No. 23-3772

In the United States Court of Appeals for the Eighth Circuit

3M COMPANY & SUBSIDIARIES,

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

ON APPEAL FROM THE UNITED STATES TAX COURT
No. 5816–13 — 160 T.C. No. 3

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF APPELLANT AND REVERSAL

Tyler S. Badgley
Maria C. Monaghan
U.S. CHAMBER LITIGATION CENTER
1615 H Street, NW
Washington, DC 20062
(202) 463-5337

Christopher J. Walker
Counsel of Record
UNIVERSITY OF MICHIGAN SCHOOL OF LAW
701 South State Street
Ann Arbor, MI 48109-3091
(734) 763-3812
christopher.j.walker@gmail.com

Counsel for Amicus Curiae

RULE 26.1 DISCLOSURE STATEMENT

The Chamber of Commerce of the United States of America (Chamber) states that it is a non-profit, tax-exempt organization incorporated in the District of Columbia. The Chamber has no parent corporation, and no publicly held company has 10% or greater ownership in the Chamber.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

TABLE OF AUTHORITIES
(continued)

Page(s)

Statutes

Other Authorities

INTEREST OF *AMICUS CURIAE*[*]

The Chamber of Commerce of the United States of America (Chamber) is the world's largest business federation. It represents approximately 300,000 direct members and indirectly represents the interests of more than 3 million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases, like this one, that raise issues of concern to the nation's business community.

This case presents a question of significant importance to the Chamber and its members: Whether the U.S. Department of Treasury (Treasury) and Internal Revenue Service (IRS) may evade their obligation to comply with the Administrative Procedure Act (APA) and related

[*] All parties consent to the filing of this brief. Pursuant to Federal Rule of Appellate Procedure 29(a)(4)(E), *amicus curiae* states that no counsel for any party authored this brief in whole or in part and no entity or person, aside from *amicus curiae*, its members, or its counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

administrative law doctrines. Here, the IRS failed in several critical respects to engage in reasoned decisionmaking as required by the APA and the Supreme Court. Yet it seeks judicial deference for its interpretation of the Internal Revenue Code. Such arbitrary and capricious rulemaking imposes tremendous negative consequences for the nation's business community and the national economy.

The business community has a particular interest in the interpretation and application of the rules governing the administrative process. Many businesses face an onslaught of regulations, with tax regulations being among the most complex. They critically depend on the procedures and protections that Congress provided in the APA to ensure that those regulations are not the result of arbitrary or otherwise unlawful agency action. Given the breadth of its membership and its long history of challenging regulations that violate the APA, the Chamber is uniquely positioned to speak to the administrative law principles implicated by this case as well as the consequences to the nation's business community of arbitrary regulatory activities that interfere with their operations and investment decisions.

SUMMARY OF ARGUMENT

I. For decades, the IRS took the position that its regulatory activities are not fully governed by the APA and related administrative doctrines. The U.S. Supreme Court, the D.C. Circuit, and the Tax Court have all properly rejected that understanding of "tax exceptionalism" and confirmed that the IRS, like other agencies, must comply with the important requirements that Congress enacted in the APA. While the IRS may now attempt to comply with those obligations, many tax regulations promulgated during that bygone era continue to impose burdensome obligations on taxpayers. And courts must apply administrative law principles to determine whether those regulations are the product of arbitrary and capricious decisionmaking. When applying normal administrative law rules, it is not a close call that this tax regulation violates the APA. In particular, the IRS did not provide a reasoned basis for its regulation or respond to significant comments made during the comment period. And the Tax Court plurality's post hoc rationalization for the regulation is not a sufficient basis to uphold the regulation and is indeed contrary to bedrock administrative law.

II. This Term, the Supreme Court is considering whether to overrule or at least further narrow *Chevron* deference.[1] But even if the *Chevron* doctrine remains in its current form, Supreme Court precedent forecloses its application here. *Chevron* deference is not warranted where an agency engages in a procedurally defective rulemaking. This Court should not permit the government to leverage the discretion *Chevron* deference affords agencies without also complying with the APA's constraints on arbitrary and capricious agency action.

