No. 18-5019

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CIC SERVICES, LLC,
Plaintiff–Appellant,

v.

INTERNAL REVENUE SERVICE, *et al.*,
Defendants–Appellees.

BRIEF FOR *AMICUS CURIAE* CAUSE OF ACTION INSTITUTE IN SUPPORT OF PLAINTIFF-APPELLANT

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Pursuant to Federal Rule of Appellate Procedure 29, Cause of Action Institute ("CoA Institute") respectfully submits this *amicus curiae* brief on its own behalf and in support of Plaintiff-Appellant CIC Services, LLC.[1]

INTEREST OF THE AMICUS CURIAE AND CORPORATE DISCLOSURE STATEMENT

Amicus curiae CoA Institute is a 501(c)(3) nonprofit, nonpartisan government oversight organization that uses investigative, legal, and communications tools to educate the public about how government accountability, transparency, and the rule of law protect liberty and economic opportunity.[2] As part of this mission, CoA Institute works to expose and prevent government misuse of power by, *inter alia*, appearing as *amicus curiae* before federal courts. *See, e.g.*, *McCutcheon*

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[1] In accordance with Federal Rule of Appellate Procedure 29(a)(2), counsel for all parties consent to the filing of this brief. No counsel for a party authored this brief in whole or in part, and neither the parties, their counsel, nor anyone except CoA Institute financially contributed to preparing this brief.

[2] CoA Inst., *About*, http://www.causeofaction.org/about (last visited Apr. 3, 2018). CoA Institute is not a publicly traded corporation and does not have any parent companies or subsidiaries that have issued shares or debt securities to the public.

v. Fed. Election Comm'n, 134 S. Ct. 1434, 1460 (2014) (citing CoA Institute brief).

CoA Institute has a particular interest in ensuring that federal agency rulemaking is subject to appropriate checks and balances. The issues addressed in the decision below—including proper application of the Anti-Injunction Act and the Internal Revenue Service's ("IRS") poor history of complying with the Administrative Procedure Act ("APA") and other procedural rulemaking requirements—impact judicial oversight of agency decision-making power and are, thus, central to CoA Institute's mission.

CoA Institute recently issued an investigative report detailing the lack of IRS compliance with regulatory procedural requirements titled: *Evading Oversight: The Origins and Implications of the IRS Claim That Its Rules Do Not Have an Economic Impact*.[3] The research underlying that report features prominently in this brief.

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[3] *See* CoA Inst., Evading Oversight: The Origins and Implications of the IRS Claim That Its Rules Do Not Have an Economic Impact (Jan. 2018) [hereinafter *Evading Oversight*], *available at* http://coainst.org/2mgpYAu.

SUMMARY OF ARGUMENT

Effective, accountable agency rulemaking requires oversight from elected officials, meaningful input from public stakeholders, and robust judicial review. Congress and the President have designed a series of oversight mechanisms to ensure that agencies are held accountable. These mechanisms include, *inter alia*, the APA, the Regulatory Flexibility Act ("RFA"), the Congressional Review Act ("CRA"), and White House regulatory review pursuant to Executive Order 12,866 and its progeny. This Court has particular exposure to and expertise with APA claims. When agencies act to subvert these mechanisms, they not only undermine legitimate checks on their power, including review by this and other courts, but they also raise questions about the propriety of their decisions, exacerbating concerns about the lack of control over the administrative state.

The IRS is one such agency. It has systematically created and expanded a series of self-bestowed exemptions from important aspects of all four of these oversight mechanisms. When an agency routinely circumvents the procedural safeguards that are designed to check agency abuses and ensure legitimacy of agency action, judicial review

takes on heightened importance. But the IRS often escapes that oversight too by employing an overly expansive reading of the Anti-Injunction Act.

Accordingly, this Court should reverse the district court's ruling that the Anti-Injunction Act denies subject-matter jurisdiction over this case and remand for a determination on the merits of whether the IRS violated the APA.

