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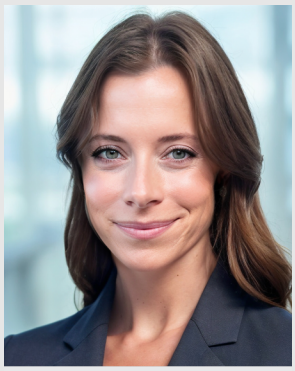

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In this installment of Practically Speaking: Tax Controversy, the authors revisit the canon of strict construction and provide insights based on recent developments from the Supreme Court and the Tax Court.

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In *Loper Bright*,[1] the Supreme Court upended 40 years of precedent on the deference owed to agency regulations by overruling the *Chevron*[2] doctrine. Much has been written about the potential impact of *Loper Bright* on statutory interpretation, but now is an opportune time to revisit interpretation in the regulatory context. *Loper Bright* directs courts to consider what the statute means, but taxpayers and courts are often faced with a separate challenge: figuring out what a regulation means.

Section I of this article provides a brief background on *Chevron*, *Loper Bright*, and the history of judicial deference to agencies' interpretations of their own regulations. Section II discusses the strict construction canon's historical roots and its role in the interpretation of Treasury regulations, including the Tax Court's approach in its recent opinions in *SN Worthington*[3] and *Bloomberg*.[4] Section III concludes with insights for taxpayers in disputes with the IRS over the interpretation and applicability of tax regulations.

I. Deference

A. Agency Interpretation of Statutes

For over 40 years, courts applied the *Chevron* doctrine to determine whether to defer to agency regulations. Under this doctrine, if certain preconditions were satisfied,[5] a court would apply a two-pronged test. The first prong was to

[1] *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024).

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

[3] *SN Worthington Holdings LLC v. Commissioner*, 162 T.C. 228 (2024).

[4] *Bloomberg LP v. Commissioner*, T.C. Memo. 2024-108.

[5] One precondition was whether Congress delegated authority to the agency to issue rules having the force of law and, if so, whether the agency acted in accordance with that authority when promulgating the rule. *See, e.g.*, *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Martin v. Social Security Administration*, 903 F.3d 1154 (11th Cir. 2018).

determine whether "Congress has directly spoken on the precise question at issue."[6] If Congress's intent was clear, that was the end of the inquiry; no regulation could override congressional intent. However, if the court determined that the statute was silent or ambiguous on the specific issue, it had to determine whether the agency's interpretation was "based on a permissible construction of the statute."[7] If both prongs were satisfied, deferral to the agency regulation was required.

The *Chevron* decision, although viewed as uncontroversial upon its release in 1984, was called into question over the last decade. Indeed, before *Loper Bright*, the Supreme Court had not deferred to an agency interpretation under *Chevron* in over eight years. *Chevron* sanctioned a departure from the traditional judicial approach of independently examining each statute to determine its meaning.[8]

In *Loper Bright*, the Supreme Court held that courts need not, and under the Administrative Procedure Act may not, defer to an agency's interpretation of the law simply because a statute is ambiguous.[9] In other words, courts must exercise their independent judgment when interpreting ambiguous statutes rather than automatically deferring to agency interpretations. However, in executing this exercise, courts may accord due respect to agency interpretations, which might depend on how Congress delegated authority to the agency to engage in interpretive rulemaking.

The Tax Court's opinion in *Varian*[10] represents the first indication of how it applies *Loper Bright*. The central issue in *Varian* was whether the IRS had the authority to promulgate a regulation that changed the effective date of a statute. The IRS argued that the statute was "at least ambiguous" and that, under *Chevron*, the court had to accept the agency's attempt to fill the gap because the agency's interpretation was "permissible."[11] The Tax Court rejected the IRS's argument, explaining that "a 'permissible' interpretation of a statute no longer prevails simply because an agency offers it to resolve a perceived ambiguity."[12] The court instead focused on the best reading of the statute and held that a regulation cannot contravene the clear statutory text.[13]

B. Agency Interpretation of Regulations

A high-water mark for deference to agency interpretations came in 1997, when the Supreme Court in *Auer* held that when an agency's own regulation was susceptible to multiple interpretations, the interpretation offered by the agency must receive deference unless it is "plainly erroneous."[14] The agency in question was not a party to the litigation in *Auer* — its interpretation was proffered to the court in an amicus brief — but in most later cases, the agency seeking deference was a party.[15] Naturally, a prerequisite to extending *Auer* deference was a finding that the regulation at issue is ambiguous.

