

ADMINISTRATIVE LAW'S GROWING INFLUENCE ON U.S. TAX ADMINISTRATION

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Abstract

In its 2011 decision in *Mayo Foundation for Medical Education and Research v. United States*, the United States Supreme Court declared itself reluctant “to carve out an approach to administrative review good for tax law only.” Since then, the government in litigation has conceded and lower courts have recognized that tax administration in the United States is subject to the Administrative Procedure Act, which imposes procedural requirements for and authorizes judicial review of the actions of federal government agencies. A growing body of tax jurisprudence in the United States explores which tax administrative practices are susceptible to legal challenge under the Administrative Procedure Act and whether particular provisions of the Internal Revenue Code justify tax-specific departures from general administrative law norms, doctrines, and requirements. This essay explores three cases that are particularly illustrative of this trend and, in turn, draws attention to the role of judicial review as a tool for prompting improvements in the administration of the tax laws.

1. INTRODUCTION

Judicial review can be a powerful tool for prompting improvements in tax administrative practices. In the U.S., cases challenging Treasury Department (Treasury) and Internal Revenue Service (IRS) actions under the Administrative Procedure Act (APA)² are driving just such change. The result will be greater transparency and accountability in the administration of the U.S. tax laws.

In 2011, in *Mayo Foundation for Medical Education and Research v. United States*, the U.S. Supreme Court declared its reluctance “to carve out an approach to administrative review good for tax law only.”³ “To the contrary,” said the Court, “we have expressly ‘[r]ecogniz[ed] the importance of maintaining a uniform approach to judicial review of administrative action.’”⁴ In making that statement, the Court was reiterating a longstanding judicial policy - derived from the APA - of applying general administrative law requirements, doctrines, and norms uniformly across government agencies and regulatory subject matters absent a good reason for deviating in a particular case. Courts and commentators have read the Court’s *Mayo Foundation* decision broadly as repudiating tax exceptionalism from general administrative law requirements, doctrines, and norms absent clear statutory evidence that Congress intended otherwise. The government in litigation has conceded, and United States Tax Court has correspondingly recognized, that “Treasury is subject to the APA” absent such justification.⁵

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² 5 U.S.C. § 551, et seq.

³ *Mayo Foundation for Medical Education & Research v. United States*, 562 U.S. 44, 55 (2011).

⁴ *Id.*

⁵ *Altera Corp. & Subs. v. Comm’r*, 145 T.C. 91, 119 (2015).

Notwithstanding the sweeping proclamation against tax exceptionalism for which it is credited, the *Mayo Foundation* decision really only resolved a single doctrinal question - that courts should apply the general *Chevron* standard,⁶ rather than the tax-specific (and arguably less deferential) *National Muffler* standard,⁷ in reviewing whether Treasury regulations interpreting the IRC are consistent with the statute or within the range of discretion.⁸ But many questions remain. How far should courts, and the tax administrators subject to their commands, take the Supreme Court's rejection of tax exceptionalism? Which tax administrative practices are susceptible to legal challenge under general administrative law principles? Do particular provisions of the Internal Revenue Code (IRC) in fact justify certain tax-specific departures from general administrative law requirements, doctrines, and norms?

A growing strand of U.S. tax jurisprudence today explores these questions. Legal scholars have identified numerous ways in which tax administrative practices arguably have deviated from general administrative law requirements, doctrines, and norms.⁹ Litigators representing taxpayers and others subject to the tax system's commands are doing all they can to push the boundaries of the Supreme Court's rejection of tax exceptionalism. The Department of Justice is fighting those cases tooth and nail, doing all it can to limit *Mayo Foundation's* reach. Several cases of note have been decided or are pending in the courts. The results thus far are both mixed and unsettled. Nevertheless, at least one such case has already resulted in changes to Treasury and IRS administrative practices; and, although change is coming slowly, these cases, collectively, could alter tax administrative practices dramatically.

Three cases are particularly illustrative of the trend. First, in *Altera Corp. & Subsidiaries v. Commissioner*, the United States Tax Court unanimously invalidated a Treasury regulation as arbitrary and capricious under the APA because Treasury and the IRS failed to link their interpretation to evidence contained in the administrative record and, instead, ignored contrary evidence provided by taxpayers in the notice-and-comment rulemaking process.¹⁰ Second, in *Florida Bankers Association v. United States Department of the Treasury*, a divided panel of the D.C. Circuit Court of Appeals considered whether the Anti-Injunction Act precludes pre-enforcement judicial review of APA-based challenges to Treasury regulations.¹¹ Lastly, in *QinetiQ U.S. Holdings, Inc. v. Commissioner*, the Fourth Circuit Court of Appeals evaluated whether IRS deficiency notices are reviewable under the APA's arbitrary and capricious

⁶ See *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984) (holding that review courts should defer to reasonable interpretations of ambiguous statutory text adopted by administering agencies).

⁷ See *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979) (calling on reviewing courts to evaluate whether Treasury regulations "harmonize[] with the plain language of the statute, its origin, and its purpose" as well as various contextual factors such as contemporaneity with statutory enactment, the longevity of the regulation, the consistency with which the IRS has applied the regulation, and congressional scrutiny of the regulation in revisiting and amending the statute).

⁸ *Mayo Foundation*, 562 U.S. at 55.

