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Tax impact of end of Chevron doctrine

Overturning 40 years of precedent, the Supreme Court rejected the Chevron doctrine, which held that courts should give deference to reasonable interpretations of statutes by regulatory agencies if the statute is silent or ambiguous on the issue. The 6-3 decision held that the doctrine was inconsistent with the Administrative Procedures Act (APA) in limiting the role of judicial review. The Court indicated deference should be given only when Congress explicitly states that the agency can make its own decision on the issue.

The ruling could have far-reaching consequences on the finality of Treasury and IRS guidance. The IRS had already been forced to comply with the APA by issuing less guidance in the form of notices and more in the form of proposed regulations with an opportunity for public comment and consideration. Now, even those proposed and final regulations may be more open to challenge and less reliable as taxpayer guidance.

The role of Congress

Congress has been accused of drafting legislation with unaddressed issues and ambiguous language. This forced regulatory agencies charged with enforcing those provisions to interpret what Congress might have intended. Under the Chevron doctrine, courts were required to give deference to such reasonable interpretations.

Congress can try to draft more comprehensive legislation addressing all possible issues. This approach will make drafting legislation more difficult, since each provision added to the legislation will be open for debate. Congress already has difficulty drafting legislation, and more complete legislation is likely to further delay or even completely frustrate the process.

The House Ways and Means Committee and Senate Finance Committee have tax experts on their staffs. However, the number of those experts is much smaller than the number available in the Treasury and IRS. These Congressional committees already work closely with Treasury and the IRS on drafting tax legislation and are likely to continue to do so in a post-Chevron environment. Congress will not likely be able to expand its staff to match the expertise of the regulatory agencies. Congress often faces deadlines trying to enact tax legislation under budget rules permitting passage in the Senate with only a majority vote.

"Congress could also try to pass general legislation enshrining the Chevron doctrine into law."

Congress frequently states that specific provisions in tax legislation are left for further clarification by the Secretary of the Treasury. Congress could try to make such deference more of a standard provision of tax legislation. However, some members of Congress may be uncomfortable with such extensive delegation of legislative authority. Sometimes, the legislative language is nonspecific, possibly using terms such as "reasonable" or "sufficient" to indicate deference to Treasury without specifically stating so.

Congress could try to clarify when it is deferring to Treasury. Congress could also try to pass general legislation enshrining the Chevron doctrine into law. Such a step would appear to address APA problems, but there could be constitutional issues with such a transfer of legislative authority to the executive branch.

The number of pages that Treasury and the IRS typically issue interpreting tax legislation far exceeds the length of the legislation. It is difficult to imagine statutes growing enough to incorporate all the interpretations. It also often takes Treasury and the IRS months or years to finalize regulations. Waiting to add those interpretations could mean many statutes would never be enacted.

The role of courts

Taxpayers frequently turn to the courts to try to overturn regulations. The cases that provided the Supreme Court with the opportunity to overturn the Chevron doctrine involved regulations requiring shippers to pay part of the cost of federal inspectors required on their vessels. The new judicial requirements for Treasury to comply with the APA also emerged from cases where taxpayers challenged IRS guidance on the procedures used to adopt the guidance if the Chevron doctrine prohibited them from challenging it on the merits. Now, taxpayers will have a freer hand to challenge even APA-compliant regulations on their merits as well.

Of course, there are many federal district courts and only one Treasury. Different district courts could interpret a particular statute differently until the cases move to the Circuit Courts of Appeals or the Supreme Court for final clarification.

Regulations are often viewed as a burden by much of the industry. However, tax regulations are also welcomed as needed finality in determining how to prepare current and future tax returns. With the judicial process of resolving these tax issues, taxpayers in different parts of the country might prepare their returns differently until the Supreme Court selects the final interpretation many years later. Judicial interpretations are not subject to the APA, so judicial interpretations of tax legislation will not be subject to a public comment period.

