The Sixth Circuit's *Ultra Vires* Opinion in *Whirlpool*—What Now?

*By Gary B. Wilcox**

I. Overview

The Sixth Circuit's decision in *Whirlpool Financial Corp. v. Comm'r*[1] can be criticized for its substantive analysis of Code Sec. 954(d)(2). It concluded that Code Sec. 954(d)(2) *unambiguously* required foreign base company sales income (FBCSI) if the two conditions in the statute were met, with no requirement to then test the income under Code Sec. 954(d)(1). This conclusion conflicts with a longstanding rule in Treasury regulations[2] that prohibits FBCSI under Code Sec. 954(d)(2)'s branch rule unless there would be FBCSI under Code Sec. 954(d)(1) if the branch were actually a subsidiary.[3] The circuit court misread the Tax Court as reaching the same holding based on the statute, when in fact the Tax Court found Code Sec. 954(d)(2) *ambiguous* on that point, analyzed Code Sec. 954(d)(2) under the regulations, and then returned to Code Sec. 954(d)(1) before holding that FBCSI must be recognized.[4]

The most remarkable aspect, however, of the Sixth Circuit's *Whirlpool* decision was the court's disregard of both the express delegation of authority to Treasury in Code Sec. 954(d)(2), and the rule in Reg. §1.954-3(b)(2)(ii)(e) that implemented this delegation. Believing that the statute clearly commanded FBSCI under Code Sec. 954(d)(2) after the provision's two conditions were met, the court dismissed whatever Treasury might have said differently in the regulations, stating "the agency's regulations can only implement the statute's commands, not vary from them."[5] The court's "go it alone" approach to interpreting Code Sec. 954(c)(2), as if it were unaware that Treasury had long ago reached a different interpretation, violates a Supreme Court mandate for judicial deference to agency regulations. For that reason alone, the Sixth Circuit's *Whirlpool* opinion—to the extent of its holding that FBCSI automatically results under Code Sec. 954(d)(2) if the two conditions are met with no requirement to apply Code Sec. 954(d)(1)—should not have any precedential value outside the Sixth Circuit, including in the Court of Federal Claims. And given the strong dissent to the majority's Sixth Circuit opinion, the persuasive effects of that opinion should be minimal.

Far from a clean victory, the *Whirlpool* opinion has created a veritable mess for the government. The rule in Reg. §1.954-3(b)(2)(ii)(e) was not invalidated,

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even though it cannot be reconciled with the court's primary holding on Code Sec. 954(d)(2). And, because the Sixth Circuit's opinion was based solely on its interpretation of the statute, the validity of the manufacturing branch regulations—which were upheld as valid in the Tax Court—was not addressed. What does that mean for Treasury and the Internal Revenue Service (IRS)? If they treat *Whirlpool* as "the law," then they need to withdraw Reg. §1.954-3(b)(2)(ii)(e) from the regulations, because otherwise the government is bound to apply those regulations.[6] That is, it cannot apply the *Whirlpool* holding and Reg. §1.954-3(b)(2)(ii)(e) at the same time—one has to go. Given the weak precedential value of *Whirlpool*, does the government risk facing a validity challenge in another circuit if it incorporates the *Whirlpool* holding into its regulations? And does it dare make those revisions retroactively?

A victory is not always a victory in the world of tax administration.

It is frustrating to know how different things could have been had the Sixth Circuit analyzed Reg. §1.954-3(b)(2)(ii)(e) under established principles of judicial deference. It is inconceivable that the court would have invalidated—or even analyzed—this provision under *Chevron* Step One,[7] particularly when both parties respected the validity of that provision. The *Chevron* analysis likely would have been limited to the manufacturing branch rule that was challenged by the taxpayer in the Tax Court. Based on what the Sixth Circuit said about the statute being unambiguous, it likely would have upheld the manufacturing branch rule in *Chevron* Step One. Then, having laid that groundwork, the Sixth Circuit could have focused on the Tax Court's holding that the controlled foreign corporation's (CFC's) sale income was FBCSI because its sales were made on behalf of a related person under Code Sec. 954(d)(1) (*i.e.,* the branch that is treated as a subsidiary under Code Sec. 954(d)(2)'s branch rule). That, in turn, might have caused the Sixth Circuit to focus on a major flaw in the Tax Court's opinion, which was the failure to articulate why the CFC could not have benefited from the manufacturing exception in the Code Sec. 954(d)(1) regulations.[8] Unfortunately, there is still no answer to that question.