III. The IRS's failure to comply with the APA has substantial negative consequences for the nation's business community and thus the national economy. Arbitrary and capricious regulations unfairly interfere with businesses' operations and investments. This is particularly true in the context of tax regulation. Properly conducted notice-and-comment rulemaking leads to more rational and effective agency decisionmaking and, in turn, higher quality regulations.

---

[1] The Chamber has set forth its views on the future of *Chevron* deference in an *amicus curiae* brief filed in one of the *Chevron* challenges the Supreme Court is considering this Term. *See* U.S. Chamber *Amicus Curiae* Br., *Loper Bright Enters. v. Raimondo*, No. 22–451 (S. Ct., filed July 24, 2023), https://www.supremecourt.gov/DocketPDF/22/22-451/272688/20230724120208874_Chamber%20-%20Loper%20Bright%20Amicus%20Brief.pdf.

ARGUMENT

I. Applying Traditional Administrative Law Principles, the IRS's Rulemaking Is Arbitrary and Capricious.

Tax law historically suffered from what has been coined "tax exceptionalism"—the misperception that tax regulation is not governed by the same longstanding rules of administrative law that generally apply to federal agency rulemaking. In recent years, however, courts have correctly and uniformly rejected that approach. *See, e.g.*, *Mayo Found. for Med. Educ. & Rsch. v. United States*, 562 U.S. 44, 55 (2011) (refusing "to carve out an approach to administrative review good for tax law only" and reiterating "'the importance of maintaining a uniform approach to judicial review of administrative action'" (quoting *Dickinson v. Zurko*, 527 U.S. 150, 154 (1999))); *Cohen v. United States,* 650 F.3d 717, 736 (D.C. Cir. 2011) (en banc) (holding that the APA's judicial review provisions apply with full force to a form of IRS guidance known as a notice); *Oakbrook Land Holdings v. Comm'r*, 28 F.4th 700, 709 (6th Cir. 2022) (analyzing the procedural validity of a tax regulation under the APA), *aff'g* 154 T.C. 180 (2020).[2] This Court should follow suit.

[2] *See also* Kristin E. Hickman, *The Need for* Mead*: Rejecting Tax Exceptionalism in Judicial Deference*, 90 Minn. L. Rev. 1537, 1541 (2006)

When reviewed under blackletter administrative law, this tax regulation provides a textbook example of an agency's failure to fulfill the APA's reasoned decisionmaking requirements for notice-and-comment rulemaking—in at least two respects. And a plurality of the Tax Court compounds these errors by upholding the tax regulation based on impermissible post hoc rationalizations.

1. The APA commands that a reviewing court must "hold unlawful and set aside" any agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). The Supreme Court has explained that, to survive arbitrary and capricious review, "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Motor Vehicles Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotations marks omitted).

(describing the "perception of tax exceptionalism that intrudes upon much contemporary tax scholarship and jurisprudence"); Stephanie Hoffer & Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 Minn. L. Rev. 221, 222–24 (2014) (chronicling how federal courts have rejected tax exceptionalism).

In what has been coined the APA's reasoned decisionmaking requirement (or "hard look" review), the *State Farm* Court provided further instruction:

> Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: "We may not supply a reasoned basis for the agency's action that the agency itself has not given."

Id. (quoting *SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947) (*Chenery II*); *accord Menorah Med. Ctr. v. Heckler*, 768 F.2d 292, 295 (8th Cir. 1985) (embracing the *State Farm* approach and explaining that the APA requires an agency to "offer a plausible explanation" and "consider [] important aspects of the problem [the agency] was intended to address").

This case is an easy reversal under *State Farm*. As Judge Toro, joined by five of his Tax Court colleagues, explained in his dissent, "Treasury offered no explanation for its choices with respect to the rule. Not a single sentence. Treasury did not explain why a revision to the existing rule was needed." Addendum to Appellant's Opening Brief (Add.) 311. The IRS's failure "to articulate a satisfactory explanation for

[agency] action," much less *any* explanation, is arbitrary and capricious under the APA. *Rauenhorst v. Dep't of Transp.*, 95 F.3d 715, 723 (8th Cir. 1996).

