



Supreme Court's Decision in *CIC Services, LLC v. Internal Revenue Service* Impacts Pre-Enforcement Challenges to IRS Reporting Mandates

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On May 17, 2021, the Supreme Court issued a unanimous decision in *CIC Services, LLC v. Internal Revenue Service*, narrowing the reach of the [tax Anti-Injunction Act](#) (AIA). The AIA provides that “no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.” The AIA [protects federal revenues](#) and supports efficient tax administration by barring lawsuits seeking pre-enforcement judicial review of [Department of the Treasury \(Treasury\) and Internal Revenue Service \(IRS\) administrative actions](#) related to tax assessment or collection. Subject to a [few exceptions](#) that the Court [deemed irrelevant](#) in *CIC Services*, the AIA requires plaintiffs seeking to challenge the validity of a tax to file their lawsuits after paying the disputed tax and filing a claim for refund.

In *CIC Services*, the petitioner, CIC Services, LLC (CIC), brought a lawsuit challenging the “lawfulness” of IRS Notice [2016-66](#) (Notice). The Notice designates [micro-captive transactions as transactions of interest](#) due to their “potential for tax avoidance or evasion” and imposes reporting requirements on both taxpayers participating in them and their material advisors, such as CIC. If CIC were to fail to comply with the Notice’s reporting mandate, the government could subject CIC to civil [tax penalties](#) and criminal penalties under the Internal Revenue Code (IRC). CIC sought relief in the form of an injunction against enforcement of the Notice, arguing primarily that the IRS did not comply with the [Administrative Procedure Act](#)’s notice-and-comment requirements when issuing the Notice. The government contended that the pre-enforcement lawsuit was barred by the AIA because, if successful, the lawsuit’s effect would be to “restrain the assessment or collection” of [the tax penalties](#). However, the Supreme Court held that the AIA did not bar pre-enforcement judicial review of the Notice that was “backed by” tax penalties because CIC’s lawsuit challenged the Notice’s “reporting mandate separate from any tax.”

This Legal Sidebar summarizes the Supreme Court’s opinion in *CIC Services* and concludes with considerations for Congress.

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The Purpose of the Lawsuit Controls Whether the AIA Applies

In *CIC Services*, the Supreme Court framed the question presented as whether the purpose of CIC's lawsuit was to stop the assessment or collection of a tax. If so, the AIA would require that the case be dismissed. In that event, CIC would have to violate the reporting requirements and wait for the IRS to impose the penalties backing the Notice in order to contest the Notice's lawfulness. On the other hand, if the purpose of CIC's lawsuit was "something other" than stopping the assessment or collection of a tax, then CIC's case could proceed.

The Court explained that when determining a lawsuit's purpose, the Court does not look at a plaintiff's subjective motive. Instead, the Court looks at the plaintiff's "objective aim." Reviewing CIC's complaint on its face, the Court observed: (1) CIC had contested the legality of the Notice, but had not contested the legality of the statutory tax penalties; (2) CIC had requested injunctive relief from the Notice's reporting requirements, but had not asked the court to block the potential tax penalties; and (3) CIC had "barely mention[ed]" the tax penalties that backed the Notice. As a result, the Court concluded that the complaint supported CIC's assertion that the lawsuit's purpose was to enjoin the Notice's reporting mandate.

Writing for the Court, Justice Kagan remarked that deciding *CIC Services* would be a "cinch" if, as in *Direct Marketing Assn. v. Brohl*, the petitioner were challenging a reporting mandate and a "downstream tax penalty did not exist." In *Direct Marketing*, the Court held that the [Tax Injunction Act](#), a statute modeled on the AIA that limits injunctive relief to "enjoin, suspend or restrain the assessment, levy or collection" of a state tax, did not bar a petitioner's [challenge to a Colorado law's reporting requirements](#). In *CIC Services*, the Court reinforced its holding in *Direct Marketing*, making plain that "[a] reporting requirement is not a tax; and a suit brought to set aside such a rule is not one to enjoin a tax's assessment or collection." Building on its reasoning in *Direct Marketing*, the Court determined that a lawsuit challenging reporting requirements does not become a lawsuit to restrain tax assessment or collection simply because the challenged reporting requirements might raise future tax revenue by making it easier for the government to identify "sham insurance transactions."

The Court disagreed with the government's argument that a lawsuit to challenge the validity of the Notice was the same as one to preclude tax assessment or collection. It acknowledged that if the government's characterization were true, no amount of artful pleading would permit CIC to prevail. Even so, the Court ruled that three aspects of the regulatory scheme, when taken together, "refute[d] the idea" that CIC's lawsuit was a "tax action in disguise."

First, the Notice imposes affirmative obligations on material advisors. The Notice itself does not levy a tax, but inflicts costs "separate and apart" from the statutory tax penalties. It requires material advisors to "collect and submit detailed information about micro-captive transactions and their participants." The Court characterized these affirmative obligations as "independently onerous reporting mandates," and suggested that the costs of complying with the Notice could surpass the costs of the tax penalties for violating the Notice. The Court also noted that CIC had estimated it would spend "hundreds of hours of labor and in excess of \$60,000 per year" to comply with the Notice. Thus, the Court concluded that CIC's complaint was evidence that CIC brought its lawsuit "to get out from under the (non-tax) burdens of a (non-tax) reporting obligation," and that not having to "worry" about the tax penalties was an "after-effect."