In 2019 the Supreme Court narrowed the application of *Auer* deference by emphasizing that courts should defer to agency interpretations only if the regulation is genuinely ambiguous and the interpretation is reasonable and reflects the agency's authoritative, expert judgment. In *Kisor*,[16] the Court held that *Auer* deference should apply only 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

[6] *Chevron*, 467 U.S. at 842. An infamous footnote, which caused controversy over the years depending on one's views regarding the importance of legislative history, stated that "if a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect." *Id.* at 843 n.9. Legislative history has generally been viewed as a "traditional tool of statutory construction," but courts over time differed on whether resorting to legislative history was appropriate under *Chevron*'s first prong. *See, e.g.*, *Intermountain Insurance Service of Vail LLC v. Commissioner*, 134 T.C. 211, 232-236 (Halpern and Holmes, JJ., concurring in result only) (2010), *rev'd*, 650 F.3d 691 (D.C. Cir. 2011), *vacated and remanded*, 566 U.S. 972 (2012).

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

[8] *Loper Bright*, 603 U.S. at 396.

[9] *Id*. at 413.

[10] *Varian Medical Systems Inc. v. Commissioner*, 163 T.C. 76 (2024).

[11] *Id*. at 105.

[12] *Id*.

[13] *Id*. at 106. The discussion in *Varian* emphasized that post-*Loper Bright*, courts must apply their own judgment to questions of statutory and regulatory interpretation, which could lead to more different outcomes than under the previous regime of deference to agencies.

[14] *Auer v. Robbins*, 519 U.S. 452, 461 (1997).

[15] *See, e.g.*, *Grecian Magnesite Mining, Industrial, and Shipping Co. SA v. Commissioner*, 149 T.C. 63, 83 (2017) (summarizing the Tax Court's approach to *Auer* deference for revenue rulings).

[16] *Kisor v. Wilkie*, 588 U.S. 558 (2019).

agency's authoritative or official position rather than an ad hoc statement; and (4) the agency's interpretation is based on its expertise and ensures fair and considered judgment.[17]

Kisor also granted agencies some latitude to interpret their own regulations within the bounds of reasonableness and expertise. However, the Supreme Court warned that "not every reasonable agency reading of a genuinely ambiguous rule should receive *Auer* deference" and that courts must also "make an independent inquiry into whether the character and context of the agency interpretation entitles it to controlling weight."[18] This inquiry ensures that courts defer only to the agency readings "that Congress would have wanted [them] to."[19]

The Supreme Court in *Loper Bright* did not expressly overrule *Kisor*; indeed, it referenced *Kisor* several times in its analysis. Yet there is a clear tension between the two. *Loper Bright* gives pride of place to the APA's command that "'the reviewing court' — not the agency whose action it reviews — is to 'decide *all* relevant questions of law'" (emphasis added by the Court).[20] *Auer* and *Kisor* stand for a departure from that command — the proposition that at least under certain circumstances, an agency rather than a court should have the final say in questions of law concerning regulatory interpretation. While *Kisor* remains on the books and may inform some judicial decisions, it is difficult to envision a lasting place for judicial deference to agencies' interpretations of their own regulations in a post-*Loper Bright* world. Indeed, as discussed below, some recent Tax Court cases have already taken a very different tack.

II. Interpreting Regulations

Of course, deciding questions of law is not a simple matter of looking at words on a page. After *Loper Bright*, courts may reach deeper into their interpretive toolkit — replete with all its canons of construction — to determine the best meaning of a statute. The rules of statutory construction apply to matters of regulatory construction.[21] Thus, when faced with interpreting tax regulations, courts follow statutory construction rules. Our focus in this article is on one of those rules: the canon of strict construction.

A. Overview of Construction Rules

At the outset, no rule of construction is absolute.[22] Courts sometimes apply or favor certain rules while dismissing others. Karl Llewellyn remarked 75 years ago that "there are two opposing canons on almost every point."[23]

When interpretating a statute or regulation, the starting point should be the actual language used by Congress or the agency.[24] If the meaning is clear, courts generally need not look to other sources of authority, such as legislative history or agency guidance. However, one must also consider the context in which the actual language is used. In assessing the actual language, undefined terms should be afforded their ordinary and customary meaning.

