MILLER CANFIELD

# The Status of the Pending Appeal in Silver v. Treasury Department

June 24, 2022

## Key Takeaways

- The pending case, *Silver v. Internal Revenue Service*,[1] will provide insight, when decided, of the view of the Court of Appeals for the District of Columbia Circuit on the scope of judicial review of administrative regulations that apply to small business.
- Small businesses should be vigilant in demanding that administrative agencies observe the requirements of the Regulatory Flexibility Act ("RFA").[2]

Introduction: The Treasury Department is using arguments based on standing – Constitutional Article III standing[3] and statutory standing[4] – to persuade the D.C. Circuit that it should not decide the merits of Monte Silver's challenge to the validity of a federal income tax regulation ("Transition Tax Regulation" or "Regulation") interpreting the transition tax. The transition tax, enacted in 2017, generally requires U.S. shareholders who control foreign corporations to include in their 2017 tax returns the accumulated earnings of their foreign corporations.[5] Treasury's argument is that neither Silver, a United States citizen, nor his Israeli corporation through which he practices United States tax law in Israel, has Article III standing to bring the action. Moreover, Treasury argues that even if Silver has Article III standing, he does not have statutory standing under the RFA to compel Treasury to consider the validity of the Regulation.

Article III Standing: A plaintiff who brings an action in federal court must have standing under Article III of the Constitution, which has three elements: (i) the plaintiff must have suffered an injury in fact that is concrete, particularized, actual, and imminent; (ii) the injury must be fairly traceable to the conduct complained of; and (iii) it must be likely that the injury will be redressed by a favorable decision.[6] When the plaintiff alleges a violation of a *procedural* right, as is Silver's case, the plaintiff must show that (i) its right was violated and that the violation invaded its own particularized interest, and (ii) a favorable decision *could* – rather than *would* – better redress plaintiff's interests.[7]

Statutory Standing under the Regulatory Flexibility Act ("RFA"): A federal administrative agency, including Treasury, must prepare a regulatory flexibility analysis when it publishes a notice of proposed rulemaking. The analysis must describe the impact on small business[8] and permit public comment.[9] When the agency finalizes the rule, it must, among other findings, evaluate and discuss the public comments of small businesses.[10] An agency may, however, avoid addressing small business concerns by publishing a certification that the rule will not have a significant economic effect on a substantial number of small entities.[11] The certification must be published at the same time as the notice of proposed rulemaking and contain the factual basis for the certification. A small entity that is adversely affected by a rule may obtain judicial review.[12] The court may order the agency to take corrective action including remanding the rule to the agency and deferring enforcement of the rule against small entities.[13] The scope of judicial review is limited by any other statute that forbids the relief sought.[14]

The Parties' Arguments: Treasury certified that the Transition Tax Regulation did not have a significant economic effect on a substantial number of small businesses, and for that reason, the RFA did not require Treasury to determine the impact on small business.[15] (A 2016 General Accountability Office report found that Treasury did not perform a regulatory flexibility analysis on 99.5 % of the regulations published between 2013 and 2015.) Silver argues that Treasury

violated the RFA by publishing the Regulation without determining the tax compliance burden that befalls small business. He seeks relief, not from the tax, but from the complexities of compliance. He asks the Court of Appeals to reject Treasury's finding that the Regulation does not adversely affect small business, invalidate Treasury's certification to that effect, and defer enforcement of the Regulation until Treasury addresses small business concerns as required by the RFA. The federal district court below found that Silver did not have constitutional standing to challenge the validity of the Regulation.

Treasury views the case as one in which Silver seeks equitable relief by asking Treasury to change *future* tax reporting relating to the transition tax.[16] If the relief sought is characterized as equitable, Silver might be stymied by the Anti-Injunction Act,[17] which provides that a federal court does not have jurisdiction to enjoin the assessment or collection of a federal tax. Silver's response is that he is not asking for an injunction and that the relief he requests is not equitable. He asks only that Treasury be ordered to perform a regulatory flexibility analysis as required by the RFA and consider whether alternative means to ease administrative compliance costs for the transition tax for small business can be formulated and promulgated.

Silver relies on the recent Supreme Court case, *C.I.C. Services, LLC, v. Internal Revenue Service*,[18] for the proposition that an action to enjoin a tax reporting requirement is not an action to enjoin an assessment or collection of a federal tax. The case is not on all fours with Silver's case, but it may be close enough for the Court of Appeals to decide that Silver should get the remand to Treasury he requests. The Court of Appeals disposition of Silver's case should be watched because agency use of the Anti-Injunction Act to avoid regulatory flexibility analyses when tax regulations are involved could severely limit protection that the RFA provides to small business.

Silver argues that as part of the RFA process, the public must be given the opportunity to comment on how Treasury can ease tax reporting requirements for small businesses. Perhaps the public, if not Treasury, can propose a realistic method to adequately account for the transition tax and its repercussions. Treasury has eased tax accounting burdens for other tax provisions.[19] Perhaps Treasury, aided by public comments, can do so for the transition tax for small business.

