Pat Smith Quoted in Tax Notes on Third Circuit Appeal of Tax Courts Decision in SIH Partners

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Ivins attorney Pat Smith was quoted in a *Tax Notes* article on the taxpayer's opening brief in the Third Circuit appeal of the Tax Court's decision in *SIH Partners* rejecting a challenge to the validity of regulations under section 956 that treat the full amount of a guarantee by a CFC of a related U.S. person's debt as an investment I U.S. property that gives rise to income to the U.S. shareholders of the CFC. *Taxpayer Balks at Challenging Tax Court's Reading of State Farm*.

> The Tax Court, comparing the facts in SIH with the seminal Supreme Court precedent in *Motor Vehicle Mfrs. Assn. of United States Inc. v. State Farm Mut. Automobile Ins. Co.,* 463 U.S. 29 (1983), found them inapposite. That comparison did not sit well with Patrick J. Smith of Ivins, Phillips, & Barker Chtd.
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> > "That direction is so wrongheaded," Smith told *Tax Notes*, adding he was surprised the taxpayer didn't focus more on the Tax Court's misreading of *State Farm* in its brief. "*State Farm* is the same kind of decision that *Chevron* is. It establishes general principles. I've never, ever seen a court opinion, apart from this one, take this approach by thinking that it's appropriate to distinguish the facts."
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> Smith argued that by making such a distinction, the Tax Court showed a lack of familiarity with the arbitrary and capricious standard.
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> While the IRS previously argued that *State Farm* is limited to changes in agency action, Smith argued this was not a fair reading of the Supreme Court decision.

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In *State Farm*, the Supreme Court rejected the contention that a revocation of a rule was subject to a different level of scrutiny than the adoption of a rule. Smith said that reasoning was clearly inconsistent with the view that the State Farm analysis was limited to changes in position.

Furthermore, in *FCC v. Fox Television Stations Inc.,* 556 U.S. 502 (2009), while a reasoned explanation for an action needs to demonstrate awareness that such a position change is occurring, the Supreme Court made clear that a change in policy does not require "a more searching review." *Fox Television* was not cited in the appellant's brief.

Smith contrasted the rationale in *SIH* with the Tax Court's unanimous decision in *Altera*, which he found to be an excellent examination of administrative law. The "large step backwards" in *SIH* follows a similarly disappointing opinion from the Tax Court in *Good Fortune Shipping SA v. Commissioner*, 148 T.C. No. 10 (2017), he argued.

While he found the argument convincing, Smith told *Tax Notes* he was surprised the brief didn't address the position more fully. Smith also said he was disappointed that the brief failed to cite *SEC v. Chenery Corp*., 318 U.S. 80 (1943), for the "universally understood" administrative law concept that an agency's action needs to be judged on its rationale presented then.

> "Obviously, to apply that standard, the reviewing court needs to know what that rationale was. You can't possibly judge whether an agency action should be upheld based on the rationale an agency used when the agency didn't express the rationale," Smith said.

Smith took the Tax Court to task over its acceptance that the explanation in the regs was adequate.

> "It's the same kind of inadequate explanation that the D.C. Circuit in *Good Fortune Shipping* said correctly won't do and isn't good enough," Smith said. "That's just completing the circle on what's wrong with the Tax Court's analysis. It's far too deferential."