EDITORIAL

Tax and Administrative Law in the United States

Tariffs and the looming trade wars between the United States and essentially everybody else seem to be dominating the tax (and non-tax) news these days.[1] This editorial, however, wishes to focus on another legal drama that requires the attention of tax professionals everywhere. It concerns the relationship between tax and administrative law, and even more specifically the extent of administrative law discipline of the Internal Revenue Service (IRS) and the Treasury Regulation it writes. Tax law, of course, is subject to the dictates of administrative law, but for many years there has been a belief that these dictates somehow apply differently to tax law.[2] The IRS behaved accordingly, feeding the notion of *tax exceptionalism.* The courts similarly gave significant deference to Treasury Regulations, making challenges to such regulations extremely rare. Such deference followed the famous (non-tax specific) Supreme Court *Chevron* precedent,[3] yet it was also strengthened by the tax exceptionalism notion. Scholars have long warned about the validity of the Chevron deference and the irregular application of administrative law to tax and Treasury Regulations.[4] These warnings had had little impact until the recent Supreme Court's *Loper Bright* decision[5] that explicitly reversed *Chevron* and its strong deference to agency version and fortified an already increasing sentiment against tax exceptionalism.

These developments have political overtones, which are expected in a society that is so divided over the appropriate magnitude of the *administrative state*, but they may also have significant impact on international tax law in the United States and therefore should be noted by tax professionals everywhere. Legal experts in the United States fiercely debate the impact of *Loper Bright* on tax law and more generally.[6] Some minimize this impact, noting long-known weaknesses of *Chevron* and its already diminishing impact in recent years. Others note the heavy reliance of the courts on *Chevron*, which is clearly noticeable in tax cases. The concrete question for tax law is whether (and to what extent) *Loper Bright* and associated developments will result in invalidation of Treasury Regulations.

The ongoing transfer pricing dispute between Coca Cola Co. and the IRS quickly became one of the first notable test cases that may begin to answer these questions. *Coca Cola* was a rare government win at the United States Tax Court,[7] now being appealed to the United States Eleventh Circuit. The dispute included two issues relevant to this editorial. The first was the applicability of a regulation that limited the ability of the taxpayer to claim that certain income allocated to it under normal transfer pricing analysis should not be taxable because it is *blocked* by foreign (Brazil in this case) law and hence cannot be paid to it.[8] The second involved a formulary allocation of income between Coca Cola in the United States and its subsidiary 'supply points'. The latter produced concentrates based on the famous Coca Cola secret recipes and later sold them to mainly unrelated parties who produced the final drinks from the concentrates and bottled them before selling them to the public. These supply points compensated Coca Cola using a 10-50-50 method, allocating 10% of the gross sales to the supply points and splitting the remaining profits 50:50 between the supply points and Coca Cola in the United States.

Notes

1 Scholars have already begun to extensively analyze the matter. *See* e.g., Doron Narotzki et al., *From Relic to Relevance: The Resurgence of Tariffs*, 77 U. Cal. L. J. (forthcoming, 2026).

2 *See* e.g., James M. Puckett, *Structural Tax Exceptionalism*, 49 Ga. L. Rev. 1067 (2015), doi: 10.17730/0888-4552-37.4.49; and David Weisbach, *Against Anti-tax Exceptionalism*, 77 Tax L. Rev. (2023), doi: 10.2139/ssrn.4328821.

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

4 *See* e.g., Kristin Hickman, *Counterpoint: Tax Exceptionalism from Notice-and-Comment Rulemaking Procedures Is Bad Policy and Bad Law*, 43 ABA Tax Times 25 (2024), doi: 10.2139/ssrn.4928214.

5 *Loper Bright Enterprises v. Raimondo*, 603 US 369 (2024).

6 *See* e.g., Mitchell M. Gans, *Does the End of Chevron Deference Mean a Weaker IRS?* 184 Tax Notes. Fed. 1503 (19 Aug. 2024); Amandeep S. Grewal, *Tax Regulations After Loper Bright*, 2024 Mich. St. L. Rev. – (forthcoming 2025); and Reuven S. Avi-Yonah, *Tax Delegation After Loper Bright*, 116 Tax Notes Int'l 97 (7 Oct. 2024), doi: 10.2139/ssrn.5007635.

7 Coca-Cola Co. & Subs. *v.* Commissioner, 155 T.C. 145 (2020), and T.C. Memo. 2023–135.

8 This issue was also at the heart of a related case 3M Co. *v.* Commissioner, 160 T.C. No. 3 (2023).

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The IRS accepted this formula in a closing agreement for the years 1987–1995. The 1996 closing agreement with the IRS was silent as to the transfer pricing methodology to be used for years after 1995, being solely a settlement of a dispute pertaining to earlier years. However, the agreement granted Coca-Cola *penalty protection* for the upcoming years. Coca Cola proceeded to use the 10-50-50 formula after 1995. The IRS raised its objection to the formula only when it examined Coca Cola's 2007–2009 tax returns, which are the subject of the dispute in this case.

