

Administrative Law Basics for Transfer Pricing Practitioners

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In this article, Bettge explores the aspects of administrative law that may be most useful to transfer pricing practitioners by examining the leading cases, relevant Treasury regulations, and avenues for regulatory challenges.

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At times, transfer pricing can appear to be an island unto itself. A cohort of regulations under section 482 — to say nothing of the OECD transfer pricing guidelines — and an army of practitioners specializing in economic issues can almost lull one into forgetting that transfer pricing is only a small part of the broader U.S. federal income tax system. Even easier to overlook is the context beyond tax: the complex world of administrative law that governs how Treasury and the IRS act, and provides taxpayers and members of the public with important rights.

This broader context has taken on increasing importance in recent years. Administrative law issues, and the resulting disputes, have proliferated throughout tax in the decade since the Supreme Court in *Mayo*¹ held that general administrative law principles apply to tax.

¹ *Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011).

Challenges have recently been spurred by a flood of new guidance following the enactment of the Tax Cuts and Jobs Act in 2017.

Transfer pricing, too, has been caught up in the current, with recent and ongoing litigation regarding the validity of IRS regulations on stock-based compensation and blocked foreign income putting administrative law in the spotlight. *Xilinx*² and *Altera*³ both grappled with the validity of stock-based compensation rules in reg. section 1.482-7, while *Coca-Cola*⁴ and the pending 3M case⁵ challenge the blocked income rules of reg. section 1.482-1(h)(2).

Transfer pricing practitioners need not master the complex field of administrative law, but they can benefit from familiarity with some key concepts. Of particular importance are two administrative law avenues for challenging regulations that are often raised together, but which are fundamentally distinct. First, failure to comply with the rulemaking procedures prescribed by the Administrative Procedure Act can invalidate otherwise appropriate regulations. Second, even regulations that have had all their i's dotted and their t's crossed in a procedural sense may fail to warrant judicial deference under *Chevron* because they do not reasonably interpret the underlying statute.⁶

This article does not endeavor to provide a complete survey of the area, nor to capture all the nuances of the issues that are discussed. Rather, it seeks to provide, at a high level, an introduction to

² *Xilinx Inc. v. Commissioner*, 598 F.3d 1191 (9th Cir. 2010), *aff'g* 125 T.C. 37 (2005).

³ *Altera Corp. v. Commissioner*, 926 F.3d 1061 (9th Cir. 2019), *rev'g* 145 T.C. 91 (2015).

⁴ *The Coca-Cola Co. v. Commissioner*, 155 T.C. No. 10 (2020).

⁵ *3M Co. v. Commissioner*, Dkt. No. 5816-13 (T.C. 2013).

⁶ *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984).

the facets of administrative law that may be most useful to transfer pricing practitioners, with a focus on Treasury regulations and regulatory challenges.

I. Sources of Rulemaking Authority

To understand Treasury's authority to make transfer pricing rules under section 482, and the limitations that exist on that power, it helps to start in the beginning — with the U.S. Constitution. The Constitution vests “all legislative Powers” in Congress,⁷ and in particular grants to Congress the “Power To lay and collect Taxes.”⁸ That power is subject to some restrictions,⁹ which around the turn of the 20th century were construed as prohibiting the imposition of an income tax¹⁰ — an obstacle overcome in 1913 by ratification of the 16th Amendment, which secured to Congress the “power to lay and collect taxes on incomes, from whatever source derived.”¹¹

Neither the Constitution nor any of its amendments refer to the modern administrative state. Indeed, it is difficult at first glance to discern how a sprawling executive bureaucracy may be reconciled with the neat division of powers espoused by the framers. Judicial precedent fills the gap — the courts have determined that Congress may delegate its legislative authority to the executive branch, as long as this delegation is circumscribed by an “intelligible principle” to guide the executive agency in its exercise of the delegated authority.¹² This requirement has been construed broadly.

