No. 15-969

IN THE

Supreme Court of the United States

FLORIDA BANKERS ASSOCIATION
AND TEXAS BANKERS ASSOCIATION,
Petitioners,

v.

UNITED STATES DEPARTMENT OF THE TREASURY; JACK LEW, SECRETARY OF THE TREASURY; INTERNAL REVENUE SERVICE; AND JOHN A. KOSKINEN, COMMISSIONER OF THE INTERNAL REVENUE SERVICE,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS LEGAL CENTER AND THE CATO INSTITUTE AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF *AMICI CURIAE* 1

SUMMARY OF ARGUMENT..................................... 2

ARGUMENT 5

I. THIS COURT MUST RESOLVE THE INTERPRETATIVE SPLIT BETWEEN THE ANTI-INJUNCTION ACT AND THE TAX INJUNCTION ACT TO ALLOW LOWER COURTS TO PROPERLY ADJUDICATE CHALLENGES TO TAX REGULATIONS. 5

II. THE VIEW THAT THE APA DOESN'T ALLOW PRE-ENFORCEMENT JUDICIAL REVIEW OF TREASURY REGULATIONS CONFLICTS WITH THE STRONG PRESUMPTION IN FAVOR OF SUCH REVIEW OF AGENCY ACTION. 10

III. TREASURY HAS STRAYED FROM THE APA'S RULEMAKING REQUIREMENTS AND MUST BE BROUGHT BACK INTO THE FOLD. 15

CONCLUSION 22

TABLE OF AUTHORITIES

Page(s)

CASES

Abbott Labs. v. Gardner,
387 U.S. 136 (1967) 11

Altera v. Commissioner,
145 T.C. No. 3, slip op. (2015) 14, 16, 20, 21

Bob Jones Univ. v. Simon,
416 U.S. 725 (1974) 5

Bowen v. Mich. Acad. of Family Physicians,
476 U.S. 667 (1986) 10

Burks v. United States,
633 F.3d 347 (5th Cir. 2011) 17

Chrysler Corp. v. Brown,
441 U.S. 281 (1979) 13

Cohen v. United States,
650 F.3d 717 (D.C. Cir. 2011) 12, 18

Conn. Light & Power Co. v. Nuclear Regulatory Comm'n,
673 F.2d 525 (D.C. Cir. 1982) 12

Dickinson v. Zurko,
527 U.S. 150 (1999) 4

Direct Marketing Ass'n v. Brohl,
135 S. Ct. 1124 (2015) .... *passim*

TABLE OF AUTHORITIES (continued)

Page(s)

Dominion Res., Inc. v. United States,
681 F.3d 1313 (Fed. Cir. 2012) 20, 21

Ex parte Young,
209 U.S. 123 (1908) 14

Fla. Bankers Ass'n v. Treasury,
19 F. Supp. 3d 111 (D.D.C. 2014) 15

Fla. Bankers Ass'n v. Treasury,
799 F.3d 1065 (D.C. Cir. 2015) 2

Gardner v. Toilet Goods Ass'n, Inc.,
387 U.S. 167 (1967) 22

General Elec. Co. v. EPA,
53 F.3d 1324 (D.C. Cir. 1995) 21

Hibbs v. Winn,
542 U.S. 88 (2004) 5

Home Box Office, Inc. v. FCC,
567 F.2d 9 (D.C. Cir. 1977) 14

Int'l Union, United Mine Workers of Am. v. Mine Safety & Health Admin.,
407 F.3d 1250 (D.C. Cir. 2005) 13

Intermountain Ins. Serv. v. Commissioner,
134 T.C. 211 (2010) 17

TABLE OF AUTHORITIES
(continued)

Page(s)