⁹ See, e.g., Michael Asimow, *Public Participation in the Adoption of Temporary Treasury Regulations*, 44 Tax Law. 343 (1991) (complaining about Treasury's issuance of temporary Treasury regulations without first allowing interested members of the public to offer comments); Kristin E. Hickman, *Coloring Outside the Lines, Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727 (2007) (documenting the rate of Treasury's noncompliance with APA public participation requirements); Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (2012) (detailing Treasury's failure to comply with the APA's requirement that agencies justify their regulations when issuing them).

¹⁰ *Altera Corp.*, 145 T.C. at 121-31 (2015).

¹¹ *Florida Bankers Association v. United States Dept. of the Treasury*, 799 F.3d 1065 (D.C. Cir. 2015).

standard.¹² Other cases are pending or contemplated raising the same issues addressed in these three cases, generating significant debate among tax litigators, legal scholars, and tax administrators - in addition to judges - regarding the precise relationship between the IRC and the APA.

All of these cases, and others like them, aim ultimately to require Treasury and the IRS to do a better job of complying with APA procedural requirements and explaining their actions at the time they undertake them - and thereby provide for greater transparency and accountability for Treasury and the IRS. The purpose of this essay is to summarize the *Altera*, *Florida Bankers*, and *QinetiQ* cases and to consider their implications for transparency and accountability in U.S. tax administration.

2. THREE KEY CASES

2.1 *Altera Corp. & Subsidiaries v. Commissioner*

A driving principle of the APA and of U.S. administrative law more generally holds that, in exercising discretionary power, agencies must engage in reasoned decision-making, typically demonstrated at the time such decisions are made. Section 706(2)(A) of the APA requires an reviewing court to set aside agency action found to be “arbitrary, capricious, an abuse of discretion, or not otherwise in accordance with law.”¹³ In 1983, in *Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Co.*, the Supreme Court interpreted this arbitrary and capricious standard as requiring agencies to provide contemporaneous explanations for their actions.¹⁴ In other words, when adopting a regulation that features a choice between competing reasonable interpretations of a statute or alternative reasonable approaches to implementing a statutory mandate, an agency cannot make its choice by arbitrarily throwing darts at a dartboard. Rather, according to *State Farm*'s interpretation of the arbitrary and capricious standard, the agency must explain and offer good reasons for its choice. A court will not just assume that the agency had good reasons, nor will a court accept reasons offered after the fact in litigation.¹⁵ Rather, a court will carefully review the administrative record to satisfy itself that the agency articulated and explained its reasoning at the time the agency adopted the regulation in question.

Historically, Treasury and the IRS have not done a great job in explaining their interpretive choices in the preambles to Treasury regulations.¹⁶ Until 2014, the Internal Revenue Manual (IRM) instructed Treasury and IRS regulation drafters that “it [was] not necessary to justify the rules that are being proposed or adopted or alternatives that were considered”- precisely the opposite of *State Farm*'s requirement.¹⁷ The IRS amended the IRM to eliminate that particular

¹² *QinetiQ U.S. Holdings, Inc. v. Comm’r*, 845 F.3d 555, 559-60 (2017).

¹³ 5 U.S.C. § 706(2)(A).

¹⁴ *Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 42-44 (1983).

¹⁵ *Id.* at 43; *see also* *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 419-20 (1971) (rejecting “post hoc rationalizations” as “an inadequate basis for review.”); *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 95 (1943) (“We merely hold that an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its action can be sustained.”).

¹⁶ Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (2012).

¹⁷ *Id.* at 274 (quoting Internal Revenue Manual § 32.1.5.4.7.3(1) as written in 2012).

instruction in 2014, but the IRM now merely tells regulation drafters “describe the substantive provisions of the regulations in clear, concise, plain language without restating particular rules contained in the regulatory text.”¹⁸ However, old habits die hard, and the preambles to Treasury regulations did not change noticeably as a result of that modification; then came *Altera*.

In the *Altera* case, the Tax Court considered a challenge to the validity of Treas. Reg. § 1.482-7(d), which required participants in qualified cost-sharing arrangements to include stock-based compensation costs in the cost pool in order to comply with the arm’s length standard for transactions between affiliated enterprises.¹⁹ The Tax Court unanimously invalidated those regulations on the ground that they were not the product of reasoned decision-making as required by the APA and *State Farm*.²⁰ In particular, the court noted: that Treasury’s assumptions in adopting the rule were unsupported by evidence regarding real-world practices; that commentators introduced “significant evidence” in the rulemaking process that contradicted Treasury’s assumptions; and that Treasury failed to respond to much of that evidence.²¹ The Tax Court also rejected the government’s claim that deficiencies in Treasury’s regulation represented harmless error for purposes of APA § 706.²²

The government has appealed the Tax Court’s decision in *Altera* to the Ninth Circuit Court of Appeals. Among other arguments, the government contends that *State Farm* review is not appropriate for evaluating most Treasury regulations because they merely interpret and implement the terms of the IRC, rather than imposing obligations on the basis of scientific or empirical evidence like regulations issued by some other agencies. The government’s distinction between statutory interpretation and empirical analysis is a weak one for two reasons.

