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Legal Sidebar

CIC Services v. Commissioner: Interpreting the Tax Anti-Injunction Act

February 23, 2021

On December 1, 2020, the Supreme Court heard oral argument in *CIC Services v. Commissioner*, a case that could resolve conflicts resulting from the way courts have interpreted the Tax Anti-Injunction Act (TAIA) in the past. The TAIA is codified in Section 7421 of the Internal Revenue Code (IRC). It is a narrow exception to the general administrative law rule permitting pre-enforcement judicial review of administrative actions in federal courts. The TAIA protects federal revenues and supports efficient tax administration by postponing litigation to contest tax assessment and collection. Subject to a few exceptions, the TAIA requires lawsuits challenging taxes to be made only after paying the disputed tax and filing a claim for refund. The petitioner in *CIC Services* claims that the TAIA, as originally understood, does not bar a pre-enforcement challenge to an Internal Revenue Service (IRS) notice containing reporting requirements that are enforced through a tax penalty.

This Legal Sidebar provides background on the TAIA, discusses the parties' arguments before the Supreme Court, and concludes with considerations for Congress.

The Tax Anti-Injunction Act

There is little legislative history to assist courts in resolving the TAIA's ambiguities, including its meaning and scope. Thus, in recent cases, courts have focused on the text of the TAIA and its counterpart, the Tax Injunction Act (TIA), 28 U.S.C. § 1341. Congress modeled the TIA on the TAIA, and the U.S. Supreme Court has looked to one to construe the other. The TAIA provides, subject to specified exceptions, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person." The TIA limits federal courts' ability to "enjoin, suspend or restrain the assessment, levy or collection of" state taxes "where a plain, speedy and efficient remedy may be had" in the applicable state's court. Notably, the Declaratory Judgment Act (DJA), 28 U.S.C. § 2201, which authorizes federal courts to issue declaratory judgments, contains a tax exception that prevents courts from issuing declaratory judgements in controversies "with respect to Federal taxes." Courts have held an action that is barred by the TAIA because its purpose is to restrain the assessment or collection of taxes is also barred by the DJA when the action seeks declaratory relief.

Congress has carved out a number of statutory exceptions to the TAIA in IRC Section 7421(a). For example, the TAIA permits IRC Section 6015(e) petitions seeking judicial review of an IRS final

determination of a plaintiff's request for innocent spouse relief—relief from responsibility for a deficiency related to items improperly reported or omitted by a taxpayer's spouse on a tax return. Another statutory exception permits a plaintiff to make a request under IRC Section 6331(i) to enjoin IRS collection of the unpaid portion of a divisible tax while a refund lawsuit for the paid portion of the divisible tax is pending.

The U.S. Supreme Court has also created judicial exceptions to the TAIA. In 1962, in *Enoch v. Williams Packing & Navigation Company*, the Court held that the TAIA does not bar an action where: (1) "under no circumstances could the Government ultimately prevail" and (2) "equity jurisdiction otherwise exists" because the legal remedy is inadequate. Later, in 1984, in *South Carolina v. Regan*, the Court ruled that the TAIA applies "only when Congress has provided an alternative avenue for an aggrieved party to litigate its claims on its own behalf." In that case, the state of South Carolina sought to challenge a statutory provision governing when interest earned on South Carolina "registration-required obligations" was exempt from a taxpayer's gross income. South Carolina claimed it could not challenge the provision in a refund lawsuit because it would incur no tax liability itself. The Supreme Court ruled in favor of South Carolina, holding that the TAIA does not preclude a lawsuit when the plaintiff has no alternative legal remedy to challenge the validity of the tax. The Court further held that it was immaterial that a purchaser of a South Carolina registration-required obligation that was liable for tax under the provision could challenge the provision in a refund lawsuit.

