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by Gary B. Wilcox and Lucas Giardelli

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Will Jurisdictional Nexus Survive *Chevron* Step 1?

by Gary B. Wilcox and Lucas Giardelli

Gary B. Wilcox and Lucas Giardelli are partners at Mayer Brown LLP.

In this article, Wilcox and Giardelli analyze whether the jurisdictional nexus requirement in the new foreign tax credit regulations will survive a validity challenge in the courts.

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"The one constant through all the years, Ray, has been baseball."
— Terence Mann, *Field of Dreams*

Overview

So true of baseball. But the same could be said about the term "income taxes" in section 901. This provision has remained substantially the same since it was first enacted in 1918. For many years, the courts and IRS have concluded that the term "income taxes" in section 901 means a foreign "income tax in the U.S. sense."[1] Regulations issued in 1983 (yes, no regulations at all for 65 years!) define a foreign income tax as one based on the excess of gross receipts over relevant costs. These 1983 regulations seek to ensure that the foreign tax base is measured in a manner similar to how the U.S. tax base is measured.

The recent final regulations (T.D. 9959), issued by Treasury on January 4, add a jurisdictional nexus requirement for determining whether a foreign tax qualifies as a foreign income tax under section 901.[2] Essentially, as a result of this new requirement, the foreign tax is not an income tax unless "the foreign country imposing the tax has sufficient nexus to the taxpayer's activities or investment of capital or other assets that give rise to the income base on which the foreign tax is imposed."[3] This means no credit for destination-based foreign taxes imposed on net income derived from the U.S. taxpayer's customers or users in the foreign country. It also means that a foreign income tax on gain recognized by a U.S. taxpayer from the transfer of stock in a corporation organized in the foreign country is not creditable unless the corporation has a sufficient real property nexus in the country. Various commonly encountered foreign withholding taxes could run the same fate, such as royalty withholding taxes based on the residence of the payer (rather than the place of use of the intangible) or withholding taxes on fees for technical services based on the location of the service recipient.

Taxpayers have good reason to be frustrated. Overnight, the entire landscape for U.S. taxpayers claiming foreign tax credits has changed drastically. In the last 100 years, section 901's reference to income taxes has never been interpreted as being conditioned on either a nexus between the taxpayer and the foreign country, or the source of the net income. Since 1921 the FTC limitation rules in both prior and contemporary versions of section 904, as well as the separate sourcing rules, have undergone significant changes. All the while, section 901's credit for foreign income taxes has remained constant, with

[1] Former reg. section 1.901-2(a)(1)(ii) (referring to an income tax "in the U.S. sense"); Rev. Rul. 56-51, 1956-1 C.B. 320 (referring to foreign tax imposed on amounts that constitute income items "by United States standards"); *Biddle v. Commissioner*, 302 U.S. 573 (1938) ("The phrase 'income taxes paid,' as used in our own revenue laws, has for most practical purposes a well-understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to it as used in section 131," which is a predecessor to section 901.).

[2] While the proposed regulations (REG-101657-20) described this new requirement as the "jurisdictional nexus requirement," the final regulations renamed it the "attribution requirement." We find the terminology in the proposed regulations to be more descriptive and will thus refer to the jurisdictional nexus requirement throughout this article.

[3] T.D. 9959.

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not a single change since 1921 other than a change of the term "paid" to "paid or accrued." One can legitimately wonder how these onerous new requirements on claiming FTCs can be imposed at this late date by Treasury without new legislation.

Unfortunately, what's done is done. The relevant question now is whether a taxpayer may successfully challenge the validity of these regulations. That depends on whether a court will defer to Treasury under the *Chevron* deference standard.[4] The battle will largely be waged at step 1. This initial step is a deep inquiry into what Congress intended by the term "income tax" in section 901, using the traditional tools of statutory construction. A court makes this determination *de novo*, without giving any deference to the IRS's position.[5] If a court determines that the term "income tax" is unambiguous and, as a result, the jurisdictional nexus requirement is not supported by congressional intent, it will invalidate the regulations.

On the other hand, if a court determines that Congress made an implicit delegation of authority to Treasury to address whether, and how, a jurisdictional nexus requirement should be imposed, it will proceed to step 2. At step 2, a court examines whether Treasury's action is considered a permissible construction of the statute,[6] without regard to whether the court actually agrees with Treasury's action. Step 2 presents a high bar for the taxpayer and often means game over.

For that reason, taxpayers are most interested in the arguments for invalidating a regulation under step 1. That is the focus of this article, with a few caveats. Any analysis for a particular taxpayer should focus on case law in the taxpayer's circuit, in addition to Supreme Court decisions. Despite the plethora of Supreme Court cases, there are still gaps in the law addressed by circuit courts, and there can be differences among the circuits (for example, whether legislative history is considered at step 1). And even Supreme Court positions evolve over time (for example, change in 2011 from *National Muffler*[7] to *Chevron* deference for interpretive tax regulations). Also, every decision in this area is heavily influenced by the particular facts; conclusions about the state of the law can be drawn only with great care. Having said that, this article hopes to present a fair description of how courts across the country could analyze these new regulations under step 1.