Firstly, although it is always dangerous to say “never” or “always” with respect to U.S. administrative law, courts have often applied *State Farm* review not only when regulations rest on empirical analysis but also in requiring agencies to explain their reasoning for choosing one interpretation of a statute over another. For example, in *Judulang v. Holder* - admittedly an immigration case rather than a tax case - the Supreme Court relied on *State Farm* in rejecting a Board of Immigration Appeals interpretation of the Immigration and Nationality Act because the Court found the agency’s reasoning in its support of its interpretation to be inconsistent with the statute’s structure and purposes.²³ In other words, the issue in *Judulang* concerned statutory interpretation supported by policy preferences rather than empirical analysis, yet the Court resolved the case using *State Farm*’s arbitrary and capricious review.

Secondly, in recent years, the Supreme Court has begun to more explicitly link *State Farm* analysis with the second step of the *Chevron* standard for reviewing agency statutory interpretations. The *Chevron* standard calls for a reviewing court to evaluate first whether the statute an agency has interpreted is clear or ambiguous.²⁴ If the statute’s meaning is clear, that

¹⁸ See Internal Revenue Manual § 32.1.5.4.7.3(1) (Oct. 20, 2014).

¹⁹ *Altera Corp. & Subs. v. Comm’r*, 145 T.C. 91, 92 (2015); see also Final Regulations: Compensatory Stock Options Under Section 482 (T.D. 9088), 68 Fed. Reg. 51,171 (Aug. 26, 2003) (adopting Treas. Reg. § 1.482-7(d)).

²⁰ *Altera Corp.*, 145 T.C. at 121-31.

²¹ *Id.*

²² *Id.* at 132-33.

²³ *Judulang v. Holder*, 565 U.S. 42 (2011).

²⁴ *Chevron*, 467 U.S. at 842.

is the end of the court's inquiry, for courts and agencies alike must respect the clearly-expressed intent of Congress.²⁵ But, if the statute is ambiguous, *Chevron's* second step calls for the court to defer to the agency's resolution of that ambiguity so long as the agency's interpretation is reasonable. But what does reasonable mean for purposes of *Chevron* step two? Obviously, the agency's choice is limited to plausible interpretations of the statute's text, history, and purpose.²⁶ However, in both *Judulang v. Holder*²⁷ and *Encino Motorcars, LLC v. Navarro*²⁸, the Court's opinion included rhetoric explicitly linking *State Farm* analysis with *Chevron's* second step and suggesting that the agency must also explain why it chose one plausible interpretation over another for the Court to deem the agency's choice reasonable under the *Chevron* standard of review.

Irrespective of how the Ninth Circuit resolves *Altera*, however, the Tax Court's application of *State Farm* and APA arbitrary and capricious review has prompted other cases raising similar challenges to other regulations.²⁹ Correspondingly, Treasury and the IRS are already approaching the regulation drafting process differently. Specifically, in three high-profile rulemakings in 2016 - concerning inversion transactions under IRC § 7874 and related provisions,³⁰ earnings stripping under IRC § 385,³¹ and property transfers to foreign corporations under IRC § 367(d)³² - Treasury and the IRS have included lengthier explanatory preambles offering greater insight into the drafters' thinking. Practitioners point to *Altera* as the reason.

2.2 *Florida Bankers Association v. United States Department of Treasury*

In 1967, in *Abbott Laboratories v. Gardner*, the Supreme Court interpreted the APA as adopting a presumption in favor of judicial review of final agency action - specifically including, but not limited to, legally-binding regulations.³³ As a result of the *Abbott Labs* decision, the norm for most U.S. administrative agencies is that courts will entertain challenges to the validity of agency regulations as soon as the agency finalizes them, before the regulations become too entrenched.³⁴ In short, when the Environmental Protection Agency, the Food and Drug Administration, or the Securities Exchange Commission issues a regulation, those

²⁵ *Id.* at 842-43.

²⁶ *See, e.g., AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 387-92 (rejecting a Federal Communications Commission interpretation of the Telecommunications Act of 1996 because, even though the statute's use of words like "necessary" and "impair" gave the agency interpretive discretion, the agency's chose interpretation was not within the range of reasonableness).

²⁷ *Judulang*, 565 U.S. at 52 n.7.

²⁸ *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016).

²⁹ *See, e.g., 3M Co. Argues IRS Can't Allocate Royalties from Brazil Subsidiary*, 2016 Tax Notes Today 128-23 (Mar. 21, 2016) (publishing opening brief in *3M Co. & Subs. v. Comm'r*, challenging the validity of Treas. Reg. § 1.482-1(h)(2)); *Business Associations Ask Court to Invalidate Inversion Rule*, 2016 Tax Notes Today 198-16 (Oct. 11, 2016) (publishing opening brief in *Chamber of Commerce of the United States of America v. IRS*, challenging the validity of Treas. Reg. § 1.7874-8T); *Estate Tax Regs May Exceed Treasury's Authority, Bar Group Says*, 2016 Tax Notes Today 228-25 (Nov. 28, 2016) (publishing comments submitted to Treasury and the IRS suggesting that proposed regulations under IRC §§ 2701 and 2704 may be arbitrary and capricious under *State Farm* because Treasury has "entirely failed to consider an important aspect of the problem" presented by the statute).

³⁰ T.D. 9761, 2016-20 I.R.B. 743.

³¹ T.D. 9790, 2016-45 I.R.B. 540.

³² T.D. 9803, 2017-3 I.R.B. 384.

³³ *Abbott Laboratories v. Gardner*, 387 U.S. 136, 140-41 (1967).

