited partner interest acquired earlier from B.

Situation 2

The tax consequences of B's sale of one-half of B's limited partner interest to A are identical to those described in Situation 1.

In 1981, A's basis in A's entire partnership interest was increase from $66x to $146x as a result of the $80x recourse borrowing (which increases only the basis of A, the sole general partner, under section 1.752-1(e) of the regulations and sections 752(a) and 722 of the Code) and was decreased to $86x as a result of the $60x loss allocated to A that year when the securities became worthless. Thus, prior to the sale of one-half of A's general partner interest to C, the adjusted basis of A's entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on A's adjusted basis, $80x (A's share of all partnership liabilities) is subtracted from $86x, leaving $6x. Because the fair market value of the transferred portion of A's interest ($10x) is one-third of the fair market value of the entire interest ($30x), $2x (⅓ of $6x) of the remaining adjusted basis must be allocated to the transferred portion of A's general partner interest. The sum of that amount ($2x) plus the amount of partnership liabilities from which A is discharged on the disposition of the transferred portion of A's general partner interest ($40), or $42x, equals the adjusted basis of the transferred portion of the interest. A realizes an $8x gain ($10x + $40x $42x) on the sale to C. The basis of the remainder of A's partnership interest is $44x ($86x $42x).

Situation 3

The tax consequences of B's sale of one-half of B's limited partner interest to A are identical to those described in Situation 1.

As in Situation 2, prior to the sale of A's limited partner interest to C, the adjusted basis of A's entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on A's adjusted basis, $80x (A's share of all partnership liabilities) is subtracted from $86x, leaving $6x. Because of the fair market value of the transferred portion of A's limited partner interest ($10x) is one-third of the fair market value of A's entire interest ($30x), $2x (⅓ of $6x) of the remaining adjusted basis must be allocated to the transferred limited partner interest. The sum of that

amount ($2x) plus the amount of partnership liabilities from which A is discharged on the disposition of the transferred limited partner interest ($0x), or $2x, equals the adjusted basis of the transferred portion of the interest. A realizes an $8x gain ($10x $2x) on the sale to C. The basis of the remainder of A's partnership interest is $84x ($86x $2x).

Situation 4

The tax consequences of B's sale of one-half of B's limited partner interest to A are identical to those described in Situation 1.

In 1981, A's basis in A's entire partnership interest was increased from $66x to $162x as a result of the $96x recourse borrowing and was decreased to $90x as a result of the $72x loss allocated to A that year when the securities became worthless. Thus, prior to the sale of one-half of A's general partner interest to C, the adjusted basis of A's entire partnership interest was $90x. In this situation, A's share of all partnership liabilities ($96x) exceeds the adjusted basis of A's entire interest ($90x). Thus, the adjusted basis of the transferred portion of A's general partner interest equals $45x, the amount which bears the same relation to A's adjusted basis in the entire interest ($90x) as the amount of partnership liabilities from which A is discharged on the disposition of the transferred portion of the general partner interest ($48x) bears to A's share of all partnership liabilities ($96x). A realizes a $9x gain ($48x + $6x $45x) on the sale of C. The basis of the remainder of A's partnership interest is $45x ($90x $45x)[441]

[441] Section 705 of the Internal Revenue Code provides rules for determining the adjusted basis of a partner's interest in a partnership.

Section 722 of the Code provides that the basis of an interest in a partnership acquired by a contribution of property equals the transferor partner's adjusted basis in the contributed property.

Section 752(a) of the Code provides that any increase in a partner's share of the partnership's liabilities is considered to be a contribution of money by the partner to the partnership.

Section 752(b) of the Code provides that any decrease in a partner's share of a partnership's liabilities is considered to be a distribution of money by the partnership to the partner.

Section 1.752-1(e) of the Income Tax Regulations provides rules for determining a partner's share of partnership liabilities with respect to both limited partnerships and general partnerships.

Section 752(d) of the Code provides that in the case of a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships.

Section 1.1001-2 of the regulations provides that the amount realized from a sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition.

Section 1.61-6(a) of the regulations provides that when a part of a larger property is sold, the basis of the entire property shall be equitably apportioned among the several parts for purposes of determining gain or loss on the part sold.

Consistent with the provisions of Subchapter K of the Code, a partner has a single basis in a partnership interest, even if such partner is both a general partner and a limited partner of the same partnership. See Rev. Rul. 84-52. Thus, for example, in applying the limitations of section 704(d) of the Code, losses allocated with respect to a partner's limited partner interest will be allowed so long as they do not exceed the partner's basis in the entire partnership interest.

Revenue Ruling 2024-14 is merely subregulatory guidance and is not entitled to special deference under *Loper Bright Enterprises*. Revenue Ruling 2024-14 also was a creature of a time when partnership interests were not as economically complex as they commonly are today. The authorities that Revenue Ruling 2024-14 cites do not provide solid support for the unitary partnership interest theory that Revenue Ruling 2024-14 espouses. Revenue Ruling 2024-14 may be subject to challenge in future tax litigation.

[34] Revenue Ruling 99-5: Conversion of Disregarded LLC to Recognized Tax Partnership.

Revenue Ruling 99-5[442] addresses this question: What are the federal income tax consequences when a single member domestic limited liability company (limited liability company) that is disregarded for federal tax purposes as an entity separate from its owner[443] becomes an entity with more than one owner that is classified as a partnership for federal tax purposes?[444]

Under section 1.61-6(a) of the regulations, when a partner makes a taxable disposition of a portion of an interest in a partnership, the basis of the transferred portion of the interest generally equals an amount which bears the same relation to the partner's basis in the partner's entire interest as the fair market value of the transferred portion of the interest bears to the fair market value of the entire interest. However, if such partnership has liabilities, special adjustments must be made to take into account the effect of those liabilities on the basis of the partner's interest.

In cases where the partner's share of all partnership liabilities does not exceed the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the transferor partner shall first exclude from the adjusted basis of such partner's entire interest an amount equal to such partner's share of all partnership liabilities, as determined under section 1.752-1(e) of the regulations. A part of the remaining adjusted basis (if any) shall be allocated to the transferred portion of the interest according to the ratio of the fair market value of the transferred portion of the interest to the fair market value of the entire interest. The sum of the amount so allocated plus the amount of the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest (under section 752(d) of the Code and section 1.1001-2 of the regulations) equals the adjusted basis of the transferred portion of the interest.

On the other hand, if the partner's share of all partnership liabilities exceeds the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the adjusted basis of the transferred portion of the interest equals an amount that bears the same relation to the partner's adjusted basis in the entire interest as the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest bears to the partner's share of all partnership liabilities, as determined under section 1.752-1(e).

[442] 1999-1 C.B. 434.

[443] Treas. Reg. § 301.7701-3.

[444] Section 721(a) generally provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

In each of the following two situations, a limited liability company is formed and operates in a state which permits a limited liability company to have a single owner. Each limited liability company has a single owner, Achyuta,[445] and is disregarded as an entity separate from its owner for federal tax purposes.[446]

In both situations, the limited liability company would not be treated as an investment company[447] if it were incorporated.

All of the assets held by each limited liability company are capital assets or property described in Section 1231.

Neither limited liability company is liable for any indebtedness, nor are the assets of the limited liability companies subject to any indebtedness.

In Situation 1,

- Badrinath, who is not related to Achyuta, purchases 50% of Achyuta's ownership interest in the limited liability company for $5,000.
- Achyuta does not contribute any portion of the $5,000 to the limited liability company.
- Achyuta and Badrinath continue to operate the business of the limited liability company as co-owners of the limited liability company.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Section 1001(a) provides that the gain or loss from the sale or other disposition of property shall be the difference between the amount realized therefrom and the adjusted basis provided in section 1011.

Section 1223(1) provides that, in determining the holding period of a taxpayer who receives property in an exchange, there shall be included the period for which the taxpayer held the property exchanged if the property has the same basis in whole or in part in the taxpayer's hands as the property exchanged, and the property exchanged at the time of the exchange was a capital asset or property described in section 1231.

Section 1223(2) provides that, regardless of how a property is acquired, in determining the holding period of a taxpayer who holds the property, there shall be included the period for which such property was held by any other person if the property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

[445] Names have been changed to protect the innocent and the guilty.

[446] Under Treas. Reg. § 301.7701-3.

[447] Within the meaning of section 351.

- No entity classification election is made[448] to treat the limited liability company as an association for federal tax purposes.

In Situation 1,

- Before the transaction the limited liability company, for federal tax purposes, is disregarded as an entity separate from its owner.
- the limited liability company is converted to a partnership when the new member, Badrinath, purchases an interest in the disregarded entity from the owner, Achyuta.
- Badrinath's purchase of 50% of Achyuta's ownership interest in the limited liability company is treated as the purchase of a 50% interest in each of the limited liability company's assets, which are treated as held directly by Achyuta for federal tax purposes.
- Immediately thereafter, Achyuta and Badrinath are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.
- Achyuta recognizes gain or loss from the deemed sale of the 50% interest in each asset of the limited liability company to Badrinath.[449]
- No gain or loss is recognized by Achyuta or Badrinath as a result of the conversion of the disregarded entity to a partnership.[450]
- Badrinath's basis in the partnership interest is equal to $5,000, the amount paid by Badrinath to Achyuta for the assets which Badrinath is deemed to contribute to the newly-created partnership.[451]
- Achyuta's basis in the partnership interest is equal to Achyuta's basis in Achyuta's 50% share of the assets of the limited liability company.
- The basis of the property treated as contributed to the partnership by Achyuta and Badrinath is the adjusted basis of that property in Achyuta's and Badrinath's hands immediately after the deemed sale.[452]
- Achyuta's holding period for the partnership interest received includes Achyuta's holding period in the capital assets and property described in Section 1231 held by the limited liability company when it converted from an

[448] Under Treas. Reg. § 301.7701-3(c).
[449] Under I.R.C. § 1001.
[450] Under I.R.C. § 721(a).
[451] Under I.R.C. § 722.
[452] Under I.R.C. § 723.

entity that was disregarded as an entity separate from Achyuta to a partnership.[453]

- Badrinath's holding period for the partnership interest begins on the day following the date of Badrinath's purchase of the limited liability company interest from Achyuta.[454]
- The partnership's holding period for the assets deemed transferred to it includes Achyuta's and Badrinath's holding periods for such assets.[455]

In Situation 2,

- Badrinath, who is not related to Achyuta, contributes $10,000 to the limited liability company in exchange for a 50% ownership interest in the limited liability company.
- The limited liability company uses all of the contributed cash in its business.
- Achyuta and Badrinath continue to operate the business of the limited liability company as co-owners of the limited liability company.
- After the sale, no entity classification election is made[456] to treat the limited liability company as an association for federal tax purposes.

In Situation 2,

- the limited liability company is converted from an entity that is disregarded as an entity separate from its owner to a partnership when a new member, Badrinath, contributes cash to the limited liability company. Badrinath's contribution is treated as a contribution to a partnership in exchange for an ownership interest in the partnership.
- Achyuta is treated as contributing all of the assets of the limited liability company to the partnership in exchange for a partnership interest.
- No gain or loss is recognized by Achyuta or Badrinath as a result of the conversion of the disregarded entity to a partnership.[457]
- Badrinath's basis in the partnership interest is equal to $10,000, the amount of cash contributed to the partnership.[458]

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[453] Under I.R.C. § 1223(1).

[454] See Rev. Rul. 66-7, 1966-1 C.B. 188 (holding period of a purchased asset is computed by excluding the date on which the asset is acquired).

[455] Under I.R.C. § 1223(2).

[456] Under Treas. Reg. § 301.7701-3(c).

[457] Under I.R.C. § 721(a),

[458] Under I.R.C. § 722.

- Achyuta's basis in the partnership interest is equal to Achyuta's basis in the assets of the limited liability company which Achyuta was treated as contributing to the newly-created partnership.
- The basis of the property contributed to the partnership by Achyuta is the adjusted basis of that property in Achyuta's hands.[459]
- The basis of the property contributed to the partnership by Badrinath is $10,000, the amount of cash contributed to the partnership.
- Achyuta's holding period for the partnership interest received includes Achyuta's holding period in the capital and Section 1231 assets deemed contributed when the disregarded entity converted to a partnership.[460]
- Badrinath's holding period for the partnership interest begins on the day following the date of Badrinath's contribution of money to the limited liability company.
- The partnership's holding period for the assets transferred to it includes Achyuta's holding period.[461]

Revenue Ruling 99-5 is subregulatory guidance. There was no need to comply with notice and comment under the Administrative Procedure Act, nor was Revenue Ruling 99-5 ever subjected to notice and comment. Had Revenue Ruling 99-5 been subjected to notice and comment, it seems likely that the comments would have been entirely favorable. Revenue Ruling 99-5 is not entitled to any presumption of correctness under *Loper Bright Enterprises*. The validity of Revenue Ruling 99-5 has not been particularly tested in litigation.

If Revenue Ruling 99-5 were contested in litigation (which seems unlikely), Revenue Ruling 99-5 would not be entitled to a presumption of correctness. It is not clear that a court would have particularly considered Revenue Ruling 99-5 beyond its reasoning. Nevertheless, Revenue Ruling 99-5 seems to qualify as the best reading of the statute and should be approved in litigation if it ever is contested. Just because Internal Revenue Service authority is not entitled to a presumption of correctness, a court will not necessarily reject that authority when it represents the best reading of the statute.

[459] Under I.R.C. § 723,
[460] Under I.R.C. § 1223(1).
[461] Under I.R.C. § 1223(2).

[35] Revenue Ruling 99-6: Acquisition of All Interests in LLC and Termination of the LLC.

Revenue Ruling 99-6[462] considered what are the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (limited liability company) that is classified as a partnership under Section 301.7701-3. The limited liability company's status as a tax partnership terminates[463]when one person buys all of the ownership interests in a limited liability company that is treated for tax purposes as a tax partnership. The transaction might have been classified as an entity level transaction or as an asset level transaction. As a revenue ruling, Revenue Ruling 99-6 is subregulatory guidance. Revenue Ruling 99-6 has never been exposed to notice and comment. Revenue Ruling 99-6 is not entitled to particular deference under *Loper Bright Enterprises* not clearly due any deference at all.

In *McCauslen v. Commissioner*,[464] one partner in an equal, two-person partnership died, and his partnership interest was purchased from his estate by the remaining partner. The purchase caused a termination of the partnership under Section 708(b)(1)(A). The Tax Court held that the surviving partner did not purchase the deceased partner's interest in the partnership, but that the surviving partner purchased the partnership assets attributable to the interest. As a result, the surviving partner was not permitted to succeed to the partnership's holding period with respect to these assets.

Revenue Ruling 67-65[465] considered the purchase of a deceased partner's interest by the other partner in a two-person partnership. Revenue Ruling 67-65 considered determining the purchaser's holding period in the assets attributable to the deceased partner's interest. The Internal Revenue Service ruled that the purchaser should treat the transaction as a purchase of the assets attributable to the interest for the purpose of determining the purchaser's holding period in the assets attributable to the deceased partner's interest. Accordingly, the purchaser was not permitted to succeed to the partnership's holding period with respect to these assets.[466]

A limited liability company is formed and operates in a state which permits a limited liability company to have a single owner. Each limited liability company is classified as a partnership under Section 301.7701-3. Neither of the limited liability companies holds any

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[462] 1999-1 C.B. 432. For interesting questions when the acquiring entity itself is a partnership, see New York State Bar Association Report No. 1432 — Report on Partnership Terminations Following the Tax Cuts and Jobs Act (January17, 2020).

[463] Under I.R.C. § 708(b)(1)(A).

[464] 45 T.C. 588 (1966).

[465] 1967-1 C.B. 168.

[466] See also Rev. Rul. 55-68, 1955-1 C.B. 372.

unrealized receivables or substantially appreciated inventory.[467] Neither limited liability company is liable for any indebtedness, nor are the assets of the limited liability companies subject to any indebtedness.

In Situation 1, Aegir and Baldu[468] are equal partners in AegirBaldur LLC, a limited liability company. Aegir sells Aegir's entire interest in AegirBaldur LLC to Baldur for $10,000. After the sale, the business is continued by the limited liability company, which is owned solely by Baldur.

In Situation 1,

- The AegirBaldur LLC partnership terminates under Section 708(b)(1)(A) when Baldur purchases Aegir's entire interest in AegirBaldur LLC.
- Aegir, the seller, must treat the transaction as the sale of a partnership interest.[469]
- Aegir must report gain or loss, if any, resulting from the sale of Aegir's partnership interest[470]
- after the sale, no entity classification election is made[471] to treat the limited liability company as an association for federal tax purposes.[472]

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[467] For purposes of section 751(b).

[468] Names have been changed to protect the innocent and the guilty.

[469] Treas. Reg. § 1.741-1(b).

[470] In accordance with section 741.

[471] Under Treas. Reg. § 301.7701-3(c)

[472] I.R.C. § 708(b)(1)(A) and I.R.C. § 1.708-1(b)(1) of the Income Tax Regulations provide that a partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

I.R.C. § 731(a)(1) provides that, in the case of a distribution by a partnership to a partner, gain is not recognized to the partner except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

I.R.C. § 731(a)(2) provides that, in the case of a distribution by a partnership in liquidation of a partner's interest in a partnership where no property other than money, unrealized receivables (as defined in I.R.C. § 751(c)), and inventory (as defined in I.R.C. § 751(d)(2)) is distributed to the partner, loss is recognized to the extent of the excess of the adjusted basis of the partner's interest in the partnership over the sum of (A) any money distributed, and (B) the basis to the distributee, as determined under I.R.C. § 732, of any unrealized receivables and inventory.

I.R.C. § 732(b) provides that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of the partner's interest in the partnership, reduced by any money distributed in the same transaction.

I.R.C. § 735(b) provides that, in determining the period for which a partner has held property received in a distribution from a partnership (other than for purposes of I.R.C. § 735(a)(2)), there shall

Under the analysis of *McCauslen* and Revenue Ruling 67-65, for purposes of determining the tax treatment of Bandur, according to Revenue Ruling 99-6,

- the AegirBaldur LLC partnership is deemed to make a liquidating distribution of all of its assets to Aegir and Baldur, and
- following this distribution, Baldur, the buyer, is treated as acquiring the assets deemed to have been distributed to Aegir in liquidation of Aegir's partnership interest.
- Baldur's basis in the assets attributable to Aegir's one-half interest in the partnership is $10,000, the purchase price for Aegir's partnership interest. [473]
- Section 735(b) does not apply with respect to the assets Baldur is deemed to have purchased from Aegir.
- Baldur's holding period for these assets begins on the day immediately following the date of the sale. [474]

Upon the termination of AegirBaldur LLC,

- Baldur is considered to receive a distribution of those assets attributable to Baldur's former interest in AegirBaldur LLC.
- Baldur must recognize gain or loss, if any, on the deemed distribution of the asset. [475]
- Baldur's basis in the assets received in the deemed liquidation of Baldur's partnership interest is determined as a distribution in liquidation. [476]

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be included the holding period of the partnership, as determined under I.R.C. § 1223, with respect to the property.

I.R.C. § 741 provides that gain or loss resulting from the sale or exchange of an interest in a partnership shall be recognized by the transferor partner, and that the gain or loss shall be considered as gain or loss from a capital asset, except as provided in I.R.C. § 751 (relating to unrealized receivables and inventory items).

I.R.C. § 1.741-1(b) provides that I.R.C. § 741 applies to the transferor partner in a two-person partnership when one partner sells a partnership interest to the other partner, and to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

I.R.C. § 301.7701-2(c)(1) provides that, for federal tax purposes, the term "partnership" means a business entity (as the term is defined in I.R.C. § 301.7701-2(a)) that is not a corporation and that has at least two members.

[473] I.R.C. § 1012.

[474] See Rev. Rul. 66-7, 1966- 1 C.B. 188, which provides that the holding period of an asset is computed by excluding the date on which the asset is acquired.

[475] To the extent required by I.R.C. § 731(a).

[476] Under I.R.C. § 732(b).

- Baldur's holding period for the assets attributable to Baldur's one-half interest in AegirBaldur LLC includes the partnership's holding period for such assets (except for purposes of Section 735(a)(2)).[477]

In Situation 2,

- Cnut and Dagur are equal partners in Cnut and Dagur LLC, a limited liability company.
- Cnut and Dagur sell their entire interests in Cnut and Dagur LLC to Embla, an unrelated person, in exchange for $10,000 each.
- After the sale, the business is continued by the limited liability company, which is owned solely by Embla.

After the sale, no entity classification election is made under Section 301.7701-3(c) to treat the limited liability company as an association for federal tax purposes.[478]

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[477] Under I.R.C. § 735(b).

[478] I.R.C. § 708(b)(1)(A) and I.R.C. § 1.708-1(b)(1) of the Income Tax Regulations provide that a partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

I.R.C. § 731(a)(1) provides that, in the case of a distribution by a partnership to a partner, gain is not recognized to the partner except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

I.R.C. § 731(a)(2) provides that, in the case of a distribution by a partnership in liquidation of a partner's interest in a partnership where no property other than money, unrealized receivables (as defined in I.R.C. § 751(c)), and inventory (as defined in I.R.C. § 751(d)(2)) is distributed to the partner, loss is recognized to the extent of the excess of the adjusted basis of the partner's interest in the partnership over the sum of (A) any money distributed, and (B) the basis to the distributee, as determined under I.R.C. § 732, of any unrealized receivables and inventory.

I.R.C. § 732(b) provides that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of the partner's interest in the partnership, reduced by any money distributed in the same transaction.

I.R.C. § 735(b) provides that, in determining the period for which a partner has held property received in a distribution from a partnership (other than for purposes of I.R.C. § 735(a)(2)), there shall be included the holding period of the partnership, as determined under I.R.C. § 1223, with respect to the property.

I.R.C. § 741 provides that gain or loss resulting from the sale or exchange of an interest in a partnership shall be recognized by the transferor partner, and that the gain or loss shall be considered as gain or loss from a capital asset, except as provided in I.R.C. § 751 (relating to unrealized receivables and inventory items).

I.R.C. § 1.741-1(b) provides that I.R.C. § 741 applies to the transferor partner in a two-person partnership when one partner sells a partnership interest to the other partner, and to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

In Situation 2,

- The Cnut and Dagur LLC partnership terminates [479] when Embla purchases the entire interests of Cnut and Dagur in Cnut Dagur LLC.
- Cnut and Dagur must report gain or loss, if any, resulting from the sale of their partnership interests [480]

For purposes of classifying the acquisition by Embla,

- the Cnut and Dagur LLC partnership is deemed to make a liquidating distribution of its assets to Cnut and Dagur.
- Immediately following this distribution, Embla is deemed to acquire, by purchase, all of the former partnership's assets. [481]
- Embla's basis in the assets is $20,000. [482]
- Embla's holding period for the assets begins on the day immediately following the date of sale.

In appropriate circumstances, taxpayers might dispute the analysis of Revenue Ruling 99-6. Revenue Ruling 99-6 treats the transaction is some respects as an asset purpose and in some respects as a purchase of an entity. Revenue Ruling 99-6 is subregulatory guidance. There was no need to comply with the notice and comment and other provisions of the Administrative Procedure Act. At the same time, Revenue Ruling 99-6 is not entitled to any special deference. In a litigation, in theory, the court might pay no greater deference to Revenue Ruling 99-6 than it does to the brief of either party. The role of the court will be to discover the best reading of the statute, although that might lead to a long and difficult analysis. If a court completely disregarded Revenue Ruling 99-6, it is not clear how the court would handle situation 1 and situation 2 to determine the best reading of the statute under *Loper Bright Enterprises*. This may pose a very close matter for a court to decide. It also will be

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I.R.C. § 301.7701-2(c)(1) provides that, for federal tax purposes, the term "partnership" means a business entity (as the term is defined in I.R.C. § 301.7701-2(a)) that is not a corporation and that has at least two members.

[479] Under section 708(b)(1)(A).

[480] In accordance with I.R.C. § 741.

[481] *Compare* Rev. Rul. 84-111, 1984-2 C.B. 88 (Situation 3) (determining the tax consequences to a corporate transferee of all interests in a partnership in a manner consistent with McCauslen, and holding that the transferee's basis in the assets received equals the basis of the partnership interests, allocated among the assets in accordance with I.R.C. § 732(c)).

[482] Under I.R.C. § 1012.

interesting to see how a court will deal with the situation in which the buyer is itself a tax partnership.[483]

[36] Check The Box Regulations.

The check-the-box regulations (Treasury Regulations Section 301.7701-3) essentially make partnership status elective (versus characterization as a corporation). A business entity that is not classified as a corporation under Section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes.[484] An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation[485]) or a partnership. An eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Elections are necessary only when an eligible entity chooses to be classified initially as other than the default classification as provided in regulations or when an eligible entity chooses to change its classification. An entity whose classification is determined under the default classification retains that classification[486] until the entity makes an election to change that classification[487] The regulations[488] provide rules for making express elections, including a rule under which a domestic eligible entity that elects to be classified as an association consents to be subject to the dual consolidated loss rules.[489] The regulations provide special rules for foreign eligible entities.[490] The regulations provide special rules for classifying entities resulting from partnership terminations and divisions under Section 708(b).[491]

The regulations provide default classification rules that aim to match taxpayers' expectations and thus reduce the number of elections that will be needed.

The regulations adopt a passthrough default for domestic entities, under which a newly formed eligible entity will be classified as a partnership if it has at least two members, or will be disregarded as an entity separate from its owner if it has a single owner.

The default for foreign entities is based on whether the members have limited liability. A foreign eligible entity will be classified as an association if all members have limited liability.

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[483] For interesting questions when the acquiring entity itself is a partnership, see New York State Bar Association Report No. 1432 — Report on Partnership Terminations Following the Tax Cuts and Jobs Act (January17, 2020).

[484] As provided in Treas. Reg. § 301.7701-3.

[485] Under Treas. Reg. § 301.7701-2(b)(2).

[486] Regardless of any changes in the members' liability that occurs at any time during the time that the entity's classification is relevant as defined in Treas. Reg. § 301.7701-2(d).

[487] Under Treas. Reg. § 301.7701-2(c)(1).

[488] Treas. Reg. § 301.7701-2(c).

[489] I.R.C. § 1503(d).

[490] Treas. Reg. § 301.7701-2(d).

[491] Treas. Reg. § 301.7701-2(e).

A foreign eligible entity will be classified as a partnership if it has two or more members and at least one member does not have limited liability. The entity will be disregarded as an entity separate from its owner if it has a single owner and that owner does not have limited liability.

The default classification for an existing entity is the classification that the entity claimed immediately prior to the effective date of the regulations. An entity's default classification continues until the entity elects to change its classification by means of an affirmative election.

An eligible entity may affirmatively elect its classification on Form 8832, Entity Classification Election. The regulations require that the election be signed by each member of the entity or any officer, manager, or member of the entity who is authorized to make the election and who represents to having such authorization under penalties of perjury. An election will not be accepted unless it includes all of the required information, including the entity's taxpayer identifying number (TIN).

Prior to the check-the-box regulations, there was a long struggle to define whether an entity formed as a partnership would be treated as a tax partnership or as an association, taxable as a corporation.

The Supreme Court in *Morrissey v. Commissioner*[492] identified seven corporate characteristics and determined that an organization will be classified as a corporation if it has more corporate characteristics than it has noncorporate characteristics. 309 was whether unincorporated organizations that resemble corporations could be associations taxable as corporations. The Court identified seven major corporate characteristics and stated that an organization resembles a corporation if it has more corporate than non-corporate characteristics. Six of the characteristics were adopted into the initial set of Regulations embodying the entity classification test: 310

Regulations adopted six corporate characteristics in their analysis of whether an unincorporated entity should be classified as a corporation:

- Associates.
- An objective to carry on business for profit as a common enterprise.
- Continuity of life.
- Centralized management.
- Limited liability.
- Free transferability of beneficial interest.

[492] *Morrissey v. Commissioner*, 296 U.S. 344 (1935) .

Later *Kintner* regulations,[493] as in effect from 1960 to 1996, based the classification decision on an analysis of four factors:

- continuity of life,
- centralization of management,
- liability for organization debts limited to the organization's assets, and
- free transferability of interests.

This four factor analysis controlled from 1960 to 1996. The four factor analysis was incorporated in most of the many tax opinions on partnership during this period.

Revenue Procedure 89-12[494] sets forth Internal Revenue Service ruling requirements for classification of a limited partnership:

> *The Service will ordinarily consider a ruling request that relates to classification of a limited partnership as a partnership, for federal tax purposes, only if the conditions in this section 4 are satisfied. Section 4.05, however, relates solely to the corporate characteristic of continuity of life described in section 301.7701-2(b) of the regulations. Similarly, section 4.06 relates solely to the corporate characteristic of centralization of management described in section 301.7701-2(c). Therefore, failure to satisfy section 4.05 or section 4.06 will preclude a specific ruling that continuity of life or centralized management is lacking, but will not necessarily preclude the issuance of a partnership classification ruling. Section 4.07 provides a safe harbor, generally applicable to a limited partnership with at least one corporate general partner, that relates to the corporate characteristic of limited liability described in section 301.7701-2(d).*
>
> *.01. Unless exempted by section 4.02 below or the provisions of this section 4.01, the interests (including limited partnership interests) of all the general partners, taken together, in each material item of partnership income, gain, loss, deduction, or credit must be equal to at least 1 percent of each such item at all times during the existence of the partnership, and the partnership agreement must expressly so provide. If the 1-percent standard will not be satisfied because of a temporary allocation required under section 704(b) of the Code, section 704(c), or corresponding Income Tax Regulations (a qualified income offset or minimum gain charge-back, for example), this will generally not be considered a violation of this section 4.01, but the ruling request must describe any such allocation and explain why the allocation is required under section 704(b) or (c), as appropriate. Any other temporary nonconformance with the 1-percent standard will be considered a violation of this section 4.01 unless it is demonstrated that the general partners' interest in net profits and losses over the anticipated life of the partnership is material. For this purpose, a profits interest generally will not be considered material unless it is substantially in excess of 1 percent and will be in effect for a substantial period of time during which it is reasonably expected that the partnership will generate profits. For example, a 20-percent interest in profits that begins 4 years after partnership formation and continues for the life of the*

[493] Prior Treas. Reg. §§ 301.7701-2, 301.7701-3 (as in effect before January 1, 1997), based on *United States v. Kintner*, 216 F2d 418 (9th Cir. 1954).

[494] 1989-1 C.B. 798.

partnership would generally be considered material if the partnership is expected to generate profits for a substantial period beyond the 4 years.

.02. If the limited partnership has total contributions exceeding $50 million, the general partners need not meet the 1-percent standard in section 4.01. However, except for a temporary allocation or nonconformance specified in section 4.01, the general partners' aggregate interest at all times in each material item must be at least 1 percent divided by the ratio of total contributions to $50 million, and the partnership agreement must expressly incorporate at least the computed percentage. For example, if total contributions are $125 million, the interest in each material item must be at least.4 percent, that is, 1 percent divided by 125/50. In no event, however, other than as a result of a temporary allocation or nonconformance specified in section 4.01, may the general partners' aggregate interest at any time in any material item be less than.2 percent.

.03. Unless section 4.04 applies, the general partners, taken together, must maintain a minimum capital account balance equal to either 1 percent of total positive capital account balances for the partnership or $500,000, whichever is less. Whenever a limited partner makes a capital contribution, the general partners must be obligated to contribute immediately capital equal to 1.01 percent of the limited partner's capital contribution or a lesser amount (including zero) that causes the sum of the general partners' capital account balances to equal the lesser of 1 percent of total positive capital account balances for the partnership or $500,000. If no limited partner capital account has a positive balance, the general partners, taken together, need not have a positive capital account balance to satisfy this section 4.03. Capital accounts and the value of contributions are determined by application of the capital accounting rules in section 1.704-1(b)-(2)(iv) of the regulations.

.04. If at least one general partner has contributed or will contribute substantial services in its capacity as a partner, apart from services for which guaranteed payments under section 707(c) of the Code are made, then the general partners need not meet the capital account standard in section 4.03. However, the partnership agreement must expressly provide that, upon the dissolution and termination of the partnership, the general partners will contribute to the partnership an amount equal to: (a) the deficit balances, if any, in their capital accounts; or (b) the excess of 1.01 percent of the total capital contributions of the limited partners over the capital previously contributed by the general partners; or (c) the lesser of (a) or (b). Those services that do not relate to day-to-day operations in the partnership's primary business activity, such as services relating to organization and syndication of the partnership, accounting, financial planning, and general business planning, and those that are in the nature of investment management will be closely scrutinized to determine if they are in fact substantial services. In making this determination, the Service will consider the nature of the partnership and its activities.

.05. For a limited partnership formed in a state with a statute corresponding to the Uniform Limited Partnership Act or the Revised Uniform Limited Partnership Act, in the case of the removal of a general partner, the partnership agreement may not permit less than a majority in interest of limited partners to elect a new general partner to continue the partnership, or the Service will not rule that the partnership lacks continuity of life.

.06. Limited partner interests, excluding those held by general partners, may not exceed 80 percent of the total interests in the partnership, or the Service will not rule that the partnership lacks centralized management. In addition, the Service will consider all the facts and circumstances, including limited partner control of the general partners (whether direct or indirect), in determining whether the partnership lacks centralized management.

.07. If the net worth of corporate general partners at the time of the ruling request equals at least 10 percent of the total contributions to the limited partnership and is expected to continue to equal at least 10 percent of the total contributions throughout the life of the partnership, then, for advance ruling purposes, the partnership will generally be deemed to lack limited liability. In the case of a limited partnership in which the only general partners are corporations that do not satisfy the safe harbor described in the preceding sentence, close scrutiny will be applied to determine whether the partnership lacks limited liability. In that connection, it must be demonstrated either that a general partner has (or the general partners collectively have) substantial assets (other than the partner's interest in the partnership) that could be reached by a creditor of the partnership or that the general partners individually and collectively will act independently of the limited partners.

The check-the-box regulations regarding partnership status represented a major departure from both the prior case law represented by *Morrissey* and *Kintner* and from prior administrative regulations and administrative practice. There was no specific statutory authorization for the check-the-box regulations beyond the general authority of Section 7805. It never was entirely clear whether the check-the-box regulations would withstand a taxpayer attack under *Chevron*. The check-the-box regulations are vulnerable[495] under *Loper Bright Enterprises* and its holdings that courts should interpret statutes based on the independent judgment of the courts and the best reading of the statute.

It is seems unlikely that the Internal Revenue Service will challenge or voluntarily cease to apply its own check-the-box regulations. A taxpayer challenge similarly may seem unlikely. Nevertheless, there may be situations in which it will be advantageous (or perceived advantageous) for a partner to challenge the validity of the check-the-box regulations. This challenge might well be successful.

[37] Bipartisan Budget Act Partnership Audit Rules

[38] Non-Income Adjustment Rule

The Internal Revenue Service receives a number of comments that non-income items should not be included in computing the imputed underpayment. In its own wisdom, the Internal Revenue Service did not agree to these comments.

[495] See note 77.

Partnerships are generally subject to partnership level audits under rules prescribed under the Bipartisan Budget Act of 2015. These rules can be highly complex and burdensome. The BBA partnership audit rules were rushed through Congress and are considerably less than skillfully drafted. The regulations had to deal with a badly drafted and in some respects badly though-through statute. Regulations also were drafted with an apparent bias in favor of ensuring that the Internal Revenue Service captured tax monies. In some respects, the BBA partnership audit rules seem unfair, perhaps to the point of Constitutional infirmity.

Whether a BBA audit adjustment results in an imputed underpayment is generally made on an item-by-item basis, with limited netting. Computing an imputed underpayment is complicated. Many will consider the rules unfair. An adjustment is classified as a positive adjustment or a negative adjustment. Positive adjustments typically increase the imputed underpayment. Since there can be duplication of positive adjustments, this process can result in an inflated imputed underpayment, unless the Internal Revenue Service exercises discretion to reduce the imputed underpayment on account of duplication of positive adjustments. The mischaracterization or overstatement of an item of income or loss, for example, will typically lead to two or more adjustments of line items on the return. This can lead to multiple positive audit adjustments. Where the adjusted item is a non-income item, there typically will be two or more audit adjustments to different line items. The adjustments, as separately stated items, will be assigned to different adjustment groups. As the adjustments are in different groups, they cannot be directly offset in computing the imputed underpayments. Both of these adjustments are positive adjustments. Regulations provide authority for the Internal Revenue Service to exercise discretion to treat an adjustment as zero if the adjustment duplicates another adjustment.[496] There, however, is no obligation for the Internal Revenue Service to exercise this discretion. The rules leave remarkable discretion to Internal Revenue Service auditors in computing the imputed underpayment. There may be little incentive in an examination for the Internal Revenue Service auditor to exercise this discretion.

The rules generally do not permit the partnership generally to net positive and negative adjustments. Negative adjustments to deductions or credits are generally disregarded. Positive adjustments are pooled together. The imputed underpayment is based on pooled positive adjustments, reduced by only some negative adjustments. That pooled amount (the total netted partnership adjustment) is multiplied by the highest rate of tax in effect for the reviewed year. The current rate would be 37%. This produced the imputed underpayment.

Adjustments typically are adjustments to partnership tax return line item amounts. What is essentially the same adjustment can appear on multiple line items on the tax return can result in overlapping or duplicative adjustments.

Grouping rules determine the extent to which negative adjustments can be used to offset positive adjustments.

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[496] Treas. Reg. §301.6225-1(b)(4).

The total netted partnership adjustment technically is the sum of –

- all net positive adjustments in the reallocation grouping[497] and
- the residual grouping[498]

To determine an imputed underpayment, partnership adjustments are placed into one of four groupings. These groupings are

- the reallocation grouping,[499]
- the credit grouping[500]
- the creditable expenditure grouping[501], and
- the residual grouping.[502]

Adjustments in groupings may be placed in subgroupings.[503]

The Internal Revenue Service may, in its discretion, group adjustments in a manner other than the manner described in Treasury Regulations Section 301.6225-1(c) when this grouping would appropriately reflect the facts and circumstances. Requests to modify groupings are discussed in the regulations[504]

The BBA partnership audit rules provides that the imputed underpayment is determined by appropriately netting all partnership adjustments with respect to the reviewed year.[505] Non-income items are considered in netting of partnership adjustments when computing the imputed underpayment.[506]

Partnership related items generally includes –

- any item or amount that is shown on a partnership's returns (or required to be maintained in the partnership's books and records) that is relevant to determine the tax of any other person,
- any partner's distributive share of such amount, or
- any imputed underpayment under the BBA partnership audit rules.

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[497] Described in Treas. Reg. § 301.6225-1(c)(2).
[498] Described in Treas. Reg. § 301.6225-1(c)(5).
[499] Described in Treas. Reg. § 301.6225-1(c)(2).
[500] Described in Treas. Reg. § 301.6225-1(c)(3).
[501] Described in Treas. Reg. § 301.6225-1(c)(4).
[502] described in Treas. Reg. § 301.6225-1(c)(5).
[503] As appropriate, in accordance with Treas. Reg. § 301.6225-1(c)(d).
[504] Treas. Reg. § 301.6225-2(d)(6).
[505] I.R.C. § 6225(b).
[506] Treas. Reg. § 301.6225-1.

Partnership related items include items that are not items of income, gain, loss, deduction, or credit.

Non-income items are treated as positive adjustments. Non-income items can include

- partner contributions to the partnership,
- partnership distributions to a partner,
- liability allocations to partners,
- Section 199A (qualified business income) information,
- Net earnings from self-employment, asset basis information.
- other items that affect the partnership balance sheet
- "non-income" items, *i.e.*, those items that are not income, gain, loss, deduction, or credit, are treated by the regulations as positive adjustments. In certain cases, a positive adjustment may be treated as "duplicative" of another positive adjustment and thus be treated as zero for purposes of the imputed underpayment calculation.

Contributions to partnerships are partnership-related items and because they do not meet the definition of negative adjustment (decrease in income/gain, increase in an expense/loss, increase in a credit) contributions to partnerships area positive adjustment (all adjustments to non-income items are positive).

A partner's outside basis is not a partnership-related item as it is not on the partnership return nor required to be maintained in the partnership books and records.

Adjustments to a partnership's non-income items are adjustments that do not result in an imputed underpayment in situations where a net negative adjustment to a credit, or an item treated as a credit, reduces the imputed underpayment to zero or less than zero.

The inclusion of non-income items calculating the partnership's imputed underpayment frequently can result in a tax liability that does not parallel the tax liability that would result if the partnership had reported all items correctly and there had been no audit adjustments. The imputed underpayment typically will be larger with including non-income items than the tax liability that would result if the partnership had reported all items correctly and there had been no audit adjustments.

In computing an imputed underpayment in an audit under the Bipartisan Budget Act of 2015, audit adjustments to non-income items are taken into account as positive adjustments.[507] Adjustments to a partnership's non-income items are always positive adjustments, are never negative adjustments, and are not netted against any adjustments to a

[507] Under Treas. Reg. §301.6225-1.

partnership's items of income, gain, loss, deduction, or credit under Section 702(a). This adjustment might be, for example, an adjustment for misreporting or mischaracterization of partnership liabilities or misallocation of partnership liabilities.

This is example 7 in the regulations:

> *Example 7. — On its partnership return for the 2020 taxable year, Partnership reported a recourse liability of $100. During an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS determines that the $100 recourse liability should have been reported as a $100 nonrecourse liability. Under paragraph (d)(2)(iii)(B) of this section, the adjustment to the character of the liability is an adjustment to an item that cannot be allocated under section 704(b). The adjustment therefore is treated as a $100 increase in income because such recharacterization of a liability could result in up to $100 in taxable income if taken into account by any person. The $100 increase in income is a positive adjustment in the residual grouping under paragraph (c)(5)(ii) of this section. There are no other adjustments for the 2020 partnership taxable year. The $100 positive adjustment is treated as a net positive adjustment under paragraph (e)(4)(i) of this section, and the total netted partnership adjustment under paragraph (b)(2) of this section is $100. Pursuant to paragraph (b)(1) of this section, the total netted partnership adjustment is multiplied by 40 percent for an imputed underpayment of $40.*

Regulations[508] provide that:

> *(4) Treatment of adjustment as zero for purposes of calculating the imputed underpayment. If the effect of one partnership adjustment is reflected in one or more other partnership adjustments, the IRS may treat the one adjustment as zero solely for purposes of calculating the imputed underpayment. In addition, if a positive adjustment to an item is related to, or results from, a positive adjustment to another item, one of the positive adjustments will generally be treated as zero solely for purposes of calculating any imputed underpayment unless the IRS determines that an adjustment should not be treated as zero in the calculation of the imputed underpayment. This paragraph applies to the calculation of any imputed underpayment, including imputed underpayments calculated by a partnership or pass-through partner (for example, as part of the filing of an administrative adjustment request (AAR) under section 6227).*

Many advisors are not comforted by the discretion that this leaves Internal Revenue Service auditors: "unless the IRS determines that an adjustment should not be treated as zero in the calculation of the imputed underpayment." The regulation does not set forth any criteria for the Internal Revenue Service exercising this discretion. This seems to leave extraordinary discretion to an Internal Revenue Service auditor.

The Preamble to T.D. 9969[509] advises:

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[508] Treas. Reg. § 301.6225-1(b)(3),

[509] TD 9969, 87 Fed. Reg. 75473 (Dec. 9 2022).

2. Adjustments to Non-Income Items

A. Taking into account adjustments to non-income items that are adjustments that do not result in an imputed underpayment

Under section 6241(2)(B) and §301.6241-1(a)(6)(ii), the term "partnership-related item" includes items or amounts "relating to any transaction with, basis in, or liability of the partnership." Accordingly, the definition of "partnership-related item" includes items that are not items of income, gain, loss, deduction, or credit (non-income items). As defined in §301.6225-1(d)(2)(iii) prior to the November 2020 NPRM, a positive adjustment is any adjustment that is not a negative adjustment as defined in §301.6225-1(d)(2)(ii). A negative adjustment is any adjustment that is a decrease in an item of income (or treated as a decrease in an item of income), or an increase to an item of credit. An adjustment to an item that is a non-income item is not a decrease in an item of income. Therefore, adjustments to a partnership's non-income items are always positive adjustments, are never negative adjustments, and are not netted against any adjustments to a partnership's items of income, gain, loss, deduction, or credit under section 702(a). Therefore, adjustments to a partnership's non-income items are adjustments that do not result in an imputed underpayment in situations where a net negative adjustment to a credit, or an item treated as a credit, reduces the imputed underpayment to zero or less than zero. Under proposed §301.6225-3(b)(8), if an adjustment to a non-income item is an adjustment that does not result in an imputed underpayment, the partnership takes this adjustment into account on its adjustment year return by adjusting the non-income item consistently with the adjustment, to the extent the non-income item appears on the adjustment year return without regard to the adjustment.

Two comments were received regarding the rules for taking into account adjustments to non-income items in the partnership's adjustment year in situations where the adjustments to non-income items are adjustments that do not result in an imputed underpayment under proposed §301.6225-3(b)(8). Both comments expressed concern that including an adjustment to a non-income item, such as an asset, in the imputed underpayment could result in recognition of gain, in the form of the imputed underpayment on the adjustment, prior to the disposition of the asset. One comment also expressed concern that it could result in double tax in situations where a non-income item is adjusted at the partnership level under the centralized partnership audit regime and at the partner level in situations where a special enforcement provision is utilized. According to the comment, the double tax would occur because the partner would pay tax on the adjustment in the partner-level proceeding and the partnership would pay an imputed underpayment on the same adjustment in a partnership examination. The comment noted that it was unclear whether the partnership must also recognize gain on that adjustment in addition to adjusting the non-income item on the partnership's adjustment year return. One of the comments recommended removing proposed §301.6225-3(b)(8) in its entirety. However, the comment seemed to focus primarily on the inclusion of non-income items in the calculation of the imputed underpayment, which is not something that is the subject of proposed §301.6225-3(b)(8). Therefore, that comment's concerns on that issue are addressed more fully in section 2.B of this preamble.

One of the comments also requested that the rule be clarified to note that the partnership would not recognize gain in the adjustment year as a result of taking into account the adjustment to the non-income item that was an adjustment that did not result in an imputed underpayment. Finally, one comment requested that

cross-references in the example be changed to refer to §§301.6225-1(d) and (f) in their entirety and requested additional examples illustrating how other adjustments to non-income items are taken into account on the adjustment year return.

With regard to the comment's concern about the potential for double tax, if an item is adjusted both in an examination of the partnership and of a partner, §301.6241-7(i) provides that an item will not be adjusted at the partner level if the partner can demonstrate that the adjustment was previously taken into account by the person in an examination under the centralized partnership audit regime (for example, by filing an amended return as part of a request to modify the imputed underpayment). Also, an item will not be adjusted at the partner level if the partner demonstrates that the adjustment was included in an imputed underpayment paid by the partnership or pass-through partner for a taxable year in which the partner was a reviewed year partner but only to the extent the adjustment exceeds the original amount reported by the partnership to the partner (that is, the partner needs to have reported the original amounts from the partnership first). In addition, if the partner-level proceeding concludes prior to the partnership-level proceeding, the partnership may request modification of the imputed underpayment for any adjustment previously taken into account at the partner level. Accordingly, in situations where an item is adjusted both in a partner-level examination and a partnership-level examination, the adjustments will not result in double tax because these rules provide for the exclusion of any potential double tax in the examination that concludes later.

The comments also had concerns about gain recognition as a result of adjusting the non-income item in the adjustment year when the adjustment is an adjustment that does not result in an imputed underpayment. There is nothing in the centralized partnership audit regime that would require the partnership to recognize gain in the adjustment year when the partnership adjusts a non-income item as a result of taking into account adjustments that do not result in an imputed underpayment.

Proposed §301.6225-3(b)(8) provides that the partnership takes an adjustment to a non-income item into account by adjusting the non-income item on its adjustment year return. As the example in proposed §301.6225-3(d)(3) demonstrated, in the case of an adjustment to the basis of an asset, the partnership would adjust its basis in the asset in the adjustment year. To avoid confusion, the example has been modified to clarify that the reduction in the basis of the asset only requires the partnership to recognize income or gain in situations where income and gain would be recognized. One comment also requested additional examples demonstrating how adjustments to other items such as liabilities and capital account adjustments are taken into account. In response to the comment, Example 4 is added to §301.6225-3(d) to demonstrate how adjustments to liabilities are taken into account when they are adjustments that do not result in an imputed underpayment. Another example, Example 5, is also added to §301.6225-3(d) in response to the public comment to demonstrate how filing an amended return as part of modification applies when there are adjustments to non-income items. In addition, the recommendation that the cross-references in the example be modified is also adopted and the cross-references are changed where they appear in the example.

One comment expressed concern about how partnerships would be able to comply with proposed §301.6225-3(b)(8) when filing their adjustment year returns. The comment noted that partnerships have different software, advisors, and levels of sophistication and, therefore, the rule might not be consistently applied

among partnerships. The comment expressed a concern that proposed §301.6225-3(b)(8) does not provide a clear and administrable standard as to when to include a non-income item adjustment on the partnership's adjustment year return. The comment expressed concern that taking into account adjustments to non-income items on the partnership's adjustment year return could preclude items that otherwise could never be reported and provided examples of items under section 199A.

Proposed §301.6225-3(b)(8) endeavors to provide clear, bright-line rules on how to account for adjustments to non-income items that must be taken into account on the partnership's adjustment year return because they did not result in an imputed underpayment. Proposed §301.6225-3(b)(8) provides rules on what to do if the non-income item is still included on the partnership's adjustment year return and rules for what happens if it is not included, as well as an example of how the rule works. The nature of non-income items precludes a regulation that could individually account for all types of non-income items because non-income items by their definition vary widely. To encompass all the types of non-income items that could be adjusted in the centralized partnership audit regime, it is necessary for the rule to be broad and apply to numerous types of non-income items. Although the Treasury Department and the IRS take seriously concerns regarding inconsistent application of provisions, varying levels of sophistication, and differences in interpretation of statutes or regulations by software or advisors, proposed §301.6225-3(b)(8) provides necessary guidance to taxpayers while appropriately balancing administrability concerns.

The comment about whether proposed §301.6225-3(b)(8) would preclude the reporting of some items is unclear. If an adjustment is an adjustment that does not result in an imputed underpayment, it is required to be taken into account on the partnership's adjustment year return under section 6225(a)(2). Therefore, those adjustments are accounted for on the adjustment year return.

As non-income items are required to be included in the calculation of the imputed underpayment, there must be rules regarding how to take those adjustments into account on the adjustment year return if they are adjustments that do not result in an imputed underpayment. Without the rule contained in proposed §301.6225-3(b)(8), partnerships would be left with no guidance as to how or when to take those adjustments into account. For this reason and for all the previous reasons, the recommendation to remove proposed §301.6225-3(b)(8) is not adopted.

One comment requested an example demonstrating how adjustments to capital accounts are taken into account if they are adjustments that do not result in an imputed underpayment. These regulations do not address any effect on partner basis and capital accounts. As a result, the comment is beyond the scope of these regulations.

B. Adjustments to non-income items in the calculation of the imputed underpayment

Section 6225 provides specific rules on how to compute the imputed underpayment, which is a liability of the partnership. Under section 6225(b), if adjustments are made to a partnership-related item, those adjustments are appropriately netted, and the highest rate under section 1 or 11 is applied as part of the calculation of the imputed underpayment. Non-income items are included in the definition of "partnership-related item." See section 6241(2)(B)(i) (noting that a partnership-related item includes any item or amount relating to liabilities of the partnership); §301.6241-1(a)(6)(v)(C), (D), and (E). Accordingly, as non-income items are partnership-related items, adjustments to non-income items are appropriately included in the

calculation of the imputed underpayment as section 6225 does not limit which adjustments to partnership-related items are included in the calculation.

The November 2020 NPRM did not propose any changes to the definition of positive adjustments in §301.6225-1(d)(2)(iii), to the formula for calculating the imputed underpayment under §301.6225-1(b), or to §301.6225-1(a)(1), which provides that all adjustments to partnership-related items are included in the calculation of the imputed underpayment. In addition, no changes were proposed to the definition of partnership-related item in §301.6241-1(a)(6)(ii), which includes examples of non-income items as partnership-related items. Accordingly, comments regarding whether a non-income item should be included in the calculation of the imputed underpayment are outside the scope of this regulation and any changes to those provisions would need to be proposed in a separate NPRM. However, the Treasury Department and the IRS have attempted to respond to the comments on this issue within the scope of the November 2020 NPRM.

Two comments were received on the inclusion of non-income items in the calculation of the imputed underpayment. Both comments recommended that all adjustments to non-income items should not be taken into account in determining whether there is an imputed underpayment or that the adjustment to the non-income items should be treated as zero in the computation.

One comment expressed a concern that including adjustments to non-income items in the calculation of the imputed underpayment would fail to reflect accurately the tax impacts of the adjustments and that the imputed underpayment could be far greater than the partners' aggregate chapter 1 tax liability, which the comment said the imputed underpayment is intended to approximate. The comment said this discrepancy would discourage partnerships from filing administrative adjustment requests (AARs) especially given that more and more items are being reported by partnerships. The comment expressed concern that the ability to push out the adjustments under section 6226 does not mitigate or alleviate these concerns.

Both comments expressed concern that an adjustment to a non-income item, such as an adjustment to the basis of an asset, could give rise to a taxable adjustment without a corresponding disposition, realization, or recognition event upon which gain or loss would be determined. One comment also had concerns that including an adjustment to a non-income item in the imputed underpayment would effectively require the partnership to recognize gain prior to when the partnership would otherwise be required to recognize gain under the Code. One comment stated that there is nothing in the Code or in the legislative history of the centralized partnership audit regime that would indicate Congress intended that the IRS could cause a recognition event where one had not occurred. The Treasury Department and the IRS note that there is no legislative history of subchapter C of chapter 63 but agree that there is nothing in subchapter C of chapter 63 that specifically mentions recognition events. However, as discussed later, under the centralized partnership audit regime, the inclusion of an adjustment to a non-income item in an imputed underpayment is not, and does not require, a recognition event.

With regard to the comment that the tax is paid early on non-income items, the comment is correct that, by paying an imputed underpayment on an adjustment to a non-income item, in some circumstances the partnership will effectively pay a tax on the change in the non-income item in situations where the partnership would not yet have recognized income aside from the partnership examination. Under section 6225, the partnership is liable for an imputed underpayment on any adjustments to partnership-related items, which is

defined under section 6241 as any item with respect to the partnership that is relevant to determining the tax liability of any person under chapter 1 of the Code, including a liability of the partnership.

Accordingly, the imputed underpayment under the centralized partnership audit regime is not designed to be the exact amount of the tax liability that would have been paid by the partners, nor is it a substitute for partner tax liability. Rather, it is an entity-level liability of the partnership alone computed by reference to any adjustments made to partnership-related items, regardless of whether those adjustments would have actually resulted in a tax liability to any particular partner. Therefore, given that adjustments are made to a specific taxable year, the adjustments could result in an imputed underpayment in situations where no income would have been recognized if the item had been correctly reported originally. But the adjustments and the imputed underpayment are not themselves realization or recognition events; they are adjustments to partnership-related items that are taken into account in calculating an imputed underpayment under the centralized partnership audit regime.

To provide the partnership with an opportunity to mitigate any inconsistency that may result with the computation of the imputed underpayment, the partnership can request to modify the imputed underpayment or may elect to push out the adjustments to its reviewed year partners. When taking into account an adjustment to a non-income item as part of filing of an amended return or calculating the additional reporting year tax under section 6226, an adjustment to a non-income item would only result in additional tax if that adjustment would have resulted in additional tax on the partner's original tax return had the item been correctly reported by the partnership on its original return for the reviewed year or any intervening year. For example, assume the basis in an asset was adjusted and, subsequent to the reviewed year but prior to the adjustment year, a partner received that asset in a distribution and disposed of that asset. In that case, an adjustment to the partnership's basis in an asset may affect the amount of tax the partner would have paid if the item had been correctly reported. As a result, in this example, the additional reporting year tax for that partner likely would be affected by the basis adjustment.

As mentioned previously, two comments requested that adjustments to non-income items be excluded from the calculation of the imputed underpayment or that those adjustments be treated as zero. As previously discussed, the imputed underpayment is an entity-level liability calculated on all of the adjustments to partnership-related items, and the highest rate is applied regardless of what the tax consequences would have been had the partners correctly taken into account the adjustments in the reviewed year. As a result, in some instances the centralized partnership audit regime shifts an adjustment, and its tax consequences, into a different year than the year to which the adjustment relates. For example, adjustments that do not result in an imputed underpayment are taken into account in the adjustment year instead of the reviewed year. In other words, there are many aspects of the centralized partnership audit regime enacted by Congress that result in income, gain, loss, deduction, or credit, and any taxes on those items, being recognized or taken into account in taxable years other than in the taxable year where the item would have been reported if the centralized partnership audit regime did not apply.

To alleviate this difference, the centralized partnership audit regime offers partnerships choices that would modify or eliminate the imputed underpayment and would make the underpayment amount closer to the

amount of tax that would have been paid if the partners had reported the proper amounts of items in the correct taxable year. For example, the partnership may request modification of the imputed underpayment, including modification of any adjustments that do not result in an imputed underpayment, or may elect to push out the adjustments to its reviewed year partners under section 6226. In addition, §301.6225-1(b)(4) provides that the IRS and partnerships may treat an adjustment as zero solely for purposes of calculating the imputed underpayment in situations where multiple positive adjustments are related to, or result from, one another. Therefore, the recommendation to remove adjustments of non-income items from the calculation of the imputed underpayment or to treat those adjustments as zero in calculating the imputed underpayment in all situations is not adopted.

In addition to the comments on the inclusion of non-income items in the calculation of the imputed underpayment, one comment was received on proposed §301.6225-1(b)(4), which provides the rules for treating an adjustment as zero solely for purposes of computing the imputed underpayment in certain situations. The comment recommended extending the rule in proposed §301.6225-1(b)(4), that allows one adjustment to be treated as zero solely for purposes of calculating the imputed underpayment, if the adjustment is related to or results from an adjustment to an item of income, gain, loss, deduction, or credit to persons other than the IRS. As stated in the preamble to the November 2020 NPRM, the sentence added to §301.6225-1(b)(4) that provides that a partnership may treat an adjustment to a non-income item as zero for purposes of computing the imputed underpayment was proposed to be expanded to provide for a broader application, including to allow partnerships to utilize this rule.

In response to the comment that the language is unclear, the language of proposed §301.6225-1(b)(4) is modified to clarify that this provision applies to both the IRS and partnerships, and the rule has been broadened further. As modified, §301.6225-1(b)(4) as set forth in this Treasury decision provides that if any positive adjustment is related to, or results from, a second positive adjustment, a partnership may treat one of the positive adjustments as zero solely for purposes of computing the imputed underpayment unless the IRS determines that the adjustment should not be treated as zero. With this change, a partnership may treat an adjustment to a non-income item as zero if the adjustment to the non-income item is related to, or results from, another adjustment to a non-income item. However, this rule does not allow the partnership to treat an adjustment as zero if one adjustment is positive and one is negative. For example, if a partnership changes an ordinary loss to a capital loss, which results in a positive adjustment to ordinary income and a negative adjustment to capital loss, the partnership could not treat the negative adjustment to capital loss as zero for purposes of calculating the imputed underpayment. This change provides more relief to partnerships and more closely aligns with the intended purpose of this rule.

One comment recommended that the phrase "unless the IRS determines that the adjustment should be included in the imputed underpayment" be removed from §301.6225-1(b)(4). It is unclear whether this recommendation was made to provide clarity that the provision also applied to determinations made by partnerships or if this recommendation was in addition to that comment. To the extent the comment was about clarifying that §301.6225-1(b)(4) applied to determinations made by partnerships as well as the IRS, as discussed previously, additional language has been added to the provision to make this clear. To the extent that this comment is an additional recommendation, the comment is not adopted. Because partnerships may treat an

adjustment as zero for purposes of calculating the imputed underpayment, there may be times when the partnership should not have treated the adjustment as zero. Accordingly, the IRS needs to be able to determine that the partnership's calculation is accurate.

The comment also requested that a cross-reference to §301.6225-1(b)(4) be added to the regulations under section 6227 to clarify that the provision may be used in AARs. Section 301.6227-2(a)(1) provides that the calculation of an imputed underpayment as part of the filing of an AAR is done in accordance with §301.6225-1, which would include §301.6225-1(b)(4). Therefore, additional clarification is not needed and adding a cross-reference to one portion of the entire regulation that is cited may cause confusion regarding whether the other provisions in §301.6225-1 are applicable.

One comment recommended that if the partnership did not include any adjustments to non-income items in calculating an imputed underpayment as part of an AAR, the rule should provide that the partnership will not be subject to penalty. Nothing in the centralized partnership audit regime prohibits a partnership from raising a defense (such as reasonable cause) to an asserted penalty if that penalty is subject to such a defense. However, if partnerships would never be subject to a penalty for failing to include adjustments to non-income items in the calculation of the imputed underpayment, this would discourage partnerships from including non-income items in the calculation as there would not be a penalty for the IRS to utilize to enforce correct reporting of partnership-related items. The penalty incentivizes proper reporting and removing the penalty's application here would negatively affect tax compliance. Therefore, this comment is not adopted.

In addition, one comment also recommended that any adjustment to a non-income item that affects the basis of partnership assets should be included under the rules of proposed §301.6225-4 and not under the provisions of computing the imputed underpayment on adjustments to partnership-related items. This comment is not adopted. Section 301.6225-1 provides rules for the calculation of the imputed underpayment. Adjustments to a partnership's reporting of its non-income items on its return are included within the calculation of the imputed underpayment as are all adjustments to partnership-related items. Accordingly, §301.6225-1, and not proposed §301.6225-4, is the proper location for rules governing the calculation of the imputed underpayment.

Finally, one comment recommended removing §301.6225-1(d)(2)(iii)(B), which provides that an adjustment that cannot be allocated under section 704(b) is treated as a positive adjustment or a credit, as appropriate, if the adjustment could result in an increase in an item of income, gain, loss, deduction, or credit. The comment stated that this rule also addresses the same issue as §301.6225-1(b)(4), which provides that an adjustment may be treated as zero for purposes of calculating the imputed underpayment if that adjustment is included within another adjustment and it would not be appropriate to include both adjustments in the calculation. The comment stated that both address adjustments to non-income items that are taken into account in calculating the imputed underpayment and, therefore, §301.6225-1(d)(2)(iii)(B) is duplicative. Although the comment noted that it is duplicative, the comment recommended that this provision be amended to provide that items that cannot be allocated under section 704(b) are not taken into account in computing the imputed underpayment.

As previously mentioned, comments requesting that non-income items be excluded completely (or always treated as zero) from the calculation of the imputed underpayment are not adopted. Section 301.6225-1(d)(2)(iii)(B) does not serve the same purpose as §301.6225-1(b)(4). Section 301.6225-1(d)(2)(iii)(B) provides that adjustments to items that are not allocated under section 704(b) are treated as positive adjustments or credits, whichever is appropriate. Section 301.6225-1(b)(4) provides that adjustments may be treated as zero solely for purposes of calculating the imputed underpayment if that adjustment is related to, or results from, another adjustment. Section 301.6225-1(b)(4) does not apply to adjustments that are not related to, or result from, another adjustment and, after amendment, it applies to all positive adjustments, not just those that are not allocated under section 704(b). Therefore, §301.6225-1(d)(2)(iii)(B) and §301.6225-1(b)(4) are not duplicative. Even though those provisions are not duplicative, the Treasury Department and the IRS agree that §301.6225-1(d)(2)(iii)(B) is duplicative of concepts in other provisions, such as the definition of positive adjustment. Accordingly, the comment recommending removing §301.6225-1(d)(2)(iii)(B) is adopted. Because §301.6225-1(d)(2)(iii)(B) is removed in these regulations, former §301.6225-1(d)(2)(iii)(A) is renumbered to be §301.6225-1(d)(2)(iii). No changes were made to the content of the paragraph.

The American Bar Association Section on Taxation commented[510] on non-income items at the proposed regulations stage:

III. Adjustments to an Item That is Not an Item of Income, Gain, Loss, Deduction, or Credit

A. Background

A change to one partnership-related item that is an item of income, gain, loss, deduction, or credit (collectively, "income items") might result in cascading changes throughout the partnership return to items that are not items of income, gain, loss, deduction, or credit (collectively referred to by the Proposed Regulations as "non-income items"). [Footnote omitted.] For example, an adjustment to ordinary business income might result in changes to qualified business income ("QBI") for purposes of section 199A and adjusted taxable income ("ATI") for purposes of section 163(j). An adjustment to QBI in turn might affect multiple lines on Statement A — QBI Pass-Through Entity Reporting, and an adjustment to ATI in turn might affect multiple lines on Form 8990, Limitation on Business Interest Expense Under Section 163(j), e.g., items of, or related to, excess business interest expense ("EBIE") and excess taxable income ("ETI").

Moreover, the Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., includes many non-income items that have no bearing on a partner's ultimate tax liability. Examples include the tax capital reporting requirements (which often will not correspond to outside basis), each partner's aggregate share of forward and reverse section 704(c) amounts, and the amount of a partner's remaining section 743(b) adjustment that has been allocated to each category of partnership property on Schedule L of the Form 1065.

[510] Letter dated October 8, 2021, from Julie A. Divola, Chair, I.R.C. § of Taxation, American Bar Association, to the Hon. Charles P. Rettig, Commissioner, Internal Revenue Service, Re: Comments Concerning BBA Special Enforcement Matters.

The Proposed Regulations address the treatment of adjustments to non-income items, an issue that had not been previously addressed in guidance. [Footnote omitted.] The Preamble states that examples of non-income items include partnership's assets, liabilities, and capital accounts. [Footnote omitted.]

Two provisions in the Proposed Regulations would include adjustments to non-income items in the computation of the imputed underpayment or that are based on including non-income items in the imputed underpayment. They are:

Prop. Treas. Reg. § 301.6225-1(b)(4), which amends the existing zero-adjustment rule to provide that if an adjustment to income items results from or relates to an adjustment to non-income items, the adjustment to a non-income item will be zero unless the Service determines that the adjustment to the non-income item should be included in the imputed underpayment; and

Prop. Treas. Reg. § 301.6225-3(b)(8), which is a new subsection that provides that a partnership takes into account an adjustment that does not result in an imputed underpayment by adjusting the non-income item on its adjustment year return, but only to the extent the item would appear on the adjustment year return without regard to the adjustment.

The Preamble to the Proposed Regulations states that "[a]n adjustment to a non-income item, by definition, is not an adjustment to [an income item], therefore, and [sic] is a positive adjustment." [Footnote omitted.]

B. Recommendations

1. Disregard adjustments to non-income items in computing the imputed underpayment.

If adjustments to all non-income items were taken into account as positive adjustments in determining an imputed underpayment, the imputed underpayment would be far greater than the partners' aggregate chapter 1 tax liability, which the imputed underpayment determination process is intended to approximate.

We are concerned that an imputed underpayment that took into account adjustments to non-income items as positive adjustments would fail to reflect accurately the tax impact of the adjustments. In addition, we are concerned that an unrealistically high imputed underpayment resulting from the inclusion of non-income items, or the uncertainty as to whether the Service subsequently may determine that non-income items should have been included in an imputed underpayment, might discourage partnerships from filing AARs. The fact that a partnership may push out adjustments does not mitigate or alleviate these concerns.

Current guidance addressing adjustments to non-income items generally is limited to a few examples involving a single adjustment (e.g., an adjustment to a partnership liability).69 These examples, however, do not take into account the vast amount of information reported on a typical partnership return. As discussed above, partnership reporting has grown to include many non-income items that have no bearing on a partner's ultimate tax liability. The 2020 Schedule K-1 includes more than 150 different codes, each of which may be used to report multiple partnership-related items. It is not difficult to imagine scenarios where hundreds of non-income items need to be adjusted. We believe that treating each of those adjustments as a positive adjustment

for purposes of determining an imputed underpayment would overstate any reasonable approximation of the proper amount of chapter 1 tax attributable to adjustments to partnership-related items.

Based on the foregoing, we recommend that the Proposed Regulations be revised to disregard all adjustments to non-income items for purposes of computing the imputed underpayment.

If this recommendation is not adopted, we recommend that the zero-adjustment rule be applied so that the partnership, and not just the Service, can determine that the rule applies. The Preamble states that the Proposed Regulations extend the zero-adjustment rule to persons other than the Service. [Footnote omitted.] However, the text of the Proposed Regulations does not appear to be consistent with this statement. Specifically, Prop. Reg. § 301.6225-1(b)(4) would allow only the Service to remedy a situation resulting in double-counting of adjustments. We believe this approach would be unfair to taxpayers and could result in an unreasonably high imputed underpayment. Accordingly, if our primary recommendation is not adopted, we recommend removing the words "unless the IRS determines that the adjustment should be included in the imputed underpayment" from Prop. Treas. Reg. § 301.6225-1(b)(4).

In addition, in the AAR context, the section 6227 regulations cross-reference the section 6225 regulations. [Footnote omitted.] In this context, the Service is not making the initial determination of which items may be adjusted and which adjustments may be netted. Rather, it is the partnership that is making these determinations, and it is the partnership who would be applying the nonduplication rule of Treas. Reg. § 301.6225-1(b)(4). Accordingly, if our primary recommendation is not adopted, we recommend that the Proposed Regulations be modified to clarify that the zero-adjustment rule applies in the AAR context by adding a cross reference to the regulations under section 6227 rather than trying to address both examinations and AARs in the section 6225 regulation.

Finally, if both of our recommendations to disregard all non-income items or to allow partnerships to apply the zero-adjustment rule, we recommend that the Proposed Regulations be modified to provide that partnerships that did not take those adjustments into account when computing and paying an imputed underpayment under the AAR rules will not be subject to penalties.

2. Remove the non-IU adjustment rule in Prop. Treas. Reg. § 301.6225-3(b)(8).

The Proposed Regulations would add a new subsection (8) to the rules under Treas. Reg. § 301.6225-3(b) to provide that a partnership takes into account an adjustment of a non-income item that does not result in an imputed underpayment by adjusting the non-income item on its adjustment year return, but only to the extent the item would appear on the adjustment year return without regard to the adjustment. [Footnote omitted.] That section of the Proposed Regulations provides, further, that if the non-income item already is reflected on the partnership's adjustment year return or any return between the review year or the adjustment year, the partnership should not create a new item in the amount of the non-income item adjustment on the adjustment year return.

The Proposed Regulations also would add an example illustrating this rule. [Footnote omitted.] In the example, the adjustments — a $10 decrease to the adjusted basis of a partnership asset and a $4 increase in credits — result in a non-IU adjustment.

We recommend that the non-IU adjustment rule and the illustrative example in Prop. Treas. Reg. § 301.6225-3(d)(3) be removed. First, the proposed rule appears to preclude reporting of items that otherwise never could be reported, for instance an increase in a partner's share of QBI or unadjusted basis immediately after acquisition ("UBIA") under section 199A, where a partnership otherwise did not report such item for that partner for the adjustment year, thus denying that partner the benefit of the UBIA or the QBI. We see no reason to deny the partner the benefit of these items.

Second, in many cases, partnerships with different software, advisors, or levels of sophistication might reasonably differ on how much information is required to be disclosed with respect to items that should or must be included on a return, as well as how that information is presented. As a result, the application of the non-IU adjustment rule likely will vary depending upon the manner in which the return is prepared, and the rule does not provide a clear and administrable standard as to when a non-income item adjustment should be reflected in the adjustment year return.

Finally, the implication in the example is that an incorrect basis of an asset, in itself, can give rise to a taxable adjustment. The example assumes that the only adjustments are the incorrect asset basis and the adjustment to the credit. It is difficult to understand why an incorrect asset basis, in itself, would give rise to a positive adjustment, to be taken into account in the calculation of an imputed underpayment, without a disposition of the asset, or a realization or recognition event upon which gain or loss would be determined. Until there is a realization and recognition event, the adjustment to an item that is not an item of income, gain, loss, deduction or credit should not be taken into account. We are not aware of anything in the statute or legislative history of the BBA that indicates that Congress intended that, in the context of an examination or AAR, the Service could cause a realization or recognition event when such events otherwise have not occurred under the Code. Furthermore, if an adjustment that is an adjustment to income, deduction, gain, loss or credit impacts the basis of an asset, the correlative asset basis adjustment seemingly is better described as an adjustment to a specified tax attribute under the rules of Prop. Treas. Reg. § 301.6225-4 than as a separate, non-income adjustment of its own. [Footnote omitted.]

IV. Recommendation to Remove the Non-704(b) item Rule in Treas. Reg. § 301.6225-1(d)(2)(iii)(B)

The non-704(b) item rule in Treas. Reg. § 301.6225-1(d)(2)(iii)(B), and the zero-adjustment rule as proposed to be amended by Prop. Treas. Reg. § 301.6225-1(b)(4), address the same thing: how adjustments to non-income items are taken into account in determining an imputed underpayment. Consistent with our primary recommendation that non-income items should not be taken into account in determining an imputed underpayment, we recommend that Treas. Reg. § 301.6225-1(d)(2)(iii)(B) be revised to provide that non-704(b) items are not taken into account in computing the imputed underpayment. To the extent that any prior guidance relies on this rule to take non-income items into account in determining an imputed underpayment, we recommend that guidance be revised, too.

The American Institute of Certified Public Accountants commented on June 28, 2024:[511]

b. Exclude Adjustments Related to Non-Income Items from imputed underpayment

Overview

Under Treas. Reg. §301.6225-1, adjustments to non-income items must be taken into account as adjustments in determining an imputed underpayment. Non-income adjustments are generally treated as positive adjustments for this purpose. In many cases, inclusion of non-income items in the calculation of the imputed underpayment results in a tax liability when one would not normally exist or a tax liability that is much larger than would result under the application of general income tax principles.

Recommendation

The AICPA recommends that Treasury and the IRS revise Treas. Reg. §301.6225-1 to provide for the exclusion of adjustments to non-income items in determining the imputed underpayment when there would be no current tax impact under substantive provisions of the tax law.

Analysis

Non-income items are partnership related items under section 6241(2)(B)(i). Section 6225(b) provides that the imputed underpayment is determined by appropriately netting all partnership adjustments with respect to the reviewed year. Treasury Reg. §301.6225-1 takes the position that all non-income items must be considered in netting of partnership adjustments to determine the imputed underpayment. For example, the IRS imputed underpayment computation includes any adjustment to capital accounts regardless of whether a recognition event has occurred during the tax year that would make the capital account relevant. While Treas. Reg. §301.6225-1(b)(4) provides the IRS with discretion to treat an adjustment as zero if it has a duplicate effect as another adjustment, it does not mandate that the IRS exercise its discretion and does not address situations where the non-income item is not duplicative of another adjustment.

The AICPA recognizes that comments were submitted on this issue in the development of the regulations. However, actual experience with the implementation of the provisions illustrates the unfairness and inaccuracy of the rule as drafted. Through the enactment of the new procedural rules, Congress did not intend to impose a significantly greater tax than would have been required under the substantive provisions of the law. In the statutory language of section 6225, Congress gave the Treasury the flexibility to promulgate rules requiring netting as appropriate. The IRS' position that all adjustments to all partnership related items must be accounted for in the computation of the imputed underpayment, arguably reads "appropriately netting" out

[511] Letter, dated June 28, 2024, from Blake Vickers, CPA, CGMA, Chair, AICPA Tax Executive Committee, American Institute of CPAs, to Ms. Aviva Aron-Dine, Acting Assistant Secretary for Tax Policy, Department of the Treasury, The Honorable Marjorie A. Rollinson, Chief Counsel, Internal Revenue Service, and The Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service, RE: Centralized Partnership Audit Regime, Including Related Forms and Schedules.

of the statute. In addition, inclusion of all non-income items is not required under the statute in appropriately determining the imputed underpayment.

The Texas Bar commented on the proposed regulations: [512]

V. NON-INCOME ADJUSTMENTS THAT DO NOT RESULT IN AN IMPUTED UNDERPAYMENT

A. Background and Proposed Regulation

Section 6225(a)(2) provides that adjustments that do not result in an imputed underpayment shall be taken into account by the partnership in the adjustment year. Proposed Regulation Section 301.6225-3(b)(8) provides that non-income adjustments (i.e., adjustments to non-income items, such as partnership assets, liabilities, and capital accounts) are taken into account by adjusting the item on the partnership's adjustment year return but only to the extent the item would appear on the adjustment year return without regard to the adjustment. The Proposed Regulations provide an example in which the IRS conducts an audit in 2022 of a partnership's 2020 tax year and adjusts the basis of a partnership asset by $10. The example includes this positive adjustment and a negative adjustment to credits when determining whether an imputed underpayment results. Because the adjustments do not result in an imputed underpayment, "the partnership takes into account the $10 adjustment to Asset on its 2022 return by reducing its basis in Asset by $10."30

B. Discussion

In the example, the non-income adjustment is included as a positive adjustment under Treasury Regulation Section 301.6225-1(d)(2)(iii)(A) in determining whether there is an imputed underpayment. Including this non-income adjustment in the imputed underpayment determination as a positive adjustment could result in the recognition of gain on an asset before the asset has been disposed of or sold. We respectfully suggest such a result is inconsistent with general federal income tax principles that gain or loss on an asset is not taken into account until there has been a realization event that results in the recognition of gain or loss.31

In addition, we respectfully note that treating the basis adjustment as a positive adjustment may lead to double taxation under Proposed Regulation Section 301.6241-7(b). Consider for example a partner-level audit in which the IRS determines that a partner's basis in a contributed asset was $30 rather than $50, and therefore there is an additional $20 of gain on the partner's sale of her partnership interest. Under Proposed Regulation Section 301.6241-7(b), the IRS can also adjust the partnership's basis in the contributed asset from $50 to $30. This $20 non-income adjustment is treated as a positive adjustment that would give rise to an imputed underpayment because there are no negative adjustments that could offset the positive adjustment. As a result, the partner would pay tax on the $20 of additional gain on the sale of the partnership interest, and the partnership would pay tax on the $20 basis adjustment in an imputed underpayment. We respectfully

[512] Letter, dated January 25, 2021, from Lora G. Davis, Chair, State Bar of Texas, Tax I.R.C. § to Internal Revenue Service, CC:PA:LPD:PR (REG-123652-18), Re: Comments Regarding Proposed Regulations on the Centralized Audit Regime.

suggest that the IRS and Treasury consider either (i) excluding non-income adjustments from the computation of the imputed underpayment entirely or (ii) treating the amount of the adjustment as zero. Either approach avoids both the acceleration of gain when there has been no realization and recognition event and the potential double taxation under Proposed Regulation Section 301.6241-7(b).

We also respectfully note that it is not clear whether the positive adjustment in the example only corrects the asset's basis in 2022 or whether the partnership must also realize and recognize gain on the $10 positive adjustment in 2022 (the adjustment year). We respectfully suggest that requiring the partnership to realize and recognize gain on the $10 basis adjustment in the adjustment year would be inconsistent with general federal income tax principles that do not tax gain or loss until there has been a realization event that results in the recognition of gain or loss.32

C. Recommendations

We respectfully recommend that the Proposed Regulations be revised to provide that non-income adjustments are not taken into account in determining whether there is an imputed underpayment. Further, we respectfully recommend that when these non-income adjustments are made in the adjustment year, the item is corrected but gain is not recognized until the partnership would otherwise recognize gain. We also respectfully recommend that the cross-references in the example be revised to refer to Treasury Regulation Section 301.6225-1(d)(2) and 301.6225-1(f) in their entirety. In addition, we respectfully recommend that the Proposed Regulations include examples illustrating how adjustments to other non-income items like partnership liabilities and capital accounts are taken into account.

There is much in the Section 6225 regulations that taxpayers might wish to challenge.

The Section 6225 regulations provide this grant of legislative authority:

(6) Other procedures for modification of imputed underpayment. The Secretary may by regulations or guidance provide for additional procedures to modify imputed underpayment amounts on the basis of such other factors as the Secretary determines are necessary or appropriate to carry out the purposes of this subsection.

This appears to be a sufficient grant of legislative authority for the regulations concerning non-income items to be classified as legislative authority. This means that those regulations will be considerably more difficult to challenge than they would be if the regulations were interpretive regulations.

The Section 6225 regulations concerning non-income items nevertheless are not immune to attack.

Taxpayers may argue that the Internal Revenue Service did not respond adequately to comments received at the notice and comment stage in order to satisfy the notice and comment requirement of the Administrative Procedure Act.

Taxpayers also can argue that the regulations' treatment of non-income adjustments are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." [513]

Regulations concerning non-income adjustments ay violate the Constitution Agency interpretations could be set aside because these interpretations violated the Sixteenth Amendment and, failing that, also fail to provide apportionment among the states. [514]

Taxpayers also may argue that the non-income adjustment regulations failed adequately to respond to public comments in the notice and comment period.

[39] Statute of Limitations Exception.

Sections 6235 and Section 6227 are limitation provisions that affect BBA partnership audits. The BBA partnership audit rules permit the Internal Revenue Service to adjust a partnership-related item. The adjustments may create an imputed underpayment. The partnership is required to pay the imputed underpayment unless push-out or pull-in procedures eliminate the imputed underpayment. The timing of partnership adjustments in a BBA partnership examination is controlled by Section 6235. Section 6235 provides that the Internal Revenue Service may not make an adjustment in a BBA partnership audit more than three years after the filing date of the partnership return. Section 6227 provides parallel rules for an administrative adjustment request for a partnership-related item. The administrative adjustment request must be made within three years of the date on which the partnership filed its tax return. Section 6501 limits Internal Revenue Service assessments to within three years from the partnership's filing of its tax return for the adjustment year. Special enforcement matters provisions [515] permit the Internal Revenue Services to make assessments based on partnership items even after expiration of the normal statute of limitations period under Section 6235. As much as anything, these special enforcement matters provisions give a Mulligan to Internal Revenue Service examiners who have failed to make assessments of the Imputed Underpayment within the Section 6235 statute of limitations.

The term "special enforcement matters" means:

- failure to comply with the requirements of Section 6226(b)(4)(A)(ii) (regarding the requirement for a partnership-partner or S corporation partner to furnish statements or compute and pay an imputed underpayment);

[513] 5 U.S.C. § 706(2)(A).

[514] *See* United States Constitution, Article I, I.R.C. § 2, Clause 3 and Article I, I.R.C. § 9, Clause 3 (requiring apportionment of direct taxes). *Hylton v. United States*, 3 US 171 (1796).

[515] Under I.R.C. § 6241(11).

- assessments under Section 6851 (relating to termination assessments of income tax) or Section 6861 (relating to jeopardy assessments of income, estate, gift, and certain excise taxes);
- criminal investigations;
- indirect methods of proof of income;
- foreign partners or partnerships; and
- other matters that the Secretary determines by regulation present special enforcement considerations. [516]

Congress prescribed that, [517] in the case of partnership-related items that involve special enforcement matters, [518] the Secretary may prescribe regulations providing that the centralized partnership audit regime does not apply to those partnership-related items and that those items are subject to special rules for assessment and collection as the Secretary determines to be necessary for the effective and efficient tax enforcement. An important part of those rules, according to the Internal Revenue Service, is the determination that the centralized partnership audit regime (or portions of it) does not apply to certain partnership-related items is the ability to adjust those partnership-related items outside of the centralized partnership audit regime.

While partnerships are generally audited at the partnership level in a BBA partnership audit, regulations [519] concerning special enforcement matters provide exceptions that authorize adjustments to partnership items during an audit of the partner rather than the partnership.

The Internal Revenue Service "may adjust any partnership-related item that relates to any item or amount for which the partner's period of limitations on assessment of tax imposed by chapter 1 of the Code (chapter 1) has not expired for the taxable year of the partner or indirect partner, without regard to subchapter C of chapter 63." [520] The rule requires that these conditions be met:

- the period of limitations under Section 6235 on making partnership adjustments has expired for a taxable year, or
- *either*

[516] I.R.C. § 6241(11)(B)

[517] Under I.R.C. § 6241(11).

[518] For an excellent discussion of special enforcement matters, see Gregory T. Armstrong, Ossie Borosh, Andrew R. Roberson, Adjusting Closed-Year Partnership-Related Items, DOC 2023-28883, 2023 TNF 44-17 (Oct 30 2023); Lee Meyercord and Dawson, "The Next Wave of Partnership Litigation — APA Challenges to BBA Regulations," Taxes (Oct. 2023).

[519] Treas. Reg. § 301.6241-7.

[520] Treas. Reg. § 301.6241-7(f).

- the direct or indirect partner is related to the partnership under Section 267(b) or 707(b); or
- the direct or indirect partner agrees, in writing, to extend the partner's Section 6501 period of limitations on assessment for the taxable year [521]

but only if

- the agreement expressly provides that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

Under these circumstances, the Internal Revenue Service may conduct an examination at the partner level. The Internal Revenue Service also can determine deficiencies in the partner level examination. The tax laws do not require the Internal Revenue Service to institute a BBA partnership audit of the partnership and to determine an imputed underpayment in that audit. This provision, in theory, will allow the Internal Revenue Service effectively and efficiently to focus on a single partner or a small group of partners with respect to a limited set of partnership-related items without unduly burdening the partnership and avoiding procedural concerns about the appropriate level at which such items must be examined. It also may reflect that the Internal Revenue Service has fumbled the statute of limitation in a partnership audit and seeks relief; however, the Internal Revenue Service is more reluctant to admit that this is a purpose of the rule.

Section 267(b)(1) provides:

(10) A corporation and a partnership if the same persons own--

(A) more than 50 percent in value of the outstanding stock of the corporation, and

(B) more than 50 percent of the capital interest, or the profits interest, in the partnership;

Section 267 also provides attribution rules.

Section 707(b) provides:

(b) Certain sales or exchanges of property with respect to controlled partnerships.

(1) Losses disallowed. No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between--

(A) a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or

(B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

[521] I.R.C. § 6501(c)(4).

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267(d) shall be applicable as if the loss were disallowed under section 267(a)(1). For purposes of section 267(a)(2), partnerships described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b).

(2) Gains treated as ordinary income. In the case of a sale or exchange, directly or indirectly, of property, which in the hands of the transferee, is property other than a capital asset as defined in section 1221--

(A) between a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or profits interest, in such partnership, or

(B) between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests,

any gain recognized shall be considered as ordinary income.

(3) Ownership of a capital or profits interest. For purposes of paragraphs (1) and (2) of this subsection, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section.

Special enforcement under Section 6241 provides in pertinent part:

(11) Treatment of special enforcement matters.

(A) In general. In the case of partnership-related items which involve special enforcement matters, the Secretary may prescribe regulations pursuant to which --

(i) this subchapter (or any portion thereof) does not apply to such items, and

(ii) such items are subject to such special rules (including rules related to assessment and collection) as the Secretary determines to be necessary for the effective and efficient enforcement of this title.

(B) Special enforcement matters. For purposes of subparagraph (A), the term "special enforcement matters" means –

(i) failure to comply with the requirements of section 6226(b)(4)(A)(ii),

(ii) assessments under section 6851 (relating to termination assessments of income tax) or section 6861 (relating to jeopardy assessments of income, estate, gift, and certain excise taxes),

(iii) criminal investigations,

(iv) indirect methods of proof of income,

(v) foreign partners or partnerships, and

(vi) other matters that the Secretary determines by regulation present special enforcement considerations.

Regulations under Section 301.6241-7 provide:

(f) Special relationships and extensions of the partner's period of limitations. If the period of limitations under section 6235 on making partnership adjustments has expired for a taxable year, the IRS may adjust any partnership-related item that relates to any item or amount for which the partner's period of limitations on assessment of tax imposed by chapter 1 of the Code (chapter 1) has not expired for the taxable year of the partner or indirect partner, without regard to subchapter C of chapter 63 if —

(1) The direct or indirect partner is related to the partnership under section 267(b) or 707(b); or

(2) Under section 6501(c)(4), the direct or indirect partner agrees, in writing, to extend the partner's section 6501 period of limitations on assessment for the taxable year but only if the agreement expressly provides that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

T.D. 9969[522] explains:

Under section 6241(11), Congress prescribed that in the case of partnership-related items that involve special enforcement matters, the Secretary may prescribe regulations providing that the centralized partnership audit regime does not apply to those partnership-related items and that those items are subject to special rules for assessment and collection as the Secretary determines to be necessary for the effective and efficient enforcement of the Code. Integral to the concept that the Secretary can determine that the centralized partnership audit regime (or portions of it) does not apply to certain partnership-related items is the ability to adjust those partnership-related items outside of the centralized partnership audit regime.

Additionally, inherent in the ability to subject items to special rules for assessment and collection is the ability to prescribe rules for assessment that differ from existing rules, including section 6235. If the centralized partnership audit regime does not apply to an item then that item may only be adjusted using the rules that apply to partnerships that have made an election out of the centralized partnership audit regime and not using any of the rules contained in subchapter C of chapter 63. For example, if the centralized partnership audit regime does not apply to an item, the item could be adjusted on the return of the partner and the section 6235 period of limitations would not apply to that item. Instead, as for partnerships that have elected out of the centralized partnership audit regime, the operative period of limitations is the partners' period of limitations on making assessments. Because section 6241(11) provides that the IRS may provide that the centralized partnership audit regime does not apply to certain items and that there are special rules for assessment and collection, the IRS may prescribe special rules that impact or rely upon the partners' periods of limitations on assessment.

[522] 87 Fed. Reg. 75473-75495.

Therefore, although the centralized partnership audit regime provides that adjustments are made at the partnership level based on the partnership's period of limitations, Congress, by enacting section 6241(11), contemplated that there would be times when the centralized partnership audit rules did not apply. Accordingly, any special enforcement provision that adjusts partnership-related items outside of the centralized partnership audit regime or provides special rules governing the period of limitations on assessment when items are adjusted outside of the centralized partnership audit regime is not inconsistent with Congress' intent. Rather, it is consistent with the intent of Congress as expressly provided in section 6241(11).

The American Bar Association commented[523] when the regulations were proposed:

Unlike TEFRA, which allows partnership adjustments if either the partnership or partner-level statute of limitations is open, [Citation omitted.] the statute of limitations for partnership adjustments under the BBA is determined exclusively at the partnership level (i.e., the partner's statute of limitations is not taken into account). [Footnote omitted.] Section 6235(a) provides the partnership-level limitations period and provides that no partnership adjustment may be made after the later of:

(1) the date which is 3 years after the latest of —

(A) the date the partnership return was filed,

(B) the due date of the return, or

(C) the date on which the partnership filed the administrative adjustment request, or

(2) if the partnership requests a modification of the imputed underpayment, 270 days (plus any agreed to extension) after the date the information is submitted, or

(3) if the partnership does not request modification of the imputed underpayment, 330 days (plus any agreed to extension) after the date of the notice of proposed partnership adjustment. [Footnote omitted.]

The statute of limitations on adjustments may be extended by agreement.36 In addition, an adjustment may be made at any time if the partnership files a false or fraudulent return or no return. [Citation omitted.] The limitations period in (1) above is extended from three years to six years if the partnership return contains a substantial omission from gross income. [Citation omitted.]

Prop. Treas. Reg. § 301.6241-7(f) would provide an exception to the statute of limitations set forth in the statute if the partner's statute of limitations is open and either (i) the partner has control over the partnership (according to the rules under sections 267(b) and 707(b)); or (ii) the partner has extended its statute of limitations under section 6501(c)(4) and the extension expressly states that the partner is extending the time to make partnership adjustments.

Statutes of limitation are strictly construed. [Citation omitted.] For example, in United States v. Brockamp, the Supreme Court found that the statutory limitations period for tax refund claims did not contain

[523] Letter, dated October 8, 2021, from Julie A. Divola, Chair, I.R.C. § of Taxation, American Bar Association, to the Honorable Charles P. Rettig, Commissioner, Internal Revenue Service, Re: Comments Concerning BBA Special Enforcement Matters.

an implied equitable exception because the statute "sets forth its limitations in a highly detailed technical manner, that linguistically speaking, cannot easily be read as containing implicit exceptions." [Citation omitted.] Likewise, section 6235 contains detailed limitations for the time period in which partnership adjustments may be made. Unlike TEFRA, there is no language in the statute suggesting that the statute of limitations for partnership adjustments may be determined at the partner level. [Citation omitted.] The JCT's explanation of that section provides further evidence that Congress intended the statute of limitations for partnership adjustments to be determined exclusively at the partnership level. [Citation omitted.]

By way of explanation, the Preamble states that Prop. Treas. Reg. § 301.6241-7(f) is necessary because certain "partnership issues might become apparent only at a future date or during an examination of a partner, which can frustrate the Service's ability to allocate resources and examine taxpayers timely, especially in situations where the partnership structure includes many related and controlled entities." [Footnote omitted.] In addition, the Preamble states that the application of the partner's statute of limitation is necessary in the case of complex multi-tiered partnership structures. [Citation omitted.]

These arguments do not seem strong to us. The procedural reforms adopted by the BBA, i.e. treating partnerships more like corporations for audit purposes, substantially reduced the possibility that upper tier or controlling partners could avoid the repercussions of adjustments made to lower tier partnerships. Instead, the BBA put the onus on partnerships and their partners to figure out how the adjustments will play out if the imputed underpayment is not paid by the partnership entity itself. Thus, we do not believe that deviation from the statutory rule that "[a]ny adjustment to a partnership-related item shall be determined, and any tax attributable thereto shall be assessed and collected, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item shall be determined, at the partnership level (emphasis added) . [citation omitted] is warranted in this context. Unlike the special enforcement areas expressly identified in section 6241(11)(B) that might warrant special rules (e.g., a criminal investigation or foreign partners), Prop. Treas. Reg. § 301.6241-7(f) would allow the Service to avoid the BBA partnership-level statute of limitations rules primarily for the Service's own convenience.

Accordingly, we recommend that Prop. Treas. Reg. § 301.6241-7(f) be withdrawn.

3. Withdraw Prop. Treas. Reg. § 301.6241-7(g).

Prop. Treas. Reg. § 301.6241-7(g) would allow the Service to adjust "any tax, penalties, additions to tax, or additional amounts imposed on, and which are the liability of, the partnership under chapter 1" outside of the BBA. [Citation omitted.] Language in the Preamble related to Prop. Treas. Reg. §§ 301.6225-1 and 301.6225-2 seems to indicate that this special enforcement authority is intended to apply to a partnership-partner who either paid an imputed underpayment or is subject to liability as a result of a push out election by a partnership in which the partnership-partner is directly or indirectly a partner. [Citation omitted.]

We do not believe such a rule is necessary within the construct of the BBA regime. That is because we do not believe a partnership-partner would owe an imputed underpayment only as a result of the partnership electing under section 6226 to push out adjustments. In such a case, the entity-level liability of the partnership making the section 6226 election no longer exists and the partners are subject to tax (and any penalties and interest associated with the tax) with respect to their allocable share of adjustments. The adjustments that are

pushed out are determined by the Service in a BBA proceeding or by the source partnership filing an AAR. The adjustments are not subsequently determined or adjusted at the partner-level under any interpretation of the BBA regime. We believe that Prop. Treas. Reg. § 301.6241-7(g) is unnecessary because there should not be a second proceeding.

We also do not believe that the statute contemplates such adjustments to partnership-related items outside the BBA. Treas. Reg. § 301.6241-1(a)(6)(ii)(C) provides that a partnership-related item includes an imputed underpayment. Treas. Reg. § 301.6241-1(a)(6)(i) provides that a partnership adjustment is an adjustment of a partnership-related item. Section 6211(c) provides that subchapter C of chapter 63 of the Code, the BBA partnership audit regime, is the exclusive means for adjustments to partnership-related items. Section 6211(c) provides that "adjustments to partnership-related items shall be made only as provided in subchapter C."

There might be disputes between the Service and a partner regarding the partner's computation of its tax liability when the partner takes into account its allocable share of adjustments that it received as a result of a push out. However, such a dispute remains part of the BBA regime and relates to how the partnership adjustments are translated into tax liability at the partner level, as opposed to how those adjustments are determined at the partnership level. In fact, section 6232(f) was enacted precisely so that the Service would have a streamlined mechanism to collect the imputed underpayment (including penalties and interest) from partnerships, including partnership-partners and S corporation partners who do not pay the correct imputed underpayment due after taking into account the adjustments. [Citation omitted.] Accordingly, section 6232(f) ensures that it is unnecessary for the Service to begin a new proceeding to collect the imputed underpayment (and penalties and interest) from a partnership-partner.

For the reasons stated above, we recommend that Prop. Treas. Reg. § 301.6241-7(g) be withdrawn.

The American Fuel & Petrochemical Manufacturers [524] commented in 2021:

1. Proposed Regulations Section 301.6241-7(b): Partnership-related item components of non-partnership-related items

The Proposed Regulations would allow the IRS to determine that the centralized partnership audit rules do not apply in situations in which the IRS adjusts or makes a determination with respect to a partnership-related item in the course of an audit of the non-partnership-related items of a partner or other person. In such cases, the partnership's treatment of the partnership-related item must be based on information provided by the individual being audited for the IRS to make this determination.

The preamble to the Proposed Regulations indicates that Treasury believes that this rule would allow partnerships to avoid the expense of audits related solely to the treatment of partner-specific items where the

[524] Letter, dated January 25, 2021, from Justin Sykes, Senior Manager, Government Relations, American Fuel & Petrochemical Manufacturers, to CC:PA:LPD:PR (REG-123652-18), room 5203, Internal Revenue Service, Re: Comments Regarding Regulations (REG-123652-18) Issued Pursuant to Code I.R.C. §s 6221, *et seq.*

partner, not the partnership, is in the best position to substantiate the information on which the partnership bases its treatment of the item. While that may be an efficient method in some cases, it is problematic in any case in which adjusting the partnership-related item as to one partner would impact even one of the other partners in a partnership. Unfortunately, that would be the result in almost every case that would be covered by this rule. Indeed, the situation described in the preamble to the Proposed Regulation — a contribution of a non-depreciable asset to a partnership — may be the only situation in which this rule would not impact the other partners in the partnership. However, Proposed Regulations Section 301.6241-7(b) is written so broadly that it would capture many more circumstances. In fact, it does not even attempt to take into account the goal that Treasury stated in the preamble: "The IRS anticipates making these adjustments in cases in which the adjustments are likely only relevant to a single partner or a small group of partners and are unlikely to involve items that are allocable to all partners generally or that impact the partnership as a whole."

In addition, by focusing on situations in which a partnership's treatment of a partnership-related item on its return or in its books and records is based "in whole, or in part," on information provided by the taxpayer under audit, Treasury misses an important practical point. This is that, in most tax partnerships, there is one partner that provides some or all of the information about tax items to the partnership: the manager or general partner. Thus, the breadth of Proposed Regulations Section 301.6241-7(b) is such that nearly any partnership-related item of a manager or general partner would be subject to adjustment on audit of that taxpayer, regardless of whether it affects any other partner in a relevant partnership and without taking into account any such impact. This outcome would be directly contrary to Congress' goal of more efficiently and fairly auditing partnership items. It would also be directly contrary to the principles of fairness in the administration of the federal tax law.

Finally, adjusting the partnership-related item of only one partner when any other partner is affected in any way would be uniquely damaging to PTPs, which have extensive holdings of depreciable and amortizable assets. One of the hallmarks of PTP units is that they are fungible, which is necessary in order to maintain a public market in them. Any adjustment of one partner's partnership-related items without making corresponding adjustments to the partnership-related items of all partners in the PTP would make the PTP interests not fungible. This lack of fungibility of PTP units would make all units issued by the PTP completely unmarketable, thus effectively destroying the ability of the PTP to remain publicly listed.

While we suggest that Proposed Regulations Section 301.6241-7(b) be removed entirely from the Treasury Regulations, at the very least, Treasury should include a limitation that this provision applies only in a case when the adjustment of the partnership-related item would not impact the other partners of the partnership at all. Without this limitation, Proposed Regulations Section 301.6241-7(b) is simply untenable from a general tax policy perspective and contrary to the purpose of the centralized audit rules.

2. Proposed Regulations Section 301.6241-7(f): Controlled partnerships and the partner's period of limitations

Proposed Regulations Section 301.6241-7(f) would allow the IRS, without regard to the centralized audit rules, to adjust any partnership-related item of a taxpayer that "is deemed to have control of a

partnership" and either the statute of limitations for the taxpayer's tax year is open or the taxpayer agrees to extend the statute of limitations.

AFPM submits that this Proposed Regulation has much the same problems as those described above in respect of Proposed Regulations Section 301.6241-7(b) because both provisions permit for adjustments as to one partner without considering the consequence of that adjustment to the other partners. In addition, while AFPM recognizes that Treasury may have policy reasons for tying control of a partnership to the proposed rules, because in many cases a manager or general partner will provide information to a partnership and thereby become subject to subsection (b) as written, this rule unreasonably overlaps with subsection (b).

Further, this provision does not define control, making it very susceptible to abuse. Proposed Regulations Section 301.6241-7(f) states in full:

If the period of limitations under section 6235 on making partnership adjustments has expired for a taxable year, the IRS may adjust any partnership-related item that relates to any item or amount for which the partner's period of limitations on assessment of tax imposed by chapter 1 of the Code (chapter 1) has not expired for the taxable year of the partner or indirect partner, without regard to subchapter C of chapter 63 if —

(1) The direct or indirect partner is deemed to have control of a partnership if such partner is related to the partnership under sections 267(b) or 707(b); or

(2) Under section 6501(c)(4), the direct or indirect partner agrees, in writing, to extend the partner's section 6501 period of limitations on assessment for the taxable year but only if the agreement expressly provides that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

Subsection (f)(1) is a continuation of a sentence, not a mere definition. As written, therefore, it is clear that a partner will be deemed to have control if Code Sections 267(b) or 707(b) apply. However, it does not state under what other conditions a partner could be construed as having control. Control of a partnership is typically defined under the Code solely by reference to Code Section 267(b) or 707(b) and does not typically use concepts of control through, e.g., voting or management rights. Accordingly, the reference to control here must be defined in order to be administrable and for the IRS' administration of the rule to be predictable for taxpayers.

Finally, the concept of control — which, based on the discussion in the preamble and the header of the provision, appears to be a principal factor in this regulation — is only used in subsection (f)(1). Thus, as written, subsection (f) in its entirety could be used to adjust any partnership-related item of any direct or indirect partner that has an open statute of limitations or agrees in writing to extend their statute of limitations. Surely this is not what Treasury intended.

AFPM suggests that Proposed Regulations Section 301.6241-7(f) also be removed entirely from the Treasury Regulations and does not see a way that, as written, this rule can be revised to be administrable by the IRS or fair to taxpayers.

The Taxation Section of the Texas Bar Association[525] commented:

II. PARTNER-LEVEL STATUTE OF LIMITATIONS

A. Background

TEFRA allows partnership adjustments if either the partnership or partner-level statute of limitations is open.[3] [[3]Section 6229 (repealed 2015). Section 6229(a) provided that the statute of limitations for adjustment of partnership items "shall not expire before" the date that is 3 years after the later of the date the partnership return was filed or the last day for filing such return. Courts concluded that the "shall not expire before" language made clear that Section 6229(a) was not an exclusive statute of limitations, and an assessment of tax attributable to a partnership item was timely as long as the period of limitations remained open under either Section 6501 (relating to a partner's statute of limitations) or Section 6229 (relating to a partnership's statute of limitations). See, e.g., Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm'r, 114 T.C. 533 (2000); Curr-Spec Partners, L.P. v. Comm'r, 579 F.3d 391 (5th Cir. 2009), cert. den., 130 S. Ct. 3321 (2010); AD Global Fund, LLC v. United States, 481 F.3d 1351 (Fed. Cir. 2007); Andantech LLC v. Comm'r, 331 F.3d 972 (D.C. Cir. 2003); Schumacher Trading Partners II v. United States, 72 Fed. Cl. 95 (2006); Grapevine Imports, Ltd. v. United States, 71 Fed. Cl. 324 (2006); Russian Recovery Fund, Ltd. v. United States, 108 A.F.T.R.2d 2011-7182 (Fed. Cl. 2011).] By contrast, the statute of limitations for partnership adjustments under the Centralized Audit Rules is determined exclusively at the partnership level; the partner's statute of limitations is not taken into account.[4] [[4]Section 6235(a).] Section 6235(a) sets forth the partnership-level limitations period and provides that no partnership adjustment may be made after the later of:

(1) the date which is 3 years after the latest of —

(A) the date the partnership return was filed,

(B) the due date of the return, or

(C) the date on which the partnership filed an administrative adjustment request ("AAR") under Section 6227, or

(2) if the partnership requests a modification of an imputed underpayment under Section 6225(c), 270 days (plus any agreed extension) after the date the information is submitted, or

(3) if the partnership does not request modification of the imputed underpayment, 330 days (plus any agreed extension) after the date of the notice of proposed partnership adjustment ("NOPPA"). [Footnote omitted.]

The statute of limitations on partnership adjustments may be extended by agreement.6 In addition, an adjustment may be made at any time if the partnership files a false or fraudulent return or no return.[7]

[525] Letter dated January 25, 2021, from Lora G. Davis, Chair, State Bar of Texas, Tax I.R.C. § to Internal Revenue Service, CC:PA:LPD:PR (REG-123652-18), RE: Comments Regarding Proposed Regulations on the Centralized Audit Regime.

[7Section 6235(c)(1), (3).] The limitations period in (1) above is extended from three years to six years if the partnership makes a substantial omission from gross income.[8] [8Section 6235(c)(2).]

B. Proposed Regulation

Proposed Regulation Section 301.6241-7(f) allows the IRS to make partnership adjustments after the partnership-level statute of limitations has expired if the partner's statute of limitations is open and either (1) the partner has control over the partnership (as determined under Sections 267(b) and 707(b)); or (2) the partner has extended the partner's statute of limitations under Section 6501 and the extension expressly states that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

C. Discussion

The Proposed Regulations appear inconsistent with Congress' clear directive in the Centralized Audit Rules to determine the statute of limitations for partnership adjustments exclusively at the partnership level. Section 6221(a) specifies that "[a]ny adjustment to a partnership-related item shall be determined, and any tax attributable thereto shall be assessed and collected, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item shall be determined, at the partnership level. . ."[9] [9Section 6221(a) (emphasis added).] Thus, the partner's statute of limitations is irrelevant to partnership adjustments.

We respectfully suggest that the IRS should not extend the statute of limitations for partnership adjustments beyond what Congress has prescribed. Statutes of limitations are strictly construed in accordance with their express terms.[10] [10Badaracco v. Comm'r, 464 U.S. 386, 391–92 (1984) (". . . even were we free to do so, there is no need to twist § 6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy. . .")] For example, in Brockamp, the Supreme Court found that the statutory limitations period for tax refund claims did not contain an implied equitable exception because the statute "sets forth its limitations in a highly detailed technical manner, that linguistically speaking, cannot easily be read as containing implicit exceptions."[11] [11United States v. Brockamp, 519 U.S. 347, 350 (1997).] Likewise, Section 6235 contains detailed limitations for the time period in which partnership adjustments may be made. Unlike TEFRA, the statutory language of Section 6235 nowhere suggests that the statute of limitations for partnership adjustments may be determined at the partner level.[12] [12Lamie v. U.S. Trustee, 540 U.S. 526, 542 (2004) ("If Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent.").] Section 6235 sets forth explicit exceptions to its general time limits, and those specific exceptions do not include whether a controlling partner's statute of limitations is open or a partner has agreed to extend its statute of limitations.[13] [13See Section 6235(b) (extension by agreement) and Section 6235(c) (fraud).]

1. Legislative History Does Not Support Determining the Statute of Limitations at the Partner Level

The legislative history of Section 6235 further confirms that Congress intended the statute of limitations for partnership adjustments to be determined exclusively at the partnership level.[14] [14The legislative history

summarizes the statute of limitations rules and never suggests an exception if the partner's statute of limitations is open or the partner agreed to an extension. STAFF OF THE JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF THE TAX LEGISLATION ENACTED IN 2015 (JCS-1-16), at 75–76 (2016). Instead, the legislative history makes clear that it is the partnership that "may consent to an extension of time within which a partnership adjustment may be made." Id. at 75. Further, the legislative history reiterates that under the Centralized Audit Rules, any partnership adjustments are "determined at the partnership level" and "[a]ny tax attributable to these items is assessed and generally is collected at the partnership level." Id. at 62 (emphasis added).] When Congress revised certain provisions of the Centralized Audit Rules after their enactment, it chose not to add a partner-level statute of limitations, even though it addressed other statute of limitations issues.[15] [[15]Corrections were made to the Centralized Audit Rules by the Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, § 411, 129 Stat. 2241 (2015), effective as if included in the BBA. Additional corrections and modifications were made by the TTCA included in the Consolidated Appropriations Act, 2018, Pub. L. No. 115-66, Div. U, Title II, 132 Stat. 348 (2018), effective as if included in the BBA.] As part of the Tax Technical Corrections Act of 2018 ("TTCA"), Congress explicitly addressed special statutes of limitations for taxes imposed by a chapter other than Chapter 1 in the same Section of the Code that includes special enforcement provisions.[16] [[16]See Section 6241(9).] The TTCA also fixed a statute of limitations glitch that would have allowed the IRS to issue a NOPPA to revive an otherwise closed statute of limitations.[17] [[17]Prior to the amendment by the TTCA, the time period when a NOPPA must be issued was not specified. The TTCA amended Section 6231(b)(1) to provide that any NOPPA must be issued within the three-year period in Section 6235(a)(1). TTCA, Pub. L. No. 115-66, Div. U, Title II, 132 Stat. 348 (2018). Therefore, the NOPPA must be issued within three years of the later of the date the partnership return was filed, the date the return was due, or the date the partnership filed an AAR. Section 6231(b)(1). As a result, the IRS cannot issue a NOPPA to revive an otherwise closed statute of limitations. STAFF OF THE JOINT COMM. ON TAX'N, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE HOUSE AMENDMENT TO THE SENATE AMENDMENT TO H.R. 1625 (JCX-6-18), at 40 (2018).

2. Preamble Does Not Support Departing from the Statute

The preamble to the Proposed Regulations suggests that IRS resource issues in partner-level audits and tiered partnership structures present "special enforcement considerations" under Section 6241(11)(B)(vi) that justify application of a partner-level statute of limitations for partnership adjustments in certain circumstances. Specifically, the preamble states that Proposed Regulation Section 301.6241-7(f) is necessary because certain "partnership issues may only become apparent at a future date or during an examination of a partner, which can frustrate the IRS's ability to allocate resources and examine taxpayers timely, especially in situations where the partnership structure includes many related and controlled entities."[18] [[18]Preamble to Prop. Treas. Reg. Section 301.6241-7(f), 85 Fed. Reg. 74,940 (Nov. 24, 2020).] Therefore, the preamble argues for a partner-level statute of limitations to carry out the results of audits of complex multi-tiered partnership structures.[19] [[19]Preamble to Prop. Treas. Reg. Section 301.6241-7(f), 85 Fed. Reg. 74,940 (Nov. 24, 2020).]

We respectfully suggest that the "special enforcement considerations" in the preamble do not warrant extending the statute of limitations by regulation, particularly when such regulation appears inconsistent with the statute and its related legislative history. We respectfully note that the statute and related legislative history do not suggest that control or a partner's agreement to extend its statute of limitations should result in a longer limitations period for partnership adjustments. As courts have recognized, "[s]tatutes of limitation frequently involve some hardship, but the alleviation of that hardship is a matter of policy for the Congress."[20] [[20]Kreiger v. United States, 539 F.2d 317, 322 (3d Cir. 1976); see also Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 300 (1946) (citing Chase Securities Corp. v. Donaldson, 325 U.S. 304, 314 (1937)) (Statutes of limitations . . . are by definition arbitrary, and their operation does not discriminate between the just and unjust claim, or the [a]voidable and unavoidable delay.").] Despite Congress' focus on statute of limitations issues in the technical corrections, Congress declined to enact any provision to alter the rule in Section 6235 that the statute of limitations for partnership adjustments is determined exclusively at the partnership level.]

In addition, the issues surrounding multi-tiered partnership structures were a significant impetus for enacting the Centralized Audit Rules, and Congress chose not to enact a partner-level statute of limitations despite its familiarity with the issues presented by such structures.[21] [[21]STAFF OF THE JOINT COMM. ON TAX'N, DESCRIPTION OF CERTAIN REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2016 BUDGET PROPOSAL (JCS-2-15), at 264 66 (2015) (Explaining that the Centralized Audit Rules are intended to address several of the difficulties under TEFRA including those that arise "in the case of tiered partnerships or partnerships with other types of passthrough partners.").

C. Recommendation

We respectfully recommend that the Proposed Regulations be amended to strike Proposed Regulation Section 301.6241-7(f).

In appropriate cases, taxpayers may be inclined to challenge the special enforcement matters statutes of limitations. The special enforcement matters are legislative regulations. The enforcement regulations are entitled to a high level of deference. The Administrative Procedure Act generally provided deference to administrative agencies unless their interpretations of statutes were "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[526] This is a very high standard for a taxpayer to satisfy in a challenge of the special enforcement matters statutes of limitations. There may be much about the special enforcement matters statutes of limitations for taxpayers to object to, but it nevertheless will be difficult for a taxpayer to convince a court to invalidate these regulations.

Agency interpretations can be set aside because these interpretations violated the Constitution or exceeded the statutory grant of interpretive authority. The statutory authority is based on this language: that the special enforcement matters statutes of limitations are "(vi)

[526] 5 U.S.C. § 706(2)(A).

other matters that the Secretary determines by regulation present special enforcement considerations." A taxpayer might argue that the regulations concerning the special enforcement matters statutes of limitations exceeded the statutory grant of interpretive authority. The grant of legislative authority in the statute seems to be a very broad one. It is difficult to discern what are the boundaries of the grant of authority. A court might be inclined to interpret the grant of authority very restrictively, while another court might interpret the grant very expansively.

Any taxpayer challenging the regulation must be aware that it is difficult to challenge legislative regulations and to establish that a legislative regulations is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." [527]

*§1.9 Pre-*Chevron *Authorities.*

[1] Skidmore v. Swift and Co. (1944): Correctness Of Agency Rules Is Determined Based On The Persuasiveness Of The Agency Arguments Supporting The Rules.

Skidmore v. Swift and Co. [528] set forth the earlier standard under which the correctness of agency rules is determined based on the persuasiveness of the agency arguments supporting

[527] 5 U.S.C. § 706(2)(A).

[528] 323 U.S. 134 (1944). *See also E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244 (1991) ("Finally, the EEOC, as one of the two federal agencies with primary responsibility for enforcing Title VII, argues that we should defer to its 'consistent' construction of Title VII, first formally expressed in a statement issued after oral argument but before the Fifth Circuit's initial decision in this case, Policy Statement No. N 915.033, BNA EEOC Compliance Manual § 605:0055 (Apr.1989), 'to apply to discrimination against American citizens outside the United States.' Brief for Petitioner in No. 89 1838, p. 22. Citing a 1975 letter from the EEOC's General Counsel, 1983 testimony by its Chairman, and a 1985 decision by the Commission, it argues that its consistent administrative interpretations 'reinforce' the conclusion that Congress intended Title VII to apply abroad. ¶ In *General Electric Co. v. Gilbert*, 429 U.S. 125, 140 146, 97 S.Ct. 401, 410 413, 50 L.Ed.2d 343 (1976), we addressed the proper deference to be afforded the EEOC's guidelines. Recognizing that 'Congress, in enacting Title VII, did not confer upon the EEOC authority to promulgate rules or regulations,' we held that the level of deference afforded "will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Id.*, at 141, 142, 97 S.Ct., at 410, 411 (*quoting Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 164, 89 L.Ed. 124 (1944)). ¶ The EEOC's interpretation does not fare well under these standards. As an initial matter, the position taken by the Commission 'contradicts the position which [it] had enunciated at an earlier date, closer to the enactment of the governing statute.' *General Electric Co., supra*, 429 U.S., at 142, 97 S.Ct., at 410. The Commission's early pronouncements on the issue supported the conclusion that the statute was limited to domestic application. See 29 CFR § 1606.1(c) (1971) ('Title VII . protects all individuals, both citizen and noncitizens, domiciled or residing in the United States, against discrimination on the basis of race,

the rules. *Skidmore v. Swift and Co.* was an action to recover overtime compensation, attorneys' fees, and liquidated damages under the Fair Labor Standards Act. *Skidmore v. Swift and Co.* sets forth a standard the apparently applies to subregulatory guidance, such as published revenue rulings. After *Loper Bright Enterprises*, *Skidmore* apparently sets forth the standard for evaluating the validity of all regulations.