The Supreme Court has pointed out that the judiciary has historical competence in resolving statutory ambiguities. However, that may be less true in the tax area, which is different from other areas of legislation. Many tax issues go first to the Tax Court unless the taxpayer pays the tax in dispute and then seeks a refund in a federal district court more likely to be receptive to their arguments. Federal district courts typically do not have staff with tax expertise and rely heavily on the staff of the litigants before them to set forth the issues, arguments and authorities.

The Tax Court speaks with one national voice, although its regular decisions can be reviewed and overturned by federal appeals courts. The Tax Court relies heavily on the expertise of Treasury and the IRS and will likely continue to do so. Chevron ending may not have much of a direct effect on Tax Court decisions but may result in more taxpayers appealing to a federal appellate court if they feel the Tax Court has given too much deference to Treasury and the IRS.

Even without Chevron, courts may still give some deference to Treasury decisions. Courts may make a greater effort to evaluate Treasury's process in reaching its decision. Some courts may still give deference to the experts in Treasury and the IRS but not cite Chevron as the basis for their decision. Taxpayers may continue to seek federal courts likely to be sympathetic to their point of view.

The Supreme Court has sent an IRS whistleblower case back to the D.C. Circuit Court of Appeals, which had cited Chevron in upholding Treasury's interpretation of the whistleblower statute.

The Chevron repeal may also cause issues at the state level, where state courts will give less deference to the state departments of revenue in interpreting state tax statutes. Many states also have tax courts for resolving issues arising from state tax statutes.

Regulatory agencies

As Treasury has responded to the need to comply with APA notice and comment requirements, Treasury and the IRS may set forth even more clearly in regulations the process of reaching decisions. Treasury may seek to work more closely with Congress to identify issues in proposed tax legislation that could be addressed in the final legislation or to seek explicit authority in the legislation for Treasury to interpret the tax provisions.

Summary

The repeal of the Chevron doctrine may increase uncertainty in the tax world, increase litigation over Treasury and IRS interpretations of tax laws and change how Congress drafts tax legislation. The burden of proof remains with the plaintiff in litigation. The Supreme Court has said its repeal of Chevron does not affect prior decisions under the Chevron doctrine. Unless the Supreme Court steps in as the final arbitrator of differences in tax interpretations in the lower courts, some of these divergent interpretations of Treasury and IRS guidance may never be fully resolved. ■

Partnership not entitled to charitable contribution deduction

A partnership was not entitled to a charitable contribution deduction claimed on its tax return. The IRS contended that the charitable contribution deduction should be denied in its entirety. The Tax Court agreed with the IRS that the taxpayer did not make any charitable contribution during the tax year for which its return was filed. The taxpayer was not a *per se* corporation under Treas. Reg. §301.7701-2(b) and did not elect to be classified as a corporation under Treas. Reg. §301.7701-3. Thus, the taxpayer during this period was disregarded as an entity separate from its owner. As a result, all income, gain, loss, deduction or credit relating to the taxpayer was directly attributable to and reportable by its owner (*Corning Place Ohio, LLC*, TC Memo. 2024-72, Dec. 62,487(M)).

Additionally, the taxpayer was not entitled to claim a net rental real estate loss. On the initial return, the taxpayer checked the box stating it was adopting the accrual method of accounting. On the attached Form 8825, *Rental Real Estate Income and Expenses of a Partnership or an S Corporation*, it reported easement expenses. However, the taxpayer did not itemize these expenses on Form 8825, and it did not indicate the nature or dollar amount of any particular expense. Further, the taxpayer at trial failed to supply evidence enabling a comprehensive itemization of the reported easement expenses.

Penalties

The taxpayer was liable for a gross valuation misstatement penalty under Code Sec. 6662(h). The taxpayer was negligent to claim the charitable contribution deduction on a return filed for a year after the contribution was made. The taxpayer asserted reliance on professional advice as the basis for its reasonable cause defense. However, there was no evidence that a tax professional supplied advice that the taxpayer's return was the correct one to report the deduction. Further, the taxpayer's principals were sophisticated real estate professionals. Even the most cursory review of the return would have made it obvious that the charitable contribution was not made during the tax year at issue. ■

IRS extends transition relief for RMDs in 2024

The IRS has provided transition relief for 2024 for certain required minimum distributions (RMDs) made to designated beneficiaries under the 10-year rule. The transition relief extends similar relief granted in 2021, 2022 and 2023. The IRS has also changed the anticipated application date for final regulations related to RMDs under Code Sec. 401(a)(9) (IRS Notice 2024-35).

