No. 19-930

In the Supreme Court of the United States

CIC SERVICES, LLC,
Petitioner,

v.

INTERNAL REVENUE SERVICE; DEPARTMENT OF TREASURY; UNITED STATES OF AMERICA,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

Ilya Shapiro
Counsel of Record
Trevor Burrus
James T. Knight II
CATO INSTITUTE
1000 Mass. Ave., NW
Washington, DC 20001
(202) 842-0200
ishapiro@cato.org

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QUESTION PRESENTED

Should courts interpret the words of the Anti-Injunction Act ("AIA"), 26 U.S.C. § 7421, differently than this Court interpreted the same words in the AIA's sister statute in *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015), such that the AIA renders the pre-enforcement judicial review provided by the Administrative Procedure Act unavailable to plaintiffs seeking to challenge an IRS reporting requirement, merely because the penalty for violating the reporting requirement is labeled as a tax?

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan public policy research foundation established in 1977 and dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies was established in 1989 to help restore the principles of limited constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences and forums, and produces the annual *Cato Supreme Court Review*.

This case interests Cato because the opinion below unnecessarily and unwisely limits judicial review of agency actions, which is essential to enforcing the separation of powers.

SUMMARY OF ARGUMENT

In *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015), this Court provided a framework for applying the Tax Injunction Act ("TIA"), 28 U.S.C. § 1341, and, by extension, its sister statute, the Anti-Injunction Act ("AIA"), 26 U.S.C. § 7421(a). Yet the opinion of the divided Sixth Circuit panel below interprets the AIA contrary to *Direct Marketing*. This deviation results in the same words being given different meanings in the AIA and the TIA without any rational justification. The ramifications of that misinterpretation of the AIA are far-reaching. In addition to creating an artificial interpretive dichotomy between the AIA and

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[1] Rule 37 statement: All parties were timely notified and consented to the filing of this brief. No part of this brief was authored by any party's counsel, and no person or entity other than *amicus* funded its preparation or submission.

the TIA, the opinion defeats the application of judicial review to Treasury regulations[2] at the time that review is needed most: *before* invalid regulations masquerade as law. In so holding, the Sixth Circuit deepened an existing circuit split on the effect of the AIA on a pre-enforcement challenge to a regulation accompanied by a tax penalty, adopting the reasoning of the D.C. Circuit and opposing the Seventh and Tenth Circuits' position allowing such challenges to go forward.

Instead of applying the AIA to prohibit only those suits "restraining the assessment or collection of any tax" in accordance with its plain statutory language, the Sixth Circuit interpreted the AIA as protecting even an obviously invalid Treasury regulation from a timely suit designed to hold the agency accountable. Specifically, the panel opinion adopts the D.C. Circuit's reasoning exempting Treasury regulations from the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 701-706 on the ground that all tax rules ultimately determine tax liabilities or tax-related penalties of specific taxpayers. *CIC Servs., LLC v. IRS*, 925 F.3d 247, 255–56 (6th Cir. 2019) (citing *Florida Bankers Ass'n v. U.S. Dep't of Treasury*, 799 F.3d 1065, 1067, 1069 (D.C. Cir. 2015)). The assessment or collection of the tax liability of a specific taxpayer, however, is not at issue in this or many other APA suits involving such regulations. Given that every tax rule necessarily must have

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[2] *Amicus* calls them "Treasury regulations" because the treasury secretary has rulemaking authority over tax regulations. *See, e.g.* 26 U.S.C. § 7805(a). It is while working with the IRS on such regulations, however, that Treasury most critically fails to apply the APA. Strangely, in other areas of rulemaking, like foreign assets control, Treasury seems to understand and comply with the APA.

some effect, when eventually applied, on the tax obligations of some taxpayer, the panel's expansive reading of the AIA effectively allows all Treasury regulations to have the force and effect of law even when Treasury has ignored the most fundamental statutory prerequisites to enshrining agency action as law.