³⁴ *See* Richard J. Pierce, Jr., *Administrative Law Treatise* § 15.4 (5th ed. 2010) ("After *Abbott*, pre-enforcement review of rules became the norm in the large class of cases in which the challenge to the rule's validity raised one or more issues that were susceptible to judicial resolution before the rule was applied.").

agencies know that parties disappointed in the regulation's content will shortly file suit claiming one or more reasons why the reviewing court should invalidate the regulation. The rationale for pre-enforcement judicial review of agency regulations is that regulated parties should not have to choose between complying with regulations that they think are invalid or facing penalties for that noncompliance just to get to court.³⁵

By comparison, a tax provision known as the Anti-Injunction Act expressly precludes judicial consideration of any "suit for the purpose of restraining the assessment or collection of any tax" except as otherwise provided in the IRC.³⁶ Whether this language supersedes the APA's pre-enforcement judicial review norm for Treasury regulations is unclear. For several decades, judicial review of tax cases has fallen almost exclusively into one of two enforcement-based categories: deficiency actions, where the IRS seeks to enforce the tax laws by issuing a notice of deficiency that the taxpayer can then challenge in the United States Tax Court, and refund actions, where the taxpayer pays the disputed taxes and sues the IRS for a refund.³⁷ The Supreme Court has often, though not always, construed the Anti-Injunction Act quite restrictively, and the tax community has, consequently, assumed that pre-enforcement judicial review of Treasury regulations is unavailable, irrespective of the APA.³⁸ However, that understanding was more an assumption than clearly established legal doctrine. For example, in 1987, in *Foodservice and Lodging Institute, Inc. v. Regan*, the D.C. Circuit held that the Anti-Injunction Act barred pre-enforcement challenges to three Treasury regulations but allowed the court to consider the validity of a fourth Treasury regulation that concerned only third-party reporting.³⁹

In the post-*Mayo Foundation* era, taxpayers are pursuing clarification regarding the availability of pre-enforcement judicial review for challenges to the validity of Treasury regulations more aggressively. The case to address this issue most directly thus far is *Florida Bankers*.⁴⁰ Much like the *Altera* case, *Florida Bankers* involved a challenge to Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 on *State Farm* grounds.⁴¹ In this instance, the regulations at issue require U.S. banks to report interest earned on U.S. bank deposits of nonresident aliens, and impose a penalty on banks that fail to file such reports.⁴² Such interest is not taxable in the United States,⁴³ but the U.S. government wants the information to exchange with other governments for similar information about non-U.S. bank deposits of U.S. citizens and residents.⁴⁴ The banks challenged the regulations under the APA on a pre-enforcement basis, claiming the regulations violated the APA's reasoned decision-making requirement. The government sought dismissal based on the Anti-Injunction Act.⁴⁵

³⁵ *Abbott Laboratories*, 387 U.S. at 151-53.

³⁶ I.R.C. § 7421(a).

³⁷ See Gerald A. Kafka & Rita A. Cavanagh, *Litigation of Federal Civil Tax Controversies* § 1.01 (2d ed. 1995) (recognizing deficiency and refund actions as the two principal types of tax litigation).

³⁸ See Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. ____ (forthcoming Dec. 2017) (analyzing the Supreme Court's Anti-Injunction Act jurisprudence).

³⁹ *Foodservice and Lodging Institute, Inc. v. Regan*, 809 F.2d 842, 846 & n.10 (D.C. Cir. 1987).

⁴⁰ *Florida Bankers Ass'n v. United States Dept. of the Treasury*, 799 F.3d 1065 (D.C. Cir. 2015).

⁴¹ Brief for Appellants, *Florida Bankers Ass'n v. United States Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015) (No. 14-5036), 2014 WL 3556435 at *28-29.

⁴² Treas. Reg. § 1.6049-4(b)(5).

⁴³ I.R.C. § 871(i)(2)(A).

⁴⁴ T.D. 9584, 2012-20 I.R.B. 900.

⁴⁵ Brief for Appellees, *Florida Bankers Ass'n v. United States Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015) (No. 14-5036), 2014 WL 4980262 at *26-34.

In a split decision, the D.C. Circuit held that the Anti-Injunction Act applied to preclude judicial review of the banks' challenge.⁴⁶ Although the banks rightly observed that Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 concerned third-party reporting obligations rather than any liability on their part to pay taxes, the court observed that the banks would be liable for penalties if they failed to file the required reports.⁴⁷ The court then cited a provision of the IRC specifying that such penalties "shall be assessed and collected in the same manner as taxes" and that references to "tax" within the IRC "shall be deemed also to refer to" penalties such as those imposed for failure to file information returns.⁴⁸ Accordingly, held the court, the penalties for noncompliance with the challenged regulations are taxes for Anti-Injunction Act purposes.⁴⁹ In other words, invalidating Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 pre-enforcement would deny the IRS the eventual opportunity to assess penalties against a bank that fails to comply with the regulations, and thus would restrain the assessment and collection of taxes.