Section 482 delegates to the secretary of the Treasury broad authority (which the regulations under section 482 delegate in turn to the IRS district director¹³) to allocate items between related parties “in order to prevent evasion of

taxes or clearly to reflect the income” of those parties. It does not, however, include an explicit grant of rulemaking power, such as may be found in (for example) sections 59A¹⁴ and 956.¹⁵ The power to issue legislative regulations — that is, regulations that make law rather than merely interpret it, and thus partake of the legislative power originally vested in Congress and delegated to Treasury — under section 482 is derived instead from generally applicable provisions of the Internal Revenue Code.

Section 7801(a)(1) provides that the “administration and enforcement of [the IRC] shall be performed by or under the supervision of the Secretary of the Treasury,” and section 7805(a) provides that “the Secretary shall prescribe all needful rules and regulations for the enforcement of this title.” The grant of legislative power in section 7805 is broad indeed, circumscribed only by the hazy requirement that regulations be “needful . . . for the enforcement” of the code. Nonetheless, the Supreme Court has held that regulations promulgated under the grant of authority in section 7805 are “without doubt the result of entirely appropriate delegations of discretionary authority by Congress.”¹⁶

It is under this general grant that the section 482 regulations are issued, though at times Treasury takes the position that regulations are also issued under section 482 itself.¹⁷ While different standards of deference were historically applied to rules promulgated under section 7805 and those issued under specific grants of statutory authority, the Supreme Court abolished this distinction in *Mayo*.¹⁸ Today, therefore, it is essentially immaterial that the section 482 regulations are issued under the auspices of section 7805 rather than a specific grant of

⁷ U.S. Const. Art. I, section 1.

⁸ U.S. Const. Art. I, section 8.

⁹ See, e.g., U.S. Const. Art. I, section 9 (no direct taxes unless proportionate to the census).

¹⁰ *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), *aff'd on reh'g*, 158 U.S. 601 (1895), *superseded by constitutional amendment as stated in Brushaber v. Union P.R. Co.*, 240 U.S. 1, 18 (1916).

¹¹ U.S. Const. Amend. XVI.

¹² *Mistretta v. United States*, 488 U.S. 361, 372 (1989) (quoting *J.W. Hampton Jr. & Co. v. United States*, 276 U.S. 394, 406 (1928)).

¹³ Reg. section 1.482-1(a)(2).

¹⁴ Section 59A(i) (“The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.”).

¹⁵ Section 956(e) (“The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations to prevent the avoidance of the provisions of this section through reorganizations or otherwise.”).

¹⁶ *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 212, 222 (1989).

¹⁷ See, e.g., T.D. 8552 (citing section 7805 as the primary authority for the 1994 final regulations, while noting that they are also issued under section 482). Cf. *Altera*, 145 T.C. 91, 116-117 (noting that the regulation at issue was issued under the general grant of section 7805).

¹⁸ *Mayo*, 562 U.S. 44, 56-57.

rulemaking authority. The principle underlying section 7805, although broad, is intelligible enough to pass constitutional muster; there is no doubt that Treasury is authorized to issue substantive transfer pricing regulations.

A distinct but analogous delegation issue arises from the “major questions” doctrine, which the Supreme Court articulated in *West Virginia*¹⁹ in June. Under this doctrine, an agency may not make rules addressing major questions unless it can identify “clear congressional authorization,” rather than “a merely plausible textual basis” permitting it to do so.²⁰ It is not clear what constitutes a major question. Nor is it clear how this doctrine would affect transfer pricing rulemaking, given that almost all major questions in this area (including the adoption of the arm’s-length standard itself) have historically been decided by Treasury.

II. APA Requirements

How Treasury goes about issuing transfer pricing rules can be somewhat more fraught. In the transfer pricing universe, APA means advance pricing agreement; in the world of administrative law (and in this article), it refers to the Administrative Procedure Act, a 1946 statute that generally provides the framework for agency rulemaking and courts’ review of agency action. To be valid, Treasury regulations must comply with the procedural requirements of the APA.