Judulang v. Holder,
132 S. Ct. 476 (2011).. 13

Mayo Found. for Med. Educ. & Research v. United States,
562 U.S. 44 (2011).. 4

NFIB v. Sebelius,
132 S. Ct. 2566 (2012).. 8

Okla. Operating Co. v. Love,
252 U.S. 331 (1920).. 4

Perez v. Mortgage Bankers Ass'n,
135 S. Ct. 1199 (2015).. 16

Radio Athens Inc. v. FCC,
401 F.2d 398 (D.C. Cir. 1968)............................ 21

Rusk v. Cort,
369 U.S. 367 (1962).. 11

SEC v. Chenery Corp.,
332 U.S. 194 (1947).. 13

Thor Power Tool Co. v. Commissioner,
439 U.S. 522 (1979).. 20

STATUTES

5 U.S.C. § 553 13

TABLE OF AUTHORITIES
(continued)

Page(s)

5 U.S.C. §§ 601-612 .... 7, 14

5 U.S.C. §§ 701-706 3

5 U.S.C. § 701(a)(1) 11

5 U.S.C. § 706(2) 12

26 U.S.C. § 1341 2

26 U.S.C. § 6511(a) 21

26 U.S.C. § 6662 21

26 U.S.C. § 7421(a) 2, 5

26 U.S.C. § 7805(a) 3

REGULATIONS

26 C.F.R. § 1.263A-11(e)(1)(ii)(B) 20

26 C.F.R. § 1.482-7(d)(2) (2003) 20

26 C.F.R. § 1.6662-3(b)(2) 21

80 Fed. Reg. 53732 (Sept. 8, 2015) 16

80 Fed. Reg. 57709 (Sept. 25, 2015) 16

80 Fed. Reg. 72192 (Nov. 18, 2015) 16

TABLE OF AUTHORITIES
(continued)

Page(s)

OTHER AUTHORITIES

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Brief for Petitioners (Anti-Injunction Act), *Dep't of Health & Human Servs. v. Fla.*, No. 11-398 (Feb. 2012)... 9

H.R. Rep. No. 79-1980 (1946) 11

Internal Revenue Manual 32.1.5.4.7.3(1) (Sept. 30, 2011) 20

Internal Revenue Manual 32.1.5.4.7.5.1(2) (Sept. 30, 2011) 16

IRS Notice 2014-52, 2014-42 I.R.B. 712............... 18

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 (2003)... 18

TABLE OF AUTHORITIES (continued)

Page(s)

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Roger Foster & Everett V. Abbot, *A Treatise on the Federal Income Tax Under the Act of 1894* (1895) 5

S. Rep. No. 79-752 (1945) 11

U.S. Response to Microsoft's Brief, *United States v. Microsoft Corp.*, No. 2:15-cv-00102 (W.D. Wash. Oct. 9, 2015) 17

INTEREST OF *AMICI CURIAE*[1]

The National Federation of Independent Business ("NFIB") is the Nation's leading small business advocacy association, representing more than 350,000 member businesses in all fifty States and the District of Columbia. NFIB's members range from sole proprietors to firms with hundreds of employees, and collectively they reflect the full spectrum of America's small business owners. Founded in 1943 as a nonpartisan organization, NFIB defends the freedom of small business owners to operate and grow their businesses and promotes public policies that recognize and encourage the vital contributions that small businesses make to our national economy. On the subject of taxes in particular, NFIB is committed to advocating for federal and state policies that provide tax relief, consistency, and certainty for small business owners across the United States.

NFIB's Small Business Legal Center is a nonprofit public interest law firm that provides legal

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[1] Pursuant to this Court's Rule 37.2(a), counsel of record for both parties received timely notice of *amici curiae's* intent to file this brief; letters of consent from both parties to the filing of this brief have been submitted to the Clerk. Pursuant to this Court's Rule 37.6, *amici* state that this brief was not authored in whole or in part by counsel for any party, and that no person or entity other than *amici*, their members, or their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

resources to NFIB's members and serves as the voice of small business in the courts. Through its Small Business Legal Center, NFIB has asserted claims in court to protect the interests of small business owners and frequently files *amicus* briefs in cases of consequence to America's small businesses, including in this Court.