Whether a court will agree with an agency's interpretation of a statute under *Skidmore v. Swift and Co.* depends on "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." This sets the current standard for reviewing agency interpretations that do not rise to the standard of legislative regulations.

Skidmore v. Swift and Co. does not disregard agency interpretations. *Skidmore v. Swift and Co.* respects agency opinions but does not automatically accept them. *Skidmore v. Swift and Co.* requires the court separately to evaluate the quality of the agency's interpretation. *Skidmore v. Swift and Co.* directs the court to consider:

- the persuasiveness of the agency's position,
- the thoroughness of the agency's investigation,
- the validity of the agency's reasoning, and
- consistency of the agency interpretation with prior agency interpretations.

Skidmore v. Swift and Co. may well be as close to authoritative guidance on the effect of nonlegislative governmental rules and regulations as we currently have after *Loper Bright Enterprises*. *Skidmore v. Swift and Co.* allows some deference to agency interpretations, but that

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color, religion, sex, or national origin'). While the Commission later intimated that the statute applied abroad, this position was not expressly reflected in its policy guidelines until some 24 years after the passage of the statute. The EEOC offers no basis in its experience for the change. The EEOC's interpretation of the statute here thus has been neither contemporaneous with its enactment nor consistent since the statute came into law. As discussed above, it also lacks support in the plain language of the statute. While we do not wholly discount the weight to be given to the 1988 guideline, its persuasive value is limited when judged by the standards set forth in *Skidmore*. *Accord, Southeastern Community College v. Davis*, 442 U.S. 397, 411 412, 99 S.Ct. 2361, 2369 2370, 60 L.Ed.2d 980 (1979); *SEC v. Sloan*, 436 U.S. 103, 117 118, 98 S.Ct. 1702, 1711 1712, 56 L.Ed.2d 148 (1978); *Espinoza v. Farah Mfg. Co.*, 414 U.S., at 93 94, 94 S.Ct., at 339. We are of the view that, even when considered in combination with petitioners' other arguments, the EEOC's interpretation is insufficiently weighty to overcome the presumption against extraterritorial application. ¶ Our conclusion today is buttressed by the fact that '[w]hen it desires to do so, Congress knows how to place the high seas within the jurisdictional reach of a statute.' *Argentine Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428, 440, 109 S.Ct. 683, 691, 102 L.Ed.2d 818 (1989). Congress' awareness of the need to make a clear statement that a statute applies overseas is amply demonstrated by the numerous occasions on which it has expressly legislated the extraterritorial application of a statute . . [Citation omitted.]").

deference is limited by the need to consider the quality of the agency interpretation. The continuing vitality of *Skidmore v. Swift and Co.* has been enhanced by *Loper Bright Enterprises.*

The Supreme Court in *Skidmore v. Swift and Co.* observed:

> *There is no statutory provision as to what, if any, deference courts should pay to the Administrator's conclusions. And, while we have given them notice, we have had no occasion to try to prescribe their influence. The rulings of this Administrator are not reached as a result of hearing adversary proceedings in which he finds facts from evidence and reaches conclusions of law from findings of fact. They are not, of course, conclusive, even in the cases with which they directly deal, much less in those to which they apply only by analogy. They do not constitute an interpretation of the Act or a standard for judging factual situations which binds a district court's processes, as an authoritative pronouncement of a higher court might do. But the Administrator's policies are made in pursuance of official duty, based upon more specialized experience and broader investigations and information than is likely to come to a judge in a particular case. They do determine the policy which will guide applications for enforcement by injunction on behalf of the Government. Good administration of the Act and good judicial administration alike require that the standards of public enforcement and those for determining private rights shall be at variance only where justified by very good reasons. The fact that the Administrator's policies and standards are not reached by trial in adversary form does not mean that they are not entitled to respect. This Court has long given considerable and in some cases decisive weight to Treasury Decisions and to interpretative regulations of the Treasury and of other bodies that were not of adversary origin.*
>
> *We consider that the rulings, interpretations and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.* [529]

[2] National Labor Relations Board V. Hearst Publications (1944): It Is Not The Court's Function To Substitute Its Own Inferences Of Fact For The Board's, When The Latter Have Support In The Record.

National Labor Relations Board v. Hearst Publications[530] arose from the refusal of respondents, publishers of four Los Angeles daily newspapers, to bargain collectively with a union representing newsboys who distributed their papers on the streets of Los Angeles. Respondents contended that they were not required to bargain because the newsboys were not their 'employees' within the meaning of that term in the National Labor Relations Act.

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[529] 323 U.S. at 139-40.

[530] *National Labor Relations Board v. Hearst Publications*, 322 U.S. 111(1944), *overruled in part by*, *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318(1992).

The Supreme Court distinguished between agency determinations involving pure issues of law and mixed questions of law and fact. The role of courts is to determine pure questions of statutory interpretation. Courts, however, generally should defer to agency interpretations of statutes that the agencies are delegated to enforce. Courts generally should defer to agencies in dealing with mixed questions of law and fact. Agency interpretations should control unless they are unreasonable

The Court in *National Labor Relations Board v. Hearst Publications* examined whether the National Labor Relations Act concept of "employee" incorporated common-law standards. The court found that this was a pure question of statutory interpretation. The answer depended exclusively based on the statute without reference to underlying facts.

According to the Court, questions of statutory interpretation are for the courts to resolve. This resolution, however required giving "appropriate weight" to the judgment of those whose special duty is to administer the statute. The Court in *National Labor Relations Board v. Hearst Publications* found that "employee" under the National Labor Relations Act was not based on common law standards.

The Court next examined whether newsboys were "employees" under the National Labor Relations Act. The question of whether newsboys were "employees" under the National Labor Relations Act was a "mixed question" of law and fact. "[W]here the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's role is limited" to determining whether the agency's resolution of the issue has "warrant in the record and a reasonable basis in law."[531] Deference to the National Labor Relations Board is appropriate as this was a mixed question of fact and law. The Board has special expertise relating to conditions of employment. The Board also was acting pursuant to Congressional delegation. The Court agreed with the Board's conclusion that "newsboys" are "employees."

The principal question in *National Labor Relations Board v. Hearst Publications* was whether the newsboys are "employees." The Court provided this analysis:

> *It is not necessary in this case to make a completely definitive limitation around the term "employee." That task has been assigned primarily to the agency created by Congress to administer the Act. Determination of "where all the conditions of the relation require protection" involves inquiries for the Board charged with this duty. Everyday experience in the administration of the statute gives it familiarity with the circumstances and backgrounds of employment relationships in various industries, with the abilities and needs of the workers for self organization and collective action, and with the adaptability of collective bargaining for the peaceful settlement of their disputes with their employers. The experience thus acquired must be brought frequently to bear on the question who is an employee under the Act. Resolving that question, like determining whether*

[531] 322 U.S. at 131.

unfair labor practices have been committed, "belongs to the usual administrative routine" of the Board. [Footnote and citations omitted.]

In making that body's determinations as to the facts in these matters conclusive, if supported by evidence, Congress entrusted to it primarily the decision whether the evidence establishes the material facts. Hence in reviewing the Board's ultimate conclusions, it is not the court's function to substitute its own inferences of fact for the Board's, when the latter have support in the record. National Labor Relations Board v. Nevada Consolidated Copper Corp., 316 U.S. 105, 62 S.Ct. 960, 86 L.Ed. 1305; cf. Walker v. Altmeyer, 2 Cir., 137 F.2d 531. Undoubtedly questions of statutory interpretation, especially when arising in the first instance in judicial proceedings, are for the courts to resolve, giving appropriate weight to the judgment of those whose special duty is to administer the questioned statute. Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294, 53 S.Ct. 350, 77 L.Ed. 796; United States v. American Trucking Associations, Inc., 310 U.S. 534, 60 S.Ct. 1059, 84 L.Ed. 1345. But where the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's function is limited. Like the commissioner's determination under the Longshoremen's & Harbor Workers' Act, [footnote omitted] that a man is not a "member of a crew" (South Chicago Coal & Dock Co. v. Bassett, 309 U.S. 251, 60 S.Ct. 544, 547, 84 L.Ed. 732) or that he was injured "in the course of his employment" (Parker v. Motor Boat Sales, Inc., 314 U.S. 244, 62 S.Ct. 221, 222, 86 L.Ed. 184) and the Federal Communications Commission's determination [footnote omitted] that one company is under the "control" of another (Rochester Telephone Corp. v. United States, 307 U.S. 125, 59 S.Ct. 754, 83 L.Ed. 1147), the Board's determination that specified persons are "employees" under this Act is to be accepted if it has "warrant in the record" and a reasonable basis in law.

In this case the Board found that the designated newsboys work continuously and regularly, rely upon their earnings for the support of themselves and their families, and have their total wages influenced in large measure by the publishers who dictate their buying and selling prices, fix their markets and control their supply of papers. Their hours of work and their efforts on the job are supervised and to some extent prescribed by the publishers or their agents. Much of their sales equipment and advertising materials is furnished by the publishers with the intention that it be used for the publisher's benefit. Stating that 'the primary consideration in the determination of the applicability of the statutory definition is whether effectuation of the declared policy and purposes of the Act comprehend securing to the individual the rights guaranteed and protection afforded by the Act,' the Board concluded that the newsboys are employees. The record sustains the Board's findings and there is ample basis in the law for its conclusion. [532]

[532] 322 U.S. at 130-32.

[3] United States v. Morton Salt Co. (1950): Agency Determinations Of Fact Are Binding On The Courts, Provided That There Is Evidence To Support The Findings.

United States v. Morton Salt Co.[533] and other courts treated agency determinations of fact as binding on the courts, provided that there was "evidence to support the findings."[534] The

[533] 338 U. S. 632, 644 (1950)

[534] See *St. Joseph Stock Yards Co. v. United States*, 298 U. S. 38, 51 ("The fixing of rates is a legislative act. In determining the scope of judicial review of that act, there is a distinction between action within the sphere of legislative authority and action which transcends the limits of legislative power. Exercising its rate-making authority, the Legislature has a broad discretion. It may exercise that authority directly, or through the agency it creates or appoints to act for that purpose in accordance with appropriate standards. The court does not sit as a board of revision to substitute its judgment for that of the Legislature or its agents as to matters within the province of either. [Citations omitted.] When the Legislature itself acts within the broad field of legislative discretion, its determinations are conclusive. When the Legislature appoints an agent to act within that sphere of legislative authority, it may endow the agent with power to make findings of fact which are conclusive, provided the requirements of due process which are specially applicable to such an agency are met, as in according a fair hearing and acting upon evidence and not arbitrarily. [Citations omitted.] In such cases the judicial inquiry into the facts goes no further than to ascertain whether there is evidence to support the findings, and the question of the weight of the evidence in determining issues of fact lies with the legislative agency acting within its statutory authority. ¶ But the Constitution fixes limits to the rate-making power by prohibiting the deprivation of property without due process of law or the taking of private property for public use without just compensation. When the Legislature acts directly, its action is subject to judicial scrutiny and determination in order to prevent the transgression of these limits of power. The Legislature cannot preclude that scrutiny or determination by any declaration or legislative finding. Legislative declaration or finding is necessarily subject to independent judicial review upon the facts and the law by courts of competent jurisdiction to the end that the Constitution as the supreme law of the land may be maintained. Nor can the Legislature escape the constitutional limitation by authorizing its agent to make findings that the agent has kept within that limitation. Legislative agencies, with varying qualifications, work in a field peculiarly exposed to political demands. Some may be expert and impartial, others subservient. It is not difficult for them to observe the requirements of law in giving a hearing and receiving evidence. But to say that their findings of fact may be made conclusive where constitutional rights of liberty and property are involved, although the evidence clearly establishes that the findings are wrong and constitutional rights have been invaded, is to place those rights at the mercy of administrative officials and seriously to impair the security inherent in our judicial safeguards. That prospect, with our multiplication of administrative agencies, is not one to be lightly regarded. It is said that we can retain judicial authority to examine the weight of evidence when the question concerns the right of personal liberty. But, if this be so, it is not because we are privileged to perform our judicial duty in that case and for reasons of convenience to disregard it in others. The principle applies when rights either of person or of property are protected by constitutional restrictions. Under our system there is no warrant for the view that the judicial power of a competent court can be circumscribed by any legislative arrangement designed to give effect to administrative action going beyond the limits of constitutional authority. This is the purport of the decisions above cited with respect to the exercise of an independent judicial judgment upon the facts

Court did not extend similar deference to agency resolutions of questions of law. "The interpretation of the meaning of statutes, as applied to justiciable controversies," remained "exclusively a judicial function."[535] The Court observed that the informed judgment of the Executive Branch could be entitled to "great weight."[536] "The weight of such a judgment in a particular case," the Court observed, would "depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."[537]

Occasionally, the Supreme Court applied deferential review after concluding that a particular statute empowered an agency to decide how a broad statutory term applied to specific facts found by the agency.[538] This deferential review, which the Supreme Court was far from consistent in applying, was limited to fact-bound determinations. The Supreme Court proclaimed that "[u]ndoubtedly questions of statutory interpretation . . . are for the courts to resolve, giving appropriate weight to the judgment of those whose special duty is to administer the questioned statute."[539]

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where confiscation is alleged. The question under the Packers and Stockyards Act is similar to that arising under any other act, and we see no reason why those decisions should be overruled. ¶ But this judicial duty to exercise an independent judgment does not require or justify disregard of the weight which may properly attach to findings upon hearing and evidence. On the contrary, the judicial duty is performed in the light of the proceedings already had and may be greatly facilitated by the assembling and analysis of the facts in the course of the legislative determination. Judicial judgment may be none the less appropriately independent because informed and aided by the sifting procedure of an expert legislative agency. Moreover, as the question is whether the legislative action has passed beyond the lowest limit of the permitted zone of reasonableness into the forbidden reaches of confiscation, judicial scrutiny must of necessity take into account the entire legislative process, including the reasoning and findings upon which the legislative action rests. We have said that 'in a question of rate-making there is a strong presumption in favor of the conclusions reached by an experienced administrative body after a full hearing.' [Citation omitted.] The established principle which guides the court in the exercise of its judgment on the entire case is that the complaining party carries the burden of making a convincing showing and that the court will not interfere with the exercise of the rate-making power unless confiscation is clearly established. [Citation omitted.]"

[535] *United States v. American Trucking Assns., Inc.*, 310 U. S. 534, 544.

[536] *Id.*, at 549.

[537] *Skidmore v. Swift & Co.*, 323 U. S. 134, 140.

[538] *See Gray v. Powell*, 314 U. S. 402; *NLRB v. Hearst Publications, Inc.*, 322 U. S. 111.

[539] *Id.*, at 130–131.

[4] Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council (1978): Courts Do Not Have The Authority To Require For Agency Rulemaking Additional Procedures In Addition To The Procedures Set Forth In The Administrative Procedure Act.

In 1978, *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council*[540] held that courts do not have the authority to require for agency rulemaking additional procedures in addition to the procedures set forth in the Administrative Procedure Act. The Court of Appeals for the District of Columbia Circuit sought to require additional agency procedures to thoroughly vet the issues involved in regulations.

The United States Supreme Court in *Vermont Yankee* did not accept this approach. The Supreme Court held: "[a]bsent constitutional constraints or extremely compelling circumstances," courts do not have the authority to impose additional requirements on rulemaking beyond the rules set forth in the Administrative Procedure Act or adopted by the agency involved.[541] The Supreme Court, however, permitted the court of appeals to require the agency to supplement the record by remanding "remand[ing] this case to the [Atomic Energy Commission] to insure that it has taken a hard look at the waste storage issue." This would impose a higher burden on inquiry on the agency and a more stringent standard of review.

Vermont Yankee advised that the D.C. Circuit should not have invalidated an agency determination because the agency did not undertake procedures in addition to those required by the Administrative Procedure Act. A court is not permitted to interject the court's own opinion of what constitutes proper procedures for adopting rules. The Administrative Procedure Act prescribed the required procedures for agency rulemaking that are required, while the agency had the discretion to add its own additional procedures. Courts, however, could not prescribe additional procedures for rulemaking. For example, oral argument is not a required part of the rulemaking process.

These cases arise from two separate decisions of the Court of Appeals for the District of Columbia Circuit. In the first, the court remanded a decision of the Atomic Energy Commission to grant a license to petitioner Vermont Yankee Nuclear Power Corp. to operate a nuclear power plant. In the second, the court remanded a decision of that same agency to grant a permit to petitioner Consumers Power Co. to construct two pressurized water nuclear reactors to generate electricity and steam.

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[540] 435 U.S. 519 (1978).

[541] *See, also Pension Benefit Guaranty Corporation v. LTV Corporation*, 496 U.S. 633, 654-655 (1990) (improper for a court to require procedures in informal adjudication beyond the procedures that are expressly required by the statute).

Vermont Yankee involved review orders of the Atomic Energy Atomic Energy Commission with respect to licensing of nuclear reactors.[542] The Court of Appeals for the District of Columbia Circuit[543] remanded for further proceedings.

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[542] After extensive hearings before the Atomic Safety and Atomic Safety and Licensing Board and the Atomic Energy Commission granted petitioner Vermont Yankee Nuclear Power Corp. a license to operate a nuclear power plant. This ruling was affirmed by the Atomic Safety and Licensing Atomic Safety and Licensing Appeal Board. Subsequently, the Atomic Energy Commission, specifically referring to the Atomic Safety and Licensing Appeal Board's decision, instituted rulemaking proceedings to deal with the question of considering environmental effects associated with the uranium fuel cycle in the individual cost-benefit analyses for light-water-cooled nuclear power reactors. In these proceedings the Atomic Safety and Licensing Board was not to use full formal adjudicatory procedures. Eventually, as a result of these rulemaking proceedings, the Atomic Energy Commission issued a so-called fuel cycle rule. At the same time the Atomic Energy Commission approved the procedures used at the hearing; indicated that the record, including the Environmental Survey, provided an adequate data base for the rule adopted. The Atomic Energy Commission ruled that to the extent the rule differed from the Atomic Safety and Licensing Appeal Board's decision the decision had no further precedential significance. The environmental effects of the uranium fuel cycle had been shown to be relatively insignificant. It was unnecessary to apply the rule to Vermont Yankee's environmental reports submitted prior to the rule's effective date or to the environmental statements circulated for comment prior to such date. The respondents appealed from both the Atomic Energy Commission's adoption of the fuel cycle rule and its decision to grant Vermont Yankee's license. With respect to the license, the Court of Appeals first ruled that in the absence of effective rulemaking proceedings, the Atomic Energy Commission must deal with the environmental impact of fuel reprocessing and disposal in individual licensing proceedings. The Atomic Energy Commission held that despite the fact that it appeared that the Atomic Energy Commission employed all the procedures required by the Administrative Procedure Act and more, the rulemaking proceedings were inadequate and overturned the rule. The Atomic Energy Commission's determination with respect to the license was also remanded for further proceedings. After examination of a report of the Advisory Committee on Reactor Safeguards and extensive hearings, and over respondent intervenors' objections, the Atomic Energy Commission granted petitioner Consumers Power Co. a permit to construct two nuclear reactors. This ruling was affirmed by the Atomic Safety and Licensing Appeal Board. The Council on Environmental Quality revised its regulations governing the preparation of environmental impact statements so as to mention for the first time the necessity for considering energy conservation as one of the alternatives to a proposed project. In view of this development and a subsequent Atomic Energy Commission ruling indicating that all evidence of energy conservation should not necessarily be barred at the threshold of Atomic Energy Commission proceedings, one of the intervenors moved to reopen the permit proceedings so that energy conservation could be considered, but the Atomic Energy Commission declined to reopen the proceedings. Respondents appealed from the granting of the construction permit. The Court of Appeals held that the environmental impact statement for the construction of the reactors was fatally defective for failure to examine energy conservation as an alternative to plants of this size. The Court of Appeals also held that the Advisory Committee on Reactor Safeguards report was inadequate and should have been returned to the Advisory Committee on Reactor Safeguards for further elucidation, understandable to a layman, and remanded the case for appropriate consideration of waste disposal and other unaddressed issues.

[543] 547 F.2d 622 and 547 F.2d 633.

The Supreme Court held that:

- the Atomic Energy Commission acted within its statutory authority in considering environmental impact of spent fuel processes in individual licensing proceedings;
- nothing in the statutes or the circumstances permitted the Court of Appeals to review and overturn a rule-making proceeding on the basis of procedural devices employed or not employed by the Atomic Energy Commission, where the Atomic Energy Commission employed at least the statutory minimum and complied with the Administrative Procedure Act;
- in light of the facts available at the time, procedure adopted by the Atomic Energy Commission in requiring intervenors to make a showing with respect to alleged energy conservation alternatives "sufficient to require reasonable minds to inquire further," was within the agency's discretion, and
- nothing justified nullification of licensing procedures on theory that the Advisory Committee on Reactor Safeguards should have clarified certain report and should have given a short explanation, understandable to any layman, of each generic safety concern.

In December 1967, after mandatory adjudicatory hearing and necessary review, the Atomic Energy Commission granted petitioner Vermont Yankee a permit to build a nuclear power plant in Vernon, Vermont. Vermont Yankee afterwards applied for an operating license.

Natural Resources Defense Council objected to the license. A hearing on the application commenced on August 10, 1971. Excluded from consideration at the hearings, was the issue of the environmental effects of operations to reprocess fuel or dispose of wastes resulting from the reprocessing operations. This ruling was affirmed by the Appeal Board in June 1972.

In November 1972, the Atomic Energy Commission instituted rulemaking proceedings that would specifically deal with the question of consideration of environmental effects associated with the uranium fuel cycle in the individual cost-benefit analyses for light water cooled nuclear power reactors. The notice of proposed rulemaking offered two alternatives, both predicated on a report prepared by the Atomic Energy Commission's staff entitled Environmental Survey of the Nuclear Fuel Cycle.

- The first alternative would have required no quantitative evaluation of the environmental hazards of fuel reprocessing or disposal because the Environmental Survey had found them to be slight.

- The second alternative would have specified numerical values for the environmental impact of this part of the fuel cycle, which values would then be incorporated into a table, along with the other relevant factors, to determine the overall cost-benefit balance for each operating license.

The *Vermont Yankee* case centered on procedures used in the rulemaking hearing which commenced in February 1973. In a supplemental notice of hearing the Atomic Energy Commission indicated that, while discovery or cross-examination would not be utilized, the Environmental Survey would be available to the public before the hearing along with the extensive background documents cited therein. All participants would be given a reasonable opportunity to present their position. All participants could be represented by counsel if they so desired. Written and, time permitting, oral statements would be received and incorporated into the record. All persons giving oral statements would be subject to questioning by the Atomic Energy Commission. At the conclusion of the hearing, a transcript would be made available to the public and the record would remain open for 30 days to allow the filing of supplemental written statements. More than 40 individuals and organizations representing a wide variety of interests submitted written comments.

After the hearing, the Atomic Energy Commission's staff filed a supplemental document for the purpose of clarifying and revising the Environmental Survey. Then, the Atomic Safety and Licensing Board forwarded its report to the Atomic Energy Commission without rendering any decision.

The Atomic Safety and Licensing Board identified as the principal procedural question the propriety of declining to use full formal adjudicatory procedures. The major substantive issue was the technical adequacy of the Environmental Survey.

In April 1974, the Atomic Energy Commission issued a rule which adopted the second of the two proposed alternatives described above: specifying numerical values for the environmental impact of this part of the fuel cycle, which values would then be incorporated into a table, along with the other relevant factors, to determine the overall cost-benefit balance for each operating license. The Atomic Energy Commission also approved the procedures used at the hearing. The Atomic Energy Commission indicated that the record, including the Environmental Survey, provided an adequate data base for the regulation adopted.

The Atomic Energy Commission ruled that, to the extent the rule differed from the Appeal Board decisions in *Vermont Yankee*, those decisions have no further precedential significance. The environmental effects of the uranium fuel cycle have been shown to be relatively insignificant. It is unnecessary to apply the amendment to applicant's environmental reports submitted prior to its effective date or to Final Environmental Statements for which Draft Environmental Statements have been circulated for comment prior to the effective date.

In January 1969, petitioner Consumers Power Co. applied for a permit to construct two nuclear reactors in Midland, Mich. Consumers Power's application was examined by the

Atomic Energy Commission's staff and the Advisory Committee on Reactor Safeguards. The Advisory Committee on Reactor Safeguards issued reports which discussed specific problems and recommended solutions. The Advisory Committee on Reactor Safeguards also referred to other problems of a more generic nature. The Advisory Committee on Reactor Safeguards suggested that efforts should be made to resolve them with respect to these as well as all other projects.

Two groups, one called Saginaw and another called Mapleton, intervened and opposed the application.

Saginaw filed with the Board a number of environmental contentions, directed over 300 interrogatories to the Advisory Committee on Reactor Safeguards, attempted to depose the chairman of the Advisory Committee on Reactor Safeguards, and requested discovery of various Advisory Committee on Reactor Safeguards documents.

The Atomic Safety and Licensing Board denied the various discovery requests directed to the Advisory Committee on Reactor Safeguards.

Hearings were then held on numerous radiological health and safety issues.

The Atomic Energy Commission's staff issued a draft environmental impact statement.

Saginaw submitted 119 environmental contentions which were both comments on the proposed draft statement and a statement of Saginaw's position in the upcoming hearings.

The staff revised the statement and issued a final environmental statement in March 1972.

Further hearings were then conducted during May and June 1972.

Saginaw, however, did not appear at or participate in these latter hearings. Saginaw indicated that it had no conventional findings of fact to set forth and had not chosen to search the record and respond to this proceeding by submitting citations of matters which we believe were proved or disproved.

The Atomic Safety and Licensing Board, recognizing its obligations to "independently consider the final balance among conflicting environmental factors in the record," nevertheless treated as contested those issues "as to which intervenors introduced affirmative evidence or engaged in substantial cross examination."

At issue now were 17 of those 119 contentions which are claimed to raise questions of "energy conservation." The Atomic Safety and Licensing Board indicated that as far as appeared from the record, the demand for the plant was made up of normal industrial and residential use. The Atomic Safety and Licensing Board went on to state that it was "beyond our province to inquire into whether the customary uses being made of electricity in our society are 'proper' or 'improper.'"

With respect to claims that Consumers Power stimulated demand by its advertising the Atomic Safety and Licensing Board indicated that "[n]o evidence was offered on this point and absent some evidence that Applicant is creating abnormal demand, the Board did not consider the question."

The Atomic Safety and Licensing Board also failed to consider the environmental effects of fuel reprocessing or disposal of radioactive wastes.

The Appeal Board ultimately affirmed the Atomic Safety and Licensing Board's grant of a construction permit and the Atomic Energy Commission declined to further review the matter.

At about the same time, the Council on Environmental Quality revised its regulations governing the preparation of environmental impact statements.[544] The regulations mentioned for the first time the necessity of considering in impact statements energy conservation as one of the alternatives to a proposed project. The new guidelines were to apply only to final impact statements filed after January 28, 1974.

On November 6, 1973, more than a year after the record had been closed in the *Consumers Power* case and while that case was pending before the Court of Appeals, the Atomic Energy Commission ruled in another case that while its statutory power to compel conservation was not clear, it did not follow that all evidence of energy conservation issues should therefore be barred at the threshold. *In re Niagara Mohawk Power Corp.*,[545] Saginaw then moved the Atomic Energy Commission to clarify its ruling and reopen the Consumers Power proceedings.

In a lengthy opinion, the Atomic Energy Commission declined to reopen the proceedings. The Atomic Energy Commission first ruled that it was required to consider only energy conservation alternatives which

- were reasonably available,
- would in their aggregate effect curtail demand for electricity to a level at which the proposed facility would not be needed, and
- were susceptible of a reasonable degree of proof.

The Atomic Energy Commission then determined, after a thorough examination of the record, that not all of Saginaw's contentions met these threshold tests. The Atomic Energy Commission further determined that the Board had been willing at all times to take evidence on the other contentions. Saginaw had simply failed to present any evidence. The Atomic Energy Commission criticized Saginaw for its total disregard of even those minimal procedural formalities necessary to give the Board some idea of exactly what was at issue. The Atomic

[544] 38 Fed. Reg. 20550 (1973).
[545] 6 A.E.C. 995 (1973).

Energy Commission emphasized that "[p]articularly in these circumstances, Saginaw's complaint that it was not granted a hearing on alleged energy conservation issues comes with ill grace." In response to Saginaw's contention that regardless of whether it properly raised the issues, the Atomic Safety and Licensing Board must consider all environmental issues, the Atomic Energy Commission basically agreed, as did the Board itself, but further reasoned that the Board must have some workable procedural rules and these rules

> *. . . in this setting must take into account that energy conservation is a novel and evolving concept. The Environmental Protection Agency 'does not require a "crystal ball" inquiry.' Natural Resources Defense Council v. Morton, [148 U.S.App.D.C. 5, 15, 458 F.2d 827, 837 (1972)]. This consideration has led us to hold that we will not apply Niagara retroactively. As we gain experience on a case-by-case basis and hopefully, feasible energy conservation techniques emerge, the applicant, staff, and licensing boards will have obligations to develop an adequate record on these issues in appropriate cases, whether or not they are raised by intervenors.*
>
> *However, at this emergent stage of energy conservation principles, intervenors also have their responsibilities. They must state clear and reasonably specific energy conservation contentions in a timely fashion. Beyond that, they have a burden of coming forward with some 535 affirmative showing if they wish to have these novel contentions explored further." [Footnote omitted.] Id., at 344 (footnotes omitted).*

Respondents challenged the granting of the construction permit in the Court of Appeals for the District of Columbia Circuit.

With respect to the challenge of Vermont Yankee's license, the court ruled that in the absence of effective rulemaking proceedings, the Atomic Energy Commission must deal with the environmental impact of fuel reprocessing and disposal in individual licensing proceedings.

The court examined the rulemaking proceedings.

Despite the fact that it appeared that the agency employed all the procedures required by 5 U.S.C. § 553 and more, the court –

- determined the proceedings to be inadequate and
- overturned the rule.

The Commission's determination with respect to Vermont Yankee's license was also remanded for further proceedings.

With respect to the permit to Consumers Power, the court first held that –

- the environmental impact statement for construction of the Midland reactors was fatally defective
- for failure to examine energy conservation as an alternative to a plant of this size.

The court also thought the report by Advisory Committee on Reactor Safeguards was inadequate.

The court did not agree that discovery from individual Advisory Committee on Reactor Safeguards members was the proper way to obtain further explanation of the report.

Instead, the court held that

- the Commission should have *sua sponte* sent the report back to the Advisory Committee on Reactor Safeguards
- for further elucidation of the other problems and their resolution.

Finally, the court

- ruled that the fuel cycle issues in this case were controlled by *NRDC v. NRC* and
- remanded for appropriate consideration of waste disposal and other unaddressed fuel cycle issues as described in that opinion.

The court in *Vermont Yankee* explained the Administrative Procedure Act:

> *In 1946, Congress enacted the Administrative Procedure Act, which as we have noted elsewhere was not only "a new, basic and comprehensive regulation of procedures in many agencies," Wong Yang Sung v. McGrath, 339 U.S. 33, 70 S.Ct. 445, 94 L.Ed. 616 (1950), but was also a legislative enactment which settled "long-continued and hard-fought contentions, and enacts a formula upon which opposing social and political forces have come to rest." Id., at 40, 70 S.Ct., at 448. Section 4 of the Act, 5 U.S.C. § 553 (1976 ed.), dealing with rulemaking, requires in subsection (b) that "notice of proposed rule making shall be published in the Federal Register . . . describes the contents of that notice, and goes on to require in subsection (c) that after the notice the agency "shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose." Interpreting this provision of the Act in United States v. Allegheny-Ludlum Steel Corp., 406 U.S. 742, 92 S.Ct. 1941, 32 L.Ed.2d 453 (1972), and United States v. Florida East Coast R. Co., 410 U.S. 224, 93 S.Ct. 810, 35 L.Ed.2d 223 (1973), we held that generally speaking this section of the Act established the maximum procedural requirements which Congress was willing to have the courts impose upon agencies in conducting rulemaking procedures. [Footnote omitted.]*

Agencies can grant additional procedural rights in the exercise of their discretion. Reviewing courts are generally not free to impose additional procedural rights if the agencies have not chosen to grant them.

> *Agencies are free to grant additional procedural rights in the exercise of their discretion, but reviewing courts are generally not free to impose them if the agencies have* not *chosen to grant them. This is not to say necessarily that there are no circumstances which would ever justify a court in overturning agency action because of a failure to employ procedures beyond those required by the statute. But such circumstances, if they exist, are extremely rare.*

The Administrative Procedure Act left formulation of procedures for rules and regulations basically within the discretion of the agencies to which Congress had confided the responsibility for substantive judgments.

> *Even apart from the Administrative Procedure Act this Court has for more than four decades emphasized that the formulation of procedures was basically to be left within the discretion of the agencies to which Congress had confided the responsibility for substantive judgments. In FCC v. Schreiber, 381 U.S. 279, 290, 85 S.Ct. 1459, 1467, 14 L.Ed.2d 383 (1965), the Court explicated this principle, describing it as "an outgrowth of the Congressional determination that administrative agencies and administrators will be familiar with the industries which they regulate and will be in a better position than federal courts or Congress itself to design procedural rules adapted to the peculiarities of the industry and the tasks of the agency involved." The Court there relied on its earlier case of FCC v. Pottsville Broadcasting Co., 309 U.S. 134, 138, 60 S.Ct. 437, 439, 84 L.Ed. 656 (1940), where it had stated that a provision dealing with the conduct of business by the Federal Communications Commission delegated to the Commission the power to resolve "subordinate questions of procedure . [such as] the scope of the inquiry, whether applications should be heard contemporaneously or successively, whether parties should be allowed to intervene in one another's proceedings, and similar questions."*

The Supreme Court granted certiorari to review the two judgments because of concern that the courts had seriously misread or misapplied this statutory and decisional law cautioning reviewing courts against engrafting their own notions of proper procedures upon agencies entrusted with substantive functions by Congress.

> *It is in the light of this background of statutory and decisional law that we granted certiorari to review two judgments of the Court of Appeals for the District of Columbia Circuit because of our concern that they had seriously misread or misapplied this statutory and decisional law cautioning reviewing courts against engrafting their own notions of proper procedures upon agencies entrusted with substantive functions by Congress. [Citation omitted.] We conclude that the Court of Appeals has done just that in these cases, and we therefore remand them to it for further proceedings. We also find it necessary to examine the Court of Appeals' decision with respect to agency action taken after full adjudicatory hearings. We again conclude that the court improperly intruded into the agency's decisionmaking process, making it necessary for us to reverse and remand with respect to this part of the cases also.*

The Supreme Court reviewed the Atomic Energy Act background:

> *Under the Atomic Energy Act of 1954, 68 Stat. 919, as amended, 42 U.S.C. § 2011 et seq., the Atomic Energy Commission was given broad regulatory authority over the development of nuclear energy. Under the terms of the Act, a utility seeking to construct and operate a nuclear power plant must obtain a separate permit or license at both the construction and the operation stage of the project. [Citation omitted.] In order to obtain the construction permit, the utility must file a preliminary safety analysis report, an environmental report, and certain information regarding the antitrust implications of the proposed project. [Citation omitted.] This application then undergoes exhaustive review by the Commission's staff and by the Advisory Committee on Reactor Safeguards (ACRS), a group of distinguished experts in the field of atomic energy. Both groups submit*

to the Commission their own evaluations, which then become part of the record of the utility's application. [Footnote and citation omitted.] The Commission staff also undertakes the review required by the National Environmental Policy Act of 1969 (the Environmental Protection Agency), 83 Stat. 852, 42 U.S.C. § 4321 et seq., and prepares a draft environmental impact statement, which, after being circulated for comment, [citation omitted], is revised and becomes a final environmental impact statement. [Citation omitted.] Thereupon a three-member Atomic Safety and Licensing Board conducts a public adjudicatory hearing, [citation omitted], and reaches a decision4 which can be appealed to the Atomic Safety and Licensing Appeal Board, and currently, in the Commission's discretion, to the Commission itself. [Citation omitted.] The final agency decision may be appealed to the courts of appeals. [Citation omitted.] The same sort of process occurs when the utility applies for a license to operate the plant, [citation omitted], except that a hearing need only be held in contested cases and may be limited to the matters in controversy. [Citation omitted and footnote omitted.]

The Supreme Court discussed the fuel cycle rule. The Court of Appeals struck down the rule because of the perceived inadequacies of the procedures employed in the rulemaking proceedings. The court first determined the intervenors' primary argument to be that the decision to preclude 'discovery or cross-examination' denied them a meaningful opportunity to participate in the proceedings as guaranteed by due process. The Court of Appeals then determined whether the procedures provided by the agency were sufficient to ventilate the issues. The Court of Appeals conceded that it is improper for a reviewing court to prescribe the procedural format an agency must follow, but it is appropriate to scrutinize the record as a whole to insure that genuine opportunities to participate in a meaningful way were provided.

We next turn to the invalidation of the fuel cycle rule. But before determining whether the Court of Appeals reached a permissible result, we must determine exactly what result it did reach, and in this case that is no mean feat. Vermont Yankee argues that the court invalidated the rule because of the inadequacy of the procedures employed in the proceedings. [Citation omitted.] Respondents, on the other hand, labeling petitioner's view of the decision a "straw man," argue to this Court that the court merely held that the record was inadequate to enable the reviewing court to determine whether the agency had fulfilled its statutory obligation. [Citation omitted.] But we unfortunately have not found the parties' characterization of the opinion to be entirely reliable; it appears here, as in Orloff v. Willoughby, 345 U.S. 83, 87, 73 S.Ct. 534, 537, 97 L.Ed. 842 (1953), that "in this Court the parties changed positions as nimbly as if dancing a quadrille."[Footnote omitted.]

After a thorough examination of the opinion itself, we conclude that while the matter is not entirely free from doubt, the majority of the Court of Appeals struck down the rule because of the perceived inadequacies of the procedures employed in the rulemaking proceedings. The court first determined the intervenors' primary argument to be "that the decision to preclude 'discovery or cross-examination' denied them a meaningful opportunity to participate in the proceedings as guaranteed by due process." [Citation omitted.] The court then went on to frame the issue for decision thus:

"Thus, we are called upon to decide whether the procedures provided by the agency were sufficient to ventilate the issues." Ibid, at 346, 547 F.2d, at 643.

The court conceded that absent extraordinary circumstances it is improper for a reviewing court to prescribe the procedural format an agency must follow, but it likewise clearly thought it entirely appropriate to "scrutinize the record as a whole to insure that genuine opportunities to participate in a meaningful way were provided. . . . Id., at 347, 547 F.2d, at 644. The court also refrained from actually ordering the agency to follow any specific procedures, Id., at 356–357, 547 F.2d, at 653–654, but there is little doubt in our minds that the ineluctable mandate of the court's decision is that the procedures afforded during the hearings were inadequate. This conclusion is particularly buttressed by the fact that after the court examined the record, particularly the testimony of Dr. Pittman, and declared it insufficient, the court proceeded to discuss at some length the necessity for further procedural devices or a more "sensitive" application of those devices employed during the proceedings. Ibid The exploration of the record and the statement regarding its insufficiency might initially lead one to conclude that the court was only examining the sufficiency of the evidence, but the remaining portions of the opinion dispel any doubt that this was certainly not the sole or even the principal basis of the decision. Accordingly, we feel compelled to address the opinion on its own terms, and we conclude that it was wrong.

Additional administrative procedures may be justified when an agency is making a quasi-judicial determination exceptionally affecting a small number of persons.

In prior opinions we have intimated that even in a rulemaking proceeding when an agency is making a "'quasi-judicial' determination by which a very small number of persons are "'exceptionally affected, in each case upon individual grounds,'" in some circumstances additional procedures may be required in order to afford the aggrieved individuals due process. [Footnote omitted.] United States v. Florida East Coast R. Co., 410 U.S., at 242–245, 93 S.Ct., at 819–821, quoting from Bi-Metallic Investment Co. v. State Board of Equalization, 239 U.S. 441, 446, 36 S.Ct. 141, 142, 60 L.Ed. 372 (1915). It might also be true, although we do not think the issue is presented in this case and accordingly do not decide it, that a totally unjustified departure from well-settled agency procedures of long standing might require judicial correction. [Footnote omitted.]

Administrative agencies should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their duties.

But this much is absolutely clear. Absent constitutional constraints or extremely compelling circumstances the "administrative agencies 'should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties.'" FCC v. Schreiber, 381 U.S., at 290, 85 S.Ct., at 1467, quoting from FCC v. Pottsville 544Broadcasting Co., 309 U.S., at 143, 60 S.Ct., at 441. Indeed, our cases could hardly be more explicit in this regard. The Court has, as we noted in FCC v. Schreiber, supra, at 290, and n. 17, 85 S.Ct., at 1467, upheld this principle in a variety of applications, [footnote omitted] including that case where the District Court, instead of inquiring into the validity of the Federal Communications Commission's exercise of its rulemaking authority, devised procedures to be followed by the agency on the basis of its conception of how the public and private interest involved could best be served. Examining § 4(j) of the Communications Act of 1934, the Court unanimously held that the Court of Appeals erred in upholding that action. And the basic reason for this decision was the Court of

Appeals' serious departure from the very basic tenet of administrative law that agencies should be free to fashion their own rules of procedure.

An agency should normally be allowed to exercise its administrative discretion in deciding how it may best proceed to develop the needed evidence and how its prior decision should be modified in light of evidence as it develops.

We have continually repeated this theme through the years, most recently in FPC v. Transcontinental Gas Pipe Line Corp., 423 U.S. 326, 96 S.Ct. 579, 46 L.Ed.2d 533 (1976), decided just two Terms ago. In that case, in determining the proper scope of judicial review of agency action under the Natural Gas Act, we held that while a court may have occasion to remand an agency decision because of the inadequacy of the record, the agency should normally be allowed to "exercise its administrative discretion in deciding how, in light of internal organization considerations, it may best proceed to develop the needed evidence and how its prior decision should be modified in light of such evidence as develops." Id., at 333, 96 S.Ct., at 583. We went on to emphasize:

"At least in the absence of substantial justification for doing otherwise, a reviewing court may not, after determining that additional evidence is requisite for adequate review, proceed by dictating to the agency the methods, procedures, and time dimension of the needed inquiry and ordering the results to be reported to the court without opportunity for further consideration on the basis of the new evidence by the agency. Such a procedure clearly runs the risk of 'propel[ling] the court into the domain which Congress has set aside exclusively for the administrative agency.' SEC v. Chenery Corp., 332 U.S. 194, 196, 67 S.Ct. 1575, 91 L.Ed. 1995 (1947)." Ibid

NRDC argues that the Administrative Procedure Act merely sets forth lower procedural bounds for agency rules and that a court can set higher requirements. The Supreme Court rejected this view.

Respondent NRDC argues that § 4 of the Administrative Procedure Act, 5 U.S.C. § 553 (1976 ed.), merely establishes lower procedural bounds and that a court may routinely require more than the minimum when an agency's proposed rule addresses complex or technical factual issues or "Issues of Great Public Import." [Citation omitted.] We have, however, previously shown that our decisions reject this view. [Citation omitted.] We also think the legislative history, even the part which it cites, does not bear out its contention. The Senate Report explains what eventually became § 4 thus:

"This subsection states . . . the minimum requirements of public rule making procedure short of statutory hearing. Under it agencies might in addition confer with industry advisory committees, consult organizations, hold informal 'hearings,' and the like. Considerations of practicality, necessity, and public interest . . . will naturally govern the agency's determination of the extent to which public proceedings should go. Matters of great import, or those where the public submission of facts will be either useful to the agency or a protection to the public, should naturally be accorded more elaborate public procedures." S.Rep. No. 752, 79th Cong., 1st Sess., 14–15 (1945).

The House Report is in complete accord:

"'[U]niformity has been found possible and desirable for all classes of both equity and law actions in the courts . . It would seem to require no argument to demonstrate that the administrative agencies, exercising but a fraction of the judicial power may likewise operate under uniform rules of practice and procedure and that they may be required to remain within the terms of the law as to the exercise of both quasi-legislative and quasi-judicial power.'

"The bill is an outline of minimum essential rights and procedures. . It affords private parties a means of knowing what their rights are and how they may protect them . . . .

". . . [The bill contains] the essentials of the different forms of administrative proceedings. . . ." H.R.Rep. No. 1980, 79th Cong., 2d Sess., 9, 16–17 (1946).

The Supreme Court determined that agencies but not the courts could prescribe additional procedural requirements for rules and regulations under the Administrative Procedure Act:

And the Attorney General's Manual on the Administrative Procedure Act 31, 35 (1947), a contemporaneous interpretation previously given some deference by this Court because of the role played by the Department of Justice in drafting the legislation, [footnote omitted] further confirms that view. In short, all of this leaves little doubt that Congress intended that the discretion of the agencies and not that of the courts be exercised in determining when extra procedural devices should be employed.

There are compelling reasons for construing § 4 in this manner. In the first place, if courts continually review agency proceedings to determine whether the agency employed procedures which were, in the court's opinion, perfectly tailored to reach what the court perceives to be the "best" or "correct" result, judicial review would be totally unpredictable. And the agencies, operating under this vague injunction to employ the "best" procedures and facing the threat of reversal if they did not, would undoubtedly adopt full adjudicatory procedures in every instance. Not only would this totally disrupt the statutory scheme, through which Congress enacted "a formula upon which opposing social and political forces have come to rest," Wong Yang Sung v. McGrath, 339 U.S., at 40, 70 S.Ct., at 450, but all the inherent advantages of informal rulemaking would be totally lost. [Footnote omitted.]

Secondly, it is obvious that the court in these cases reviewed the agency's choice of procedures on the basis of the record actually produced at the hearing, [Citation omitted.], and not on the basis of the information available to the agency when it made the decision to structure the proceedings in a certain way. This sort of Monday morning quarterbacking not only encourages but almost compels the agency to conduct all rulemaking proceedings with the full panoply of procedural devices normally associated only with adjudicatory hearings.

Finally, and perhaps most importantly, this sort of review fundamentally misconceives the nature of the standard for judicial review of an agency rule. The court below uncritically assumed that additional procedures will automatically result in a more adequate record because it will give interested parties more of an opportunity to participate in and contribute to the proceedings. But informal rulemaking need not be based solely on the transcript of a hearing held before an agency. Indeed, the agency need not even hold a formal hearing. [Citation omitted.] Thus, the adequacy of the "record" in this type of proceeding is not correlated directly to the type of

procedural devices employed, but rather turns on whether the agency has followed the statutory mandate of the Administrative Procedure Act or other relevant statutes. If the agency is compelled to support the rule which it ultimately adopts with the type of record produced only after a full adjudicatory hearing, it simply will have no choice but to conduct a full adjudicatory hearing prior to promulgating every rule. In sum, this sort of unwarranted judicial examination of perceived procedural shortcomings of a rulemaking proceeding can do nothing but seriously interfere with that process prescribed by Congress.

The Environmental Protection Agency argues that the National Environmental Policy Act of 1969 permits a court to require procedures beyond those specified in the Administrative Procedure Act when investigating factual issues through rulemaking. The Supreme Court rejected this view.

Respondent NRDC also argues that the fact that the Commission's inquiry was undertaken in the context of the Environmental Protection Agency somehow permits a court to require procedures beyond those specified in § 4 of the APA when investigating factual issues through rulemaking. The Court of Appeals was apparently also of this view, indicating that agencies may be required to "develop new procedures to accomplish the innovative task of implementing the Environmental Protection Agency through rulemaking." 178 U.S.App.D.C., at 356, 547 F.2d, at 653. But we search in vain for something in the Environmental Protection Agency which would mandate such a result. We have before observed that "the Environmental Protection Agency does not repeal by implication any other statute." [Citation omitted.] In fact, just two Terms ago, we emphasized that the only procedural requirements imposed by the Environmental Protection Agency are those stated in the plain language of the Act. [Citation omitted.] Thus, it is clear the Environmental Protection Agency cannot serve as the basis for a substantial revision of the carefully constructed procedural specifications of the APA.

In short, nothing in the APA, the Environmental Protection Agency, the circumstances of this case, the nature of the issues being considered, past agency practice, or the statutory mandate under which the Commission operates permitted the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory minima, a matter about which there is no doubt in this case.

The Supreme Court also considered whether the rule was sufficiently justified in the administrative proceedings that it should be upheld by the reviewing court. The Supreme Court remanded the rule to the Court of Appeals.

There remains, of course, the question of whether the challenged rule finds sufficient justification in the administrative proceedings that it should be upheld by the reviewing court. Judge Tamm, concurring in the result reached by the majority of the Court of Appeals, thought that it did not. There are also intimations in the majority opinion which suggest that the judges who joined it likewise may have thought the administrative proceedings an insufficient basis upon which to predicate the rule in question. We accordingly remand so that the Court of Appeals may review the rule as the Administrative Procedure Act provides. We have made it abundantly clear before that when there is a contemporaneous explanation of the agency decision, the validity of that action must "stand or fall on the propriety of that finding, judged, of course, by the appropriate standard

of review. If that finding is not sustainable on the administrative record made, then the Comptroller's decision must be vacated and the matter remanded to him for further consideration." [Citation omitted.] The court should engage in this kind of review and not stray beyond the judicial province to explore the procedural format or to impose upon the agency its own notion of which procedures are "best" or most likely to further some vague, undefined public good. [Footnote omitted.]

The Supreme Court next considered whether rejection of energy conservation on the basis of the threshold test was capricious and arbitrary:

We now turn to the Court of Appeals' holding "that rejection of energy conservation on the basis of the 'threshold test' was capricious and arbitrary," [Citation omitted.], and again conclude the court was wrong.

The Court of Appeals ruled that the Commission's "threshold test" for the presentation of energy conservation contentions was inconsistent with the Environmental Protection Agency's basic mandate to the Commission. [Citation omitted.] The Commission, the court reasoned, is something more than an umpire who sits back and resolves adversary contentions at the hearing stage. [Citation omitted.] And when an intervenor's comments "bring 'sufficient attention to the issue to stimulate the Commission's consideration of it,'" the Commission must "undertake its own preliminary investigation of the proffered alternative sufficient to reach a rational judgment whether it is worthy of detailed consideration in the EIS. Moreover, the Commission must explain the basis for each conclusion that further consideration of a suggested alternative is unwarranted." [Citation omitted.]

The Supreme Court found that this argument misconceived the scope of the agency's statutory responsibility and the nature of the administrative process. the Environmental Protection Agency was not meant to require detailed discussion of the environmental effects of alternatives' put forward in comments when these effects cannot be readily ascertained and the alternatives are deemed only remote and speculative possibilities. The Supreme Court found inappropriate to characterize the actions of the Commission as "arbitrary or capricious" in light of the facts then available to it.

While the court's rationale is not entirely unappealing as an abstract proposition, as applied to this case we think it basically misconceives not only the scope of the agency's statutory responsibility, but also the nature of the administrative process, the thrust of the agency's decision, and the type of issues the intervenors were trying to raise.

There is little doubt that under the Atomic Energy Act of 1954, state public utility commissions or similar bodies are empowered to make the initial decision regarding the need for power. [Citation omitted.] The Commission's prime area of concern in the licensing context, on the other hand, is national security, public health, and safety. [Citation omitted.] And it is clear that the need, as that term is conventionally used, for the power was thoroughly explored in the hearings. Even the Federal Power Commission, which regulates sales in interstate commerce, [citation omitted], agreed with Consumers Power's analysis of projected need. [Citation omitted.]

EPA, of course, has altered slightly the statutory balance, requiring "a detailed statement by the responsible official on . . . alternatives to the proposed action." [Citation omitted.] But, as should be obvious even upon a moment's reflection, the term "alternatives" is not self-defining. To make an impact statement something more than an exercise in frivolous boilerplate the concept of alternatives must be bounded by some notion of feasibility. As the Court of Appeals for the District of Columbia Circuit has itself recognized:

"There is reason for concluding that the Environmental Protection Agency was not meant to require detailed discussion of the environmental effects of 'alternatives' put forward in comments when these effects cannot be readily ascertained and the alternatives are deemed only remote and speculative possibilities, in view of basic changes required in statutes and policies of other agencies—making them available, if at all, only after protracted debate and litigation not meaningfully compatible with the time-frame of the needs to which the underlying proposal is addressed." Natural Resources Defense Council v. Morton, 148 U.S.App.D.C. 5, 15–16, 458 F.2d 827, 837–838 (1972).

[Citation omitted.] Common sense also teaches us that the "detailed statement of alternatives" cannot be found wanting simply because the agency failed to include every alternative device and thought conceivable by the mind of man. Time and resources are simply too limited to hold that an impact statement fails because the agency failed to ferret out every possible alternative, regardless of how uncommon or unknown that alternative may have been at the time the project was approved.

. .

With these principles in mind we now turn to the notion of "energy conservation," an alternative the omission of which was thought by the Court of Appeals to have been "forcefully pointed out by Saginaw in its comments on the draft EIS." [Citation omitted.] Again, as the Commission pointed out, "the phrase 'energy conservation' has a deceptively simple ring in this context. Taken literally, the phrase suggests a virtually limitless range of possible actions and developments that might, in one way or another, ultimately reduce projected demands for electricity from a particular proposed plant." [Citation omitted.] Moreover, as a practical matter, it is hard to dispute the observation that it is largely the events of recent years that have emphasized not only the need but also a large variety of alternatives for energy conservation. Prior to the drastic oil shortages incurred by the United States in 1973, there was little serious thought in most Government circles of energy conservation alternatives. Indeed, the Council on Environmental Quality did not promulgate regulations which even remotely suggested the need to consider energy conservation in impact statements until August 1, 1973. [Citation omitted.] And even then the guidelines were not made applicable to draft and final statements filed with the Council before January 28, 1974. [Citation omitted.] The Federal Power Commission likewise did not require consideration of energy conservation in applications to build hydroelectric facilities until June 19, 1973. [Citation omitted.] And these regulations were not made retroactive either. [Citation omitted.] All this occurred over a year and a half after the draft environmental statement for Midland had been prepared, and over a year after the final environmental statement had been prepared and the hearings completed.

We think these facts amply demonstrate that the concept of "alternatives" is an evolving one, requiring the agency to explore more or fewer alternatives as they become better known and understood. This was well understood by the Commission, which, unlike the Court of Appeals, recognized that the Licensing Board's

decision had to be judged by the information then available to it. And judged in that light we have little doubt the Board's actions were well within the proper bounds of its statutory authority. Not only did the record before the agency give every indication that the project was actually needed, but also there was nothing before the Board to indicate to the contrary

We also think the court's criticism of the Commission's "threshold test" displays a lack of understanding of the historical setting within which the agency action took place and of the nature of the test itself. In the first place, while it is true that the Environmental Protection Agency places upon an agency the obligation to consider every significant aspect of the environmental impact of a proposed action, it is still incumbent upon intervenors who wish to participate to structure their participation so that it is meaningful, so that it alerts the agency to the intervenors' position and contentions. This is especially true when the intervenors are requesting the agency to embark upon an exploration of unchartered territory, as was the question of energy conservation in the late 1960's and early 1970's.

"[C]omments must be significant enough to step over a threshold requirement of materiality before any lack of agency response or consideration becomes of concern. The comment cannot merely state that a particular mistake was made . ; it must show why the mistake was of possible significance in the results. . . ." [Citation omitted.]

Indeed, administrative proceedings should not be a game or a forum to engage in unjustified obstructionism by making cryptic and obscure reference to matters that "ought to be" considered and then, after failing to do more to bring the matter to the agency's attention, seeking to have that agency determination vacated on the ground that the agency failed to consider matters "forcefully presented." In fact, here the agency continually invited further clarification of Saginaw's contentions. Even without such clarification it indicated a willingness to receive evidence on the matters. But not only did Saginaw decline to further focus its contentions, it virtually declined to participate, indicating that it had "no conventional findings of fact to set forth" and that it had not "chosen to search the record and respond to this proceeding by submitting citations of matter which we believe were proved or disproved."

We also think the court seriously mischaracterized the Commission's "threshold test" as placing "heavy substantive burdens . . . on intervenors. . . ." [Citation omitted.] On the contrary, the Commission explicitly stated:

"We do not equate this burden with the civil litigation concept of a prima facie case, an unduly heavy burden in this setting. But the showing should be sufficient to require reasonable minds to inquire further." App. 344 n. 27.

We think this sort of agency procedure well within the agency's discretion.

In sum, to characterize the actions of the Commission as "arbitrary or capricious" in light of the facts then available to it as described at length above, is to deprive those words of any meaning. As we have said in the past:

"Administrative consideration of evidence . . . always creates a gap between the time the record is closed and the time the administrative decision is promulgated [and, we might add, the time the decision is judicially

reviewed]. . If upon the coming down of the order litigants might demand rehearings as a matter of law because some new circumstance has arisen, some new trend has been observed, or some new fact discovered, there would be little hope that the administrative process could ever be consummated in an order that would not be subject to reopening." ICC v. Jersey City, 322 U.S. 503, 514, 64 S.Ct. 1129, 1134, 88 L.Ed. 1420 (1944).

See also Northern Lines Merger Cases, 396 U.S. 491, 521, 90 S.Ct. 708, 722, 24 L.Ed.2d 700 (1970).

We have also made it clear that the role of a court in reviewing the sufficiency of an agency's consideration of environmental factors is a limited one, limited both by the time at which the decision was made and by the statute mandating review.

"Neither the statute nor its legislative history contemplates that a court should substitute its judgment for that of the agency as to the environmental consequences of its actions. Kleppe v. Sierra Club, 427 U.S., at 410 n. 21, 96 S.Ct., at 2731 n. 21.

We think the Court of Appeals has forgotten that injunction here and accordingly its judgment in this respect must also be reversed. [Footnote omitted.]

B

Finally, we turn to the Court of Appeals' holding that the Licensing Board should have returned the ACRS report to ACRS for further elaboration, understandable to a layman, of the reference to other problems.

The Court of Appeals reasoned that since one function of the report was "that all concerned may be apprised of the safety or possible hazard of the facilities," the report must be in terms understandable to a layman and replete with cross-references to previous reports in which the "other problems" are detailed. Not only that, but if the report does not so elaborate, and the Licensing Board fails to sua sponte return the report to ACRS for further development, the entire agency action, made after exhaustive studies, reviews, and 14 days of hearings, must be nullified.

Again the Court of Appeals has unjustifiably intruded into the administrative process. It is true that Congress thought publication of the ACRS report served an important function. But the legislative history shows that the function of publication was subsidiary to its main function, that of providing technical advice from a body of experts uniquely qualified to provide assistance. See 42 U.S.C. § 2039; S.Rep. No. 296, 85th Cong., 1st Sess., 24 (1957); U.S.Code Cong. & Admin.News, p. 1803; Joint Committee on Atomic Energy, A Study of AEC Procedures and Organization in the Licensing of Reactor Facilities, 85th Cong., 1st Sess., 32–34 (Comm. Print 1957). The basic information to be conveyed to the public is not necessarily a full technical exposition of every facet of nuclear energy, but rather the ACRS's position, and reasons therefore, with respect to the safety of a proposed nuclear reactor. Accordingly, the ACRS cannot be faulted for not dealing with every facet of nuclear energy in every report it issues.

Of equal significance is the fact that the ACRS was not obfuscating its findings. The reports to which it referred were matters of public record, on file in the Commission's public-documents room. Indeed, all ACRS reports are on file there. Furthermore, we are informed that shortly after the Licensing Board's initial decision,

ACRS prepared a list which identified its "generic safety concerns." In light of all this it is simply inconceivable that a reviewing court should find it necessary or permissible to order the Board to sua sponte return the report to ACRS. Our view is confirmed by the fact that the putative reason for the remand was that the public did not understand the report, and yet not one member of the supposedly uncomprehending public even asked that the report be remanded. This surely is, as petitioner Consumers Power claims, "judicial intervention run riot." Brief for Petitioner in No. 76–528, p. 37.

We also think it worth noting that we find absolutely nothing in the relevant statutes to justify what the court did here. The Commission very well might be able to remand a report for further clarification, but there is nothing to support a court's ordering the Commission to take that step or to support a court's requiring the ACRS to give a short explanation, understandable to a layman, of each generic safety concern.

All this leads us to make one further observation of some relevance to this case. To say that the Court of Appeals' final reason for remanding is insubstantial at best is a gross understatement. Consumers Power first applied in 1969 for a construction permit—not even an operating license, just a construction permit. The proposed plant underwent an incredibly extensive review. The reports filed and reviewed literally fill books. The proceedings took years, and the actual hearings themselves over two weeks. To then nullify that effort seven years later because one report refers to other problems, which problems admittedly have been discussed at length in other reports available to the public, borders on the Kafkaesque. Nuclear energy may some day be a cheap, safe source of power or it may not. But Congress has made a choice to at least try nuclear energy, establishing a reasonable review process in which courts are to play only a limited role. The fundamental policy questions appropriately resolved in Congress and in the state legislatures are not subject to reexamination in the federal courts under the guise of judicial review of agency action. Time may prove wrong the decision to develop nuclear energy, but it is Congress or the States within their appropriate agencies which must eventually make that judgment. In the meantime courts should perform their appointed function. the Environmental Protection Agency does set forth significant substantive goals for the Nation, but its mandate to the agencies is essentially procedural. See 42 U.S.C. § 4332. See also Aberdeen & Rockfish R. Co. v. SCRAP, 422 U.S., at 319, 95 S.Ct., at 2355. It is to insure a fully informed and well-considered decision, not necessarily a decision the judges of the Court of Appeals or of this Court would have reached had they been members of the decisionmaking unit of the agency. Administrative decisions should be set aside in this context, as in every other, only for substantial procedural or substantive reasons as mandated by statute, Consolo v. FMC, 383 U.S. 607, 620, 86 S.Ct. 1018, 1026, 16 L.Ed.2d 131 (1966), not simply because the court is unhappy with the result reached. And a single alleged oversight on a peripheral issue, urged by parties who never fully cooperated or indeed raised the issue below, must not be made the basis for overturning a decision properly made after an otherwise exhaustive proceeding.

[5] National Muffler Dealers Association v. United States (1979): Courts Should Defer To Administrative Interpretations Of Statutes Only If The Administrative Interpretations Properly Implement A Congressional Mandate And Harmonize With The Plain Language Of The Statute, Its Origin, And Purpose.

National Muffler Dealers Association v. United States,[546] in 1979, provided a lesser standard of deference for interpretive regulations: courts should defer to administrative interpretations of statutes only if the administrative interpretations properly implement a Congressional mandate and "harmonize with the plain language of the statute, its origin, and purpose."

National Muffler Dealers Association, Inc. is a trade organization for muffler dealers. The issue was whether the Association, which has confined its membership to dealers franchised by Midas International Corporation, and its activities to the Midas muffler business, and thus is not "industrywide," is a "business league" entitled to the exemption from federal income tax provided by Section 501(c)(6).

In 1971, during a contest for control of Midas, Midas muffler franchisees organized the Association. The Association's purpose was to establish a group to negotiate unitedly with Midas management. The Association's principal activity was to serve as a bargaining agent for its members in dealing with Midas. The Association had enrolled most Midas franchisees as members.

The Association negotiated a new form of franchise agreement which prevented termination during its 20-year life except for cause. It also persuaded Midas to eliminate its requirement that a customer pay a service charge when a guaranteed Midas muffler is replaced. The Association sponsored group insurance programs, held an annual convention, and published a newsletter for members.

The Association sought the exemption from federal income tax which § 501(c)(6) provides for a "business league."

Treasury Regulation § 1.501(c)(6)–1 states that the activities of a tax exempt business league "should be directed to the improvement of business conditions of one or more lines of business."

The Internal Revenue Service initially rejected the Association's exemption application, stating that Section 501(c)(6) "would not apply to an organization that is not industry wide."

The Association in October 1972 amended its bylaws and eliminated the requirement that its members be Midas franchisees. Despite that amendment, and despite the Association's announced purpose to promote the interests of individuals "engaged in business as muffler

[546] 440 U.S. 472 (1979).

dealers," the Association neither recruited nor acquired a member who was not a Midas franchisee.

The Internal Revenue Service issued a final rejection of the Association's exemption application. The Association brought this suit in the United States District Court for the Southern District of New York asserting its entitlement to a refund for the income taxes paid for three fiscal years.

The District Court found: "There is no evidence that [the Association] confers a benefit on the muffler industry as a whole or upon muffler franchisees as a group." The District Court concluded that "Midas Muffler franchisees do not constitute a 'line of business,'" and held that the Association was not a "business league" and was not entitled to the claimed refund. The United States Court of Appeals for the Second Circuit affirmed. It confronted what it called the "lexicographer's task of deciding what is meant by a 'business league'." Finding no direct guidance in the statute, the court applied the maxim noscitur a sociis ("[i]t is known from its associates," Black's Law Dictionary 1209 (Rev. 4th ed. 1968)), and looked "at the general characteristics of the organizations" with which business leagues were grouped in the statute, that is, chambers of commerce and boards of trade. The court agreed with the Internal Revenue Service determination in Section 1.501(c)(6)–1 of the Treasury regulations, that a business league is an "organization of the same general class as a chamber of commerce or board of trade." Reasoning that it was the "manifest intention" of Congress by the statute "to provide an exemption for organizations which promote some aspect of the general economic welfare rather than support particular private interests," the court concluded that the "line of business" requirement set forth in the regulations is "well suited to assuring that an organization's efforts do indeed benefit a sufficiently broad segment of the business community."

The Supreme Court noted that the statute's term "business league" has no well-defined meaning or common usage outside the perimeters of Section 501(c)(6). It is a term "so general . . . as to render an interpretive regulation appropriate."[547] In such a situation, A Court customarily defers to the regulation, which, "if found to 'implement the Congressional mandate in some reasonable manner,' must be upheld."[548]

A court does this because "Congress has delegated to the [Secretary of the Treasury and his delegate, the] Commissioner [of Internal Revenue], not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a)."[549] That delegation helps to ensure that in "this area of limitless factual variations,"[550], like cases will be treated alike. It also helps guarantee that the rules will

[547] *Helvering v. Reynolds Co.*, 306 U.S. 110, 114 (1939).

[548] *United States v. Cartwright*, 411 U.S. 546, 550, 93 S.Ct. 1713, 1716, 36 L.Ed.2d 528, 532 (1973), *quoting United States v. Correll*, 389 U.S. 299, 307, 88 S.Ct. 445, 449, 19 L.Ed.2d 537, 543 (1967).

[549] *United States v. Correll*, 389 U.S., at 307.

[550] *Id.*

be written by "masters of the subject,"[551], who will be responsible for putting the rules into effect.

In determining whether a particular regulation carries out the Congressional mandate in a proper manner, the court

> *look[s] to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of Congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute. See Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501, 68 S.Ct. 695, 698, 92 L.Ed. 831, 836 (1948); Helvering v. Winmill, 305 U.S. 79, 83, 59 S.Ct. 45, 46, 83 L.Ed. 52, 55 (1938)."*

The court noted that:

> *In short, while the Commissioner's reading of § 501(c)(6) perhaps is not the only possible one, it does bear a fair relationship to the language of the statute, it reflects the views of those who sought its enactment, and it matches the purpose they articulated. It evolved as the Commissioner administered the statute and attempted to give to a new phrase a content that would reflect Congressional design. The regulation has stood for 50 years, and the Commissioner infrequently but consistently has interpreted it to exclude an organization like the Association that is not industrywide. The Commissioner's view therefore merits serious deference.*

The taxpayer noted that an earlier regulation provided a different definition of "business league". This definition provided that its work "need not be similar to that of a chamber of commerce or board of trade."[552] The Association contended that, because this language differs from the language that replaced it in 1929, the latter is not a "contemporaneous construction" to which this Court should defer.

The Supreme Court responded:

> *Contemporaneity, however, is only one of many considerations that counsel courts to defer to the administrative interpretation of a statute. It need not control here. Nothing in the regulations or case law, see Produce Exchange Stock Clearing Assn. v. Helvering, 71 F.2d 142 (CA2 1934), directly explains the regulatory shift. We do know, however, that the change in 1929 incorporated an interpretation thought necessary to match the statute's construction to the original Congressional intent. [Footnote omitted.] We would be reluctant to adopt the rigid view that an agency may not alter its interpretation in light of administrative experience. In Helvering v. Wilshire Oil Co., 308 U.S. 90, 101, 60 S.Ct. 18, 24, 84 L.Ed.2d 101, 107 (1939), the Court acknowledged the need for flexibility and applied a 1929 regulation to a taxpayer even though the taxpayer had acted in reliance on an opposite interpretation incorporated in an earlier regulation.*

[551] *United States v. Moore*, 95 U.S. 760, 763 (1878).

[552] Treas. Reg. 45, Art. 518 (1919).

Here, where there is no claim that the Association ever relied on the Commissioner's prior view, the case for accepting the later regulation as authoritative is even stronger.

The Supreme Court further observed:

In sum, the "line of business" limitation is well grounded in the origin of § 501(c)(6) and in its enforcement over a long period of time. The distinction drawn here, that a tax exemption is not available to aid one group in competition with another within an industry, is but a particular manifestation of an established principle of tax administration. Because the Association has not shown that either the regulation or the Commissioner's interpretation of it fails to "implement the Congressional mandate in some reasonable manner," United States v. Correll, 389 U.S., at 307, 88 S.Ct. at 450, the Association's claim for a § 501(c)(6) exemption must be denied.

[6] Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Auto Insurance Co. (1983): Discussion of Arbitrary and Capricious Standard.

Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Auto Insurance Co.[553] involved insurance companies' petition for review of an order of the National Highway Traffic Safety Administration rescinding crash protection requirements of federal motor vehicle safety standard. The Court of Appeals[554] held that the rescission was arbitrary and capricious. The Supreme Court held that the National Highway Traffic Safety Administration acted arbitrarily and capriciously in revoking the requirement in motor vehicle safety standard 208 that new motor vehicles produced after September of 1982 be equipped with passive restraints to protect the safety of the occupants of the vehicle in the event of a collision. The National Highway Traffic Safety Administration failed to present an adequate basis and explanation for rescinding the passive restraint requirement. The Supreme Court held that the National Highway Traffic Safety Administration's rescission of the passive restraint requirement in Modified Standard 208 was arbitrary and capricious. The National Highway Traffic Safety Administration failed to provide an adequate basis and explanation for its action in eliminating the requirement of passive restraints. The National Highway Traffic Safety Administration agency failed to present an adequate basis and explanation for rescinding the requirement. Consequently, the National Highway Traffic Safety Administration must either consider the matter further or adhere to or amend the Standard along lines which its analysis supports.

The court discussed the arbitrary and capricious standard:

[553] 463 U.S. 29 (1983).
[554] 680 F.2d 206,

(b) The Court of Appeals correctly found that the "arbitrary and capricious" standard of judicial review applied to rescission of agency regulations, but erred in intensifying the scope of its review based upon its reading of legislative events. While an agency's interpretation of a statute may be confirmed or ratified by subsequent Congressional failure to change that interpretation, here, even an unequivocal ratification of the passive restraint requirement would not connote approval or disapproval of NHTSA's later decision to rescind the requirement. That decision remains subject to the "arbitrary and capricious" standard. [Citation omitted.]

(c) The first reason for finding NHTSA's rescission of Modified Standard 208 was arbitrary and capricious is that it apparently gave no consideration to modifying the Standard to require that airbag technology be utilized. Even if NHTSA's conclusion that detachable automatic seatbelts will not attain anticipated safety benefits because so many individuals will detach the mechanism were acceptable in its entirety, standing alone it would not justify any more than an amendment of the Standard to disallow compliance by means of one technology which will not provide effective passenger protection. It does not cast doubt on the need for a passive restraint requirement or upon the efficacy of airbag technology. The airbag is more than a policy alternative to the passive restraint requirement; it is a technology alternative within the ambit of the existing standard. [Citation omitted.]

(d) NHTSA was too quick to dismiss the safety benefits of automatic seatbelts. Its explanation for rescission of the passive restraint requirement is not sufficient to enable this Court to conclude that the rescission was the product of reasoned decisionmaking. The agency took no account of the critical difference between detachable automatic seatbelts and current manual seatbelts, failed to articulate a basis for not requiring nondetachable belts, and thus failed to offer the rational connection between facts and judgment required to pass muster under the "arbitrary and capricious" standard. [Citation omitted.]

The Supreme Court further explained:

Unlike the Court of Appeals, we do not find the appropriate scope of judicial review to be the "most troublesome question" in the case. Both the Motor Vehicle Safety Act and the 1974 Amendments concerning occupant crash protection standards indicate that motor vehicle safety standards are to be promulgated under the informal rulemaking procedures of § 553 of the Administrative Procedure Act. 5 U.S.C. § 553 (1976). The agency's action in promulgating such standards therefore may be set aside if found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 414, 91 S.Ct. 814, 822, 28 L.Ed.2d 136 (1971); Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 95 S.Ct. 438, 42 L.Ed.2d 447 (1974). We believe that the rescission or modification of an occupant protection standard is subject to the same test. Section 103(b) of the Motor Vehicle Safety Act, 15 U.S.C. § 1392(b), states that the procedural and judicial review provisions of the Administrative Procedure Act "shall apply to all orders establishing, amending, or revoking a Federal motor vehicle safety standard," and suggests no difference in the scope of judicial review depending upon the nature of the agency's action.

Petitioner Motor Vehicle Manufacturers Association (MVMA) disagrees, contending that the rescission of an agency rule should be judged by the same standard a court would use to judge an agency's refusal to promulgate a rule in the first place—a standard Petitioner believes considerably narrower than the traditional

arbitrary and capricious test and "close to the borderline of nonreviewability." Brief of Petitioner MVMA, at 35. We reject this view. The Motor Vehicle Safety Act expressly equates orders "revoking" and "establishing" safety standards; neither that Act nor the APA suggests that revocations are to be treated as refusals to promulgate standards. Petitioner's view would render meaningless Congress' authorization for judicial review of orders revoking safety rules. Moreover, the revocation of an extant regulation is substantially different than a failure to act. Revocation constitutes a reversal of the agency's former views as to the proper course. A "settled course of behavior embodies the agency's informed judgment that, by pursuing that course, it will carry out the policies committed to it by Congress. There is, then, at least a presumption that those policies will be carried out best if the settled rule is adhered to." Atchison, T. & S.F.R. Co. v. Wichita Bd. of Trade, 412 U.S. 800, 807–808, 93 S.Ct. 2367, 2374–2375, 37 L.Ed.2d 350 (1973). Accordingly, an agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance.

In so holding, we fully recognize that "regulatory agencies do not establish rules of conduct to last forever," American Trucking Assoc., Inc. v. Atchison, T. & S.F.R. Co., 387 U.S. 397, 416, 87 S.Ct. 1608, 1618, 18 L.Ed.2d 847 (1967), and that an agency must be given ample latitude to "adapt their rules and policies to the demands of changing circumstances." Permian Basin Area Rate Cases, 390 U.S. 747, 784, 88 S.Ct. 1344, 1368–1369, 20 L.Ed.2d 312 (1968). But the forces of change do not always or necessarily point in the direction of deregulation. In the abstract, there is no more reason to presume that changing circumstances require the rescission of prior action, instead of a revision in or even the extension of current regulation. If Congress established a presumption from which judicial review should start, that presumption—contrary to petitioners' views—is not against safety regulation, but against changes in current policy that are not justified by the rulemaking record. While the removal of a regulation may not entail the monetary expenditures and other costs of enacting a new standard, and accordingly, it may be easier for an agency to justify a deregulatory action, the direction in which an agency chooses to move does not alter the standard of judicial review established by law.

The Supreme Court discussed its arbitrary and capricious review standard:

The Department of Transportation accepts the applicability of the "arbitrary and capricious" standard. It argues that under this standard, a reviewing court may not set aside an agency rule that is rational, based on consideration of the relevant factors and within the scope of the authority delegated to the agency by the statute. We do not disagree with this formulation. [Footnote omitted.] The scope of review under the "arbitrary and capricious" standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made." Burlington Truck Lines v. United States, 371 U.S. 156, 168, 83 S.Ct. 239, 245–246, 9 L.Ed.2d 207 (1962). In reviewing that explanation, we must "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." Bowman Transp. Inc. v. Arkansas-Best Freight System, supra, 419 U.S., at 285, 95 S.Ct., at 442; Citizens to Preserve Overton Park v. Volpe, supra, 401 U.S., at 416, 91 S.Ct., at 823. Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered

an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: "We may not supply a reasoned basis for the agency's action that the agency itself has not given." SEC v. Chenery Corp., 332 U.S. 194, 196, 67 S.Ct. 1575, 1577, 91 L.Ed. 1995 (1947). We will, however, "uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned." Bowman Transp. Inc. v. Arkansas-Best Freight System, supra, 419 U.S., at 286, 95 S.Ct., at 442. See also Camp v. Pitts, 411 U.S. 138, 142–143, 93 S.Ct. 1241, 1244, 36 L.Ed.2d 106 (1973) (per curiam). For purposes of these cases, it is also relevant that Congress required a record of the rulemaking proceedings to be compiled and submitted to a reviewing court, 15 U.S.C. § 1394, and intended that agency findings under the Act would be supported by "substantial evidence on the record considered as a whole." S.Rep. No. 1301, 89th Cong., 2d Sess. 8 (1966); H.R.Rep. No. 1776, 89th Cong., 2d Sess. 21 (1966).

The Supreme Court continued:

The first and most obvious reason for finding the rescission arbitrary and capricious is that NHTSA apparently gave no consideration whatever to modifying the Standard to require that airbag technology be utilized. Standard 208 sought to achieve automatic crash protection by requiring automobile manufacturers to install either of two passive restraint devices: airbags or automatic seatbelts. There was no suggestion in the long rulemaking process that led to Standard 208 that if only one of these options were feasible, no passive restraint standard should be promulgated. Indeed, the agency's original proposed standard contemplated the installation of inflatable restraints in all cars. [Footnote omitted.] Automatic belts were added as a means of complying with the standard because they were believed to be as effective as airbags in achieving the goal of occupant crash protection. 36 Fed.Reg. 12,858, 12,859 (July 8, 1971). At that time, the passive belt approved by the agency could not be detached. [Footnote omitted.] Only later, at a manufacturer's behest, did the agency approve of the detachability feature—and only after assurances that the feature would not compromise the safety benefits of the restraint. [Footnote omitted.] Although it was then foreseen that 60% of the new cars would contain airbags and 40% would have automatic seatbelts, the ratio between the two was not significant as long as the passive belt would also assure greater passenger safety.

The agency has now determined that the detachable automatic belts will not attain anticipated safety benefits because so many individuals will detach the mechanism. Even if this conclusion were acceptable in its entirety, see infra, at 2871 2872, standing alone it would not justify any more than an amendment of Standard 208 to disallow compliance by means of the one technology which will not provide effective passenger protection. It does not cast doubt on the need for a passive restraint standard or upon the efficacy of airbag technology. In its most recent rule-making, the agency again acknowledged the life-saving potential of the airbag:

"The agency has no basis at this time for changing its earlier conclusions in 1976 and 1977 that basic airbag technology is sound and has been sufficiently demonstrated to be effective in those vehicles in current use. . NHTSA Final Regulatory Impact Analysis (RIA) at XI–4 (App. 264).

Given the effectiveness ascribed to airbag technology by the agency, the mandate of the Safety Act to achieve traffic safety would suggest that the logical response to the faults of detachable seatbelts would be to

require the installation of airbags. At the very least this alternative way of achieving the objectives of the Act should have been addressed and adequate reasons given for its abandonment. But the agency not only did not require compliance through airbags, it did not even consider the possibility in its 1981 rulemaking. Not one sentence of its rulemaking statement discusses the airbags-only option. Because, as the Court of Appeals stated, "NHTSA's . . . analysis of airbags was nonexistent," 680 F.2d, at 236, what we said in Burlington Truck Lines v. United States, 371 U.S., at 167, 83 S.Ct., at 245, is apropos here:

"There are no findings and no analysis here to justify the choice made, no indication of the basis on which the [agency] exercised its expert discretion. We are not prepared to and the Administrative Procedure Act will not permit us to accept such . . . practice. . Expert discretion is the lifeblood of the administrative process, but 'unless we make the requirements for administrative action strict and demanding, expertise, the strength of modern government, can become a monster which rules with no practical limits on its discretion.' New York v. United States, 342 U.S. 882, 884 [72 S.Ct. 152, 153, 96 L.Ed. 662] (dissenting opinion)." (footnote omitted).

We have frequently reiterated that an agency must cogently explain why it has exercised its discretion in a given manner, Atchison, T & S.F.R. Co. v. Wichita Bd. of Trade, 412 U.S. 800, 806, 93 S.Ct. 2367, 2374, 37 L.Ed.2d 350 (1973); FTC v. Sperry & Hutchinson Co., 405 U.S. 233, 249, 92 S.Ct. 898, 907, 31 L.Ed.2d 170 (1972); NLRB v. Metropolitan Ins. Co., 380 U.S. 438, 443, 85 S.Ct. 1061, 1064, 13 L.Ed.2d 951 (1965); and we reaffirm this principle again today.

The automobile industry has opted for the passive belt over the airbag, but surely it is not enough that the regulated industry has eschewed a given safety device. For nearly a decade, the automobile industry waged the regulatory equivalent of war against the airbag [footnote omitted] and lost—the inflatable restraint was proven sufficiently effective. Now the automobile industry has decided to employ a seatbelt system which will not meet the safety objectives of Standard 208. This hardly constitutes cause to revoke the standard itself. Indeed, the Motor Vehicle Safety Act was necessary because the industry was not sufficiently responsive to safety concerns. The Act intended that safety standards not depend on current technology and could be "technology-forcing" in the sense of inducing the development of superior safety design. See Chrysler Corp. v. Dept. of Transp., 472 F.2d, at 672–673. If, under the statute, the agency should not defer to the industry's failure to develop safer cars, which it surely should not do, a fortiori it may not revoke a safety standard which can be satisfied by current technology simply because the industry has opted for an ineffective seatbelt design.

Although the agency did not address the mandatory airbags option and the Court of Appeals noted that "airbags seem to have none of the problems that NHTSA identified in passive seatbelts," petitioners recite a number of difficulties that they believe would be posed by a mandatory airbag standard. These range from questions concerning the installation of airbags in small cars to that of adverse public reaction. But these are not the agency's reasons for rejecting a mandatory airbag standard. Not having discussed the possibility, the agency submitted no reasons at all.

The court rejected justifications for regulations first proposed on brief:

The short—and sufficient—answer to petitioners' submission is that the courts may not accept appellate counsel's post hoc rationalizations for agency action. Burlington Truck Lines v. United States, supra, 371 U.S., at 168, 83 S.Ct., at 245. It is well-established that an agency's action must be upheld, if at all, on the basis articulated by the agency itself. Ibid; SEC v. Chenery, 332 U.S. 194, 196, 67 S.Ct. 1575, 1577, 91 L.Ed. 1995 (1947); American Textile Manufacturers Inst. v. Donovan, 452 U.S. 490, 539, 101 S.Ct. 2478, 2505, 69 L.Ed.2d 185 (1981). [Footnote omitted.]

The Supreme Court commented on *Vermont Yankee Nuclear Power Corp. v. NRDC*:[555]

Petitioners also invoke our decision in Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 98 S.Ct. 1197, 55 L.Ed.2d 460 (1978), as though it were a talisman under which any agency decision is by definition unimpeachable. Specifically, it is submitted that to require an agency to consider an airbags-only alternative is, in essence, to dictate to the agency the procedures it is to follow. Petitioners both misread Vermont Yankee and misconstrue the nature of the remand that is in order. In Vermont Yankee, we held that a court may not impose additional procedural requirements upon an agency. We do not require today any specific procedures which NHTSA must follow. Nor do we broadly require an agency to consider all policy alternatives in reaching decision. It is true that a rulemaking "cannot be found wanting simply because the agency failed to include every alternative device and thought conceivable by the mind of man . . . regardless of how uncommon or unknown that alternative may have been. . 435 U.S., at 551, 98 S.Ct., at 1215–1216. But the airbag is more than a policy alternative to the passive restraint standard; it is a technological alternative within the ambit of the existing standard. We hold only that given the judgment made in 1977 that airbags are an effective and cost-beneficial life-saving technology, the mandatory passive-restraint rule may not be abandoned without any consideration whatsoever of an airbags-only requirement.

B

Although the issue is closer, we also find that the agency was too quick to dismiss the safety benefits of automatic seatbelts. NHTSA's critical finding was that, in light of the industry's plans to install readily detachable passive belts, it could not reliably predict "even a 5 percentage point increase as the minimum level of expected usage increase." 46 Fed.Reg., at 53,423. The Court of Appeals rejected this finding because there is "not one iota" of evidence that Modified Standard 208 will fail to increase nationwide seatbelt use by at least 13 percentage points, the level of increased usage necessary for the standard to justify its cost. Given the lack of probative evidence, the court held that "only a well-justified refusal to seek more evidence could render rescission non-arbitrary." 680 F.2d, at 232.

The Plaintiff's argued that substantial uncertainty that a regulation will accomplish its purpose is sufficient to rescind s regulation:

Petitioners object to this conclusion. In their view, "substantial uncertainty" that a regulation will accomplish its intended purpose is sufficient reason, without more, to rescind a regulation. We agree with petitioners that just as an agency reasonably may decline to issue a safety standard if it is uncertain about its efficacy, an agency may also revoke a standard on the basis of serious uncertainties if supported by the record

[555] 435 U.S. 519 (1978).

and reasonably explained. Rescission of the passive restraint requirement would not be arbitrary and capricious simply because there was no evidence in direct support of the agency's conclusion. It is not infrequent that the available data does not settle a regulatory issue and the agency must then exercise its judgment in moving from the facts and probabilities on the record to a policy conclusion. Recognizing that policymaking in a complex society must account for uncertainty, however, does not imply that it is sufficient for an agency to merely recite the terms "substantial uncertainty" as a justification for its actions. The agency must explain the evidence which is available, and must offer a "rational connection between the facts found and the choice made." Burlington Truck Lines, Inc. v. United States, supra, 371 U.S., at 168, 83 S.Ct., at 246. Generally, one aspect of that explanation would be a justification for rescinding the regulation before engaging in a search for further evidence.

The court found the government explanation inadequate:

In this case, the agency's explanation for rescission of the passive restraint requirement is not sufficient to enable us to conclude that the rescission was the product of reasoned decisionmaking. To reach this conclusion, we do not upset the agency's view of the facts, but we do appreciate the limitations of this record in supporting the agency's decision. We start with the accepted ground that if used, seatbelts unquestionably would save many thousands of lives and would prevent tens of thousands of crippling injuries. Unlike recent regulatory decisions we have reviewed, Industrial Union Department v. American Petroleum Institute, 448 U.S. 607, 100 S.Ct. 2844, 65 L.Ed.2d 1010 (1980); American Textile Manufacturers Inst., Inc. v. Donovan, 452 U.S. 490, 101 S.Ct. 2478, 69 L.Ed.2d 185 (1981), the safety benefits of wearing seatbelts are not in doubt and it is not challenged that were those benefits to accrue, the monetary costs of implementing the standard would be easily justified. We move next to the fact that there is no direct evidence in support of the agency's finding that detachable automatic belts cannot be predicted to yield a substantial increase in usage. The empirical evidence on the record, consisting of surveys of drivers of automobiles equipped with passive belts, reveals more than a doubling of the usage rate experienced with manual belts.16 Much of the agency's rulemaking statement—and much of the controversy in this case—centers on the conclusions that should be drawn from these studies. The agency maintained that the doubling of seatbelt usage in these studies could not be extrapolated to an across-the-board mandatory standard because the passive seatbelts were guarded by ignition interlocks and purchasers of the tested cars are somewhat atypical. [Footnote omitted.] Respondents insist these studies demonstrate that Modified Standard 208 will substantially increase seatbelt usage. We believe that it is within the agency's discretion to pass upon the generalizability of these field studies. This is precisely the type of issue which rests within the expertise of NHTSA, and upon which a reviewing court must be most hesitant to intrude.

The court also noted:

While the agency is entitled to change its view on the acceptability of continuous passive belts, it is obligated to explain its reasons for doing so.

The agency also failed to offer any explanation why a continuous passive belt would engender the same adverse public reaction as the ignition interlock, and, as the Court of Appeals concluded, "every indication in the record points the other way." 680 F.2d, at 234. [Footnote omitted.] We see no basis for equating the two devices: the continuous belt, unlike the ignition interlock, does not interfere with the operation of the vehicle. More importantly, it is the agency's responsibility, not this Court's, to explain its decision.

VI

"An agency's view of what is in the public interest may change, either with or without a change in circumstances. But an agency changing its course must supply a reasoned analysis . . . Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (CADC), cert. denied, 403 U.S. 923, 91 S.Ct. 2233, 29 L.Ed.2d 701 (1971). We do not accept all of the reasoning of the Court of Appeals but we do conclude that the agency has failed to supply the requisite "reasoned analysis" in this case. Accordingly, we vacate the judgment of the Court of Appeals and remand the case to that court with directions to remand the matter to the NHTSA for further consideration consistent with this opinion. [Footnote omitted.]

*§1.10 Post-*Chevron *Authorities.*

[1] Auer v Robbins (1997): Administrative Interpretation Of Agency Regulation is Controlling Unless Plainly Erroneous Or Inconsistent With The Regulation.

In *Auer v. Robbins*,[556] police sergeants sued a city board of police commissioners under Fair Labor Standards Act of 1938 for overtime wage benefits. The board responded that sergeants were *"bona fide* executive, administrative, or professional" employees exempt from the Fair Labor Standards Act's overtime requirements. *Auer* established the principal that courts will defer to an agency's of its own ambiguous rules and regulations.

The Supreme Court, held that:

- the Secretary of Labor reasonably applied to public employees a regulation requiring that employees, in order to be exempt from overtime pay requirements, must not be subject to salary reduction because of variations in quantity or quality of work performed;
- that Secretary failed to give adequate consideration to whether a disciplinary-deduction rule should be applied to public employees, could not be raised in first instance in sergeants' suit against board; and
- the Secretary reasonably interpreted regulation as denying exempt status to employees who were covered by policy permitting disciplinary or pay deductions from their salaries as practical matter.

The *Auer* court reasoned:

Because the salary-basis test is a creature of the Secretary's own regulations, his interpretation of it is, under our jurisprudence, controlling unless "'plainly erroneous or inconsistent with the regulation.'" Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 359, 109 S.Ct. 1835, 1850, 104 L.Ed.2d 351

[556] 519 U.S. 452 (1997).

(1989) (quoting Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414, 65 S.Ct. 1215, 1217, 89 L.Ed. 1700 (1945)). That deferential standard is easily met here. The critical phrase "subject to" comfortably bears the meaning the Secretary assigns. See American Heritage Dictionary 1788 (3d ed.1992) (def. 2: defining "subject to" to mean "prone; disposed"; giving as an example "a child who is subject to colds"); Webster's New International Dictionary 2509 (2d ed.1950) (def. 3: defining "subject to" to mean "[e]xposed; liable; prone; disposed"; giving as an example "a country subject to extreme heat").

The Secretary's approach is usefully illustrated by reference to this case. The policy on which petitioners rely is contained in a section of the police manual that lists a total of 58 possible rule violations and specifies the range of penalties associated with each. All department employees are nominally covered by the manual, and some of the specified penalties involve disciplinary deductions in pay. Under the Secretary's view, that is not enough to render petitioners' pay "subject to" disciplinary deductions within the meaning of the salary-basis test. This is so because the manual does not "effectively communicate" that pay deductions are an anticipated form of punishment for employees in petitioners' category, since it is perfectly possible to give full effect to every aspect of the manual without drawing any inference of that sort. If the statement of available penalties applied solely to petitioners, matters would be different; but since it applies both to petitioners and to employees who are unquestionably not paid on a salary basis, the expressed availability of disciplinary deductions may have reference only to the latter. No clear inference can be drawn as to the likelihood of a sanction's being applied to employees such as petitioners. Nor, under the Secretary's approach, is such a likelihood established by the one-time deduction in a sergeant's pay, under unusual circumstances.

[2] United States v. Mead Corporation (2001): No Chevron Deference to Informal Agency Guidance Not Subject to Notice and Comment.

United States v. Mead Corporation[557] considered tariff classification of day planners. *Mead* considered whether *Chevron* deference applied to Customs Service tariff classifications. The Supreme Court held that the Customs Service tariff ruling did not qualify for *Chevron* deference. The Supreme Court determine that the failure of the Customs Service to provide adequate formal procedures in adopting the tariff classification ruling deprived the ruling of *Chevron* deference. Mead addressed one of the many agency decisions that were not adopted in accordance with the notice and comment standards of the Administrative Procedure Act.

The Harmonized Tariff Schedule of the United States authorizes the United States Customs Service to classify and fix the rate of duty on imports, under rules and regulations issued by the Secretary of the Treasury. The Secretary provides for tariff rulings before the entry of goods by regulations authorizing "ruling letters" setting tariff classifications for particular imports. These rulings letters can be issued by any of the 46 port-of-entry Customs offices and the Customs Headquarters Office. Mead Corporation imports "day planners," three-ring binders with pages for daily schedules, phone numbers and addresses, a calendar,

[557] 533 U.S. 218 (2001).

and the like. After classifying the planners as duty free for several years, Customs Headquarters issued a ruling letter classifying them as bound diaries subject to tariff. Mead Corporation disputed this classification. Mead Corporation filed suit in the Court of International Trade. This court gave the Government summary judgment. Mead appealed to the Federal Circuit Court of Appeals.

United States v. Mead Corporation concluded:

> *Chevron did nothing to eliminate Skidmore's holding that an agency's interpretation may merit some deference whatever its form, given the 'specialized experience and broader investigations and information' available to the agency, and given the value of uniformity in its administrative and judicial understandings of what a national law requires.* [558]

United States v. Mead Corporation further advised:

> *The fair measure of deference to an agency administering its own statute has been understood to vary with circumstances, and courts have looked to the degree of the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position.* [559]

The question in *United States v. Mead Corporation* was whether a tariff classification ruling by the United States Customs Service deserves judicial deference. The classification ruling was not subject to Administrative Procedure Act notice and comment and was adopted much less formally.

The Customs Service asserted that its ruling letters were entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* [560]

The Supreme Court agreed with Mead Corporation that a tariff classification has no claim to judicial deference under *Chevron*. The Supreme Court saw no indication that Congress intended letter rulings to carry the force of law.

The Supreme Court in *United States v. Mead Corporation* followed *Skidmore v. Swift & Co.*, [561] The ruling was eligible to claim respect according to its persuasiveness. The Federal Circuit found that ruling letters should not be treated like Customs regulations. Customs regulations receive the highest level of deference under *Chevron*. The Federal Circuit determined that ruling letters –

- are not preceded by notice and comment,
- do not carry the force of law, and

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[558] *Mead*, 533 U.S. at 234 *quoting Skidmore v. Swift & Co.*, 323 U.S. 134, 139-40 (1944) (citations omitted).

[559] *Mead*, 533 U.S. at 228 (footnotes omitted) (citations omitted).

[560] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[561] 323 U.S. 134 (1944).

- are not intended to clarify importers' rights and obligations beyond the specific case.

The Federal Circuit did not give the ruling letter in *Mead Corporation* any deference.

After the transaction with respect to which the letter ruling was issued, a ruling letter is to "be applied only with respect to transactions involving articles identical to the sample submitted with the ruling request or to articles whose description is identical to the description set forth in the ruling letter." A ruling letter is "subject to modification or revocation without notice to any person, except the person to whom the letter was addressed." Regulations provide that "no other person should rely on the ruling letter or assume that the principles of that ruling will be applied in connection with any transaction other than the one described in the letter." Ruling letters respond to transactions of the moment. Ruling letters are not subject to notice and comment before being issued. Ruling letters, may be published but need only be made "available for public inspection." Ruling letters, at the time the action arose, could be modified without notice and comment under most circumstances.

Any of the 464 port-of-entry Customs offices may issue ruling letters, and so may the Customs Headquarters Office. The ruling letters provide "[a]dvice or guidance as to the interpretation or proper application of the Customs and related laws with respect to a specific Customs transaction [which] may be requested by Customs Service field offices . . . at any time, whether the transaction is prospective, current, or completed." Most ruling letters contain little or no reasoning. Ruling letters simply describe goods and state the appropriate category and tariff. A few letters set out a rationale in some detail.

Between 1989 and 1993, Customs repeatedly treated day planners under the "other" HTSUS subheading, not subject to tariffs. In January 1993, Customs changed its position, and issued a Headquarters ruling letter classifying Mead's day planners as "Diaries . . . bound" subject to tariff. That letter was short on explanation. After Mead's protest, Customs Headquarters issued a new letter, carefully reasoned but never published, reaching the same conclusion.

Customs rejected Mead's further protest of the second Headquarters ruling letter, and Mead filed suit in the Court of International Trade. The Court of International Trade granted the Government's motion for summary judgment, adopting Customs' reasoning without saying anything about deference. [562]

Mead then went to the United States Court of Appeals for the Federal Circuit. Meanwhile, the Supreme Court determined in *United States v. Haggar Apparel Co.*,[563] holding

[562] 17 F. Supp. 2d 1004 (1998).
[563] 526 U.S. 380 (1999).

that Customs regulations receive the deference described in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,[564]

The Federal Circuit, however, reversed the Court of International Trade and held that Customs classification rulings should not receive *Chevron* deference. The basis of this holding was the differences from the regulations at issue in *Haggar*.

- Ruling letters are not preceded by notice and comment as under the Administrative Procedure Act.[565]
- Ruling letters "do not carry the force of law and are not, like regulations, intended to clarify the rights and obligations of importers beyond the specific case under review."[566]

The appeals court determined that classification rulings had a weaker *Chevron* claim even than Internal Revenue Service interpretive rulings, to which that court gives no deference. Customs rulings issue from many locations and need not be published.

The Court of Appeals accordingly gave no deference at all to the ruling classifying the Mead day planners. The Court of Appeals rejected the agency's reasoning as to both "diary" and "bound." The Court of Appeals thought that planners were not diaries because they had no space for "relatively extensive notations about events, observations, feelings, or thoughts" in the past. The Court of Appeals concluded that diaries "bound" in subheading 4810.10.20 presupposed "unbound" diaries, such that treating ring-fastened diaries as "bound" would leave the "unbound diary" an empty category.

The Supreme Court granted certiorari in *United States v. Mead Corporation* in order to consider the limits of *Chevron* deference owed to administrative practice in applying a statute.

The Supreme Court held in *United States v. Mead Corporation* that administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority. Delegation of such authority may be shown in a variety of ways. This can include an agency's power to engage in adjudication or notice-and-comment rulemaking, or by some other indication of a comparable Congressional intent. The Supreme Court found that the Customs ruling at issue here failed to qualify.

When Congress has "explicitly left a gap for an agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by

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[564] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[565] 5 U.S.C. § 553.

[566] 185 F.3d, at 1307.

regulation," under *Chevron* any ensuing regulation was binding in the courts unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute.

Agencies charged with applying a statute necessarily make all sorts of interpretive choices. Not all of those choices bind judges to follow them. These choices nevertheless may influence courts facing questions the agencies have already answered. "[T]he well-reasoned views of the agencies implementing a statute 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance,'"[567] "We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer. . . ."[568]

The fair measure of deference to an agency administering its own statute varies with circumstances. Courts look to –

- the degree of the agency's care,[569]
- its consistency,[570]
- formality,[571]
- relative expertness,[572] and
- the persuasiveness of the agency's position.[573]

A basic question is whether the ruling letters were entitled to *Chevron* deference. The Supreme Court reasoned the ruling letters were not entitled to *Chevron* deference:

> *We have recognized a very good indicator of delegation meriting Chevron treatment in express Congressional authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed. See, e.g., EEOC v. Arabian American Oil Co., 499 U.S. 244, 257, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991) (no Chevron deference to agency guideline where Congressional delegation did not include the power to "'promulgate rules or regulations'" (quoting General Elec. Co. v. Gilbert, 429 U.S. 125, 141, 97 S.Ct. 401, 50 L.Ed.2d 343 1976))); see also Christensen v. Harris County, 529 U.S. 576, 596–597, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000) (*BREYER, J., *dissenting) (where it is in doubt that Congress actually intended to delegate particular interpretive authority to*

[567] *Bragdon v. Abbott*, 524 U.S. 624 540 (1998) (*quoting Skidmore*, 323 U.S., at 139–140,),

[568] *Chevron, supra*, at 844, 104 S.Ct. 2778 (footnote omitted).

[569] *See, e.g., General Elec. Co. v. Gilbert*, 429 U.S. 125, 142 (1976) (courts consider the "'thoroughness evident in [the agency's] consideration"'(*quoting Skidmore v. Swift & Co.*, 323 U.S. 134 (1944)).

[570] *See, e.g., Good Samaritan Hospital v. Shalala*, 508 U.S. 402, 417 (1993) ("[T]he consistency of an agency's position is a factor in assessing the weight that position is due").

[571] *See, e.g., Reno v. Koray*, 515 U.S. 50, 61 (1995) (internal agency guideline that is not "subject to the rigors of the [APA], including public notice and comment," is entitled only to "some deference" (internal quotation marks omitted)).

[572] *See, e.g., Aluminum Co. of America v. Central Lincoln Peoples' Util. Dist.*, 467 U.S. 380, 390 (1984).

[573] See *Skidmore, supra*, at 139–140.

an agency, Chevron is "inapplicable"). It is fair to assume generally that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force. [Footnote omitted.] Cf. Smiley v. Citibank (South Dakota), N. A., 517 U.S. 735, 741, 116 S.Ct. 1730, 135 L.Ed.2d 25 (1996) (APA notice and comment "designed to assure due deliberation"). Thus, the overwhelming number of our cases applying Chevron deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication. [Footnote omitted.] That said, and as significant as notice-and-comment is in pointing to Chevron authority, the want of that procedure here does not decide the case, for we have sometimes found reasons for Chevron deference even when no such administrative formality was required and none was afforded, see, e.g., NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 256–257, 263, 115 S.Ct. 810, 130 L.Ed.2d 740 (1995). [Footnote omitted.] The fact that the tariff classification here was not a product of such formal process does not alone, therefore, bar the application of Chevron.

There are, nonetheless, ample reasons to deny Chevron deference here. The authorization for classification rulings, and Customs' practice in making them, present a case far removed not only from notice-and-comment process, but from any other circumstances reasonably suggesting that Congress ever thought of classification rulings as deserving the deference claimed for them here.

. .

No matter which angle we choose for viewing the Customs ruling letter in this case, it fails to qualify under Chevron. On the face of the statute, to begin with, the terms of the Congressional delegation give no indication that Congress meant to delegate authority to Customs to issue classification rulings with the force of law. We are not, of course, here making any global statement about Customs' authority, for it is true that the general rulemaking power conferred on Customs, see 19 U.S.C. § 1624, authorizes some regulation with the force of law, or "legal norms," as we put it in Haggar, 526 U.S., at 391, 119 S.Ct. 1392.14 It is true as well that Congress had classification rulings in mind when it explicitly authorized, in a parenthetical, the issuance of "regulations establishing procedures for the issuance of binding rulings prior to the entry of the merchandise concerned," 19 U.S.C. § 1502(a). [Footnote omitted.] The reference to binding classifications does not, however, bespeak the legislative type of activity that would naturally bind more than the parties to the ruling, once the goods classified are admitted into this country. And though the statute's direction to disseminate "information" necessary to "secure" uniformity, ibid, seems to assume that a ruling may be precedent in later transactions, precedential value alone does not add up to Chevron entitlement; interpretive rules may sometimes function as precedents, [citation omitted], and they enjoy no Chevron status as a class. In any event, any precedential claim of a classification ruling is counterbalanced by the provision for independent review of Customs classifications by the CIT, see 28 U.S.C. §§ 2638–2640; the scheme for CIT review includes a provision that treats classification rulings on par with the Secretary's rulings on "valuation, rate of duty, marking, restricted merchandise, entry requirements, drawbacks, vessel repairs, or similar matters," § 1581(h); see § 2639(b). It is hard to imagine a Congressional understanding more at odds with the Chevron regime. [Citation omitted.]

Further,

Customs does not generally engage in notice-and-comment practice when issuing [classification ruling letters], and their treatment by the agency makes it clear that a letter's binding character as a ruling stops short of third parties; Customs has regarded a classification as conclusive only as between itself and the importer to whom it was issued, 19 CFR § 177.9(c) (2000), and even then only until Customs has given advance notice of intended change, §§ 177.9(a), (c). Other importers are in fact warned against assuming any right of detrimental reliance. § 177.9(c).

Failure to qualify for *Chevron* deference does not put ruling letters beyond all deference:

To agree with the Court of Appeals that Customs ruling letters do not fall within Chevron is not, however, to place them outside the pale of any deference whatever. Chevron did nothing to eliminate Skidmore's holding that an agency's interpretation may merit some deference whatever its form, given the "specialized experience and broader investigations and information" available to the agency, 323 U.S., at 139, 65 S.Ct. 161, and given the value of uniformity in its administrative and judicial understandings of what a national law requires, Id., at 140, 65 S.Ct. 161. See generally Metropolitan Stevedore Co. v. Rambo, 521 U.S. 121, 136, 117 S.Ct. 1953, 138 L.Ed.2d 327 (1997) (reasonable agency interpretations carry "at least some added persuasive force" where Chevron is inapplicable); Reno v. Koray, 515 U.S. 50, 61, 115 S.Ct. 2021, 132 L.Ed.2d 46 (1995) (according "some deference" to an interpretive rule that "do[es] not require notice and comment"); Martin v. Occupational Safety and Health Review Comm'n, 499 U.S. 144, 157, 111 S.Ct. 1171, 113 L.Ed.2d 117 (1991) ("some weight" is due to informal interpretations though not "the same deference as norms that derive from the exercise of . . . delegated lawmaking powers").

The ruling letters still could claim a degree of deference under *Skidmore*. This claim is based on the merit of its writer's thoroughness, logic, and expertness, its fit with prior interpretations, and any other sources of weight.

Nothing in *Chevron* eliminated *Skidmore*'s recognition of various justifications for deference depending on statutory circumstances and agency action. *Chevron* left *Skidmore* intact.

The Supreme Court vacated and remanded for further proceedings consistent with this opinion.

[3] City of Arlington, Texas v. Federal Communications Commission (May 2013): Deferral To Agency In Interpreting Jurisdiction Of Agency To Adopt Rule.

City of Arlington, Texas v. Federal Communications Commission,[574] concerns the scope of an agency's authority in providing administrative guidance. Even under *Chevron*,[575] the court must determine whether Congress has directly spoken to the precise question at issue and whether

[574] 569 U.S. 290 (2013).

[575] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

the intent of Congress is clear. If so, the agency and the court must give effect to the unambiguously expressed intent of Congress. If the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute. In this case, the question was the agency determination of its jurisdiction under the statute. The continuing validity of *City of Arlington, Texas v. Federal Communications Commission* after *Loper Bright Enterprises* is questionable.

Two cities petitioned in *City of Arlington, Texas v. Federal Communications Commission* for review of declaratory ruling of the Federal Communications Commission establishing reasonable time frames under the Telecommunications Act for a state or locality to act on wireless facility siting applications. The Court held that *Chevron* deference applied to Federal Communications Commission's declaratory ruling establishing reasonable time frames under Telecommunications Act for state or locality to act on wireless facility siting applications, where Congress had unambiguously vested the Federal Communications Commission with general authority to administer the Act through rulemaking and adjudication, and the agency interpretation at issue was promulgated in the exercise of that authority.[576]

The Communications Act of 1934 requires state or local governments to act on siting applications for wireless facilities "within a reasonable period of time after the request is duly filed."[577] The Federal Communications Commission issued a Declaratory Ruling concluding that the phrase "reasonable period of time" is presumptively (but rebuttably) 90 days to process an application to place a new antenna on an existing tower and 150 days to process all other applications.[578] The cities of Arlington and San Antonio, Texas, sought review of the Declaratory Ruling in the Fifth Circuit. They argued that the Commission lacked authority to interpret the limitations of Section 332(c)(7)(B). The Court of Appeals deferred to the agency's interpretation of its own statutory jurisdiction. Finding the statute ambiguous, it upheld as a permissible construction of the statute the FCC's view that Section 201(b)'s broad grant of regulatory authority empowered it to administer Section 332(c)(7)(B).

The Supreme Court held that the court must apply *Chevron* to an agency's interpretation of a statutory ambiguity that concerns the scope of the agency's statutory authority (*i.e.*, its jurisdiction). A reviewing court must first ask whether Congress has directly spoken to the precise question at issue; if so, the court must give effect to Congress' unambiguously expressed intent. If "the statute is silent or ambiguous," the court must defer to the administering agency's construction of the statute so long as it is permissible. When a court reviews an agency's interpretation of a statute it administers, the question is always whether

[576] Telecommunications Act of 1996, 47 U.S.C.A. § 332(c)(7)(B)(ii).

[577] 47 U.S.C. § 332(c)(7)(B)(ii).

[578] Relying on its broad authority to implement the Communications Act, see 47 U.S.C. § 201(b).

the agency has stayed within the bounds of its statutory authority. There is no distinction between an agency's "jurisdictional" and "nonjurisdictional" interpretations.

When agencies act outside of the power prescribed by Congress, they act improperly. When they act beyond their jurisdiction, what they do is *ultra vires*. There is no principled basis for carving out an arbitrary subset of "jurisdictional" questions from the *Chevron* framework.[579]

The contention that *Chevron* deference is not appropriate because the FCC asserted jurisdiction over matters of traditional state and local concern is meritless. The statute explicitly supplants state authority. For *Chevron* deference to apply, the agency must have received congressional authority to determine the particular matter at issue in the particular manner adopted.[580] *Mead* denied *Chevron* deference to action, by an agency with rulemaking authority, that was not rulemaking. There is no case in which a general conferral of rulemaking or adjudicative authority has been held insufficient to support *Chevron* deference for an exercise of that authority within the agency's substantive field. A general conferral of rulemaking authority validates rules for all the matters the agency is charged with administering. It suffices that the preconditions to deference under *Chevron* are satisfied because Congress has unambiguously vested the Federal Communications Commission with general authority to administer the Communications Act through rulemaking and adjudication, and the agency interpretation at issue was promulgated in the exercise of that authority.

The Supreme Court provided this analysis of whether a court must defer under *Chevron* to an agency's interpretation of a statutory ambiguity that concerns the scope of the agency's statutory authority (that is, its jurisdiction):

> *The question here is whether a court must defer under Chevron to an agency's interpretation of a statutory ambiguity that concerns the scope of the agency's statutory authority (that is, its jurisdiction). The argument against deference rests on the premise that there exist two distinct classes of agency interpretations: Some interpretations—the big, important ones, presumably—define the agency's "jurisdiction." Others—humdrum, run-of-the-mill stuff—are simply applications of jurisdiction the agency plainly has. That premise is false, because the distinction between "jurisdictional" and "nonjurisdictional" interpretations is a mirage. No matter how it is framed, the question a court faces when confronted with an agency's interpretation of a statute it administers is always, simply, whether the agency has stayed within the bounds of its statutory authority.*
>
> *The misconception that there are, for Chevron purposes, separate "jurisdictional" questions on which no deference is due derives, perhaps, from a reflexive extension to agencies of the very real division between the jurisdictional and nonjurisdictional that is applicable to courts. In the judicial context, there is a meaningful line: Whether the court decided correctly is a question that has different consequences from the question whether it had the power to decide at all. Congress has the power (within limits) to tell the courts what classes of cases they may decide, see Trainmen v. Toledo, P. & W.R. Co., 321 U.S. 50, 63–64, 64 S.Ct. 413, 88 L.Ed.*

[579] *See, e.g., National Cable & Telecommunications Assn., Inc. v. Gulf Power Co.*, 534 U.S. 327, 333, 339, 122 S.Ct. 782, 151 L.Ed.2d 794. Pp. 1868 – 1871.

[580] *United States v. Mead Corp.*, 533 U.S. 218, 121 S.Ct. 2164, 150 L.Ed.2d 292.

534 (1944); Lauf v. E.G. Shinner & Co., 303 U.S. 323, 330, 58 S.Ct. 578, 82 L.Ed. 872 (1938), but not to prescribe or superintend how they decide those cases, see Plaut v. Spendthrift Farm, Inc., 514 U.S. 211, 218–219, 115 S.Ct. 1447, 131 L.Ed.2d 328 (1995). A court's power to decide a case is independent of whether its decision is correct, which is why even an erroneous judgment is entitled to res judicata effect. Put differently, a jurisdictionally proper but substantively incorrect judicial decision is not ultra vires.

That is not so for agencies charged with administering congressional statutes. Both their power to act and how they are to act is authoritatively prescribed by Congress, so that when they act improperly, no less than when they act beyond their jurisdiction, what they do is ultra vires. Because the question—whether framed as an incorrect application of agency authority or an assertion of authority not conferred—is always whether the agency has gone beyond what Congress has permitted it to do, there is no principled basis for carving out some arbitrary subset of such claims as "jurisdictional."

. . . .

This point is nicely illustrated by our decision in National Cable & Telecommunications Assn., Inc. v. Gulf Power Co., 534 U.S. 327, 122 S.Ct. 782, 151 L.Ed.2d 794 (2002). That case considered whether the FCC's "jurisdiction" to regulate the rents utility-pole owners charge for "pole attachments" (defined as attachments by a cable television system or provider of telecommunications service) extended to attachments that provided both cable television and high-speed Internet access (attachments for so-called "commingled services"). Id., at 331–336, 122 S.Ct. 782. We held, sensibly, that Chevron applied. 534 U.S., at 333, 339, 122 S.Ct. 782. Whether framed as going to the scope of the FCC's delegated authority or the FCC's application of its delegated authority, the underlying question was the same: Did the FCC exceed the bounds of its statutory authority to regulate rents for "pole attachments" when it sought to regulate rents for pole attachments providing commingled services?

The label is an empty distraction because every new application of a broad statutory term can be reframed as a questionable extension of the agency's jurisdiction. One of the briefs in support of petitioners explains, helpfully, that "[j]urisdictional questions concern the who, what, where, and when of regulatory power: which subject matters may an agency regulate and under what conditions." [Citation omitted.] But an agency's application of its authority pursuant to statutory text answers the same questions. Who is an "outside salesman"? What is a "pole attachment"? Where do the "waters of the United States" end? When must a Medicare provider challenge a reimbursement determination in order to be entitled to an administrative appeal? These can all be reframed as questions about the scope of agencies' regulatory jurisdiction—and they are all questions to which the Chevron framework applies. See Christopher v. SmithKline Beecham Corp., 567 U.S. ——, ——, ——, 132 S.Ct. 2156, 2162, 2165, 183 L.Ed.2d 153 (2012); National Cable & Telecommunications Assn., supra, at 331, 333, 122 S.Ct. 782; United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 123, 131, 106 S.Ct. 455, 88 L.Ed.2d 419 (1985); Sebelius v. Auburn Regional Medical Center, 568 U.S. ——, ——, ——, 133 S.Ct. 817, 821, 826–827, 184 L.Ed.2d 627 (2013).

In sum, judges should not waste their time in the mental acrobatics needed to decide whether an agency's interpretation of a statutory provision is "jurisdictional" or "nonjurisdictional." Once those labels are sheared

away, it becomes clear that the question in every case is, simply, whether the statutory text forecloses the agency's assertion of authority, or not. See H. Edwards & L. Elliott, Federal Standards of Review 146 (2007) ("In practice, it does not appear to matter whether delegated authority is viewed as a threshold inquiry."). The federal judge as haruspex, sifting the entrails of vast statutory schemes to divine whether a particular agency interpretation qualifies as "jurisdictional," is not engaged in reasoned decisionmaking.

. . . .

