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Will the Supreme Court finally deflate the IRS's overblown AIA argument?

Introduction

Few statutory provisions have been subject to as disparate judicial interpretations as the Anti-Injunction Act (AIA), codified in 26 U.S.C. § 7421. For over a century and a half, courts have failed to uniformly apply its proscription against any suit "for the purpose of restraining the assessment or collection of any tax." The government has largely benefited from the lack of clarity. The Treasury and the Internal Revenue Service (IRS) often invoke the AIA to insulate the agencies from a pre-enforcement review of their rules and regulations. Taxpayers have argued — with varying degrees of success —that the government's proffered interpretation of the AIA extends the statute's effect beyond its intended contours. However, no cohesive judicial approach has emerged. Instead, courts have applied malleable case law and dicta in unprincipled, ends-oriented opinions. The result, to quote a set of influential commentators, is "jurisprudential chaos."[1]

Adding to the complexity is the AIA's interplay with a separate statutory regime, the Administrative Procedure Act (APA), 5 U.S.C. secs. 551-559 and 701-706, which "embodies a basic presumption" of pre-enforcement review of agency regulatory actions.[2] Courts have struggled to compellingly harmonize the statutes, but have historically looked to the more specific AIA to set the jurisdictional standard in tax-related cases. This form of "tax exceptionalism" has received increased scrutiny with Congress' expansion of the Internal Revenue Code's breadth and scope beyond the traditional tax sphere (e.g., healthcare).[3] Importantly, the Treasury and the IRS's track record of meeting the basic requirements of the APA is notoriously poor.[4]

The Supreme Court can provide wanting clarity. In the upcoming October term, it will hear arguments in *CIC Services, LLC v. Internal Revenue Service*, a case focusing squarely on whether the AIA forecloses most pre-enforcement challenges to tax rules under the APA. The preferential path, from both an interpretative and practical perspective, is to allow this narrow category of suits to proceed. Indeed, the textual keys of the AIA and the historical context of its enactment strongly support its limited scope. And any broader interpretation of

[1] Kristin E. Hickman and Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683, 1686 (2017).
[2] *Abbott Laboratories v. Gardner*, 387 U.S. 136, 141 (1967).
[3] The Supreme Court has "recognized the importance of maintaining a uniform approach to judicial review of administrative action" and declined "to carve out an approach to administrative review good for tax law only." *Mayo Found. for Medical Educ. & Research v. United States*, 562 U.S. 44, 55 (2011) (citations and quotations omitted).
[4] *See* Hickman and Kerska 1712-17; *see also* Internal Revenue Manual pt. 32.1.1.2.6 (09-23-2011) (the IRS contends that most of its promulgated regulations are excepted from APA procedures).

the AIA restricts judicial review of tax rules to deficiency or refund proceedings, leaving taxpayers in the untenable position of "bet[ting] the farm" to "test the validity" of agency action.[5] The Court should, therefore, endorse the "better" view: the AIA does not bar pre-enforcement suits challenging the validity of tax rules under the APA.

Statutory Background

The AIA traces its origins to the Civil War era.[6] It "has no recorded legislative history,"[7] but tax administration contemporaneous with its enactment provides important contextual clues to its purpose.[8] During that period, income tax was owed **only** after a series of administrative steps.[9] Taxpayers first filed a return, which was thereafter reviewed by an "assessor" who assigned a tentative assessment and heard any taxpayer appeals thereto.[10] Thereafter, the assessor forwarded final assessments to a "collector" who published the ultimate tax owed.[11] Taxpayers delinquent in remitting their tax risked collection actions (e.g., levies and seizures).[12] Taxpayer-initiated lawsuits seeking injunctive and declaratory relief at any point subsequent to filing a return threatened to materially undermine this process.[13] Congress, therefore, enacted the AIA to limit judicial review to post-payment refund suits.[14]

The pressures animating the initial enactment of the AIA no longer exist. Most income tax payments are made to the government through withholding and estimated tax remittances and the US Tax Court provides litigants a prepayment judicial forum. Moreover, the tax assessment and collection process, as well as the administrative state, have fundamentally evolved.