Argument

I. Robust Judicial Review of IRS Rulemaking Is Critically Needed Because the Agency Consistently Acts to Evade Oversight

It is important that this Court reverse the district court's decision that the Anti-Injunction Act denied it subject-matter jurisdiction to review the propriety of IRS Notice 2016-66, as modified by Notice 2017-08 (collectively "the micro-captive transactions rule"), because only by so doing can the Court prevent the IRS from routine evasion of effective oversight of its rulemaking process.

The judicial doctrines that have affirmed the constitutionality of administrative processes rest on the active control of agencies by the Executive and effective review of those actions by the Judiciary. *See e.g.*, *Kucana v. Holder*, 558 U.S. 233, 252 (2010) (narrowly construing

jurisdictional bar because otherwise "the Executive would have a free hand to shelter its own decisions from . . . court review"); *Interstate Commerce Comm'n v. Union Pac. R.R. Co.*, 222 U.S. 541, 547 (1912) (collecting cases that summarize the courts' role to ensure an agency's action is not "beyond the power which it could constitutionally exercise" of "beyond its statutory power"); *Buttfield v. Stranahan*, 192 U.S. 470, 496 (1904) (finding delegation constitutional because "Congress legislated on the subject as far as was reasonably practicable, and . . . [left] to executive officials the duty of bringing about the result pointed out by the statute"). The regime the IRS has used to insulate itself from effective Executive and judicial review undermine these doctrines.

Presidential control over and judicial review of actions taken by the federal agencies are critical checks on administrative power. The "faithful execution of the laws enacted by the Congress . . . ordinarily allows and frequently requires the President to provide guidance and supervision to his subordinates . . . [who] are duty-bound to give effect to the policies embodied in the President's direction, to the extent allowed by the law." *Bldg. & Const. Trades Dep't, AFL-CIO v. Allbaugh*, 295 F.3d 28, 32 (D.C. Cir. 2002); *see Free Enter. Fund v. Pub.*

Co. Accounting Oversight Bd., 561 U.S. 477, 492–98 (2010) (discussing importance of president's appointment and removal powers); *Bowsher v. Synar*, 478 U.S. 714, 726 (1986) (recognizing that administrative officers who execute the laws must be answerable to the president).

Judicial review of that process is critical to "appropriately guard the liberty of regulated parties when agencies overstep." *PHH Corp. v. Consumer Fin. Prot. Bureau*, 881 F.3d 75, 106 (D.C. Cir. 2018); *see City of Arlington v. Fed. Commc'ns Comm'n*, 569 U.S. 290, 310 (2013) (Breyer, J., concurring in part and concurring in judgment) ("The question whether Congress has delegated to an agency the authority to provide an interpretation that carries the force of law is for the judge to answer independently."); *id.* at 317 (Roberts, C.J., dissenting) (emphasizing that "an agency literally has no power to act . . . unless and until Congress confers power upon it," which is a "relevant question of law" that the court must answer) (citing *Louisiana Pub. Serv. Comm'n v. Fed. Commc'ns Comm'n*, 476 U.S. 355, 374 (1986)).

A. The IRS has created a series of self-bestowed exemptions to avoid complaince with regulatory oversight mechanisms.

1. The IRS invented the claim that its rules do not have an economic impact to avoid conducting Regulatory Flexibility Act analyses.

In 1996, Congress amended the RFA explicitly to cover IRS interpretive rulemakings, in an effort to end the agency's ongoing practice of claiming those types of rules were categorically exempt from the RFA. *Evading Oversight* at 11. Instead of complying with the amended statute, the IRS simply asserted that "any possible revenue impact of the regulations is inherently part of the revenue impact of the underlying statute," and thus, it claimed, was irrelevant under the RFA. *Id*. at 8 (citing IRS Office of Chief Counsel Notice N(30)(15)(531-1) (Mar. 3, 1998)). Over time, the IRS has expanded this claim to ignore not just the "revenue impact" from its interpretative rules but all effects from all of its rules. The Internal Revenue Manual provides that IRS rule writers do not need comply with the RFA because, it claims, "to the extent the significant economic impact on a substantial number of small entities contained in the regulation flows directly from the underlying statute or other legal authority, [an RFA] analysis is not

required." Internal Revenue Serv., Internal Revenue Manual § 32.1.5.4.7.5.4.3.5 [hereinafter I.R.M.].