II. Court's Statutory Interpretation Exceeded its Authority

This judicial deference analysis is being approached with some amount of hesitation. In sum, the Sixth Circuit was *required* by Supreme Court precedent to analyze the issues before it through the lens of the applicable Treasury regulations, and its failure to do so was a judicial error. However, to arrive at that conclusion one must tread through a complex web of Supreme Court and lower court opinions that ebb and flow with varying degrees of uncertainty and clarity, as the judiciary changes and the precedent evolves. Concepts that were once important in tax, such as the distinction between legislative and interpretative regulations, now seem less important.[9] However, other similar concepts, such as the distinction between an express delegation and an implied delegation, have continuing importance.[10]

While a deeper analysis of this issue is better suited for a constitutional scholar than a busy tax attorney, it is clear that Code Sec. 954(d)(2) contains an express delegation of authority from Congress to Treasury.[11] Code Sec. 954(d)(2) first describes the conditions for its application: (i) that a CFC has carried on activities through a branch outside the country of the CFC's incorporation and (ii) such carrying on of activities has substantially the same effect as if the branch were a wholly owned subsidiary of the CFC. Then, following those conditions it has the following command: "… *under regulations prescribed by the Secretary* the income attributable to the carrying on of such activities of such branch or similar establishment shall be treated as income derived by a wholly owned subsidiary of the controlled foreign corporation and shall constitute foreign base company sales income of the controlled foreign corporation." (emphasis added).

Whenever Congress has made an express delegation of authority to an agency, and the agency has issued regulations pursuant to the delegation, a court must consider how the issue before it has been addressed by those regulations.[12] It does not have the privilege to indulge in an independent analysis of what the statute means, if the regulations have already addressed the issue in the case.[13] It does not matter that the court has a different view than the agency.[14] The court must defer to the agency's regulations unless it finds that the regulations are arbitrary, capricious, or manifestly contrary to the statute.[15] Effectively, in the case of an express

delegation, the court bypasses *Chevron* Step One and goes directly to Step Two. If a court makes such a finding in its Step Two analysis, it must "set aside" the regulations as invalid.[16]

The Sixth Circuit's "betwixt and between" interpretation of Code Sec. 954(d)(2) reaches a conclusion that is entirely contrary to Reg. §1.954-3(b)(2)(ii)(e), yet it never declares that the regulation is contrary to the statute or invalid. Indeed, the court does not even mention the particular regulatory provision that conflicts with its statutory interpretation; it just dismisses whatever Treasury said about the statute as irrelevant. Moreover, it is extraordinarily odd for a court to pursue a statutory interpretation that conflicts with the agency's interpretation when neither side of the litigation made that interpretation an issue. In short, the Sixth Circuit's statutory journey in *Whirlpool* seems unlike anything that exists in nature.

There are a few situations where a court has declared that the statutory interpretation issue is not appropriate for *Chevron* deference on grounds that Congress could not possibly have delegated resolution of that issue to the agency.[17] Commonly called "*Chevron* Step Zero," that is what the Court applied in *King v. Burwell* when it interpreted the language "an Exchange established by the State."[18] Courts also have refused to apply the two-part *Chevron* test to interpretations of statutes that establish the right of judicial review, on grounds that courts have more expertise than agencies to decide those issues.[19] Courts similarly have declined to extend *Chevron* deference on interpretations of effective dates, particularly in the immigration area.[20]

The circumstances under which it is appropriate to treat income derived by a branch as income derived by a subsidiary and, then, when it is appropriate to treat such income as FBCSI, are not in the same category of issues for which courts have denied *Chevron* deference. Indeed, the express delegation in Code Sec. 954(d)(2) is a firm indication that Congress wanted these matters determined by persons with the appropriate expertise. The Sixth Circuit's opinion to go it alone, and effectively deny *Chevron* deference in an act of judicial hubris, simply cannot be explained as a *Chevron* Step Zero approach.

Had the Sixth Circuit engaged in a *Chevron* Part Two analysis of the applicable regulations, it conceivably could have declared Reg. §1.954-3(b)(2)(ii)(e) invalid, notwithstanding the oddity of invalidating a regulation that neither litigant claimed was invalid. Other courts have invalidated regulations issued under express delegations as being manifestly contrary to the statute.[21] Further, there is precedent for courts having the ability to invalidate only a portion of regulations, leaving the remainder intact.[22] Generally it must be shown that the remainder could stand alone and make sense even if the invalid portion is excised. Whether that dissection could have been done here is beyond the scope of the article. But, clearly, the court's failure to try this analysis has left all the regulations intact, with an irreconcilable conflict between a portion of the regulations and the court's holding.

