US Supreme Court Unanimously Holds IRS Notice Seeking Information Can Be Enjoined

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In *CIC Services, LLC,v. IRS,* 127 AFTR 2d2021-XXXX, (S. Ct.) 05/17/201, the U.S. Supreme Court has unanimously held that the Anti-Injunction Act[1] did not prohibit a pre-enforcement challenge to an IRS information reporting requirement, where the failure to comply could result in civil and criminal penalties.

While the case involved an IRS Notice relating to "micro-captives", it has broad application to all areas of Federal tax procedure and drew amicus briefs from the American College of Tax Counsel, the U.S. Chamber of Commerce, numerous other business associations, the Cato Institute, law school professors on each side, a coalition of almost two dozen captive insurance associations and others.

The Internal Revenue Code permits insurance companies whose premiums do not exceed a threshold[2] to elect to be taxed only on their net investment income[3] , and not on their net insurance income. The IRS was concerned that this could be used abusively, and issued Notice 2016-66[4] naming the use of this election (under certain circumstances), a "Transaction of Interest"[5] . The Notice required participants in the transaction and "material advisors"[6] who provided tax advice to the participants to supply substantial information in Forms 8886 and 8918, respectively. Failure to supply the information could subject the non-filer to a civil penalty[7] , and could also result in a criminal penalty[8] .

CIC Services, LLC is a material advisor who sought to enjoin the enforcement of Notice 2016-66 as an unlawful IRS rule, and to declare the Notice unlawful, because it was not issued in compliance with the Administrative Procedures Act. The IRS argued that civil penalties are treated as "taxes" under the section 6671(a) of the Internal Revenue Code; and that the Anti-Injunction Act prohibits any "suit for the purpose of restraining the assessment or collection of any tax.[9] " The Anti-Injunction Act was enacted to allow the IRS to collect tax without interruption, and required anyone who wanted to challenge a tax to pay it first, and then sue for refund. Accordingly, if the issue in the case was whether the plaintiff could enjoin the imposition of a tax, the answer is clearly no.

Justice Kagan wrote the opinion and stated that if Notice 2016-66 had only sought information, and no penalty arose for non-compliance, that the plaintiff would clearly be able to seek an injunction (a reporting requirement is not a tax). The question presented in the case was whether the fact that the Notice involved a tax (the penalty for noncompliance) changed this result and precluded the injunction.

The Court concluded that the penalty for noncompliance did not trigger the Anti-Injunction Act for a combination of three reasons:

- The reporting obligation inflicts costs separate and apart from the tax penalty.
- The penalty is several steps away from the reporting requirement (first, the plaintiff would have to fail to disclose the information, then the IRS would have to identify that the disclosure had not occurred, then the IRS would have to impose the entirely discretionary penalty).
- A violation of the Notice could be subject to a criminal penalty, as much as one year in prison, for willful failure to comply with the Notice's requirement[10] . This precludes the plaintiff from taking the normal route of paying the tax, then suing for refund. If the plaintiff does not disclose, it subjects itself to criminal penalties, which necessitates providing the ability to have a "pre-enforcement" challenge.

The purpose of the plaintiff's suit was to challenge the Notice, not to restrain collection of the tax.

The Court rejected the IRS' concern that this holding would trigger a wave of pre-enforcement actions. This plaintiff's suit does not run against a tax, but, rather, a separate legal mandate.

Justice Sotomayor concurred, but made it clear that in her view the holding applied where the material advisor sought an injunction of the Notice, since the material advisor does not bring the suit "for the purposes of restraining the assessment of collection of any tax" 26 U.S.C. Section 7421(a). The decision might not necessarily apply if a taxpayer--captive participant sought the injunction.