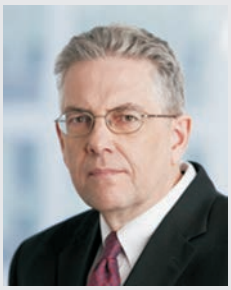
Challenges to Tax Regulations: The APA and the Anti-Injunction Act

By Patrick J. Smith


Patrick J. Smith

Patrick J. Smith is a partner at Ivins, Phillips & Barker in Washington.

In this report, Smith focuses on post-*Mayo* tax regulation challenges under the direct review provisions of the Administrative Procedure Act (APA). He examines how those cases overcame the procedural hurdle traditionally presented by the Anti-Injunction Act and argues that in light of the Supreme Court's recent decision in *Direct Marketing Association*, the Anti-Injunction Act will likely pose much less of an obstacle to future direct APA challenges to tax regulations.

Table of Contents

I. Introduction

Traditionally, taxpayers have sometimes challenged the validity of tax regulations in litigation and have sometimes prevailed. Nevertheless, litigation on the validity of tax regulations traditionally has not been nearly as common as it has on regulations issued by federal agencies other than the IRS.[1] Instead, when a particular regulation produces results a taxpayer doesn't like, the taxpayer usually responds either by avoiding transactions that would give the IRS a basis for applying the regulation to the taxpayer or by developing technical arguments for why the regulation doesn't apply to the taxpayer's situation.

In the past several years, however, challenges to the validity of tax regulations have become more common, and there have been several significant taxpayer victories. It seems likely that both trends will continue.

The Supreme Court's 2011 decision in *Mayo Foundation v. United States*[2] can be seen as a turning point that marked the beginning of these trends, which may seem surprising. When *Mayo* was decided, most people in the tax world saw it as negative for taxpayers,[3] not only because the taxpayer in *Mayo* lost, but also because *Mayo* established a more demanding test for challenging the validity of IRS regulations than was previously applied.[4]

That new test was the two-step *Chevron*[5] test, established by the Supreme Court in 1984. That test

[1]Kristin E. Hickman, "A Problem of Remedy: Responding to Treasury's (Lack of) Compliance With Administrative Procedure Act Rulemaking Requirements," 76 *Geo. Wash. L. Rev.* 1153 (2008). Hickman noted that litigated challenges to IRS regulations based on alleged violations of the Administrative Procedure Act notice-and-comment requirements have not been nearly as common as similar challenges to regulations issued by other agencies. Many of the reasons Hickman identifies for the relative infrequency of those challenges also apply to challenges to regs *on any ground*.

[2]*Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011).

[3]A few months after the case was decided, I wrote that this negative view was misguided for the same reasons discussed here: Patrick J. Smith, "Life After *Mayo*: Silver Linings," *Tax Notes*, June 20, 2011, p. 1251.

[4]While there was debate about whether *Chevron* might apply in tax cases before *Mayo*, either most tax professionals had never heard of *Chevron* before *Mayo* or they believed *Chevron* did not apply to tax regulations. The prevailing view before *Mayo* was that challenges to tax regulations were evaluated under a tax-specific test established in *National Muffler Dealers Association v. United States*, 440 U.S. 472 (1979).

[5]*Chevron USA Inc. v. Natural Research Defense Council Inc.*, 467 U.S. 837 (1984). Under the *Chevron* two-step test, the first step requires asking whether the statute related to the challenged regulation provides a clear answer to the litigated issue that the regulation addresses. *Chevron* clarified that to answer this question, it is necessary to apply "traditional tools of statutory construction." If the court concludes that the statute does not

(Footnote continued on next page.)

clearly had applied for evaluating the validity of regulations issued by all federal agencies other than the IRS. In holding that *Chevron* applies to tax regulations, *Mayo* announced the general principle that challenges to the validity of IRS actions are subject to the same principles and rules of administrative law regarding judicial review of agency action that apply to all federal agencies. That general principle has energized the challenges to IRS regulations since *Mayo*.

Before *Mayo*, there was a tendency to think that tax was special or different from other areas of federal law. Thus, those in the tax world seldom thought it was necessary, relevant, or helpful to look at other federal laws in making arguments about what the right outcome should be in tax cases. That perspective was called "tax exceptionalism,"[6] or "tax myopia,"[7] depending on whether you thought it was correct. Now, however, nearly everyone in the tax world agrees that *Mayo* was at least the beginning of the end for tax exceptionalism.

Before *Mayo*, some important general principles of administrative law were seldom — or never — used to challenge IRS regulations or other actions. However, since *Mayo*, much of the significant litigation challenging IRS regulations has applied those principles for the first time or, if not for the first time, in a much more sustained way.

Apart from the application of *Chevron*, the most obvious consequence of *Mayo's* holding — that the IRS is subject to the same administrative law rules regarding judicial review of agency action that apply to all other federal agencies — is the conclusion that the Administrative Procedure Act (APA) rules concerning judicial review of agency action apply to litigation regarding IRS action. The APA was enacted in 1946 as a response to the substantial growth of federal agencies in the 1930s and during World War II.

The APA has two main sets of broadly applicable rules. One set establishes notice-and-comment procedures that agencies must use in adopting regulations.[8] Even before *Mayo*, the notice-and-comment rules had been identified as a tool for taxpayers to use in challenging tax regulations.[9] This report does not explore that set of rules.

The other set of APA rules relates to judicial review of agency action.[10] The judicial review provisions include two that are particularly relevant for challenges to tax regulations. One is the arbitrary and capricious standard of review that applies when a court reviews any action taken by a federal agency, including the issuance of regulations.[11] I have discussed the arbitrary and capricious standard extensively in prior articles and will not repeat that discussion here.[12]

The other relevant judicial review provision is the right for a "person suffering legal wrong because of agency action" to receive judicial review of that agency action.[13] That right applies not only for "agency action [that is] made reviewable by statute" but also for any other "final agency action for which there is no other adequate remedy in a court."[14] This gives parties who would be adversely affected by agency regulations the right to challenge those regulations in court as soon as the regulations have been issued, without needing to wait until the agency seeks to apply the regulations to the affected party.[15] This report focuses on that aspect of the APA.

Before *Mayo*, there were few cases in which challenges to IRS action had been brought under the APA's direct review provisions.[16] One likely reason for the lack of such cases is section 7421(a), generally referred to as the Anti-Injunction Act, which provides (with specified exceptions) that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person." The Anti-Injunction Act has

---

provide a clear answer, then under the second step the court must accept the agency's interpretation, provided it is reasonable, even though the court may believe it is not the best interpretation.

[6]*See, e.g.*, Hickman, "The Need for *Mead*: Rejecting Tax Exceptionalism in Judicial Deference," 90 *Minn. L. Rev.* 1537 (2009).

[7]*See* Paul L. Caron, "Tax Myopia, or Mamas Don't Let Your Babies Grow Up to Be Tax Lawyers," 13 *Va. Tax Rev.* 517 (1994).

[8]5 U.S.C. section 553.

[9]*See, e.g.*, Hickman, "Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance With Administrative Procedure Act Rulemaking Requirements," 82 *Notre Dame L. Rev.* 1727 (2007).

[10]5 U.S.C. sections 701-706.

[11]5 U.S.C. section 706(2)(A). "In all cases agency action must be set aside if the action was 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.'" *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 413-414 (1971).

[12]*See* Smith, "The APA's Arbitrary and Capricious Standard and IRS Regulations," *Tax Notes*, July 16, 2012, p. 271; Smith, "The APA's Reasoned-Explanation Rule and IRS Deficiency Notices," *Tax Notes*, Jan. 16, 2012, p. 331; and Smith, "*Mannella*, *State Farm*, and the Arbitrary and Capricious Standard," *Tax Notes*, Apr. 25, 2011, p. 387; *see also* Steve R. Johnson, "Reasoned Explanation and IRS Adjudication," 63 *Duke L. J.* 1771 (2014); and Johnson, "Using Administrative Law to Challenge IRS Determinations," *Fla. B.J.*, June 2014, at 81.

[13]5 U.S.C. section 702.

[14]5 U.S.C. section 704.

[15]*See, e.g.*, *Abbott Labs. v. Gardner*, 387 U.S. 136, 139-141 (1967).