III. What is the Current State of the Law?

The current state of the law is different for taxpayers in the Sixth Circuit than it is in other circuits. Sixth Circuit taxpayers are directly impacted by both the Tax Court and Sixth Circuit opinions. Taxpayers in other circuits are directly impacted by the Tax Court opinion, but are only indirectly impacted by the Sixth Circuit opinion to the extent courts in their circuit would follow the Sixth Circuit.

A. Sixth Circuit's Opinion

The Sixth Circuit opinion has two holdings. The first one is that a CFC's sales income is automatically treated as FBCSI if it is determined that (i) the CFC has been operating as a branch outside its country of incorporation and (ii) the branch's activities have substantially the same effect as if the branch were a wholly owned subsidiary. Under this holding, there is no opportunity to then determine how branch's income would be treated under Code Sec. 954(d)(1) if it were actually a subsidiary. Thus, there is no opportunity to rely on the manufacturing exception. The Sixth Circuit believes that the two conditions as well as the "automatic" conclusion can be determined solely on the basis of the statute without even consulting the regulations. The second holding is that Code Sec. 954(d)(2) causes CFC's sales income to be treated as FBSCI, and is not focused, as the taxpayer argued, on taxing only the manufacturing income derived by the manufacturing branch as FBCSI.

The Sixth Circuit's first holding should have no immediate impact on taxpayers in *any circuit* as long as Reg. §1.954-3(b)(2)(ii)(e) remains outstanding. That is because the IRS is bound to apply its own regulations.[23] It

cannot choose to cease applying its regulations because some circuit court has questioned them, or even officially invalidated them. Only a Supreme Court opinion could justify the Service's decision to not enforce its regulations.[24] Otherwise, if the IRS wants to apply the first holding, it must eliminate Reg. §1.954-3(b)(2)(ii)(e) from the regulations. If that occurs—and it is not certain whether it could occur retroactively—taxpayers in *all circuits* would be subject to the elimination and could, if they were so inclined, challenge that action. Taxpayers in the Sixth Circuit could have a more difficult time with that challenge in light of the circuit court opinion.

The Sixth Circuit's second holding directly impacts only taxpayers residing in the Sixth Circuit. However, given that the Tax Court issued a similar holding based on the regulations, taxpayers in all circuits are impacted to the extent they litigate in the Tax Court.

B. Tax Court's Opinion

Even if the Sixth Circuit's first holding is not immediately impactful on taxpayers residing in that circuit, and even if this holding may have limited to no precedential value outside of the Sixth Circuit, *all taxpayers* still have to contend with the precedential value of the Tax Court opinion. Unlike the Sixth Circuit, the Tax Court made a number of statements regarding the application of Code Sec. 954(d)(1) and the manufacturing exception in Reg. §1.954-3(a)(4) before it tackled the Code Sec. 954(d)(2) issues.[25] Unfortunately or fortunately, depending on the issue, those statements are *dicta* because the court chose not to answer those questions in light of its holding on Code Sec. 954(d)(2). That kind of thing tends to happen when courts rule at the summary judgment stage.

While the Tax Court teed up a statutory analysis of Code Sec. 954(d)(2) that resembles the first holding by the Sixth Circuit, its holding on Code Sec. 954(d)(2) *was not* based on that analysis. The Tax Court said that "even without the refinements supplied by the regulations implementing Code Sec. 954(d)(2), the bare text of the statute, literally read, indicates that Whirlpool Luxembourg's sales income is FBSCI that must be included in petitioner's income under subpart F."[26] But it then proceeded to analyze the Code Sec. 954(d)(2) issue through the lens of its regulations, by circling back to apply Code Sec. 954(d)(1) after it concluded that the two conditions in Code Sec. 954(d)(2) were met.[27]

There is one unsatisfying disconnect in the Tax Court's analysis of the same issue that was addressed in the Sixth Circuit's first holding. After circling back to Code Sec. 954(d)(1) and concluding that the CFC's sales income was derived from "the sales of personal property to any person on behalf of a related person," the court abruptly concluded that this sales income "thus constituted FBCSI under Code Sec. 954(d) and was taxable to petitioner as subpart F income under Code Sec. 951(a)."[28] Inexplicably, the court did not return to its analysis of the manufacturing exception that it included earlier in its opinion as *dicta*. Are we to believe that the Tax Court concluded that the CFC could not avoid FBCSI under Code Sec. 954(d)(1) because it failed to meet the manufacturing exception, even though it previously concluded that it was unnecessary to address the manufacturing exception? Or, was the court under the mistaken belief that circling back to Code Sec. 954(d)(1) after its Code Sec. 954(d)(2) analysis would not put the manufacturing exception back on the table?