The RFA requires agencies to study the impact their rules have on small businesses and to publish that analysis in the *Federal Register* for public comment. *See* 5 U.S.C. § 603. It also requires agencies to submit the analysis to the U.S. Small Business Administration ("SBA") for that agency's feedback on whether the originating agency has reasonably mitigated the impacts. *Id.*

But the IRS dodges these responsibilities on a regular basis. For example, in 2016, the IRS proposed changes to the way it valued interests in closely held businesses for the purposes of estate, gift, and generation-skipping transfer taxes. *Evading Oversight* at 5 (citing Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, 81 Fed. Reg. 51,413 (proposed Aug. 4, 2016) (to be codified at 26 C.F.R. pt. 25)). The IRS claimed this was an interpretative rule and, in its *Federal Register* filing, provided no more than the boilerplate claim that "any economic impact on entities affected by section 2704 . . . is derived from the operation of the statute . . . not from the proposed regulations . . . [and an RFA] analysis is not

required." *Id*. (citing 81 Fed. Reg. at 51,418). A review of the Regulatory Flexibility Checklist the IRS prepared for the rule, obtained via the Freedom of Information Act ("FOIA"), reveals that the IRS rule writers did not provide any substantive justification for this claim. *Id*.

The IRS did submit the rule to the SBA's Office of Advocacy for comment on its impact on small businesses. The SBA rejected the IRS claim, which it said "suggests [the IRS believes] that any regulatory implementation of a statute should not be subject to an RFA analysis. [The Office of] Advocacy does not agree with this analysis. The proposed regulations are a legislative rulemaking that should be subject to an RFA analysis." *Id*. (citing Letter from Darryl L. DePriest, Chief Counsel, Office of Advocacy, Small Bus. Admin., *et al*., to William J. Wilkins, Chief Counsel, Internal Revenue Serv. (Nov. 1, 2016)).
The IRS did not respond.

In addition to the RFA, the IRS has an independent statutory obligation to submit its proposed rules to SBA for comment on the impact to small businesses. *See* 26 U.S.C. § 7805(f). The IRS has a similarly cavalier attitude to this responsibility, as evidenced by its behavior while issuing a highly controversial rule related to a type of

business-ownership restructuring known as an "inversion." In its *Federal Register* notice accompanying that rule, the IRS stated that "[p]ursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel of Advocacy of the [SBA] for comment on its impact on small business." Inversions and Related Transactions, 81 Fed. Reg. 20,588, 20,588 (proposed Apr. 8, 2016) (to be codified at 26 C.F.R. pt. 1). However, a search of the SBA's website shows no documents related to the inversion rule and a FOIA request seeking the IRS submission to SBA generated a response that the agency has no such records.[4]

2. The IRS extended its claim that its rules have no economic impact in order to avoid elements of the Congressional Review Act.

In addition to claiming an exemption from the RFA, the IRS has extended its claim that its rules do not have an economic impact to the CRA. Under the CRA, agencies are required to work with the U.S. Government Accountability Office ("GAO") to prepare reports for Congress on "major rules." *See* 5 U.S.C. § 801(a)(2). The reports detail

[4] *See* Letter from Claudia Rodgers, Senior Counsel, Office of Advocacy, Small Bus. Admin., to James Valvo, Cause of Action Inst. (Jan. 25, 2018), *available at* http://coainst.org/2FL3uzF.

whether the agency complied with various procedural requirements. One way a rule can qualify as "major" is if it has an annual economic impact of $100 million or more. *Id.* § 804(2).

However, the IRM discourages a finding that a regulation qualifies as a major rule under the CRA by echoing the language from other sections of the IRM. *Evading Oversight* at 25. The IRS instructs its rule writers that "IRS rules are rarely major rules because the effect of most IRS rules is due to the underlying statute, rather than to the regulation" and they should "[c]onsult the Chief [of the] Regulations Unit before responding that the document is a major rule." I.R.M. Ex. 32.1.6-6. But the IRS belies its own claim when it changes a prior regulation for an unamended statute. *See Evading Oversight* at 5 (discussing IRS proposed estate-tax valuation rule, which reinterpreted a statutory provision of the Internal Revenue Code that Congress had not altered for twenty years).

