

Disputing Proposed Tax Regs Is Growing, Panel Says

By **David Hansen**

Law360, Washington (March 9, 2018, 7:11 PM EST) -- Challenging proposed tax regulations before they are enforced is a growing legal strategy that may give the bar a new way to represent clients, attorneys said during a panel discussion Friday at a Federal Bar Association meeting.

Clients traditionally have had two options for overturning a regulation: violate it and wait for the government to prosecute them or follow it and pay before seeking a refund, Miller & Chevalier Chtd. counsel James R. Gadwood said at the panel in Washington, D.C.

Each option has its drawbacks — break the law or pay — so pre-enforcement challenge to a regulation may be an attractive third option, he said. It's unclear how successful it may be — Gadwood described pre-enforcement challenge as “cloudy with a chance of success” — because standing and the Anti-Injunction Act are two big obstacles to bringing a suit. The Anti-Injunction Act bars challenges to assessment and collection of taxes.

Clients can't say a ruling has hurt them if it hasn't been enforced yet. But a federal court allowed a pre-enforcement challenge in *Chamber of Commerce v. IRS* in 2015, Gadwood said. A chamber member, Allergan, engaged in past transactions that would have been affected by a new IRS regulation and could prove the regulation targeted the company. The federal government is appealing the decision.

The Anti-Injunction Act, however, stopped a pre-enforcement challenge to a temporary U.S. Treasury Department regulation in *Florida Bankers Association. v. Treasury* in 2015, Gadwood said. The regulation required banks to report interest by non-U.S. account holders or face financial penalties. The D.C. Circuit ruled the penalty was defined in the Internal Revenue Code as a tax, and invalidating the reporting requirement would block its assessment and collection. But if it hadn't been a tax, the suit could have proceeded, the court said.

The Anti-Injunction Act didn't bar the Chamber of Commerce in the 2015 Internal Revenue Service case, Gadwood noted. The court held that the disputed regulation was not a tax but a rule determining who was subject to it, he said.

Attorneys can challenge tax regulations on several grounds, Covington & Burling LLP special counsel S. Starling Marshall said.

Courts have ruled that the IRS must follow the Administrative Procedures Act, giving notice and collecting public comment on rulemaking, she said. But a procedures challenge isn't likely to succeed, she said. The IRS can claim Treasury regulations are interpretive rules that, unlike legislative rules, do not need to meet the APA, she said. Moreover, the IRS gives notice and collects comments. The Chamber of Commerce case was an exception because it involved a legislative rule, Marshall said.

Attorneys also can claim the IRS issued a regulation in an arbitrary or capricious process, Marshall said. In *Altera v. Commissioner*, the U.S. Tax Court found that a tax regulation requiring cost-sharing participants to share stock-based compensation costs had no rational connection to facts and that the Treasury had disregarded public comments saying that participants did not share costs.

For a third line of argument, attorneys also can attack a Treasury regulation by arguing the regulation is promulgated in a way that defeats the purpose of the statute for which the regulation was written, Marshall said. An example is *Dominion Resources Inc. v. U.S.*, where the Federal Circuit held that a Treasury regulation under IRC § 263A on deduction of interest incurred on debt was not a "reasonable interpretation" of § 263A, she said.

--Editing by Tim Ruel.