This result cannot stand because it prohibits preenforcement judicial review of the rulemaking process under the APA for Treasury regulations alone, once again "carrv[ing] out an approach to administrative review good for tax law only." *Contra Mayo Found. For Med. Educ. & Research v. United States*, 565 U.S. 44, 55 (2011); *see also Dickinson v. Zurko*, 527 U.S. 150, 154 (1999) (where the Court "recogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action"). It also frustrates, and does not aid, compliance with tax law. Under such a framework, the only recourse against defective Treasury regulations is to purposely violate the regulation and await increased taxes, penalties, and interest at a subsequent enforcement proceeding in which the regulation's validity can be challenged. *Cf. Okla. Operating Co. v. Love*, 252 U.S. 331, 336–37 (1920) (holding that regulated parties cannot be forced to violate the law, incur penalties, and suffer contempt proceedings to obtain judicial review of agency action). Requiring taxpayers to break the law simply to determine the validity of a questionable regulation undermines the AIA, emasculates the APA, and does nothing to aid tax assessment and collection, which hasn't even begun. This result is particularly offensive because the IRS has repeatedly disregarded the strictures of the APA—likely more than any other agency.

This Court should grant review to consider whether it is appropriate for a different standard of judicial review to apply to suits challenging Treasury and IRS rulemaking under the APA even where the assessment and collection of taxes are unrestrained by such suits.

REASONS FOR GRANTING THE PETITION

I. This Court Should Resolve the Interpretive Split Between the Anti-Injunction Act and the Tax Injunction Act to Allow Lower Courts to Properly Adjudicate Challenges to Tax Regulations

The AIA prohibits suits "for the purpose of restraining the assessment or collection of any tax." 26 U.S.C. § 7421(a). The AIA "apparently has no recorded legislative history," but by its terms, its "principle purpose" is to protect "the Government's need to *assess* and *collect* taxes as expeditiously as possible." *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974) (emphasis added). "When the income tax was first imposed during the civil war, a number of applications were made for injunctions against its assessment or collection." Roger Foster & Everett V. Abbot, *A Treatise on the Federal Income Tax Under the Act of 1894* 231 (1895). Congress enacted the AIA to prevent these suits: *i.e.*, suits that would stop assessment and collection from a taxpayer of tax. The key terms of the AIA—"assessment" and "collection"—are not "synonymous with the entire plan of taxation." *Hibbs v. Winn*, 542 U.S. 88, 102 (2004). The AIA was not designed to prevent every suit that could have some impact on the amount of revenue ultimately collected by the IRS.

In 2015, *Direct Marketing* addressed the meaning of the applicable statutory words in the context of analyzing the AIA and the TIA together. 135 S. Ct. at 1129. There, the Court made clear that restraining the assessment or collection of tax means to "stop" the assessment or collection, not merely to inhibit it. *Id.* at 1133. The Court further explained that "assessment" and "collection" refer to specific phases of the tax administration process. "Assessment" means "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," while "collection" means "the act of obtaining payment of taxes due." *Id.* at 1130. These definitions apply to both the TIA and the AIA. *Id.* at 1129 ("We assume that words used in both Acts are generally used in the same way").

In reaching its contrary conclusion, the Sixth Circuit panel wholly adopted the D.C. Circuit's approach in *Florida Bankers. CIC v. IRS*, 925 F.3d at 257 ("[W]e find the D.C. Circuit's recent, unequivocal pronouncement on this issue in *Florida Bankers* persuasive."). In the midst of the "jurisprudential chaos" of inconsistent applications of the AIA, *id*. at 251 (quoting Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683, 1686 (2017)), the approach adopted by the Sixth and D.C. Circuits attempts to follow this Court's "rule favoring 'clear boundaries' in the interpretation of jurisdictional statutes," *id*. at 257 (quoting *Direct Marketing*, 135 S. Ct. at 1131).

Alas, the "clear boundary" adopted by this approach relies on the very same statutory interpretation that the Court rejected in *Direct Marketing* by reading the term "restrain" broadly to cover any action

that could potentially reduce revenue. Specifically, the approach of the D.C. and Sixth Circuits reads the word "restrained" to act on the word "tax" rather than "assessment" and "collection." *Contra* 135 S. Ct. at 1132.