The role of canons can be illustrated through an exception to the plain meaning rule. The absurd results doctrine originated over 200 years ago when the Supreme Court held that plain meaning will be discarded only if it is "one in which the absurdity and injustice of applying the [plain meaning] to the case, would be so monstrous, that all mankind would, without hesitation, unite in rejecting the application."[25] Although courts have come to different conclusions on when to apply the doctrine, an odd result generally does not attain the requisite absurdity,[26] nor does one that might result in treating taxpayers differently.[27]

[17] *Id.* at 559.

[18] *Id.*

[19] *Id.*; *see also Rand v. Commissioner*, 141 T.C. 376, 394 (2013) ("Judicial deference need not give way to judicial abdication.").

[20] *Loper Bright*, 603 U.S. at 371 (quoting 5 U.S.C. section 706).

[21] *See, e.g.*, *Caltex Oil Venture v. Commissioner*, 138 T.C. 18, 34 (2012).

[22] *Connecticut National Bank v. Germain*, 503 U.S. 249, 253-254 (1992).

[23] Llewellyn, "Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed," 3 *Vand. L. Rev.* 395, 401 (1950).

[24] *Id.*

[25] *Sturges v. Cowninshield*, 17 U.S. 122, 203 (1819); *see also Crooks v. Harrelson*, 282 U.S. 55, 60 (1930) ("the absurdity must be so gross as to shock the general moral or common sense"); *Varian*, 163 T.C. at 100 ("the absurd results doctrine imposes a high bar").

[26] *Exxon Mobil Corp. v. Allapattah Services Inc.*, 292 U.S. 55, 60 (1930).

[27] *Varian*, 163 T.C. at 101.

There are many other canons that can be invoked when it comes to interpreting statutes or regulations. Examples include (1) specific rules take precedence over general ones;[28] (2) superfluity should be avoided;[29] (3) prior interpretations of rules that have been reenacted should be followed;[30] and (4) additional exceptions to rules should not be inferred when specific exceptions are provided.[31] This article focuses on another canon: that ambiguities in rules should be strictly construed against the drafter.

B. Strict Construction Rule

The strict construction rule is a statutory interpretation rule of the English courts, "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*" (emphasis in original).[32] In *Gould*, the Supreme Court said that in case of doubt, statutes levying taxes "are construed most strongly against the Government and in favor of the citizen."[33] This canon has also been applied to tax regulations.[34]

Yet over the years, courts have applied this rule less frequently. As the Tax Court noted over a decade ago, "The application of the strict-construction canon to tax law no longer enjoys universal approval."[35] This decline would to some extent appear to be a corollary to the rise of deference: Strict construction would seem to have little place in a world where, under *Auer*, the agency is the presumptive arbiter of regulatory meaning. As a result, taxpayers need to review case law to determine how courts in their jurisdiction apply the strict construction rule.

Today, the strict construction rule may be making a comeback. In *SN Worthington*, the Tax Court was tasked with interpreting regulations under the Bipartisan Budget Act of 2015 dealing with electing into the BBA procedures. Section 1101(g)(4) of the BBA gives partnerships the right to make that election in the form and manner prescribed by the Treasury secretary. To implement this, the IRS promulgated reg. section 301.9100-22(b)(2) setting forth requirements for the election. The parties in *SN Worthington* disputed whether the partnership satisfied the regulation, which required a series of representations including that the partnership had sufficient assets (and reasonable anticipates having sufficient assets) to pay a potential imputed underpayment.

As part of its analysis, the Tax Court turned to the strict construction rule:

> Further, when there is doubt to the meaning of a regulation, we interpret the regulation against the drafter. *See United States v. Merriam*, 263 U.S. 179, 187-88 (1923) ("[I]n statutes levying taxes the literal meaning of the words employed is most important[,] for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer."). When we interpret regulations, we presume "the drafter of the regulation . . . said what it means and means what it said." *Sklar, Greenstein & Scheer, P.C. v. Commissioner*,

[28] *Morales v. Trans World Airlines Inc.*, 504 U.S. 374, 384 (1992) ("It is a commonplace of statutory construction that the specific governs the general.").

[29] *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'") (quoting *Duncan v. Walker*, 533 U.S. 167 (2001)).

[30] *Lorillard v. Pons*, 434 U.S. 575, 580 (1978) ("Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.").

[31] *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993) ("*Expressio unius est exclusio alterius*.").