[16]*See, e.g.*, *Foodservice and Lodging Institute Inc. v. Regan*, 809 F.2d 842 (D.C. Cir. 1987).

been viewed traditionally as an obstacle to using the APA's direct review provisions as a route for challenging tax regulations.

Since *Mayo*, however, most cases challenging tax regulations have taken the form of direct challenges brought under the APA judicial review provisions. In most of those challenges, the parties challenging the tax regulations have been able to avoid the obstacle presented by the Anti-Injunction Act in one way or another. In many, the challenges have also succeeded on the merits. There is good reason to believe that future cases may hold that the Anti-Injunction Act presents less of an obstacle to direct court challenges of tax regulations than traditionally has been thought.

This report focuses on the challenges to tax regulations since *Mayo* that have been brought or decided under the APA's direct review provisions and how these challenges have avoided the AIA obstacle. It also focuses on the strong likelihood that recent developments regarding the application and interpretation of the Anti-Injunction Act will make it less of an obstacle to direct challenges to the validity of tax regulations than has been thought for the past 50 years. The clearest and strongest signal pointing in that direction is the Supreme Court's recent decision in *Direct Marketing*,[17] which interpreted a statutory provision that is similar to the Anti-Injunction Act in a narrow way, making it more likely that the Anti-Injunction Act will be interpreted more narrowly now.

II. Timing of Challenges to IRS Regulations

What made *Mayo* important and favorable for taxpayers was that it clarified that the IRS is subject to the same principles and rules of administrative law regarding judicial review of agency action that apply to all other federal agencies. Apart from *Chevron*, the most important source of administrative law rules relating to judicial review of agency action is the APA.

One aspect of the APA judicial review provisions that could have an important effect in tax cases is the arbitrary and capricious standard. Another significant consequence of applying the APA to tax regulation challenges — and one of the most significant developments in those challenges since *Mayo* — is that the APA's judicial review provisions allowing direct challenges to agency action in U.S. district court may have a significant effect on the timing of taxpayer court challenges.

Traditionally, taxpayers have believed that challenges to the validity of tax regulations must be litigated the same way all other tax issues have been litigated. The traditional way to litigate tax issues, including the validity of tax regulations, is either for the taxpayer to pay the tax relating to the issue that is in dispute after receiving a deficiency notice from the IRS and then file suit for a refund of the tax or for the taxpayer to petition the Tax Court to review the IRS notice of deficiency.

In contrast, outside the tax world, the standard way to challenge the validity of a regulation issued by a federal agency is to file a lawsuit directly challenging the regulation's validity immediately after it is first issued, without waiting for the agency to apply the regulation to the party making the challenge. For federal agencies other than the IRS, the statute authorizing the agency to issue regulations typically provides that a lawsuit challenging the validity of any regulation may be filed within a relatively short period immediately after it is issued, without the need for the agency to apply the regulation to the taxpayer before the challenge can be made. These statutory provisions specifically authorizing direct challenges ordinarily provide that these challenges are to be brought in the U.S. Court of Appeals.[18]

However, if the governing substantive statute that authorizes the agency to issue regulations does not include a provision specifically authorizing lawsuits to challenge that agency's regulations, a lawsuit to challenge a regulation may be brought in district court purely on the basis that the regulation has been issued and will adversely affect the party making the challenge before the regulation has actually been applied. These direct district court challenges are authorized by the APA.[19] This authorization of direct challenges in district court before the agency applies the regulation is the second aspect of the APA, in addition to the arbitrary and capricious standard, that is potentially important in tax cases.

However, in tax cases, it has been thought that direct challenges to the validity of tax regulations, before the IRS has applied the regulation to the taxpayer making the challenge, are barred by the Anti-Injunction Act, which 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." This provision has been the basis for the traditional thinking that tax regulations can be challenged only in the traditional types

[17] *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015).

[18] *See* Smith, "May Regulations That Violate the APA Be Remanded to the IRS?" *Tax Notes*, Oct. 7, 2013, p. 84 (including citations providing examples of statutory provisions authorizing judicial review of agency regulations in the courts of appeals).

[19] *Abbott Labs. v. Gardner*, 387 U.S. 136 (1967).

of tax litigation — refund suits and deficiency actions in the Tax Court — and not through direct actions brought in district court under the APA before the IRS has actually applied the regulation to the taxpayer.

However, several cases since *Mayo* have involved direct challenges to tax regulations that were brought in district court under the APA before the regulations had been applied to the taxpayers. In nearly all those cases, the taxpayers making the challenges have overcome the Anti-Injunction Act obstacle to direct challenges to tax regulations.

As discussed below, while some of these cases have involved special circumstances regarding the applicability of the Anti-Injunction Act that will not be easy to duplicate for most tax regulations challenges, some of those cases either do not involve those special circumstances or contain reasoning suggesting that it may be more possible in the future to avoid the Anti-Injunction Act obstacle to direct challenges to tax regulations. Also, the Supreme Court's recent decision in *Direct Marketing* strongly supports the conclusion that the Anti-Injunction Act will be applied more narrowly now than it has been for the past 50 years.

The ability to challenge tax regulations immediately after they have been issued — without waiting for the regulations to be applied to the taxpayer — has at least two significant advantages compared with the traditional route.

The first advantage is that the taxpayer can obtain a judicial resolution of the challenge's merits much sooner than would be possible under the traditional methods for challenging tax regulations. The traditional necessity of the regulation first being applied by the IRS before the challenge can take place would ordinarily delay, by at least several years, when the taxpayer could receive a definitive judicial resolution of the challenge's merits, compared with when resolution could be achieved with a direct challenge.

The second significant advantage of challenging a tax regulation immediately after it is issued involves the potentially adverse consequences for the taxpayer, if the challenge is unsuccessful, resulting from the steps required to challenge a tax regulation under the traditional route. To challenge a tax regulation in the traditional manner, the taxpayer must first engage in a transaction that makes the regulation apply to the taxpayer. The taxpayer then has two options. He can file his return based on applying the regulation to that transaction and then file a lawsuit for a refund of the tax. Or he can file his return disputing the validity of the regulation, expecting to have the return position challenged by the IRS in a deficiency notice, and then challenge either through a Tax Court petition or by paying the disputed amount and filing a refund suit.

If a taxpayer followed the traditional route for challenging a tax regulation and failed, the taxpayer would face the adverse consequences of engaging in a transaction that made the regulation applicable. If the taxpayer had not challenged the regulation, the taxpayer might have engaged in alternative transactions to which the regulation clearly would not have applied, avoiding the adverse consequences. While those alternative transactions would not have produced tax results as favorable for the taxpayer as he would have had with a successful challenge, the alternative transaction route would be far better than the tax results of a failed challenge. Thus, by challenging the regulation and failing, the taxpayer would be in a worse position than if he had accepted the regulation and engaged in alternative transactions to which the regulations would not have applied.

This aspect of the traditional route for challenging tax regulations may be one important reason why traditionally there have been relatively few challenges to tax regulations. Thus, to the extent the APA makes it possible for a taxpayer to file suit challenging a tax regulation without the challenger first having to engage in a transaction to which the regulation would apply, challenging a tax regulation directly under the APA is preferable to the traditional method.

However, since the 1962 Supreme Court decision in *Williams Packing*[20] and two 1974 Supreme Court decisions, courts have interpreted the Anti-Injunction Act broadly, applying it whenever a successful lawsuit by a taxpayer relating to taxes would adversely affect the collection of tax revenue.[21] Nevertheless, as discussed below, this broad interpretation is likely to change, particularly because of the Supreme Court's recent decision in *Direct Marketing*.

III. Cases Where Anti-Injunction Act Avoided

Before discussing the potential for a narrower reading of the Anti-Injunction Act, I will first discuss the cases since *Mayo* in which direct challenges to tax regulations under the APA have not been barred by the Anti-Injunction Act.

---

[20]*Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1 (1962).

[21]*See, e.g., Bob Jones University v. Simon*, 416 U.S. 725, 739 (1974).

A. *Cohen*

Cohen v. United States[22] is the earliest of the recent cases permitting direct challenges to IRS pronouncements in district court under the APA, despite the Anti-Injunction Act. *Cohen* was an *en banc* decision by the U.S. Court of Appeals for the D.C. Circuit that was decided about six months after *Mayo*.