A review of the GAO database of major rules submitted by agencies reveals how pervasively IRS has claimed this exemption. The database lists only four interim and six final major rules linked to the

IRS.[5] But eight of those ten rules were co-promulgated with other agencies, who may have insisted that the rules be sent to GAO. Left to its own devices, the IRS has only classified two rules as major since the CRA became law in 1996—a startling level of oversight avoidance.[6]

3. The IRS rarely submits its rules to the White House for prepublican review pursuant to Executive Order 12,866.

To oversee and ensure effective rulemaking, EO 12,866 and its progeny require Executive Branch agencies to submit significant regulatory actions to the White House Office of Management and Budget's ("OMB") Office of Information and Regulatory Affairs ("OIRA") for prepublication review. 58 Fed. Reg. 51,735 (Sept. 30, 1993).[7] The results of this review form an important part of the administrative

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[5] *See* Gov't Accountability Office, Congressional Review Act, Federal Rules Database, http://bit.ly/2nDMHI9 (database searched Feb. 5, 2018, using parameters, Agency: Department of the Treasury, Subagency: Internal Revenue Service, and Rule Type: Major).

[6] The micro-captive transactions rule under review here does appear in GAO's database, but is categorized as a non-major rule. *See* Gov't Accountability Office, GAO Federal Rules Summary Listing, Transaction of Interest—Section 831(b) Micro-Captive Transactions; Notice 2017-08 (Jan. 3, 2017, http://bit.ly/2ENK3KG); Notice 2016-66 (Nov. 2, 2016, http://bit.ly/2ompTND).

[7] Presidents Trump and Obama have reaffirmed EO 12,866's role in the regulatory process. *See* Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Jan. 30, 2017); Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011).

record during judicial review. *See, e.g.*, *Michigan v. Envtl. Prot. Agency*, 135 S. Ct. 2699, 2715, 2721–22 (2015) (Kagan, J., dissenting) (citing EO 12,866 cost-benefit analysis from record); *R.J. Reynolds Tobacco Co. v. Food & Drug Admin.*, 696 F.3d 1205, 1219 n.14 (D.C. Cir. 2012) (using EO 12,866 analysis in review).[8]

Significant regulatory actions subject to EO 12,866 include, *inter alia*, those with an annual economic impact of more than $100 million and those that raise novel legal or policy issues. EO 12,866 § 3(f). Agencies are required to submit proposed rules to OIRA with a cost-benefit analysis, an analysis of other alternatives, and the reason that alternatives were not selected. *Id.* § 6(a)(3)(C). The order also directs that agencies "should afford the public a meaningful opportunity to

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[8] For judicial review of an agency's rulemaking to be meaningful, a court must have access to the "whole record" of the process. *Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 419 (1971); 5 U.S.C. § 706. It is "especially important for the agency to identify and make available technical studies and data that it has employed in reaching the decision to propose particular rules." *Conn. Light & Power Co. v. Nuclear Regulatory Comm'n*, 673 F.2d 525, 530 (D.C. Cir. 1982); *see Am. Radio Relay League, Inc. v. Fed. Commc'ns Comm'n*, 524 F.3d 227, 236 (D.C. Cir. 2008) (collecting cases). Regulatory impact analyses are an important part of such disclosures.

comment on any proposed regulation, which in most cases should include a comment period of not less than 60 days." *Id.* § 6(a).

OIRA conducts interagency review of significant rules before publication, acting as a convener or facilitator for that review. Although some may claim this process is unnecessary, former OIRA Administrator Cass Sunstein has observed that "[t]here are countless instances in which the process of interagency comment during OIRA review . . . leads the agency to make changes quickly and with enthusiasm." Cass R. Sunstein, *The Office of Information and Regulatory Affairs: Myths and Realities*, 126 Harv. L. Rev. 1838, 1848 (2013). OIRA "may also have its own views on both process and substance[.]" *Id.* at 1856.