SECURE Act changes

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 (P.L. 116-94) changed the RMD rules for employees and IRA owners. Generally, the changes apply to distributions with respect to employees who died after Dec. 31, 2019. Under Code Sec. 401(a)(9)(H)(i), if an IRA owner or employee in a defined contribution plan has a designated beneficiary, the five-year distribution period has lengthened to 10 years, and the 10-year rule applies regardless of whether the employee dies before the required beginning date.

"This aspect of the 10-year rule differs from the five-year rule, which required no RMD until the end of the five-year period."

IRS proposed regulations that would apply beginning with the 2022 calendar year would interpret the 10-year rule to require the beneficiary of an employee who died after the required beginning date to take annual RMDs beginning in the first calendar year after the employee's death. This aspect of the 10-year rule differs from the five-year rule, which required no RMD until the end of the five-year period.

The IRS received comments concerning the proposed regulations. Some individual owners of inherited IRAs or beneficiaries under defined contribution plans submitted comments that they thought the new 10-year rule would apply differently. These commenters expected that, regardless of when an employee died, the 10-year rule would operate like the five-year rule, so no RMD would be due for a calendar year until the last year of the 10-year period following the specified event.

In response to the comments, the IRS provided transition relief for 2021, 2022 and 2023. For example, IRS Notice 2023-5 extended the relief to specified RMDs for 2023 and announced that the final regulations applied no earlier than the 2024 distribution calendar year.

Guidance for specified RMDs for 2024

Under the transition guidance, a defined contribution plan will not be treated as having failed to satisfy Code Sec. 401(a)(9) for not making an RMD in 2024 that would have been required under the proposed regulations. The relief also applies to an individual who would have been liable for an excise tax under Code Sec. 4974.

The guidance applies to any distribution that, under the interpretation in the proposed regulations, would be required under Code Sec. 401(a)(9) in 2024 for a defined contribution plan or IRA subject to the rules of Code Sec. 401(a)(9)(H) for the year in which the employee (or designated beneficiary) died, if that payment would be required to be made to one of the following:

- A designated beneficiary of an employee or IRA owner under the plan, if the employee or IRA owner died in 2020, 2021, 2022 or 2023, on or after the employee's or IRA owner's required beginning date, and the designated beneficiary is not using the lifetime or life expectancy payments exception under Code Sec. 401(a)(9)(B)(iii)
- A beneficiary of an eligible designated beneficiary, if the eligible designated beneficiary died in 2020, 2021, 2022 or 2023, and that eligible designated beneficiary was using the lifetime or life expectancy payments exception under Code Sec. 401(a)(9)(B)(iii) ■

Exceptions from 10% additional tax for emergency personal expenses and domestic abuse survivors

The IRS has provided guidance on the application of exceptions to the 10% additional tax under Code Sec. 72(t)(1) for emergency personal expense and domestic abuse victim distributions. These early permissible retirement plan distributions were added by the SECURE 2.0 Act of 2022 (Division T of the Consolidated Appropriations Act, 2023, Pub. L. 117-328), and the provisions became effective on Jan. 1, 2024 (IRS Notice 2024-55).

Generally, Code Sec. 72(t)(1) provides for a 10% additional tax on a distribution from a qualified retirement plan unless the distribution qualifies for one of the exceptions listed in Code Sec. 72(t)(2). The 10% additional tax applies only to the portion of the distribution includible in gross income. SECURE 2.0 amended Code Sec. 72(t)(2) to add two exceptions for distributions from an applicable eligible retirement plan for emergency personal expenses and for domestic abuse victims.