> 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." Such a broad construction would thus render "assessment [and] levy"—not to mention "enjoin [and] suspend"—mere surplusage, a result we try to avoid.

Id. The Sixth Circuit reasoned that a challenge to a regulation could, if successful, prevent the IRS from imposing a penalty because the regulation would be declared invalid. *See CIC v. IRS*, 925 F.3d at 255-56 ("Plaintiff's suit 'would have the effect of restraining—*fully stopping*' the IRS from collecting the penalties imposed for violating the Notice's requirements."). But that logic is both flawed and untethered from the statutory text. A challenge to the regulation addresses the rulemaking process, not the assessment or collection process for any specific taxpayer. A contrary view foists invalid regulations on taxpayers until questions of their validity bubbles up through garden-variety tax litigation—a process that routinely takes years.

Those problems are particularly evident here. Petitioner challenges the *regulatory process* for making the regulation at issue. It seeks to resolve the question of whether Treasury and the IRS complied with the notice-and-comment requirements of the APA in promul-

gating the regulations that mandate a reporting requirement and related penalty. It does not seek to restrain any assessment or collection process for that penalty. Indeed, a penalty may be assessed only if there is a failure to comply with the reporting requirement. Answering Petitioner's question thus does not require an injunction to restrain any assessment or collection process. Indeed, since Petitioner is not in the habit of consciously violating laws, there may never be such processes. Because the failure-to-report penalty is the supposed "tax" on which the AIA's restrictions are allegedly triggered, if Petitioner does not violate the law no "tax" arises to be assessed and collected and the AIA never applies. But the Sixth Circuit found even this tenuous connection to an inchoate and illusory "tax" enough to bar judicial review under the AIA.

To the contrary, judicial review of agency rulemaking comports with the AIA because such review—whether in this case or any other—does not stop the tax assessment or collection process for any taxpayer. Judicial review of agency rulemaking has another aim entirely: to provide a necessary check on the agency rulemaking process and to promote clarity *and validity* in the regulations that bind regulated parties. The relief requested in such a challenge is not designed to stop the assessment or collection process because judicial review of agency rulemaking is not tied to the tax assessment and collection procedures; indeed it is separate from (and often predates) the predicate facts required for assessment and collection to even occur. Agency rulemaking and judicial review of that rulemaking are simply not part of the assessment or collection process. They are different things entirely.

The opinion below also conceals the proper scope of the AIA and undermines this Court's "rule favoring clear boundaries in the interpretation of jurisdictional statutes" even as it seeks to follow it. *Direct Marketing*, 135 S. Ct. at 1131. Instead of furthering the clarity of *Direct Marketing*, the lower court's opinion muddles the boundaries of the AIA. The confusion caused by the lower court's analysis is further compounded by the government's inconsistent positions regarding the proper interpretation of the AIA, as exemplified in *NFIB v. Sebelius*, 132 S. Ct. 2566 (2012). In the district court briefs in that case, the government contended that the AIA barred a challenge to the minimum-care provision of the Affordable Care Act. The government later changed its position and contended that the AIA did not bar judicial review. Brief for Petitioners (Anti-Injunction Act) at 5 n.4, *Dep't of Health and Human Servs. v. Fla.*, No. 11-398 (Feb. 2012) (describing the government's shifting positions on the AIA). Specifically, the government initially argued that a "penalty" was a "tax" under the AIA. Then it said the opposite. "Under the Code, [of which the AIA is a part,] the term 'tax' carries with it a wide array of substantive and procedural statutory consequences, and a 'penalty' is not the same thing as a 'tax' for statutory purposes under the Code." *Id.* at 21. Here, however, the government abandons its text-based interpretation of the AIA. The reporting "penalty" at issue here is again a "tax." Like the TIA, the AIA should be limited to and construed by its terms and not by the government's day-to-day changes in litigating position designed to shield its invalid actions from judicial review.