Over the years, as the IRS's role has expanded beyond the areas of assessment and collection of tax, it has become harder to predict when courts will rule that the TAIA precludes challenges to Treasury and IRS actions. Some tax experts argue that contemporary disputes discussing the TAIA's meaning and scope fail to take into account the time period in which Congress passed the TAIA and how administrative law has evolved. Congress enacted the TAIA in 1867, prior to its adoption of the modern federal income tax and the Administrative Procedure Act (APA), to support the assessment and collection of income taxes imposed to pay for the Civil War. Increasingly today, courts have to determine whether the TAIA bars challenges to Treasury and IRS actions that indirectly, or only tangentially, relate to the assessment or collection of tax, which has resulted in federal court opinions that are difficult to reconcile.

CIC Services v. Commissioner

At issue in *CIC Services*, which is on appeal from the Sixth Circuit, is whether the TAIA precludes pre-enforcement judicial review of IRS Notice 2016-66 (Notice). CIC Services (CIC) claims that the IRS promulgated the Notice in violation of the APA's notice-and-comment requirements, did not publish it in the Federal Register, and failed to submit the Notice for congressional review before it took effect, in violation of the Congressional Review Act. CIC alleges that the Notice, issued on November 1, 2016, was "effective immediately, applied retroactively to tax years 2006 to 2015, and gave taxpayers and their material advisors a few months to report any captive-insurance transactions over the last decade." The Sixth Circuit rejected CIC's challenge to the Notice, holding that even though CIC claimed to be challenging only the regulatory aspect of the Notice, the TAIA barred CIC's lawsuit because it also challenged the taxes used to enforce the Notice.

The Notice imposes reporting requirements on parties engaging in IRC Section 831(b) micro-captive insurance transactions and their "material advisers." The IRS has identified these transactions as "transactions of interest," a type of "reportable transaction" that has the "potential for tax avoidance or evasion." Pursuant to IRC Section 6011, Treasury promulgated regulations requiring taxpayers to disclose certain reportable transactions, including transactions of interest that the IRS has "identified by notice, regulation, or other form of published guidance." As such, the Notice is a part of the government's longstanding campaign to address abusive tax shelters.

CIC is a material advisor to parties engaged in micro-captive insurance transactions. Material advisors who fail to comply with reporting requirements for reportable transactions may be subject to civil monetary penalties under Sections 6707 and 6708 of Subchapter 68B of the IRC. IRC Section 6671(a) deems Subchapter 68B penalties to be "taxes." Additionally, under IRC Section 7203, a material advisor who "willfully" violates the reporting requirements is guilty of a misdemeanor and could be subject to criminal fines or imprisonment up to a year, or both.

CIC argues the TAIA is not implicated, and thus, federal courts can hear its claims, because it is challenging the mandates in the Notice, not the tax penalties used to enforce it. CIC contends that its challenge, if successful, would not result in a restraint on the assessment or collection of taxes, but at most would create an impediment to the assessment and collection of taxes, like the Supreme Court permitted in *Direct Marketing v. Brohl*. Indeed, CIC contends that the IRS could not assess or collect a tax penalty from CIC because CIC has not violated the reporting requirements and is fully complying with the reporting requirements while the case is pending. CIC asserts that an injunction against the Notice would end the requirement that captive insurers and their material advisors flag their activities as reportable transactions and that any downstream effects to taxes are irrelevant to the TAIA.

According to the government, CIC's challenge falls squarely within the purview of the TAIA. The crux of the government's argument is that the case at hand is distinguishable from *Direct Marketing* due to the fact that the penalties used to enforce the Notice are deemed taxes under IRC Section 6671, and are not merely financial penalties. In *Direct Marketing*, the Supreme Court—relying on both TIA and TAIA precedent—held that the TIA did not bar the petitioner's challenge to a Colorado law that was enacted to improve the collection of sales and use taxes. The Colorado law required out-of-state retailers who did not collect sales and use taxes to maintain and report records on their sales to Colorado customers and imposed financial penalties on retailers violating the Colorado law's reporting requirements. The Court held the TIA did not bar the petitioner's challenge to the Colorado law because the law focused on the information gathering phase of tax administration, not the distinct subsequent acts of assessment and collection of sales and use taxes. In *CIC Services*, the government asserts that the *Direct Marketing* Court did not address whether the petitioner's challenge to the Colorado law impeded the assessment or collection of the financial penalties used to enforce the Colorado law because the government in *Direct Marketing* never argued or suggested the Colorado law's financial penalties were taxes. Thus, the government's main argument is fairly straightforward—if the relief requested in the lawsuit would bar the collection of a "tax," then the TAIA precludes the lawsuit because Congress has made the determination that the proper channel for the dispute is a refund lawsuit. Accordingly, the government argues that a court lacks subject-matter jurisdiction over CIC's claims because, if successful, their effect would be to directly or indirectly restrain the assessment or collection of the tax penalties used to enforce the Notice.