. . . We have afforded Chevron deference to the Commerce Department's determination that its authority to seek antidumping duties extended to uranium imported under contracts for enrichment services, United States v. Eurodif S. A., 555 U.S. 305, 316, 129 S.Ct. 878, 172 L.Ed.2d 679 (2009); to the Interstate Commerce Commission's view that courts, not the Commission, possessed "initial jurisdiction with respect to the award of reparations" for unreasonable shipping charges, Reiter v. Cooper, 507 U.S. 258, 269, 113 S.Ct. 1213, 122 L.Ed.2d 604 (1993) (internal quotation marks and ellipsis omitted); and to the Army Corps of Engineers' assertion that its permitting authority over discharges into "waters of the United States" extended to "freshwater wetlands" adjacent to covered waters, Riverside Bayview Homes, supra, at 123–124, 131, 106 S.Ct. 455. We have even deferred to the FCC's assertion that its broad regulatory authority extends to pre-empting conflicting state rules. City of New York v. FCC, 486 U.S. 57, 64, 108 S.Ct. 1637, 100 L.Ed.2d 48 (1988); Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 700, 104 S.Ct. 2694, 81 L.Ed.2d 580 (1984). [Footnote omitted.]

Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.[581] applies equally to statutes designed to curtail the scope of agency discretion.[582] *Chemical Mfrs. Assn. v. Natural Resources Defense Council, Inc.* considered a statute prohibiting the Environmental Protection Agency from "modify[ing] any requirement of this section as it applies to any specific pollutant which is on the toxic pollutant list." The Environmental Protection Agency construed the statute as not precluding it from granting variances with respect to certain toxic pollutants. Finding no "clear congressional intent to forbid Environmental Protection Agency's sensible variance mechanism,"[583] the court deferred to the Environmental Protection Agency's construction of this express limitation on its own regulatory authority.[584]

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[581] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[582] *Chemical Mfrs. Assn. v. Natural Resources Defense Council, Inc.,* 470 U.S. 116, 123 (1985).

[583] *Id.*, at 134.

[584] *Id.*, at 125, *citing Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024); *see also, e.g., Japan Whaling Assn. v. American Cetacean Soc.*, 478 U.S. 221, 226, 232–234 (1986).*Chevron* has been widely applied to agencies' constructions of the scope of their own jurisdiction. Courts have applied *Chevron* where concerns about agency self-aggrandizement are at their apogee: in cases where an agency's expansive construction of the extent of its own power would have wrought a fundamental change in the regulatory scheme. In *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000), the threshold question was the "appropriate framework for analyzing" the Food and Drug Administration's assertion of "jurisdiction to regulate tobacco products," *id.*, at 126—a question of

The false dichotomy between "jurisdictional" and "nonjurisdictional" agency interpretations may be no more than a bogeyman, but it is dangerous all the same, according to the Supreme Court in *City of Arlington, Texas v. Federal Communications Commission*.[585] Challengers of agency action would play the "jurisdictional" card in every case.[586] Some judges would be deceived by the specious "jurisdictional"-"nonjurisdictional" line. Other judges would make public policy by prescribing the meaning of ambiguous statutory commands. The effect would be to transfer any number of interpretive decisions—*Chevron* questions, about how best to construe an ambiguous term in light of competing policy interests—from the agencies that administer the statutes to federal courts. "[J]udges ought to refrain from substituting their own interstitial lawmaking" for that of an agency.[587]That is precisely what *Chevron* prevents.

One group of respondents contended that *Chevron* deference is inappropriate here because the Federal Communications Commission has "assert[ed] jurisdiction over matters of traditional state and local concern." This case has nothing to do with federalism. Section 332(c)(7)(B)(ii) explicitly supplants state authority by requiring zoning authorities to render a decision "within a reasonable period of time." The meaning is a question of federal law. The Supreme Court in *AT & T Corp. v. Iowa Utilities Bd.* rejected a similar faux-federalism argument in terms that apply equally here: "This is, at bottom, a debate not about whether the States will be allowed to do their own thing, but about whether it will be the FCC or the federal courts that draw the lines to which they must hew."[588] These lines will be drawn either by unelected federal bureaucrats, or by unelected (and even less politically accountable) federal judges.

The dissent proposed that, even where a rule is at issue and the statute contains a broad grant of rulemaking authority, a court should search provision-by-provision to determine "whether [that] delegation covers the 'specific provision' and 'particular question' before the court." *United States v. Mead Corp.*[589]requires that, for *Chevron* deference to apply, the agency must have received congressional authority to determine the particular matter at issue in the particular manner adopted. *Mead* denied *Chevron* deference to action, by an agency with rulemaking authority, that was not rulemaking. There is apparently not a single case in which

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vast "economic and political magnitude," *id.*, at 133. "Because this case involves an administrative agency's construction of a statute that it administers," *Chevron* applied. 529 U.S., at 132. *MCI Telecommunications Corp. v. American Telephone & Telegraph Co.*, 512 U.S. 218 (1994), applied the *Chevron* framework to the Federal Communication Commission's assertion that the statutory phrase "modify any requirement" gave it authority to eliminate rate-filing requirements, "the essential characteristic of a rate-regulated industry," for long-distance telephone carriers.

[585] 569 U.S. 290 (2013).

[586] *See, e.g., Cellco Partnership v. FCC,* 700 F.3d 534, 541 (D.C. Cir. 2012).

[587] *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 568 (1980).

[588] *AT & T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366. 379n.6 (1999).

[589] 533 U.S. 218 (2001).

a general conferral of rulemaking or adjudicative authority has been held insufficient to support *Chevron* deference for an exercise of that authority within the agency's substantive field.

The dissent proposed that, even when general rulemaking authority is clear, every agency rule must be subjected to a *de novo* judicial determination of whether the particular issue was committed to agency discretion. The majority rejected this approach.

Where Congress has established a clear line, the agency cannot go beyond it. Where Congress has established an ambiguous line, the agency can go no further than the ambiguity will fairly allow. A court need not pause to puzzle over whether the interpretive question presented is "jurisdictional." If "the agency's answer is based on a permissible construction of the statute," that is the end of the matter.[590]

In dissent, Chief Justice Roberts wrote:

> *My disagreement with the Court is fundamental. It is also easily expressed: A court should not defer to an agency until the court decides, on its own, that the agency is entitled to deference. Courts defer to an agency's interpretation of law when and because Congress has conferred on the agency interpretive authority over the question at issue. An agency cannot exercise interpretive authority until it has it; the question whether an agency enjoys that authority must be decided by a court, without deference to the agency.*
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> *I*
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> *One of the principal authors of the Constitution famously wrote that the "accumulation of all powers, legislative, executive, and judiciary, in the same hands, . . . may justly be pronounced the very definition of tyranny." The Federalist No. 47, p. 324 (J. Cooke ed. 1961) (J. Madison). Although modern administrative agencies fit most comfortably within the Executive Branch, as a practical matter they exercise legislative power, by promulgating regulations with the force of law; executive power, by policing compliance with those regulations; and judicial power, by adjudicating enforcement actions and imposing sanctions on those found to have violated their rules. The accumulation of these powers in the same hands is not an occasional or isolated exception to the constitutional plan; it is a central feature of modern American government.*
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> *The administrative state "wields vast power and touches almost every aspect of daily life." Free Enterprise Fund v. Public Company Accounting Oversight Bd., 561 U.S. ——, ——, 130 S.Ct. 3138, 3156, 177 L.Ed.2d 706 (2010). The Framers could hardly have envisioned today's "vast and varied federal bureaucracy" and the authority administrative agencies now hold over our economic, social, and political activities. Ibid. "[T]he administrative state with its reams of regulations would leave them rubbing their eyes." Alden v. Maine, 527 U.S. 706, 807, 119 S.Ct. 2240, 144 L.Ed.2d 636 (1999) (Souter, J., dissenting), quoted in Federal Maritime Comm'n v. South Carolina Ports Authority, 535 U.S. 743, 755, 122 S.Ct. 1864, 152 L.Ed.2d 962 (2002). And the federal bureaucracy continues to grow; in the last 15 years, Congress has launched more than 50 new agencies. Compare Office of the Federal Register, United States Government Manual 1997/1998, with Office of the Federal Register, United States Government Manual*

[590] *Chevron*, 467 U.S.

2012. And more are on the way. See, e.g., Congressional Research Service, C. Copeland, New Entities Created Pursuant to the Patient Protection and Affordable Care Act 1 (2010) (The PPACA "creates, requires others to create, or authorizes dozens of new entities to implement the legislation").

*Although the Constitution empowers the President to keep federal officers accountable, administrative agencies enjoy in practice a significant degree of independence. As scholars have noted, "no President (or his executive office staff) could, and presumably none would wish to, supervise so broad a swath of regulatory activity." Kagan, Presidential Administration, 114 Harv. L.Rev. 2245, 2250 (2001); see also S. Breyer, Making Our Democracy Work 110 (2010) ("the president may not have the time or willingness to review [agency] decisions"). President Truman colorfully described his power over the administrative state by complaining, "I *314 thought I was the president, but when it comes to these bureaucrats, I can't do a damn thing." See R. Nathan, The Administrative Presidency 2 (1986). President Kennedy once told a constituent, "I agree with you, but I don't know if the government will." See id., at 1. The collection of agencies housed outside the traditional executive departments, including the Federal Communications Commission, is routinely described as the "headless fourth branch of government," reflecting not only the scope of their authority but their practical independence. See, e.g., Administrative Conference of United States, D. Lewis & J. Selin, Sourcebook of United States Executive Agencies 11 (2012).*

As for judicial oversight, agencies enjoy broad power to construe statutory provisions over which they have been given interpretive authority. In Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., we established a test for reviewing "an agency's construction of the statute which it administers." 467 U.S. 837, 842, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). If Congress has "directly spoken to the precise question at issue," we said, "that is the end of the matter." Ibid. A contrary agency interpretation must give way. But if Congress has not expressed a specific intent, a court is bound to defer to any "permissible construction of the statute," even if that is not "the reading the court would have reached if the question initially had arisen in a judicial proceeding." Id., at 843, and n. 11, 104 S.Ct. 2778.

When it applies, Chevron is a powerful weapon in an agency's regulatory arsenal. Congressional delegations to agencies are often ambiguous—expressing "a mood rather than a message." Friendly, The Federal Administrative Agencies: The Need for Better Definition of Standards, 75 Harv. L.Rev. 1263, 1311 (1962). By design or default, Congress often fails to speak to "the precise question" before an agency. In the absence of such an answer, an agency's interpretation has the full force and effect of law, unless it "exceeds the bounds of the permissible." Barnhart v. Walton, 535 U.S. 212, 218, 122 S.Ct. 1265, 152 L.Ed.2d 330 (2002).

It would be a bit much to describe the result as "the very definition of tyranny," but the danger posed by the growing power of the administrative state cannot be dismissed. See, e.g., Talk America, Inc. v. Michigan Bell Telephone Co., 564 U.S. ——, ——, 131 S.Ct. 2254, 2266, 180 L.Ed.2d 96 (2011) (SCALIA, J., concurring) (noting that the FCC "has repeatedly been rebuked in its attempts to expand the statute beyond its text, and has repeatedly sought new means to the same ends"); Sackett v. EPA, 566 U.S. ——, —— – ——, 132 S.Ct. 1367, 1374, 182 L.Ed.2d 367 (2012) (rejecting agency argument that would "enable the strong-arming of regulated parties into 'voluntary compliance' without the opportunity for judicial review").

What the Court says in footnote 4 of its opinion is good, and true (except of course for the "dissent overstates" part). Ante, at 1873, n. 4. The Framers did divide governmental power in the manner the Court describes, for the purpose of safeguarding liberty. And yet . . . the citizen confronting thousands of pages of regulations—promulgated by an agency directed by Congress to regulate, say, "in the public interest"—can perhaps be excused for thinking that it is the agency really doing the legislating. And with hundreds of federal agencies poking into every nook and cranny of daily life, that citizen might also understandably question whether Presidential oversight—a critical part of the Constitutional plan—is always an effective safeguard against agency overreaching.

It is against this background that we consider whether the authority of administrative agencies should be augmented even further, to include not only broad power to give definitive answers to questions left to them by Congress, but also the same power to decide when Congress has given them that power.

Before proceeding to answer that question, however, it is necessary to sort through some confusion over what this litigation is about. The source of the confusion is a familiar culprit: the concept of "jurisdiction," which we have repeatedly described as a word with "'many, too many, meanings.'" Union Pacific R. Co. v. Locomotive Engineers, 558 U.S. 67, 81, 130 S.Ct. 584, 175 L.Ed.2d 428 (2009).

*The Court states that the question "is whether a court must defer under Chevron to an agency's interpretation of a statutory ambiguity that concerns the scope of the agency's statutory authority (that is, its jurisdiction)." Ante, at 1868. That is fine—until the parenthetical. The parties, amici, and court below too often use the term "jurisdiction" imprecisely, which leads the Court to misunderstand the argument it must confront. That argument is not that "there exist two distinct classes of agency interpretations," some "big, important ones" that "define the agency's 'jurisdiction,' " and other "humdrum, run-of-the-mill" ones that "are simply applications of jurisdiction the agency plainly has." Ibid. The argument is instead that a court should not defer to an agency on **1880 whether Congress has granted the agency interpretive authority over the statutory ambiguity at issue.*

You can call that "jurisdiction" if you'd like, as petitioners do in the question presented. But given that the term is ambiguous, more is required to understand its use in that question than simply "having read it." Ante, at 1873, n. 5. It is important to keep in mind that the term, in the present context, has the more precise meaning noted above, encompassing congressionally delegated authority to issue interpretations with the force and effect of law. See 668 F.3d 229, 248 (C.A.5 2012) (case below) ("The issue in the instant case is whether the FCC possessed statutory authority to administer § 332(c)(7)(B)(ii) and (v) by adopting the 90– and 150–day time frames"). And that has nothing do with whether the statutory provisions at issue are "big" or "small."

II

"It is emphatically the province and duty of the judicial department to say what the law is." Marbury v. Madison, 1 Cranch 137, 177, 2 L.Ed. 60 (1803). The rise of the modern administrative state has not changed that duty. Indeed, the Administrative Procedure Act, governing judicial review of most agency action, instructs reviewing courts to decide "all relevant questions of law." 5 U.S.C. § 706.

We do not ignore that command when we afford an agency's statutory interpretation Chevron deference; we respect it. We give binding deference to permissible agency interpretations of statutory ambiguities because Congress has delegated to the agency the authority to interpret those ambiguities "with the force of law." United States v. Mead Corp., 533 U.S. 218, 229, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001); see also Monaghan, Marbury and the Administrative State, 83 Colum. L.Rev. 1, 27–28 (1983) ("the court is not abdicating its constitutional duty to 'say what the law is' by deferring to agency interpretations of law: it is simply applying the law as 'made' by the authorized law-making entity").

*But before a court may grant such deference, it must on its own decide whether Congress—the branch vested with lawmaking authority under the Constitution—has in fact delegated to the agency lawmaking power over the ambiguity at issue. See ante, at 1876 (*BREYER, *J., concurring in part and concurring in judgment) ("The question whether Congress has delegated to an agency the authority to provide an interpretation that carries the force of law is for the judge to answer independently."). Agencies are creatures of Congress; "an agency literally has no power to act . . . unless and until Congress confers power upon it." Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374, 106 S.Ct. 1890, 90 L.Ed.2d 369 (1986). Whether Congress has conferred such power is the "relevant question[ ] of law" that must be answered before affording Chevron deference. 5 U.S.C. § 706.*

III

A

Our precedents confirm this conclusion—beginning with Chevron itself. In Chevron, the EPA promulgated a regulation interpreting the term "stationary sources" in the Clean Air Act. 467 U.S., at 840, 104 S.Ct. 2778 (quoting 42 U.S.C. § 7502(b)(6)(1982 ed.)). An environmental group petitioned for review of the rule, challenging it as an impermissible interpretation of the Act. 467 U.S., at 841, 859, 104 S.Ct. 2778. Finding the statutory text "not dispositive" and the legislative history "silent on the precise issue," we upheld the rule. Id., at 862, 866, 104 S.Ct. 2778.

In our view, the challenge to the agency's interpretation "center[ed] on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress." Id., at 866, 104 S.Ct. 2778. Judges, we said, "are not experts in the field, and are not part of either political branch of the Government." Id., at 865, 104 S.Ct. 2778. Thus, because Congress had not answered the specific question at issue, judges had no business providing their own resolution on the basis of their "personal policy preferences." Ibid. Instead, the "agency to which Congress ha[d] delegated policymaking responsibilities" was the appropriate political actor to resolve the competing interests at stake, "within the limits of that delegation." Ibid.

Chevron*'s rule of deference was based on—and limited by—this congressional delegation. And the Court did not ask simply whether Congress had delegated to the EPA the authority to administer the Clean Air Act generally. We asked whether Congress had "delegat[ed] authority to the agency to elucidate a specific provision of the statute by regulation." Id., at 843–844, 104 S.Ct. 2778 (emphasis added); see id., at 844, 104 S.Ct. 2778 (discussing "the legislative delegation to an agency on a particular question" (emphasis added)). We deferred to the EPA's interpretation of "stationary sources" based on our conclusion that the agency had*

been "charged with responsibility for administering the provision." Id., at 865, 104 S.Ct. 2778 (emphasis added).

B

We have never faltered in our understanding of this straightforward principle, that whether a particular agency interpretation warrants Chevron deference turns on the court's determination whether Congress has delegated to the agency the authority to interpret the statutory ambiguity at issue.

We made the point perhaps most clearly in Adams Fruit Co. v. Barrett, 494 U.S. 638, 110 S.Ct. 1384, 108 L.Ed.2d 585 (1990). In that case, the Department of Labor contended the Court should defer to its interpretation of the scope of the private right of action provided by the Migrant and Seasonal Agriculture Worker Protection Act (AWPA), 29 U.S.C. § 1854, against employers who intentionally violated the Act's motor vehicle safety provisions. We refused to do so. Although "as an initial matter" we rejected the idea that Congress left a "statutory 'gap' " for the agency to fill, we reasoned that if the "AWPA's language establishing a private right of action is ambiguous," the Secretary of Labor's interpretation of its scope did not warrant Chevron deference. 494 U.S., at 649, 110 S.Ct. 1384.

In language directly applicable to the question before us, we explained that "[a] precondition to deference under Chevron is a congressional delegation of administrative authority." Ibid. Although "Congress clearly envisioned, indeed expressly mandated, a role for the Department of Labor in administering the statute by requiring the Secretary to promulgate standards implementing AWPA's motor vehicle provisions," we found "[n]o such delegation regarding AWPA's enforcement provisions." Id., at 650, 110 S.Ct. 1384 (emphasis added). It would therefore be "inappropriate," we said, "to consult executive interpretations" of the enforcement provisions to resolve ambiguities "surrounding the scope of AWPA's judicially enforceable remedy." Ibid. Without questioning the principle that agency determinations "within the scope of delegated authority are entitled to deference," we explained that "it is fundamental 'that an agency may not bootstrap itself into an area in which it has no jurisdiction.'" Ibid. (quoting Federal Maritime Comm'n v. Seatrain Lines, Inc., 411 U.S. 726, 745, 93 S.Ct. 1773, 36 L.Ed.2d 620 (1973)).

Our subsequent cases follow the same approach. In United States v. Mead Corp., supra, for example, Chevron deference turned on whether Congress had delegated to the agency authority to interpret the statutory ambiguity by a particular means. The Customs Service had issued a "classification ruling," interpreting the term "diaries" in a tariff schedule to include "day planners" of the type Mead imported, and on that basis subjected the planners to a four-percent tariff. Mead protested the imposition of the tariff, the Customs Service claimed Chevron deference for its interpretation, and the controversy made its way to our Court. Id., at 224–226, 121 S.Ct. 2164.

In Mead, we again made clear that the "category of interpretative choices" to which Chevron deference applies is defined by congressional intent. Id., at 229, 121 S.Ct. 2164. Chevron deference, we said, rests on a recognition that Congress has delegated to an agency the interpretive authority to implement "a particular provision" or answer "'a particular question.' " Ibid. (quoting Chevron, 467 U.S., at 844, 104 S.Ct. 2778). An agency's interpretation of "a particular statutory provision" thus qualifies for Chevron deference only "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and

that the agency interpretation claiming deference was promulgated in the exercise of that authority." 533 U.S., at 226–227, 121 S.Ct. 2164.

The Court did not defer to the agency's views but instead determined that Congress had not delegated interpretive authority to the Customs Service to definitively construe the tariff schedule through classification rulings. Neither the statutory authorization for the classification rulings, nor the Customs Service's practice in issuing such rulings, "reasonably suggest[ed] that Congress ever thought of [such] classification rulings as deserving the deference claimed for them." Id., at 231, 121 S.Ct. 2164. And in the absence of such a delegation, we concluded the interpretations adopted in those rulings were "beyond the Chevron pale." Id., at 234, 121 S.Ct. 2164.

Gonzales v. Oregon, 546 U.S. 243, 126 S.Ct. 904, 163 L.Ed.2d 748 (2006), is in the same line of precedent. In that case, as here, deference turned on whether a congressional delegation of interpretive authority reached a particular statutory ambiguity. The Attorney General claimed Chevron deference for his interpretation of the phrase " legitimate medical purpose" in the Controlled Substances Act (CSA) to exclude the prescribing and dispensing of controlled substances for the purpose of assisting suicide. Id., at 254, 258, 126 S.Ct. 904. No one disputed that "legitimate medical purpose" was "ambiguous in the relevant sense." Id., at 258, 126 S.Ct. 904. Nor did any Justice dispute that the Attorney General had been granted the power in the CSA to promulgate rules with the force of law. Ibid.; see id., at 281, 126 S.Ct. 904 (SCALIA, J., dissenting). Nevertheless, the Court explained, "Chevron deference . . . is not accorded merely because the statute is ambiguous and an administrative official is involved." Id., at 258, 126 S.Ct. 904. The regulation advancing the interpretation, we said, "must be promulgated pursuant to authority Congress has delegated to the official." Ibid. (citing Mead, supra, at 226–227, 121 S.Ct. 2164).

In the CSA, Congress delegated to the Attorney General the authority to promulgate regulations "relating to the registration and control of the manufacture, distribution, and dispensing of controlled substances," 21 U.S.C. § 821, or "for the efficient execution of his functions under [the CSA]," § 871(b). After considering the text, structure, and purpose of the Act, the Court concluded on its own that interpreting "legitimate medical purpose" fell under neither delegation. Gonzales, 546 U.S., at 258–269, 126 S.Ct. 904. Because the regulation "was not promulgated pursuant to the Attorney General's authority, its interpretation of 'legitimate medical purpose' d[id] not receive Chevron deference." Id., at 268, 126 S.Ct. 904.

Adams Fruit, Mead, and Gonzales thus confirm that Chevron deference is based on, and finds legitimacy as, a congressional delegation of interpretive authority. An agency interpretation warrants such deference only if Congress has delegated authority to definitively interpret a particular ambiguity in a particular manner. Whether Congress has done so must be determined by the court on its own before Chevron can apply. See H. Edwards, L. Elliott, & M. Levy, Federal Courts Standards of Review 168 (2d ed. 2013) ("a court decides de novo whether an agency has acted within the bounds of congressionally delegated authority" (citing Mead, supra, at 226–227, 121 S.Ct. 2164, and Gonzales, supra, at 258, 126 S.Ct. 904)); Sales & Adler, The Rest is Silence: Chevron Deference, Agency Jurisdiction, and Statutory Silences, 2009 U. Ill. L.Rev. 1497, 1564 (2009) ("if delegation really is antecedent to deference, as Mead insists, it cannot be that courts should defer to an agency's views on whether a delegation has taken place").

In other words, we do not defer to an agency's interpretation of an ambiguous provision unless Congress wants us to, and whether Congress wants us to is a question that courts, not agencies, must decide. Simply put, that question is "beyond the Chevron pale." Mead, supra, at 234, 121 S.Ct. 2164

IV

Despite these precedents, the FCC argues that a court need only locate an agency and a grant of general rulemaking authority over a statute. Chevron deference then applies, it contends, to the agency's interpretation of any ambiguity in the Act, including ambiguity in a provision said to carve out specific provisions from the agency's general rulemaking authority. If Congress intends to exempt part of the statute from the agency's interpretive authority, the FCC says, Congress "can ordinarily be expected to state that intent explicitly." Brief for Federal Respondents 30 (citing American Hospital Assn. v. NLRB, 499 U.S. 606, 111 S.Ct. 1539, 113 L.Ed.2d 675 (1991)).

If a congressional delegation of interpretive authority is to support Chevron deference, however, that delegation must extend to the specific statutory ambiguity at issue. The appropriate question is whether the delegation covers the "specific provision" and "particular question" before the court. Chevron, 467 U.S., at 844, 104 S.Ct. 2778. A congressional grant of authority over some portion of a statute does not necessarily mean that Congress granted the agency interpretive authority over all its provisions. See Adams Fruit, 494 U.S., at 650, 110 S.Ct. 1384.

. . . When presented with an agency's interpretation of such a statute, a court cannot simply ask whether the statute is one that the agency administers; the question is whether authority over the particular ambiguity at issue has been delegated to the particular agency.

By the same logic, even when Congress provides interpretive authority to a single agency, a court must decide if the ambiguity the agency has purported to interpret with the force of law is one to which the congressional delegation extends. A general delegation to the agency to administer the statute will often suffice to satisfy the court that Congress has delegated interpretive authority over the ambiguity at issue. But if Congress has exempted particular provisions from that authority, that exemption must be respected, and the determination whether Congress has done so is for the courts alone.

The FCC's argument that Congress "can ordinarily be expected to state that intent explicitly," Brief for Federal Respondents [footnote omitted] (citing American Hospital, supra), goes to the merits of that determination, not to whether a court should decide the question de novo or defer to the agency. Indeed, that is how the Court in American Hospital considered it. It was in the process of "employing the traditional tools of statutory construction" that the Court said it would have expected Congress to speak more clearly if it had intended to exclude an entire subject area—employee units for collecting bargaining—from the NLRB's general rulemaking authority. Id., at 613, 614, 111 S.Ct. 1539. The Court concluded, after considering the language, structure, policy, and legislative history of the Act on its own—without deferring to the agency—that the meaning of the statute was "clear and contrary to the meaning advanced by petitioner." Id., at 609–614, 111 S.Ct. 1539. To be sure, the Court also noted that "[e]ven if we could find any ambiguity in [the provision] after employing the traditional tools of statutory construction, we would still defer to Board's reasonable

interpretation." Id., at 614, 111 S.Ct. 1539 (emphasis added). But that single sentence of dictum cannot carry the day for the FCC here.

. . . .

VI

The Court sees something nefarious behind the view that courts must decide on their own whether Congress has delegated interpretative authority to an agency, before deferring to that agency's interpretation of law. What is afoot, according to the Court, is a judicial power-grab, with nothing less than "Chevron itself" as "the ultimate target." Ante, at 1873.

The Court touches on a legitimate concern: Chevron importantly guards against the Judiciary arrogating to itself policymaking properly left, under the separation of powers, to the Executive. But there is another concern at play, no less firmly rooted in our constitutional structure. That is the obligation of the Judiciary not only to confine itself to its proper role, but to ensure that the other branches do so as well.

An agency's interpretive authority, entitling the agency to judicial deference, acquires its legitimacy from a delegation of lawmaking power from Congress to the Executive. Our duty to police the boundary between the Legislature and the Executive is as critical as our duty to respect that between the Judiciary and the Executive. See Zivotofsky v. Clinton, 566 U.S. ——, ——, 132 S.Ct. 1421, 1428, 182 L.Ed.2d 423 (2012). In the present context, that means ensuring that the Legislative Branch has in fact delegated lawmaking power to an agency within the Executive Branch, before the Judiciary defers to the Executive on what the law is. That concern is heightened, not diminished, by the fact that the administrative agencies, as a practical matter, draw upon a potent brew of executive, legislative, and judicial power. And it is heightened, not diminished, by the dramatic shift in power over the last 50 years from Congress to the Executive—a shift effected through the administrative agencies.

We reconcile our competing responsibilities in this area by ensuring judicial deference to agency interpretations under Chevron—but only after we have determined on our own that Congress has given interpretive authority to the agency. Our "task is to fix the boundaries of delegated authority," Monaghan, 83 Colum. L.Rev., at 27; that is not a task we can delegate to the agency. We do not leave it to the agency to decide when it is in charge.

[4] Treasury Policy Statement On The Tax Regulatory Process (2019).

Treasury published its Treasury Policy Statement On The Tax Regulatory Process on March 5, 2019.[591] The Policy Statement reaffirms the Treasury and Internal Revenue Service commitment to a tax regulatory process that encourages public participation, fosters transparency, affords fair notice, and ensures adherence to the rule of law.

[591] Treasury Policy Statement On The Tax Regulatory Process (March 5, 2019), https://home.treasury.gov/system/files/131/Policy-Statement-on-the-Tax-Regulatory-Process-3-4-19.pdf, accessed on August 23, 2024.

The Policy Statement comments with respect to the Administrative Procedure Act and notice and comment:

> *I. Commitment to Notice-and-Comment Rulemaking*
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> *The best practice for agency rulemaking is the notice-and-comment process established by the Administrative Procedure Act (APA). This process allows the public to participate before any final rule becomes effective and ensures that all views are adequately considered. It also enables the public to apprise the government of relevant information that the government may not possess or to alert the government to consequences that it may not foresee. The APA generally requires notice and comment for legislative rules.*
>
> *The APA exempts interpretive rules from notice-and-comment requirements. Nonetheless, as a matter of sound regulatory policy, the Treasury Department and the IRS will continue to adhere to their longstanding practice of using the notice-and-comment process for interpretive tax rules published in the Code of Federal Regulations.*

The Policy Statement provides with respect to temporary regulations:

> *II. Limited Use of Temporary Regulations*
>
> *Under the APA, if an agency finds that it has "good cause" to do so, it may issue an interim final rule that becomes effective immediately without notice and comment. The interim final rule must be promulgated with a statement of good cause explaining the basis for that finding. The Treasury Department and the IRS have long interpreted the Internal Revenue Code, however, to permit the issuance of immediately-effective temporary tax regulations without a statement of good cause. As a matter of sound regulatory policy, the Treasury Department and the IRS commit to include a statement of good cause when issuing any future temporary regulations under the Internal Revenue Code. In certain exceptional circumstances, sound tax administration may require temporary regulations to be issued without notice and comment. For example, such regulations may be necessary and appropriate to stop abusive practices or to immediately resolve an injurious inconsistency between existing regulations and a new statute or judicial decision. When sound tax administration does warrant temporary regulations, the Treasury Department and the IRS will make their reasons for issuing such immediately-effective regulations clear by including a statement of good cause in the preamble.*
>
> *The Treasury Department and the IRS will also continue to adhere to other limitations in the Internal Revenue Code, which mandate that temporary regulations must expire within three years of issuance and that proposed regulations must be issued simultaneously with any temporary regulations. These limitations ensure that, even where good cause justifies immediate action without notice and comment, any resulting final regulations will be subject to notice and comment.*

The Policy Statement provides this with respect to subregulatory guidance documents:

II. Proper Scope of Subregulatory Guidance Documents

In addition to formal regulations that carry the force and effect of law, sound tax administration necessitates less formal guidance to efficiently advise the public about the meaning of the tax laws. The Treasury Department and the IRS use a variety of forms of guidance to interpret and implement federal tax laws, including revenue rulings, revenue procedures, notices, and announcements.[1] [[1] For the purpose of this policy statement, "subregulatory guidance" means subregulatory guidance published in the Internal Revenue Bulletin. The following types of subregulatory guidance are published in the Internal Revenue Bulletin: revenue rulings, revenue procedures, notices, and announcements. This policy statement does not apply to regulations issued jointly with the Department of Health and Human Services and the Department of Labor under 26 U.S.C. § 9833.] Such guidance often provides taxpayers much-needed clarity and certainty concerning the legal interpretation that the IRS intends to apply, and taxpayers thus regularly request such guidance.

Subregulatory guidance is not intended to affect taxpayer rights or obligations independent from underlying statutes or regulations. Unlike statutes and regulations, subregulatory guidance does not have the force and effect of law. Taxpayers can have confidence, however, that the IRS will not take positions inconsistent with its subregulatory guidance when such guidance is in effect. In applying subregulatory guidance, the effect of subsequent legislation, court decisions, rulings, and procedures must be considered.

When proper limits are observed, subregulatory guidance can provide taxpayers the certainty required to make informed decisions about their tax obligations. Such guidance cannot and should not, however, be used to modify existing legislative rules or create new legislative rules. The Treasury Department and the IRS will adhere to these limits and will not argue that subregulatory guidance has the force and effect of law. In litigation before the U.S. Tax Court, as a matter of policy, the IRS will not seek judicial deference under Auer v. Robbins, 519 U.S. 452 (1997) or Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), to interpretations set forth only in subregulatory guidance.

In deciding whether to issue regulations or subregulatory guidance, the Treasury Department and the IRS must consider the content and nature of the interpretation or position being announced. Factors to be considered include the intended effect on taxpayers' rights or duties, the need for public comments, the form and content of prior positions, the significance of the issues, the statutory framework, and whether the interpretation or position is of short-term or long-term value. After weighing relevant factors, if the intended interpretation or position would have the effect of modifying existing legislative rules or creating new legislative rules on matters not addressed in existing regulations, the interpretation or position will generally be issued through notice-and-comment rulemaking, absent exceptional circumstances. Where the Treasury Department and the IRS intend to provide only an interpretation of existing law applied to a limited set of facts, a statutorily prescribed form of relief, a statement of agency procedure or practice, a public announcement of intent to issue proposed legislative rules, or an

announcement that has only immediate or short-term value, the intended interpretation or position will generally be issued as subregulatory guidance rather than through notice-and-comment rulemaking.

[5] Kisor v Wilkie (2019): Deference to Agency Interpretations of Its Regulations.

A court generally will give great deference to an administrative agency's interpretation of its own rules and regulations[592] In *Kisor v. Wilkie*,[593] the Supreme Court held that *Auer* deference to agencies' reasonable readings of genuinely ambiguous regulations retains an important role in construing agency regulations. *Auer* deference applies only when there is genuine ambiguity. Courts must apply normal tools of construction and interpretation (such as text, structure, history, and purpose of the regulation) before the courts determine that authority is ambiguous. Courts first should apply traditional tools of construction. Agency constructions of ambiguous regulations do not receive greater deference under *Auer* than agency constructions of statutes. *Auer* deference applies only to authoritative administrative agency interpretations. Interpretations must show the fair and considered judgment of the administrative agency. *Kisor v. Wilkie* was determined on a 5-4 vote at the Supreme Court. The Supreme Court appeared close to overruling *Auer* deference. The status of *Kisor* after *Loper Bright Enterprises* is uncertain. Kisor may be distinguishable from *Loper Bright Enterprises* since *Kisor* dealt with an agency's interpretation of its own regulations and not the agency's interpretation of a statute. Nevertheless, *Loper Bright Enterprises* may implicitly overrule *Kisor*.

James Kisor, a Vietnam War veteran, first sought disability benefits from the Department of Veterans Affairs in 1982, alleging that he had developed post-traumatic stress disorder from his military service.

The agency denied his initial request, but in 2006, Kisor moved to reopen his claim. The Veteran's Administration this time agreed Mr. Kisor was eligible for benefits, but the Veterans Administration granted those benefits only from the date of his motion to reopen, not (as Kisor had requested) from the date of his first application.

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[592] See *PLIVA, Inc. v. Mensing*, 131 S. Ct. 2567, 2575 (2011); *Federal Exp. Corp. v. Holowecki*, 552 U.S. 389 (2008) *Encarnacion ex rel. George v. Barnhart*, 331 F.3d 78, 86 (2d Cir. 2003); *Leia v. Ashcroft*, 393 F.3d 427 (3d Cir. 2005). *See Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413,14 (1945) ("Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt. The intention of Congress or the principles of the Constitution in some situations may be relevant in the first instance in choosing between various constructions. But the ultimate criterion is the interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation. . . Our only tools, therefore, are the plain words of the regulation and any relevant interpretation of the Administrator.")

[593] 588 U.S. 558 (2019).

The Board of Veterans' Appeals—a part of the Veteran's Administration—affirmed that retroactivity decision, based on its interpretation of an agency rule governing such claims.

The Court of Appeals for Veterans Claims affirmed. The Federal Circuit also affirmed. The Federal Circuit applied *Auer* deference. *Kisor v. White* established these principles for respecting an agency interpretation of an agency rule:

- The regulation must be genuinely ambiguous.
- The agency interpretation must be reasonable.
- The character and context of the agency interpretation must justify deference. The interpretation must be –
  - authoritative,
  - within the agency expertise, and
  - representative of fair and considered judgment.

Under the doctrine of *Auer* deference, the Supreme Court has long deferred to an agency's reasonable reading of its own genuinely ambiguous regulations. The Court of Appeals concluded that the Veteran's Administration regulation at issue was ambiguous. The Court of Appeals therefore deferred to the Board's interpretation of the rule. Kisor asked the Supreme Court to overrule *Auer*, as well as its predecessor *Seminole Rock*, discarding the deference those decisions give to agencies.

The Supreme Court held that *Auer* and *Seminole Rock* are not overruled. The Supreme Court stressed that "the possibility of deference can arise only if a regulation is genuinely ambiguous."

According to the Supreme Court in *Kisor*,

> *In each case, interpreting the regulation involves a choice between (or among) more than one reasonable reading. To apply the rule to some unanticipated or unresolved situation, the court must make a judgment call. How should it do so?*[594]

Courts will generally defer to an agency in interpreting the agency's regulation (*Auer* deference) unless the agency's interpretation is clearly erroneous:

> *In answering that question, we have often thought that a court should defer to the agency's construction of its own regulation. For the last 20 or so years, we have referred to that doctrine as Auer deference, and applied it often. [Footnote omitted.] But the name is something of a misnomer. Before the doctrine was called Auer deference, it was called Seminole Rock deference—for the 1945 decision in which we declared that when "the meaning of [a regulation] is in doubt," the agency's interpretation "becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation." 325 U.S. at 414, 65 S.Ct. And Seminole Rock itself*

[594] 588 U.S. at 568.

was not built on sand. Deference to administrative agencies traces back to the late nineteenth century, and perhaps beyond. See United States v. Eaton, 169 U.S. 331, 343, 18 S.Ct. 374, 42 L.Ed. 767 (1898) ("The interpretation given to the regulations by the department charged with their execution . . . is entitled to the greatest weight"); [citations omitted].

We have explained Auer deference (as we now call it) as rooted in a presumption about Congressional intent—a presumption that Congress would generally want the agency to play the primary role in resolving regulatory ambiguities. [Citation omitted.] Congress, we have pointed out, routinely delegates to agencies the power to implement statutes by issuing rules. [Citation omitted.] In doing so, Congress knows (how could it not?) that regulations will sometimes contain ambiguities. [Citation omitted.] But Congress almost never explicitly assigns responsibility to deal with that problem, either to agencies or to courts. Hence the need to presume, one way or the other, what Congress would want. And as between those two choices, agencies have gotten the nod. We have adopted the presumption—though it is always rebuttable—that "the power authoritatively to interpret its own regulations is a component of the agency's delegated lawmaking powers." [Citation omitted.] Or otherwise said, we have thought that when granting rulemaking power to agencies, Congress usually intends to give them, too, considerable latitude to interpret the ambiguous rules they issue. [595]

The agency that proposed promulgated the regulation generally knows best how to interpret the regulation. "The drafters will know what it was supposed to include or exclude or how it was supposed to apply to some problem."

In part, that is because the agency that promulgated a rule is in the "better position [to] reconstruct" its original meaning. [Citation omitted.] Consider that if you don't know what some text (say, a memo or an e-mail) means, you would probably want to ask the person who wrote it. And for the same reasons, we have thought, Congress would too (though the person is here a collective actor). The agency that "wrote the regulation" will often have direct insight into what that rule was intended to mean. [Citation omitted.] The drafters will know what it was supposed to include or exclude or how it was supposed to apply to some problem. To be sure, this justification has its limits. It does not work so well, for example, when the agency failed to anticipate an issue in crafting a rule (e.g., if the agency never thought about whether and when chest X-rays would count as a "diagnosis"). [Citation omitted.] Then, the agency will not be uncovering a specific intention; at most (though this is not nothing), it will be offering insight into the analogous issues the drafters considered and the purposes they designed the regulation to serve. And the defense works yet less well when lots of time has passed between the rule's issuance and its interpretation—especially if the interpretation differs from one that has come before. All that said, the point holds good for a significant category of "contemporaneous" readings. [Citation omitted.] Want to know what a rule means? Ask its author.

In still greater measure, the presumption that Congress intended Auer deference stems from the awareness that resolving genuine regulatory ambiguities often "entail[s] the exercise of judgment grounded in policy concerns." [Citation omitted.] Return to our TSA example. [Citation omitted.] In most of their applications, terms like "liquids" and "gels" are clear enough. (Traveler checklist: Pretzels OK; water not.) But resolving the uncertain issues—the truffle pâtés or olive tapenades of the world—requires getting in the

[595] 588 U.S. at 568-570.

weeds of the rule's policy: Why does TSA ban liquids and gels in the first instance? What makes them dangerous? Can a potential hijacker use pâté jars in the same way as soda cans? Or take the less specialized-seeming ADA example. [Citation omitted.] It is easy enough to know what "comparable lines of sight" means in a movie theater—but more complicated when, as in sports arenas, spectators sometimes stand up. How costly is it to insist that the stadium owner take that sporadic behavior into account, and is the viewing value received worth the added expense? That cost-benefit calculation, too, sounds more in policy than in law. Or finally, take the more technical "moiety" example. [Citation omitted.] Or maybe, don't. If you are a judge, you probably have no idea of what the FDA's rule means, or whether its policy is implicated when a previously approved moiety is connected to lysine through a non-ester covalent bond. [596]

Agencies have unique expertise, often of a scientific or technical nature, relevant to applying a regulation "to complex or changing circumstances." Agencies can conduct factual investigations, can consult with affected parties, can consider how their experts have handled similar issues over the long course of administering a regulatory program. Agencies also have political accountability.

And Congress, we have thought, knows just that: It is attuned to the comparative advantages of agencies over courts in making such policy judgments. Agencies (unlike courts) have "unique expertise," often of a scientific or technical nature, relevant to applying a regulation "to complex or changing circumstances." [Citation omitted.] Agencies (unlike courts) can conduct factual investigations, can consult with affected parties, can consider how their experts have handled similar issues over the long course of administering a regulatory program. [Citation omitted.] And agencies (again unlike courts) have political accountability, because they are subject to the supervision of the President, who in turn answers to the public. [Citation omitted.] It is because of those features that Congress, when first enacting a statute, assigns rulemaking power to an agency and thus authorizes it to fill out the statutory scheme. And so too, when new issues demanding new policy calls come up within that scheme, Congress presumably wants the same agency, rather than any court, to take the laboring oar. [597]

Accepting agency interpretation also supports uniformity.

Finally, the presumption we use reflects the well-known benefits of uniformity in interpreting genuinely ambiguous rules. We have noted Congress' frequent "preference for resolving interpretive issues by uniform administrative decision, rather than piecemeal by litigation." [Citation omitted.] That preference may be strongest when the interpretive issue arises in the context of a "complex and highly technical regulatory program." [Citation omitted.] After all, judges are most likely to come to divergent conclusions when they are least likely to know what they are doing. (Is there anything to be said for courts all over the country trying to figure out what makes for a new active moiety?) But the uniformity justification retains some weight even for more accessible rules, because their language too may give rise to more than one eminently reasonable reading. Consider Auer itself. [Citation omitted.] There, four Circuits held that police captains were "subject to" pay deductions for disciplinary infractions if a police manual said they were, even if the department had never docked anyone. Two other Circuits held that captains were "subject to" pay deductions only if the department's actual practice made

[596] 588 U.S. at 570-571.

[597] 588 U.S. at 571-572.

that punishment a realistic possibility. [Citation omitted.] Had the agency issued an interpretation before all those rulings (rather than, as actually happened, in a brief in this Court), a deference rule would have averted most of that conflict and uncertainty. [Citation omitted.] Auer deference thus serves to ensure consistency in federal regulatory law, for everyone who needs to know what it requires. [598]

Auer deference to agency interpretation of their regulations does not answer every question of interpretation. Deference only arises when a regulation is genuinely ambiguous. Also, "courts should not give deference to an agency's reading, except to the extent it has the 'power to persuade.'" *Auer* deference will not apply "when a court concludes that an interpretation does not reflect an agency's authoritative, expertise-based, 'fair[, or] considered judgment.'"

But all that said, Auer deference is not the answer to every question of interpreting an agency's rules. Far from it. As we explain in this section, the possibility of deference can arise only if a regulation is genuinely ambiguous. And when we use that term, we mean it—genuinely ambiguous, even after a court has resorted to all the standard tools of interpretation. Still more, not all reasonable agency constructions of those truly ambiguous rules are entitled to deference. As just explained, we presume that Congress intended for courts to defer to agencies when they interpret their own ambiguous rules. [Citation omitted.] But when the reasons for that presumption do not apply, or countervailing reasons outweigh them, courts should not give deference to an agency's reading, except to the extent it has the "power to persuade." [Citation omitted.] We have thus cautioned that Auer deference is just a "general rule"; it "does not apply in all cases." [Citation omitted.] And although the limits of Auer deference are not susceptible to any rigid test, we have noted various circumstances in which such deference is "unwarranted." [Citation omitted.] In particular, that will be so when a court concludes that an interpretation does not reflect an agency's authoritative, expertise-based, "fair[, or] considered judgment." [Citation omitted.] [599]

Auer deference will not apply when an agency's construction is "plainly erroneous or inconsistent with the regulation,"

We take the opportunity to restate, and somewhat expand on, those principles here to clear up some mixed messages we have sent. At times, this Court has applied Auer deference without significant analysis of the underlying regulation. [Reference omitted.] At other times, the Court has given Auer deference without careful attention to the nature and context of the interpretation. [Citation omitted.] And in a vacuum, our most classic formulation of the test— whether an agency's construction is "plainly erroneous or inconsistent with the regulation," [citation omitted]—may suggest a caricature of the doctrine, in which deference is "reflexive." [Citation omitted.] So we cannot deny that Kisor has a bit of grist for his claim that Auer "bestows on agencies expansive, unreviewable" authority. [Citation omitted.] But in fact Auer does no such thing: It gives agencies their due, while also allowing—indeed, obligating—courts to perform their reviewing and restraining functions.

[598] 588 U.S. at 572-73.

[599] 588 U.S. at 573-574.

So before we turn to Kisor's specific grievances, we think it worth reinforcing some of the limits inherent in the Auer doctrine. [Citation omitted.] [600]

Auer deference depends on the regulation being genuinely ambiguous:

First and foremost, a court should not afford Auer deference unless the regulation is genuinely ambiguous. [Citation omitted.] If uncertainty does not exist, there is no plausible reason for deference. The regulation then just means what it means—and the court must give it effect, as the court would any law. Otherwise said, the core theory of Auer deference is that sometimes the law runs out, and policy-laden choice is what is left over. [Citation omitted.] But if the law gives an answer—if there is only one reasonable construction of a regulation—then a court has no business deferring to any other reading, no matter how much the agency insists it would make more sense. Deference in that circumstance would "permit the agency, under the guise of interpreting a regulation, to create de facto a new regulation." [Citation omitted.] Auer does not, and indeed could not, go that far. [601]

To conclude that a rule is ambiguous, a court must exhaust traditional tools of construction:

And before concluding that a rule is genuinely ambiguous, a court must exhaust all the "traditional tools" of construction. [Citation omitted.] For again, only when that legal toolkit is empty and the interpretive question still has no single right answer can a judge conclude that it is "more [one] of policy than of law." [Citation omitted.] That means a court cannot wave the ambiguity flag just because it found the regulation impenetrable on first read. Agency regulations can sometimes make the eyes glaze over. But hard interpretive conundrums, even relating to complex rules, can often be solved. [Citation omitted.] To make that effort, a court must "carefully consider[ ]" the text, structure, history, and purpose of a regulation, in all the ways it would if it had no agency to fall back on. [Citation omitted.] Doing so will resolve many seeming ambiguities out of the box, without resort to Auer deference. [602]

If the rule is ambiguous, the court will defer to the agency interpretation if the agency interpretation is reasonable.

If genuine ambiguity remains, moreover, the agency's reading must still be "reasonable." [Citation omitted.] In other words, it must come within the zone of ambiguity the court has identified after employing all its interpretive tools. (Note that serious application of those tools therefore has use even when a regulation turns out to be truly ambiguous. The text, structure, history, and so forth at least establish the outer bounds of permissible interpretation.) Some courts have thought (perhaps because of Seminole Rock's "plainly erroneous" formulation) that at this stage of the analysis, agency constructions of rules receive greater deference than agency constructions of statutes. [Citation omitted.] But that is not so. Under Auer, as under Chevron, the agency's

[600] 588 U.S. at 574.
[601] 588 U.S. at 574-75.
[602] 588 U.S. at 575.

reading must fall "within the bounds of reasonable interpretation." [Citation omitted.] And let there be no mistake: That is a requirement an agency can fail. [603]

Not all agency interpretations of genuinely ambiguous rules are entitled to *Auer* deference.

Still, we are not done—for not every reasonable agency reading of a genuinely ambiguous rule should receive Auer deference. We have recognized in applying Auer that a court must make an independent inquiry into whether the character and context of the agency interpretation entitles it to controlling weight. [Citation omitted.] As explained above, we give Auer deference because we presume, for a set of reasons relating to the comparative attributes of courts and agencies, that Congress would have wanted us to. [Citation omitted.] But the administrative realm is vast and varied, and we have understood that such a presumption cannot always hold. [Citation omitted.] The inquiry on this dimension does not reduce to any exhaustive test. But we have laid out some especially important markers for identifying when Auer deference is and is not appropriate. [604]

For *Auer* deference, the regulatory interpretation must be the authoritative position of the agency.

To begin with, the regulatory interpretation must be one actually made by the agency. In other words, it must be the agency's "authoritative" or "official position," rather than any more ad hoc statement not reflecting the agency's views. [Citation omitted.] That constraint follows from the logic of Auer deference—because Congress has delegated rulemaking power, and all that typically goes with it, to the agency alone. Of course, the requirement of "authoritative" action must recognize a reality of bureaucratic life: Not everything the agency does comes from, or is even in the name of, the Secretary or his chief advisers. So, for example, we have deferred to "official staff memoranda" that were "published in the Federal Register," even though never approved by the agency head. [Citation omitted.] But there are limits. The interpretation must at the least emanate from those actors, using those vehicles, understood to make authoritative policy in the relevant context. [Citation omitted.] If the interpretation does not do so, a court may not defer. [605]

For *Auer* deference, the agency's interpretation must in some way implicate its substantive expertise. When the agency has no comparative expertise in resolving a regulatory ambiguity, *Auer* deference will not apply.

Next, the agency's interpretation must in some way implicate its substantive expertise. Administrative knowledge and experience largely "account [for] the presumption that Congress delegates interpretive lawmaking power to the agency." [Citation omitted.] So the basis for deference ebbs when "[t]he subject matter of the [dispute is] distan[t] from the agency's ordinary" duties or "fall[s] within the scope of another agency's authority." [Citation omitted.] This Court indicated as much when it analyzed a "split enforcement" scheme, in which Congress divided regulatory power between two entities. [Citation omitted.] To decide "whose reasonable interpretation" of a rule controlled, we "presum[ed] Congress intended to invest interpretive power"

[603] 588 U.S. at 575-76.
[604] 588 U.S. at 576-77.
[605] 588 U.S. at 577.

in whichever actor was "best position[ed] to develop" expertise about the given problem. [Citation omitted.] The same idea holds good as between agencies and courts. "Generally, agencies have a nuanced understanding of the regulations they administer." [Citation omitted.] That point is most obvious when a rule is technical; think back to our "moiety" or "diagnosis" examples. [Citation omitted.] But more prosaic-seeming questions also commonly implicate policy expertise; consider the TSA assessing the security risks of pâté or a disabilities office weighing the costs and benefits of an accommodation. [Citation omitted.] Once again, though, there are limits. Some interpretive issues may fall more naturally into a judge's bailiwick. Take one requiring the elucidation of a simple common-law property term, [citation omitted], or one concerning the award of an attorney's fee, [citation omitted]. [Citation omitted.] When the agency has no comparative expertise in resolving a regulatory ambiguity, Congress presumably would not grant it that authority. [Footnote omitted.][606]

For *Auer* deference, an agency's reading of a rule must reflect "fair and considered judgment." A court may not defer to a new interpretation that creates "unfair surprise" to regulated parties. An agency interpretation that conflicts with a prior agency determination is unlikely to receive *Auer* deference. A court may not defer to an interpretation that would have imposed retroactive liability on parties for longstanding conduct that the agency had never before addressed. Lack of "fair warning" can prevent *Auer* deference to an agency interpretation.

Finally, an agency's reading of a rule must reflect "fair and considered judgment" to receive Auer deference. [Citation omitted.] That means, we have stated, that a court should decline to defer to a merely "convenient litigating position" or "post hoc rationalizatio[n] advanced" to "defend past agency action against attack." [Citation and footnote omitted.] And a court may not defer to a new interpretation, whether or not introduced in litigation, that creates "unfair surprise" to regulated parties. [Citation omitted.] That disruption of expectations may occur when an agency substitutes one view of a rule for another. We have therefore only rarely given Auer deference to an agency construction "conflict[ing] with a prior" one. [Citation omitted.] Or the upending of reliance may happen without such an explicit interpretive change. This Court, for example, recently refused to defer to an interpretation that would have imposed retroactive liability on parties for longstanding conduct that the agency had never before addressed. [Citation omitted.] Here too the lack of "fair warning" outweighed the reasons to apply Auer. [Citation omitted.][607]

Auer deference gives an agency significant leeway to say what its own rules mean. This enables the agency to fill out the regulatory scheme Congress has placed under its supervision. *Auer* deference often does not apply. "What emerges is a deference doctrine not quite so tame as some might hope, but not nearly so menacing as they might fear."

When it applies, Auer deference gives an agency significant leeway to say what its own rules mean. In so doing, the doctrine enables the agency to fill out the regulatory scheme Congress has placed under its supervision. But that phrase "when it applies" is important—because it often doesn't. As described above, this Court has cabined Auer's scope in varied and critical ways—and in exactly that measure, has maintained a

[606] 588 U.S. at 577-578.

[607] 588 U.S. at 579.

strong judicial role in interpreting rules. What emerges is a deference doctrine not quite so tame as some might hope, but not nearly so menacing as they might fear.[608]

[6] Mayo Foundation for Medical Education and Research v. United States (2021): Applied Chevron Deference to Interpretive Regulations.

Mayo Foundation for Medical Research v. United States,[609] rejected a lesser standard of deference for interpretive regulations than for legislative regulations. The Supreme Court subjected all regulations, whether interpretive or legislative, to *Chevron*[610] deference.

According to *Mayo Foundation*, "[t]he principles underlying our decision in *Chevron* apply with full force in the tax context." *Mayo Foundation* applied *Chervon* deference both to legislative regulations and to interpretive regulations: "[t]he principles underlying our decision in *Chevron* apply with full force in the tax context." *Mayo Foundation* rejected to concept of a tax exceptionalism that would exempt tax regulations from the general requirements for agency regulations.

Mayo Foundation clarified that tax regulations were subject to the Administrative Procedure Act. This included both the notice and comment requirement and the requirement that the Internal Revenue Service much provide reasoned explanations of its regulations. Failure to provide reasoned explanations potentially subjects Treasury Regulation to the argument that Treasury and the Internal Revenue Service acted arbitrarily and capriciously in adopting regulations. The obligation to explain agency actions places a considerable burden on Treasury and the Internal Revenue Service, since Treasury Regulations are often both extensive and extensive. The requirement of providing reasoned explanations may be difficult for Treasury and the Internal Revenue Service to satisfy in the future and may provide a vulnerability of many past regulations.

Mayo Foundation did not advance any justification for applying a less deferential standard of review to Treasury Department regulations than to the rules of any other agency. In the absence of such justification, the Supreme Court in *Mayo Foundation* was not inclined to carve out an approach to administrative review good for tax law only. The court expressly"[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action." *Mayo Foundation* indicated that the Supreme Court was "not inclined to carve out an approach to administrative review good for tax law only."[611]

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[608] 588 U.S. at 580.

[609] 562 U.S. 44 (2011).

[610] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[611] 562 U.S. at 55.

In *Mayo Foundation for Medical Education and Research v. United States*,[612] the United States Supreme Court held that the Treasury regulations that excluded medical residents from the student exception to Federal Insurance Contributions Act taxation were a reasonable interpretation of Section 3121(b)(10).

The Treasury Department rule provided that, if a person was scheduled to work more than 40 hours a week for an educational institution, that work could not be considered exempt from taxation under the Federal Insurance Contributions Act as "incident to and for purpose of pursuing a course of study." This rule was promulgated under the general authority of Section 7805(a). The Supreme Court in *Mayo Foundation* applied the two-prong test developed in *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*[613]

Chevron deference is appropriate under *Mead* "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." The delegation of authority may be either general or specific.

The Supreme Court in *Mayo Foundation* first found that Section 3121(b)(10) was ambiguous. Section 3121(b)(10) does not define "student" or the application of the term to medical residents.

The second prong of the *Chevron* test asks whether the agency rule is a "reasonable interpretation" of the statute. The Supreme Court in *Mayo Foundation* found that the Federal Insurance Contributions Act rule was a "reasonable interpretation" of the statute. The "rule takes into account the Social Security Administration's concern that exempting residents from the Federal Insurance Contributions Act would deprive residents and their families of vital disability and survivorship benefits that Social Security provides."

The Mayo Foundation offers residency programs to doctors for additional instruction in a chosen specialty. Those programs train doctors primarily through hands-on experience. Residents are required to take part in formal educational activities. These doctors generally spend the bulk of their time typically 50 to 80 hours a week caring for patients. Mayo pays Foundation pays its residents annual "stipends" of over $40,000 and also provides them with health insurance, malpractice insurance, and paid vacation time.

The Federal Insurance Contributions Act requires employees and employers to pay taxes on all "wages" employees receive.[614] The Federal Insurance Contributions Act defines "wages" to include "all remuneration for employment."[615]. The Federal Insurance Contributions Act defines "employment" as "any service . . . performed . . . by an employee

[612] 562 U.S. 44 (2011).

[613] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[614] 26 U.S.C. §§ 3101(a), 3111(a).

[615] 26 U.S.C. § 3121(a).

for the person employing him."[616] The Federal Insurance Contributions Act excludes from taxation any "service performed in the employ of . . . a school, college, or university . . . if such service is performed by a student who is enrolled and regularly attending classes at [the school]."[617]

Since 1951, the Treasury Department had construed the student exception to exempt from taxation students who work for their schools "as an incident to and for the purpose of pursuing a course of study."[618]

In 2004, the Department issued regulations providing that "[t]he services of a full-time employee" which includes an employee normally scheduled to work 40 hours or more per week "are not incident to and for the purpose of pursuing a course of study."[619] The Department explained that this analysis "is not affected by the fact that the services . . . may have an educational, instructional, or training aspect."[620] The rule offers as an example a medical resident whose normal schedule requires him to perform services 40 or more hours per week, and concludes that the resident is not a student.

Mayo Foundation filed suit asserting that this rule was invalid.

The District Court agreed that the rue was invalid. The District Court in *Mayo Foundation* found the full-time employee rule inconsistent with Section 3121's unambiguous text. The District Court in *Mayo Foundation* concluded that the factors governing the Court's analysis in *National Muffler Dealers Assn., Inc. v. United States*[621] also indicated that the rule was invalid.

The Eighth Circuit reversed in *Mayo Foundation*. Applying *Chevron U.S. A. Inc. v. Natural Resources Defense Council, Inc.,*[622] the Court of Appeals concluded that the Department's regulation was a permissible interpretation of an ambiguous statute.

The Supreme Court in *Mayo Foundation* began its analysis by asking whether Congress has "directly addressed the precise question at issue." The Supreme Court agreed with the Court of Appeals in *Mayo Foundation* that Congress had not done so. The statute does not define the term "student," and does not otherwise attend to the precise question whether medical residents are subject to Federal Insurance Contributions Act.[623]

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[616] 26 § 3121(b).

[617] 26 § 3121(b)(10).

[618] 16 Fed. Reg. 12474.

[619] 26 CFR § 31.3121(b)(10)-2(d)(3)(iii).

[620] *Id.*

[621] 440 U.S. 472.

[622] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[623] See 26 U.S.C. § 3121(b)(10).

Mayo Foundation contended that the Treasury Department's full-time employee rule must be rejected under *Chevron* step one. Mayo Foundation argued that the dictionary definition of "student" one "who engages in 'study' by applying the mind 'to the acquisition of learning, whether by means of books, observation, or experiment'" plainly encompasses residents. Residents are not excluded from that category by the only limitation on students Congress has imposed under the statute that they "be 'enrolled and regularly attending classes at [a] school.'"

Mayo Foundation's reading does not eliminate the statute's ambiguity as applied to working professionals. Mayo Foundation acknowledged that a full-time professor taking evening classes a person who presumably would satisfy the statute's class-enrollment requirement and apply his mind to learning could be excluded from the exemption and taxed because he is not "'predominant[ly]'" a student. Medical residents might likewise be excluded on the same basis; the statute itself does not resolve the ambiguity.

The District Court interpreted Section 3121(b)(10) as unambiguously foreclosing the Department's rule by mandating that an employee be deemed "a 'student' so long as the educational aspect of his service predominates over the service aspect of the relationship with his employer."[624] The Supreme Court observed that the statutory text still would offer no insight into how Congress intended predominance to be determined or whether Congress thought that medical residents would satisfy the requirement.

To the extent Congress has specifically addressed medical residents in Section 3121, it expressly excluded these doctors from exemptions they might otherwise invoke.[625] That choice casts doubt on any claim that Congress specifically intended to insulate medical residents from FICA's reach in the first place.

Neither the plain text of the statute nor the District Court's interpretation of the exemption "speak[s]with the precision necessary to say definitively whether [the statute] applies to" medical residents.[626]

In the typical case, such an ambiguity would lead us inexorably to *Chevron* step two, under which we may not disturb an agency rule unless it is "'arbitrary or capricious in substance, or manifestly contrary to the statute.'" Household Credit Services, Inc. v. Pfennig, 541 U.S. 232, 242 (2004) (quoting United States v. Mead Corp., 533 U.S. 218, 227 (2001)). In this case, however, the parties disagree over the proper framework for evaluating an ambiguous provision of the Internal Revenue Code.

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[624] 503 F. Supp. 2d, at 1175.

[625] See 26 U.S. C. §§ 3121(b)(6)(B), (7)(C)(ii) (excluding medical residents from exemptions available to employees of the District of Columbia and the United States).

[626] *United States v. Eurodif S. A.*, 555 U.S. ___, ___ (2009) (slip op., at 13).

Mayo Foundation asks us to apply the multi-factor analysis we used to review a tax regulation in *National Muffler*.[627] There the Supreme Court explained:

> *A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of Congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent reenactments of the statute.*[628]

The Government, on the other hand, contended that the *National Muffler* standard has been superseded by *Chevron*. The sole question for the Court at step two under the *Chevron* analysis is "whether the agency's answer is based on a permissible construction of the statute."[629]

National Muffler and *Chevron* call for different analyses of an ambiguous statute.

Under *National Muffler*, a court might view an agency's interpretation of a statute with heightened skepticism

- when it has not been consistent over time,
- when it was promulgated years after the relevant statute was enacted, or
- because of the way in which the regulation evolved.[630]

Under *Chevron*, deference to an agency's interpretation of an ambiguous statute does not turn on such considerations.

"Agency inconsistency is not a basis for declining to analyze the agency's interpretation under the *Chevron* framework."[631]

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[627] 440 U.S. 472

[628] *Id.*, at 477.

[629] 467 U.S., at 843. Since deciding *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024), the Supreme Court has cited both *National Muffler* and *Chevron* in review of Treasury Department regulations. *See, e.g., United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001), *citing National Muffler*; *Cottage Savings Assn. v. Commissioner*, 499 U.S. 554, 560-561 (1991) (same); *United States v. Boyle*, 469 U.S. 241, 246, n. 4 (1985) (citing *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024)); *see also Atlantic Mut. Ins. Co. v. Commissioner*, 523 U.S. 382, 387, 389 (1998) (citing *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024) and *Cottage Savings*).

[630] 440 U.S. at 477.

[631] *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967, 981 (2005).

"[N]either antiquity nor contemporaneity with [a] statute is a condition of [a regulation's] validity."[632] It is immaterial that a "regulation was prompted by litigation."[633] In *United Dominion Industries, Inc. v. United States*,[634] the court invited the Treasury Department to "amend its regulations" if troubled by the consequences of the court's resolution of the case.

Mayo Foundation did not advance any justification for applying a less deferential standard of review to Treasury Department regulations than to the rules of any other agency. In the absence of such justification, the Supreme Court in *Mayo Foundation* was not inclined to carve out an approach to administrative review good for tax law only. The court expressly"[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action."[635]

The principles underlying *Chevron* apply with full force in the tax context. *Chevron* recognized that "[t]he power of an administrative agency to administer a Congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress."[636] *Chevron* acknowledged that the formulation of that policy might require "more than ordinary knowledge respecting the matters subjected to agency regulations."[637] Filling gaps in the Internal Revenue Code requires the Treasury Department to make interpretive choices for statutory implementation at least as complex as the ones other agencies must make in administering their statutes.[638] The Supreme Court in *Mayo Foundation* said that it saw no reason why review of tax regulations should not be guided by agency expertise pursuant to *Chevron* to the same extent as our review of other regulations.

Both the full-time employee rule and the rule at issue in *National Muffler* were promulgated pursuant to the Treasury Department's general authority under 26 U.S.C. § 7805(a) to "prescribe all needful rules and regulations for the enforcement" of the Internal Revenue Code. The Court previously had stated that "we owe the [Treasury Department's] interpretation less deference" when it is contained in a rule adopted under that "general

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[632] *Smiley v. Citibank (South Dakota), N. A.*, 517 U.S. 735, 740 (1996).

[633] *Id.*, at 741.

[634] 532 U.S. 822, 838 (2001).

[635] *Dickinson v. Zurko*, 527 U.S. 150, 154 (1999). *See, e.g., Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 222-223 (1989) (declining to apply "a different and stricter nondelegation doctrine in cases where Congress delegates discretionary authority to the Executive under its taxing power").

[636] 467 U.S., at 843 (internal quotation marks omitted).

[637] *Id.*, at 844 (internal quotation marks omitted).

[638] *Cf. Bob Jones Univ. v. United States*, 461 U.S. 574, 596 (1983) ("[I]n an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems").

authority" than when it is "issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision."[639]

Since then, the Supreme Court had held that *Chevron* deference is appropriate "when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority."[640] Inquiry in that regard does not turn on whether Congress' delegation of authority was general or specific. For example, in *National Cable & Telecommunications Assn., supra*, the Supreme Court held that the Federal Communications Commission was delegated "the authority to promulgate binding legal rules" entitled to *Chevron* deference under statutes that gave the Commission "the authority to 'execute and enforce,'" and "to 'prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions' of," the Communications Act of 1934.[641]

The Supreme Court in *Mayo Foundation* determined that *Chevron* and *Mead*, rather than *National Muffler* and *Rowan*, provide the appropriate framework for evaluating the full-time employee rule. The Department issued the full-time employee rule pursuant to the explicit authorization to "prescribe all needful rules and regulations for the enforcement" of the Internal Revenue Code.[642] This "express Congressional authorizations to engage in the process of rulemaking" is "a very good indicator of delegation meriting *Chevron* treatment."[643] The Department issued the full-time employee rule only after notice-and-comment procedures.[644] This is a consideration identified in precedents as a "significant" sign that a rule merits *Chevron* deference.[645]

"[T]he ultimate question is whether Congress would have intended, and expected, courts to treat [the regulation] as within, or outside, its delegation to the agency of 'gap-filling' authority."[646] In the *Long Island Care* case, the Supreme Court found that *Chevron* provided the appropriate standard of review "[w]here an agency rule sets forth important individual rights and duties, where the agency focuses fully and directly upon the issue, where the agency uses

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[639] *Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981); *United States v. Vogel Fertilizer Co.,* 455 U.S. 16, 24 (1982) (*quoting Rowan*).

[640] *Mead*, 533 U.S., at 226-227.

[641] 545 U.S., at 980-981 (*quoting* 47 U.S.C. §§ 151, 201(b)). *See also Sullivan v. Everhart*, 494 U.S. 83, 87, 88-89 (1990) (applying *Chevron* deference to rule promulgated pursuant to delegation of "general authority to 'make rules and regulations and to establish procedures, not inconsistent with the provisions of this subchapter, which are necessary or appropriate to carry out such provisions'"(*quoting* 42 U.S. C. § 405(a) (1982 ed.))).

[642] 26 U.S.C. § 7805(a).

[643] *Mead, supra*, at 229.

[644] 69 Fed. Reg. 76405.

[645] *Mead, supra*, at 230-231; *see, e.g., Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 173-174 (2007).

[646] *Id.*, at 173 (emphasis deleted).

full notice-and-comment procedures to promulgate a rule,[and] where the resulting rule falls within the statutory grant of authority."[647] These same considerations point to the same result in *Mayo Foundation*. *Mayo Foundation*, according to the Supreme Court, falls squarely within the bounds of, and is properly analyzed under, *Chevron* and *Mead*.

The full-time employee rule easily satisfies the second step of *Chevron*. This second step asks whether the Department's rule is a "reasonable interpretation" of the enacted text.[648]

Mayo Foundation –

- accepts that "the 'educational aspect of the relationship between the employer and the employee, as compared to the service aspect of the relationship, [must] be predominant'" in order for an individual to qualify for the exemption.
- objected to the Department's conclusion that residents who work more than 40 hours per week categorically cannot satisfy that requirement.
- argued that, because residents' employment is itself educational, Mayo Foundation argued, the hours a resident spends working make him "more of a student, not less of one."
- contended that the Treasury Department should be required to engage in a case-by-case inquiry into "what [each] employee does [in his service] and why" Mayo Foundation also objects that the Department has drawn an arbitrary distinction between "hands-on training" and "classroom instruction."

The Supreme Court in *Mayo Foundation* disagreed. Regulation often requires drawing lines. Mayo Foundation does not dispute that the Treasury Department reasonably sought a way to distinguish between workers who study and students who work,[649] Focusing on the hours an individual works and the hours he spends in studies is a perfectly sensible way of accomplishing that goal. The Department explained that an individual's service and his "course of study are separate and distinct activities" in "the vast majority of cases," and reasoned that "[e]mployees who are working enough hours to be considered full-time employees . . . have filled the conventional measure of available time with work, and not study."[650] The Department did not distinguish classroom education from clinical training but rather education from service. The Department reasonably concluded that its full-time employee rule would "improve administrability," and it thereby "has avoided the wasteful litigation and continuing uncertainty that would inevitably accompany any purely case-by-case approach" like the one Mayo Foundation advocates.[651].

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[647] 551 U.S., at 173.
[648] 467 U.S., at 844.
[649] See LTR 9332005 (May 3, 1993).
[650] 69 Fed. Reg. 8607.
[651] *United States v. Correll*, 389 U.S. 299, 302 (1967).

The full-time employee rule has more to recommend it than administrative convenience, according to the Supreme Court. Taxing residents under the Federal Insurance Contributions Act would further the purpose of the Social Security Act and comport with precedent. The Supreme Court has understood the terms of the Social Security Act to "'import a breadth of coverage.'"[652] "[E]xemptions from taxation are to be construed narrowly."[653] Mayo Foundation contended that medical residents have not yet begun their "working lives" because they are not "fully trained." The Supreme Court recognized that the Treasury Department did not act irrationally in concluding that these doctors "who work long hours, serve as highly skilled professionals, and typically share some or all of the terms of employment of career employees" are the kind of workers that Congress intended to both contribute to and benefit from the Social Security system.[654]

The Department's rule takes into account the Social Security Act's concern that exempting residents from the Federal Insurance Contributions Act would deprive residents and their families of vital disability and survivorship benefits that Social Security provides. Mayo Foundation wonders whether the full-time employee rule will result in residents being taxed under the Federal Insurance Contributions Act but denied coverage by the Social Security Act. The Government informed the court that the Social Security Administration continues to adhere to its longstanding position that medical residents are not students and thus remain eligible for coverage.

The Supreme Court observed that Mayo Foundation's residents are engaged in a valuable educational pursuit or that they are students of their craft. The question whether they are "students" for purposes of Section 3121 is a different matter. This is a question to which Congress has not directly spoken. The Treasury Department's rule is a reasonable construction of what Congress has said. Consequently, the Supreme Court affirmed the judgment of the Court of Appeals.

[7] Mann Construction, Inc. v. United States (2022): Internal Revenue Service Is Generally Subject To Notice And Comment Requirements of the Administrative Procedure Act.

Mann Construction, Inc. v. United States[655] considered the Internal Revenue Service's enforcement of an administrative rule (Notice 2007-8[656]) that requires reporting transactions involving cash-value life insurance policies connected to employee-benefit plans. The taxpayers claimed that the Internal Revenue Service failed to meet a reporting requirement of

[652] 69 Fed. Reg. 8605 (quoting *Social Security Bd. v. Nierotko*, 327 U.S. 358, 365 (1946))
[653] *Bingler v. Johnson*, 394 U.S. 741, 752 (1969).
[654] 69 Fed. Reg. 8608.
[655] *Mann Construction, Inc. v. United States,* 27 F.4th 1138 (6th Cir. 2022).
[656] 2007-2 C.B. 960.

its own by skipping the notice-and-comment process before promulgating this legislative rule. The Sixth Circuit concurred. The Sixth Circuit determined that an Internal Revenue Service notice was not a legislative rule that was subject to the notice and comment requirements of the Administrative Procedure Act. Also, the Internal Revenue Service is not exempt from notice and comment under the Administrative Procedure Act.

Mann Construction, Inc. considered authority published under Section 6707A. Section 6707A permits the Internal Revenue Service to penalize the failure to provide information concerning "reportable" and "listed" transactions. The Sixth Circuit held: "Because the IRS's process for issuing Notice 2007-83 did not satisfy the notice-and-comment procedures for promulgating legislative rules under the APA, we must set it aside. In the absence of this Notice, we need not address the taxpayers' remaining claims."

A "reportable transaction" is one that has the "potential for [illegal] tax avoidance or evasion."[657] A "listed transaction" is one that "is the same as, or substantially similar to, a transaction" that the IRS has identified as a "tax avoidance transaction." *Id.* § 6707A(c)(2). The statute authorizes monetary penalties and criminal sanctions for noncompliance with these reporting requirements.[658]

In 2007, the IRS issued Notice 2007-83, entitled "Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits."[659] The Notice designates certain employee-benefit plans featuring cash-value life insurance policies as listed transactions. From 2013 to 2017, Mann Construction established an employee-benefit trust that paid the premiums on a cash-value life insurance policy benefitting principals of Mann Construction. The Internal Revenue Service concluded that this structure fit the description identified in Notice 2007-83. The agency imposed penalties on the company ($10,000) and both of its shareholders ($8,642 and $7,794) for failing to disclose their participation in the trust. The taxpayers sued the federal government to recover the penalties. They challenged the validity of the Notice and penalties on four grounds:

- Notice 2007-83 failed to comply with the notice-and-comment requirements of the Administrative Procedure Act;
- Notice 2007-83 constituted unauthorized agency action;
- Notice 2007-83 was arbitrary and capricious; and
- even if Notice 2007-83 was valid, the arrangement at issue did not fall within its scope.

The district court ruled for the government. The Sixth Circuit held: "Because the IRS's process for issuing Notice 2007-83 did not satisfy the notice-and-comment procedures for

[657] I.R.C. § 6707A(c)(1).
[658] I.R.C. §§ 6707A(b), 7203.
[659] 2007-2 C.B. 960.

promulgating legislative rules under the APA, we must set it aside. In the absence of this Notice, we need not address the taxpayers' remaining claims."[660]

The Sixth Circuit agreed with the taxpayers concerning failure of the government to comply with the notice and comment rules of the Administrative Procedure Act. "Under normal circumstances, the agency must publish a notice about the proposed rule, allow the public to comment on the rule, and, after considering the comments, make appropriate changes and include in the final rule a concise general statement of its contents."[661] "Notice and comment gives affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes — and it affords the agency a chance to avoid errors and make a more informed decision."[662] The process shines a light on delegations of authority from Congress to an executive-branch agency to ensure they remain subject to public scrutiny. Courts must set aside agency actions that fail to follow these requirements.[663]

The Internal Revenue Service did not follow these notice-and-comment procedures when it issued Notice 2007-83. The Internal Revenue Service offered two explanations for declining to follow the notice-and-comment process:

- Notice 2007-83 is merely an interpretive rule (which does not require notice and comment) as opposed to a legislative rule (which does require notice and comment); and
- Even if the Notice amounts to a legislative rule, Congress exempted the Internal Revenue Service from the Administrative Procedure Act's requirements with respect to these disclosure rules.

The Sixth Circuit rejected both defenses.

The Sixth Circuit determined that the rule was clearly a legislative rule.

The APA distinguishes between "legislative rules" and "interpretive rules." Only the former are subject to the Act's notice-and-comment requirements. By statute, Congress has exempted interpretive rules from notice and comment. 5 U.S.C. § 553(b)(3)(A). Binding "substantive agency regulations" by contrast must satisfy the required procedures. [Citation omitted.] Some guideposts offer some clues in distinguishing the two types of rules.

Legislative rules have the "force and effect of law"; interpretive rules do not. [Citation omitted.] Legislative rules impose new rights or duties and change the legal status of regulated parties; interpretive rules articulate what an agency thinks a statute means or remind parties of pre-existing duties. [Citation omitted.] When rulemaking carries out an express delegation of authority from Congress to an agency, it usually leads to

[660] 27 F.4th 1148.
[661] 27 F4th at 1142.
[662] *Azar v. Allina Health Servs.*, 139 S. Ct. 1804, 1816 (2019).
[663] 5 U.S.C. § 706(2)(D); *see Tenn. Hosp. Ass'n v. Azar*, 908 F.3d 1029, 1042 (6th Cir. 2018).

legislative rules; interpretive rules merely clarify the requirements that Congress has already put in place. [Citation omitted.]

Measured by these metes and bounds, Notice 2007-83 amounts to a legislative rule. The Notice has the force and effect of law. It defines a set of transactions that taxpayers must report, and that duty did not arise from a statute or a notice-and-comment rule. It springs from the IRS's own Notice. Taxpayers like Mann Construction had no obligation to provide information regarding listed transactions like this one to the IRS before the Notice. They have such a duty after the Notice. Obeying these new duties can "involve significant time and expense," and failure to comply comes with the risk of penalties and criminal sanctions, all characteristics of legislative rules. [Citation omitted.]

The Notice also stems from an express and binding delegation of rulemaking power. Congress tasked the IRS with determining "by regulations" how taxpayers must "make a return or statement" and the information they must provide to the IRS when doing so. 26 U.S.C. § 6011(a). Under the penalty provision for failing to report certain types of transactions, the statute delegates to the Secretary of the Treasury authority to "determine[ ]" which transactions have "a potential for tax avoidance or evasion" or are "the same as, or substantially similar to, a transaction" deemed "a tax avoidance transaction." Id. § 6707A(c)(1)–(2). The long and the short of it is that Congress "delegates to the Secretary of the Treasury, acting through the IRS, the task of identifying particular transactions with the requisite risk of tax abuse." [Citation omitted.] In identifying a new type of transaction purportedly satisfying these demands, Notice 2007-83 purports to carry out this Congressional delegation. In every relevant way, the Notice has the stripes and colors of a legislative rule subject to the notice-and-comment process.

The government argued that Notice 2007-83 merely interprets the term "tax avoidance transaction" and that the regulation was an interpretive regulation not subject to the notice and comment requirements of the Administrative Procedure Act. The Sixth Circuit found this argument unconvincing:

Attempting to fend off this conclusion, the government argues that Notice 2007-83 merely interprets the term "tax avoidance transaction" in § 6707A. But, as shown, the substance of the Notice is legislative. It creates new substantive duties, the violations of which prompt exposure to financial penalties and criminal sanctions. Those are hallmarks of a legislative, not an interpretive, rule. The government's argument also overlooks the reality that the relevant statutory terms are not self-defining, which explains why Congress delegated to the IRS authority to "determine[ ]" and "identif[y]" which transactions need to be reported. [Citation omitted.] That feature of the Notice, once again, represents a quality of a quintessential legislative rule. [Citation omitted.]

The Sixth Circuit found that Congress did not exempt the Internal Revenue Service from the Internal Revenue Service notice and comment requirements:

Did Congress expressly exempt the IRS from the APA's requirements? No. In explaining why, some background again is in order. The baseline assumption for agency action that will have the force and effect of

law is that it must go through notice and comment. 5 U.S.C. § 553. But Congress may exempt an agency from the process. It has done so before. [Citation omitted.]

Did it do so here? Before an agency may regulate without the protections of the notice-and-comment process, it must show that Congress "expressly" carved out the exception. 5 U.S.C. § 559. "Exemptions from the terms of the Administrative Procedure Act are not lightly to be presumed." [Citation omitted.]

That is not to say that Congress must "employ magical passwords in order to effectuate an exemption from the Administrative Procedure Act." [Citation omitted.] Modifications of the APA in a given area may take more than one form. Indeed, Congress may "exempt the current statute from the earlier statute" and can "express any such intention either expressly or by implication as it chooses." [Citation omitted.] What is needed is an "express[ ]" indication of Congressional intent. [Citation omitted.] That leaves courts with the task of determining whether the statute at hand indicates that Congress intended to abrogate the APA's notice-and-comment requirements in a "clear" or "plain" way in a later statute. [Citation omitted.]

The Sixth Circuit gave examples of valid exemptions from notice and comment under the Administrative Procedure Act.

As the concrete tends to inform the abstract, let us offer some examples. Start with cases in which the court accepted an express Congressional deviation from the conventional notice-and-comment requirements. In one case, the U.S. Supreme Court accepted Congress' clear rejection of the APA's baseline approach based on Congress' "laborious adaptation of the" APA to deportation proceedings and the "specific points at which deviations" were made from APA procedures. [Citation omitted.] In another case, our court highlighted an example of how Congress could unequivocally modify the APA's procedures with statutory text: "Except as otherwise provided in this chapter, the provisions of sections 551 to 559 and sections 701 to 706 of [the APA] shall not apply to the making of any order, notice, or decision made pursuant to this chapter, or to any proceeding for the review thereof." [Citation omitted.] In still another case, the D.C. Circuit identified a clear rejection of the APA's baseline approach based on Congress' creation of "specific procedures" that "differ from those of the APA." [Citation omitted.]

According to the Sixth Circuit, *Mann Construction, Inc.*

This case falls on the failure-to-be-express side of the line. Two relevant provisions exist, one with respect to reportable transactions, the other with respect to listed transactions. "The term 'reportable transaction,'" one says, "means any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion." 26 U.S.C. § 6707A(c)(1). "The term 'listed transaction,'" the other says, "means a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011." Id. § 6707A(c)(2). On top of that, Congress more generally tasked the IRS with determining "by regulations" how taxpayers must "make a return or statement" and the information they must provide to the IRS when doing so. Id. § 6011.

Note to begin the absence of any express variation of the APA's notice-and-comment procedures. The statutes do not say anything, expressly or otherwise, that modifies the baseline procedure for rulemaking established by the APA. Id. §§ 6011, 6707A. Nor did Congress expressly displace those requirements by creating a new procedure for these regulations. The statutes do not provide any "express direction to the" agency "regarding its procedure" for identifying reportable and listed transactions, let alone procedures "that cannot be reconciled with" notice-and-comment requirements or any other indication within the statutory text that "plainly expresses a Congressional intent to depart from" the normal APA procedures. [Citation omitted.] The statutes merely establish a disclosure and penalty regime for the IRS to administer. As to the statutory text, Congress did not change the background procedural requirements of the APA or otherwise indicate an exemption from those requirements in a "clear" or "plain" way that would make the APA's procedures inapplicable to the IRS. [Citation omitted.][664]

The government argued that Congress implicitly approved identifying reportable and listed transactions by implication. The Ninth Circuit rejected this reasoning.

Not true, the government pushes back. It starts by pointing to the cross-reference language in the reportable transaction definition, which describes such transactions as those "determined under regulations prescribed under section 6011." 26 U.S.C. § 6707A(c)(1). It then adds that, at the time Congress enacted § 6707A, one such regulation provided that the IRS could identify reportable and listed transactions by "notice, regulation, or other form of published guidance." 26 C.F.R. § 1.6011-4(b)(1)–(2) (2003). Because a "notice" is the type of IRS action at issue, it claims that the statute contains an express exception from the APA's notice-and-comment process.

But the agency's reference to its apparent rules of process, without more, does not show that Congress exempted Notice 2007-83 from notice-and-comment rulemaking. The question is whether Congress amended the APA's prerequisites, not whether the IRS did. While the cross-reference is probative of whether Congress was aware of the IRS's transaction-listing procedures, it does not alone suffice to show an express exemption from the APA procedures. Even on its own terms, moreover, the argument falls short. Section 6707A deals with penalties for not reporting certain transactions to the IRS. The statute's key feature is to describe the "type[s]" of "transaction[s]" subject to penalties for non-reporting, namely the ones "determined" by "the Secretary" "because" they have a "potential for tax avoidance or evasion." 26 U.S.C. § 6707A(c)(1). The statute thus addresses a "which transactions" question, not a "what process" question. That does not suffice to create an express modification of the APA's background assumption that rulemaking will go through the notice-and-comment requirements.[665]

Exemption from notice and comment requires that the govern show that Congress clearly departed from the Administrative Procedure Act's baseline requirement of notice and comment:

[664] 27 F4th at 1145-46.

[665] 27 F4th at 1146-47.

The driving inquiry is whether Congress "clearly" departed from the APA's baseline rule. [Citation omitted.] Potential inferences layered on top of conjectural implications do not suffice. The government, notably, has not identified any case in which Congress exempted an agency from the APA's requirements via such a winding and elaborate route. Accepting the government's approach "would require us to create § 559 precedent that itself could prove disruptive by too readily permitting other agencies to depart from uniform APA requirements." [Citation omitted.][666]

The government argued that Congress ratified by inaction the Internal Revenue Service's nonconformance with the Administrative Procedure Act. The Sixth Circuit rejected this assertion. The Administrative Procedure Act requires that Congress must expressly override the normal notice-and-comment rules for those rules to be effectively overridden.

The government separately argues that Congress ratified by inaction the IRS's nonconformance with the APA. Congress, it is true, sometimes may be deemed to "ratify acts which it might have authorized and give the force of law to official action unauthorized when taken." [Citation omitted.] But this argument faces a lot of yellow lights. Inaction may, but does not always, mean ratification. And it rarely suffices to show express modification of the APA's bedrock procedural guarantees given the raft of potential explanations for inaction on Capitol Hill. The government identifies nothing beyond Congress' "mere acquiescence" to the IRS's non-conforming practices over the years, which does not suffice. [Citation omitted.]

Implied ratification also would be odd in this context. It may be the case in some settings that Congress is "presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change." [Citation omitted.] But Congress presumably is equally aware of the APA's requirement that it must "expressly" override the normal notice-and-comment rules. 5 U.S.C. § 559. It takes far more than the clanging silence we have here to infer that Congress has expressly altered the prerequisites for creating a rule that imposes financial and criminal penalties. [667]

The government argued that their position was supported by legislative history. The government argued that legislative history supported that the Internal Revenue Service needs to be able to address tax shelters without the procedural burdens of the Administrative Procedure Act. The Sixth Circuit rejected this argument.

Last of all, the government invokes legislative history. It notes that tax shelters have been a rampant problem that the IRS needs to address promptly, all without the procedural burdens that the APA imposes, and the legislative history shows as much. A representative of the IRS testifying in Congress, for example, noted that prior to § 6707A's enactment "the best tool we have in dealing with [abusive transactions] is early identification." [Citation omitted.] The IRS, he added, had to be able to "[i]dentify[ ] questionable transactions early . . . and issue guidance, in some cases before the transactions even show up on tax returns." [Citation omitted.] But the U.S. Supreme Court has already rejected the idea that tax law deserves special

[666] 27 F4th at 1147.
[667] 27 F4th at 1147.

treatment under the APA. In its words, "we are not inclined to carve out an approach to administrative review good for tax law only." [Citation omitted.]

Also problematic is that legislative history standing alone cannot supply the "express," "plain," or "clear" direction needed to show that Congress modified the APA's procedures in this area. "Legislative history, for those who take it into account, is meant to clear up ambiguity, not create it." [Citation omitted.] A Congressional ambiguity does not a clear statement make. In the last analysis, if the IRS "doesn't like Congress' notice-and-comment policy choices, it must take its complaints there." [Citation omitted.] Any exceptions to the sturdy protections established by the APA's notice-and-comment requirements must come from Congress, not us and not the IRS.[668]

§1.11 Post Loper Bright Enterprises *Authorities.*

[1] Tennessee v. Beccera (July 2024): Recognizing and Deferring to Pre-Loper Bright Authorities under Stare Decisis.

Tennessee v. Becerra[669] involved a United States Department of Health and Human Services rule requiring Title X grant recipients to provide neutral, nondirective counseling and referrals for abortions to patients who request it. Title X provides grants for reproductive healthcare for low-income patients. Tennessee, which has been a Title X recipient for over 50 years, recently outlawed most abortions in the state. After doing so, Tennessee would commit only to conducting counseling and referrals for options deemed legal in the state. Health and Human Services considered Tennessee's commitment to be out of compliance with its regulatory requirements. Health and Human Services discontinued the grant. Tennessee filed suit to challenge Health and Human Services' action and to enjoin it from closing the grant.

The district court denied Tennessee's request for preliminary injunction because it held that Tennessee does not have a strong likelihood of succeeding on the merits of its claim and that the balance of the remaining preliminary injunction factors weigh in Health and Human Services' favor. The Sixth Circuit affirmed.

In June 2022, the Supreme Court handed down its decision in *Dobbs v. Jackson Women's Health Organization*[670] in which it held that there is no individual right under the Constitution to obtain an abortion. Following *Dobbs*, several states—Tennessee included—implemented laws that criminalized abortion in all but a few circumstances.

@@@@Reasoning that *Dobbs* did not affect the Title X grant regime, in January 2023, Health and Human Services notified grantees it would be auditing their compliance with its counseling and referral regulations. Health and Human Services requested that grantees submit

[668] 27 F.4th at 1147-48.

[669] 117 F.4th 348, 2024 W.L. 3934560 (6th Cir. 2024)

[670] 597 U.S. 215 (2022).

copies of their policies for providing neutral, nondirective options counseling and referrals for abortion services and a signed statement confirming compliance with those regulations. Tennessee responded by submitting a letter confirming its compliance with the regulation and attaching its policy. The policy stated that Title X patients with positive pregnancy tests must be offered the opportunity to be provided information and counseling regarding all options that are legal in the State of Tennessee. The letter did not clarify which options the state deemed "legal in the State of Tennessee," but seemed to allude to a new law that had recently taken effect restricting abortion in the State. Health and Human Services notified Tennessee that its response appeared to place it out of compliance. Health and Human Services offered Tennessee the option of submitting an alternate compliance proposal with specific examples of acceptable arrangements. Health and Human Services suggested the option of providing Title X patients with the number for a national call-in hotline where operators would supply referral information.

Tennessee responded by reiterating its compliance based on its understanding of its obligations under state law and federal regulations. Health and Human Services disagreed with Tennessee's assertion that it was in compliance.

On March 20, 2023, Health and Human Services sent the state a letter explaining its decision to decline to issue a Title X continuation award to the Tennessee Department of Health.

In October 2023, Tennessee brought the instant action in the United States District Court for the Eastern District of Tennessee seeking:

- a declaratory judgment[671] stating that Health and Human Services' termination of the state's Title X funding was unlawful;
- dissolution of Health and Human Services' March 20, 2023, discontinuation decision;
- a preliminary injunction enjoining Health and Human Services and others from enforcing or implementing the discontinuation decision;
- to enjoin Health and Human Services from withholding Title X funds based on the counseling and referral clause;
- reinstatement of Title X funds from the date of discontinuation; and
- any and all other relief the court deemed proper.

The district court denied Tennessee's preliminary injunction, concluding that Tennessee was not likely to succeed on the merits and that the balance of the equities and the public interest did not favor relief. The district court further concluded that Tennessee had "no basis to force funding from HHS without meeting the obligations upon which the [Title

[671] Under 28 U.S.C. § 2201.

X] funding [was] conditioned." Tennessee appealed. Tennessee asserted that, in the face of an ambiguous statute, regulations alone generally cannot establish conditions. The Sixth Circuit rejected this argument.

In October 2021, Health and Human Services promulgated a rule requiring Title X programs to offer pregnant clients the opportunity to receive neutral factual information and nondirective counseling regarding prenatal care and delivery, infant care, foster care, adoption, and abortion. The 2021 Rule also required Title X programs to provide referrals for any of these options in response to a patient request. To comply with Section 1008's prohibition of funding for programs where abortion is a method of family planning, the 2021 Rule emphasized that a referral for abortion services may include providing a patient with the name, address, telephone number, and other relevant factual information about a medical provider, but that a Title X project may not take further affirmative action (such as negotiating a fee reduction, making an appointment, providing transportation) to secure abortion services for the patient.

In March 2022, Health and Human Services awarded the Tennessee Department of Health a Title X grant for the period from April 1, 2022, through March 31, 2023. The award stated that the amount requested represented the one-year budget period and that it was not obligated to make additional Federal Funds available.

Tennessee maintained that Health and Human Services' enforcement (through rescission of funding) of the 2021 Rule's counseling and referral requirements violated the Spending Clause of the United States Constitution. Tennessee argued that HHS's imposition of these requirements usurped Congress' exclusive authority to regulate Title X funding. The court found that Title X unambiguously authorized Health and Human Services to impose conditions for federal grants to ensure that the funds issued will be efficaciously put to use for their intended purpose. This clear delegation of authority to Health and Human Services, viewed in combination with Health and Human Services' 2021 counseling and referral regulation, are sufficient for notice purposes under the Spending Clause.

Tennessee argued that Rust's holding that Section 1008 is ambiguous as it relates to counseling and referrals for abortions, precluded Health and Human Services from requiring counseling and referrals and violated the Spending Clause. The Supreme Court, however, has long recognized Congress' power to authorize agencies to issue grants and leave the minutia of its spending programs to be clarified through regulations and other guidelines—even in the face of statutory ambiguity.

Title X authorizes Health and Human Services "to make grants . . . to State health authorities to assist in planning, establishing, maintaining, coordinating, and evaluating family planning services."[672] It directs that these grants "shall be made in accordance with such

[672] 42 U.S.C. § 300a(a).

regulations as the Secretary may promulgate."[673] Congress made the disbursement of grant funds "subject to such conditions as the Secretary may determine to be appropriate to assure that such grants will be effectively utilized for the purposes for which made."[674] These clauses, in addition to Health and Human Services' regulations explaining the importance of nondirective counseling and referrals for Title X services, foreclose Tennessee's arguments. Congress' inclusion of a yearly appropriations rider which expressly contemplates nondirective pregnancy counseling lends further support for the notion that Health and Human Services acted within its authority in setting that condition for funding—a fact that has implications for both the Spending Clause and Administrative Procedure Act analysis.

Tennessee relied on *Kentucky v. Yellen*[675] and *West Virginia ex rel. Morrisey v. U.S. Department of Treasury*.[676] Tennessee insisted that these cases supported its argument that, in the face of an ambiguous statute, regulations alone generally cannot establish conditions. Tennessee argued that Health and Human Services was barred from resolving Section 1008's ambiguity through its own interpretations.

Kentucky v. Yellen, dealing with a vague rather than an ambiguous statute, did not reach a holding on the broader question of whether Congress could condition funding on compliance with agency regulations. In *Kentucky v. Yellen*, the Department of Treasury argued that statutory language alone sufficiently placed states on notice of its conditions for funding. In *Morrisey*, the Eleventh Circuit found that grantees were subject to regulations and legal requirements in place when the grants were made. Because Section 1008 is situated among other provisions of Title X that clearly instruct Health and Human Services to determine the eligibility requirements, the District Court did not err in concluding that Congress' delegation to Health and Human Services would not violate the Spending Clause.

According to the Sixth Circuit, the district court in *Tennessee v. Beccera* likely did not err in determining that Tennessee voluntarily and knowingly agreed to Health and Human Services' requirement for nondirective counseling and referrals. Despite Congress' broad powers to set the unambiguous terms of its grants, it may not do so in a manner that surprises participating States with post acceptance or retroactive conditions. Health and Human Services' decision to discontinue Tennessee's grant based on the state's refusal to adhere to the counseling and referral conditions would violate the Spending Clause if it imposed new requirements after Tennessee's acceptance of the grant. Health and Human Services issued the nondirective counseling and referral requirements in 2021, which then went into effect on November 8, 2021—several months before Tennessee accepted its Title X grant award in March 2022. The Counseling and Referral Rule has been in place in all but two of the last twenty-nine years. As a decades-long recipient of Title X funds, Tennessee was aware of this

[673] 42 U.S.C. § 300a-4(a).
[674] 42 U.S.C. § 300a-4(b).
[675] 54 F.4th 325 (6th Cir. 2022).
[676] 59 F.4th 1124 (11th Cir. 2023).

fact. Tennessee was on clear notice of the 2021 Rule and voluntarily agreed to its requirements when it accepted the grant.

Health and Human Services issued the 2021 Rule at a time when the law stated that women had a constitutional right to obtain an abortion. There was no possibility that the state's adherence to the Rule might conflict with a law banning the procedure. After the Supreme Court's decision in *Dobbs*, Tennessee criminalized the procedure in all but the narrowest of cases. Tennessee argued that this supervening illegality of abortions in the state demonstrated a clear and permissible public policy statement on an issue within the domain of its own sovereignty. This critical shift in circumstances, according to Tennessee, rendered inadequate any notice of the Rule it had received pre-criminalization because the 2021 Rule did not contemplate such a scenario.

To the extent that Tennessee argued that the 2021 Rule is "silent" regarding its obligations post-*Dobbs*, Health and Human Services provided detailed guidance on how its nondirective counseling and referral requirements remained unchanged and active. Health and Human Services reiterated that Title X projects may not take further affirmative action to secure abortion services for the patient. After Tennessee raised compliance concerns following its criminalization of abortion, Health and Human Services offered Tennessee the opportunity to submit an alternate compliance proposal. This opportunity included the option to use a national call-in hotline where third-party operators would supply the requisite information. Considering that *Dobbs* did not address what, if any, effect the decision might have on Title X's underlying program requirements, the District Court did not err in determining that Tennessee voluntarily and knowingly agreed to the conditions when accepting its grant award.

Tennessee argued in *Tennessee v. Beccera* that Health and Human Services' decision to discontinue funding its grant violated the Administrative Procedure Act. Tennessee asserted that Health and Human Services' action to enforce the 2021 Rule:

- exceeded Health and Human Services' regulatory authority under Title X;
- is unreasonable;
- is arbitrary and capricious; and
- represents a new legislative rule which may only be promulgated via notice-and-comment rulemaking.

Tennessee argued in *Tennessee v. Beccera* that Health and Human Services misinterpreted Section 1008's prohibition on the use of Title X funds for programs where abortion is a method of family planning. Tennessee argued that the best reading of that provision, according to its text and history, is that it bars Health and Human Services from conditioning Title X funding on grantees' counseling or referring for abortion services.

The court must "hold unlawful and set aside agency action . . . found to be . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[677]

The Sixth Circuit in *Tennessee v. Beccera* reasoned:

> *Several states raised similar arguments before this court in Ohio, 87 F.4th at 770–75. In Ohio, we held that HHS's application of the 2021 Rule was within its statutory authority. Id. In deciding Ohio, we relied on the Supreme Court's conclusion in Rust, that § 1008 is indeed ambiguous with respect to nondirective counseling and referral options under Chevron step one and that given this ambiguity, under Chevron step two, HHS's "reasoned analysis" for proscribing such actions was a permissible construction of Title X. Rust, 500 U.S. at 187, 111 S.Ct. 1759; see also Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). Thus, in reviewing HHS's 2021 Rule requiring nondirective counseling and referral in Ohio, we held that HHS's action also "must" have been permissible under Chevron's step two analysis so long as HHS adequately explained its choice. Ohio, 87 F.4th at 772. In other words, because Rust held that a permissible construction of § 1008 permitted HHS to promulgate regulations banning counseling and referrals for abortion, we held that HHS's subsequent promulgation of a rule going the opposite way also "must" have been permissible so long as it adequately explained its choice. Id. at 722, 105 S.Ct. 1544. We also concluded that HHS's reasoned analysis was sufficient to establish that the 2021 Rule is not arbitrary and capricious—regardless of whether it represents the best reading of the statute.*

The Sixth Circuit in *Tennessee v. Beccera* addressed *Loper Bright Enterprises* and its effect. The Sixth Circuit seems implicitly to have applied *stare decisis*. At the least, the Sixth Circuit accepted the reasoning of prior cases.

> *Since our decision in Ohio, Chevron deference has fallen. See Loper Bright Enters. v. Raimondo, __ U.S. __, 144 S. Ct. 2244, 2273, __ L.Ed.2d __ (2024). Consequently, given Rust's and Ohio's application of Chevron deference to HHS's actions relating to the provisions of neutral, nondirective counseling [footnote omitted.] and referrals in those cases, Tennessee challenges their precedential effect. However, the extent to which Loper Bright undermines the validity of prior cases that were decided using Chevron deference depends on several factors not addressed by the parties in their briefing. In its guidance to lower courts, the Court broadly stated that it "do[es] not call into question prior cases that relied on the Chevron framework." Id. And it further explained that "[t]he holdings of those cases that specific agency actions are lawful . . . are still subject to statutory stare decisis despite [its] change in interpretive methodology." Id. (citing CBOCS West, Inc. v. Humphries, 553 U.S. 442, 457, 128 S.Ct. 1951, 170 L.Ed.2d 864 (2008)). So, while Loper Bright opens the door to new challenges based on new agency actions interpreting statutes, it forecloses new challenges based on specific agency actions that were already resolved via Chevron deference analysis. See Id. Unremarked upon was whether statutory stare decisis includes Circuit court precedent. See Id.; see also Amy Coney Barrett, Statutory Stare decisis in the Court of Appeals, 73 Geo. Wash. L. Rev. 317 (2005). For instance, here, Tennessee's argument involves the same "specific agency action" [footnote omitted] challenged in Ohio—the HHS's application of its 2021 Rule interpreting § 1008 to require nondirective counseling and referral options. In Ohio, we concluded that the 2021 Rule was lawful. Regardless of whether Ohio binds us, [footnote omitted]*

[677] 5 U.S.C. § 706(2).

like the Oklahoma court, we find its conclusion upholding the 2021 Rule—and by extension its enforcement against Tennessee here—persuasive. Ohio relied on Rust for its determination that HHS acted within statutory authority in treating referrals as falling outside of § 1008's restriction on using funds for programs in which abortion is a "method of family planning." We have held that we are bound by precedent "unless a Supreme Court decision 'mandates modification' of our precedent." RLR Investments, LLC v. City of Pigeon Forge, Tenn., 4 F.4th 380, 390 (6th Cir. 2021) (quoting United States v. Moody, 206 F.3d 609, 615 (6th Cir. 2000)). A fair reading of Loper Bright leads us to conclude that the district court did not improperly accede to the holdings in Rust and our earlier decision in Ohio. The Supreme Court cautioned litigants hoping to rehash or relitigate previously settled issues decided on Chevron that "[m]ere reliance on Chevron cannot constitute a special justification for overruling such a holding." Loper Bright, 144 S. Ct. at 2273 (quoting Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258, 266, 134 S.Ct. 2398, 189 L.Ed.2d 339 (2014) (cleaned up)). To argue as much, the Court continued, would "at best," be "just an argument that the precedent was wrongly decided." Id. And this, as the majority concluded, is "not enough to justify overruling a statutory precedent." Id.

Tennessee argued in *Tennessee v. Beccera* that *Loper Bright Enterprises* ended the precedential effect of *Rust* and *Ohio* because those cases relied on *Chevron*. The Sixth Circuit disagreed and followed these cases. This is a sign that current courts will not necessarily consider decisions made under a *Chevron* standard as dead.

Here, Tennessee argues that Loper Bright abrogated the precedential effect of Rust and Ohio because they relied on Chevron. But this is exactly the conclusion that Loper Bright rejected; Loper Bright does not dictate abandonment of Rust or Ohio because it does not "call into question prior cases that relied on Chevron." Id. And, even if the "specific agency action" in Rust was HHS's 1988 Rule prohibiting counseling and referral requirements pursuant to § 1008, our own circuit precedent addressed the inverse specific agency action and specifically affirmed HHS's authority under Title X to require nondirective counseling and referral options. See Ohio, 87 F.4th at 772. In short, abandoning Rust and Ohio based on their reliance on Chevron, is unwarranted. Alternatively, Tennessee argues Ohio and Rust are distinguishable because they only involved facial challenges to § 1008. Tennessee asserts that its claim is as-an applied challenge because it disputes HHS's decision to discontinue its Title X funding based on the state's refusal to unqualifiedly confirm its commitment to give neutral nondirective counseling and referrals after passing a law banning abortion post-Dobbs. But this as-applied distinction is less meaningful where, as discussed above, Dobbs did not address its effect on Title X's underlying program requirements or HHS's enforcement of such requirements. See Dobbs, 597 U.S. at 231, 142 S.Ct. 2228. In other words, despite the change in circumstances, Tennessee's claim centers on its challenge of HHS's statutory authority to apply the 2021 Rule. See 42 U.S.C. § 300a-4(b). Notably, the counseling and referral requirements were unambiguously in place before Tennessee accepted its grant award and before it changed its own laws. As such, Tennessee's arguments amount to whether the counseling and referral requirements were legal as per the limitation contained in § 1008. Because this is the same issue addressed in Rust and Ohio, it has likely been foreclosed. Nevertheless, while the district court must ultimately determine whether HHS's actions complied with Title X, we confine our inquiry to whether the

district court erred in its tentative conclusion. See Oklahoma, 107 F.4th at 1226. And even if we accept that Ohio is no longer binding, we agree with its conclusion that the 2021 Rule is lawful.

The Sixth Circuit also found that *Rust* and *Ohio* represented the best reading of Section 1008:

Applying Loper Bright, the best reading of § 1008 permits both neutral, non-directive counseling and referrals. As noted earlier, Congress' yearly spending rider presumes the provision of such counseling, specifically instructing—like the 2021 Rule—that all pregnancy counseling must be non-directive. Requiring grantees to follow up with additional information to those who request it, in the form of names, addresses, and phone numbers of health care providers, is a natural outgrowth of that counseling. And short of that, HHS has granted Tennessee the option of merely providing patients with a hotline number where they can obtain such health care provider information. Under either scenario, the grant recipient's role is informational only. It neither recommends nor promotes any particular pregnancy care option, while, at the same time, it promotes HHS's stated intention to advance a patient-centered approach. In this light, it seems quite a stretch to say that merely supplying to patients health provider information or a means to obtain such information elevates a grantee's actions to the status of having abortion as a method of family planning. Even accepting the dissent's definition of the term "method," the provision of such information cannot be characterized as a deliberate or systematic action toward a particular end. Offering a list of phone numbers is simply too attenuated an act to characterize an entire program as one that conclusively offers abortion as a "method of family planning." For this reason, Tennessee is unlikely to succeed on its claim that the 2021 Rule violates the APA. The 2021 Rule's counseling and referral requirement is consistent with the meaning of § 1008.

Tennessee also argued that the major questions doctrine applied. The Sixth Circuit rejected this argument.

Tennessee also relies on a series of other arguments to attack HHS's authority based on § 1008's ambiguity. For instance, it argues that because of § 1008's ambiguity, HHS's actions implicated the major-questions doctrine, which requires agencies to have "clear Congressional authorization" before making major policy decisions. W. Virginia v. EPA, 597 U.S. 697, 722, 142 S.Ct. 2587, __ L.Ed.2d __ (2022). But, given the limited scope of HHS's authority under Title X, the doctrine is likely not implicated. Title X describes HHS's authority to "make grants to and enter into contracts with public or nonprofit private entities to assist in establishment and operation of voluntary family planning projects which shall offer a broad range of acceptable and effective family planning methods and services." 42 U.S.C. § 300(a). We agree with the district court's conclusion that this language sets forth a sufficiently intelligible principle supporting Congress' delegation. See Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 474, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001). And as the district court accurately observed, HHS does not "exercise powers of vast economic and political significance." Ala. Ass'n of Realtors v. Dep't of Health & Hum. Servs., 594 U.S. 758, 141 S. Ct. 2485, 2489, 210 L.Ed.2d 856 (2021). It issued only eighty-six Title X grants in 2023 with an average award value of $3 million. Office of Population Affairs, Fiscal Year 2023 Title X Service Grant Awards, https://opa.hhs.gov/grantprograms/title-x-service-grants/current-title-x-servicegrantees/fy2023-title-X-service-grant-awards (last accessed Aug. 16, 2024). Given this relatively circumscribed grant-making authority,

it is unlikely that HHS has run afoul of the non-delegation doctrine here and we see no reason to disturb the district court's conclusion on this point. See, e.g., FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 159–60, 120 S.Ct. 1291, 146 L.Ed.2d 121 (2000) (finding nondelegation problem where "the FDA . . . asserted jurisdiction to regulate an industry constituting a significant portion of the American economy.").

Tennessee argued that Health and Human Services' actions were inconsistent with its own regulations because program services must be allowable under state law and referrals must be made to service providers in close physical proximity. Tennessee argued that the plain meaning of 42 C.F.R. § 59.5(b)(6) is that its Title X project may not encompass services relating to abortions.

Compliance with HHS Regulations. Tennessee next argues that HHS's actions are inconsistent with its own regulations because program services must be "allowable under state law" and referrals must be made to service providers "in close physical proximity." [Citation omitted.]

Allowable Under State Law. "[A] fundamental canon of statutory construction is that when interpreting statutes, the language of the statute is the starting point for interpretation, and it should also be the ending point if the plain meaning of that language is clear." Saginaw Chippewa Indian Tribe of Mich. v. Blue Cross Blue Shield of Mich., 32 F.4th 548, 557 (6th Cir. 2022) (citations and quotations omitted). 42 C.F.R. § 59.5(b)(6) states that Title X projects must "[p]rovide that family planning medical services will be performed under the direction of a clinical services provider, with services offered within their scope of practice and allowable under state law, and with special training or experience in family planning." (emphasis added). Tennessee first argues that the plain meaning of § 59.5(b)(6) is that its Title X project may not encompass services relating to abortions because the procedure is not allowable under state law in Tennessee. But as the district court correctly concluded, Tennessee's interpretation does not reflect the plain meaning of the regulation. There is no indication that the nondirective options for counseling and the neutral information required by the Rule are not "allowable under state law" in Tennessee. Though Tennessee law prohibits a person from performing an abortion, the law "contains no language whatsoever related to counseling or referral[s]," and does not overlap with § 59.5(b)(6). (R. 30, PageID 840); see Tenn. Code Ann. § 39-15-213. Indeed, HHS's commentary accompanying the 2021 Rule indicates HHS included the "allowable under state law" phrase to "more clearly reflect the role of a broader range of healthcare providers in providing Title X services." 86 Fed. Reg. at 56163–64 (emphasis added). Thus, this provision addresses "who" may qualify as a clinical services provider, not the types of services provided under Title X programs. In short, because Tennessee law does not prohibit mere abortion-related counseling or referrals, we find no conflict between § 59.5(b)(6) and Tennessee law. The district court did not err in this regard.

Close Physical Proximity. Tennessee next argues that 42 C.F.R. § 59.5(b)(8)'s mandate to provide services close to patients, conflicts with its need to refer patients to out-of-state providers due to its laws criminalizing abortions. Section 59.5(b)(8) requires Title X projects to "[p]rovide for coordination and use of referrals and linkages with [other health-care entities], who are in close physical proximity to the Title X site, when feasible, in order to promote access to services and provide a seamless continuum of care." (emphasis

added). However, the phrase "when feasible" in this provision plainly modifies the requirement to refer to providers "in close physical proximity to the Title X site." Id. Thus, as the district court again correctly determined, the regulation only requires that Title X projects refer patients to nearby healthcare providers "when it is possible to do so." When such close-in-proximity referrals are not possible, it permits the referral to be made "to a provider farther away." [Citation omitted.] This regulation does not require a referral to a provider within the state. The district court did not err.

Tennessee argued that the counseling and referral conditions are arbitrary and capricious.

Finally, Tennessee contends that HHS's counseling and referral conditions are arbitrary and capricious because the agency failed to consider several "important aspect[s]" of its requirement. [Citation omitted.]

Federalism Concerns. First, Tennessee asserts that HHS ignored federalism concerns because its decision to discontinue Tennessee's grant award did not consider the effect of Dobbs on counseling and referral requirements. But as discussed above, HHS issued extensive guidance about the effect of Dobbs on the requirements regarding counseling and referrals. Though Tennessee is correct that the 2021 Rule did not contemplate Dobbs, that case did not address the power of the agency to set conditions on federal grants. [Citation omitted.] And as the Supreme Court has previously noted, "[t]he recipient is in no way compelled to operate a Title X project; to avoid the force of the regulations, it can simply decline the subsidy." Rust, U.S. at 199 n.5. The district court did not err here.

Tennessee argued that rescinding the requirement was an unlawful policy switch.

Unlawful Position Switch. Tennessee argues that the rescindment was an "unlawful position switch," because it came only months after HHS approved Tennessee's Title X program with "full awareness the State's post-Dobbs policy that '[n]o referrals for abortion are made.' [Citation omitted.] Tennessee points to HHS's July 2022 program review of its Title X project to support its argument that the agency unlawfully changed positions. However, the July 2022 program review indicated that there would be a follow-up if Tennessee changed its counseling and referral policies in response to the abortion restriction that was soon to take effect. And regardless, the counseling and referral requirements have been in place since 2021, before Tennessee applied for and received Title X funds.

Tennessee also made a notice and comment argument that the court rejected:

Reliance Interests. Lastly, Tennessee argues that the rescindment overlooked Tennessee's legitimate reliance interests in the grant award because it has been receiving Title X funding for 50 years. And the rescindment was procedurally invalid because HHS was required to undertake notice-and-comment rulemaking procedures to impose "new requirements" on Tennessee's Title X project. [Citation omitted.] But Tennessee's notice-and-comment arguments fail because HHS did not impose any "new" requirements on grantees. Furthermore, Tennessee likely has no legally cognizable reliance interest in the receipt of a discretionary funding award on the conditions that it prefers. [Citation omitted.] HHS's regulations make clear that Title X grants provide funding for one year with the option of issuing noncompetitive continuation grants for additional years.

[Citation omitted.] HHS was not obligated to award more. [Citation omitted.] The district court did not err in this regard.

[2] Restaurant Law Center v. United States Department of Labor (August 2024): No Deferral to Agency Interpretation Unless Statute is Ambiguous.

Restaurant Law Center v. United States Department Of Labor[678] involved a challenge to a final rule promulgated by the Department of Labor that restricts when employers may claim a "tip credit" for "tipped employees" under the Fair Labor Standards Act. Fifth Circuit determined that the Department of Labor rule involved was contrary to the Fair Labor Standards Act's clear statutory text, was not in accordance with law, and was arbitrary and capricious. The Fifth Circuit applied *Loper Bright Enterprises v. Raimondo*[679] and determined that the Department of Labor rule was not entitled to a presumption of correctness. that courts "may not defer to an agency interpretation of the law simply because a statute is ambiguous."[680] The 5th Circuit observed:

[678] F.4th (5th Cir. 2024)

[679] 144 S. Ct. 2244, 2273 (2024).