But the IRS's error is even more egregious in light of fact that the regulation diverged from the agency's prior approach as well as from settled judicial precedents. When an agency changes its position, Supreme Court precedent requires that "the agency must at least 'display awareness that it is changing position' and 'show that there are good reasons for the new policy.'" *Encino Motorcars v. Navarro*, 579 U.S. 211, 221 (2016) (quoting *FCC v. Fox Television Stations*, 556 U.S. 502, 515 (2009)). The Supreme Court further requires the agency to consider reasonable regulatory alternatives and to demonstrate that it has adequately considered the reliance interests at stake in changing the regulatory baseline. *See, e.g.*, *Dep't of Homeland Sec. v. Regents of Univ. of Cal.*, 140 S. Ct. 1891, 1911–15 (2020).

Here, the IRS failed to comply with any of these reasoned-decisionmaking requirements. *See also* Appellant's Opening Brief (App. Br.) 53–60 (further detailing how the IRS's rulemaking was arbitrary and capricious under the APA).

2. The IRS's failure to engage in reasoned decisionmaking as required by the APA and *State Farm* is exacerbated by its failure to consider, much less respond to, significant comments lodged during the public comment period. It is basic administrative law that "[a]n agency must consider and respond to significant comments received during the period for public comment." *Perez v. Mort. Bankers Ass'n*, 575 U.S. 92, 96 (2015) (citing *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971)). As the D.C. Circuit has explained, this APA-guaranteed "opportunity to comment is meaningless unless the agency responds to significant points raised by the public." *Home Box Off. v. FCC*, 567 F.2d 9, 35–36 (D.C. Cir. 1977) (per curiam) (footnote omitted).

Judge Toro's dissent rightly categories the following as "quintessential 'significant comments'":

> Specifically, four commenters pointed out that the proposed rule contradicted the Supreme Court's decision in *First Security* and the decisions of this Court and the U.S. Court of Appeals for the Sixth Circuit in *Procter & Gamble* and called for changes to the rule. The comments questioned whether, under that precedent, Treasury had the authority to promulgate Treasury Regulation § 1.482-1(h)(2) in the form that was ultimately adopted.

Add. 322; *see also* App. Br. 60–66 (further detailing why these are significant comments and how the Tax Court's plurality opinion misapplies

this APA requirement and misreads the relevant precedent); *accord* Add. 320–329 (Toro, J., dissenting).

Had the IRS responded to these significant comments, it would have had to engage in reasoned decisionmaking. It would have had to explain how the new regulation is reconcilable with existing judicial precedent and explain how and why the IRS decided to depart from its prior approach. It would have had to consider the reliance interests engendered by the prior approach and explore reasonable alternatives. That reasoned decisionmaking would have led to a higher quality, more effective regulation—and more public confidence in the IRS's regulatory activities. As the Supreme Court has explained, notice-and-comment rulemaking "gives affected parties fair warning of potential changes in the law and an opportunity to be heard on those changes" while "afford[ing] the agency a chance to avoid errors and make a more informed decision." *Azar v. Allina Health Servs.*, 139 S. Ct. 1804, 1816 (2019).

3. In an attempt to salvage the regulation after the fact, the Tax Court's plurality opinion "is constrained to speculate and construct a rationale on the agency's behalf." Add. 312 (Toro, J., dissenting). Such an approach to judicial review violates the APA. As the Supreme Court has

repeatedly instructed, "[t]he reviewing court should not attempt itself to make up for [agency] deficiencies"; the court may "'not supply a reasoned basis for the agency's action that the agency itself has not given.'" *State Farm*, 463 U.S. at 43 (quoting *Chenery II*, 332 U.S. at 196). Put differently, as the Supreme Court did more than eight decades ago, "an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained." *SEC v. Chenery Corp.*, 318 U.S. 80, 95 (1943) (*Chenery I*); *accord Red River Valley Sugarbeet Growers Ass'n v. Regan*, 85 F.4th 881, 890 n.2 (8th Cir. 2023).