The only clue to this mystery is the court's citation in footnote 11 to Reg. §1.954-3(b)(4), *Example (2)*, which the court believed "reaches a similar conclusion after positing facts substantially identical to those here."[29] In the example, a CFC's branch manufactured products that were sold through the CFC's sales offices. Importantly, "[t]hese activities constitute the only activities of [the CFC]." On that basis, CFC's sales income was FBCSI because it was derived from the sale of personal property on behalf of the branch, which had been treated as a wholly owned subsidiary under Code Sec. 954(d)(2). This implies that the Tax Court is saying that the CFC in *Whirlpool* does not get the benefit of the manufacturing exception because it only conducted sales activities. But wait, the Tax Court already explored the question of whether the CFC had to conduct manufacturing activities by its own employees in its "*dicta*" discussion of Code Sec. 954(d)(2), and chose not to decide the "legal questions" and "factual matters" involved with that issue.[30]

The Tax Court opinion addresses several other interpretive issues in Code Sec. 954(d)(2) that were also covered in the Sixth Circuit opinion, the difference being that the Tax Court analyzed the regulations, whereas the Sixth Circuit focused only on the statutory language. One issue was how to compare the effective rates of tax under manufacturing branch rules in Reg. §1.954-3(b)(1)(ii). Another issue was whether Code Sec. 954(d)(2) can apply to sales income earned by a CFC where the branch conducts manufacturing.

Interestingly, in analyzing the validity of the manufacturing branch rule in the regulations, the Tax Court engages in a statutory analysis of whether Code Sec. 954(d)(1) must be applied after determining that a branch should be treated as a subsidiary under Code Sec. 954(d)(2). After again noting that a literal reading of Code Sec. 954(d)(2) means "the branch's income *automatically* constitutes FBCSI once the branch is treated as a subsidiary," the court reversed course and stated "we must refer back to subsection (d)(1) and ascertain whether a specified category of sales transaction exists."[31] The court stated further that the language following the clause "under regulations prescribed by the Secretary" in Code Sec. 954(d)(2), namely that the branch's income shall be deemed derived by a subsidiary and shall constitute FBCSI, "appears" to be "ambiguous."[32] Thus, the Tax Court clearly did not hold that the CFC "automatically" has FBCSI by virtue of the branch being treated as a subsidiary. Yet somehow the Sixth Circuit believed, incorrectly, that its first holding was in sync with the Tax Court.[33]

IV. What Are the Government's Options?

According to the Department of Justice (DOJ), Tax Division, the Sixth Circuit's opinion is a significant victory for the government. However, in its Response to Whirlpool's Petition for Rehearing and Rehearing En Banc,[34] the DOJ compounded the Sixth Circuit's errors by repeating them. First, it described Code Sec. 954(d)(2) by leaving out the critical phrase "under regulations prescribed by the Secretary," and then mischaracterized the Tax Court as holding that the CFC had FBCSI based solely on the text of Code Sec. 954(d)(2).[35] Second, the DOJ defended the Sixth Circuit's "go it alone" approach, stating "the Court need not base its decision on statute-implementing regulations issued pursuant to the statutory language 'under regulations.'"[36] Finally, it mischaracterized the Tax Court's statement about the regulations "yielding the same result," as well as what the Tax Court actually concluded on the applicability of the manufacturing exception.[37] On March 2, 2022, the Sixth Circuit denied Whirlpool's petition for rehearing and rehearing on banc.

Notwithstanding the high fives at the DOJ, the Sixth Circuit's first holding in *Whirlpool* presents a real dilemma for the Service. Claiming the result of this holding may not be worth the costs. It would be endorsing a judicial analysis that violates a Supreme Court mandate for deference to agency regulations issued under an express delegation. It also would require the Service to acknowledge that its interpretation of Code Sec. 954(d)(2), which has been in regulations since 1964, is incorrect. At the same time, the Service will want to preserve the benefit of the court's second holding regarding the validity of the manufacturing branch rule.

One option, and likely the only option as a practical matter, is for the Service to issue a nonacquiescence to the first holding while acquiescing to the second holding.[38] The Action on Decision could provide that the Service will continue to follow the coordination rule in Reg. §1.954-3(b)(2)(ii)(e) of its regulations and, accordingly, will not follow the first holding that requires automatic FBCSI once the branch is treated as a subsidiary. This action will avoid an extensive and controversial overhaul of the applicable regulations. It would ensure that the manufacturing exception remains potentially in play when a CFC sells products that are manufactured by a branch. The meaning of the Tax Court's conclusion that the CFC made sales on behalf of a related person, with no mention of whether the manufacturing exception could be applicable, will likely remain uncertain until the issue is litigated again. All other options spell much more trouble for the Service.

The option of enforcing the first holding while leaving the existing regulations in place is not really an option. The Service's duty to follow its regulations simply cannot be reconciled with the Sixth Circuit's holding. The Service has to choose one or the other.