Cohen related to the telephone excise tax, which several circuits had held was being illegally collected by the IRS. The statute imposing the tax applied to telephone call charges based on the length of the call and the distance between the calling parties. Charges for long-distance telephone calls stopped being based on the distance between the calling parties long ago. This change in billing practices made the tax inapplicable to the calls on which the IRS was continuing to collect the tax. Because of the change in billing practices, the circuit courts held that the IRS could no longer collect the tax.

Responding to those decisions, the IRS issued a notice setting forth procedures for taxpayers to claim refunds for the illegally collected tax. The taxpayer in *Cohen* challenged those refund procedures directly under the APA in the D.C. district court.

The D.C. Circuit opinion dealt primarily with whether the lawsuit was barred by the Anti-Injunction Act. It did not directly address the merits of the challenge. Before *Mayo*, a three-judge panel had held in 2009 that the Anti-Injunction Act did not apply. After the panel decision, the D.C. Circuit granted a government petition for an *en banc* rehearing.

Although *Cohen* involved a challenge to an IRS notice, not a regulation, the panel held that this notice should be considered what the APA calls a substantive rule, which is in substance a regulation. As a substantive rule under the APA, the notice was subject to the APA rules regarding the issuance of regulations.

In a 6-3 decision, the *en banc* D.C. Circuit agreed with the original panel that the Anti-Injunction Act did not apply because the lawsuit involved the propriety of refund procedures for a tax the IRS acknowledged it had collected improperly and accordingly had stopped collecting. Thus, the lawsuit could not possibly affect the collection of any future taxes, even under a very broad interpretation of the Anti-Injunction Act. Because of this narrow rationale, the *Cohen* decision seemed unlikely to lead to a flood of challenges to IRS regulations directly under the APA when the challenged regulation related to taxes to be collected in the future, which would be the typical situation in nearly all challenges to IRS regulations. However, as will be discussed below, in a recent oral argument in a currently pending D.C. Circuit tax case, the panel of judges suggested that *Cohen* should be read more broadly.

B. *NFIB v. Sebelius*

The next relevant post-*Mayo* Anti-Injunction Act case was the Supreme Court's decision in *NFIB v. Sebelius*,[23] involving a challenge to the constitutionality of the Patient Protection and Affordable Care Act. In *NFIB*, the Supreme Court held that the Anti-Injunction Act did not apply to the charge for not complying with the individual mandate in the ACA, because the Internal Revenue Code labels that charge as a penalty — and not a tax — and the Anti-Injunction Act explicitly applies only to something that is a tax. Because this rationale is very narrow and limited, like the rationale in *Cohen*, *NFIB v. Sebelius* could also be viewed as irrelevant for cases in which the statute at issue relates to the core concepts for determining the liability for the income tax.

C. *Loving* and *Ridgely*

A significant and ongoing line of cases involving post-*Mayo* direct challenges to IRS regulations under the APA that have not been barred by the Anti-Injunction Act relate to Circular 230, which regulates practice before the IRS. The statute that authorizes the IRS to regulate practice is in Title 31 of the U.S. Code, which deals with the Treasury Department.[24]

In *Loving v. IRS*,[25] the D.C. Circuit considered recent additions to Circular 230 that imposed continuing education and testing requirements on tax return preparers who are not CPAs, attorneys, or enrolled agents. The court held that those provisions were invalid because they applied to people who did nothing relating to dealings with the IRS but prepare tax returns. The court concluded that the provision in Title 31 that the IRS relied on as authority for issuing the rules authorizes the IRS to regulate only the practice of representatives before the IRS and that people who do nothing in relation

[22]*Cohen v. United States*, 650 F.3d 717 (D.C. Cir. 2011) (*en banc*). For a more detailed discussion of this case, see Smith, "D.C. Circuit: 'The IRS Is Not Special,'" *Tax Notes*, Aug. 29, 2011, p. 907.

[23]*NFIB v. Sebelius*, 132 S. Ct. 2566 (2012).

[24]31 U.S.C. section 330.

[25]*Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014). I submitted an amicus curiae brief in *Loving* in support of the challengers on behalf of the Tax Foundation and several tax return preparers, CPAs, and enrolled agents who would be adversely affected by the regulation.

to the IRS beyond preparing tax returns are not ''representatives'' and do not ''practice'' ''before'' the IRS.

Loving was brought directly under the APA in the D.C. district court. The Anti-Injunction Act was not an issue in *Loving* because the tax return preparer rules in Circular 230 did not raise any revenue. Accordingly, a holding that the regulations are invalid would not affect the collection of revenue. The IRS did not seek Supreme Court review of the D.C. Circuit's *Loving* decision. Instead, it substituted a voluntary program having basically the same continuing education and testing requirements at issue in *Loving*.

As with *Cohen* and *NFIB v. Sebelius*, the reason the Anti-Injunction Act did not apply in *Loving* might be viewed as making the *Loving* decision not significant for using the APA to directly challenge tax regulations without running afoul of the Anti-Injunction Act. However, *Loving* is significant for its effect on the IRS's ability to regulate tax professionals in their performance of tax services that do not involve any direct interaction with the IRS.

Ridgely v. Lew[26] is the next case in the *Loving* line of cases. Like *Loving*, *Ridgely* was brought directly under the APA in district court. *Ridgely* challenged the Circular 230 provisions that prohibited tax practitioners from charging contingent fees for preparing refund claims. Like *Loving*, *Ridgely* did not present any issue under the Anti-Injunction Act.

The D.C. district court held in *Ridgely*, based on *Loving*'s reasoning, that preparing refund claims is not practicing before the IRS and that people who merely prepare refund claims are not representatives and are not practicing before the IRS. Thus, as in *Loving*, the IRS was not authorized to prohibit contingent fees for merely preparing tax refund claims.

What is even more significant is that the *Ridgely* opinion stated that although a person performing tax-related services may spend part of his time actually representing taxpayers before the IRS — thereby authorizing the IRS to regulate his activities when he is doing that sort of work — the IRS is not authorized to regulate that person when he is performing client services that do not constitute representing the taxpayers before the IRS. The IRS did not appeal *Ridgely* to the D.C. Circuit because, based on *Loving*, it was certain to lose.[27]

It seems likely that the ultimate result of *Loving*, *Ridgely*, and related pending cases will be that many Circular 230 provisions will be declared invalid as beyond the IRS's authority to regulate the practice of representatives before the IRS.[28]

Regarding the Anti-Injunction Act, *Loving* and *Ridgely* are examples of situations in which a regulation issued by the IRS and Treasury can be directly challenged in district court under the APA without raising any issue under the Anti-Injunction Act. Admittedly, those situations will be rare.

D. *Florida Bankers Association*

Florida Bankers[29] was another challenge to the validity of an IRS regulation that was brought directly under the APA in the D.C. district court. While unsuccessful on the merits,[30] the challengers overcame the Anti-Injunction Act obstacle. The district court opinion has a noteworthy discussion of the issue.

The regulations in *Florida Bankers* required banks to provide information to the IRS on interest earned on bank accounts held by nonresident aliens, which is not subject to income tax by the United States. However, the IRS argued that the information reporting was necessary for the United States to comply with its information-sharing agreements with foreign governments. Those agreements require each country to share information about interest earned on bank accounts held in that country by citizens of the other country. The IRS argued that the United States benefits from those agreements because it receives information on interest earned by U.S. citizens from foreign bank accounts.

The government argued that the lawsuit should be dismissed because it was barred by the Anti-Injunction Act and that the proper way for the banks to challenge the reporting requirement regulations was for one of the banks to violate the reporting requirement, be subjected to the resulting penalty, pay the penalty, and then sue for a refund.

The district court held that the Anti-Injunction Act was inapplicable for several reasons. First, the imposition of a tax or penalty did not flow directly from the imposition of the reporting requirement. Instead, a tax in the form of a penalty would be imposed only if one of the banks violated the

[26]*Ridgely v. Lew*, No. 1:12-cv-00565 (D.D.C. 2014).

[27]*See* William R. Davis, ''OPR Will Narrowly Apply *Ridgely*,'' *Tax Notes*, Sept. 29, 2014, p. 1537.