University of Michigan Law Professor Steven Croley writes that OIRA review is important for at least two reasons. First, OIRA can dispassionately review the proposed rule and, consequently, offer a more objective analysis than the drafting agency. Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. Chi. L. Rev. 821, 831 (2003). Second, presidential oversight of agency rulemaking is necessary to "preserve the political and constitutional

legitimacy of the regulatory state." *Id.* Without that oversight, agencies may "advance their own visions of good regulatory policy, but, electorally unaccountable, those visions lack political legitimacy." *Id.*

In 1983, as the Reagan Administration was implementing Executive Order 12,291 (the precursor to EO 12,866), OMB and the Department of the Treasury entered into a memorandum of agreement exempting all IRS rules from OMB review "except legislative regulations that are 'major' as defined in the Executive Order." *Evading Oversight* at 14 (citing Mem. of Agreement between Dep't of the Treasury and Office of Mgmt. & Budget, Implementation of Executive Order 12291, at § II(a)(1) (Apr. 29, 1983)).[9] This

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[9] GAO has recommended that the director of OMB and the Secretary of the Treasury (1) reexamine "the relevance of the long-standing agreement that exempts certain IRS regulations from executive order requirements and OIRA oversight," and (2) "develop a process to ensure that OIRA has the information necessary to determine whether IRS rules are major under CRA and significant under E.O. 12866." Gov't Accountability Office, GAO-16-720, Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-Standing Exemptions of Tax Regulations and Guidance at 35 (2016) [hereinafter GAO Report on IRS Regulatory Processes]. Senate Finance Committee Chairman Orrin Hatch also has voiced concern that the IRS exemption from the "transparency and accountability requirements [of EO 12,866] appear to have been thwarted for decades due to the Treasury Department's long-secret MOA with . . . OIRA." Letter from Sen. Orrin Hatch, to Hon.

memorandum had long been kept secret and was only recently made public following a FOIA request by CoA Institute. *Id*.

The agreement created a three-tiered system for OIRA review of IRS rules. *Id*. at 16. At the highest level were major legislative rules, which were subject to White House review, the same as other agencies. At the middle level were non-major or non-legislative rules that were reviewed by or subject to approval by an Assistant Secretary. At the lowest level were rules that were exempted from both review regimes and thus were to receive no substantive OIRA review at all.

This three-tiered approach creates myriad opportunities for IRS to game the system and avoid OIRA review. The most obvious is the well-known and largely unrestrained IRS practice of claiming that nearly all of its rules are non-legislative. *Evading Oversight* at 17. GAO found that "[b]etween 2013 and 2015 . . . nearly 90 percent of the proposed, temporary, and final regulations issued [by the IRS]" were claimed to be exempt from APA procedures. GAO Report on IRS Regulatory Processes at 22. Such claims not only allow the IRS to evade the APA's

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Jacob Lew, Sec'y, Dep't of the Treasury (Oct. 11, 2016), *available at* http://bit.ly/2BpLAkx.

notice-and-comment regime, but also allow it to claim it is exempt from EO 12,866 review.

Another way for the IRS to avoid EO 12,866 review is by claiming that a rule does not meet the definition of a "significant regulatory action," which the IRS almost always does. *See* I.R.M. § 32.1.2.3.4; *see also* Jennifer Nou, *Agency Self-Insulation Under Presidential Review*, 126 Harv. L. Rev. 1755, 1786–87 (2013) (discussing ways agencies avoid OIRA review, including claiming rules are not significant).

Over the past ten years, the IRS has submitted only three distinct rules to OIRA for review because the rule was economically significant.[10] Those three rules are less than one percent of the final rules the IRS published in the *Federal Register* over the same period.[11] The IRS routinely avoids the requirements of EO 12,866 and the

[10] Statistics gathered from Historical Reports, Office of Info. & Regulatory Affairs, Office of Mgmt. & Budget, Exec. Office of the Pres., http://bit.ly/2GUR9u6 (last visited Feb. 7, 2018). The IRS sent five rules in total but two were different versions of the same rule, leaving only three distinct rulemakings that it deemed economically significant.

[11] From 2008–2017, the IRS published 751 final rules in the *Federal Register*. Statistics gathered from www.FederalRegister.gov (last visited Feb. 7, 2018).

oversight checks that derive from OIRA and inter-agency review.[12] The consequence of this avoidance is overbroad and often unworkable rules.