The option of incorporating the first holding into the regulations would be no easy task. It could not be accomplished by simply excising Reg. §1.954-3(b)(2)(ii)(e). The concept that Code Sec. 954(d)(1) applies after running through the two conditions in Code Sec. 954(d)(2) is pervasive in the regulations.[39] Any revisions would require careful thought, and would need to account for comments received during the notice and comment process.

Any regulations incorporating the first holding would most likely apply prospectively only, with the earliest effective date being the date of notice of proposed rulemaking. Thus, while judicial opinions interpreting statutes typically have retroactive effect, here the Service could not enjoy a retroactive benefit from the first holding unless it eliminates Reg. §1.954-3(b)(2)(ii)(e) on a retroactive basis. There is still some uncertainty of which version of Code Sec. 7805(b) applies—that is, the version that existed before the 1996 amendments, or after—when regulations issued after 1996 relate to a statute enacted before 1996.[40] Regardless, even if the pre-1996 judicial

standards for retroactive regulations are applicable, retroactively unwinding a regulation provision in existence since 1964—particularly when Code Sec. 954(d) has remained substantially the same since 1962—would be unthinkable.[41]

Going forward, the Service would bear the risk that another circuit court would disagree with the first holding in *Whirlpool* and undermine, or perhaps even invalidate, any regulations that incorporate that holding. The costs of that scenario to the Service would vastly exceed the costs of the nonacquiescence option recommended above.

V. Conclusion

A victory is not always a victory in the world of tax administration. Ideally, the best option here for tax administration would have been for the Sixth Circuit to grant a rehearing, and then analyze the case by taking Reg. §1.954-3(b)(2)(ii)(e) into account. Then, assuming the Sixth Circuit continued to hold that the manufacturing branch rule is valid, and that the CFC's branch is treated as a subsidiary under Code Sec. 954(d)(2), it would have been forced to consider whether the manufacturing exception was available to prevent CFC's sales income from being treated as FBCSI under Code Sec. 954(d)(1). Resolution of that issue would have required a remand to Tax Court, where once and for all the availability of the manufacturing exception to Whirlpool's fact pattern could have been answered. By blindly objecting to a rehearing for the sake of protecting a victory, the DOJ has left the IRS with a set of challenging and undesirable options going forward. That is not good tax administration.

ENDNOTES

* Gary appreciates the valuable contributions from Lucas Giardelli, also a partner at the firm.

1 19 F.4th 944 (6th Cir. 2021).

2 All references to Treasury regulations are to the Reg. §1.954-3 regulations that were last amended in T.D. 9008, 2002-2 CB 335 (Jul. 7, 2002), and were at issue in *Whirlpool*. These regulations were originally issued in 1964. T.D. 6734, 1964-1 CB (Part 1) 237 (May 14, 1964). Subsequent versions of these regulations in 2008 and 2011 were not at issue. T.D. 9438, IRB 2009-5, 387 (Dec. 24, 2008); T.D. 9563, IRB 2012-6, 354 (Dec. 15, 2011).

3 Reg. §1.954-3(b)(2)(ii)(e), entitled "Comparison with ordinary treatment," provides: "Income derived by the branch or similar establishment, or by the remainder of the controlled foreign corporation, shall not be considered foreign base company sales income if the income would not be so considered if it were derived by a separate controlled foreign corporation under like circumstances."

4 *See Whirlpool Financial Corp.*, 154 TC 142, Dec. 61,661, 154 TC No. 9 (2020).

5 19 F.4th at 952-53.

6 *United States ex. rel. Accardi v. Shaughnessy*, 347 US 260, 74 SCt 499 (1954) (Agency must abide by its own valid and applicable regulations); *Mutual Savings Life Insurance*, CA-5, 74-1 USTC ¶9208, 488 F2d 1142, 1145 (1974) ("A taxpayer has the right to rely upon the Government's Regulations ... Treasury Regulations having the force and effect of law are binding on tax officials, as well as taxpayers ... [T]he Government cannot just abandon ... the regulation[ ] and direct it into some type of obscurity oblivion as if it never existed"); Notice CC-2003-014 (May 8, 2003) ("Chief Counsel attorneys may *not* rely on case law to take a position that is less favorable to the taxpayer in a particular case than the position set forth in published guidance"). *See also Rauenhorst*, 119 TC 157, 171, Dec. 54,899 (2002) ("However, we cannot agree that the Commissioner is not bound to follow his revenue rulings in Tax Court proceedings"); *Dover Corp. and Subsidiaries*, 122 TC 324, 350, Dec. 55,630 (2004) (same).