[32] *Eidman v. Martinez*, 184 U.S. 578 (1902).

[33] *Gould v. Gould*, 245 U.S. 151, 153 (1917); *see also United States v. Merriam*, 263 U.S. 179, 188 (1923). Courts have held that rules that provide tax exemptions are strictly construed in favor of the government. *See, e.g., Helvering v. Northwest Steel Rolling Mills Inc.*, 311 U.S. 46, 49 (1940).

[34] *See, e.g., The Falconwood Corp. v. United States*, 422 F.3d 1339, 1348 (Fed. Cir. 2005) (applying *Gould* in interpreting consolidated return regulations); *American National Bank & Trust Co. v. United States*, 594 F.2d 1141, 1148 (7th Cir. 1979) ("Given the stricter and more rigorous standards involved in a penalty case, any questions which we may have had as to our prior construction of this regulation in the plaintiff's favor, completely disappear."). For a more detailed discussion of the strict construction rule, see Andrew R. Roberson and Roger J. Jones, "Lenity and Strict Construction — Overlooked Tools of Construction," *Tax Notes*, Apr. 14, 2014, p. 247.

[35] *Mohamed v. Commissioner*, T.C. Memo. 2013-255.

> 113 T.C. 135, 143 (1999). And when interpreting a transitional provision with limited applicability, as is the case here, we construe the provision liberally. *See Younger*, 64 T.C.M. (CCH) at 92-93. The Commissioner could have required partnerships to establish that they have enough assets to pay an imputed underpayment. But that is not what the Commissioner has written. Instead, he requires the partnership to make a representation that it has enough assets to pay an imputed underpayment, which is what SN Worthington has represented. *See Mississippi ex rel. Hood v. AU Optronics Corp.*, 571 U.S. 161, 169 (2014) (stating that if the drafter of a law intended a specific meaning, "it easily could have drafted language to the effect").[36]

Because the partnership, consistent with the regulatory language, made a written representation that it had — and anticipated having — sufficient assets to pay a potential imputed underpayment, the IRS did "not have the authority to create additional hurdles to make the election."[37]

Although not specifically referencing the strict construction rule, the Tax Court's more recent opinion in *Bloomberg*, decided after *Loper Bright*, followed that approach. Part of the dispute in that case centered on the proper interpretation of provisions of reg. section 1.199-3.[38] The parties disagreed on the proper interpretation and application of the regulations, with the IRS arguing for what the court described as an "overly restrictive" interpretation.[39] The court ultimately disagreed with the IRS's interpretation of those regulations. In its analysis, the court repeated some of the rules of construction and, citing *Loper Bright*, held that "our reading represents the best interpretation of both section 199 and the regulation text itself."[40] The Tax Court concluded by stating:

> We decline respondent's request to interpret in his favor the ambiguity that he created. Throughout this Opinion we interpret the ambiguous provisions of Treasury Regulation section 1.199-3 consistently with the statute and congressional intent, rather than reward the Commissioner for drafting an ambiguous regulation.[41]

This approach aligns with the Supreme Court's instruction in *Loper Bright* that court interpret statutes independently, without automatically deferring to an agency's regulation or the agency's interpretation of the regulation.

III. Conclusion

The long-term impact of *Loper Bright* remains to be seen, as does whether *Kisor* has any remaining vitality. However, in appropriate situations, arguing for a certain reading of a regulation that harmonizes with the statutory text may be more advantageous to taxpayers than seeking to invalidate the regulation itself. Taxpayers should therefore revisit rules of construction when facing disputes over the meaning of tax regulations. ■

[36] *SN Worthington*, 162 T.C. at 238-239.

[37] *Id.* at 239.

[38] The taxpayer did not argue that the regulations were invalid, either before or after *Loper Bright*, and the Tax Court did not address that potential issue.

[39] The IRS argued that the court should interpret reg. section 1.199-3(i)(6)(iii) in its favor because "exceptions are narrowly construed in order to preserve the contours of the general rule." *Bloomberg*, T.C. Memo. 2024-108, at 44. The Tax Court noted that Congress drafted the statute to include "any computer software to qualify for the section 199 deduction," while the distinction between computer software used while connected to the internet and computer software used otherwise was drawn only in the tax regulations. The court therefore rejected this argument, holding that it was interpreting the regulations to avoid conflict with the statute.

[40] *Id.* at 43.

[41] *Id.* at 44.