Section 553 of the APA requires that agencies abide by specified procedures designed to give the public meaningful notice and the opportunity to comment on proposed regulations.²¹ This generally requires that an agency publish a notice of proposed rulemaking in the *Federal Register*, which must include the authority under which the rule is proposed and a description of the proposed rule.²² The public must then be given an opportunity to comment on the proposed rule, and the agency is required to consider any

comments and include with the final rules a statement of their basis and purpose.²³ In the case of Treasury regulations, this statement takes the form of a preamble, which is published along with the regulations as a Treasury decision. Because a comment period would be moot if agencies were not required to heed stakeholders’ input, courts require that the statement of basis and purpose respond to all material comments.²⁴

In addition to requiring that an agency give due consideration to relevant comments, the APA provides that the agency must engage in a reasoned decision-making process. This is also reflected in the APA’s standard for judicial review, which provides that a court shall invalidate (among other things) any agency action that is “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”²⁵ In *State Farm*, the Supreme Court held that an agency fails to meet this standard — referred to as the “arbitrary and capricious” standard for short — if it does not engage in reasoned decision-making.²⁶ This means that the agency has to consider relevant data and articulate an explanation for its action that is rationally connected to its fact-finding.²⁷ Importantly, arbitrary and capricious review under the APA applies to all agency action, not just the issuance of legislative regulations.²⁸

While arbitrary and capricious review is generally applicable, there are important exceptions to the notice and comment requirements. Rules that are merely interpretive or procedural (as opposed to legislative), as well as general statements of policy, are exempt from notice and comment. Compliance is also excused if the agency finds (and explains) good cause why notice and comment would be impracticable, unnecessary, or contrary to the public interest.²⁹

²³ *Id.* section 553(c).

²⁴ See, e.g., *United States v. Nova Scotia Food Products Corp.*, 568 F.2d 240 (2d Cir. 1977).

²⁵ 5 U.S.C. section 706(2). See, e.g., *Altera Corp.*, 926 F.3d 1061, 1080 (noting the application of this standard to the court’s review of a transfer pricing regulation under the APA).

²⁶ *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 52 (1983).

²⁷ *Id.* at 43.

²⁸ 5 U.S.C. section 706.

²⁹ 5 U.S.C. section 553(b).

¹⁹ *West Virginia v. EPA*, No. 20-1530 (2022).

²⁰ *Id.*, slip op. at 19.

²¹ 5 U.S.C. section 553.

²² *Id.*

Treasury rarely invokes the good cause exception. Indeed, its official position is that the APA notwithstanding, the code authorizes it to issue immediately effective temporary regulations without notice and comment even in the absence of good cause. That position may matter little in practice, because Treasury committed in a March 2019 policy statement to include statements of good cause “as a matter of sound regulatory policy,”³⁰ and Treasury recently included such a statement when it issued immediately effective temporary regulations addressing the TCJA participation exemption under section 245A in June 2019.³¹ But stating that good cause exists does not make it so, and Treasury’s statement failed to persuade the district court in *Liberty Global*, which accordingly invalidated the section 245A temporary regulations for failure to comply with the APA.³²

Although Treasury recognizes that APA section 553 applies to its rulemaking,³³ its general position is that most Treasury regulations are interpretive and thus not subject to notice and comment.³⁴ Of course, Treasury generally does provide notice and comment and committed to continue doing so in its 2019 policy statement,³⁵ but this is in its view a matter of administrative grace rather than legal obligation.