7 The reference to *Chevron* deference, Step One and Step Two are derived from the two-step framework for judicial review of agency regulations set forth by the Supreme Court in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 US 837, 104 SCt 2778 (1984).

8 To compound the frustration, Judge Nalbandian's dissenting opinion sets forth a compelling analysis of why the CFC's sales income should not have been treated as FBSCI due to the manufacturing exception in Reg. §1.954-3(a)(4), or why, at a minimum, the taxpayer should have had an opportunity to present evidence at trial on its ability to qualify for that exception. Unlike the majority's narrow focus on the "shall constitute" language in the final clause of Code Sec. 954(d)(2), the dissent looks more broadly at the structure and purpose of Code Secs. 954(d)(1) and (d)(2) to conclude "that it only makes sense if (d)(2) transactions filter back through (d)(1)'s framework, including its Manufacturing Exception." *Whirlpool*, 19 F.4th at 956 (J. Nalbandian, dissenting). Unlike the majority's disregard of Reg. §1.954-3(b)(2)(ii)(e) in its analysis of Code Sec. 954(d)(2), the dissent recognized that "Congress gave Treasury a role in defining when branch transactions generate FBCSI," and concluded that this regulation "explicitly tells us to apply the (d)(1) *exceptions* to the (d)(2) transaction." *Id*. at 956-59.

9 The Supreme Court's opinion in *Mayo Found. for Medical Educ. and Research*, SCt, 2011-1 USTC ¶50,143, 562 US 44, 57–58, 131 SCt 704 (2011) confirmed that regulations issued under Code Sec. 7805(a)'s general grant of authority are entitled to the same *Chevron* deference as regulations issued under a specific grant of authority, if issued pursuant to the notice and comment process of the Administrative Procedure Act. That does not mean, however, that any regulation issued under Code Sec. 7805(a)—which is nearly every tax regulation other than regulations issued under a specific grant of authority—has an automatic path to *Chevron*'s Step Two. *E.g., Wisconsin Central Ltd.*, SCt, 2018-1 USTC ¶50,291, 138 SCt 2067, 2074 (2018) (Reg. §31.3231(e)-1, promulgated pursuant to Code Sec. 7805(a), held invalid; insufficient statutory ambiguity to move to *Chevron* Step Two). Any Code Sec. 7805(a) regulation hoping for *Chevron* deference must still point to a gap in the statute that needs to be filled, in order to have the requisite authority to fill that gap. *E.g., Sea-Land Serv., Inc. v. Dept. of Trans.*, 137 F3d 640, 645 (D.C. Cir. 1998) ("[Chevron] deference comes into play, of course, only as a consequence of statutory ambiguity, and then only if the reviewing court finds an implicit delegation of authority to an agency").

10 In *Chevron* the Court described two different deference standards—the arbitrary and capricious standard and the permissible construction standard—with the former applying where the delegation of authority from

Congress is explicit and the latter applying where the delegation is only implicit as a result of ambiguity or silence. 467 US at 843-44.

[11] *See, e.g., E.I. du Pont de Nemours & Co.*, CA-3, 94-2 USTC ¶50,620, 41 F3d 130, 135 (1994) ("Code Sec. 58(h) provided that the 'Secretary shall prescribe regulations ...,' which appears to be precisely the type of 'express delegation of authority to the agency' that *Chevron* contemplates"); *Mohamed*, 103 TCM 1814, Dec. 59,074(M), TC Memo. 2012-152 (2012) (Regarding Code Sec. 170(a)(1) which provided that "[A] charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary," the Tax Court stated: "This language is an 'express delegation of authority' to create rules about how a donation will be verified .... We can't invalidate regulations unless they are arbitrary, capricious, or manifestly contrary to the statute"). *See also* Berg, *Judicial Deference to Tax Regulations: Reconsideration in Light of National Cable, Swallows Holding, and Other Developments*, 61 TAX LAWYER, 61(2), 485–490 (author explores the various types of delegations of regulation-writing authority).

