Miller & Chevalier

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Introduction

In this month's roundup, we consider the future of *Chevron* deference following oral argument at the Supreme Court in *Loper Bright* and *Relentless*, highlight the allocation of additional IRS resources toward audits of complex partnerships and high-wealth individuals, discuss expansion of the IRS corporate private letter ruling program, and review case law developments in the microcaptive insurance space.

Tax Fact: In general, a Valentine's Day gift to your spouse is not taxable. For gifts to others, the annual federal gift tax exclusion increased to $18,000 per recipient in 2024. Those amounts are not counted toward the lifetime exclusion, which – under current law – will drop to $5 million in 2026 with an added adjustment for inflation.

> "Aviva Aron-Dine has decades of experience in tax policy, an uncanny ability to think like a lawyer, economist, and implementer simultaneously, and cares passionately about making the tax system fairer." – Departing Assistant Treasury Secretary for Tax Policy Lily Batchelder on her expected replacement

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U.S. Supreme Court to Decide Whether *Chevron* Deference Sinks or Swims in *Loper Bright* and *Relentless*

Lisandra Ortiz, Samuel Lapin, and Omar Hussein

On January 17, 2024, the U.S. Supreme Court heard argument in two consolidated cases, *Loper Bright Enterprises v. Raimondo*, No. 22-451, and *Relentless, Inc. v. Dept. of Commerce*, No. 22-1219, that could have a significant impact on judicial review of executive branch rulemaking, including tax guidance. The cases challenge a rule issued by the National Marine Fisheries Service (NMFS) that requires commercial fishers to pay the cost of having federal observers aboard their ships to monitor compliance with applicable fishing regulations. NMFS argued, and the lower courts agreed, that the rule was a permissible exercise of its rulemaking authority under the framework set forth by the Supreme Court in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc*., 467 U.S. 837 (1984), known as *Chevron* deference. The Court decided to consider these cases and whether to overturn *Chevron* deference, which has formed, in part, the backdrop for administrative rulemaking for the last 40 years.

Under *Chevron*, courts review administrative rulemaking under a two-step framework. At step one, courts apply traditional tools of statutory interpretation to determine if the statute is ambiguous. If the statute is unambiguous, a court will apply the statute as written and will not regard contrary agency interpretation. If a court determines that a statute is "silent or ambiguous," it moves to step two, where it defers to an agency's interpretation of the statute so long as it is reasonable. Among other things, petitioners asserted that by deferring to the executive branch interpretation, *Chevron* deference erodes the policy-setting role of the legislative branch and undermines the duty of the judiciary to say what the law means, thus violating the separation of powers inherent in the Constitution. Petitioners also argued that the *Chevron* framework has become unworkable, leading to inconsistent applications and results at the lower courts, particularly at *Chevron* step one.

Several key themes emerged during argument (*Relentless*, *Loper Bright*). Some justices expressed concerns about the results of overturning *Chevron*, namely whether it may cause judges to become "uber legislators" left to make policy decisions that might be best suited to agencies with subject-matter expertise. The Court also focused on reliance interests implicated by the maintenance or removal of *Chevron* deference. Some justices echoed the petitioners' view that *Chevron* allows agencies to change policy direction, sometimes as often as with the change of each administration, and that protecting reliance interests did not weigh in favor of preserving *Chevron*. The government, by contrast, focused on the uniformity *Chevron* promoted across lower courts by demanding deference to reasonable agency interpretations of ambiguous statutes, which seemed to resonate with some justices. Potential alternatives to either cabin or replace *Chevron* also came up during argument. The Court discussed the possibility of "Kisorizing" *Chevron*, a reference to the Court's prior unanimous decision in *Kisor v. Wilkie*, 139 S. Ct. 2400 (2019), that narrowed the role of judicial deference in interpreting ambiguous agency regulations under *Auer v. Robbins*, 519 U.S. 452 (1997). Other justices voiced interest in a regime based on *Skidmore v. Swift & Company*, 323 U.S. 134 (1944), where agency interpretations are afforded weight only to the extent that the interpretation has "the power to persuade."