On the question of redressability, the third element of Article III standing, Treasury argues that Silver has already performed the tax compliance work for the transition tax and reported the tax in his 2017 income tax return, with the result that retroactive relief is not possible. The cost expended by Silver to comply simply is not recoverable by ordering Treasury to perform a regulatory flexibility analysis. Moreover, Treasury argues that prospective injury is not redressable because it is too speculative. Silver will have a tax compliance burden only if he causes his foreign corporation to distribute a dividend to him. He has never caused his foreign corporation to distribute a dividend and may never do so.

Silver treats the discussion of prospective injury as a red herring. The RFA does not require proof of imminent prospective injury. The RFA requires only that Treasury analyze the effect of the Transition Tax Regulation on small business. Nonetheless, Silver offered evidence during the trial court summary judgment proceeding that he intends to have his foreign corporation distribute a dividend, but the trial court ruled that the proffered evidence was untimely and did not consider it.

Of interest is whether the Court of Appeals will take a narrow or expansive view of the effect of the Transition Tax Regulation. A narrow view would find that the complex accounting burden about which Silver complains did not result from the Regulation itself, but from collateral effects. An expansive view would consider all the tax accounting ramifications and repercussions of the Regulation and recognize that Congress, through the RFA, directs administrative

agencies to consider administrative relief for small business when agency action economically aggrieves them. The trial court described the transition tax as "complicated, to say the least," and Silver's explanation of the tax accounting required for a dividend distribution from the foreign corporation "impenetrable." Perhaps these are circumstances when administrative relief for small business from the record-keeping and the information reporting is appropriate.

Statutory Standing: The Department of Justice argues that even if Silver has Article III standing, he does not have statutory standing because he is not within the sphere of plaintiffs that the RFA protects. The RFA gives statutory standing to a "small entity," which includes a small business concern that is independently owned and operated, and not dominant in the field.[20]

Silver argues that he is imbued with the characteristics of a domestic corporation because he has elected to treat the amount that is included in his income by virtue of the transition tax as if received by a domestic corporation.[21] The Justice Department responds that the proper focus is on Silver, who is an individual and not an entity. Only "entities" are protected by the RFA. Silver, as an individual, might, of course, be a "small business concern" and within the protected sphere. It would be surprising if Congress did not intend RFA protection for individuals operating as sole proprietors who are unreasonably burdened by federal tax compliance requirements.

Perhaps of greater concern for Silver is whether Silver, having elected to be treated as a domestic corporation, has a "business." The business activity is conducted through his foreign corporation. The transition tax burdens him as the corporate shareholder to account for it. Treasury contends Silver's law practice business is conducted in corporate form, is separate from the compliance burden, and Silver, as an individual, does not conduct the business. Silver argues he has the compliance burden to report income from the foreign corporation, including future dividend distributions, and the RFA compels Treasury to address the burden.

We will report when the D.C. Circuit issues its potentially significant decision. In the meantime, should you wish to discuss this issue, please contact your Miller Canfield attorney or the authors of this alert.

[1] 531 F.Supp.3d 346 (2021) *appeal pending*, No. 21-5116 (D.C. D. May 25, 2021).

[2] 5 U.S.C. §§601-612.

[3] U.S. Const. Art. III, §2, cl. 1.

[4] Regulatory Flexibility Act, 5 U.S.C. §611(a)(1).

[5] I.R.C. §965(a)(1).

[6] *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560–61 (U.S.1992).

[7] *Office v. Fed. Energy Reg. Comm'n*, 949 F.3d 8, 13 (D.C. Cir. 2020.

[8] 15 U.S.C. §632. A small business is independently owned, not dominant in its field, satisfies other definitions and standards promulgated by the Small Business Administrator.

[9] 5 U.S.C. §603.

[10] 5 U.S.C. §604.

[11] *Id.*

[12] 5 U.S.C. §611(a)(4).

[13] *Id.*

[14] 5 U.S.C. §702.

[15] Treas. Dec. 9846 (Feb. 4, 2019).

[16] Appellee-Internal Revenue Service "Final Brief" (D.C.D. June 13, 2022).

[17] I.R.C. §7421(a).

[18] 141 S.Ct. 1582 (2021).

[19] An example is Treas. Reg. §1.263(a)-1 et seq., which relieves a taxpayer of what otherwise would be an excruciating tax accounting burden by permitting the taxpayer to deduct the cost of property that otherwise might require capitalization pursuant to the literal terms of IRC §263(a).

[20] 5 U.S.C. §§601(3), -(6), 611(a)(1), 15 U.S.C. 632(a)(1).

[21] I.R.C. 962(a). Silver elected to be treated as a domestic corporation to offset the income on which the transition tax is based with credits for foreign taxes paid on that income. As an individual, he could not claim these "indirect" foreign tax credits.