Silver Strikes Gold for Taxpayer Administrative Law Challenges

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Historically, not a lot of thought has been given in tax litigation circles to the Regulatory Flexibility Act (RFA) or the Paperwork Reduction Act (PRA); that may be about to change.

“The IRS and Treasury have not been conscientious about following what the Regulatory Flexibility Act requires. . . . There is definitely a lot potential in applying the same analysis [in *Silver*] to other regulations,” said Patrick J. Smith of Ivins Phillips & Barker Chtd. “Oftentimes there are specific provisions in regulations that companies want to challenge. They’re not necessarily interested in having the whole package invalidated. This is kind of a sledgehammer approach. . . . Still, if this is what works ...”

Monte Silver, a U.S. citizen with a legal practice in Israel, has challenged the validity of the final regs on the transition tax — which is imposed on offshore accumulated earnings by the Tax Cuts and Jobs Act — over the IRS's alleged failure to perform the required small-business impact evaluations necessary under the RFA and PRA. The IRS sought dismissal of the suit on the grounds that Silver lacked standing or, alternatively, that the Anti-Injunction Act (AIA) barred the action.

A district court's December 24 order denying the government’s motion and allowing Silver to proceed to the merits was unexpected and, although scarcely over six pages, has tilted the litigation decidedly in the taxpayer’s favor. Silver has promised to bring a motion for summary judgment and is confident that he will prevail.

Silver’s allegation of procedural injury meant that “the redressability and imminence requirements of standing are relaxed,” Judge Amit Mehta of the U.S. District Court for the District of Columbia held.

“Judge Mehta is not going out on a limb here. He is well within the overall body of jurisprudence with respect to standing to cite cases like *Lujan* [*v. Defenders of Wildlife*, 504 U.S. 555 (1992)] and approach this case through that lens,” said Kristin Hickman of the University of Minnesota Law

School.

While he did not owe any transition tax, Silver argued that he incurred significant costs in collecting information and in recordkeeping associated with compliance. The government countered that it was the statute, not its regs, that gave rise to any injury to Silver. The court, however, disagreed.

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"This argument fundamentally misconstrues Plaintiffs' claims. Plaintiffs are not challenging any specific regulation that might or might not be traceable directly to the TCJA. Rather Plaintiffs allege that the agencies neglected to undertake procedural measures designed to protect small business from the burden of unwieldy and cost-intensive regulations — namely, the publishing of an initial and a final regulatory flexibility analysis," the opinion states. "Plaintiffs' alleged injuries are therefore traceable to Defendants' alleged violation of these separate statutory requirements, not the TCJA."

Smith said this language from the court's holding could be read as applicable even beyond the PRA and RFA. The same analysis could be applied to IRS defects in notice and comment procedures required for reg writing.

Surprise, Surprise

The AIA also did not prevent the suit from proceeding, the court held, because Silver was not seeking a refund or to stop revenue collection, but rather was challenging the IRS procedure of adopting regs without conducting the necessary review.

Under the AIA, suits that would restrain the assessment or collection of tax are disallowed.

The surprise decision from the circuit court could have larger ramifications beyond the transition tax, especially if the D.C. Circuit were to affirm any potential appeal.

Hickman noted that historically, Treasury has taken the position that the vast majority of its regs are exempt from RFA analysis, though that claim "was not well-founded."

Silver told *Tax Notes* that it wasn't until he started reading the regs that it occurred to him that he should conduct a deeper investigation of the RFA and PRA. It was then that he discovered the dearth of court challenges to rules under those grounds — not just in the tax world, but more generally — though he did review litigation on the matter related to grazing rights.

Hickman noted that only a small number of cases from circuit courts have involved RFA challenges under the *State Farm* analysis.

“To date, the circuit courts have not been especially receptive to those challenges,” Hickman said, specifically pointing to *Montgomery County v. FCC*, 863 F.3d 485 (6th Cir. 2017), in which the court reviewed an agency action based on the relatively low bar that it made a “reasonable good faith effort” to comply with the RFA. “That said, it is not a large body of case law, and Treasury’s track record with compliance with the Regulatory Flexibility Act has been spotty," she said. "Given [this], a court might be more willing to find a particular tax regulatory action arbitrary and capricious on these grounds.”