Which Versions of Section 901 Are Analyzed?

The answer is potentially all of them. The reference to foreign "income, war profits, and excess profits taxes" in the current version of section 901(b)(1) is identical to the language in the original version of section 901, enacted as section 238(a) in the Revenue Act of 1918.[8] Until 1921 the statutory language read: "the amount of any income, war profits, and excess profits taxes paid during the same taxable year to any foreign country *upon income derived from sources therein*, or to any possession of the United States" (emphasis added).

In 1921 Congress removed the italicized language and, at the same time, enacted the predecessor of section 904 as a proviso limiting the amount of the credit allowable for foreign taxes under section 901 based on the taxpayer's share of foreign-source income relative to its

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[4] *See Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984). Taxpayers might also claim that the final regulations made significant modifications to the proposed regulations without providing sufficient notice and opportunity to comment, in violation of the Administrative Procedure Act. Any such procedural challenge is outside the scope of this article.

[5] *American Bar Association v. Federal Trade Commission*, 430 F.3d 457, 468 (D.C. Cir. 2005) ("The first question, whether there is such an ambiguity, is for the court, and we owe the agency no deference on the existence of ambiguity.").

[6] *Chevron*, 467 U.S. at 843.

[7] *National Muffler Dealers Association v. United States*, 440 U.S. 472 (1979).

[8] Sections 238(a) and 222(a)(1) provided FTCs for domestic corporations and individuals, respectively. Revenue Act of 1918, 40 Stat. 1057, 1073, 1080-1082 (1919). For a more detailed history of the term "income taxes" in section 901, please consult the valuable work of others. Robert E. Culbertson, "Sense and Sensibility and Creditability: Redefining an Income Tax 'in the U.S. Sense,'" *Tax Notes Int'l*, Oct. 11, 2021, p. 147; Catherine G. Schultz, "Proposed FTC Regulations Reg. 101657-20," National Foreign Trade Council comment letter on REG-1021657-20 (Feb. 10, 2021); William J. Sample, "IRS REG-101657-20 — Guidance Related to the Foreign Tax Credit; Clarification of Foreign-Derived Intangible Income," U.S. Council for International Business comment letter on REG-1021657-20 (Feb. 8, 2021); Leslie J. Schneider and Patrick J. Smith, "Comments on Proposed Regulations Under Sections 901 and 903 Reg-101657-20," Ivins, Phillips & Barker comment letter on REG-101657-20 (Feb. 8, 2021).

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worldwide income.[9] Thus, Congress removed any connection between foreign income taxes and source from the predecessor to section 901 and instead incorporated the foreign-source income requirement into the predecessor of section 904.[10] Other than eventually becoming section 901 and the change of the term "paid" to "paid or accrued," the 1921 version of section 238 has remained the same through multiple reenactments of the code, including in 1939, 1954, and 1986.

In these circumstances, courts will first attempt to determine what Congress intended those words to mean in 1918. The seminal case on this topic is *Plesha*,[11] in which the Court observed that a provision in the Soldiers' and Sailors' Civil Relief Act of 1940 "substantially reenacted the insurance provisions of the Soldiers' and Sailors' Civil Relief Act of 1918 and had little legislative history." On that basis, "we must therefore examine the history of the 1918 bill."[12] Courts have taken a similar approach when interpreting code sections that have not changed from one enactment to another.[13]

Then, at each modification of section 901, courts will determine whether Congress's intent regarding the language at issue was either clarified or modified. In *Square D*,[14] the Tax Court's step 1 interpretation of section 267(a)(2) was influenced by the enactment of section 267(a)(3) two years later: "The subsequent enactment of section 267(a)(3) may, under the principles of *Brown & Williamson*, be interpreted as altering the precise contours of section 267(a)(2) for purposes of applying the *Chevron* doctrine."[15] Similarly here, Congress's deletion of the "source" reference in 1921, combined with its incorporation of the foreign-source income requirement into the predecessor of section 904, made it clear that any connection between foreign income taxes and source had been removed from the predecessor to section 901.[16]

Courts also may consider whether the enactment or revision of a separate statute may be informative as to Congress's intent regarding the language in section 901. In *Brown & Williamson*,[17] the Supreme Court believed that its step 1 interpretation of an agency regulation must involve a detailed analysis of "the tobacco-specific legislation that Congress has enacted over the past 35 years," stating: "At the time a statute is enacted, it may have a range of plausible meanings. Over time, however, subsequent acts can *shape or focus* those meanings. . . . This is particularly so where the scope of the earlier statute is broad, but the subsequent statutes more specifically address the topic at hand"[18] (emphasis added).