A recent example was the IRS attempt to update its guidance on what constitutes political activity by nonprofit corporations following the U.S. Supreme Court's decision in *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010). In November 2013, the IRS issued a notice of proposed rulemaking to change the rules governing political activity by section 501(c)(4) organizations. *See* Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, 78 Fed. Reg. 71,535 (proposed Nov. 29, 2013) (to be codified at 26 C.F.R. pt. 1). Per its usual practice, the IRS claimed that this rule was not significant and thus not subject to EO 12,866. *Id.* at 71,540.[13]

[12] The Tax Court will not review IRS violations of EO 12,866. *See BLAK Investments v. Comm'r*, 133 T.C. 431, 447 (2009) (finding "petitioner has no right to challenge compliance with [EO] 12,866").

[13] CoA Institute submitted a regulatory comment arguing the rulemaking was "significant" because it would have an economic impact of more than $100 million per year on the nonprofit sector and because it raised novel legal and policy issues. *See* Letter from CoA Inst. to Internal Revenue Serv. 4–6 (Feb. 26, 2014), *available at* http://coainst.org/2Eqafde. CoA Institute also requested and participated in a meeting with OIRA urging the office to classify the rulemaking as significant. *See* Letter from CoA Inst. to Hon. Howard A.

The resulting proposed rule was so poorly conceived that a Center for Competitive Politics analysis found that ninety-four percent of public comments and ninety-seven percent of experts, organizations, and public officials either opposed or partially opposed the rule. *See* Matt Nese & Kelsey Drapkin, Ctr. for Competitive Politics, Overwhelmingly Opposed at 2 (July 2014), *available at* http://bit.ly/2C1B6qQ. The comments "were not limited to one interest group or political party, but rather were from citizens and organizations of all political persuasions, tax statuses, and geographical locations." *Id.* Complaints about the rule ranged from overbroad terms to inconsistent definitions, which made the rule unworkable in practice. *Id.* at 10–11. This is the type of broad-ranging opposition to rules that occurs when agencies regulate without appropriate institutional checks.

This combination of self-made exemptions from oversight mechanisms and avoidance behavior to prevent stakeholders in the process from understanding the economic impacts of IRS rules highlights the importance of judicial review.

Shelanski, Adm'r, Office of Info. & Regulatory Affairs (Feb. 5, 2014), *available at* http://coainst.org/2FWPRxr.

B. The IRS Often Escapes Judicial Review under the Administrative Procedure Act

The APA is designed "to guarantee to the public an opportunity to participate in the rule making process," Dep't of Justice, Attorney General's Manual on the Administrative Procedure Act § 4 (1947); 5 U.S.C. § 553(b)–(c), and "embodies the basic presumption of judicial review." *Abbott Labs. v. Gardner*, 387 U.S. 136, 140 (1967); 5 U.S.C. § 702. To ensure proper oversight and stakeholder input, the APA requires agencies to follow certain procedures when they promulgate legislative rules, including public notice and allowing interested parties to meaningfully comments before a rule is finalized. 5 U.S.C. § 553(b)–(c). The IRS often avoids these requirements by asserting that its rules are merely interpretative and exempt from APA notice and comment. *See* I.R.M. § 32.1.5.4.7.5.1.3.

In theory, an agency assertion that its rule is interpretative and exempt from APA notice-and-comment requirements is subject to judicial review. *See Fed. Commc'ns Comm'n v. Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009) (The APA "sets forth the full extent of judicial authority to review executive agency action for procedural correctness[.]"). And courts do not defer to an agency and "classify a

rule as interpretive just because the agency says it is." *Chamber of Commerce of U.S. v. Occupational Safety & Health Admin.*, 636 F.2d 464, 468 (D.C. Cir. 1980). Unlike other agencies, however, the IRS can prevent such review by invoking the Anti-Injunction Act—just as it did here. Such reliance effectively grants the IRS immunity from judicial review of many of its rules and removes a proper check on its discretionary power.