Though tax administration of 1867 shares few features with modern tax practice and procedure, the AIA's initial text remains largely intact. [15] Its present iteration provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."[16] Congress has incorporated a series of 13 exceptions to the statute, most of which permit taxpayers to file suit **after** the IRS has commenced enforcement or collection procedures. For example, exceptions permit taxpayers to file suit upon receipt of

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[5] *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 490-91 (2010) (citations and quotations omitted); *see also* 26 U.S.C. § 6662(a),(b) (accuracy-related penalties for failing to comply with "rules and regulations").
[6] *See* Revenue Act of 1867, Chapter 169, at §10, 14 Stat. 471, 475.
[7] *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974).
[8] Hickman and Kerska, at 1721-26.
[9] *Id.* at 1723-24.
[10] *Id.*
[11] *Id.* at 1724.
[12] *Id.*
[13] *Id.*
[14] *Id.* at 1725.
[15] The Supreme Court has distilled the AIA's modern "principal purpose" as protecting "the Government's need to assess and collect taxes as expeditiously as possible." *Bob Jones*, 416 U.S. at 736. However, 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).
[16] 26 U.S.C. § 7421(a).

a notice of deficiency, for premature adjustments to partnership return items, and in circumstances where the IRS seeks to wrongfully levy taxpayer property, among others.[17] The textual orientation of the modern AIA is, therefore, directed to legal action initiated to thwart **actual ongoing** audit and collection activity.

In 1946, nearly 80 years after it enacted the AIA, Congress promulgated the APA,[18] reshaping, among other things, the way the US' sprawling administrative state crafts and issues its rules and regulations. In particular, the APA requires agencies to provide the public greater access to, and meaningful participation in, their decision-making, most clearly by mandating a public notice and comment procedure prior to promulgating rules that have the force of law.[19] The APA also provides aggrieved parties an avenue for judicial review, empowering courts to "hold unlawful and set aside agency action, findings, and conclusions" that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[20] The APA embodies not only a "strong presumption" of judicial review,[21] but also a strong presumption of "*preenforcement* judicial review."[22] Overcoming that presumption requires "clear and convincing evidence of a contrary legislative intent."[23] Exceptions are narrowly construed.[24]

There is no tension between the AIA and the APA. The AIA seeks to maintain the integrity and efficacy of the tax assessment and collection process, while the APA seeks to ensure that agency rules and regulations meet baseline standards of reasoned decision-making. The statutes can, and should, coexist in their separate spheres, but the Supreme Court must untangle knots of the judiciary's own making.

Direct Marketing vs. Florida Bankers

The AIA and APA battle lines have been drawn in two relatively recent cases: *Direct Mktg. Ass'n v. Brohl*, 575 U.S. 1 (2015) and *Florida Bankers Ass'n* v. *U.S. Dep't of the Treasury,* 799 F.3d 1065 (DC Cir. 2015). *Direct Marketing* strongly supports a narrowly construed AIA, allowing pre-enforcement APA claims to go forward in most circumstances, while *Florida Bankers* forecloses under the AIA any APA-based, pre-enforcement challenges ultimately tied to a tax owed. Then-Judge Brett Kavanaugh drafted the majority opinion in *Florida Bankers*, providing it an unspoken weight greater than it would otherwise be accorded.

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[17] *See id.*
[18] *See* Pub. L. 79-404, 60 Stat. 237 (1946).
[19] Under 5 U.S.C. § 553, an agency must: (1) publish a notice of proposed rule-making in the Federal Register; (2) provide "interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation"; and (3) "[a]fter consideration of the relevant matter presented … incorporate in the rules adopted a concise general statement of their basis and purpose."
[20] 5 U.S.C. §§ 702, 706(2)(A).
[21] *Bowen v. Mich. Acad. of Family Physicians,* 476 U.S. 667, 670 (1986).
[22] *Shalala v. III. Council on Long Term Care, Inc.,* 529 U.S. 1, 45 (2000) (Thomas, J., dissenting).
[23] *Abbott Labs.,* 387 U.S. at 141 (quoting *Rusk v. Cort,* 369 U.S. 367, 379-80 (1962)).
[24] *See id.* at 140-41.

Direct Marketing addressed whether the AIA's sister statute for state taxes — the Tax Injunction Act (TIA)[25] — foreclosed a lawsuit seeking to enjoin enforcement of a Colorado law requiring certain retailers to maintain and submit records regarding sales in which the retailers did not collect state sales and use taxes.[26] The Court first sought to clarify statutory terminology. Acknowledging that the TIA was "modeled on" the AIA and had similar operative text (including the key terms "assessment," "collection" and "restraint"), it assumed that the statutory terms shared the same meanings.[27] It then dissected the language of the TIA using the AIA as an interpretive touchstone.

