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Taking Stock of Challenges to the TCJA and Its Regulations

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The Tax Cuts and Jobs Act[1] (TCJA) was hastily enacted and ushered in a sea change to how the U.S. imposes tax on international operations; it was inevitable that litigation would follow. Recent important decisions in *FedEx* and *Liberty Global* provide an ideal opportunity to take stock of where things stand with at least some of the many challenges to the TCJA and its implementing regulations.

GOVERNMENT VICTORIES IN EARLY CHALLENGES

At the outset, we should note that a few of the earliest challenges are close to being resolved in the government's favor. One challenge came from a couple—Charles and Kathleen Moore—who challenged the constitutionality of the §965 transition tax (as applied to their closely held corporation) on the grounds that it violated both the Apportionment Clause (because the transition tax is imposed on unrealized amounts and therefore is not an income tax exempt from that Clause) and the Due Process Clause under the Fifth Amendment (because by imposing tax on amounts already earned, the transition tax is retroactive).[2] The Moores lost on their constitutional challenges in district court and then the Ninth Circuit; they filed a petition for certiorari in February 2023.[3]

Two other challenges came from Monte Silver, an Israeli-based lawyer who challenged the Treasury Regulations on transition-tax reporting and GILTI under the APA—the former because they allegedly violated two relatively obscure rulemaking statutes (the Regulatory Flexibility Act (RFA) and the Paperwork Reduction Act), the latter on the grounds that they violated just the RFA.[4] Silver's challenge to the transition tax regulations survived a motion to dismiss under the Anti-Injunction Act (AIA) and even got some traction on a motion for reconsideration, but ultimately Silver could not show that he would face transition-tax liability and lost at district court. The D.C. Circuit affirmed per curiam and the Supreme

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[1] Pub. L. 115-97.

[2] *Charles G. Moore, et. al. v. United States*, No. 2:19-CV-01539 (W.D. Wash. 2020).

[3] *Charles G. Moore, et. al. v. United States*, 36 F.4th 930 (9th Cir. 2022), *petition for cert. filed*, 2023 WL 2241819 (U.S. Feb. 21, 2023) (No. 22-800).

[4] *Silver v. IRS*, No. 1:19-CV-00247 (D.C. Cir. 2022), *cert. denied*, __ S.Ct. __, 2023 WL 3158386 (2023); *Silver v. IRS*, 531 F. Supp.3d 346 (D.D.C. Mar. 28, 2021).

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Court denied his cert petition. Silver's challenge to the GILTI regulations is on a similar trajectory—Silver lost on AIA grounds in district court and is now appealing that loss to the D.C. Circuit.

Those government victories indicated little about how other TCJA challenges would fare. Two district courts have now invalidated Treasury Regulations promulgated under the TCJA, albeit on meaningfully different grounds.

LIBERTY GLOBAL: PROCEDURAL GOVERNMENT LOSS ON REGULATION WITH SUBSTANTIVE PROBLEMS

One glitch in TCJA was what has come to be known colloquially as the ''GILTI donut.'' To oversimplify the issue, Congress enacted (1) the §965 transition tax, with a specific date by which earnings and profits subject to the tax are measured, (2) an effective date for when the new 100% dividends-received deduction (DRD) (under §245A) was available, and (3) an effective date for when the new Global Intangible Low-Taxed Income (GILTI) regime of §951A kicked in. Those varying effective dates made it possible for some taxpayers to generate income that was never subject to the §965 transition tax *or* GILTI but could subsequently be eligible for the §245A DRD and thus repatriated without paying U.S. tax. Treasury and the IRS tried to address this by enacting Temporary and Proposed Regulations. In the preamble to those Temporary Regulations, Treasury and the IRS did their best to justify why—despite the unambiguous statutory effective dates—the law supported regulations that closed what appeared to be a loophole.