[680] *Loper Bright Enters. v. Raimondo,* 144 S. Ct. 2244, 2273 (2024). *See, also, Pacific Gas and Electric Company v. Federal Energy Regulatory Commission*, __ F.4th __ (D.C. Cir 2024) ("The plain meaning of "ultimate consumer" refers to end users of electric service as of the specified date. I.R.C. § 824k(h) nowhere references general classes of consumers of electric service. Instead, the provision emphasizes 'an ultimate consumer' and 'such ultimate consumer,' both of which naturally refer to a particular consumer of electric service. We assume that 'statutory terms bear their ordinary meaning' unless evidence suggests otherwise. [Citation omitted.] The ordinary meaning of 'ultimate consumer' refers to a discrete end user, not a class or category of end users unmoored from the statutory text" "But policy concerns cannot override the text of a statutory provision. "An agency has no power to 'tailor' legislation to bureaucratic policy goals by rewriting unambiguous statutory terms." *Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 325 (2014). FERC has substantial discretion when approving tariffs as just and reasonable but has no discretion to rewrite statutes to make them more reasonable in the eyes of the Commission. FERC must exercise its authority within the boundaries set by Congress." "FERC's orders are contrary to law and we vacate them. We remand for FERC to interpret the grandfathering clause because the application of the statutory text to the meaning of the Tariff may 'rest[ ] on factual premises within the agency's expertise.' *Loper Bright*, 144 S. Ct. at 2267 (cleaned up); see also *id.* at 2257 (explaining that 'exercising independent [judicial] judgment often included according due respect to Executive Branch interpretations'). On remand, FERC must apply the plain meaning of section 824k(h)(2) consistent with this opinion and determine which of SFPUC's consumers qualify for wheeled service under section 14.2 of the 2015 Tariff.") *But see United States v. Boler*, __ F.4th __ (4th Cir. 2024) ("The Supreme Court's recent ruling in *Loper Bright Enterprises v. Raimondo*, __ U.S. __, 144 S. Ct. 2244, __ L.Ed.2d __ (2024), calls into question the viability of *Auer* deference. In *Loper Bright*, the Court rejected the long-standing notion that "ambiguities" in statutory language act as "implicit delegations to agencies." *Id.*. at 2265. Since *Loper Bright* dealt specifically with ambiguities in statutory

"Chevron is overruled." Loper Bright, 144 S. Ct. at 2273. In its place, the Court has instructed that we are to return to the APA's basic textual command: "independently interpret[ing] the statute and effectuat[ing] the will of Congress." [Citation omitted.] Courts are constantly faced with statutory ambiguities and genuinely hard cases. But "instead of declaring a particular party's reading 'permissible' in such a case, courts use every tool at their disposal to determine the best reading of the statute and resolve the ambiguity." [Citation omitted.] [681]

The court proceeded with a meticulous examination of statutory text. The court determined that the Department of Labor's rules were not the best reading of the statute.

The court also was not impressed by the argument that the agency interpretation had lasted since 1988:

We pause to note that, even in the absence of Chevron, courts are well-advised to consider agency "interpretations issued contemporaneously with the statute at issue, and which have remained consistent over time." Loper Bright, 144 S. Ct. at 2262. As the Department of Labor points out, the 80/20 standard (but not the 30-minute requirement) is indeed of some vintage, having been applied with brief interregna since at least 1988. But while longstanding agency practice might have the "power to persuade," it has never had the "power to control." See Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944). Nor can we permit agency practice to "defeat a statute's text by 'adverse possession.' Airlines for Am. v. Dep't of Transp., No. 24-60231, 2024 WL 3580314 (5th Cir. July 29, 2024) (quoting Rapanos v. United States, 547 U.S. 715, 752 (2006)). We are not persuaded that the 80/20 standard, however longstanding, can defeat the Fair Labor Standards Act's plain text.[9] [[9] The Associations also urge that we apply the major questions doctrine, which requires agencies to point to "clear Congressional authorization" for actions of major "economic and political significance." West Virginia v. EPA, 597 U.S. at 721, 724 (citations and internal quotation marks omitted). There is some uncertainty over whether we should apply this doctrine as a substantive clear-statement rule, see Id. at 740 (Gorsuch, J., concurring), or as a purely linguistic canon of construction, see Biden v. Nebraska, 143 S. Ct. 2355, 2376 (2023) (Barrett, J., concurring). We take no position on the major questions doctrine's application here because it is not necessary to our ultimate holding.] [682]

The court also found that the Department of Labor rule was arbitrary and capricious:

An agency rule is arbitrary and capricious if:

the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. [683]

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directives to agencies and did not address the issue of agency interpretations of their own regulations, we will apply the Supreme Court's recent guidance in *Kisor* to address the issue before us today.").

[681] __ F.4th at __.

[682] __ F.4th at __n.9.

[683] __ F.4th at __.

[3] Varian Medical Systems, Inc. v. Commissioner (August 2024): Close Reading of the Statute and Employing Conventional Rules of Statutory Interpretation, Particularly Plain Meaning Analysis.

Varian Medical Systems, Inc. v. Commissioner,[684] published shortly after *Loper Bright Enterprises*, is all about effective dates of tax provisions that would exclude from the dividends received deduction foreign taxes paid by foreign subsidiaries. The Tax Court found that a regulation was invalid that applied to an effective date rule that barred fiscal-year taxpayers from exploiting the gap between effective dates of Section 245A and Section 78. The Tax Court applies a plain meaning analysis to determine that the taxpayer was able to deduct foreign taxes paid by a foreign subsidiary. *Varian Medical Systems* determined that an effective date provision in Treasury Regulations Section 1.78-1 was invalid. *Varian Medical Systems* undertakes an intensive textual analysis of the applicable statutes. *Varian Medical Systems* rejected the Internal Revenue Service's interpretation of the statutes as reflected in Treasury Regulations Section 1.78-1. *Varian Medical Systems* concluded that the statute was clear on its face. This holding and the court's analysis reflects one of the schools of statutory interpretation to emphasize close reading of the statute and to employ conventional rules of statutory interpretation, particularly plain meaning analysis. *Varian Medical Systems* was a victory for the plain meaning textualists.

Varian Medical Systems considered:

- how do two effective date provisions enacted by the Tax Cuts and Jobs Act[685], and Section 78 interact?
- how does a new Code provision enacted by the Tax Cuts and Jobs Act actually apply?

The Tax Court in *Varian Medical Systems* determined that the two effective dates in question were not ambiguous. Treasury Regulations Section 1.78-1 was inconsistent with the statute. The court in *Varian Medical Systems* determined that no delegation of authority to Treasury could overcome the clarity of the effective dates prescribed in the statute.

In *Varian Medical Systems*, the Tax Court invalidated Treasury Regulations Section 1.78-1 and determined that the taxpayer was entitled to favorable tax treatment resulting from the gap in effective dates between new Section 245A and Section 78. The Tax Court in *Varian Medical Systems* based this decision on careful textual analysis. As this textual analysis was undertaken by the Tax Court, it did not support the Internal Revenue Service's Section Treasury Regulations Section 1.78-1.

The Tax Court in *Varian Medical Systems* held:

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[684] 163 T.C. No. 4 (2024).

[685] Pub. L. No. 115-97, 131 Stat. 2054 (2017).

- The taxpayer was permitted a dividend received deduction with respect to a Section 78 dividend for its final tax year.
- A proportionate amount of the deemed paid credits attributable to the Section 78 gross up was disallowed as a foreign tax credit.[686]

Congress enacted the Tax Cuts and Jobs Act in 2017. The Tax Cuts and Jobs Act added Section 245A. Section 245A allows a domestic corporation a deduction for certain dividends received from foreign subsidiaries. Section 245A applies to "distributions made after . . . December 31, 2017."[687]

The deduction under Section 245A applies to dividends received by a domestic corporation from a foreign corporation.

Section 245 potentially could interact with existing Section 78. Section 245A(a) provides: "In the case of any dividend received from a specified 10-percent owned foreign corporation by a domestic corporation which is a United States shareholder with respect to such foreign corporation, there shall be allowed as a deduction an amount equal to the foreign-source portion of such dividend."

As in effect before the Tax Cuts and Jobs Act, Section 78 provided that, for taxpayers who claimed foreign tax credits, a specified amount "shall be treated for purposes of this title (other than Section 245) as a dividend received by such domestic corporation from the foreign corporation."

Section 245A otherwise might allow a taxpayer who claims foreign tax credits to deduct a dividend that Section 78 would have deemed he taxpayer to receive. The Tax Cuts and Jobs Act amended Section 78 to preclude that result. Instead of using the same effective date that the Tax Cuts and Jobs Act applied to Section 245A, the Tax Cuts and Jobs Act amended Section 78 for "taxable years of foreign corporations beginning after December 31, 2017, and . . . taxable years of United States shareholders in which or with which such taxable years of foreign corporations end."[688]

For taxpayers with foreign subsidiaries whose taxable years do not run from January 1 to December 31 of each year, the effective date mismatch created a window during which Section 245A was in effect, but the amendments to Section 78 were not in effect.

The court was required to address whether, during that window, Section 245A provided Varian Medical Systems, Inc. a deduction for a dividend that Varian Medical Systems was deemed to receive under Section 78.

The Internal Revenue Service argued that,

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[686] I.R.C. § 245A(d).

[687] Tax Cuts and Jobs Act § 14101(f), 131 Stat. at 2192.

[688] Tax Cuts and Jobs Act § 14301(d), 131 Stat. at 2225.

- despite the disparate effective dates, Varian Medical Systems cannot claim a deduction for its Section 78 dividend

  because

  - Section 245A permits a deduction only for dividends that are actually distributed (or treated as distributed) from earnings.

- Section 78 dividends do not satisfy this requirement.
- Alternatively, Treasury Regulation Section 1.78-1, as amended June 21, 2019, disallows the deduction.

Varian Medical Systems argued:

- the operative text of Section 245A permits the deduction and
- no other provision prohibits it.
- Treasury Regulations Section 1.78-1 is invalid

  because

  - Treasury Regulations Section 1.78-1 purports to apply amended Section 78 to a period starting before the effective date provided in the Tax Cuts and Jobs Act.

The Tax Court concluded that a plain reading of the statutory text authorizes the deduction under Section 245A. The Tax Court found for Varian Medical Systems.

The Internal Revenue Service also argued that,

if –

- Varian Medical Systems is entitled to the deduction,

then

- Section 245A(d)(1) limits the amount of foreign tax credits Varian Medical Systems may claim.

The Tax Court agreed with the Internal Revenue Service on this issue.

In 1962, Congress enacted the Revenue Act of 1962[689]The Act adopted Section 78. As enacted in 1962, Section 78 provided:

> *If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under section 902(a)(1) (relating to credit for corporate stockholder in foreign corporation) or under section 960(a)(1)(C) (relating to taxes paid by foreign corporation) for such*

[689] Pub. L. No. 87-834, 76 Stat. 960.

> *taxable year shall be treated for purposes of this title (other than section 245) as a dividend received by such domestic corporation from the foreign corporation.*[690]

After the adoption of Section 78,

if

- a domestic corporation were to claim foreign tax credits for the $15 it was deemed to pay to Country A,

then

- Section 78 would treat the domestic corporation

as if

- the domestic corporation received an additional $15 dividend from is foreign subsidiary for the year.

Instead of reporting $85 of taxable income, the domestic corporation would report $100 of taxable income. This is the

- $85 actual dividend from the foreign subsidiary

plus

- the $15 deemed dividend under Section 78.

After applying its foreign tax credits,

- the domestic corporation would owe $5 in United States tax:

$$(\$100 \times 20\%)\ \$15 = \$5.$$

Section 78 eliminated the perceived tax benefit to United States corporations operating through foreign subsidiaries.

The Department of the Treasury and the Internal Revenue Service adopted the first Treasury Regulations Section 1.78-1 under Section 78.[691] The Treasury Regulations Section 1.78-1 explained that "[a] section 78 dividend shall be treated as a dividend for all purposes of the Code, except that it shall not be treated as a dividend under section 245, relating to dividends received from certain foreign corporations, or increase the earnings and profits of the domestic corporation."[692] The Treasury Regulations Section 1.78-1 also explained that Section 78 dividends are treated as received in the same taxable year in which the United States corporation –

[690] Revenue Act of 1962, § 9(b), 76 Stat. at 1001.

[691] See T.D. 6805, 1965-1 C.B. 38, 30 Fed. Reg. 3208 (Mar. 9, 1965).

[692] Treas. Reg. § 1.78-1(a) (1965).

- received the dividend of foreign earnings upon which it was deemed to pay foreign taxes or
- included in its subpart F income amounts for which it had deemed paid foreign taxes under Section 960.[693]

Section 78 remained virtually unchanged for more than 50 years until Congress' sweeping changes to the international tax system in 2017.

The Tax Cuts and Jobs Act made significant changes to how the United States taxes income that a domestic corporation earns outside the United States.[694] "The primary goal of the changes was to encourage Americans who controlled foreign corporations to invest earnings from their foreign investments back in the United States instead of abroad."[695]

The Tax Cuts and Jobs Act moved the United States from the worldwide system of taxation described above to a partial territorial tax system.

Under a partial territorial system,

- certain income a domestic corporation earns from subsidiaries operating outside the United States generally
- is eliminated from
- the United States taxable base
- through a deduction.

As part of this transition, the Tax Cuts and Jobs Act enacted a one-time Mandatory Repatriation Tax.[696]

The Mandatory Repatriation Tax generally required that –

- certain accumulated foreign earnings held by controlled foreign corporations,
    - but not repatriated to the United States shareholders,

  be included in

- the United States shareholders' subpart F income and
- taxed at a lower-than-normal rate.[697]

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[693] Treas. Reg. § 1.78-1(d) (1965).

[694] *See Moore v. United States*, 144 S. Ct. 1680, 1685 (2024).

[695] *Id.*. at 1685–86.

[696] Tax Cuts and Jobs Act § 14103, 131 Stat. at 2195–208 (codified at I.R.C. § 965); see also *Moore*, 144 S. Ct. at 1686.

[697] See Tax Cuts and Jobs Act § 14103, 131 Stat. at 2195–208; Moore, 144 S. Ct. at 1686.

The Tax Cuts and Jobs Act enacted new Section 245A. This provision granted United States corporations a deduction for the foreign-source portion of any dividends they received from certain foreign corporations.[698] Section 245A also provides –

- rules for calculating the foreign-source portion of dividends that a United States corporation may deduct from its income,[699]

  as well as

- a rule limiting the foreign tax credit "with respect to any dividend" for which Section 245A permits a deduction (which we will discuss later).[700]

The Tax Cuts and Jobs Act made new Section 245A effective for "distributions made after . . . December 31, 2017."[701]

The Tax Cuts and Jobs Act amended Section 78 to read:

> *Sec. 78. Gross up for deemed paid foreign tax credit.*
>
> *If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under subsections (a), (b), and (d) of section 960 (determined without regard to the phrase "80 percent of" in subsection (d)(1) thereof) for such taxable year shall be treated for purposes of this title (other than sections 245 and 245A) as a dividend received by such domestic corporation from the foreign corporation.*[702]

The revised statute no longer references Section 902, which the Tax Cuts and Jobs Act eliminated.[703]

The revised statute mirrors changes Congress made to Section 960.[704]

Section 78 dividends are not treated as dividends for purposes of Section 245A.

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[698] Tax Cuts and Jobs Act § 14101(a), 131 Stat. at 2189–90. The operative rule of section 245A was included in subsection (a), which reads as follows:

Sec. 245A. Deduction for foreign source-portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations.

(a) In general.—In the case of any dividend received from a specified 10-percent owned foreign corporation by a domestic corporation which is a United States shareholder with respect to such foreign corporation, there shall be allowed as a deduction an amount equal to the foreign-source portion of such dividend.

[699] See I.R.C. § 245A(c).

[700] See I.R.C. § 245A(d).

[701] TCJA § 14101(f), 131 Stat. at 2192.

[702] Tax Cuts and Jobs Act § 14301(c), 131 Stat. at 2222.

[703] See Tax Cuts and Jobs Act § 14301(a), 131 Stat. at 2221.

[704] See Tax Cuts and Jobs Act § 14301(b), 131 Stat. at 2221–22.

Congress gave the amendments made to Section 78, as well those made to sections 902 and 960, a different effective date from that used for Section 245A.

Congress applied the amendments "to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end."[705]

The amendments to Section 78 (and Sections 902 and 960) had different effective dates based on whether a taxpayer and its foreign subsidiaries use a calendar year tax year (January 1 to December 31) or a fiscal year tax year (e.g., July 1 to June 30).9

The question before the Tax Court was whether Varian Medical Systems was entitled to deduct an amount equal to its Section 78 dividend for the 2018 Year.

The Tax Court concluded that Varian Medical Systems was entitled to the Section 78 dividend for the 2018 Year.

The Tax Court started with a plain meaning approach. "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there."[706] Further, "the sole function of the courts—at least where the disposition required by the text is not absurd—'. . to enforce [plain statutory text] according to its terms.'"[707]

When "Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."[708]

Applying these principles here produces a clear result, according to the Tax Court.

Section 245A allows a United States corporation to deduct

an amount equal to

- the foreign-source portion of
  - "any dividend received from a specified 10-percent owned foreign corporation"
  - in which
    - the United States corporation "is a United States shareholder with respect to such foreign corporation."[709]

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[705] Tax Cuts and Jobs Act § 14301(d), 131 Stat. at 2225.

[706] *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992).

[707] *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (*quoting United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989)).

[708] *Cheneau v. Garland*, 997 F.3d 916, 920 (9th Cir. 2021), *quoting INS v. Cardoza-Fonseca*, 480 U.S. 421, 432 (1987).

[709] I.R.C. § 245A(a).

To calculate the foreign-source portion, the United States corporation must apply a ratio.[710]

Varian Medical Systems is a "United States shareholder" of specified 10% owned foreign corporations.

The parties disagreed concerning whether Varian Medical Systems' Section 78 dividend qualifies as a "dividend [it] received" within the meaning of Section 245A(a).

The Tax Court concluded that

- Varian Medical Systems' Section 78 dividend

  qualifies as

- a "dividend [it] received" within the meaning of Section 245A(a).

Section 78 is clear, according to the Tax Court.

The amount Varian Medical Systems includes under Section 78 "shall be treated for purposes of this title (other than section 245 [which is not at issue here]) as a dividend received . . . from the foreign corporation."[711]

Section 245A(a) authorizes taxpayers to deduct "any dividend received from a specified 10-percent owned foreign corporation."

The relevant text in the two provisions is effectively identical.

Section 78 specifies that –

- the amount to which it applies

  is treated as

- a dividend for purposes of the entire Code
- with just one exception not currently relevant (Section 245).

Longstanding regulations reiterated this rule until their amendment in 2019.[712]

Section 78 provides that –

- Varian Medical Systems must treat the amount to which Section 78 applies
- as a dividend received from its foreign subsidiaries

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[710] I.R.C. § 245A(c)(1).

[711] I.R.C. § 78.

[712] See Treas. Reg. § 1.78-1(a) (1965) ("A section 78 dividend shall be treated as a dividend for all purposes of the Code, except that it shall not be treated as a dividend under section 245, relating to dividends received from certain foreign corporations, or increase the earnings and profits of the domestic corporation.")

- for all relevant purposes of the Code.

Section 245A(a) provides –

- a deduction for
  - the foreign-source portion of
    - any dividend received from such subsidiaries.

The obvious conclusion, according to the Tax Court, is that

- Section 245A and Section 78, read together, authorize
- Varian Medical Systems to deduct its Section 78 dividend for the 2018 Year.

No other provision in effect for that year disallows the deduction.

The disparate effective dates for –

- new Section 245A and
- the amendments to Section 78

  resulted in

  - a gap period in which
  - Varian Medical Systems' Section 78 dividend qualified for a deduction under Section 245A.

The Internal Revenue Service argued:

- Section 78 dividends are not qualifying dividends for purposes of Section 245A

  because

- Section 78 dividends are not "distributed (or treated as distributed) out of [a foreign corporation's] earnings to the U.S. shareholder."

The Internal Revenue Service based this argument on the effective date provision under the Tax Cuts and Jobs Act. This effective date provision states that Section 245A applies to "distributions made after . . . December 31, 2017.[713]

The Internal Revenue Service emphasized Section 245A(c)(2)(A). In describing how to calculate the foreign-source portion of a dividend, Section 245A(c)(2)(A) refers to "the taxable year . . . in which the dividend is distributed."

According to the Tax Court, the Internal Revenue Service argument fails for at least five reasons:

[713] Tax Cuts and Jobs Act § 14101(f), 131 Stat. at 2192.

- First, the operative rule in Section 245A sets out the conditions for deductibility, but says nothing about distributions. Rather, it says simply that the deduction is available "[i]n the case of any dividend received,"[714]
- Second, even if we did read a distribution requirement into Section 245A(a), we would conclude that a deemed dividend under Section 78 satisfies the requirement.[715]
- Third, coordinating amendments that Congress made to other Code sections in the Tax Cuts and Jobs Act confirm that a dividend or deemed dividend—without an express provision for a distribution—suffices to qualify for the deduction under Section 245A. These amendments establish that either
    - no distribution requirement exists, or
    - alternatively, any distribution requirement is satisfied by a dividend or a deemed dividend.[716]

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[714] I.R.C. § 245A(a) (emphasis added), essentially mirroring the text of I.R.C. § 78. The Tax Court was not inclined to read the reference to "distributions" in the effective date provision to add another unstated requirement to the operative rule. Similarly, the references in I.R.C. § 245A(c)(2) to the "year . in which the dividend is distributed" and the "dividends distributed during [the] taxable year" simply explain how to compute the foreign-source portion of a dividend for purposes of I.R.C. § 245A. The computation works for I.R.C. § 78 dividends: one simply treats the I.R.C. § 78 dividend as the dividend for purposes of applying the instructions, as I.R.C. § 78 mandates. The Tax Court expressed disagreement with the proposition that a computation that may easily be applied to a I.R.C. § 78 dividend somehow shows that I.R.C. § 78 dividends cannot qualify for the deduction.

[715] A I.R.C. § 78 dividend is treated as a dividend for purposes of the entire Code, with one inapplicable exception. A dividend is a distribution, both under the statutory definition of the term and in accordance with its ordinary meaning. The former, found at I.R.C. § 316(a), states that, "[f]or purposes of this subtitle [which includes I.R.C. § 245A], the term 'dividend' means any distribution of property made by a corporation to its shareholders . out of its earnings and profits accumulated after February 28, 1913, or . its earnings and profits of the taxable year." There are many examples of the latter. If I.R.C. § 78 requires a taxpayer to deem a dividend received from a foreign corporation, that dividend would also be deemed to be distributed by the foreign corporation, satisfying any implicit requirement in I.R.C. § 245A.12 *Cf. Rawat v. Commissioner*, 108 F.4th 891, 896 (D.C. Cir. 2024) ("[A]lthough a definitional provision is typically used to give meaning to a defined term, rather than . to give meaning to the language of the definition, such a provision works both ways: if a statute defines 'house' as 'an enclosed structure used as a residence,' one would be hard-pressed to say that the statute's use elsewhere of the phrase 'an enclosed structure used as a residence' means anything but 'house.'"), *rev'g* T.C. Memo. 2023-14.

[716] The Tax Court considered I.R.C. § 1248. I.R.C. § 1248 applies when a United States person who meets certain ownership requirements sells or exchanges stock in a foreign corporation. I.R.C. § 1248(a) generally provides that the gain recognized on the sale or exchange of the stock "shall be included in the gross income of such person as a dividend." I.R.C. § 1248(a) provides a recharacterization rule that treats a portion of the gain from the sale as a dividend inclusion for the seller. The Tax Cuts and Jobs Act coordinated I.R.C. § 1248 with I.R.C. § 245A by adding I.R.C.

§ 1248(j). New I.R.C. § 1248(j) provides that "any amount received by the domestic corporation which is treated as a dividend by reason of this section shall [also] be treated as a dividend for purposes of applying section 245A." The Internal Revenue Service argued that this amendment would have been unnecessary if simply recharacterizing an amount as a dividend were sufficient to qualify for a deduction under I.R.C. § 245A. Even before the Tax Cuts and Jobs Act, I.R.C. § 1248(a) affected such a recharacterization. As the Internal Revenue Service's argument goes, I.R.C. § 1248(j) was needed to satisfy the "distribution" requirement that the Internal Revenue Service reads into I.R.C. § 245A. According to the Tax Court, the Internal Revenue Service misconstrued the statute, which, when considered carefully, contradicts its arguments. The addition of I.R.C. § 1248(j) was necessary, according to the Tax Court, because the reach of the dividend recharacterization under I.R.C. § 1248(a) was unclear. Before the addition of I.R.C. § 1248(j), I.R.C. § 1248 simply provided that gain recognized on a sale or exchange by a certain type of person would be included in the gross income of that person as a dividend. The provision did not say that the recharacterized amount would be a dividend for all purposes of the Code. The provision did not say that the dividend would be treated as a deemed distribution of some sort, although Congress addressed distributions elsewhere in I.R.C. § 1248. See, e.g., I.R.C. § 1248(f), (k). Because the recharacterization work of I.R.C. § 1248(a) was limited in its reach, Congress needed to adopt an affirmative rule to ensure that gain recharacterized by virtue of I.R.C. § 1248(a) was treated as a dividend received for purposes of I.R.C. § 245A. That is what Congress did in adding I.R.C. § 1248(j). There, Congress provided that gain recharacterized as a dividend by virtue of I.R.C. § 1248(a) would also "be treated as a dividend for purposes of applying I.R.C. § 245A." I.R.C. § 1248(j).

No such rule was necessary for a I.R.C. § 78 dividend. Existing I.R.C. § 78 already provided that the amount discussed in that I.R.C. § "shall be treated . as a dividend received by such domestic corporation from the foreign corporation" for purposes of this title. Saying that an amount will be treated in a particular manner "for purposes of this title" (*i.e.*, the Code) is equivalent to listing every section in the Code and saying that the amount will be so treated for purposes of each section. Congress did not need to say more to bring an I.R.C. § 78 dividend within the scope of I.R.C. § 245A. I.R.C. § 245A plainly is within the Code. I.R.C. § 78 provided that the relevant amounts would be treated as dividends received for purposes of that section, precisely as I.R.C. § 1248(j). Congress did need to say something if it wanted to preclude a I.R.C. § 78 dividend from being considered under I.R.C. § 245A.

I.R.C. § 1248(j) highlights an even greater problem for the view the Internal Revenue Service advanced. The Internal Revenue Service claimed that a deduction under I.R.C. § 245A is predicated on the existence of a distribution and a deemed dividend does not suffice. I.R.C. § 1248 addresses gains on sales or exchanges of stock. These transactions involve no actual distributions by the foreign subsidiary whose stock is being transferred. Any consideration in this type of transaction would come from a counterparty, not from the subsidiary. I.R.C. § 1248(a) does not create any deemed distribution—only a deemed dividend, which is inadequate in the Internal Revenue Service's view. If a distribution (actual or expressly deemed) were a prerequisite for I.R.C. § 245A to apply, a person with recharacterized gain under I.R.C. § 1248(a) would be out of luck with respect to a I.R.C. § 245A deduction, absent some further rule. The Internal Revenue Service acknowledged as much and contended that I.R.C. § 1248(j) fills the gap. I.R.C. § 1248(j) says that amounts treated as dividends for purposes of I.R.C. § 1248 "shall [also] be treated as a dividend for purposes of applying section 245A." I.R.C. § 1248(j). I.R.C. § 1248(j) says that any amount I.R.C. § 1248(j) covers shall be treated as a dividend—not that any amount I.R.C. § 1248(j) covers shall be treated as a distribution. I.R.C. § 1248(j) does not fill the gap the Internal Revenue Service purports to see. If we were to accept the

Internal Revenue Service's argument, then the addition of I.R.C. § 1248(j) would have been insufficient to entitle taxpayers to the deduction under I.R.C. § 245A. The Tax Court did not presume that Congress enacts legislation that has no effect. The Internal Revenue Service acknowledged that the addition of I.R.C. § 1248(j) was in fact sufficient to provide a deduction for amounts under I.R.C. § 245A. The same is true for I.R.C. § 78. I.R.C. § 1248(j) added nothing to the Code that I.R.C. § 78 did not already include. The wording of I.R.C. § 1248(j) confirms that I.R.C. § 245A requires nothing more than (1) an amount being treated as a dividend and (2) that treatment being extended for I.R.C. § 245A purposes either by express cross-reference to I.R.C. § 245A (as in the case of I.R.C. § 1248) or by a broader cross-reference that includes I.R.C. § 245A (as in the case of I.R.C. § 78). I.R.C. § 1248(j) also undercuts the Internal Revenue Service's reliance on the computation provisions of I.R.C. § 245A. For purposes of determining the foreign-source portion of a dividend, I.R.C. § 245A(c) applies a ratio. I.R.C. § 245A(c)(1) provides that the foreign-source portion "is an amount which bears the same ratio to [the] dividend" as "the undistributed foreign earnings" of the foreign corporation bear to "the total undistributed earnings" of the foreign corporation. In calculating the undistributed earnings, I.R.C. § 245A(c)(2) refers to the "year . in which the dividend is distributed" and the "dividends distributed during [the] year." Because I.R.C. § 78 dividends, the Internal Revenue Service says, are not actual or deemed "distributions," the ratio does not work, presumably because there would be no "year . in which the dividend is distributed." If the Internal Revenue Service's reading of I.R.C. § 245A(c) were correct, the same analysis would apply to amounts treated as dividends under I.R.C. § 1248. Those amounts also are not "distributed," and nothing in I.R.C. § 1248 deems them as distributions. So for those amounts too the ratio would not work if an actual or deemed distribution were required. Yet, counsel for the Internal Revenue Service conceded that the ratio would work for I.R.C. § 1248 dividends and that they are in fact eligible for the deduction under I.R.C. § 245A. So, the computation provisions of I.R.C. § 245A cannot be the impediment that the Internal Revenue Service portrays them to be.

I.R.C. § 964(e), the other provision that the Internal Revenue Service cites, deals with gain recognized by a controlled foreign corporation on the sale or exchange of stock in a foreign corporation. Like I.R.C. § 1248(a), I.R.C. § 964(e)(1) recharacterizes a portion of the gain as a dividend received by the controlled foreign corporation. Congress coordinated the rule with I.R.C. § 245A by providing that the deduction "shall be allowable" to the ultimate United States shareholder for the resulting subpart F income "in the same manner as if such subpart F income were a dividend received by the shareholder from the selling [controlled foreign corporation]." I.R.C. § 964(e)(4)(A)(iii). For the same reasons that the Tax Court discussed with respect to I.R.C. § 1248, Congress needed to add an affirmative rule if Congress wished for gain recharacterized under I.R.C. § 964(e)(4) to receive the benefit of I.R.C. § 245A. As with I.R.C. § 1248, the text of I.R.C. § 964 does not provide specifically for a distribution to a domestic corporation, as the Internal Revenue Service says is required. The amounts for which a taxpayer may claim a I.R.C. § 245A deduction are subpart F inclusions (*i.e.*, not distributions). I.R.C. § 964(e)(4) does not fill the purported gap. I.R.C. § 964(e)(4) provides for the subpart F inclusion to be treated in the same manner as a dividend and not as a distribution. Congress viewed treating an amount as a dividend as sufficient to accomplish its purpose of making an amount eligible for a deduction under I.R.C. § 245A.

Adopting a rule that treats an amount as a dividend for purposes of I.R.C. § 245A is sufficient to qualify the amount for the dividends received deduction. See I.R.C. §§ 964(e)(4)(A)(iii), 1248(j). By its express terms, I.R.C. § 78 already treated the amount discussed there as a dividend for all purposes of the Code (other than one section that is not relevant here). There was no need for Congress to change I.R.C. § 78 to confirm that I.R.C. § 78 dividends qualified for the deduction.

- Fourth, the Tax Court's conclusion is consistent with Congress' historical practice in this area of the Code.[717]
- Finally, the Commissioner argued that Varian Medical Systems' "position is illogical in treating its subpart F income as ineligible for the Section 245A dividends received deduction but the Section 78 gross-up arising from that inclusion as qualifying, even though the latter is the tax expense that was incurred on subpart F income."[718]

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[717] The Tax Court asked counsel whether these and similar statements in the Internal Revenue Service's Motion papers were intended to invoke the absurd results doctrine, which allows a court to depart from a statute's clear text in certain circumstances. Counsel clarified that the Internal Revenue Service was not invoking the absurd results doctrine. The absurd results doctrine imposes a high bar. Specifically, an interpretation is absurd only if the result would be "so gross as to shock the general moral or common sense," *Crooks v. Harrelson*, 282 U.S. 55, 60 (1930), or if it is "quite impossible that Congress could have intended the result . and [if] the alleged absurdity is so clear as to be obvious to most anyone," *Tamm v. UST-U.S. Trustee* (*In re Hokulani Square, Inc.*), 776 F.3d 1083, 1088 (9th Cir. 2015) (*quoting Pub. Citizen v. U.S. Dep't of Just.*, 491 U.S. 440, 471 (1989) (Kennedy, J., concurring in the judgment)). These circumstances are not present here. The Code is full of provisions that treat taxpayers differently. This does not mean that those provisions are absurd. Similarly, the Tax Court's interpretation of I.R.C. § 245A will reduce the amount of income tax owed by certain taxpayers does not mean that result is absurd. Further, general policy concerns (*i.e.*, those that fall short of an absurd result) and speculation about Congressional intent cannot override clear statutory text. That is so because "[a]chieving a better policy outcome . is a task for Congress, not the courts."

Congress spoke clearly on the point at issue when it enacted I.R.C. § 245A and selected the mismatched effective dates for that provision and the amendments to I.R.C. § 78. Appeals to policy and Congress' overarching purpose cannot overcome these choices, no matter how much the Internal Revenue Service may dislike them. An unenacted technical correction proposal does not alter the result.

The force of these principles is especially apparent in a case like this one, where Congress chose the rule it adopted over a readily available alternative. Specifically, the Senate version of the bill that became the Tax Cuts and Jobs Act had conforming effective dates for the bill's I.R.C. § 78 amendments and for new I.R.C. § 245A, which, if applied, would have precluded Varian Medical Systems' deduction. Congress chose the rule it adopted for I.R.C. § 78 despite making changes to other statutory provisions to reflect the adoption of I.R.C. § 245A and made those changes effective at the same time as I.R.C. § 245A. See, e.g., Tax Cuts and Jobs Act § 14101(b) and (c), 131 Stat. at 2191 (inserting references to I.R.C. § 245A into I.R.C. § 246); *id.* subsec. (d) (inserting references to I.R.C. § 245A into I.R.C. § 904(b)). Congress could have included in Tax Cuts and Jobs Act § 14101 a similar, modest amendment to I.R.C. § 78 with an effective date matching that of I.R.C. § 245A, while leaving the more substantive amendments for Tax Cuts and Jobs Act § 14301 with an effective date that matched the repeal of I.R.C. § 902 and the amendments to I.R.C. § 960. Congress followed a different path. The Tax Court stated that I would respect the choice that Congress made and give effect to the statute as written.

[718] The Tax Court acknowledged that it struggled to see why Varian Medical Systems' position is illogical. As a general matter, subpart F income is not a dividend; rather it is simply an inclusion in gross income. Subpart F income does not qualify for a deduction under the terms of I.R.C. § 245A.

The Internal Revenue Service argued that Treasury Regulation Section 1.78-1, as revised June 21, 2019, precludes Varian Medical Systems from deducting its Section 78 dividend. The second sentence of Treasury Regulation Section 1.78-1(a) (as amended in 2019) says:

> *A section 78 dividend is treated as a dividend for all purposes of the Code, except that it is not treated as a dividend for purposes of section 245 or 245A, and does not increase the earnings and profits of the domestic corporation or decrease the earnings and profits of the foreign corporation.*

Subsection (c) applies this sentence (and this sentence only) "to section 78 dividends that are received after December 31, 2017, by reason of taxes deemed paid under section 960(a) with respect to a taxable year of a foreign corporation beginning before January 1, 2018." The rule adopted by the revised Treasury Regulations Section 1.78-1s gives one of the Tax Cuts and Jobs Act's amendments to Section 78 an earlier effective date than provided for in the Tax Cuts and Jobs Act to prevent taxpayers like Varian Medical Systems from deducting Section 78 dividends. The plain text of the statutes provides for the deduction.

The Tax Court observed that "self-serving regulations never 'justify departing from the statute's clear text.'"[719]

The Internal Revenue Service initially argued that,

- even if the Tax Court disagreed with his interpretation of the statute,
- the statute was at least ambiguous and
- under *Chevron*,[720] the Tax Court had to accept his Treasury Regulations Section 1.78-1's attempt to fill the gap because his interpretation was permissible.

The Tax Court acknowledged that *Chevron* has now been overruled.[721]

I.R.C. § 78 expressly deems Varian Medical Systems to receive a dividend, which does qualify for the deduction. The Internal Revenue Service's problem lies with the text of the statute, not Varian Medical Systems' position, according to the Tax Court.

[719] *Niz-Chavez v. Garland*, 141 S. Ct. 1474, 1485 (2021) (*quoting Pereira v. Sessions*, 138 S. Ct. 2105, 2118 (2018)); *see also Util. Air Regul. Grp. v. EPA*, 573 U.S. 302, 328 (2014) ("[T]he need to rewrite clear provisions of the statute should have alerted [the Government] that it had taken a wrong interpretive turn."); *Koshland v. Helvering*, 298 U.S. 441, 447 (1936) ("[W]here . the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation."); *Abdo v. Commissioner*, No. 5514-20, 162 T.C., slip op. at 21 (Apr. 2, 2024) (reviewed) ("Respondent's regulation . cannot change the result dictated by an unambiguous statute."), *citing Niz-Chavez*, 141 S. Ct. at 1485).

[720] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[721] *See Loper Bright*, 144 S. Ct. at 2273.

A "permissible" interpretation of a statute no longer prevails simply because an agency offers it to resolve a perceived ambiguity.[722]

The Supreme Court observed in *Loper Bright*, "statutes, no matter how impenetrable, do—in fact, must—have a single, best meaning. That is the whole point of having written statutes; 'every statute's meaning is fixed at the time of enactment.'"[723]

In cases involving ambiguity, "instead of declaring a particular party's reading 'permissible' . , courts [must] use every tool at their disposal to determine the best reading of the statute and resolve the ambiguity."[724] "In an agency case as in any other . . . even if some judges might (or might not) consider the statute ambiguous, there is a best reading all the same—the reading the court would have reached if no agency were involved."[725] "In the business of statutory interpretation, if it is not the best, it is not permissible."[726] The best reading of the provisions at issue here permits Varian Medical Systems' deduction, according to the Tax Court.

The Tax Court observed that it gave "[c]areful attention to the judgment of the Executive Branch."[727] The Executive's views "constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance."[728] "The weight of such a judgment in a particular case," of course, "depend[s] upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."[729]

Nevertheless, "[c]ourts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority."[730] It "remains the responsibility of the court to decide whether the law means what the agency says."[731] "Congress expects courts to do their ordinary job of interpreting statutes."[732] "And to the extent that Congress and the Executive Branch may disagree with how the courts have performed that job in a particular case, they are of course always free to act by revising the statute."[733]

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[722] *See Loper Bright*, 144 S. Ct. at 2273.
[723] *See Loper Bright*, 144 S. Ct. at 2273.
[724] *Id.*
[725] *Id.*. (cleaned up).
[726] *Id.*
[727] *Id.*. at 2273.
[728] *Id.*. at 2262 (*quoting Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)).
[729] *Id.*. at 2259 (quoting *Skidmore*, 323 U.S. at 140).
[730] *Id.*. at 2273.
[731] *Id.*. at 2261 (*quoting Perez v. Mortg. Bankers Ass'n*, 575 U.S. 92, 109 (2015) (Scalia, J., concurring in the judgment)).
[732] *Id.*. at 2267.
[733] *Id.*

In *Varian Medical Systems*, "the question that matters [is]: Does the statute authorize the challenged agency action?"[734] The court may not follow the Executive's guidance (expressed in a regulation or elsewhere) when (as here) it contradicts the statutory text.[735] The Supreme Court's view on this principle is unanimous.[736] When the court can find that meaning—a 'single right answer'—that is 'the end of the matter': The court cannot defer because it "must give effect to the unambiguously expressed intent of Congress."[737]

That Congress delegated certain rulemaking authority to Treasury under Section 245A did not help the Internal Revenue Service in its defense of the Section 78 Treasury Regulations Section 1.78-1. The Treasury Regulations Section 1.78-1 purports to modify the effective date provision for new Section 78, which could hardly have been clearer. Th Treasury Regulations Section 1.78-1 impermissibly attempts to change an unambiguous provision of the statute. As a result, the Treasury Regulations Section 1.78-1 falls outside the boundaries of any authority that Congress may have delegated under Section 245A or 7805.[738]

The Internal Revenue Service pushes back on this reading of the Treasury Regulations Section 1.78-1. Specifically, the Internal Revenue Service says that the Treasury Regulations Section 1.78-1 was not intended to interpret the statute's effective date, but rather "the ambiguous interaction between [s]ection 245A and [p]rior [s]ection 78 during the relevant period." The Tax Court rejected this argument.

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[734] *Id.*. at 2269.

[735] *See, e.g., Niz-Chavez*, 141 S. Ct. at 1485; *Koshland v. Helvering*, 298 U.S. at 447.

[736] *See Loper Bright*, 144 S. Ct. at 2264 (observing that, even under *Chevron*, "'[i]f the intent of Congress is clear, that is the end of the matter,' [*Chevron*, 467 U.S. at 842,] and courts were therefore to 'reject administrative constructions which are contrary to clear Congressional intent,' [*Chevron*, 467 U.S. at 843, n.9]"); see also *id.* at 2297 (Kagan, J., dissenting) (summarizing *Chevron* and observing that the step one "inquiry is rigorous: A court must exhaust all the 'traditional tools of statutory construction' to divine statutory meaning. [*Chevron*, 467 U.S.] at 843, n.9."). See also *id.* at 2297 (Kagan, J., dissenting) (summarizing *Chevron* and observing that the step one "inquiry is rigorous: A court must exhaust all the 'traditional tools of statutory construction' to divine statutory meaning. [*Chevron*, 467 U.S.] at 843, n.9. And when it can find that meaning—a 'single right answer'—that is 'the end of the matter': The court cannot defer because it 'must give effect to the unambiguously expressed intent of Congress.' *Kisor* [*v. Wilkie*, 139 S. Ct. 2400, 2415 (2019)] (opinion of the Court); *Chevron*, 467 U.S., at 842–843"); *id.* at 2300 (Kagan, J., dissenting) ("Where Congress has spoken, Congress has spoken; only its judgments matter. And courts alone determine when that has happened: Using all their normal interpretive tools, they decide whether Congress has addressed a given issue.").

[737] *Kisor v. Wilkie*, 139 S. Ct. 2400, 2415 (2019),

[738] *See, e.g., United States v. Locke*, 471 U.S. 84, 95 (1985) ("There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted." (*quoting Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978))); *see also Loper Bright*, 144 S. Ct. at 2263 (noting that, where Congress has delegated discretionary authority to an agency, courts fulfill their role by "fix[ing] the boundaries of [the] delegated authority" (*quoting* Henry P. Monaghan, Marbury and the Administrative State, 83 Colum. L. Rev. 1, 27 (1983))).

First, if the revised Treasury Regulations Section 1.78-1 truly were aimed at resolving an ambiguity between Section 245A and prior Section 78, one would expect it to reference Section 902.[739]

Second, the revised Treasury Regulations Section 1.78-1 makes precisely the same change as new Section 78 (adding an explicit carveout for Section 245A), but with an earlier effective date. No matter what the revised Treasury Regulations Section 1.78-1 intended to interpret, the revised effective date provided in the Section 78 Treasury Regulations Section 1.78-1 cannot contradict the clear effective date provided for in the statutory text.

For these reasons, the Tax Court held that the amended Treasury Regulations Section 1.78-1 does not alter its conclusion as to Varian Medical Systems' claimed deduction.

The court also discussed how Section 245A(d) affected the foreign tax credits that Varian Medical Systems claimed for its deemed paid foreign taxes.

[4] United States ex rel. Kyer v. Thomas Health System, Inc. (September 2024): District Court Ordered Briefing On The Effects Of Loper Bright Enterprises..

United States ex rel. Kyer v. Thomas Health System, Inc.,[740] involved a *qui tam* action brought by a private citizen to enforce the False Claims Act,[741] the Stark Law,[742], and the Anti-Kickback Statute.[743] The Stark Law prohibits physicians and entities in financial relationships from improperly benefiting from self-referrals. Relator bought four causes of action under the False Claims Act:

- presentment of false claims to the United States for payment or approval, in violation of 31 U.S.C. § 3729(a)(1)(A);

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[739] I.R.C. § 902was referenced in prior I.R.C. § 78 and was still in effect for Varian Medical Systems' 2018 Year. See Tax Cuts and Jobs Act § 14301(d), 131 Stat. at 2225 (striking I.R.C. § 902 for "taxable years of foreign corporations beginning after December 31, 2017, and [for] taxable years of United States shareholders in which or with which such taxable years of foreign corporations end"). Neither the revised regulation nor its effective date provision mentions I.R.C. § 902. The sentence of the revised regulation purporting to disallow I.R.C. § 245A deductions for I.R.C. § 78 dividends applies only "to section 78 dividends that are received . by reason of taxes deemed paid under section 960(a)." Treas. Reg. § 1.78-1(c). The revised regulation ignores a key part of prior I.R.C. § 78 and presumably would not prevent Varian Medical Systems from claiming a I.R.C. § 245A deduction for its I.R.C. § 78 dividends related to I.R.C. § 902 deemed paid taxes. The omission of any reference to I.R.C. § 902 from the new regulation casts doubt on the Internal Revenue Service's claim that the regulation interprets prior I.R.C. § 78.

[740] __ F. Supp. 3d __, 2024 W.L. 4165082 (S.D.W. Va 2024).

[741] 31 U.S.C. §§ 3729-33.

[742] 42 U.S.C. § 1395nn.

[743] 42 U.S.C. §§ 1320a-7a(a)(7) and 1320a-7b(b).

- using false statements material to the payment of false of fraudulent claims, in violation of 31 U.S.C. § 3729(a)(1)(B);
- conspiracy between Defendants to commit a violation of the False Claims Act, in violation of 31 U.S.C. § 3729(a)(1)(C); and
- making, using, or causing to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly concealing or knowingly and improperly avoiding or decreasing an obligation to pay or transmit money or property to the Government, in violation of 31 U.S.C. § 3729(a)(1)(G).

The District Court wrote:

> *Rulemaking has reshaped the Stark Law for the last thirty years. [Citation omitted.] Relative to the pending case, the Stark Regulations find an "indirect compensation arrangement" when three conditions are met. 42 C.F.R. §§ 411.354(c)(2)(i)–(iii). Generally, they are (1) an unbroken chain of persons and/or entities with a financial relationship with each other, (2) a referring physician receives "aggregate compensation" from a financially related entity that "varies with the volume or value of referrals," and (3) the entity furnishing designated health services "has actual knowledge of, or acts in reckless disregard or deliberate ignorance of" the aggregate compensation scheme. Id. Complicated further, the Stark Regulations provide special rules and exceptions to indirect compensation agreements. Id. at 411.354(c)(4). Exceptions in § 411.355 and § 411.357(p) redefine certain indirect compensation arrangements to take them outside the Stark Law.*

The District Court was uncertain of the effect of *Loper Bright Enterprises* on the case. The District Court ordered briefing on the effects of *Loper Bright Enterprises*.

> *Rulemaking has reshaped the Stark Law for the last thirty years. [Citation omitted.] Relative to the pending case, the Stark Regulations find an "indirect compensation arrangement" when three conditions are met. 42 C.F.R. §§ 411.354(c)(2)(i)–(iii). Generally, they are (1) an unbroken chain of persons and/or entities with a financial relationship with each other, (2) a referring physician receives "aggregate compensation" from a financially related entity that "varies with the volume or value of referrals," and (3) the entity furnishing designated health services "has actual knowledge of, or acts in reckless disregard or deliberate ignorance of" the aggregate compensation scheme. Id. Complicated further, the Stark Regulations provide special rules and exceptions to indirect compensation agreements. Id. at 411.354(c)(4). Exceptions in § 411.355 and § 411.357(p) redefine certain indirect compensation arrangements to take them outside the Stark Law.*
>
> *For 40 years, federal courts were instructed to defer—in varying ways—to agency interpretation of statutory language. Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984), overruled by Loper Bright Enterprises v. Raimondo, __ U.S. __–, 144 S. Ct. 2244, 219 L.Ed.2d 832 (2024). On June 28, 2024, The Supreme Court overruled Chevron and held Loper Bright in its place. The Court, abolishing the two-step Chevron deference analysis, reaffirmed that "[i]t is emphatically the province and duty of the judicial department to say what the law is." Id. at 2257 (quoting Marbury v. Madison, 5 U.S. 137, 1 Cranch 137, 177, 2 L.Ed. 60 (1803)).*

The Administrative Procedure Act, "a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices," could not be reconciled with Chevron for multiple reasons. Id. at 2261 (quoting U.S. v. Morton Salt Co., 338 U.S. 632, 644, 70 S.Ct. 357, 94 L.Ed. 401 (1950)). First, the "best" reading of a statute is the one the court—not the agency—concludes is best "after applying all relevant interpretive tools." Id. at 2266. Second, courts have the expert competence necessary to resolve statutory ambiguities. Id. Agencies do not. Id. Lastly, courts are expected to handle technical statutory questions. Id. at 2267. In every case, the parties are "steeped in the subject matter," and the courts do not answer questions blindly. Id.

Of course, the Executive Branch's expertise and interpretation may be informative, especially "to the extent it rests on factual premises within [the agency's] expertise." Id. (quoting Bureau of Alcohol, Tobacco and Firearms v. FLRA, 464 U.S. 89, 98, n.8, 104 S.Ct. 439, 78 L.Ed.2d 195 (1983) (emphasis added)). Nevertheless, courts may not abandon their responsibility to interpret the law. Id. at 2273. "[C]ourts need not and under the APA may not defer to an agency interpretation of the law simply because a statute is ambiguous." Id.

III. Discussion

In the time since Defendants' Motion became ripe, the United States Supreme Court decided Loper Bright. No party supplemented its Motion to Dismiss argument to discuss Loper Bright's impact on Relator's claim, however, I am concerned that I must carefully consider this newest precedent.

Over time the Stark Law (and accompanying regulations) has evolved into a labyrinth of multipart compliance requirements where the exception-to-the-exception-to-the-exception is the norm. Steven D. Wales, The Stark Law: Boon or Boondoggle? An Analysis of the Prohibition on Physician Self-Referrals, 27 Law & Psychol. Rev. 1, 22–23 (2003) (collecting critical descriptions of the Stark Law, which can just as easily be used to describe the Stark Regulations today). Perhaps, under Chevron, federal courts could wade through Stark Law claims by deferring and defaulting to an agency's interpretation. United States ex rel. Drakeford v. Tuomey Healthcare System, Inc., 675 F.3d 394, 407 (4th Cir. 2012) (determining what constitutes a "referral" under Stark Regulations); Council for Urological Interests v. Burwell, 790 F.3d 212, 219–24 (D.C. Cir. 2015) (interpreting regulations of physician-entity equipment leases and the definition of "entit[ies] furnishing designated health services"); United States v. Solinger, 457 F.Supp.2d 743, 756-57 (W.D. Ky. 2006) (interpreting a regulation establishing a Stark exception).

That deference is no longer required; indeed, that deference is no longer acceptable. Loper Bright Enterprises, 144 S. Ct. at 2273. Inevitably, Loper Bright will begin to ripple through the Stark Regulations. The only question for courts is when and how. Because I have seen very little research on this intersection of law, the parties should welcome the opportunity to lay out Loper Bright versus Stark for the first time.

As mentioned, commentary on Loper Bright's impact is sparce: one federal court and two speculative online blog posts. Scholarship and cases across the country have only begun to address Loper Bright's impact on federal healthcare regulation. United States ex rel. Sheldon v. Forest Laboratories, LLC, No. ELH-14-2535, 2024 WL 3555116 at 33 (D. Md. July 23, 2024) (slip copy) (inviting the parties to submit supplemental briefing on Loper Bright's impact on the court's interpretation of the Medicaid Rebate Statute in

a False Claims Act claim); Anna Akers Hornsby, et al., The Overturn of Chevron: A New Design for Healthcare Law, Eye on Enforcement (Jul. 15, 2024), https://www.eyeonenforcement.com/2024/07/the-overturn-of-Chevron-a-new-design-for-healthcare-law (". . Loper may give a defendant that has not complied with guidance the opportunity to argue to a court that the guidance is inconsistent with a statute or otherwise outside of an agency's statutory authority."); Pascal Naples, et al., Post-Chevron Health Care Regulations: What May Be in Store for Stark Law Litigation, JD Supra (Jul. 24, 2024), https://www.jdsupra.com/legalnews/post-Chevron-health-care-regulations-1965853 ("the court could disagree with . . . any definition contained within a regulation promulgated by CMS pursuant to the Stark Law.").

The problem is that I cannot determine if Relator has stated a claim upon which relief can be granted if I do not know what the Stark Law requires. Here, the Stark Regulations provide the definitional foundation of Relator's Stark Law claim. 42 C.F.R. § 411.354(a) (providing that financial relationships may be "direct or indirect compensation arrangements"); 42 C.F.R. § 411.354(c)(1) (defining a "direct compensation arrangement"); 42 C.F.R. § 411.354(c)(2) (defining an "indirect compensation arrangement"); 42 C.F.R. § 411.354(c)(4) (exceptions to indirect compensation arrangements). The question before the court is whether those definitions are consistent with Congressional authorization and the statute.

Without regulations, the Stark Law is certainly shorter: When a physician and an entity have a "financial relationship," (1) the physician may not make referrals to the entity "for the furnishing of designated health services for which payment otherwise may be made" and (2) an entity may not present a claim to a third-party payor "furnished pursuant to" a prohibited referral. 42 U.S.C. § 1395nn(a). Loper Bright mandates a careful, considerate examination.

Because the parties have not had an opportunity to address Loper Bright's, impact on the pending claim, if any, I ORDER both the Plaintiff and Defendants to file simultaneous briefs on the issue by October 4, 2024. Both Plaintiff and Defendants shall file responses to the opposing party's brief by October 18, 2024.

[5] In re MCP No. 185: Loper Bright Enterprises *Appied to Federal Communications Commission Net Neutrality Rules.*

The United States Court of Appeals for the Sixth Circuit set aside FCC net neutrality regulations for mobile broadband in *In re MCP No. 185*.[744] This case applied *Loper Bright Enterprises* principles to hold that the Federal Communications Commission regulations were not entitled to deference. *In re MCP No. 185* addressed whether Broadband Internet Service Providers offer the "information service" or "telecommunications service." The Sixth Circuit held that Broadband Internet Service Providers offer an information service and that mobile broadband is a private mobile service. Therefore, the Federal Communications Commission exceeded its statutory authority by issuing the Safeguarding Order discussed below. *In re MCP No. 185* invalidated the Federal Communications Commission rules concerning "net

[744] *In re MCP No. 185*, 2025 W.L. 16388 (6th Cir. January 2, 2025).

neutrality." The Federal Communications Commission "net neutrality" rules prohibit internet service providers from blocking, slowing down, or charging extra for internet content and applications.

The Federal Communications Commission regulates the Internet under the authority of the Telecommunications Act of 1996. Beginning in the late 2000s, the Federal Communications Commission undertook various attempts to impose net neutrality policies concerning broadband internet access. Those "net neutrality policies" prohibit Broadband Internet Service Providers from controlling users' Internet access—by varying speeds or blocking connections to third-party websites, for example—based on content, commercial agreements, and other reasons a provider might want to manage a user's Internet experience.

In 2015, the Federal Communications Commission determined that Broadband Internet Service Providers offer to consumers a "telecommunications service" and thus are common carriers. As such, Broadband Internet Service Providers were subject to extensive regulation (including net-neutrality restrictions) under Title II of the Communications Act.[745]

The Federal Communications Commission rescinded its 2015 determination in 2018. Then, the Federal Communications Commission concluded that Broadband Internet Service Providers offered only "information service."[746] That change lifted the net-neutrality requirements.

In re MCP No. 185 considered a Federal Communications Commission order, issued in 2024 (the Safeguarding and Securing the Open Internet Order). Under this order, Broadband Internet Service Providers are deemed to offer a "telecommunications service" under Title II. This requires those Broadband Internet Service Providers to abide by net-neutrality principles ("Safeguarding Order").[747]

The Sixth Circuit observed in *In re MCP No. 185* that the court no longer afforded deference to the Federal Communications Commission's reading of the statute.[748] The task of the court is to determine "the best reading of the statute" in the first instance.[749] This follows from *Loper Bright Enterprises*.

The Sixth Circuit in *In re MCP No. 185* applied "the traditional tools of statutory construction," to hold that Broadband Internet Service Providers offer only an "information service"[750]

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[745] 47 U.S.C. § 153(51).

[746] 47 U.S.C. § § 153(24).

[747] 89 Fed. Reg. 45404 (May 22, 2024) (to be codified at 47 C.F.R. pts. 8, 20)

[748] *Loper Bright Enters. v. Raimondo*, 603 U.S. 369 (2024), *overruling Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

[749] *Id.*

[750] Under 47 U.S.C. § 153(24).

The Sixth Circuit held that the Federal Communications Commission lacks the statutory authority to impose its desired net-neutrality policies through the "telecommunications service" provision of the Communications Act.[751]

Further, the Sixth Circuit found that the Federal Communications Act permitted the Federal Communications Commission to classify mobile broadband—a subset of broadband Internet services—as a "commercial mobile service" under Title III of the Act (and then similarly impose net-neutrality restrictions on those services).[752]

Broadband Internet Service Providers connect "end users" (consumers) to "edge providers" (websites that generate their own content, such as video streaming services (Netflix), commercial marketplaces (Amazon), social media (Facebook), and search engines (Google)) via an interconnected network of fiber optic cables, high-speed routers, and other equipment. Over 90% of all households in the United States have a broadband Internet subscription.

In re MCP No. 185 considered the degree to which the Federal Communications Commission can regulate Broadband Internet Service Providers under the authority granted to it by the Communications Act of 1934, as amended by the Telecommunications Act of 1996. The Federal Communications Act extends similar oversight to wire and radio communications. The Federal Communications Act provides the Federal Communications Commission with regulatory authority that depends on the type of service the regulated entity provides.[753]

The Federal Communications Act provides for light regulation under Title I[754] unless a provider qualifies as a "common carrier" under Title II of the Federal Communications Act,[755] The common-carrier designation results in significant regulatory oversight. This regulatory oversight includes requirements to "charge just and reasonable, nondiscriminatory rates to their customers, design . . . systems so that other carriers can interconnect with their communications networks, and contribute to the federal 'universal service' fund."[756]

The Telecommunications Act of 1996[757] specifies two new services that the Federal Communications Commission may regulate:

- "information service,"[758] and

[751] 47 U.S.C. § 153(51).

[752] 47 U.S.C. § 332(c)(1)(A).

[753] Communications Act of 1934, Pub. L. 73-416, 48 Stat. 1064 (1934).

[754] 47 U.S.C. §§ 154(i), 161.

[755] 47 U.S.C. § 201–03.

[756] *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 975 (2005), *citing* 47 U.S.C. §§ 201–09, 251(a)(1), 254(d).

[757] Pub. L. 101-104, 110 Stat. 56 (1996).

[758] 47 U.S.C. § 153(24).

- "telecommunications service."[759]

"[I]nformation service" manipulates data.

A "telecommunications service" does not.

In re MCP No. 185 addressed whether Broadband Internet Service Providers offer "information service" or "telecommunications service."

The Federal Communications Act prescribes that a telecommunications carrier "shall be treated as a common carrier . . . to the extent that it is engaged in providing telecommunications services."[760]

A Broadband Internet Service Providers that does not offer an "information service" is not subject to common-carrier regulations.

For almost 20 years after Congress enacted the Telecommunications Act,

- the Federal Communications Commission's position was that
  - companies providing access to the Internet offered
  - information services and not telecommunications services.

Thus, Title II's common-carrier regulations did not apply.

Applying the *Chevron* framework,

- the Supreme Court upheld the Federal Communications Commission determination that −
  - cable companies providing cable modem service—a precursor to the service that Broadband Internet Access Providers provide—
    - offered only an information service and
  - thus could not be regulated as Title II common carriers.[761]

The Federal Communications Commission's 2015 Open Internet Order −

- reclassified Broadband Internet Service Providers as −
  - offering a telecommunications service subject to common-carrier regulation under Title II and
  - then imposed net-neutrality regulations on them.[762]

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[759] 47 U.S.C. § 153(53).

[760] 47 U.S.C. § 153(51).

[761] Brand X, 545 U.S. at 986, 125 S.Ct. 2688 (upholding the 2002 Internet Over Cable Declaratory Ruling).

[762] 30 FCC Rcd. 5601.

The D.C. Circuit found this interpretation permissible under *Chevron*. It then denied *en banc* review.[763]

The Federal Communications Commission later changed course. With its In re Restoring Internet Freedom Order, the Federal Communications Commission determined that broadband Internet is an information service.[764] The D.C. Circuit upheld this determination under *Chevron*.[765]

The Safeguarding Order once more imposes net-neutrality policies on Broadband Internet Service Providers by reclassifying broadband Internet as a telecommunications service subject to common-carrier regulation under Title II.[766] This order undoes the earlier order issued during the first Trump administration, which undid the order issued during the Obama administration, which undid orders issued during the Bush and Clinton administrations.

A panel of the Sixth Circuit denied motions by the Federal Communications Commission and one petitioner to transfer these petitions to the D.C. Circuit. The Sixth Circuit panel then stayed the Order pending review.[767]

In the Six Circuit's view, whether Broadband Internet Service Providers are Title II common carriers and subject to net-neutrality policies is "likely a major question requiring clear congressional authorization."

Further, the Communications Act "likely does not plainly authorize the Commission to resolve this question."[768]

Chief Judge Sutton, writing separately, would have granted the stay for the additional reason that "[t]he best reading of the statute, and the one in place for all but three of the last twenty-eight years, shows that Congress likely did not view broadband providers as common carriers under Title II of the Telecommunications Act."[769]

The Administrative Procedure Act mandates that courts "hold unlawful and set aside agency action" that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" or "in excess of statutory jurisdiction, authority, or limitations."[770]

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[763] *See U.S. Telecom Ass'n v. Federal Communications Commission*, 855 F.3d 381, 382 (D.C. Cir. 2017) The Supreme Court denied certiorari. 586 U.S. 994 (2018).

[764] 33 FCC Rcd. 311 (2018).

[765] *See Mozilla Corp. v. Federal Communications Commission*, 940 F.3d 1 (D.C. Cir. 2019) (per curiam).

[766] 89 Fed. Reg. at 45404.

[767] *In re MCP No. 185*, 2024 W.L. 3650468, at *1, *5 (6th Cir. Aug. 1, 2024) (per curiam).

[768] *Id.* at *3; *see, e.g., West Virginia v. E.P.A.*, 597 U.S. 697, 724–32, (2022) (reviewing the major questions doctrine).

[769] *In re MCP No. 185*, 2024 W.L. 3650468, at *5 (Sutton, C.J., concurring).

[770] 5 U.S.C. § 706(2)(A), (C).

Based on that standard, the Sixth Circuit found that the Safeguarding Order misreads the text of the Communications Act as it applies to Broadband Internet Service Providers and mobile broadband services.

The Sixth Circuit held that Broadband Internet Service Providers offer an information service and that mobile broadband is a private mobile service. Therefore, the Federal Communications Commission exceeded its statutory authority by issuing the Safeguarding Order.

The core of the Internet and its associated services is the ability to retrieve and to utilize information.

Broadband Internet Service Providers offer to members of the public Internet access.

The question is whether,

- in offering public Internet access, they are merely a conduit for data transmission and thus offer consumers a telecommunications service (as the Safeguarding Order concludes); or
- instead, Broadband Internet Service Providers offer consumers the capability to acquire, to store, and to utilize data—and thus offer consumers an information service.

The Sixth Circuit found that, under the Federal Communications Act,

- Broadband Internet Service Providers offer consumers the capability to acquire, to store, and to utilize data—and thus
- offer consumers an information service.

Title II provides that a "telecommunications carrier shall be treated as a common carrier . . . only to the extent that it is engaged in providing telecommunications services." [771] A "'telecommunications carrier' means any provider of telecommunications services." [772]

"The term 'telecommunications service' means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." [773]

"Telecommunications means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." [774]

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[771] 47 U.S.C. § 153(51).
[772] *Id.*
[773] 47 U.S.C. § 153(53).
[774] 47 U.S.C. § 153(50).

"The term 'information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."[775] A provider that offers information service may not be classified as a common carrier.[776]

The Sixth Circuit determined that *Brand X*[777]did not bind the statutory-interpretation analysis.

Brand X involved a challenge to a Federal Communications Commission ruling determining that cable companies that owned cable lines used to provide broadband Internet service offered only an information service, not a telecommunications service as well.[778]

Applying *Chevron*, the Court in *Brand X* held that −

- the Federal Communications Act's use of the term "offering of telecommunications"[779] was ambiguous and
- the Federal Communications Commission's construction was therefore permissible.[780]

In the *Brand X* Court's view, the Federal Communications Commission reasonably chose to define "offering" to mean −

- offering "consumers an information service in the form of Internet access . . . via telecommunications"

  instead of

- more broadly construing it as offering "consumers the high-speed data transmission (telecommunications) that is an input used to provide this service."[781]

Loper Bright ended *Chevron*'s deference to an agency's statutory interpretation upon a finding of ambiguity.

The Court found such a view of implicit delegation inconsistent with the Administrative Procedure Act's command that courts "decide all relevant questions of law and interpret statutory provisions."[782]

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[775] 47 U.S.C. § 153(24).
[776] 47 U.S.C. § 153(11), (51).
[777] *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005).
[778] 545 U.S. at 978.
[779] as used in Section 153(53)
[780] *Id.* at 986–1000.
[781] *Id.* at 989, 125 S.Ct. 2688 (citations omitted).
[782] *Loper Bright*, 144 S. Ct. at 2255 (internal quotation marks and ellipsis omitted).

Now, "[c]ourts must exercise their independent judgment in deciding whether an agency has acted within its statutory authority" by "us[ing] every tool at their disposal to determine the best reading of the statute and resolve the ambiguity."[783]

The *Loper Bright Enterprises* Court advised that, "[W]e do not call into question prior cases that relied on the *Chevron* framework. The holdings of those cases that specific agency actions are lawful . . . are still subject to statutory *stare decisis* despite our change in interpretive methodology."[784]

According to the Sixth Circuit in *In re MCP No. 185*, "Chevron did not invalidate 'specific agency actions' that the Supreme Court has already found lawful."

The Sixth Circuit in *In re MCP No. 185* opined:

> *Following Loper Bright, we cannot agree with petitioners that Brand X expressly bars the FCC's order at issue. The "specific agency action" that the Court approved in Brand X was the FCC's 2002 Internet Over Cable Declaratory Ruling. The specific action before us here is the FCC's 2024 Safeguarding Order, which came 22 years later. The Safeguarding Order therefore is not the "specific agency action" that the Court approved in Brand X. And that means we are not bound by Brand X's holding as a matter of statutory stare decisis.*

The Sixth Circuit continued:

> *We now turn to the merits, which the parties have argued here in exemplary fashion. But the key flaw in the FCC's arguments throughout is that the FCC elides the phrase "offering of a capability" as used in § 153(24). That phrase makes plain that a provider need not itself generate, process, retrieve, or otherwise manipulate information in order to provide an "information service" as defined in § 153(24). Instead, a provider need only offer the "capability" of manipulating information (in the ways recited in that subsection) to offer an "information service" under § 153(24). Even under the FCC's narrower interpretation of "capability," Broadband Internet Access Providers allow users, at minimum, to "retrieve" information stored elsewhere. And we think it equally plain, for the reasons recited below, that Broadband Internet Service Providers offer at least that capability.*

The Sixth Circuit continued with a careful textual and intent-oriented analysis that may typify how courts will apply *Loper Bright Enterprises*:

> *In the view of the current Commission, Broadband Internet Service Providers offer a telecommunications service that merely connects consumers to edge providers (like Netflix, Amazon, Facebook, and Google). Safeguarding Order, 89 Fed. Reg. at 45425, ¶ 99 ("[C]onsumers today perceive [Broadband Internet Service Providers to offer] . . . a telecommunications service that is primarily a transmission conduit used as a means to send and receive information to and from third-party services."). In essence, the FCC contends that edge providers offer an "information service" but that Broadband Internet Service Providers do not.*

[783] *Id.* at 2266, 2273.

[784] *Id.* at 2273 (citations omitted and emphasis added).

Everyone agrees with the Commission's classification of edge providers as offering an information service. Those providers indisputably "'generate' and 'make available' information to others through email and blogs; 'acquire' and 'retrieve' information from sources such as websites, online streaming services, and file sharing tools; 'store' information in the cloud; 'transform' and 'process' information through image and document manipulation tools, online gaming, cloud computing, and machine learning capabilities; 'utilize' information by interacting with stored data; and publish information on social media sites." Id. at 45426, ¶ 105.

Yet, by connecting consumers to edge providers' information, Broadband Internet Service Providers plainly provide a user with the "capability" to, at minimum, "retrieve" third-party content. 47 U.S.C. § 153(24); see also Telecom (en banc), 855 F.3d at 395 (Brown, J., dissenting from the denial of rehearing en banc) ("The 'offering of a capability' for engaging in all [Internet] activities is exactly what is provided by broadband Internet access."). That is, they offer a "feature[ ] permitting" consumers to stream videos stored on Netflix's servers, Merriam-Webster's Collegiate Dictionary 168 (10th ed. 1997), the "ability" to purchase gifts from information stored on Amazon's servers, Random House Unabridged Dictionary 308 (2d ed. 1993), the "capacity" to view posts stored on Facebook's servers, id., and the "power" to conduct a search using Google's servers, A Dictionary of Modern Legal Usage 129 (2d ed. 1995). By utilizing high-speed Internet offered by Broadband Internet Service Providers, consumers are capable of obtaining edge providers' information. In our view, then, the Safeguarding Order reads out the key phrase—"offering of a capability"—that precedes the gerunds ("generating," "acquiring," "storing," "transforming," "processing," "retrieving," "utilizing," and "making available information") set forth in § 153(24). [Footnote omitted.]

"While the statute's language spells trouble for the Government's position, a wider look at the statute's structure gives us even more reason for pause." Van Buren v. United States, 593 U.S. 374, 389, 141 S.Ct. 1648, 210 L.Ed.2d 26 (2021) (internal quotation marks omitted). Specifically, Congress emphasized the importance of deregulating the "Internet and other interactive computer systems," finding in the Telecommunications Act of 1996 that "[t]he Internet and other interactive computer services have flourished, to the benefit of all Americans, with a minimum of government regulation." 47 U.S.C. § 230(a)(4). Thus, the policy of the United States is "to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation." Id. § 230(b)(2). It would be strange for Congress to enact this policy while, in the same bill, shackling Internet access providers with onerous Title II regulation.

Further, Congress defined "interactive computer service" as an "information service . . . that provides access to the Internet," id. § 230(f)(2), and specified that "[n]othing in th[at] section shall be construed to treat interactive computer services as common carriers or telecommunications carriers," id. § 223(e)(6). True, as the FCC points out, the definition of "interactive computer service" applies to that term as it is "used in" § 230 itself. Id. § 230(f). But that means the definition of "interactive computer service" as a whole is limited to § 230—not that the meaning of every word or phrase within that definition likewise has a meaning peculiar to that subsection. (In that case, § 230 itself would have to define every word used within it.) And the usage of the term "information service" in § 230(f)(2) takes for granted that "information service" includes Internet providers. We see no reason why that usage should be understood as peculiar to § 230—any more than its

usage of, say, "transmit" or "receive" is. Id. § 230(f)(4)(C). The Act's structure thus favors petitioners' position, not the FCC's.

So too does history. Brand X persuasively posits that we should view the definitions of "telecommunications service" and "information service" "against the background of" the FCC's pre-Telecommunications Act's regulatory efforts. 545 U.S. at 992–93, 125 S.Ct. 2688. In its 1980 Computer II decision, the FCC "distinguished between 'basic' service (like telephone service) and 'enhanced' service (computer-processing service offered over telephone lines)." Id. at 976, 125 S.Ct. 2688. It noted that "in an enhanced service the content of the information need not be changed and may simply involve subscriber interaction with stored information." See In re Amendment of Section 64.702 of the Comm'rs Rules and Regs. (Second Computer Inquiry), 77 F.C.C.2d 384, 421, ¶ 97 (1980) [hereinafter Computer II]. The Telecommunications Act of 1996 codified these distinctions: "telecommunications service" is "the analog to basic service," and "information service" is "the analog to enhanced service." Brand X, 545 U.S. at 977, 125 S.Ct. 2688 (quotation marks omitted). When Congress borrows long-existing regulatory history, "it brings the old soil with it." George v. McDonough, 596 U.S. 740, 746, 142 S.Ct. 1953, 213 L.Ed.2d 265 (2022) (citation omitted). And when Congress approvingly adopted the FCC's prior regulatory approach, it "placed Internet access on the 'enhanced service' side, and thus prohibited the FCC from construing the 'offering' of 'telecommunications service' to be the 'information service' of Internet access." Telecom (en banc), 855 F.3d at 405 (Brown, J., dissenting) (ellipsis and internal citations omitted).

Following enactment, various historical datapoints indicate that treating broadband Internet as a telecommunications service under Title II contradicts the Act. The FCC has hewed to this view from enactment until recent administration changes, which is "especially useful in determining the statute's meaning." Loper Bright, 144 S. Ct. at 2262.

. . . .

. . . it makes sense to exclusively classify integrated services, including those offered by Broadband Internet Service Providers, as information services because the definition expressly contemplates telecommunications usage, tying the "offering of a capability" to utilize (for example) information "via telecommunications." 47 U.S.C. § 153(24) (emphasis added); see also Vonage Holdings Corp. v. FCC, 489 F.3d 1232, 1241 (D.C. Cir. 2007) ("Indeed, the Act clearly contemplates that 'telecommunications' may be a component of an 'information service.'"); Stevens Report, 13 FCC Rcd. at 11529, ¶ 57 ("Because information services are offered 'via telecommunications,' they necessarily require a transmission component in order for users to access information."); United States v. W. Elec. Co., 552 F. Supp. 131, 189 (D.D.C. 1982) [hereinafter AT&T Consent Decree] ("All information services are provided directly via the telecommunications network."). The key here is not whether Broadband Internet Service Providers utilize telecommunications; it is instead whether they do so while offering to consumers the capability to do more. See Computer II, 77 F.C.C.2d at 420, ¶ 97 ("An enhanced service is any offering over the telecommunications network which is more than a basic transmission service."). And as set forth above, they do. See Brand X, 545 U.S. at 1000, 125 S.Ct. 2688. The Brand X Court made an observation that remains apposite here: "Cable modem service"—a precursor to the service that Broadband Internet Access Providers offer—"is an

information service . . . because it provides consumers with a comprehensive capability for manipulating information using the Internet via high-speed telecommunications." Id. at 987, 125 S.Ct. 2688.

. . . .

The Act's text and its pre-enactment history demonstrate that the definition of information service incorporates the narrower sense of "information." Computer II defined basic service in part as "limited to the common carrier offering of . . . the analog or digital transmission of voice, data, video, etc., information." 77 F.C.C.2d at 419, ¶ 93 (emphasis added). The AT&T Consent Decree, which defined information service in language almost identical to the Act, said " '[i]nformation' means knowledge or intelligence represented by any form of writing, signs, signals, pictures, sounds, or other symbols." 552 F. Supp. at 229. Reducing knowledge to a tangible medium explains how an information service "generates" information, but computers themselves do not "generate" ideas or thoughts as such. Further, this understanding of "information" permeates other sections of the Act, where it would be absurd to interpret information as equivalent to intangible thoughts or ideas. See 47 U.S.C. § 153(50) ("'telecommunications' means the transmission . . . of information of the user's choosing without change in the form or content of the information as sent and received"); id. § 256(a)(2) ("ensure the ability of users and information providers to seamlessly and transparently transmit and receive information between and across telecommunications networks"); id. § 256(d) ("exchange information without degeneration"); id. § 271(g)(4) ("retrieve stored information from, or file information for storage in, information storage facilities"); id. § 274(h)(2)(C) ("the transmission of information as part of a gateway to an information service that does not involve the generation or alteration of the content of information"). In sum, the "capability" of "retrieving" "information" does not refer to a phone call with a friend; it refers to an interaction with data stored on a computer. Id. § 153(24).

**10 The FCC counters that telephone service enables users to interact with stored data, citing voicemail and call menus. Computer II considered this argument for answering machines in 1980 and the Stevens Report did the same for voicemail in 1998. Computer II, 77 F.C.C.2d at 421, ¶ 98; Stevens Report, 13 FCC Rcd. at 11530, ¶ 60. The answer remains the same. These ancillary services may themselves be information services. But they do not transform the categorization of telephone service because its core standalone offering is the transparent transmission of telecommunications.*

*Nor do the FCC's other counterarguments hit the mark. The FCC points to the Act's "advanced telecommunications incentives" section. Known as Section 706(a), it "encourage[s]" the FCC and its state analogues to "deploy[ ] . . . advanced telecommunications capability to all Americans . . . by utilizing" certain regulatory measures, including "price cap regulation" and "regulatory forbearance." 47 U.S.C. § 1302(a). In the FCC's view, this section's mention of those terms—which are associated with common-carrier regulation under Title II—demonstrate that broadband can be a telecommunications service. That is too sweeping of a reading of the statute. In re MCP No. 185, 2024 WL 3650468, at *6 (Sutton, C.J., concurring) ("[T]his authorization under Title VII to impose some regulations on broadband providers does not provide the Commission with the power to regulate all broadband providers as common carriers under Title II.").*

Moreover, in the late 1990s, when greater than 90% of households accessed the Internet through dial-up, Universal Service Order, 12 FCC Rcd. at 8823, ¶83 n.154, there was a distinct possibility that advanced

services would improve the last mile of transmission, which telecommunications carriers provided across notoriously slow copper phone lines, Advanced Services Order, 13 FCC Rcd. at 24016, ¶ 8. Indeed, the Advanced Services Order shows that this possibility came to fruition with the introduction of DSL. And in line with Section 706(a), the FCC categorized this improvement over dial-up as a telecommunications service when offered for a fee directly to the public. Id. at 24029–30, ¶ 35. But that tells us nothing about how to treat Broadband Internet Service Providers, which offer a service integrating the last mile of transmission in addition to Internet access. And to be clear, the Advanced Services Order reiterated that Internet access is an information service. See id. at 24030, ¶ 36.

. . . . One final response. We acknowledge that the workings of the Internet are complicated and dynamic, and that the FCC has significant expertise in overseeing "this technical and complex area." Brand X, 545 U.S. at 992, 125 S.Ct. 2688. Yet, post-Loper Bright, that "capability," if you will, cannot be used to overwrite the plain meaning of the statute.

4.

In sum, applying the plain meaning of § 153(24) to the interconnected nature of the Internet, we conclude that Broadband Internet Service Providers at the very least "offer[ ]" consumers the "capability" of "retrieving" "information via telecommunications." Accordingly, the FCC's contrary conclusion is unlawful.

*Given our conclusion that the FCC's reading is inconsistent with the plain language of the Communications Act, we see no need to address whether the major questions doctrine also bars the FCC's action here. See In re MCP No. 185, 2024 WL 3650468, at *1, *5. Nor do we consider petitioners' additional arguments, including that their provision of Domain Name Services and caching—which they contend are integrated products to the offering of Internet access services—further (or independently) demonstrate that they qualify as offering an information service to end users, cf. Brand X, 545 U.S. at 987, 125 S.Ct. 2688, and that the Safeguarding Order is arbitrary and capricious.*

B.

Finally, we turn to the Safeguarding Order's related provisions concerning mobile broadband. Because users can access broadband Internet when using mobile devices connected to cellular networks like 5G, separate from wired (or Wi-Fi) connections, the Safeguarding Order similarly imposes net-neutrality policies on those so-called "mobile broadband services" through the Act's "commercial mobile service" provision. 47 U.S.C. § 332(c)(1)(A). Although comparable, our conclusion that Broadband Internet Service Providers offer only an "information service" under § 153(24) does not govern our resolution of this related issue, for we deal here with separate statutory provisions that do not automatically operate in tandem. As explained below, the plain text of the statute forecloses the FCC's position on mobile broadband as well.

. . . .

Mobile-broadband services emerged in the mid-2000s. At that time (when BlackBerry dominated the market and Apple had just introduced its iPhone), the FCC classified mobile broadband as a private mobile service not subject to common-carrier regulation. In the Matter of Appropriate Regul. Treatment for Broadband Access to the Internet over Wireless Networks, 22 FCC Rcd. 5901, 5901 (2007).

That changed with the FCC's 2015 Open Internet Order, which "classif[ied] mobile broadband Internet access as a commercial mobile service." 30 FCC Rcd. at 5786, ¶ 399. As it did with broadband, the D.C. Circuit in Telecom approved this reclassification. Telecom (panel), 825 F.3d at 713–24.

After an administration change, the FCC flipped its position in 2018 back to its original understanding. That is, "mobile broadband Internet access should not be classified as a commercial mobile service." RIF Order, 33 FCC Rcd. at 352, ¶ 65. The D.C. Circuit again upheld this determination under Chevron. Mozilla, 940 F.3d at 35–45.

Corresponding with another change in administration, today's Safeguarding Order again attempts to regulate mobile broadband as a "commercial mobile service." 89 Fed. Reg. at 45447–52, ¶¶ 198–220.

2.

There is no disputing that mobile broadband is a "mobile service" "provided for profit" "to the public" (or a "substantial portion of the public."). 47 U.S.C. § 332(d)(1). Instead, whether mobile broadband is a "commercial mobile service" that is subject to Title II common-carrier regulation depends on if mobile broadband is an "interconnected service," which in turn means a "service that is interconnected with the public switched network." Id. § 332(d)(1), (2). Mobile broadband does not satisfy this definition.

We start with the text's use of a definite article. It would be one thing if the statute said, "interconnected with a public switched network," for that would connote multiple networks. But § 332(d)(2) does not do so; it uses "the," a fixed, singular reference. See Rumsfeld v. Padilla, 542 U.S. 426, 434, 124 S.Ct. 2711, 159 L.Ed.2d 513 (2004) (explaining that the "use of the definite article . . . indicates that there is generally only one" noun covered); see also Corner Post, Inc. v. Bd. of Governors of Fed. Rsrv. Sys., 603 U.S. 799, 817, 144 S.Ct. 2440, 219 L.Ed.2d 1139 (2024) ("[T]he statute's use of the definite article 'the' takes precedence" over an indefinite reading to the contrary.); Slack Techs., LLC v. Pirani, 598 U.S. 759, 767, 143 S.Ct. 1433, 216 L.Ed.2d 18 (2023) (a statute's use of a definite article signals "particular[ity]").

So what is "the public switched network"? In basic terms, it is the patchwork of telecommunication services that consumers use to place and receive calls from their telephone. More technically, it is "[a]ny common carrier switched network, whether by wire or radio, including local exchange carriers, interexchange carriers, and mobile service providers, that use the North American Numbering Plan [(NANP)] in connection with the provision of switched services." In the Matter of Implementation of Sections 3(n) & 332 of the Commc'ns Act, 9 FCC. Rcd. 1411, 1517 (1994); see also Newton's Telecom Dictionary 799 (6th ed. 1993) (defining "public switched network" as "Any common carrier network that provides circuit switching between public users. The term is usually applied to the public telephone network but it could be applied more generally to other switched networks such as Telex, MCI's Executnet, etc."). Importantly, then, "the public switched network" means a network interconnected to the NANP's 10-digit system of telephone switching. Cf. Mozilla, 940 F.3d at 37–38 (approving the RIF Order's similar reasoning under Chevron deference).

History supports this reading. When Congress added "the public switched network" to Title III in 1993, it legislated against a backdrop that included "contemporaneous understandings of 'public switched network' by the Commission and the courts suggesting that it was commonly understood to refer to the 'public

switched telephone network.' " Id. at 38; see also Telecom (en banc), 855 F.3d at 396 (Brown, J., dissenting). As the RIF Order cogently summarizes, "[o]n multiple occasions before 332(d)(2) was enacted, the [FCC and the courts] used the term 'public switched network' to refer to the traditional public switched telephone network." 33 FCC Rcd. at 356, ¶ 75 (citing Ad Hoc Telecomms. Users Comm. v. FCC, 680 F.2d 790, 793 (D.C. Cir. 1982); Pub. Util. Comm'n v. FCC, 886 F.2d 1325, 1327, 1330 (D.C. Cir. 1989)). And the FCC's contemporaneous interpretations—which Loper Bright says "may be especially useful in determining the statute's meaning," 144 S. Ct. at 2262—track this original understanding, see, e.g., In the Matter of Implementation of Sections 3(n) & 332 of the Commc'ns Act, 9 FCC Rcd. at 1517; In the Matter of Appropriate Regul. Treatment for Broadband Access to the Internet over Wireless Networks, 22 FCC Rcd. at 5916–17, ¶¶ 43–45.

To its credit, the FCC concedes that the public switched network means the 10-digit telephone system, but the FCC argues that the public switched network also encompasses Internet Protocol (IP) addresses. In support, it points to the statute's delegation provision to assert that Congress intentionally drafted a dynamic statute. In its view, § 332(d)(2) permits the FCC to say again what it said in the 2015 Open Internet Order: "the network that includes any common carrier switched network, whether by wire or radio, including local exchange carriers, interexchange carriers, and mobile service providers, that use[s] the North American Numbering Plan, or public IP addresses, in connection with the provision of switched services." Safeguarding Order, 89 Fed. Reg. at 45448, ¶ 203 (emphasis added). By adding IP addresses, the FCC says, it permissibly updated the definition of public switched network to account for technological changes—e.g., Voice over Internet Protocol (VoIP) services like Skype, Google Voice, and Apple Facetime, which allow mobile broadband users to effectively connect with the 10-digit system by placing and receiving phone calls. The D.C. Circuit accepted this argument strain when, in Telecom, it found for the FCC's position in its 2015 Open Internet Order that "mobile broadband is a commercial mobile service." Telecom (panel), 825 F.3d at 718.

But delegation is not unfettered, and it is still our task to "fix the boundaries of the delegated authority." Loper Bright, 144 S. Ct. at 2263 (brackets and internal quotation marks omitted). And we see nothing in the statute that permits the FCC to effectively change the statute's original meaning of "the public switched network" as set forth above by adding "public IP addresses" to adapt to new technology.5 Nor can we agree with our colleagues on the D.C. Circuit, who apparently did not consider the contemporaneous meaning or the definite-versus-indefinite-article analysis set forth above.

With this understanding of "the public switched network," we cannot agree with the FCC's assertion that the telephone network and the Internet are "interconnected" due to commingling of facilities and the use of VoIP technology.6 This is for the simple reason that the definition of "commercial mobile service" focuses on the whole (mobile broadband) and not the part (a third-party provided service, VoIP). See Mozilla, 940 F.3d at 43 ("The gap in [this] theory is shown most clearly in the obvious inability of a would-be caller from a NANP number who seeks to reach a person with mobile broadband but no form of VoIP (or mobile voice service)."); see also Telecom (en banc), 855 F.3d at 407 (Brown, J., dissenting) ("Nothing about the increase of consumers accessing mobile broadband Internet service via smart phones, the speed of Internet connection, or the 'bundling' of VoIP applications with smart phones, undermines the . . . distinction between the transmission of VoIP traffic and the VoIP service to the end user. Mobile broadband Internet access simply does not

constitute a service interconnected with 'the public switched network.' " (internal citations omitted)). But see Telecom (panel), 825 F.3d at 722–23 (coming to the opposite conclusion under Chevron).

Finally, the FCC says it "makes little sense" to classify mobile broadband as a "private mobile service," which "stands in marked contrast to 'the private mobile services of 1994, such as a private taxi dispatch service, services that offered users access to a discrete and limited set of endpoints.' " See id. at 715 (brackets omitted). But that point is lost because the definitions of "commercial" and "private" mobile services are mutually exclusive, with "the latter [being] defined negatively, as 'any mobile service that is not a commercial service.' " Mozilla, 940 F.3d at 35 (emphasis and ellipsis omitted, quoting 47 U.S.C. § 332(d)(3)). Because mobile broadband is not a commercial mobile service, it necessarily is a private mobile service.7

3.

In sum, mobile broadband does not qualify as "commercial mobile service" under § 332(d)(1) and therefore may not be regulated as a common carrier.

III.

For these reasons, we grant the petitions for review and set aside the FCC's Safeguarding Order.

All Citations

--- F.4th ----, 2025 WL 16388

Footnotes

1

The term Broadband Internet Service Providers refers to providers of what the FCC calls "broadband internet access service." In the Safeguarding Order, the FCC defined that phrase as "a mass-market retail service by wire or radio that provides the capability to transmit data to and receive data from all or substantially all Internet endpoints, including any capabilities that are incidental to and enable the operation of the communications service, but excluding dial-up Internet access service." See 89 Fed. Reg. at 45441, ¶ 173. Notably, the FCC also includes providers within that definition "regardless of whether the . . . provider leases or owns the facilities used to provide the service." Id. at 45442, ¶ 174.

2

This order followed earlier endeavors by the FCC to impose net-neutrality policies similar to those at issue today, including one in 2010 that attempted to rely on Title I. See In re Preserving the Open Internet, 25 FCC Rcd. 17905 (2010). The D.C. Circuit rejected this approach, holding the FCC could only impose such regulations on Title II common carriers. See Verizon v. FCC, 740 F.3d 623 (D.C. Cir. 2014); accord Comcast Corp. v. FCC, 600 F.3d 642 (D.C. Cir. 2010) (vacating In re Formal Compl. of Free Press & Public Knowledge Against

Comcast Corp. for Secretly Degrading Peer–to–Peer Applications, 23 FCC Rcd. 13028 (2008)).

3

Yet it declines to enforce, through the FCC's forbearance power, several traditional Title II requirements (like rate regulation, tariffing, and certain enforcement and information collection and reporting mandates) because, in the FCC's view, such regulatory powers were unnecessary, and that forbearance was in the public interest under 47 U.S.C. § 160. 89 Fed. Reg. at 45468–99. In the government's own words, the Safeguarding Order forbears "the bulk" of Title II's requirements.

4

Ironically, the Commission used this very view of "capability" when it first imposed common-carrier regulation on mobile broadband services. We discuss that issue in detail below but highlight here the FCC's finding in the Open Internet Order "that mobile broadband . . . gives its users the capability to send and receive communications from all other users of the Internet." 30 FCC Rcd. at 5785, ¶ 398 (emphasis added); see also Telecom (panel), 825 F.3d at 719 (accepting this assertion as "undisputed"). Its Safeguarding Order readopts this reading. 89 Fed. Reg. at 45449, ¶ 209 ("Mobile [broadband] . . . is a broadly available mobile service that gives users the ability to send and receive communications to and from all other users of the internet.") (emphasis added).

5

Indeed, Congress subsequently demonstrated it knows how to differentiate between "the public Internet" and "the public switched network" when it created the First Responder Network Authority in 2012. Spectrum Act of 2012, Pub L. 112-96, § 6202. That statute set forth a "public safety broadband network" that provided "connectivity between . . . (i) the radio access network; and (ii) the public Internet or the public switched network, or both." 47 U.S.C. § 1422(b)(1)(B)(i–ii); see also Telecom (*en banc*), 855 F.3d at 406–07 (Brown, J., dissenting) ("This subsequent, specific distinction can inform what 'the public switched network' meant to Congress in 1996.").

6

The FCC does not otherwise claim mobile broadband is "interconnected" with the 10-digit telephone plan. Nor could it, for there are no internal connections between the Internet and the telephone network. See Merriam-Webster's Collegiate Dictionary 609 (10th ed. 1993) (defining "interconnected" as "having internal connections between the parts and elements").

7

We likewise reject the FCC's fallback position that mobile broadband is a "functional equivalent" of a commercial mobile service under 47 U.S.C. § 332(d)(3) given the significant

service disparity offered by broadband and mobile services. Cf. Mozilla, 940 F.3d at 44–45 ("[M]obile voice and mobile broadband 'have different service characteristics and intended uses and are not closely substitutable for each other.' ") (quoting RIF Order, 33 FCC Rcd. at 361–62, ¶ 85); Aegerter v. City of Delafield, 174 F.3d 886, 891 (7th Cir. 1999) ("functionally equivalent" means "services (or products) [that] are direct substitutes for one another").

The Federal Communications Commission (FCC) is required by law to classify communications technologies like broadband internet as falling within one of two buckets—"information service" or "telecommunications service"—and regulate them accordingly. In May 2024, the FCC classified broadband as a telecommunications service, which gives the FCC greater authority to regulate its use. The FCC also adopted "net neutrality" regulations for broadband. Net neutrality means that internet service providers cannot block lawful content or applications, throttle particular internet content, or engage in "paid prioritization." For example, an internet service provider cannot favor a particular e-commerce company over others by making its website load more quickly than those of its competitors.

Industry associations filed numerous challenges to the net neutrality regulation, arguing that the FCC may not regulate broadband as a telecommunications service because of the "major questions doctrine." The cases were consolidated in the U.S. Court of Appeals for the Sixth Circuit, and in September 2024, CAC filed an amicus brief in support of the FCC. Our brief makes three main points.

First, we explain that under Supreme Court precedent, the major questions doctrine applies only in "extraordinary" cases, where an agency's assertion of breathtaking new power reflects a dubious effort to transform the fundamental nature of its authority. Supreme Court decisions have consistently demonstrated that more is needed to implicate the doctrine than economic and political significance alone; other factors must indicate that the agency is subverting congressional intent by seeking "an unheralded power representing a transformative expansion in its regulatory authority."

Second, we show that none of the requirements for applying the major questions doctrine is satisfied in this case. The economic and political significance of the FCC's action is not sufficient to trigger the doctrine, nor does the regulation transform the authority Congress meant to confer on the FCC. Instead, the FCC is exercising the same power it has always exercised under the Telecommunications Act of 1996: determining how communications services should be classified and regulated under the statute. The major questions doctrine is not implicated simply because an industry does not like the FCC's resolution of those questions.

Third, we argue that extending the major questions doctrine to cases like this would undermine traditional statutory interpretation and constitutional principles. We discuss how the major questions doctrine is in tension with textualism because it emphasizes pragmatic considerations outside the statutory text. We also explain that the Constitution's original public meaning does not support the premise underlying the doctrine: the Founders had no qualms about directing the executive branch to handle major policy questions, and history does not suggest that Congress must speak in any particular manner to do so. Finally, overuse of the major questions doctrine would undermine the separation of powers and thrust the courts beyond their proper role in interpreting the law.

Because the FCC's net neutrality regulation does not meet the high standard the Supreme Court has prescribed for applying the major questions doctrine, and because applying the doctrine more widely would exacerbate its tensions with textualism, the Constitution's original meaning, and the separation of powers, the Sixth Circuit should decline to apply the doctrine and should uphold the FCC's action.

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§1.12 Statute of Limitations under Administrative Procedure Act.

[1] Corner Post v. Board of Governors of the Federal Reserve System (July 2024): Statute of Limitations for Bringing Actions under Administrative Procedure Act.

In *Corner Post v. Board of Governors of the Federal Reserve System*,[785] the Supreme Court limited the statute of limitations in the Administrative Procedure Act. This makes it easier for an entity to seek judicial review of public agency rules. *Corner Post* encourages challenges to agency rules and regulations by effectively extending the statute of limitations on the period during which a person can bring a claim under the Administrative Procedure Act. Coupled with *Loper Bright Enterprises*, *Corner Post* means that it is possible to challenge many older rules and regulations where the challenge otherwise might have been barred by the six-year statute of limitations under the Administrative Procedure Act.

[785] 603 U.S. 144 (2024).

Corner Post addressed whether the statute of limitations[786] begins to run at the time of injury or at the time of final administrative agency action. A six-year limitations period[787] is imposed for bringing actions against the United States. The running of his statute commences when "the right of action first accrues." An Administrative Procedure Act claim accrues at the time of injury by final agency action under *Corner Post*. This applies even though the injury occurred pursuant to a rule adopted considerably before that injury. A claim under the Administrative Procedure Act accrues when the party first suffers damage or adverse effects from a rule. The Administrative Procedure Act claim does not first accrue when the administrative agency issues and publishes a rule. Similarly, the Administrative Procedure Act claim does not accrue on the effectiveness of the rule. A company that was formed long after a rule is promulgated may challenge the rule if the company initiates its action within six years of the first time it is subject to the effects of the rule. *Corner Post* interpreted the statute of limitations under the Administrative Procedure Act to permit challenges to agency actions that are filed within six years of the entity's injury, regardless of whether the rule was issued more than six years before the action was filed.[788] A claim under the Administrative Procedure Act does not exist for purposes of the 6-year statute of limitations for suits against the United States until the injured party is injured by final agency action. The statute of limitations "begins to run only when the plaintiff has a complete and present cause of action."

Corner Post, particularly when considered in the light of *Loper Bright Enterprises*, may considerably increase litigation concerning the validity of administrative agency rules and regulations. This creates the possibility that taxpayers will challenge some regulations that are decades old and that were approved under *Chevron* deference or merely were acquiesced to on account of *Chevron*. When a rule is in question, if an action is otherwise barred by the six year statute of limitation, a party might be able to form a new LLC to contest a rule.

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[786] Under 28 U.S.C. § 2401(a).

[787] Under 28 U.S.C. § 2401(a).

[788] *Corner Post* involved a challenge to Federal Reserve Board Regulation II. Regulation II limited the maximum interchange fee that a bank issuing a credit card could charge merchants on debit card transactions. Corner Post, the plaintiff, operated a North Dakota truck stop and convenience store. The plaintiff in Corner Post argues that Regulation II was invalid because it permitted higher interchange fees that the maximum fee permitted under Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The plaintiff's case was discussed by the district court as barred by the general statute of limitations under 28 U.S.C. § 2401(a). The Eighth Circuit affirmed. The Eight Circuit rules that "when plaintiffs bring a facial challenge to a final agency action, the right of action accrues, and the limitations period begins to run, upon publication of the regulation." Under the district court and Eighth circuit view, the six-year statute of limitations period when Regulation II was published. The statute ran six years later. This was before Corner Post was opened. The plaintiff, under this view, was required to bring its action to invalidate the regulation before it was formed.

Nevertheless, planners typically will be reluctant to challenge regulations in their planning on account of possible deficiencies and penalties. Also, challenging a regulation even a dubious regulation is expensive.

The Supreme Court in *Corner Post* held that "Section 2401(a) embodies the plaintiff-centric traditional rule that a statute of limitations begins to run only when the plaintiff has a complete and present cause of action. Because injury, not just finality, is required to sue under the APA, Corner Post's cause of action was not complete and present until it was injured by Regulation II. Therefore, its suit is not barred by the statute of limitations."

This holding was based on the settled meaning of "accrue": "it was well understood that a claim does not 'accrue' as soon as the defendant acts, but only after the plaintiff suffers the injury required to press her claim in court." Further, "a cause of action does not become 'complete and present' for limitations purposes until the plaintiff can file suit and obtain relief." Challenges to old regulations can be brought either by newly-formed entities that were not formed when the rule or regulations was adopted or by entities that existed on the adoption date but that were first harmed within six years of filing the challenge to the rule or regulation. A new entity could be formed to challenge the rule or regulation. Corner Post leaves open question of whether 6 year limitation applies to procedural challenges and whether those challenges are limited to 6 years after promulgation. In dissent, Justice Jackson observed: "[i]n one fell swoop, the Court has effectively eliminated any limitations period for APA lawsuits . [meaning] that, from this day forward, administrative agencies can be sued in perpetuity over every final decision they make." Further, "[n]ow, every legal claim conceived of in those last four decades — and before — can possibly be brought before courts newly unleashed from the constraints of any such deference" and "[a]ny new objection to any old rule must be entertained and determined de novo by judges who can now apply their own unfettered judgment as to whether the rule should be voided." Justice Jackson predicted that the "tsunami of lawsuits against agencies that the Court's holdings in this case and Loper Bright Enterprises have authorized has the potential to devastate the functioning of the Federal Government."

§1.13 Failure to Provide Notice and Comment.

[1] Green Rock LLC v. Internal Revenue Service (June 2024): Internal Revenue Service Violated Administrative Procedure Act in Issuing Notice 2017-10 Without Public Notice And Comment.

Green Rock LLC v. Internal Revenue Service[789] holds that Internal Revenue Service in adopting Notice 2017-10 failed to follow required notice and comment requirements. Notice 2017-1[790] requires taxpayers and their advisors to comply with tax shelter reporting requirements when claiming deductions for donations of conservation easements. Green Rock, LLC, solicited taxpayers to invest in arrangements promising conservation-easement

[789] *Green Rock LLC v. Internal Revenue Service*, 104 F.4th 220 (11th Cir. 2024).
[790] 2017-4 I.R.B. 522.

deductions. Green Rock sued the Internal Revenue Service to challenge Notice 2017-10. The district court granted summary judgment for Green Rock. It ruled that the Service promulgated Notice 2017-10 unlawfully because Congress did not expressly authorize its issuance without notice and comment.

This appeal concerns a "listed transaction". Listed transactions are potentially the most tax abusive transactions. Designation of a listed transaction triggers reporting and recordkeeping requirements.[791] For each listed transaction, a taxpayer must file a Form 8886. Material advisors must keep detailed records for each listed transaction. Taxpayers and material advisors who violate reporting requirements face monetary penalties.[792]

To date, the Service has identified 36 listed transactions—28 through revenue "notice" and others through revenue "ruling." Revenue notices are not published in the Federal Register and do not undergo public notice and comment. A revenue ruling is the Service's interpretation of an existing statute or regulation. It is also published exclusively in the Bulletin without undergoing notice and comment. For over two decades, the Service has listed transactions without notice-and-comment procedures.

Listing notices as unlawfully promulgated without notice and comment has been invalidated in *Mann Constr., Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022) (Notice 2007-83); *Green Valley Invs., LLC v. Commissioner*[793] (Notice 2017-10).

The 11th Circuit observed:

> *To enact regulations that have the force of law, a federal agency ordinarily must abide by the notice-and-comment procedures prescribed in the Administrative Procedure Act, 5 U.S.C. § 553(b). See Chrysler Corp. v. Brown, 441 U.S. 281, 302–03, 99 S.Ct. 1705, 60 L.Ed.2d 208 (1979) ("legislative" rules—those that are "binding" or have the "force of law"—must be promulgated through the procedures set forth in the Administrative Procedure Act (citation and internal quotation marks omitted)). The agency must publish a notice of the proposed regulation, offer the public an opportunity to voice comments and concerns, consider and respond to feedback, and include in the final regulation a "concise general statement of the basis and purpose of the regulation. 5 U.S.C. § 553(c). This process "gives affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes—and it affords the agency a chance to avoid errors and make a more informed decision." [Citation omitted.]*[794]

[791] See I.R.C. §§ 6011, 6111.

[792] A taxpayer who fails to disclose information about a listed transaction faces a penalty of at least $10,000 (or $5,000 if the taxpayer is a natural person), and up to $200,000 (or $100,000 if a natural person). A material advisor to a listed transaction who fails to disclose faces a penalty of at least $200,000 and up to 50 percent of the gross income the advisor receives for its advice or assistance. If the disclosure violation is willful, a material advisor faces a penalty of up to 75 percent of its gross income and possible criminal sanctions.

[793] 159 T.C. No. 5 (Nov. 9, 2022).

[794] *Green Rock LLC* at 226.

The Sixth Circuit also found that Congress had not exempted the Internal Revenue Service from notice and comment.

The provision in the 2003 Treasury regulation stated that the Internal Revenue Service may list transactions "by notice, regulation, or other form of published guidance" did not help the government's position:

> *Notably, the 2003 Treasury regulation provides a process for identifying listed transactions: it states that the Service may list transactions "by notice, regulation, or other form of published guidance." [Citation omitted.] "Notice" refers to a revenue notice—that is, official Service guidance published in the Internal Revenue Bulletin and not subject to public notice and comment. [Citation omitted.] But, of course, an agency regulation alone cannot displace the notice-and-comment requirements of the Administrative Procedure Act.*
>
> *The Service argues that through a series of statutory cross-references, section 6707A ratified the entirety of the 2003 Treasury regulation, including the language specifying the Service's listing process. According to the Service, because Congress was aware of the regulation and adopted parts of its language, Congress must have also intended to endorse the notice-listing process. But the Code omits the regulation's "by notice" language. So the Service would have us rely on the phrase "as determined under regulations prescribed under section 6011," see 26 U.S.C. § 6707A(c)(1), as a statutory hook to overcome the requirement of notice and comment.*
>
> *To be sure, Congress was aware of the Treasury regulation. The parallel language in the Code, the Treasury regulation, and the legislative history of the 2004 Act suggest that Congress knew of the Service's listing process and of existing listed transactions. [Citation omitted.] And we generally presume that when Congress legislates and does not disturb an agency's existing regulation, Congress ratifies the agency's legal interpretation. [Citation omitted.] But when it comes to the Administrative Procedure Act, the presumption of acquiescence is not enough—something more is needed to overcome "expressly" the requirements of the Act. [Citation omitted.]*[795]

The Internal Revenue Service published this acquiescence in AOD 2024-01 on December 23, 2024:[796]

> *Subject: Green Rock LLC v. Internal Revenue Serv., 104 F.4th 220 (11th Cir. 2024).*
>
> *Issue Statement IRS.gov: Whether listing notices, issued without following notice-and-comment rulemaking procedures after the American Jobs Creation Act of 2004, are invalid under the Administrative Procedure Act.*
>
> *Issue*
>
> *Is Notice 2017-10, which identifies certain syndicated conservation easement arrangements as "listed transactions," invalid under the Administrative Procedure Act ("APA"), 5 U.S.C. §551 et seq., because it was issued without following notice-and-comment rulemaking procedures?*

[795] 104 F.4th at 227-28.

[796] 2024-52 I.R.B. 1354.

Discussion

In March 2003, Treasury promulgated final regulations requiring taxpayers to affirmatively disclose their participation in "reportable transactions" and a sub-category of reportable transactions called "listed transactions." Treas. Reg. §1.6011-4. The regulations define a listed transaction as "a transaction that is the same as or substantially similar to one of the types of transactions that the [Service] has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction." Treas. Reg. §1.6011-4(b)(2).

As part of the American Jobs Creation Act of 2004 (AJCA), Congress enacted I.R.C §6707A and amended I.R.C §§6707 and 6708, which provide civil penalties with respect to reportable transactions; enacted I.R.C. §6662A, which provides accuracy-related penalties on understatements with respect to reportable transactions; amended I.R.C. §6501 to add subsection (c)(10), which provides an exception to the assessment period of limitations for undisclosed listed transactions; and amended I.R.C. §6404(g)(2) to add subparagraph (E) which provides an exception to the suspension of interest rules for reportable transactions.

The Service generally identified listed (and other reportable) transactions through sub-regulatory guidance such as notices, which are issued without following APA notice-and-comment rulemaking procedures. Notice 2017-10, which identified certain syndicated conservation easement transactions as listed transactions, was no exception. 2017-4 I.R.B. 544. Notice 2017-10 identifies transactions in which promoters of syndicated conservation easement transactions offer prospective investors in a pass-through entity ("syndicate") the possibility of a charitable contribution deduction that equals or exceeds 2.5 times the amount of the investor's investment. Id. at 545.

In Green Rock, the plaintiff, Green Rock LLC, filed suit under the APA seeking to set aside Notice 2017-10 for violating notice-and-comment rulemaking requirements. Green Rock LLC v. Internal Revenue Serv., 654 F. Supp. 3d 1249 (N.D. Ala. 2023). APA notice-and-comment rulemaking procedures require an agency, before publishing a legislative rule, to publish a Notice of Proposed Rulemaking in the Federal Register and provide the public with an opportunity to submit written comments. The District Court granted Green Rock LLC summary judgment. In its decision, the court adopted the reasoning of the Sixth Circuit in Mann Construction, Inc. v. United States, 27 F.4th 1138 (6th Cir. 2022), which invalidated a different listing notice and held that the statutory language in I.R.C. §6707A lacked the necessary express statement of Congress's intent to create an exception to the APA notice-and-comment rulemaking procedures. The Green Rock court set aside Notice 2017-10 as to Green Rock LLC.

On appeal, the Eleventh Circuit affirmed the District Court's decision. Green Rock LLC v. Internal Revenue Serv., 104 F.4th 220 (11th Cir. 2024). The court held that because Notice 2017-10 did not follow notice-and-comment rulemaking procedures, the Service violated the APA. As a result, the court held that Notice 2017-10 was set aside as to Green Rock LLC. The court held that the APA express-exemption rule sets a "high bar" and that the Internal Revenue Code does not expressly or otherwise exempt the listing of transactions from the APA notice-and-comment rulemaking procedures. See 5 U.S.C. §559; Marcello v. Bonds, 349 U.S. 302 (1955); Citizens for Resp. & Ethics in Washington v. FEC, 993 F.3d 880 (D.C. Cir. 2021). Further, the court stated that, although Treas. Reg. §1.6011-4(b)(2) provides that the Service

may list transactions by notice, a regulation without anything more cannot displace the requirements of the APA. The court also indicated that Congress was aware of the aforementioned Treasury regulation, but that acquiescence alone is not enough when it comes to the APA. Thus, the court held that the Service failed a duty to comply with the APA's notice-and-comment rulemaking procedures when issuing Notice 2017-10.

The court's opinion clarified that it was not ruling on the validity of any listed transaction notices issued before the AJCA and briefly discussed that these notices were issued in a different regulatory context. Mainly, the pre-AJCA notices were not backed by the statutory penalties under §6707A at the time of issuance, and those penalties, according to the court, are what render a listing notice a legislative rule subject to notice-and-comment rulemaking procedures.

The Eleventh Circuit largely followed the lead of the Sixth Circuit's reasoning in Mann Construction and is now the second court of appeals to hold that a post-AJCA listing notice must follow notice-and-comment rulemaking procedures. The Tax Court reached the same holding in Green Valley Investors, LLC v. Commissioner, 159 T.C. 80 (2022).

Despite our disagreement with the Eleventh Circuit's ruling, we recognize that there is controlling adverse precedent in both the Sixth Circuit and the Eleventh Circuit, as well as in the Tax Court. The reasoning of this precedent applies to all existing post-AJCA listing notices, which are not distinguishable with respect to the application of notice-and-comment rulemaking procedures. The Sixth Circuit, Eleventh Circuit, and Tax Court have all held that the post-AJCA notices create new substantive duties, the violations of which can lead to financial penalties and criminal sanctions. The Eleventh Circuit explicitly noted that 28 of the 34 existing listed transactions, issued pre-AJCA, were not backed by statutory penalties at the time of their issuance, and held that "penalties and criminal sanctions" are what render a listing notice a "legislative" rule subject to notice-and-comment rulemaking procedures. Green Rock, 104 F.4th at 229. Therefore, the reasoning of this adverse precedent applies to all existing post-AJCA reportable transaction notices.

The Service will follow the Sixth and Eleventh Circuit and the Tax Court decisions in all circuits and will no longer defend post-AJCA reportable transaction notices.[1] [[1] In response to these decisions, Treasury has issued final and proposed regulations following APA notice-and-comment rulemaking procedures identifying certain transactions as listed transactions and transactions of interest. The issuance of T.D. 10007 identifying syndicated conservation easement transactions as a listed transaction is one such example.] The Service will not enforce the disclosure and reporting requirements set forth in those notices and will not assert penalties under sections 6662A, 6707, 6707A, and 6708 resulting from identification of reportable transactions pursuant to post-AJCA guidance that did not go through notice-and-comment rulemaking procedures. The Service will also not take the position that transactions are reportable transactions solely due to being identified in post-AJCA guidance that did not go through notice-and-comment rulemaking procedures for purposes of other legal provisions; for example, the Service will not assert the exception to the assessment period of limitations under section 6501(c)(10) or the exception to the suspension of interest rules under section 6404(g)(2)(E) with respect to these transactions. Further, the Service will concede or abate penalties asserted under sections 6662A, 6707, 6707A, and 6708 in ongoing cases (whether pending in Tax Court and district courts or cases at any stage in which taxpayers request the abatement, removal, or refund of penalties administratively) resulting from

identification of reportable transactions pursuant to post-AJCA notices that did not go through notice -and-comment rulemaking procedures. The Service will not take these steps in cases where there is a court-approved settlement or closing agreement relating to the aforementioned penalties, there is an existing final court decision, or the applicable statutes of limitations have expired. This AOD does not apply to pre-AJCA notices.

§1.14 Failure to Explain Reasons or Answer Comments in Regulatory Process.

[1] Oakbrook Land Holdings, LLC v. Commissioner (2020): Consideration of Public Comments to Proposed Regulations

Oakbrook Land Holdings, LLC v. Commissioner[797] upheld the substantive and procedural validity of Treasury Regulations Section 1.170A-14(g)(6)(ii). In *Oakbrook Land Holdings, LLC v. Commissioner*,[798] the Tax Court held that that the easement Oakbrook granted did not satisfy the "protected in perpetuity" requirement of Section 170(h)(5)(A) and Treasury Regulations Section 1.170A-14(g)(6). The donee's share of the proceeds, in the event the property were sold following a judicial extinguishment of the easement, would be (1) determined according to a fixed historical value rather than a proportionate share of the proceeds and (2) reduced by the value of any improvements made by the donor.

In a concurrent opinion challenging the validity of the regulation, the Tax Court upheld the validity of Treasury Regulations Section 1.170A-14(g)(6).

The court found that:

- the regulation was properly promulgated under the Administrative Procedure Act.
- the regulation was a reasonable interpretation of the statute regarding the perpetuity requirement upon judicial extinguishment of an easement.
- the regulation was subjected to notice and comment as required by the Administrative Procedure Act.
- the regulation was not invalid because the preamble failed to discuss the "basis and purpose" of the judicial extinguishment provision in the regulation specifically.

[797] *Oakbrook Land Holdings, LLC v. Commissioner,* 154 T.C. 180 (2020), *aff'd*, 28 F.4th 700 (6th Cir. 2022), *cert. denied*, 143 S. Ct. 626 (2023).

[798] T.C. Memo. 2020-54.

The court then applied the two part *Chevron* test.[799]

The court reasoned that Treasury "clearly considered" comments on the requirement that the donee receive a proportional share of the proceeds because Treasury "substantially revised the text of [the proceeds regulation] . in response to those comments." The regulatory text was changed only to re-articulate the formula by which the proceeds would be apportioned.

The regulatory text was not changed to delete the apportionment provision altogether. Commenters found the regulation "unnecessary" and unlikely to be enforceable beyond the original easement donor. Treasury offered no explanation for the restatement of the formula, nor did it address comments' concern about the operation of the proposed rule in the context of Treasury's own fact pattern. The court rejected the argument that Treasury did not comply with the APA because the preamble "did not discuss the 'basis and purpose' of the judicial extinguishment provision specifically."[800] The majority opinion reasoned that "[e]ven where a regulation contains no statement of basis and purpose whatsoever, it may be upheld 'where the basis and purpose . [are] considered obvious.'" As the Eleventh Circuit subsequently explained in *Hewitt*, "[b]asis and purpose statements must enable the reviewing court to see the objections and why the agency reacted to them as it did" and that agencies should rebut relevant comments.[801]

The Department of the Treasury issued a notice of proposed rulemaking with "proposed regulations relating to contributions of partial interests in property for conservation purposes."[802] The preamble explained the history of Congressional enactments in this area. The preamble highlighted the requirement that a donated easement "be perpetual in order to qualify for a deduction." The preamble noted that the House and Senate committee reports accompanying the 1980 Act had "provided, for the first time, an in-depth statement of Congressional intent concerning the donation of partial interests for conservation purposes." The preamble stated that the proposed regulations "reflect the major policy decisions made by the Congress and expressed in these committee reports."

In response to its request for public comments, Treasury received more than 700 pages of commentary. Ninety organizations or individuals submitted comments addressing various aspects of the proposed rules. Of the 90 commenters only 13 mentioned the judicial extinguishment provision. Of those 13, most comments devoted only a few sentences to the

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[799] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[800] *See Hewitt v. Commissioner*, 21 F.4th at 1347.