Second, the Notice's reporting requirements and the tax penalties were "several steps removed from each other." That is to say, the connection between the two was too attenuated. A material advisor would be liable for the tax penalty if, and only if: (1) the material advisor withheld information required by the Notice; (2) the IRS determined that the material advisor had violated the Notice; and (3) the IRS made the "entirely discretionary" decision to impose a tax penalty. The Court stated that it was "hard" to characterize the lawsuit's purpose as one to restrain a tax given that CIC stood "nowhere near the cusp of tax liability." The Court declared, the "river runs long" between the "upstream Notice" and the "downstream tax."

Third, the punishment for violating the Notice can include criminal penalties under IRC Section 7203. That Section provides that 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. This fact “clinched” the Court’s decision to characterize the purpose of the lawsuit as one to set aside the Notice, as opposed to one brought to restrain a tax penalty. The Court explained that criminal penalties are the reason “why an entity like CIC must bring an action in just this form, framing its requested relief in just this way.” As discussed above, if the AIA precluded CIC’s lawsuit, CIC could not challenge the Notice’s validity unless it first violated the Notice, paid a penalty, and then sued for a refund. The Court expressed concern that such a procedure would require one to break the law “at the start,” and stated that this “is not the kind of thing an ordinary person risks, even to contest the most burdensome regulation.” The Court noted that none of its other AIA cases require a challenger to follow a “pay-now-sue-later” procedure that exposes the challenger to criminal penalties.

The Court dismissed the government’s argument that criminal liability would not attach to a taxpayer or advisor that violates the Notice in “good faith” because the taxpayer or advisor would not be “willful” under IRC Section 7203. Quoting *Cheek v. United States*, the Court stated, “We have held in no uncertain terms that ‘a defendant’s views about the validity’ of a tax provision—even if held ‘in good faith’—do not ‘negate[] willfulness or provide[] a defense to criminal prosecution.’” Thus, the Court concluded that the criminal penalties under IRC Section 7203 “practically necessitated” a pre-enforcement lawsuit that sought an injunction against the Notice, because it was the only procedure that yielded relief from the Notice’s reporting requirements without subjecting CIC to criminal liability.

After reviewing these three aspects of the Notice’s regulatory scheme, the Court held that the AIA did not bar pre-enforcement judicial review of CIC’s claims. The Court explained that the facts of the case “readily explain[ed]” why the purpose of CIC’s lawsuit was the “upstream reporting mandate, not the downstream tax.” The Court also remarked that nothing in CIC’s complaint “smacks of artful pleading.”

The Future of Pre-Enforcement Tax Litigation

In *CIC Services*, the Supreme Court also addressed fears that a decision in CIC’s favor would “enfeeble” the AIA. Previously, the government and some tax experts expressed concern that a decision in favor of CIC would shift tax litigation from refund lawsuits to pre-enforcement lawsuits, hinder the IRS’s ability to assess taxes, and lead to a decline in the amount of taxes collected. The government argued that a decision in CIC’s favor would open the floodgates to pre-enforcement tax litigation. The Court stated that these concerns were “overstate[d],” and underscored the nature of its ruling.

The Court stressed that CIC’s lawsuit fell outside the AIA’s domain, as CIC’s lawsuit did “not run against a tax at all.” Instead, CIC’s lawsuit challenged the Notice’s reporting requirements “separate from any tax.” The Court reiterated that when a dispute is about the validity of a tax, not an *independent* rule prohibiting or commanding an action that is backstopped by a tax penalty, then, as set out in the AIA, the “sole recourse is to pay the tax and seek a refund.” The Court also differentiated a revenue-raising tax from a regulatory tax. It defined a regulatory tax as “a tax designed mainly to influence private conduct, rather than to raise revenue.” Regardless of whether the tax is a regulatory tax or a revenue-raising tax, the Court held that the AIA prevents pre-enforcement judicial review of challenges to the tax’s validity.

Considerations for Congress

The impact of the Court’s decision in *CIC Services* is unclear. For example, it is unclear whether the Court would have ruled the [same way](#) if CIC was a taxpayer participating in a reportable transaction as opposed to a material advisor. Presumably the costs of complying with the Notice would be less for a taxpayer than a material advisor, and it is arguable that there would be fewer steps between the upstream Notice and a downstream tax. In addition, despite CIC’s success in *CIC Services*, CIC could still lose on

the merits. In *Mann Construction, Inc. v. United States*, a district court held that another reportable transaction [notice](#), concerning a transaction that the IRS designated a [listed transaction](#), was not subject to the Administrative Procedure Act’s notice-and-comment requirements because Congress had “authorized” the IRS to issue the notice without notice and comment.

If Congress imposes a tax on a prescribed reportable transaction, then there might be a different outcome in cases like *CIC Services*—the AIA may bar judicial review of pre-enforcement challenges. The Court’s opinion suggests that the AIA would have barred pre-enforcement judicial review of CIC’s challenge if Congress imposed a tax on the micro-captive transactions themselves or Congress had delegated that authority to Treasury, instead of simply providing Treasury with the authority to issue guidance requiring reportable transaction disclosures and backing that guidance with statutory penalties. Under the current reportable transaction scheme, Treasury has statutory [authority](#) to promulgate regulations that require material advisors to make certain reportable transaction disclosures and has statutory [authority](#) to subject any person liable for a tax, or a collection of a tax, under the IRC to “make a return or statement according to the forms and regulations prescribed by the Secretary.” Treasury has used its authority to promulgate Treasury Regulation Section 1.6011-4, which requires persons to disclose certain reportable transactions as “identified by notice, regulation, or other form of published guidance.” Treasury published the Notice at issue in *CIC Services* pursuant to Treasury Regulation Section 1.6011-4. The Court viewed the statutory tax penalties and criminal penalties that backed the Notice’s reporting mandate as separate and independent statutes that merely operated as sanctions for noncompliance with the Notice, and consequently concluded that the AIA did not apply.

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