Complying with the *Chenery* doctrine not only incentivizes more sensible regulations but also protects courts from being forced into making the types of policy decisions reserved for Congress and administrative agencies. *See generally* Kevin M. Stack, *The Constitutional Foundations of* Chenery, 116 Yale L.J. 952 (2007). It is not the Tax Court's (or this Court's) responsibility to articulate a reasonable basis for a regulation or to choose between competing policy alternatives. *See, e.g.*, *Mayo v. Schiltgen*, 921 F.2d 177, 179 n.6 (8th Cir. 1990) (quoting *Chenery I*'s command, 318 U.S. at 88, that "an appellate court cannot intrude upon the

domain which Congress has exclusively entrusted to an administrative agency"). Courts are in the business of interpreting statutes, not defending the wisdom of an agency's policy choices. As the Supreme Court has emphasized, the *Chenery* doctrine ensures that "[t]he agency can bring its expertise to bear upon the matter; it can evaluate the evidence; it can make an initial determination; and, in doing so, it can, through informed discussion and analysis, help a court later determine whether its decision exceeds the leeway that the law provides." *INS v. Ventura*, 537 U.S. 12, 17 (2002) (per curiam).

The appropriate judicial response to a rulemaking that fails to articulate a rationale or address significant comments is to set aside the regulation and tell the agency to try again and, this time, show its work. This Court should underscore for the Tax Court the *Chenery* doctrine's foundational role in administrative law.

II. No *Chevron* Deference Applies Where, as Here, an Agency Engages in a Defective Rulemaking Process.

Not only does the Tax Court plurality contravene the basic administrative law doctrines articulated by the Supreme Court in *State Farm*, *Mortgage Bankers*, and *Chenery*, see Part I *supra*, but it compounds these errors by deferring to the IRS's statutory interpretation under *Chevron*.

See Chevron, U.S.A. v. Nat. Res. Def. Council, 467 U.S. 837, 842–43 (1984) (instructing courts to defer to an agency's reasonable interpretation of an ambiguous statute that the agency administers).

Encino Motorcars is instructive—indeed, controlling. There, the Supreme Court found that the "regulation was issued without the reasoned explanation that was required in light of the [agency's] change in position and the significant reliance interests involved." 579 U.S. at 222. Accordingly, the Supreme Court refused to defer to the agency's statutory interpretation. *Id.* at 224. "[W]here a proper challenge is raised to the agency procedures, and those procedures are defective," the Court explained, "a court should not accord *Chevron* deference to the agency interpretation." *Id.* at 221.

As Judge Toro astutely observed in his dissent, "[t]he parallels to this case are easy to see." Add. 319. Here, like in *Encino Motorcars*, the agency changed its position in a way that conflicted with judicial precedent, upsetting settled expectations within the industry. One difference, though, is that "here we have significantly less discussion (none in fact) of the reasons for the change than was present in *Encino Motorcars*." *Id.* at 319–320; *see also* App. Br. 46–47 (expanding on this argument).

To be sure, perhaps in response to the death of tax exceptionalism in the federal courts, the IRS has made considerable strides in recent years to comply with the APA and related administrative law doctrines. Yet, the IRS continues, at times, to attempt to reap administrative law's benefits of agency discretion—such as *Chevron* deference—while avoiding its constraints—such as the APA's reasoned-decisionmaking requirements.

This case is illustrative. At the rule's adoption, the IRS asserted that the APA does not apply to the regulation, which no doubt contributed to the IRS's failure to engage in reasoned decisionmaking. *See* Add. 341 (Toro, J., dissenting). In the Tax Court, the IRS wisely reversed course and recognized the APA's applicability. *See* App. Br. 18. Yet despite failing to engage in the APA-required reasoned decisionmaking, see Part I *supra*, the IRS still requests *Chevron* deference to salvage the regulation.

The dangers inherent in the IRS's tactics should be plain: the IRS wants to take advantage of the agency discretion afforded by administrative law's judicial deference doctrines without also being bound by the constraints administrative law imposes to ensure that discretion is not

exercised in an arbitrary and capricious manner. That sort of "have our cake and eat it too" approach to administrative law has been routinely rejected, and it should fare no better with respect to the tax regulation at issue in this case.

III. Allowing the IRS to Ignore or Bend the APA's Requirements Would Lead to Lower Quality, Arbitrary Regulations and Substantial Costs to the National Economy.

The IRS's arbitrary and capricious rulemaking has real-world, substantial impacts on the business community and thus the national economy. Businesses depend on clear, predictable rules—and fair and nonarbitrary administrative processes—when planning their operations and investing for their businesses. This is particularly true of tax regulations, especially as the IRS's activities have evolved beyond revenue raising to regulate various sectors of the economy in substantial ways. *See generally* Kristin E. Hickman, *Administering the Tax System We Have*, 63 Duke L.J. 1717 (2014). An agency's refusal to be constrained by administrative law's procedural protections imposes great costs and uncertainties on the individuals, businesses, and industries regulated by those laws.

