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IN FOCUS

April 8, 2024

The Possible Elimination of *Chevron* Deference: Potential Implications for Tax Revenue and Administration

The Supreme Court has heard oral argument in the cases *Loper Bright Enterprises v. Raimondo* and *Relentless v. Department of Commerce*. The cases challenge the constitutionality of a judicial doctrine known as *Chevron* deference, which takes its name from the 1984 case *Chevron U.S.A., Inc. v. Natural Resources Defense Council*. This In Focus addresses some potential consequences for tax administration, including effects on revenue, costs of tax administration, and fairness and certainty for taxpayers, if *Chevron* were overruled.

Loper Bright Enterprises v. Raimondo and *Relentless v. Department of Commerce* could allow the Court to overturn *Chevron* deference, which requires courts to defer to an agency's reasonable interpretation of an ambiguous federal statute that the agency administers. See CRS Legal Sidebar LSB11061, *Chevron at the Bar: Supreme Court to Hear Challenges to Chevron Deference*, by Benjamin M. Barczewski and CRS Report R44954, *Chevron Deference: A Primer*, by Benjamin M. Barczewski for additional background on *Chevron* deference.

Prior to 2011, not all lower courts agreed that tax regulations were eligible for *Chevron* deference. In 2011, however, the Supreme Court resolved the disagreement and held that tax regulations were eligible for *Chevron* deference in *Mayo Foundation for Medical Education and Research v. United States.*

Potential Revenue Consequences

The federal tax code is complicated, and its subsequent interpretation often requires the issuance of federal regulations. Those regulations are crucial to determining tax liability, especially for businesses and corporations. Seemingly subtle differences in these interpretations can have substantial effects on federal revenues.

In general, challenges to Treasury regulations are most common where taxpayers contend they should owe less tax. Where those challenges are successful, they tend to reduce, rather than increase, federal tax revenue. If changes to *Chevron* make it easier for taxpayers to successfully challenge Treasury regulations, therefore, that could result in lower revenues than Treasury would otherwise collect.

An Illustration: Cost-Sharing Rules for Multinational Firms

Profit shifting by multinationals is estimated to cost tens of billions of dollars in corporate tax revenue, as discussed in CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by Jane G. Gravelle. The statute governing the allocation of income and deductions, contained in Section 482 of the Internal Revenue Code, is general and brief, so the methods to allocate profits are contained in Treasury regulations. See CRS In Focus IF12524, *Corporate Taxation: Profit Shifting, Transfer Pricing, and Cost Sharing*, by Jane G. Gravelle.

One method of profit shifting is cost sharing, where a U.S. firm's foreign subsidiary makes a buy-in payment to existing technology, then shares in the costs of further development for the right to a share of future profits.

In the 2019 case *Altera Corp. v. Commissioner*, Altera challenged the 2003 Treasury regulation requiring related companies engaged in cost sharing to also share the cost of stock-based compensation. The Ninth Circuit, applying *Chevron*, found that Section 482 was silent regarding the method Treasury is to use to make allocations based on stock-based compensation and that Treasury's choice of a method was a reasonable interpretation of the statute. If *Chevron* were overruled, and if a future court adopted a different interpretation of Section 482, it could result in rulings that favored plaintiffs like Altera and, therefore, considerably reduce federal revenues.

Tax Administration

Separate from influencing litigation outcomes, changes to *Chevron* deference could also affect how agencies interpret statutes when they promulgate regulations. Treasury may have to rewrite its regulations more often to match statutory interpretations provided by the courts. One survey found that 88% of agency rule drafters either "agreed" or "somewhat agreed" that *Chevron* made them more willing to adopt "a more aggressive interpretation." The loss of *Chevron* deference, therefore, might lead Treasury to write more taxpayer-friendly original regulations, which could lead to less revenue.

A study of the shift to the broad application of *Chevron* deference to tax regulations in 2011 identified specific changes in how those regulations were written. According to the author, Treasury's rulemaking statements began to focus more on policy issues and to engage more with public comments. The shift to *Chevron* also appears to have increased incentives to use the Administrative Procedure Act's (APA's) notice and comment rulemaking, which may make some interpretations eligible for *Chevron* deference. The Internal Revenue Service (IRS) also changed its manual to eliminate the statement that most regulations are interpretive and not subject to procedural requirements under APA. These findings suggest that Treasury devoted more resources to promulgating regulations once tax regulations were held to be eligible for *Chevron* deference. Treasury may believe its use of notice and comment rulemaking procedures increases its chances of receiving

judicial deference and prevailing in challenges to its regulations.

