Suit Challenging Transition Tax Regs Can Proceed to Merits

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Neither the Anti-Injunction Act nor a lack of standing bars a U.S. citizen and shareholder in an Israeli controlled foreign corporation from challenging the transition tax regulations, according to the D.C. district court.

In a December 24 memorandum opinion and order in *Monte Silver and Monte Silver Ltd. v. IRS*, No. 19-cv-00247, Judge Amit Mehta of the U.S. District Court for the District of Columbia denied the government's motion to dismiss for lack of standing and subject matter jurisdiction. The ruling clears a major hurdle for Silver's suit alleging that the transition tax regulations are procedurally invalid under the Regulatory Flexibility Act, which requires that federal agencies perform and publicly release an analysis of a regulation's effects on small businesses and the appropriateness of simplified compliance requirements or exemptions. According to the complaint, Silver and the wholly owned Israeli CFC through which he advises worldwide clients on U.S. law have annual receipts of less than $1 million and therefore qualify as a small business.

Because Silver is a U.S. citizen, his Israeli corporation is a CFC potentially subject to a number of the Tax Cuts and Jobs Act's international provisions. His suit specifically targets the section 965 regulations (T.D. 9846), finalized in January, which implement the transition tax enacted by the TCJA. Section 965 imposes a one-time tax — at a 15.5 percent rate for cash and cash equivalents and at an 8 percent rate for other assets — on U.S. shareholders of a CFC or other specified foreign corporation equal to their pro rata share of the foreign corporation's deferred income accumulated after 1986.

Silver also argues that the section 965 regulations violate the Paperwork Reduction Act, which requires that agencies offer factual support for their certification that a regulation minimizes small businesses' compliance burdens. The failure by Treasury and the IRS to perform the statutorily mandated reviews renders the regulations invalid under the Administrative Procedure Act, according to Silver.

"In issuing the final regulations, defendants made no effort to examine the helpless situation of small business, and did not attempt to address alternatives, which would allow small business to comply with the law without undue burden. Thus, in promulgating the final regulations, the defendants unlawfully failed to comply with the governing provisions of the" Regulatory Flexibility Act, Administrative Procedure Act, and Paperwork Reduction Act, Silver argued.

Mehta's opinion rejects the government's argument that Silver lacks standing to challenge the regulations, holding that Silver's claims that he must spend significant time and resources to ensure compliance with the regulations — even if he ultimately has no transition tax liability —

"plausibly establish a concrete injury to support standing." The opinion also rejects the government's argument that any alleged injury cannot have been caused by the regulations because the regulatory complexity simply reflects the complexity inherent in the statute itself.

"This argument fundamentally misconstrues plaintiffs' claims. Plaintiffs are not challenging any specific regulation that might or might not be traceable directly to the TCJA," the opinion says. "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 . . . and a certification that the regulation has reduced compliance burdens on small businesses."

The government was also unsuccessful in its claim that the court lacks subject matter jurisdiction under the Anti-Injunction Act, which denies courts jurisdiction in suit filed "for the purpose of restraining the assessment or collection of any tax" and was seen by some observers as a prohibitive obstacle for Silver's case. The D.C. Circuit Court of Appeals held in *Florida Bankers Ass'n v. U.S. Dep't of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015), that the Anti-Injunction Act barred U.S. banks from challenging a regulation that required reporting of nonresident aliens' interest income.

However, Mehta held that Silver's suit does not affect tax assessment or collection and is therefore not covered by the Anti-Injunction Act.

"Plaintiffs do not seek a refund or to impede revenue collection. Instead, they challenge the IRS's adopting of regulations without conducting statutorily mandated reviews designed to lessen the regulatory burden on small businesses," the opinion says. "As relief, they ask the court simply to compel the agencies to do what the law requires — Regulatory Flexibility Act and Paperwork Reduction Act analyses. Tax revenues and their collection are unaffected by such relief."

Precedent Setting

The direct effect of Mehta's rejection of the government's motion is only to allow the case to proceed to the merits, and Silver must still establish that the regulations did in fact violate the Regulatory Flexibility Act, Paperwork Reduction Act, and Administrative Procedure Act. However, Silver told *Tax Notes* that the final outcome is now assured because the merits are overwhelmingly in his favor. "The merits are a slam dunk, and the Treasury knows this," he said.

Silver said a motion for summary judgment will be forthcoming shortly. "We have them on the ropes, and they know I'm aggressive," he said.

The decision sets a far-reaching precedent that extends well beyond the transition tax regulations, according to Silver. By allowing a challenge of a Treasury regulation to proceed to the merits, the opinion upends the near-unanimous prediction of practitioners that his case could never survive a motion to dismiss based on the Anti-Injunction Act, Silver said. "Every single expert I spoke to — from Baker McKenzie all the way down — everybody said I would lose this case and I would never pass this motion," he said.

According to Silver, the opinion also represents the first time the Regulatory Flexibility Act has been successfully used against a major federal agency, and the consequences are not limited to Treasury and the IRS. Silver said his next target will be Treasury's finalized global intangible low-taxed income regulations, but added that he plans to use the Regulatory Flexibility Act against multiple other federal agencies as well.

"I am going to promptly file a copycat GILTI action, and I'm going to start using the Regulatory Flexibility Act against all agencies. Because I've gone against Treasury and the TCJA, I can now become the leader of this whole small business protection thing, and that's exactly what I'm going to do," Silver said. "I'm going to hammer them because I'm going to become more and more famous, and plus I'd help a lot of small businesses."

Silver predicted that his current and future challenges based on the Regulatory Flexibility Act will force dramatic changes in the way Treasury and every other federal agency use their regulatory authority. Agencies will now have to seriously consider small business exemptions and fully explain their reasoning for any exemption they reject, according to Silver.

"Whether I settle with them or not, the Treasury will have to institute processes to comply with the Regulatory Flexibility Act, meaning they're going to have to move manpower away from just thinking about [the] Apples and Googles of the world," Silver said.