The Court first defined "assessment" and "collection" as terms of art referencing specific phases of the tax administration process. It noted that "assessment" refers to "the official recording of a taxpayer's liability, which occurs after information relevant to the calculation of that liability is reported to the taxing authority,"[28] while "collection" involves "the act of obtaining payment of taxes due."[29]

Turning to the definition of "restrain," the Court stated that "standing alone [it] can have several meanings."[30] One is a "broad meaning" that "captures orders that merely *inhibit* acts of assessment, levy and collection."[31] "Another, narrower meaning, however, is 'to prohibit from action; to put compulsion upon … [or] to enjoin,'" and this "captures only those orders that stop (or perhaps compel) acts of assessment, levy and collection."[32] The Court held that the TIA, and by implication the AIA, uses "restrain" in the "narrower, equitable sense."[33] Accordingly, the Court's focus was on "whether the relief [sought] to some degree stops assessment, levy or collection, not whether it merely inhibits them."[34]

Applying the correct definitional framework, the Court determined that the TIA did not bar the suit.[35] While "[e]nforcement of the notice and reporting requirements may [have] improve[d] Colorado's ability to assess and ultimately collect its sales and use taxes from consumers … [t]he TIA is keyed to the acts of assessment, levy, and collection themselves, and enforcement of the notice and reporting

[25] 28 U.S.C. § 1341 ("The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State").
[26] *Direct Marketing*, 575 U.S. at 4-7.
[27] *Id.* at 8; *see also Hibbs v. Winn*, 542 U.S. 88, 102 (2004) ("In composing the TIA's text, Congress drew particularly on … the Anti-Injunction Act").
[28] *Direct Marketing*, 575 U.S. at 9.
[29] *Id.*
[30] *Id.* at 12.
[31] *Id.* at 13 (citations and quotations omitted).
[32] *Id.* (citations and quotations omitted).
[33] *Id.* at 14.
[34] *Id.* (quotations omitted).
[35] *Id.* at 16.

requirements is none of these."[36] And, separately, the suit "merely inhibit[ed]" the "assessment, levy or collection" of the state tax, it did not restrain them.[37]

The DC Circuit purported to distinguish *Direct Marketing* in *Florida Bankers*.[38] The plaintiffs in the case sought to enjoin the enforcement of an IRS regulation that imposed a "penalty" on US banks that failed to report interest paid to certain foreign account holders.[39] The court held that the "penalty" at issue constituted a "tax" for purposes of the AIA,[40] which, it concluded, was sufficient to differentiate it from the tax reporting obligations at issue in *Direct Marketing*.[41] The DC Circuit noted that a nominal penalty attached to the failure to report sales in *Direct Marketing* "was not itself a tax, or at least it was never argued or suggested that the penalty in that case was itself a tax."[42] The panel majority concluded that the regulation's imposition of the tax/penalty in *Florida Bankers*, however, triggered the AIA: "If the penalty here were not itself a tax, the [AIA] would not bar this suit. But because this penalty is deemed a tax … the [AIA] bars this suit as premature."[43] Unlike in *Direct Marketing*, the tax was not "two or three steps removed from the regulation in question."[44] Instead, "tax [would be] imposed as a direct consequence of violating the regulation. Invalidating the regulation would directly bar collection of that tax."[45]

The DC Circuit then addressed whether the plaintiff's purported purpose for the lawsuit, i.e., seeking "relief from a regulatory mandate that exists separate and apart from the assessment or collection of taxes," rendered the AIA inapplicable.[46] Characterizing the argument as "nifty wordplay," the court held that "plaintiffs cannot evade the [AIA] by purporting to challenge only the regulatory aspect of a regulatory tax."[47] Citing a series of Supreme Court holdings, the court explained that "[a] taxpayer could almost always characterize a challenge to a regulatory tax as a challenge to the regulatory component of the tax. That would reduce the [AIA] to dust in the context of challenges to regulatory taxes."[48] It concluded, "[p]laintiffs' challenge to the reporting requirement is necessarily also a challenge to the tax imposed for failure to comply with that

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[36] *Id.* at 11-12.
[37] *Id.* at 14. The US District Court for the Western District of Texas held similarly in *Chamber of Commerce v. IRS*, No. 16-944, 2017 U.S. Dist. LEXIS 166985, *10-11 (W.D. Tex. Oct. 6, 2017). In that case, the court held that the AIA did not bar a suit under the APA challenging regulations governing whether a tax applied to domestic corporations engaging in an inversion transaction. *Id.* at *2-3. The court noted that the plaintiffs were not seeking to "restrain assessment or collection of a tax against or from them," but rather had "challenge[d] the validity of the Rule so that a reasoned decision [could] be made about whether to engage in a potential future transaction that would subject them to taxation." *Id.* at *10.
[38] 799 F.3d 1065 (DC Cir. 2015).
[39] *Id. at* 1067-68.
[40] *Id.* at 1068.
[41] *Id.* at 1069.
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] *Id.* at 1070.
[47] *Id.*
[48] *Id.* at 1071.