In *Liberty Global*, the taxpayer benefitted from the ''GILTI donut.''[5] And when the IRS disallowed its dividends-received deduction, the taxpayer challenged the validity of the Temporary Regulations under *Chevron* and the APA. The case thus presented what could have been a riveting *Chevron* step-one showdown, pitting unambiguous statutory language (which allowed some taxpayers what appears to have been an unintended tax benefit) against Temporary Regulations (which cut off the tax benefit but were contrary to that unambiguous statutory language). But the district court never reached that issue, deciding instead that Treasury failed to meet the APA's notice-and-comment requirements when promulgating the Temporary Regulations. It may be some time before the case gets appealed; it is currently mired in discovery on the government's other arguments that the taxpayer is not entitled to benefits, including an argument under the codified economic substance doctrine at §7701(o)(1).[6]

FEDEX: SUBSTANTIVE GOVERNMENT LOSS ON TECHNICAL FOREIGN-TAX-CREDIT REGULATIONS

The GILTI donut was not the only TCJA wrinkle that Treasury and the IRS tried to iron out with regulations. In computing taxpayers' transition tax liability, TCJA allowed taxpayers to offset the accumulated earnings of profitable foreign subsidiaries with the losses from unprofitable subsidiaries. Although taxpayers would not pay transition tax on the portion of accumulated earnings that were offset by losses from unprofitable subsidiaries (which portion the court in *FedEx* refers to as ''offset earnings''), they nevertheless had paid foreign taxes on those offset earnings. But Treasury and the IRS promulgated Treas. Reg. §1.965-5(c)(1)(ii) to deny foreign tax credits (FTCs) for foreign taxes paid on ''offset earnings.'' And they offered a policy argument for denying those credits—FTCs are a mechanism for preventing double taxation and should therefore be unavailable for offset earnings that are never subject to U.S. tax.

FedEx challenged the validity of that regulation in district court, arguing that its offset earnings met all of the statutory requirements under the relevant statute governing creditability (prior §960(a)(3)).[7] And Fed Ex argued because Treas. Reg. §1.965-5(c)(1)(ii) denied the credits that the relevant statute allowed, that regulation was contrary to the plain language of §960(a)(3) and therefore invalid under *Chevron* step one.[8] The government offered a technical (and somewhat convoluted) defense of the regulation based on language in §965(b)(4)(A), but the district court was unpersuaded and found both that statute (the plain language of which restricted its application to only §959) and §960(a)(3) were unambiguous. The district court acknowledged that the government's policy arguments about the purpose of FTCs had ''considerable weight,'' but those arguments were not enough to overcome the statute's plain language.

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[5] *Liberty Global, Inc., v. United States*, No. 1:20-CV-03501-RBJ (D. Colo. Apr. 4, 2022).

[6] The government has also filed what is effectively a countersuit in the same court on similar grounds. *See United States v. Liberty Global, Inc.*, No. 1:22-CV-02622-RBJ-STV (D. Colo. Oct. 7, 2022).

[7] *FedEx Corp. & Subs. v. United States*, No. 20-CV-2794 (W.D. Tenn. Mar. 31, 2023).

[8] *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984). Under *Chevron* step one, the court must ask ''whether Congress has directly spoken to the precise question at issue.'' If it has, the court's inquiry ends and it must invalidate regulations contrary to the statute.

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LOOKING AHEAD

In addition to the almost inevitable appeals of the decisions in *Liberty Global* and *FedEx*, there are several other pending TCJA-related cases to watch. Kyocera has challenged Treasury Regulations that altered the effective date that Congress enacted for determining whether amounts treated as dividends under the §78 ''gross up'' for foreign taxes are eligible for the dividends received deduction under §245A (although this case may be dismissed after Treasury paid a refund to the taxpayer).[9] Sysco filed a case in Tax Court in which it challenges several Treasury Regulations under §965 (like the challenge that FedEx just won at district court) and brings a challenge like that in *Kyocera*.[10] And in another case raising constitutional challenges, Altria is challenging the IRS's apparent interpretation of the TCJA's repeal of a former limitation on ''downward attribution'' for determining stock ownership under the CFC rules.[11]

More cases are likely to follow. We may see more constitutional challenges, just as procedural challenges to regulations have multiplied in the recent decade. In its next term, the Supreme Court will consider a case asking the Court to overrule *Chevron*,[12] which would upend the current paradigm for challenging tax regulations and dramatically affect the government's approach to agency rulemaking.

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[9] Complaint for Refund, *KYOCERA AVX Components Corp. v. United States*, No. 6:22-CV-02440 (D.S.C. July 28, 2022).

[10] Petition, *Sysco Corp. v. Commissioner*, No. 5728-23 (T.C. Apr. 18, 2023).

[11] Complaint at ¶ 64, *Altria Grp. v. United States*, No: 3:23-CV-293 (E.D. Va. May 1, 2023).

[12] *Loper Bright Enter. v. Raimondo*, 45 F.4th 359 (D.C. Cir. 2022), *cert. granted*, __ S.Ct.__, 2023 WL 3158352 (2023) (No. 22-451).

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