Considering Kisor's Deference Decision In The Tax Context

By **Andrew Roberson**

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On Wednesday, the U.S. Supreme Court issued its opinion in Kisor v. Wilkie,[1] substantially restricting the scope of Auer deference.[2] The opinion is sharply divided; Justice Elena Kagan wrote an opinion that commanded a majority only in part. There are three additional concurring opinions. Much ink could be spilled going into the details of each opinion, but the following analysis focuses on the potential impact of the majority opinion on future tax cases.

To briefly recap, Auer deference is a rule of construction that potentially applies to an agency's interpretation of its own regulations. A prerequisite to such deference is a finding that the regulation at issue is ambiguous. As Kisor reinforced, several limitations govern whether deference should be afforded to an agency interpretation.[3]

In the tax context, the Internal Revenue Service and the U.S. Department of the Treasury promulgate regulations interpreting the Internal Revenue Code. Questions often arise as to the proper interpretation and application of a regulation. Sometimes the IRS issues additional guidance purporting to explain the meaning of the regulation; other times it simply takes a position in litigation. Under either scenario, the IRS may argue that Auer deference applies. Unlike many other areas of the law, the assertion of Auer deference by the IRS can occur many years after a taxpayer has taken a position on a tax return. And, the IRS issues many different forms of guidance that vary in terms of precedential or persuasive value.

Kisor's Retooling of Auer Deference

In Kisor, the majority declined to overrule Auer, but it substantially restricted the circumstances in which it should be applied. The court established five preconditions for application of Auer.

First, Auer deference is appropriate only if the regulation is "genuinely ambiguous." To determine whether there is a genuine ambiguity requires applying all the standard tools of interpretation. Put another way, "only when that legal toolkit is empty and the interpretation question still has no single right answer" will deference be considered for the agency's interpretation. In discussing this precondition, the majority opinion referenced the traditional tools of construction used in step one of the test in Chevron U.S.A. v. Natural Resources Defense Council.[4]

Second, even if a genuine ambiguity remains, the agency's reading must be reasonable. The court appears to have equated this reasonableness standard with step two of Chevron and dispelled any contrary readings of Auer that the interpretation be only not plainly erroneous.

Third, the interpretation must be the agency's authoritative or official position as opposed to an ad hoc interpretation that does not stem from the agency heads. Decisions by lower-level officials, including administrative law judges, may not warrant deference.

Fourth, the agency's interpretation must implicate its substantive knowledge. That is, no deference should be given to an agency interpretation that it outside its area of

expertise. For this reason, when a regulation merely parrots the statutory text any interpretation by an agency of the regulation is not entitled to Auer deference. In such situations, a court is in the better position to interpret the regulation.

Finally, the agency's interpretation must reflect fair and considered judgment. New interpretations, whether or not introduced in litigation, that create unfair surprise to regulated parties should not receive deference. In this regard, the court observed that the general rule is not to give deference to interpretations advanced for the first time in briefs.

However, in explaining how it has "not entirely foreclosed this practice," the court noted that deference to an agency interpretation in an amicus curiae brief was given in the past where "the agency was not a party to the litigation, and had expressed its views only in response to the Court's request."

Having restated and expanded upon the limitations to Auer deference, the majority opinion relied on principles of stare decisis to support its determination not to overrule Auer. It observed that overruling Auer would require overruling 75 or more years of precedent and dozens of cases, that abandoning the doctrine would cast doubt on cases that relied on Auer and that Congress has been aware of Auer and has never sought to overrule it.

Justice Kagan, who authored the majority opinion, could only achieve a plurality in other areas, including the discussion of Congress' delegation of authority to agencies to interpret their own rules and whether Auer is consistent with the Administrative Procedure Act. Justice Neil Gorsuch, joined by in parts by Justices Clarence Thomas, Samuel Alito and Brett Kavanaugh, would have overruled Auer.

Chief Justice John Roberts, who concurred in portions of the opinion, and Justice Kavanaugh both authored additional opinions. Both agreed that the positions of the majority and Justice Gorsuch were not that far apart and that nothing in the opinion should be read as touching upon any issues related to Chevron deference.

Observations on Potential Application of Kisor to Tax Cases

So, what does Kisor mean for taxpayers? Tax reform and the Tax Cuts and Jobs Act have injected great uncertainty for taxpayers in certain areas. There are some TCJA regulations that are arguably ambiguous and for which the IRS could seek Auer deference in the future.

Some observations if, and when, this happens.