Under *Motor Vehicle Manufacturers Association of the United States Inc. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983), an agency must articulate a reasoned explanation for its actions or its rule will be invalidated as arbitrary and capricious.

Clinton G. Wallace of the University of South Carolina School of Law said he also was surprised by the *Silver* court’s decision.

“The government is right that the underlying thing that the taxpayer is concerned about is the law, not the regulations, and certainly not the analysis of how the regulations would affect particular taxpayers,” Wallace said, before pointing to the regs' language, which goes beyond the more typical “summary dismissals” of the PRA and RFA requirements. “They gave it a real shot here, and it was not dismissive. It was serious engagement with their obligation to consider the burdens they were creating. . . . I don’t remember seeing anything that is even this comprehensive,” Wallace added.

Although it dedicates seven paragraphs to the RFA, including an estimate of the net tax to be collected from small entities over the next decade, and states that the average compliance burden is a “minimal” five hours, the preamble to the final regs (T.D. 9846) ultimately concludes that the guidance will not have a significant economic impact on a substantial number of small entities and that an RFA analysis is not required. No comments were received on the proposed rules' impact on small business when they were submitted to the Small Business Administration, the preamble notes.

Speaking generally about the IRS's typical RFA section, Smith said it was often "very perfunctory." He compared it with the analysis under Executive Order 12866.

"They now go through the motion of doing those, but the analysis is very unpersuasive. It's basically always the benefit to taxpayers is certainty and clear answers," Smith said. "It certainly doesn't justify any particular rules."

Executive Order 12866 establishes review of regs by the Office of Management and Budget and requires agencies to assess costs and benefits of regulatory alternatives. While Treasury and OMB for decades exempted tax regs from regulatory review, that agreement was superseded by another one in 2018 that subjects significant tax regs to such review.

Forget Something?

Smith said one of the most striking things about the decision is the failure to address *Florida Bankers Association v. U.S. Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015). In that case, the D.C. Circuit held that the AIA barred U.S. banks from challenging a regulation that required reporting of nonresident aliens' interest income. The case was addressed by both the government, which wanted to rely on it, and the taxpayer, which wanted to distinguish it, on brief.

Smith had predicted that *Florida Bankers* would present a significant hurdle to Silver looking to reach the merits of his case.

While *Florida Bankers* is one of the few tax cases in which an RFA challenge to a reg was raised, the majority opinion there does not address the issue. And although the dissent does address the RFA, it does so only in rejecting the government's contention that the plaintiff lacks standing.

Silver told *Tax Notes* that his case is not directly comparable to *Florida Bankers,* in which no overriding statutes were at issue. "I'm not asking to invalidate anything. I'm just asking to follow procedure. . . . [My case] can be easily distinguished from *Florida Bankers*," he said.

The *Silver* decision instead leans heavily on *Cohen v. United States*, 650 F.3d 717 (D.C. Cir. 2011).

"The idea that the plaintiffs in this case are not seeking to have their tax liability determined but are instead seeking to compel the IRS and Treasury to follow the procedures that they are statutorily required to follow by the Regulatory Flexibility Act in particular: that seems to me to be a very plausible and respectable position, and certainly, something that could be applied much more broadly," Smith said.

Cohen is an interesting case for the court to analogize to because it involved the AIA not presenting a bar to a suit relating to IRS refund procedures for illegally collected telephone excise taxes. Unlike in *Silver*, the IRS had already assessed and collected the tax in *Cohen*.

When it was first handed down, Smith said, he did not count on *Cohen* having much application, given its narrowness involving litigation of a refund procedure. He did acknowledge, however, "a lot of broad language" in that decision about the IRS "trying to insulate itself from all types of challenges" through the AIA.

If Mehta had wished to craft a potentially narrower decision, he could have leaned on *South Carolina v. Regan,* 465 U.S. 367 (1984). Interestingly, although the decision references Silver's assertion that he does not owe the transition tax, it makes no mention of that case, though it was raised in briefing. That case was arguably more analogous to *Silver* than *Cohen* because it centered on a suit brought by the state involving the tax-free status of bonds. In that case, with no alternative remedy available, the court rejected the argument that the AIA barred the suit. Silver, too, has argued that he does not owe the transition tax and if the AIA were to bar his suit, he would have no remedy available.