The D.C. Circuit's *Florida Bankers* decision was not unanimous, as Judge Karen LeCraft Henderson wrote a scathing dissent.⁵⁰ Apart from its 1987 decision in the *Foodservice and Lodging Institute* case, the D.C. Circuit had issued two post-*Mayo Foundation* decisions that seemingly interpreted the Anti-Injunction Act as more limited in scope. In *Cohen v. United States*, the D.C. Circuit sitting en banc held that taxpayers could bring an APA-based challenge against IRS Notice 2006-50, which adopted special procedures for refunding a defunct telephone excise tax that the IRS had improperly collected for several years.⁵¹ And in *Seven-Sky v. Holder*, a D.C. Circuit panel held that pre-enforcement constitutional challenges against Affordable Care Act penalties to be collected by the IRS were reviewable notwithstanding the Anti-Injunction Act.⁵² Writing for the court in *Florida Bankers*, Judge Brett Kavanaugh contended that all of these precedents were distinguishable from the circumstances at bar. However, Judge Henderson accused the *Florida Bankers* majority of disregarding the court's own precedents for specious reasons.⁵³

Also significant, the D.C. Circuit's *Florida Bankers* decision seems to contradict the Supreme Court's decision in *Direct Marketing Association v. Brohl*.⁵⁴ Like *Florida Bankers*, *Direct Marketing* concerned a third-party reporting requirement imposed by the state of Colorado on retailers. Unlike *Florida Bankers*, *Direct Marketing* concerned the Tax Injunction Act rather than the Anti-Injunction Act. Passed by Congress in 1937,⁵⁵ the Tax Injunction Act provides that "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".⁵⁶ In an opinion by Justice Thomas, the *Direct Marketing* Court recognized that the acts of assessment and collection are statutorily defined functions, and also that judicial review only enjoins, suspends, or restrains those actions when it actually stops them from

⁴⁶ *Florida Bankers Ass'n v. United States Dept. of the Treasury*, 799 F.3d 1065, 1067 (D.C. Cir. 2015).

⁴⁷ *Id.* at 1068 (citing I.R.C. § 6721(a), imposing a penalty for failure to file an information return).

⁴⁸ *Id.* (citing I.R.C. § 6671(a)).

⁴⁹ *Id.*

⁵⁰ *Id.* at 1072 (Henderson, J. dissenting). It is worth noting that Judge Henderson is not known for writing scathing dissents.

⁵¹ *Cohen v. United States*, 650 F.3d 717, 724-27 (D.C. Cir. 2011) (en banc).

⁵² *Seven-Sky v. Holder*, 661 F.3d 1, 8-10 (D.C. Cir. 2012), *abrogated on other grounds* by *National Federation of Independent Business v. Sebelius*, 132 S. Ct. 2566 (2012).

⁵³ *Florida Bankers*, 799 F.3d at 1072-73.

⁵⁴ *Direct Marketing Ass'n v. Brohl*, 135 S. Ct. 1124 (2015).

⁵⁵ Pub. L. No. 332, ch. 726, 50 Stat. 738 (1937).

⁵⁶ 28 U.S.C. § 1341 (2012).

occurring.⁵⁷ By contrast, the Tax Injunction Act does not apply when judicial review would merely inhibit the acts of assessment and collection indirectly by making it harder for state taxing authorities to enforce the law, e.g., by denying them the information they would otherwise obtain through third-party reporting.⁵⁸ Although the wording of the Tax Injunction Act is slightly different from that of the Anti-Injunction Act, the Court has always counseled construing the two statutes similarly.⁵⁹

It is hard to reconcile the D.C. Circuit's decision in *Florida Bankers Association* with the Supreme Court's decision in *Brohl*. If judicial review of third-party reporting regulations would not stop, and thus would not "restrain" the assessment or collection of taxes for purposes of the Tax Injunction Act, and the Anti-Injunction Act is to be construed similarly, then on what basis can judicial review of the third-party reporting requirements of Treas. Reg. §§ 1.6049-4(b)(5) and 1.6049-8 be said to stop or "restrain" the assessment or collection of taxes for purposes of the Anti-Injunction Act? The D.C. Circuit's only response was that no one in *Direct Marketing* suggested that penalties for noncompliance should be considered taxes - completely ignoring the Supreme Court's interpretation of "restrain" as to stop rather than to inhibit.⁶⁰ Moreover, the Court's reasoning in *Direct Marketing* arguably would seem to extend additionally to regulations that define taxable income.

Finally, one should never forget that the Anti-Injunction Act originated in 1867 to stop courts from enjoining the collection process for a short-lived income tax adopted to finance the Civil War.⁶¹ Treasury regulations did not exist at that time, nor did the APA. Tax administrative practices of that era, however, are directly traceable to those utilized today *once the IRS has initiated enforcement* of the tax laws and not before.⁶² Although "no recorded legislative history" exists explaining the scope of the Anti-Injunction Act,⁶³ its historical context strongly suggests that Congress did not intend the Anti-Injunction Act to cut off pre-enforcement judicial review of Treasury regulations in the manner claimed by the D.C. Circuit in *Florida Bankers Association*.

The current eight-Justice Supreme Court declined to consider whether the D.C. Circuit erred in *Florida Bankers*⁶⁴, but that denial may not hold in the event a circuit split develops. Tax litigators are endeavoring to create precisely that circuit split. For example, a case in the Western District of Texas, *Chamber of Commerce of the United States of America v. Internal Revenue Service*, challenges on a pre-enforcement basis the validity of Treasury regulations

⁵⁷ *Direct Marketing*, 135 S. Ct. at 1133.

