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In this article, Campolieta and Coravos argue that regulations limiting the reasonable cause defense for information reporting penalties may be invalid under *Loper Bright*, and they explain why the traditional all-facts-and-circumstances approach to reasonable cause should prevail.

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We are all constitutional lawyers now. That takes some getting used to, especially for tax lawyers who grew up in the shadow of *Chevron*¹ and made a living mastering the intricacies of regulations whose constitutional validity may, in

¹ *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984).

hindsight, be dubious. But there's no turning back. As the Supreme Court articulated in *Loper Bright*,² a court's role is — and always has been — to find the best reading of the statute, not to defer to agency rulemakers. At first, it looked like the Tax Court recognized this change and embraced it with gusto.³ In *Varian* and in other cases, the Tax Court asked *sua sponte* for briefing on the impact of *Loper Bright*.⁴ And the Tax Court has been willing to consider *Loper Bright*'s impact on recently decided cases.⁵ But in still other cases, it seems like the Tax Court has forgotten about the issue (although, to be fair, this is likely because the parties don't always raise it).

That is what happened recently when the Tax Court issued its memorandum opinion in *Dealers Auto*.⁶ The taxpayer, a car dealership, was penalized under sections 6721 and 6722 for not reporting cash payments from its customers. In response to IRS collection efforts, the dealership asserted a reasonable cause defense under section 6724 — in this case, a “dog ate my homework” strategy, blaming the failures on its software. Predictably, the Tax Court rejected that argument largely because of a lack of proof, which is unfortunate because the dealership agreed to submit the case on stipulated facts under Tax Court Rule 122. But importantly, in rejecting the dealership's reasonable cause defense, the Tax Court applied regulatory factors that appear

² *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024).

³ See *Varian Medical Systems v. Commissioner*, 163 T.C. No. 4 (2024).

⁴ See Order, *Varian*, No. 8435-23 (T.C. June 28, 2024); see also Order, *Oliver Inge Trust v. Commissioner*, No. 12515-22 (T.C. July 22, 2024); *Sysco Corp. v. Commissioner*, No. 5728-23 (T.C. June 28, 2024).

⁵ See Order, *YA Global Investments LP v. Commissioner*, Nos. 14546-15 and 28751-15 (T.C. Aug. 27, 2024).

⁶ *Dealers Auto Auction of Southwest LLC v. Commissioner*, T.C. Memo. 2025-38.

nowhere in the statutory language of section 6724. Does *Loper Bright* permit that approach?

Reasonable Cause and Good Faith Defense

Before we answer that question, some context is helpful. Section 6664 is the general reasonable cause and good faith defense. It's a "get out of jail free" card for the section 6662 accuracy-related penalties and the section 6663 fraud penalty. But it also serves as the model for other statutory penalty defenses.⁷ Subject to certain exceptions and special rules not relevant here, section 6664(c) generally provides, "No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion." That's it. The statute doesn't elaborate on what the terms "reasonable cause" and "good faith" mean.⁸

Fortunately, the courts — fulfilling their constitutional role of interpreting statutes — have decided legions of cases interpreting these statutory phrases, and Treasury has published regulations that set forth the agency's interpretation (although without an express delegation of authority in either section 6664 or section 6662). Typically, reasonable cause requires a taxpayer to exercise "ordinary business care and prudence" regarding the challenged item.⁹ The inquiry is inherently fact-intensive, and the facts

and circumstances must be judged on a case-by-case basis.¹⁰ Although the regulations look at all relevant facts and circumstances, the most important factor is the taxpayer's effort to assess its proper tax liability.¹¹ Other circumstances that may indicate reasonable cause include an honest misunderstanding of fact or law that is reasonable in light of all the facts and circumstances, including the experience, knowledge, and education of the taxpayer, and the complexity of the tax issue.¹² An isolated computational error is also generally consistent with reasonable cause.¹³

Likewise, reliance on an information return or professional tax advice can demonstrate reasonable cause depending on the facts and circumstances.¹⁴ However, reasonable cause is not indicated by mere reliance on facts that, unbeknownst to the taxpayer, are incorrect.¹⁵ In short, the standard reasonable cause defense under section 6664(c) is an all-facts-and-circumstances test. But that standard doesn't apply for information reporting penalties, at least as far as Treasury is concerned.