The distinction between substantive or legislative³⁶ rules subject to notice and comment and interpretive rules exempt from those procedures is fraught, with courts applying

different tests. For instance, the Fifth Circuit has looked to whether a rule has binding effect on an agency’s discretion,³⁷ while the D.C. Circuit has identified several factors indicating that a rule is legislative, including whether there would be a basis for enforcement in the absence of a rule, and whether the rule has been published in the Code of Federal Regulations.³⁸

In the transfer pricing context, these nuances are generally unimportant. Despite Treasury’s largely prophylactic position that most of its regulations are non-substantive and thus exempt from notice and comment, there seems to be no real doubt that whatever test is applied, the section 482 regulations — which flesh out a sparse statute with immense and often prescriptive detail — are in fact substantive rules.³⁹ Certainly, the regulations do in some measure interpret Congress’ amorphous direction that related parties’ arrangements “clearly reflect [their] incomes,”⁴⁰ but this is no object. The presence of some element of interpretation does not prevent a rule from qualifying as substantive; indeed, the Supreme Court has made it clear that only administrative interpretations that possess the force of law (that is, substantive rules) qualify for *Chevron* deference, which is discussed later.⁴¹

In fact, the Internal Revenue Manual itself concedes that “if Congress simply provided an end result, without any guidance as to how to achieve the desired result, then regulations promulgated to achieve that result are considered to be legislative.”⁴² Section 482 provides the ends — related-party transactions should result in a clear reflection of income, and should not enable tax evasion — but apart from a recent addition addressing aggregation and realistic alternatives, it provides no guidance whatsoever on how that result is to be achieved. Even the bedrock of U.S.

³⁰ Treasury Department, “Policy Statement on the Tax Regulatory Process” (Mar. 5, 2019).

³¹ T.D. 9865.

³² *Liberty Global Inc. v. United States*, No. 1:20-cv-03501 (D. Colo. 2022).

³³ See, e.g., reg. section 601.601(a)(2).

³⁴ See, e.g., Internal Revenue Manual sections 32.1.2.3(3), 32.1.5.4.7.4.5(1).

³⁵ Treasury, 2019 policy statement, *supra* note 30.

³⁶ Note that the terminology has not historically been consistent in this area. As the Tax Court in *Altera* explained: “We have previously referred to regulations issued pursuant to specific grants of rulemaking authority as legislative regulations and regulations issued pursuant to Treasury’s general rulemaking authority, under sec. 7805(a), as interpretive regulations. Because the terms ‘legislative’ and ‘interpretive’ have different meanings in the administrative law context, we will refer to regulations issued pursuant to specific grants of rulemaking authority as specific authority regulations and regulations issued pursuant to Treasury’s general rulemaking authority, under sec. 7805(a), as general authority regulations.” *Altera Corp.*, 145 T.C. 91, 111 n.10, *rev’d on other grounds*, 926 F.3d 1061 (9th Cir. 2019). This article follows the administrative law definitions, rather than the superseded definitions previously used in tax cases.

³⁷ *Professionals & Patients for Customized Care v. Shalala*, 56 F.3d 592 (5th Cir. 1995).

³⁸ *American Mining Congress v. Mine Safety & Health Administration*, 995 F.2d 1106 (D.C. Cir. 1993).

³⁹ See, e.g., *Morton-Norwich Products Inc. v. United States*, 221 Ct. Cl. 83, 104 (1979) (stating that the section 482 regulations “are more than mere interpretation. They are the nuts and bolts, the girders and beams, of section 482 operations.”).

⁴⁰ Section 482.

⁴¹ *Christensen v. Harris County*, 529 U.S. 576 (2000).

⁴² IRM section 32.1.1.2.8.

transfer pricing law, the arm's-length standard, is to be found not in the statute, but in Treasury's regulations.⁴³ In *Altera*, the Tax Court held — over the IRS's objection — that the challenged stock-based compensation rule in reg. section 1.482-7 was a legislative rather than an interpretive rule,⁴⁴ and the Ninth Circuit implicitly accepted this conclusion.⁴⁵ The IRS may not like it, but the APA applies to transfer pricing regulations.

III. Types of Regulations

Transfer pricing practitioners will be familiar with a few flavors of regulations. In addition to final regulations, Treasury releases proposed regulations and temporary regulations. Proposed regulations are not regulations as such, but rather (along with their preambles) are part of what the APA refers to as a notice of proposed rule making.⁴⁶ They serve to alert the public to contemplated rules and to provide an opportunity for comment, but unless and until finalized, they have no other effect — although Treasury and the IRS sometimes include statements indicating that taxpayers may rely on the notice.