⁵⁸ *Id.*

⁵⁹ See, e.g., *Hibbs v. Winn*, 542 U.S. 88, 115 (2004); *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 6 (1962).

⁶⁰ *Florida Bankers*, 799 F.3d at 1069.

⁶¹ Revenue Act of 1867, ch. 169, § 10, 14 Stat. 471, 475; see also Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Petitioners, *Florida Bankers Ass'n v. United States Department of the Treasury*, No. 15-969 (U.S. Sup. Ct. Feb. 29, 2016), available at 2016 WL 825989 (advancing this argument); Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. __ (forthcoming Dec. 2017) (offering more extensive historical analysis).

⁶² See Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. __ (forthcoming Dec. 2017) (comparing and analyzing the Anti-Injunction Act in light of the evolution of tax administrative practices since the 1860s).

⁶³ *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974); see also Erin Morrow Hawley, *The Equitable Anti-Injunction Act*, 90 Notre Dame L. Rev. 81 (2014) (noting an absence of any congressional record defining the scope of the Anti-Injunction Act).

⁶⁴ *Florida Bankers Ass'n v. United States Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015), cert. denied, 136 S. Ct. 2429 (2016).

issued in 2016 to curtail inversion transactions.⁶⁵ Moving for dismissal, the government has asserted the Anti-Injunction Act.⁶⁶ Whatever the district court's conclusion, its decision will be appealable to the Fifth Circuit, which is sometimes more demanding of agency compliance with the APA than other circuits' Court of Appeals. The government has also asserted the Anti-Injunction Act in a case in the Eastern District of Tennessee, *CIC Services LLC v. Internal Revenue Service*, challenging an IRS notice requiring information reporting in connection with certain captive insurance arrangements.⁶⁷ The district court's decision in that case will be appealable to Sixth Circuit Court of Appeals.

2.3 *QinetiQ U.S. Holdings, Inc. v. Commissioner*

The *Altera* and *Florida Bankers* cases involved challenges that Treasury regulations were arbitrary and capricious under APA § 706(2)(A) and the *State Farm* case. General administrative law doctrine does not, however, limit the applicability of APA § 706(2)(A) or *State Farm* to agency regulations. In *Judulang v. Holder*, the Supreme Court applied the same requirement in rejecting a Board of Immigration Appeals deportation order - i.e., an adjudication - as an unreasonable exercise of discretionary power.⁶⁸ For that matter, although *State Farm* itself required contemporaneous evidence of reasoned decision-making in the rulemaking context, the Court in that decision drew from existing precedents concerning judicial review of agency discretion exercised through adjudication. In *SEC v. Chenery Corp.*, for example, the Court declined to uphold an agency decision on grounds not offered by the agency in its original adjudicatory order.⁶⁹ Additionally, in *Citizens to Preserve Overton Park v. Volpe*, the Court interpreted APA § 706(2)(A) as requiring an agency to supply a contemporaneous administrative record to facilitate judicial review of an agency adjudicatory decision that lacks a formal order - or see agency officials hauled into court to explain their actions through sworn testimony.⁷⁰ In short, APA § 706(2)(A) requires government agencies to explain the reasoning driving their adjudicatory decisions, and to do so contemporaneously, just as with regulations. And, as with regulations, courts limit their review of the reasonableness of agency adjudicatory outcomes to those contemporaneous explanations and refuse to entertain justifications for agency decisions advanced for the first time in litigation.

Yet, statutory provisions governing judicial review of agency regulations tend to be relatively centralized in the APA.⁷¹ By contrast, specific statutes that contemplate agency adjudications in the context of particular government programs often also address judicial review of those adjudications with some specificity. Although the APA instructs courts to interpret the APA and provisions of specific statutes to give maximum effect to both, the APA is a statute of general applicability, and standard rules of statutory construction say that specific statutes trump general ones.⁷² Hence, courts are often called upon to evaluate whether and to what extent specific statutory provisions override APA provisions governing the availability and scope of judicial review of agency action and specific statutory provisions.

⁶⁵ Chamber of Commerce of the United States of America v. Internal Revenue Service, No. 1:16-cv-944-LY (W.D. Tex. filed Aug. 4, 2016).

⁶⁶ Defendant's Motion to Dismiss for Lack of Subject-Matter Jurisdiction, *Chamber of Commerce of the United States of America v. Internal Revenue Service*, No. 1:16-cv-944-LY (W.D. Tex. Oct. 11, 2016).

⁶⁷ Defendant's Opposition to Plaintiffs' Motion for Expedited Hearing, *CIC Services, LLC v. Internal Revenue Service*, No. 3:17-cv-110 (E.D. Tenn. Apr. 5, 2017).

⁶⁸ *Judulang v. Holder*, 565 U.S. 42, 53 (2011).

⁶⁹ *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 95 (1943).

⁷⁰ *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 414 (1971).

⁷¹ See 5 U.S.C. § 553 (imposing procedural requirements upon agencies engaging in rulemaking).

