Challenging the IRS Anti-Inversion Notice: A Hollow Threat

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On September 22, 2014, Treasury and the IRS issued Notice 2014-52, 2014-42 I.R.B. 712 (the Notice), announcing their intention to issue regulations aimed at blunting certain of the benefits from so-called inversion transactions. The Notice adopts a two-pronged approach: It expands the scope of transactions that are subject to the existing anti-inversion regime by announcing new rules under Sections 7874 and 367 of the Internal Revenue Code, and it limits certain U.S. tax benefits that can be achieved by companies that undertake inversion transactions on or after September 22, 2014. The latter changes fundamentally alter several generally applicable Internal Revenue Code provisions in a manner that adversely impacts a narrow class of taxpayers. Moreover, unlike some other recent Treasury and IRS notices, the Notice lacks a "binding commitment exception" for transactions that were the subject of binding contractual commitments, but had not yet closed, before September 22, 2014. Parties to these transactions and other taxpayers affected by the Notice have raised serious concerns about the legal authority for the rules contained in the Notice, but those considering a timely challenge to the Notice face a number of procedural hurdles.

The normal procedures for challenging IRS rules and regulations are of little practical use to taxpayers seeking to challenge the Notice now. Taxpayers generally cannot challenge an IRS rule or regulation until the IRS disputes the taxpayer's position taken on a filed tax return or denies a taxpayer's request for a refund of taxes paid. Specifically, the Anti-Injunction Act (AIA), 26 U.S.C. § 7421(a), prohibits a "suit for the purpose of restraining the assessment or collection of any tax [from being] maintained in any court by any person." Further, the Declaratory Judgment Act (DJA), 28 U.S.C. § 2201(a), prohibits any suit for declaratory judgment "with respect to Federal taxes" other than certain circumscribed topics not relevant to the Notice. Accordingly, a taxpayer generally must pay its taxes and file a claim for refund before commencing any suit against the IRS, or, alternatively, wait for the IRS to examine its return and assert a deficiency, after which the taxpayer may bring suit in the Tax Court. Either way, a taxpayer generally has to wait (usually for years) until an IRS rule or regulation is enforced against it before bringing its challenge in court.

A taxpayer could file a separate action claiming that Notice 2014-52 violates the procedural or substantive requirements of the Administrative Procedure Act (APA), 5 U.S.C. § 551 et seq. But the government likely would challenge the suit on two grounds: (1) Section 704 of the APA requires that the Notice represent a "final agency action" and that there exists "no other adequate remedy in a court," and (2) Section 702 of the APA precludes an action for review under its provisions if "any other statute … expressly or impliedly forbids the relief sought." Notice 2014-52 describes possible regulations that the IRS and Treasury "intend to issue" and requests comments on these proposals and thus arguably does not represent a "final agency action." The government also would likely contend that taxpayers can obtain an "adequate remedy" by bringing suit (eventually) in Tax Court or federal district court once the rules of Notice 2014-52 have been enforced against the taxpayer.

Taxpayers have cleared these procedural hurdles in certain unusual circumstances. For example, courts have permitted claims for declaratory and other prospective relief to proceed if they pertain to agency action "unrelated to tax assessment and collection." *Cohen v. United States*, 650 F.3d 717, 733 (D.C. Cir. 2011) (*en banc*). Courts also have concluded that similar claims for prospective relief are not adequately addressed via the refund mechanism, thus opening the door to suit under Section 702 of the APA. *See, e.g., King v. Burwell*, 759 F.3d 358, 367 (4th Cir. 2014), *cert. granted on other issues*, 135 S. Ct. 475 (2014) (No. 14-114); *Halbig v. Burwell*, 758 F.3d 390, 397-98 (D.C. Cir. 2014), *rehearing en banc granted*, No. 14-5018, 2014 WL 4627181 (D.C. Cir. Sept. 4, 2014).[1] Further, the APA's "final agency action" requirement is not a jurisdictional bar but rather a prudential exhaustion requirement that the courts have concluded can yield to other compelling interests. See Cohen, 650 F.3d at 732-33 (describing cases). But it is not clear that the unusual circumstances present in those cases are sufficiently analogous to warrant application of this case law to the Notice.

Given the intense political focus on halting inversion transactions by any means, and the government's position that informal administrative pronouncements like the Notice are immune to immediate legal challenge, one might wonder whether Treasury and the IRS strategically targeted inversion transactions in this manner to exploit the historic procedural rules promulgated in response to very different concerns in a different era. At the very least, the procedural limitations on timely challenges to Treasury and IRS action taken via notice suggest a need for greater temperance on the part of Treasury and the IRS when regulating via notice.

[1] The plaintiffs' suits in both *King and Halbig*, while effectively challenging the tax credits granted on the federal health care exchange, did not in fact involve claims for tax refunds. Instead, they challenged the imposition of the "penalty" under the Affordable Care Act, which, per the Supreme Court, is not considered a tax for purposes of the AIA and thus is not subject to the AIA's bar on pre-enforcement challenges.