Temporary regulations, on the other hand, are effective as of their stated effective date, just like final regulations. They offer Treasury a way to issue effective rules (sometimes after having gone through an initial round of proposed regulations), observe how they are working in practice, and make any needed changes before replacing them with final regulations.

The APA draws no distinction between temporary and final regulations. As far as it is concerned, temporary regulations must proceed through the same notice and comment process as final regulations. As noted, Treasury has historically disagreed, arguing that section 7805 permits it to promulgate temporary regulations without following APA procedures. Like other facets of tax exceptionalism, that position may have had its last gasp: In *Liberty Global*, the district

court held that temporary Treasury regulations are subject to the APA's notice and comment requirements.⁴⁷

But there is one important difference between final and temporary Treasury regulations. Section 7805(e)(2) imposes a sunset rule that requires temporary regulations to expire within three years of their issuance. Because the rule applies only to regulations issued after 1988,⁴⁸ one occasionally encounters “temporary” zombies that have been around for decades without finalization, such as the transfer-pricing-adjacent reg. section 1.367(d)-1T, which came out in 1986 and, with a couple of later tweaks, is still standing.

This three-year time limit on temporary regulations has real consequences. The final section 482 regulations historically contained aggregation rules,⁴⁹ but in 2015, Treasury removed them, substituting a temporary regulation that applied a more expansive aggregation concept.⁵⁰ Treasury intended to finalize the temporary regulation, but a flurry of TCJA-related activities prevented it from doing so within the allotted period, and thus the temporary regulation expired in September 2018. Final rules are expected,⁵¹ and taxpayers cannot afford to ignore potential aggregation issues in the meantime — the TCJA added aggregation language to the text of section 482 itself.

IV. Classifying Guidance

Regulations possess the force and effect of law. This makes sense, because Treasury partakes of the legislative power delegated to it by Congress when engaging in regulatory rulemaking. By contrast, subregulatory guidance — such as revenue rulings, revenue procedures, notices, announcements, and FAQs — generally

⁴³ Reg. section 1.482-1(b).

⁴⁴ *Altera*, 145 T.C. at 116-117.

⁴⁵ Note that the Ninth Circuit's discussion of *Chevron* and the APA was necessarily premised on the conclusion that the regulation was a legislative rule to which those authorities apply.

⁴⁶ 5 U.S.C. section 553(b).

⁴⁷ *Liberty Global*, No. 1:20-cv-03501.

⁴⁸ Technical and Miscellaneous Revenue Act of 1988, section 6232(b).

⁴⁹ Reg. section 1.482-1(f)(2)(i)(A) (2011).

⁵⁰ T.D. 9738.

⁵¹ See, e.g., Treasury, “2022-2023 Priority Guidance Plan” (Nov. 4, 2022) (including as a priority guidance plan item “Regulations under sections 367 and 482, including (1) regulations addressing the changes to sections 367(d) and 482 on aggregation, realistic alternatives, and the definition of intangible property, and (2) regulations under section 482 clarifying certain aspects of the arm's length standard, including periodic adjustments. Proposed and temporary regulations were published on September 16, 2015.”).

should not have the effect of law, and that guidance is not meant to affect taxpayers' rights or obligations. Rather, that guidance generally provides the IRS's (or Treasury's) interpretation of the law (that is, the code and Treasury regulations). As will be seen, this distinction affects how regulations and subregulatory guidance fare in court.

That distinction does not always hold true. The form in which a rule is issued is not dispositive. For example, Treasury and the IRS cannot turn off the APA by electing to issue a legislative rule through a revenue ruling rather than a regulation. In *Mann Construction*, for instance, the Sixth Circuit held that an IRS notice identifying listed transactions was a legislative rule that required notice and comment.⁵² Still, for simplicity of discussion, this article generally assumes that subregulatory guidance truly is subregulatory and is not legislative in effect.