Defense to Information Reporting Penalties

The penalties at issue in *Dealers Auto* were imposed for failure to file and furnish proper information returns (sections 6721 and 6722, respectively) upon receipt of cash payments. Those penalties have their own reasonable cause defense under section 6724, which provides: "No penalty shall be imposed under this part with respect to any failure if it is shown that such

⁷ Compare section 6664(c) (providing that section 6662 accuracy-related and section 6663 fraud penalties may not be imposed if the taxpayer had reasonable cause and good faith) with section 6651 (penalizing the failure to file federal income tax returns and to pay the amount shown or required to be shown on tax returns, unless those failures are attributable to reasonable cause and not willful neglect), section 6652 (penalizing failure to file certain information returns and registration statements, unless those failures are attributable to reasonable cause and not willful neglect), section 6724 (similar), and section 6656 (penalizing the failure to make a deposit of taxes, unless that failure is attributable to reasonable cause and not willful neglect).

⁸ Interestingly enough, the statute elaborates on what it means to have a "reasonable belief" regarding the tax treatment of an item that is attributable to a reportable transaction (see section 6664(d)(4)), but it provides no gloss on what it means to have reasonable cause and good faith.

⁹ See, e.g., *United States v. Boyle*, 469 U.S. 241, 243 (1985) (noting decades of cases interpreting and applying this phrase and the attendant regulations); reg. sections 1.6664-4 (accuracy-related penalties); 301.6651-1(c)(1) (failure to file/pay penalties); and 391.6724-1 (information return penalties).

¹⁰ Reg. section 1.6664-4(b)(1); see also *Crimi v. Commissioner*, T.C. Memo. 2013-51 (evaluating reasonable cause for failure to comply with procedural requirements for charitable contributions under section 170).

¹¹ See reg. section 1.6664-4(b)(1). Reasonable cause is also defined in reg. sections 301.6651-1(c) and 301.6652-1(f), which both look to all the facts and circumstances, but it is not defined in the regulations interpreting section 6656.

¹² Reg. section 1.6664-4(b)(1).

¹³ *Id.*

¹⁴ *Id.* The regulations provide additional guidance for when a taxpayer's reliance on the advice of a professional, such as a CPA or tax attorney, may constitute reasonable cause and good faith. Reg. section 1.6664-4(c)(1). Although all the facts and circumstances matter, to qualify for relief, the taxpayer must demonstrate that they (1) reasonably believed the professional was a competent tax adviser with sufficient expertise to justify reliance, (2) provided necessary and accurate information to the advising professional, and (3) actually relied in good faith on the professional's advice. *Id.* See also *Neonatology Associates PA v. Commissioner*, 115 T.C. 43, 98-99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

¹⁵ Reg. section 1.6664-4(b)(1).

failure is due to reasonable cause and not to willful neglect.”¹⁶ While section 6724 has many definitions and special rules, like section 6664, it doesn’t define or elaborate on the statutory phrases “reasonable cause” and “willful neglect.”¹⁷ Nature abhors a vacuum, so Treasury stepped in to fill it by publishing regulations that limit the scope of the reasonable cause defense for information reporting penalties. Therein lies the problem, as we explain below.

Reg. section 301.6724-1, titled “Reasonable Cause,” provides for a waiver of the information reporting penalty if the taxpayer (aka filer) establishes its failure is “due to reasonable cause and is not due to willful neglect.”¹⁸ So far, so good. But unlike the statute, the regulation goes on to define — and impermissibly limit — that defense.¹⁹ According to the regulations, reasonable cause for information reporting penalties is not an all-facts-and-circumstances test as it is under section 6664. Instead, the defense is available only if the filer establishes that (1) either there are “significant mitigating factors” for each failure or (2) “the failure arose from events beyond the filer’s control (impediment)”²⁰ and that (3) it “acted in a responsible manner . . . both before and after the failure occurred.”²¹ The regulations elaborate on each of these three conditions precedent for a reasonable cause penalty waiver.²² In sum, the taxpayer must not only establish reasonable cause for its failure to file or furnish (or both) but also show that there were significant mitigating factors, that the failure was beyond its control, and that it acted in a responsible manner before and after the failure. Of course, none of those regulatory requirements

are in the statutory language of section 6724. So are these regulations valid under *Loper Bright*?

What’s the Best Reading of Section 6724?

In *Loper Bright*, the Supreme Court held that courts must “exercise independent judgment in determining the meaning of statutory provisions.”²³ For four decades, courts had assumed that agencies were authorized to fill the gaps created by any ambiguity in statutory text. But that was incorrect, according to *Loper Bright*. The Supreme Court explained that an ambiguity doesn’t necessarily reflect “a congressional intent that an agency, as opposed to a court, resolve the resulting interpretative question.” In fact, it noted, courts “routinely confront statutory ambiguities.”²⁴ Now the only question before a court is whether the statute authorizes the disputed agency action.²⁵ To answer that question, courts may use any tool at their disposal, but they may not simply “declar[e] a particular party’s reading permissible,” the Supreme Court said.²⁶

As noted, 6724 provides a reasonable cause defense for taxpayers that fail to file and furnish information returns and are therefore subject to penalties under 6721 and 6722. However, the statute doesn’t define reasonable cause, nor does it contain an express delegation of authority for Treasury to prescribe regulations interpreting reasonable cause. So using traditional tools of statutory construction, what’s the best reading of section 6724?