The Cato Institute ("Cato") was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1989 to promote the principles of limited constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences, produces the annual *Cato Supreme Court Review*, and files *amicus* briefs.

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"), 26 U.S.C. § 1341, and, by extension, its sister statute, the Anti-Injunction Act ("AIA"), 26 U.S.C. § 7421(a). Yet the D.C. Circuit's opinion in *Florida Bankers Association v. Treasury*, 799 F.3d 1065 (D.C. Cir. 2015), 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 the D.C. Circuit's misinterpretation of the AIA are far-reaching. In addition to creating an artificial interpretive dichotomy between the AIA and 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.

Rather than applying the AIA to prohibit only those suits "restraining the assessment or collection of any tax" in accordance with its plain statutory language, the D.C. Circuit reads the AIA as protecting even an obviously invalid Treasury regulation from a timely suit designed to hold the agency accountable as envisioned by Congress. Specifically, the D.C. Circuit's opinion exempts Treasury regulations from the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 701-706, merely because all tax rules ultimately determine tax liabilities (or tax-related penalties) of specific taxpayers. This is in spite of the fact that the assessment or collection of the tax liability of a specific taxpayer is not at issue in this or many other APA suits involving such regulations. Given that every tax rule necessarily must have some effect, when eventually applied, on the tax obligations of some taxpayer, the D.C. Circuit's expansive reading of the AIA effectively allows all Treasury regulations and other guidance to have the force and effect of law even when Treasury has ignored the most

[2] *Amici* call the regulations at issue "Treasury regulations" because the Secretary of the Treasury has rulemaking authority over tax regulations. *See, e.g.*, 26 U.S.C. § 7805(a). However, it is while working with the IRS on such regulations that Treasury most often and most critically fails to apply the APA. Strangely, in other areas of rulemaking, like the area of foreign assets control, Treasury appears to understand and comply with the APA.

fundamental statutory prerequisites to enshrining agency action as law.

This result cannot stand because it prohibits pre-enforcement judicial review of the rulemaking process under the APA for Treasury regulations alone, once again "carv[ing] out an approach to administrative review good for tax law only." *Contra Mayo Found. for Med. Educ. & Research v. United States*, 562 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 the tax law. Under such a framework, the only recourse against defective Treasury regulations is purposely to violate the regulation masquerading as valid and await increased tax, penalties, and interest at a subsequent enforcement proceeding in which the validity of the regulation can be challenged. *Cf. Okla. Operating Co. v. Love*, 252 U.S. 331, 336-37 (1920) (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 policies of the AIA, emasculates the APA, and does nothing to aid assessment and collection, which hasn't even begun. This result is particularly offensive because the IRS has disregarded the strictures of the APA more than any other executive agency.

Based on the foregoing, 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 assessment and collection of taxes are unrestrained by such suits.

ARGUMENT

I. THIS COURT MUST RESOLVE THE INTERPRETATIVE 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 "principal 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, this Court made clear that restraining the assessment or collection of tax means to "stop" the assessment or collection, not to merely inhibit assessment or collection. *Id.* at 1133. This 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 D.C. Circuit disregarded this Court's statutory analysis and, in doing so, applied the very same statutory interpretation that this Court rejected in *Direct Marketing* by reading the term "restrain" broadly to cover any action that could potentially reduce revenue. Specifically, the D.C. Circuit read 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 D.C. 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. But that logic is both flawed and untethered to 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 upon taxpayers invalid regulations until such time as the validity of those regulations bubbles up through garden-variety tax litigation—a process that routinely takes years.

These problems are particularly evident in this case. Petitioners challenge the *regulatory process* for making the regulation at issue. They seek to resolve the question of whether the Treasury and the IRS complied with the requirements of the APA and the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612, in promulgating regulations that mandate a reporting requirement and related penalty. They do 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 petitioners' question thus does not require an injunction to restrain any assessment or collection process. Indeed, since petitioners are Federally regulated banks—institutions 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 the banks do not violate the law no "tax" arises to

be assessed and collected and the AIA never applies. But the D.C. 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 in any way. 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." *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 & 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 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 possibly been intended by the AIA. The D.C. Circuit'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 that 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 invalid regulations was the sole course for challenging invalid regulations.