V. Judicial Deference

A. Deference to Regulations

The fact that Congress has delegated rulemaking authority to Treasury does not give Treasury a blank slate for its regulations. Treasury's regulations must reasonably interpret the underlying statute. Of course, Treasury does not have an exclusive claim to interpretive authority when it comes to the IRC. Courts, taxpayers, and tax practitioners must all, on occasion, engage in similar interpretive activity, and the conclusions they reach about what the code means will not always accord with Treasury's regulations or with subregulatory guidance. Often the question in a tax controversy is whose interpretation prevails.

In some circumstances, the law puts a thumb on the scale in favor of Treasury's interpretations. This recognizes the deep expertise and experience of Treasury, as well as its special situation as the agency tasked by Congress with interpreting the code. The history of this judicial deference to tax regulations is a long one. Until 2011, the relevant standard was supplied by *National Muffler*, which looked at several considerations, including

whether the regulation was contemporaneous with the relevant statute.⁵³ In 2011 the Supreme Court in *Mayo* aligned the administrative law treatment of tax regulations with the treatment of regulations issued by other executive agencies, holding that *National Muffler's* tax-specific rule had been superseded by *Chevron*, which supplies the general standard for review of regulations.

Decided in 1984, *Chevron* addressed a challenge to Environmental Protection Agency regulations under the Clean Air Act. In 1981 the incoming EPA under the Reagan administration reversed a prior agency position and relaxed some rules regarding plants' pollutant emissions. The D.C. Circuit invalidated the new regulation, but the Supreme Court reversed. In doing so, it ushered in a new standard for deference to agency regulations, which recognizes not only that executive agencies are generally expert in the areas they are authorized to regulate, but also that agencies are politically accountable through the president. Article III courts, on the other hand, are almost entirely unaccountable, with judges entitled to "hold their Offices during good Behaviour" — that is, absent any egregious incident, for life.⁵⁴ Judicial deference under *Chevron* is therefore motivated by the fact that "judges are not experts" in the fields entrusted to the agencies, and by the fact that "it is entirely appropriate for this political branch of the Government to make . . . policy choices" in rulemaking.⁵⁵

The analysis under *Chevron*, which applies to legislative rules like the section 482 regulations,⁵⁶ comprises two steps. First, it is necessary to determine "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."⁵⁷ Treasury cannot rewrite the code to

⁵³ *National Muffler Dealers Association v. United States*, 440 U.S. 472 (1979).

⁵⁴ U.S. Const. Art. III, section 1.

⁵⁵ *Chevron*, 467 U.S. at 865.

⁵⁶ See *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Christensen*, 529 U.S. 576.

⁵⁷ *Chevron*, 467 U.S. at 842.

⁵² *Mann Construction v. United States*, 27 F.4th 1138 (6th Cir. 2022).

suit its purposes; its delegated authority does not permit it to directly contradict Congress.

In the transfer pricing context, of course, Congress will almost never have spoken to the precise question at issue, and thus it is necessary to turn to the second step of the *Chevron* analysis: whether the regulation is “based on a permissible construction of the statute”; that is, whether it is reasonable.⁵⁸ If the regulation is reasonable, taking into account the underlying statute, a court will defer to it, rather than substitute its own interpretation of the statute.

An interesting wrinkle arises when an agency seeks to use a regulation to abrogate a prior judicial decision. *Brand X* addressed a situation in which a court had interpreted the relevant statute before the agency issued regulations that espoused a different interpretation.⁵⁹ The Supreme Court held that the court’s construction of the statute trumps the agency’s only if the court decided under *Chevron* step 1 that the statute was unambiguous; because the court in *Brand X* had not done so, the agency’s regulation was upheld.