Arguably several code provisions enacted in 1934 and 1942 helped "shape or focus" Congress's intent that "income taxes" in section 901 refers to taxes measured by deducting relevant costs from gross receipts and nothing more. Section 891, enacted in 1934 and still in the code, doubles the U.S. tax rate imposed on citizens and corporations of a foreign country "whenever the President

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[9] The following proviso was added to the language in section 901 that provided the credit for "foreign income, war profits, and excess profits taxes": "*Provided*, That the amount of credit taken under this subdivision shall in no event exceed the same proportion of the taxes, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year."

[10] This is not a distinction without a difference. While a taxpayer may not be allowed a credit for a foreign tax by reason of the section 904 limitation, that does not mean that the foreign tax was not *creditable* under section 901 (*e.g.*, subject to applicable carryover period limitations, the taxpayer could be allowed a credit for that same foreign tax in the prior tax year or future tax years).

[11] *United States v. Plesha*, 352 U.S. 202 (1957).

[12] *Id*. at 205. *See also United States v. Laub*, 253 F. Supp. 433, 457 (E.D.N.Y. 1966) (Because the 1952 provision in question "has no independent legislative history" and "is cast in language almost identical to that of" legislation in 1918 and 1941, "one may ascertain the intent of the Congress by examining the history of those earlier acts.").

[13] *United States v. Price*, 361 U.S. 304 (1960); *Commissioner v. Bilder*, 289 F.2d 291(3d Cir. 1961); *Spector v. Commissioner*, T.C. Memo. 1994-147.

[14] *Square D Co. v. Commissioner*, 118 T.C. 299 (2002).

[15] *Id*. at 309.

[16] Others have made eloquent arguments supporting this point. *See, e.g.*, Culbertson, *supra* note 8, at 158-160 ("Given that Congress in 1921 deleted a statutory requirement that conditioned the creditability of a foreign tax on whether the foreign country was imposing that tax on income it had appropriate jurisdiction to tax, the scope of Treasury's authority to reimpose a similar requirement by regulatory fiat seems doubtful at best."); Sample, comment letter by the U.S. Council for International Business, *supra* note 8, at 6 ("Considering this history [regarding the 1921 amendment], the notion that 'income taxes' in the 1918 Act should be interpreted to encapsulate international norms regarding taxing jurisdiction seems patently wrong.").

[17] *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000).

[18] *Id*. at 143. Based in part on that reasoning, the Court held that the FDA regulation was invalid in light of Congress's expressing its intent regarding that regulation in six subsequent pieces of legislation. *See also Texas v. United States*, 497 F.3d 491, 504 (5th Cir. 2007) ("Later enacted statutory provisions may be relevant for purposes of *Chevron* ambiguity.").

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finds that . . . the citizens or corporations of the United States are being subject to discriminatory or extraterritorial taxes" in that country. So, as far back as 1934, Congress was aware that some foreign countries were attempting to impose "extraterritorial" taxes on U.S. taxpayers yet did nothing to incorporate a jurisdictional nexus requirement into section 901. That is, the U.S. taxpayers might still be able to claim a credit for those taxes; it was the foreign persons who were penalized.

Section 903, enacted in 1942, can be seen as Congress doubling down on its intent to define "income taxes" in section 901 by reference to net income as opposed to gross receipts. Congress explained that the IRS and the courts "have consistently adhered to a concept of income tax rather closely related to our own, and if such foreign tax was not imposed upon a basis corresponding approximately to net income it was not recognized as a basis for such credit."[19] Section 903 was enacted to provide domestic corporations a credit in situations in which a foreign country, "for reasons growing out of the administrative difficulties of determining net income or taxable basis within that country," imposed a tax on gross income or gross receipts in lieu of its income tax.[20]

Whether other subsequent code sections helped shape or focus Congress's intent regarding income taxes is beyond the scope of this article.[21] However, anyone conducting a deeper step 1 analysis might explore whether some international provisions in the Tax Reform Act of 1986 or the Tax Cuts and Jobs Act had that effect.

Is the Term 'Income Taxes' Ambiguous?

In *Chevron* step 1, the court, "employing traditional tools of statutory construction,"[22] will ask "whether Congress has directly addressed the precise question at issue."[23] If Congress has directly addressed the question, its intent controls.[24] If the statute is either ambiguous or silent, the analysis proceeds to step 2, in which "the question for the court is whether the agency's answer is based on a permissible construction of the statute."[25]

In analyzing whether the statutory language in question is ambiguous, *Chevron* says to apply "the traditional tools of statutory construction." The Supreme Court has defined these tools to include "an analysis of the plain language of the [statute], its symmetry with [related provisions of law], and its legislative history."[26] The Court has emphasized the importance of context, stating that at step 1, "a reviewing court should not confine itself to examining a particular statutory provision in isolation. The meaning — or ambiguity — of certain words or phrases may only become evident when placed in context."[27] Various canons of constructions apply at this stage,[28] and it is common for a court to consult dictionary definitions of terms that are not defined.[29]

[19] S. Rep. No. 77-1631, at 131 (1942).