Emergency personal expense distributions

The IRS provides that a taxpayer can receive a distribution from an applicable eligible retirement plan to meet unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses. The guidance:

- Defines emergency personal expense distributions, including what is an unforeseeable or immediate financial need
- Provides that qualified defined contribution plans (including 401(k) plans), 403(a) annuity plans, 403(b) plans, governmental 457(b) plans and IRAs) are eligible for emergency personal expense distributions
- Describes the limitations (both dollar amount and frequency) on receiving emergency personal expense distributions
- Provides that individuals receiving emergency personal expense distributions can repay these distributions to certain plans

Distributions to victims of domestic abuse

A taxpayer can receive a distribution from an applicable eligible retirement plan if made during the one-year period beginning on the date on which the individual is a victim of domestic abuse by a spouse or domestic partner. The IRS:

- Defines domestic abuse and victim distributions
- Provides that IRAs and certain retirement plans that are not subject to the spousal consent requirements under Code Sec. 401(a)(11) and Code Sec. 417 are eligible for domestic abuse victim distributions
- Describes the dollar limitation (indexed for inflation) on receiving domestic abuse victim distributions
- Provides that domestic abuse individuals can repay domestic abuse victim distributions to certain plans

The IRS also provides guidance to eligible retirement plans on requirements for the new exceptions, including that it is optional for a plan to permit these types of distributions.

> "The IRS notes that these distributions are includible in gross income but not subject to the 10% additional tax."

The IRS notes that these distributions are includible in gross income but not subject to the 10% additional tax. Individuals report early distributions not subject to the 10% additional tax on line 2 of Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts.* ■

Treatment of taxable distributions from DAFs

The Treasury and the IRS have released the first installment of proposed guidance relating to donor advised funds (DAFs). The proposed regulations expand on earlier guidance clarifying the scope of accounts treated as DAFs and what constitutes taxable distributions. Future guidance is expected to address prohibited transactions.

The proposed regulations address the application of excise taxes under Code Sec. 4966 to taxable distributions from DAFs as well as providing guidance on agreements by certain fund managers to make such distributions (NPRM REG-142338-07). The regulations would apply generally to community foundations and similar organizations maintaining DAFs and to individuals involved with the DAFs, including donors and their advisors, related persons and certain fund managers.

> "If a donor-advisor delegates any advisory privileges to another person, that person would also be a donor-advisor."

The proposed regulations would clarify the definition of a DAF (under Code Sec. 4966(d)(2)(A)) as any fund or account that:

- Is separately identified by reference to the contributions of donors
- Is owned and controlled by a sponsoring organization
- Has at least one donor (or donor-advisor) who reasonably expects advisory privileges regarding distributions from or the investment of amounts held in the fund simply by reason of being a donor to the fund

The proposed regulations would presume that advisory privileges of a donor or donor-advisor arise from the donor's status as a donor unless specifically provided otherwise. If a fund or account meets all three elements of this test, it would be a DAF except as specified otherwise in Code Sec. 4966(d)(2).

The proposed regulations would provide a six-category list of facts and circumstances relevant in determining whether a fund or account is separately identified (Code Sec. 4966(d)(2)(A)(i)). The regulations would also provide four special rules relating to advisory privileges, each based on the presumable reason for the advisory privileges:

- Being a donor or donor-advisor
- Service on an advisory committee
- Being a director, officer or employee of a sponsoring organization
- Being the sole person with advisory privileges for a fund or account

The proposed regulations would define a donor-advisor as a person appointed or designated by a donor to have advisory privileges for the distribution or investment of assets held in a fund or account of a sponsoring organization. If a donor-advisor delegates any advisory privileges to another person, that person would also be a donor-advisor. Three special rules regarding donor-advisors are also proposed. In addition, special rules would apply to the advisory committees of sponsoring organizations.

The proposed regulations generally would except from being defined as a DAF any fund or account that makes distributions only to a single identified organization or certain grants to individuals for travel, study or similar purposes. Also, the IRS would have discretionary authority to exempt a fund or account from the definition of DAF for certain disaster relief funds and certain scholarship funds whose committee is nominated by a Code Sec. 501(c)(4) organization with a broad-based membership. ■

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