Chevron deference has been central to several significant tax cases in recent years, including *3M*, *FedEx*, and *Altera*. Although *Loper Bright* and *Relentless* contemplate agency rulemaking outside of the tax context, the Court's decision as to the fate of *Chevron* might lead to additional challenges to tax rules. The Supreme Court's opinion is expected in June 2024.

IRS Ramps Up Enforcement for Partnerships and High-Wealth Individuals

Jim Gadwood and Samuel Lapin

A recent publication from the U.S. Department of the Treasury (Treasury) provides updates on Internal Revenue Service (IRS) enforcement initiatives focused on partnerships and high-wealth individuals and funded by Inflation Reduction Act (IRA) resources. The Fact Sheet comes as the IRS continues to hire revenue agents for the Global High Wealth program and passthrough units and make partnership compliance issues a priority. Taxpayers should expect the IRS to continue investing in and focusing on enforcement in these areas.

Partnerships have long presented enforcement challenges for the IRS. Using IRA funding, the IRS is poised to invest more resources into partnership enforcement. The IRS continues to operationalize its Large Partnership Compliance (LPC) Program, first launched as a pilot in 2021, under which it has promised to audit the largest partnerships in the country. The LPC program uses artificial intelligence (AI) to identify high-risk issues and taxpayers. As of December 2023, the IRS had opened examinations of 76 partnerships under the LPC program. The IRS has also identified several areas that it perceives to present significant compliance risk and made these areas a focus of enforcement efforts. For example, the IRS has sent letters to nearly 500 partnerships — each with over $10 million in assets — whose returns show substantial balance sheet discrepancies to ask the partnerships for an explanation. The IRS's Large Business & International Division (LB&I) also recently announced a compliance campaign focused on partnerships in the sports industry that report large tax losses, following recent litigation involving sports partnerships. *See, e.g., Hoops, LP v. Comm'r*, 77 F.4th 557 (7th Cir. 2023); *Tribune Media Co. v. Comm'r*, T.C. Memo. 2021-122 (on appeal to the U.S. Court of Appeals for the Seventh Circuit).

The IRS is also investing IRA funds in compliance efforts focused on high-wealth individuals. As a first step, it has begun to take collection action against high-wealth individuals that carry large federal tax debts, so far, producing over $500 million in collections. Additionally, the IRS is staffing up its high-wealth enforcement initiatives, aiming to more than triple the size of the Global High Wealth unit from approximately 150 employees to 500. Global High Wealth audits can be particularly wide-ranging because they are designed to foster a holistic examination of all aspects of a high-wealth individual's economic footprint. The IRS also intends to audit employment tax compliance of wealthy individuals who own limited partnership interests, aiming to build on the its recent success in *Soroban Capital Partners, LP v. Comm'r*, 161 T.C. No. 12 (2023).

The IRS is actively working to expand its enforcement workforce and train these employees to understand and audit issues specific to partnerships and high-wealth individuals. While this hiring and training will take some time, we expect examination activity in these areas to increase meaningfully in 2025 and beyond.

Another Microcaptive Insurance Company Falls in Tax Court

*Maria Jones, Lisandra Ortiz, and Andrew Beaghley**

On January 4, 2024, the U.S. Tax Court held in favor of the IRS in another case involving a section 831(b) microcaptive insurance company, concluding that the arrangement did not qualify as insurance. *See Keating v. Commissioner*, T.C. Memo. 2024-2. The Tax Court explained that qualification as insurance is based on four factors: (1) whether the arrangement involves insurance risk; (2) whether the arrangement shifts risk of loss from the insured to the insurer; (3) whether the insurer has sufficiently distributed its risk; and (4) whether the arrangement follows commonly accepted notions of insurance. In *Keating*, the IRS conceded that the arrangement involved insurance risk and risk shifting. The court decided the case against the taxpayers based on its finding that the arrangement was not insurance in the commonly accepted sense and left the risk distribution factor unaddressed. In reaching its conclusion, some of the facts the court focused on included the pricing of premiums, the documentation and practices surrounding the issuance of policies, and the process for reviewing, approving, and paying claims. The court also sustained the IRS's imposition of accuracy-related penalties under section 6662(a).