While not overruling Auer, the Supreme Court significantly reduced its application. The court emphasized that any ambiguity must be "genuine" and that an ambiguity can only arise after the entire toolkit of statutory construction is exhausted. The Supreme Court's discussion in this area strongly suggests that courts should do as much searching as possible to determine the meaning of a regulation and only in rare occasions deem a regulation to be ambiguous.

In this regard, it is important to note that, although not specifically referenced in the majority, plurality or concurring opinions, one tool at taxpayers' disposal is the strict construction tool. Under this rule, which has been applied to regulations and in the tax context, ambiguities are to be construed against the IRS and in favor of taxpayers.[5]

Regarding the reasonableness of an interpretation of an ambiguous statute, the Supreme Court rejected any notion that reasonable meant "plainly erroneous" as implied in Bowles v.

Seminole Rock & Sand Co. And, it injected into the reasonable analysis a contemporaneous inquiry and a look at from where the interpretation was coming.

In the tax context, one could argue that the IRS should issue any interpretation potentially eligible for Auer deference in guidance that is published in the Internal Revenue Bulletin. Such guidance should also be issued as soon as a regulation is identified; with the various media publications today, it is common to hear concerns from taxpayers and tax practitioners regarding ambiguity in new regulations.

Timely and published guidance on the IRS' interpretation of its own ambiguous regulations would go a long way in ensuring that different divisions or individuals within the IRS, including those that were not involved in the drafting of the regulation at issue, are not creating new law under the guise of regulatory interpretation.

The Supreme Court's further requirement that the agency actually be interpreting an area in which it has substantive knowledge is helpful for taxpayers. This theme, which has surfaced in recent terms in the Chevron debate, can protect against the IRS claiming deference for an interpretation on a matter that does not implicate substantive tax knowledge. For example, an interpretation of an effective date provision does not seem like the type of situation for which Auer deference is appropriate. Additionally, if a tax regulation merely parrots the statutory language then the IRS is not allowed to argue for Auer deference for its interpretation of that regulation.

In the tax context, the Supreme Court's discussion of the agency's interpretation reflecting fair and considered judgment raises some interesting temporal questions and may overlap with the reasonableness inquiry. Fair and considered judgment should mean that the IRS has looked at the issue at the highest levels and reached a uniform position on how an ambiguous regulation should be interpreted. It should not, as has happened sometimes in the past, be a litigation tactic whereby a position not previously espoused finds its way into a legal brief. The IRS is involved in both promulgating tax regulations and litigating tax cases involving the application of tax regulations. The Supreme Court's observation about the limitations on granting Auer deference to positions taken in briefs is particularly apt in tax cases.

Conclusion

The Kisor opinion, while not overruling Auer, has taken a substantial bite out of the deference doctrine. In the tax context, one would hope that Auer deference would return to its prior status of rarely being invoked by the IRS.[6] Additionally, the comments by Chief Justice Roberts and Justice Kavanaugh regarding Chevron highlight the continuing debate as to whether the Supreme Court will revisit Chevron deference in the future.

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Disclosure: Kisor was represented at oral arguments by Paul W. Hughes, who has since joined McDermott Will & Emery LLP.

[1] 588 U.S. __ (2019), available at https://www.supremecourt.gov/opinions/18pdf/18-15_9p6b.pdf).

[2] Auer deference, which is the practice of deferring to agency interpretations of ambiguous regulations, stems primarily from the cases of Bowles v. Seminole Rock & Sand Co., 325 U.S. 410 (1945) and Auer v. Robbins, 519 U.S. 452 (1997).

[3] For further background on Auer deference, see Andrew Roberson & Timothy Shuman, Deference Principles: Tax Litigation's Next Battleground, Law360 Tax Authority (Jan. 7, 2019).

[4] Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc., 467 U.S. 837 (1984).

[5] For a further discussion of this tool and others in the "toolkit," see Andrew Roberson & Roger Jones, Rules of Construction Provide Framework for Decoding TCJA, Law360 Authority (Feb. 28, 2019).

[6] On March 5, 2019, Treasury issued a policy statement providing, in part, that the IRS will not seek Auer — or Chevron — deference for interpretations in subregulatory guidance. In light of Kisor, it will be interesting to see whether Treasury changes it position. For further discussion of the policy statement, see Andrew R. Roberson & Timothy Shuman, Significant Changes in IRS Regulatory Process Ahead, Law360 Taxing Authority (Mar. 8, 2019).