A similar issue arose in *Home Concrete*, a tax case that, unlike *Brand X*, involved an earlier judicial opinion — *Colony*⁶⁰ — that both predated *Chevron* and had been issued by the Supreme Court.⁶¹ Although the Supreme Court had acknowledged in *Colony* that the statute in question was “not ‘unambiguous,’”⁶² the *Home Concrete* Court held that the statute, as interpreted in *Colony*, left no gap for the agency to fill, and thus it invalidated the regulation.⁶³ While the majority opinion in *Home Concrete* does not acknowledge any inconsistency with *Brand X*, it is difficult to extract a consistent rule from both cases.⁶⁴

In the transfer pricing arena, the *Brand X/Home Concrete* problem is posed by *3M Co.*,⁶⁵ which has

been on the Tax Court’s docket since 2013 without an opinion, and involves a challenge to the blocked income rule of reg. section 1.482-1(h)(2) on the grounds that — among other things — the regulation impermissibly seeks to overrule the Supreme Court’s prior decision in *First Security Bank of Utah*.⁶⁶ The same issue was raised, but not addressed, in *Coca-Cola*,⁶⁷ with the Tax Court deferring consideration of the blocked income issue until the issuance of an opinion in *3M*’s case.⁶⁸

B. Subregulatory Guidance

Courts approach subregulatory guidance differently from regulations. As a general administrative law matter, subregulatory guidance that interprets a regulation is entitled to deference. In *Auer*, the Supreme Court concluded that an agency’s interpretation of its own regulation is entitled to deference unless it is plainly erroneous or inconsistent with the regulation.⁶⁹ This is a very deferential stance, and it has not proven to be a popular one. A recent challenge to *Auer* was rebuffed in *Kisor*,⁷⁰ though the Court in that case did provide clarity as to the limits of *Auer* deference.

Courts have granted *Auer* deference in tax cases.⁷¹ Yet in keeping with the historical evolution of tax law as a province unto itself, courts traditionally approached tax subregulatory guidance with a different lens. For instance, some precedents established that positions taken in revenue rulings are “entitled to no special deference” — a revenue “ruling or other interpretation by the Commissioner is only as persuasive as [its] reasoning and the precedents upon which [it] relies.”⁷² Other courts have held

⁶⁶ Brief for Petitioners, *3M Co.*, Dkt. No. 5816-13 (Mar. 21, 2016) (discussing *Commissioner v. First Security Bank of Utah*, 405 U.S. 394 (1972)).

⁶⁷ *Coca-Cola*, 155 T.C. No. 10.

⁶⁸ *Id.* at 185. For an in-depth discussion of the blocked income issue, see Mark R. Martin and Thomas D. Bettge, “The Blocked Income Problem in Transfer Pricing,” *Tax Notes Federal*, June 21, 2021, p. 1935.

⁶⁹ *Auer v. Robbins*, 519 U.S. 452 (1997). See also *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945) (applying the same standard).

⁷⁰ *Kisor v. Wilkie*, 139 S. Ct. 2400 (2019).

⁷¹ E.g., *Union Carbide Corp. v. Commissioner*, 697 F.3d 104, 108-109 (2d Cir. 2012) (granting *Auer* deference to interpretation set forth in IRS brief); *Polm Foundation Inc. v. United States*, 644 F.3d 406 (D.C. Cir. 2011) (same).

⁷² *Halliburton Co. v. Commissioner*, 100 T.C. 216, 232 (1993).

⁵⁸ *Id.* at 843.

⁵⁹ *National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005).

⁶⁰ *Colony Inc. v. Commissioner*, 357 U.S. 28 (1958).

⁶¹ *United States v. Home Concrete & Supply LLC*, 566 U.S. 478 (2012).

⁶² *Id.* at 482 (quoting *Colony*, 357 U.S. at 33).

⁶³ *Id.* at 490.

⁶⁴ See, e.g., *id.* at 494-495 (Scalia, J., concurring in part and concurring in the judgment).