"What the government kept saying was, 'He doesn't owe tax yet.' Well, the transition tax is a one-time tax. It's not something you are going to owe every year. So if he doesn't owe it yet, he's never going to owe it," Smith said.

Both Smith and Hickman were confident that the government would be eager to appeal the decision. If the D.C. Circuit were to reach the same result, Smith argued, it would be easier to do so on the grounds that Silver had no tax to pay.

Ultimate Remedy

What a potential remedy would look like if the taxpayer were to win on the merits is another open question. Wallace argued that the transition tax regs aid taxpayers in complying with the law and that Silver is concerned with the regs because of his controlled foreign corporation, which is a defined term in the code.

"If you have a CFC, you are potentially subject to this tax, and that cannot change based on the regulations. That's the law. I don't think you can fault the regulations or the Regulatory Flexibility Act analysis for getting swept up in this," Wallace said.

Wallace argued that a court should remand the reg to the IRS, but leave the substance in place and give the government a chance to fix its defective procedure. He acknowledged that while there is precedent for such action (remand without vacatur), courts have been reluctant to take such steps.

"It makes a lot of sense in the tax context where the agency is getting up to speed on administrative law requirements and needs to learn from the courts," Wallace said. "There's a lot of Treasury regulations floating around with potential procedural deficiencies."

Remand without vacatur has principally been used in the D.C. Circuit, according to Hickman. Given that *Silver* would be appealed to the D.C. Circuit, it is at the very least plausible that remand without vacatur would be used there, she said, adding that there would be much less certainty if similar challenges arose in other circuits that have been reluctant to accept this "very controversial remedy."

Another possibility is that the court invalidates the reg in its entirety. Invalidation is the traditional remedy in administrative law, according to Hickman.

But with the statute still on the books, what would a taxpayer, big or small, do then?

"Probably the safest thing to do is apply the provisions of the reg until something else happens, as though it was still good," Smith said.

Hickman agreed and added that the biggest implication flowing from invalidated regs would be that if a taxpayer didn't follow them and had a reasonable basis for doing so, the IRS could not penalize the taxpayer.

Ultimately what Silver desires is a carveout from the transition tax rules for small taxpayers like himself. But a carveout is far from guaranteed even if a court were to invalidate the regs, because Treasury could conduct the proper analysis and then issue the same rules.

"That's one of the reasons the D.C. Circuit originally adopted the remand without vacatur remedy, as sort of recognizing if the only flaw with the regulations is some sort of explanatory piece, then why upset the entire set of regulations? Just have the agency go back and fix that little bit, and everything will go on as before," Hickman said.

But Hickman added that historically when regs have been vacated, "a fair percentage of the time agencies don't end up adopting the same position," even though nothing is preventing them legally from doing so. She speculated that such a change could stem from the additional analysis, a decline in the significance of the regs, or a shift in the political picture. Hickman cited a 1990 study from E. Donald Elliott and Peter H. Schuck of Yale Law School that showed in approximately 40 percent of remands, agencies adopted major changes to their actions.

Silver said the likelihood that Treasury reverses course on its rule and offers some sort of exemption for small taxpayers is strengthened by the fact that the government would otherwise "have to go through a thousand hoops" to abide by the requirements of the PRA and RFA, including explaining why alternatives to its rules for small entities were rejected. He also argued that with "one person . . . doing a rubber stamp" of the RFA and PRA requirements for tax regs, it would be very difficult for Treasury to do the needed analysis.

Silver reiterated his promise to also challenge the global intangible low-taxed income provision, under which he also does not owe any taxes, but which imposes an even greater compliance burden, especially considering its ongoing nature and his need to make section 962 elections.

By not providing an exemption previously, Silver said, Treasury was "opening up Pandora's box."

In *Silver v. IRS*, No. 19-cv-00247, Silver is represented by Stuart J. Bassin of the Bassin Law Firm PLLC.

DOCUMENT ATTRIBUTES

CODE SECTIONS	SEC. 965 TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO PARTICIPATION EXEMPTION SYSTEM OF TAXATION
JURISDICTIONS	UNITED STATES
SUBJECT AREAS / TAX TOPICS	LITIGATION AND APPEALS; ACCUMULATED EARNINGS; CONTROLLED FOREIGN CORPORATIONS (CFCS)
AUTHORS	ANDREW VELARDE
INSTITUTIONAL AUTHORS	TAX ANALYSTS
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