[801] *Hewitt v. Commissioner*, 21 F.4th at 1350 (*quoting Lloyd Noland Hosp. & Clinic v. Heckler*, 762 F.2d 1561, 1566-67 (11th Cir. 1985)); *see also Home Box Off., Inc.*, 567 F.2d at 35-36 ("[A] dialogue is a two-way street: the opportunity to comment is meaningless unless the agency responds to significant points raised by the public." (footnote omitted)).

[802] 48 Fed. Reg. 22940 (May 23, 1983).

judicial extinguishment provision. Most of the commenters who mentioned the judicial extinguishment provision supported it. Several commenters recommended that the proceeds formula be revised to make it more favorable to the donee, such that the donee's share would be "equal to the greater of its original proportionate value or its proportionate value at the time of the extinguishment." Some commenters who supported the judicial extinguishment rule suggested minor tweaks to it. Several commenters suggested that the judicial extinguishment rule might be unnecessary or difficult to enforce against future owners. Two commenters noted concern that donors or donees might be subject to State transfer taxes upon distribution of extinguishment proceeds. Three commenters questioned the "proportionate value" approach as applied to facade easements on certified historic structures, while agreeing that this approach was appropriate "as applied to open space easements" on land. Two commenters were definitely opposed to the judicial extinguishment rule, fearing that it would "create a potential disincentive to the donation of easements." The New York Landmarks Conservancy was the only commenter to mention donor improvements to the conservation area. The New York Landmarks Conservancy urged that the proportionate value formula "fails to take into account that improvements may be made * * * by the owner which should properly alter the ratio." It contended that failure to offset improvements against the donee's share of the proceeds "would obviously be undesirable to the prospective donor and would constitute a windfall to the donee organization." The New York Landmarks Conservancy failed to suggest alternative text to address this concern, other than to "recommend deletion of the entire extinguishment provision." No other commenter suggested alternative text to address the concerns that it expressed.

A public hearing on proposed amendments to the regulations was held. Treasury adopted the proposed amendments with numerous revisions. The preamble to the final regulations provides a summary of the law and states that, "[a]fter consideration of all comments regarding the proposed amendments * * *, those amendments are adopted as revised by this Treasury decision." In a Section captioned "Summary of Comments," the preamble explained that Treasury had made substantial revisions in response to the comments it received. The preamble discussed seven aspects of the proposed regulations in detail; in each case Treasury revised or clarified text, filled in gaps, or provided additional explanatory examples. Several provisions had generated "many comments." The "judicial extinguishment" provision was not addressed in "Summary of Comments." Treasury did make changes to that provision in response to the comments it received. As originally proposed, the "judicial extinguishment" rule vested the donee with a property right having a fair market value "that is a minimum ascertainable proportion of the fair market value to the entire property." The final regulation revised subparagraph (6)(ii) to refer to a property right with a fair market value "that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time." Treasury made three other technical and conforming changes to the text of this provision. These changes to

the "judicial extinguishment" rule responded to comments that Treasury had received. Section 170(h)(5)(A) requires that the conservation purpose underlying the easement be "protected in perpetuity." But the statute does not indicate how (or whether) this requirement could be deemed satisfied given the possibility that the easement might later be extinguished. The regulation specifies the circumstances in which "the conservation purpose can nonetheless be treated as protected in perpetuity." To secure "protected in perpetuity" treatment, the regulation requires that the donor agree, at the time of the gift, to a specified division of proceeds in the event the property is sold following judicial extinguishment of the easement. Because the regulation imposes a requirement not explicitly set forth in the statute, it is appropriately treated as a legislative rule.

Legislative rules are subject to Administrative Procedure Act notice-and-comment rulemaking procedures. An agency must: (1) publish a notice of proposed rulemaking in the Federal Register; (2) provide "interested persons an opportunity to participate * * * through submission of written data, views, or arguments"; and (3) "[a]fter consideration of the relevant matter presented, * * * incorporate in the rules adopted a concise general statement of their basis and purpose."[803]

Treasury satisfied the first two requirements. The taxpayer contended that Treasury failed to consider a "relevant matter presented" to it and failed to include in the final regulations a "concise general statement of their basis and purpose." The Administrative Procedure Act provides that a reviewing court shall set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[804] The scope of our review narrow because "[t]he court is not empowered to substitute its judgment for that of the agency."[805] The court considers only whether the agency "articulate[d] a satisfactory explanation for its action."[806] The court will "uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned."[807] "So long as an agency's rationale can reasonably be discerned and that rationale coincides with the agency's authority and obligations under the relevant statute, a reviewing court may not 'broadly require an agency to consider all policy alternatives in reaching decision.'"[808] Indeed, "regulations with no statement of basis and purpose have been upheld where the basis and purpose w[ere] considered obvious."[809]

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[803] See 5 U.S.C. § 553(b), (c).

[804] 5 U.S.C. § 706(2)(a).

[805] *Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 285 (1974) (*quoting Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971)).

[806] *Motor Vehicle Mfrs. Ass'n, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

[807] *Bowman Transp., Inc.*, 419 U.S. at 285-286.

[808] *SIH Partners*, 150 T.C. at 47 (*quoting State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 51 (1983).

[809] *Cal-Almond, Inc. v. U.S. Dep't of Agric.*, 14 F.3d 429, 443 (9th Cir. 1993), *citing Citizens to Save Spencer Cty. v. Environmental Protection Agency*, 600 F.2d 844, 884 (D.C. Cir. 1979).

The preamble to the proposed regulations supplied extensive background about the legislative history, explaining that "[t]he regulations reflect the major policy decisions made by the Congress and expressed in the[ ] committee reports." Treasury noted that "[t]he most difficult problem posed in this regulation was how to provide a workable framework for donors, donees, and the * * * [IRS] to judge the deductibility of open space easements," inviting public comments on this and other points.

Treasury received comments from 90 organizations and individuals who supplied voluminous commentary on many aspects of the proposed regulations. Treasury considered these comments and made numerous changes throughout, highlighting the most important revisions in a two-page "Summary of Comments." The preamble to the final regulations states that, "[a]fter consideration of all comments regarding the proposed amendments * * *, those amendments are adopted as revised by this Treasury decision." The court has found a similar statement, coupled with the administrative record, sufficient to find that Treasury had considered the relevant matter presented to it.[810]

The preamble to the final regulations discusses seven major groups of comments and the changes Treasury made in response to them. An agency cannot reasonably be expected to address every comment it received. The Administrative Procedure Act "has never been interpreted to require the agency to respond to every comment, or to analyze every issue or alternative raised by the comments, no matter how insubstantial."[811] "We do not expect the agency to discuss every item of fact or opinion included in the submissions made to it."[812]

The two aspects of the "judicial extinguishment" rule to which the taxpayer objected are the requirement that the donee receive a proportional share of the proceeds and the fact that the "proportionate share" formula does not account for the possibility of donor improvements. Treasury clearly considered the comments it received on the first point because it substantially revised the text of Treasury Regulations Section 1.170A-14(g)(6)(ii) in response to those comments. Only one of the 90 commenters mentioned donor improvements, and it devoted exactly one paragraph to this subject. That commenter was concerned about facade easements on historic structures, as opposed to "perpetual open space easements," with which Treasury was chiefly concerned. The comment mentioned this point to support its belief that donors of facade easements "are likely to be discouraged from making a donation," a supposition that Treasury may reasonably have discounted. "The administrative record

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[810] See *Wing v. Commissioner*, 81 T.C. 17, 31-32 (1983) (upholding a regulation whose preamble stated that, "[a]fter consideration of all comments regarding the proposed amendments, this Treasury Decision is adopted", *quoting* T.D. 7523, 42 Fed. Reg. 63640 (Dec. 19, 1977)).

[811] *Thompson v. Clark*, 741 F.2d 401, 408 (D.C. Cir. 1984).

[812] *Simms v. Nat'l Highway Traffic Safety Admin.*, 45 F.3d 999, 1005 (6th Cir. 1995) (*quoting Auto. Parts & Accessories Ass'n, Inc. v. Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968)); *see Action on Smoking & Health v. Civil Aeronautics Bd.*, 699 F.2d 1209, 1216 (D.C. Cir. 1983) ("An agency need not respond to every comment.").

reflects that no substantive alternatives to the final rules were presented for Treasury's consideration."[813] The commenter offered no suggestion about how the subject of donor improvements might be handled; it simply recommended "deletion of the entire extinguishment provision." Only one other commenter of the 13 mentioning judicial extinguishment voiced that recommendation.

The Administrative Procedure Act requires "consideration of the relevant matter presented" during the rulemaking process.[814] The court found no doubt that Treasury considered the relevant matter presented to it. The court found equally little merit in taxpayer's assertion that Treasury failed to "incorporate in the rules adopted a concise general statement of their basis and purpose."[815]

[2] Good Fortune Shipping S.A. Shipping (2018): Failure to Explain Reason for Distinction in Regulation Between Treatment of Bearer Shares and Nominee Shares Resulted in Invalidity of Regulation.

Good Fortune Shipping S.A. Shipping SA v. Commissioner[816] determined that the definition of "qualified foreign corporation" in Treasury Regulations Section 1.883-1(b) as interpreted under the stock ownership test of Treasury Regulations Section 1.883-4 that precluded a foreign corporation from taking into account stock shares that were issued in bearer form when determining its ownership did not constitute a reasonable interpretation of Internal Revenue Code and, thus, was invalid. The Court of Appeals for the District of Columbia Circuit particularly emphasized the failure of the Internal Revenue Service to explain its distinction between the treatment of bearer shares and shares held in nominee ownership. This failure to explain was material in the holding of *Good Fortune Shipping SA* that the regulation was invalid.

When an agency interprets a statute to afford disparate treatment between two different objects of concern, the court "cannot defer to the [agency's] interpretation premised on such a difference unless the [agency] adequately supports it."[817] The agency should be able to show a contemporaneous explanation justifying disparate treatment.

In 2007, the foreign shipping corporation Good Fortune Shipping S.A. Shipping SA attempted to exempt some of its United States-based income from taxation under Section 833. The exemption required that a certain percentage of Good Fortune Shipping S.A. Shipping

[813] *SIH Partners*, 150 T.C. at 44.
[814] 5 U.S.C. § 553(c).
[815] See 5 U.S.C. sec. 553(c).
[816] *Good Fortune Shipping S.A. Shipping SA v. Commissioner*, 897 F.3d 256 (D.C. Cir., 2018),
[817] *Northpoint Tech.*, 412 F.3d at 156.

SA's stock needed to be owned by residents of a country that provided a reciprocal tax exemption.

The Internal Revenue Service prohibited any consideration of bearer shares—securities owned by whoever holds physical certificates issued by the company—when assessing whether a sufficient amount of a foreign shipper's stock was owned by qualifying shareholders. This potentially made the shareholding test ore difficult to satisfy where a material portion of its shares were held in bearer form. The Internal Revenue Service refused to grant Good Fortune Shipping S.A. Shipping SA the exemption. All of the Good Fortune Shipping S.A. Shipping SA stock was made up of bearer shares.

Good Fortune Shipping S.A. disputed the Internal Revenue Service's approach as inconsistent with the Internal Revenue Code. The Tax Court ruled in favor of the Internal Revenue Service.

The D.C. Circuit reversed and held for Good Fortune Shipping S.A. Shipping SA under theory that the definition of "qualified foreign corporation" in Treasury Regulations Section 1.883-1(b) as interpreted under the stock ownership test of Treasury Regulations 1.883-4 that precluded foreign corporation from taking into account stock shares that were in bearer form unreasonably interpreted the Code was invalid.

Good Fortune Shipping S.A. claimed that the income qualified for that exemption and provided documentation purporting to show that all of its bearer shares were indirectly owned by individuals residing in countries that provide a reciprocal exemption to United States corporations. Good Fortune Shipping S.A. also argued that the regulations definition of the definition of "qualified foreign corporation" in Treasury Regulations Section 1.883-1(b) prohibiting any consideration of bearer shares was unlawful.

The Internal Revenue Service maintained that "Congress has not directly spoken" to whether shippers may use bearer shares to satisfy Section 883(c)(1)'s ownership requirement. Under *Chevron*,[818] the D.C. Circuit observed that, for the Internal Revenue Service to prevail, it must demonstrate that Section 883 is silent or ambiguous as to the treatment of bearer shares under Section 883(c)(1) and that its interpretation, as embodied in the definition of "qualified foreign corporation" in Treasury Regulations Section 1.883-1(b) as interpreted under the stock ownership test of Treasury Regulations 1.883-4 is reasonable.

The starting point in examining the lawfulness of an agency's statutory interpretation under *Chevron* usually is determining whether the statute at issue "unambiguously forecloses the agency's interpretation."[819] The D.C. Circuit assumed *arguendo* that the statute is ambiguous and proceeded to *Chevron*'s second step. The D.C. Circuit made this assumption because it concluded that the Internal Revenue Service's interpretation of Section 883 in the 2003

[818] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[819] *Nat'l Cable & Telecomms. Ass'n v. FCC*, 567 F.3d 659, 663 (D.C. Cir. 2009).

Regulation is unreasonable and cannot stand. Under *Chevron* Step Two, the D.C. Circuit asked whether the Internal Revenue Service's interpretation is "reasonable."[820] The D.C. Circuit considered whether the interpretation is "arbitrary or capricious in substance, or manifestly contrary to the statute."[821] The D.C. Circuit's focus was on "whether the [agency] has reasonably explained how the permissible interpretation it chose is 'rationally related to the goals of' the statute."[822]

Whether an agency's construction is reasonable depends, in part, "on the construction's 'fit' with the statutory language, as well as its conformity to statutory purposes."[823] "The starting place for any *Chevron* Step Two inquiry is the text of the statute."[824]

Section 883(c)(1) is silent as to "what type of proof suffices to show any corporation's entitlement to the exemption." Section 883 implies that if a sufficient portion of a foreign corporation's stock is "owned" by qualified shareholders, the corporation will qualify for the exemption. Bearer shares are a valid form of ownership. The regulations acknowledged as much.[825]

The IRS claimed that its refusal to consider bearer shares reasonably "treat[s] the ownership of bearer shares at a prior time as a fact not capable of sufficient proof." The Internal Revenue Service attempted to characterize the regulation as merely establishing modes of proving corporate ownership. The D.C. Circuit observed that, when the agency goes sets an insurmountable burden of proof, the line between merely establishing a method of proving ownership and defining what counts as ownership begins to dissolve. The Internal Revenue Service's refusal to attribute ownership for bearer shares risked "conflat[ing] proof

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[820] *AT&T Corp. v. FCC*, 220 F.3d 607, 621 (D.C. Cir. 2000).

[821] *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53, 131 S.Ct. 704, 178 L.Ed.2d 588 (2011) (*quoting Household Credit Servs., Inc. v. Pfennig*, 541 U.S. 232, 242, 124 S.Ct. 1741, 158 L.Ed.2d 450 (2004)).

[822] *Village of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 665 (D.C. Cir. 2011) (*quoting AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 388, 119 S.Ct. 721, 142 L.Ed.2d 835 (1999)).

[823] *Goldstein v. SEC*, 451 F.3d 873, 881 (D.C. Cir. 2006) (*quoting Abbott Labs. v. Young*, 920 F.2d 984, 988 (D.C. Cir. 1990)).

[824] *Van Hollen v. FEC*, 811 F.3d 486, 492 (D.C. Cir. 2016). I.R.C. § 883(c)(1) states in relevant part that the exemption for foreign shippers introduced in I.R.C. § 883(a)(1) "shall not apply to any foreign corporation if 50 percent or more of the value of the stock of such corporation is owned by individuals who are not residents of" a country granting a reciprocal tax exemption. Congress has determined that the tax exemption shall not be granted to foreign corporations if a certain percentage of their stock "is owned by individuals who are not residents of" a reciprocating country. I.R.C. § 883(c)(1). If 50 percent or more of a shipper's stock "is owned by individuals" who are residents of reciprocating countries, then I.R.C. § 883(c)(1) poses no obstacle to an exemption. If I.R.C. § 883(c)(1) poses no obstacle, then the relevant income "shall not be included in gross income of a foreign [shipping] corporation" and "shall be exempt from taxation." I.R.C. § 883(a).

[825] See Treas. Reg. § 1.883-4(b)(1)(ii) (requiring that a qualified shareholder "not own its interest in the foreign corporation through bearer shares").

of ownership with the meaning of ownership." Bearer shares are a legally valid form of corporate ownership. The Internal Revenue Service's regulations deny those shares any role in establishing ownership for the purposes of the Section 883 exemption. This approach risks undercutting Section 883(c)(1)'s use of the term "owned."

Even if Section 883 grants the Internal Revenue Service significant discretion to establish how to prove ownership, Section 883 does not authorize the agency to deny consideration of a recognized form of ownership based on only a single, undeveloped statement that it is "difficult[ ]" to reliably track the location of a given owner. If the Internal Revenue Service found that the transferable nature of bearer shares made substantiation impossible, the D.C. Circuit might conclude that the regulation reasonably implemented that finding. A kind of stock that is impossible to track might not constitute a form of ownership contemplated by Section 883(c)(1). The Internal Revenue Service, however, has never made such an absolute claim of impossibility with regard to bearer shares. The Internal Revenue Service's interpretation appears to rewrite Section 883(c)(1) to require not only valid ownership, but ownership that is not "difficult" to track. Even if this regulatory amendment to Section 883 is not unambiguously foreclosed by the statute's language, its unsubstantiated treatment of ownership "comes close to violating the plain language of the statute"—indicating that the regulations is "arbitrary and capricious" at *Chevron* Step Two.[826]

The Internal Revenue Service's interpretation of Section 883 is "entitled to no less deference . . . simply because it has changed over time."[827] The Internal Revenue Service must nevertheless engage in "'reasoned analysis' sufficient to command our deference under *Chevron*,"[828] A sufficiently reasoned analysis requires the Internal Revenue Service to "display awareness that it is changing position" and "show that there are good reasons for the new policy."[829] When assessing the reasonableness of the Internal Revenue Service's interpretation, the court looks only to "what the agency said at the time of the rulemaking—not to its lawyers' post-hoc rationalizations."[830]

As early as 1991 the Internal Revenue Service presumed that bearer shares were "owned by individual residents of a foreign country which does not provide an equivalent exemption, for purposes of Section 883(c).[831] This presumption was triggered only "[i]n the absence of . . . documentation" demonstrating that more than 50 percent of the corporation's

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[826] *Goldstein*, 451 F.3d at 881.

[827] *Nat'l Home Equity Mortg. Ass'n v. Office of Thrift Supervision*, 373 F.3d 1355, 1360 (D.C. Cir. 2004)

[828] *Ala. Educ. Ass'n v. Chao*, 455 F.3d 386, 396 (D.C. Cir. 2006).

[829] *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515, 129 S.Ct. 1800, 173 L.Ed.2d 738 (2009); *see also Northpoint Tech., Ltd. v. FCC*, 412 F.3d 145, 156 (D.C. Cir. 2005) ("A statutory interpretation . that results from an unexplained departure from prior [agency] policy and practice is not a reasonable one.").

[830] *Council for Urological Interests v. Burwell*, 790 F.3d 212, 222 (D.C. Cir. 2015).

[831] Rev. Proc. 91-12, § 8.02(3), 1991-1 C.B. 473.

shares were owned by residents of a reciprocating country.[832] Between 1991 and 2003, the Internal Revenue Service apparently thought sufficient documentation regarding the ownership of bearer shares could secure a tax exemption under Section 883. In 2003 the Internal Revenue Service concluded that the "difficulty of reliably demonstrating the true ownership of bearer shares" warranted the flat prohibition of considering bearer stock The Internal Revenue Service never explained how the pre-existing opportunity to provide substantiating documentation had become unworkable since 1991. The Internal Revenue Service did not explain if or how "reliably demonstrating the true ownership of bearer shares" was any more difficult in 2003 than in 1991.

Considering the Internal Revenue Service's later recognition in 2010 that some forms of bearer shares were becoming easier to track over time, the Internal Revenue Service decision to treat bearer shares less favorably in 2003 than in 1991 was all the more inexplicable to the D.C. Circuit.

In 2010, the Internal Revenue Service ultimately amended its treatment of bearer shares for purposes of the exemption in Section 883(a)(1). Rather than categorically exclude bearer shares from consideration, the amended regulation allows bearer shares to count toward the Section 883 exemption if they satisfy one of two conditions. First, bearer share count toward the exemption if the shares are "dematerialized" or "represented only by book entries" with "no physical certificates . . . issued or transferred."[833] Second, the bearer shares count toward the exemption if they are "immobilized," in which "evidence of ownership is maintained on the books and records of the corporate issuer or by a broker or financial institution."[834] While the Internal Revenue Service continued to maintain that it has "been difficult to reliably prove ownership of bearer shares," the Internal Revenue Service nevertheless recognized in 2010 that dematerialized and immobilized bearer shares had "become increasingly common" and "provide the ability to reliably identify the beneficial owner of bearer shares."[835]

The Internal Revenue Service abandoned the 2003 regulation's categorical, exclusionary rule in 2010 in response to the "recent increase in the number of corporations switching to immobilized or dematerialized bearer shares." While the Internal Revenue Service maintained that dematerialized and immobilized bearer shares had become "increasingly common" by 2010, at no time has the Internal Revenue Service ever argued that such bearer shares were nonexistent or obscure between 2003 and 2010, nor that they were less prevalent in 2003 than in 1991. Even if the Internal Revenue Service were correct that "there is no guarantee" that foreign shippers kept such records of bearer shares before 2010, that skepticism alone does not justify the regulation's categorical ban, according to the D.C. Circuit.

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[832] *Id.*

[833] Treas. Reg. § 1.883-1(c)(3)(i)(G) (2010); see also Treas. Reg. § 1.883-4(b)(1)(ii).

[834] Treas. Reg. § 1.883-1(c)(3)(i)(G).

[835] Exclusions from Gross Income of Foreign Corporations, 75 Fed. Reg. 56,858, 56,860 (Sept. 17, 2010).

The 2003 regulation also appears unreasonable, according to the D.C. Circuit, because the 2003 regulation treats bearer shares with disproportionate disfavor compared to other forms of corporate ownership sharing similar alleged problems. The Internal Revenue Service argued that Section 883(c)(1) is an "anti-abuse provision" that would be undermined if the Internal Revenue Service accepted bearer shares as proof of ownership without any "reasonable method of proving or disproving [a] statement of ownership." Even assuming that is true, according to the court, there is a potential for abuse with other types of corporate shares, many of which the Internal Revenue Service accepts as proof of ownership under Section 883(c)(1).

When an agency interprets a statute to afford disparate treatment between two different objects of concern, the court "cannot defer to the [agency's] interpretation premised on such a difference unless the [agency] adequately supports it."[836] When the Internal Revenue Service promulgated the 2003 regulation, the Internal Revenue Service offered no justification for treating bearer shares differently than nominees and trustees under Section 883. That is enough to render the distinction inadequate for purposes of *Chevron* Step Two.[837]

The Internal Revenue Service's post-hoc attempt to distinguish nominees and trustees does not adequately support the agency's disparate treatment of bearer shares. The Internal Revenue Service argued that a "substantiation-based solution" is simply "inappropriate" for bearer shares because of their "transferable nature," a problem that is not as acute with nominees and trustees.

While bearer shares' transferable nature might make it more difficult to substantiate the identity of their owners at any given time, the Internal Revenue Service has never explained why that difficulty alone makes a substantiation-based method of proving bearer-share ownership "inappropriate" relative to proving the ownership of nominees and trustees. Indeed, the Internal Revenue Service concedes that "corporations might have formal records of the ownership of bearer shares even though there is no requirement that they keep such records." The Internal Revenue Service's conclusory rejection in 2003 of any substantiation-based method for proving bearer-share ownership does not adequately consider analogous problems of proof facing other forms of ownership.

Finally, the exclusion of bearer shares endorsed in the 2003 Regulation was even out of step with the Internal Revenue Service's treatment of bearer shares in similar contexts. In another provision of the Code, some foreign corporations can receive comparably favorable tax treatment if their stock is regularly traded on an established securities market in their countries of residence.[838] However, stock that is otherwise regularly traded will not qualify for

[836] *Northpoint Tech.*, 412 F.3d at 156.

[837] *See Envtl. Def. Fund, Inc. v. Environmental Protection Agency*, 898 F.2d 183, 189 (D.C. Cir. 1990) ("We cannot sustain an action merely on the basis of interpretive theories that the agency might have adopted and findings that (perhaps) it might have made.").

[838] See I.R.C. § 884(e)(4)(B).

favorable treatment if the stock is "closely held."[839] A foreign corporation is closely held if at least 50 percent of its stock is owned by a certain type of shareholder.[840] While the foreign corporation bore the burden of proving that it is not closely held, it can meet that burden "with either registered or bearer shares . . . if it has no reason to know and no actual knowledge of facts that would cause the corporation's stock not to be treated as regularly traded .[841] The Internal Revenue Service recognizes that even if the owners of bearer shares are difficult to identify, a categorical prohibition on considering such shares is not necessary to cope with that challenge.

The Internal Revenue Service attempted to explain away these regulations implementing Section 884 by focusing on the "impetus" for the restriction of bearer shares in Section 883. The Internal Revenue Service explains "the abusive use of bearer shares to hide ownership constitutes a well-recognized problem in the shipping industry." What matters is that the Internal Revenue Service has recognized in the Section 884 regulations that bearer shares are capable of proving ownership. The presence or absence of a risk of abuse has no effect on the ability of bearer shares to "reliably demonstrat[e]" who owns the share.[842] If bearer shares were reliable enough under Section 884, the D.C. Circuit sees no reason why bearer shares would not have been reliable enough to justify their consideration under Section 883. The Internal Revenue Service cannot reasonably rely on the risk of abuse to treat bearer shares as a form of second-class ownership in some contexts but not in others, especially without any contemporaneous explanation justifying the disparate treatment. The Internal Revenue Service's inconsistent approach to bearer shares is the last straw needed to break this camel's back, according to the D.C. Circuit.

The Internal Revenue Service chose to "paint[ ] with such a broad brush" that it "failed adequately to justify" its categorical rule excluding the use of bearer shares in qualifying for the tax exemption in Section 883.[843] Even if the Internal Revenue Service reasonably concluded that sometimes—maybe oftentimes—bearer shares are incapable of proving the residence of their owners, the 2003 Regulation's categorical bar on considering bearer shares does not follow from that premise. The Internal Revenue Service has not justified treating all bearer shares as incapable of proving ownership. If some corporations' bearer shares are not kept in record form, and thus are not capable of proving the location of an owner, then the Internal Revenue Service "should have identified those [corporations' shares] and tailored its rule accordingly."

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[839] See Branch Profits Tax, 57 Fed. Reg. 41,644, 41,648 (Sept. 11, 1992).

[840] See Treas. Reg. § 1.884-5(d)(4)(iii) (2007).

[841] Treas. Reg. § 1.884-5(d)(5); see also 57 Fed. Reg. at 41,648 ("[C]orporations with bearer shares can meet the burden of proof . as long as they have no knowledge and no reason to know their stock is closely held.").

[842] 68 Fed. Reg. at 51,399.

[843] *Goldstein*, 451 F.3d at 883.

The D.C. Circuit held that the 2003 regulation is unreasonable and therefore invalid under *Chevron* Step Two.

[3] Altera Corporation v. Commissioner (2019): Agency Must Examine The Relevant Data And Articulate A Satisfactory Explanation For Its Action Including A Rational Connection Between The Facts Found And The Choice Made.

Altera Corporation v. Commissioner[844] considered regulations on qualified cost-sharing arrangements, such as research and development agreements. The case presents the question of the validity of Treasury Regulations Section 1.482-7A(d)(2), under which related business entities must share the cost of employee stock compensation in order for their cost-sharing arrangements to be classified as qualified cost-sharing arrangements ("QCSA"). The parties agreed that, under the governing tax statute, the "arm's length" standard applies. They disagreed about how the standard may be met. The taxpayers, among other things, argued that Treasury's failure to consider and to address comments and asserted that this violated the Administrative Procedure Act and invalidated the regulation. The Ninth Circuit, however, found that the comments that were disregarded were immaterial comments.

Altera argued that the regulations fail on the second step pf *Chevron*, asserting that:

- Treasury improperly rejected comments submitted in opposition to the proposed rule,
- Treasury's current litigation position is inconsistent with statements made during the rulemaking process,
- Treasury did not adequately support its position that employee stock compensation is a cost, and
- a more searching review is required under Fox, because the agency altered its position.

"[T]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[845]

"[A]gency action is lawful only if it rests 'on a consideration of the relevant factors.'"[846]

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[844] *Altera Corporation v. Commissioner,* 941 F.3d. 1200 (9th Cir. 2019).

[845] *Id.*. at 43 (*quoting Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156 (1962)).

[846] *Michigan v. Environmental Protection Agency*, U.S. 135 S. Ct. 2699, 2706 (2015) (*quoting State Farm*, 463 U.S. at 43, 103 S.Ct. 2856).

A court may not set aside agency action simply because the rulemaking process could have been improved; rather, the court must determine whether the agency's "path may reasonably be discerned."[847]

In considering and responding to comments, "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[848]

"[A]n agency need only respond to 'significant' comments, *i.e.*, those which raise relevant points and which, if adopted, would require a change in the agency's proposed rule."[849]

If the comments ignored by the agency would not bear on the agency's "consideration of the relevant factors," the court may not reverse the agency's decision.[850]

The Ninth Circuit in *Altera* concluded that they could not find a failure in Treasury's refusal to consider comments that proved irrelevant to its decision making process. Treasury gave sufficient notice of what it intended to do and why, and the submitted comments were irrelevant to the issues Treasury was considering. Because the comments had no bearing on "relevant factors" to the rulemaking, nor any bearing on the final rule, there was no Administrative Procedure Act violation.[851]

According to the Ninth Circuit in *Altera*, the 2003 regulations are not arbitrary and capricious under the standard of review imposed by the Administrative Procedure Act. Treasury's regulatory path may be reasonably discerned. Treasury understood Section 482 to authorize it to employ a purely internal, commensurate with income approach in dealing with related companies. Treasury provided adequate notice of its intent and adequately considered the objections. Treasury's conclusion that stock based compensation should be treated as a cost was adequately supported in the record. Treasury's position did not represent a policy change under *Fox*.

The taxpayer in *Altera* argued that Treasury must employ a specific method to meet the arm's length standard: a comparability analysis using comparable transactions between unrelated business entities.

Treasury in *Altera* disagreed that the arm's length standard requires the specific comparability method in all cases. Instead, according to Treasury, the standard generally requires that Treasury reach an arm's length result of tax parity between controlled and

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[847] *State Farm*, 463 U.S. at 43 (*quoting Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 286, (1974)).

[848] *Id.*. (*quoting 1081 Burlington Truck Lines*, 371 U.S. at 168).

[849] *Am. Mining Congress v. Environmental Protection Agency*, 965 F.2d 759, 771 (9th Cir. 1992) (*quoting Home Box Office v. FCC*, 567 F.2d 9, 35 & n.58 (D.C. Cir. 1977) (*per curiam*)).

[850] *Id.*

[851] *Am. Mining Congress*, 965 F.2d at 771.

uncontrolled business entities. With respect to the transactions at issue, the governing statute allows Treasury to apply a purely internal method of allocation, distributing the costs of employee stock options in proportion to the income enjoyed by each related taxpayer.

Treasury had promulgated a regulation requiring participants in a qualified cost-sharing arrangement to share "all of the costs" of developing intangibles.[852] Treasury interpreted stock-based compensation to be such a cost. Treasury published a rule codifying its decision that qualified cost-sharing arrangement parties should share stock-based compensation costs. Treasury updated the arm's length standard provision, Treas. Reg. § 1.482-1, with a cross-reference to its 1995 "all of the costs" provision,[853] and specifically defined "operating expenses" to include stock-based compensation,[854] Treasury purported to "believe that requiring stock-based compensation to be taken into account for purposes of QCSAs is consistent with the legislative intent underlying Section 482 and with the arm's length standard," because "unrelated parties entering into QCSAs would generally share stock-based compensation costs."

Xilinx, Inc. challenged this interpretation. The Tax Court ruled in Xilinx's favor.[855] The Tax Court found as a factual matter that "two unrelated parties in a cost sharing agreement would not share any costs related to [stock-based compensation]."[856] At the same time, it found that Section 1.482-1(b)(1)—*i.e.*, the arm's length standard—still controlled over Treasury's new all costs regulation. The Tax Court found Treasury's re-allocation of Xilinx's stock-based compensation costs to be arbitrary and capricious. The Ninth Circuit in *Xilinx* affirmed the Tax Court.

Altera Corporation shared certain costs with one of its foreign subsidiaries, Altera International, pursuant to a research and development cost-sharing agreement. Relying on the Tax Court's 2005 decision in *Xilinx*, the companies did not share the costs of stock-based compensation. After Altera filed consolidated income tax returns for these years, Treasury issued notices of deficiency on the grounds that it had to re-allocate over $100 million in income from Altera International to Altera to account for the unshared costs of stock-based compensation. Treasury asserted that this re-allocation was necessary under Section 1.482-7(d)(2).

The Tax Court agreed with Altera and concluded that the regulation is arbitrary and capricious.[857] The Tax Court determined that, during the rulemaking process, Treasury specifically justified its new stock-based compensation rule on the ground "was required by—

[852] Treas. Reg. § 1.482-7(d)(1) (1995).
[853] Treas. Reg. § 1.482-7.
[854] Treas. Reg. § 1.482-7(d)(2).
[855] *Xilinx, Inc. v. Commissioner*, 125 T.C. 37, 62 (2005).
[856] *Xilinx*, 598 F.3d at 1194.
[857] *Altera Corp. v. Commissioner*, 145 T.C. 91, 133–34 (2015).

or was at least consistent with—the arm's-length standard."[858] The Tax Court found that Treasury did not rely on Section 482's "commensurate with income" language, nor could this language sustain an inconsistent rule in any event given Congress' intent for it to work "consistently with the arm's-length standard."[859] The Tax Court proceeded to analyze whether Treasury had articulated a reasoned basis for its conclusion that "unrelated parties entering into QCSAs would generally share stock-based compensation costs."[860] The Tax Court found that:

- the administrative record contained no empirical data supporting such a conclusion,
- that Treasury had made no attempt to search for evidence supporting such a conclusion, and
- that Treasury was unaware of any actual transaction illustrating such a result.[861]

The Tax Court in *Altera* noted that Treasury "seemed to accept the commentators' economic analyses, which concluded that . . . unrelated parties to a QCSA would be unwilling to share the exercise spread or grant date value of stock-based compensation."[862] The Tax Court therefore found that "'Treasury's 'explanation for its decision . . . runs counter to the evidence before' it."[863] The Tax Court concluded that "'Treasury's '*ipse dixit* conclusion, coupled with its failure to respond to contrary arguments resting on solid data, epitomizes arbitrary and capricious decisionmaking.'"[864] A divided panel of the Ninth Circuit reversed.[865] On appeal, Treasury adopted a new position: that its 2003 rule was justified not because unrelated parties would actually share costs in the manner the rule now specifies, but because Treasury no longer needs to consider the behavior of unrelated parties at all. Treasury's new theory was that it can allocate costs under a qualified cost-sharing arrangement based on a standard purely internal to the participants, with no analysis of comparable transactions between unrelated entities, and call this an arm's length result.

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[858] *Id.*. at 121 & n.17, *citing* 68 Fed. Reg. at 51,173 ("The final regulations provide that stock-based compensation must be taken into account in the context of QCSAs because such a result is consistent with the arm's length standard.")).

[859] *Id.*

[860] *Id.*. at 123.

[861] *Id.*. at 122–23.

[862] *Id.*. at 131.

[863] *Id.*. (*quoting Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, (1983)).

[864] *Id.*. at 134 (*quoting Ill. Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555, 564 (D.C. Cir. 1997)).

[865] *Altera Corp. v. Commissioner*, 926 F.3d 1061, 1087 (9th Cir. 2019).

Applying *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[866] the Ninth Circuit found that this revised interpretation of Section 482 is permissible.[867] The Ninth Circuit further concluded that "Treasury's decision to do away with analysis of comparable transactions" was neither arbitrary nor capricious, because it "was made clear enough by citations to legislative history in the notice of proposed rulemaking and in the preamble to the final rule."[868] Because Treasury abandoned the comparability standard, Treasury was not required to address public comments that emphasized the absence of stock-based compensation cost-sharing in comparable transactions.[869]

The Ninth Circuit considered the impact of *Chevron* on Altera and the regulation. Under *Chevron*, the court first applied the traditional rules of statutory construction to determine whether "Congress has directly spoken to the precise question at issue."[870] The Ninth Circuit started with the plain statutory text. "[W]hen deciding whether the language is plain, we must read the words 'in their context and with a view to their place in the overall statutory scheme.'"[871]

The Ninth Circuit examined

- the legislative history,
- the statutory structure, and
- "other traditional aids of statutory interpretation"

in order to ascertain Congressional intent.[872]

If,

- after conducting that *Chevron* step one examination,
- the court concludes that the statute is silent or ambiguous on the issue,

then

- the court then defers to the agency's interpretation

so long as

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[866] *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).

[867] *Altera*, 926 F.3d at 1075–78.

[868] *Id.*. at 1082.

[869] *Id.*

[870] 467 U.S. at 842.

[871] King v. Burwell, 576 U.S. 473 (2015) (*quoting FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000)).

[872] *Middlesex Cty. Sewerage Auth. v. Nat'l Sea Clammers Ass'n*, 453 U.S. 1, 13 (1981).

- the agency interpretation "is based on a permissible construction of the statute."[873]

A permissible construction is one that is not "arbitrary, capricious, or manifestly contrary to the statute."[874]

Questions of deference depend on whether "it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority."[875]

"When Congress has 'explicitly left a gap for an agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation,' and any ensuing regulation is binding in the courts unless procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute."[876]

The resolution of the step one *Chevron* examination was straightforward. Section 482 does not speak directly to whether the Commissioner may require parties to a qualified cost-sharing arrangement to share employee stock compensation costs in order to receive the tax benefits associated with entering into a qualified cost-sharing arrangement. The statute remains ambiguous regarding the method by which Treasury is to make allocations based on stock-based compensation.

Altera argued that the statute, by its terms, cannot apply to stock-based compensation. Stock-based compensation is not "transferred" between parties because only preexisting intangibles can be transferred. According to Altera, Treasury exceeded the delegation of authority apparent from the plain text of the statute.

The Ninth Circuit was not persuaded. When parties enter into a qualified cost-sharing arrangement, they are transferring future distribution rights to intangibles, albeit intangibles that have yet to be developed. The present-day transfer of those rights provides the main incentive for entering into a qualified cost-sharing arrangement. The right to distribute intangibles to be developed later is one right in the bundle of property rights that exists at the time that parties enter into a qualified cost-sharing arrangement.

Assuming that the crucial transfer does not occur contemporaneously, Section 482 applies "[i]n the case of any transfer . . . of intangible property" that produces income. That phrasing is as broad as possible. That language, according to the Ninth Circuit, cannot reasonably be read to exclude the transfers of expected intangible property. The sentence necessarily is forward-looking because the production of taxable income always follows the

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[873] *Chevron*, 467 U.S. at 843.

[874] *Id.*. at 844.

[875] *United States v. Mead Corp.*, 533 U.S. 218, 226–27 (2001).

[876] *Id.*. at 227 (*quoting Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984), *overruled by Loper Bright Enterprises v. Raimondo*, —— U.S. ——, 144 S. Ct. 2244 (2024).).

transfer. The text of the statute does not limit its application to preexisting intangibles in the way Altera's argument suggests. Parties to a qualified cost-sharing arrangement transfer cost-shared intangibles—including stock-based compensation. The parties are subject to regulation under Section 482.

The Ninth Circuit considered *Chevron* step two. This step involved whether Treasury's interpretation of Section 482 as to allocation of employee stock option costs is permissible. An agency's interpretation of statutory authority is examined "in light of the statute's text, structure and purpose."[877] The interpretation fails if it is "unmoored from the purposes and concerns" of the underlying statutory regime.[878] Congress' purpose in enacting and amending Section 482 in 1986 is key to resolution of this issue.

The Congressional purpose in enacting Section 482, according to the Ninth Circuit in *Altera*, was to establish tax parity.[879] Congress called for an approach to allocation of costs and income that would "reasonably reflect the actual economic activity undertaken by each [party to a QCSA]."[880] Congress' objective in amending Section 482 was to ensure that income follows economic activity.[881] Although the 1986 amendment delegates to Treasury the choice of a specific methodology to achieve that end, it suggested: "In the case of any transfer (or license) of intangible property . . . the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible." This standard is a purely internal one, internal to the entity being taxed. Evidence supports Treasury's belief that Congress intended it to be.[882] In the qualified cost-sharing arrangement context, Congress did not want to interfere with controlled cost-sharing arrangements, but only to the degree that the allocation of costs and income "reasonably reflect[s] the actual economic activity undertaken by each."[883] According to the Ninth Circuit in *Altera*, Treasury's decision to adopt a methodology that followed actual economic activity was reasonable.

Treasury's determination that uncontrolled cost-sharing arrangements do not provide helpful guidance regarding allocations of employee stock compensation also was reasonable, according to the Ninth Circuit in *Altera*. When Congress amended Section 482 in 1986, Congress bemoaned the difficulties associated with finding and using data involving high-profit intangibles.[884] It follows that Congress granted Treasury authority to develop methods

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[877] *Miguel-Miguel v. Gonzales*, 500 F.3d 941, 949 (9th Cir. 2007).

[878] *Judulang v. Holder*, 565 U.S. 42, 64 (2011).

[879] *First Sec. Bank of Utah*, 405 U.S. at 400.

[880] H.R. Rep. No. 99-841, at II-638 (1986) (Conf. Rep.).

[881] *Id.*. at II-637.

[882] H.R. Rep. No. 99-426, at 423–35; H.R. Rep. No. 99-841, at II-637 (Conf. Rep.).

[883] H.R. Rep. No. 99-841, at II-638 (Conf. Rep.).

[884] See H.R. Rep. No. 99-426, at 425 ("There are extreme difficulties in determining whether the arm's length transfers between unrelated parties are comparable. . [I]t is appropriate to require that the payment made on a transfer of intangibles to a related foreign corporation be commensurate with the income attributable to the intangible."); see also Compensatory Stock Options Under Section 482,

that did not rely on analysis of these problematic comparable transactions. Treasury echoed Congress' rationale for amending Section 482 when Treasury published the final rule.[885]

Altera suggested that there can be only one understanding of the methodology required by the arm's length standard. However, historically the definition of the "arm's length standard" has been a more fluid one. For most of the twentieth century, the arm's length standard explicitly permitted the use of flexible methodology in order to achieve an arm's length result. More recently, an understanding that the primary means of reaching an arm's length result suggested the analysis of comparable transactions. Congress, however, voiced numerous concerns regarding reliance on this methodology. Courts for more than half a century have held that a comparable transaction analysis was not the exclusive methodology to be employed under the statute. In light of the historic versatility of methodology, according to the Ninth Circuit in *Altera*, it is reasonable that Treasury would understand that Congress intended for the court to depart from analysis of comparable transactions as the exclusive means of achieving an arm's length result.

According to the Ninth Circuit in *Altera*, Treasury reasonably concluded that doing away with analysis of comparable transactions was an efficient means of ensuring that Section 482 would "operat[e] to assure adequate allocations to the U.S. taxable entity of income attributable to intangibles in [QCSAs]."[886] Congress expressed numerous concerns that pre-1986 allocation methods permitted entities to undervalue their tax liability by placing undue emphasis on "the concept of comparables" and basing allocations on industry norms, rather than on actual economic activity.[887] Doing away with analysis of comparable transactions, and instead requiring an internal method of allocation, proves a reasonable method of alleviating these concerns, according to the Ninth Circuit.

According to the Ninth Circuit in *Altera*, Treasury reasonably understood Section 482 as an authorization to require internal allocation methods in the *Altera* context, provided that the costs and income allocated are proportionate to the economic activity of the related parties. These internal allocation methods, according to the Ninth Circuit, are reasonable methods for reaching the arm's length results required by statute. While interpreting the statute to do away with reliance on comparables may not have been "the only possible interpretation" of Congress' intent, it is a reasonable one, according to the Ninth Circuit. According to the Ninth

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68 Fed. Reg. 51,171-02, 51,173 (Aug. 26, 2003), *citing* H.R. Rep. No. 99-426, at 423–25) ("As recognized in the legislative history of the Tax Reform Act of 1986, there is little, if any, public data regarding transactions involving high-profit intangibles."

[885] *Id.*. at 51,173 ("The uncontrolled transactions cited by commentators do not share enough characteristics of QCSAs involving the development of high-profit intangibles to establish that parties at arm's length would not take stock options into account in the context of an arrangement similar to a QCSA.").

[886] H.R. Rep. No. 99-426, at 423.

[887] *Id.*. at 424–25.

Circuit, Treasury's interpretation is not "arbitrary, capricious, or manifestly contrary to the statute," and it is therefore permissible under *Chevron*.

Altera contended that the Commissioner misread Section 482 and its history. Altera argued that the addition of the commensurate with income standard to Section 482 did nothing to change the meaning and operation of the arm's length standard, thus rendering Treasury's interpretation unreasonable. Altera supported its argument with a canon of construction: "Amendments by implication, like repeals by implication, are not favored."[888] According to the Ninth Circuit in *Altera*, that canon did not apply in this case. The canon operates to prevent courts from attributing unspoken motives to legislators, not to force courts to ignore legislative action and express legislative history. Cases invoking the maxim typically refer to a later-enacted, separate statute or provision amending a previous statute or provision; most cases do not involve changes to the same statute or provision. According to the Ninth Circuit, it is illogical to argue that amending a singular statute does not alter its meaning. According to the Ninth Circuit, Altera's interpretation of the 1986 amendment would render the commensurate with income clause meaningless except in two circumstances: (1) to allow the Commissioner periodically to adjust prices initially assigned following a comparability analysis; and (2) to reflect a party's contribution of existing intangible property or "buy-in" to a cost-sharing arrangement. This narrow reading of Section 482, according to the Ninth Circuit, is not supported by the text or history of the 1986 amendment.

The Ninth Circuit concluded that the Commissioner's allocation of employee stock compensation costs between related parties is necessary for Treasury to fulfill its obligation under Section 482. Congress did not intend to interfere with qualified cost-sharing arrangements when those arrangements provided for the allocation of income consistent with the commensurate with income provision.[889]

Altera emphasized the United States' treaty obligations with other countries. Altera asserted that a purely internal standard is inconsistent with the standards agreed to in those treaties and is unreasonable. However, according to the Ninth Circuit, there is no evidence that treaty obligations bind the United States to the analysis of comparable transactions. As demonstrated by nearly a century of interpreting Section 482 and its precursor, the arm's length standard is not necessarily confined to one methodology. The arm's length standard reflects neither how related parties behave nor how they are taxed. The most recent treaties incorporate not only the arm's length standard, but also the 2003 regulations.

Though Treasury's interpretation of its statutory grant of authority was reasonable, the Ninth Circuit also examined whether the procedures used in its promulgation prove defective

[888] *United States v. Welden*, 377 U.S. 95, 103 n.12 (1964).
[889] H.R. Rep. No. 99-841, at II-638 (Conf. Rep.).

under the Administrative Procedure Act.[890] After reviewing the administrative record, the Ninth Circuit concluded that Treasury complied with the procedural requirements of the Administrative Procedure Act and, therefore, the regulations survive *State Farm* scrutiny.

Section 706 of the Administrative Procedure Act directs courts to "decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action."[891] Agencies may not act in ways that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[892]

The Administrative Procedure Act "sets forth the full extent of judicial authority to review executive agency action for procedural correctness."[893] It "prescribes a three-step procedure for so-called 'notice-and-comment rulemaking.'[894]

- First, a "[g]eneral notice of proposed rule making" must ordinarily be published in the Federal Register.[895]
- Second, provided that "notice [is] required," the agency must "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments."[896] "An agency must consider and respond to significant comments received during the period for public comment."[897]
- Third, the agency must incorporate in the final rule "a concise general statement of [its] basis and purpose."[898]

Altera did not dispute that Treasury satisfied the first step by giving notice of the 2003 regulations. Altera apparently did not dispute whether Treasury included in the final rule "a concise general statement of [its] basis and purpose."[899]

Altera argued that the regulations fail on the second step, asserting that:

- Treasury improperly rejected comments submitted in opposition to the proposed rule,

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[890] *Catskill Mountains*, 846 F.3d at 522 ("[I]f an interpretive rule was promulgated in a procedurally defective manner, it will be set aside regardless of whether its interpretation of the statute is reasonable.").

[891] 5 U.S.C. § 706 (flush language).

[892] 5 U.S.C. § 706(2)(A).

[893] *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 513, (2009).

[894] *Perez v. Mortg. Bankers Ass'n*, U.S. ——(2015), *citing* 5 U.S.C. § 553.

[895] 5 U.S.C. § 553(b).

[896] 5 U.S.C. § 553(c).

[897] *Perez*, 135 S. Ct. at 1203.

[898] 5 U.S.C. § 553(c).

[899] *Id.*; 5 U.S.C. § 553.

- Treasury's current litigation position is inconsistent with statements made during the rulemaking process,
- Treasury did not adequately support its position that employee stock compensation is a cost, and
- a more searching review is required under Fox, because the agency altered its position.

Under *State Farm*, the touchstone of "arbitrary and capricious" review under the Administrative Procedure Act is "reasoned decisionmaking."[900]

"[T]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[901]

"[A]gency action is lawful only if it rests 'on a consideration of the relevant factors.'"[902]

A court may not set aside agency action simply because the rulemaking process could have been improved; rather, the court must determine whether the agency's "path may reasonably be discerned."[903]

In considering and responding to comments, "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[904]

"[A]n agency need only respond to 'significant' comments, *i.e.*, those which raise relevant points and which, if adopted, would require a change in the agency's proposed rule."[905]

If the comments ignored by the agency would not bear on the agency's "consideration of the relevant factors," the court may not reverse the agency's decision.[906]

Treasury published its notice of proposed rulemaking in 2002. In its notice, Treasury made clear that it was relying on the commensurate with income provision. To support its position, Treasury drew from the legislative history of the 1986 amendment, explaining that Congress intended a party to a qualified cost-sharing arrangement to "bear its portion of all

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[900] *State Farm*, 463 U.S. at 52.

[901] *Id.*. at 43 (*quoting Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156 (1962)).

[902] *Michigan v. Environmental Protection Agency*, U.S. 135 S. Ct. 2699, 2706 (2015) (*quoting State Farm*, 463 U.S. at 43*,* 103 S.Ct. 2856).

[903] *State Farm*, 463 U.S. at 43 (*quoting Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 286, (1974)).

[904] *Id.*. (*quoting 1081 Burlington Truck Lines*, 371 U.S. at 168).

[905] *Am. Mining Congress v. Environmental Protection Agency*, 965 F.2d 759, 771 (9th Cir. 1992) (*quoting Home Box Office v. FCC*, 567 F.2d 9, 35 & n.58 (D.C. Cir. 1977) (*per curiam*)).

[906] *Id.*

research and development costs." Treasury also informed interested parties of its intent to coordinate the new regulations with the arm's length standard. Treasury suggested that it was attempting to synthesize the potentially disparate standards found within Section 482 itself.

Commenters responded by attacking the proposed regulations as inconsistent with the traditional arm's length standard because the methodology did not involve analysis of comparable transactions. Commenters primarily discussed arm's length agreements in which unrelated parties did not mention employee stock options. Commenters explained that unrelated parties do not share stock compensation costs because it is difficult to value stock-based compensation. There can be a great deal of expense and risk involved.

In the preamble to the final rule, Treasury dismissed the comments (and, relatedly, the behavior of controlled taxpayers):

> *Treasury and the IRS continue to believe that requiring stock-based compensation to be taken into account for purposes of QCSAs is consistent with the legislative intent underlying section 482 and with the arm's length standard (and therefore with the obligations of the United States under its income tax treaties . .). The legislative history of the Tax Reform Act of 1986 expressed Congress' intent to respect cost sharing arrangements as consistent with the commensurate with income standard, and therefore consistent with the arm's length standard, if and to the extent that the participants' shares of income "reasonably reflect the actual economic activity undertaken by each." See H.R. Conf. Rep. No. 99-481, at II-638 (1986). .. [I]n order for a QCSA to reach an arm's length result consistent with legislative intent, the QCSA must reflect all relevant costs, including such critical elements of cost as the cost of compensating employees for providing services related to the development of the intangibles pursuant to the QCSA. Treasury and the IRS do not believe that there is any basis for distinguishing between stock-based compensation and other forms of compensation in this context.*
>
> *Treasury and the IRS did not agree with the comments that assert that taking stock-based compensation into account in the QCSA context would be inconsistent with the arm's length standard in the absence of evidence that parties at arm's length take stock-based compensation into account in similar circumstances. . The uncontrolled transactions cited by commentators do not share enough characteristics of QCSAs involving the development of high-profit intangibles to establish that parties at arm's length would not take stock options into account in the context of an arrangement similar to a QCSA.* [907]

Treasury added:

> *Treasury and the IRS believe that if a significant element of [the costs shared by unrelated parties] consists of stock-based compensation, the party committing employees to the arrangement generally would not agree to do so on terms that ignore the stock-based compensation.* [908]

[907] Compensatory Stock Options under Section 482 (Preamble to Final Rule), 68 Fed. Reg. 51,171-02, 51,172–73 (Aug. 26, 2003).

[908] *Id.*. at 51,173.

According to the Ninth Circuit in *Altera*, by submitting the cited transactions between unrelated parties, the commentators apparently assumed that Treasury would employ analysis of comparable transactions. This assumption, however, overlooked Treasury's decision to do away with analysis of comparable transactions in the first place—a decision that was made clear enough by citations to legislative history in the notice of proposed rulemaking and in the preamble to the final rule. Treasury's conclusion that it could require parties to a qualified cost-sharing arrangement to share all costs was a reasonable one. "[S]ignificant" comments that required a response would have spoken to why this interpretation was not, in fact, reasonable, so that adopting the comments would require Treasury to change the regulation.[909] As an example, Treasury would have been required to respond to comments demonstrating that doing away with analysis of comparables did not serve the purposes of parity set out in the statute.

The cited transactions actually reinforced the original justification for adopting a purely internal methodology—the lack of transactions comparable to those occurring between parties to a qualified cost-sharing arrangement. The submitted transactions did not "share enough characteristics of QCSAs involving the development of high-profit intangibles" to provide grounds for accurate comparison. Because of this lack of similar transactions, Treasury justifiably chose to employ methodology that did not depend on non-existent comparables to satisfy the commensurate with income test and achieve tax parity. In this way, the comments reinforced Treasury's premise for adopting the purely internal methodology, but were irrelevant to the underlying choice of methodology. Treasury did not err in refusing to examine them more rigorously.

The Ninth Circuit in *Altera* concluded that they could not find a failure in Treasury's refusal to consider comments that proved irrelevant to its decision making process. Treasury gave sufficient notice of what it intended to do and why, and the submitted comments were irrelevant to the issues Treasury was considering. Because the comments had no bearing on "relevant factors" to the rulemaking, nor any bearing on the final rule, there was no Administrative Procedure Act violation.[910]

According to the Ninth Circuit in *Altera*, Treasury's current litigation position is consistent with the statements it made to support the 2003 regulations at the time of the rulemaking.

Altera argues that its position is justified by SEC v. *Chenery* Corp.,[911] "[A] reviewing court . . . must judge the propriety of [agency] action solely by the grounds invoked by the agency."[912] "If those grounds are inadequate or improper, the court is powerless to affirm the

[909] *Am. Mining Congress*, 965 F.2d at 771.
[910] *Am. Mining Congress*, 965 F.2d at 771.
[911] 332 U.S. 194 (1947).
[912] *Id.*. at 196.

administrative action by substituting what it considers to be a more adequate or proper basis." *Id.*

Altera argued that the Commissioner cannot now claim that "Treasury reasonably determined that it was statutorily authorized to dispense with comparability analysis" because "[n]owhere in the regulatory history did the Secretary suggest that he 'was statutorily authorized to dispense with comparability analysis.'"

According to the Ninth Circuit in *Altera*, these arguments misunderstand the rulemaking requirements imposed by *Chenery*. *Chenery* does not require us to adopt Altera's position as to how the arm's length standard operates. Instead, we must "defer to an interpretation which was a necessary presupposition of [the agency's] decision," if reasonable, even when alternative interpretations are available.[913]

According to the Ninth Circuit in *Altera*, Treasury reasonably interpreted Congressional intent in the 1986 amendments as permitting Treasury to dispense with a comparable transaction analysis in the absence of actual comparable transactions. Treasury's interpretation was all the more reasonable considering that the arm's length standard has historically been understood as more fluid than Altera suggests. Because *Chenery* does not require agencies to provide "exhaustive, contemporaneous legal arguments to preemptively defend its action," its references to the 1986 amendments provide an adequate ground for its determination.[914]

Altera contended further that the Commissioner's position is incompatible with Treasury's statements during the rulemaking process. Then, the Secretary claimed that the cost-sharing regulations were consistent with the arm's length standard (as well as the commensurate with income standard). According to the Ninth Circuit in *Altera*, this argument misinterprets Treasury's position. Treasury asserted then, and still asserts in the litigation, that using an internal method of reallocation is consistent with the arm's length standard because the internal method of reallocation attempts to bring parity to the tax treatment of controlled and uncontrolled taxpayers, as does comparison of comparable transactions when they exist. Treasury's position was also consistent with its White Paper,[915] and Treasury's interpretation in the 1994 regulation of the arm's length standard as result-oriented, rather than method-oriented, with the goal of achieving tax parity.[916]

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[913] *Nat'l R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407 (1992).

[914] *Nat'l Elec. Mfrs. Ass'n v. U.S. Dep't of Energy*, 654 F.3d 496, 515 (4th Cir. 2011).

[915] Altera argued that a passage in the White Paper (A Study of Intercompany Pricing Under Section 482 of the Code, I.R.S. Notice 88-123, 1988-2 C.B. 458 ("White Paper").), in which Treasury wrote that "intangible income must be allocated on the basis of comparable transactions if comparables exist," demonstrates inconsistency. However, that statement is entirely consistent with Treasury's view that a different methodology must be applied when comparable transactions do not exist.

[916] Treas. Reg. § 1.482-1(b)(1) (1994).

Altera's argument is founded on its belief that an arm's length analysis always must be method-oriented, and rooted in actual transactional analysis. The Ninth Circuit stressed that the question before the court was not which view is superior; it was whether Treasury's position in 2003 was incompatible with its prior position in promulgating the 1994 and 1995 regulations. According to the Ninth Circuit, it was clear in 1994 and 1995 that, in implementing the commensurate with income amendment, Treasury was moving away from a purely method-based, comparable-transaction view of the arm's length standard in attempting to achieve tax parity. Treasury's citation to the amendment, and its legislative history, demonstrates that its position was consistent, and there is no basis under *Chenery* to invalidate it.

Altera also argued that Treasury did not adequately support its position that employee stock compensation is a cost, asserting that Treasury wrongfully ignored evidence that companies do not factor stock-based compensation into their pricing decisions. As an accounting matter in the past, this issue may have been disputed. At one point, "[t]he debate on accounting for stock-based compensation . . . became so divisive that it threatened the [Financial Accounting Standards] Board's future working relationship with some of its constituents."[917] However, it is uncontroversial today. Since 1995, the Financial Accounting Standards Board has supported treating stock options as costs.

According to the Ninth Circuit, Treasury's rulemaking process was sufficient. Treasury articulated why treating stock-based compensation as a cost led to arm's length results. Treasury first noted that stock-based compensation is a "critical element" of research and development costs for parties to a qualified cost-sharing arrangement and noted that this compensation is "clearly related to the intangible development area."[918] Logic supports these conclusions. Parties dealing at arm's length, as Treasury explained, would not "ignore" stock-based compensation if this compensation were a "significant element" of the compensation costs one party incurs and another party agrees to reimburse when developing high-profit intangibles. Rather, "through bargaining," each party would ensure that the cost-sharing agreement is in its best interest, meaning that the parties will consider the internal costs of stock compensation without requiring the other party to recognize those costs.

Though commentators presented evidence of some transactions in which stock-based compensation was not a cost, this evidence provided little guidance because it did not concern parties to a qualified cost-sharing arrangement developing high-profit intangibles. This out-of-context data did not require a different decision. In the absence of applicable evidence,

[917] Financial Accounting Standards Board, Financial Accounting Foundation, Accounting for Stock-Based Compensation: Statement Of Financial Accounting Standards No. 123, at 25 (1995).

[918] Compensatory Stock Options Under Section 482 (Preamble to Final Rule), 68 Fed. Reg. at 51,173.

Treasury's analysis provides a logical explanation of how treating stock-based compensation as a cost leads to arm's length results.

In addition, generally accepted accounting principles supported Treasury's conclusion, and Treasury cited generally to "tax and other accounting principles" for its determination that there is a "cost associated with stock-based compensation."[919] One such principle is that a distinction exists between the economic costs of stock compensation—which are debatable—versus the accounting costs—which are not. Because entities account for the cost of providing employee stock options, it is reasonable for Treasury to allocate that cost. In light of these fundamental understandings, Treasury's reference to "tax and other accounting principles" provides a solid foundation for the Commissioner's interpretation.

The Internal Revenue Code classifies stock-based compensation as a trade or business "expense."[920] The challenged regulation cites the provision providing that this expense is a deductible expense.[921] The reference to the Internal Revenue Code's classifications in the regulation itself serves as yet another articulation of Treasury's reasoning, the reasonableness of which is made clear by the Code's treatment of stock-based compensation as a cost.

Treasury "articulated a rational connection" between its decision and these industry standards.[922] Presuming that Treasury was authorized to dispense with a comparability analysis, making the economic behavior of uncontrolled taxpayers irrelevant, Altera did not offer any compelling argument against the reasonableness of Treasury's determination.

Finally, in addition to its general *State Farm* argument, Altera asked for a more searching review under *Fox*.[923] Altera claimed that the cost-sharing amendments present a major shift in administrative policy such that Treasury could not issue the regulations without carefully considering and broadcasting its decision. Altera argued that "[t]he assertion that the commensurate with income clause supplants the arm's-length standard with a 'purely internal' analysis is a sharp—but unacknowledged—reversal from Treasury's long-standing prior policy."

"Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change."[924] "When an agency changes its existing position, it 'need not always provide a more detailed justification than what would suffice for a new policy created

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[919] Compensatory Stock Options Under Section 482 (Proposed), 67 Fed. Reg. at 48,999.

[920] I.R.C. § 162(a).

[921] Treas. Reg. § 1.482-7A(d)(2)(iii)(A) ("[T]he operating expense attributable to stock-based compensation is equal to the amount allowable . as a deduction for Federal income tax purposes . (for example, under [26 U.S.C. § 83(h)]).").

[922] *County of Amador v. U.S. Dep't of Interior*, 872 F.3d 1012, 1027 (9th Cir. 2017) (internal quotation marks omitted), *cert. denied*, U.S. 139 S. Ct. 64 (2018).

[923] *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009).

[924] *Encino Motorcars, LLC v. Navarro*, U.S. 136 S. Ct. 2117, 2125 (2016).

on a blank slate."'[925] However, an agency may not "depart from a prior policy *sub silentio* or simply disregard rules that are still on the books."[926]

> *[A] policy change complies with the APA if the agency*
>
> *(1) displays "awareness that it is changing position,"*
>
> *(2) shows that "the new policy is permissible under the statute,"*
>
> *(3) "believes" the new policy is better, and*
>
> *(4) provides "good reasons" for the new policy, which, if the "new policy rests upon factual findings that contradict those which underlay its prior policy," must include "a reasoned explanation . . . for disregarding facts and circumstances that underlay or were engendered by the prior policy."*[927]

According to the Ninth Circuit in *Altera*, this argument is not meaningfully different from Altera's general Administrative Procedure Act argument. If the arm's length standard allows the Commissioner to allocate costs between related parties without a comparability analysis, there is no policy change, merely a clarification of the same policy. Further, the policy change was occasioned by the Congressional addition of the "commensurate with income" sentence in the Tax Reform Act of 1984 and the 1994 and 1995 implementing regulations. Those changes occurred well before 2003. The 2003 regulations clarified, rather than altered, prior policy. The enactment of a statutory amendment obviously makes a concomitant regulatory amendment appropriate.

According to the Ninth Circuit in *Altera*, the 2003 regulations are not arbitrary and capricious under the standard of review imposed by the Administrative Procedure Act. Treasury's regulatory path may be reasonably discerned. Treasury understood Section 482 to authorize it to employ a purely internal, commensurate with income approach in dealing with related companies. Treasury provided adequate notice of its intent and adequately considered the objections. Treasury's conclusion that stock based compensation should be treated as a cost was adequately supported in the record. Treasury's position did not represent a policy change under *Fox*.

Altera also argued that the outcome of this case was controlled by *Xilinx*. The Ninth Circuit in *Altera* disagreed. Although the *Xilinx* panel could have reached a holding that would foreclose the Commissioner's current position, it did not. In *Xilinx*, the Ninth Circuit considered the 1994 and 1995 cost-sharing regulations. The case involved a matter of regulatory interpretation, not executive authority. Xilinx, Inc., another maker of programmable logic devices, challenged the Commissioner's allocation of employee stock options between Xilinx and its Irish subsidiary. The issue was whether Section 1.482-1

[925] *Id.*. at 2125–26 (*quoting Fox*, 556 U.S. at 515).

[926] *Fox*, 556 U.S. at 515.

[927] *Organized Vill. of Kake v. U.S. Dep't of Agric.*, 795 F.3d 956, 966 (9th Cir. 2015) (*en banc*) (format altered) (*quoting Fox*, 556 U.S. at 515–16).

(1994)—which sets forth the arm's length standard—could be reconciled with Section 1.482-7(d)(1) (1995)—under which parties to a qualified cost-sharing arrangement were required to share "all . . . costs" incurred in developing intangibles. Xilinx does not govern here. First, the parties in *Xilinx* were not debating administrative authority. *Xilinx* did not consider the "commensurate with income" standard, which Congress itself did not see as inconsistent with the arm's length standard. Second, and more significantly, the *Xilinx* panel was faced with a conflict between two rules. If the rules were conceptually distinguishable, they were also in direct conflict. The arm's length rule [928] listed specific methods for calculating an arm's length result. The all-costs provision was not one of those methods, as the first *Xilinx* majority noted. Treasury issued the coordinating amendment in 2003, after the tax years at issue in *Xilinx*, and the arm's length regulation now expressly references the cost-sharing provision that Altera challenges. The *Xilinx* panel did not address the "open question" of whether the 2003 regulations remedied the error identified in that decision. Today, there is no conflict in the regulations, and Altera did not challenge the regulations on the ground that a conflict exists.

Xilinx did not involve the question of statutory interpretation, the Commissioner's authority, or the regulation at issue in this appeal: Accordingly, Xilinx did not assist Altera.

The 1986 amendment focused specifically on intangibles, and it gave Treasury the ability to respond to rapid changes in the high tech industry. "The broad language of [§ 482] reflects an intentional effort to confer the flexibility necessary to forestall . . . obsolescence." [929] In the modern economy, employee stock options are integral to R&D arrangements. In Altera's 2015 annual report, its stock-based compensation cost equaled nearly five percent of total revenue. The rise in employee stock compensation is an economic development that Treasury cannot ignore without rejecting its obligations under Section 482.

The Ninth Circuit observed that it disagreed with the Tax Court that the 2003 regulations are arbitrary and capricious under the standard of review imposed by the Administrative Procedure Act. While the rulemaking process was less than ideal, the Administrative Procedure Act does not require perfection. The Ninth Circuit was able to reasonably discern Treasury's path—Treasury understood Section 482 to authorize it to employ a purely internal, commensurate with income approach where comparable transactions are not comparable.

In light of the statute's plain text and the legislative history, Treasury also reasonably concluded that Congress intended to hone the definition of the arm's length standard so that it could work to achieve an arm's length result, instead of forcing application of a particular comparability method. Given the long history of the application of other methods, and the text and legislative history of the Tax Reform Act of 1984, Treasury's understanding of its

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[928] Treas. Reg. § 1.482-1(b)(1) (1994).

[929] *Massachusetts v. Environmental Protection Agency*, 549 U.S. 497, 532, 127 S.Ct. 1438, 167 L.Ed.2d 248 (2007).

power to use methodologies other than a pure transactional comparability analysis was reasonable. The Ninth Circuit deferred to its interpretation under *Chevron*. The Commissioner did not exceed the authority delegated to him by Congress in issuing the regulations.

[4] 3M Company V. Commissioner (2023): Failure Of Preamble To Explain Regulation.

3M Company v. Commissioner[930] considered a consolidated group of subsidiary domestic and foreign corporations. The action petitioned for redetermination of tax deficiencies arising from allocation of income between group and its subsidiaries, to account for Brazilian subsidiary's use of domestic subsidiary's intellectual property pursuant to three licensing agreements during taxable year at issue. The taxpayer argued that the regulation in question failed properly explain how a taxpayer should take into account payment restrictions under foreign law in making income allocations among controlled corporations. The regulation failed to take into account that payment of the income was blocked under foreign law.

The Tax Court in *3M Company* sustained a $3.6 million deficiency in a transfer pricing case. The deficiency resulted from a consolidated group's failure to include $23 million in royalty income from a controlled foreign subsidiary on its consolidated return for 2006. Payment of the royalty income to the United States was blocked by foreign law. The case centered on the validity of Treasury Regulations Section 1.482-1(h)(2). The regulation failed to take into account barriers to payment of the royalty income under foreign law. The taxpayer argued that this regulation was invalid under *Chevron*. The taxpayer alternatively argued that the regulation was invalid for procedural defects in its adoption under the Administrative Procedure Act. The taxpayer argued that the regulation failed properly explain how a taxpayer should take into account payment restrictions under foreign law in making income allocations among controlled corporations. The regulation failed to take into account that payment of the income was blocked under foreign law.

The Tax Court held that Treasury Regulations Section 1.482-1(h)(2) is valid. This regulation governs the effect of foreign legal restrictions on Section 482 adjustments. The regulation disregards Brazilian restrictions on payments by 3M Brazil.

The Tax Court applied a *Chervon* analysis to the contested regulation.

On appeal, in its brief before the Eighth Circuit Court of Appeals, taxpayer argues:

> *The Supreme Court's recent decisions confirm that reversal is warranted and make the resolution of this appeal still more straightforward. Supreme Court precedent already answered both questions presented. Its decision in Commissioner v. First Security Bank of Utah, N.A., 405 U.S. 394 (1972), forecloses the only substantive ground the Internal Revenue Service (IRS) asserted in support of its allocation and the Tax Court*

[930] 160 T.C. 50 (2023).

plurality adopted: that 26 U.S.C. §482 permits treating as a taxpayer's "income" (ibid.) payments never made to the taxpayer by an affiliate because they were legally prohibited. And a long line of decisions, from SEC v. Chenery Corp., 318 U.S. 80 (1943), to Motor Vehicle Manufacturers Ass'n of the United States, Inc. v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983), and beyond, make clear that Treasury was required to articulate on the record its own rationale for its rule and to respond to significant concerns commenters raised — duties Treasury did not discharge but instead disavowed. The Court's decisions last Term in Loper Bright Enterprises v. Raimondo, 144 S. Ct. 2244 (2024), and Ohio v. EPA, 144 S. Ct. 2040 (2024), put both conclusions beyond dispute and repudiate the IRS's and Tax Court plurality's contrary position.

Loper Bright eliminates the IRS's and Tax Court plurality's sole basis for concluding that, notwithstanding First Security, the IRS could allocate as "income" to 3M payments that were illegal. The IRS and plurality maintained that deference under Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), empowered Treasury to supersede a Supreme Court decision settling the statute's meaning. That conclusion was never correct, but it is untenable today because Loper Bright expressly "overruled" Chevron deference altogether. 144 S. Ct. at 2273. Loper Bright makes clear that courts must read statutes to mean what they say — as First Security did in construing Section 482 — and cannot elevate an agency's contrary view over the best reading of the statute determined by the court. Indeed, the IRS now disavows any claim to deference. This Court must simply apply First Security and conclude, as both circuits to reach the issue concluded, that it bars the IRS from allocating as "income" under Section 482 payments forbidden by law.

Ohio ends any debate on the blocked-income rule's procedural invalidity under the Administrative Procedure Act (APA), 5 U.S.C. §§551 et seq., 701 et seq., and refutes the IRS's and Tax Court plurality's proffered reasons for excusing Treasury's refusal to follow the APA here. Treasury offered no rationale for the blocked-income rule, but the plurality improperly backfilled its own pieced-together explanation. And the plurality excused Treasury's failure to respond to serious concerns commenters raised because the agency was purportedly "aware" of them. Add. 268-269. The IRS has defended both conclusions — downplaying its APA obligation to set forth a reasoned explanation on the record and disclaiming any duty to respond to comments "in writing," Br. 51 — and alternatively urges this Court (Br. 62) to overlook those procedural errors because the IRS believes its action is substantively lawful.

In Ohio, the Supreme Court rejected every plank of the plurality's and IRS's position. Ohio reaffirmed that courts cannot uphold agency action based on an explanation the agency never articulated; that an agency's mere "awareness" of a problem "is not itself an explanation," 144 S. Ct. at 2054; and that courts cannot ignore an agency's APA violations merely because the agency's position on the merits might be upheld.

Individually, Loper Bright and Ohio each provides an independent basis for reversal here. Together, they leave no doubt that the Tax Court plurality's ruling is incompatible with controlling law and cannot stand.

Unlike Loper Bright and Ohio, the Supreme Court's decision in Moore v. United States, 144 S. Ct. 1680 (2024), has no bearing here. Moore did not involve Section 482 or the APA. It presented only a "precise and narrow" question under the Sixteenth Amendment: whether Congress, in imposing a transitional, one-

time tax in 2017, could attribute a foreign corporation's realized-but-not-yet-distributed income to its U.S. shareholders. Id. at 1688-1689. The Court's holding on that highly particularized constitutional question in no way disturbs First Security's statutory holding that Section 482 does not permit the IRS to attribute as income to a taxpayer payments that are legally prohibited. That this construction avoids a "distinct" constitutional question not raised in Moore (3M Br. 24) was further reason Treasury deserved no deference. But deference and constitutional avoidance are now academic here after Loper Bright. Moreover, even if Moore and First Security were somehow inconsistent, that would not empower this Court to depart from First Security where it squarely applies; the Supreme Court has made clear that it is that Court's exclusive prerogative to declare one of its own precedents overtaken by its later rulings. In any event, Moore sheds no light on the blocked-income rule's procedural invalidity under the APA.

The taxpayer brief continues to discuss *Loper Bright Enterprises*:

I. LOPER BRIGHT ELIMINATES THE TAX COURT PLURALITY'S BASIS FOR UPHOLDING THE IRS'S SECTION 482 ALLOCATION HERE

The Tax Court plurality accepted the IRS's invitation to ignore First Security based solely on the doctrine formerly known as Chevron deference. But Loper Bright erased that ersatz doctrine from federal law.

A. Loper Bright Overrules Chevron And Its Corollaries

Chevron announced a novel rule for judicial review of agency interpretations of federal statutes: When Congress had "directly spoken" in a statute "to the precise question at issue," courts were bound to apply that "clear" and "unambiguously expressed intent." Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-843 (1984). But, if a statute was "ambiguous" on an issue — signaling that Congress had not "directly addressed" it — courts had to defer to the agency's "permissible construction of the statute." Id. at 843. And under National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967 (2005), courts were bound to defer "even when [the] reviewing court" or a "preexisting judicial precedent" "rea[d] the statute differently." Loper Bright Enterprises v. Raimondo, 144 S. Ct. 2244, 2254, 2265 (2024).

The Supreme Court's decision last Term in Loper Bright ended Chevron's failed 40-year experiment and expressly "overruled" the "Chevron doctrine." 144 S. Ct. at 2269, 2273. Rejecting Chevron's "mechanica[l]" deference "to agency interpretations" of ambiguous statutes, Loper Bright holds that courts must "exercise their independent judgment in deciding whether an agency has acted within its statutory authority." Id. at 2265, 2273. A court thus cannot "defer to an agency interpretation of the law simply because a statute is ambiguous." Id. at 2273.

Loper Bright rooted its decision in the APA's text, which directs courts to "decide all relevant questions of law" and to "hold unlawful and set aside agency action" determined to be "not in accordance with law." 144 S. Ct. at 2261 (quoting 5 U.S.C. §706(2)(A)). As the Court explained, the APA "codifies for agency cases the unremarkable, yet elemental proposition reflected by judicial practice dating back to Marbury: that courts decide legal questions by applying their own judgment." Ibid.; see Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803). In other words, "the role of the reviewing court under the APA is, as always, to

independently interpret the statute and effectuate the will of Congress subject to constitutional limits." Loper Bright, 144 S. Ct. at 2263.

The "traditional conception of the judicial function" that Loper Bright restored contrasts starkly with Chevron, which had "triggered a marked departure from the traditional approach." 144 S. Ct. at 2263-2264. Chevron mandated "binding deference to agency interpretations," so long as the agency "had offered 'a permissible construction of the statute,' even if not 'the reading the court would have reached if the question initially had arisen in a judicial proceeding.'" Id. at 2264-2265 (citation omitted). That deference doctrine rested, moreover, on a legal fiction: that Congress's failure to address a particular question in the statute itself amounted to a deliberate delegation to an agency to provide the answer. Chevron rested on "a presumption" that, when Congress "left ambiguity in a statute," it meant for that agency, rather than a reviewing court, to "resolv[e]" the latent uncertainty, within "whatever degree of discretion the ambiguity allows." Id. at 2265.

Loper Bright laid bare the incoherencies of Chevron's approach. As the Court explained, Chevron's presumption of "implicit delegations to agencies" lacks any sound basis. 144 S. Ct. at 2265. There is no reason to believe that purported "ambiguities" in statutes reflect intentional but unstated Congressional delegations. Rather, "ambiguities may result from an inability on the part of Congress to squarely answer the question at hand, or from a failure to even 'consider the question' with the requisite precision." Ibid.

Loper Bright also rejected Chevron's core assumption that incorrect agency interpretations of statutes can nonetheless be legally "permissible." 144 S. Ct. at 2266. As Loper Bright recognized, that assumption "makes no sense": "[S]tatutes, no matter how impenetrable, do — in fact, must — have a single, best meaning," and in agency cases no less than others, courts must "use every tool at their disposal to determine the best reading of the statute and resolve the ambiguity." Ibid. The notion of wrong-yet-permissible statutory interpretations is a null set.

Finally, and "[p]erhaps most fundamentally," Chevron's theory that Congress intended to delegate interpretive questions to administrative agencies rested on a mistaken view of courts' and agencies' proper roles in answering legal questions. Loper Bright, 144 S. Ct. at 2266. "[A]gencies have no special competence in resolving statutory ambiguities," but "[c]ourts do." Ibid. And it is especially improper to abdicate judicial responsibility where, as here, the issue concerns "the scope of an agency's own power." Ibid. Agencies may not arrogate authority insulated from effective review.

Loper Bright sounded the death knell not only for Chevron, but also the spinoff doctrines it had produced. Most significantly for this appeal, Loper Bright interred Chevron's corollary set forth in Brand X, 545 U.S. 967, which held that Chevron required courts to defer to an agency's construction even if it contradicted a prior judicial interpretation, "unless the prior court happened to also say that the statute is 'unambiguous.'" Loper Bright, 144 S. Ct. at 2265. But the Brand X "regime," the Court explained, "is the antithesis of the time honored approach the APA prescribes." Ibid. Courts decide whether to override agency interpretations — not the other way around.

B. The Tax Court Plurality's Ruling Rests Entirely On The Now-Overruled Doctrine Of Chevron Deference

Loper Bright eviscerates the Tax Court plurality's sole rationale for upholding the IRS's view that payments never made to 3M because they were legally barred may be treated as 3M's "income" under Section 482.

The Tax Court plurality never suggested that the IRS's position represents the best reading of Section 482. Nor could it have: The Supreme Court made clear half a century ago in Commissioner v. First Security Bank of Utah, N.A., 405 U.S. 394 (1972), that Section 482 does not permit the IRS to treat legally prohibited payments as 3M's "income." See 3M Br. 34-47. Underscoring limits inherent in the "concept of income," First Security held that Section 482 does not empower the Commissioner to treat as "income" payments that a taxpayer "did not receive" and "was prohibited from receiving." 405 U.S. at 403. The Tax Court plurality did not dispute that First Security construed the term "income" in this manner. And neither the plurality nor the IRS has otherwise attempted to show that the "best meaning," Loper Bright, 144 S. Ct. at 2266, of "income" in Section 482 encompasses payments forbidden by law.

Instead, at the IRS's urging, the plurality sustained the interpretation of Section 482 embodied in Treasury's blocked-income rule based entirely on Chevron and Brand X — a position that Loper Bright renders untenable. Consistent with the IRS's notice of deficiency to 3M, the IRS argued below only that its allocation of income was supported by the blocked-income rule, which the agency advocated as a "reasonable construction of section 482" entitled to deference under Chevron. IRS T.C. Br. 65 (Mar. 21, 2016); see id. at 60, 85. According to the IRS, "Section 482 does not directly address," and "is silent as to[,] the precise issue addressed by section 1.482-1(h)(2)," i.e., whether blocked income may be treated as "income." Id. at 88-89 (capitalization altered; emphasis omitted). The IRS asserted that such statutory silence reflected an implicit delegation to Treasury to promulgate regulations "address[ing] allocation of income subject to foreign legal restrictions." Ibid. The IRS urged that "Congress left gaps for Treasury to fill" in Section 482 and that the blocked-income rule permissibly "filled a gap left in the statute." App. 433.

The Tax Court plurality endorsed the same misguided theory. The plurality reasoned that Section 482 is not "unambiguou[s]" and that Treasury's interpretation in the blocked-income rule merited deference at "Chevron step two." Add. 254 (citation omitted); Add. 231-263. The plurality downplayed First Security based on Brand X, reasoning that First Security did not expressly label Section 482 "unambiguous" — a label that a pre-Chevron case had no reason to apply — and that Treasury was free to override the Supreme Court's holding by adopting a contrary, "reasonable" interpretation of the statute. Add. 235; see Add. 231-241.

As 3M showed, the IRS's and Tax Court plurality's rationales were wrong even while Chevron remained on the books. See 3M Br. 36-38. As commenters highlighted, Treasury's blocked-income rule was a transparent effort to overrule judicial precedent by regulation. Id. at 56. Chevron and Brand X never authorized administrative agencies to countermand a Supreme Court decision that definitively construed a statute — as illustrated by the Supreme Court in United States v. Home Concrete & Supply, LLC, 566 U.S. 478 (2012), and this Court sitting en banc in MikLin Enterprises, Inc. v. NLRB, 861 F.3d 812 (8th Cir. 2017).

But whatever disagreement the IRS might once have had with those propositions is now inconsequential. Loper Bright "overruled" Chevron and Brand X, describing their ancien régime as the "antithesis" of what the APA has always required. 144 S. Ct. at 2265, 2273. And the Tax Court plurality's reasoning exemplifies the errors Loper Bright condemned. By applying Chevron and Brand X "mechanically" to "afford binding deference" to Treasury's blocked-income rule — in the face of "a pre-existing judicial precedent" holding that Section 482 "means something else" — the Tax Court plurality "turn[ed] the statutory scheme for judicial review of agency action upside down." Id. at 2265. Loper Bright leaves no doubt that such abdication of the judicial role and outsourcing of statutory interpretation to agencies is impermissible.

Without Chevron, the only justification offered below for refusing to follow First Security has vanished. Like both courts of appeals to address the issue previously, this Court should simply apply First Security and reject the IRS's unlawful overreach. 3M Br. 29-31 (discussing Texaco, Inc. v. Commissioner, 98 F.3d 825 (5th Cir. 1996), and Procter & Gamble Co. v. Commissioner, 961 F.2d 1255 (6th Cir. 1992)).

C. The IRS's Responses Effectively Concede That Loper Bright Vitiates The Tax Court Plurality's Rationale

Even before Loper Bright, the IRS made little effort in this Court to defend the Tax Court plurality's Chevron-based holding. And after Loper Bright, the IRS has properly abandoned reliance on deference principles altogether. Its response to 3M's post-briefing letter addressing Loper Bright disavowed the agency's earlier position that Chevron deference applies here. IRS Loper Bright Response 1 (July 12, 2024). Indeed, the IRS disclaimed any form of deference, stating that "3M's Chevron-related arguments on appeal all turn on whether Treasury lacked authority to issue the regulation due to [First Security]" and that this "is a legal question for this Court that does not turn on deference principles." Ibid. And rightly so: The blocked-income rule has none of the characteristics that might give agency interpretations "power to persuade." Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944). It was promulgated long after the statute's enactment, embodies no specialized expertise, and seeks to expand the agency's power by overriding Supreme Court precedent. The IRS's admissions should end the merits analysis: The defendant agency has conceded that the only ground offered below for upholding its action is unsound.

Instead, echoing its response brief, the IRS contended in its letter that this Court "need not reach" the blocked-income regulation's validity at all because Section 482's second, "commensurate with income" sentence unambiguously authorizes the IRS's Section 482 reallocation. IRS Loper Bright Response 1; see IRS Br. 17-28. As 3M has shown, however, that argument is both waived and wrong.

The IRS never contended that Section 482's second sentence independently authorizes the blocked-income rule or the allocation here. Instead, it expressly argued that "[t]he statute is silent" on blocked income and that "[n]owhere does [Section 482] address the impact of foreign legal restrictions on the Commissioner's authority to allocate income." IRS T.C. Br. 88; accord id. at 95; see pp. 10-11, supra. According to the IRS, Congress had "left gaps for Treasury to fill" through such "silen[ce]" on the "precise issue." App. 433; see IRS T.C. Br. 88. Any argument that Section 482 authorizes allocating blocked income is therefore not merely forfeited, but waived, and off-limits on appeal. Stewart v. Norcold, Inc., 24 F.4th 1183, 1185 (8th Cir. 2022).

In any event, the IRS's novel, revisionist position is meritless. Section 482's second, commensurate-with-income sentence says nothing about blocked income and deals only with valuation of intangibles, which bears no necessary relationship to blocked income. 3M Reply Br. 23-26. The IRS has never explained how that statutory language focused on intangibles negates or alters the basic directive in Section 482's first sentence, which was the basis for the IRS's action here and which the IRS's blocked-income rule purports to interpret. The IRS's inability to square its position with text or precedent should end the Section 482 analysis.

D. The IRS's Proposed Carveout Of Legal Issues From APA Review Is Baseless

Although the IRS has acknowledged that Loper Bright dooms any defense of its regulation based on Chevron, it has gamely attempted to spin Loper Bright as support for its position on the APA. The IRS argued that the decision "actually supports the Commissioner" on Treasury's failure to satisfy the APA's "reasoned-decisionmaking standard." IRS Loper Bright Response 1. The IRS now apparently reads Loper Bright as absolving agencies from articulating a reasoned explanation for their positions on "legal question[s]," as distinct from "matters of policymaking and factfinding." Ibid. That remarkable contention lacks any plausible basis in the Supreme Court's decision or existing law.

For decades before Loper Bright, courts recognized that the APA's requirement that agencies reasonably explain their actions applies to policymaking and statutory-interpretation issues alike. For example, under Chevron, before determining whether to accord "deference" to an agency's interpretation of a statute, a court "must first understand that interpretation." American Federation of Government Employees, AFL-CIO, Local 1738 v. FLRA, 806 F.2d 1105, 1108 (D.C. Cir. 1986). "[T]he agency charged with administering the [s]tatute," courts recognized, thus "must carefully examine [its] meaning" and "explain its application." Ibid. An agency's "failure to explain its reading of the statute" makes it "impossible to conclude" that agency action "was anything other than arbitrary and capricious." CSI Aviation Services, Inc. v. Department of Transportation, 637 F.3d 408, 416 (D.C. Cir. 2011); accord Verizon v. FCC, 740 F.3d 623, 636 (D.C. Cir. 2014) ("The APA's requirement of reasoned decision-making ordinarily demands that an agency acknowledge and explain the reasons for a changed interpretation."); Williams Natural Gas Co. v. FERC, 943 F.2d 1320, 1327 (D.C. Cir. 1991) (agency must "lay out for the court its understanding of the statute"); Prill v. NLRB, 755 F.2d 941, 942, 948, 953 (D.C. Cir. 1985) (deeming agency action as "without adequate rationale" where agency took action on "misconception" that its action was legally required, even though agency could perhaps have taken the same action "in the exercise of its discretion"). Indeed, an agency's statutory authority vel non is so fundamental that agencies must address it sua sponte. See 3M Reply Br. 20. The IRS cites no case supporting its purported carveout for legal issues.

To the extent the IRS views Loper Bright as freeing federal agencies from the APA's reasoned-explanation requirement for legal issues, the Supreme Court's decision says no such thing. Loper Bright did not suggest — much less hold — that by eliminating Chevron it was somehow empowering agencies to ignore their settled APA obligations to offer reasoned explanations of their positions on "legal question[s]." IRS Loper Bright Response 1. To the contrary, Loper Bright underscored that overruling Chevron was necessary to enforce the APA's requirements. See, e.g., 144 S. Ct. at 2261. The only passage of the opinion the IRS cited that addressed "reasoned decisionmaking" simply makes clear that, even when Congress has delegated authority to

an agency, the APA still governs the agency's exercise of that authority. IRS Loper Bright Response 1 (citing Loper Bright, slip op. 14-15, 144 S. Ct. at 2263). It is implausible that the Supreme Court's historic decision overturning a doctrine of agency deference because it was unfaithful to the APA simultaneously created a novel, a textual carveout from the APA for legal issues.

The IRS's invented exception would be unavailing in any event because Treasury also never explained the blocked-income rule's rationale, and it also failed to respond to public comments raising policy concerns. 3M Br. 61. For example, commenters explained that the blocked-income rule would have harmful effects on certain industries and would deter cross-border transactions in certain regions where restrictions on transactions with foreign affiliates were common. Ibid. Treasury likewise never answered those comments. Even on the IRS's latest conception of the APA, the blocked-income rule still flunks its bedrock requirements.

II. OHIO CONFIRMS THAT THE BLOCKED-INCOME RULE VIOLATES THE APA

The APA's arbitrary-and-capricious standard compels agencies to explain reasonably how they are addressing every important aspect of a regulatory problem and to respond to significant comments in writing. See 3M Br. 47-66. Ohio v. EPA, 144 S. Ct. 2040 (2024), reaffirms these "long-settled standards" and refutes the IRS's and Tax Court plurality's position that an agency's "awareness" of commenters' "concern[s]" is a substitute for the "explanation" the APA demands. Id. at 2053-2055.

A. Ohio Reaffirms The APA's Requirements That An Agency Itself Articulate A Reasoned Explanation For Its Action And Respond To Significant Comments

In Ohio, the Supreme Court held that stay applicants were likely to succeed in showing that an Environmental Protection Agency (EPA) "final rule" under the Clean Air Act, 42 U.S.C. §7401 et seq., was arbitrary and capricious because the agency "failed to supply 'a satisfactory explanation'" or a "reasoned response" to comments. 144 S. Ct. at 2054-2055. The EPA rule at issue set forth a federal plan specifying emissions-control measures for 23 States. Id. at 2048-2051. In the rulemaking, commenters had argued that EPA's proposal "assum[ed] that the [Plan] would apply to all [23] covered States" and that, if some States were removed — as 12 ultimately were — EPA would need to revisit the Plan. Id. at 2050. EPA's final rule added a "severability provision" providing that, if any States were removed, the Plan would still apply without change to the remaining States. Id. at 2051. But "EPA did not address whether or why the same emissions-control measures" would continue to be warranted. Ibid.

The Supreme Court stayed enforcement of the Plan. Ohio, 144 S. Ct. at 2052-2057. The Court reasoned that the challengers were likely to succeed on their APA challenges because EPA had failed to explain why the Plan should remain unchanged even if certain States were removed and because the agency had "offered no reasoned response" to commenters' concerns. Id. at 2054. The Court specifically and expressly rejected EPA's argument that its "severability provision" sufficed as a response because it showed the agency "was aware of [commenters'] concern." Ibid. (emphasis added). The Court explained that an agency's "awareness" of a problem "is not itself an explanation" and that EPA "did not address [commenters'] concern so much as sidestep it." Id. at 2054-2055. The Court concluded that, "if there [wa]s an explanation, it d[id] not appear

in the final rule." Id. at 2054. Accordingly, the Court held that EPA's action was not "reasonably explained" and had "ignored an important aspect of the problem before it." Ibid. (internal quotation marks omitted).

Ohio thus dispels any doubt that agencies must expressly "address" commenters' significant concerns and reasonably explain their actions at the time they act.144 S. Ct. at 2052-2054. Those requirements, Ohio recognized, are "long-settled." Id. at 2053.

B. Ohio Repudiates The IRS's And Tax Court Plurality's Key Premises In Defending The Blocked-Income Rule's Validity Under The APA

Ohio refutes three key premises invoked by the IRS and Tax Court plurality to overcome Treasury's explanatory failures in adopting the blocked-income rule: (1) that the Tax Court may undertake an indulgent effort to reconstruct Treasury's thinking; (2) that an agency's "awareness" of comments suffices as an explanation; and (3) that procedural invalidity is harmless error so long as a rule is substantively authorized.

1. Ohio confirms that the Tax Court plurality erred by inferring rationales for the blocked-income rule that the agency itself never articulated "in the final rule." 144 S. Ct. at 2054. In adopting that rule, Treasury offered no explanation of the rule's purported rationale. 3M Br. 53-54; 3M Reply Br. 12. The Tax Court plurality sought to overcome that shortcoming by backfilling a rationale, positing that the rule embodies "a specific application of two principles of section 482: (1) the arm's-length standard and (2) the principle that section 482 should achieve tax parity between controlled and uncontrolled parties." Add. 265. Even before Ohio, that imaginative judicial reconstruction of an agency's unstated thinking was improper under settled APA precedent. 3M Br. 57-59.

Ohio confirms that the APA forbids such judicial ventriloquism. As the Ohio Court explained, "if there [wa]s an explanation" of the agency's rationale and a response to commenters' significant criticisms, that explanation had to "appear in the final rule." 144 S. Ct. at 2054 (emphasis added). As Ohio illustrates, not even subsequent statements by the agency itself can fill that gap. Ohio refused to consider EPA's post hoc attempts to cure its failure to explain its action: Although EPA had later "issued a document in which it sought to provide further explanations for the course it pursued," the Supreme Court rejected those after-the-fact assertions as out of bounds, because courts look "to only 'the grounds that the agency invoked'" when it acted. Id. at 2055 n.11 (citation omitted); accord SEC v. Chenery Corp., 318 U.S. 80, 87 (1943). A fortiori, explanations invented by courts are off-limits.

So too with Treasury's blocked-income rule. The only explanation that counts is one the agency itself supplies in adopting the regulation. But Treasury provided none.

2. Ohio also squarely forecloses the Tax Court plurality's view — echoed by the IRS on appeal (Br. 60) — that an agency need not respond to comments in writing so long as it was purportedly "aware" of the significant concerns commenters raised. 144 S. Ct. at 2054-2055. For instance, the IRS now contends that Treasury was "aware" of commenters' criticisms that Treasury lacked statutory authority to promulgate the blocked-income rule under Section 482 itself, First Security, and related circuit-court decisions and that Treasury's approach presented numerous policy and practical concerns. 3M Br. 61-62. But Treasury's only

response to comments during the rulemaking process was silence, as the IRS concedes. See IRS Br. 54 (acknowledging that Treasury's final rule did not "explicitly discus[s]" these comments).

The Tax Court plurality asserted that Treasury's failure to respond did not matter because Treasury was supposedly "aware" of these concerns and had included a boilerplate disclaimer that it was adopting the rule "[a]fter consideration of all the comments." Add. 203, 268 n.208. The IRS backs the same view, contending that Treasury had no obligation to "respond in writing" to "criticism[s]" of which "Treasury was already well aware." IRS Br. 50, 58, 60, 62. And the IRS notes that Treasury "revised the final regulation" in other ways to address other comments. Id. at 62.

Ohio rejected these same arguments. In Ohio, as here, the agency argued that it was "aware of [commenters'] concern," pointing to its addition of the severability provision in the final rule. 144 S. Ct. at 2051, 2054 (describing this provision as EPA's "response to the problem commenters raised"). The Court was unmoved. "EPA's response did not address the applicants' concern so much as sidestep it," the Court explained, and "awareness is not itself an explanation." Id. at 2055.

The same reasoning is dispositive here. Contrary to the IRS's mistaken view, Ohio makes plain that Treasury's supposed "awareness" of commenters' concerns was insufficient and that Treasury was required to "respond in writing" to significant comments. Cf. IRS Br. 62. Accordingly, that Treasury concededly never "explicitly discussed" (IRS Br. 54) commenters' concerns with the proposed blocked-income rule is fatal. Ohio confirms that the blocked-income rule violates the APA.

3. Finally, Ohio refutes the IRS's fallback contention that the blocked-income rule's procedural invalidity would be harmless error if the IRS is right on the statutory merits — i.e., if Section 482 and First Security authorize allocating payments forbidden by law as "income." See IRS Br. 61. Ohio rejected that very argument, concluding that the stay applicants there were likely to succeed on their challenge even though the Court expressly reserved the possibility that EPA's action could be substantively reasonable. See 144 S. Ct. at 2054 ("Perhaps there is some explanation why the number and identity of participating States does not affect what measures maximize cost-effective downwind air-quality improvements."). The dissent stressed the procedure-only focus of the Court's ruling and argued (inter alia) that harmless-error principles should have precluded issuance of a stay. Id. at 2060 (Barrett, J., dissenting). But the majority was unpersuaded. See id. at 2057. The Court's conclusion that the challengers were likely to succeed and entitled to a stay confirms that a rule's procedural invalidity is independent of its substantive merits and is reason enough to invalidate unlawful agency action.

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Here, the sole basis the IRS invoked in its deficiency notice and the Tax Court for the lawfulness of its deficiency determination was the blocked-income rule. App. 106. That regulation is not only statutorily unauthorized but also arbitrary and capricious and therefore invalid under the APA. Ohio lays to rest each of the IRS's excuses for overlooking that independently fatal flaw.

C. The IRS's Attempt To Carve Out Legal Issues From The APA's Reasoned-Explanation Requirement Is Baseless

In its response to 3M's post-briefing letter addressing Ohio, the IRS doubled down on its suggestion that legal issues are exempt from the APA's reasoned-decisionmaking requirement. See IRS Loper Bright Response 2. But as explained above, there is no such exemption, and it would not apply here in any event. See pp. 16-18, supra; 3M Reply Br. 20.

Ohio certainly does not support the IRS's contention. Although Ohio happened to involve an agency's failure to explain a particular decision EPA made within its statutory authority, the "long-settled standards" the Court reaffirmed and applied in granting a stay apply equally to statutory-interpretation and policy questions. 144 S. Ct. 2053-2054. The Supreme Court had no occasion to confirm that the APA's reasoned-explanation requirement applies to legal issues because EPA's final rule did address "the Agency's legal authority for taking th[at] action." 87 Fed. Reg. 20,036, 20,050 (Apr. 6, 2022). Treasury, in contrast, never did so in adopting the blocked-income rule.

[5] Valley Park Ranch v. Commissioner (March 2024): Contribution of Conservation Easement; Regulation Invalid For Failure To Respond To Significant Comments.

In *Valley Park Ranch v. Commissioner*[931] in 2024, the Tax Court held, in a case involving charitable contribution of a conservation easement, that Treasury Regulations Section 1.170A-14(g)(6)(ii) was procedurally invalid under the Administrative Procedure Act. The Internal Revenue Service and Treasury failed to respond to significant comments to the regulations when the regulation was proposed. The Tax Court thus concluded that the deed involved in a charitable contribution of an easement met the "restriction (granted in perpetuity)" requirement of Section 170(h)(2)(C). The deed also met the protected in perpetuity requirement of Treasury Regulations Section 170(h)(5)(A).

Under the Administrative Procedure Act, a "reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[932] A court's review standard is "narrow." The court will not substitute its judgment for that of the agency.[933] The court must determine whether the agency decision was based on consideration of the relevant factors and whether there was a clear error of judgment.[934] Furthermore, the court "may not supply a reasoned basis for the agency's action that the agency itself has not given," although it will

[931] *Valley Park Ranch v. Commissioner*, 62 T.C. No. 6 (2024).

[932] 5 U.S.C. §706(2)(A).

[933] *Zyym v. Pompeo*, 958 F.3d 1014, 1022 (10th Cir. 2020) (*quoting Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

[934] *W. Watersheds Project v. Bureau of Land Mgmt.*, 721 F.3d 1264, 1273 (10th Cir. 2013), *citing State of N.M. ex rel. Richardson v. BLM*, 565 F.3d 683, 704-05 (10th Cir. 2009).

"uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned."[935]

As the Supreme Court has explained, "[r]ules issued through the notice-and-comment process are often referred to as 'legislative rules' because they have the 'force and effect of law.'"[936] Basis and purpose statements must contain sufficient information to allow a court to exercise judicial review[937] as "[o]ne of the basic procedural requirements of administrative rulemaking is that an agency must give adequate reasons for its decisions."[938] An agency must respond to comments "that can be thought to challenge a fundamental premise" underlying the proposed agency decision.[939] An agency should respond to significant points and consider vital relevant comments.[940]

Section 170(h)(5)(A) provides that a contribution shall not be treated as "exclusively for conservation purposes," unless the conservation purpose of the contribution is "protected in perpetuity." The statute does not define the term "protected in perpetuity" nor elaborate on the requirement. To the extent a taxpayer claims a deduction for the charitable contribution of a conservation easement under Section 170(h), the Internal Revenue Service's position is that the contribution must also satisfy the relevant regulatory requirements promulgated pursuant to Section 170(h).

The Department of the Treasury and the Internal Revenue Service issued a notice of proposed rulemaking with "proposed regulations relating to contributions of partial interests in property for conservation purposes."[941] In response to the notice, Treasury received more

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[935] *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43, *citing SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947), *quoting Bowman Transp., Inc. v. Ark.-Best Freight Sys., Inc.*, 419 U.S. 281, 286 (1974).

[936] *Mortg. Bankers Ass'n*, 575 U.S. at 96 (*quoting Chrysler Corp. v. Brown*, 441 U.S. 281, 302-03 (1979)). The Administrative Procedure Act prescribes a three-step procedure for so-called notice-and-comment rulemaking. First, an agency "must issue a '[g]eneral notice of proposed rule making,' ordinarily by publication in the Federal Register." Second, "if 'notice [is] required,' the agency must "give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments,"' and the agency "must consider and respond to significant comments received during the period for public comment." Third, in promulgating the final rule, the agency must include in its text a "concise general statement of [the rule's] basis and purpose."

[937] *See, e.g., Kennecott Copper Corp. v. Environmental Protection Agency*, 612 F.2d 1232, 1236 (10th Cir. 1979).

[938] *Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016); *see also United States v. Frontier Airlines, Inc.*, 563 F.2d 1008, 1013 (10th Cir. 1977) ("The Basis and Purpose Statement is a very significant portion of a regulation when an issue arises as to its application and scope.").

[939] *MCI WorldCom, Inc. v. FCC*, 209 F.3d 760, 765 (D.C. Cir. 2000).

[940] *W. Coal Traffic League v. United States*, 677 F.2d 915, 927 (D.C. Cir. 1982); *see also Balt. Gas & Elec. Co. v. United States*, 817 F.2d 108, 116 (D.C. Cir. 1987) (noting that under the arbitrary and capricious standard of review, an agency is "required to respond to significant comments that cast doubt on the reasonableness of the rule the agency adopts").

[941] Prop. Treas. Reg. §1.170A-13, 48 Fed. Reg. 22,940, 22,940 (May 23, 1983).

than 700 pages of comments during the comment period. A public hearing on the proposed amendments to the regulations was held. Treasury issued final regulations with revisions, including the regulation at issue in this case — Treasury Regulation Section 1.170A-14(g)(6)(ii) — concerning requirements in contemplation of an easement's extinguishment by judicial proceedings. The Treasury Decision spanned roughly 12 pages, of which approximately 10 contained the actual text of the regulations, leaving just over 2 pages for Treasury's responses to comments and other administrative matters.

Comments and concerns regarding the extinguishment provision, including how to treat post-donation improvements, were submitted to Treasury during the comment period. The New York Landmarks Conservancy submitted a comment letter urging Treasury to delete the proposed proceeds regulation because it contained pervasive "problems of policy and practical application." New York Landmarks Conservancy stated that while Congress enacted the statute "to encourage the protection of [the] . environment through the donation of conservation restrictions," the proposed regulation "would thwart the purpose of the statute by deterring prospective donors." On the basis of its concerns and because "the possibility of extinguishment is relatively remote," New York Landmarks Conservancy stated it was "unnecessary" for Treasury "to provide for allocation of proceeds after extinguishment." New York Landmarks Conservancy also commented on whether the value of post-donation improvements to the easement property should be included or excluded from the proceeds formula in the regulation. New York Landmarks Conservancy stated that the regulation's structure "contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter." According to New York Landmarks Conservancy, the formula "fail[ed] to take into account that improvements may be made thereafter by the owner which should properly alter the ratio." New York Landmarks Conservancy presented a mathematical example, based on a fact pattern in the proposed regulations, to show that requiring the prospective donor to turn over extinguishment proceeds "would obviously be undesirable to the prospective donor and would constitute a windfall to the donee organization." New York Landmarks Conservancy recommended that the proposed formula be revised to prevent inequities in the event Treasury retained the extinguishment provision. New York Landmarks Conservancy "strongly recommend[ed] deletion of the entire extinguishment provision." Although New York Landmarks Conservancy offered the most extensive comments on the proposed extinguishment provision, other commenters similarly expressed criticism or urged caution. The Landmarks Preservation Council of Illinois "urge[d] caution in the treatment of the concept of 'extinguishment' in the regulations," as "[t]he discussion in the regulations of the conditions under which that binding agreement may be abrogated lends an undesirable air of legitimacy to the concept of 'extinguishment.'" Landmarks Preservation Council of Illinois also cautioned that the regulations could create a disincentive to donate easements. The Land Trust Exchange cautioned that the regulations "may result in donors or donees having to pay

real estate transfer taxes" and that it was "unnecessary." The Trust for Public Land commented that it had "serious doubts whether the provision . . . could be enforced against anyone other than the original donor of the easement" and that "the tax benefit rule is a satisfactory means of meeting any concern the IRS may have that a donor might receive the double benefit of an easement deduction followed by later recovery of the value donated." The Brandywine Conservancy asserted that the proposed regulation "may unnecessarily restrict the amount, payable to the holder of an easement, if changes in surrounding territory have made the easement proportionately more valuable than the retained interest" and that "[t]he donee should be entitled to proceeds equal to the greater of its original proportionate value or its proportionate value at the time of the extinguishment." The Nature Conservancy and the Maine Coast Heritage Trust both stated that the regulation should be "clear" that the original proportionate value is the minimum that a donee will receive in extinguishment proceeds.

After a public hearing, Treasury adopted the proposed regulations with revisions. In the preamble to the final rulemaking, Treasury stated that "[t]hese regulations provide necessary guidance to the public for compliance with the law and affect donors and donees of qualified conservation contributions" and that it had "consider[ed] . all comments regarding the proposed amendments." In the subsequent "Summary of Comments" section, Treasury did not discuss or respond to the comments made by New York Landmarks Conservancy or the other six commenters concerning the extinguishment provision.

The court in *Valley Park* found that Treasury's actions did not provide "an explanation [that] is clear enough that its 'path may reasonably be discerned.'"[942] Treasury's action did not provide any insight on "what major issues of policy were ventilated . . . and why the agency reacted to them as it did" with respect to the proceeds regulation.[943] Absent any explanation from Treasury on why the considerations raised by New York Landmarks Conservancy and other commentators should not have been heeded, "[i]t is not the role of the courts to speculate on reasons that might have supported an agency's decision. '[W]e may not supply a reasoned basis for the agency's action that the agency itself has not given.'"[944] "[New York Landmarks Conservancy]'s comment was significant and required a response by Treasury to satisfy the APA's procedural requirements."[945] New York Landmarks Conservancy — and others — made comments "'that can be thought to challenge a fundamental premise' underlying the proposed agency decision."[946] The preamble to the proposed regulations

[942] *Hewitt v. Commissioner*, 21 F.4th at 1349 (alteration in original) (*quoting Encino Motorcars*, 579 U.S. at 221).

[943] See *id., quoting Carlson v. Postal Regul. Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019).

[944] *Encino Motorcars*, 579 U.S. at 224 (second alteration in original) (*quoting Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43).

[945] *Hewitt v. Commissioner*, 21 F.4th at 1351.

[946] *Carlson*, 938 F.3d at 344 (*quoting MCI WorldCom, Inc.*, 209 F.3d at 765); *Oakbrook I*, 154 T.C. at 243 (Holmes, J., dissenting) (describing significant comments as those that "identify a specific and

explained that the proposed rules "reflect the major policy decisions made by the Congress." The New York Landmarks Conservancy comments essentially countered that the proposed proceeds regulation was contrary to those policy decisions and offered comments that, "if adopted, would require a change in an agency's proposed rule."[947] The New York Landmarks Conservancy comments stated that while Congress enacted the statute "to encourage the protection of [the] . environment through the donation of conservation restrictions," the proposed regulation "would thwart the purpose of the statute by deterring prospective donors."[948] The New York Landmarks Conservancy comments noted that the regulation's structure "contemplates that a ratio of value of the conservation restriction to value of the fee will be fixed at the time of the donation and will remain in effect forever thereafter."[949] According to the New York Landmarks Conservancy comments, the formula "fail[ed] to take into account that improvements may be made thereafter by the owner which should properly alter the ratio."[950] The New York Landmarks Conservancy comments expressly tied its comments both to a specific rule included in the proposed regulations and to a specific fact pattern contemplated by the proposed regulations.[951] The New York Landmarks Conservancy comments explained why the regulation contained "problems of policy and practical application" and therefore "strongly recommend[ed] deletion of the entire extinguishment provision."[952] The Tax Court determined to follow the Eleventh Circuit and hold that those comments were both "relevant and significant," requiring a response.[953] In agreement with the Eleventh Circuit's reasoning in *Hewitt v. Commissioner*,[954] the Tax Court held that Treasury Regulation Section 1.170A-14(g)(6)(ii) is procedurally invalid under the Administrative Procedure Act because Treasury failed to respond to a significant comment.

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objective issue created by the language of the proposed rule and give some explanation for why that language is troublesome").

[947] *Home Box Off., Inc. v. FCC*, 567 F.2d 9, 35 n.58 (D.C. Cir. 1977).

[948] Hewitt v. Commissioner, 21 F.4th at 1345.

[949] *Hewitt v. Commissioner*, 21 F.4th at 1345.

[950] *Hewitt v. Commissioner*, 21 F.4th at 1345.

[951] *Hewitt v. Commissioner*, 21 F.4th at 1348 (citing *Oakbrook I*, 154 T.C. at 224 (Toro, J., concurring in the result)).

[952] *Id.*. at 1345 (alteration in original).

[953] *Hewitt v. Commissioner*, 21 F.4th at 1351; *Grand Canyon Air Tour Coal. v. FAA*, 154 F.3d 455, 468 (D.C. Cir. 1998); *accord Carlson*, 938 F.3d at 343-44.

[954] 21 F.4th at 1350-53.

[6] Ohio v. Environmental Protection Agency (July 2024): Invalidity Based On Failure Adequately To Respond To Comments During Notice And Comment Process.

In *Ohio v. Environmental Protection Agency*,[955] various states, whose plans for implementing the Environmental Protection Agency's (EPA) revised air-quality standards for ozone were rejected by the EPA, together with industry groups, petitioned for review of the EPA's federal implementation plan, which imposed on the States emissions-control measures for nitrogen oxide to maximize cost-effectiveness in achieving downwind ozone air quality improvements, alleging the federal implementation plan was arbitrary or capricious in violation of the Clean Air Act (CAA). The Supreme Court held that:

- the petitioners were likely to prevail on their claim the federal implementation plan was arbitrary or capricious;
- the severability provision that the Environmental Protection Agency included in the federal implementation plan did not address concern expressed in public comments over what would happen if fewer States were subject to the federal implementation plan so much as sidestep it;
- the Court was required to look to only the grounds that the Environmental Protection Agency invoked when it promulgated the federal implementation plan;
- the Environmental Protection Agency had notice, in public comments, of the petitioners' objection to the federal implementation plan, thus satisfying the Act's reasonable specificity requirement;
- the Court would not consider arguments forfeited by the Environmental Protection Agency.

The Supreme Court particularly stressed the need for an agency to provide a satisfactory explanation for its regulatory action. Commenters prosed concern to the Environmental Protection Agency during the notice and commend period, and the Environmental Protection Agency failed to provide a reasoned response.[956]

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[955] *Ohio v. Environmental Protection Agency*, 603 U.S. 279 (2024).

[956] See 603 U.S. at 293-94 ("Although commenters posed this concern to EPA during the notice and comment period, see Part I – C, supra, EPA offered no reasoned response. Indeed, at argument the government acknowledged that it could not represent with certainty whether the cost-effectiveness analysis it performed collectively for 23 States would yield the same results and command the same emissions-control measures if conducted for, say, just one State. Tr. of Oral Arg. 58 – 59. Perhaps there is some explanation why the number and identity of participating States does not affect what measures maximize cost-effective downwind air-quality improvements. But if there is an explanation, it does not appear in the final rule. As a result, the applicants are likely to prevail on their

Ohio v. Environmental Protection Agency stressed the importance of an agency responding to comments made during the notice and comment period for regulations. Treasury and the Internal Revenue Service need to do more than acknowledge comments. They need to respond rationally and address the concerns raised in the comments.

Treasury and the Internal Revenue Service presumably will note that some regulations projects received hundreds, thousands, or even tens of thousands of comments. This makes responding to all of these comments difficult.

The Clean Air Act envisions a collaborative effort between States and the federal government to regulate air quality. When the Environmental Protection Agency sets standards for common air pollutants, States must submit a State Implementation Plan, providing for the "implementation, maintenance, and enforcement" of those standards in their jurisdictions.[957] Air currents can carry pollution across state borders. States must also design their plans with neighboring States in mind. Under the Act's "Good Neighbor Provision," state plans must prohibit emissions "in amounts which will . . . contribute significantly to nonattainment in, or interfere with maintenance by, any other State" of the relevant air-quality standard.[958] Only if a SIP fails to satisfy the "applicable requirements" of the Act may the Environmental Protection Agency issue a Federal Implementation Plan for the noncompliant State that fails to correct the deficiencies in its State Implementation Plan.[959]

In 2015, the Environmental Protection Agency revised its air-quality standards for ozone. These revisions required for States to submit new State Implementation Plans. Years later, the Environmental Protection Agency announced its intention to disapprove over 20 State Implementation Plans because the agency believed they had failed to address adequately obligations under the Good Neighbor Provision.

During the public-comment period for the proposed State Implementation Plan disapprovals, the Environmental Protection Agency issued a single proposed Federal Implementation Plan to bind all those States. Environmental Protection Agency designed its proposed Federal Implementation Plan based on which emissions-control measures would maximize cost-effectiveness in improving ozone levels downwind and on the assumption the Federal Implementation Plan would apply to all covered States.

Commenters warned that the proposed State Implementation Plan disapprovals were flawed and that a failure to achieve all the State Implementation Plan disapprovals as

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argument that EPA's final rule was not 'reasonably explained,' *Prometheus Radio Project*, 592 U.S. at 423, 141 S.Ct. 1150, that the agency failed to supply 'a satisfactory explanation for its action[,]' *State Farm Mut. Automobile Ins. Co.*, 463 U.S. at 43, 103 S.Ct. 2856, and that it instead ignored 'an important aspect of the problem' before it, *ibid*. The applicants are therefore likely to be entitled to 'revers[al]' of the FIP's mandates on them. § 7607(d)(9). [Footnote omitted.]").

[957] See 42 U.S.C. § 7410(a)(1).

[958] 42 U.S.C. § 7410(a)(2)(D)(i)(I).

[959] 42 U.S.C. § 7410(k)(3), (c)(1).

