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LIFE-5115 7/24

Supreme Court overturns *Chevron* deference, challenging agency rulemaking

Loper Bright Enterprises v. Raimondo, **603 U.S. **** (2024).**

Facts

The question presented in this case was whether a fisheries law could require fishing vessels to bear the costs, including wages, of a government observer. The National Marine Fisheries Service (NMFS), the agency tasked with administering the law, determined that independent boats could be required to pay those costs if a government-paid observer was not available.

In the two cases involved in this decision, the district courts concluded that NMFS's interpretation of the law was permissible. The D.C. and First Circuits, applying *Chevron*, affirmed. The Supreme Court granted certiorari on the limited (but very consequential) question of whether the doctrine established in *Chevron v. National Resources Defense Council*, which requires deference to an agency's interpretation of legislation in certain circumstances, should be overturned. The test laid out in *Chevron* requires courts to undertake a two-step analysis when reviewing agency rules. Under the first step, courts determine whether the Congressional intent behind the statute is clear. If it is, then that intent governs the interpretation of the statute. If, however, "the statute is silent or ambiguous with respect to the specific issue" at hand (i.e., Congressional intent is not clear), then the question becomes whether the agency's interpretation "is based on a permissible construction of the statute." If the agency's interpretation is permissible, even if it is different from the court's interpretation of the statute, then the agency's interpretation will control.

Holding

Writing for the majority, Chief Justice Roberts confirmed: "Chevron is overruled." In his decision, the Chief Justice begins with a historical review, starting with Article III of the Constitution and selections from the Federalist Papers, followed by the expansion of administrative processes beginning with the New Deal, and then the enactment of the Administrative Procedures Act (APA) in 1946. Concluding that, historically, the role of courts has always been to interpret laws, the Court next looks at practice between the passage of the APA and the decision in *Chevron*. While the APA authorizes courts to defer to agencies on issues of fact, there is no similar language regarding issues of law, and courts continued to analyze each statute independently to interpret its meaning. After *Chevron*, courts deferred to agency interpretation of statutes, which the Supreme Court finds could not be squared with the text of the APA. Courts, not agencies, should determine all relevant questions of law — even on technical matters — and courts have limited *Chevron's* application in subsequent cases. Finally, the Court concludes that *stare decisis* does not require that *Chevron* remain the law. However, the Court states explicitly that the decision in this case does "not call into question prior cases that relied on the *Chevron* framework."

Takeaway

Chevron was decided in 1984 and has been cited thousands of times by other courts, including in many Supreme Court decisions. While this decision will have considerable impact on administrative practice, it is important to note that of the many forms of Treasury guidance — including regulations, revenue rulings, revenue procedures, notices, and announcements — only Treasury Regulations received deference under

Chevron, and that was not even the case for all regulations until 2011. Lower levels of deference, like *Skidmore* or *Auer*, may still apply. This decision also acknowledges that where Congress has expressly delegated its authority (as happens often in the tax code), the court's role is to determine whether the agency used "reasoned decisionmaking" within the limits of the delegated authority. Which leaves the level of deference afforded to agency interpretations unclear, but the likelihood of much more litigation apparent.

Supreme Court upholds constitutionality of Mandatory Repatriation Tax

Moore v. United States, **602 U.S. **** (2024).**

Facts

Taxpayers invested in their friends' Company, based in India; their investment gave them a 13% ownership share in Company. Company generated income, but it was not distributed to the American shareholders, so no tax on Company's income was paid to the United States. When Taxpayers filed their 2017 return, they were forced to report and pay taxes on their share of Company's undistributed income because of the Mandatory Repatriation Tax (MRT), part of the Tax Cuts and Jobs Act that was passed in 2017. The MRT (IRC §965) included a one-time tax on American shareholders of foreign corporations, based on the foreign corporations' undistributed income. The tax rate ranged from 8–15.5% and applied to shareholders who held at least a 10% ownership interest. Taxpayers paid the tax ($14,729), and then sued for a refund. Taxpayers claimed that the MRT was unconstitutional because it 1) was an unapportioned direct tax on their stock shares (and therefore violated the direct tax clause of the Constitution) and 2) violated the Due Process clause of the Fifth Amendment because it applied retroactively to past income. The District Court dismissed the case, and the Ninth Circuit Court of Appeals affirmed. The Ninth Circuit found that the MRT was a permissible tax on income (not a direct tax) and rejected the Due Process claim based on the Supreme Court's decision in *United States v. Carlto*n (512 U.S. 26 (1994)). Taxpayers sought Supreme Court review only on the direct tax issue.

