SN Worthington: Another Tool for Statutory and Regulatory Construction

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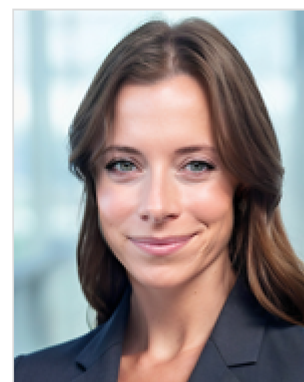
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In this post, the authors discuss *SN Worthington*, a case in which the Tax Court strictly construed a Treasury regulation in favor of the taxpayer and against the IRS.

Introduction

The recent opinions in *Loper Bright Enterprises Inc. v. Raimondo*[1] and *Varian Medical Systems Inc. v. Commissioner*[2] have impacted the way agency guidance is analyzed now that the *Chevron* doctrine[3] has been overruled. Instead of deferring to an agency's reasonable interpretation of an ambiguous statute, courts must exercise their independent judgment to determine the "best reading" of a statute. Although *Chevron* is now dead, courts, particularly in the tax context, will continue to be haunted by administrative law questions, including delegation principles, *stare decisis* for pre-*Loper Bright* decisions, and the relevance of *Skidmore* deference.[4] This post does not address *Loper Bright* in detail, but instead focuses on the Tax Court's recent opinion in *SN Worthington Holdings LLC v. Commissioner*[5] and its application of the strict construction rule in the context of interpreting Treasury regulations.

The strict construction rule originated in the English courts and is "applicable to all forms of taxation, and particularly special taxes, that the sovereign is bound to express its intention to tax in *clear and unambiguous language*."[6] In *Gould v. Gould*, the Supreme Court stated: "In case of doubt [statutes]

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are construed most strongly against the Government and in favor of the citizen."[7] Over the years, the Supreme Court and other courts began applying the strict construction rule more frequently to resolve doubts and ambiguities against the drafter of the statute. And, in *The Falconwood Corp. v. United States*,[8] the Federal Circuit applied the rule to Treasury regulations. However, over time use of the strict construction rule diminished with only occasional application by some courts.[9]

SN Worthington

In *SN Worthington* a partnership, after being selected for examination for its 2016 tax year, elected to have the Bipartisan Budget Act of 2015 ("BBA") rules apply to the exam. It did so by filing Form 7036, "Election under Section 1101(g)(4) of the Bipartisan Budget Act of 2015," representing, among other things, that it had sufficient assets to pay a potential imputed underpayment. The IRS, which conducted the audit under the 1982 Tax Equity and Fiscal Responsibility Act procedures, argued that the partnership's election was invalid because the partnership did not prove, as opposed to merely represent, that it had sufficient assets to pay a potential imputed underpayment. The issue before the Tax Court was whether the partnership complied with reg. section 301.9100-22, which provides that a partnership must represent that it has sufficient assets to pay the potential imputed underpayment.[10]

The Tax Court found the partnership complied with the plain text of the regulation and therefore its election was valid. As part of its analysis, the court relied on the strict construction rule and interpreted the regulation in favor of the partnership, not the IRS. The court emphasized that the IRS could have written the regulation to require partnerships to prove sufficient assets, but that is not how the regulation was written, and the regulation therefore could not be extended by implication beyond the plain reading of the regulatory language.

SN Worthington is a reminder to taxpayers that the strict construction rule — at least in the Tax Court — is alive and well and that taxpayers who comply with the literal terms of regulatory rules should have confidence their actions will be respected by the IRS and the court. The opinion reaffirms the principle that the IRS may not alter or expand the requirements for making an election after the fact. This limitation could provide taxpayers with greater certainty and predictability, as they can rely on published rules without fear of additional, unforeseen requirements being imposed later by the government. The holding also may prompt clearer and more precise regulatory language to avoid implications and ambiguity, thereby improving the overall quality and clarity of Treasury regulations.

Other Considerations

Before the demise of *Chevron*, the Supreme Court was faced with determining the fate of so-called *Auer* deference, which provided that courts should under certain circumstances defer to an agency's interpretation of its own ambiguous regulations.[11] In *Kisor v. Wilkie*,[12] the Supreme Court held that any deference in this situation was limited to when: (1) the regulation is genuinely ambiguous; (2) the agency's interpretation is reasonable and falls within the bounds of the ambiguity; (3) the interpretation reflects the agency's authoritative or official position, rather than an ad hoc statement;

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and (4) the agency's interpretation is based on its expertise and ensures fair and considered judgment.

After *Loper Bright* and considering the Tax Court's reaffirmation of the strict construction rule, the scope and applicability of *Kisor* remain uncertain. The strict construction rule appears to counsel interpreting a regulation, whether ambiguous or not, against the agency, whereas *Kisor* may be read to allow the agency to prevail based on an after-the-fact interpretation of an ambiguous regulation. One approach may be that courts, consistent with *Loper Bright*, should exercise their own judgement to determine the "best meaning" of a regulation without deferring to the agency's interpretation and in close cases to resolve any questions of doubt against the agency. As the Tax Court stated in *SN Worthington*: "When there is doubt to the meaning of a regulation, we interpret the regulation against the drafter."

FOOTNOTES

[1] 144 S. Ct. 2244 (2024).

[2] 163 T.C. No. 4 (2024).

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

[4] *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

[5] 162 T.C. No. 10 (May 22, 2024).

[6] *Eidman v. Martinez*, 184 U.S. 578 (1902) (emphasis added).

[7] 245 U.S. 151 (1917); *see also United States v. Merriam*, 263 U.S. 179 (1923).

[8] 422 F.3d 1339 (Fed. Cir. 2005).

[9] *Mohamed v. Commissioner*, T.C. Memo. 2013-255; *see also* Andrew R. Roberson and Roger J. Jones, "Lenity and Strict Construction — Overlooked Tools of Construction?" 143 *Tax Notes* 247 (Apr. 14, 2014).

[10] For a more detailed discussion of the *SN Worthington* opinion, see Gregory T. Armstrong, "*SN Worthington*: Electing Into the Centralized Partnership Audit Regime," 183 *Tax Notes Federal* 2359 (June 24, 2024).

[11] *Auer v. Robbins*, 519 U.S. 452 (1997).

[12] 588 U.S. 558 (2019).

END FOOTNOTES

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