Environmental Protection Agency envisioned would mean that Environmental Protection Agency would need to reassess the measures necessary to maximize cost-effective ozone-level improvements in light of a different set of States. Environmental Protection Agency proceeded to issue its final Federal Implementation Plan without addressing this concern. Instead, the Environmental Protection Agency announced that its plan was severable: Should any jurisdiction drop out, the plan would continue to apply unchanged to the remaining jurisdictions. Ongoing litigation over the State Implementation Plan disapprovals soon vindicated at least some of the commenters' concerns. Courts stayed 12 of the State Implementation Plan disapprovals, which meant that the Environmental Protection Agency could not apply its Federal Implementation Plan to those States.

A number of the remaining States and industry groups challenged the Federal Implementation Plan in the D. C. Circuit. They argued that the Environmental Protection Agency's decision to apply the Federal Implementation Plan after so many other States had dropped out was "arbitrary" or "capricious." They asked the court to stay any effort to enforce the Federal Implementation Plan against them while their appeal unfolded. The D. C. Circuit denied relief. The parties renewed their request in the Supreme Court.

The Supreme Court stayed enforcement of the Environmental Protection Agency's rule against the applicants pending the disposition of the applicants' petition for review in the D. C. Circuit and any petition for writ of certiorari, timely sought. The Supreme Court concluded that the applicants were likely to prevail on their arbitrary-or-capricious claim.

The Supreme Court reasoned:

Because each side has strong arguments about the harms they face and equities involved, our resolution of these stay requests ultimately turns on the merits and the question who is likely to prevail at the end of this litigation. See Nken, 556 U.S. at 434, 129 S.Ct. 1749; Labrador, 601 U. S., at 144 S.Ct., at 930–931 (opinion of KAVANAUGH, J.).

B

When it comes to that question, the parties agree on the rules that guide our analysis. The applicants argue that a court is likely to hold EPA's final FIP "arbitrary" or "capricious" within the meaning of the Act and thus enjoin its enforcement against them. 42 U.S.C. § 7607(d)(9)(A); see, e.g., States' Application 15–16; Application for American Forest & Paper Association et al. 14; see also 5 U.S.C. § 706(2)(A). An agency action qualifies as "arbitrary" or "capricious" if it is not "reasonable and reasonably explained." FCC v. Prometheus Radio Project, 592 U.S. 414, 423, 141 S.Ct. 1150, 209 L.Ed.2d 287 (2021). In reviewing an agency's action under that standard, a court may not "'substitute its judgment for that of the agency.'" FCC v. Fox Television Stations, Inc., 556 U.S. 502, 513, 129 S.Ct. 1800, 173 L.Ed.2d 738 (2009). But it must ensure, among other things, that the agency has offered "a satisfactory explanation for its action[,] including a rational connection between the facts found and the choice made." Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co., 463 U.S. 29, 43, 103 S.Ct. 2856,

77 L.Ed.2d 443 (1983) (internal quotation marks omitted). Accordingly, an agency cannot simply ignore "an important aspect of the problem." Ibid.

We agree with the applicants that EPA's final FIP likely runs afoul of these long-settled standards. The problem stems from the way EPA chose to determine which emissions "contribute[d] significantly" to downwind States' difficulty meeting national ozone standards. 42 U.S.C. § 7410(a)(2)(D)(i)(I). Recall that EPA's plan rested on an assumption that all 23 upwind States would adopt emissions-reduction tools up to a "uniform" level of "costs" to the point of diminishing returns. 87 Fed. Reg. 20076, 20095; 88 Fed. Reg. 36661, 36683–36684, 36719; see Part I–C, supra. But as the applicants ask: What happens—as in fact did happen—when many of the upwind States fall out of the planned FIP and it may now cover only a fraction of the States and emissions EPA anticipated? See, e.g., States' Application 16–21; Application for American Forest & Paper Association et al. 14–15, 19–20. Does that affect the "knee in the curve," or the point at which the remaining States might still "maximiz[e] cost-effectiv[e]" downwind ozone-level improvements? 87 Fed. Reg. 20055. As "the mix of states changes, . and their particular technologies and industries drop out with them," might the point at which emissions-control measures maximize cost-effective downwind air-quality improvements also shift? Tr. of Oral Arg. 6.

Although commenters posed this concern to EPA during the notice and comment period, see Part I–C, supra, EPA offered no reasoned response. Indeed, at argument the government acknowledged that it could not represent with certainty whether the cost-effectiveness analysis it performed collectively for 23 States would yield the same results and command the same emissions-control measures if conducted for, say, just one State. Tr. of Oral Arg. 58–59. Perhaps there is some explanation why the number and identity of participating States does not affect what measures maximize cost-effective downwind air-quality improvements. But if there is an explanation, it does not appear in the final rule. As a result, the applicants are likely to prevail on their argument that EPA's final rule was not "reasonably explained," Prometheus Radio Project, 592 U.S. at 423, 141 S.Ct. 1150, that the agency failed to supply "a satisfactory explanation for its action[,]" State Farm Mut. Automobile Ins. Co., 463 U.S. at 43, 103 S.Ct. 2856, and that it instead ignored "an important aspect of the problem" before it, ibid. The applicants are therefore likely to be entitled to "revers[al]" of the FIP's mandates on them. § 7607(d)(9). [Footnote omitted.]

III

A

Resisting this conclusion, EPA advances three alternative arguments.

First, the government insists, the agency did offer a reasoned response to the applicants' concern, just not the one they hoped. When finalizing its rule in response to public comments, the government represents, "the agency did consider whether the [FIP] could cogently be applied to a subset of the 23 covered States." EPA Response 27; see also post, at 2066 2067 (BARRETT, J., dissenting). And that consideration, the government stresses, led EPA to add a "severability" provision to its final rule in which the agency announced that the FIP would "'continue to be implemented' without regard to the number of States remaining, even if just one State remained subject to its terms. EPA Response 27 (quoting 88 Fed. Reg. 36693). In support of

its severability provision, EPA cited, among other things, its intent to address "'important public health and environmental benefits" and encourage reliance by others "on th[e] final rule in their planning.'" Ibid.

None of this, however, solves the agency's problem. True, the severability provision highlights that EPA was aware of the applicants' concern. But awareness is not itself an explanation. The severability provision highlights, too, the agency's desire to apply its rule expeditiously and "'to the greatest extent possible,' no matter how many States it could cover. Ibid. But none of that, nor anything else EPA said in support of its severability provision, addresses whether and how measures found to maximize cost effectiveness in achieving downwind ozone air-quality improvements with the participation of 23 States remain so when many fewer States, responsible for a much smaller amount of the originally targeted emissions, might be subject to the agency's plan. Put simply, EPA's response did not address the applicants' concern so much as sidestep it.[11] [[11] Despite the Court's suggestion of forfeiture, ante, at 2056 2057, EPA could not have forfeited the argument that the comments the Court cites were too insubstantial to merit a response. The Court relies on comments that were not raised until the applicants' reply briefs or that were uncovered later by the Court itself. See, e.g., Reply Brief in No. 23A351, p. 11 (raising the Air Stewardship Coalition "modeling" comment for the first time).]

Second, the government pivots in nearly the opposite direction. Now, it says, if its final rule lacks a reasoned response to the applicants' concern, it is because no one raised that concern during the public comment period. And, the agency stresses, a litigant may pursue in court only claims premised on objections first "'raised with reasonable specificity' before the agency during the public comment period. Id., at 2067 2068 (quoting § 7607(d)(7)(B)); see also post, at 2061 2063.

We cannot agree. The Act's "reasonable specificity" requirement does not call for "a hair-splitting approach." Appalachian Power Co. v. EPA, 135 F.3d 791, 817 (CADC 1998). A party need not "rehears[e]" the identical argument made before the agency; it need only confirm that the government had "notice of [the] challenge" during the public comment period and a chance to consider "in substance, if not in form, the same objection now raised" in court. Id., at 818; see also, e.g., Bahr v. Regan, 6 F.4th 1059, 1070 (CA9 2021).

Here, EPA had notice of the objection the applicants seek to press in court. Commenters alerted the agency that, should some States no longer participate in the plan, the agency would need to return to the drawing board and "conduct a new assessment and modeling of contribution" to determine what emissions-control measures maximized cost effectiveness in securing downwind ozone air-quality improvements. Comments of Air Stewardship Coalition, at 13–14; see also Part I–C, supra (noting examples of other comments). And, as we have just seen, EPA's own statements and actions confirm the agency appreciated that concern. In preparing the final rule in response to public comments, the agency emphatically insists, it "did consider whether the [r]ule could cogently be applied to a subset of the 23 covered States." EPA Response 27. And as a result of that consideration, the agency observes, it opted to add a severability provision to its final rule. Ibid. By its own words and actions, then, the agency demonstrated that it was on notice of the applicants' concern. Yet, as we have seen, it failed to address the concern adequately.[12] [[12]The Court faults EPA for "refus[ing] to say with certainty" at oral argument that it would have reached the same conclusions if different States were included in the FIP. Ante, at 2057. But § 7607(d)(8) does not require the Government to show that the rule would be the same;

it is most naturally read to require the challenger to demonstrate a "substantial likelihood that the rule would have been significantly changed if such errors had not been made." (Emphasis added.) And though § 7607(d)(9)(A) appears to allow reversal of "'any' arbitrary or capricious "'action,' ante, at 2057 2058, § 7607(d)(8)'s more specific harmless-error rule and § 7607(d)(9)(D)'s more specific requirements for reversal based on arbitrary or capricious procedural errors would seem to control.]

Third, the government pursues one more argument in the alternative. As the agency sees it, the applicants must return to EPA and file a motion asking it to reconsider its final rule before presenting their objection in court. They must, the agency says, because the "grounds for [their] objection arose after the period for public comment." § 7607(d)(7)(B); see EPA Response 20–21. As just discussed, however, EPA had the basis of the applicants' objection before it during the comment period. It chose to respond with a severability provision that in no way grappled with their concern. Nothing requires the applicants to return to EPA to raise (again) a concern EPA already had a chance to address.

Taking the government's argument (much) further, the dissent posits that every "objection that [a] final rule was not reasonably explained" must be raised in a motion for reconsideration. Post, at 2061 (internal quotation marks omitted; emphasis deleted). But there is a reason why the government does not go so far. The Clean Air Act opens the courthouse doors to those with objections the agency already ignored. If an "objection [is] raised with reasonable specificity during the period for public comment" but not reasonably addressed in the final rule, the Act permits an immediate challenge. § 7607(d)(7)(B). A person need not go back to the agency and insist on an explanation a second time. Tellingly, the case on which the dissent relies involves an entirely different situation: a "'logical outgrowth' challeng[e]." Post, at 2061. There, the objection was that EPA had supposedly "'significantly amend[ed] the [r]ule between the proposed and final versions,' making it impossible for people to comment on the rule during the comment period. Ibid. (quoting EME Homer, 795 F.3d at 137). That is nothing like the challenge here, where EPA failed to address an important problem the public could and did raise during the comment period.

[7] Teche Vermilion Sugar Cane Growers Association Inc., v. Su (September 2024): Agency Failure To Examine Relevant Data And Articulate Satisfactory Explanation For Its Action.

Teche Vermilion Sugar Cane Growers Association Inc., v. Su[960] is about sugar cane and sugar cane hauling. *Teche Vermilion Sugar Cane Growers Association* involves a challenge to a United States Department of Labor regulation that effectively increases the wage rates that Louisiana sugarcane growers must pay foreign workers admitted to the country under H-2A agricultural worker visas and whose duties include hauling sugarcane using heavy or tractor-trailer trucks. The regulation contested in *Teche Vermilion Sugar Cane Growers Association* increases the wage rates applicable to these workers in Louisiana to approximately $25 an hour. Plaintiffs asserted that the Department of Labor's regulatory change impermissibly requires agricultural

[960] *Teche Vermilion Sugar Cane Growers Association Inc., v. Su*, 2024 W.L. 4246272 (W.D. Louisiana, September 18, 2024).

employers to pay some H-2A[961] agricultural workers wages that are based on the higher average wage rates for "non-farm" domestic workers who are not "similarly employed."[962] The District Court granted a preliminary injunction from enforcing a final rule. The District Court concluded that Plaintiffs demonstrated a substantial likelihood of success on their claim that the Final Rule is arbitrary and capricious because the record reflects that the Department of Labor failed to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." Plaintiffs demonstrated a substantial likelihood of success on the merits of their challenge to the Final Rule under the Administrative Procedure Act.

While not a tax case, *Teche Vermilion Sugar Cane Growers Association* may provide a template of what cases after *Loper Bright Enterprises* will be like in considering agency interpretations of statutes. *Teche Vermilion Sugar Cane Growers Association* sets forth a careful, painstaking factual analysis without deference to the government agency. *Teche Vermilion Sugar Cane Growers Association* also carefully considered the Department of Labor justification for its regulation and found it lacking.

Plaintiffs in *Teche Vermilion Sugar Cane Growers Association* are four sugar cane farm operators who employ or plan to employ temporary foreign workers to perform agricultural work through the H-2A program and three organizations that represent or advocate for agricultural businesses. Some of the H-2A workers employed by the Plaintiff growers are required to haul sugarcane from field to mill using heavy trucks as one of their tasks on the farm.

Before the Attorney General may approve the importation of a prospective worker under the H-2A program, the prospective employer must certify to the Secretary of Labor that:

> *(A) there are not sufficient workers who are able, willing, and qualified, and who will be available at the time and place needed, to perform the labor or services involved in the petition, and*
>
> *(B) the employment of the alien in such labor or services will not adversely affect the wages and working conditions of workers in the United States similarly employed.8*

[961] The H-2A program was established at 8 U.S.C. § 1101(a)(15)(H)(ii)(a). This program was "created by the Immigration and Nationality Act of 1952 [('INA') as] amended by the Immigration Reform and Control Act of 1986" and "permits employers to hire foreign workers to perform temporary agricultural work in the United States." Under the H-2A program, employers may temporarily hire foreign workers to perform agricultural work "when there are not enough qualified and available American workers to fill open jobs." The United States Attorney General has authority to approve requests to import foreign labor under the H-2A program, after consulting with the Secretary of Labor.

[962] 8 U.S.C. § 1188(a)(1)(A)–(B).

The statute directs the Secretary of Labor to create the regulatory framework for the H-2A program. The Department of Labor is thus tasked with overseeing the H-2A program and promulgating regulations to ensure that temporary nonresident agricultural workers are not paid wages that will "adversely affect" the wages or working conditions of "similarly employed" domestic workers. The governing statute does not dictate how the Department of Labor is to ensure that the employment of H-2A workers does not adversely the wages and working conditions of domestic workers. The Department of Labor addresses this statutory requirement, in part, by requiring H-2A employers to pay participating workers the highest of the following wage rages applicable to the relevant activity: the adverse effect wage rate; the prevailing wage; the collectively bargained wage rate; the federal or state minimum wage rate; or "[a]ny other wage rate the employer intends to pay." All occupations in the United States are assigned Standard Occupational Classification codes, which are defined by the nature of the jobs. The Department of Labor calculates adverse effect wage rates for each applicable Standard Occupational Classification. The adverse effect wage rate for an occupation effectively establishes a minimum wage for H-2A visa workers and domestic workers performing the same work. The Department of Labor has generally based the adverse effect wage rate on wage data from the Farm Labor Survey of the United States Department of Agriculture. In 2020, the Department of Labor altered its adverse effect wage rate methodology to incorporate Farm Labor Survey wage data when available and, when not available, to supplement it with Occupational Employment and Wage Statistics wage data. The 2020 Rule was preliminarily enjoined—and ultimately vacated and remanded to the Department of Labor—after the Eastern District of California found that

- the rule failed to protect United States workers against adverse effects,
- the Department of Labor failed to explain part of its decision and failed to properly analyze potential harm to United States workers, and
- the Department of Labor failed to comply with notice-and-comment requirements.[963]

[963] *United Farm Workers v. United States Department of Labor*, 598 F. Supp. 3d 878 (E.D. Cal. 2022) ("a. The 2020 Rule Contravenes Federal Law ¶ In its previous order, the court first determined that 'plaintiffs have established that they are likely to prevail on their claim that the Final Rule is arbitrary and capricious' because it contravenes federal law by failing to protect United States workers against adverse effects. [Citation omitted.] The court now adopts the same reasoning applied in that order and concludes that the Final Rule is arbitrary and capricious because it contravenes the Immigration and Nationality Act ('INA') by failing to protect United States workers against adverse effects to their wages and working conditions. ¶ b. The Department of Labor Failed to Offer a Reasoned Explanation in the 2020 Rule ¶ In its order granting plaintiffs' motion for a preliminary injunction, the court next determined that the Final Rule is arbitrary and capricious because the Department of Labor failed to offer a reasoned explanation in the Final Rule. (*Id.* at 15.) In particular, the court concluded that plaintiffs had demonstrated they were likely to prevail because: (1) 'defendants have failed to explain the decision to freeze H-2A wages below market rates for two years' and (2) defendants failed to

The Department of Labor issued a notice of proposed rulemaking in December 2021. The 2021 Notice of Proposed Rulemaking proposed adopting the 2020 Rule's new method of calculating adverse effect wage rates by using Farm Labor Survey data to calculate H-2A adverse effect wage rates whenever possible, and using Occupational Employment and Wage Statistics when Farm Labor Survey data are not available. Occupational Employment and Wage Statistics data would also be used for H-2A jobs that do not fall within the "field and livestock workers (combined)" classification, on the grounds that OEWS data are more specific and reliable for such occupations. Additionally, the 2021 Notice of Proposed Rulemaking proposed a requirement "that employers pay the highest applicable wage if the job opportunity can be classified within more than one occupation, when those occupations are subject to different AEWRs" (the "Highest AEWR Rule"). The Department of Labor would review all aspects of a proposed H-2A job opportunity and identify all the tasks an employee would be required to perform. The Department of Labor would then correlate each of those tasks with the Standard Occupational Classification that includes them, and identify the adverse effect wage rate applicable to each Standard Occupational Classification. If an H-2A laborer would be expected to perform tasks falling under distinct Standard Occupational Classifications, and those Standard Occupational Classifications are associated with different adverse effect wage rates, then the employer would be required to pay the highest wage rate among those adverse effect wage rates.[964]

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properly analyze the harm to U.S. farmworkers. (*Id.* at 15 21.) Again, the court now adopts the same reasoning and concludes that the Final Rule is arbitrary and capricious because the Department of Labor failed to offer a reasoned explanation in the Final Rule for its imposition of a two-year wage freeze and failed to analyze the economic effects of the new AEWR methodology on U.S. workers. ¶ c. The 2020 Rule Violates the APA's Notice-and-Comment Requirement ¶ Finally, in its previous order, the court determined that plaintiffs were likely to succeed on their claim that the Final Rule violates the APA's notice-and-comment requirement. (*Id.* at 23 27.) This same conclusion is warranted now as the court addresses the merits of this claim on summary judgment. Accordingly, the court adopts the reasoning from its prior order and concludes that the Department of Labor failed to comply with notice-and-comment rulemaking requirements in issuing the Final Rule, thus rendering it unlawful. ¶ As explained above, if a reviewing court concludes that a rule is unlawful, vacatur and remand is the standard remedy that, absent rare circumstances not present here, should be imposed. *See E. Bay Sanctuary Covenant*, 994 F.3d at 987. ¶ For the reasons explained above and in the court's previous orders addressing plaintiffs' motion for preliminary injunction, plaintiffs' motion for summary judgment will be granted and defendants' request to stay this case will be denied.").

[964] This rule would only apply in some situations. An H-2A job opportunity might include some duties classified under SOC 45-2091 (Agricultural Equipment Operators) and others classified under SOC 45-2093 (Farmworkers, Farm, Ranch, and Aquacultural Animals). Since those SOCs are both part of "field and livestock workers (combined)," only the combined adverse effect wage rate would apply. Regarding agricultural employees who operate heavy trucks, the 2021 Notice of Proposed Rulemaking provides the following discussion:

[A] job opportunity involving driving duties may be properly classified under SOC 45-2091 (Agricultural Equipment Operators), SOC 53-3032 (Heavy and Tractor-Trailer Truck Drivers), or a combination of the two, depending on the duties described in the employer's job order. A job

The Department of Labor accepted comments on the 2021 Notice of Proposed Rulemaking. On February 28, 2023, after reviewing comments on the 2021 Notice of Proposed Rulemaking, the Department of Labor issued a final rule, "Adverse Effect Wage Rate Methodology for the Temporary Employment of H-2A Nonimmigrants in Non-Range Occupations in the United States"[965] (the "Final Rule"). The Final Rule includes the Highest AEWR Rule.[966] In the Final Rule, the Department of Labor substantially reiterated its analysis from the 2021 Notice of Proposed Rulemaking regarding opportunities that require agricultural laborers to occasionally operate heavy trucks:[967]

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opportunity for workers to drive tractors and other mechanized, electrically powered or motor-driven equipment on farms to plant, cultivate, and harvest a crop (including driving tractors in and out of fields carrying bins and driving forklifts to transfer and stack bins of full product onto trailers), which requires 12 months of experience operating such equipment, would be properly classified under SOC 45-2091 and subject to the field and livestock worker (combined) FLS-based AEWR. In contrast, a job opportunity for workers to drive semi tractor-trailer trucks to and from specified destinations within an area of intended employment (including maneuvering trucks into and out of loading and unloading positions as well as driving in both on-road (paved) and off-road conditions), which requires 12 months of experience operating such equipment and a valid Class A CDL or equivalent, would be properly classified under SOC 53-3032 and subject to the OEWS-based, occupation-specific AEWR. In the event an employer seeks workers to both drive tractors and other mechanized, electrically powered or motor-driven equipment on farms and semi tractor-trailer units, as described above, the employer's job opportunity constitutes a combination of SOC 45-2091 and SOC 53-3032, subject to either the field and livestock worker (combined) FLS-based AEWR applicable to SOC 45-2091 or the OEWS-based, occupation-specific AEWR applicable to SOC 53-3032, whichever is a higher rate per hour.

[965] 88 Fed. Reg. 12760-01

[966] Codified at 20 C.F.R. §§ 655.103(b) and 120(b)(1), (2), and (5).

[967] 2021 NPRM at 68183-84 ("[A] job opportunity involving driving duties may be properly classified under SOC 45-2091 (Agricultural Equipment Operators), SOC 53-3032 (Heavy and Tractor-Trailer Truck Drivers), or a combination of the two, depending on the duties described in the employer's job order. A job opportunity for workers to drive tractors and other mechanized, electrically powered or motor-driven equipment on farms to plant, cultivate, and harvest a crop (including driving tractors in and out of fields carrying bins and driving forklifts to transfer and stack bins of full product onto trailers), which requires 12 months of experience operating such equipment, would be properly classified under SOC 45-2091 and subject to the field and livestock worker (combined) FLS-based AEWR. In contrast, a job opportunity for workers to drive semi tractor-trailer trucks to and from specified destinations within an area of intended employment (including maneuvering trucks into and out of loading and unloading positions as well as driving in both on-road (paved) and off-road conditions), which requires 12 months of experience operating such equipment and a valid Class A CDL or equivalent, would be properly classified under SOC 53-3032 and subject to the OEWS-based, occupation-specific AEWR. In the event an employer seeks workers to both drive tractors and other mechanized, electrically powered or motor-driven equipment on farms and semi tractor-trailer units, as described above, the employer's job opportunity constitutes a combination of SOC 45-2091 and SOC 53-3032, subject to either the field and livestock worker (combined) FLS-based AEWR applicable to SOC 45-2091 or the OEWS-based, occupation-specific AEWR applicable to SOC 53-3032, whichever is a higher rate per hour. [Citation omitted.]").

Plaintiffs filed suit in *Teche Vermilion Sugar Cane Growers Association* challenging the Final Rule and, specifically, the Highest AEWR Rule. Plaintiffs argued that, under the scheme in place prior to the Final Rule, H-2A workers whose tasks are primarily agricultural and only occasionally include driving heavy trucks on public roads were previously classified as SOC 45-2091 (Agricultural Equipment Operators), which is part of "field and livestock workers (combined)." Under the Final Rule, these workers must now be reclassified as heavy truck drivers (SOC 53-3032, Heavy and Tractor-Trailer Truck Drivers) and must be paid the higher wage rate associated with the latter classification. Plaintiffs argued that this reclassification is improper, as these laborers are agricultural workers who perform many functions, only one of which is driving heavy trucks on public roads. They should not be reclassified as non-agriculture-specific heavy truck drivers simply because they occasionally drive heavy trucks. Plaintiffs asserted that the Highest AEWR Rule will require farm operators like them to pay occasional truck drivers nearly double what they would be paid under the prior method of calculation, which will have harmful consequences on Plaintiffs, the workers, and the United States economy as a whole.

Plaintiffs asserted that the Final Rule

- violates the Administrative Procedure Act ("APA") because it exceeds the Department of Labor's statutory mandate;
- violates the APA because it is arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with the law;
- violates the Congressional Review Act ("CRA"); and
- violates the Regulatory Flexibility Act ("RFA").38

Plaintiffs sought –

- a preliminary injunction prohibiting the Department of Labor from enacting or enforcing the Final Rule or the Highest AEWR Rule:
- a preliminary injunction directing the Department of Labor to process H-2A applications using the AEWRs applicable prior to the Final Rule;
- a declaratory judgment that the Final Rule "and its methodology for calculating the AEWR" are invalid;
- an order vacating the Final Rule and permanently enjoining its enforcement; and
- costs and expenses, including attorney fees.

Plaintiffs later applied for a preliminary injunction, asking the Court to –

- enjoin the Department of Labor from enforcing the Final Rule within Louisiana;

- enjoin the Department of Labor from requiring employers to advertise wages other than those in place before the Final Rule was promulgated;
- enjoin the Department of Labor from requiring H-2A employers to pay wage rates "resulting from the Final Rule's methodology;" and
- require the Department of Labor to amend and reissue any H-2A certifications issued prior to any injunction in conformity with the court's orders.

Plaintiffs claimed that the Final Rule violates the Congressional Review Act because it is a "major rule" under that statute. The Department of Labor failed to submit the Final Rule for a Congressional review before it went into effect.[968] Defendants argue that the Congressional Review Act prohibits judicial review of challenges brought under it, so this Court does not have jurisdiction over Plaintiffs' claim. Alternatively, they assert the Final Rule is not a major rule for Congressional Review Act purposes.

Under the Congressional Review Act, before an agency promulgates a rule, it must provide reports to Congress and the Comptroller General regarding the content of the rule, including whether it is a "major rule"[969] and the proposed effective date for the major rule. The Congressional Review Act creates a sixty-day period before major rules may take effect. Congress and the President may undertake review of proposed major rules in that period. Congress and the President may take steps to prevent the major rules from going into effect. "No determination, finding, action, or omission under [the Congressional Review Act] shall be subject to judicial review."[970] Whether Section 805 of the Congressional Review Act absolutely precludes review of challenges under the Congressional Review Act had not been addressed by the Fifth Circuit, and is far from settled in other circuit and district courts. Several circuit courts have held that section 805 strips courts of jurisdiction to review any challenge

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[968] As required by 5 U.S.C. § 801.78.

[969] See Congressional Review Act, 32 Fed. Prac. & Proc. Judicial Review § 8213 (2d ed.) The CRA defines a "major rule" as:

any rule that the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget finds has resulted in or is likely to result in—

(A) an annual effect on the economy of $100,000,000 or more;

(B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or

(C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.

See 5 U.S.C.A. § 804(2). Compare Executive Order 12,866, Regulatory Planning and Review, § 3(f), 58 Fed. Reg. 51735 (Sept. 30, 1993) (defining "significant" regulatory actions for purposes of review by Office of Information and Regulatory Affairs of agency rules).

[970] Under 5 U.S.C. § 805.

to acts or omissions under the CRA, as per the statute's plain language.[971] Other circuit and district courts have concluded that some species of review are not barred[972], including this one in a previous case.

The District Court agreed with those courts who have found that Section 805 precludes judicial review. The Court found the Tenth Circuit's analysis in *Kansas Nat. Res. Coal. v. United States Dep't of Interior*[973] to be thorough and persuasive. There, the plaintiff alleged that the United States Department of Interior failed to submit a rule to Congress for review. This violated Section 801(a)(1)(A). The court held that review of that claim was barred by Section 805. The plain language of Section 805 bars judicial review of alleged actions or omissions under the Congressional Review Act. A post-passage statement in legislative history expressed the intent that courts may not review "major rule determinations" or "whether Congress complied with the [Congressional Review Act's] Congressional review procedures." The statement noted, however, that courts were not intended to be prohibited "from giving effect to a resolution of disapproval that was enacted into law," and the authors "expect[ed]" that a court "might recognize that a rule has no legal effect due to the operation of subsections 801(a)(1)(A) [requiring the submission of reports] or 801(a)(3) [providing effective dates for agency rules]." These statements were not available at the time the CRA was passed, and, moreover, these statements are not controlling when they contradict the plain language of the statute. The District Court held that judicial review of Plaintiffs' Congressional Review Act claims is barred.

The Complaint alleges that the Final Rule violates the Congressional Review Act because the Department of Labor failed to seek Congressional review at least sixty days prior to the effective date of the Rule, even though the Final Rule is estimated to have an economic impact of greater than $100 million.[974] The implications of this language are that Plaintiffs

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[971] *Kansas National Resource Coalition v. Department of Interior*, 971 F.3d 1222, 1235 (10th Cir. 2020); *Washington Alliance of Technological Workers v. Department of Homeland Security*, 892 F.3d 332, 346 (D.C. Cir. 2018); *Montanans for Multiple Use v. Barbouletos*, 568 F.3d 225, 229 (D.C. Cir. 2009); *Via Christi Regional Medical Ctr. v. Leavitt*, 509 F.3d 1259, 1271 n.11 (10th Cir. 2007) (*abrogated on other grounds by Azar v. Allina Health Services*, 139 S. Ct. 1804 (2019))

[972] *Tugaw Ranches, LLC v. Department of Interior*, 362 F.Supp.3d 879, 884-886 (D. Idaho 2019) (canvassing case law and holding that court had jurisdiction to review claim that agencies had violated Congressional Review Act by failing to submit rules for review). *Compare with Kansas Natural Resources Coalition v. U.S. Department of the Interior*, 382 F.Supp.3d 1179 (D. Kan. 2019) (holding Congressional Review Act prohibited review of claim that agency had failed to submit rule to Congress and Comptroller General), *aff'd* 71 F.3d 1222 (10th Cir. 2020). *See United States v. Reece*, 956 F. Supp. 2d 736 (W.D. La. 2013) (analyzing the meaning of certain terms in the Congressional Review Act and deciding whether an agency was required to comply with certain obligations under the statute in light of that analysis).

[973] 971 F.3d 1222, 1230 (10th Cir. 2020).

[974] 5 U.S.C. § 801.

assert that the Final Rule is a "major rule."[975] This obligated the Department of Labor to submit certain reports to Congress and meant that the Final Rule would go into effect at least sixty days after submission of those reports. The Department of Labor failed to submit those reports, thus violating its obligation under Section 801(a)(1). Plaintiffs sought judicial review of an alleged failure by an agency to comply with an obligation imposed by Section 801 of the Congressional Review Act, which is barred by Section 805.

Defendants' motion to dismiss the Congressional Review Act claim for lack of jurisdiction is was granted.

The court next dealt with the Plaintiff's claim that the Department of Labor rule violated the Regulatory Flexibility Act.

Under the Regulatory Flexibility Act, when an agency promulgates a rule which requires notice and a period of comment, it generally must issue both initial and final regulatory flexibility analyses.[976] Those analyses must include several components. Section 604(a)(6) requires a final rule to include:

> *a description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected.*[977]

Under 5 U.S.C. § 605(b), agencies do not need to issue regulatory flexibility analyses if:

> *the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. If the head of the agency makes a certification under the preceding sentence, the agency shall publish such certification in the Federal Register at the time of publication of general notice of proposed rulemaking for the rule or at the time of publication of the final rule, along with a statement providing the factual basis for such certification.*

Compliance with sections 604 and 605(b) is subject to judicial review only to determine "whether an agency has made a reasonable, good-faith effort to carry out the mandate of the RFA." The Regulatory Flexibility Act imposes procedural, not substantial, requirements. Judicial review is "'highly deferential' as to the substance of the analysis, particularly where an agency is predicting the likely economic effects of a rule."[978]

The Complaint asserts that the Department of Labor has conceded it made no attempt to procure any data from which it could estimate the Final Rule's impact on small entities. The Final Rule failed to provide a meaningful comparative analysis between the Highest AEWR

[975] Under 5 U.S.C. § 804.

[976] 5 U.S.C. §§ 603, 604.

[977] 5 U.S.C. § 605(a)(6).

[978] *Council for Urological Interests v. Burwell*, 790 F.3d 212, 227 (D.C. Cir. 2015) (*quoting Helicopter Association International, Inc. v. Federal Aviation Administration*, 722 F.3d 430, 438 (D.C. Cir. 2013)).

Rule and "significant alternatives" proposed in public comments. The Final Rule did not offer any empirical, or otherwise reasonable, explanation to support its rejection of alternative proposals. The Final Rule's Section 605(b) certification was not made by the "head of the agency" so it has no effect.

The District Court denied that the Plaintiff's Regulatory Flexibility Act claim.

The District Court, however, granted a preliminary injunction enjoining the Department of Labor from enforcing the Final Rule with respect to the change in the AEWR determination for H-2A workers employed by Plaintiffs to haul sugarcane using heavy and tractor-trailer trucks.

Plaintiffs grounded their request for injunctive relief on their APA claims that the Final Rule violates 8 U.S.C. § 1188(a) and that the Department of Labor's promulgation of the Final Rule was arbitrary and capricious. Plaintiffs argued that the Final Rule exceeded the Department of Labor's statutory authority because the Final Rule based the adverse effect wage rate for certain agricultural jobs on non-agricultural Standard Occupational Classification codes. Plaintiffs challenged the Department of Labor's decision to base the adverse effect wage rate for H-2A workers who haul sugarcane from the field to the processing plants using heavy or tractor-trailer trucks on the wage rates for a Standard Occupational Classification code that includes non-agricultural heavy truck drivers.

The District Court cited this background:

> *The APA provides that a "reviewing court shall . . . hold unlawful and set aside agency action . . . found to be—(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . [or] (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right." [Citation omitted.] Until the Supreme Court's recent decision in Loper Bright Enterprises v. Raimondo, [citation omitted] Courts generally applied the two-step Chevron framework in determining whether an agency's action exceeded its statutory authority. [Citation omitted.] Under this framework, courts were required to first exhaust the traditional tools of statutory construction to determine whether "Congress has directly spoken to the precise question at issue;" if it has, the court's inquiry ended and the court had to "give effect to the unambiguously expressed intent of Congress." [Citation omitted.] If the statute was silent or ambiguous as to the legality of the agency's action, a court would proceed to step two of the Chevron framework and determine whether the agency's interpretation of the statute "is based on a permissible construction of the statute." [Citation omitted.] "If a statute is ambiguous, and if the implementing agency's construction [of the statute] is reasonable," a court would generally defer to the agency's interpretation of the statute. [Citation omitted.]*
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> *The Supreme Court overruled Chevron in Loper Bright Enter. [Citation omitted.] Now, when an agency's interpretation of statute is challenged, the agency is not entitled to deference even when a statute is ambiguous. [Citation omitted.] Rather, the APA requires courts to "exercise independent judgment in determining the meaning of statutory provisions." [Citation omitted.] Courts may consider an agency's interpretation as "a body of experience and informed judgment to which courts and litigants may properly resort for guidance," [citation omitted] especially when the interpretation "rests on factual premises within the agency's*

expertise." [Citation omitted.] But an agency's interpretation of a statute cannot supplant the role of the judiciary as the final arbiter of a statute's meaning. [Citation omitted.] Courts might also consider "interpretations issued contemporaneously with the statute at issue, and which have remained consistent over time," when determining the statute's meaning. operating partnership units

Statutes may authorize an agency to exercise discretion, and that discretion could take many forms—including the authority to define a statutory term that Congress chose not to elucidate, [citation omitted] the authority to "fill up the details" of a statutory scheme, [citation omitted] or merely the authority to regulate within the clear limits of statute in a manner that is "appropriate" or "reasonable. [citation omitted] When statute delegates authority to an agency, "the role of the reviewing court under the APA is, as always, to independently interpret the statute and effectuate the will of Congress subject to constitutional limits" by "recognizing constitutional delegations, fixing the boundaries of the delegated authority, and ensuring the agency has engaged in reasoned decision-making within those boundaries." [Citation omitted.]

Plaintiffs had relied on *Chevron* deference in briefing. The District Court, however, had to apply the las post-*Loper Bright Enterprises*.

This change in the applicable standard impacts the present case because Plaintiffs' challenge to the statutory basis for the Department of Labor's Final Rule turns on the meaning and application of the term "similarly employed" in 8 U.S.C. § 1188(a)(1)(B). Defendants' briefing on the issue relies heavily on Chevron to argue that the Court should defer to the Department of Labor's interpretation of the statute and that the Final Rule is grounded on a permissible construction of the statute. Moreover, two district courts that rejected similar challenges to the Final Rule — USA Farm Labor, Inc., et al. v. Su, et al. [citation omitted] and Florida Growers Ass'n, Inc., et al. v. Su, et al. [citation omitted] — based their decisions, in part, on Chevron and deferred to the Department of Labor's interpretation of the statute. In light of Loper Bright Enter., however, Chevron's rule of deference is no longer applicable. Accordingly, following Loper Bright Enter., the Court must turn to the task of "exercising independent judgment in determining the meaning of" section 1188(a)(1)(B), and whether the Final Rule is consistent with that meaning.

Plaintiffs argued that Section 1188(a)(1)(B) limits the Department of Labor to the agricultural occupations covered by the Farm Labor Survey in determining the adverse effect wage rate for H-2A workers. Section 1188(a)(1)(B) requires the Department of Labor to certify that "the employment of the alien in such labor or services will not adversely affect the wages and working conditions of workers in the United States similarly employed" as a condition for approval of an H-2A application. The statute does not direct the Department of Labor how to determine whether the employment of an H-2A worker will "adversely affect" the wages and working conditions of domestic workers. The statute does not define the term "similarly employed." Courts have held that the statute grants discretion to the Department of Labor to implement a regulatory regime to address that question. The Department of Labor exercised its discretion by implementing regulations adopting the adverse effect wage rate and requiring employers to pay H-2A workers the adverse effect wage rate in order to prevent downward pressure on the wage rates of domestic workers similarly employed. The Department of

Labor's adverse effect wage rate methodology has changed over the years but the statutory authority for the methodology remains grounded on Section 1188(a)(1)(B).183 If the Department of Labor adopts an adverse effect wage rate methodology that exceeds the boundaries set by the statute, the agency's action is unlawful.

Plaintiffs contended that workers employed in agricultural settings and non-agricultural setting are not "similarly employed" within the meaning of Section 1188(a)(1)(B). When interpreting statutory language, statutory terms are generally interpreted in accordance with their ordinary meaning. The Court must "interpret the words consistent with their ordinary meaning . . . at the time Congress enacted the statute."[979] However, "the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.[980] The Court must not hold to the ordinary meaning of statutory terms if the context "suggests some other meaning."[981] Statutory provisions "should be interpreted harmoniously" when they are given *"in pari materia* ('in a like matter')."[982]

The statute does not define the term "similarly employed." The term "similar" has to be read in the context of the statute and its purpose. The purpose of Section 1188(a)(1)(B) is to ensure that the employment of H-2A workers does not adversely affect the wages or working conditions of domestic workers who are similarly employed. An H-2A job must have sufficient common characteristics with a non-H-2A job that the wages and working conditions of one job impact the wages and working conditions of the other. If the nature of the work, qualifications, and experience required for jobs performed by two groups of workers are sufficiently different, the wages and working conditions of one group of workers are not likely to adversely affect the wages and working conditions of the other group of workers.

The statute clarifies that, in determining whether "a specific qualification is appropriate in a job offer, the Secretary shall apply the normal and accepted qualifications required by non-H-2A-employers in the same or comparable occupations and crops."[983] Before the Department of Labor may certify that no domestic workers are qualified and available to perform an employer's labor, the statute requires the Department of Labor to examine any job offers that an employer has made to domestic workers. Those job offers must require domestic workers to have qualifications that comport with "the normal and accepted

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[979] *National Association of Private Fund Managers v. Securities and Exchange Commission*, 103 F.4th at 1110.

[980] *National Association of Private Fund Managers v. Securities and Exchange Commission*, 103 F.4th at 1111.

[981] *National Association of Private Fund Managers v. Securities and Exchange Commission*, 103 F.4th at 1110.

[982] *National Association of Private Fund Managers v. Securities and Exchange Commission*, 103 F.4th at 1110.

[983] 8 U.S.C. § 1188(c)(3)(A)(ii).

qualifications required" by employers who hire domestic laborers to work "in the same or comparable occupations and crops."

Plaintiffs asserted that the only domestic workers who are "similarly employed" to H-2A workers are those who perform "the same or comparable occupations" working with "the same or comparable crops." A truck driver hauling sugarcane is not "similarly employed" to a truck driver hauling crawfish because they do not haul the same crop. Plaintiffs asserted that, in light of the statute's plain meaning, "the only reasonable construction of the statutory scheme is that a domestic worker is considered 'similarly employed' if his or her work involves 'the same or comparable occupations and crops' as H-2A laborers working for the same employer."

The Court disagreed. According to the court, Plaintiffs' reading of the statute gives the "similarly employed" language in Section 1188(a)(1)(B) too narrow of a construction by limiting its application to employment involving the same crops. The provisions cited by Plaintiffs serve different purposes. Section 1188(c)(3)(A)(ii) addresses whether there are sufficient domestic agricultural workers available to the employer and, accordingly, whether hiring an H-2A worker would displace a domestic worker. Section 1188(a)(1)(B) addresses the broader question of the impact of hiring H-2A workers on the wages and working conditions of domestic workers who are similarly employed. The text of Section 1188(a)(1)(B) does not limit the Department of Labor's "adverse wage effect" determination to workers employed to farm the "same crop." The statute does not dictate the methodology that the Department of Labor must use to determine the adverse effect wage rate or otherwise limit the Department of Labor to using a particular survey, such as the Farm Labor Survey. The only statutory constraints are the boundaries set by Section 1188(a)(1)(B). Considering the record as a whole, the Court stated that it could not conclude that the Department of Labor's use of non-farm wage surveys, such as the Occupational Employment and Wage Statistics, to supplement data from the Farm Labor Survey in setting the adverse effect wage rate for H-2A workers exceeds the Department of Labor's statutory authority as long as its methodology is based on workers who are "similarly employed." According to the court, Plaintiffs failed to show that agricultural and non-agricultural employees can never be "similarly employed" such that the Department of Labor is limited to only using the Farm Labor Survey wage survey.

Plaintiffs argued that the Department of Labor's use of average wage rates for non-farm heavy and tractor-trailer truck drivers to calculate the adverse effect wage rate for H-2A workers who drive sugarcane trucks violates the statute because these two classes of workers are not "similarly employed." Plaintiffs argued that H-2A workers who drive sugarcane trucks only fall under the Department of Labor's "Agricultural Equipment Operators" Standard Occupational Classification code. Accordingly, the average wage rates reflected in the Farm Labor Survey for this category should be used to calculate the adverse effect wage rate for sugarcane truck drivers. Plaintiffs pointed to the Department of Labor's narrative for the Agricultural Equipment Operators Standard Occupational Classification code, which

describes multiple tasks that characterize the jobs that fall under that code, including "[d]riv[ing] trucks to haul crops, supplies, tools, or farmworkers." Plaintiffs argued that this task description best describes the work of H-2A workers who drive sugarcane trucks. In contrast, under the Final Rule, the Department of Labor bases the adverse effect wage rate for H-2A workers who haul sugarcane using heavy or tractor-trailer trucks on the non-farm OEWS wage rate for jobs that fall under the Department of Labor's SOC for "Heavy and Tractor-Trailer Truck Drivers." The narrative for this Standard Occupational Classification category states that it applies to workers who "drive a tractor-trailer combination or a truck with a capacity of at least 26,001 pounds gross vehicle weight. . Plaintiffs argued that more than 70% of the jobs covered by this latter category are full-time, non-farm transportation jobs, including long-haul interstate trucking jobs, that differ from the jobs performed by H-2A sugarcane haulers in terms of the nature of the work, tasks, experience, duration, and qualifications.

The Plaintiffs submitted expert witness testimony concerning the activities of sugar cane truckers. Plaintiffs contended that this evidence demonstrates the distinctions between the nature of the work, experience, and qualifications required for sugarcane haulers and nonagricultural heavy and tractor-trailer truck drivers, and that these categories of workers are not "similarly employed" within the meaning of Section 1188(a)(1)(B).

Plaintiffs also submitted declarations of the American Sugar Cane League and Louisiana sugar cane growers.

Considering the record as a whole, the Court concluded that Plaintiffs showed a substantial likelihood of success on their claim that the Final Rule exceeds the Department of Labor's statutory authority as it pertains to the Highest AEWR Rule for H-2A workers who haul sugarcane using heavy or tractor-trailer trucks.

While Section 1188(a)(1)(B) does not require that the Department of Labor base the adverse effect wage rate on average wage rates for jobs or occupations that are the same or identical, the statute requires that the jobs be sufficiently comparable that the wage rates and working conditions of the H-2A job at issue can adversely impact the wage rates and working conditions of domestic workers employed in the non-H-2A job. Otherwise, the adverse effect wage rate would have no correlation to whether the employment of an H-2A worker adversely impacts similarly employed domestic workers. Absent this correlation, the adverse effect wage rate methodology set forth in the Final Rule exceeds the scope of Section 1188(a), according to the court.

The Department of Labor's explanation for how occupations are categorized in its Standard Occupational Classification codes provides some guidance for comparing jobs that fall under each category. According to the Department of Labor, "occupations are classified based upon work performed, skills, education, training, and credentials" for purposes of the SOC codes. The record reflected that, while H-2A sugarcane truck drivers use equipment

similar to non-farm heavy and tractor-trailer truck drivers and both use public roads, there are significant, material differences between the "work performed, skills, education, training, and credentials" between the jobs performed by these two categories of workers. According to the court, the evidence in the record showed:

- Employment duration: H-2A workers who drive sugarcane trucks during harvest season 3-4 months out of the year—in contrast, many non-farm heavy and tractor-trailer truck drivers work year-round full time;
- Work Environment: H-2A sugarcane haulers drive relatively short distances back and forth between the field and the mill—in contrast, the "Heavy and Tractor-Trailer Truck Driver" Standard Occupational Classification code includes interstate truck drivers who drive long distances as well as messengers and couriers who may operate in densely populated urban areas;
    - H-2A sugarcane truck drivers also often live in communal settings on the farm. There is no evidence in the record that these working conditions are comparable to the working conditions of non-farm truck drivers (or that the Department of Labor considered this difference);
- Nature of Tasks Performed: H-2A sugarcane haulers may perform other harvest-related tasks when not driving—in contrast, the Department of Labor's own task descriptions for the "Heavy and Tractor-Trailer Truck Driver" Standard Occupational Classification code does not list farm-related tasks;
- Credential Requirements: The record does not reflect any credential or training requirements for H-2A sugarcane haulers, who are exempt from Commercial Driver's License requirements—in contrast, long-haul interstate truck drivers are subject to Commercial Driver's License requirements as well as federal regulations on training.

The record did not reflect that the Department of Labor considered the extent to which the wages and working conditions of H-2A sugarcane truck drivers affected the wages and working conditions of the much broader group of domestic, non-farm transportation workers. In response to comments addressing the effect of the Final Rule on agricultural truck drivers, the Department of Labor merely responded that "the Department views operating semi-trucks hauling commodities over public roads to generally involve the same or similar skills, qualifications, and tasks, whether the commodity is agricultural or nonagricultural in nature." The Department of Labor offered no explanation or analysis with respect to the significant differences in the "work performed, skills, education, training, and credentials" of H-2A workers who drive sugarcane trucks and the non-agricultural workers who fall under the Heavy and Tractor-trailer Truck Driver Standard Occupational Classification code. The Department of Labor discounts the fact that H-2A haulers may be exempt from Commercial

Driver's License requirements: "an H-2A job opportunity requiring a worker to operate semi-trucks with at least 26,001 pounds gross vehicle weight, whether a commercial driver's license is required or not, over public roads . . . would likely result in the [the Department of Labor] assigning SOC code 53-3032 (Heavy and Tractor-Trailer Truck Drivers)" as far as the adverse effect wage rate. The Department of Labor did not address the fact that an H-2A worker with no Commercial Driver's License is qualified to haul sugarcane during the harvest season but would not be qualified to perform other transportation jobs falling under the non-farm Heavy and Tractor-trailer Truck Driver Standard Occupational Classification code. The Department of Labor appears to have grounded its new adverse effect wage rate methodology—at least as it applies to sugarcane truck drivers—solely on the type of equipment used by these workers without considering the broader question of whether the wages and working conditions of one group will have any impact on the wages and working conditions of the other group, which is what Section 1188 requires.

The Department of Labor relied heavily on Standard Occupational Classification codes in justifying an increase in the adverse effect wage rate applicable to sugar cane haulers, yet ignored its own guidance in how workers are categorized under its own Standard Occupational Classification codes. The Department of Labor's Standard Occupational Classification code for "Agricultural Equipment Operators" specifically refers to the tasks performed by H-2A workers who use trucks to haul sugarcane from the field to the mill: "Drive trucks to haul crops, supplies, tools, or farm workers." In contrast, the Standard Occupational Classification code that the Department of Labor contends best applies to these H-2A workers—the Standard Occupational Classification code for "Heavy and Tractor-trailer Truck Drivers"—lists no farm-related tasks similar to the tasks performed by H-2A workers. The Department of Labor's description for the non-farm "Heavy and Tractor-trailer Truck Driver" Standard Occupational Classification code includes an annotation for "related occupations" but lists no farm-related occupations or tasks similar to those performed by H-2A workers who haul sugarcane.

Two earlier District Court cases did not support the Department of Labor's position in the present case. In both cases, the courts rejected claims that the Final Rule exceeded the Department of Labor's authority under Section 1188(a)(1)(B). Both courts relied on *Chevron* and deferred to the Department of Labor's broad reading of Section 1188(a)(1)(B). After *Loper Bright Enterprises*, this deferential standard of review is no longer applicable. Neither court addressed the significant differences between H-2A sugarcane haulers and non-farm heavy and tractor-trailer truck drivers, or the extent to which the wage rates and working conditions of the former have any effect on the latter.

According to the District Court, Plaintiffs demonstrated that they are likely to succeed on the merits of their claim that the Final Rule exceeds the Department of Labor's authority under Section 1188(a)(1)(B) because the Final Rule bases its revised adverse effect wage rate

methodology for H-2A sugarcane truck drivers on the average wages of domestic, non-farm transportation workers who are not similarly employed.

Plaintiffs alternatively argued that, even if the Department of Labor had statutory authority for the Final Rule, the Final Rule is arbitrary and capricious, in violation of section 706(2)(A) of the Administrative Procedure Act, because:

- the Department of Labor failed to sufficiently explain its shift in long-standing policy or practice, and
- regardless of any explanation, the Final Rule's treatment of agricultural heavy truck drivers is unreasonable.

Under the Administrative Procedure Act, courts must set aside "agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[984] Agency action does not violate this standard so long as it is "reasonable and reasonably explained," so long as the agency "has acted within a zone of reasonableness and, in particular, that the agency has reasonably considered the relevant issues and reasonably explained the decision."[985] To act reasonably, the agency "must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[986] Reasoning that "fails to account for relevant factors or evinces a clear error of judgment" must be set aside.[987] In general, an agency action is arbitrary and capricious if

> *the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.*[988]

The reasoning on which an action was based must be articulated by the agency at the time the decision was made, and not developed after the fact.[989]253 The reasoning need not be perfectly clear, but it is sufficient so long as "the agency's path may reasonably be discerned."[990]

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[984] 5 U.S.C. § 706(2)(A).

[985] *BNSF Railway Company v. Federal Railroad Administration*, 62 F.4th 905, 910 (5th Cir. 2023) (*quoting FCC v. Prometheus Radio Project*, 592 U.S. 414, 423 (2021)).

[986] *Id.*. (*quoting Motor Vehicle Manufacturers Association of the United States v. State Farm Mutual Auto. Insurance Co.*, 463 U.S. 29, 43 (1983)).

[987] *Id.*. (*quoting University of Texas M.D. Anderson Cancer Ctr. v. U.S. Dep't of Health & Hum. Servs.*, 985 F.3d 472, 475 (5th Cir. 2021)).

[988] *Id.*. (*quoting State Farm*, 463 U.S. at 43).

[989] *Id.*. (*quoting Texas v. United States*, 40 F.4th 205, 226-27 (5th Cir. 2022)).

[990] *Id.*. (*quoting State Farm*, 463 U.S. at 43).

Here, according to the District Court, the Department of Labor has failed to consider or "reasonably explain" the basis for its decision to calculate the adverse effect wage rate for H-2A workers who drive sugarcane trucks based on the higher average wage rates for non-farm heavy and tractor-trailer truck drivers. The record does not reflect any attempt by the Department of Labor to analyze the differences in the "work performed, skills, education, training, and credentials" of these two groups of workers. The record does not reflect that the Department of Labor analyzed or even considered whether the wages and working conditions of H-2A workers has any effect on the broader, more diverse pool of non-farm heavy and tractor-trailer truck drivers. The Department of Labor appears to focus entirely on the type of equipment used by the two groups of workers. Finally, the Department of Labor appears to ignore its own guidance with respect to the Standard Occupational Classification codes on which it bases the Final Rule. The tasks performed by H-2A sugarcane truck drivers matches the Standard Occupational Classification description for agricultural equipment operators—"Drive trucks to haul crops. . . ." The SOC code on which the Department of Labor bases its revised adverse effect wage rate for this group of workers—Heavy and Tractor-trailer Truck Drivers—lists no farm or agricultural related tasks.

The District Court concluded that Plaintiffs demonstrated a substantial likelihood of success on their claim that the Final Rule is arbitrary and capricious because the record reflects that the Department of Labor failed to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." Plaintiffs have demonstrated a substantial likelihood of success on the merits of their challenge to the Final Rule under the Administrative Procedure Act.

§1.15 Right to Jury Trial.

[1] Securities and Exchange Commission v. Jarkesy (June 2024): Seventh Amendment Gives Citizens A Right To Jury Trial In All Statutory Actions That Are Legal In Nature.

The ability of an administrative agency to impose fines was contested in *Securities and Exchange Commission v. Jarkesy.*[991] an opinion which was released on June 27, 2024. While *Jarkesy* was a securities opinion, advisors are questioning whether *Jarkesy* can require that a jury impose the civil fraud penalty under Section 6663 and other tax penalty provisions.

Jarkesy held that the Seventh Amendment did not permit the Securities and Exchange Commission to impose civil-penalty actions for securities fraud in administrative proceedings.

[991] 603 U.S. 109 (2024).

Instead, the Securities and Exchange Commission must file penalty actions in a federal court where the defendant it entitled to a jury trial. The Seventh Amendment gives citizens a right to jury trial in all "[s]uits at all common law". This right to jury trial applies to all statutory actions that are "legal in nature". The *Jarkesy* court opined "because they tie the availability of civil penalties to the perceived need to punish the defendant rather than to restore the victim, such considerations are legal rather than equitable." The Supreme Court especially emphasized that the penalties imposed by the Securities and Exchange Commission were intended to be punitive rather than seeking merely to restore a prior condition. The penalties were "designed to punish and deter, not to compensate." Punishments must be imposed by a court of law, with a right of trial by jury. The full scope of *Jarkesy* is still to be determined, particularly in the tax area, in which administratively imposed penalties are common. Nevertheless, *Jarkesy* recognized an exception for government prerogatives, such as revenue collection, customs, immigration, public lands administration, and public benefits. *Jarkesy* also recognized a public rights exception for, among other things, relations with Indian tribes, administration of public lands, and granting of public benefits such as payments to veterans, pensions, and patent rights.

One remedy for securities violations is civil penalties. Originally, the Securities and Exchange Commission could obtain civil penalties from unregistered investment advisers only in federal court.

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[992] The Dodd-Frank Act authorized the Securities and Exchange Commission to impose civil fraud penalties through its own in-house administrative proceedings.

Shortly after passage of the Dodd-Frank Act, the Securities and Exchange Commission initiated an enforcement action for civil penalties against investment adviser George Jarkesy, Jr., and his firm, Patriot28, LLC. The proceedings charged alleged violations of the "antifraud provisions" contained in the federal securities laws.

The Securities and Exchange Commission adjudicated the matter in-house without any provision for jury. The final order determined that Mr. Jarkesy and Patriot28 had committed securities violations and levied a civil penalty of $300,000.

Mr. Jarkesy and Patriot28 petitioned for judicial review. The Fifth Circuit in *Jarkesy* vacated the order on the ground that adjudicating the matter in-house violated the defendants' Seventh Amendment right to a jury trial.

The Supreme Court in *Jarkesy* held that when the Securities and Exchange Commission seeks civil penalties against a defendant for securities fraud, the Seventh Amendment entitles the defendant to a jury.

[992] 124 Stat. 1376. See H. R. Rep. No. 111–687 (2010).

Jarkesy poses a straightforward question: whether the Seventh Amendment entitles a defendant to a jury trial when the Securities and Exchange Commission seeks civil penalties against him for securities fraud.[993] The threshold issue was whether this action implicated the Seventh Amendment. According to the Supreme Court, the action in *Jarkesy* did implicate the Seventh Amendment and its requirements for trial by jury.

The Securities and Exchange Commission's antifraud provisions replicate common law fraud. Common law claims must be heard by a jury. The Supreme Court in *Jarkesy* also held that the "public rights" exception did not apply.

A divided panel of the Fifth Circuit in *Jarkesy* granted the Jarkesy and Patriot28 petition and vacated the final order. The Fifth Circuit in *Jarkesy* applied a two-part test from *Granfinanciera, S. A. v. Nordberg.*[994]

The Fifth Circuit panel held that the Security and Exchange Commission's decision to adjudicate the matter in-house without a jury violated Jarkesy's and Patriot28's Seventh Amendment right to a jury trial. The Fifth Circuit panel determined that because these Securities and Exchange Commission antifraud claims were "akin to [a] traditional action[] in debt," a jury trial would be required if this case were brought in an Article III court.

The Fifth Circuit in *Jarkesy* then considered whether the "public rights" exception applied. The "public rights" exception permits Congress, under certain circumstances, to assign an action to an agency tribunal without a jury, consistent with the Seventh Amendment. The Fifth Circuit concluded that the "public rights" exception did not apply. Therefore, the case should have been brought in federal court, where a jury could have found the facts pertinent to the defendants' fraud liability. Based on this Seventh Amendment violation, the panel vacated the final order.

The Fifth Circuit in *Jarkesy* identified two additional constitutional problems.

- First, the Fifth Circuit in *Jarkesy* determined that Congress had violated the nondelegation doctrine by authorizing the Securities and Exchange

[993] The Supreme Court relied on the approach set forth in *Granfinanciera and Tull v. United States*, 481 U. S. 412 (1987). In *Tull*, the Government sued a real estate developer for civil penalties in federal court. The developer responded by invoking his right to a jury trial. The cause of action arose under the Clean Water Act. The Court surveyed early cases to show that the statutory nature of the claim was not legally relevant. "Actions by the Government to recover civil penalties under statutory provisions, historically ha[d] been viewed as [a] type of action in debt requiring trial by jury." *Id.*, at 418–419. To determine whether a suit is legal in nature, the Supreme Court directed courts to consider the cause of action and the remedy it provides. Since some causes of action sound in both law and equity, the Supreme Court concluded that the remedy was the "more important" consideration. *Id.*. at 421.

[994] 492 U. S. 33 (1989).

Commission, without adequate guidance, to choose whether to litigate this action in an Article III court or to adjudicate the matter itself.

- Second, the Fifth Circuit in *Jarkesy* also found that the insulation of the Securities and Exchange Commission ALJs from executive supervision with two layers of for-cause removal protections violated the separation of powers.

The Fifth Circuit in *Jarkesy* denied rehearing *en banc*.[995]

The Seventh Amendment guarantees that in "[s]uits at common law, . the right of trial by jury shall be preserved." The right is not limited to the "common-law forms of action recognized" when the Seventh Amendment was ratified.[996] The term "common law" in the Amendment stands "in contradistinction to equity, and admiralty, and maritime jurisprudence."[997] The Seventh Amendment "embrace[s] all suits which are not of equity or admiralty jurisdiction, whatever may be the peculiar form which they may assume."[998]

The Seventh Amendment extends to a particular statutory claim if the claim is "legal in nature."[999] Whether that claim is statutory is immaterial.[1000] In *Granfinanciera*, the Government sued a real estate developer for civil penalties in federal court. The developer responded by invoking his right to a jury trial. The cause of action arose under the Clean Water Act. The Supreme Court in *Granfinanciera* determined that the statutory nature of the claim was not legally relevant. "Actions by the Government to recover civil penalties under statutory provisions historically ha[d] been viewed as [a] type of action in debt requiring trial by jury."[1001] To determine whether a suit is legal in nature, courts consider the cause of action and the remedy it provides. Since some causes of action sound in both law and equity, the remedy was the "more important" consideration.[1002]

In *Jarkesy*, the remedy is all but dispositive, according to the Supreme Court. For respondents' alleged fraud, the Securities and Exchange Commission sought civil penalties, a form of monetary relief. Monetary relief can be legal or equitable. Money damages are the prototypical common law remedy.[1003] From this, the court determined that the Securities and Exchange Commission action was legal in nature rather than an action in equity. The key was that the Securities and Exchange Commission civil penalties were designed to punish and deter rather than to enforce a public right and to restore the *status quo ante*. What determines whether a monetary remedy is legal is if it is designed to punish or deter the wrongdoer, or, on the

[995] 51 F. 4th 644 (5th Cir. 2022).
[996] *Curtis v. Loether*, 415 U. S. 189, 193 (1974).
[997] *Parsons*, 3 Pet., at 446.
[998] *Id.*, at 447.
[999] *Granfinanciera*, 492 U. S., at 53.
[1000] See 481 U. S., at 414–415, 417–425.
[1001] *Id.*, at 418–419.
[1002] *Id.*, at 421 (brackets and internal quotation marks omitted); see *Id.*, at 418–421.
[1003] *See Mertens v. Hewitt Associates*, 508 U. S. 248, 255 (1993).

other hand, solely to "restore the *status quo*."[1004] "[A] civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment."[1005] While courts of equity could order a defendant to return unjustly obtained funds, only courts of law issued monetary penalties to "punish culpable individuals."[1006] "[C]ivil penalt[ies are] a type of remedy at common law that could only be enforced in courts of law."[1007] The same is true here in *Jarkesy*.

The *Jarkesy* court observed that Securities Exchange Act and the Investment Advisers Act condition the availability of civil penalties on six statutory factors:

- whether the alleged misconduct involved fraud, deceit, manipulation, or deliberate or reckless disregard for regulatory requirements,
- whether it caused harm,
- whether it resulted in unjust enrichment, accounting for any restitution made,
- whether the defendant had previously violated securities laws or regulations, or had previously committed certain crimes,
- the need for deterrence, and
- other "matters as justice may require."[1008]

Several factors concern culpability, deterrence, and recidivism. Because these factors tie the availability of civil penalties to the perceived need to punish the defendant rather than to restore the victim, these considerations are legal rather than equitable.

The Securities Act, the Securities Exchange Act, and the Investment Advisers Act establish three "tiers" of civil penalties.[1009] Violating a federal securities law or regulation exposes a defendant to a first tier penalty. A second tier penalty may be ordered if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard for regulatory requirements. If those acts also resulted in substantial gains to the defendant or losses to another, or created a "significant risk" of the latter, the defendant is subject to a third tier penalty. Each successive tier authorizes a larger monetary sanction.[1010]

Like the considerations that determine the availability of civil penalties in the first place, the criteria that divide these tiers are also legal in nature. Each tier conditions the available penalty on the culpability of the defendant and the need for deterrence, not the size of the

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[1004] *Tull*, 481 U. S., at 422.
[1005] *Austin v. United States*, 509 U. S. 602, 610 (1993).
[1006] *Tull*, 481 U. S., at 422.
[1007] *Id.*
[1008] §§78u–2(c), 80b–3(i)(3).
[1009] See §§77h–1(g)(2), 78u–2(b), 80b–3(i)(2).
[1010] *See id.*

harm that must be remedied. Indeed, showing that a victim suffered harm is not even required to advance a defendant from one tier to the next. Nothing in this analysis turns on "restor[ing] the *status quo*."[1011] These factors show that these civil penalties are designed to be punitive.

The final proof for the *Jarkesy* that the Securities and Exchange Commission penalty remedy was punitive was that the Securities and Exchange Commission is not obligated to return any money to victims.[1012] The Securities and Exchange Commission can choose to compensate injured shareholders from the civil penalties it collects.[1013] The Securities and Exchange Commission is not required to do so.[1014] Such a penalty by definition does not "restore the *status quo*" and can make no pretense of being equitable.[1015] In sum, the civil penalties in *Jarkesy* are designed to punish and deter, not to compensate. They are therefore "a type of remedy at common law that could only be enforced in courts of law."[1016] That conclusion effectively decided that the suit in *Jarkesy* implicates the Seventh Amendment right, and that a defendant would be entitled to a jury on these claims.[1017]

The close relationship between the causes of action in *Jarkesy* and common law fraud confirmed for the Supreme Court in *Jarkesy* the conclusion that the civil securities fraud remedy is punitive. Both target the same basic conduct: misrepresenting or concealing material facts. Congress deliberately used "fraud" and other common law terms of art in the Securities Act, the Securities Exchange Act, and the Investment Advisers Act. Congress incorporated prohibitions from common law fraud into federal securities law. The Securities and Exchange Commission has followed suit in rulemakings. Rule 10b–5, for example, prohibits "any device, scheme, or artifice to defraud," and "engag[ing] in any act . . . which operates or would operate as a fraud."[1018] Congress' decision to draw upon common law fraud created an enduring link between federal securities fraud and its common law "ancestor." Federal securities fraud and common law fraud are not identical. In some respects, federal securities fraud is narrower. Federal securities law does not "convert every common-law fraud that happens to involve securities into a violation."[1019] Federal securities law targets only certain subject matter and certain disclosures. In other respects, federal securities fraud is broader. Federal securities fraud employs the burden of proof typical in civil cases. The common law analogue traditionally used a more stringent standard. Courts have not typically interpreted federal securities fraud to require a showing of harm to be actionable by the Securities and Exchange

[1011] *Tull*, 481 U. S., at 422.
[1012] *See Id.*, at 422–423.
[1013] *See* 15 U. S. C. §7246(a).
[1014] 17 CFR §201.1100.
[1015] *Tull*, 481 U. S., at 422.
[1016] *IbId.*
[1017] *See Id.*, at 421–423.
[1018] 17 CFR § 240.10b–5(a), (c).
[1019] *SEC v. Zandford*, 535 U. S. 813, 820 (2002).

Commission.[1020] Nevertheless, the close relationship between federal securities fraud and common law fraud confirmed for the Supreme Court in *Jarkesy* that this action was "legal in nature."[1021]

The Government argued in *Jarkesy* that a jury trial for imposing civil securities fraud penalties is not required because the "public rights" exception applies. Under this exception and consistent with the Seventh Amendment, Congress may assign the matter for decision to an agency without a jury. The Supreme Court found that *Jarkesy* did not fall within the "public rights" exception, so Congress may not avoid a jury trial by preventing the case from being heard before an Article III tribunal.

The Constitution prohibits Congress from "withdraw[ing] from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law."[1022] Once such a suit "is brought within the bounds of federal jurisdiction," an Article III court must decide it, with a jury if the Seventh Amendment applies.[1023] "Under 'the basic concept of separation of powers . . . that flow[s] from the scheme of a tripartite government' adopted in the Constitution, 'the judicial Power of the Court the United States'" cannot be shared with the other branches.[1024]

Matters concerning private rights may not be removed from Article III courts.[1025] A hallmark that the courts have looked to in determining if a suit concerns private rights is whether suit "is made of 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789.'"[1026] If a suit is in the nature of an action at common law, then the matter presumptively concerns private rights. Adjudication by an Article III court is mandatory.[1027]

A class of cases concern "public rights." Such matters "historically could have been determined exclusively by [the executive and legislative] branches,"[1028] even when they were "presented in such form that the judicial power [wa]s capable of acting on them,"[1029] In contrast to common law claims, no involvement by an Article III court in the initial adjudication is necessary in such a case.

[1020] *See, e.g., Blavin*, 760 F. 2d, at 711; *SEC v. Life Partners Holdings, Inc.*, 854 F. 3d 765, 779 (CA5 2017).

[1021] *Granfinanciera*, 492 U. S., at 53.

[1022] *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 284 (1856).

[1023] *Stern v. Marshall*, 564 U. S. 462, 484 (2011).

[1024] *Id.*, at 483 (*quoting United States v. Nixon*, 418 U. S. 683, 704 (1974); alteration in original).

[1025] *Murray's Lessee*, 18 How., at 284; *Granfinanciera*, 492 U. S., at 51–52; Stern, 564 U. S., at 484.

[1026] *Id.*, at 484 (*quoting Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U. S. 50, 90 (1982) (Rehnquist, J., concurring in judgment)).

[1027] *Stern*, 564 U. S., at 484.

[1028] *Id.*, at 493 (internal quotation marks omitted).

[1029] *Murray's Lessee*, 18 How., at 284.

The decision that first recognized the public rights exception was *Murray's Lessee.*[1030] A federal customs collector failed to deliver public funds to the Treasury. The Government issued a "warrant of distress" to compel him to produce the withheld sum.[1031] The Government eventually seized and sold a plot of the collector's land.[1032] Plaintiffs later attacked the purchaser's title. Plaintiffs argued that the initial seizure was void because the Government had audited the collector's account and issued the warrant itself without judicial involvement.[1033] The *Murray's Lessee* Court upheld the sale. Pursuant to its power to collect revenue, the Government could rely on "summary proceedings" to compel its officers to "pay such balances of the public money" into the Treasury "as may be in their hands."[1034] The *Murray's Lessee* Court observed, there was an unbroken tradition of using these kinds of proceedings to "enforce payment of balances due from receivers of the revenue."[1035] In light of this historical practice, the Government could issue a valid warrant without intruding on the domain of the Judiciary.[1036] The challenge to the sale thus lacked merit.

In *Oceanic Steam Navigation Co. v. Stranahan*[1037] the court considered the imposition of a monetary penalty on a steamship company. Congress had excluded immigration by aliens afflicted with "loathsome or dangerous contagious diseases." Congress authorized customs collectors to enforce the prohibition with fines.[1038] When a steamship company challenged the penalty under Article III, the Supreme Court upheld the penalty. Congress' power over foreign commerce was so total that no party had a "'vested right'" to import anything into the country. Congress could also prohibit immigration by certain classes of persons and enforce those prohibitions with administrative penalties assessed without a jury.

In *Ex parte Bakelite Corp.*, the Supreme Court upheld a law authorizing the President to impose tariffs on goods imported by "unfair methods of competition."[1039] The law permitted the President to set whatever tariff was necessary, subject to a statutory cap, to produce competition. If the President was "satisfied the unfairness [was] extreme," the law even authorized the President to "exclude[]" foreign goods entirely.[1040] Because the political branches had traditionally held exclusive power over this field and had exercised this power, the assessment of tariffs did not implicate Article III.[1041]

[1030] *Murray's Lessee*, 18 How.
[1031] *Murray's Lessee v. Hoboken Land & Improvement Co.*, 18 How. 272, 284 (1856).
[1032] *Id.*, at 274.
[1033] *Id.*, at 275.
[1034] *Id.*, at 281, 285.
[1035] *Id.*, at 278; see *Id.*, at 281.
[1036] See *Id.*, at 280–282.
[1037] 214 U. S. 320 (1909).
[1038] *Id.*, at 331–334.
[1039] 279 U. S. 438, 446 (1929).
[1040] *Id.*
[1041] *Id.*, at 458, 460–461, 49 S.Ct. 411.

Certain other historic categories of adjudications fall within the "public rights" exception, including:

- relations with Indian tribes,[1042]
- the administration of public lands,[1043] and
- the granting of public benefits such as payments to veterans,[1044] pensions,[1045], and patent rights.[1046]

The public rights exception is an "area of frequently arcane distinctions and confusing precedents."[1047] The Court "has not 'definitively explained' the distinction between public and private rights," and we do not claim to do so today.[1048]

The public rights exception is an exception. It has no textual basis in the Constitution. The public rights exception derives from background legal principles.

Murray's Lessee justified the application of the public rights exception by explaining that the public rights exception flowed from centuries-old rules concerning revenue collection by a sovereign.[1049] From the beginning the Supreme Court has emphasized: "To avoid misconstruction upon so grave a subject, we think it proper to state that we do not consider Congress can . . . withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty."[1050] The Supreme Court has never embraced the proposition that "practical" considerations alone can justify extending the scope of the public rights exception to such matters. "[E]ven with respect to matters that arguably fall within the scope of the 'public rights' doctrine, the presumption is in favor of Article III courts."[1051] "Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decisionmaking if the other branches of the Federal Government could confer the Government's 'judicial Power' on entities outside Article III."[1052]

The Supreme Court earlier determined in *Granfinanciera* that the Seventh Amendment guarantees the right to a jury trial "in the face of Congress' decision to allow a non-Article III

[1042] *See United States v. Jicarilla Apache Nation*, 564 U.S. 162 (2011).

[1043] *Crowell v. Benson*, 285 U.S. 22, 51 (1932).

[1044] *Id.*

[1045] *Id.*

[1046] *United States v. Duell*, 172 U.S. 576, 582–583, (1899).

[1047] *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 583, (1985) (internal quotation marks omitted).

[1048] *Oil States Energy Services, LLC v. Greene's Energy Group*, LLC, 584 U.S. 325, 334, (2018).

[1049] See 18 How. at 281–285.

[1050] *Murray's Lessee*, 18 How. at 284.

[1051] *Northern Pipeline Constr. Co.*, 458 U.S. at 69, n. 23, *citing Glidden Co. v. Zdanok*, 370 U.S. 530, 548–549, and n. 21.

[1052] Stern, 564 U.S. at 484.

tribunal to adjudicate" a statutory "fraud claim."[1053] *Granfinanciera* involved a statutory action for fraudulent conveyance. As codified in the Bankruptcy Code, the claim permitted a trustee to void a transfer or obligation made by the debtor before bankruptcy if the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation."[1054] Actions for fraudulent conveyance were well known at common law.[1055] Even when Congress added these claims to the Bankruptcy Code in 1978, Congress preserved parties' rights to a trial by jury. In 1984, however, Congress designated fraudulent conveyance actions "core [bankruptcy] proceedings" and authorized non-Article III bankruptcy judges to hear them without juries.

The issue in *Granfinanciera* was whether this designation was permissible under the public rights exception. The Supreme Court in *Granfinanciera* concluded that this designation was not permissible under the public rights exception. Although Congress had assigned fraudulent conveyance claims to bankruptcy courts, that assignment was not dispositive. What mattered was the substance of the suit. "[T]raditional legal claims" must be decided by courts, "whether they originate in a newly fashioned regulatory scheme or possess a long line of common-law forebears." To determine whether the claim implicated the Seventh Amendment, the Court in *Granfinanciera* examined whether the matter was "from [its] nature subject to 'a suit at common law.'" A survey of English cases showed that "actions to recover . . . fraudulent transfers were often brought at law in late 18th-century England." The remedy that the trustee sought in these cases was also one "traditionally provided by law courts." Fraudulent conveyance actions were thus "quintessentially suits at common law."

The Supreme Court in *Granfinanciera* considered whether these actions were "closely intertwined" with the bankruptcy regime. The Supreme Court in *Granfinanciera* concluded that these actions were not "closely intertwined" with the bankruptcy process. The court in *Granfinanciera* also noted that Congress had already authorized jury trials for certain bankruptcy matters, demonstrating that jury trials were not generally "incompatible" with the overall regime. The Supreme Court in *Granfinanciera* concluded that fraudulent conveyance actions were akin to "suits at common law" and were not inseparable from the bankruptcy process. The public rights exception therefore did not apply, and a jury was required.

Notwithstanding *Granfinanciera*, the Securities and Exchange Commission in *Jarkesy* contended that the public rights exception still applied in the case because Congress created "new statutory obligations, impose[d] civil penalties for their violation, and then commit[ted] to an administrative agency the function of deciding whether a violation ha[d] in fact occurred."

[1053] 492 U.S. at 37, 50.

[1054] 11 U.S.C. § 548(a)(2)(A) (1982 ed., Supp. V).

[1055] 492 U.S. at 43.

According to the Supreme Court in *Jarkesy*, Congress cannot "conjure away the Seventh Amendment by mandating that traditional legal claims be . . . taken to an administrative tribunal."[1056] The fact that the Securities and Exchange Commission action "originate[d] in a newly fashioned regulatory scheme" did not permit Congress to siphon the current action away from an Article III court. The constructive fraud claim in *Granfinanciera* was also statutory, but the Supreme Court in *Granfinanciera* nevertheless explained that the public rights exception did not apply. If the action resembles a traditional legal claim, its statutory origins are not dispositive.

The Supreme Court earlier clarified that the Seventh Amendment does apply to novel statutory regimes, so long as the claims are akin to common law claims.[1057] The public rights exception does not apply automatically whenever Congress assigns a matter to an agency for adjudication. When a matter "from its nature, is the subject of a suit at the common law," Congress may not "withdraw [it] from judicial cognizance."[1058]

The "public rights" exception to Article III jurisdiction has been held to permit Congress to assign certain matters to agencies for adjudication even though such proceedings would not afford the right to a jury trial. The public rights exception did not apply in *Jarkesy* because the action that did not fall within any of the distinctive areas involving governmental prerogatives where the Court has concluded that a matter may be resolved outside of an Article III court, without a jury. The Seventh Amendment therefore applies and a jury is required.

Congress "embedded" the right to jury trial in the Constitution, securing it "against the passing demands of expediency or convenience."[1059] Since then, "every encroachment upon it has been watched with great jealousy."[1060] The Seventh Amendment guarantees that in "[s]uits at common law, . the right of trial by jury shall be preserved." The right is not limited to the "common-law forms of action recognized" when the Seventh Amendment was ratified.[1061] The Seventh Amendment used the term "common law" "in contradistinction to equity, and admiralty, and maritime jurisprudence."[1062] The Seventh Amendment "embrace[s] all suits which are not of equity or admiralty jurisdiction, whatever may be the peculiar form which they may assume."[1063] The Seventh Amendment extends to a particular statutory claim

[1056] 492 U.S. at 52.
[1057] *Tull v. United States.* 481 U.S. 412.
[1058] *Murray's Lessee*, 18 How. at 284.
[1059] *Reid v. Covert*, 354 U.S. 1, 10 (1957).
[1060] *Parsons v. Bedford*, 3 Pet. 433, 28 U.S. 433 (1830).
[1061] *Curtis v. Loether*, 415 U.S. 189, 193, (1974).
[1062] *Parsons*, 3 Pet. at 446.
[1063] *Id.*. at 447.

if the claim is "legal in nature."[1064] Whether that claim is statutory is immaterial to this analysis.[1065]

In this case, the penalty remedy is all but dispositive. For respondents' alleged fraud, the Securities and Exchange Commission seeks monetary relief in the form of civil penalties. While monetary relief can be legal or equitable, money damages are the prototypical common law remedy. What determines whether a monetary remedy is legal is if it is designed to punish or deter the wrongdoer, or, on the other hand, solely to "restore the status quo."[1066] "[A] civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment."[1067] While courts of equity could order a defendant to return unjustly obtained funds, only courts of law issued monetary penalties to "punish culpable individuals."[1068] "[C]ivil penalt[ies are] a type of remedy at common law that could only be enforced in courts of law."[1069]

The Supreme Court has also recognized a class of cases concerning "public rights." Such matters "historically could have been determined exclusively by [the executive and legislative] branches," even when they were "presented in such form that the judicial power [wa]s capable of acting on them,"[1070] In contrast to common law claims, no involvement by an Article III court in the initial adjudication is necessary in such a case.

In *Murray's Lessee*, a federal customs collector failed to deliver public funds to the Treasury. The Government issued a "warrant of distress" to compel him to produce the withheld sum. Pursuant to the warrant, the Government eventually seized and sold a plot of the collector's land. Plaintiffs later attacked the purchaser's title, arguing that the initial seizure was void because the Government had audited the collector's account and issued the warrant itself without judicial involvement.

The Court upheld the sale. It explained that pursuant to its power to collect revenue, the Government could rely on "summary proceedings" to compel its officers to "pay such balances of the public money" into the Treasury "as may be in their hands."[1071]Indeed, the Court observed, there was an unbroken tradition—long predating the founding—of using these kinds of proceedings to "enforce payment of balances due from receivers of the revenue."[1072] The Government could issue a valid warrant without intruding on the domain of the Judiciary. The challenge to the sale thus lacked merit.

[1064] *Granfinanciera*, 492 U.S. at 53, 109 S.Ct. 2782.
[1065] See 481 U.S. at 414–415, 417–425.
[1066] Tull, 481 U.S. at 422.
[1067] *Austin v. United States*, 509 U.S. 602, 610 (1993).
[1068] *Tull*, 481 U.S. at 422, 107 S.Ct. 1831.
[1069] *Id.*
[1070] *Murray's Lessee*, 18 How. at 284.
[1071] *Id.*, at 281, 285.
[1072] *Id.*. at 278; see *id.* at 281.

This principle of the public rights exception to right to jury trial before imposition of monetary penalties extends beyond cases involving the collection of revenue. *Oceanic Steam Navigation Co. v. Stranahan*[1073] considered the imposition of a monetary penalty on a steamship company. Congress had excluded immigration by aliens afflicted with "loathsome or dangerous contagious diseases." Congress authorized customs collectors to enforce the prohibition with fines. When a steamship company challenged the penalty under Article III, the Supreme Court upheld the penalty. Congress' power over foreign commerce was so total that no party had a "'vested right' to import anything into the country. Congress could also prohibit immigration by certain classes of persons and enforce those prohibitions with administrative penalties assessed without a jury.

In Ex parte Bakelite Corp., the Supreme we upheld a law authorizing the President to impose tariffs on goods imported by "unfair methods of competition."[1074] The law permitted him to set whatever tariff was necessary, subject to a statutory cap, to produce fair competition. If the President was "satisfied the unfairness [was] extreme," the law authorized him to "exclude[ ]" foreign goods entirely. Because the political branches had traditionally held exclusive power over this field and had exercised it, the assessment of tariffs did not implicate Article III.

Certain other historic categories of adjudications fall within the public rights exception. These include

- relations with Indian tribes,[1075]
- the administration of public lands,[1076]and
- the granting of public benefits such as payments to veterans, *ibid.*, pensions, *ibid.*, and patent rights,[1077]

Opinions governing the public rights exception have not always spoken in precise terms. This is an "area of frequently arcane distinctions and confusing precedents."[1078] The Court "has not 'definitively explained' the distinction between public and private rights." Nevertheless, since *Murray's Lessee*, the Supreme Court has typically evaluated the legal basis for the assertion of the doctrine with care. The public rights exception is an exception. The public rights exception has no textual basis in the Constitution. The public rights exception must derive instead from background legal principles. Murray's Lessee itself took pains to justify the application of the exception in that particular instance by explaining that it flowed from centuries-old rules concerning revenue collection by a sovereign. The Supreme Court

[1073] 214 U.S. 320 (1909),
[1074] 279 U.S. 438, 446 (1929).
[1075] *United States v. Jicarilla Apache Nation*, 564 U.S. 162, 174(2011).
[1076] *Crowell v. Benson*, 285 U.S. 22 (1932).
[1077] *United States v. Duell*, 172 U.S. 576 (1899).
[1078] *Thomas v. Union Carbide Agricultural Products Co.*, 473 U.S. 568, 583 (1985).

has emphasized: "To avoid misconstruction upon so grave a subject, we think it proper to state that we do not consider Congress can . . . withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty."[1079] The Supreme Court has never embraced the proposition that "practical" considerations alone can justify extending the scope of the public rights exception to such matters. "[E]ven with respect to matters that arguably fall within the scope of the 'public rights' doctrine, the presumption is in favor of Article III courts."[1080] "Article III could neither serve its purpose in the system of checks and balances nor preserve the integrity of judicial decisionmaking if the other branches of the Federal Government could confer the Government's 'judicial Power' on entities outside Article III."[1081]

The Securities and Exchange Commission asserted in *Jarkesy* that the public rights exception still applied in *Jarkesy* because Congress created "new statutory obligations, impose[d] civil penalties for their violation, and then commit[ted] to an administrative agency the function of deciding whether a violation ha[d] in fact occurred."

Congress cannot "conjure away the Seventh Amendment by mandating that traditional legal claims be . . . taken to an administrative tribunal."[1082] The fact that the SEC action "originate[d] in a newly fashioned regulatory scheme" did not permit Congress to siphon this action away from an Article III court. If the action resembles a traditional legal claim, its statutory origins are not dispositive.

A defendant facing a fraud suit has the right to be tried by a jury of his peers before a neutral adjudicator.

§1.16 Major Questions.

[1] Mayes V. Biden (April 2023): Executive Order Did Not Violate Major Questions Doctrine.

Mayes v. Biden[1083] involved a challenge to the validity of President Biden's Executive Order 13991 requiring federal contractors' and subcontractors' employees to be vaccinated against COVID-19. The United States District Court for the District of Arizona granted the

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[1079] *Murray's Lessee*, 18 How. at 284.

[1080] *Northern Pipeline Constr. Co.*, 458 U.S. at 69, n. 23 (c*iting Glidden Co. v. Zdanok*, 370 U.S. 530, 548–549, and n. 21 (1962).

[1081] *Stern*, 564 U.S. at 484.

[1082] 492 U.S. at 52.

[1083] 67 F.4th 921 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023).

plaintiffs' motion for permanent injunction, and federal government appealed. The Court of Appeals held that:

- the major questions doctrine did not apply in evaluating executive order;
- the executive order did not violate major questions doctrine;
- the executive order fell within scope of President's authority under Procurement Act;
- the executive order did not violate nondelegation doctrine;
- neither federalism nor state sovereignty concerns barred the executive order;
- the task force created by executive order was not executive "agency" subject to Procurement Policy Act's procedural requirements;
- the Federal Acquisition Regulation Council memorandum was not subject to the Procurement Policy Act's notice-and-comment requirements; and
- the acting Office of Management and Budget director properly invoked Procurement Policy Act's waiver of its notice-and comment provisions.

Mayes addressed the lawfulness of the federal contractor COVID-19 vaccine mandate. *Mayes* concluded that the Federal Property and Administrative Services Act provided the President with the authority to issue the COVID-19 vaccine mandate.[1084] The Ninth Circuit later vacated as moot the opinion in *Mayes v. Biden.*[1085]

The Office of Federal Procurement Policy Act[1086] states that a "procurement policy, regulation, procedure, or form . . . may not take effect until 60 days after it is published for public comment in the Federal Register" if it "relates to the expenditure of appropriated funds" and either "has a significant effect beyond the internal operating procedures of the agency issuing the policy, regulation, procedure, or form" or "has a significant cost or administrative impact on contractors or offerors."[1087] The Procurement Policy Act's requirements apply to specific "executive agenc[ies]."[1088] "If urgent and compelling circumstances make compliance with the [notice and comment] requirements impracticable," the officer authorized to issue the procurement policy may waive notice and comment.[1089]

President Joseph Biden issued Executive Order 13,991, establishing the Safer Federal Workforce Task Force. Executive Order 13,991 charged the Task Force with "provid[ing] ongoing guidance to heads of agencies on the operation of the Federal Government, the safety

[1084] *Id.*. at 940.
[1085] 67 F.4th 921 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023).
[1086] 41 U.S.C. § 1707
[1087] 41 U.S.C. § 1707(a)(1).
[1088] 41 U.S.C. § 1707(c)(1).
[1089] 41 U.S.C. § 1707(d).

of its employees, and the continuity of Government functions during the COVID-19 pandemic."

The Office of Federal Procurement Policy is part of the Office of Management and Budget Congress has authorized it to "provide overall direction of Government-wide procurement policies . . . and promote economy, efficiency, and effectiveness in the procurement of property and services."[1090]

Congress created the Federal Acquisition Regulatory Council.[1091] The Administrator of the Office of Federal Procurement Policy chairs the Federal Acquisition Regulatory Council and provides guidance on how agencies should obtain full and open competition in contracting.[1092] The Federal Acquisition Regulatory Council promulgates the Federal Acquisition Regulation,[1093] which contains standard provisions that are included in certain government contracts.

In response to the COVID pandemic, President Joseph Biden issued an executive order requiring federal contractors' employees to be vaccinated if they worked on or in connection with federal government contracts or worked in the same workplace as these employees.

Mayes v. Biden centered on four documents that together comprise the Contractor Mandate:

- the Executive Order,
- the Safer Federal Workforce Task Force Guidance,
- the Office of Management and the Budget Determination, and
- the Federal Acquisition Regulatory Council Guidance.

In September 2021, President Biden issued Executive Order 14,042, Ensuring Adequate COVID Safety Protocols for Federal Contractors. The Executive Order was issued pursuant to the Procurement Act to "promote[] economy and efficiency in Federal procurement by ensuring that the parties that contract with the Federal Government provide adequate COVID-19 safeguards to their workers performing on or in connection with a Federal Government contract or contract-like instrument."[1094]

The Executive Order directs executive agencies subject to the Procurement Act to include, in qualifying federal contracts, a clause requiring contractors to comply with guidance that would subsequently be issued by the Safer Federal Workforce Task Force. The Executive

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[1090] 41 U.S.C. § 1101(b).
[1091] 41 U.S.C. § 1302(a).
[1092] See 41 U.S.C. §§ 1121, 1122(a)(1)–(2), 1302(b).
[1093] 41 U.S.C. §§ 1303.
[1094] 67 F.4th 926 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023).

Order states that, the Office of Management and the Budget Director "shall, as an exercise of the delegation of my authority under the [Procurement] Act, see 3 U.S.C. § 301, determine whether such Guidance will promote economy and efficiency in Federal contracting if adhered to by Government contractors." The Executive Order further instructs the Federal Acquisition Regulatory Council to amend the Federal Acquisition Regulation to include the same COVID-19 safety clause. The Executive Order states that "agencies are strongly encouraged, to the extent permitted by law," to seek to modify existing contracts to include the COVID-19 safety clause.

The Safer Federal Workforce Task Force issued its initial guidance for federal contractor and subcontractor work locations. The guidance was later updated and states, in relevant part:

> *Covered contractors must ensure that all covered contractor employees are fully vaccinated for COVID-19, unless the employee is legally entitled to an accommodation. Covered contractor employees must be fully vaccinated no later than January 18, 2022. After that date, all covered contractor employees must be fully vaccinated by the first day of the period of performance on a newly awarded covered contract, and by the first day of the period of performance on an exercised option or extended or renewed contract when the clause has been incorporated into the covered contract.* [1095]

The State of Arizona and then-Attorney General Mark Brnovich filed a lawsuit challenging the Executive Order. Once the scope of the Contractor Mandate became clear, Arizona amended its complaint to also challenge the Safer Federal Workforce Task Force Guidance, Office of Management and the Budget Determination, and Federal Acquisition Regulatory Council Guidance, and filed a motion for a preliminary injunction. All plaintiffs filed a renewed motion for a preliminary injunction with the Second Amended Complaint.

The district court issued an order granting plaintiffs' request for a preliminary injunction. [1096]

The district court first held that Arizona had standing to challenge the Contractor Mandate because of its proprietary interests (its contracts with the federal government) and its sovereign interests (its own vaccination policies).

Next, the district court concluded that the Contractor Mandate exceeded the President's statutory authority under the Procurement Act. The district court reasoned that allowing the Mandate to go into effect would allow the President to enact any policy, "no

[1095] Safer Federal Workforce Task Force, COVID-19 Workplace Safety: Guidance for Federal Contractors and Subcontractors 5 (updated Nov. 10, 2021) ("Safer Federal Workforce Task Force Guidance").

[1096] *See generally Brnovich v. Biden*, 562 F. Supp. 3d 123 (D. Ariz. 2022).

matter how tenuous[ly]" connected to "the broad goals of achieving economy and efficiency in federal procurement."[1097]

The district court concluded that the Contractor Mandate is a public health measure, not a procurement policy. The district court held that the Procurement Act does not clearly authorize the passage of such a measure, because "[w]e expect Congress to speak clearly when authorizing [the executive branch] to exercise powers of 'vast economic and political significance.'"[1098]

The district court then concluded that, as many Arizona agencies are federal contractors, Arizona would suffer irreparable harm from implementing the Contractor Mandate in the form of (1) lost contracts, funds, and employees; (2) "compliance and monitoring costs"; and (3) the purported conflict between the Mandate and Arizona's vaccination laws.

The district court found that the balance of harms and public interest weighed in favor of an injunction because "issuing an injunction here would do [the government] little harm" as the President could "recommend vaccination among contractors" rather than mandating it.

[1097] *Id.* at 152. The Safer Federal Workforce Task Force Guidance defines "covered contractor employee" as "any full-time or part-time employee of a covered contractor working on or in connection with a covered contract or working at a covered contractor workplace." The definition extends to employees who were "not themselves working on or in connection with a covered contract." A "covered contractor workplace" excludes a covered employee's residence but encompasses any location "controlled by a covered contractor at which any employee of a covered contractor working on or in connection with a covered contract is likely to be present during the period of performance for a covered contract." The Safer Federal Workforce Task Force Guidance includes exceptions for otherwise-covered employees who are not vaccinated against COVID-19 because of a disability (including medical conditions) or a "sincerely held religious belief, practice, or observance." The Acting Office of Management and the Budget Director—exercising power delegated under Section 2(c) of the Executive Order—determined that the Safer Federal Workforce Task Force Guidance would promote economy and efficiency in federal contracting. The Acting Office of Management and the Budget Director reasoned that the Safer Federal Workforce Task Force Guidance would "decrease the spread of COVID-19, which will in turn decrease worker absence, save labor costs on net, and thereby improve efficiency in Federal contracting." The Office of Management and the Budget Determination also explained how COVID-19 infections "impose[ ] significant costs on contractors and the federal government," and how vaccination against COVID-19 "reduces net costs." The Federal Acquisition Regulatory Council issued guidance on how to include the COVID-19 safety clause in new contracts and solicitations. The Federal Acquisition Regulatory Council Guidance included a sample clause that implements the COVID-19 vaccination requirement.

[1098] *Id.* at 153 (*quoting Alabama Ass'n of Realtors v. Dep't of Health & Human Servs.*, —— U.S. ——, 141 S. Ct. 2485, 2489, 210 L.Ed.2d 856 (2021) (*per curiam*)).

The district court rejected Arizona's proposal for a nationwide injunction, reasoning that "[e]quitable remedies should redress only the injuries sustained by a particular plaintiff in a particular case."[1099]

The district court issued a permanent injunction barring the federal government from enforcing the Contractor Mandate in any contract (i) "to which a contracting party [was] domiciled in or headquartered in the State of Arizona" or (ii) "to be performed principally in the State of Arizona." The court also issued a final judgment pursuant to Federal Rule of Civil Procedure 54(b). The federal government appealed.

The Ninth Circuit reviewed the district court's decision to grant a permanent injunction for abuse of discretion. The Ninth Circuit reviewed under three standards: "factual findings for clear error, legal conclusions de novo, and the scope of the injunction for abuse of discretion."[1100]

The Ninth Circuit held that the major questions doctrine did not apply.

The major questions doctrine does not apply to actions by the President.

In its current form, the major questions doctrine requires "Congress to speak clearly if it wishes to assign to an agency decisions of vast 'economic and political significance.'"[1101] According to the Ninth Circuit, there is no relevant agency action here.

Through the Procurement Act, Congress delegated to the President the authority to "prescribe policies and directives that the President considers necessary" to "provide the Federal Government with an economical and efficient system" for "[p]rocuring . . . property and nonpersonal services, and performing related functions including contracting."[1102]

The major questions doctrine is motivated by skepticism of agency interpretations that "would bring about an enormous and transformative expansion in . . . regulatory authority without clear congressional authorization."[1103] Those concerns are not implicated here as the President "does not suffer from the same lack of political accountability that agencies may, particularly when the President acts on a question of economic and political significance."[1104]

Article II of the Constitution provides that "[t]he executive Power shall be vested in a President," who must "take Care that the Laws be faithfully executed."[1105] "[T]he Framers

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[1099] *See id.* at 166–67.

[1100] *United States v. Washington*, 853 F.3d 946, 962 (9th Cir. 2017).

[1101] *Util. Air. Regul. Grp. v. EPA*, 573 U.S. 302 (2014) (*quoting FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 160 (2000)).

[1102] 40 U.S.C. §§ 101, 121.

[1103] 573 U.S. at 324.

[1104] *Georgia v. President of the United States*, 46 F.4th 1283, 1313 (11th Cir. 2022) (Anderson, J., concurring in part and dissenting in part); *see also Louisiana v. Biden*, 55 F.4th 1017, 1038 (5th Cir. 2022). (Graves, J., dissenting).

[1105] U.S. Const. art. II, §§ 1–3.

made the President the most democratic and politically accountable official in Government."[1106] This accountability is ensured through regular elections and "the solitary nature of the Executive Branch, which provides 'a single object for the jealousy and watchfulness of the people.'" [1107]

First, the President's actions must be authorized by and consistent with the Procurement Act.

Second, the Constitution always provides checks on all branches of government. If the court were to determine that the major questions doctrine prevents the President from exercising lawfully delegated power, it would be rewriting the Constitution's Faithfully Executed Clause in a way never contemplated by the Framers.

Three other circuits had concluded that the Major Questions Doctrine applies to Presidential action.

The Sixth Circuit never squarely had addressed its reasoning for treating Presidential action the same as agency action.[1108]

The lead opinion from the Eleventh Circuit—while not labeling its analysis as pursuant to the major questions doctrine—discussed the "statutory parameters" of contracting for agencies, but never discussed how or why such constraints apply to the President.[1109]

In its opinion upholding a preliminary injunction enjoining the Contractor Mandate, the Fifth Circuit similarly held that "delegations to the President and delegations to an agency should be treated the same under the major questions doctrine" because the Constitution "makes a single President responsible for the actions of the Executive Branch."[1110]

The Supreme Court treats agencies as different from the President.[1111] The Supreme Court does not assume that the President is limited in the performance of his duties. The

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[1106] *Seila L. LLC v. Consumer Fin. Prot. Bureau*, —— U.S. ——, 140 S. Ct. 2183, 2203, 207 L.Ed.2d 494 (2020).

[1107] *Id.*. (*quoting The Federalist* No. 70, at 479 (A. Hamilton) (J. Cooke ed., 1961).

[1108] See *Kentucky v. Biden*, 23 F.4th 585, 606–08 (6th Cir. 2022) (relying on circuit precedent involving the Occupational Safety & Health Administration to equate Congressional requirements for agency action with those for Presidential action).

[1109] See *Georgia v. President of the United States*, 46 F.4th 1283, 1295–97 (11th Cir. 2022).

[1110] *Louisiana v. Biden*, 55 F.4th 1017, 1031 n.40 (5th Cir. 2022).

[1111] *See, e.g., Free Enter. Fund*, 561 U.S. at 513–14 (holding that the structure of an independent agency violated the Constitution because the President, who is "accountable to the people for executing the laws," lacked the ability to hold the independent agency accountable).

Supreme Court instead requires an "express statement" to find that Congress meant to subject the President's actions to additional scrutiny.[1112]

It is perhaps for these reasons that, before other circuits enjoined the Contractor Mandate, the Major Questions Doctrine had "never been applied to the exercise of power by the President."[1113] The Ninth Circuit found that the major questions doctrine does not apply to Presidential actions and therefore does not bar the Contractor Mandate.

According to the Ninth Circuit, even if the major questions doctrine applied to Presidential actions, it would still not preclude the Contractor Mandate. Arizona initially argued that the Doctrine applies here because the Contractor Mandate satisfies what Arizona described as the Doctrine's three "independent triggers": the Major Questions Doctrine −

- involves "a matter of great 'political significance,'"
- "seeks to regulate 'a significant portion of the American economy," and
- "'intrud[es] into an area that is the particular domain of state law,'" (*i.e.*, compulsory vaccination mandates.
- Arizona relied on Justice Gorsuch's concurrence in West Virginia in advancing this position.[1114]

The majority in *West Virginia* described the effect of the "the Environmental Protection Agency action in that case as "restructur[ing] the American energy market" because it "represent[ed] a 'transformative expansion in [its] regulatory authority.'"[1115] The Ninth Circuit said that it did not read that sentence to mean that restructuring a sector or seeking to regulate a significant portion of the American economy is sufficient by itself to trigger the major questions doctrine. Even if that were sufficient, according to the Ninth Circuit, no part of the Contractor Mandate represents an "enormous and transformative expansion in . . . regulatory authority."[1116]

The Contractor Mandate is not an exercise of regulatory authority at all, according to the court in in *Mayes v. Biden*.[1117] The Contractor Mandate is an exercise of proprietary authority. The district court concluded that the Mandate is a regulatory public health measure,

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[1112] *Cf. Franklin v. Massachusetts*, 505 U.S. 788, 800–01 (1992) (declining to consider the President an "agency" under the Administrative Procedure Act because Congress did not explicitly subject his actions to review under the statute).

[1113] *Georgia v. President of the United States*, 46 F.4th 1283, 1314 (11th Cir. 2022).

[1114] *West Virginia v. Environmental Protection Agency*, —— U.S. ——, 142 S. Ct. 2587, 2620–21 (2022) (Gorsuch, J., concurring).

[1115] *Id.* at 2610 (*quoting* 573 U.S. at 324).

[1116] 573 U.S. at 324.

[1117] *Mayes v. Biden*, 67 F.4th 921 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023).

not a proprietary procurement policy. Nothing in the Mandate constitutes a regulation. The Contractor Mandate's broad scope alone does not make it regulatory.

"An exercise of proprietary authority can amount to a regulation if it seeks to regulate conduct unrelated to the government's proprietary interests."[1118] The conduct that the Contractor Mandate seeks to regulate is related to the government's proprietary interest here: efficient and economic procurement of services. The Contractor Mandate requires vaccination of all contractor employees who will work on or in connection with a covered contract. The Contractor Mandate also imposes that requirement on employees in the same workplace as a covered contractor employee, presumably because of the way a contagious disease such as COVID-19 spreads. To some, the requirement may appear overinclusive; to others, it may seem underinclusive. Even if the Contractor Mandate were overinclusive or underinclusive (or both), that would not mean that the Contractor Mandate is unrelated to efficient and economic procurement of services.

The government drew certain lines. Perfection in line-drawing is not required.[1119] Imperfect over- or under-inclusiveness does not mean that the authority being exercised is regulatory rather than proprietary, nor does it give courts the authority to redraw those lines.

The Contractor Mandate is not a "transformative expansion" of any authority—regulatory or proprietary. Arizona, the district court, and other circuits raised alarms about how the federal government has never sought, under the authority of the Procurement Act, to regulate the health decisions of American workers or to reduce absenteeism. This argument equates inactivity with forbidden activity. The history of the Procurement Act, Executive Orders passed under its authority, and subsequent judicial interpretations demonstrate that the Contractor Mandate is not a transformative expansion of the President's statutory authority.

The Procurement Act was enacted in 1949. The purpose of the Act is to promote an economical and efficient system of federal government procurement. "[T]he most prominent use of the President's authority under the [Act]" in the first few decades of its existence was "a series of anti-discrimination requirements for Government contractors."[1120] Several Presidents issued Executive Orders forbidding contractors from discriminating on the basis of race, creed, color, or national origin.

In *American Federation of Labor & Congress of Industrial Organizations v. Kahn*,[1121] the *en banc* D.C. Circuit recognized that some of these Executive Orders "were issued under the

[1118] *Georgia v. President of the United States*, 46 F.4th 1283, 1314n.3 (11th Cir. 2022). (Anderson, J., concurring in part and dissenting in part).

[1119] *Cf. Dandridge v. Williams*, 397 U.S. 471, 484–85 (1970) (discussing how "the concept of 'overreaching' "has "no place" in analysis of a "regulation in the social and economic field").

[1120] *American Federation of Labor & Congress of Industrial Organizations v. Kahn*, 618 F.2d 784, 790–91 (D.C. Cir. 1979) (*en banc*).

[1121] *Id.* at 790–91.

President's war powers and special wartime legislation," but that "for the period from 1953 to 1964[,] only the [Procurement Act] could have provided statutory support for the Executive action."[1122]

The Third Circuit became the first appellate court to consider these executive actions.[1123] The *Farmer* court ruled that the President had the authority to issue the orders under the Procurement Act.[1124] The Fifth Circuit also declined to hold that an antidiscrimination Executive Order was so unrelated to the Procurement Act's purpose that it "should be treated as issued without statutory authority."[1125] The Third Circuit upheld an Executive Order requiring contractors to commit to affirmative action hiring programs.[1126] The court found the Executive Order supported by the President's authority under the Procurement Act because preventing the federal government's suppliers from "increasing its costs and delaying its programs by excluding from the labor pool available minority workmen" would improve the economy and efficiency of federal contracts.[1127]

In 1979, the *en banc* D.C. Circuit in *American Federation of Labor and Congress of Indus. Organizations v. Kahn* upheld an Executive Order by President Carter that required federal contractors to adhere to price and wage guidelines.[1128] The *Kahn* court recognized that the Executive Order had the additional motive of slowing inflation in the economy. The *Kahn* court respected the President's calculation that there was a "nexus between the wage and price standards and likely savings to the Government,"[1129]

In 1986 and 1996, Congress recodified the Procurement Act without any substantive change. In 2001, President Bush issued an Executive Order that required government contractors and their subcontractors to post notices at their facilities informing their employees of certain labor rights.[1130] This was the first Executive Order to explicitly cite the Procurement Act as its source of authority. A year later, Congress recodified the Procurement

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[1122] *Id.* at 790–91.

[1123] *See Farmer v. Philadelphia Elec. Co.*, 329 F.2d 3 (3d Cir. 1964).

[1124] *Id.* at 8 ("In view of the [Procurement Act], we have no doubt that the applicable executive orders and regulations have the force of law.").

[1125] *Farkas v. Texas Instrument, Inc.*, 375 F.2d 629, 632n.1 (5th Cir. 1967).

[1126] *Contractors Association of East Pennsylvania v. Secretary of Labor*, 442 F.2d 159, 170 (3d Cir. 1971).

[1127] *Id.*

[1128] *American Federation of Labor and Congress of Indus. Organizations v. Kahn*, 618 F.2d 784, 785 (D.C. Cir. 1979) (Executive Order No. 12092 (Nov. 1, 1978) establishing procurement policy under which President was authorized to deny government contracts above $5 million to companies which failed or refused to comply with voluntary wage and price standards was authorized under provisions of Federal Property and Administrative Services Act of 1949).

[1129] *Id.* at 793.

[1130] Executive Order No. 13,201, 66 Fed. Reg. 11,221, 11,221–22 (Feb. 17, 2001).

Act. Congress made minor changes but clarified that those edits made "no substantive change in existing law." This is the Act's present form as to the provisions relevant here.

In 2003, the D.C. Circuit upheld the validity of President Bush's 2001 Executive Order.[1131]President Bush had justified the Executive Order by asserting a nexus to economy and efficiency because "[w]hen workers are better informed of their rights, . . . their productivity is enhanced" and because "[t]he availability of such a workforce from which the United States may draw facilitates the efficient and economical completion of its procurement contracts."[1132] The D.C. Circuit recognized that the "link may seem attenuated" but found that there was "enough of a nexus" to uphold the Order.[1133]

In 2009, the District Court of Maryland upheld an Executive Order issued by President Bush requiring federal contractors to use the E-Verify system to confirm employees' compliance with immigration law.[1134] The district court deferred to the President's judgment that contractors with "rigorous employment eligibility confirmation policies" would be "more efficient and dependable procurement sources,"[1135] and noted that "[t]he President and his Administration are in a better position than this Court to make such determinations,"[1136]

In 2015, President Obama issued an Executive Order requiring federal contractors to "ensur[e] that employees on [federal] contracts can earn up to 7 days or more of paid sick leave annually, including paid leave allowing for family care."[1137] President Obama justified the order under the Procurement Act on the following basis:

> Providing access to paid sick leave will improve the health and performance of employees of Federal contractors and bring benefits packages at Federal contractors in line with model employers, ensuring that they remain competitive employers . . . These savings and quality improvements will lead to improved economy and efficiency in Government procurement.[1138]

As this history demonstrates, Presidents have used the Procurement Act to require federal contractors to commit to affirmative action programs when racial discrimination was threatening contractors' efficiency; to adhere to wage and price guidelines to help combat inflation in the economy; to ensure compliance with immigration laws; and to attain sick leave parity with non-contracting employers because federal contractors were lagging behind and losing talent.

[1131] *UAW-Labor Employment & Training Corp. v. Chao*, 325 F.3d 360, 362 (D.C. Cir. 2003).
[1132] Id. at 366, *quoting* 66 Fed. Reg. at 11,221.
[1133] *Id.* at 366–67.
[1134] *Chamber of Commerce v. Napolitano*, 648 F. Supp. 2d 726, 738 (D. Md. 2009).
[1135] *Id.*, *quoting* Executive Order No. 13,465, 73 Fed. Reg. 33,285 (June 11, 2008).
[1136] *Id.*
[1137] Executive Order No. 13,706, 80 Fed. Reg. 54,697, 54,697 (Sept. 7, 2015).
[1138] *Id.*

This is not a "transformative expansion" of that same authority to require federal contractors—amid an unprecedented global pandemic—to take vaccination-related steps (already required by many private employers) that promote economy and efficiency by reducing absenteeism, project delays, and cost overruns.

Congress' re-enactment of the Procurement Act is also instructive. "Congress is presumed to be aware of a[ ] . . . judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without [substantive] change." [1139] The court presumed that, when recodifying the Act in 2002, Congress knew that the Third, Fifth, and D.C. Circuits had interpreted the President's Procurement Act authority and the statutory terms "economy" and "efficiency" broadly, and that President Bush had—just a year prior in 2001—relied on those terms to issue an Executive Order requiring government contractors to post notices informing their employees of certain labor rights.

Congress' affirmation of the broad understandings of those terms through re-enactment adds further weight to the holding that the Procurement Act supports an exercise of authority like the Contractor Mandate. Presidents have used the Procurement Act in ways they found necessary to promote economy and efficiency in federal contracting and procurement. The Contractor Mandate fits well within the Procurement Act's historical uses. The Contractor Mandate was not a transformative expansion of the President's authority under that Act. [1140]

The Fifth Circuit concluded that the Contractor Mandate was "strikingly unlike" any past action taken under the Act, not least because "a vaccination cannot be undone at the end of the workday." [1141] The impacts of anti-discrimination or affirmative action programs, wage and price policies, and immigration law compliance mechanisms also do not end with the workday—and even if they did, the court did not see how that in itself would circumscribe the President's authority. The Fifth Circuit also found important that previous Executive Orders

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[1139] *Chugach Mgmt. Servs. v. Jetnil*, 863 F.3d 1168, 1174 (9th Cir. 2017) (citation omitted); *see also Tex. Dep't of Hous. & Cmty. Affs. v. Inclusive Cmtys. Project, Inc.*, 576 U.S. 519, 536, 135 S.Ct. 2507, 192 L.Ed.2d 514 (2015) (If a word or phrase has been given a uniform interpretation by inferior courts, a later version of that act perpetuating the wording is presumed to carry forward that interpretation." (cleaned up) (*quoting* A. Scalia & B. Garner, *Reading Law: The Interpretation of Legal Texts* 322 (2012))).

[1140] *Mayes v. Biden*, 67 F.4th 921, 939n.32 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023) ("At oral argument, counsel for one Intervenor stated that it "is difficult to reconcile" multiple historical uses of the Procurement Act—such as the antidiscrimination orders or the E-Verify Order—with their view of the Major Questions Doctrine. Oral Arg., at 45:20–46:15. We think that might well be true: if Arizona's initial and Intervenors' current view of the Doctrine were correct, then many prior actions by Presidents would be suspect. But that provides us with an additional reason why that view of the Doctrine is not correct. We agree with the courts that upheld those prior Executive Orders as within the President's authority under the Procurement Act for the same (or similar) reasons we now find that the Contractor Mandate is within President Biden's authority.").

[1141] *Louisiana v. Biden*, 55 F.4th 1017, 1030 (cleaned up), *quoting Nat'l Fed'n of Indep. Bus. v. Dep't of Lab.*,595 U.S. 109, 118 (2022) (*per curiam*)).

"govern[ed] the conduct of employers, [whereas] the vaccine mandate purports to govern the conduct of employees."[1142] This supposed distinction "frames the issue at the wrong level of generality."[1143] The employer/employee distinction does not stand up to scrutiny, according to the Ninth Circuit.

The Ninth Circuit found that the Major Questions Doctrine is not relevant because the Contractor Mandate is a Presidential—not an agency—action.

Further, the Ninth Circuit expressed the view that, if the Major Questions Doctrine applied, that Doctrine would not bar the Contractor Mandate because the Mandate is not a transformative expansion of the President's authority under the Procurement Act.

The Ninth Circuit found that the Procurement Act has a clear textual limiting principle in that the President can only prescribe policies and directives that he "considers necessary" to ensure "an economical and efficient system" for procurement and contracting.[1144]

The Ninth Circuit also discussed the nondelegation doctrine:

1. Nondelegation Doctrine

*The district court also invoked the constitutional avoidance canon to invalidate *943 the Contractor Mandate, reasoning that the Mandate "raises serious constitutional questions" under the nondelegation doctrine. Brnovich, 562 F. Supp. 3d. at 155–56. We disagree. The nondelegation doctrine arises out of the principle that Congress "may not transfer to another branch 'powers which are strictly and exclusively legislative.'" Gundy, 139 S. Ct. at 2123 (quoting Wayman v. Southard, 23 U.S. 1, 42–43, 10 Wheat. 1, 6 L.Ed. 253 (1825)). But the Supreme Court has recognized that "Congress simply cannot do its job absent an ability to delegate power under broad general directives," Mistretta v. United States, 488 U.S. 361, 372, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989), and has concluded that a statutory delegation is constitutional so long as Congress "lay[s] down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform," id. (second alteration in original) (quoting J.W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624 (1928)).*

The Supreme Court has only twice found statutory delegations excessive under the nondelegation doctrine.35 No statutory delegation has been invalidated due to nondelegation concerns in nearly ninety years. The Supreme Court has found an intelligible principle when the agency was authorized to regulate in the "public interest," see National Broadcasting Co. v. United States, 319 U.S. 190, 215–17, 63 S.Ct. 997, 87 L.Ed. 1344 (1943), and—more recently—when the agency issued air quality standards "requisite to protect the public health," Whitman, 531 U.S. at 473, 121 S.Ct. 903. The Procurement Act has a clear intelligible principle that easily clears the low threshold established by National Broadcasting Company: it authorizes the President to "prescribe policies and directives that the President considers necessary" to secure "an economical and efficient system" for procurement and contracting. 40 U.S.C. §§ 101, 121(a). This principle "can be

[1142] *Id.*

[1143] *Kentucky v. Biden*, 23 F.4th 585, 610 (6th Cir. an. 5, 2022).

[1144] 40 U.S.C. §§ 101, 121(a).

applied generally to the President's actions to determine whether those actions are within the legislative delegation." Kahn, 618 F.2d at 793 n.51.