Keating follows several other Tax Court decisions against taxpayers in this space: *Avrahami v. Commissioner*, *Reserve Mechanical Corp. v. Commissioner* (which the Tenth Circuit affirmed), *Syzygy Insurance Co. v. Commissioner*, and *Caylor Land & Development, Inc. v. Commissioner*. At the end of 2021, the IRS conceded the amounts at issue in *Puglisi* (a microcaptive case that was docketed in the Tax Court and in line for trial), which signaled a willingness on the IRS's part to recognize that at least some microcaptive arrangements can qualify as insurance for federal tax purposes. *See Puglisi v. Commissioner*, Docket Nos. 4796-20, 4799-20, 4826-20, 13487-20, 13488-20, 13489-20 (T.C. Nov. 5, 2021). *Keating*, however, gives the IRS another win, which is likely to further embolden the IRS to continue its challenge against insurance arrangements involving section 831(b) captives.

IRS Expands Scope of Corporate Private Letter Ruling Program

David Zimmerman, Layla Asali, and Caroline Reaves

The annual release of Revenue Procedure 2024-1 and Revenue Procedure 2024-3 addressing private letter ruling (PLR) requests expanded the scope of rulings the IRS Associate Chief Counsel (Corporate) is willing to consider in several respects. Under the revised procedures, the IRS will now issue rulings on "devices" and on whether a distribution is pursuant to a "plan" under § 355(e) when issuing PLRs on section 355 spin-offs. In accordance with the previous policy, the IRS will issue rulings on "significant issues" involving the business purpose requirement that are not inherently factual, but it will not issue rulings on whether the business purpose requirement is satisfied. In addition, the IRS will now issue "transactional rulings" on whether a transaction qualifies under section 332, 351, 355, 368, or 1036, and it removed the no-rule policy on "comfort rulings" for such transactions. The previous policy of the IRS Associate Chief Counsel (Corporate), set forth in Revenue Procedure 2013-32, restricted rulings to "significant issues" under sections 332, 351, 368, and 1036 (rather than ruling more broadly on whether a transaction qualified for tax-free treatment). The IRS also added the excise tax on repurchases of corporate stock under section 4501 to the list of issues under the jurisdiction of the Associate Chief Counsel (Corporate).

In public comments, officials noted that the previous policy restricting the scope of PLRs to "significant issues" was adopted in 2013 due to resource limitations. Now with more capacity, the IRS believes expanding the scope of transactional rulings will provide the IRS insight into transactions occurring in the marketplace, help develop guidance, and provide greater tax certainty to taxpayers. The IRS is also updating the revenue procedures listing the representations that taxpayers will need to provide to receive rulings under sections 332, 351, 368, and 1036, but will consider new ruling requests in the meantime.

Penalty Relief for Partnerships Required to Provide Forms 8308 to Transferor and Transferee Partners

Jim Gadwood and Caroline Reaves

The IRS provided partial penalty protection to partnerships required to provide Form 8308 to transferor and transferee partners in connection with a section 751 exchange that occurred during 2023. Form 8308 is used to report a sale or exchange of a partnership interest involving unrealized receivables or inventory items and was recently revised, in October of 2023, to include a new Part IV that provides information on the transferor partner's share of section 751 gain and loss. Partnerships expressed concern to the IRS that such information — which often requires a valuation to prepare — would not be available by the generally applicable January 31, 2024, deadline for providing Forms 8308 to transferor and transferee partners.

Notice 2024-19 responds to these concerns by providing that the IRS will not impose section 6722 penalties for failing to timely furnish completed Forms 8308, provided a partnership sends Parts I through III of Form 8308 to the relevant partners by the applicable deadline and provides a completed Form 8308 (including Part IV) by the due date of the partnership's 2023 tax return. This penalty relief applies only with respect to section 751(a) exchanges that occurred in 2023 and only with respect to furnishing Forms 8308 to transferor and transferee partners. The notice provides no relief regarding filing Form 8308 as an attachment to the partnership's Form 1065 and, as such, provides no relief from section 6721 penalties for failing to file (as distinguished from failing to furnish) correct information returns.

**Former Miller & Chevalier attorney*