reporting requirement. If plaintiffs' challenge were successful, the IRS would be unable to assess or collect that tax for failure to comply with the reporting requirement. Invalidating the reporting requirement would necessarily 'restrain' the assessment and collection of the tax. This we cannot do."[49]

In a scathing dissent, Judge Henderson challenged the majority's reasoning and highlighted its apparent willingness to either disregard or bend precedent, including *Direct Marketing*, past its breaking point:[50] "[P]recedent makes plain that neither a pre-enforcement challenge to a tax-reporting requirement nor a pre-enforcement challenge to a regulation enforced by a tax penalty is barred by the AIA."[51] Judge Henderson also indicated, with alarm, the broader implications of the majority's decision: "According to my colleagues, no party can obtain pre-enforcement review of a regulation that is enforced by a tax penalty; instead, he must *violate* the regulation (*i.e.*, break the law) and be assessed a tax penalty before he can have his day in court. I shudder at the government-empowering consequences of their decision. I therefore dissent from my colleagues' dismissal under the AIA."[52]

Irrespective of these criticisms, the *Florida Bankers* majority opinion seemingly rehabilitates and strengthens the AIA in the wake of *Direct Marketing*. Whether the DC Circuit did so by adequately differentiating the case from *Direct Marketing* remains in dispute.[53] Regardless, if *Florida Bankers* is indeed reflective of the current state of law, pre-enforcement APA review of the Treasury and IRS rules and regulations would be, in the vast majority of circumstances, foreclosed under the AIA. The *CIC Services* case provides the Supreme Court the final word on the matter.

CIC Services, LLC

The Sixth Circuit ambled into the AIA thicket in *CIC Services* to address the plaintiff-adviser's contention that the IRS promulgated IRS Notice 2016-66, 2016-47 I.R.B. 745 ("**Notice**") in violation of APA notice-and-comment requirements.[54] The Notice identified certain "micro-captive transactions" as "transactions of interest," a subset of reportable transactions, which subjected taxpayers engaging in those transactions and their "material advisors" — e.g., the plaintiff in the case — to certain reporting requirements and potential penalties for failing to

[49] *Id.* at 1071-72.
[50] *Id.* at 1075-80 (Henderson, J., dissenting).
[51] *Id.* at 1081.
[52] *Id.* at 1073.
[53] *See CIC Servs., LLC v. IRS*, 925 F.3d 247, 261 (6th Cir. 2019) (Nalbandian, J., dissenting). ("[The DC Circuit] misses the mark. Enjoining a reporting requirement enforced by a tax does not necessarily bar the assessment or collection of that tax. That is because the tax does not result from the requirement per se. The only way for the IRS to assess and collect the tax is for a party to violate the requirement. So enjoining the requirement only stops the assessment and collection of the tax in the sense that a party cannot first violate the requirement and then become liable for the tax. Surely, this is the kind of attenuated relationship between 'restrain,' 'assessment,' and 'collection' that *Direct Marketing* rejected").
[54] 925 F.3d at 249.

adhere to those requirements.[55] In district court, the plaintiff sought both a declaration that the Notice was invalid and an "injunction prohibiting the IRS from enforcing the disclosure requirements set forth in the Notice."[56] The district court granted a government motion to dismiss on jurisdictional grounds, relying on the reasoning of *Florida Bankers* to conclude that the penalties at issue were "taxes" for purposes of the AIA and that the challenge to the reporting requirements was, in essence, an effort to restrain the IRS's assessment or collection of a tax.[57]

On appeal, the Sixth Circuit followed suit, affirming that the plaintiff's lawsuit was foreclosed under the AIA. The Sixth Circuit considered closely both *Direct Marketing* and *Florida Bankers*,[58] found them reconcilable and identified *Florida Bankers* as a compelling analog: "*Florida Bankers* is directly on point, consistent with *Direct Marketing*, and in accordance with a broader survey of Supreme Court and circuit court precedent."[59]

The Sixth Circuit opinion, unsurprisingly, aligns closely with the reasoning in *Florida Bankers.* The court found that: (1) third-party taxes — the collection of which the Notice was "designed to facilitate" — were not the relevant taxes for the AIA analysis; rather, the relevant taxes were the penalties imposed for violation of the Notice, which were appropriately defined as "taxes" for purposes of the AIA;[60] (2) the plaintiff's suit, while directed at the Notice's "information gathering" and "records maintenance" requirements, was inextricably tied to a penalty (i.e., a "tax"), rendering the suit "focused on *that* tax's assessment or collection" and, if successful, would "restrain (indeed eliminate)" those actions;[61] (3) even assuming the *Direct Marketing* definition of restrain applied, the "[p]laintiff's suit 'would have the effect of restraining — *fully stopping*' the IRS from collecting the penalties imposed for violating the Notice's requirements";[62] and (4) the plaintiff's subjective **purpose** for his suit was all but irrelevant "because a challenge to the regulatory aspect of a regulatory tax is necessarily also a challenge to the tax aspect of a regulatory tax."[63] The court concluded[64] that the plaintiff's suit was "within the purview of the AIA" and, accordingly, that it did not have subject matter jurisdiction over it.[65]