[12] The Supreme Court's command in *Chevron* is unequivocal: "If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." 467 US at 843-44. The opinions cited as authority for this statement include *Morton*, 467 US 822, 834, 104 SCt 2769 (1984) ("As part of the 1977 amendment, Congress authorized the promulgation of 'regulations for the implementation of the provisions of section 659' .... Because Congress explicitly delegated authority to construe the statute by regulation, in this case we must give the regulations legislative and hence controlling weight unless they are arbitrary, capricious, or plainly contrary to the statute"); *Schweiker v. Gray Panthers*, 453 US 34, 101 SCt 2633 (1981) (Referring to regulations issued under the Social Security Act, the Court stated: "Congress conferred on the Secretary exceptionally broad authority to prescribe standards for applying certain sections of the Act .... Of special relevance in the present case is the delegation of authority in §1902(a)(17)(B) of the Act .... In view of this explicit delegation of substantive authority, the Secretary's definition of the term 'available' is 'entitled to more than mere deference or weight.' .... Rather, the Secretary's definition is entitled to 'legislative effect' because, '[i]n a situation of this kind, Congress entrusts to the Secretary, rather than to the courts, the primary responsibility for interpreting the statutory term'"); *Batteron v. Francis*, 432 US 416, 424–426, 97 SCt 2399 (1977) ("Congress in §407(a) expressly delegated to the Secretary the power to prescribe standards for determining what constitutes 'unemployment' for purposes of AFDC-UF eligibility .... In exercising that responsibility, the Secretary adopts regulations with legislative effect. A reviewing court is not free to set aside those regulations simply because it would have interpreted the statute in a different manner .... The regulation at issue in this case is therefore entitled to more than mere deference or weight. It can be set aside only if the Secretary exceeded his statutory authority or if the regulation is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' 5 USC 706(2)(A), (C)").

[13] *E.g.*, *Thorne v. U.S. Dep't of Defense*, 916 FSupp. 1358, 1366 (E.D. Va. 1996) ("Considered in isolation, then, the statute on its face imposes a restriction on speech. But this does not end the matter for the statute should not be read apart from the Department of Defense's implementing regulations, as Congress explicitly provided that the 'Don't Ask, Don't Tell' plan embodied in §654 was to be implemented 'under regulations prescribed by the Secretary of Defense,' 10 USC §654(b)"); *Barnhart v. Walton*, 535 US 212, 222, 122 SCt 1265 (2002) ("*Chevron* provides the appropriate legal lens through which to view the legality of the Agency interpretation here at issue").

[14] *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 US 967, 980, 125 SCt 2688 (2005) ("*Chevron* requires a federal court to accept the agency's construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation").

[15] *Id.*

[16] *Mead Corp.*, 533 US 218, 229, 121 SCt 2164 (2001) (citing the Administrative Procedure Act, 5 USC §706(2), stating that "a reviewing court shall set aside agency action, findings, and conclusions found to be 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law'").

[17] Some commentators and courts also refer to this initial determination as "*Chevron* step zero," where the court examines whether *Chevron* applies. *See generally,* Sunstein, *Chevron Step Zero*, 92 VA L. REV. 187 (2006).

[18] In *King v. Burwell*, SCt, 2015-1 USTC ¶50,356, 576 US 473, 485-86, 135 SCt 2480 (2015), the Supreme Court addressed IRS regulations interpreting Code Sec. 36B. The Court considered that the tax credits under Code Sec. 36B "are among the Act's key reforms, involving billions of dollars in spending each year and affecting the price of health insurance for millions of people," and whether they are available "is central to this statutory scheme." The Court chose to interpret Code Sec. 36B as if there were no regulation, stating: "It is especially unlikely that Congress would have delegated this decision to the *IRS*, which has no expertise in crafting health insurance policy of this sort." 576 US at 486.

[19] *See, e.g., Murphy Exploration & Prod. Co. v. U.S. Dep't of the Interior*, 252 F3d 473, 478-80 (D.C. Cir. 2001) (explaining that *Chevron* does not apply to the provisions of a statute establishing rights of judicial review); *Ramey v. Bowsher*, 9 F3d 133, 136 n. 7 (D.C. Cir. 1993) ("Interpreting statutes granting jurisdiction to Article III courts is exclusively the province of the courts."); *Reeb v. Econ. Opportunity Atlanta, Inc.*, CA-5, 516 F2d 924, 926 (1975) ("The courts ... have to make their own determination whether the district court has jurisdiction, rather than defer to the [agency] in the first instance.").

[20] *Fernandez-Vargas v. Gonzales*, 548 US 30, 126 SCt 2422 (2006); *Castro-Cortez v. INS*, CA-9, 239 F3d 1037, 1053 (2006) ("... it is inconceivable that Congress intended to delegate to the BIA the decision whether to apply [the new statute] to conduct that pre-dates its enactment"); *Bejjani v. INS*, CA-6, 271 F3d 670, 679 (2001); *Jurado-Gutierrez v. Greene*, CA-10, 190 F3d 1135, 1148 (1999), *cert. denied*, 529 US 1041 (2000) (noting that the determination of a statute's temporal reach does not involve any "special agency expertise," and reaching such determination without affording any deference to the Attorney General); *Pak v. Reno*, CA-6, 196 F3d 666, 675 (1999) (stating that "[d]etermining a statute's temporal reach ... does not require agency expertise but, rather, presents a pure question of statutory interpretation for the courts to decide"); *Sandoval v. Reno*, CA-3, 166 F3d 225, 239 (1999) ("An issue concerning a statute's effective date is not one that implicates agency expertise in a meaningful way, and does not, therefore, appear to require *Chevron* deference"); *Goncalves v. Reno*, CA-1, 144 F3d 110, 127 (1998) ("We think it is a significant question whether the determination of the application of the effective date of a governing statute is the sort of policy matter which Congress intended the agency to decide and thus whether the doctrinal underpinnings of Chevron are present here").