[20] *Id*.

[21] It is also noted that, over the years, the Senate has ratified several income tax treaties that include resourcing provisions, another clear acknowledgment that the tax rules of foreign countries often conflict with the domestic source rules of the code.

[22] *Chevron*, 467 U.S. at 843, n.9.

[23] *See Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44, 57-58 (2011).

[24] *See Wisconsin Central Ltd. v. United States*, 138 S. Ct. 2067, 2074 (2018) ("in light of all the textual and structural clues before us, we think it's clear enough that the term 'money' excludes 'stock,' leaving no ambiguity for the agency to fill").

[25] *Chevron*, 467 U.S. at 843.

[26] *INS v. Cardoza-Fonseca*, 480 U.S. 421, 449 (1987). *See also Kisor v. Wilkie*, 139 S. Ct. 2400, 2415 (2019), in which, in the context of evaluating an agency's interpretation of its own regulations, and citing *Chevron*, the Court said that "a court must carefully consider the text, structure, history, and purpose of a regulation before resorting to deference." It should be noted that circuit courts differ on the amount of analysis they are willing to conduct under step 1. *Compare Square D Co. v. Commissioner*, 438 F.3d 739, 745 n.4 (7th Cir. 2006) ("We do not share [appellant's] enthusiasm for determining whether relevant provisions have a clear and plain meaning by wandering outside the actual statutory language and into the legislative history in the first step of the *Chevron* analysis."), *with Salman Ranch Ltd. v. Commissioner*, 647 F.3d 929, 937 (10th Cir. 2011) (stating that both statutory language and statutory history are appropriate considerations in conducting step 1 of the *Chevron* analysis).

[27] *Brown & Williamson*, 529 U.S. at 132.

[28] *Arangure v. Whitaker*, 911 F.3d 333, 339-340 (6th Cir. 2018) ("The Supreme Court has repeatedly applied canons at step one."), citing *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612, 1617, 1625-1630 (2018).

[29] *See, e.g., Koyo Seiko Co. v. United States*, 36 F.3d 1565, 1571 (Fed. Cir. 1994).

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Courts sometimes say that a particular term is ambiguous if not defined in the statute.[30] Courts also say that "the lack of a statutory definition," however, "does not render a term ambiguous."[31] There is no universal rule here; it always depends on the facts. A great example is *Chicago Portrait*,[32] cited in *Chevron* for the proposition that the courts "must reject administrative constructions which are contrary to clear congressional intent."[33] The issue turned on the meaning of "foreign country" for purposes of the FTC. The Supreme Court recognized that the term in the abstract was ambiguous but held that it was unambiguous after a deep dive into the larger statutory context, the use of the term in other statutes, and the legislative purpose to "mitigate the evil of double taxation."[34]

Fortunately, in the case of the new FTC regulations, there could be a simple way to bypass all the foregoing murkiness associated with whether a statutory term is ambiguous. That is because Treasury already told us what the term "income taxes" means in the 1983 regulations.[35] Specifically, a foreign levy is an income tax if (1) it is a tax, and (2) its predominant character is that of an income tax. The predominant character requirement is met if (1) the tax is likely to reach net gain in the normal circumstances in which it applies, and (2) it is not a "soak-up" tax. The net gain requirements have three component requirements: realization, gross receipts, and net income. Nothing in these regulations requires or even implies a jurisdictional nexus requirement. In fact, these regulations included an example that allowed a credit for a foreign tax that would fail the jurisdictional nexus requirement.[36]

There are three levels at which Treasury's 1983 interpretation can be used to determine congressional intent regarding the term "income taxes." First, it can be used simply as a factor in ascertaining congressional intent. The Supreme Court's decision in *Consumer Product Safety Commission*[37] has been credited by courts with using a four-part test to interpret the meaning of a statute: (1) the language of the statute, (2) contemporaneous legislative history, (3) subsequent legislation that reveals the congressional purpose in enacting the original statute, and (4) agency interpretations of the statute; these same courts have used the four-part test in step 1.[38] The Supreme Court also has recognized that post-legislation administrative interpretation "is of relevance" to the court's construction of the statute and "must be given weight."[39]

Second, if the post-legislation administrative interpretation is followed by different legislation that reenacts the statutory language "without pertinent change," "a court may accord *great weight* to the longstanding interpretation placed on a statute by an agency charged with its administration"[40] (emphasis added). Said another way, "congressional failure to revise or repeal the agency's interpretation is *persuasive evidence* that the interpretation is the one intended by Congress"[41] (emphasis added).