⁷² 5 U.S.C. § 559

The IRC contains several provisions governing the issuance and judicial review of tax deficiency notices. The IRC authorizes the IRS to send a taxpayer a deficiency notice when the IRS determines the taxpayer owes additional taxes.⁷³ This notice is supposed to “describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice.”⁷⁴ “An inadequate description” in the deficiency notice, however, is not necessarily fatal to the IRS’s position - “shall not invalidate such notice.”⁷⁵ A taxpayer who receives a deficiency notice, meanwhile, may seek judicial review thereof in the United States Tax Court without first paying the taxes allegedly due.⁷⁶ The IRC gives the Tax Court “jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount” listed in the deficiency notice,⁷⁷ meaning that the Tax Court reviews deficiency notices de novo as to issues of both fact and law, without deference to or consideration of the administrative record developed by the IRS.⁷⁸

In the *QinetiQ* case, the taxpayer - QinetiQ - received a deficiency notice denying its claim to a particular (and very large) tax deduction and, consequently, adjusting the taxpayer’s income tax liability upward substantially. QinetiQ pressed its eligibility for the deduction in question first before the Tax Court and, subsequently, on appeal to the Fourth Circuit. QinetiQ also, however, challenged the deficiency notice itself as arbitrary and capricious under APA § 706(2)(A) and *State Farm*. QinetiQ acknowledged that “[t]he IRS had informally made various arguments about the appropriateness of QinetiQ’s deduction during the preceding audit of QinetiQ, and QinetiQ had responded to those arguments in various filings.”⁷⁹ QinetiQ complained, however, that the deficiency notice itself “provided no explanation of how, or why, the [IRS] had arrived at its final determination.”⁸⁰

Both the Tax Court and the Fourth Circuit categorically rejected the applicability of APA § 706(2)(A) and *State Farm* to IRS deficiency notices. The Tax Court offered little analysis of the issue. In a brief interlocutory order, Judge Goeke contended merely that the Supreme Court’s decision in *Mayo Foundation* “dealt with agency rulemaking only” and did not “overrule more than 85 years of jurisprudence and practice reviewing deficiency determinations de novo.”⁸¹ While QinetiQ’s appeal was pending before the Fourth Circuit, however, in *Ax Commissioner*, Judge Gustafson offered more extensive analysis of the relationship between the APA and the IRC’s provisions concerning Tax Court review of deficiency notices.⁸² According to Judge Gustafson, the APA contemplates that specific statutes will sometimes override its requirements.⁸³ As regards judicial review of deficiency

⁷³ I.R.C. § 6212(a).

⁷⁴ I.R.C. § 7522(a) & (b)(1).

⁷⁵ *Id.*

⁷⁶ I.R.C. § 6213(a).

⁷⁷ I.R.C. § 6214(a).

⁷⁸ *Ewing v. Comm’r*, 122 T.C. 32, 52-53 (2004) (Thornton, J. concurring) (discussing history of Tax Court de novo review), *overruled on other grounds*, 439 F.3d 1009 (9th Cir. 2006); *see also, e.g., Eren v. Comm’r*, 180 F.3d 594, 597 (4th Cir. 1999) (acknowledging de novo review by Tax Court); *Gatlin v. Comm’r*, 754 F.2d 921, 923 (11th Cir. 1985) (same); *Raheja v. Comm’r*, 725 F.2d 64, 66 (7th Cir. 1984) (same).

⁷⁹ Brief for Appellant, *QinetiQ U.S. Holdings, Inc. & Subs. v. Comm’r*, 845 F.3d 555 (4th Cir. 2017), 2016 WL 303820 at *14.

⁸⁰ *Id.*

⁸¹ Order of Dec. 27, 2013 at 2, No. 14122-13, available at <https://www.ustaxcourt.gov/USTCDockInq/DocumentViewer.aspx?IndexID=6178478>.

⁸² *Ax v. Comm’r*, 146 T.C. 153 (2016).

⁸³ *Id.* at 162.

notices, by providing for trial de novo by the Tax Court, the IRC is just such a specific statute.⁸⁴ Subsequently, in rejecting QinetiQ's appeal, the Fourth Circuit reached a similar conclusion, holding that "the APA's general procedures for judicial review, including the requirement of a reasoned explanation in a final agency decision, were not intended by Congress to be superimposed on the [IRC's] specific procedures for de novo judicial review of the merits of a Notice of Deficiency."⁸⁵

Yet, the Fourth Circuit's decision is not likely to be the last word regarding the applicability of APA § 706(2)(A) and *State Farm* to IRS deficiency notices. The Fourth Circuit was at least partly influenced in its decision by its own longstanding precedent holding that the APA's judicial review provisions do not apply to IRS deficiency determinations, but predate both *Mayo Foundation* or *State Farm* along with much contemporary administrative law jurisprudence.⁸⁶ By comparison, in *Fisher v. Commissioner*, the Tenth Circuit Court of Appeals rejected an IRS deficiency notice imposing penalties on a taxpayer because the IRS had offered no written explanation for declining to waive the penalty.⁸⁷ "It is an elementary principle of administrative law that an administrative agency must provide reasons for its decisions," said the court.⁸⁸ In dicta, the Ninth Circuit similarly has suggested that "major errors" in a notice of deficiency, though "quite rare," could invalidate a notice of deficiency, without specifying what such an error might look like.⁸⁹ Although these precedents fall a bit short of a clear disagreement among the circuits, the Tenth and Ninth Circuit precedents are likely to inspire taxpayers to continue to press the argument that courts should require deficiency notices to satisfy APA § 706(2)(A) and *State Farm*. Meanwhile, *QinetiQ* has filed a petition seeking Supreme Court review of the Fourth Circuit's decision in its case.⁹⁰