[21] *See, e.g., Rite Aid Corp.*, CA-FC, 2001-2 USTC ¶50,516, 255 F3d 1357 (2001); *Murfam Farms*, FedCl, 2009-2 USTC ¶50,529, 88 FedCl 516 (2009).

[22] *Ariz. Pub. Serv. Co. v. U.S. E.P.A.*, CA-10, 562 F2d 1116, 1122 (2009) ("We may partially set aside a regulation if the invalid portion is severable. A regulation is severable if the severed parts 'operate entirely independently of one another,' and the circumstances indicate the agency would have adopted the regulation even without the faulty provision"), citing *Davis County Solid Waste Management v. U.S. E.P.A.*, 108 F3d 1454, 1459 (D.C. Cir. 1997).

[23] *See Mutual Savings Life Insurance*, *supra*.

[24] IRM 4.10.7.2.9.8 (3) (Jan. 1, 2006) provides that the IRS is not required to follow any court

decision other than one from the Supreme Court: "Adverse decisions of lower courts do not require the Service to alter its position for other taxpayers."

[25] 154 TC at 155-61.

[26] 154 TC at 166.

[27] 154 TC at 166-70.

[28] 154 TC at 170.

[29] 154 TC at 170, footnote 11.

[30] 154 TC at 161.

[31] 154 TC at 177.

[32] *Id.*

[33] 19 F.4th at 952 ("We therefore agree with the Tax Court that, under the text of the statute alone, '[Lux's] sales income is FBCSI that must be included in petitioner's income under subpart F'"). The court also falsely believed that the Tax Court viewed Reg. §1.954-3(b)(2)(ii)(e) as being consistent with this possible interpretation based on "the text of the statute alone. *Id*. ("The court also determined that the IRS's implementing regulations 'yield the same result by a more complicated process'"). The Tax Court's reference to its regulations "yield[ing] the same result" was referring to the allocation between manufacturing income and branch income under the "substantially the same" condition, and not the issue over how Code Sec. 954(d)(2) should be interpreted.

[34] Appellee's Response to Appellant's Petition for Rehearing and Rehearing En Banc, *Whirlpool Financial Corp.*, CA-6, Nos. 20-1899, 20-1900, 2022-1 USTC ¶50,101 (2022).

[35] *Id*. at 6-7.

[36] *Id*. at 10.

[37] *Id*. at 11-14.

[38] There is precedent for the Service issuing a partial acquiescence to a court opinion. *See, e.g.,* AOD 1990-027 (Oct. 15, 1990) (Service nonacquiesced to a court's holding that interest income was patronage-sourced income but acquiesced in result to court's holding that barge rental income was patronage-sourced income).

[39] *See, e.g.,* Reg. §1.954-3(b)(4), *Example (2).*

[40] Compare *A. Tarricone, Inc.,* 4 FSupp2d 323, 327, n., 2 (S.D.N.Y. 1998) (court applied pre-1996 version of Code Sec. 7805(b) with respect to regulations that relate to statutory provisions enacted before Jul. 30, 1996) with *Stobie Creek Investments LLC*, CA-FC, 82 FedCl 636, 668 (2008), *aff'd on other grounds*, 608 F3d 1366 (2010) (court applied post-1996 version of Code Sec. 7805(b) to regulations that relate to Code provision enacted in 1954).

[41] The issue before the 1996 statutory change was whether a retroactive change was "an abuse of discretion." *Automobile Club of Michigan*, SCt, 57-1 USTC ¶9593, *cert. denied* 1807, 353 US 180, 185, 77 SCt 707 (1957). At one extreme, a longstanding regulation that acquired the "force of law" as a result of the legislative reenactment doctrine could not be amended retroactively. *Helvering v. R. J. Reynolds Tobacco Co*., 306 US 110, 59 SCt 423 (1939). At the other extreme, a retroactive change in administration position was permissible where it corrected a mistake of law. *Dixon*, SCt, 65-1 USTC ¶9386, *cert. denied* 1898, 381 US 68, 79-80, 85 SCt 1301 (1965).