[30] *See, e.g.*, *Mayo Foundation*, 562 U.S. at 52 (Court held that the term "student" was ambiguous regarding medical students because "the statute does not define the term 'student,' and does not otherwise attend to the precise question whether medical residents are subject to FICA"); *Miller v. United States*, 65 F.3d 687 (8th Cir. 1995) (court proceeded to step 2 because statute did not define "business interest").

[31] *American Federation of Employees v. Glickman*, 215 F.3d 7, 10 (D.C. Cir. 2000).

[32] *Burnet v. Chicago Portrait Co.*, 285 U.S. 1 (1932).

[33] *Chevron*, 467 U.S. at 843, n.9.

[34] *Chicago Portrait*, 285 U.S. at 7. *See also Emergency Services Billing Corp. Inc. v. Allstate Insurance Co.*, 668 F.3d 459 (7th Cir. 2012) (court determined that the term "consumer product" was unambiguous despite the lack of a statutory definition).

[35] T.D. 7918; reg. section 1.901-2.

[36] Reg. section 1.903-1(b)(3), Example 3, describes a case in which Country X imposed a withholding tax on payments for technical services performed outside Country X. The example concludes that the withholding tax is creditable. The recent final regulations, as expected, eliminate this example.

[37] *Consumer Product Safety Commission v. GTE Sylvania Inc.*, 447 U.S. 102 (1980).

[38] *See, e.g.*, *Commonwealth of Massachusetts v. Secretary of Health and Human Services*, 899 F.2d 53, 58 (1st Cir. 1990); *West Virginia Association of Community Health Centers Inc. v. Sullivan*, 737 F. Supp. 929, 936 (S.D. W.Va. 1990).

[39] *Zemel v. Rusk*, 381 U.S. 1, 11 (1965).

[40] *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 274-275 (1974).

[41] *Id.*; *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833, 846 (1986); *Boeing Co. v. United States*, 537 U.S. 437, 457 (2003). The Court's use of reenactment as an interpretive tool in *NLRB* has been described as "a variant of the re-enactment doctrine," as compared with "the doctrine's older and most rigid form which treats regulations extent during statutory re-enactment as having been promoted nearly to the status of the statutes themselves." *Peoples Federal Savings and Loan Association of Sidney v. Commissioner*, 948 F.2d 289, 300, n.7 (6th Cir. 1991).

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Third, if Congress is actually aware of the administrative interpretation during the enactment of the subsequent legislation and gives "a strong affirmative indication that it wishes the present interpretation to remain in place,"[42] the administrative interpretation is frozen[43] into the subsequent legislation and actually attains the force of law.[44] That is the so-called legislative reenactment doctrine.

In 1986 the entire code was reenacted.[45] The term "income taxes" in section 901 was not changed. However, the Senate Committee report for this legislation makes it clear that Congress, at a minimum, was aware of the 1983 regulations: "To be creditable, a foreign levy must be the substantial equivalent of an income tax in the U.S. sense, whatever the foreign government that imposes it may call it. To be considered an income tax, a foreign levy must be directed at the taxpayer's net gain. Treasury regulations promulgated under Code sections 901 and 903 provide detailed rules for determining whether a foreign levy is creditable (Treas. Reg. secs. 1.901-1 through 1.904-1 and 1.903-1)."[46] The report goes on to describe the details of the regulations.

Certainly, this is enough to make a prima facie case for the legislative reenactment doctrine, based on Congress seemingly endorsing the 1983 regulation in the legislative history of TRA 1986. Whether the doctrine is applied by a court may depend on how the court otherwise feels about the ambiguous or unambiguous nature of the term "income taxes." If the court is leaning toward treating "income taxes" as having an unambiguous meaning consistent with the 1983 regulations, the legislative reenactment doctrine may be just the additional support the court needs to make that conclusion in step 1. For example, in *Brown & Williamson*, the Supreme Court relied on Congress's subsequent reenactment of an established Food and Drug Administration policy to buttress its step 1 conclusion that the earlier statute at issue unambiguously precluded the FDA from reversing its established policy.[47] The taxpayer can always assert that this legislative history is persuasive evidence of Congress's intent at step 1 if the legislative reenactment doctrine becomes too much of a reach.[48]

On the other hand, if a court is leaning toward treating "income taxes" as ambiguous and moving on to step 2, urging the court to constrain the agency's ability to craft regulations because of the legislative reenactment doctrine may be a more challenging pursuit. Once step 2 begins, the court's view of the agency's powers changes drastically. Courts have deferred to agency interpretations issued over 100 years after the statute in question;[49] there is no requirement for the agency to be contemporaneous.[50] Nor does it matter that the agency completely reverses a long-standing interpretation, based on a variety of changing circumstances.[51] All that matters is whether the agency's action is a "reasonable

[42] *American Federation of Labor and Congress of Industrial Organizations v. Brock*, 835 F.2d 912, 916 (D.C. Cir. 1987).