⁶⁵ *3M Co.*, Dkt. No. 5816-13.

that revenue rulings receive what is referred to as *Skidmore* deference,⁷³ which comes to about the same thing as no special deference.⁷⁴ *Skidmore* provides that a court will defer to agency guidance to the extent it is persuasive. In effect, this is no deference at all: It requires the court to consider an agency interpretation, but nothing more.

While not all revenue rulings interpret regulations, some do, setting up a conflict between tax-specific rules and *Auer*. In one case, the D.C. Circuit considered the IRS's claim that *Auer* deference should be given to a position set out in a revenue ruling, but did not decide the question, holding that the ruling was a well-reasoned interpretation of the statute on its own merits.⁷⁵ It is not clear whether the heralded end to tax exceptionalism in *Mayo* extends beyond the application of *Chevron* and overrides tax-specific precedent by pulling in *Auer*.

We may never know what the answer is. In its 2019 policy statement, Treasury stated that the IRS will not seek *Auer* deference for subregulatory guidance in litigation before the Tax Court,⁷⁶ though litigation handled by the Department of Justice could still raise the issue. Interestingly, the government did not ask for *Auer* deference from the Ninth Circuit in *Altera*.⁷⁷

VI. Conclusion

The notice and comment process, and in particular whether Treasury has adequately taken stakeholder comments into account in formulating a final regulation and its preamble, can be a lightning rod for APA-related controversy. This makes sense. Treasury's preambles are often voluminous, but given the sheer number of interested taxpayers and practitioners, figuring out what comments are material — and how to adequately respond to them — requires a degree of time and effort that Treasury has not always provided. Then, too, the *State Farm* reasoned

decision-making standard poses a hurdle — even if commenters do not raise concerns, Treasury may not act arbitrarily in formulating its rules.

Similarly, contests often center on whether Treasury's regulations permissibly interpret the code section or sections to which they relate. If they do, they get *Chevron* deference; if they do not, the court will set them aside. While *Chevron* is framed in terms of deference, rather than validity, it comes down to the same thing for taxpayers looking to avoid the application of a regulation. If a court concludes a regulation does not reasonably interpret the underlying statute, it will necessarily substitute a different interpretation.

The APA and *Chevron* inquiries are distinct but related. The Ninth Circuit's opinion in *Altera* shows how one can depend on the other. There, the court first examined section 482 and determined that Treasury reasonably interpreted the statute as allowing it to dispense with a comparability analysis in cases involving transfers of intangibles.⁷⁸ Having done so, it was fairly easy for the court to brush aside as immaterial Treasury's failure to respond to key comments stating that third parties do not share stock-based compensation costs — after all, under the interpretation of section 482 the court had just espoused, third-party behavior “had no bearing on ‘relevant factors’ to the rulemaking.”⁷⁹

Administrative law is an area filled with nuance and no little uncertainty. In the past decade, it has impinged on transfer pricing to a historically unprecedented degree. This discussion is far from exhaustive, but it is hoped that it can play some small part in introducing key features of this strange new world to transfer pricing practitioners.⁸⁰ ■

⁷⁸ *Altera*, 926 F.3d 1061, 1076-1078.

⁷⁹ *Id.* at 1082 (quoting *American Mining Congress v. EPA*, 965 F.2d 759, 771 (9th Cir. 1992)).

⁸⁰ The foregoing information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author only, and does not necessarily represent the views or professional advice of KPMG LLP.

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⁷³ *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

⁷⁴ *E.g.*, *Seaview Trading LLC v. Commissioner*, 858 F.3d 1281 (2017).

⁷⁵ *Mellow Partners v. Commissioner*, 890 F.3d 1070, 1078 (D.C. Cir. 2018). The court determined that, whether *Auer* or *Skidmore* were the correct standard, the agency's interpretation passed muster. *Id.* at 1078-1080.

⁷⁶ Treasury, 2019 policy statement, *supra* note 30.

⁷⁷ *Altera*, 941 F.3d 1200, 1210 (9th Cir. 2019) (Smith, J., dissenting), *denying rehearing en banc* in 926 F.3d 1061.