[28]For more comprehensive discussions of this subject, see Johnson, ''How Far Does Circular 230 Exceed Treasury's Statutory Authority?'' *Tax Notes*, Jan. 12, 2015, p. 221; Michael Desmond, ''Is There a Future Role for Circular 230 in the Internal Revenue Service's Efforts to Improve Tax Compliance?'' *Procedurally Taxing*, Oct. 1, 2014.

[29]*Florida Bankers Association v. Treasury*, 19 F. Supp.3d 111 (2014), *appeal pending*, No. 14-5036 (D.C. Cir.).

[30]I have criticized portions of the district court opinion regarding the merits of the challenge. *See* Smith, ''District Court Misapplies APA in *Florida Bankers Association*,'' *Tax Notes*, Feb. 17, 2014, p. 745; and Smith, ''More Ways *Florida Bankers* Misapplied the APA,'' *Tax Notes*, Apr. 21, 2014, p. 361.

reporting requirement. The member banks in the bankers associations that brought the challenge had neither violated the reporting requirement nor threatened to do so:

> In this case, the imposition of a federal tax does not necessarily follow from the promulgation of the reporting requirements, and no tax has yet been incurred. A tax would be imposed here only if one of Plaintiffs' members refused to comply with the reporting requirements — and none has threatened to do so.

Second, the district court relied on a 1987 D.C. Circuit decision that held that a challenge to tip reporting regulations was not barred by the Anti-Injunction Act. The district court also relied on the recent D.C. Circuit opinion on the issues ultimately resolved by the Supreme Court in *NFIB v. Sebelius*, which held that the Anti-Injunction Act doesn't apply to challenges to regulatory requirements that have no relationship to tax revenue.

Regarding the Anti-Injunction Act, the court's reasoning that the challenged regulation was merely a reporting requirement rather than a substantive provision with an effect on the determination of taxable income was relatively narrow. However, the part of the court's reasoning that considered that the tax or penalty would be imposed only if the parties challenging the tax took specific actions that they had not yet taken, and could avoid taking, could be applied much more broadly. Many regulations that might be challenged could be viewed in this way. With most provisions, taxpayers can avoid a bad result by avoiding specific action.

As discussed earlier, it is precisely that aspect of a direct challenge to a tax regulation that makes it much more appealing to a taxpayer than the more traditional routes. If that type of analysis is sufficient to make the Anti-Injunction Act inapplicable, many more challenges to tax regulations could be brought directly under the APA without violating the Anti-Injunction Act. Under the reasoning in the *Florida Bankers* passage quoted above, the Anti-Injunction Act bars a challenge to a tax regulation only when the taxpayer has already taken action that would be sufficient to cause the challenged regulation to apply to him. As discussed below, *Direct Marketing* provides strong support for that aspect of the *Florida Bankers* decision.

Oral argument in the D.C. Circuit took place on February 13, 2015. One of the panel judges, Brett Kavanaugh, seemed particularly interested in the Anti-Injunction Act issue, but the other two judges seemed more interested in the merits.[31] One series of questions between Kavanaugh and the government's lawyer focused on whether a bank would be violating the law if it pursued the route for challenging the validity of the reporting regulation advocated by the government — violating the requirement, paying the resulting penalty, and suing for a refund. Kavanaugh seemed to believe that the government attorney had acknowledged that this would be a violation of the law by the bank, which would weigh against applying the Anti-Injunction Act. The judge noted that in *NFIB v. Sebelius*, in which the Supreme Court held that the Anti-Injunction Act did not apply, the Court placed some weight on the government's concession that incurring the penalty would not represent a violation of law. Because the oral argument took place before the Supreme Court's decision in *Direct Marketing* was issued, that decision did not come up during the oral argument.

E. *King v. Burwell*

Two recent decisions that also suggest courts may be moving in the direction of being less stringent in applying the Anti-Injunction Act are *King v. Burwell*[32] and *Halbig v. Burwell*.[33] Both cases involved a challenge to the validity of a regulation issued by the IRS relating to an IRC provision added by the ACA.[34] Both cases were brought directly in district court under the APA.

The government did not rely directly on the Anti-Injunction Act in either case, presumably because the Supreme Court held in *NFIB v. Sebelius* that the penalty imposed by the ACA for violations of the individual mandate was not a tax for purposes of the Anti-Injunction Act.[35] Nevertheless, the government made an alternative argument for dismissing each case on procedural grounds that was closely related to the rationale that courts have traditionally relied on in interpreting the Anti-Injunction Act broadly — that through the Anti-Injunction Act, Congress expressed the policy that all tax issues should be litigated by the taxpayer first paying the tax and then filing suit to have the tax refunded.

In each case, the government argued that the direct challenge was barred by an APA provision that makes the availability of a direct challenge turn

---

[31]*See* Amy S. Elliott, "Judges Focused on Merits of Guidance in *Florida Bankers*," *Tax Notes*, Feb. 17, 2015, p. 955.

[32]759 F.3d 358 (4th Cir. 2014), *cert. granted*, 135 S. Ct. 475 (2014).

[33]758 F.3d 390 (D.C. Cir. 2014), *rehearing en banc granted and judgment vacated* (Sept. 4, 2014), *held in abeyance pending Supreme Court decision in King*, 114 AFTR.2d 2014-6576 (Nov. 12, 2014).

[34]P.L. 111-148.

[35]132 S. Ct. 2566, 2582-2584.

on the conclusion that ''there is no other adequate remedy in a court''[36] and that filing a tax refund lawsuit was an adequate alternative remedy to filing a direct challenge under the APA.

While the Fourth Circuit and the D.C. Circuit disagreed on the merits of the challenge to the validity of the regulations, they both rejected the government's ''adequate alternative remedy'' argument. The D.C. Circuit opinion was somewhat more expansive on the issue than the Fourth Circuit opinion.

Both circuits concluded that requiring the parties challenging the regulation to violate the individual mandate, pay the resulting penalty, and then file suit for a refund would not provide the same degree of relief that would be provided through a successful direct challenge under the APA. The parties challenging the regulation sought to avoid being subjected to the individual mandate in the first place, and that relief would clearly not be available through a tax refund lawsuit. The D.C. Circuit questioned whether such a suit could ever provide the type of prospective relief that the party challenging the regulation was seeking.[37]

While the Supreme Court has agreed to decide the substantive issue of the validity of the regulation being challenged in those cases, the ''adequate alternative remedy'' issue is not before the Court. As noted above, the Anti-Injunction Act was not directly at issue in those cases. But because the traditionally cited rationale supporting a broad reading of the Anti-Injunction Act is the same concept that the government invoked to support its ''adequate alternative remedy'' argument, the discussion and rejection of that argument will clearly be relevant for cases in which the Anti-Injunction Act is directly at issue.

In *South Carolina v. Regan*,[38] a 1984 Supreme Court decision, the Court held that the Anti-Injunction Act did not bar a lawsuit under the APA by the state of South Carolina, which argued that an IRC provision regarding the issuance of tax-exempt bonds was unconstitutional. The Court held that the Anti-Injunction Act was not a bar, because the state had no alternative way to bring its challenge in court. Because the tax at issue in *South Carolina v. Regan* would be imposed on bondholders rather than bond issuers, the state would not be able to challenge the tax through the mechanism of a tax refund lawsuit. Thus, a suit under the APA was the only way the state could bring its challenge in court.

If not for the Supreme Court's recent decision in *Direct Marketing*, it would have been interesting to see whether courts would extend the analysis in the ACA cases — that a tax refund lawsuit is not an adequate alternative remedy for purposes of the APA because the party bringing the suit seeks to have the IRS enjoined from enforcing a particular regulation — to the applicability of the Anti-Injunction Act. That type of argument could be combined with the reasoning from *Florida Bankers* that suggested that the Anti-Injunction Act might not apply when the challenger could avoid being subject to the regulation by avoiding the behavior to which the regulation attaches adverse tax consequences.