[43] The term "frozen" emanates from *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 100-101 (1939), which is cited by Treasury in T.D. 9959 for the proposition that the legislative reenactment doctrine does not preclude an agency from changing its regulatory interpretation of a statute. Treasury is mistaken on the state of the law regarding the legislative reenactment doctrine. *See infra* section on creditable step 1 defense.

[44] *E.g.*, *Cottage Savings Association v. Commissioner*, 499 U.S. 554, 561 (1991), citing *United States v. Correll*, 389 U.S. 299, 305-306 (1967), quoting *Helvering v. Winmill*, 305 U.S. 79, 83 (1938) ("Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have congressional approval and have the effect of law.").

[45] *National Association for Fixed Annuities v. Perez*, 217 F. Supp. 3d 1, 26 (D.D.C. 2016).

[46] S. Rep. No. 99-313, at 293 (1986).

[47] *Brown & Williamson*, 529 U.S. at 156-158.

[48] *Creekstone Farms Premium Beef LLC v. Department of Agriculture*, 539 F.3d 492, 500 (D.C. Cir. 2008) ("Even assuming the 1985 amendment does not satisfy the legislative reenactment doctrine, however, the Congress's 1985 decision to leave section 102.5(d) undisturbed is 'persuasive evidence' that it is consistent with congressional intent.").

[49] *Smiley v. Citibank (South Dakota)*, 517 U.S. 735 (1996) ("The 100-year delay makes no difference. . . . Neither antiquity nor contemporaneity with the statute is a condition of validity.").

[50] *Mayo Foundation*, 562 U.S. at 54-55.

[51] *Chevron*, 467 U.S. at 862-865 (The Court rejected the argument that an agency's interpretation "is not entitled to deference because it represents a sharp break with prior interpretations" of the statute in question, finding that a revised interpretation deserves deference because "an initial agency interpretation is not instantly carved in stone" and "the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis."); *Motor Vehicle Manufacturers Association v. State Farm Mutual Insurance Co.*, 463 U.S. 29, 42 (1983), quoting *American Trucking Associations Inc. v. Atchison, Topeka & Santa Fe Railway Co.*, 387 U.S. 397, 416 (1967), and *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968) (An agency is not required to "establish rules of conduct to last forever," but rather "must be given ample latitude to 'adapt [its] rules and policies to the demands of changing circumstances.'"); *Swallows Holding Ltd. v. Commissioner*, 515 F.3d 162, 166-167 (3d Cir. 2008) (The Tax Court erroneously denied deference under some *National Muffler* factors, such as the regulation not being a substantially contemporaneous construction of the statute and also being a departure from long-standing regulations, which are "not mandatory or dispositive inquiries under *Chevron*.").

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interpretation."[52] It is therefore no surprise that some courts have recognized the conflict between the legislative reenactment doctrine and "the concept of *Chevron* — which assumes and approves the ability of administrative agencies to change their interpretation."[53]

Does Mere Silence Invoke Step 2?

The references in *Chevron* step 1 to whether Congress addressed the precise question, or whether the statute is simply silent, have sometimes prompted arguments that step 1 is met merely by Congress's silence on a particular issue, even when the statute is otherwise unambiguous. Here, the argument might be that Congress has implicitly delegated regulatory authority to Treasury to address jurisdictional nexus based solely on the fact that section 901 did not preclude Treasury from exercising that authority. As we know, with a few notable exceptions,[54] Congress rarely issues a directive that regulations shall *not* be issued on a particular topic. Thus, if that argument could be made, there would seemingly be no end to the scope of Treasury's authority. Moreover, courts have rejected these kinds of attempts to force an analysis of a regulation under *Chevron* step 2 merely because the statute does not explicitly prohibit such a rule.

For example, in *NLRB*,[55] the Fourth Circuit addressed the validity of an NLRB rule that required employers to post a notice informing employees of their rights under the National Labor Relations Act, with adverse consequences for failing to do so. In holding that the NLRB exceeded its authority in issuing the notice-posting requirement, the court rejected the NLRB's argument that it had authority to issue the rule because Congress did not expressly withhold that authority. The appropriate question for analyzing the rule is not whether "Congress expressly withheld that authority," but rather "whether Congress intended to grant authority."[56] Having phrased the question in that manner, the court concluded that step 1 analysis was required, stating: "Because we do not presume a delegation of power simply from the absence of an express withholding of power, we do not find *Chevron*'s second step is implicated 'any time a statute does not expressly *negate* the existence of a claimed administrative power'"[57] (emphasis added). Instead, the court engaged in a detailed statutory construction analysis under *Chevron* step 1 to conclude that there was "no indication in the plain language of the Act that Congress intended to grant the Board the authority to promulgate such a requirement."[58]

Has Treasury Mounted a Credible Step 1 Defense?