2. Federalism and State Sovereignty

Neither federalism nor state sovereignty concerns bar the Contractor Mandate. The district court viewed the Mandate as a "regulation of health and safety matters" and thus in conflict with Arizona's "traditional police power." See Brnovich, 562 F. Supp. 3d at 156–57 (citations omitted). But the Contractor Mandate is aimed at federal contracting, even if also motivated by health and safety concerns. And the federal government undisputedly has the power to regulate the performance of federal contracts. See Gartrell Constr. Inc. v. Aubry, 940 F.2d 437, 440–41 (9th Cir. 1991) (exempting federal contractors from state licensing requirements); United States v. Virginia, 139 F.3d 984, 990 (4th Cir. 1998) ("[F]ederal contractors cannot be required to satisfy state 'qualifications in addition to those that the [Federal] Government has pronounced sufficient.'" (second alteration in original) (quoting Leslie Miller, Inc. v. Arkansas, 352 U.S. 187, 190, 77 S.Ct. 257, 1 L.Ed.2d 231 (1956))). Even if the Mandate did regulate health and safety, the federal government does not "invade[ ]" areas of state sovereignty "simply because it exercises its authority . . . in a manner that displaces the States' exercise of their police powers." Hodel v. Virginia Surface Min. & Reclamation Ass'n, 452 U.S. 264, 291, 101 S.Ct. 2352, 69 L.Ed.2d 1 (1981).

The nondelegation doctrine and state sovereignty concerns do not somehow invalidate the Contractor Mandate.

[2] West Virginia v. Environmental Protection Agency (2022): Major Questions Doctrine.

In *West Virginia v. Environmental Protection Agency,*[1145] the Supreme Court announced the major questions doctrine:

[1145] *West Virginia v. United States Environmental Protection Agency*, 142 S. Ct. 2587 (2022). *See, also, Biden v. Nebraska*, 600 U.S. __, 143 S.Ct. 2355 (2023) (declaratory and injunctive relief action, alleging that Secretary of Education's program to forgive student loan debt under Higher Education Relief Opportunities for Students Act of 2003 (HEROES Act), which was promulgated to address financial harms caused by COVID-19 pandemic, contravened separation of powers and violated Administrative Procedure Act (APA); held: Secretary's authority under HEROES Act, to modify, in connection with national emergency, existing statutory or regulatory provisions applicable to financial assistance programs under Title IV of Higher Education Act of 1965, did not extend to Secretary's loan forgiveness program; Secretary's authority under HEROES Act to waive existing statutory or regulatory provisions did not extend to Secretary's loan forgiveness program; and under major questions doctrine, loan forgiveness was decision resting with Congress or an agency acting pursuant to clear delegation from Congress.) ("Among Congress' most important authorities is its control of the purse. U. S. Const., Art. I, § 9, cl. 7; *see also Office of Personnel Management v. Richmond*, 496 U.S. 414, 427, 110 S.Ct. 2465, 110 L.Ed.2d 387 (1990) (the Appropriations Clause is 'a most useful and salutary check upon profusion and extravagance' (internal quotation marks omitted)). It would be odd to think that separation of powers concerns evaporate simply because the Government is providing monetary

benefits rather than imposing obligations. As we observed in *West Virginia*, experience shows that major questions cases 'have arisen from all corners of the administrative state,' and administrative action resulting in the conferral of benefits is no exception to that rule. 597 U. S., at – – 142 S.Ct., at 2608. In *King v. Burwell*, 576 U.S. 473, 135 S.Ct. 2480, 192 L.Ed.2d 483 (2015), we declined to defer to the Internal Revenue Service's interpretation of a healthcare statute, explaining that the provision at issue affected 'billions of dollars of spending each year and . the price of health insurance for millions of people.' *Id.*, at 485, 135 S.Ct. 2480. Because the interpretation of the provision was 'a question of deep 'economic and political significance' that is central to [the] statutory scheme,' we said, we would not assume that Congress entrusted that task to an agency without a clear statement to that effect. Ib*Id.* (quoting *Utility Air*, 573 U.S., at 324, 134 S.Ct. 2427). That the statute at issue involved government benefits made no difference in King, and it makes no difference here. ¶ All this leads us to conclude that '[t]he basic and consequential tradeoffs' inherent in a mass debt cancellation program 'are ones that Congress would likely have intended for itself.' *West Virginia*, 597 U. S., at __, 142 S.Ct., at 2613. In such circumstances, we have required the Secretary to 'point to 'clear Congressional authorization' to justify the challenged program. *Id.*, at __, __, 142 S.Ct., at 2609, 2614 (*quoting Utility Air*, 573 U.S., at 324, 134 S.Ct. 2427). And as we have already shown, the HEROES Act provides no authorization for the Secretary's plan even when examined using the ordinary tools of statutory interpretation—let alone 'clear Congressional authorization' for such a program. [Footnote omitted]"). *See, also*, *Sackett v. Environmental Protection Agency*, 598 U.S. 651 (2023) (action under Administrative Procedure Act alleging Environmental Protection Agency lacked jurisdiction to issue compliance order informing landowners that backfilling residential lot near lake with dirt and rocks in preparation for construction of home violated Clean Water Act on the basis that this lot contained protected wetlands and demanding restoration; holdings: (1) for wetlands to qualify as "waters of the United States" subject to the Clean Water Act, the wetlands must be indistinguishably part of a body of water that itself constitutes "waters" under the Clean Water Act; (2) court did not defer to Environmental Protection Agency interpretation in rule defining "the waters of the United States" to include wetlands adjacent to covered waters if wetlands possessed significant nexus to traditional navigable waters; and (3) wetlands located on residential lot did not constitute "waters of the United States.") ("First, this Court 'require[s] Congress to enact exceedingly clear language if it wishes to significantly alter the balance between federal and state power and the power of the Government over private property.' *United States Forest Service v. Cowpasture River Preservation Assn.*, 590 U. S. – – – – – – – – 140 S.Ct. 1837, 1849-1850, 207 L.Ed.2d 186 (2020); *see also Bond*, 572 U.S., at 858, 134 S.Ct. 2077. Regulation of land and water use lies at the core of traditional state authority. *See, e.g., SWANCC, 531 U.S.*, at 174, 121 S.Ct. 675, *citing Hess v. Port Authority Trans-Hudson Corporation*, 513 U.S. 30, 44, 115 S.Ct. 394, 130 L.Ed.2d 245 (1994)); *Tarrant Regional Water Dist. v. Herrmann*, 569 U.S. 614, 631, 133 S.Ct. 2120, 186 L.Ed.2d 153 (2013). An overly broad interpretation of the CWA's reach would impinge on this authority. The area covered by wetlands alone is vast—greater than the combined surface area of California and Texas. And the scope of the EPA's conception of 'the waters of the United States' is truly staggering when this vast territory is supplemented by all the additional area, some of which is generally dry, over which the Agency asserts jurisdiction. Particularly given the CWA's express policy to 'preserve' the States' 'primary' authority over land and water use, § 1251(b), this Court has required a clear statement from Congress when determining the scope of 'the waters of the United States.' *SWANCC*, 531 U.S., at 174, 121 S.Ct. 675; *accord, Rapanos*, 547 U.S., at 738, 126 S.Ct. 2208 (plurality opinion). ¶ The EPA, however, offers only a passing attempt to square its interpretation with the text of § 1362(7), and its 'significant nexus' theory is particularly implausible. It suggests that the meaning of 'the waters of the United States' is so 'broad and unqualified' that, if viewed in isolation, it would extend to all water in the United States. Brief for Respondents 32. The EPA thus turns to the

"'It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.' Davis v. Michigan Dept. of Treasury,

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'significant nexus' test in order to reduce the clash between its understanding of 'the waters of the United States' and the term defined by that phrase, *i.e.*, 'navigable waters.' As discussed, however, the meaning of 'waters' is more limited than the EPA believes. *See supra*, at 1336. And, in any event, the CWA never mentions the 'significant nexus' test, so the EPA has no statutory basis to impose it. *See Rapanos*, 547 U.S., at 755 756, 126 S.Ct. 2208 (plurality opinion). ¶ Second, the EPA's interpretation gives rise to serious vagueness concerns in light of the CWA's criminal penalties. Due process requires Congress to define penal statutes "'with sufficient definiteness that ordinary people can understand what conduct is prohibited"' and "'in a manner that does not encourage arbitrary and discriminatory enforcement."' *McDonnell v. United States*, 579 U.S. 550, 576, 136 S.Ct. 2355, 195 L.Ed.2d 639 (2016) (*quoting Skilling v. United States*, 561 U.S. 358, 402 403, 130 S.Ct. 2896, 177 L.Ed.2d 619 (2010)). Yet the meaning of 'waters of the United States' under the EPA's interpretation remains 'hopelessly indeterminate.' *Sackett*, 566 U.S., at 133, 132 S.Ct. 1367 (ALITO, J., concurring); *accord, Hawkes Co.*, 578 U.S., at 602, 136 S.Ct. 1807 (opinion of KENNEDY, J.). ¶ The EPA contends that the only thing preventing it from interpreting 'waters of the United States' to 'conceivably cover literally every body of water in the country' is the significant-nexus test. Tr. of Oral Arg. 70 71; *accord*, Brief for Respondents 32. But the boundary between a 'significant' and an insignificant nexus is far from clear. And to add to the uncertainty, the test introduces another vague concept—'similarly situated' waters—and then assesses the aggregate effect of that group based on a variety of open-ended factors that evolve as scientific understandings change. This freewheeling inquiry provides little notice to landowners of their obligations under the CWA. Facing severe criminal sanctions for even negligent violations, property owners are 'left "to feel their way on a case-by-case basis."' *Sackett*, 566 U.S., at 124, 132 S.Ct. 1367 (*quoting Rapanos*, 547 U.S., at 758, 126 S.Ct. 2208 (ROBERTS, C. J., concurring)). Where a penal statute could sweep so broadly as to render criminal a host of what might otherwise be considered ordinary activities, we have been wary about going beyond what 'Congress certainly intended the statute to cover.' *Skilling*, 561 U.S., at 404, 130 S.Ct. 2896. ¶ Under these two background principles, the judicial task when interpreting 'the waters of the United States' is to ascertain whether clear Congressional authorization exists for the EPA's claimed power. The EPA's interpretation falls far short of that standard."); *Ala. Ass'n of Realtors v. Dep't of Health & Human Servs.*, 141 S. Ct. 2485 (2021) (authority to impose eviction moratorium related to COVID); *Nat'l Fed'n of Indep. Bus. v. Dep't of Lab.*, 595 U.S. 109 (2022) (vaccine-or-test imposed on businesses with more than 100 employees); *West Virginia v. EPA*, 597 U.S. 697 (2022) (reducing greenhouse gas emissions from power plants); *Biden v. Nebraska*, 143 S. Ct. 2355 (2023) (forgiving student loans). *See also Alabama Association of Realtors v. Department of Health and Human Services*, 141 S. Ct. 2485 (2021) (*per curiam*) (Centers for Disease Control exceeded authority with a national eviction moratorium on account of COVID-19 pandemic; moratorium would affect at least 80% of the country and cost approximately $50 billion); *National Federation of Independent Business v. Occupational Safety and Health Administration*, 142 S. Ct. 661 (2022) (Occupational Safety and Health Administration did not have statutory authority for COVID-19 vaccination program imposed on employers; COVID-19 did not fall within authority of the Occupational Safety and Health Administration; program would affect 84 million Americans); *Biden v. Missouri*, 142 S. Ct. 647, 653 (2022) (Department of Health and Human Services possessed authority to condition the disbursement of Medicare and Medicaid funds to healthcare facilities on the condition that employees be vaccinated against COVID-19; vaccination policy fit within statute; agency was permitted by statute to impose funding conditions); *Biden v. Nebraska*, 143 S. Ct. 2355 (2023) (student loan forgiveness policy exceeded agency authority).

489 U. S. 803, 809 (1989). Where the statute at issue is one that confers authority upon an administrative agency, that inquiry must be 'shaped, at least in some measure, by the nature of the question presented'—whether Congress in fact meant to confer the power the agency has asserted. FDA v. Brown & Williamson Tobacco Corp., 529 U. S. 120, 159 (2000). In the ordinary case, that context has no great effect on the appropriate analysis. Nonetheless, our precedent teaches that there are "extraordinary cases" that call for a different approach—cases in which the 'history and the breadth of the authority that [the agency] has asserted,' and the 'economic and political significance' of that assertion, provide a 'reason to hesitate before concluding that Congress' meant to confer such authority. Id., at 159–160."[1146]

[1146] The court continued:

Such cases have arisen from all corners of the administrative state. In *Brown & Williamson*, for instance, the Food and Drug Administration claimed that its authority over "drugs" and "devices" included the power to regulate, and even ban, tobacco products. *Id.*, at 126–127. We rejected that "expansive construction of the statute," concluding that "Congress could not have intended to delegate" such a sweeping and consequential authority "in so cryptic a fashion." *Id.*, at 160. In *Alabama Assn. of Realtors v. Department of Health and Human Servs.*, 594 U. S. __, __ (2021) (*per curiam*) (slip op., at 3), we concluded that the Centers for Disease Control and Prevention could not, under its authority to adopt measures "necessary to prevent the . spread of disease, institute a nationwide eviction moratorium in response to the COVID–19 pandemic. We found the statute's language a "wafer-thin reed" on which to rest such a measure, given "the sheer scope of the CDC's claimed authority," its "unprecedented" nature, and the fact that Congress had failed to extend the moratorium after previously having done so. *Id.*, at __–__ (slip op., at 6–8).

Our decision in *Utility Air* addressed another question regarding the Environmental Protection Agency's authority—namely, whether the Environmental Protection Agency could construe the term "air pollutant," in a specific provision of the Clean Air Act, to cover greenhouse gases. 573 U. S., at 310. Despite its textual plausibility, we noted that the Agency's interpretation would have given it permitting authority over millions of small sources, such as hotels and office buildings, that had never before been subject to such requirements. *Id.*, at 310, 324. We declined to uphold the Environmental Protection Agency's claim of "unheralded" regulatory power over "a significant portion of the American economy." *Id.*, at 324. In *Gonzales v. Oregon*, 546 U. S. 243 (2006), we confronted the Attorney General's assertion that he could rescind the license of any physician who prescribed a controlled substance for assisted suicide, even in a State where such action was legal. The Attorney General argued that this came within his statutory power to revoke licenses where he found them "inconsistent with the public interest," 21 U. S. C. §823(f). We considered the "idea that Congress gave [him] such broad and unusual authority through an implicit delegation . not sustainable." 546 U. S., at 267. Similar considerations informed our recent decision invalidating the Occupational Safety and Health Administration's mandate that "84 million Americans . either obtain a COVID–19 vaccine or undergo weekly medical testing at their own expense." *National Federation of Independent Business v. Occupational Safety and Health Administration*, 595 U. S. __, __ (2022) (*per curiam*) (slip op., at 5). We found it "telling that Occupational Safety and Health Administration, in its half century of existence," had never relied on its authority to regulate occupational hazards to impose such a remarkable measure. *Id.*, at __ (slip op., at 8). All of these regulatory assertions had a colorable textual basis. And yet, in each case, given the various circumstances, "common sense as to the manner in which Congress [would have been] likely to delegate" such power to the agency at issue, *Brown & Williamson*, 529 U. S., at 133, made it very unlikely that Congress had actually done so. Extraordinary grants of regulatory

West Virginia v. Environmental Protection Agency held that Section 111(d) of the Clean Air Act did not give the Environmental Protection Agency authority to impose emissions caps based on the generation shifting approach under the Clean Power Plan and to order power plants to move from more polluting means of generating energy (*e.g.*, coal), to less polluting means of generating energy (*e.g.* wind and solar). The Environmental Protection Agency rules were directed at curbing carbon dioxide air pollution. The United States is the second-largest emitter of carbon dioxide waste. Much of this pollution comes from generation of electrical power (particularly coal-fired electrical power plants). Electrical power plants are the largest industrial source of air pollution in the United States.

The Clean Air Act was passed in 1970. The Act gave the Environmental Protection Agency broad power to reduce industrial pollution. The Environmental Protection Agency was charged with defining the "best system of emission reduction" for each industry. The Environmental Protection Agency (the Environmental Protection Agency) promulgated the Clean Power Plan rule, which addressed carbon dioxide emissions from existing coal- and natural-gas-fired power plants. For authority, the Agency cited Section 111 of the Clean Air Act, which authorizes regulation of certain pollutants from existing sources under Section 111(d). Under that provision, although the States set the actual enforceable rules governing existing sources (such as power plants), Environmental Protection Agency determines the emissions limit with which they will have to comply. The Environmental Protection Agency derives that limit by determining the "best system of emission reduction . . . that has been adequately demonstrated, "for the kind of existing source at issue. The limit then reflects the amount of pollution reduction "achievable through the application o*f*" that system. [1147]

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authority are rarely accomplished through "modest words," "vague terms," or "subtle device[s]." *Whitman*, 531 U. S., at 468. Nor does Congress typically use oblique or elliptical language to empower an agency to make a "radical or fundamental change" to a statutory scheme. *MCI Telecommunications Corp. v. American Telephone & Telegraph Co.*, 512 U. S. 218, 229 (1994). Agencies have only those powers given to them by Congress, and "enabling legislation" is generally not an "open book to which the agency [may] add pages and change the plot line." E. Gellhorn & P. Verkuil, Controlling *Chevron* Based Delegations, 20 Cardozo L. Rev. 989, 1011 (1999). We presume that "Congress intends to make major policy decisions itself, not leave those decisions to agencies." *United States Telecom Assn. v. FCC*, 855 F. 3d 381, 419 (CADC 2017) (Kavanaugh, J., dissenting from denial of rehearing *en banc*). Thus, in certain extraordinary cases, both separation of powers principles and a practical understanding of legislative intent make us "reluctant to read into ambiguous statutory text" the delegation claimed to be lurking there. *Utility Air*, 573 U. S., at 324. To convince us otherwise, something more than a merely plausible textual basis for the agency action is necessary. The agency instead must point to "clear Congressional authorization" for the power it claims. *IbId.*

597 U.S. At 17-18

[1147] The Supreme Court explained:

In the Clean Power Plan, the Environmental Protection Agency determined that the BSER ["best system of emission reduction"] for existing coal and natural gas plants included three types of measures, which the Agency called "building blocks." 80 Fed. Reg. 64667. The first building block

was "heat rate improvements" at coal-fired plants—essentially practices such plants could undertake to burn coal more cleanly. *Id.*, at 64727. This sort of source-specific, efficiency-improving measure was similar in kind to those that the Environmental Protection Agency had previously identified as the BSER ["best system of emission reduction"] in other I.R.C. § 111 rules.

Building blocks two and three were quite different, as both involved what the Environmental Protection Agency called "generation shifting" at the grid level—*i.e.*, a shift in electricity production from higher-emitting to lower-emitting producers. Building block two was a shift in generation from existing coal-fired power plants, which would make less power, to natural-gas-fired plants, which would make more. Ib*Id.* This would reduce carbon dioxide emissions because natural gas plants produce less carbon dioxide per unit of electricity generated than coal plants. Building block three worked like building block two, except that the shift was from both coal and gas plants to renewables, mostly wind and solar. *Id.*, at 64729, 64748. The Agency explained that, to implement the needed shift in generation to cleaner sources, an operator could reduce the regulated plant's own production of electricity, build or invest in a new or existing natural gas plant, wind farm, or solar installation, or purchase emission allowances or credits as part of a cap-and-trade regime. *Id.*, at 64731–64732. Taking any of these steps would implement a sector-wide shift in electricity production from coal to natural gas and renewables. *Id.*, at 64731.

Having decided that the BSER ["best system of emission reduction"] was one that would reduce carbon pollution mostly by moving production to cleaner sources, the Environmental Protection Agency then set about determining "the degree of emission limitation achievable through the application" of that system. § 7411(a)(1). The Agency recognized that, in translating the BSER ["best system of emission reduction"] into an operational emissions limit, it could choose whether to require anything from a little generation shifting to a great deal. It settled on what it regarded as a "reasonable" amount of shift, which it based on modeling how much more electricity both natural gas and renewable sources could supply without causing undue cost increases or reducing the overall power supply. *Id.*, at 64797–64811. The Agency ultimately projected, for instance, that it would be feasible to have coal provide 27% of national electricity generation by 2030, down from 38% in 2014. From these projected changes, the Environmental Protection Agency determined the applicable emissions performance rates, which were so strict that no existing coal plant would have been able to achieve them without engaging in one of the three means of generation shifting. The Government projected that the rule would impose billions in compliance costs, raise retail electricity prices, require the retirement of dozens of coal plants, and eliminate tens of thousands of jobs.

This Court stayed the Clean Power Plan in 2016, preventing the rule from taking effect. It was later repealed after a change in Presidential administrations. Specifically, in 2019, the Environmental Protection Agency found that the Clean Power Plan had exceeded the Agency's statutory authority under I.R.C. § 111(d), which it interpreted to "limit[ ] the BSER ["best system of emission reduction"] to those systems that can be put into operation at a building, structure, facility, or installation." 84 Fed. Reg. 32524. the Environmental Protection Agency explained that the Clean Power Plan, rather than setting the standard "based on the application of equipment and practices at the level of an individual facility," had instead based it on "a shift in the energy generation mix at the grid level," *Id.*, at 32523. The Agency determined that the interpretive question raised by the Clean Power Plan fell under the major questions doctrine. Under that doctrine, it determined, a clear statement is necessary for a court to conclude that Congress intended to delegate authority "of this breadth to regulate a fundamental sector of the economy." *Id.*, at 32529. It found none. The Agency replaced the Clean Power Plan by promulgating a different I.R.C. § 111(d) regulation, known as the Affordable Clean Energy (ACE) rule. *Id.*, at 32532. In that rule, the Environmental Protection Agency determined that the BSER ["best system of emission reduction"] would be akin to building block one of the Clean

A number of states and private parties filed petitions for review, challenging the Environmental Protection Agency's repeal of the Clean Power Plan and its enactment of the replacement Affordable Clean Energy (ACE) rule. In that ACE rule, the Environmental Protection Agency determined that the BSER ["best system of emission reduction"] would be akin to building block one of the Clean Power Plan: a combination of equipment upgrades and operating practices that would improve facilities' heat rates.

The Court of Appeals for the Eleventh Circuit held that Environmental Protection Agency's "repeal of the Clean Power Plan rested critically on a mistaken reading of the Clean Air Act"—generation shifting cannot be a "system of emission reduction" under Section 111. The Eleventh Circuit vacated the Environmental Protection Agency's repeal of the Clean Power Plan and remanded to the Environmental Protection Agency for further consideration. The Eleventh Circuit also vacated and remanded the ACE rule for the same reason. The Environmental Protection Agency moved the court partially to stay its mandate as to the Clean Power Plan while the Environmental Protection Agency considered whether to promulgate a new Section 111(d) rule. The Court of Appeals agreed to stay its vacatur of the Agency's repeal of the Clean Power Plan. [1148]

Power Plan: a combination of equipment upgrades and operating practices that would improve facilities' heat rates. *Id.*, at 32522, 32537.

597 U.S. 697-99.

[1148] The Supreme Court recounted the detailed situation:

Things changed on October 2015, when "the EPA promulgated two rules addressing carbon dioxide pollution from power plants—one for new plants under I.R.C. § 111(b), the other for existing plants under I.R.C. § 111(d). Both were premised on the Agency's earlier finding that carbon dioxide is an "air pollutant" that "may reasonably be anticipated to endanger public health or welfare" by causing climate change. Carbon dioxide is not subject to a National Ambient Air Quality Standard and has not been listed as a hazardous pollutant.

The first rule announced by 'the EPA established federal carbon emissions limits for new power plants of two varieties: fossil-fuel-fired electric steam generating units (mostly coal fired) and natural-gas-fired stationary combustion turbines. *Id.*, at 64512. Following the statutory process set out above, the Agency determined the BSER ["best system of emission reduction"] for the two categories of sources. For steam generating units, for instance, 'the EPA determined that the BSER ["best system of emission reduction"] was a combination of high-efficiency production processes and carbon capture technology. See 80 Fed. Reg. 64512. 'the EPA then set the emissions limit based on the amount of carbon dioxide that a plant would emit with these technologies in place. *Id.*, at 64513.

The second rule was triggered by the first: Because 'the EPA was now regulating carbon dioxide from new coal and gas plants, I.R.C. § 111(d) required 'the EPA o also address carbon emissions from existing coal and gas plants. See § 7411(d)(1). It did so through what it called the Clean Power Plan rule.

In that rule, 'the EPA established "final emission guidelines for states to follow in developing plans" to regulate existing power plants within their borders. *Id.*, at 64662. To arrive at the guideline limits, 'the EPA did the same thing it does when imposing federal regulations on new sources: It identified the BSER ["best system of emission reduction"].

The BSER ["best system of emission reduction"] that the Agency selected for existing coal-fired power plants, however, was quite different from the BSER ["best system of emission reduction"] it had chosen for new sources. The BSER ["best system of emission reduction"] for existing plants included three types of measures, which the Agency called "building blocks." *Id.*, at 64667. The first building block was "heat rate improvements" at coal-fired plants—essentially practices such plants could undertake to burn coal more efficiently. *Id.*, at 64727. But such improvements, 'the EPA stated, would "lead to only small emission reductions," because coal-fired power plants were already operating near optimum efficiency. Ib*Id.* On the Agency's view, "much larger emission reductions [were] needed from [coal-fired plants] to address climate change." *Ibid.*

So the Agency included two additional building blocks in its BSER ["best system of emission reduction"], both of which involve what it called "generation shifting from higher-emitting to lower-emitting" producers of electricity. *Id.*, at 64728. Building block two was a shift in electricity production from existing coal-fired power plants to natural-gas-fired plants. Ib*Id.* Because natural gas plants produce "typically less than half as much" carbon dioxide per unit of electricity created as coal-fired plants, the Agency explained, "this generation shift [would] reduce[ ] CO2 emissions." Ib*Id.* Building block three worked the same way, except that the shift was from both coal- and gas-fired plants to "new low- or zero-carbon generating capacity," mainly wind and solar. *Id.*, at 64729, 64748. "Most of the CO2 controls" in the rule came from the application of building blocks two and three. *Id.*, at 64728.

The Agency identified three ways in which a regulated plant operator could implement a shift in generation to cleaner sources. *Id.*, at 64731. First, an operator could simply reduce the regulated plant's own production of electricity. Second, it could build a new natural gas plant, wind farm, or solar installation, or invest in someone else's existing facility and then increase generation there. Ib*Id.* Finally, operators could purchase emission allowances or credits as part of a cap-and-trade regime. *Id.*, at 64731–64732. Under such a scheme, sources that achieve a reduction in their emissions can sell a credit representing the value of that reduction to others, who are able to count it toward their own applicable emissions caps.

the Environmental Protection Agency explained that taking any of these steps would implement a sector-wide shift in electricity production from coal to natural gas and renewables. *Id.*, at 64731. Given the integrated nature of the power grid, "adding electricity to the grid from one generator will result in the instantaneous reduction in generation from other generators," and "reductions in generation from one generator lead to the instantaneous increase in generation" by others. *Id.*, at 64769. So coal plants, whether by reducing their own production, subsidizing an increase in production by cleaner sources, or both, would cause a shift toward wind, solar, and natural gas.

Having decided that the "best system of emission reduction . adequately demonstrated" was one that would reduce carbon pollution mostly by moving production to cleaner sources, the Environmental Protection Agency then set about determining "the degree of emission limitation achievable through the application" of that system. 42 U. S. C. § 7411(a)(1). The Agency recognized that—given the nature of generation shifting—it could choose from "a wide range of potential stringencies for the BSER ["best system of emission reduction"]." 80 Fed. Reg. 64730. Put differently, in translating the BSER ["best system of emission reduction"] into an operational emissions limit, the Environmental Protection Agency could choose whether to require anything from a little generation shifting to a great deal. The Agency settled on what it regarded as a "reasonable" amount of shift, which it based on modeling of how much more electricity both natural gas and renewable sources could supply without causing undue cost increases or reducing the overall power supply. *Id.*, at 64797–64811. Based on these changes, the Environmental Protection Agency projected that by 2030, it would be feasible to have coal provide 27% of national electricity generation, down from 38% in 2014. *Id.*,

The Environmental Protection Agency eventually repealed the ACE rule in 2019, concluding that the Clean Power Plan had been "in excess of its statutory authority" under Section 111(d).[1149]

The Environmental Protection Agency determined that "the interpretative question raised" by the Clean Power Plan—" *i.e.*, whether a 'system of emission reduction' can consist

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at 64665, 64694; see Dept. of Energy, *U. S. Energy Information Admin., Monthly Energy Review* (May 2015), Electricity Net Generation: Electric Power Sector, p. 106 (Table 7.2b).

From these significant projected reductions in generation, 'the EPA developed a series of complex equations to "determine the emission performance rates" that States would be required to implement. 80 Fed. Reg. 64815. The calculations resulted in numerical emissions ceilings so strict that no existing coal plant would have been able to achieve them without engaging in one of the three means of shifting generation described above. Indeed, the emissions limit the Clean Power Plan established for existing power plants was actually stricter than the cap imposed by the simultaneously published standards for new plants. Compare *Id.*, at 64742, with *Id.*, at 64513.

The point, after all, was to compel the transfer of power generating capacity from existing sources to wind and solar. The White House stated that the Clean Power Plan would "drive a[n] . aggressive transformation in the domestic energy industry." White House Fact Sheet, App. in *American Lung Assn. v. EPA*, No. 19–1140 etc. (CADC), p. 2076. 'The EPA's own modeling concluded that the rule would entail billions of dollars in compliance costs (to be paid in the form of higher energy prices), require the retirement of dozens of coal-fired plants, and eliminate tens of thousands of jobs across various sectors. 'the EPA, Regulatory Impact Analysis for the Clean Power Plan Final Rule 3–22, 3–30, 3–33, 6–24, 6–25 (2015). The Energy Information Administration reached similar conclusions, projecting that the rule would cause retail electricity prices to remain persistently 10% higher in many States, and would reduce GDP by at least a trillion 2009 dollars by 2040. Dept. of Energy, Analysis of the Impacts of the Clean Power Plan 21, 63–64 (May 2015).

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These projections were never tested, because the Clean Power Plan never went into effect. The same day that 'the EPA promulgated the rule, dozens of parties (including 27 States) petitioned for review in the D. C. Circuit. After that court declined to enter a stay of the rule, the challengers sought the same relief from this Court. We granted a stay, preventing the rule from taking effect. *West Virginia v. Environmental Protection Agency*, 577 U.S. 1126, 136 S.Ct. 1000, 194 L.Ed.2d 17 (2016). The Court of Appeals later heard argument on the merits *en banc*. But before it could issue a decision, there was a change in Presidential administrations. The new administration requested that the litigation be held in abeyance so that 'the EPA could reconsider the Clean Power Plan. The D. C. Circuit obliged, and later dismissed the petitions for review as moot.

597 U.S. at 711-15.

[1149] The Environmental Protection Agency concluded that generation shifting should not have been considered as part of the BSER ["best system of emission reduction"]. The Environmental Protection Agency interpreted I.R.C. § 111 as "limit[ing] the BSER ["best system of emission reduction"] to those systems that can be put into operation at a building, structure, facility, or installation," such as "add-on controls" and "inherently lower-emitting processes/practices/designs." It then explained that the Clean Power Plan, rather than setting the standard "based on the application of equipment and practices at the level of an individual facility," had instead based it on "a shift in the energy generation mix at the grid level,"—not the sort of measure that has "a potential for application to an individual source."

of generation-shifting measures"—fell under the "major question doctrine." Under that doctrine, the Environmental Protection Agency explained, courts "expect Congress to speak clearly if it wishes to assign to an agency decisions of vast economic and political significance." The Environmental Protection Agency concluded that the Clean Power Plan was such a decision, for a number of reasons.[1150] The Environmental Protection Agency argued that under the major questions doctrine, a clear statement was necessary to conclude that Congress intended to delegate authority "of this breadth to regulate a fundamental sector of the economy." The Environmental Protection Agency found none. "Indeed, it concluded, "Congress has directly spoken to this precise question and precluded" the use of measures such as generation shifting.

The Environmental Protection Agency replaced the Clean Power Plan by promulgating a different Section 111(d) regulation, known as the Affordable Clean Energy (ACE) Rule. The Environmental Protection Agency determined that the best system would be akin to building block one of the Clean Power Plan: a combination of equipment upgrades and operating practices that would improve facilities' heat rates. The ACE Rule determined that the application of its BSER ["best system of emission reduction"] measures would result in only small reductions in carbon dioxide emissions.

The Court of Appeals held that Environmental Protection Agency's "repeal of the Clean Power Plan rested critically on a mistaken reading of the Clean Air Act"—namely, that generation shifting cannot be a "system of emission reduction" under Section 111. The court concluded that the statute could reasonably be read to encompass generation shifting. The Court of Appeals concluded that the major questions doctrine did not apply, and thus rejected the need for a clear statement of Congressional intent to delegate such power to Environmental Protection Agency. Having found that Environmental Protection Agency misunderstood the scope of its authority under the Clean Air Act, the Eleventh Circuit vacated the Environmental Protection Agency's repeal of the Clean Power Plan and remanded to the Environmental Protection Agency for further consideration. The Eleventh Circuit also vacated and remanded the ACE Rule, for the same reason.

The Supreme Court first considered the Government's contention that no petitioner has Article III standing to seek Supreme Court review. The Supreme Court rejected this contention and proceeded to rule on the merits.

The Supreme Court explained that words of a statute must be read in context. The courts, however, hesitate in extraordinary cases of extraordinary economic and political significance, cases "in which the 'history and the breadth of the authority that [the agency] has

[1150] Its "generation-shifting scheme was projected to have billions of dollars of impact." "[N]o section 111 rule of the scores issued ha[d] ever been based on generation shifting." That novel reading of the statute would empower the Environmental Protection Agency "to order the wholesale restructuring of any industrial sector" based only on its discretionary assessment of "such factors as 'cost' and 'feasibility.'"

asserted,' and the 'economic and political significance' of that assertion, provide a "reason to hesitate before concluding that Congress" meant to confer such authority."

"It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." [Citation omitted.] Where the statute at issue is one that confers authority upon an administrative agency, that inquiry must be "shaped, at least in some measure, by the nature of the question presented"—whether Congress in fact meant to confer the power the agency has asserted. [Citation omitted.] In the ordinary case, that context has no great effect on the appropriate analysis. Nonetheless, our precedent teaches that there are "extraordinary cases" that call for a different approach—cases in which the "history and the breadth of the authority that [the agency] has asserted," and the "economic and political significance" of that assertion, provide a "reason to hesitate before concluding that Congress" meant to confer such authority. [Citation omitted.]

Such cases have arisen from all corners of the administrative state. In Brown & Williamson, for instance, the Food and Drug Administration claimed that its authority over "drugs" and "devices" included the power to regulate, and even ban, tobacco products. [Citation omitted.] We rejected that "expansive construction of the statute," concluding that "Congress could not have intended to delegate" such a sweeping and consequential authority "in so cryptic a fashion." [Citation omitted.] In Alabama Assn. of Realtors v. Department of Health and Human Servs., [citation omitted], we concluded that the Centers for Disease Control and Prevention could not, under its authority to adopt measures "necessary to prevent the . . . spread of disease, institute a nationwide eviction moratorium in response to the COVID–19 pandemic. We found the statute's language a "wafer-thin reed" on which to rest such a measure, given "the sheer scope of the CDC's claimed authority," its "unprecedented" nature, and the fact that Congress had failed to extend the moratorium after previously having done so. [Citation omitted.]

Our decision in Utility Air addressed another question regarding EPA's authority—namely, whether EPA could construe the term "air pollutant," in a specific provision of the Clean Air Act, to cover greenhouse gases. [Citation omitted.] Despite its textual plausibility, we noted that the Agency's interpretation would have given it permitting authority over millions of small sources, such as hotels and office buildings, that had never before been subject to such requirements. [Citation omitted.] We declined to uphold the EPA's claim of "unheralded" regulatory power over "a significant portion of the American economy." [Citation omitted.] In Gonzales v. Oregon, [citation omitted], we confronted the Attorney General's assertion that he could rescind the license of any physician where he found them "inconsistent with the public interest," 21 U. S. C. § 823(f). We considered the "idea that Congress gave [him] such broad and unusual authority through an implicit delegation . . . not sustainable." [Citation omitted.] Similar considerations informed our recent decision invalidating the Occupational Safety and Health Administration's mandate that "84 million Americans . . . either obtain a COVID–19 vaccine or undergo weekly medical testing at their own expense." [Citation omitted.] We found it "telling that Occupational Safety and Health Administration, in its half century of existence," had never relied on its authority to regulate occupational hazards to impose such a remarkable measure. [Citation omitted.]

All of these regulatory assertions had a colorable textual basis. And yet, in each case, given the various circumstances, "common sense as to the manner in which Congress [would have been] likely to delegate" such power to the agency at issue, Brown & Williamson, [citation omitted], made it very unlikely that Congress had actually done so. Extraordinary grants of regulatory authority are rarely accomplished through "modest words," "vague terms," or "subtle device[s]." [Citation omitted.] Nor does Congress typically use oblique or elliptical language to empower an agency to make a "radical or fundamental change" to a statutory scheme. [Citation omitted.] Agencies have only those powers given to them by Congress, and "enabling legislation" is generally not an "open book to which the agency [may] add pages and change the plot line." [Citation omitted.] We presume that "Congress intends to make major policy decisions itself, not leave those decisions to agencies." [Citation omitted.]

Thus, in certain extraordinary cases, both separation of powers principles and a practical understanding of legislative intent make us "reluctant to read into ambiguous statutory text" the delegation claimed to be lurking there. [Citation omitted.] To convince us otherwise, something more than a merely plausible textual basis for the agency action is necessary. The agency instead must point to "clear Congressional authorization" for the power it claims.[Citation omitted.][1151]

The Supreme Court continued:

One of the Judiciary's most solemn duties is to ensure that acts of Congress are applied in accordance with the Constitution in the cases that come before us. To help fulfill that duty, courts have developed certain "clear-statement" rules. These rules assume that, absent a clear statement otherwise, Congress means for its laws to operate in congruence with the Constitution rather than test its bounds. In this way, these clear-statement rules help courts "act as faithful agents of the [Citation omitted.]

Consider some examples. The Constitution prohibits Congress from passing laws imposing various types of retroactive liability. [Citation omitted.] Consistent with this rule, Chief Justice Marshall long ago advised that "a court . . . ought to struggle hard against a [statutory] construction which will, by a retrospective operation, affect the rights of parties." [Citation omitted.] Justice Paterson likewise insisted that courts must interpret statutes to apply only prospectively "unless they are so clear, strong, and imperative, that no other meaning can be annexed to them." [Citation omitted.]

The Constitution also incorporates the doctrine of sovereign immunity. [Citation omitted.] To enforce that doctrine, courts have consistently held that "nothing but express words, or an insurmountable implication" would justify the conclusion that lawmakers intended to abrogate the States' sovereign immunity. [Citation omitted.] In a similar vein, Justice Story observed that "[i]t is a general rule in the interpretation of legislative acts not to construe them to embrace the sovereign power or government, unless expressly named or included by necessary implication." [Citation omitted.]

The major questions doctrine works in much the same way to protect the Constitution's separation of powers. [Citation omitted.] In Article I, "the People" vested "[a]ll" federal "legislative powers . . . in Congress." Preamble; Art. I, § 1. As Chief Justice Marshall put it, this means that "important

[1151] 597 U.S. at 721-23.

subjects . . . must be entirely regulated by the legislature itself," even if Congress may leave the Executive "to act under such general provisions to fill up the details." [Citation omitted.] Doubtless, what qualifies as an important subject and what constitutes a detail may be debated. [Citation omitted.] But no less than its rules against retroactive legislation or protecting sovereign immunity, the Constitution's rule vesting federal legislative power in Congress is "vital to the integrity and maintenance of the system of government ordained by the Constitution." [Citation omitted.]

It is vital because the framers believed that a republic—a thing of the people—would be more likely to enact just laws than a regime administered by a ruling class of largely unaccountable "ministers." [Citation omitted.] From time to time, some have questioned that assessment.1 But by vesting the lawmaking power in the people's elected representatives, the Constitution sought to ensure "not only that all power [w]ould be derived from the people," but also "that those [e]ntrusted with it should be kept in dependence on the people." Id., No. 37, at 227 (J. Madison). The Constitution, too, placed its trust not in the hands of "a few, but [in] a number of hands," ibid, so that those who make our laws would better reflect the diversity of the people they represent and have an "immediate dependence on, and an intimate sympathy with, the people." Id., No. 52, at 327 (J. Madison). Today, some might describe the Constitution as having designed the federal lawmaking process to capture the wisdom of the masses. See P. Hamburger, Is Administrative Law Unlawful? 502–503 (2014).

Admittedly, lawmaking under our Constitution can be difficult. But that is nothing particular to our time nor any accident. The framers believed that the power to make new laws regulating private conduct was a grave one that could, if not properly checked, pose a serious threat to individual liberty. [Citation omitted.] As a result, the framers deliberately sought to make lawmaking difficult by insisting that two houses of Congress must agree to any new law and the President must concur or a legislative supermajority must override his veto.

The difficulty of the design sought to serve other ends too. By effectively requiring a broad consensus to pass legislation, the Constitution sought to ensure that any new laws would enjoy wide social acceptance, profit from input by an array of different perspectives during their consideration, and thanks to all this prove stable over time. [Citation omitted.] The need for compromise inherent in this design also sought to protect minorities by ensuring that their votes would often decide the fate of proposed legislation—allowing them to wield real power alongside the majority. [Citation omitted.] The difficulty of legislating at the federal level aimed as well to preserve room for lawmaking "by governments more local and more accountable than a distant federal" authority, [citation omitted], and in this way allow States to serve as "laborator[ies]" for "novel social and economic experiments," [Citation omitted.]

Permitting Congress to divest its legislative power to the Executive Branch would "dash [this] whole scheme." [Citation omitted.] Legislation would risk becoming nothing more than the will of the current President, or, worse yet, the will of unelected officials barely responsive to him. [Citation omitted.] In a world like that, agencies could churn out new laws more or less at whim. Intrusions on liberty would not be difficult and rare, but easy and profuse. [Citation omitted.] Stability would be lost, with vast numbers of laws changing with every new Presidential administration. Rather than embody a wide social consensus and input from minority voices, laws would more often bear the support only of the party currently in power. Powerful special interests, which are sometimes "uniquely" able to influence the agendas of administrative agencies, would flourish

while others would be left to ever-shifting winds. [Citation omitted.] Finally, little would remain to stop agencies from moving into areas where state authority has traditionally predominated. [Citation omitted.] That would be a particularly ironic outcome, given that so many States have robust nondelegation doctrines designed to ensure democratic accountability in their state lawmaking processes. [Citation omitted.]

The Supreme Court continued: its analysis

The Court has applied the major questions doctrine for the same reason it has applied other similar clear-statement rules—to ensure that the government does "not inadvertently cross constitutional lines." [Citation omitted.] And the constitutional lines at stake here are surely no less important than those this Court has long held sufficient to justify parallel clear-statement rules. At stake is not just a question of retroactive liability or sovereign immunity, but basic questions about self-government, equality, fair notice, federalism, and the separation of powers. [Citation omitted.] The major questions doctrine seeks to protect against "unintentional, oblique, or otherwise unlikely" intrusions on these interests. [Citation omitted.] The doctrine does so by ensuring that, when agencies seek to resolve major questions, they at least act with clear Congressional authorization and do not "exploit some gap, ambiguity, or doubtful expression in Congress' statutes to assume responsibilities far beyond" those the people's representatives actually conferred on them. [Citation omitted.] As the Court aptly summarizes it today, the doctrine addresses "a particular and recurring problem: agencies asserting highly consequential power beyond what Congress could reasonably be understood to have granted." [Citation omitted.]

Turning from the doctrine's function to its application, it seems to me that our cases supply a good deal of guidance about when an agency action involves a major question for which clear Congressional authority is required.

First, this Court has indicated that the doctrine applies when an agency claims the power to resolve a matter of great "political significance," [citation omitted]. So, for example, in Gonzales, the Court found that the doctrine applied when the Attorney General issued a regulation that would have effectively banned most forms of physician-assisted suicide even as certain States were considering whether to permit the practice. [Citation omitted.] And in NFIB v. Occupational Safety and Health Administration, the Court held the doctrine applied when an agency sought to mandate COVID–19 vaccines nationwide for most workers at a time when Congress and state legislatures were engaged in robust debates over vaccine mandates. [Citation omitted.] Relatedly, this Court has found it telling when Congress has "'considered and rejected'" bills authorizing something akin to the agency's proposed course of action. [Citation omitted.] That too may be a sign that an agency is attempting to "'work [a]round' the legislative process to resolve for itself a question of great political significance. [Citation omitted.]

Second, this Court has said that an agency must point to clear Congressional authorization when it seeks to regulate "'a significant portion of the American economy,' [citation omitted], or require "billions of dollars in spending" by private persons or entities, [citation omitted]. The Court has held that regulating tobacco products, eliminating rate regulation in the telecommunications industry, subjecting private homes to Clean Air Act restrictions, and suspending local housing laws and regulations can sometimes check this box. [Citation omitted.]

> *Third, this Court has said that the major questions doctrine may apply when an agency seeks to "intrud[e] into an area that is the particular domain of state law." [Citation omitted.] Of course, another longstanding clear-statement rule—the federalism canon—also applies in these situations. To preserve the "proper balance between the States and the Federal Government" and enforce limits on Congress' Commerce Clause power, courts must "'be certain of Congress' intent' before finding that it "legislate[d] in areas traditionally regulated by the States." [Citation omitted.] But unsurprisingly, the major questions doctrine and the federalism canon often travel together. When an agency claims the power to regulate vast swaths of American life, it not only risks intruding on Congress' power, it also risks intruding on powers reserved to the States. [Citation omitted.]*

First, courts must look to the legislative provisions on which the agency seeks to rely "'with a view to their place in the overall statutory scheme.'"

Second, courts may examine the age and focus of the statute the agency invokes in relation to the problem the agency seeks to address.

Third, courts may examine the agency's past interpretations of the relevant statute.

Fourth, skepticism may be merited when there is a mismatch between an agency's challenged action and its Congressionally assigned mission and expertise.

[3] Biden V. Nebraska (June 2024): Major Questions Doctrine.

The Supreme Court in *Biden v. Nebraska*[1152] applied the major questions doctrine. The Supreme Court also applied the plain meaning doctrine as an alternative analysis. The result was to hold that the Biden student debt relief plan was not properly authorized by the statute. The Supreme Court invalidated the Biden Administration plan for cancellation of student debt. The Supreme Court particularly emphasized the overall cost of the debt relief plan and the large number of borrowers affected by the debt cancellation. The Court additionally observed that Congress has declined directly to authorize the debt cancellation.

[4] Swisher International, Inc., V. United States Food And Drug Administration (September 2024): Major Questions Doctrine.

Swisher International, Inc., v. United States Food And Drug Administration[1153] denied a summary judgement motion involving a Food and Drug Administration rule concerning classification of tobacco products. Swisher International Inc. is a tobacco company known for its "Swisher Sweets" line of cigars. Swisher International Inc. challenged the promulgation and implementation of the Food and Drug Administration's 2016 "Deeming Rule." This rule

[1152] *Biden v. Nebraska*, 143 S. Ct. 2355 (2023).

[1153] *Swisher International, Inc., V. United States Food And Drug Administration,* 2024 W.L. 4119480 (D.D.C. 2024).

subjected tobacco products to regulation under the Family Smoking Prevention and Tobacco Control Act of 2009. The Deeming Rule required companies to submit pre-market applications to sell their products. Swisher International Inc. asserted that the Food and Drug Administration unreasonably delayed reviewing the company's applications. The court found for the Food and Drug Administration.

In 2009, Congress passed the Family Smoking Prevention and Tobacco Control Act to create a comprehensive scheme for regulating tobacco products.[1154] The Family Smoking Prevention and Tobacco Control Act initially covered four enumerated categories of "tobacco products"—"all cigarettes, cigarette tobacco, roll-your-own tobacco, and smokeless tobacco". The Act contained the Deeming Provision.[1155] The Deeming Provisions specified that, in addition to enumerated products, the Food and Drug Administration could regulate any other tobacco products that the Secretary of Health and Human Services by regulation deems to be subject to the Family Smoking Prevention and Tobacco Control Act.

In 2016, the Food and Drug Administration exercised its authority under the Deeming Provision by promulgating a rule (the Deeming Rule) to sweep all tobacco products, including cigars, into the Family Smoking Prevention and Tobacco Control Act's ambit.[1156] The Deeming Rule made cigars subject to the Family Smoking Prevention and Tobacco Control Act's requirement that manufacturers obtain FDA approval before they market and sell any new tobacco product. A "new tobacco product" was defined as any product "that was not commercially marketed in the United States as of February 15, 2007."[1157]

For truly new products, manufacturers must submit a premarket tobacco application that demonstrates that permitting the tobacco product to be marketed would be appropriate for the protection of public health.

Manufacturers also could gain approval by submitting substantial equivalence reports that demonstrate a tobacco product is "substantially equivalent" to a product that was on the market as of February 15, 2007.[1158]

For products that are modified only by adding, deleting, or changing the quantity of a tobacco additive, manufacturers can seek exemptions from the substantial equivalence requirement.[1159]

[1154] Pub. L. No. 111-31, § 2(6), 123 Stat. 1776, 1777.

[1155] 21 U.S.C. § 387a(b).

[1156] Deeming Tobacco Products to be Subject to the Federal Food Drug, and Cosmetic Act, 81 Fed. Reg. 28,974, 29,102 (May 10, 2016).

[1157] 21 U.S.C. §§ 387b(6), 387j(a)(1).

[1158] 21 U.S.C. § 387j(a)(2)(A)(i), (3)(A).

[1159] 21 U.S.C. §§ 387j(a)(2)(A)(ii), 387e(j)(3).

Products marketed without receiving authorization may be considered "adulterated" and seized, and the manufacturers, distributors, and retailers may be subject to civil and criminal enforcement.

The Deeming Rule went into effect 90 days after its publication. The Food and Drug Administration delayed much of its force by establishing "compliance periods" for manufacturers to prepare and submit premarket applications. Manufacturers had twelve months to submit substantial equivalent exemption requests, eighteen months to submit substantial equivalent reports, and twenty-four months to submit premarket tobacco applications. The Food and Drug Administration staggered the initial compliance periods based on the expected complexity of the applications to be submitted. In the Deeming Rule, the Food and Drug Administration also announced that if manufacturers submitted applications by the close of the appropriate compliance windows, the agency would not enforce the premarket review requirement for an additional twelve months following the close of the initial compliance period (*i.e.*, twenty-four months for substantial equivalent exemption requests, thirty months for substantial equivalent reports, and thirty-six months for premarket tobacco applications). In May 2017, the Food and Drug Administration extended the compliance periods by three months—both the deadlines for manufacturers to submit applications and the enforcement moratoriums. Then, in August 2017, the FDA pushed the compliance periods back again. For combustible products (like cigars), manufacturers would have until August 2021 to submit applications (under any of the three pathways), and for non-combustible products (like e-cigarettes), manufacturers would have until August 2022. The Food and Drug Administration further provided that it would extend its own enforcement moratoriums for any product on the market on August 8, 2016 and for which an application had been submitted, until the agency rendered a decision on an application or the application was withdrawn.

The Food and Drug Administration received a deluge of applications. By the September 2020 submission deadline set by the court, the Food and Drug Administration received over 7,000 substantial equivalent reports and eight million premarket tobacco applications. As of March 2024, that number had grown to nearly 9,000 substantial equivalent reports and over nine million premarket tobacco applications. Among the thousands of substantial equivalent reports, Swisher submitted 171. The Food and Drug Administration adopted a randomized ordering system for reviewing the substantial equivalent reports.

Swisher International Inc. filed this suit in Middle District of Florida and simultaneously sought a preliminary injunction prohibiting the Food and Drug Administration from enforcing the Family Smoking Prevention and Tobacco Control Act against Swisher's cigars and requiring the agency to expedite review of its substantial equivalent reports.[1160]

[1160] The Food and Drug Administration assured Swisher International Inc. that no enforcement actions against it were on the horizon and that it would notify the company if that

Among other things, Swisher International Inc. alleged that the Deeming Rule is arbitrary and capricious. Agency action is arbitrary and capricious "if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."[1161] The agency is entitled to a "presumption of regularity,"[1162], and courts must defer to the agency's expertise.[1163] Though a court may not substitute its judgment for the agency's, the agency must "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[1164]

Swisher International Inc. claimed that the Deeming Rule was arbitrary and capricious for three reasons: The agency unreasonably failed to –

- examine foreseeable consequences of the rule,
- account for manufacturers' reliance interests, and
- consider obvious alternatives.

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changed. The court denied Swisher International Inc.'s preliminary injunction motion and transferred the case to the district. Swisher International Inc. then amended its complaint to remove the preliminary injunction request. Swisher International Inc. subsequently moved to complete or supplement the administrative record that the agency had certified and sought limited discovery. The Court denied Swisher's motion. Swisher moved for summary judgment on five of the eight counts in its amended complaint. Those counts allege that the Deeming Provision violates the non-delegation doctrine (Count One), the Deeming Rule exceeds the FDA's statutory authority (Count Four), the Deeming Rule is otherwise unlawful under the Administrative Procedure Act (Count Five), the Food and Drug Administration's failure to act on Swisher International Inc.'s substantial equivalent reports is unlawful (Count Six), and the Food and Drug Administration's threatened enforcement against Swisher's cigars is unlawful (Count Eight). The Food and Drug Administration cross-moved for summary judgment on all the counts in the complaint, the remainder of which allege that the Deeming Provision violates the Appointments Clause (Count Two), the Food and Drug Administration's attempts to ratify the Deeming Rule are unlawful (Count Three), and the Food and Drug Administration's purported de facto ban on Swisher International Inc.'s cigars is unlawful (Count Seven). The Food and Drug Administration also moved to dismiss Count Eight for lack of standing and moved to amend its answer to include the affirmative defense of claim preclusion. The Food and Drug Administration asserted that all but Count Six of the amended complaint are precluded by a lawsuit brought by the cigar trade association of which Swisher International Inc. is a prominent member.

[1161] *Motor Vehicle Mfrs. Ass'n of U.S., Inc., v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

[1162] *Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 415 (1971).

[1163] *See State Farm*, 463 U.S. at 43, 53.

[1164] *Id.*. at 43.

The court rejected these assertions.[1165]

[1165] Swisher International Inc. claimed that the Food and Drug Administration's decision to deem all tobacco products at once was premised on the faulty assumption that the agency could complete premarket review for millions of newly deemed products by 2019. According to Swisher International Inc., it was therefore arbitrary for the agency to assume it could review all of the premarket tobacco applications and substantial equivalence reports for the newly deemed products in less time than it had already spent struggling to review the few thousand reports precipitated by the enactment of the Family Smoking Prevention and Tobacco Control Act.

The Food and Drug Administration made clear in the final rule the it chose the compliance deadlines based on three factors—only one of which related to its review of applications. Namely, the agency set the various deadlines to "balance the public health concerns raised" in comments to the proposed rule, "allow the Agency to more efficiently manage the flow of incoming applications," and "encourage high-quality premarket submissions from applicants." As for the "public health" consideration, the —the Food and Drug Administration received a range of recommendations, including that it afford no compliance period whatsoever to manufacturers of cigars or flavored tobacco products. The Food and Drug Administration set the compliance periods based on a range of considerations, and they were not a forecast of when the Food and Drug Administration would finish premarket review.

The Food and Drug Administration's other representations at the time the Deeming Rule was finalized confirm that it expected to be reviewing applications past the expiration of the compliance periods. The Food and Drug Administration promised to act as expeditiously as possible with respect to all new applications. The Food and Drug Administration never confirmed that it would complete review by the end of the compliance periods. The Food and Drug Administration made clear that it would "actively monitor and enforce the premarket authorization requirements . . . even if [products listed in] a submission [were] still under review" by the agency. The Food and Drug Administration explained that, at the expiration of the compliance windows, it may still choose to defer enforcement on a case-by-case basis—a representation that makes sense only if the Food and Drug Administration expected to still be reviewing applications at that time. The Deeming Rule was not premised on the assumption that the FDA would finish premarket review by 2019. The court concluded against Swisher International Inc.'s first claim.

Even if the Deeming Rule were premised on the assumption that the agency could review applications by the end of the compliance period, the rule would still satisfy arbitrary-and-capricious review. The Food and Drug Administration did not fail to provide a "reasoned response" to "significant concerns' raised by commenters." The Food and Drug Administration explained how it estimated the number of entities and products that would be affected by the rule (and therefore how many applications the Food and Drug Administration would receive).

Though the Food and Drug Administration underestimated the number of applications it would receive, this miscalculation does not render the rule arbitrary and capricious. Despite misjudging the number of applications, the Food and Drug Administration's action was not arbitrary and capricious. The "'arbitrary and capricious' standard is particularly deferential in matters implicating predictive judgments[.]" "Such calculations fall squarely within the ambit of [the agency's] expertise." "[W]hen an agency's decision is primarily predictive, [a court's] role is limited" to ensuring that the agency "acknowledge[d] factual uncertainties and identif[ied] the considerations it found persuasive."

Swisher International Inc. asserted that the Food and Drug Administration failed to consider the reliance interests of tobacco manufacturers impacted by the Deeming Rule. "When an agency changes course, . . . it must be cognizant that longstanding policies may have engendered serious

reliance interests that must be taken into account." Action is arbitrary and capricious unless the agency "assess[es] whether there were reliance interests, determine[s] whether they were significant, and weigh[s] any such interests against competing policy concerns." "Supreme Court precedent requiring the consideration of reliance interests before agencies shift policies . . . does not set a high bar." Swisher International Inc. outlined two categories of manufacturers whose interests the Food and Drug Administration allegedly ignored: (1) those affected by the Food and Drug Administration's delayed processing times and (2) those whose products could not pass premarket review at all.

For the first group, Swisher International Inc. contended that the Food and Drug Administration failed to appreciate the impact of delays because it arbitrarily assumed that it could complete premarket review by 2019. The Food and Drug Administration did not make that assumption. The Food and Drug Administration did mistakenly expect that its backlog would not grow as large as the one that accumulated for products initially deemed under the Family Smoking Prevention and Tobacco Control Act, but that miscalculation was not arbitrary and capricious. The Court therefore declined to ding the Food and Drug Administration for failing to appreciate reliance interests it reasonably did not anticipate.

For manufacturers whose applications would ultimately be denied, the Food and Drug Administration did take their reliance interests into account, albeit in somewhat piecemeal fashion. The Food and Drug Administration first assessed the relevant reliance interests. The Food and Drug Administration considered public comments that claimed the Deeming Rule's application of the grandfather date set by the Family Smoking Prevention and Tobacco Control Act was unfair to the manufacturers of the newly deemed tobacco products (particularly e-cigarettes) because these manufacturers were not on notice of pending regulation and their products would be forced from the market. The Food and Drug Administration determined that these reliance interests were not significant because it believed products would either be grandfathered into the rule or could be the subject of premarket authorization requests. The Food and Drug Administration noted that some manufacturers might fail to receive authorization for all their products, but deemed the reliance interests of these manufacturers not to be significant because they had been on notice for more than four years. The Food and Drug Administration had announced its intention to deem all tobacco products in July 2011. The Food and Drug Administration weighed these reliance interests against competing policy concerns. The Food and Drug Administration's consideration of reliance interests was not arbitrary and capricious.

Swisher International Inc. asserted that the Deeming Rule was arbitrary and capricious because the Food and Drug Administration failed to consider obvious alternatives. Agencies are required to "consider responsible alternatives to [their] chosen policy and to give [ ] reasoned explanation[s]" for rejecting those alternatives. Swisher International Inc. offered three possible alternatives that Swisher International Inc. says the agency should have considered.

Swisher International Inc. suggested that the Food and Drug Administration should have allowed "products to remain on the market while premarket review was pending so long as manufacturers submitted timely reports." Congress allowed products that were introduced after February 2007 but before the close of the Family Smoking Prevention and Tobacco Control Act's twenty-one-month compliance window to remain on the market while their applications were pending. The Food and Drug Administration considered adopting the same approach for newly deemed products. The Notice of Proposed Rulemaking contemplated indefinite compliance periods that would immunize products from enforcement while the Food and Drug Administration reviewed applications. The Food and Drug Administration opted not to adopt this proposal. The Food and Drug Administration chose to set staggered deadlines after weighing the factors described above

Count One alleged that the Deeming Provision violates the non-delegation doctrine while Count Four alleges that the Deeming Rule exceeds the FDA's statutory authority.

Swisher International Inc. claimed that the Deeming Rule exceeded the FDA's statutory authority because the Food and Drug Administration lacked authority to deem all tobacco products at once. In its view, the Food and Drug Administration was required to

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(public health, the flow of incoming applications, and the quality of premarket submissions). The Food and Drug Administration considered this alternative and gave a reasoned explanation for rejecting it.

Swisher International Inc. claimed that the Food and Drug Administration failed to consider whether cigars should have been accorded special compliance periods. The Food and Drug Administration considered this option as well. The Food and Drug Administration rejected this approach because nicotine use in any form is of particular concern for youth and pregnant women. This explanation too passes muster, according to the court.

Swisher International Inc. contended that the Food and Drug Administration failed to consider adopting a specialized process for premarket review of cigars despite comments requesting that the Food and Drug Administration adopt a distinct process that would take into account cigars' unique manufacturing processes and level of health risk relative to other tobacco products. The Food and Drug Administration was not required to respond to each proposal from the public comments. In any event, the Food and Drug Administration did address many of the specific comments Swisher International Inc. identified.

Though Swisher may disagree with some of the Food and Drug Administration's conclusions, the Food and Drug Administration did not fail to consider an alternative pathway for cigars.

Swisher International Inc. claimed that the Food and Drug Administration failed to meaningfully consider limiting the scope of the Deeming Rule to specific products, for example, only vaping products, which were the primary new entrant to the industry. The Food and Drug Administration considered limiting the scope of the rule. The Food and Drug Administration rejected that approach because it determined doing so would create regulatory loopholes and substantial delay (at the risk to public health), and would significantly impede the Food and Drug Administration's ability to create a comprehensive regulatory scheme. Deeming all tobacco products will provide the Food and Drug Administration with critical information regarding the health risks of the products. Obtaining this information is particularly important given the addictiveness of nicotine and the toxicity associated with tobacco products. The Food and Drug Administration noted its concern that manufacturers may be labeling, packaging, or otherwise representing tobacco products that are, in fact, cigarettes to be little cigars, cigarillos, or other products in order to evade the prohibition against characterizing flavors in cigarettes." The Food and Drug Administration cited research suggesting that the rise "in consumption of non-cigarette combustible products, particularly increases large cigar and pipe tobacco use, [was] associated with a decline in cigarette consumption," and noted that "industry documents indicate[d] that tobacco firms have been aware of disparities in the legal treatment of cigarettes and cigars and have made efforts to develop small cigars that cigarette smokers would smoke[.]" The Food and Drug Administration concluded that "[w]ithout a common regulatory framework, tobacco firms can exploit differences in regulatory requirements to drive consumers to different product markets."

According to the court, each of Swisher International Inc.'s arbitrary-and-capricious arguments missed the mark. The Court granted summary judgment to the Food and Drug Administration on Count Five.

deem products on a class-by-class basis. It offered three supporting theories but none succeeded with the court.

The court reviewed the statutory text. Swisher International Inc. argued that the language of the statute precluded the Deeming Rule. User fees can be assessed only on tobacco products that have been deemed either by Congress or the Food and Drug Administration. The statute makes clear that Congress contemplated that such deeming decisions would operate on a class by class basis of tobacco products. The court disagreed.[1166]

The court next addressed the major questions doctrine. Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes."[1167] Swisher International Inc. asserted that the power to deem all tobacco products to be subject to the Family Smoking Prevention and Tobacco Control Act was a major decision for which the Food and Drug Administration lacked clear Congressional authorization. The history and text of the Family Smoking

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[1166] Swisher International Inc. contended that the text of the Family Smoking Prevention and Tobacco Control Act required the Food and Drug Administration to deem each class of products one-by-one. In the Deeming Provision, Congress established that "[t]his subchapter shall apply to all cigarettes, cigarette tobacco, roll-your-own tobacco, and smokeless tobacco and to any other products that the Secretary by regulation deems to be subject to this subchapter." Swisher International Inc. suggested that because "[s]tatutory words are often known by the company they keep," Congress intended for the Food and Drug Administration, "like Congress itself, [to] make category-by-category deeming decisions." The court observed that this canon of construction is unnecessary when the words of the statute are clear. "When the words of a statute are unambiguous, then, this first canon is also the last: judicial inquiry is complete." Congress permitted the Food and Drug Administration to deem "any other tobacco product[ ]" to be subject to the Family Smoking Prevention and Tobacco Control Act. That language could hardly be clearer. "We must enforce plain and unambiguous statutory language according to its terms." It would not make sense, according to the court, for the Deeming Provision to include limitations on how the Food and Drug Administration deemed products. The Deeming Provision is listed in a subsection titled "Applicability." The provision dictates the kinds of products the Food and Drug Administration can sweep into the Family Smoking Prevention and Tobacco Control Act, not the manner by which the Food and Drug Administration effects that deeming.

21 U.S.C. § 387s provides that the Secretary shall not assess user fees "on a class of tobacco products unless such class of tobacco products is listed in section 387a(b) of this title or is deemed by the Secretary in a regulation under section 387a(b) of this title." Swisher International Inc.'s argued: "User fees can be assessed only on tobacco products that have been 'deemed,' either by Congress or the FDA—and Section 387s makes clear that Congress contemplated that such deeming decisions would operate on a 'class' by 'class' basis of tobacco products." The court observed that Section 387s governs how the Food and Drug Administration assesses user fees, not how it makes deeming decisions. Section 387s does not purport to govern how the Food and Drug Administration makes deeming decisions. It would not make sense for Congress to bury such an important limiting principle in a separate section. Swisher International Inc. sought to impose a textual constraint not found in the text, according to the court.

[1167] *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001).

Prevention and Tobacco Control Act did not support the principle, the court found. In *FDA v. Brown & Williamson Tobacco Corp.*,[1168] the Supreme Court found that Congress had not delegated to the Food and Drug Administration the authority to regulate tobacco products in the Food, Drug, and Cosmetic Act ("FDCA"). The Family Smoking Prevention and Tobacco Control Act was Congress's answer to *Brown & Williamson*.[1169] Congress intended for the Food and Drug Administration to address the public health risks of tobacco products "comprehensively, that is, in an 'all-encompassing or sweeping' fashion."[1170] Congress made that purpose manifest in the text of the statute. The Deeming Provision "is written in starkly broad terms."[1171] While the power to regulate tobacco products is a significant delegation of authority, Congress made that delegation explicit.

Swisher International Inc. claimed instead that Congress did not authorize the Food and Drug Administration to declare all tobacco products subject to regulation "in a single order . . . with the clarity required by the major-questions doctrine." Swisher International Inc. pointed to *NFIB v. Department of Labor*, 595 U.S. 109 (2022). There, the Supreme Court found that Congress did not authorize the Occupational Safety and Health Administration to issue a vaccine mandate to workers across the country. The Supreme Court noted that Occupational Safety and Health Administration could "regulate occupation-specific risks related to COVID-19"—for example, if "the virus poses a special danger because of the particular features of an employee's job or workplace" or if "researchers [ ] work with the COVID-19 virus."[1172] The "indiscriminate approach" of the nationwide vaccine mandate failed "to account for [the] crucial distinction [ ] between occupational risk and risk more generally."'[1173] Swisher International Inc. suggested that the Food and Drug Administration was in a similar position to the Occupational Safety and Health Administration. Like the Occupational Safety and Health Administration, the Food and Drug Administration cannot pass expansive regulations but has "statutory authority to issue narrower regulations on the same topic." However, unlike the Occupational Safety and Health Administration, the Food and Drug Administration does have the authority to regulate the activity at issue here—the marketing of any tobacco product. While the Supreme Court would presumably strike down Occupational Safety and Health Administration regulations that, even though enacted piecemeal, amount to a nationwide vaccine mandate, the same would not be true if the FDA took a class-by-class approach to tobacco products. *NFIB* deals with a grant of regulatory authority unlike the one at issue here, according to the court.

[1168] 529 U.S. 120 (2000).

[1169] *See Nicopure Labs, LLC v. Food and Drug Administration*, 944 F.3d 267, 272 (D.C. Cir. 2019).

[1170] *Big Time Vapes*, 963 F.3d at 445 (*quoting Gundy v. United States*, 588 U.S. 128, 141 (2019) (footnote omitted).

[1171] *Bostock v. Clayton Cnty., Georgia*, 590 U.S. 644, 680 (2020).

[1172] *Id.*. at 119.

[1173] *Id.*. (*quoting* 29 U.S.C. § 655(b)).

Swisher International Inc. suggested that to avoid non-delegation concerns with the Family Smoking Prevention and Tobacco Control Act, the Deeming Provision must be interpreted to require class-by-class decisions. "The canon of constitutional avoidance comes into play only when, after the application of ordinary textual analysis, the statute is found to be susceptible of more than one construction." [1174] Where, as here, the statute is unambiguous, "the canon simply has no application." [1175] (cleaned up).

The court determined Count Four (Deeming Rule exceeds the FDA's statutory authority) in favor of the Food and Drug Administration.

Swisher International Inc. asserted that the Deeming Provision is unconstitutional because it affords the Food and Drug Administration "unfettered discretion to deem whatever products it chooses." In *Big Time Vapes, Incorporated v. Food & Drug Administration*, [1176] the Fifth Circuit considered a non-delegation challenge to the Family Smoking Prevention and Tobacco Control Act raised by an electronic nicotine delivery systems manufacturer and an electronic nicotine delivery systems industry trade association. The Fifth Circuit rejected that challenge wholesale. The court in *Swisher International, Inc.* similarly rejected the constitutional challenge to the agency rule.

A delegation is "constitutionally sufficient if Congress clearly delineates [1] the general policy, [2] the public Food and Drug Administration which is to apply it, and [3] the boundaries of this delegated authority." [1177] The Family Smoking Prevention and Tobacco Control Act easily met these requirements. First, Congress delineated its general policy in both the purpose and fact-finding sections of the Family Smoking Prevention and Tobacco Control Act. Second, the Family Smoking Prevention and Tobacco Control Act specifies the Food and Drug Administration that makes deeming decisions: the Department of Health and Human Services, within which the Food and Drug Administration sits. Third, Congress limited the Food and Drug Administration's discretion by "enacting a controlling definition of 'tobacco product,' which necessarily restricts the HHS Secretary's power to only products meeting that definition," and by "making many of the key regulatory decisions itself." For example, the act requires manufacturers to submit data about their products and ingredients, file annual registration statements, and submit premarket authorization applications. The Family Smoking Prevention and Tobacco Control Act also placed an important outer boundary on the Secretary's authority: The Secretary cannot ban many forms of tobacco products or require "the reduction of nicotine yields of a tobacco product to zero." "As those substantive provisions show, Congress painted much of the regulatory canvas, leaving the finishing

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[1174] *Jennings v. Rodriguez*, 583 U.S. 281, 296 (2018).

[1175] *Id.*

[1176] 963 F.3d 436 (5th Cir. 2020)

[1177] *Mistretta v. United States*, 488 U.S. 361, 372–73 (1989) (*quoting Am. Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946)).

touches to the FDA. The [Supreme] Court has held, time after time, that that's enough to clear the Constitution's low hurdles."[1178]

Swisher International Inc. claimed that if the "Family Smoking Prevention and Tobacco Control Act's ten 'stated purposes' . . . provide 'clear guidance to guide' the FDA's deeming discretion," then the "Deeming Rule is unlawful because the FDA did not mention (let alone consider) the statutory purposes when enumerating the 'only pertinent limitations on the scope of the FDA's deeming authority.'" "The only pertinent limitations on the scope of Food and Drug Administration's deeming authority are the definition of "tobacco product" set forth in section 201(rr) of the FD&C Act and a provision regarding tobacco growers and similar entities and tobacco leaf[.]"

"[A]n agency's rule normally is arbitrary and capricious if it 'entirely failed to consider an important aspect of the problem' before it."'[1179] An agency defies a "statutory limitation on [its] authority" when it ignores a mandatory factor.[1180] The Food and Drug Administration did not run afoul of either stricture. While the Food and Drug Administration did not specifically acknowledge that the Family Smoking Prevention and Tobacco Control Act's purposes limited its discretion, the Food and Drug Administration nonetheless considered those purposes in crafting the Deeming Rule. "[T]he Family Smoking Prevention and Tobacco Control Act's purpose sounds in (1) protecting public health and (2) preventing young people from accessing (and becoming addicted to) tobacco products."[1181] The Food and Drug Administration factored both considerations into its decision.

Even if it was arbitrary and capricious for the Food and Drug Administration not to specifically acknowledge the Family Smoking Prevention and Tobacco Control Act's purposes, that error was harmless, according to the court. "Courts reviewing Food and Drug Administration action under section 706(2)(A)'s 'arbitrary and capricious' standard must take 'due account . . . of the rule of prejudicial error.'"[1182] "The harmless error rule applies to agency action because '[i]f the Food and Drug Administration's mistake did not affect the outcome, if it did not prejudice the petitioner, it would be senseless to vacate and remand for reconsideration.'"[1183] The Food and Drug Administration did factor the Family Smoking Prevention and Tobacco Control Act's purposes into the Deeming Rule and therefore its mistake, if it committed one, did not affect the outcome.

[1178] *Big Time Vapes*, 963 F.3d at 446.

[1179] *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1216 (D.C. Cir. 2004) (*quoting State Farm*, 463 U.S. at 43)

[1180] *United Mine Workers v. Dole*, 870 F.2d 662, 673 (D.C. Cir. 1989).

[1181] *Big Time Vapes*, 963 F.3d at 444.

[1182] *Jicarilla Apache Nation v. U.S. Dep't of Interior*, 613 F.3d 1112, 1121 (D.C. Cir. 2010) (*quoting* 5 U.S.C. § 706).

[1183] *Id.*. (*quoting PDK Labs., Inc. v. U.S. DEA*, 362 F.3d 786, 799 (D.C. Cir. 2004)).

The Court thus found that the Food and Drug Administration is entitled to summary judgment on Count One (the Deeming Provision violates the non-delegation doctrine).

[5] State Of Nebraska V. Su (November 2024): Executive Order Did Not Violate Major Questions Doctrine But Department Of Labor Acted Arbitrarily And Capriciously.

State of Nebraska v. Su[1184] was an action brought by various states alleging that an executive order directing federal agencies to include a clause in federal contracts requiring contractors to pay employees a $15 minimum wage and the Department of Labor's implementing rule violated the Federal Property and Administrative Services Act (the Federal Property and Administrative Services Act) and major questions doctrine, and that the implementing rule violated Administrative Procedure Act. The Court of Appeals for the Ninth Circuit held that:

- the executive order and the Department of Labor's rule exceeded authority granted to President and the Department of Labor in the Federal Property and Administrative Services Act;
- the executive order did not violate major questions doctrine;
- the Administrative Procedure Act applied to Department of Labor's final rule; and
- the Department of Labor acted arbitrarily and capriciously when it overlooked alternatives before adopting final rule.

In 2021, President Joseph Biden issued Executive Order 14026. This Executive Order directed federal agencies to include a clause in federal contracts requiring contractors to pay employees a $15 minimum wage. Following notice and comment, the Department of Labor issued a rule implementing the executive order. Five states challenged enforcement of the minimum wage mandate. Four of those states argued on appeal that the executive order and implementing rule violate the Federal Property and Administrative Services Act and the major questions doctrine, and that the implementing rule violates the Administrative Procedure Act.

The Ninth Circuit concluded that the Plaintiff States stated legally sufficient claims and therefore reversed the district court's order dismissing the complaint. The Ninth Circuit also vacated the district court's order denying the Plaintiff States a preliminary injunction and remanded for further proceedings consistent with the Ninth Circuit opinion.

Congress enacted the Federal Property and Administrative Services Act of 1949 "to provide the Federal Government with an economical and efficient system for . . . [p]rocuring

[1184] 121 F.4th 1 (November 2024).

and supplying property and nonpersonal services, and performing related functions including contracting."[1185]

In 2014, President Obama invoked the Federal Property and Administrative Services Act to issue an executive order requiring federal contractors to pay employees a $10.10 per hour minimum wage.[1186] Following notice and comment, the Department of Labor issued a rule implementing the executive order. The rule was not challenged.

In 2018, President Trump issued an executive order that excluded contracts related to seasonal recreational services from the minimum wage requirements of President Obama's 2014 executive order.[1187] President Trump's executive order maintained the minimum wage requirement for lodging and food services associated with seasonal recreational services. The Department of Labor issued an implementing rule following notice and comment. This rule was also unchallenged.

President Biden issued Executive Order 14026 which required federal contractors to pay employees a $15 minimum wage. President Biden rescinded President Trump's 2018 exemption for seasonal recreational services. The executive order noted that "[r]aising the minimum wage enhances worker productivity and generates higher-quality work by boosting workers' health, morale, and effort; reducing absenteeism and turnover; and lowering supervisory and training costs."

The Department of Labor issued a final rule implementing President Biden's executive order. The Department of Labor acknowledged that government expenditures may rise if the increased cost to contractors is passed along to the government. The Department of Labor concluded that increased productivity, reduced turnover, and reduced absenteeism would offset some of those costs. The Department of Labor estimated that federal contractors would pay $1.7 billion annually in extra expenses because of the rule. The Department of Labor did not quantify any cost savings resulting from increased productivity, reduced *6 turnover, and reduced absenteeism.

Five states challenged the wage mandate immediately after it took effect. The states alleged that the wage mandate violated the Federal Property and Administrative Services Act, the Administrative Procedure Act, the major questions doctrine, the non-delegation doctrine, and the Spending Clause. They sought to enjoin and to vacate both the executive order and the Department of Labor's implementing rule. The states sought a preliminary injunction, and the government sought dismissal or summary judgment.

The states, on appeal, asserted that the executive order and implementing rule violated the Federal Property and Administrative Services Act and the major questions doctrine, and

[1185] 40 U.S.C. § 101(1).

[1186] Exec. Order No. 13658, 79 Fed. Reg. 9851 (Feb. 12, 2014).

[1187] Exec. Order No. 13838, 83 Fed. Reg. 25,341 (May 25, 2018).

that the implementing rule violates the Administrative Procedure Act. They did not raise the non-delegation or spending clause claims on appeal.

Nebraska, Idaho, and Indiana had minimum wages of between $7.25 and $9.00 per hour when the mandate took effect. Arizona had a minimum wage of $12.80 per hour. And South Carolina lacked a state-specific minimum wage. In January 2024, the mandated minimum wage increased to $17.20 because of inflation, which exceeded the minimum wage in every Plaintiff State.

Appellant states raised three main arguments on appeal:

- First, Appellants argued that the district court erred in concluding that the executive order and the Department of Labor's implementing rule did not exceed the authority granted under the Federal Property and Administrative Services Act.
- Second, they argued that the minimum wage mandate violates the major questions doctrine because the Federal Property and Administrative Services Act lacks a clear statement, and the minimum wage mandate is economically and politically significant.
- Third, they argued that the district court erred in concluding that the rule was not subject to arbitrary-or-capricious review under the Administrative Procedure Act.

The Government pointed to two provisions of the Federal Property and Administrative Services Act that plausibly provided the President with the authority to issue the minimum wage mandate:

> *§ 101. Purpose*
>
> *The purpose of this subtitle is to provide the Federal Government with an economical and efficient system for the following activities:*
>
> *Procuring and supplying property and nonpersonal services, and performing related functions including contracting . . . .*
>
> *40 U.S.C. § 101.*
>
> *§ 121. Administrative*
>
> *(a) Policies prescribed by the President. – The President may prescribe policies and directives that the President considers necessary to carry out this subtitle. The policies must be consistent with this subtitle*[1188]

The Government argued that these two provisions, read together, provide the President with broad authority to implement any policy he considers necessary to carrying out

[1188] 40 U.S.C. § 121(a).

the Federal Property and Administrative Services Act so long as the policy bears some nexus to the statutory goals of economy and efficiency. The minimum wage mandate, the Government argued, has the requisite nexus to economy and efficiency.

The Ninth Circuit in *Nebraska v. Su* concluded that the minimum wage mandate exceeds the authority granted to the President and the Department of Labor in the Federal Property and Administrative Services Act.

No binding precedent had addressed the scope of the President's authority under the Federal Property and Administrative Services Act. The Ninth Circuit recently vacated as moot their opinion in *Mayes v. Biden*, which addressed the lawfulness of the federal contractor COVID-19 vaccine mandate under the Federal Property and Administrative Services Act.[1189] *Mayes* construed the Section 101 purpose statement as operative. *Mayes* concluded that the Federal Property and Administrative Services Act provided the President with the authority to issue the COVID-19 vaccine mandate.[1190] The Ninth Circuit in *Nebraska v. Su* did not find the *Mayes* analysis persuasive. The better analysis, according to the Ninth Circuit, is that the President can only issue a policy that carries out an operative provision of the Federal Property and Administrative Services Act.

The Ninth Circuit in *Nebraska v. Su* was persuaded by the analysis from other circuits which have not construed the Federal Property and Administrative Services Act's purpose statement as operative. Like the Sixth Circuit, an Eleventh Circuit judge, in assessing the legality of the COVID-19 vaccine mandate, reasoned that executive orders "cannot rest merely on the 'policy objectives of the [the Federal Property and Administrative Services Act].'"[1191] "Statements of purpose are 'in reality as well as in name not part of the Congressionally legislated or privately created set of rights and duties.'"[1192] The Fifth Circuit also held that the Federal Property and Administrative Services Act's purpose statement was not a broad grant of authority for the COVID-19 vaccine mandate.[1193] Such a broad interpretation was "in violation of Supreme Court precedent."[1194]

Relevant tools of statutory interpretation reinforced this conclusion. The Supreme Court avoids "interpreting any statutory provision in a manner that would render another provision superfluous."[1195] Elsewhere in the Federal Property and Administrative Services Act, Congress directed agencies to promote economy and efficiency in specific ways. For example, agencies must keep furniture when they move to a new office unless "the

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[1189] 67 F.4th 921 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023).

[1190] *Id.*. at 940.

[1191] *Georgia v. President of the United States*, 46 F.4th 1283, 1298 (11th Cir. 2022) (Grant, J.) (*quoting Indep. Meat Packers Ass'n v. Butz*, 526 F.2d 228, 235 (8th Cir. 1975)).

[1192] *Id.*. (*quoting* Scalia & Garner, *supra*, at 217).

[1193] *Louisiana v. Biden*, 55 F.4th 1017, 1023 n.17 (5th Cir. 2022).

[1194] *Id.*

[1195] *Bilski v. Kappos*, 561 U.S. 593, 607–08 (2010).

Administrator determines . . . that it would not be more economical and efficient to make suitable replacements." [1196] Agencies may "repair, alter, or improve rented premises if the Administrator determines that doing so is advantageous to the Government in terms of economy, efficiency, or national security." [1197] Under the Government's preferred interpretation, these sections are superfluous.

The Government's preferred interpretation would wildly expand the President's authority from other statutes that contain both the "carry out" language and a Congressional statement of purpose. For example, under the Defense Production Act, "the President may prescribe such regulations and issue such orders as the President may determine to be appropriate to carry out this chapter." [1198] A purpose section in the referenced chapter adds that "the security of the United States is dependent on the ability of the domestic industrial base to supply materials and services for the national defense." [1199] The two statutes combined surely do not authorize the President to impose any regulation on the industrial sector he deems necessary to promote national security.

The Supreme Court endorsed this interpretive approach when addressing whether Section 121 authorized the President to issue an executive order prohibiting employment discrimination by federal contractors. [1200] The Court determined that it was not necessary to decide whether the Federal Property and Administrative Services Act authorized the executive order. The Court suggested that the executive order lacked authority under the Federal Property and Administrative Services Act because Section 121(a) "authorizes Executive Orders 'necessary to effectuate [its] provisions'" and "nowhere in the Act is there a specific reference to employment discrimination." [1201]

Section 121 does not give the President unrestrained authority to issue any procurement policy that the President desires. The President can only use Section 121 to issue a policy that carries out an operative provision of the Federal Property and Administrative Services Act.

The Federal Property and Administrative Services Act authorizes the President to "'carry out' the Act's subtitles—including the above-mentioned provisions authorizing agencies to specify the terms of federal contracts." The dissent would have held that executive action under the Federal Property and Administrative Services Act is consistent with the Act's

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[1196] 40 U.S.C. § 588(c).

[1197] 40 U.S.C. § 581(c)(4); see also, e.g., 40 U.S.C. §§ 501(a)(1)(A), 506(b), 582(b), 590(a), 603(a)(1).

[1198] 50 U.S.C. § 4554(a).

[1199] 50 U.S.C. § 4502(a)(1).

[1200] *See Chrysler Corp. v. Brown*, 441 U.S. 281, 304 (1979).

[1201] *Id.*. at 304 n.34.

subtitles so long as it has some nexus to economy and efficiency. That is the law in three other circuits. That is the view that the Court applied in *Mayes v. Biden*.[1202]

The D.C. Circuit requires a "sufficiently close nexus" between a policy issued under the Federal Property and Administrative Services Act and economy and efficiency.[1203] In *Chao*,[1204] the D.C. Circuit upheld President George W. Bush's executive order requiring contractors to post notices informing employees of their right to not join a union because the policy enhanced worker productivity and had a "sufficiently close nexus" to economy and efficiency.[1205] The Fourth Circuit requires a policy only to be "reasonably related to the [Federal Property and Administrative Services Act's] purpose of ensuring efficiency and economy in government procurement."[1206] Neither court has grappled with the interpretive analysis set out above—the Fourth Circuit addressed this issue more than 40 years ago. The Fourth Circuit largely ignored any analysis using the tools of statutory interpretation, which undermines its conclusions.

The Tenth Circuit addressed a slightly different scenario: whether the Department of Labor minimum wage mandate rule is permissible as applied to recreational services permittees.[1207] The Tenth Circuit majority held that the Federal Property and Administrative Services Act authorizes the President to implement policies he considers necessary to promote an economic and efficient procurement system, pointing to Section 101 as the only source for this authority.[1208] The majority then upheld the rule because it "advances the statutory objectives of economy and efficiency."[1209]

The Ninth Circuit disagreed with this interpretive approach. The circuits that have taken this view ignored principles of statutory construction by relying on the statement-of-purpose section to locate unfettered authority for the President, according to the Ninth Circuit. Their rule would give the President the authority to implement any procurement policy he considers necessary so long as it has some relation to economy and efficiency. This interpretation would allow the President to require that "all federal contractors certify that

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[1202] 67 F.4th 921, 940 (9th Cir. 2023), *vacated as moot*, 89 F.4th 1186 (9th Cir. 2023) (lawfulness of the federal contractor COVID-19 vaccine mandate under the Federal Property and Administrative Services Act; construed the Section 101 purpose statement as operative and concluded that the Federal Property and Administrative Services Act provided the President with the authority to issue the COVID-19 vaccine mandate).

[1203] *UAW-Labor Employment & Training Corp. v. Chao*, 325 F.3d 360, 366 (D.C. Cir. 2003) (*quoting AFL-CIO v. Kahn*, 618 F.2d 784, 792 (D.C. Cir. 1979) (*en banc*)).

[1204] *UAW-Labor Employment & Training Corp. v. Chao*, 325 F.3d 360 (D.C. Cir. 2003).

[1205] *Id.*. at 362, 366–67.

[1206] *Liberty Mutual Insurance Co. v. Friedman*, 639 F.2d 164, 170 (4th Cir. 1981).

[1207] *See Bradford v. Department of Labor*, 101 F.4th 707, 732 (10th Cir. 2024), *petition for cert. filed*, No. 24-232 (U.S. Aug. 28, 2024).

[1208] *Id.*. at 721.

[1209] *Id.*. at 714.

their employees take daily vitamins, live in smoke-free homes, exercise three times a week, or even, at the extremity, take birth control in order to reduce absenteeism relating to childbirth and care."[1210] A statutory purpose statement alone cannot bear that weight, according to the Ninth Circuit.

Even under this interpretation, the Ninth Circuit found that the administrative record did not establish that the Department of Labor's rule serves the interests of economy and efficiency.

According to the Ninth Circuit in *Nebraska v. Su*, the President cannot issue an executive order instructing agencies to carry out the minimum wage mandate by pointing to any of the Federal Property and Administrative Services Act's operative sections. The Department of Labor similarly cannot issue a minimum wage rule under any of the Federal Property and Administrative Services Act's operative sections.

Appellants contended in *Nebraska v. Su* that the minimum wage mandate violates the major questions doctrine because the Federal Property and Administrative Services Act lacks a clear statement, and the minimum wage mandate is economically and politically significant. "Where the statute at issue is one that confers authority upon an administrative agency," there are certain "'extraordinary cases' that . . . provide a 'reason to hesitate before concluding that Congress' meant to confer such authority."[1211] In these cases, the agency "must point to 'clear Congressional authorization'" for the proposed regulation.[1212]

This is the *Nebraska v. Su* analysis for the major questions doctrine:

> *The Supreme Court has adopted a two-prong framework to analyze the major questions doctrine. First, we ask whether the agency action is "unheralded" and represents a "transformative expansion" in the agency's authority in the vague language of a long-extant, but rarely used, statute. Id. at 724–25 (citations omitted). Second, we ask if the regulation is of "vast economic and political significance" and "extraordinary" enough to trigger the doctrine. Id. at 716, 721 (citations omitted). If both prongs are met, the major questions doctrine applies, and we should greet the agency's assertion of authority with "skepticism" and require the agency to identify "clear congressional authorization" for its action. Id. at 724 (citation omitted).*[1213]

The Ninth Circuit concluded in *Nebraska v. Su* that the first prong of this analysis was not met because the Executive's reliance on the Federal Property and Administrative Services Act for the wage mandate is not a "transformative" expansion of its authority.[1214]

[1210] *Louisiana v. Biden*, 55 F.4th 1017, 1032 (5th Cir. 2022).

[1211] *West Virginia v. Environmental Protection Agency*, 597 U.S. 697, 721 (2022) (*quoting Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159–60 (2000)).

[1212] 597 U.S. at 723 (*quoting Util. Air Regul. Grp. v. Env't Prot. Agency*, 573 U.S. 302, 324 (2014)).

[1213] 121 F.4th at 14.

[1214] President Obama used the Federal Property and Administrative Services Act to issue a federal contractor minimum wage. President Trump issued an executive order that maintained the minimum wage requirement excepting recreational services. The relevant provisions of the Federal

Appellant States also argued on appeal that the district court erred in concluding that the Department of Labor's implementing rule is not subject to arbitrary-or-capricious review under the Administrative Procedure Act. The Administrative Procedure Act requires courts to "hold unlawful and set aside agency action . . . found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[1215] The Ninth Circuit concluded that the Department of Labor's implementing rule is subject to arbitrary-or-capricious review and that the Department of Labor acted arbitrarily or capriciously when it failed to consider alternatives.

According to the Ninth Circuit in *Nebraska v. Su*, the district court erroneously held that the Administrative Procedure Act does not apply to the Department of Labor's rule implementing President Biden's executive order. The district court reasoned that, because the President's actions are not reviewable under the Administrative Procedure Act, a court cannot review an agency's implementing rule when the executive order gives agencies no policy discretion. The district court's holding defied fundamental principles of administrative law, according to the Ninth Circuit. The district court's holding conflicts with the plain language of the Administrative Procedure Act and existing precedent, the Ninth Circuit said. (According to the Ninth Circuit, the Tenth Circuit made the same error in *Bradford*.[1216]) The district court's

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Property and Administrative Services Act have been regularly invoked. Presidents have used the Federal Property and Administrative Services Act to direct agencies to include contract provisions prohibiting discrimination, requiring contractors to inform employees that they have a right to not pay union dues, and requiring contractors to provide employees with paid sick leave.

[1215] 5 U.S.C. § 706(2)(A).

[1216] *Bradford v. Department of Labor*, 101 F.4th 707 (10th Cir. 2024) (outdoor adventure company, its owner, and trade association representing recreational services outfitters filed suit against Department of Labor, President of United States, and Department of Labor officials, claiming that Department of Labor rule that implemented President's executive order, by requiring federal contractors to pay employees $15.00 minimum hourly wage and rescinding exemption for recreational services outfitters that operated on federal lands based on permits from federal agencies, allegedly exceeded President's authority under Federal Property and Administrative Services Act, was arbitrary and capricious under Administrative Procedure Act, violated separation of powers, and that even if Federal Property and Administrative Services Act authorized Department of Labor's rule, Federal Property and Administrative Services Act unconstitutionally delegated legislative power to President and Department of Labor; District Court denied plaintiffs' motion for preliminary injunction preventing enforcement of Department of Labor's rule pending final judgment and, subsequently, denied injunction pending appeal; Court of Appeals held that: 1 plaintiffs were not likely to succeed on merits of claim that Department of Labor's rule exceeded authority granted under Federal Property and Administrative Services Act; 2 major questions doctrine did not apply to require narrowed interpretation of Federal Property and Administrative Services Act; 3 nondelegation doctrine rooted in separation of powers did not apply to require narrowed interpretation of Federal Property and Administrative Services Act; and 4 plaintiffs were not likely to succeed on merits of claim that Department of Labor's rule was arbitrary and capricious under Administrative Procedure Act).

holding would allow Presidents to insulate any desired rulemaking from judicial review with the single stroke of an executive pen, according to the Ninth Circuit.

According to the Ninth Circuit, the Administrative Procedure Act's language is plain. The Administrative Procedure Act applies to any "final agency action."[1217] No language in the Administrative Procedure Act prevents or excepts review of an agency action that implements a Presidential action. As a textual matter, final agency actions, even if implementing an executive order, are subject to judicial review under the Administrative Procedure Act.

In *Franklin v, Massachusetts*,[1218] the Supreme Court held that the President's actions are not reviewable under the Administrative Procedure Act because the President does not meet the definition of "agency." The Court reasoned that although the President is not explicitly excluded from the definition of "agency" in 5 U.S.C. Sections 701(b)(1) and 551(1), the President's unique Constitutional position is enough to overcome this "textual silence."[1219] The Government sought to extend *Franklin* to cover final agency actions that adopt policy decisions issued by the President in executive orders. Expanding *Franklin* to cover such actions−taken by an agency −in the view of the Ninth Circuit, contradicts the text of the Administrative Procedure Act. Even a purposive approach to interpreting the Administrative Procedure Act undermines such an expansion.

Such an expansion of *Franklin* is not supported by existing precedent. Neither the Supreme Court or any Circuit has never excepted a final rule from Administrative Procedure Act review because the final rule carried out a Presidential directive. The Government pointed to two district court cases in support of its argument: *Feds for Med. Freedom v. Biden*,[1220] and *Tulare County v. Bush.*[1221]. These decisions, like the district court's decision in this case, misapprehend the Administrative Procedure Act.

The D.C. Circuit has noted that just because an agency's regulations are based on an executive order, this "hardly seems to insulate them from judicial review under the APA, even if the validity of the [executive order] were thereby drawn into question."[1222] The Ninth Circuit has subjected agency actions that incorporate a Presidential directive to Administrative Procedure Act review (and specifically to arbitrary-or-capricious review).[1223] The district

[1217] 5 U.S.C. § 704.

[1218] *Franklin v. Massachusetts*, 505 U.S. 788, 800-01 (1992).

[1219] *Id.*. at 800.

[1220] 581 F. Supp. 3d 826, 835n.6 (S.D. Tex. 2022), *vacated and remanded on other grounds*, 30 F.4th 503 (5th Cir. 2022).

[1221] 185 F. Supp. 2d 18, 29 (D.D.C. 2001).

[1222] *Chamber of Commerce of the United States v. Reich*, 74 F.3d 1322, 1327 (D.C. Cir. 1996).

[1223] *See E. Bay Sanctuary Covenant v. Trump*, 932 F.3d 742, 773 (9th Cir. 2018) ("The Rule [incorporating the Presidential Proclamation] together with the Proclamation is arbitrary and capricious . . . ."); *Hawaii v. Trump*, 878 F.3d 662, 681 (9th Cir. 2017) (*per curiam*) ("[B]ecause these agencies have 'consummat[ed]' their implementation of the Proclamation, from which 'legal consequences will flow,' their actions are 'final' and therefore reviewable under the APA." (*quoting*

court's reasoning appears to rest chiefly on the policy justification that agencies would be put in the "untenable position" of having to follow mandatory executive orders and engage in Administrative Procedure Act-required deliberation about whether to choose a policy alternative unavailable under the executive order. Policy justifications cannot supersede statutory text. There is nothing untenable about analyzing the impacts, costs, and benefits of alternative policy options when issuing a rule that implements an executive order. The district court's reasoning ignores the dynamic reality of executive branch policy development, which often involves back-and-forth debate between the President and his agents. Detailing alternatives provides the President with a better understanding of the policy outcomes, gives him a chance to change his mind, and informs future decisions. Detailing alternatives does exactly what the Administrative Procedure Act is designed to do: encourage reasoned and informed policymaking.

Countervailing policy justifications caution against exempting rules implementing an executive order from Administrative Procedure Act review, according to the Ninth Circuit in *Nebraska v. Su*. To hold as the Government urges would allow Presidential administrations to issue agency regulations that evade Administrative Procedure Act-mandated accountability by simply issuing an executive order first. Agencies would be permitted to implement regulations without the public involvement, transparency, and deliberation required under the Administrative Procedure Act.

"[C]ourts should hesitate to disturb the legislative bargain embodied in the APA." [1224] This is especially true where the best justification for departing from the text of the Administrative Procedure Act is a policy reason that does not withstand scrutiny. According to the Ninth Circuit, the Department of Labor acted arbitrarily and capriciously when it overlooked alternatives to the $15 per hour minimum wage mandate. "As the APA requires that agencies engage in reasoned decisionmaking, the agency had an obligation to consider its other obligations and any alternatives, even if it could properly end up rejecting them." [1225] An agency's obligation to consider alternatives "is well settled" and includes "a duty . . . to give a reasoned explanation for its rejection of such alternatives." [1226]

Because the Government acknowledges that the Department of Labor did not consider alternatives, the Ninth Circuit in *Nebraska v. Su* confirmed that the Department of Labor rule

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Bennett v. Spear, 520 U.S. 154, 177–78 (1997))), *vacated in part on other grounds by Trump v. Hawaii*, 585 U.S. 667, 682, 775 (2018).

[1224] Kathryn E. Kovacs, *Constraining the Statutory President*, 98 Wash. U. L. Rev. 63, 84 (2020) (arguing that even the exclusion of the President from "agency" under Franklin conflicts with the history of the Administrative Procedure Act).

[1225] *National Urban League v. Ross*, 977 F.3d 770, 779 (9th Cir. 2020).

[1226] *City of Brookings Municipal Telephone Co. v. Federal Communications Commission*, 822 F.2d 1153, 1169 (D.C. Cir. 1987) (internal quotation marks and citation omitted).

violates the Administrative Procedure Act. The Ninth Circuit vacated the rule under the Administrative Procedure Act.

A concurring opinion wrote on the major questions doctrine:

As the majority concludes, the minimum wage mandate does not violate the major questions doctrine because it is not a "transformative expansion" of the President's authority under the Federal Property and Administrative Services Act (the Federal Property and Administrative Services Act). West Virginia v. Env't Prot. Agency, 597 U.S. 697, 724, 142 S.Ct. 2587, —— L.Ed.2d —— (2022) (quoting Util. Air Regul. Grp. v. Env't Prot. Agency (UARG), 573 U.S. 302, 324, 134 S.Ct. 2427, 189 L.Ed.2d 372 (2014)). I write separately to explore a more fundamental question: Does the major questions doctrine apply to statutes that delegate authority to the President? The answer, in my view, is yes. The Supreme Court has never suggested that the President is exempt from major questions analysis. And it makes little sense to think that he is. Broad legislative delegations to the Executive Branch—whether to the President or to administrative agencies—are inherently suspect. And by any measure, the minimum wage mandate is a question of "vast economic and political significance." Id. at 716, 142 S.Ct. 2587 (quoting UARG, 573 U.S. at 324, 134 S.Ct. 2427).

I

Much ink has been spilled on the "source and status" of the major questions doctrine. Biden v. Nebraska, —— U.S. ——, 143 S. Ct. 2355, 2376, 216 L.Ed.2d 1063 (2023) (Barrett, J., concurring). Some view the doctrine as a substantive canon rooted in non-delegation principles. See Nat'l Fed'n of Indep. Bus. v. Dep't of Lab., OSHA, 595 U.S. 109, 124, 142 S.Ct. 661, 211 L.Ed.2d 448 (2022) (per curiam) (Gorsuch, J., concurring) (the major questions doctrine and non-delegation doctrine are both "designed to protect the separation of powers"). Others understand the doctrine as a linguistic canon—"an interpretive tool reflecting 'common sense as to the manner in which Congress is likely to delegate a policy decision of such economic and political magnitude to an administrative agency.'" Nebraska, 143 S. Ct. at 2378 (Barrett, J., concurring) (quoting Food & Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133, 120 S.Ct. 1291, 146 L.Ed.2d 121 (2000)). The Supreme Court in West Virginia—its clearest explanation of the major questions doctrine—does not take a side on that debate. 597 U.S. at 723, 142 S.Ct. 2587 (the doctrine's justifications include "both separation of powers principles and a practical understanding of legislative intent"). Regardless of its source, the major questions doctrine does not yield because Congress delegated authority to the President and not an agency.

A

Let's assume major questions is fundamentally a separation of powers doctrine. On that view, the doctrine keeps Congress in its constitutional lane, preventing it from delegating "fundamental policy decisions" to the Executive Branch. Indus. Union Dep't, AFL-CIO v. Am. Petrol. Inst., 448 U.S. 607, 687, 100 S.Ct. 2844, 65 L.Ed.2d 1010 (1980) (Rehnquist, J., concurring in the judgment); see U.S. Const. art. I, § 1.

It makes no difference which Executive Branch officer has received an unlawful delegation: the "entire 'executive Power' belongs to the President alone." Seila Law LLC v. Consumer Fin. Prot. Bureau, 591 U.S.

197, 213, 140 S.Ct. 2183, 207 L.Ed.2d 494 (2020) (quoting U.S. Const. art. II, § 1). Yet "it would be 'impossib[le]' for 'one man' to 'perform all the great business of the State,'" thus why the President enlists subordinates to assist him in "faithfully execut[ing]" the laws. Id. (quoting 30 Writings of George Washington 334 (J. Fitzpatrick ed. 1939); U.S. Const. art. II, § 3). But the "buck stops with the President." Free Enter. Fund v. Pub. Co. Acct. Oversight Bd., 561 U.S. 477, 493, 130 S.Ct. 3138, 177 L.Ed.2d 706 (2010). Article II "makes a single President responsible for the actions of the Executive Branch"—whether they stem from the White House or a federal agency. [Citation omitted.] Id. at 496–97, 130 S.Ct. 3138 (quotation omitted); see Louisiana v. Biden, 55 F.4th 1017, 1031 n.40 (5th Cir. 2022) ("[D]elegations to the President and delegations to an agency should be treated the same under the major questions doctrine.").

Indeed, a unitary executive is entrenched in our constitutional structure. The Founders envisioned a system in which the executive power is concentrated in a single President who does not make the laws, but executes them. See The Federalist No. 51 (James Madison), Nos. 70, 77 (Alexander Hamilton). The Supreme Court's major questions cases recognize that basic premise: "Under our system of government, Congress makes laws and the President, acting at times through agencies . . . 'faithfully execute[s]' them." UARG, 573 U.S. at 327, 134 S.Ct. 2427 (quoting U.S. Const. art. II, § 3). Unconstitutional delegations are no less problematic when they are directed to the individual who ultimately "bears responsibility for the actions of the many departments and agencies within the Executive Branch." Trump, 144 S. Ct. at 2327.

Distinguishing between Presidential and agency delegations also ignores the realities of administrative decision-making. The President is likely to be closely involved in major policies, even if they are ultimately promulgated by an agency. Take student loans. President Biden campaigned on a promise to provide student debt relief for low- to middle-income borrowers. . . . After taking office, President Biden announced, "that the Department of Education will provide targeted debt relief to address the financial harms of the [COVID-19] pandemic, fulfilling [his] campaign commitment." Id. Six days later, the Department of Education published a memorandum interpreting federal law to give the Education Secretary authority "to effectuate a program of targeted loan cancellation directed at addressing the financial harms of the COVID-19 pandemic." Notice of Debt Cancellation Legal Memorandum, 87 Fed. Reg. 52,944 (Aug. 30, 2022). That agency interpretation—which satisfied a Presidential campaign promise—was later found to violate the major questions doctrine. Nebraska, 143 S. Ct. at 2372–75. The same can be said of the Department of Labor's (the Department of Labor) implementing rule. The President campaigned on this issue and directed the Department to implement a rule by Executive Order.

B

Now assume the major questions doctrine operates as a linguistic canon that "situates text in context." Nebraska, 143 S. Ct. at 2378 (Barrett, J., concurring). Here, it would be even stranger to treat the President differently. We regularly interpret statutory grants of authority. In so doing, we recognize that Congress does not "hide elephants in mouseholes." Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001); see also U.S. Telecom Ass'n v. FCC, 855 F.3d 381, 419 (D.C. Cir. 2017) (Kavanaugh, J., dissenting from denial of rehearing en banc) (the Supreme Court presumes "that Congress intends to make major policy decisions itself, not leave those decisions to agencies"). Why would our normal

interpretive process turn on the identity of the Executive Branch officer to whom Congress delegated power? An implausible reading of a statute is no less implausible when that statute confers authority on the President versus an agency.

II

The Government would have us hold that the major questions doctrine does not apply to Presidential action. It relies on our now-vacated decision in Mayes v. Biden, which concluded for the first time that the President is categorically exempt from major questions analysis.2 67 F.4th 921, 932–34 (9th Cir. 2023), vacated as moot, 89 F.4th 1186 (9th Cir. 2023).

Mayes described the Supreme Court's 2014 decision in Utility Air as the "current form" of the major questions doctrine, even though West Virginia was decided ten months before Mayes. Id. at 932–33. Casting West Virginia aside, Mayes described the doctrine as "motivated by skepticism of agency interpretations that 'would bring about an enormous and transformative expansion in . . . regulatory authority without clear Congressional authorization.'" Id. at 933 (quoting UARG, 573 U.S. at 324, 134 S.Ct. 2427) (emphasis added). Those concerns, the panel reasoned, do not apply to the President because he is more politically accountable than federal agencies. Id.

No court has ever embraced Mayes' political accountability theory. And no court is likely to after West Virginia, which does not reference "accountability" a single time in the majority opinion. See 597 U.S. at 706–35, 142 S.Ct. 2587. True, Justice Gorsuch touched on the democratic ills of divesting legislative power to administrative agencies. Id. at 739 (Gorsuch, J., concurring). Justice Gorsuch reasoned that unchecked Congressional delegations to the Executive Branch risk legislation that reflects "nothing more than the will of the current President." Id. And it would be "worse yet" if legislation embodied "the will of unelected officials barely responsive to" the President. Id.

That distinction makes sense—the President is politically accountable to the people, while his subordinates are unelected. But under separation of powers principles, it is a distinction without a difference. Again, "the executive power of the government was vested in one person"—the President. Myers v. United States, 272 U.S. 52, 116, 47 S.Ct. 21, 71 L.Ed. 160 (1926). So if major questions cases "have arisen from all corners of the administrative state," as the Supreme Court has observed, then the doctrine should apply whether a delegation is directed to the President or one of his subordinate officials. Nebraska, 143 S. Ct. at 2375 (quoting West Virginia, 597 U.S. at 721, 142 S.Ct. 2587); see Gonzales v. Oregon, 546 U.S. 243, 267, 126 S.Ct. 904, 163 L.Ed.2d 748 (2006) (the major questions doctrine applies to a Congressional delegation to the Attorney General).

In any event, a statutory delegation to the President must be valid "regardless of how likely the public is to hold the Executive Branch politically accountable." See Brown & Williamson, 529 U.S. at 161, 120 S.Ct. 1291. The President is more politically accountable than his agencies, but that does not fix an unlawful delegation. Nor does it correct what is otherwise a linguistically implausible reading of a statute. The Constitution places "carefully defined limits on the power of each Branch"—political accountability aside. INS v. Chadha, 462 U.S. 919, 958, 103 S.Ct. 2764, 77 L.Ed.2d 317 (1983).

III

Applying the major questions doctrine here, we reason that because multiple Presidents have invoked the Federal Property and Administrative Services Act to issue a wage mandate, President Biden's mandate is not a "transformative" expansion of his authority. Maj. Op. at 14-15 (quoting West Virginia, 597 U.S. at 724, 142 S.Ct. 2587). But that conclusion is only part of the story. Executive action does not implicate the major questions doctrine unless it involves a question of "vast economic and political significance." West Virginia, 597 U.S. at 716, 142 S.Ct. 2587 (quoting UARG, 573 U.S. at 324, 134 S.Ct. 2427). The minimum wage mandate satisfies that standard.

A

Start with economic significance. The major questions doctrine applies when the Executive claims authority over "a significant portion of the American economy," Nebraska, 143 S. Ct. at 2373 (quoting UARG, 573 U.S. at 324, 134 S.Ct. 2427), or requires "billions of dollars in spending" by private entities, King v. Burwell, 576 U.S. 473, 485, 135 S.Ct. 2480, 192 L.Ed.2d 483 (2015). The Department of Labor estimates that the minimum wage mandate will cost federal contractors $1.7 billion annually. Increasing the Minimum Wage for Federal Contractors, 86 Fed. Reg. 67,194 (Nov. 24, 2021). Over the next decade, the Department of Labor predicts that federal contractors will spend more than $18 billion to comply with the mandate. Id. at 67,210.

Those figures are "significant" in any sense of the word. They exceed the Biden Administration's own $200 million annual cutoff for "significant regulatory actions." Exec. Order No. 14094, 88 Fed. Reg. 21,879 (Apr. 6, 2023). And the minimum wage mandate would similarly qualify as a "major rule" under the Congressional Review Act because it has "an annual effect on the economy of $100,000,000 or more." 8 U.S.C. § 804(2)(A). As the majority explains, the mandate also causes "a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions." Id. § 804(2)(B); see Maj. Op. at 10-11, 12-14; 86 Fed. Reg. 67,206 ("relevant consumer for procurement contracts is the Federal Government" and "Government expenditures may rise" because of the mandate). "Given these circumstances, there is every reason to 'hesitate before concluding that Congress' meant to confer" on the President the authority to issue a minimum wage mandate. West Virginia, 597 U.S. at 725, 142 S.Ct. 2587 (quoting Brown & Williamson, 529 U.S. at 159, 120 S.Ct. 1291).

*The district court concluded that the minimum wage mandate is not economically significant enough to involve a major question. See Arizona v. Walsh, No. CV-22-00213, 2023 WL 120966, at *8 (D. Ariz. Jan. 6, 2023). It noted that the Clean Power Plan's $1 trillion reduction in GDP, at issue in West Virginia, significantly eclipsed the cost of President Biden's wage mandate. Id. Same with the $50 billion the Supreme Court considered a "reasonable proxy" for the nationwide eviction moratorium that flunked the major questions doctrine in Alabama Association of Realtors v. Department of Health & Human Services, 594 U.S. 758, 764–65, 141 S.Ct. 2485, 210 L.Ed.2d 856 (2021) (per curiam). Id. But this kind of side-by-side comparison cannot be dispositive. The Supreme Court has never set a floor on what qualifies as economically vast. And in at least one major questions case the Court engaged in little economic analysis at all. See Nat'l Fed'n of Indep. Bus., 595 U.S. at 117, 142 S.Ct. 661. The minimum wage mandate is less economically*

significant than other major questions, but that does not control the analysis. Thus, the Department of Labor implementing rule is economically significant.

B

The minimum wage mandate is also politically significant. The Supreme Court finds it telling when the Executive's asserted authority "has 'conveniently enabled it to enact a program' that Congress has chosen not to enact itself." Nebraska, 143 S. Ct. at 2373 (quoting West Virginia, 597 U.S. at 731, 142 S.Ct. 2587) (internal alteration omitted). Such maneuvers are a sign the Executive "is attempting to work around the legislative process to resolve for itself a question of great political significance." West Virginia, 597 U.S. at 743, 142 S.Ct. 2587 (Gorsuch, J., concurring) (cleaned up).

The President did just that here. During his 2020 campaign, President Biden promised to raise the nationwide minimum wage for all workers to $15 an hour. Statement by President Joe Biden on $15 Minimum Wage for Federal Workers and Contractors Going into Effect, The White House (Jan. 28, 2022), https://perma.cc/QLS2-R8WD. That proposal failed on the Senate floor in a bipartisan vote. Emily Cochrane & Catie Edmondson, Minimum Wage Increase Fails as 7 Democrats Vote Against the Measure, N.Y. Times (Mar. 5, 2021), https://perma.cc/M7UQ-Z8WW. Later, once the Department of Labor implementing rule took effect, President Biden described it as "a down payment" on his original campaign pledge. Statement by President Joe Biden, supra.

The minimum wage mandate's detour from the legislative process is no different from the student loan forgiveness program in Nebraska or the Clean Power Plan in West Virginia. In both cases, the Supreme Court noted that Congress considered and rejected the challenged policies before the President resorted to legislating by executive order. See Nebraska, 143 S. Ct. at 2373–74; West Virginia, 597 U.S. at 731–32, 142 S.Ct. 2587. Like student loans and greenhouse gas emissions, minimum wages have long "been the subject of an earnest and profound debate across the country," making the President's unilateral attempt to settle that debate "all the more suspect." West Virginia, 597 U.S. at 732, 142 S.Ct. 2587 (quoting Gonzales, 546 U.S. at 267–68, 126 S.Ct. 904).

IV

No matter the source of the major questions doctrine, nothing excuses the President from its commands. And the minimum wage mandate is economically and politically significant. While the doctrine does not apply here for other reasons, the faulty reasoning in the vacated Mayes opinion and by the district court below should not be repeated in future cases.

§1.17 Non-Delegation.

[1] Gundy v. United States (2019): Nondelegation Doctrine.

Gundy v. United States,[1227] involved the nondelegation doctrine.[1228] The nondelegation doctrine is based on Article I of the Constitution. The nondelegation doctrine is the concept

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[1227] 139 S. Ct. 2115 (2019). *See, also Oklahoma v. United States*, 62 F.4th 221, 228–29 (6th Cir. 2023), *cert. denied*, 144 S. Ct. 2679 (2024); *National Horsemen's Benevolent & Protective Association v. Black*, 107 F.4th 415 (5th Cir. 2024), *stay granted sub nom Horseracing Integrity and Safety Authority, Incorporated v. National Horsemen's Benevolent and Protective Association*, 2024 W.L. 4589181 (Mem.) (Octobre 28, 2024). *See, also, Cargo of the Brig Aurora v. United States*, 11 U.S. (7 Cranch) 382 (1813); *Wayman v. Southard*, 23 U.S. (10 Wheat.) 1 (1825); *Field v. Clark*, 143 U.S. 649 (1892); *In re Kollock*, 165 U.S. 526, 533 (1897); *Buttfield v. Stranahan*, 192 U.S. 470, 489 (1904); *United States v. Grimaud*, 220 U.S. 506, 509, 516 (1911); *Union Bridge Co. v. United States*, 204 U.S. 364, 386 (1907); *Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U.S. 194 (1912); *Mutual Film Corp. v. Industrial Commission of Ohio*, 236 U.S. 230, 245 (1915); *Mahler v. Eby*, 264 U.S. 32, 36-37, 40 (1924); *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394 (1928); *Shreveport Grain & Elevator Co.*, 287 U.S. 77, 85 (1932); *Federal Radio Commission v. Nelson Brothers Bond & Mortgage Co.*, 289 U.S. 266, 276 (1933); *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Wickard v. Filburn*, 317 U.S. 111, 125 (1942); *National Labor Relations Board v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 37 (1937); *Currin v. Wallace*, 306 U.S. 1 (1939); *Yakus v. United States*, 321 U.S. 414, 426 (1944); *Lichter v. United States*, 334 U.S. 742, 785 (1948); *Department of Transportation v. Association of American Railroads*, 575 U.S. 43, 61 (2015); *Currin v. Wallace*, 306 U.S. 1, 6 (1939); *Amalgamated Meat Cutters & Butcher Workmen of North America v. Connally*, 337 F. Supp. 737, 762 (D.D.C. 1971); *Mistretta v. United States*, 488 U.S. 361 (1989); *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 214 (1989); *Whitman v. American Trucking Associations*, 531 U.S. 457 (2001).