Holding

The Court ultimately finds that the MRT is a Constitutional tax. The Court's reasoning rests largely on the current taxation of S corporations, partnerships, and Subpart F income (which generally applies to passive income of controlled foreign corporations). Reviewing the history of taxation and the evolution of corporate taxation, courts have repeatedly found that Congress may tax either the entity or the shareholders (of S corporations) or partners (of partnerships) — this is commonly referred to as pass-through taxation. In 1962, Congress passed Subpart F of the Internal Revenue Code, attributing certain income of a controlled foreign corporation to its American shareholders, and taxing the shareholders on their portion of that income (generally, passive income). In upholding the constitutionality of the Subpart F tax, courts have repeatedly found that Congress may treat foreign corporations as pass-through entities, and therefore may tax the shareholders rather than the entity itself. Taxpayers concede that the taxation of S corporations, partnerships, and Subpart F income are all constitutional taxes on income. They attempt to distinguish the MRT as a tax not on income, but on property. They contend that income requires realization, and that the MRT applies to unrealized income held by a foreign corporation; therefore, the MRT cannot be an income tax but is rather a direct tax on their property (the stock shares). Because the Constitution requires that any direct tax to be apportioned among the states

(meaning that each state pays a fixed percentage of the total tax, based on their population), and the MRT is not apportioned, Taxpayers assert that the MRT is unconstitutional. The Court does not decide whether an income tax requires realization, finding instead that Company did realize income, which may be taxed either to the entity or to the shareholders. In ruling against Taxpayers, the Court notes that their arguments could lead to large parts of the tax code being found unconstitutional. The holding itself is narrow: the "(i) taxation of shareholders of an entity, (ii) on undistributed income realized by the entity, (iii) which has been attributed to shareholders, (iv) when the entity itself has not been taxed on that income" is constitutional. While the Court avoids ruling on whether realization is a prerequisite for income taxation, it notes that the validity of an unapportioned tax on appreciation may depend on whether there is a realization requirement.

Takeaway

One might question why the Supreme Court even accepted a case on a one-time tax that did not have broad application. Cynics may suggest that the Court sought to weigh in on how they might view the constitutionality of a wealth tax — e.g., a tax on unrealized income or on assets themselves. Indeed, Justices Barrett and Alito, concurring in the judgment, and Justices Thomas and Gorsuch, who dissented, all conclude that any tax on income requires realization.

IRS issues guidance on distributions from qualified plans for emergencies and domestic abuse victims

IRS Notice 2024-55.

When Congress passed SECURE 2.0 Act (Act) in 2022, they included new exceptions to the 10% early withdrawal penalty under IRC §72(t). Notice 2024-55 (Notice) provides guidance on two of those new exceptions: emergency personal expense (EPE) distributions (section 115 of the Act) and domestic abuse victim distributions (section 314 of the Act). Under the Act, EPE distributions of up to $1,000 and domestic abuse victim distributions of up to $10,000 (indexed for inflation) are excepted from the 10% early distribution tax, can be made even from plans that don't otherwise allow in-service distributions, are exempt from certain requirements related to rollovers, and can be recontributed within three years. There are three limitations to EPE distributions: 1) there can only be one per calendar year, 2) the maximum amount per calendar year is $1,000, and 3) subsequent distributions within three years of an EPE may only be made if the initial EPE has either been repaid directly or additional contributions equal to the outstanding EPE have been made to the plan.

