

An IRS Notice That a Court Vacates and Sets Aside May Still Be Enforceable Against Nonparties

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Taxpayers who are not parties to an action voiding an IRS Notice published without notice and comment should carefully consider the risk that the IRS may nonetheless treat the Notice as valid as to nonparties.

In two recent cases, federal district courts held that the IRS had issued “Notices” in violation of the Administrative Procedure Act (“APA”) but differed as to the effect of the violation on nonparties. The issue of whether a district court has the power to invalidate a regulation as to parties and non-parties alike currently is before the United States Supreme Court in *Texas v. United States*.^[1] The Court’s decision may resolve this split of authority.

The APA requires a federal agency to notify the public of a proposed regulation that is legislative in nature and invite the public to comment on the proposal.^[2] The IRS issued “Notices” regarding transactions that it believed had the potential for tax avoidance or evasion and exposed taxpayers who engaged in the transactions to reporting requirements^[3] and penalties for failure to report.^[4] The IRS issued the Notices without following the APA notice and comment provision, believing that Congress excluded the IRS from the APA for these types of transactions.

In November 2022, the Federal District Court for the Northern District of Ohio set aside and vacated an IRS Notice but stated that it is unclear whether an IRS violation of the notice and comment provision empowered the court to set aside and vacate the Notice universally.^[5] The court explained that vacatur is an equitable remedy, and the court exercised its equitable power to set aside the Notice only for parties to the federal court proceeding. That meant that the IRS could enforce the Notice against nonparties to the district court action.

In January 2023, the Federal District Court for the Eastern District of Michigan vacated and set aside an IRS Notice to nonparties as well as to parties to the federal district proceeding. According to the district court, the IRS could not enforce the Treasury Department rule against nonparties to the district court action because the Notice itself was void.^[6]

In the *Texas* case, a district court set aside and vacated a Department of Homeland Security immigration rule against nonparties as well as parties. The Supreme Court heard oral argument on November 29, 2022, and that argument provided lively exchanges on this issue.

United States Solicitor General Elizabeth Prelogar stated the question as whether one district judge could claim the authority to settle the issue for an entire nation. Chief Justice John Roberts expressed surprise at Ms. Prelogar’s argument:

Roberts: And, in that area, your—your position on vacatur, that sounded to me to be fairly radical and inconsistent with, for example, you know, with those of us who were on the D.C. Circuit, you know, five times before breakfast, that’s what you do in an APA case. And all of a sudden you’re telling us that, no, you can’t vacate it, you do something different. Are you overturning that whole established practice under the APA?

Prelogar: Yes, I acknowledge, Mr. Chief Justice, that the lower courts, including the D.C. Circuit, have in our view been getting this one wrong. They have reflexively assumed that vacatur is authorized under Section 706 of the

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APA. But what I would say is that they haven't reached—

Roberts: Wow.

In contrast, Justice Neil Gorsuch appeared to doubt that Congress would have “sneakily” authorized a federal district court to issue a universal remedy:

Gorsuch: I think it is kind of interesting that remedies are expressly listed in 703 [of the APA] that Congress would sneak in the most important remedy and by far the most sweeping one [set aside and vacate] in Section 706, what is it, (2)(b), something like that, which governs the scope of review, and that nobody at the time, Davis, Jaffe [commentators on administrative law], you know, people who noticed things, noticed this innovation.

Prelogar: That's correct. We think that certainly, if Congress were going to take the action of creating this kind of unprecedented remedy that operates directly on the agency rule itself rather than with respect to the parties, someone would have said something and Congress would have made that much clearer in the text of the statute and not separately addressed remedies in 703.

Justices Brett Kavanaugh and Ketanji Brown Jackson appeared to line up with Justice Roberts.

Despite the questions and comments of the justices, forecasting a decision based on oral argument is unwise. The Court expressed concern that the question had received little attention in the lower courts and was minimally briefed by the parties now before it. Remand for a detailed analysis of the question would not be surprising.

At this juncture, a prudent taxpayer who is not a party to an action in which an IRS Notice is set aside and vacated might still consider whether to maintain a financial reserve for the transaction described in the Notice and to disclose it in its IRS filings because, for a nonparty, the Notice may still have vitality.

If you would like to discuss the subject of this alert, please contact the authors or your Miller Canfield attorney.

[1] *United States v. Texas*, Oyez, <https://www.oyez.org/cases/2022/22-58> (last visited Feb 13, 2023).

[2] 5 U.S.C. §553(b), -(c).

[3] IRC §6111(a); Treas. Reg. §1.6011-4(a), -(b)(2).

[4] IRC §§6707(a), 6707A, 6708(a). See, for example, Notice 2007-83, 2007-2 C.B. 960 (10-17-07) (discussed in *Mann Construction*, *infra* fn. 5) and Notice 2017-10, 2017-4 IRB 544 (12-23-16) (discussed in *GBX Associates*, *infra* fn. 4).

[5] *GBX Associates, LLC v. United States*, 130 AFTR 2d 2022-6440, (D.C. OH November 14, 2022) (vacated Notice 2017-10, which treated a charitable contribution of a conservation easement as a tax avoidance listed transaction because of the donor's overvaluation of the contribution, but limited vacatur to the parties to the action).

[6] *Mann Construction, Inc. v. United States*, Case No. 1:20-cv-11307 (E.D. MI Jan. 18, 2023) (vacated Notice 2007-83, which described a tax-exempt welfare fund that held cash value life insurance on the lives of owners of a closely held business that deducted contributions to the fund for the life insurance and whose beneficiaries of the fund – the business owners – reported little or no income from distributions to them from the fund).