The Tax Court sided with the IRS on the blocked income issue, following its related *3M* decision.[9] It side-stepped the question of the validity of the relevant regulation. The *3M* decision, however, explicitly upheld the regulation (albeit in a narrow 9–8 majority). The majority there relied on the Chevron deference in a weakly reasoned analysis. Such reasoning could not stand post *Loper Bright*, because the regulation at stake significantly burdens taxpayers who claim that certain income is blocked and hence is not *income. Coca Cola's appeal* is interesting since the Tax Court's reference to the regulation and its validity was not critical to the decision because Coca Cola itself engaged in circumvention of Brazilian limitations on the payments of royalties via the use of dividend distributions. It will be interesting to observe the weight given by the Court of Appeals to the mention in Coca Cola of agreement with the upholding of the blocked income regulation by the *3M* decision. It is difficult to predict the outcome of both appeals, but one should note that they were filed in different Circuits and conflicting decisions may lead to Supreme Court intervention.

The future validity or invalidations of questionable regulations is the key issue concerning US tax experts post *Loper Bright.* Coca cola is however not the right case to test this change and potentially make new law. The actions of the taxpayer made it unnecessary for the Tax Court to rely on the regulation and it could have delivered the same (correct) decision without reference to this question. This would be more difficult in the *3M* case where the majority focused on the question of the validity of the blocked income regulation.

The success of the appeal there is not, however, guaranteed. Chief Justice Roberts language in *Loper Bright* excepting explicit delegations of regulatory power require attention in this appeal.[10] §482 (the US transfer pricing statutory provision) is one of the most powerful delegation provisions in the Internal Revenue Code, vaguely stating the goal of transfer pricing (anti-abuse or clear reflection of income) in its first sentence and leaving the implementation entirely to the Treasury. It does not refer directly to regulations. The code includes however a general authority to regulate 'needful' tax regulations (§7805), a similar language too the 'when necessary' language in §482. It is unclear whether the transfer pricing regulations are protected therefore under *Loper Bright.* To make things even more complicated, the blocked income regulation is not a simple application of the arm's length standard. One could question whether the regulation is necessary. The Treasury may argue that it is because the US would not want competing jurisdictions or taxpayers to take advantage of the United States and falsely portray income as blocked. But is it necessary to limit the recognition of blocked income to generally applicable legal restrictions and to the narrow circumstances mentioned in the regulation? I do not think that it is, but it is difficult at the moment to predict the perspective taken by the Court of Appeals.

The (second) matter of the Coca Cola 10-50-50 formula caught much more of the media's attention. Various *amici Curiae* were filed in support of Coca Cola's appeal,[11] joined by various administrative and constitutional law experts decrying the abrupt change of heart of the IRS when it rejected Coca Cola's use of the said formula after agreeing to it first (in 1996) and not rejecting it before 2005. There is no question that government agencies should be clear about their positions on matters of law, and indeed governments should not arbitrarily and capriciously change course without taking all the steps required by administrative law and by simple reason. One could also question whether the IRS decisions should be given more or different deference than other agencies'. It is regrettable, however, that *Coca Cola* arose as the test case to examine the matter.

Despite the noise around the case and its monetary value (that undoubtedly contributed to this noise), *Coca Cola* is primarily a case concerning the application of the arm's length standard. It is hard to believe that anyone could successfully defend the 10-50-50 formula as compatible with the standard.[12] It is not surprising therefore that the taxpayer and its *amici* chose to focus on the actions of the IRS. Indeed, the IRS should not have ever agreed to the use of the said formula, but such agreement was only in a long-passed closing agreement. There was not prospective agreement at the time or later and no permission to rely on it prospectively as one may get in rulings of advanced pricing agreements, a procedure available but not used in this case. It is unreasonable to expect tax authorities to be bound to their past mistakes when there is no legal obligation to do so. The argument that Coca Cola reasonably expected the IRS to do so is weak too. It had legal options to secure the agreement of the IRS to it after 1996, but

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9 *3M Co. v. Commissioner*, 160 T.C. No. 3 (2023). Now on appeal to the Eighth Circuit Court of Appeals.

10 *See also* Avi-Yonah, *supra* n. 6; and Monte A. Jackel, *Supreme Court May (or May Not) Invalidate Delegations to Tax Regs*, 187 Tax Notes Fed. 165 (7 Apr. 2025).

11 *See* e.g., Alexander F. Peter, *Businesses Bemoan Broken Trust in IRS in Coca-Cola*, 117 Tax Notes Int'l 2034 (24 Mar. 2025).

12 For a more detailed analysis, *See* e.g., Ryan Finley, *In Coca-Cola, Amici Focus on Procedure and Avoid Substance*, 118 Tax Notes Int'l 67 (7 Apr. 2025).

did not use them, but, most importantly, it could not have thought that the formula used would have received further stamps of approval from the IRS. Again, one cannot predict the outcome of the appeal in this case, but one could only wish that the courts will clarify the application of administrative law rules to taxa matters in the post *Loper Bright* in other and better opportunities.

Intertax editorials do not normally engage in domestic matters, yet I thought that the discussed potential developments in US tax law may be of interest to a wide audience of readers who engage in transactions involving the United States.[13] These developments may impact the certainty that US tax advisers may provide others in some cases and hence warrant attention.

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13 Especially in transfer pricing matters. *See also* e.g., Thomas D. Bettge, Mark R. Martin & Hans Gerling, *Does Transfer Pricing Have a Loper Bright Problem?*, 117 Tax Notes Int'l 2147 (31 Mar. 2025).