With respect to EPE distributions, the Notice states that to qualify, the distribution must be made "for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses," and that this determination is made based on all of the relevant facts and circumstances. Relevant factors include expenses related to medical care, casualty losses, imminent foreclosure or eviction from a primary residence, a funeral or burial, and car repairs. The Notice confirms that an applicable eligible retirement plan (Plan) (which the Notice explains includes most retirement plans other than a defined benefit plan) has the option to permit emergency personal expense distributions, and that any plan amendment to permit such distributions are "discretionary" amendments. If a Plan does not permit these distributions, individuals who meet the criteria may claim the distribution on their Form 5329 (e.g., if they took a hardship distribution from

their plan that meets the criteria for an emergency personal expense). Plan administrators may accept an employee's written certification that they are eligible for the distribution. The Notice explains the circumstances under which a Plan must accept a repayment within three years of the distribution, and that employers may allow participants to make withdrawals from elective, qualified nonelective, qualified matching, or safe harbor contributions under a 401(k) plan, but need not.

The Act defines a domestic abuse victim and allows a distribution to a domestic abuse victim within one year of abuse by a spouse or domestic partner. Importantly, abuse against a victim's child or another household member can qualify. Much of the guidance for domestic abuse victim distributions is the same – like EPE distributions, it is optional for a plan to permit them and any amendment to do so is discretionary; if a plan does not allow for them, an individual may claim the distribution on their Form 5329; employers may accept a written self-certification; the plan may permit a distribution from elective, nonqualified elective, qualified matching or safe harbor contributions; and a plan must accept repayment of these distributions under certain circumstances. There are some differences, however. For example, the Notice defines an applicable eligible retirement plan as "an eligible retirement plan described in Code section 402(c)(8)(B), other than a defined benefit plan or a plan to which the spousal consent requirements of sections 401(a)(11) and 417 apply."

Comments on this Notice are due October 7, 2024.

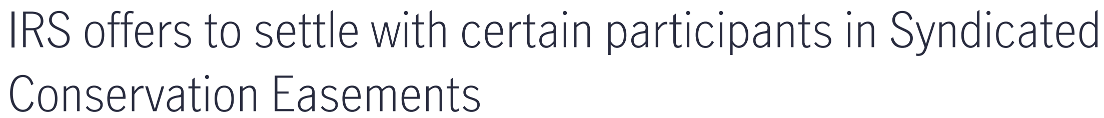
IRS issues final regulations on conservation easement deduction disallowance

89 FR 54284, 26 CFR Part 1, RIN 1545-BQ90.

Also, as part of the SECURE 2.0 Act, Congress included a rule disallowing deductions made by partnerships or S corporations for certain qualified conservation contributions after December 29, 2022. Section 170(h)(7) disallows a qualified conservation contribution if the amount of the contribution is more than two and a half times the sum of each partner's or shareholder's relevant basis in the entity. The statute does provide limited exceptions for family entities, contributions made beyond a three-year holding period, and those made to preserve a certified historic structure. The statute also includes a specific grant of regulatory authority to the Treasury Secretary to issue guidance (including regulations) necessary to carry out the rule, "including reporting requirements and rules to prevent the avoidance" of the rule.

The highly technical final regulations define key terms, provide a methodology to calculate the relevant basis, expand on the exceptions, and delineate reporting requirements. The regulations also include reporting requirements for partners and S corporation shareholders that receive a distributive or pro rata share of a noncash charitable contribution made by the entity, even if the noncash contribution is neither a qualified conservation contribution nor real property.

The final regulations became effective June 28, 2024.



