The Fast-Changing Landscape for APA Challenges to Tax Regulations

Pat Smith, Ivins, Phillips & Barker
Jud Judkins, Baker & McKenzie
January 10, 2018

DC BAR Communities
CONNECT • COLLABORATE • CONTRIBUTE

Overview

1. *Chamber v. IRS*, No. 1:16-cv-00944 (W.D. Tex. Sept. 29, 2017): The regulations at issue and the background of the case
2. The Anti-Injunction Act ("AIA")
   A. Judicial interpretation of the AIA
   B. Direct Marketing v. Brohl
   C. Post-*Direct Marketing* decisions
   D. The AIA in the *Chamber* opinion
3. The APA Challenge to the Anti-Inversion Rules
   A. The intersection of the APA's notice-and-comment rulemaking requirements and I.R.C. § 7805(b)
   B. The Interpretive-Rule Exception

Background of *Chamber v. IRS*

- Corporate Inversions and the Enactment of I.R.C. § 7874
  - Section 7874 recharacterizes new foreign-parented corp. as domestic entity and imposes a corporate-level tax on inversion gain under certain circumstances
  - Percentage test for foreign and domestic ownership
  - Rulemaking authority: I.R.C. § 7874(g)
- Intended merger of Pfizer and Allergan in Nov. 2015
  - Allergan's prior acquisition of U.S. corporations
  - Treasury's Multiple-Acquisition Rule (issued as an immediately effective temporary rule in April 2016)
- Chamber sued in W.D. Texas in August 2016
  - Chamber alleged APA violations
  - Government argued suit barred by AIA and lack of standing

Scope of the AIA before *Direct Marketing*

- *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967), held "pre-enforcement" challenges to the validity of regulations issued by federal agencies are authorized by the APA.
- The Anti-Injunction Act ("AIA"), section 7421(a) of the Internal Revenue Code, provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."
- *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962): "The manifest purpose of § 7421(a) is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund. In this manner the United States is assured of prompt collection of its lawful revenue."
- *Williams Packing* also held that the only exception to the application of the AIA was where "it is clear that under no circumstances could the Government ultimately prevail" on the merits. *Id.* at 7. This standard is so stringent that it is essentially impossible to meet.
- *Bob Jones University v. Simon*, 416 U.S. 725 (1974), and *Alexander v. "Americans United" Inc.,* 416 U.S. 752 (1974) held the AIA barred suits challenging the IRS's revocation of an organization's tax-exempt status, in part because these suits sought to provide "advance assurance" to contributors to such organizations that their future contributions would be tax-deductible.

Scope of the AIA before *Direct Marketing*

- Most cases dealing with the AIA after *Bob Jones* and *"Americans United"* and before *Direct Marketing* involved situations where the IRS was already investigating the past tax liability of the plaintiffs in the suit where the AIA was applied at the time the suit was brought, and where the goal of the suit was to stop the investigation or to prevent the IRS from using particular investigatory procedures.
- A frequently quoted example of this type of case was *United States v. Dema*, 544 F.2d 1373, 1376 (7th Cir. 1976): "It is also clear that this ban against judicial interference is applicable not only to the assessment or collection itself, but is equally applicable to activities which are intended to or may culminate in the assessment or collection of taxes."
- A few cases, however, applied the AIA to bar pre-enforcement challenges to tax regulations or revenue rulings: *Foodservice & Lodging Institute, Inc. v. Regan*, 809 F.2d 842 (D.C. Cir. 1987) (regulations); *Investment Annuity, Inc. v. Blumenthal*, 609 F.2d 1 (D.C. Cir. 1979) (revenue ruling).

Scope of the AIA before *Direct Marketing*

- In *South Carolina v. Regan*, 465 U.S. 367 (1984), the Supreme Court established a second exception to the applicability of the AIA, for cases where the plaintiff has no alternative way of challenging an adverse tax result in court.
- *Hibbs v. Winn*, 542 U.S. 88 (2004), was an important precursor to *Direct Marketing*, dealing with the Tax Injunction Act, 28 U.S.C. § 1341, which imposes limitations on suits in federal district court relating to state taxes that are similar to the AIA's limitations on suits in federal district court relating to federal taxes. This case rejected a broad interpretation of the scope of the TIA and held it did not bar a suit challenging state tax benefits provided to other parties.
- *Cohen v. United States*, 650 F.3d 717 (D.C. Cir. 2011) (*en banc*), dealt with the AIA and rejected the government position that the AIA bars any and all suits relating in any way to federal taxes, holding the AIA did not bar a suit challenging IRS procedures for refunding a tax that had been illegally collected.
- *NFIB v. Sebelius*, 132 S. Ct. 2566 (2012), held the penalty for failure to comply with the individual mandate in the Affordable Care Act was not a "tax" for purposes of the AIA.
- *Seven-Sky v. Holder*, 661 F.3d 1 (D.C. Cir. 2011). D.C. Circuit decision on the same issues subsequently decided by the Supreme Court in *NFIB v. Sebelius*. Applied the same reasoning as the Supreme Court as to why the AIA did not bar the challenge to the individual mandate, but also said the AIA did not apply because the suit challenged the requirement imposed by the ACA rather than the penalty that was imposed on non-compliance.