In a well-reasoned dissent[66] echoing the concerns articulated by Judge Henderson in *Florida Bankers* and criticizing many of the majority's findings,[67]

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[55] *Id.* at 249-50.
[56] *CIC Servs., LLC v. IRS*, No. 3:17-cv-110, 2017 U.S. Dist. LEXIS 181482, at *4 (E.D. Tenn., Nov. 2, 2017).
[57] *Id.* at *8-9.
[58] *CIC Servs., LLC v. IRS*, 925 F.3d at 251-57.
[59] *Id.* at 254.
[60] *Id.* at 254-55.
[61] *Id.* at 255.
[62] *Id.* at 255-56.
[63] *Id.* at 257.
[64] The Sixth Circuit also addressed the inapplicability of the *South Carolina v. Regan*, 465 U.S. 367 (1984) exception to the AIA. *Id.* at 258.
[65] *Id.* at 257.
[66] *Id.* at 259 (Nalbandian, J., dissenting).
[67] For example, the dissent found tenuous and "abstract[]" the notion that the suit was initiated **with the purpose of** restraining the assessment or collection of any tax. *Id.* at 259. Rather, Judge

Baker McKenzie
North America Tax

Chicago
+1 312 861 8000

Dallas
+1 214 978 3000

Houston
+1 713 427 5000

Miami
+1 305 789 8900

New York
+1 212 626 4100

Palo Alto
+1 650 856 2400

San Francisco
+1 415 576 3000

Toronto
+1 416 863 1221

Washington, DC
+1 202 452 7000

Judge Nalbandian characterized the plaintiff's situation as being "caught between a hammer and an anvil."[68] Judicial review, he noted, "obviates the dilemma of either complying with potentially unlawful (and onerous) regulations or 'risk[ing] prosecution.' But that is the choice CIC Services is left with today."[69] Under the majority's decision, he later noted, "CIC now only has two options: (1) acquiesce to a potentially unlawful reporting requirement that will cost it significant money and reputational harm or (2) flout the requirement, i.e., 'break the law.'"[70] This, in effect, "leaves CIC in precisely the bind that pre-enforcement judicial review was meant to avoid."[71]

Broad Implications

This fall, the Supreme Court will once again wade into the unsettled waters of the AIA. The implications are significant. If the Court aligns with the DC Circuit in *Florida Bankers* and the Sixth Circuit in *CIC Services*, it will effectively foreclose all pre-enforcement review of Treasury regulations and IRS guidance. Taxpayers will thereafter have to pursue most APA-based suits through back-end litigation in the US Tax Court or in refund proceedings. This disjointed approach undermines the APA's basic presumption of meaningful pre-enforcement review, delays potentially viable claims of regulatory validity, and places taxpayers in untenable financial positions relative to compliance and litigation decisions. Alternatively, the Court can follow its holding in *Direct Marketing*, apply the AIA's plain statutory text, and consider the statute's historical context to more fully effect its purpose and harmonize it with the APA. Therein lies the "better" approach. Nonetheless, after 150 years on the books, some clarity is in order.

Nalbandian surmised, the plaintiffs "t[ook] issue with the hundreds of hours of labor and tens of thousands of dollars the requirement will cost to comply with." *Id*. Preferring a textually grounded analysis under the AIA, he stated that a "suit to enjoin the enforcement of a *reporting requirement* is not a suit for the purpose of restraining the *assessment* or *collection* of any tax." *Id*. at 260 (quotations omitted). In addition, Judge Nalbandian did not find the majority's distinction between *Direct Marketing* and *Florida Bankers* compelling. *Id*. at 260-63.

[68] *Id*. at 259.

[69] *Id*. (citing *Abbott Laboratories v. Gardner*, 387 U.S. 136, 152 (1967)).

[70] *Id*. at 263.

[71] *Id*.

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For additional information, please contact the authors of this Client Alert or any member of Baker McKenzie's North America Tax Practice Group.

Brendan Sponheimer
+1 212 626 4435
brendan.sponheimer@bakermckenzie.com

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