The ability to bind parties on the date a notice issues,[14] combined with an effective immunity from pre-enforcement review, subverts the legitimate rulemaking process. As one commentator stated in the context of an IRS notice of proposed regulations on inversion transactions:

> Given the intense political focus on halting inversion transactions by any means, and the government's position that informal administrative pronouncements like the Notice are immune to immediate legal challenge, one might wonder whether Treasury and the IRS strategically targeted inversion transactions in this manner to exploit the historic procedural rules promulgated in response to very different

[14] Although the APA provides that publication of a final rule must be made at least thirty days before its effective date, 5 U.S.C. § 553(d), IRS rules have binding effect as early as the date on which "any notice substantially describing the expected contents of any temporary, proposed, or final regulation is issued to the public." 26 U.S.C. § 7805(b)(1)(C).

> concerns in a different era. At the very least, the procedural limitations on timely challenges to Treasury and IRS action taken via notice suggest a need for greater temperance on the part of Treasury and the IRS when regulating via notice.

Christopher P. Bowers, *et al.*, *Challenging the IRS Anti-Inversion Notice: A Hollow Threat*, Skadden's 2015 Insights (Jan. 2015), *available at* http://bit.ly/2os3FcZ.

This is not an isolated example. Professor Kristin Hickman of the University of Minnesota Law School has conducted an empirical study of compliance with APA rulemaking requirements by the Department of Treasury, the parent agency of the IRS. *See* Kristin E. Hickman, *Coloring Outside the Lines, Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727 (2007). She found that Treasury, even when issuing notice and soliciting comments, rarely complies with the actual requirements of the APA. *Id.* at 1748–50. In almost ninety-three percent of the cases she surveyed over a three-year period, "Treasury claimed explicitly that the rulemaking requirements of APA section 553(b) did not apply." *Id*. at 1750; *see* Br. of Appellant at 6 (detailing the IRS behavior in this case of evading the statutory requirement that

"transactions of interest" be created "under regulations"); *id.* at 10–11 (explaining the IRS failure to comply with the APA).

To avoid IRS abuse of the rulemaking process and ensure proper oversight, the Anti-Injunction Act should be construed—consistent with the Supreme Court's decision in *Direct Marketing Ass'n v. Brohl*, 135 S. Ct. 1124 (2015)—to allow judicial review of the rule at issue in this case.

II. The Anti-Injunction Act Should Not Be Construed to Require Regulated Parties to Violate the Law Before They Can Challenge It

The IRS insists, and the district court agreed, that the Anti-Injunction Act protects the rule at issue from pre-enforcement judicial review because violation of the micro-captive transactions rule would result in a penalty and the Act bars pre-enforcement review of penalties. *See CIC Servs., LLC v. Internal Revenue Serv.*, No. 17-110, 2017 WL 5015510, at *2–3 (E.D. Tenn. Nov. 2, 2017).

This overly formalistic interpretation expands the Anti-Injunction Act's narrow exemption from judicial review and grants the IRS a powerful shield to hide the abuse of its discretionary power. The problem with this approach to pre-enforcement review "should be obvious: it removes the courts as a critical check against sweeping IRS

policymaking discretion, serving the convenience of the IRS and the courts, but disserving taxpayers and the credibility of the tax system as a whole." Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683, 1748–49 (2017). It also contradicts the Supreme Court's interpretation of the coterminous Tax Injunction Act in *Direct Marketing.*

It is well-established that regulated parties should not be required to violate the law before they can challenge it in court. *See Free Enter. Fund*, 561 U.S. at 490 ("We normally do not require plaintiffs to 'bet the farm . . . by taking the violative action' before 'testing the validity of the law[.]'" (quoting *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 129 (2007)). When a "regulation requires an immediate and significant change in the plaintiffs' conduct of their affairs with serious penalties attached to noncompliance, access to the courts . . . must be permitted, absent a statutory bar[.]" *Abbott Labs.*, 387 U.S. at 153.

The district court followed the D.C. Circuit's decision in *Florida Bankers* and found that the Anti-Injunction Act presents such a statutory bar by creating "a narrow exception to the general administrative law principle that pre-enforcement review of agency

regulations is available[.]" *Fla. Bankers Ass'n v. Dep't of the Treasury*, 799 F.3d 1065, 1066 (D.C. Cir. 2015) (citing *Abbott Labs.*, 387 U.S. at 152–53).[15] In relevant part, the Anti-Injunction Act states that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person[.]" 26 U.S.C. § 7421(a). This exception exists to "protect[] the Government's ability to collect a consistent stream of revenue." *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566, 2582 (2012).