As Judge Toro observed in his dissent, "requiring agencies to comply with the APA's procedural requirements is not a pointless exercise."

Add. 342. These requirements "'serve[] important values of administrative law.'" *Id.* (quoting *Regents of University of California*, 140 S. Ct. at 1909). "Requiring a new decision before considering new reasons promotes 'agency accountability,'" the Supreme Court has explained, "by ensuring that parties and the public can respond fully and in a timely manner to an agency's exercise of authority." *Regents of University of California*, 140 S. Ct. at 1909 (quoting *Bowen v. Am. Hosp. Ass'n*, 476 U.S. 610, 643 (1986). It also "instills confidence" in administrative governance for the regulated and the public more generally. *Id.*

Perhaps most importantly, the APA's procedural requirements are vital to producing higher quality federal regulations. It is not difficult to appreciate how notice-and-comment rulemaking serves this purpose. After all, the APA requires that the agency release its proposed rule and supporting evidence and information to the public so industry and other experts have the opportunity to comment on it, allowing the agency to leverage expertise outside the agency to make the final rule better. And in promulgating the final rule, the agency is required to consider the significant public comments, revise the rule to address them where appropriate, and otherwise engage in reasoned decisionmaking. *See, e.g.*,

Christopher J. Walker & Scott T. MacGuidwin, *Interpreting the Administrative Procedure Act: A Literature Review*, 98 Notre Dame L. Rev. 1963, 1967–71 (2023) (detailing how the Supreme Court and lower courts have interpreted the requirements of APA notice-and-comment rulemaking).

Over the decades, the Chamber and its members have experienced firsthand the critical importance of these APA requirements in implementing new regulations. The Chamber has also commissioned numerous reports and studies that explore how notice-comment-rulemaking leads to higher quality regulations. *See, e.g.*, Paul Rose & Christopher J. Walker, *Examining the SEC's Proxy Advisor Rule* (U.S. Chamber Report, 2020), https://ssrn.com/abstract=3728163. When agencies fully engage in notice-and-comment rulemaking and reasoned decisionmaking, agencies are more likely to carefully tailor their regulatory efforts to maximize benefits, minimize costs, and take into account unintended consequences and reliance interests.

CONCLUSION

For these reasons, the Tax Court's decision should be reversed.

Respectfully submitted,

February 14, 2024

/s/ Christopher J. Walker

Tyler S. Badgley
Maria C. Monaghan
U.S. CHAMBER
LITIGATION CENTER
1615 H Street, NW
Washington, DC 20062
(202) 463-5337

Christopher J. Walker
Counsel of Record
UNIVERSITY OF MICHIGAN
SCHOOL OF LAW
701 South State Street
Ann Arbor, MI 48109-3091
(734) 763-3812
christopher.j.walker@gmail.com
* *Institutional affiliation is provided for identification purposes only.*

Counsel for Amicus Curiae

CERTIFICATE OF COMPLIANCE

I certify that the foregoing brief complies with the type-volume limitation of Federal Rules of Appellate Procedure 29(a)(5) and 32(a)(7) because it contains 3,377 words, as determined by the word-count function of Microsoft Word, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(f).

I further certify that this brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Century Schoolbook font.

February 14, 2024

/s/ Christopher J. Walker

Christopher J. Walker
Counsel of Record
UNIVERSITY OF MICHIGAN
SCHOOL OF LAW
701 South State Street
Ann Arbor, MI 48109-3091
(734) 763-3812
christopher.j.walker@gmail.com
* *Institutional affiliation is provided for identification purposes only.*

CERTIFICATE OF SERVICE

I certify that on February 14, 2024, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Eighth Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

February 14, 2024

/s/ Christopher J. Walker

Christopher J. Walker
Counsel of Record
UNIVERSITY OF MICHIGAN
SCHOOL OF LAW
701 South State Street
Ann Arbor, MI 48109-3091
(734) 763-3812
christopher.j.walker@gmail.com
* *Institutional affiliation is provided for identification purposes only.*