An Illustration: The Clean Hydrogen Production Credit Proposed Rulemaking

A tax credit for the production of clean hydrogen was enacted as part of P.L. 117-169 (commonly referred to as the Inflation Reduction Act, IRA) to provide an incentive based on the amount of hydrogen produced, the lifecycle CO_2 equivalent emissions rate of the hydrogen through the point of production (well-to-gate), and other factors. The act specified a general definition and model for calculating lifecycle greenhouse gas emissions and delegated to the Secretary of the Treasury the authority to produce additional necessary regulations.

Treasury issued a notice of proposed rulemaking on December 26, 2023. The proposed rule addresses how to determine life cycle greenhouse gas emissions and how taxpayers may use energy attribute certificates (EACs) to qualify for the credit when using grid electricity. Treasury's interpretation of the rules for a qualifying EAC includes a requirement that carbon-free sources must represent new capacity (commonly referred to as *additionality*). Public comments were extensive and have suggested that this interpretation may limit the use of the tax incentive and hinder the development of the clean hydrogen industry.

If Treasury adopts the proposed rulemaking as a final rule, some taxpayers may challenge that rule as inconsistent with the Inflation Reduction Act itself. Treasury's explanation for its interpretation, including its engagement with and response to public comments, might support an argument in favor of *Chevron* deference under current law. If *Chevron* were overruled or limited, Treasury might have to demonstrate not only that its interpretation was reasonable, but that it had adopted the *best* interpretation of the IRA, increasing the potential that a court would require a different interpretation.

Taxpayer Certainty and Fairness

Treasury regulations can help taxpayers understand their tax obligations. When enacted tax changes are made effective on short notice, Treasury and the IRS issue preliminary notices and proposed regulations that indicate what the final regulations may look like. (Preliminary or proposed regulations are generally subject to public comment before they become final.) The importance of preliminary regulations was illustrated in two recent major tax reforms, P.L. 115-97 (from 2017, commonly referred to as the Tax Cuts and Jobs Act or TCJA) and the IRA.

Among other changes, the TCJA disallowed or scaled back a number of deductions, revised international tax rules, altered cost-recovery provisions, reduced the corporate tax rate, and allowed a pass-through deduction for unincorporated business. To the extent these provisions of the TCJA are ambiguous, *Chevron* deference makes it more likely that Treasury can successfully defend the regulations that it promulgates to implement them. In this way, *Chevron* may support continuity and predictability for taxpayers. On the other hand, *Chevron* deference also protects Treasury's discretion to advance a different interpretation of the TCJA under a future Administration, which may mean that tax regulations can shift from Administration to Administration.

Congress might consider whether eliminating *Chevron* deference would make tax administration more or less fair to taxpayers. Critics of *Chevron* have argued that agencies are not impartial, and that it is unfair for an agency to both interpret a statute and enforce it. However, overruling *Chevron* may increase the odds that different courts come to different conclusions as to the meaning of the tax code, because courts may be more likely to disagree about the best meaning of a statute than whether the statute is ambiguous. In this scenario, similarly situated taxpayers could receive different treatment (violating the economic principle of horizontal equity).

An Illustration: The Clean Hydrogen Production Credit Taxpayer Comments

As described in the previous illustration, taxpayers producing hydrogen at qualified clean hydrogen production facilities may receive a credit based on a variety of factors—including the amount of hydrogen produced and the lifecycle CO_2 equivalent emissions rate of the hydrogen. Implementation of this provision was delegated largely to the Secretary of the Treasury, and a notice of proposed rulemaking was published on December 26, 2023. During the comment period, which ended on February 26, 2024, over 28,000 written comments were submitted.

Comments on proposed regulations serve multiple purposes, including identifying unclear or confusing language, and revealing effects that may not have been fully understood by those drafting the regulations. The extent to which agencies feel compelled to respond to and incorporate comments is driven by a complex set of factors, including whether a court would consider the comment "significant" and whether ignoring the comment could be grounds by itself for a court to vacate the regulations. Included in an agency's calculus is whether the regulation is likely to receive judicial deference, because an agency may rely on its response to comments to demonstrate that its interpretation of a statute is reasonable. Although there are multiple incentives for agencies to address public comments, it is possible that if Treasury could no longer rely on *Chevron* deference, it could decline to use notice-and-comment rulemaking to interpret provisions like this, or it could pay less heed to the many issues raised by industry experts and others in the comments on the proposed clean hydrogen regulations. Although Congress has plenary power over taxation and could supersede *Chevron* by prescribing its requirements directly in legislation, as a practical matter, Congress may not currently have the expertise to legislate a clear rule in every tax situation that Treasury currently addresses through regulation.

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IF12630

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