Direct Marketing Ass'n v. Brohl, 135 S. Ct. 124 (2015)

- Colorado's information-return requirement and Direct Marketing's suit
- The Tax Injunction Act: "The district courts shall not enjoin, suspend, or restrain the assessment, levy, or collection of any tax under State law."
- The TIA "was modeled on the [AIA]" and "words used in both Acts are generally used in the same way."
- "[R]estrain" means to "stop[]" not to "merely inhibit[]."

Cases involving the AIA after *Direct Marketing Ass'n* (other than *Chamber v. IRS*)

- *Z Street v. Koskinen*, 791 F.3d 24 (D.C. Cir. 2015). In dictum, the court noted that its rejection of the government's broad reading of the scope of the AIA was supported by *Direct Marketing*.
- *Florida Bankers Association v. Department of the Treasury*, 799 F.3d 1065 (D.C. Cir. 2015). Applied the broad view of the scope of the AIA that was prevalent before *Direct Marketing* and essentially ignored the issue of what effect the reasoning in *Direct Marketing* might have on the interpretation of the scope of the AIA.
- *Green Solution Retail, Inc. v. United States*, 855 F.3d 1111 (10th Cir. 2017). Concluded that *Direct Marketing* was not sufficiently inconsistent with a Tenth Circuit holding from 1987 to the effect that the AIA prohibits suits challenging activities leading up to and culminating in assessment and collection to justify a conclusion that this circuit precedent had been implicitly overruled.
- *Maze v. IRS*, 862 F.3d 1087 (D.C. Cir. 2017). Even assuming that restrain means to stop, the AIA barred plaintiffs' suit to directly enter the Streamlined Procedures because the IRS would be stopped from collecting accuracy-related penalties.
- *CIC Services, LLC v. IRS*, No. 3:17-cv-110 (E.D. Tenn. Nov. 2, 2017). Applied *Florida Bankers* to conclude that a challenge to a notice imposing information reporting requirements was barred by the AIA.

Chamber v. IRS holding on the AIA

- Analysis based on *Direct Marketing*
- "Assessment and collection of taxes does not include all activities that may improve the government's ability to assess and collect taxes."
- The Chamber did not seek to restrain assessment or collection but instead "challenge[d] the validity of the Rule so that a reasoned decision can be made about whether to engage in a potential future transaction that would subject them to taxation under the Rule."
- Rule is "not a tax" but rather "a regulation determining who is subject to taxation. . . ."
- Enforcement of the Rule precedes assessment or collection of taxes.

Chamber v. IRS holding on the status of IRS temporary regulations

- Section 7805(e) of the Internal Revenue Code provides that any temporary regulation that is issued by the IRS and Treasury must also be issued as a proposed regulation, and that any temporary regulation that is issued must expire within three years after it was issued.
- District court in *Chamber v. IRS* rejected the long-standing IRS position that these references to temporary regulations in section 7805(e) have the effect of exempting temporary regulations from the APA notice-and-comment rulemaking requirements.

Chamber v. IRS holding on the APA's interpretive-rule exception

- The abandoned tax-law distinction between legislative and interpretive rules.
- The APA's distinction: legislative rules impose some legal duty or create some legal right whereas interpretive rules merely state what the agency thinks the statute means.
- Interpretive rules are excepted from the APA's notice-and-comment rulemaking requirements.
- The Government contended that the Rule merely clarified terms in the statute and advised the public about how Treasury construes the statute.
- The Rule "changes the computation for determining whether a corporation shall be treated as a surrogate foreign corporation by directing that certain stock that would otherwise be included in the calculation is excluded."

Conclusion

- The Government's appeal to the Fifth Circuit
- Litigation in other circuit courts
- Questions?

DC BAR Communities
CONNECT • COLLABORATE • CONTRIBUTE