In justifying the jurisdictional nexus requirement, Treasury largely presumed it had already passed step 1 and offered its various reasons for why its position is a reasonable and appropriate interpretation of the term "income taxes" and is not contrary to the policy of the FTC. All that may be suitable for part 2 but doesn't explain why these regulations survive part 1.

Treasury never says it believes that the term "income taxes" is ambiguous. It does, however, attempt to undermine any position by taxpayers that the 1921 legislative change removed the jurisdictional nexus requirement from the 1918 version of section 901. It suggests that the sourcing concept was not entirely removed from

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[52] *Chevron*, 467 U.S. at 844.

[53] *Micron Technology Inc. v. United States*, 243 F.3d 1301, 1312 (Fed. Cir. 2001).

[54] For example, section 530(b) of the Revenue Act of 1978 prohibited the issuance of regulations and rulings on employment status for employment tax purposes until Congress passes appropriate legislation. Section 935 of the Taxpayer Relief Act of 1997 placed a moratorium on regulations regarding employment taxes of limited partners. Section 223 of the 1981 Economic Recovery Tax Act placed a moratorium on the application of reg. section 1.861-8 to research and experimental expenditures.

[55] *Chamber of Commerce v. NLRB*, 721 F.3d 152 (4th Cir. 2013).

[56] *Id.* at 158. *See also American Bar Association*, 430 F.3d at 468 ("Plainly, if we were 'to *presume* a delegation of power' from the absence of 'an express withholding of such power, agencies would enjoy virtually limitless hegemony.'") (quoting *Railway Labor Executives' Association v. National Mediation Board*, 29 F.3d 655, 671 (D.C. Cir. 1994)); *Sierra Club v. EPA*, 311 F.3d 853, 861 (7th Cir. 2002) (Courts "will not presume a delegation of power based solely on the fact that there is not an express withholding of such power.") (quoting *American Petroleum Institute v. EPA*, 52 F.3d 1113, 1120 (D.C. Cir. 1995)); *Brown & Williamson Tobacco Corp. v. FDA*, 153 F.3d 155, 161 (4th Cir. 1998), *aff'd*, 529 U.S. 120 (2000) (Court found that the district court incorrectly framed the issue as "whether Congress has evidenced its clear intent to withhold from FDA jurisdiction to regulate tobacco products as 'customarily marketed,'" and that "the issue is correctly framed as whether Congress intended to delegate such jurisdiction to the FDA.").

[57] *Chamber of Commerce*, 721 F.3d at 160 (citing *American Bar Association*, 430 F.3d at 468).

[58] *Id.* at 161.

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section 901 and that even if it were, it is only one element of jurisdictional nexus. That is, it seems to suggest that jurisdictional nexus was inherent in the 1918 version of section 901 and was never stripped out. Presumably this is the government's position that because the term "income taxes" was susceptible to this interpretation, it is ambiguous. This position, however, does not line up with the judicial and administrative interpretations of that term over the next 100 years.

Treasury then relies on the silence of Congress to pave the way for step 2. It recognizes that "Congress has not explicitly addressed jurisdictional nexus with respect to the foreign tax credit."[59] It then states: "The statute is silent with respect to jurisdictional nexus, and it is reasonable and appropriate for regulations to apply U.S. tax concepts in addressing the creditability of extraterritorial foreign levies that Congress could not have anticipated when the foreign tax credit provisions were first enacted."[60] As explained, despite *Chevron*'s reference to "silence" as grounds for a delegation of authority, courts have been cautious in using silence to pass step 1. Further, Treasury's claim that it needs the ability to address unanticipated changes could be part of a part 2 analysis but is not a relevant consideration during step 1.[61]

Treasury's attempt to refute the legislative reenactment doctrine potentially touches on step 1. As explained, some courts have relied on this doctrine (or a lesser version commonly termed the "persuasive evidence" rule) to confirm an unambiguous meaning of a statutory term in step 1. It is also considered during step 2 but may face some judicial resistance if it is being claimed as a constraint on the agency's ability to reverse a prior interpretation. But Treasury's position that the doctrine does not prevent an agency from changing its regulatory interpretation is an overstatement because the Supreme Court cases it relies on considered the doctrine only after the statutory term in question had been regarded as ambiguous — hence, quotes from those statements were made only during a part 2 analysis.[62] Moreover, the two Supreme Court cases cited for Treasury's position are still sometimes cited in more contemporary cases, but with the caveat that an "affirmative indication" by Congress to follow an earlier interpretation can indeed prevent an agency from changing that interpretation.[63]

Treasury then goes on to say that the legislative reenactment doctrine could not be used to prevent the imposition of the jurisdictional nexus requirement unless Congress, in the course of enacting TRA 1986 or the TCJA, actually indicated that the 1983 regulations may not be amended to include such a requirement. The cases cited by Treasury are not dispositive on that point.[64] No doubt that issue will be fertile ground for the litigants in the event of a challenge.