The instant case, however, does not implicate the government's ability to collect a consistent stream of revenue because neither the penalty nor the regulatory command to which it is attached are involved in the assessment or collection of a tax. This is so for two reasons.

First, penalties like the one at issue in this case are, by their nature, designed to incentivize compliance with a regulatory scheme, not to generate revenue. If "the penalty is avoided—and presumably

[15] The district court considered the Anti-Injunction Act to be a jurisdictional bar. *CIC Servs.*, 2017 WL 5015510, at *4 ("Defendants' motion to dismiss is GRANTED . . . because the Court lacks subject-matter jurisdiction[.]"). *But see* Erin Morrow Hawley, *The Equitable Anti-Injunction Act*, 90 Notre Dame L. Rev. 81 (2014) (arguing that the Act is an exhaustion requirement and thus a quintessential non-jurisdictional claims-processing rule).

this is the Government's intent—then individuals will have complied with the regulation and the IRS will collect zero revenue." *Fla. Bankers Ass'n*, 799 F.3d at 1078 (Henderson, J., dissenting). The Supreme Court has previously said that if a provision is "unrelated to the protection of the revenues," then the Anti-Injunction Act should not prevent judicial review. *Bob Jones Univ. v. Simon*, 416 U.S. 725, 740 (1974).

Second, the underlying regulatory command is not an assessment or collection of a tax but instead creates a new transaction of interest, a type of reportable transaction. *See* Notice 2016-66. As the Supreme Court unanimously ruled in *Direct Marketing*, "reporting requirements precede the steps of 'assessment' and 'collection'" and therefore challenges to reporting requirements do not implicate the same concerns. 135 S. Ct. at 1131.[16] The Supreme Court also instructed that a lawsuit does not restrain the assessment or collection of a tax "if it merely inhibits those activities." *Id.* at 1133.

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[16] The statute at issue in *Direct Marketing* was the Tax Injunction Act, which was modeled off the Anti-Injunction Act. The Supreme Court explained that it "assume[s] that words used in both Acts are generally used in the same way, and [it] discern[s] the meaning of the terms in the [Anti-Injunction Act] by reference to the broader Tax Code." *Direct Mktg.*, 135 S. Ct. at 1129.

Professor Hickman argues that while the Supreme Court "provided no test for determining precisely where to draw the line operationally between stopping and inhibiting the assessment and collection" of taxes, by looking to the Anti-Injunction Act's original meaning and purpose courts can both honor Congress's goal of protecting revenue assessment and collection and also "bring[] the [Anti-Injunction Act] into harmony with the APA and the Supreme Court's interpretation . . . by clearing the way for pre-enforcement challenges to Treasury regulations, restoring transparency and public accountability to tax administration." Hickman & Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. at 1749.

As the penalty here is not intended to generate revenue and the reporting requirement does not restrain the assessment or collection of a tax, the Anti-Injunction Act does not bar pre-enforcement judicial review of the IRS rule at issue.

CONCLUSION

For the foregoing reasons, this Court should reverse the district court and remand with the direction that the Anti-Injunction Act does not bar subject-matter jurisdiction over this case.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rules of Appellate Procedure 29 and 32 and Sixth Circuit Rule 32, I hereby certify that this brief complies with the type-volume limitation because it contains 5,533 words, excluding the parts of the brief exempted. I hereby certify that this brief also complies with the typeface and the type-style requirements because it has been prepared in a proportionally spaced typeface using Microsoft Word 2013 in Century Schoolbook 14-point font.

Date: April 4, 2018 *<u>/s/ John. J. Vecchione</u>*
John J. Vecchione

CERTIFICATE OF SERVICE

I hereby certify that I caused the foregoing document to be electronically filed with the Clerk of the Court for the United States Court of Appeals for the Sixth Circuit by using the appellate CM/ECF system, thereby serving all persons required to be served.

Date: April 4, 2018 *<u>/s/ John. J. Vecchione</u>*
John J. Vecchione