If judicial review of agency rulemaking has any impact on the assessment and collection procedure, it is

to *facilitate* proper and timely assessment and collection rather than impede it. Where there is a regulation of questionable validity due to APA violations, the lingering uncertainty regarding the effect of that regulation interferes with the assessment and the collection of tax regardless of whether a pre-enforcement action is filed because taxpayers do not know what the law actually is. Preventing any pre-enforcement challenge only perpetuates that uncertainty because taxpayers must wait years to address the issue in the ordinary course of tax litigation, all the while incurring compliance costs and having to choose whether to comply with potentially invalid rules. As this case illustrates, barring pre-enforcement judicial review of agency rulemaking also creates absurd results that could not have possible been intended by the AIA. The Sixth Circuit panel's opinion necessitates that taxpayers violate the reporting requirements in a potentially invalid Treasury regulation, wait to see if enforcement action occurs, accept the assessment of any penalty in the enforcement action, pay that penalty, and then challenge that penalty in a refund proceeding—all to determine if the regulation was valid in the first place. The AIA could not have intended that violating an invalid regulation was the sole means to challenge it.

II. The View That the APA Does Not Allow Pre-Enforcement Judicial Review of Treasury Regulations Conflicts with the Strong Presumption in Favor of Such Review of Agency Action

The decision below also unnecessarily creates a conflict between the AIA and APA, even though the language of the two statutes is easily reconciled. The

APA contains a "strong presumption" in favor of pre-enforcement judicial review of agency action. *See Bowen v. Mich. Acad. of Family Physicians*, 476 U.S. 667, 670 (1986). The panel applied the AIA beyond its terms and obliterated the strong presumption of pre-enforcement judicial review.

Congress authorized judicial review under the APA, including judicial review of agency rulemaking, except to the extent precluded by statute. 5 U.S.C. § 701(a)(1). "Very rarely do statutes withhold judicial review. It has never been the policy of Congress to prevent the administration of its own statutes from being judicially confined to the scope of authority granted or to the objectives specified." S. Rep. No. 79-752, at 26 (1945). Consistent with that policy, statutes are not intended to be "blank checks drawn to the credit of some administrative agency. *Id.* The right to seek judicial review of agency action is so fundamental that "only upon a showing of 'clear and convincing evidence'" of congressional intent to withhold judicial review should courts restrict access to such review. *Abbott Labs v. Gardner*, 387 U.S. 136, 141 (1967) (quoting *Rusk v. Cor*, 369 U.S. 367, 379-80 (1962)); *see also* H.R. Rep. No. 79-1980, at 41 (1946). Some statutes expressly authorize judicial review, but that does not mean that Congress intended to exclude from review statutes that lack such authorization. *Abbott Labs.*, 387 U.S. at 141 ("The right to review is too important to be excluded on such slender and indeterminate evidence of legislative intent."). These principles presume *pre-enforcement* judicial review of agency rulemaking, which often is the only effective way for regulated parties to obtain *timely* and *useful* judicial review of a regulation.

The text of the AIA shows that Congress did not intend to preclude pre-enforcement judicial review of Treasury regulations. By its terms, the AIA prohibits only those suits whose "purpose" is to "restrain" "the assessment or collection" of tax, a small subset of all potential suits. As discussed above, the rulemaking process and pre-enforcement judicial review of those rules are independent of and separate from the assessment and collection procedures for any specific taxpayer. Indeed, in most cases, rulemaking and pre-enforcement judicial review occur well before any tax could even be assessed or collected. Thus, the AIA does not address pre-enforcement judicial review, much less prohibit it. The Internal Revenue Code also does not expressly preclude judicial review of tax regulations. Indeed, no statute precludes judicial review of agency rulemaking by Treasury or the IRS. *Cohen v. United States*, 650 F.3d 717, 723 (D.C. Cir. 2011) (en banc) ("The IRS is not special in this regard; no exception exists shielding it—unlike the rest of the Federal Government—from suit under the APA."). But the court below prohibited pre-enforcement judicial review based on an erroneous construction of the AIA's text. That undermines Congress's intent to allow judicial review to ensure that agency action is reasoned, not contrary to statute, and not procedurally defective. *See* 5 U.S.C. § 706(2). Rather than reconcile the purposes of the APA and the AIA, the lower court's decision imposes a blanket rule that undermines the congressional intent underlying both statutes.