It is not so hard to imagine that a court might conclude that the traditional route to challenging an IRS regulation, which requires that the challenger first behave in a way that makes the regulation applicable to the taxpayer before being able to make the challenge, imposes such a large burden that the Anti-Injunction Act must give way. However, after the Supreme Court's *Direct Marketing* decision, it seems more likely that courts faced with this type of situation will now rely on that decision to apply a narrow reading to the Anti-Injunction Act without focusing directly on the burden for taxpayers who follow the traditional route for challenging tax regulations.[39]

IV. *Direct Marketing Association*

By far the most significant recent development concerning the potential narrowing of the Anti-Injunction Act did not directly involve that provision itself but rather a parallel provision commonly referred to as the Tax Injunction Act (TIA). This development was the Supreme Court's March 3 decision in *Direct Marketing*.[40] The Court interpreted the TIA narrowly, which has direct implications for

[36]5 U.S.C. section 704.
[37]*Halbig*, 758 F.3d, at 398.
[38]465 U.S. 367 (1984).

[39]*See* Hickman, *supra* note 1, at 1210-1214, for a discussion of two alternative ways to interpret the Anti-Injunction Act narrowly, one based on the type of approach later taken by the Supreme Court in *Direct Marketing* and the other based on an expansion of the *South Carolina v. Regan* exception.

[40]No. 13-1032 (Mar. 3, 2015). I have discussed the implications of the *Direct Marketing* decision for the interpretation of the Anti-Injunction Act in comments quoted by Marie Sapirie in ''The Effect of *Direct Marketing Association*,'' *Tax Notes*, Mar. 30, 2015, p. 1577, and in a blog post shortly after the decision was released. *See* Smith, ''Supreme Court's Direct Marketing Case May Have Great Significance in Anti-Injunction Act Cases,'' *Procedurally Taxing*, Mar. 4, 2015, *available at* http://www.proceduralltaxing.com/supreme-courts-direct-marketing-case-may-have-great-significance-in-anti-injunction-act-cases/. For a different perspective on the *Direct Marketing* decision, see Steve R. Johnson, ''How Would the Supreme Court Decide *Loving* and *Ridgely*?'' *Tax Notes*, May 4, 2015, p. 559.

interpretation of the Anti-Injunction Act because of the strong parallels between the two provisions and because the Court's interpretation of the TIA in *Direct Marketing* was largely based on these parallels and on the meaning of the statutory terms the TIA and Anti-Injunction Act have in common in the context of the IRC.

Direct Marketing concerned a lawsuit that had been brought in district court to enjoin notice and reporting requirements imposed by the state of Colorado on out-of-state Internet retailers relating to sales to Colorado residents. The purpose of the requirements was to assist the state in collection of use tax on those sales.

The issue in the case was whether the district court was barred from hearing the lawsuit by the TIA, which requires that some suits regarding state taxes must be pursued in state courts rather than federal courts. The Supreme Court held that the TIA did not bar the district court from hearing the case.

While *Direct Marketing* has considerable significance in its direct application regarding the meaning of the TIA, *Direct Marketing* may have as much significance in its implications for interpretation of the Anti-Injunction Act because the Anti-Injunction Act imposes limitations on the types of lawsuits relating to federal taxes that may be maintained in U.S. district courts that are similar to the limitations imposed by the TIA on suits in U.S. district courts regarding state taxes. Because of *Direct Marketing*, the Anti-Injunction Act is likely to be interpreted more narrowly now than it has been since two significant Supreme Court decisions in 1974, *Bob Jones University v. Simon*[41] and *Alexander v. "Americans United" Inc.*[42] Those decisions held that a lawsuit to enjoin revocation by the IRS of the tax-exempt status of the organization bringing the suit was barred by the Anti-Injunction Act because the suit would affect tax revenue by affecting the ability of persons to claim tax deductions for contributions made to the organization.

Bob Jones University and *"Americans United"* could be read as standing for the proposition that any suit that could, if successful, adversely affect the collection of federal tax revenue is barred from being heard in district court by the Anti-Injunction Act except through the mechanism of a tax refund suit. The *Direct Marketing* decision clearly rejected that broad reading of the TIA, which should apply equally to the Anti-Injunction Act.

The texts of the TIA and Anti-Injunction Act are similar. The TIA[43] provides that "the district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law." The Anti-Injunction Act provides that with several listed exceptions, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."[44]

In *Direct Marketing*, the Court relied on the similarities between the Anti-Injunction Act and the TIA in interpreting the TIA. The Court also relied on the historical relationship between the two provisions, noting that the Anti-Injunction Act, originally enacted in 1867, was the model for the TIA, which was enacted in 1937:

> In defining the terms of the TIA, we have looked to federal tax law as a guide. Although the TIA does not concern federal taxes, it was modeled on the Anti-Injunction Act (AIA), which does.[45]

The Court focused on the close relationship between the TIA and the Anti-Injunction Act to give a narrow, technical reading to the terms "assessment," "collection," and "restrain," all of which appear in both the TIA and the Anti-Injunction Act:

> We assume that words used in both Acts are generally used in the same way, and we discern the meaning of the terms in the Anti-Injunction Act by reference to the broader Tax Code.

The Court relied on the fact that in the IRC, where the Anti-Injunction Act is located, the terms "assessment," "levy," and "collection" have very narrow and precise technical meanings:

> These three terms refer to discrete phases of the taxation process that do not include informational notices or private reports of information relevant to tax liability.

---

[41]*Bob Jones University v. Simon*, 416 U.S. 725 (1974).
[42]*Alexander v. "Americans United" Inc.*, 416 U.S. 752 (1974).
[43]28 U.S.C. section 1341.

[44]However, the TIA and the Anti-Injunction Act are dissimilar in how they phrase their limitations. The TIA describes them in terms of the district court's power to act, but the Anti-Injunction Act does not. There is a recent line of Supreme Court cases clarifying that the courts must be more precise and analytical when determining whether statutory limitations on maintaining an action in court are "jurisdictional." Justice Clarence Thomas, in his opinion for the Court in *Direct Marketing*, repeatedly referred to the TIA as jurisdictional. This classification mattered because the state of Colorado had not raised the TIA as an issue in the district court and had affirmatively stated that the TIA did not apply. If the TIA were not jurisdictional, this would mean the TIA was waived. However, jurisdictional limitations can be raised at any litigation stage. I have argued that the Anti-Injunction Act is not jurisdictional, based partly on the differences in how each provision phrases its limitations. *See* Smith, "Is the Anti-Injunction Act Jurisdictional?" *Tax Notes*, Nov. 28, 2011, p. 1093. However, this issue remains to be definitively resolved by the courts.
[45]*Direct Marketing*, 135 S. Ct. at 1129 (citation omitted).

While the TIA includes the term ''levy'' and the Anti-Injunction Act does not, that slight difference between the two provisions should not result in any significant difference in interpretation for the terms that appear in both provisions. As the Court noted:

> The Federal Tax Code has long treated information gathering as a phase of tax administration procedure that occurs before assessment, levy, or collection. This step includes private reporting of information used to determine tax liability, including reports by third parties who do not owe the tax.
>
> 'Assessment' . . . refers to the official recording of a taxpayer's liability, which occurs after information relevant to the calculation of that liability is reported to the taxing authority.
>
> Finally, 'collection' is the act of obtaining payment of taxes due.
>
> 'Collection' is a separate step in the taxation process from assessment and the reporting on which assessment is based.

Based on the meaning of the terms ''assessment,'' ''levy,'' and ''collection'' in the IRC, the Court held that ''these terms do not encompass Colorado's enforcement of its notice and reporting requirements.'' The Court noted that Colorado did not contend that the term ''levy'' was applicable but did assert that ''assessment'' and ''collection'' were implicated by the state's requirements at issue. The Court disagreed, stating, ''The notice and reporting requirements precede the steps of 'assessment' and 'collection.'''

> Enforcement of the notice and reporting requirements may improve Colorado's ability to assess and ultimately collect its sales and use taxes from consumers, but the TIA is not keyed to all activities that may improve a State's ability to assess and collect taxes. . . . The TIA is keyed to the acts of assessment, levy, and collection themselves, and enforcement of the notice and reporting requirements is none of these.

The Tenth Circuit had relied on giving the term ''restrain,'' which appears in both the TIA and the Anti-Injunction Act, a broad meaning, basically, the sort of meaning that *Bob Jones University* and *''Americans United''* might be read as giving to the Anti-Injunction Act, namely, that ''restrain'' means any action that would adversely affect the collection of tax revenue:

> Specifically, the Court of Appeals concluded that the TIA bars any suit that would ''limit, restrict, or hold back'' the assessment, levy, or collection of state taxes. Because the notice and reporting requirements are intended to facilitate collection of taxes, the Court of Appeals reasoned that the relief Direct Marketing Association sought and received would ''limit, restrict, or hold back'' the Department's collection efforts.