Regardless, as has proven the case with respect to *Altera*, the mere possibility that courts might accept those arguments may be enough to persuade the IRS to incorporate more extensive explanations in its deficiency notices. Anecdotally, the IRS occasionally issues a deficiency notice without first having determined its own theory of the case - which occasions are precisely when the reasoned decision-making requirement APA § 706(2)(A) and *State Farm* would pose a problem for the IRS. In most cases, however, the IRS's own administrative record undoubtedly provides exactly the reasoning in support of the deficiency notice that would suffice to demonstrate reasoned decision-making. Incorporating analysis from the administrative record in future deficiency notices seems easy enough to accomplish. The IRS would still lose some deficiency cases on the merits, particularly given the Tax Court's de novo review. However, the deficiency notices themselves would generally no longer be susceptible to challenge under APA § 706(2)(A) and *State Farm*.

3. IMPLICATIONS

Jurisprudence exploring the boundaries of the *Mayo Foundation* decision's rejection of tax exceptionalism from general administrative law requirements is distinctly a work in progress. Although each of the three principal cases described above has been at least tentatively if not

⁸⁴ *Id.*

⁸⁵ *QinetiQ U.S. Holdings, Inc. & Subs. v. Comm'r*, 845 F.3d 555, 561 (4th Cir. 2017).

⁸⁶ *Id.* at 560 (citing *O'Dwyer v. Comm'r*, 266 F.2d 575, 580 (4th Cir. 1959)).

⁸⁷ *Fisher v. Comm'r*, 45 F.3d 396 (10th Cir. 1995).

⁸⁸ *Id.* (quoting *Harberson v. NLRB*, 810 F.2d 977, 984 (10th Cir. 1987), in turn citing *SEC v. Chenery Corp.*, 318 U.S. 80, 94 (1943)).

⁸⁹ *Elings v. Comm'r*, 324 F.3d 1110, 1113 (9th Cir. 2003).

⁹⁰ Petition for Writ of Certiorari, *QinetiQ U.S. Holdings Inc. & Subs v. Comm'r*, No. ___ (U.S. Apr. 4, 2017).

conclusively resolved, the law is far from settled. Litigation continues and is likely to for some years to come. Is all of the resulting legal uncertainty worth it?

At least anecdotally, past and present government tax lawyers have suggested to this author that tax administration in the United States has functioned effectively for decades without the intrusion of general administrative law principles. Indeed, for many years, the IRS held a reputation as a particularly effective and efficient government agency.⁹¹ However, the fact that a system has functioned well in the past does not mean that it continues to fire on all cylinders today. Today's IRS is struggling. Reasons for the IRS's difficulties abound, including but not limited to, political scandals⁹²; budget cuts and staffing declines⁹³; and an ever-expanding portfolio of programmatic responsibilities that the IRS is ill-equipped to handle.⁹⁴ Collectively, however, they add up to a corresponding crisis of legitimacy for the IRS and the tax system.

Meanwhile, the focus of tax administration in the United States has changed substantially. In addition to administering an array of government spending programs through tax expenditures, the IRS is one of the government's principal welfare agencies and is heavily involved in regulating the nonprofit and health care sectors of the economy.⁹⁵ Many actions the IRS seeks to shield from general administrative law procedure and process requirements, and judicial review, concern programs and functions other than traditional revenue raising.⁹⁶ Yet, as the IRS has transitioned from a mission-driven agency focused on tax collection to an omnibus agency that does many things, the rationale for tax exceptionalism from general administrative law norms - to the extent it was ever justified - has diminished substantially. Why should the IRS avoid general administrative law requirements when other agencies administering substantially similar programs must follow them?

Given the IRS's many problems, it would be foolish to suggest that increasing transparency and accountability by complying assiduously with general administrative law principles is a panacea. However, APA requirements and general administrative law principles emphasize transparency and accountability in the administrative process precisely because those features are thought important to perceptions of legitimacy for administrative action. Correspondingly, judicial review is the principal tool chosen by Congress to ensure that agencies follow the procedure and process requirements that facilitate transparency and accountability. The IRS's recalcitrance in this regard, as evidenced by the litigation described in this essay, demonstrates the importance of judicial review in protecting tax administrators from themselves.

⁹¹ See, e.g., Jonathan Barry Forman, *Let's Keep (and Expand Upon) the Earned Income Credit*, 56 Tax Notes 233 (1992) ("The IRS is far and away one of the most efficient agencies in the federal government.").

⁹² Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 99 Cornell L. Rev. Online 41, 49-51 (2013).

⁹³ U.S. Gov't Accountability Off., GAO-14-534R, Internal Revenue Service: Absorbing Budget Cuts Has Resulted in Significant Staffing Declines and Uneven Performances 8-9 (2014), <http://www.gao.gov/assets/670/662681.pdf> [http://perma.cc/H9ER-49RE].

⁹⁴ Kristin E. Hickman, *Pursuing A Single Mission (Or Something Closer To It) For The IRS*, 7 Colum. J. Tax L. 169, 172-73 (2016).

⁹⁵ *Id.* at 174-79.

⁹⁶ See generally, e.g., Kristin E. Hickman, *Administering the Tax System We Have*, 63 Duke L.J. 1717 (2014) (studying subject matter of Treasury regulation projects over five-year period).

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