The phrase “reasonable cause” is used throughout the Internal Revenue Code and has a settled meaning: It requires ordinary care and prudence, which is determined based on all the facts and circumstances. No court has ever held that reasonable cause relief is available “only if” taxpayers can establish that there were significant mitigating factors or events beyond their control and that they behaved reasonably before and after the failures. To be sure, those factors might be considered in a reasonable cause analysis, but they are not conditions precedent to granting

¹⁶ Section 6724(a).

¹⁷ See, e.g., section 6724(c) (providing special rules for magnetic media) and 6724(d) (defining the terms “information returns,” “payee statement,” “specified information reporting requirement,” and “required filing date”).

¹⁸ Reg. section 301.6724-1(a).

¹⁹ Although the regulation claims to have “defined” reasonable cause for purposes of waiving information reporting penalties, it does not actually define what reasonable cause means. Rather, it limits the circumstances in which it applies. For instance, the regulation does not say “reasonable cause is defined as X” but rather says, “The penalty is waived for reasonable cause *only if* . . .”

²⁰ Reg. section 301.6724-1(a)(2)(i) and (ii).

²¹ Reg. section 301.6724-1(a)(2)(iii).

²² See reg. section 301.6724-1(b) (significant mitigating factors), -1(c) (events beyond the filers control), and -1(d) (responsible manner).

²³ *Loper Bright*, 603 U.S. at 387.

²⁴ *Id.* at 399-400.

²⁵ *Id.* at 406.

²⁶ *Id.*

penalty relief. That's where reg. section 301.6724-1 goes beyond the statute, and that's why it should be set aside.

Can Section 7805(a) Save the Regulations?

In *Loper Bright*, the Supreme Court acknowledged that the best reading of a statute may be that "it delegates discretionary authority to an agency."²⁷ And in those cases, the courts must let the agency exercise its discretion, so long as it stays within the boundaries set by Congress.²⁸ Here, however, there is no express delegation of authority to prescribe regulations defining reasonable cause under section 6724. So Treasury's decision to limit the availability of the reasonable cause defense in reg. section 301.6724-1 to only those taxpayers that can satisfy three additional conditions (beyond the general reasonable cause defense) is arguably invalid unless it falls under the protection of section 7805(a)'s general delegation of authority to "prescribe all needful rules and regulations for the enforcement" of the code.

The text of section 7805 is best read not as authorizing Treasury to make substantive rules but rather as giving Treasury leeway to establish any procedural rules necessary to put the code into force. Indeed, for decades after the enactment of section 7805, courts presumed that it did not give Treasury authority to interpret the code, and Congress continued to specify when it did want Treasury to define terms or otherwise fill gaps.

²⁷ *Id.* at 395.

²⁸ *Id.*

Further, *Loper Bright* indicates that general rulemaking provisions, such as section 7805, do not authorize an agency to define the terms of the statute. *Loper Bright* itself involved a rulemaking provision much like section 7805, and the Court declined to suggest that this provision sufficed. To the contrary, the examples of delegations the Court referenced clearly define the terms or circumstances of an agency's authority. *Loper Bright* thus reinforces a reading of section 7805 as focused on procedure, not substantive gap filling.

The problem is that reg. section 301.6724-1 is not just a procedural regulation; it is substantive. The regulation creates (at least) three additional barriers that taxpayers must clear for reasonable cause relief. Those barriers appear nowhere in section 6724, section 6664, or the case law interpreting the statutory phrase "reasonable cause." Treasury needed a substantive delegation of authority from Congress to upend — and significantly limit — the well-settled interpretation of the reasonable cause defense as an all-facts-and-circumstances test without conditions precedent. Section 7805's general grant of authority to proscribe needful enforcement rules cannot support that weight.

In sum, these regulations are not a valid exercise of a statutory delegation of authority to Treasury and should carry no weight. Moreover, they conflict with the plain language of the statute and with decades of judicial precedent that look to all the facts and circumstances. That said, on the facts in *Dealers Auto*, taxpayers may still lose. But it should not be because the regulations compel that result. ■