Needless to say, Treasury does not embrace the reality that its interpretation of "income taxes" in the 1983 regulations should be entitled to "great weight" as "persuasive evidence" of Congress's intent, as part of a step 1 analysis,

[59]T.D. 9959.

[60]*Id.*

[61]Compare the government's significant losses in five circuit courts when it litigated its position that the term "and" in section 4252(b)(1) should be interpreted to mean "or," especially in light of changes in the telecommunications industry over the past 40 years. These courts held that the term "and" is unambiguous and, while "this interpretation limits the effectiveness of the tax on long distance calls . . . the IRS must take its case to Congress," not to the courts. *National Railroad Passenger Corp. v. United States*, 431 F.3d 374, 379 (D.C. Cir. 2005). *See also American Bankers Insurance Group v. United States*, 408 F.3d 1328 (11th Cir. 2005); *OfficeMax Inc. v. United States*, 428 F.3d 583 (6th Cir. 2005); *Fortis v. United States*, 447 F.3d 190 (2d Cir. 2006); and *Reese Brothers v. United States*, 447 F.3d 229 (3d Cir. 2006).

[62]In *Helvering v. Wilshire Oil Co.*, 308 U.S. 90 (1939), Treasury regulations interpreting the term "net income" for depletion purposes made no reference to "development expenditures." After the 1921 statute was reenacted in 1928, Treasury revised the regulations to refer to development expenditures. By then the IRS had taken a similar position in litigation. The Court observed that the 1928 enactment "did nothing more than to restore to the phrase 'net income . . . from the property' its original ambiguity," and that phrase, accordingly, "became peculiarly susceptible to new administrative interpretation." *Id.* at 100. In *Helvering v. Reynolds*, 313 U.S. 428 (1941), the Court stated that the term "acquisition" "was far from clear" and the prior administrative constructions and judicial decisions did not have sufficient "consistency and uniformity" to apply the doctrine. *Id.* at 432-433.

[63]*American Federation of Labor*, 835 F.2d at 916.

[64]In *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947), Treasury interpreted the code to require a two-year limitation period for refunds. Lower courts began holding that a four-year period applied. Rejecting application of the legislative reenactment doctrine, the Court reasoned that application of the two-year period was unambiguous and that "legislative silence" in the wake of some "rather recent contrary decisions by lower federal courts" was not sufficient to overcome its conclusion on Congress's intent. *Id.* at 534. In *Oklahoma Tax Commission v. Texas Co.*, 336 U.S. 342 (1949), the Court rejected the taxpayer's claim that the Court's evolving view on the taxation of lessees of mineral rights in allotted Native American land had been implicitly approved by Congress, stating: "mere Congressional silence . . . did not preclude this Court from curtailing the lessee's immunity." *Id.* at 367.

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regardless of whether the legislative reenactment doctrine is applied.

Conclusion

Overnight, the recent FTC regulations have significantly increased a U.S. multinational's tax cost of operating in some foreign countries. Typically these companies cannot easily avoid the increased tax burden by moving operations to another country whose taxes are creditable, and thus are facing enormous additional costs for the foreseeable future. Because these regulations apply immediately to tax years beginning on or after January 1, 2022, companies are under immense pressure to determine how these regulations could impact their first quarter earnings. Unfortunately, given the inability of taxpayers to challenge regulations on a pre-enforcement basis, it could be years before the validity of these regulations is decided in litigation (absent Congress otherwise coming to the rescue).

Taxpayers have complained that various TCJA regulations have exceeded Treasury's rulemaking authority. And no doubt taxpayers will make a similar complaint about the jurisdictional nexus requirement in the recent FTC regulations. But this time it feels different, and it is. Like baseball, the term "income taxes" is a part of our past. It has had the same meaning for over 100 years. Code provisions like this are real gems; this one even refers to "war profits taxes." Then, without being prompted by any change of law, and apparently based on political considerations, the term "income taxes" is changed to something no one could have imagined a few years ago. Taxpayers feel robbed.

One major difference affecting the validity of these regulations is the fact that Treasury interpreted the term "income taxes" nearly 40 years ago, without any hint that the term could encompass a jurisdictional nexus requirement. Then, in 1986 Congress reenacted the entire code and specifically described the regulations in the legislative history as the rules defining the term "income taxes," again without any hint of a jurisdictional nexus requirement. In a step 1 analysis, courts will place significant weight on Treasury's 1983 interpretation and Congress's 1986 reenactment in determining what Congress meant by "income taxes" in 1918. Yes, in step 2 courts will respect Treasury's power to change its interpretations so long as they are defensible. But a court never gets to step 2 if Congress's intent is clear in step 1. Hence the focus of this article. ■

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