During oral argument before the Supreme Court, the Justices expressed particular interest in CIC's contention that applying the TAIA's prohibition against pre-enforcement judicial review to CIC's claims would force it to risk criminal liability under IRC Section 7203 in order to obtain judicial review. CIC argued that an intentional violation of the Notice's reporting requirement might be "willful" for the purpose of establishing criminal liability under IRC Section 7203. Moreover, CIC emphasized that it could not obtain judicial review in a refund lawsuit unless the IRS decided to assess a tax penalty for CIC's violation. On this basis, CIC contends that it would be unreasonable to interpret the TAIA to make judicial review contingent on CIC risking criminal liability and the IRS exercising its discretion to assess a tax penalty. Thus, CIC argues that due process principles compel the expansion of the TAIA exception established in *South Carolina v. Regan* from one permitting judicial review when "Congress has not provided the plaintiff with an alternative legal way to challenge the validity of a tax" to one permitting judicial review when there is no way to challenge the validity of a tax in a refund lawsuit without risking criminal liability.

The government responds that the facts underlying CIC's challenge do not raise any due process concerns that could justify departing from the TAIA requirement that a taxpayer seek judicial review only in a refund lawsuit. The government posits that CIC will not subject itself to criminal exposure if it files a refund lawsuit after filing a return that withholds the information required by the Notice and attaches a statement that objects to disclosing the information. The government contends that this procedure would not constitute "willfully failing" to report the required information in violation of IRC Section 7203. Relying on *Cheek v. United States*, the seminal case construing "willfulness" under IRC Section 7203, the government attests that a taxpayer who has a "good faith belief" that it is not legally required to report prescribed information, but knows of the IRS's conflicting view, does not act willfully in withholding the information. Nevertheless, the government acknowledges in its brief that if CIC follows this procedure, it "'take[s] the risk of being wrong' and incurring a penalty that it might have avoided if it had received an advance judicial ruling that Notice 2016-66 is valid." The government states it is not aware of any case in which it has prosecuted a defendant under similar circumstances for a violation of IRC Section 7203. Therefore, the government takes the position that the risk of being wrong does not include criminal prosecution.

Considerations for Congress

Until recently, tax practitioners have viewed the TAIA, and its complement, the DJA, as shields preventing pre-enforcement judicial review of Treasury and IRS guidance. As a consequence, potential plaintiffs may have avoided challenging Treasury and IRS guidance because they believed that injunctive relief and declaratory relief were unavailable. The government has benefited from this view because it relieves pressure on the IRS's limited regulatory resources and controls the time and place where plaintiffs can bring lawsuits. However, the TAIA's ability to deter taxpayers from entering transactions where the adverse tax consequences are significant has raised concerns that some "legally defective rules [could] escape judicial oversight." As the IRS's role has greatly expanded beyond its assessment and collection function, there is growing concern that there are a number of Treasury and IRS rules that might be legally defective and could escape judicial review. To the extent that Congress desires to provide plaintiffs with a forum to make prompt APA challenges to Treasury and IRS guidance, it can do so by limiting the scope of the TAIA and DJA by creating statutory exceptions detailing the types of challenges permissible. Furthermore, as the Supreme Court explained in *National Federation of Independent Business v. Sebelius*, by not deeming a specific penalty a tax, Congress can grant courts jurisdiction to hear challenges to Treasury and IRS penalties.

Author Information

Milan N. Ball
Legislative Attorney

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