Consistent with that intent, the APA's notice-and-comment rulemaking provides a vital check on an agency's administration of statutes through regulations or other guidance. By ensuring that regulated

parties have an opportunity to meaningfully participate in the promulgation of rules before the rules are applied in an enforcement action, the APA's rulemaking requirements provide a mechanism for "a genuine interchange" of views intended to lead to the promulgation of "improved rules." *See Conn. Light & Power Co. v. Nuclear Regulatory Comm'n*, 673 F.2d 525, 533 (D.C. Cir. 1982). "In enacting the APA, Congress made a judgment that notions of fairness and informed administrative decisionmaking require that agency decisions be made only after affording interested persons notice and an opportunity to comment." *Chrysler Corp. v. Brown*, 441 U.S. 281, 316 (1979). To comply with U.S.C. § 553, an agency generally must publish proposed rules in the Federal Register to provide affected persons with notice of proposed rulemaking. The notice must specify the legal authority for the proposed rule and offer the terms or substance of the proposed rule or a description of the subjects and issues involved. 5 U.S.C. § 553(b). Then the agency must offer interested persons an opportunity to participate in the rulemaking process through the submission of "written data, views, or arguments." *Id.* § 553(c). After considering the material provided by interested parties, the agency must include in the final rule a "concise statement of [the] basis and purpose" of the rule. *Id.*

The APA's judicial review provisions in turn ensure agency compliance with these bedrock notice-and-comment rulemaking requirements. "[C]ourts retain a role, and an important one, in ensuring that agencies have engaged in reasoned decisionmaking." *Judulang v. Holder*, 132 S. Ct. 476, 483–84 (2011). Courts rely on the materials in the rulemaking record, including

the agency's statement of basis and purpose, to determine the reasonableness of agency decisionmaking. *See SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947). Indeed, the rulemaking requirements "enhance the quality of judicial review" by testing agency action through exposure to public comment. *Int'l Union, United Mine Workers of Am. v. Mine Safety & Health Admin.*, 407 F.3d 1250, 1259 (D.C. Cir. 2005). Judicial review of rulemaking also ensures that businesses and individuals whose interests are affected by agency action have an opportunity to participate in the rulemaking process before the rules are applied in an enforcement action. The APA's "procedural requirements are intended to assist judicial review as well as to provide fair treatment for persons affected by a rule," which requires that there be "an exchange of views, information, and criticism between interested persons and the agency.'" *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 (D.C. Cir. 1977) (citations omitted).

Without pre-enforcement judicial review under the APA, Treasury and the IRS are insulated from the public accountability Congress intended to govern *all* agencies. If courts treat Treasury regulations differently than the regulations of every other agency, then Treasury and the IRS will continue to promulgate regulations that are manifestly contrary to statute, arbitrary and capricious, and procedurally defective. They will continue to ignore the views, information, and criticism of businesses and individuals affected by those rules. And the IRS will continue to force business and individuals to apply those defective rules until, years later, in an enforcement action, a taxpayer challenges the rule at great financial risk to itself. *Cf. Ex parte Young*, 209 U.S. 123, 148 (1908) (forcing a business to

risk penalties to challenge a rule in court violates due process). The AIA was not intended to insulate Treasury and the IRS from reasonable judicial review or to foster defective rulemaking. Contrary to the opinion below, the AIA does not abrogate the right of taxpayers to challenge such guidance before enforcement.