The Court in *Direct Marketing* clearly rejected that interpretation, with reasoning that is equally applicable to the Anti-Injunction Act:

> As used in the TIA, ''restrain'' acts on a carefully selected list of technical terms — ''assessment, levy, collection'' — not on an all-encompassing term, like ''taxation.'' To give ''restrain'' the broad meaning selected by the Court of Appeals would be to defeat the precision of that list, as virtually any court action related to any phase of taxation might be said to ''hold back'' ''collection.''

Applying the correct definition, a lawsuit cannot be understood to ''restrain'' the ''assessment, levy or collection'' of a state tax if it merely inhibits those activities.

The fact that the Court in *Direct Marketing* interpreted terms in the TIA that appear in both the TIA and the Anti-Injunction Act by reference to the precise meaning those terms have in the IRC should mean that in the context of the Anti-Injunction Act, these precise meanings are if anything even more controlling than in the context of the TIA. Thus, based on *Direct Marketing*, it seems clear that the broad reading of the Anti-Injunction Act that might be taken from *Bob Jones University* and *''Americans United''* cannot be correct.

Based on *Direct Marketing*, the mere fact that a lawsuit in U.S. district court, if successful, could potentially have an adverse impact on the collection of tax revenue is not enough to cause the Anti-Injunction Act to apply. Instead, the relationship between the suit and the effect on assessment or collection must be much more direct.

When a taxpayer brings a suit in U.S. district court directly challenging the validity of a regulation issued by the IRS and Treasury that does not yet apply to the taxpayer because it has not engaged in an applicable transaction, that suit could not possibly relate to the assessment or collection of taxes with the meaning given to those terms by *Direct Marketing*. If information reporting regarding transactions that have actually happened does not relate to the assessment or collection of taxes owed on those transactions, a challenge to a regulation that does not apply to any transaction the taxpayer actually engaged in could not possibly relate to the assessment or collection of taxes within the meaning of *Direct Marketing*.

Thus, for example, the *Direct Marketing* decision should be relevant for the Anti-Injunction Act issue in *Florida Bankers* because that case also involved an

information reporting requirement and because the information subject to the reporting requirement concerns income not taxable in the United States. Also, the district court's reasoning regarding the government's argument that the penalty for noncompliance with the reporting requirement was sufficient to make the Anti-Injunction Act applicable is clearly supported by *Direct Marketing*. The district court stated that one reason the potential applicability of this penalty was insufficient to make the Anti-Injunction Act applicable was that none of the banks had acted in a way that would make the penalty applicable. Based on the reasoning outlined above, *Direct Marketing* strongly supports the district court's conclusion that the potential applicability of the noncompliance penalty was insufficient to make the Anti-Injunction Act apply.

Another currently pending D.C. Circuit case in which the Anti-Injunction Act is the primary issue is *Z Street Inc. v. Koskinen*.[46] This case is a case that was brought in district court that involves an application to the IRS for tax-exempt status by an organization that claims the processing of the application is being delayed by the IRS for constitutionally impermissible reasons. The government claims the suit is barred by the Anti-Injunction Act.

The oral argument took place on May 4 of this year, and the Direct Marketing decision played a prominent role in the questioning by the panel of judges of the lawyer representing the IRS. One of the judges on the panel, Chief Judge Merrick Garland, said that he was "shocked" that the decision, which he characterized as the most relevant Supreme Court decision on the Anti-Injunction Act issue, was mentioned in the government's briefs only in a footnote. Judge Garland and the other judges on the panel clearly seemed to consider the *Direct Marketing* decision as being directly relevant to the resolution of the Anti-Injunction Act issue.

It seems virtually certain that when the opinion in this case is issued, it will hold the Anti-Injunction Act does not apply to the case, and that it will rely heavily on the *Direct Marketing* decision in reaching that conclusion. In addition, these judges also clearly viewed the outcome in the D.C. Circuit's Cohen decision, discussed earlier, as not being limited to the specific facts in that case but instead as broadly rejecting the government's position that because of the Anti-Injunction Act, litigation of tax issues is limited to tax refund claims and Tax Court deficiency actions.

V. Distinguishing Prior Supreme Court Cases

Taking into account *Direct Marketing*'s effect on interpretation of the Anti-Injunction Act, it will be necessary for courts to determine how this decision relates to the Supreme Court decisions from 1962 and 1974 that might be viewed as applying the Anti-Injunction Act in a way that is inconsistent with *Direct Marketing*'s interpretation of the TIA. The following discussion addresses how those earlier decisions can be reconciled with *Direct Marketing* in the context of a lawsuit brought directly under the APA to challenge a tax regulation that is not yet directly applicable to the taxpayer because he has not yet engaged in an applicable transaction.

One seemingly relevant consideration that I have not seen discussed in commentary relating to the issue of how the Anti-Injunction Act should be interpreted is the significance for this issue of the availability of review in the Tax Court of IRS notices of deficiency. The Tax Court did not exist in 1867 when the Anti-Injunction Act was first enacted. The predecessor body to the Tax Court was not created until 1924.

The policy rationale for a broad interpretation of the Anti-Injunction Act that has typically been cited in court decisions is that the Anti-Injunction Act reflects a congressional policy that tax disputes are to be resolved in court by the taxpayer first paying the disputed tax and then suing for a refund. The current Supreme Court expressed this concept in *Williams Packing* with language that has frequently been quoted in decisions on application of the Anti-Injunction Act:

> The manifest purpose of section 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.[47]

However, the availability of Tax Court review of IRS deficiency notices would seem to seriously undermine that policy rationale, because the principal advantage to taxpayers of litigating tax cases in Tax Court rather than filing refund lawsuits is the availability of a judicial resolution without first having to pay the tax. Thus, the availability of the Tax Court as a forum to litigate tax issues would seem to be totally inconsistent with the rationale that is typically given for interpreting the Anti-Injunction Act broadly.

[46]No. 15-5010 (D.C. Cir.).

[47]*Williams Packing*, 370 U.S. 1, at 7.

Also, when the Supreme Court decisions from 1962 and 1974 that are usually cited for a broad interpretation of the Anti-Injunction Act are carefully examined, it is possible to read them as standing for far less than is usually attributed to them, especially regarding the relevance of the availability of the Tax Court for the interpretation and application of the Anti-Injunction Act. It may be necessary for the Supreme Court to consider whether some of those decisions would need to be overruled because they conflict with the principles expressed in *Direct Marketing*. However, a court could apply those principles to hold that the Anti-Injunction Act does not bar a direct district court challenge to the validity of a tax regulation that does not apply to the taxpayer because he has not yet engaged in an applicable transaction — without being in conflict with those earlier Supreme Court decisions.

In two of these earlier cases, the tax most directly at issue was one for which the Tax Court would not have been an available forum. In *Williams Packing*, which the two 1974 Supreme Court decisions primarily rely on for their holdings, the Supreme Court explicitly noted that the Tax Court was not an available forum for the dispute as part of the relevant context for the decision.

The opinion first quoted section 7421(a) as it read at the time, with a much shorter list of exceptions than the current version — exceptions that applied only to Tax Court deficiency actions:

> Except as provided in sections 6212(a) and (c), and 6213(a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

Immediately after the foregoing quotation, the Court noted as follows:

> The exception for Tax Court proceedings created by sections 6212(a) and (c) and 6213(a) was not applicable because that body is without jurisdiction over taxes of the sort here in issue. Nevertheless, on July 14, 1959, relying upon *Miller v. Standard Nut Margarine Co.*, 284 U.S. 498, permanently enjoined collection of the taxes on the ground that they were not, in fact, payable and because collection would destroy respondent's business.

The Court's use of "nevertheless" to link its initial statement that the exception for Tax Court proceedings was inapplicable with its description of the action taken by the district court could imply that if the Tax Court had been an available forum, the result might have been different.

Later in the opinion, the Court stated:

> The object of section 7421(a) is to withdraw jurisdiction from the state and federal courts to entertain suits seeking injunctions prohibiting the collection of federal taxes.