II. THE VIEW THAT THE APA DOESN'T 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 AIA must be read in harmony with that presumption and in accordance with the purposes of the APA. The decision below 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. Cort*, 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 (noting that "[t]he 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 requirements provide 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 5 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 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 agency

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. "Meaningful judicial review and fair treatment of affected persons require 'an exchange of views, information, and criticism between interested persons and the agency.'" *Altera v. Commissioner*, 145 T.C. No. 3, slip op. at 65 (2015) (quoting *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 (D.C. Cir. 1977)).

Without pre-enforcement judicial review under the APA, Treasury and the IRS are insulated from the public accountability Congress intended to govern *all* agencies.[3] If courts treat Treasury regulations differently than the regulations of every other agency, then Treasury and the IRS will continue to promulgate tax 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 businesses 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 in order to challenge a rule of law in court violates due process).

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[3] The lack of such review also eviscerates the protections of the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612, by denying affected small businesses any opportunity to raise concerns under that Act until those businesses are faced with an enforcement action or ruinous penalties.

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 more 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[4] 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 explanation

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[4] Although many of the Treasury regulations discussed *infra*, unlike the regulations in the case below, are revenue-raising regulations, after *Direct Marketing*, the distinction between "regulatory and revenue-raising" is beside the point. The analysis in that case provides a direct analytical framework to the application of 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. 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 of tax against any specific taxpayer, but is instead intended to question the rule's validity.

for promulgated rules. The IRS then compounds the harm by penalizing taxpayers that do not follow this defective guidance. By raising the AIA as a bar to pre-enforcement judicial review, the opinion below eliminates the key mechanism provided by Congress to ensure that these 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, 1203-4 (2015)), the IRS claims that regulated parties are legally bound by rules it considers "interpretative." *See, e.g.*, *Altera v. Commissioner*, 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.").

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. Commissioner*, 134 T.C. 211, 246 (2010) (Halpern and Holmes, JJ., concurring), *rev'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 steps in the rulemaking process. *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 and 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 the infirmities in their rulemaking by finalizing rules that are not the product of reasoned decisionmaking. Two recent cases are illustrative. The first is *Altera v.*

Commissioner, 145 T.C. No. 3, slip op. (2015). In 2003 Treasury required related parties to include stock-based compensation in the cost pool of intercompany cost-sharing arrangements. 26 C.F.R. § 1.482-7(d)(2) (2003). The IRS then used that rule as the sole basis to increase the taxable income of businesses. Fifteen Tax Court judges unanimously held that the rule was invalid because it lacked any basis in fact. The second case, *Dominion Resources, Inc. v. United States*, 681 F.3d 1313 (Fed. Cir. 2012), highlights Treasury's routine failure to provide a reasoned explanation for its tax rules. 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 decision-making 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. Commissioner*, 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. The rule at issue in *Altera*, which was invalid from its inception, took 12 years to vacate. The associated-property rule at issue in *Dominion Resources* was invalidated 18 years

after it was finalized. Immediate judicial review would have prevented these delays, provided certainty in the law, and not affected assessment and collection one iota. In the absence of such pre-enforcement challenges, taxpayers must, like they did after *Dominion Resources* and are doing after *Altera*, 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 IRS 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 who are too scared to do so.

CONCLUSION

The opinion below cloaks Treasury's defective rulemaking behind a contorted interpretation of the AIA 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 take a contrary position and 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. *Gardner v. Toilet Goods Ass'n, Inc.*, 387 U.S. 167, 172 (1967). If the opinion below stands, Treasury and the IRS'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. Accordingly, this Court must grant the petition for a writ of certiorari.

Respectfully submitted,

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