III. Treasury Has Strayed from the APA's Rulemaking Requirements and Must Be Brought Back into the Fold

Tax rules affect more individuals and businesses than those of any other agency. But the IRS, and Treasury on its behalf, has habitually refused to comply with the APA absent judicial intervention. Treasury and the IRS: (i) regularly issue force-of-law Treasury regulations[3] without giving regulated parties any prior opportunity for comment and without any showing of good cause; (ii) ignore the APA's requirement to publish proposed rules in the Federal Register; (iii) promulgate "fact-based" rules that lack any basis in fact; and (iv) consistently fail to provide a reasoned ex-

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[3] Although many of the Treasury regulations discussed *infra*, unlike the regulations here, are revenue-raising, after *Direct Marketing*, the distinction between "regulatory" and "revenue-raising" is irrelevant. The analysis in that case provides a direct analytical framework for applying the AIA based on the plain text of the Act. Under that framework, the AIA bars only those actions that stop the assessment or collection of tax of a particular taxpayer. APA challenges, by contrast, target "the regulation itself." *Florida Bankers Ass'n v. U.S. Dep't of Treasury*, 19 F. Supp. 3d 111, 121 (D.D.C. 2014). Thus, the AIA does not apply to pre-enforcement challenges of either sort of regulation because the purpose of the litigation is not to stop assessment or collection against any taxpayer, but instead questions the rule's validity.

planation for promulgated rules. The IRS then compounds the harm by penalizing taxpayers who do not follow this defective guidance. By raising the AIA as a bar to pre-enforcement judicial review, the court below eliminates the key mechanism Congress provided to ensure that agencies do not systematically disregard the APA's fundamental rulemaking requirements.

Treasury routinely ignores the notice-and-comment rulemaking and reasoned decisionmaking requirements of the APA when it promulgates tax regulations. Its regulatory preambles often proclaim that "[i]t has . . . been determined that section 553(b) of the Administrative Procedure Act . . . does not apply to these regulations." *See, e.g.*, Final Rules for Grandfathered Plans, Preexisting Condition Exclusions, Lifetime and Annual Limits, Rescissions, Dependent Coverage, Appeals, and Patient Protections Under the Affordable Care Act, 80 Fed. Reg. 72192, 72237 (Nov. 18, 2015); Reliance Standards for Making Good Faith Determinations, 80 Fed. Reg. 57709, 57715 (Sept. 25, 2015); Integrated Hedging Transactions of Qualifying Debt, 80 Fed. Reg. 53732, 53733 (Sept. 8, 2015). The IRS contends that "most IRS/Treasury regulations will be interpretative regulations." Internal Revenue Manual 32.1.5.4.7.5.1(2) (Sept. 30, 2011). Despite this Court's holdings that legislative rules have the force and effect of law and interpretive rules do not (*e.g.*, *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1203–04 (2015)), the IRS claims that regulated parties are legally bound by rules in considers "interpretative." *See*, *e.g.*, *Altera v. Comm'r*, 145 T.C. No. 3, slip op. at 41 (2015) ("Respondent agrees that the final rule has the force of law but disagrees . . . that it is a legislative

rule."), *rev'd by Altera Corp. & Subsidiaries v. Comm'r*, 926 F.3d 1061 (9th Cir. 2019).

Treasury and the IRS also attempt to bind regulated parties through "temporary" regulations that purport to be immediately effective despite the absence of pre-promulgation notice and comment. Courts criticize Treasury for this continued use of temporary regulations and its concomitant failure to comply with the APA. The Fifth Circuit has disapprovingly observed that Treasury and the IRS "regularly" issue "Temporary Regulations without subjecting them to notice and comment procedures." *Burks v. United States*, 633 F.3d 347, 360 n.9 (5th Cir. 2011). "That the government allowed for notice and comment after the final Regulations were enacted is not an acceptable substitute for pre-promulgation notice and comment." *Id.* U.S. Tax Court judges also have condemned the IRS's attempt to circumvent the APA through the use of temporary regulations. "[B]oth the Supreme Court and the APA itself provide that exceptions to the APA's terms cannot be inferred. . . . Respondent may think that section 7805(e) makes him special when it comes to rulemaking, but the APA makes it clear that he is not." *Intermountain Ins. Serv. v. Comm'r*, 134 T.C. 211, 246 (2010) (Halpern & Holmes, JJ., concurring), *rec'd*, 650 F.3d 691 (D.C. Cir. 2011), *vacated*, 132 S. Ct. 2120 (2012). But Treasury and the IRS ignore these criticisms and continue to issue "temporary" Treasury regulations without the necessary showing of good cause. *See*, *e.g.*, U.S. Response to Microsoft's Brief at 22, *United States v. Microsoft Corp.*, No. 2:15-cv-00102 (W.D. Wash. Oct. 9, 2015) (Department of Justice attorney asserting that "[t]he IRS has specific authority

to issue immediately effective temporary regulations before the notice-and-comment process is completed").