[1228] *See, e.g., Gundy v. United States,* 139 S. Ct. 2116 (2019); *United States v. Cooper*, 750 F.3d 263, 266-72 (3d Cir. 2014), *cert. denied*, 135 S. Ct. 209 (2014); *United States v. Richardson*, 754 F.3d 1143, 1145-46 (9th Cir. 2014) (*per curiam*); *United States v. Nichols*, 775 F.3d 1225, 1231-33 (10th Cir. 2014), *rev'd on other grounds*, 136 S. Ct. 1113 (2016); *United States v. Sampsell*, 541 F. App'x. 258, 259 (4th Cir. 2013) (*per curiam*) (Fourth Circuit has "consistently rejected similar non-delegation challenges in unpublished decisions"); *United States v. Goodwin*, 717 F.3d 511, 516-17 (7th Cir. 2013), *cert. denied*, 134 S. Ct. 334 (2013); *United States v. Kuehl*, 706 F.3d 917, 918-20 (8th Cir. 2013); *United States v. Parks*, 698 F.3d 1, 7-8 (1st Cir. 2012), *cert. denied*, 133 S. Ct. 2021 (2013); *United States v. Felts*, 674 F.3d 599, 606 (6th Cir. 2012); *United States v. Guzman*, 591 F.3d 83, 91-93 (2d Cir. 2010), *cert. denied*, 561 U.S. 1019 (2010); *United States v. Whaley*, 577 F.3d 254, 262-64 (5th Cir. 2009); *United States v. Ambert*, 561 F.3d 1202, 1212-14 (11th Cir. 2009); *Interstate Commerce Commission v. Cincinnati, New Orleans, & Tex. Pac. Ry. Co.*, 167 U.S. 479, 499 (1897) ("The construction put upon the statute by the supreme court of Minnesota must be accepted by this court, for the purposes of the present case, as conclusive, and not to be re-examined here as to its propriety or accuracy. The supreme court authoritatively declares that it is the expressed intention of the legislature of Minnesota, by the statute, that the rates recommended and published by the commission, if it proceeds in the manner pointed out by the act, are not simply advisory, nor merely *prima facie* equal and reasonable, but final and conclusive as to what are equal and reasonable charges; that the law neither contemplates nor allows any issue to be made or inquiry to be had as to their equality or reasonableness in fact; that, under the statute, the rates published by the

that Congress cannot delegate its constitutional law making authority to the executive branch, such as an administrative agency. The nondelegation prevents Congress from ceding its

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commission are the only ones that are lawful, and therefore, in contemplation of law, the only ones that are equal and reasonable; and that, in a proceeding for a mandamus under the statute, there is no fact to traverse except the violation of law in not complying with the recommendations of the commission. In other words, although the railroad company is forbidden to establish rates that are not equal and reasonable, there is no power in the courts to stay the hands of the commission, if it chooses to establish rates that are unequal and unreasonable. This being the construction of the statute by which we are bound in considering the present case, we are of opinion that, so construed, it conflicts with the constitution of United States in the particulars complained of by the railroad company. It deprives the company of its right to a judicial investigation, by due process of law, under the forms and with the machinery provided by the wisdom of successive ages for the investigation judicially of the truth of a matter in controversy, and substitutes therefor, as an absolute finality, the action of a railroad commission which, in view of the powers conceded to it by the state court, cannot be regarded as clothed with judicial functions, or possessing the machinery of a court of justice. Under section 8 of the statute, which the supreme court of Minnesota says is the only one which relates to the matter of the fixing by the commission of general schedules of rates, and which section, it says, fully and exclusively provides for that subject, and is complete in itself, all that the commission is required to do is, on the filing with it by a railroad company of copies of its schedules of charges, to 'find' that any part thereof is in any respect unequal or unreasonable, and then it is authorized and directed to compel the company to change the same, and adopt such charge as the commission 'shall declare to be equal and reasonable;' and to that end it is required to inform the company in writing in what respect its charges are unequal and unreasonable. No hearing is provided for; no summons or notice to the company before the commission has found what it is to find, and declared what it is to declare; no opportunity provided for the company to introduce witnesses before the commission,-in fact, nothing which has the semblance of due process of law; and although, in the present case, it appears that, prior to the decision of the commission, the company ap[p]eared before it by its agent, and the commission investigated the rates charged by the company for transporting milk, yet it does not appear what the character of the investigation was, or how the result was arrived at. By the second section of the statute in question, it is provided that all charges made by a common carrier for the transportation of passengers or property shall be equal and reasonable. Under this provision, the carrier has a right to make equal and reasonable charges for such transportation. In the present case, the return alleged that the rate of charge fixed by the commission was not equal or reasonable, and the supreme court held that the statute deprived the company of the right to show that judicially. The question of the reasonableness of a rate of charge for transportation by a railroad company, involving, as it does, the element of reasonableness both as regards the company and as regards the public, is eminently a question for judicial investigation, requiring due process of law for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law, and in violat[i]on of the constitution of the United States; and, in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws.").

legislative power to the executive branch. This restriction reflects the checks and balances system established by the Constitution.[1229]

The general grant of authority to promulgate rules and regulations under Section 7805(a) is merely a grant of power to interpret the statute. It is not a power to create law. This contrasts with specific limited grants of rulemaking authority in many other statutes. The

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[1229] *See, e.g., Loving v. United States*, 517 U.S. 748, 758 (1996); *Immigration & Naturalization Serv. v. Chadha*, 462 U.S. 919, 959 (1983); *Department of Transportation v. Association of American Railroads*, 575 U.S. 43, 61 (2015) (Alito, J., concurring) ("The principle that Congress cannot delegate away its vested powers exists to protect liberty. Our Constitution, by careful design, prescribes a process for making law, and within that process there are many accountability checkpoints. *See INS v. Chadha*, 462 U.S. 919, 959, 103 S.Ct. 2764, 77 L.Ed.2d 317 (1983). It would dash the whole scheme if Congress could give its power away to an entity that is not constrained by those checkpoints. The Constitution's deliberative process was viewed by the Framers as a valuable feature, see, e.g., Manning, *Lawmaking Made Easy*, 10 Green Bag 2d 202 (2007) ('[B]icameralism and presentment make lawmaking difficult by design' (*citing, inter alia*, The Federalist No. 62, p. 378 (J. Madison), and No. 63, at 443 – 444 (A. Hamilton))), not something to be lamented and evaded. ¶ Of course, this Court has "'almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law.'" *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 474 – 475, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) (*quoting Mistretta, supra*, at 416, 109 S.Ct. 647 (SCALIA, J., dissenting)). But the inherent difficulty of line-drawing is no excuse for not enforcing the Constitution. Rather, the formal reason why the Court does not enforce the nondelegation doctrine with more vigilance is that the other branches of Government have vested powers of their own that can be used in ways that resemble lawmaking. *See, e.g., Arlington v. FCC*, 569 U.S. – – – – , – – – – – – – – – – , n. 4, 133 S.Ct. 1863, 1873, n. 4, – – – L.Ed.2d – – – – (2013) (explaining that agency rulemakings 'are exercises of—indeed, under our constitutional structure they must be exercises of—the 'executive Power'" (*quoting* Art. II, § 1, cl. 1)). Even so, 'the citizen confronting thousands of pages of regulations—promulgated by an agency directed by Congress to regulate, say, 'in the public interest'—can perhaps be excused for thinking that it is the agency really doing the legislating.' 569 U.S., at – – – – – – – – – – , 133 S.Ct., at 1879 (ROBERTS, C.J., dissenting). ¶ When it comes to private entities, however, there is not even a fig leaf of constitutional justification. Private entities are not vested with 'legislative Powers.' Art. I, § 1. Nor are they vested with the 'executive Power,' Art. II, § 1, cl. 1, which belongs to the President. Indeed, it raises '[d]ifficult and fundamental questions' about 'the delegation of Executive power' when Congress authorizes citizen suits. *Friends of the Earth, Inc. v. Laidlaw Environmental Services (TOC), Inc.*, 528 U.S. 167, 197, 120 S.Ct. 693, 145 L.Ed.2d 610 (2000) (KENNEDY, J., concurring). A citizen suit to enforce existing law, however, is nothing compared to delegated power to create new law. By any measure, handing off regulatory power to a private entity is 'legislative delegation in its most obnoxious form.' *Carter v. Carter Coal Co.*, 298 U.S. 238, 311, 56 S.Ct. 855, 80 L.Ed. 1160 (1936). ¶ For these reasons, it is hard to imagine how delegating 'binding' tie-breaking authority to a private arbitrator to resolve a dispute between Amtrak and the FRA could be constitutional. No private arbitrator can promulgate binding metrics and standards for the railroad industry. Thus, if the term 'arbitrator' refers to a private arbitrator, or even the possibility of a private arbitrator, the Constitution is violated. See 721 F.3d, at 674 ('[T]hat the recipients of illicitly delegated authority opted not to make use of it is no antidote. It is Congress's decision to delegate that is unconstitutional' (*citing Whitman, supra*, at 473, 121 S.Ct. 903)). ¶ *Dep't of Transp. v. Ass'n of Am. Railroads*, 575 U.S. 43, 61 – 62, 135 S. Ct. 1225, 1237 – 38, 191 L. Ed. 2d 153 (2015)").

courts have rarely used nondelegation as a principle to invalidate a rule or regulation. The Supreme Court in *J.W. Hampton, Jr. & Co. v. United States*[1230] established the "intelligible principle" under which a delegation to an administrative agency satisfies nondelegation if Congress prescribed "an intelligible principle to which the person or body authorized . . . is directed to conform."[1231]

The Supreme Court in *Gundy v. United States* rejected a challenge based on the nondelegation doctrine to provisions of the Sex Offender Registration and Notification Act. *Gundy v. United States*, however, was a close call. Subsequent changes in the Supreme Court could breathe life into the nondelegation doctrine. In a future case, Justice Kavanaugh could possibly provide a decisive Supreme Court vote in favor of applying the nondelegation doctrine more generally.[1232]

The principle of nondelegation is that the Constitution does not permit Congress to delegate legislative powers to executive agencies.[1233] The nondelegation doctrine is based on separation of powers under the Constitution. The nondelegation doctrine challenges Congressional delegations of legislative power to executive agencies.[1234]

[1230] *J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394 (1928).

[1231] *Id.*. At 409.

[1232] On nondelegaion generally, see Johnathan Hall, *The Gorsuch Test: Gundy v. United States, Limiting The Administrative State, And The Future Of Nondelegation*, 70 Duke L.J. 175; Ronald A. Cass, *Delegation Reconsidered: A Delegation Doctrine for the Modern Administrative State*, 40 Harv. J.L. & Pub. Pol'y 147 (2017); Keith E. Whittington & Jason Iuliano, *The Myth of the Nondelegation Doctrine*, 165 U. Pa. L. Rev. 379 (2017); Lisa Schultz Bressman, *Disciplining Delegation After Whitman v. American Trucking Ass'ns*, 87 Cornell L. Rev. 452 (2002); Gary Lawson, *Discretion as Delegation: The "Proper" Understanding of the Nondelegation Doctrine*, 73 Geo. Wash. L. Rev. 235 (2005); Aditya Bamzai, Comment, *Delegation and Interpretive Discretion: Gundy, Kisor, and the Formation and Future of Administrative Law*, 133 Harv. L. Rev. 164 (2019); Gary Lawson, Wayne A. Logan, 17 Ohio St. J. Crim. L. 185 (2019); Jennifer L. Mascott, *Gundy v. United States: Reflections on the Court and the State of the Nondelegation Doctrine*, 26 Geo. Mason L. Rev. 1 (2018); Julian Davis Mortenson & Nicholas Bagley, *Delegation at the Founding*, 121 Colum. L. Rev. 277 (2021); Jenny Roberts, *Gundy and the Civil-Criminal Divide*, 17 Ohio St. J. Crim. L. 207 (2019) (assessing the difference between nondelegation in the criminal and civil context after Gundy).

[1233] Julian Davis Mortenson and Nicholas Bagley, *Delegation at the Founding*, 121 Colum. L. Rev. 277 (2021) (rejecting the nondelegation doctrine);

[1234] Congress has sought, for the past quarter century, to combat sex crimes and crimes against children through sex-offender registration schemes. The Sex Offender Registration and Notification Act makes more uniform and effective the prior patchwork of sex crime registration systems. The Sex Offender Registration and Notification Act requires a broader range of sex offenders to register and backs up those requirements with criminal penalties. The Act elaborates the initial registration requirements for sex offenders.[1234] The Act sets out the general rule: An offender must register "before completing a sentence of imprisonment with respect to the offense giving rise to the registration requirement."[1234] addresses the initial registration of sex offenders unable to comply with subsection (b).[1234] For individuals

The Supreme Court concluded:

> *The nondelegation doctrine bars Congress from transferring its legislative power to another branch of Government. This case requires us to decide whether 34 U.S.C. § 20913(d), enacted as part of the Sex Offender Registration and Notification Act (SORNA), violates that doctrine. We hold it does not. Under § 20913(d), the Attorney General must apply SORNA's registration requirements as soon as feasible to offenders convicted before the statute's enactment. That delegation easily passes constitutional muster.*

The Supreme Court examined Section 20913 of the Sex Offender Registration and Notification Act:

> *Section 20913—the disputed provision here—elaborates the "[i]nitial registration" requirements for sex offenders. §§ 20913(b), (d). Subsection (b) sets out the general rule: An offender must register "before completing a sentence of imprisonment with respect to the offense giving rise to the registration requirement" (or, if the offender is not sentenced to prison, "not later than [three] business days after being sentenced"). Two provisions down, subsection (d) addresses (in its title's words) the "[i]nitial registration of sex offenders unable to comply with subsection (b)." The provision states:*
>
> *"The Attorney General shall have the authority to specify the applicability of the requirements of this subchapter to sex offenders convicted before the enactment of this chapter . . . and to prescribe rules for the registration of any such sex offenders and for other categories of sex offenders who are unable to comply with subsection (b)."*
>
> *Subsection (d), in other words, focuses on individuals convicted of a sex offense before SORNA's enactment—a group we will call pre-Act offenders. Many of these individuals were unregistered at the time of*

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convicted of a sex offense before the Sex Offender Registration and Notification Act's enactment ("pre-Act offenders"), the Attorney General shall have the authority to specify the applicability of the Sex Offender Registration and Notification Act's registration requirements and to prescribe rules for their registration." [1234] Under that delegated authority under the Sex Offender Registration and Notification Act, the Attorney General issued a rule specifying that the Sex Offender Registration and Notification Act's registration requirements apply in full to pre-Act offenders. Herman Gundy, a pre-Act offender, was convicted of failing to register.

Both the District Court and the Second Circuit rejected his claim that Congress unconstitutionally delegated legislative power when it authorized the Attorney General to specify the applicability of the Sex Offender Registration and Notification Act's registration requirements to pre-Act offenders. The Supreme Court held that the Sex Offender Registration and Notification Act's provision authorizing the Attorney General to specify the applicability of the Sex Offender Registration and Notification Act's registration requirements to offenders convicted of sex offenses before the Sex Offender Registration and Notification Act's enactment did not violate the nondelegation doctrine. Justice Alito filed a concurring opinion. Justice Gorsuch filed a dissenting opinion, in which Chief Justice Roberts and Justice Thomas joined. Justice Gorsuch's dissent basically would have made a distinction between delegations that permitted executive agencies to fill up the details in legislation versus delegations that conferred the discretion to make legislative policy on an executive agency. Justice Kavanaugh took no part in the consideration or decision of the case.

SORNA's enactment, either because pre-existing law did not cover them or because they had successfully evaded that law (so were "lost" to the system). See supra, at 2121-2122. And of those potential new registrants, many or most could not comply with subsection (b)'s registration rule because they had already completed their prison sentences. For the entire group of pre-Act offenders, once again, the Attorney General "shall have the authority" to "specify the applicability" of SORNA's registration requirements and "to prescribe rules for [their] registration."

Under that delegated authority, the Attorney General issued an interim rule in February 2007, specifying that SORNA's registration requirements apply in full to "sex offenders convicted of the offense for which registration is required prior to the enactment of that Act." 72 Fed. Reg. 8897. The final rule, issued in December 2010, reiterated that SORNA applies to all pre-Act offenders. 75 Fed. Reg. 81850. That rule has remained the same to this day.

The Supreme Court looked to Article I of the Constitution concerning the nondelegation doctrine:

Article I of the Constitution provides that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States. "§ 1. Accompanying that assignment of power to Congress is a bar on its further delegation. Congress, this Court explained early on, may not transfer to another branch "powers which are strictly and exclusively legislative." Wayman v. Southard, 23 U.S. (10 Wheat.) 1, 42–43, 6 L.Ed. 253 (1825). But the Constitution does not "deny[ ] to the Congress the necessary resources of flexibility and practicality [that enable it] to perform its function[s]." Yakus v. United States, 321 U.S. 414, 425, 64 S.Ct. 660, 88 L.Ed. 834 (1944) (internal quotation marks omitted). Congress may "obtain[ ] the assistance of its coordinate Branches"—and in particular, may confer substantial discretion on executive agencies to implement and enforce the laws. Mistretta v. United States, 488 U.S. 361, 372, 109 S.Ct. 647, 102 L.Ed.2d 714 (1989). "[I]n our increasingly complex society, replete with ever changing and more technical problems," this Court has understood that "Congress simply cannot do its job absent an ability to delegate power under broad general directives." Ibid. So we have held, time and again, that a statutory delegation is constitutional as long as Congress "lay[s] down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform." Ibid. (quoting J. W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409, 48 S.Ct. 348, 72 L.Ed. 624 (1928); brackets in original).

Nondelegation depends on whether Congress has supplied an intelligible principle to guide the delegee's use of discretion:

Given that standard, a nondelegation inquiry always begins (and often almost ends) with statutory interpretation. The constitutional question is whether Congress has supplied an intelligible principle to guide the delegee's use of discretion. So the answer requires construing the challenged statute to figure out what task it delegates and what instructions it provides. See, e.g., Whitman v. American Trucking Assns., Inc., 531 U.S. 457, 473, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) (construing the text of a delegation to place constitutionally adequate "limits on the EPA's discretion"); American Power & Light Co. v. SEC, 329 U.S. 90, 104–105, 67 S.Ct. 133, 91 L.Ed. 103 (1946) (interpreting a statutory delegation, in light of its "purpose[,]

factual background[, and] context," to provide sufficiently "definite" standards). Only after a court has determined a challenged statute's meaning can it decide whether the law sufficiently guides executive discretion to accord with Article I. And indeed, once a court interprets the statute, it may find that the constitutional question all but answers itself.

The Supreme Court found that Section 29013 does not give the Attorney General unguided authority:

That is the case here, because § 20913(d) does not give the Attorney General anything like the "unguided" and "unchecked" authority that Gundy says. Brief for Petitioner 37, 45. The provision, in Gundy's view, "grants the Attorney General plenary power to determine SORNA's applicability to pre-Act offenders—to require them to register, or not, as she sees fit, and to change her policy for any reason and at any time." Id., at 42. If that were so, we would face a nondelegation question. But it is not. This Court has already interpreted § 20913(d) to say something different—to require the Attorney General to apply SORNA to all pre-Act offenders as soon as feasible. See Reynolds, 565 U.S. at 442–443, 132 S.Ct. 975. And revisiting that issue yet more fully today, we reach the same conclusion. The text, considered alongside its context, purpose, and history, makes clear that the Attorney General's discretion extends only to considering and addressing feasibility issues. Given that statutory meaning, Gundy's constitutional claim must fail. Section 20913(d)'s delegation falls well within permissible bounds.

The Court cited *Reynolds v. United States*: [1235]

This is not the first time this Court has had to interpret § 20913(d). In Reynolds, the Court considered whether SORNA's registration requirements applied of their own force to pre-Act offenders or instead applied only once the Attorney General said they did. We read the statute as adopting the latter approach. But even as we did so, we made clear how far SORNA limited the Attorney General's authority. And in that way, we effectively resolved the case now before us.

Everything in Reynolds started from the premise that Congress meant for SORNA's registration requirements to apply to pre-Act offenders. The majority recounted SORNA's "basic statutory purpose," found in its text, as follows: "the 'establish[ment of] a comprehensive national system for the registration of [sex] offenders' that includes offenders who committed their offenses before the Act became law." 565 U.S. at 442, 132 S.Ct. 975 (quoting § 20901; emphasis and alterations in original; citation omitted). That purpose, the majority further noted, informed SORNA's "broad[]" definition of "sex offender," which "include[s] any 'individual who was convicted of a sex offense.'" Id., at 442, 132 S.Ct. 975 (quoting § 20911(1); emphasis added). And those two provisions were at one with "[t]he Act's history." Id., at 442, 132 S.Ct. 975. Quoting statements from both the House and the Senate about the sex offenders then "lost" to the system, Reynolds explained that the Act's "supporters placed considerable importance upon the registration of pre-Act offenders." Ibid. In recognizing all this, the majority (temporarily) bonded with the dissenting Justices, who found it obvious that SORNA was "meant to cover pre-Act offenders." Id., at 448, 132 S.Ct. 975 (Scalia, J., dissenting). And indeed, the dissent emphasized that common ground, remarking that "the Court acknowledges" and

[1235] 565 U.S. 432, 435, 132 S.Ct. 975, 181 L.Ed.2d 935.

"rightly believes" that registration of pre-Act offenders was "what the statute sought to achieve." Id., at 448–449, 132 S.Ct. 975. [Footnote omitted.]

The Attorney General's role under Section 20913(d) was limited to apply the Sex Offender Registration and Notification Act to pre-Act offenders as soon as he thought it feasible to do so.

But if that was so, why had Congress (as the majority held) conditioned the pre-Act offenders' duty to register on a prior "ruling from the Attorney General"? Id., at 441, 132 S.Ct. 975. The majority had a simple answer: "[I]nstantaneous registration" of pre-Act offenders "might not prove feasible," or "[a]t least Congress might well have so thought." Id., at 440–441, 443, 132 S.Ct. 975. Here, the majority explained that SORNA's requirements diverged from prior state law. See id., at 440, 132 S.Ct. 975; supra, at 2121 2122. Some pre-Act offenders (as defined by SORNA) had never needed to register before; others had once had to register, but had fulfilled their old obligations. And still others (the "lost" or "missing" offenders) should have registered, but had escaped the system. As a result, SORNA created a "practical problem[ ]": It would require "newly registering or reregistering a large number of pre-Act offenders." Reynolds, 565 U.S. at 440, 132 S.Ct. 975 (internal quotation marks omitted). And attached to that broad feasibility concern was a more technical one. Recall that under SORNA "a sex offender must initially register before completing his 'sentence of imprisonment.'" Id., at 439, 132 S.Ct. 975 (quoting § 20913(b)); see supra, at 2122. But many pre-Act offenders were already out of prison, so could not comply with that requirement. That inability raised questions about "how[ ] the new registration requirements applied to them." 565 U.S. at 441, 132 S.Ct. 975. "Congress['s] solution" to both those difficulties was the same: Congress "[a]sk[ed] the Department of Justice, charged with responsibility for implementation, to examine [the issues] and to apply the new registration requirements accordingly." Ibid.

On that understanding, the Attorney General's role under § 20913(d) was important but limited: It was to apply SORNA to pre-Act offenders as soon as he thought it feasible to do so. That statutory delegation, the Court explained, would "involve[ ] implementation delay." Id., at 443, 132 S.Ct. 975. But no more than that. Congress had made clear in SORNA's text that the new registration requirements would apply to pre-Act offenders. See id., at 442–445, 132 S.Ct. 975. So (the Court continued) "there was no need" for Congress to worry about the "unrealistic possibility" that "the Attorney General would refuse to apply" those requirements on some excessively broad view of his authority under § 20913(d). Id., at 444–445, 132 S.Ct. 975. Reasonably read, SORNA enabled the Attorney General only to address (as appropriate) the "practical problems" involving pre-Act offenders before requiring them to register. Id., at 440, 132 S.Ct. 975. The delegation was a stopgap, and nothing more. [Footnote omitted.]

The Court turned to whether Section 20913(c) violated the Constitution:

Now that we have determined what § 20913(d) means, we can consider whether it violates the Constitution. The question becomes: Did Congress make an impermissible delegation when it instructed the Attorney General to apply SORNA's registration requirements to pre-Act offenders as soon as feasible? Under this Court's long-established law, that question is easy. Its answer is no.

As noted earlier, this Court has held that a delegation is constitutional so long as Congress has set out an "intelligible principle" to guide the delegee's exercise of authority. J. W. Hampton, Jr., & Co., 276 U.S. at 409, 48 S.Ct. 348; see supra, at 2123. Or in a related formulation, the Court has stated that a delegation is permissible if Congress has made clear to the delegee "the general policy" he must pursue and the "boundaries of [his] authority." American Power & Light, 329 U.S. at 105, 67 S.Ct. 133. Those standards, the Court has made clear, are not demanding. "[W]e have 'almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law.'" Whitman, 531 U.S. at 474–475, 121 S.Ct. 903 (quoting Mistretta, 488 U.S. at 416, 109 S.Ct. 647 (Scalia, J., dissenting)). Only twice in this country's history (and that in a single year) have we found a delegation excessive—in each case because "Congress had failed to articulate any policy or standard" to confine discretion. Mistretta, 488 U.S. at 373, n. 7, 109 S.Ct. 647 (emphasis added); see A. L. A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 55 S.Ct. 837, 79 L.Ed. 1570 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388, 55 S.Ct. 241, 79 L.Ed. 446 (1935). By contrast, we have over and over upheld even very broad delegations. Here is a sample: We have approved delegations to various agencies to regulate in the "public interest." See, e.g., National Broadcasting Co., 319 U.S. at 216, 63 S.Ct. 997; New York Central Securities Corp. v. United States, 287 U.S. 12, 24, 53 S.Ct. 45, 77 L.Ed. 138 (1932). We have sustained authorizations for agencies to set "fair and equitable" prices and "just and reasonable" rates. Yakus, 321 U.S. at 422, 427, 64 S.Ct. 660; FPC v. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944). We more recently affirmed a delegation to an agency to issue whatever air quality standards are "requisite to protect the public health." Whitman, 531 U.S. at 472, 121 S.Ct. 903 (quoting 42 U.S.C. § 7409(b)(1)). And so forth.

In that context, the delegation in SORNA easily passes muster (as all eleven circuit courts to have considered the question found, see supra, at 2122-2123). The statute conveyed Congress's policy that the Attorney General require pre-Act offenders to register as soon as feasible. Under the law, the feasibility issues he could address were administrative—and, more specifically, transitional—in nature. Those issues arose, as Reynolds explained, from the need to "newly register[] or reregister[] 'a large number' of pre-Act offenders" not then in the system. 565 U.S. at 440, 132 S.Ct. 975; see supra, at 2124-2125. And they arose, more technically, from the gap between an initial registration requirement hinged on imprisonment and a set of pre-Act offenders long since released. See 565 U.S. at 441, 132 S.Ct. 975; see supra, at 2124-2125. Even for those limited matters, the Act informed the Attorney General that he did not have forever to work things out. By stating its demand for a "comprehensive" registration system and by defining the "sex offenders" required to register to include pre-Act offenders, Congress conveyed that the Attorney General had only temporary authority. Or again, in the words of Reynolds, that he could prevent "instantaneous registration" and impose some "implementation delay." 565 U.S. at 443, 132 S.Ct. 975. That statutory authority, as compared to the delegations we have upheld in the past, is distinctly small-bore. It falls well within constitutional bounds. [Footnote omitted.]

Indeed, if SORNA's delegation is unconstitutional, then most of Government is unconstitutional—dependent as Congress is on the need to give discretion to executive officials to implement its programs. Consider again this Court's long-time recognition: "Congress simply cannot do its job absent an ability to delegate power

under broad general directives." Mistretta, 488 U.S. at 372, 109 S.Ct. 647; see supra, at 2123. Or as the dissent in that case agreed: "[S]ome judgments . . . must be left to the officers executing the law." 488 U.S. at 415, 109 S.Ct. 647 (opinion of Scalia, J.); see Whitman, 531 U.S. at 475, 121 S.Ct. 903 ("[A] certain degree of discretion[ ] inheres in most executive" action (internal quotation marks omitted)). Among the judgments often left to executive officials are ones involving feasibility. In fact, standards of that kind are ubiquitous in the U.S. Code. See, e.g., 12 U.S.C. § 1701z–2(a) (providing that the Secretary of Housing and Urban Development "shall require, to the greatest extent feasible, the employment of new and improved technologies, methods, and materials in housing construction[ ] under [HUD] programs"); 47 U.S.C. § 903(d)(1) (providing that "the Secretary of Commerce shall promote efficient and cost-effective use of the spectrum to the maximum extent feasible" in "assigning frequencies for mobile radio services"). In those delegations, Congress gives its delegee the flexibility to deal with real-world constraints in carrying out his charge. So too in SORNA.

It is wisdom and humility alike that this Court has always upheld such "necessities of government." Mistretta, 488 U.S. at 416, 109 S.Ct. 647 (Scalia, J., dissenting) (internal quotation marks omitted); see ibid. ("Since Congress is no less endowed with common sense than we are, and better equipped to inform itself of the 'necessities' of government; and since the factors bearing upon those necessities are both multifarious and (in the nonpartisan sense) highly political . . . it is small wonder that we have almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law"). We therefore affirm the judgment of the Court of Appeals.

In a possibly important dissent, Justice Gorsuch asserted that Congress could delegate power to administrative agencies only for three purpose:

- to fill up the details of the statute;
- to make the application of that rule depend on executive fact-finding.
- (2) to make the application of a rule dependent on certain executive fact-finding; or
- To assign the executive and judicial branches certain non-legislative responsibilities.

Justice Gorsuch wrote:

The Constitution promises that only the people's elected representatives may adopt new federal laws restricting liberty. Yet the statute before us scrambles that design. It purports to endow the nation's chief prosecutor with the power to write his own criminal code governing the lives of a half-million citizens. Yes, those affected are some of the least popular among us. But if a single executive branch official can write laws restricting the liberty of this group of persons, what does that mean for the next?

Today, a plurality of an eight-member Court endorses this extraconstitutional arrangement but resolves nothing. Working from an understanding of the Constitution at war with its text and history, the plurality reimagines the terms of the statute before us and insists there is nothing wrong with Congress handing off so

much power to the Attorney General. But Justice ALITO supplies the fifth vote for today's judgment and he does not join either the plurality's constitutional or statutory analysis, indicating instead that he remains willing, in a future case with a full Court, to revisit these matters. Respectfully, I would not wait.

I

For individuals convicted of sex offenses after Congress adopted the Sex Offender Registration and Notification Act (SORNA) in 2006, the statute offers detailed instructions. It requires them "to provide state governments with (and to update) information, such as names and current addresses, for inclusion on state and federal sex offender registries." [Footnote omitted.] The law divides offenders into three tiers based on the seriousness of their crimes: Some must register for 15 years, others for 25 years, and still others for life.2 The statute proceeds to set registration deadlines: Offenders sentenced to prison must register before they're released, while others must register within three business days after sentencing.3 The statute explains when and how offenders must update their registrations. [Footnote omitted.] And the statute specifies particular penalties for failing to comply with its commands. [Footnote omitted.] On and on the statute goes for more than 20 pages of the U.S. Code.

But what about those convicted of sex offenses before the Act's adoption? At the time of SORNA's enactment, the nation's population of sex offenders exceeded 500,000, and Congress concluded that something had to be done about these "pre-Act" offenders too. But it seems Congress couldn't agree what that should be. The treatment of pre-Act offenders proved a "controversial issue with major policy significance and practical ramifications for states." [Footnote omitted.] Among other things, applying SORNA immediately to this group threatened to impose unpopular and costly burdens on States and localities by forcing them to adopt or overhaul their own sex offender registration schemes. [Footnote omitted.] So Congress simply passed the problem to the Attorney General. For all half-million pre-Act offenders, the law says only this, in 34 U.S.C. § 20913(d):

"The Attorney General shall have the authority to specify the applicability of the requirements of this subchapter to sex offenders convicted before the enactment of this chapter . . . and to prescribe rules for the registration of any such sex offender."

Yes, that's it. The breadth of the authority Congress granted to the Attorney General in these few words can only be described as vast. As the Department of Justice itself has acknowledged, SORNA "does not require the Attorney General" to impose registration requirements on pre-Act offenders "within a certain time frame or by a date certain; it does not require him to act at all." [Footnote omitted.] If the Attorney General does choose to act, he can require all pre-Act offenders to register, or he can "require some but not all to register." [Footnote omitted.] For those he requires to register, the Attorney General may impose "some but not all of [SORNA's] registration requirements," as he pleases. [Footnote omitted.] And he is free to change his mind on any of these matters "at any given time or over the course of different [political] administrations." [Footnote omitted.] Congress thus gave the Attorney General free rein to write the rules for virtually the entire existing sex offender population in this country—a situation that promised to persist for years or decades until pre-Act offenders passed away or fulfilled the terms of their registration obligations and post-Act offenders came to predominate.

Unsurprisingly, different Attorneys General have exercised their discretion in different ways. [Footnote omitted.] For six months after SORNA's enactment, Attorney General Gonzales left past offenders alone. Then the pendulum swung the other direction when the Department of Justice issued an interim rule requiring pre-Act offenders to follow all the same rules as post-Act offenders. [Footnote omitted.] A year later, Attorney General Mukasey issued more new guidelines, this time directing the States to register some but not all past offenders. [Footnote omitted.] Three years after that, Attorney General Holder required the States to register only those pre-Act offenders convicted of a new felony after SORNA's enactment. Various Attorneys General have also taken different positions on whether pre-Act offenders might be entitled to credit for time spent in the community before SORNA was enacted. [Footnote omitted.]

These unbounded policy choices have profound consequences for the people they affect. Take our case. Before SORNA's enactment, Herman Gundy pleaded guilty in 2005 to a sexual offense. After his release from prison five years later, he was arrested again, this time for failing to register as a sex offender according to the rules the Attorney General had then prescribed for pre-Act offenders. As a result, Mr. Gundy faced an additional 10-year prison term—10 years more than if the Attorney General had, in his discretion, chosen to write the rules differently.

II

A

Our founding document begins by declaring that "We the People . . . ordain and establish this Constitution." At the time, that was a radical claim, an assertion that sovereignty belongs not to a person or institution or class but to the whole of the people. From that premise, the Constitution proceeded to vest the authority to exercise different aspects of the people's sovereign power in distinct entities. In Article I, the Constitution entrusted all of the federal government's legislative power to Congress. In Article II, it assigned the executive power to the President. And in Article III, it gave independent judges the task of applying the laws to cases and controversies.

To the framers, each of these vested powers had a distinct content. When it came to the legislative power, the framers understood it to mean the power to adopt generally applicable rules of conduct governing future actions by private persons—the power to "prescrib[e] the rules by which the duties and rights of every citizen are to be regulated," [footnote omitted] or the power to "prescribe general rules for the government of society."[Footnote omitted.]

The framers understood, too, that it would frustrate "the system of government ordained by the Constitution" if Congress could merely announce vague aspirations and then assign others the responsibility of adopting legislation to realize its goals. [Footnote omitted.] Through the Constitution, after all, the people had vested the power to prescribe rules limiting their liberties in Congress alone. No one, not even Congress, had the right to alter that arrangement. As Chief Justice Marshall explained, Congress may not "delegate . . . powers which are strictly and exclusively legislative." [Footnote omitted.] Or as John Locke, one of the thinkers who most influenced the framers' understanding of the separation of powers, described it:

"The legislative cannot transfer the power of making laws to any other hands; for it being but a delegated power from the people, they who have it cannot pass it over to others. The people alone can appoint the form of the commonwealth, which is by constituting the legislative, and appointing in whose hands that shall be. And when the people have said we will submit to rules, and be governed by laws made by such men, and in such forms, nobody else can say other men shall make laws for them; nor can the people be bound by any laws but such as are enacted by those whom they have chosen and authorised to make laws for them." [Footnote omitted.]

Why did the framers insist on this particular arrangement? They believed the new federal government's most dangerous power was the power to enact laws restricting the people's liberty. [Footnote omitted.] An "excess of law-making" was, in their words, one of "the diseases to which our governments are most liable." [Footnote omitted.] To address that tendency, the framers went to great lengths to make lawmaking difficult. In Article I, by far the longest part of the Constitution, the framers insisted that any proposed law must win the approval of two Houses of Congress—elected at different times, by different constituencies, and for different terms in office—and either secure the President's approval or obtain enough support to override his veto. Some occasionally complain about Article I's detailed and arduous processes for new legislation, but to the framers these were bulwarks of liberty.

Nor was the point only to limit the government's capacity to restrict the people's freedoms. Article I's detailed processes for new laws were also designed to promote deliberation. "The oftener the measure is brought under examination," Hamilton explained, "the greater the diversity in the situations of those who are to examine it," and "the less must be the danger of those errors which flow from want of due deliberation, or of those missteps which proceed from the contagion of some common passion or interest." [Footnote omitted.]

Other purposes animated the framers' design as well. Because men are not angels [footnote omitted] and majorities can threaten minority rights, the framers insisted on a legislature composed of different bodies subject to different electorates as a means of ensuring that any new law would have to secure the approval of a supermajority of the people's representatives. This, in turn, assured minorities that their votes would often decide the fate of proposed legislation. Indeed, some even thought a Bill of Rights would prove unnecessary in light of the Constitution's design; in their view, sound structures forcing "[a]mbition [to] . . . counteract ambition" would do more than written promises to guard unpopular minorities from the tyranny of the majority. [Footnote omitted.] Restricting the task of legislating to one branch characterized by difficult and deliberative processes was also designed to promote fair notice and the rule of law, ensuring the people would be subject to a relatively stable and predictable set of rules. [Footnote omitted.] And by directing that legislating be done only by elected representatives in a public process, the Constitution sought to ensure that the lines of accountability would be clear: The sovereign people would know, without ambiguity, whom to hold accountable for the laws they would have to follow. [Footnote omitted.]

If Congress could pass off its legislative power to the executive branch, the "[v]esting [c]lauses, and indeed the entire structure of the Constitution," would "make no sense." [Footnote omitted.] Without the involvement of representatives from across the country or the demands of bicameralism and presentment, legislation would risk becoming nothing more than the will of the current President. And if laws could be simply declared by a single person, they would not be few in number, the product of widespread social consensus, likely

to protect minority interests, or apt to provide stability and fair notice. [Footnote omitted.] Accountability would suffer too. Legislators might seek to take credit for addressing a pressing social problem by sending it to the executive for resolution, while at the same time blaming the executive for the problems that attend whatever measures he chooses to pursue. In turn, the executive might point to Congress as the source of the problem. These opportunities for finger-pointing might prove temptingly advantageous for the politicians involved, but they would also threaten to "'disguise . . . responsibility for . . . the decisions.'" [Footnote omitted.]

The framers warned us against permitting consequences like these. As Madison explained, "'[t]here can be no liberty where the legislative and executive powers are united in the same person, or body of magistrates.'" [Footnote omitted.] The framers knew, too, that the job of keeping the legislative power confined to the legislative branch couldn't be trusted to self-policing by Congress; often enough, legislators will face rational incentives to pass problems to the executive branch. Besides, enforcing the separation of powers isn't about protecting institutional prerogatives or governmental turf. It's about respecting the people's sovereign choice to vest the legislative power in Congress alone. And it's about safeguarding a structure designed to protect their liberties, minority rights, fair notice, and the rule of law. So when a case or controversy comes within the judicial competence, the Constitution does not permit judges to look the other way; we must call foul when the constitutional lines are crossed. Indeed, the framers afforded us independence from the political branches in large part to encourage exactly this kind of "fortitude . . . to do [our] duty as faithful guardians of the Constitution." [Footnote omitted.]

B

Accepting, then, that we have an obligation to decide whether Congress has unconstitutionally divested itself of its legislative responsibilities, the question follows: What's the test? Madison acknowledged that "no skill in the science of government has yet been able to discriminate and define, with sufficient certainty, its three great provinces—the legislative, executive, and judiciary." [Footnote omitted.] Chief Justice Marshall agreed that policing the separation of powers "is a subject of delicate and difficult inquiry." [Footnote omitted.] Still, the framers took this responsibility seriously and offered us important guiding principles.

First, we know that as long as Congress makes the policy decisions when regulating private conduct, it may authorize another branch to "fill up the details." In Wayman v. Southard, this Court upheld a statute that instructed the federal courts to borrow state-court procedural rules but allowed them to make certain "alterations and additions." Writing for the Court, Chief Justice Marshall distinguished between those "important subjects, which must be entirely regulated by the legislature itself," and "those of less interest, in which a general provision may be made, and power given to those who are to act . . . to fill up the details." [Footnote omitted.] The Court upheld the statute before it because Congress had announced the controlling general policy when it ordered federal courts to follow state procedures, and the residual authority to make "alterations and additions" did no more than permit courts to fill up the details.

Later cases built on Chief Justice Marshall's understanding. In In re Kollock, for example, the Court upheld a statute that assigned the Commissioner of Internal Revenue the responsibility to design tax stamps for margarine packages. [Footnote omitted.] Later still, and using the same logic, the Court sustained other and far more consequential statutes, like a law authorizing the Secretary of Agriculture to adopt rules regulating

the "use and occupancy" of public forests to protect them from "destruction" and "depredations." [Footnote omitted.] Through all these cases, small or large, runs theme that Congress must set forth standards "sufficiently definite and precise to enable Congress, the courts, and the public to ascertain" whether Congress's guidance has been followed. [Footnote omitted.]

Second, once Congress prescribes the rule governing private conduct, it may make the application of that rule depend on executive fact-finding. Here, too, the power extended to the executive may prove highly consequential. During the Napoleonic Wars, for example, Britain and France each tried to block the United States from trading with the other. Congress responded with a statute instructing that, if the President found that either Great Britain or France stopped interfering with American trade, a trade embargo would be imposed against the other country. In Cargo of Brig Aurora v. United States, this Court explained that it could "see no sufficient reason, why the legislature should not exercise its discretion [to impose an embargo] either expressly or conditionally, as their judgment should direct." [Footnote omitted.] Half a century later, Congress likewise made the construction of the Brooklyn Bridge depend on a finding by the Secretary of War that the bridge wouldn't interfere with navigation of the East River. The Court held that Congress "did not abdicate any of its authority" but "simply declared that, upon a certain fact being established, the bridge should be deemed a lawful structure, and employed the secretary of war as an agent to ascertain that fact." [Footnote omitted.]

Third, Congress may assign the executive and judicial branches certain non-legislative responsibilities. While the Constitution vests all federal legislative power in Congress alone, Congress's legislative authority sometimes overlaps with authority the Constitution separately vests in another branch. [Footnote omitted.] So, for example, when a Congressional statute confers wide discretion to the executive, no separation-of-powers problem may arise if "the discretion is to be exercised over matters already within the scope of executive power." [Footnote omitted.] Though the case was decided on different grounds, the foreign-affairs-related statute in Cargo of the Brig Aurora may be an example of this kind of permissible lawmaking, given that many foreign affairs powers are constitutionally vested in the president under Article II. Wayman itself might be explained by the same principle as applied to the judiciary: Even in the absence of any statute, courts have the power under Article III "to regulate their practice." [Footnote omitted.]

C

Before the 1930s, federal statutes granting authority to the executive were comparatively modest and usually easily upheld. But then the federal government began to grow explosively. And with the proliferation of new executive programs came new questions about the scope of Congressional delegations. Twice the Court responded by striking down statutes for violating the separation of powers.

In A. L. A. Schechter Poultry Corp. v. United States, the Court considered a statute that transferred to the President the power "to approve 'codes of fair competition'" for slaughterhouses and other industries. [Footnote omitted.] But Congress offered no meaningful guidance. It did not, for example, reference any pre-existing common law of fair competition that might have supplied guidance on the policy questions, as it arguably had done earlier with the Sherman Act. [Footnote omitted.] And it did not announce rules contingent on executive fact-finding. Nor was this assigned power one that anyone thought might inhere in the executive power.

Proceeding without the need to convince a majority of legislators, the President adopted a lengthy fair competition code written by a group of (possibly self-serving) New York poultry butchers.

Included in the code was a rule that often made it a federal crime for butchers to allow customers to select which individual chickens they wished to buy. Kosher butchers such as the Schechters had a hard time following these rules. Yet the government apparently singled out the Schechters as a test case; inspectors repeatedly visited them and, at times, apparently behaved abusively toward their customers. When the Schechters finally kicked the inspectors out, they were greeted with a criminal indictment running to dozens of counts. After a trial in which the Schechters were found guilty of selling one allegedly "unfit" chicken and other miscellaneous counts, [footnote omitted] this Court agreed to hear the case and struck down the law as a violation of the separation of powers. If Congress could permit the President to write a new code of fair competition all his own, Justice Cardozo explained, then "anything that Congress may do within the limits of the commerce clause for the betterment of business [could] be done by the President . . . by calling it a code. This is delegation running riot." [Footnote omitted.]

The same year, in Panama Refining Co. v. Ryan, the Court struck down a statute that authorized the President to decide whether and how to prohibit the interstate transportation of "'hot oil,'" petroleum produced or withdrawn from storage in excess of state-set quotas. As in Schechter Poultry, the law provided no notice to regulated parties about what the President might wind up prohibiting, leading the Court to observe that Congress "ha[d] declared no policy, ha[d] established no standard, ha[d] laid down no rule." [Footnote omitted.] The Court explained that the statute did not call for the executive to "ascertai[n] the existence of facts to which legislation is directed." [Footnote omitted.] Nor did it ask the executive to "'fill up the details'" "within the framework of the policy which the legislature has sufficiently defined." [Footnote omitted.] "If [the statute] were held valid," the Court continued, "it would be idle to pretend that anything would be left of limitations upon the power of the Congress to delegate its law-making function." [Footnote omitted.]

After Schechter Poultry and Panama Refining, Congress responded by writing a second wave of New Deal legislation more "[c]arefully crafted" to avoid the kind of problems that sank these early statutes. [Footnote omitted.] And since that time the Court hasn't held another statute to violate the separation of powers in the same way. Of course, no one thinks that the Court's quiescence can be attributed to an unwavering new tradition of more scrupulously drawn statutes. Some lament that the real cause may have to do with a mistaken "case of death by association" because Schechter Poultry and Panama Refining happened to be handed down during the same era as certain of the Court's now-discredited substantive due process decisions. [Footnote omitted.] But maybe the most likely explanation of all lies in the story of the evolving "intelligible principle" doctrine.

This Court first used that phrase in 1928 in J. W. Hampton, Jr., & Co. v. United States, where it remarked that a statute "lay[ing] down by legislative act an intelligible principle to which the [executive official] is directed to conform" satisfies the separation of powers. [Footnote omitted.] No one at the time thought the phrase meant to effect some revolution in this Court's understanding of the Constitution. While the exact line between policy and details, lawmaking and fact-finding, and legislative and non-legislative functions had sometimes invited reasonable debate, everyone agreed these were the relevant inquiries. And when Chief Justice

Taft wrote of an "intelligible principle," it seems plain enough that he sought only to explain the operation of these traditional tests; he gave no hint of a wish to overrule or revise them. Tellingly, too, he wrote the phrase seven years before Schechter Poultry and Panama Refining, and it did nothing to alter the analysis in those cases, let alone prevent those challenges from succeeding by lopsided votes.

There's a good argument, as well, that the statute in J. W. Hampton passed muster under the traditional tests. To boost American competitiveness in international trade, the legislation directed the President to "'investigat[e]'" the relative costs of production for American companies and their foreign counterparts and impose tariffs or duties that would "'equalize'" those costs. [Footnote omitted.] It also offered guidance on how to determine costs of production, listing several relevant factors and establishing a process for interested parties to submit evidence. [Footnote omitted.] The President's fact-finding responsibility may have required intricate calculations, but it could be argued that Congress had made all the relevant policy decisions, and the Court's reference to an "intelligible principle" was just another way to describe the traditional rule that Congress may leave the executive the responsibility to find facts and fill up details. [Footnote omitted.]

Still, it's undeniable that the "intelligible principle" remark eventually began to take on a life of its own. We sometimes chide people for treating judicial opinions as if they were statutes, divorcing a passing comment from its context, ignoring all that came before and after, and treating an isolated phrase as if it were controlling. [Footnote omitted.] But that seems to be exactly what happened here. For two decades, no one thought to invoke the "intelligible principle" comment as a basis to uphold a statute that would have failed more traditional separation-of-powers tests. In fact, the phrase sat more or less silently entombed until the late 1940s. Only then did lawyers begin digging it up in earnest and arguing to this Court that it had somehow displaced (sub silentio of course) all prior teachings in this area. [Footnote omitted.]

This mutated version of the "intelligible principle" remark has no basis in the original meaning of the Constitution, in history, or even in the decision from which it was plucked. Judges and scholars representing a wide and diverse range of views have condemned it as resting on "misunderst[ood] historical foundations." [Footnote omitted.] They have explained, too, that it has been abused to permit delegations of legislative power that on any other conceivable account should be held unconstitutional. Indeed, where some have claimed to see "intelligible principles" many "less discerning readers [have been able only to] find gibberish." [Footnote omitted.] Even Justice Douglas, one of the fathers of the administrative state, came to criticize excessive Congressional delegations in the period when the intelligible principle "test" began to take hold. [Footnote omitted.]

Still, the scope of the problem can be overstated. At least some of the results the Court has reached under the banner of the abused "intelligible principle" doctrine may be consistent with more traditional teachings. Some delegations have, at least arguably, implicated the president's inherent Article II authority. The Court has held, for example, that Congress may authorize the President to prescribe aggravating factors that permit a military court-martial to impose the death penalty on a member of the Armed Forces convicted of murder—a decision that may implicate in part the President's independent commander-in-chief authority. [Footnote omitted.] Others of these cases may have involved laws that specified rules governing private conduct but

conditioned the application of those rules on fact-finding—a practice that is, as we've seen, also long associated with the executive function. [Footnote omitted.]

More recently, too, we've sought to tame misunderstandings of the intelligible principle "test." In Touby v. United States, the Court considered a provision of the Controlled Substances Act that allowed the Attorney General to add a substance to a list of prohibited drugs temporarily if he determined that doing so was "'necessary to avoid an imminent hazard to the public safety.'" [Footnote omitted.] Notably, Congress required the Attorney General, before acting, to consider the drug's "'history and current pattern of abuse,'" the "'scope, duration, and significance of [that] abuse,'" and "'[w]hat, if any, risk there is to the public health.'" [Footnote omitted.] In approving the statute, the Court stressed all these constraints on the Attorney General's discretion and, in doing so, seemed to indicate that the statute supplied an "intelligible principle" because it assigned an essentially fact-finding responsibility to the executive. Whether or not one agrees with its characterization of the statute, in proceeding as it did Touby may have at least begun to point us back in the direction of the right questions. To determine whether a statute provides an intelligible principle, we must ask: Does the statute assign to the executive only the responsibility to make factual findings? Does it set forth the facts that the executive must consider and the criteria against which to measure them? And most importantly, did Congress, and not the Executive Branch, make the policy judgments? Only then can we fairly say that a statute contains the kind of intelligible principle the Constitution demands.

While it's been some time since the Court last held that a statute improperly delegated the legislative power to another branch—thanks in no small measure to the intelligible principle misadventure—the Court has hardly abandoned the business of policing improper legislative delegations. When one legal doctrine becomes unavailable to do its intended work, the hydraulic pressures of our constitutional system sometimes shift the responsibility to different doctrines. [Footnote omitted.] And that's exactly what's happened here. We still regularly rein in Congress's efforts to delegate legislative power; we just call what we're doing by different names.

Consider, for example, the "major questions" doctrine. Under our precedents, an agency can fill in statutory gaps where "statutory circumstances" indicate that Congress meant to grant it such powers. [Footnote omitted.] But we don't follow that rule when the "statutory gap" concerns "a question of deep 'economic and political significance' that is central to the statutory scheme." [Footnote omitted.] So we've rejected agency demands that we defer to their attempts to rewrite rules for billions of dollars in healthcare tax credits, [Footnote omitted.] to assume control over millions of small greenhouse gas sources, [Footnote omitted.] and to ban cigarettes. [Footnote omitted.] Although it is nominally a canon of statutory construction, we apply the major questions doctrine in service of the constitutional rule that Congress may not divest itself of its legislative power by transferring that power to an executive agency.

Consider, too, this Court's cases addressing vagueness. "A vague law," this Court has observed, "impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an ad hoc and subjective basis." [Footnote omitted.] And we have explained that our doctrine prohibiting vague laws is an outgrowth and "corollary of the separation of powers." [Footnote omitted.] It's easy to see, too, how most any challenge to a legislative delegation can be reframed as a vagueness complaint: A statute that does not contain "sufficiently definite and precise" standards "to enable Congress, the courts, and the public to ascertain" whether

Congress's guidance has been followed at once presents a delegation problem and provides impermissibly vague guidance to affected citizens. [Footnote omitted.] And it seems little coincidence that our void-for-vagueness cases became much more common soon after the Court began relaxing its approach to legislative delegations. Before 1940, the Court decided only a handful of vagueness challenges to federal statutes. Since then, the phrase "void for vagueness" has appeared in our cases well over 100 times.

Nor have we abandoned enforcing other sides of the separation-of-powers triangle between the legislative, executive, and judiciary. We have not hesitated to prevent Congress from "confer[ring] the Government's 'judicial Power' on entities outside Article III." [Footnote omitted.] We've forbidden the executive from encroaching on legislative functions by wielding a line-item veto. [Footnote omitted.] We've prevented Congress from delegating its collective legislative power to a single House. [Footnote omitted.] And we've policed legislative efforts to control executive branch officials. [Footnote omitted.] These cases show that, when the separation of powers is at stake, we don't just throw up our hands. In all these areas, we recognize that abdication is "not part of the constitutional design." [Footnote omitted.] And abdication here would be no more appropriate. To leave this aspect of the constitutional structure alone undefended would serve only to accelerate the flight of power from the legislative to the executive branch, turning the latter into a vortex of authority that was constitutionally reserved for the people's representatives in order to protect their liberties.

III

A

Returning to SORNA with this understanding of our charge in hand, problems quickly emerge. Start with this one: It's hard to see how SORNA leaves the Attorney General with only details to fill up. Of course, what qualifies as a detail can sometimes be difficult to discern and, as we've seen, this Court has upheld statutes that allow federal agencies to resolve even highly consequential details so long as Congress prescribes the rule governing private conduct. But it's hard to see how the statute before us could be described as leaving the Attorney General with only details to dispatch. As the government itself admitted in Reynolds, *SORNA leaves the Attorney General free to impose on 500,000 pre-Act offenders all of the statute's requirements, some of them, or none of them. The Attorney General may choose which pre-Act offenders to subject to the Act. And he is free to change his mind at any point or over the course of different political administrations. In the end, there isn't a single policy decision concerning pre-Act offenders on which Congress even tried to speak, and not a single other case where we have upheld executive authority over matters like these on the ground they constitute mere "details." This much appears to have been deliberate, too. Because members of Congress could not reach consensus on the treatment of pre-Act offenders, it seems this was one of those situations where they found it expedient to hand off the job to the executive and direct there the blame for any later problems that might emerge.*

Nor can SORNA be described as an example of conditional legislation subject to executive fact-finding. To be sure, Congress could have easily written this law in that way. It might have required all pre-Act offenders to register, but then given the Attorney General the authority to make case-by-case exceptions for offenders who do not present an "'imminent hazard to the public safety'" comparable to that posed by newly released post-Act offenders. [Footnote omitted.] It could have set criteria to inform that determination, too,

asking the executive to investigate, say, whether an offender's risk of recidivism correlates with the time since his last offense, or whether multiple lesser offenses indicate higher or lower risks than a single greater offense.

But SORNA did none of this. Instead, it gave the Attorney General unfettered discretion to decide which requirements to impose on which pre-Act offenders. The Attorney General's own edicts acknowledge the considerable policy-making powers he enjoys, describing his rules governing pre-Act offenders as "'of fundamental importance to the initial operation of SORNA, and to its practical scope . . . since [they] determin[e] the applicability of SORNA's requirements to virtually the entire existing sex offender population.'" [Footnote omitted.] These edicts tout, too, the Attorney General's "discretion to apply SORNA's requirements to sex offenders with pre-SORNA convictions if he determines (as he has) that the public benefits of doing so outweigh any adverse effects." [Footnote omitted.] Far from deciding the factual predicates to a rule set forth by statute, the Attorney General himself acknowledges that the law entitles him to make his own policy decisions.

Finally, SORNA does not involve an area of overlapping authority with the executive. Congress may assign the President broad authority regarding the conduct of foreign affairs or other matters where he enjoys his own inherent Article II powers. But SORNA stands far afield from any of that. It gives the Attorney General the authority to "prescrib[e] the rules by which the duties and rights" of citizens are determined, a quintessentially legislative power. [Footnote omitted.]

Our precedents confirm these conclusions. If allowing the President to draft a "cod[e] of fair competition" for slaughterhouses was "delegation running riot," then it's hard to see how giving the nation's chief prosecutor the power to write a criminal code rife with his own policy choices might be permissible. [Footnote omitted.] And if Congress may not give the President the discretion to ban or allow the interstate transportation of petroleum, then it's hard to see how Congress may give the Attorney General the discretion to apply or not apply any or all of SORNA's requirements to pre-Act offenders, and then change his mind at any time. [Footnote omitted.] If the separation of powers means anything, it must mean that Congress cannot give the executive branch a blank check to write a code of conduct governing private conduct for a half-million people.

The statute here also sounds all the alarms the founders left for us. Because Congress could not achieve the consensus necessary to resolve the hard problems associated with SORNA's application to pre-Act offenders, it passed the potato to the Attorney General. And freed from the need to assemble a broad supermajority for his views, the Attorney General did not hesitate to apply the statute retroactively to a politically unpopular minority. Nor could the Attorney General afford the issue the kind of deliberative care the framers designed a representative legislature to ensure. Perhaps that's part of the reason why the executive branch found itself rapidly adopting different positions across different administrations. And because SORNA vested lawmaking power in one person rather than many, it should be no surprise that, rather than few and stable, the edicts have proved frequent and shifting, with fair notice sacrificed in the process. Then, too, there is the question of accountability. In passing this statute, Congress was able to claim credit for "comprehensively" addressing the problem of the entire existing population of sex offenders (who can object to that?), while in fact leaving the Attorney General to sort it out.

It would be easy enough to let this case go. After all, sex offenders are one of the most disfavored groups in our society. But the rule that prevents Congress from giving the executive carte blanche to write laws for sex offenders is the same rule that protects everyone else. Nor is it hard to imagine how the power at issue in this case—the power of a prosecutor to require a group to register with the government on pain of weighty criminal penalties—could be abused in other settings. To allow the nation's chief law enforcement officer to write the criminal laws he is charged with enforcing—to "'unit[e]'" the "'legislative and executive powers . . . in the same person'"—would be to mark the end of any meaningful enforcement of our separation of powers and invite the tyranny of the majority that follows when lawmaking and law enforcement responsibilities are united in the same hands. [Footnote omitted.]

Nor would enforcing the Constitution's demands spell doom for what some call the "administrative state." The separation of powers does not prohibit any particular policy outcome, let alone dictate any conclusion about the proper size and scope of government. Instead, it is a procedural guarantee that requires Congress to assemble a social consensus before choosing our nation's course on policy questions like those implicated by SORNA. What is more, Congress is hardly bereft of options to accomplish all it might wish to achieve. It may always authorize executive branch officials to fill in even a large number of details, to find facts that trigger the generally applicable rule of conduct specified in a statute, or to exercise non-legislative powers. Congress can also commission agencies or other experts to study and recommend legislative language. Respecting the separation of powers forecloses no substantive outcomes. It only requires us to respect along the way one of the most vital of the procedural protections of individual liberty found in our Constitution.

B

What do the government and the plurality have to say about the constitutional concerns SORNA poses? Most everyone, the plurality included, concedes that if SORNA allows the Attorney General as much authority as we have outlined, it would present "a nondelegation question."89 So the only remaining available tactic is to try to make this big case "small-bore"90 by recasting the statute in a way that might satisfy any plausible separation-of-powers test. So, yes, just a few years ago in Reynolds the government represented to this Court that SORNA granted the Attorney General nearly boundless discretion with respect to pre-Act offenders. But now, faced with a constitutional challenge, the government speaks out of the other side of its mouth and invites us to reimagine SORNA as compelling the Attorney General to register pre-Act offenders "to the maximum extent feasible." And, as thus reinvented, the government insists, the statute supplies a clear statement of legislative policy, with only details for the Attorney General to clean up.

But even this new dream of a statute wouldn't be free from doubt. A statute directing an agency to regulate private conduct to the extent "feasible" can have many possible meanings: It might refer to "technological" feasibility, "economic" feasibility, "administrative" feasibility, or even "political" [Footnote omitted.] feasibility. Such an "evasive standard" could threaten the separation of powers if it effectively allowed the agency to make the "important policy choices" that belong to Congress while frustrating "meaningful judicial review." [Footnote omitted.] And that seems exactly the case here, where the Attorney General is left free to make all the important policy decisions and it is difficult to see what standard a court might later use to judge whether he exceeded the bounds of the authority given to him.

But don't worry over that; return to the real world. The bigger problem is that the feasibility standard is a figment of the government's (very recent) imagination. The only provision addressing pre-Act offenders, § 20913(d), says nothing about feasibility. And the omission can hardly be excused as some oversight: No one doubts that Congress knows exactly how to write a feasibility standard into law when it wishes. [Footnote omitted.] Unsurprisingly, too, the existence of some imaginary statutory feasibility standard seemed to have escaped notice at the Department of Justice during the Attorney General's many rulemakings; in those proceedings, as we have seen, the Attorney General has repeatedly admitted that the statute affords him the authority to "balance" the burdens on sex offenders with "public safety interests" as and how he sees fit. [Footnote omitted.]

Unable to muster a feasibility standard from the only statutory provision addressing pre-Act offenders, the plurality invites us to hunt in other and more unlikely corners. It points first to SORNA's "[d]eclaration of purpose," which announces that Congress, "[i]n order to protect the public from sex offenders and offenders against children . . . establishes a comprehensive national system for the registration of those offenders." [Footnote omitted.] But nowhere is feasibility mentioned here either. In fact, this provision doesn't purport to guide the Attorney General's discretion at all. Instead, it simply declares what Congress believed the rest of the statute's enacted provisions had already "establishe[d]," without the need for any action by the Attorney General. And by now surely we must all agree that broad and sweeping statements like these about "a statute's 'basic purpose' are . . . inadequate to overcome the words of its text regarding the specific issue under consideration." [Footnote omitted.] While those adopting SORNA might have declared that they hoped and wished for a "comprehensive national system," the fact remains that the law they actually adopted for pre-Act offenders leaves everything to the Attorney General. Hopes and dreams are not laws.

Besides, even if we were to pretend that § 20901 amounted to a directive telling the Attorney General to establish a "comprehensive national system" for pre-Act offenders, the plurality reads too much into the word "comprehensive." Comprehensive coverage does not mean coverage to the maximum extent feasible. "Comprehensive" means "having the attribute of comprising or including much; of large content or scope," "[i]nclusive of; embracing," or "[c]ontaining much in small compass; compendious."96 So, for example, a criminal justice system may be called "comprehensive" even though many crimes go unpursued. And SORNA itself contains all sorts of coverage exceptions for post-Act offenders yet claims to comprehensively address them. [Footnote omitted.] In the same way, no reason exists why SORNA might not also claim to address pre-Act offenders "comprehensively" even though the Attorney General is free to exercise his discretion to forgo registration for some, many, or maybe all of them. The statute still "comprehensively" addresses these persons by indicating they must abide whatever rules an Attorney General may choose. In all these ways, SORNA might be said to address sex offenders past, present, and future in a way that "compris[es] or includ[es] much," and that is "of large content or scope," but in a way that nevertheless delegates important policy decisions to the executive branch.

Finding it impossible to conscript the statute's declaration of purpose into doing the work it needs done, the government and plurality next ask us to turn to SORNA's definition of "'sex offender.'" [Footnote omitted.] They emphasize that SORNA defines a "sex offender" as "'an individual who was convicted of a sex offense'"—and, they note, pre-Act offenders meet this definition. [Footnote omitted.] Because pre-Act

offenders fall within the definition of "sex offender[s]," the government and plurality continue, it follows that the Attorney General must ensure all of them are registered and subject to SORNA's demands.

That much, however, does not follow. To say that pre-Act sex offenders fall within the definition of "sex offenders" is merely a truism: Yes, of course, these people have already been convicted of sex offenses under state law. But whether these individuals are also subject to federal registration requirements is a different question entirely. And as we have seen, the only part of the statute that speaks to pre-Act sex offenders—§ 20913(d)—makes plain that they are not automatically subject to all the Act's terms but are left to their fate at the hands of the Attorney General. Look at it this way: If the statute's definitional section were really enough to command the registration of all sex offenders, the Act would have had no need to proceed to explain, as it does at great length, when post-Act sex offenders must register and when they need not.

If that argument won't work, the plurality points us to § 20913(d)'s second clause, which grants the Attorney General the authority "to prescribe rules for the registration of . . . sex offenders . . . who are unable to comply" with the Act's initial registration requirements. [Footnote omitted.] According to the plurality, this language suggests that Congress expected the Attorney General to register pre-Act offenders to the maximum extent feasible. But, of course, this clause, too, says nothing of the sort. And the authority provided under § 20913(d)'s first clause—which gives the Attorney General the blanket authority "to specify the applicability of the requirements of this subchapter"—is additional to the authority granted under the second clause. So not only does the Attorney General have the authority to prescribe rules for the registration of pre-Act offenders under the second clause, he is free to specify which statutory requirements he does and does not wish to apply under the first clause. Far from suggesting a maximalist approach then, the second clause read in light of the first only serves to underscore the breadth of the Attorney General's discretion.

With so little in statutory text to work with, the government and the plurality "can't resist" highlighting certain statements from the Act's legislative history. [Footnote omitted.] But "legislative history is not the law." [Footnote omitted.] Still less can committee reports or statements by individual legislators be used "to muddy clear statutory language" like that before us. [Footnote omitted.] And even taken on their own terms, these statements do no more than confirm that some members of Congress hoped and wished that the Attorney General would exercise his discretion to register at least some pre-Act offenders. None of these snippets mentions a "feasibility" standard, and none can obscure the absence of such a standard in the law itself.

That leaves the plurality and the government to try to fish its feasibility standard from our decision in Reynolds. But Reynolds would make a difference only if it bound us as a matter of stare decisis to adopt an interpretation inconsistent with the statute's terms. And, of course, it does no such thing. The government and the plurality submit that Reynolds was premised on an understanding that Congress intended the statute to apply to pre-Act offenders to the maximum extent feasible. To support their reading they point to Reynolds' surmise that Congress "may well have thought [that there could be] practical problems" with applying SORNA to pre-Act offenders and for that reason left their registration obligations to be sorted out by the Attorney General. [Footnote omitted.] But speculation about some of Congress's motives in adopting § 20913(d) aside, Reynolds plainly understood the statute itself as investing the Attorney General with sole power to decide whether and when to apply SORNA's requirements to pre-Act offenders. [Footnote omitted.]

Nothing found here can come as a surprise. In Reynolds, the government told this Court that SORNA supplies no standards regulating the Attorney General's treatment of pre-Act offenders. This Court agreed, and everyone proceeded with eyes open about the potential constitutional consequences; in fact, the dissent expressly warned that adopting such a broad construction of the statute would yield the separation-of-powers challenge we face today. [Footnote omitted.] Now, when the statute faces the chopping block, the government asks us to ignore its earlier arguments and reimagine (really, rewrite) the statute in a new and narrower way to avoid its long-predicted fate. No wonder some of us are not inclined to play along.

The only real surprise is that the Court fails to make good on the consequences the government invited, resolving nothing and deferring everything. In a future case with a full panel, I remain hopeful that the Court may yet recognize that, while Congress can enlist considerable assistance from the executive branch in filling up details and finding facts, it may never hand off to the nation's chief prosecutor the power to write his own criminal code. That "is delegation running riot." [Footnote omitted.]

Justice Alito wrote in his concurrence:

The Constitution confers on Congress certain "legislative [p]owers," Art. I, § 1, and does not permit Congress to delegate them to another branch of the Government. See Whitman v. American Trucking Assns., Inc., 531 U.S. 457, 472, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001). Nevertheless, since 1935, the Court has uniformly rejected nondelegation arguments and has upheld provisions agencies to adopt important rules pursuant to extraordinarily capacious standards. See ibid.

If a majority of this Court were willing to reconsider the approach we have taken for the past 84 years, I would support that effort. But because a majority is not willing to do that, it would be freakish to single out the provision at issue here for special treatment.

Because I cannot say that the statute lacks a discernable standard that is adequate under the approach this Court has taken for many years, I vote to affirm.

[2] Ryan LLC v. Federal Trade Commission (August 2024): Nondelegation Doctrine.

Ryan LLC v. Federal Trade Commission[1236] considered the validity of the Federal Trade commission's Non-Compete Rule,[1237] which makes most non-compete agreements unenforceable. The District Court set aside the Non-Compete Rule. Consequently, the Non-Compete Rule shall not be enforced or otherwise take effect on its effective date of September 4, 2024 or thereafter. The Chamber of Commerce President and Chief Executive Officer Suzanne P. Clark said, "This decision is a significant win in the Chamber's fight against government micromanagement of business decisions. A sweeping prohibition of noncompete agreements by the FTC was an unlawful extension of power that would have put American

[1236] *Ryan LLC v. Federal Trade Commission,* __ F. Supp. 3d __ (2024).
[1237] 16 C.F.R. § 910.1–.6,

workers, businesses, and our economy at a competitive disadvantage, We remain committed to holding the FTC — and all agencies — accountable to the rule of law, ensuring American workers and businesses can thrive." The *Ryan LLC* case represents an important affirmation of the non-delegation, as originally articulated in *Wayman v. Southard*: "It will not be contended that Congress can delegate . . . powers which are strictly and exclusively legislative. [1238]

The Federal Trade Commissioner is vested with power to prevent unfair method of competition. [1239] In 1938, Congress expanded the Commission's power to also prevent unfair deceptive acts or practices.

The *Ryan LLC* case involved a dispute over the Federal Trade Commission's rulemaking authority concerning the enforceability of employer/employee non-compete agreements. These agreements are restrictive covenants that prohibit an employee from competing against the employer. On January 19, 2023, the Federal Trade Commission proposed the Non-Compete Rule—which would "prohibit employers from entering into non-compete clauses with workers starting on the rule's compliance date" and "require employers to rescind existing non-compete clauses no later than the rule's compliance date." On April 23, 2024, the Federal Trade Commission adopted the final Non-Compete Rule. [1240] *Ryan LLC* held that the final Non-Compete Rule violated the Administrative Procedure Act.

According to the brief by *Ryan LLC*:

> *The Federal Trade Commission by a 3-2 vote has adopted an economically destabilizing, legally unprecedented rule outlawing the use of nearly all non-compete agreements by every employer, in every industry, across the entire United States ("Non-Compete Rule" or "Rule"). [Footnote omitted.] According to the Commission, it has the authority to take this momentous step, because a provision of the Federal Trade Commission Act ("FTC Act") that authorizes procedural rules supposedly also authorizes a sweeping substantive prohibition on "unfair methods of competition"-and because, the Commission maintains, non-competes are nearly always "unfair."*
>
> *If ever a federal agency attempted to pull an elephant out of a mousehole, this is it. What's more, the Rule rests on an open-ended statutory phrase "unfair methods of competition" that provides no intelligible principle to guide the agency or constrain its policy preferences, in violation of the Constitution's restriction on the delegation of legislative powers. Perhaps unsurprisingly, this brazen power grab has been perpetrated by a politically unaccountable "independent" agency that is unconstitutionally insulated from the President's removal powers. This action contravenes the FTC Act, violates the Constitution, and is arbitrary, capricious, and otherwise unlawful under the Administrative Procedure Act ("APA").*
>
> *For hundreds of years, employers and employees have had the freedom to negotiate mutually beneficial non-compete agreements. Reasonably tailored non-competes are permitted by the vast majority of States-including*

[1238] 23 U.S. (10 Wheat.) 1, 42 (1825); *Shankland v. The Corp. of Wash.*, 30 U.S. 390, 395 (1831) ("the general rule of law is that a delegated authority cannot be delegated.").

[1239] I.R.C. § 5 of the Federal Trade Commission Act. See 15 U.S.C. § 45(a)(2).

[1240] See 16 C.F.R. § 910.

Texas, where Ryan is headquartered-which apply state statutes and a rich body of state common law to determine on a case-by-case basis when a non-compete is reasonable in duration, geographic scope, and other respects. The Commission has nonetheless finalized a one-size-fits-all rule outlawing nearly all non-compete agreements, declaring them to be per se unfair methods of competition in violation of Section 5 of the FTC Act.

The Non-Compete Rule far exceeds the Commission's statutory authority. The Commission cannot promulgate substantive rules defining unfair methods of competition. And, even if Congress did grant the Commission authority to promulgate some substantive unfair-competition rules, it did not invest the Commission with authority to decide the major question of whether non-compete agreements are categorically unfair and anticompetitive, a question with seismic consequences affecting tens of millions of workers, millions of employers, and billions of dollars in economic productivity. Indeed, Congress could not constitutionally have conferred this authority on the Commission with the open-ended language to which the Commission points. As Commissioner Ferguson summarized in his oral dissent, the Commission does not have "the power to nullify tens of millions of existing contracts; to preempt the laws of forty-six States; to declare categorically unlawful a species of contract that was lawful when the [FTC Act] was adopted in 1914; and to declare those contracts unlawful across the whole country irrespective of their terms, conditions, historical contexts, and competitive effects." [Citation omitted.]

This immensely disruptive Rule should be stayed and barred from taking effect during the pendency of this litigation. Non-competes have been actively authorized and supervised by the States for centuries-there is no need for them to be invalidated nationwide with scarcely four months' notice by the diktat of one impatient federal agency. Allowing the Rule to go into effect only to later vacate it would create the worst of all worlds, where workers are informed their non-competes are unenforceable, only for that message to be later countermanded. In the meantime, people would have moved jobs, the market goodwill and customer relationships that were previously safeguarded by non-competes would have already been misused, and confidential business information could have been disclosed to competitors.

The Non-Compete Rule essentially provides that it is an unfair method of competition—a violation of Section 5 of the Federal Trade Commission Act—for persons to enter or to enforce non-compete agreements. The Non-Compete Rule also supersedes state laws that would "permit or authorize" non-compete agreements.

The Non-Compete Rule also contains other exceptions regarding –

- *bona fide* sales of businesses;
- circumstances where a cause of action accrued prior to the effective date; and
- circumstances where a person has a good-faith basis to believe that the Non-Compete Rule is inapplicable. [1241]

The Federal Trade Commission asserted in *Ryan LLC* that—

[1241] See 16 C.F.R. § 910.3(a)–(c).

- because non-compete clauses are "unfair methods of competition" under Section 5 of the Federal Trade Commission Act, and
- the Commission has the authority to issue the Non-Compete Rule.[1242]

The *Ryan LLC* action assert these causes of action against the Federal Trade Commission under the Administrative Procedure Act ("APA"), which empowers a reviewing court to hold unlawful and set aside certain agency action(s), findings, and conclusions.[1243] The Federal Trade Commission's actions were unlawful because

- the Federal Trade Commission acted without statutory authority;
- the Non-Compete Rule is the product of an unconstitutional exercise of power; and
- the Federal Trade Commission's acts, findings, and conclusions were arbitrary and capricious.

The plaintiff further asserted a claim under the Declaratory Judgment Act, challenging the Non-Compete Rule as unlawful.

Plaintiffs averted that the Federal Trade Commission's Non-Compete Rule —

- exceeds the Federal Trade Commission's statutory authority;
- is patently unconstitutional; and
- is arbitrary and capricious.

The plaintiff asserted that the Non-Compete Rule violates the Administrative Procedure Act because the Federal Trade Commission:

> *lacked statutory authority to promulgate the Non-Compete Rule; that if Congress did grant such authority, it did so in violation of the non-delegation doctrine; that the Rule is unlawfully retroactive; that the Commission's reasons for adopting the Rule are arbitrary and capricious, and that the Commission is unconstitutionally insulated from Presidential control.*[1244]

Plaintiff-Intervenors argued that the Non-Compete Rule exceeds the Commission's statutory authority for three reasons:

- the Federal Trade Commission Act does not authorize the Commission to issue substantive unfair-competition rules,

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[1242] Pursuant to the authority granted them in 16 C.F.R. § 6(g), See 15 U.S.C. §§ 45(a)(2), 46(g); see generally 16 C.F.R. § 910.1–6.

[1243] 5 U.S.C. § 706(2).

[1244] _ F. Supp. at __.

- categorically prohibiting all worker noncompete agreements as "unfair methods of competition" cannot be squared with the meaning of that phrase in Section 5 of the Federal Trade Commission Act, and
- the Commission lacks statutory authority to retroactively invalidate millions of existing contracts.

Plaintiff-Intervenors further asserted that the Non-Compete Rule is arbitrary and capricious for three reasons:

- the Federal Trade Commission offers no evidence to support its categorical ban on non-competes,
- the Commission unjustifiably dismissed alternatives that would have allowed the Commission to achieve its purported objectives at lower cost, and
- the Federal Trade Commission relied on a flawed cost-benefit analysis to prop up its Rule.

The Federal Trade Commission contended:

- Congress authorized the Federal Trade Commission in clear language to prevent unfair methods of competition through both adjudication and rulemaking, and the Federal Trade Commission's choice of rulemaking to address the anticompetitive effects of non-competes is both logical and unremarkable;
- the major questions doctrine is not implicated, as the Non-Compete Rule falls squarely within the Federal Trade Commission's delegated authority and expertise;
- the Sherman Act's framework is inapplicable, since the Federal Trade Commission Act was designed to supplement the Sherman Act and expressly confers the authority to prevent unfair methods of competition;
- the Federal Trade Commission Act provides an intelligible principle by which the Non-Compete Rule can be measured;
- the Non-Compete Rule is not unlawfully retroactive since it has only prospective effects;
- Ryan's removal challenge is foreclosed by binding precedent; and
- the Federal Trade Commission easily satisfies the deferential arbitrary-and-capricious standard given its exhaustive study of non-competes and thorough economic justifications for the Non-Compete Rule.

The Court concluded that Plaintiffs were entitled to summary judgment on all of their claims under the Administrative Procedure Act and Declaratory Judgment Act because the Federal Trade Commission exceeded its statutory authority in implementing the Non-Compete Rule, and the Non-Compete Rule is arbitrary and capricious.

By a plain reading, Section 6(g) of the Act does not expressly grant the Commission authority to promulgate substantive rules regarding unfair methods of competition. Next, Section 18 empowers the Federal Trade Commission to prescribe "interpretive rules and general statements of policy with respect to unfair or deceptive acts or practices in or affecting commerce." See 15 U.S.C. § 57a. Section 18 limits the Federal Trade Commission's ability to make rules dealing with unfair or deceptive practices—not unfair methods of competition. 15 U.S.C. § 57a(2). [Footnote omitted.] However, Section 18 acknowledges the Federal Trade Commission has some rulemaking power "with respect to unfair methods of competition in or affecting commerce." 15 U.S.C. § 57a(2). [Footnote omitted.]

Plainly read, the Court concludes the Federal Trade Commission has some authority to promulgate rules to preclude unfair methods of competition. Indeed, the Act alludes to this power in Section 18. See 15 U.S.C. § 57a. However, after reviewing the text, structure, and history of the Act, the Court concludes the Federal Trade Commission lacks the authority to create substantive rules through this method. Section 6(g) is "indeed a 'housekeeping statute,' authorizing what the APA terms 'rules of agency organization procedure or practice' as opposed to 'substantive rules.' [Citation omitted.]

Plaintiffs next contend the lack of a statutory penalty for violating rules promulgated under Section 6(g) demonstrates its lack of substantive rulemaking power. [Citation omitted.] The Court agrees. When authorizing legislative rulemaking, Congress also historically prescribes sanctions for violations of the agency's rules—confirming that those rules create substantive obligations for regulated parties. [Footnote omitted.] "If the statute prescribed a sanction, then the authority to make 'rules and regulations' included the authority to adopt legislative rules having the force of law . [but] [i]f the statute did not include a sanction, the authority to make 'rules and regulations' encompassed only interpretive or procedural rules." [Citation omitted.] Section 6(g) contains no penalty provision—which indicates a lack of substantive force. See generally 15 U.S.C. § 46. In contrast, Section 5 adjudications include a penalty provision. See 15 U.S.C.§ 45(l)–(m). Thus, the lack of a penalty included with Section 6(g) supports that such provision encompasses only housekeeping rules—not substantive rulemaking power. [1245]

The court found that the Non-Compete Rule was arbitrary and capricious:

A court must "hold unlawful and set aside agency action, findings and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). The Supreme Court explains this arbitrary-and-capricious standard as follows:

The APA's arbitrary-and-capricious standard requires that agency action be reasonable and reasonably explained. Judicial review under that standard is deferential, and a court may not substitute its own policy judgment for that of the agency. A court simply ensures that the agency has acted within a zone of

[1245] _ F. Supp. at __.

reasonableness and, in particular, has reasonably considered the relevant issues and reasonably explained the decision.

[Citations omitted.] Generally, an agency rule is arbitrary and capricious if:

[T]he agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

[Citation omitted.]

In applying this standard, the Court is limited to "the basis articulated by the agency itself." [Citation omitted.] Although "'we may not provide a reasoned basis for the agency's action that the agency itself has not given,' we will 'uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.' [Citation omitted.] "The Supreme Court has made clear that when it comes to arbitrary-and-capricious review, 'the Government should turn square corners in dealing with the people.' [Citation omitted.] "A decision is arbitrary or capricious only when it is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." [Citation omitted.][1246]

The court found the Non-Compete Rule arbitrary and capricious:

Because the Federal Trade Commission is an administrative agency, the Court may analyze the Commission's actions under the APA's arbitrary-and-capricious standard. See 5 U.S.C. § 706(2)(A). The Court concludes that the Rule is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation. The Rule imposes a one-size-fits-all approach with no end date, which fails to establish a "rational connection between the facts found and the choice made." [Citation omitted.][1247]

The record did not support why the Federal Trade Commission adopted a sweeping prohibition of noncompete agreements:

The record does not support the Rule . . The Commission's lack of evidence as to why they chose to impose such a sweeping prohibition—that prohibits entering or enforcing virtually all non-competes—instead of targeting specific, harmful non-competes, renders the Rule arbitrary and capricious. See Transitional Learning Cmty. at Galveston, Inc. v. U.S. Off. of Pers. Mgmt., 220 F.3d 427, 430 n.2 (5th Cir. 2000) (holding that "failing to give a reasonable explanation for how [an agency] reached its decision" may make an agency's decision arbitrary and capricious under the APA). In sum, the Rule is based on inconsistent and flawed empirical evidence, [citation omitted] fails to consider the positive benefits of non-compete agreements, and disregards the substantial body of evidence supporting these agreements.[1248]

The Federal Trade Commission failed sufficiently to address alternatives:

[1246] _ F. Supp. at __.
[1247] _ F. Supp. at __.
[1248] _ F. Supp. at __.

Second, the record shows the Federal Trade Commission failed to sufficiently address alternatives to issuing the Rule. "The role of this court is to determine whether the [Federal Trade Commission] provides a sufficient explanation of the alternatives to permit a reasoned choice among the different courses of action." [Citation omitted.] However, the Federal Trade Commission provides no such explanation. [Citation omitted.] While considering less disruptive alternatives, the Federal Trade Commission "was required to assess whether there were reliance interests, determine whether they were significant, and weigh any such interests against competing policy concerns." [Citation omitted.] The record shows the Commission did not conduct such analysis—instead offering the conclusion that "case-by-case adjudication of the enforceability of non-competes has an in terrorem [footnote omitted] effect that would significantly undermine the Commission's objective to address non-competes' tendency to negatively affect competitive conditions in a final rule." [Citation omitted.][1249]

[3] Mayfield v. United States Department of Labor (September 2024): Nondelegation.

Mayfield v. United States Department of Labor[1250] involved a Department rule that raised from $455 per week to $684 per week the minimum salary required to qualify for the so-called "White Collar Exemption." This exemption exempted executive, administrative, or professional employees from the Fair Labor Standards Act's minimum wage and overtime requirements. The plaintiff alleged that the rule exceeded the Department's statutorily conferred authority and violated the nondelegation doctrine. The Fifth Circuit Court of Appeals held that:

- the major questions doctrine did not apply;
- the Department of Labor had statutory authority under the Fair Labor Standards Act to promulgate the rule; and
- the Department of Labor's exercise of that authority to issue the rule did not violate the nondelegation doctrine.

For more than eighty years, the Department of Labor has defined the so-called White Collar Exemption in the Fair Labor Standards Act to include a minimum-salary requirement. Robert Mayfield challenged the latest rule, which updates the minimum salary necessary to fall within the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption, on the ground that promulgating any rule imposing a salary requirement exceeded the Department's statutorily conferred authority or else violates the nondelegation doctrine. The district court granted the Department of Labor's motion for summary judgment. The Fifth Circuit found that the 2019 Minimum Salary Rule falls within the Department of Labor's explicitly delegated authority to define and delimit the terms of the Executive, Administrative,

[1249] _ F. Supp. at __.

[1250] *Mayfield v. United States Department of Labor*, 117 F.4th 611 (5th Cir. 2024).

Professional, Computer & Outside Sales Employee Exemption, and that this power is not an unconstitutional delegation of legislative power.

The Fair Labor Standards Act sets out a variety of standards and protections governing labor conditions.[1251] For example, the Fair Labor Standards Act sets a minimum wage and requires overtime for work beyond forty hours per week.[1252] Though the Fair Labor Standards Act defines the workers to whom the statute applies broadly, it also contains a series of exemptions that exclude certain types of employees from that definition. The Fair Labor Standards Act exempts "any employee employed in a bona fide executive, administrative, or professional capacity."[1253] That Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption or the "White Collar Exemption," gives the Secretary of the Department of Labor the power to "define[ ] and delimit[ ]" the terms of the exemption.

Though the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption, like many of the other Fair Labor Standards Act exemptions, defines qualifying workers through duties and job types, the Department of Labor has repeatedly issued a minimum-salary rule that prevents workers from qualifying for the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption if their salary falls below a specified level. The Department of Labor has long justified its rules on the ground that the terms used in the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption connote a particular status and prestige that is inconsistent with low salaries. "Historically, the Department has justified the use of a salary-level test by pointing to its effectiveness as a screen for an employee's actual duties."

In 2019, the Department of Labor issued a new version of what is known as the "Minimum Salary Rule." The Minimum Salary Rule raised the minimum salary required to qualify for the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption from $455 per week to $684 per week, an increase of 50.3%. The Department of Labor is currently considering a proposed rule that would raise the minimum salary to $1,059 per week, a roughly 55% increase from the 2019 Rule.

Mayfield sued the Department of Labor, claiming that the 2019 Rule exceeds the Department of Labor's statutory authority. According to Mayfield, his fast-food restaurant businesses succeed by offering high bonus payments to the best performing store managers. He asserts that the Rule forces him to pay a higher salary to all managers regardless of performance, leaving him with insufficient funds to reward the best performers.

Mayfield does not argue that the Department of Labor lacks the authority to raise the minimum salary, nor does he maintain that the particular salary level the Department of Labor chose is invalid. Rather, he argues that the Department of Labor lacks, and has always lacked,

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[1251] See 29 U.S.C. § 201, *et seq.*

[1252] 29 U.S.C. §§ 206(a), 207(a)(1).

[1253] 29 U.S.C. § 213(a)(1).

the authority to define the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption in terms of salary level.

Mayfield and the Department of Labor filed cross-motions for summary judgment. The district court granted the Department of Labor's motion and denied Mayfield's motion. Mayfield timely appealed.

The Fifth Circuit began with two questions:

- whether precedent dictates the outcome in this case, and if not,
- whether the major questions doctrine applies.

The Department of Labor contended that Mayfield's arguments were foreclosed by *Wirtz v. Mississippi Publishers Corp.*[1254] *Wirtz* considered whether the Minimum Salary Rule is an unjustified regulation under the Fair Labor Standards Act because the Minimum Salary Rule is not rationally related to the determination of whether an employee is employed in a bona fide executive capacity.[1255] Because the Fair Labor Standards Act gives the Department of Labor "broad latitude" to define the meaning of "bona fide executive," the court in *Wirtz* determined that it could not say that the minimum salary requirement is arbitrary or capricious. The Fifth Circuit determined that *Wirtz* did not control. *Wirtz* addressed whether the Minimum Salary Rule is arbitrary and capricious. Mayfield, however, argued that the Minimum Salary Rule exceeded the Department of Labor's statutory authority. The Administrative Procedure Ac[1256] distinguishes between two types of challenges:

- the arbitrary and capricious challenge.[1257]
- the exceeding statutory authority challenge.[1258]

Holding that a rule survives a particular type of Administrative Procedure Act review does not determine how it fares under other types of review.

The Fifth Circuit observed that it must next consider whether the major questions doctrine plays a role in its analysis. "[I]n certain extraordinary cases, both separation of powers principles and practical understanding of legislative intent make [the court] reluctant to read into ambiguous statutory text the delegation claimed to be lurking there. To convince [the court] otherwise, something more than a merely plausible textual basis for the agency action is necessary. The agency instead must point to clear Congressional authorization for the power it claims."[1259]

[1254] 364 F.2d 603 (5th Cir. 1966).

[1255] *Id.*. at 608 (*quoting* 29 U.S.C. § 213(a)(1)).

[1256] 5 U.S.C. § 551 *et seq.*

[1257] 5 U.S.C. § 706(2)(A).

[1258] 5 U.S.C. § 706(2)(C),

[1259] *West Virginia v. EPA*, 597 U.S. 697, 723, 142 S.Ct. 2587 (2022) (citation and internal quotation marks omitted).

There are three indicators that each independently trigger the major question doctrine:

- when the agency "claims the power to resolve a matter of great political significance";
- when the agency "seeks to regulate a significant portion of the American economy or require billions of dollars in spending by private persons or entities"; and
- when an agency "seeks to intrude into an area that is the particular domain of state law."[1260]

Once triggered, whether the major question doctrine is one interpretative tool among many or a clear-statement rule[1261] is the subject of ongoing debate[1262] The Fifth Circuit in *Mayfield* determined that *Mayfield* neither was one of vast political or economic significance under Supreme Court or Fifth Circuit precedent nor intruded into an area that is the particular domain of state law.

No case has set the threshold for "economic significance." Recent cases applying the doctrine based on economic significance have involved hundreds of billions of dollars of

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[1260] *Id.*. at 743–44 (Gorsuch, J., concurring) (citations and internal quotation marks omitted); *see also Texas v. Nuclear Regul. Comm'n*, 78 F.4th 827, 844 (5th Cir. 2023) (applying the major questions doctrine because of the political significance of the issue).

[1261] *Hayden v. Pataki*, 449 F.3d 305 (2d Cir. 2006) ("The clear statement rule provides that, '[i]f Congress intends to alter the 'usual constitutional balance between the States and the Federal Government,' it must make its intention to do so 'unmistakably clear in the language of the statute.' Gregory, 501 U.S. at 460 – 61, 111 S.Ct. 2395 (*quoting Atascadero*, 473 U.S. at 242, 105 S.Ct. 3142) (internal quotation marks omitted). According to the Supreme Court, '[i]n traditionally sensitive areas, such as legislation affecting the federal balance, the requirement of clear statement assures that the legislature has in fact faced, and intended to bring into issue, the critical matters involved in the judicial decision.' *Id.* at 461, 111 S.Ct. 2395 (citations and internal quotation marks omitted) (emphasis added). Thus, we have stated that federal courts will construe a statute to alter the federal balance only when Congress expresses an 'affirmative intention' to do so. *DeMarco v. Holy Cross High Sch.*, 4 F.3d 166, 169 (2d Cir.1993)."); Atascadero State Hospital v. Scanlon, 473 U.S. 234 ("Congress may abrogate the States' constitutionally secured immunity from suit in federal court only by making its intention unmistakably clear in the language of the statute. The fundamental nature of the interests implicated by the Eleventh Amendment dictates this conclusion."; "For these reasons, we hold . . . that Congress must express its intention to abrogate the Eleventh Amendment in unmistakable language in the statute itself. [Footnote omitted.]").

[1262] *Compare Biden v. Nebraska*, 600 U.S. ——, 143 S. Ct. 2355, 2368–75 (2023) (applying the doctrine in conjunction with traditional interpretative tools), and *Biden v. Nebraska*, 600 U.S. at ——, 143 S. Ct. 2355 at 2378 (Barrett, J., concurring) (explaining that the major questions doctrine is a textual tool that emphasizes context, not a substantive canon), with *West Virginia*, 597 U.S. at 724–32 (starting with the major questions doctrine and arguably treating it as a substantive canon), and *West Virginia*, 597 U.S. at 735(Gorsuch, J., concurring) (arguing that the doctrine is a clear-statement rule).

impact.[1263] Here, the impact of the Rule is roughly $472 million in the first year, including both the costs of implementing the Rule and the transfers from employers to employees. While the Supreme Court's recent decisions by no means set the lower bound of economic significance, the Fifth Circuit opined that the gap between the economic impact in those cases and this case too large to warrant applying the major questions doctrine here based on economic significance[1264]

The Fifth Circuit considered whether the Department of Labor seeks to regulate a significant portion of the American economy. The 2019 Rule removes 1.2 million workers from the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption who would otherwise be exempt. Because 1.2 million workers is a small percentage of the overall workforce, according to the Fifth Circuit, regulating that number of workers does not trigger the major questions doctrine.

Even if the Fifth Circuit assumed that labor relations are a politically controversial topic, whether to use salary level to determine which employees should be exempt from various Fair Labor Standards Act protections is not in line with the types of issues that have been considered politically contentious enough to trigger the doctrine.[1265]

Finally, the Supreme Court's major-questions analysis turns in part on whether the agency has previously claimed the authority at issue.[1266] The Department of Labor asserted an authority that it had asserted continuously since 1938.

While a particular minimum-salary rule could raise issues because of its size, Mayfield's argument is that any consideration of salary is improper. Even though the particular salary

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[1263] *See, e.g., Biden v. Nebraska*, 143 S. Ct. at 2362 ($430 billion); *West Virginia*, 597 U.S. at 715($1 trillion by 2040).

[1264] Mayfield urges the court to look to the economic impact that could result from the broadest possible rule that is consistent with the Department of Labor's asserted authority rather than the impact of the rule that Department of Labor actually promulgated. While the Supreme Court has occasionally considered the potential impact of the authority asserted, *see, e.g., Gonzales v. Oregon*, 546 U.S. 243, 268, (2006) (considering other decisions the Attorney General could make based on the authority asserted), the Fifth Circuit observed that Supreme Court's more recent cases are a more reliable guide, and those cases look to the promulgated rule. *See, e.g.*, *West Virginia*, 597 U.S. at 724–30, 142 S.Ct. 2587 (analyzing the impact of the rule in question); *Nebraska*, 143 S. Ct. at 2372 (same).

[1265] *E.g., West Virginia v, Environmental Protection Agency*, 597 U.S. 697, 729–30 (how much coal-based energy generation the country should engage in;); *see also Texas v. Nuclear Regulatory Commission*, 78 F.4th 827 (5th Cir..2023) (how to store nuclear waste; deference to Commission's interpretation of Acts was unwarranted under major questions doctrine; pursuant to the major questions doctrine, in certain extraordinary cases involving statutes that confer authority upon an administrative agency, the agency must point to clear Congressional authorization for the authority it claims; in the section of the Clean Air Act establishing the New Source Performance Standards program, Congress did not grant Environmental Protection Agency the authority to devise emissions caps based on the generation-shifting approach the agency took in the Clean Power Plan.).

[1266] *West Virginia v, Environmental Protection Agency*, 597 U.S. at 721–23.

level in question here is novel, the assertion of authority to consider salary is not. According to the Fifth Circuit, this is not an instance where the agency discovered in a long-extant statute an unheralded power to regulate a significant portion of the American economy.

Having determined that the major questions doctrine did not apply, the Fifth Circuit turned to Mayfield's argument that the 2019 Minimum Salary Rule exceeds the Department of Labor's statutory authority. In *Loper Bright Enterprises v. Raimondo*, the Supreme Court clarified the proposition reflected in judicial practice that courts decide legal questions by applying their own judgment. Where Congress has clearly delegated discretionary authority to an agency, the court must independently interpret the statute and effectuat the will of Congress subject to constitutional limits. The court must "independently identify and respect [constitutional] delegations of authority, police the outer statutory boundaries of those delegations, and ensure that agencies exercise their discretion consistent with the APA."[1267] This requires using all relevant interpretive tools to determine the "best" reading of a statute. A merely "permissible" reading is not enough. Here there is a delegation of authority. The question is whether the Rule is within the outer boundaries of that delegation. The Fifth Circuit determined that the Minimum Salary Rule was within the boundaries of the statutory delegation.[1268]

[1267] *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244, 2268 (2024).

[1268] By promulgating the Minimum Salary Rule, the Department of Labor defined what it means to work in an executive, administrative, or professional capacity (*viz.*, to earn at least a particular amount of money). The Minimum Salary Rule can be construed as an exercise of the power to delimit the scope of the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption. The Rule sets a limit on what is otherwise defined by the text of the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption. The Fifth Circuit determined that the Department of Labor action was within the scope of its authority. Mayfield contended that the power to define and delimit the terms of the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption is only the power to further specify and enumerate the types of duties that qualify an employee for the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption. Mayfield argued that the Minimum Salary Rule arbitrarily imposes a new requirement that lacks a textual basis because the statute only speaks of duties. Any classification based on a characteristic other than duties would exceed the Department of Labor's authority. Mayfield pointed to the fact that many Fair Labor Standards Act exemptions are defined in terms of job duties and that other exemptions explicitly reference salary level, demonstrating that Congress knows how to impose such a requirement when it wants one. The Fifth Circuit asserted that using salary level as a criterion for Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption status has a strong textual foundation. The terms in the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption, particularly "executive," connote a particular status or level for which salary may be a reasonable proxy. Distinctions based on salary level are consistent with the Fair Labor Standards Act's broader structure, which sets out a series of salary protections for workers that common sense indicates are unnecessary for highly paid employees.

Mayfield's argument raised an important point: adding an additional characteristic is consistent with the power to define and delimit, but that power is not unbounded. A characteristic with no

In *Loper Bright*, the Supreme Court explained that "courts may . . . . seek aid from the interpretations of those responsible for implementing particular statutes."[1269] Under *Skidmore*, the weight given to the agency's interpretation "depend[s] upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade."[1270] "The last factor, persuasiveness, is the touchstone in determining how much to defer to an agency interpretation."[1271]

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rational relationship to the text and structure of the statute would raise serious questions. A characteristic that differs so broadly in scope from the original that it effectively replaces it. The same is true if one characterizes the Rule as the Department of Labor implementing a proxy to determine who falls within the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption. Using salary as a proxy for Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption status is a permissible choice, according to the Fifth Circuit, because the link between the job duties identified and salary is strong. That does not mean, however, that use of a proxy characteristic will always be a permissible exercise of the power to define and delimit. If the proxy characteristic frequently yields different results than the characteristic Congress initially chose, then use of the proxy is not so much defining and delimiting the original statutory terms as replacing them. The Fifth Circuit opined that that is not the case here.

Mayfield argued that Congress knows how to impose a salary requirement when it wants to. That argument is inapposite. The courts generally presume that Congress acted "intentionally and purposely" when it "includes particular language in one section of a statute but omits it in another." Here, however, the question is not whether the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption's terms should be interpreted to contain a salary requirement. The question is whether the power conferred by the explicit delegation to "define[ ] and delimit[ ]" the terms of the statute allows the Department of Labor to impose a salary requirement. Even if Congress acted intentionally by omitting a salary requirement from the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption, that does not mean that the power it conferred excludes the option of imposing the requirement.

Mayfield's argument raised an important point: adding an additional characteristic is consistent with the power to define and delimit, but that power is not unbounded. A characteristic with no rational relationship to the text and structure of the statute would raise serious questions. A characteristic that differs so broadly in scope from the original that it effectively replaces it. The same is true if one characterizes the Rule as the Department of Labor implementing a proxy to determine who falls within the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption. Using salary as a proxy for Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption status is a permissible choice, according to the Fifth Circuit, because the link between the job duties identified and salary is strong. That does not mean, however, that use of a proxy characteristic will always be a permissible exercise of the power to define and delimit. If the proxy characteristic frequently yields different results than the characteristic Congress initially chose, then use of the proxy is not so much defining and delimiting the original statutory terms as replacing them. The Fifth Circuit opined that that is not the case here.

[1269] *Loper Bright*, 144 S. Ct. at 2262, *citing Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

[1270] *Id.*. at 2259, *quoting Skidmore*, 323 U.S. at 140.

[1271] *Midship Pipeline, Co., LLC v. FERC*, 45 F.4th 867, 875 (5th Cir. 2022); *see also Rest. L. Ctr. v. the Department of Labor*, 2024 W.L. 3911308 (5th Cir. 2024).

The court in *Mayfield* posed the question of what work *Skidmore* deference can do given the Supreme Court's statements that (1) statutes have a "best reading . . . . the reading the court would have reached if no agency were involved," and (2) "[i]n the business of statutory interpretation, if it is not the best, it is not permissible."[1272] Taking these statements together, it seems that either the agency's interpretation is the best interpretation (in which case no deference is needed) or the agency's interpretation is not best (in which case it lacks persuasive force and is not owed deference). According to the court, the Department of Labor's interpretation of the statute is "best" based on traditional tools of statutory interpretation and without reliance on deference of any kind.

If *Skidmore* deference does any work, it applies here. The Department of Labor has consistently issued minimum salary rules for over eighty years.[1273] Though the specific dollar value required has varied, the Department of Labor's position that it has the authority to promulgate such a rule has been consistent. The Department of Labor began doing so immediately after the Fair Labor Standards Act was passed. Congress has amended the Fair Labor Standards Act numerous times without modifying, foreclosing, or otherwise questioning the Minimum Salary Rule.

The Ninth Circuit joined four circuits in holding that the Department of Labor has the statutory authority to promulgate the Minimum Salary Rule.[1274]

The Ninth Circuit turned to the nondelegation doctrine, the argument that the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption, when interpreted to grant the Department of Labor the authority to issue the 2019 Minimum Salary Rule, violates the nondelegation doctrine because it lacks an intelligible principle to guide the Department of Labor's power to define and delimit the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption's terms.

The intelligible-principle test requires Congress to set out guidance that "delineates the general policy, the public agency which is to apply it, and the boundaries of this delegated authority."[1275] As the Supreme Court explained, "[t]hose standards . . . are not demanding," and the Supreme Court has only twice found an excessive delegation of power, doing so in each case because "Congress had failed to articulate any policy or standard to confine

[1272] *Loper Bright*, 144 S. Ct. at 2266 (internal quotation marks omitted).

[1273] 3 Fed. Reg. 2518 (Oct. 20, 1938); 5 Fed. Reg. 4077 (Oct. 15, 1940); 14 Fed. Reg. 7705 (Dec. 24, 1949); 23 Fed. Reg. 8962 (Nov. 18, 1958); 28 Fed. Reg. 9505 (Aug. 30, 1963); 35 Fed. Reg. 883 (Jan. 22, 1970); 40 Fed. Reg. 7091 (Feb. 19, 1975); 69 Fed. Reg. 22,122 (Apr. 23, 2004); 81 Fed. Reg. 32,391 (May 23, 2016).

[1274] *Prakash v. Am. Univ.*, 727 F.2d 1174, 1177–78 (D.C. Cir. 1984); *Fanelli v. U.S. Gypsum Co.*, 141 F.2d 216, 218 (2d Cir. 1944); *Walling v. Morris*, 155 F.2d 832, 836 (6th Cir. 1946), *vacated on other grounds sub nom. Morris v. McComb*, 332 U.S. 422, 68 S.Ct. 131, 92 L.Ed. 44 (1947); *Walling v. Yeakley*, 140 F.2d 830, 832–33 (10th Cir. 1944).

[1275] *Mistretta v. United States*, 488 U.S. 361, 372–73 (1989) (*quoting Am. Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946)).

discretion."[1276] "[t]hat does not mean we must rubber-stamp all delegations of legislative power."[1277] To do so would be to "shy away from our judicial duty to invalidate unconstitutional delegations."[1278]

At least two principles guide and confine the authority delegated to the Department of Labor: the Fair Labor Standards Act's statutory directive to eliminate substandard labor conditions that are detrimental to the health, efficiency, and general wellbeing of workers, and the text of the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption itself. The guidance provided by these provisions is not straightforward. The boundaries that this guidance delineates are neither clear nor uncontroversial.

The existing standard is not demanding.[1279] Under that existing standard, both the Fair Labor Standards Act's purpose and the text of the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption itself provide at least some guidance for how the Department of Labor can exercise its authority. They are each independently sufficient to satisfy the nondelegation doctrine's requirements.

The Fair Labor Standards Act's purpose speaks to what workers should be protected from. The Fair Labor Standards Act provides guidance that the Department of Labor can look to whether a particular group of workers is subject to the very problems the Act seeks to remedy to determine whether the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption should be clarified to include or to exclude that group of workers. The Department of Labor is also constrained by the qualification that the Fair Labor Standards Act should improve working conditions "without substantially curtailing employment or earning power."

While the Fair Labor Standards Act's purpose speaks to what workers should be protected from, the Act nevertheless guides and limits the Department of Labor's authority to enact a rule determining which workers require protection.

The words "executive," "administrative," and "professional" each have meaning. That meaning both guides and limits the Department of Labor's power to "define[ ] and delimit[ ]" them. The Department of Labor can promulgate rules that clarify the meaning of those terms or, as in the case of the Minimum Salary Rule, impose some limitations on their scope. By contrast, the Department of Labor cannot enact rules that replace or swallow the meaning those terms have. The Executive, Administrative, Professional, Computer & Outside Sales

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[1276] *Gundy*, 588 U.S. at 146 (internal quotations omitted); *see also Jarkesy v. SEC*, 34 F.4th 446 (5th Cir. 2022) (holding a delegation unconstitutional because Congress provided "no guidance whatsoever"), *aff'd*, 603 U.S. 109 (2024).

[1277] *Consumers' Rsch. v. FCC*, 109 F.4th 743, 759 (5th Cir. 2024) (alterations adopted), *quoting Big Time Vapes, Inc. v. FDA*, 963 F.3d 436, 443 (5th Cir. 2020).

[1278] *Id., quoting Big Time Vapes*, 963 F.3d at 443).

[1279] *Gundy*, 588 U.S. at 146, 139 S.Ct. 2116.

Employee Exemption's text does not provide a precise line for what is permissible and what is not. A rule that uses a proxy to determine whether something falls within the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption poses the difficult question of how accurate the proxy must be to be permissible. A rule imposing a new characteristic raises the question of whether that characteristic is sufficiently connected to the existing definition. An intelligible principle is a guide, not a definitive guide, to what can and cannot be done. As such, the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption itself provides an intelligible principle for the power to define and to delimit its terms. The lack of clarity in both intelligible principles raises reasonable concerns, but they are concerns that are only legally relevant under a test that has been floated but never grounded in law. To require more is to ask for a level of specificity that the law does not currently demand.

The Fifth Circuit found that, under the existing test, the Department of Labor's authority to define and to delimit the terms of the Executive, Administrative, Professional, Computer & Outside Sales Employee Exemption is guided by an intelligible principle.

§1.18 Anti-Injunction Act.

[1] CIC Services v. Internal Revenue Service (2021): Anti-Injunction Act Did Not Prohibit Material Advisor's Suit To Enjoin The IRS Notice 2016-66 Concerning Micro-Captive Insurance Transactions as Tax Shelters, Even Though A Violation Of The Notice Might Result In A Tax Penalty.

In *CIC Services, LLC v. Internal Revenue Service*,[1280] the taxpayers challenged micro-captive insurance transactions as tax shelters and the Anti-Injunction Act. Notice 2016–66.[1281] The Supreme Court held that the Anti-Injunction Act did not prohibit a material advisor's suit to enjoin Notice 2016–66, even though a violation of Notice 2016–66 might result in a tax penalty. In a memorandum opinion, the District Court for the Eastern District of Tennessee.

[1280] 593 U.S. 209 (2021)

[1281] 2016-47 I.R.B. 745. *See, also, Green Rock LLC v. Commissioner*, 104 F.4th 220 (11th Cir. 2024) (Notice 2017-10 invalid; failure to comply with the notice and comment provisions of the Administrative Procedure Act); *Mann Construction, Inc. v. United States*, 27 F.4th 1138, 1147 (6th Cir. 2022) (Notice 2007-83, 2007-2 C.B. 960, invalid on account of failure to comply with notice and comment requirements of Administrative Procedure Act.); *Standard Insurances v. Commissioner*, __ F. Supp. 3d __ (No. 2:23-cv-00047, D. Utah, August 23, 2024) (Notice 2016-66, 2016-47 I.R.B. 745 invalid on account of failure to comply with notice and comment provisions of Administrative Procedure Act); Announcement 2023-11, Listed Transactions and Transactions of Interest, 2023-17 I.R.B. 798 (2023).

Notice 2016–66 identifies certain "micro-captive transactions" and substantially similar transactions as transactions of interest for purposes of the listed transaction rules of Treasury Regulations Section 1.6011-4(b)(6) and Sections 6111 and 6112. Notice 2016–66 alerts persons involved in such transactions to certain responsibilities and penalties that may arise from their involvement with these transactions. Notice 2016–66 requires taxpayers and "material advisors" like petitioner CIC Services to report information about certain insurance agreements called micro-captive transactions. The consequences for noncompliance include both civil tax penalties and criminal prosecution.

CIC Services filed a complaint in District Court challenging Notice 2016–66 as invalid under the Administrative Procedure Act and asking the District Court to grant injunctive relief setting the Notice aside.

CIC Services' complaint:

- asserted that the Internal Revenue Service violated the Administrative Procedure Act by issuing the Notice 2016–66 without notice-and-comment procedures.
- asked for injunctive relief from the Notice 2016–66's reporting rules, not from any impending or eventual tax obligation.
- alleges that the Notice 2016–66 is arbitrary and capricious under the Administrative Procedure Act because Notice 2016–66 imposes new reporting requirements without proven need.
- asks the court to "set[ ] aside IRS Notice 2016–66"—more specifically, to "enjoin the enforcement of Notice 2016–66 as an unlawful IRS rule" and to "declar[e] that Notice 2016–66 is unlawful."

The District Court dismissed the action as barred by the Anti-Injunction Act.

A divided panel of the Sixth Circuit affirmed.

The Supreme Court in *CIC Services* held that –

- a suit to enjoin Notice 2016–66 does not trigger the Anti-Injunction Act even though a violation of the Notice may result in a tax penalty.
- a suit to enjoin a requirement to report information is not an action to restrain the "assessment or collection" of a tax, even if the information will help the Internal Revenue Service collect future tax revenue.
- the addition of a tax penalty complicates matters, but it does not ultimately change the answer.

The classification of sub-regulatory guidance within the Administrative Procedure Act is also relevant in determining the degree of deference a court will afford to a particular piece of guidance.

All agency guidance, whether a legislative rule or guidance that is classified as an interpretative rule, a general statement of policy, or a rule of agency organization, procedure, or practice, is subject to judicial challenge when it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."

In a 2019 policy statement, the Treasury explained as follows:

> *In deciding whether to issue regulations or subregulatory guidance, the Treasury Department and the IRS must consider the content and nature of the interpretation or position being announced. Factors to be considered include the intended effect on taxpayers' rights or duties, the need for public comments, the form and content of prior positions, the significance of the issues, the statutory framework, and whether the interpretation or position is of short-term or long-term value. After weighing relevant factors, if the intended interpretation or position would have the effect of modifying existing legislative rules or creating new legislative rules on matters not addressed in existing regulations, the interpretation or position will generally be issued through notice-and-comment rulemaking, absent exceptional circumstances. Where the Treasury Department and the IRS intend to provide only an interpretation of existing law applied to a limited set of facts, a statutorily prescribed form of relief, a statement of agency procedure or practice, a public announcement of intent to issue proposed legislative rules, or an announcement that has only immediate or short-term value, the intended interpretation or position will generally be issued as subregulatory guidance rather than through notice-and-comment rulemaking.* [1282]

[1282] See Policy Statement on the Tax Regulatory Process (March 5, 2019), DOC 2019-8204, 2019 TNT 44-12 (March 6, 2019). The Internal Revenue Service also contends:

The Treasury Department and the IRS continue to take the position that listed transactions can be identified by notice or other subregulatory guidance because Congress, in enacting the American Jobs Creation Act of 2004, exempted the identification of such transactions from the APA's notice-and-comment procedure. As stated in Announcement 2022-28, 2022-52 I.R.B. 659 (Dec. 27, 2022), the Treasury Department and IRS will continue to defend existing listing notices in cases in which Mann Construction is not controlling precedent. Consistent with the aim expressed in Announcement 2022-28 of avoiding confusion and preventing disruption of the IRS's ongoing efforts to identify and examine abusive tax shelters, the Treasury Department and the IRS are following notice and comment procedures in identifying certain micro-captive transactions as listed transactions in order to eliminate any confusion and ensure that the IRS's efforts to combat abusive tax shelters throughout the nation continue undisrupted.

The Treasury Department and the IRS intend to finalize these regulations, after due consideration of public comments, in 2023 and intend to issue proposed regulations identifying additional listed transactions in the near future.

Taxpayers should take note that, if a transaction becomes a listed transaction or a transaction of interest after a taxpayer files a tax return (including an amended return) reflecting the taxpayer's participation in the transaction, § 1.6011-4(e) (2)(i) generally requires the participant to file a disclosure statement (Form 8886, Reportable Transaction Disclosure Statement) with the Office of Tax Shelter Analysis (OTSA) within 90 days of the transaction becoming a listed transaction or a transaction of

On remand in *CIC Services, LLC, v. Commissioner*,[1283] the District Court for the Eastern District of Tennessee held, in pertinent part:

- Notice 2016–66 classifying micro-captive transactions as "transactions of interest" was a legislative rule.
- The rule was subject to the notice and comment provisions of the Administrative Procedure Act.
- Notice 2016–66 was arbitrary and capricious;
- Notice 2016–66 was vacated in its entirety.

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interest if the assessment limitations period remains open for any taxable year in which the taxpayer participated in the transaction. Accordingly, any taxpayer who has participated in a transaction in any year for which the assessment limitation period remains open when the regulation identifying the transaction as a listed transaction or a transaction of interest is finalized will have an obligation to disclose the transaction, unless otherwise provided in the final regulations. Failure to disclose will subject the taxpayer to the penalty under section 6707A of the Internal Revenue Code (Code). Participants required to disclose listed transactions who fail to do so are also subject to an extended period of limitations under section 6501(c)(10) of the Code. That section provides that the time for assessment of any tax with respect to the transaction will not expire before the date that is one year after the earlier of the date the participant discloses the transaction or the date a material advisor discloses the participation pursuant to a written request under section 6112(b)(1)(A) of the Code.

Likewise, if a regulation identifying a transaction as a listed transaction or a transaction of interest is finalized after the occurrence of the events described in § 301.6111-3(b)(4)(i) of the Procedure and Administration Regulations, a material advisor will be treated as becoming a material advisor on the date the regulation is finalized pursuant to § 301.6111-3(b)(4)(iii) (if not deemed a material advisor earlier pursuant to a valid listing notice). A material advisor is required to file a Form 8918, Material Advisor Disclosure Statement, with OTSA by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to the transaction. See § 301.6111-3(d) and (e).

In addition, a material advisor must maintain a list identifying each person with respect to whom the advisor acted as a material advisor with respect to a listed transaction or transaction of interest, if the person advised by the material advisor entered into the transaction within six years before the date the transaction was identified as a listed transaction or transaction of interest in published guidance. See § 301.6112-1(b)(2).

Policy Statement on the Tax Regulatory Process (March 5, 2019), DOC 2019-8204, 2019 TNT 44-12 (March 6, 2019).

[1283] 92 F. Supp. 3d 677 (E.D. Tennessee 2022).