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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Narrow Path Paved For Tax Rule Challenges After CIC Services

By **Dylan Moroses**

Law360 (July 23, 2021, 7:19 PM EDT) -- The U.S. Supreme Court's revival of a company's case disputing an Internal Revenue Service information reporting requirement for microcaptive insurance arrangements likely won't lead to a barrage of pre-enforcement suits challenging complicated international tax rules, tax specialists said.

The high court's judgment in May that the Anti-Injunction Act didn't preclude CIC Services' suit may lead to similar kinds of pre-enforcement challenges, but those efforts likely will meet the same amount of scrutiny by the IRS and the courts, tax attorneys told Law360.

The IRS had labeled microcaptive insurance arrangements as potentially abusive in Notice 2016-66, and said they must be reported to the agency under threat of penalties.

In those transactions, companies set up small, in-house insurers that are taxed only on investment income, excluding payments received under the insurance contract from taxable income. The IRS argued that the AIA prevented the company's suit because the information requirements and the associated penalties were too closely connected to the assessment and collection of tax, according to court documents.

Justice Elena Kagan, who wrote the Supreme Court's opinion, said the company's suit wouldn't restrain tax collection. The IRS notice requires information reporting separate from the tax penalty, she said. CIC Services was not close to incurring a tax penalty and those failing to comply with the notice could face criminal penalties in addition to tax-related ones, the opinion said.

Justice Kagan added that the ruling was narrow and likely wouldn't "open the floodgates" to pre-enforcement litigation, or suits that challenge guidance before it is violated.

Similar kinds of challenges to tax rulemaking will likely face the same scrutiny, as well as similar arguments from the government that the AIA would prevent those suits.

The justices' opinion in the case shouldn't be interpreted as a "wholesale endorsement" of pre-enforcement litigation that challenges tax rules, S. Starling Marshall of Crowell & Moring LLP told Law360.

"The decision is very careful to be based upon the fact that these are reporting requirements that are separate from the penalties which are attached, and there were also criminal penalties associated with

noncompliance so that the normal post-enforcement challenge wasn't really a viable option," she said.

Even before the Supreme Court ruled in CIC Services, the U.S. Treasury and IRS had been more careful to issue rules in accordance with the Administrative Procedure Act, according to Susan C. Morse of University of Texas School of Law. As a result, she said, taxpayers may have a harder time prevailing in pre-enforcement challenges targeting recent rulemaking.

Morse, along with several other law professors, submitted a friend-of-the-court brief in CIC Services on behalf of former government officials who argued the AIA should have prevented the company's suit.

The government can be expected to continue to raise the AIA to prevent suits challenging tax regulations in situations where the information collected is more closely related to the assessment and collection of a tax, Morse said.

Pre-enforcement challenges may be rarer following CIC because a litigant would have to be proactive and foresee the burden and costs associated with the regulations in question prior to the IRS assessing taxes or issuing a notice to file suit. The potential litigant would also need to have sufficient standing to file the suit, Morse said.

"That's not how it usually works for taxpayers," Morse said. "I would say that I, as a taxpayer, am really only interested in discussing things with the IRS if they come to me first."

Monte Silver, a tax attorney operating a firm in Israel that is organized as a U.S. corporation for tax purposes, has mounted his own pre-enforcement challenges against the IRS for what he argues was a failure to include final regulatory flexibility analysis in final guidance as required by law.

Silver has filed two suits challenging finalized rules issued to administer the one-time transition tax created under the 2017 Tax Cuts and Jobs Act and regulations to administer a levy on global intangible low-taxed income, also known as the tax on GILTI.

Silver sued the IRS in 2019 over the transition tax rules in D.C. federal court, challenging the regulations issued under Internal Revenue Code Section 965, and his case is now pending before the D.C. Circuit.

The D.C. federal court ruled in March that the Anti-Injunction Act didn't prevent Silver's suit, but that he lacked standing to bring such a challenge in court because he could not show with facts that his burden to comply with the new regulations would change if the government granted the relief he requested.

Silver also filed a similar suit against the federal government arguing that the regulations issued to administer the GILTI tax regime also violated the Regulatory Flexibility Act when the government didn't provide a regulatory impact analysis in its rulemaking, which also violates the APA. That case is stayed while Silver appeals his challenge in the D.C. Circuit to the Section 965 regulations, according to court documents.

In the GILTI case, the IRS has argued Silver's suit should be barred by the AIA because the rules he is challenging relate to the self-reporting of GILTI and are "tightly intertwined with tax assessment." The pre-enforcement suit should be prohibited by the AIA because Silver can challenge the regulations in a refund suit after he has reported his GILTI and paid tax, the government said.

Silver argued in June that the Supreme Court's ruling in CIC Services should support his GILTI suit

because his challenge deals with procedures and it is not seeking to enjoin the assessment or collection of tax.

"The AIA does not pose any obstacle to proceed in this action. In fact, the circumstances surrounding this case make the CIC analysis even more compelling," Silver said in the June filing.

Silver told Law360 that while his disputes are ongoing, there may be additional areas of tax law where challenges supported by the Supreme Court's ruling in CIC Services could be considered. Information reporting notices that have attached significant penalties for noncompliance, similar to the notice at issue at CIC, could be prone to pre-enforcement challenges, he said.

Finalized regulations involving IRC Section 958, which deal with ownership attribution for controlled foreign corporations and U.S. shareholders, and rules for passive foreign investment companies may also be the subject of future litigation, Silver said.

On another front, information requests issued by the IRS to cryptocurrency exchanges, and the proposal by the Biden administration to create a cross-border information exchange system for U.S.-based crypto platforms, could also draw scrutiny that may lead to pre-enforcement challenges in court, Marshall of Crowell & Moring said.

To avoid those kinds of challenges, the IRS and U.S. Treasury could subject reporting requirements to notice-and-comment periods to reduce the risk of pre-enforcement litigation, but they also would have to consider whether allowing the public to assist in crafting those rules would make them less effective, Marshall said.

The IRS could not be reached for comment.

--Additional reporting by David Hansen, Natalie Olivo and Joshua Rosenberg. Editing by Tim Ruel and Roy LeBlanc.