To compound their errors, Treasury and the IRS leave their temporary regulations in place for years without taking further rulemaking steps. *See* Michael Asimow, *Interim-Final Rules: Making Haste Slowly*, 51 Admin. L. Rev. 703 (1999). Indeed, some Treasury regulations have become "permanently temporary." *See* Juan F. Vasquez, Jr. & Peter A. Lowy, *Challenging Temporary Treasury Regulations: An Analysis of the Administrative Procedure Act, Legislative Reenactment Doctrine, Deference, and Invalidity*, 3 Hous. Bus. & Tax L.J. 248, 254 (2003). This defective rulemaking undermines the central purpose of the APA, which is to provide regulated parties the opportunity to meaningfully participate in the rulemaking process before agencies promulgate legally binding rules.

The IRS also ignores the APA's requirement to publish proposed regulations in the Federal Register and instead publishes "Notices" that purportedly set forth immediately binding rules. An *en banc* D.C. Circuit told the IRS that it "is not special" when it comes to agency rulemaking and that it cannot issue binding rules through Notices. *Cohen v. United States*, 650 F.3d 717, 723 (D.C. Cir. 2011). But the IRS continues to do so, primarily for the *in terrorem* effect. For example, IRS Notice 2014-52, 2014-42 I.R.B. 712, sets forth guidance regarding corporate inversions. Treasury simultaneously released a "Fact Sheet" that described the Notice's intended legal effect, which was "to reduce the tax benefits of—and when possible, stop—corporate tax inversions." Press Release, U.S. Dep't of the Treasury, Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions (Sept. 22, 2014). Treasury's

"Fact Sheet" treated the Notice as if it contained force-of-law rules. "[T]he Notice *eliminates* certain techniques inverted companies currently use to access the overseas earnings of foreign subsidiaries of the U.S. company that inverts without paying U.S. tax." *Id.* (Emphasis added.) And Treasury's "Fact Sheet" contended that these "rules" were immediately effective. "Today's actions apply to deals closed today or after today." *Id.* But Treasury did not simultaneously publish any proposed regulations in the Federal Register, did not give advance notice of or opportunity to comment on the rules, and did not establish good cause for their noncompliance. Through its campaign of *in terrorem* rulemaking, the IRS attempts to do by Notice what Treasury what it cannot do by regulation. Taxpayers know the intended *in terrorem* effect all too well. *See* Andrew Velarde & Amanda Athanasiou, *IRS Eliminates Intangible Transfer Foreign Goodwill Exception*, 148 Tax Notes 1291 (Sept. 21, 2015) (proposed Treasury regulations under 26 U.S.C § 367(d) are "yet another piece of guidance that may be intended to have an *in terrorem* effect") (quoting Layla J. Aksakal); Andrew Velarde, *New Inversion Notice Complicates an Already Complicated Field*, 2015 TNT 226-3 (Nov. 23 2015) (provisions of IRS Notice 2015-79, 2015-49 I.R.B. 1 "that disregard certain stock seem to be . . . an *in terrorem* provision") (quoting Carol P. Tello).

Treasury and the IRS compound infirmities in their rulemaking by finalizing rules that are not the product of reasoned decisionmaking. For years, the IRS had a *policy* of providing no explanation—reasoned or otherwise—for tax regulations. Until 2014, the IRS's Chief Counsel Directives Manual provided that "[i]t is not necessary to justify the rules that are being proposed

or adopted or alternatives that were considered." Internal Revenue Manual 32.1.5.4.7.3(1) (Sept. 30, 2011). As a consequence, many, if not most, tax regulations failed to explain the decisionmaking that produced the rule. The associated-property rule in 26 C.F.R. § 1.263A-11(e)(1)(ii)(B) suffered from the lack of any "justification," and the Federal Circuit invalidated that rule on those grounds. Treasury regulations lacking legal justification create confusion in a body of law, tax law, that "can give no quarter to uncertainty." *Thor Power Tool Co. v. Comm'r*, 439 U.S. 522, 543 (1979).