This description of the Anti-Injunction Act's purpose as applying to "suits seeking injunctions prohibiting the collection of federal taxes" suggests a much more immediate connection between the suits to which the act applies and the collection of taxes than exists for a case in which a taxpayer seeks to challenge a regulation that does not yet apply because he has not yet engaged in an applicable transaction. That statement is entirely consistent with the reasoning and the result in *Direct Marketing*.

As noted earlier, the opinion also stated:

> The manifest purpose of section 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.

If the Anti-Injunction Act's purpose is "to permit the United States to assess and collect taxes alleged to be due without judicial intervention," that purpose does not extend to a situation in which no tax could possibly be "alleged to be due" based on the situation that exists at the time of the challenge. For a case in which a taxpayer wishes to challenge a regulation that does not yet apply to him because he has not yet engaged in an applicable transaction, there is clearly no tax that could be "alleged to be due" by reason of the application of the challenged regulation.

In light of the explicit recognition earlier in the opinion of an exception from the Anti-Injunction Act for Tax Court deficiency proceedings, the statement here that the "manifest purpose" of the Anti-Injunction Act is "to require that the legal right to the disputed sums be determined in a suit for refund" could be interpreted as implying that the Anti-Injunction Act applies only to taxes for which the Tax Court is not an available forum, because when the Tax Court is available, it makes no sense to say that the Anti-Injunction Act's purpose is "to require that the legal right to the disputed sums be determined in a suit for refund" when the Anti-Injunction Act has an explicit exception for Tax Court proceedings.

Finally, the opinion stated as follows:

> Thus, in general, the Act prohibits suits for injunctions barring the collection of federal taxes when the collecting officers have made the assessment and claim that it is valid.

Once again, this description of the circumstances in which the Anti-Injunction Act applies, namely to

"suits for injunctions barring the collection of federal taxes when the collecting officers have made the assessment and claim that it is valid," clearly does not encompass a situation in which no tax has yet been assessed and no tax could be assessed because the taxpayer bringing the suit has not yet engaged in an applicable transaction. This statement, like the one noted above, is entirely consistent with the reasoning and the result in *Direct Marketing*.

The other Supreme Court cases usually cited for a broad interpretation of the Anti-Injunction Act date from 1974. Although these cases rely on *Williams Packing*, they extend the application of the Anti-Injunction Act beyond what the language from *Williams Packing* would suggest.

Nevertheless, even these cases do not necessarily require the Anti-Injunction Act to be read so broadly as to apply when a taxpayer wishes to challenge the validity of a regulation that would not yet apply to the taxpayer at the time of the challenge because the taxpayer has not engaged in a transaction to which the challenged regulation would apply.

In *Bob Jones University*,[48] the taxpayer sought an injunction to prevent the IRS from revoking its status as a tax-exempt organization under section 501(c)(3). The Supreme Court held that the lawsuit was barred by the Anti-Injunction Act. The Court based its holding on three effects the suit would have on the assessment or collection of taxes if the suit succeeded on the merits: (1) the suit would affect the organization's liability to pay income tax on its taxable income; (2) the suit would affect the organization's liability to pay FICA and FUTA taxes on wages paid to the organization's employees; and (3) the suit would affect the income tax liability of persons making contributions to the organization by affecting the ability of such persons to claim income tax deductions for the contributions:

> Because an injunction preventing the Service from withdrawing a section 501(c)(3) ruling letter would necessarily preclude the collection of FICA, FUTA, and possibly income taxes from the affected organization, as well as the denial of section 170(c)(2) charitable deductions to donors to the organization, a suit seeking such relief falls squarely within the literal scope of the Act.[49]

This passage could be read as requiring a much less direct effect between a lawsuit and the assessment or collection of taxes than would be consistent with the *Direct Marketing* decision and thus requiring the Supreme Court to consider whether *Bob Jones University* should be overruled as inconsistent with *Direct Marketing*. Nevertheless, even before the Supreme Court is faced with a case raising that issue, the effect of the challenge to IRS action that was at issue in *Bob Jones University* on the organization's liability for income taxes and FICA and FUTA taxes is clearly a much more direct and immediate impact on tax liability than would exist in the case of a challenge by a taxpayer to a regulation that does not yet apply to the taxpayer because the taxpayer has not yet engaged in a transaction to which the regulation would apply and would not engage in such a transaction until and unless the regulation is declared invalid. Thus, it could be argued that *Bob Jones University* is distinguishable from that type of situation involving a challenge to a tax regulation.

However, the IRS might argue that the effect of the revocation of tax-exempt status on the ability of donors to claim tax deductions for their contributions has similarities to the situation of a taxpayer challenging a regulation because presumably some donors would not make contributions without having the tax issue resolved. In response to that potential argument, the history of the *Bob Jones University* litigation illustrates the difference.

The district court decided the case in 1971,[50] and the Supreme Court decision was in 1974. Responding to the favorable Supreme Court decision, the IRS revoked the taxpayer's tax exemption in 1976 with retroactive effect back to 1970.[51] Thus the revocation applied retroactively to the actual tax liabilities of both the organization and its donors for a substantial period. This is very different from the situation involving a challenge to a regulation that does not yet apply to the taxpayer making the challenge.

Also, the effect on donors was only one of three effects identified by the Court in *Bob Jones University* as making the Anti-Injunction Act applicable. It could be argued that, therefore, this effect was not necessary for the decision.

However, that argument could not be made about the other major case from 1974, "*Americans United*,"[52] which was decided the same day as its companion case, *Bob Jones University*. "*Americans United*" was similar to *Bob Jones University* in that both cases involved an IRS revocation of an organization's status as a tax-exempt section 501(c)(3)

[48]*Bob Jones University*, 416 U.S. 725.
[49]*Id.* at 731-732.
[50]*Bob Jones University*, 341 F. Supp. 277 (D.S.C. 1971).
[51]*See Bob Jones University v. United States*, 461 U.S. 574, 581 (1983).
[52]"*Americans United*," 416 U.S. 752.

organization. But in "*Americans United*," that revocation had already taken place before the suit was filed. The purpose of the suit was to reverse the revocation.

The change in status in "*Americans United*" did not subject the organization to income tax liability because the IRS reclassified the organization as a section 501(c)(4) social welfare organization, but the change in status did have the effect of making contributions to the organization nondeductible. The Court held that effect was sufficient to make the Anti-Injunction Act applicable:

> Respondent would not be interested in obtaining the declaratory and injunctive relief requested if that relief did not effectively restrain the taxation of its contributors. . . . 'To remove the burden of taxation from those presently contributing'. . . .[is a goal that] can be accomplished only by restraining the assessment and collection of a tax in contravention of section 7421(a).[53]

Thus, for a case similar to "*Americans United*," it might be necessary for the Supreme Court to decide whether that decision should be overruled as being inconsistent with *Direct Marketing*. However, for a case involving a direct challenge brought in district court to a tax regulation that does not yet apply to the taxpayer because the taxpayer has not yet engaged in a transaction to which the regulation would apply, it should be sufficient to conclude that "*Americans United*" is factually distinguishable.

VI. Application to Notice 2014-52

The general principles discussed in this report can be illustrated by applying them to a provision that might be vulnerable to a serious challenge on the validity of the regulation. A relevant context would be the provisions described in Notice 2014-52, 2014-42 IRB 712, in which the IRS and Treasury stated that they intend to issue regulations under several IRC provisions that would impose a variety of restrictions on the tax benefits obtained from corporate inversion transactions. This notice received a great deal of attention in the tax world when it was issued. Several planned inversion transactions were abandoned after the notice was issued.

Much of the attention given to the notice dealt with whether some of the planned regulations would be within the authority of the IRS and Treasury. The rule described in the notice that seems the most vulnerable to challenge is under section 7701(l).[54]

Section 7701(l) authorizes the IRS to issue regulations "recharacterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties." The rule that Notice 2014-52 describes that is supposedly authorized by section 7701(l) concerns a situation in which, after an inversion transaction, a controlled foreign corporation of the inverted U.S. corporation issues new stock to the foreign acquirer of the inverted U.S. corporation in a sufficient amount to cause the CFC to cease to be a CFC.