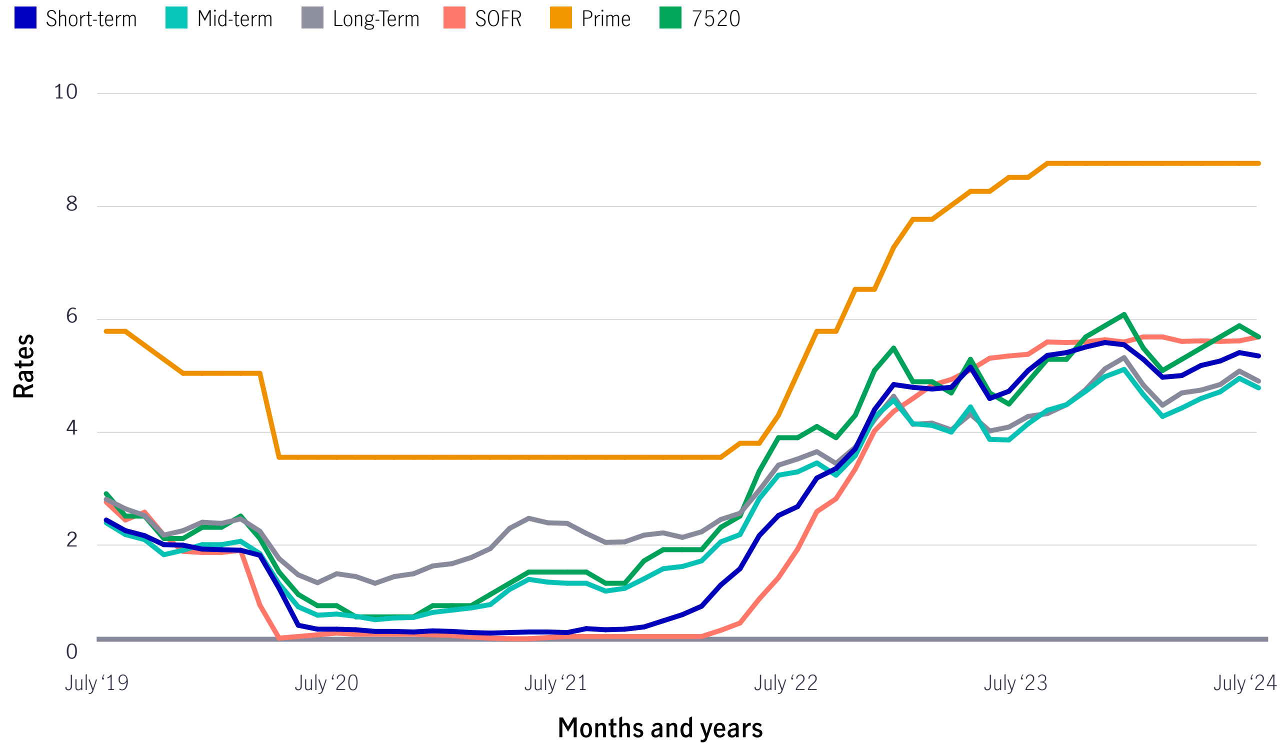
IRS offers to settle with certain participants in Syndicated Conservation Easements

IR-2024-174.

The IRS announced that they will be mailing time-limited settlement offers to certain taxpayers who participated in Syndicated Conservation Easement (SCE) transactions. The IRS has been auditing SCE transactions and other substantially similar transactions. Not all taxpayers participating in such transaction will be eligible for settlement, including those with cases pending in Tax Court. Taxpayers who do receive a settlement letter may opt not to participate (in which case enforcement actions will continue, including the potential full disallowance of charitable contributions associated with the SCE, plus penalties). The settlement offer includes concessions on both the income tax benefits (from the taxpayers) and the penalties (from the IRS). SCEs have been on the IRS's radar for years. Several promoters have been sentenced to over 20 years in prison for their role and at least 9 taxpayers have entered guilty pleas; there are also many Tax Court opinions. The IRS previously made settlement offers involving SCEs in June 2020 and October 2005. According to the IRS, this "settlement offer is the most effective and efficient way for taxpayers to bring finality to the transactions and achieve tax certainty."

The following are historical graphs of various rates that are commonly used by the Advanced Markets group

Short, Mid, Long Term Applicable Federal Rate (AFR), 7520, SOFR, Prime Rates from July 2019 – July 2024



Take a look at how rates compare this month to last month*

	Short-term AFR	Mid-term AFR	Long-term AFR	7520	SOFR	Prime
July 2024	5.06%	4.49%	4.61%	5.40%	5.40%	8.50%
June 2024	5.12%	4.66%	4.79%	5.60%	5.33%	8.50%

*For more information on these rates, please visit https://www.irs.gov/applicable-federal-rates

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