Pre-enforcement challenges to flawed tax rules eliminate this confusion and bring certainty to the law in an expeditious manner. In the absence of such pre-enforcement challenges, taxpayers must try to recoup money paid because of the invalid regulations. But because of the passage of time, refund actions generally are not an option. The Internal Revenue Code bars suits for taxes paid more than two years before a claim or returns filed more than three years before a claim. 26 U.S.C. § 6511(a).

Worse yet, the IRS amplifies the effect of defective guidance by penalizing taxpayers for failing to follow it. The Internal Revenue Code imposes a 20 percent penalty on the disregard of rules or regulations. 26 U.S.C. § 6662. The IRS interprets this to include temporary regulations and Notices. 26 C.F.R. § 1.6662-3(b)(2). Thus, while the IRS refuses to comply with notice-and-comment rulemaking and ignores the process of issuing reasoned rules, it simultaneously arrogates to itself the authority to punish taxpayers for failing to comply with that same faulty guidance. This practice makes a mockery of the principle that "'elementary

fairness compels clarity' in the statements and regulations setting forth the actions with which the agency expects the public to comply." *General Elec. Co. v. EPA*, 53 F.3d 1324, 1329 (D.C. Cir. 1995) (quoting *Radio Athens Inc. v. FCC*, 401 F.2d 398, 404 (D.C. Cir. 1968)). Congress could not have intended the AIA to allow the IRS to penalize those who dare challenge its invalid regulations and to tax those too scared to do so.

CONCLUSION

The opinion below cloaks Treasury's defective rulemaking behind a contorted AIA interpretation and nullifies an essential check on agency action. Without that check, regulated parties have no good choices. They can either comply with invalid regulations or risk increased taxes and penalties. As this Court has held, requiring a regulated party to "refuse to comply . . . and test the regulations by defending against government criminal, seizure, or injunctive suits against them" is not a "satisfactory alternative" to pre-enforcement judicial review. *Garner v. Toilet Goods Ass'n, Inc.*, 387 U.S. 167, 172 (1967).

The power of taxation—the power to force the surrender of private property for public use—is critical and dangerous in equal measure. In this area, it is vital that the rule of law, rather than an arbitrary whim, governs the exercise of power. As Alexander Hamilton, the first Secretary of the Treasury wrote in Federalist No. 33: "What is the power of laying and collecting taxes, but a *legislative power*, or a power of *making laws* to lay and collect taxes?" The Federalist No. 33, (Hamilton). Although Congress may delegate to the executive branch a limited degree of discretion in the enforcement of the law, the executive's exercise of

those delegations must follow the procedures set forth in law. In declining to follow the lawful processes for the promulgation of tax regulations, Treasury and the IRS exceed the authority delegated by Congress to fill in the gaps of tax law and usurp the legislative powers vested exclusively in Congress. Thankfully, Congress provided a path to hold agencies to their lawful and constitutional limits and strike down invalid rules and regulations: pre-enforcement judicial review through the APA.

The widening circuit split on the interaction of the APA and the AIA threatens this crucial check on the Constitution's separation of powers. Without the Court's intervention, reaffirming its holding in *Direct Marketing*, Treasury's disregard of the APA will continue, individuals and businesses will remain uncertain of the applicable law, and the only choices for regulated parties will continue to be bad ones.

For the foregoing reasons, and those expressed by the petitioner, the Court should grant certiorari.

Respectfully submitted,

Ilya Shapiro
Counsel of Record
Trevor Burrus
James T. Knight II
CATO INSTITUTE
1000 Mass. Ave., NW
Washington, DC 20001
(202) 842-0200
ishapiro@cato.org

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