Notice 2014-52 stated that this type of transaction will be recharacterized as a transaction in which the foreign acquirer transfers to the inverted U.S. corporation the property that it actually transferred to the CFC in exchange for the new CFC stock and in which the inverted U.S. corporation transfers that property to the CFC for the new stock that the CFC actually issued to the foreign acquirer. However, this recharacterization seems completely inconsistent with section 7701(l) because this recharacterization turns what was in form a single-step transaction that was entered into directly between only two parties into a less-direct, two-step transaction involving three parties, whereas section 7701(l) contemplates a recharacterization that *reduces* the number of parties and makes the transaction simpler and more direct, not one that *increases* the number of parties and makes the transaction more complex and less direct.

As noted earlier, after the notice was issued, there was a great deal of discussion in the tax world of potential challenges to the rules in the notice. One aspect of those discussions was the possibility of challenging the notice before any regulations are issued.[55]

As discussed, many of the challenges to tax regulations since *Mayo* were brought directly under the APA soon after the regulations were issued and without the challenger having gone through the lengthy and complicated process of engaging in a transaction that makes the regulation applicable and then filing a refund suit or a Tax Court petition challenging an IRS deficiency notice. However, all those challenges were brought after final regulations were issued.

---

[53]*Id.* at 761.

[54]I was quoted making the same comments about this rule in an article in *Tax Notes* shortly after the notice was issued. *See* Amanda Athanasiou, "Challenges to Anti-Inversion Guidance Loom," *Tax Notes*, Oct. 13, 2014, p. 165.

[55]I commented on this aspect of the discussions in Athanasiou's article, *id.*

Bringing a lawsuit under the APA challenging a notice that merely describes regulations that the IRS and Treasury plan to issue at some time in the future would be accelerating the timing of the process of challenging tax regulations to a much greater degree than has been attempted so far. *Cohen*, discussed earlier, involved a successful challenge to a notice. However, the notice was a very different sort than Notice 2014-52. The notice in *Cohen* did not describe regulations that the IRS and Treasury planned to issue. Instead, it described procedures for taxpayers seeking a refund of a tax for which collection had been held to be improper.

The most substantial procedural obstacle to bringing a lawsuit under the APA challenging a notice that describes regulations the IRS and Treasury plan to issue is an APA requirement that to bring suit directly under the APA, there must have been "final agency action."[56] A discussion of that requirement is beyond the scope of this report.

However, once the IRS and Treasury issue final regulations incorporating the rules from the notice, there will clearly be final agency action. Once final regulations are issued, if taxpayers are interested in challenging the rules directly under the APA, they would need to overcome the obstacle of the Anti-Injunction Act.

I have described the argument that could achieve that result, namely the reasoning from the district court decision in *Florida Bankers* that the Anti-Injunction Act is inapplicable when a taxpayer files suit in U.S. district court under the APA challenging a tax regulation that does not yet apply to the taxpayer because the taxpayer has not yet engaged in a transaction to which the regulation would apply. As discussed, this position is strongly supported by *Direct Marketing*.

One of the disadvantages of the traditional way of challenging IRS regulations was that for a taxpayer to make such a challenge, the taxpayer first had to engage in a transaction that would make the regulation applicable. For regulations that impose rules like those described in Notice 2014-52, that would make the traditional route extremely burdensome and impractical.

To traditionally challenge a regulation embodying the rule discussed above regarding section 7701(l), the taxpayer would not only need to engage in an inversion transaction within the meaning of the notice, but also would need to have one of its CFCs issue stock to the foreign acquiring corporation in a transaction that would be covered by the rule. The taxpayer would then have to engage in another transaction relating to the CFC's earnings and profits that would be treated differently than it would be treated in the absence of the rule. For the reasons described earlier, this route would be burdensome and disadvantageous, not only because the judicial resolution of the challenge would be substantially delayed, but also because of the adverse tax consequences of having engaged in these transactions if the challenge were ultimately unsuccessful on the merits.

In contrast, if a direct challenge to the rule in U.S. district court under the APA, after regulations are issued, is not barred by the Anti-Injunction Act, under the analysis described earlier, it would not be necessary for the taxpayer bringing the challenge to engage in this entire series of transactions before challenging the validity of the rule. As a practical matter, it would probably be necessary for the taxpayer to engage in the basic corporate inversion transaction, assuming the desire to challenge the rule was motivated by a particular planned inversion transaction, but the taxpayer would not need to have a CFC issue stock in a transaction that would be subject to the rule and thus would not be burdened with the adverse consequences of having done so if the challenge were unsuccessful. Moreover, even in the absence of a specific planned inversion transaction, a taxpayer that believed it might be desirable to engage in an inversion transaction at some point could challenge the rule based on the effect the rule would have on its existing CFCs.[57]

Thus, the ability to bring a direct challenge to this rule in the notice, once regulations embodying the

[56]5 U.S.C. section 704. The Supreme Court has said that for agency action to be "final" within the meaning of the APA, two requirements must be met. First, the agency action must represent the consummation of the agency decision-making process. Second, legal consequences must flow from the agency action. *Bennett v. Spear*, 520 U.S. 154 (1997).

[57]The taxpayer would also need to satisfy the standing requirement. The government would likely argue that a taxpayer lacks standing if it has not engaged in an applicable transaction. The main issue in the standing inquiry is whether the party bringing the suit has been harmed by the challenged action. A taxpayer challenging one of the rules in the notice would have a strong argument that the taxpayer has been harmed by the rules in the notice even without having engaged in an inversion transaction by having its ability to engage in or benefit from such a transaction limited. The IRS and Treasury didn't expect the rules in Notice 2014-52 to collect any revenue by actually being applicable to any real-world situations. What the IRS and Treasury instead wanted to accomplish with the rules in Notice 2014-52 was to preserve existing revenue streams by preventing inversion transactions. What they wanted to accomplish was to prevent taxpayers from engaging in inversion transactions that would make any of the rules applicable. In light of this fact, a taxpayer would have a strong argument that the standing requirement would be satisfied without actually engaging in an inversion transaction. However, a more thorough discussion of the issue of standing will have to wait.

rule are issued, provides substantial advantages compared with the traditional, cumbersome route to challenging the validity of tax regulations.

VII. Conclusion

The ability of taxpayers to directly challenge tax regulations in U.S. district court under the APA — without first engaging in a transaction that would make the regulations applicable and without requiring that the IRS has applied the regulation to the taxpayer — has substantial advantages for taxpayers compared with the traditional route. In light of recent developments, particularly *Direct Marketing*, the obstacle seemingly presented by the Anti-Injunction Act may no longer apply to future challenges.

IN THE WORKS

A look ahead to planned commentary and analysis.

The taxation of contractors under the 2015 amendments to Arizona's sales tax reform laws (*State Tax Notes*)

James Busby summarizes when construction contractors are required to pay Arizona transaction privilege tax on the construction materials they purchase and when they are required to pay prime contracting tax on 65 percent of their gross receipts instead under the 2015 amendments to Arizona's sales tax laws.

'Waive' goodbye to the statute of limitations when you file a New Jersey Tax Court complaint? (*State Tax Notes*)

Leah Robinson and Open Weaver Banks discuss how New Jersey corporate taxpayers may inadvertently waive the statute of limitations on an issue for all open tax years if they file a complaint in Tax Court.

The trade date rule (*Tax Notes*)

John Kaufmann explains how the trade date rule is inconsistent with established rules of tax ownership, and he suggests how future guidance could address problems caused by that inconsistency.

FATCA status of trusts as accepted nonfinancial group entities (*Tax Notes*)

Quan M. Nguyen argues that if a trust is a holding company of a nonfinancial group of companies, the trust can be classified as a nonfinancial foreign entity and that such a result is similar to the one achieved under intergovernmental agreement look-through.

CJEU rules on Dutch withholding taxes on dividends (*Tax Notes International*)

Tom O'Shea analyzes *X BV and TBG Ltd.*, a recent Court of Justice of the European Union case concerning the Dutch withholding taxes on dividends paid by Dutch companies to companies resident in the Netherlands Antilles.

Measuring BEPS (*Tax Notes International*)

Robert Robillard analyzes the base erosion and profit-shifting phenomenon as it is defined by the OECD and highlights the main shortcomings of that restrictive definition.