CIC Services Asks Court to Expand Injunction in Microcaptive Case

Dated Oct. 8, 2021

Full text Published By Tax Analysts

CIC SERVICES, LLC
Plaintiff,
v.
INTERNAL REVENUE SERVICE, *et al.,*
Defendants.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TENNESSEE
NORTHERN DIVISION (KNOXVILLE)

CHIEF JUDGE TRAVIS R. McDONOUGH

MOTION TO RECONSIDER SCOPE OF PRELIMINARY INJUNCTION

Plaintiff CIC Services, Inc. respectfully requests that the Court reconsider the scope of the present Preliminary Injunction (Doc. 82). Although the Court's rationale for granting the preliminary injunction is correct — Notice 2016-66 *is* a legislative rule that requires notice and comment rulemaking — the Court's injunctive remedy is too narrow to protect Plaintiff from some of the most significant irreparable harms. The scope of the injunction is inconsistent with the Administrative Procedures Act.

I. Relevant Background.

In its Motion for Preliminary Injunction (Doc. 59), Plaintiff requested an injunction consistent with Count 1 of its Verified Complaint (Doc. 1). That is, a declaration “that Notice 2016-66 violates the notice-and-comment provisions of the APA and to declare that such Notice is therefore invalid.” (Doc. 1, PageID #15).

In its Order, although the Court stated that “CIC's motion for preliminary injunction (Doc. 59) is **GRANTED**”, the Court limited the requested relief with the following sentence: “The IRS is hereby **ENJOINED** from enforcing Notice 2016-66 against CIC Services.” (Doc. 82, PageID #958).

CIC Services respectfully submits that this injunction is too narrow for several reasons: (a) the injunction does not explicitly excuse CIC Services from maintaining the records Notice 2016-66 compels; (b) CIC Services's clients and referral sources are still subject to Notice 2016-66

enforcement and CIC Services must continue to comply with its clients' reporting obligations; and (c) CIC Services will continue to suffer irreparable harm to its business so long as Notice 2016-66 can be enforced against its clients and referral sources (third parties who wish to refer CIC Services business but who won't for fear of being deemed a “material advisor” and becoming subject to the requirements of the Notice)..

II. The Injunction Should Not be Limited to Only CIC Services.

A. The proper scope of an injunction under the APA is a national, outright injunction.

In this case, the Supreme Court has already advised that the relief CIC Services seeks — a total injunction and invalidation of Notice 2016-66–is the proper relief:

> To begin with, we agree with CIC's reading of its complaint. The complaint contests the legality of Notice 2016-66. . . . CIC's complaint asks for injunctive relief from the Notice's reporting rules, not from any impending or eventual tax obligation. Contra the Government's view, *a request in an APA action to 'enjoin the enforcement' of an IRS reporting rule is most naturally understood as a request to 'set aside' that rule* (as the complaint elsewhere says), not to block the application of a penalty that might be imposed for some yet-to-happen violation. 5 U.S.C. §706. . . . *The complaint, and particularly its request for relief, sets out this suit's purpose as enjoining the Notice*.” (Id. at 9 (emphasis added).)

CIC Servs., LLC v. IRS, 141 S.Ct. 1582, 1590 (2021). “CIC's complaint seeks to set aside the Notice itself . . .” *Id*. at syllabus. “[T]hose penalties necessitate a suit aimed at eliminating the Notice, rather than the statutory tax penalty. Only an injunction against the Notice gives the taxpayer or advisor what it wants: relief from the obligation to report transactions. . . . Small wonder that CIC's complaint asks for an injunction against the Notice . . .” *Id*. at 1592. “[T]he presence of criminal penalties forces CIC to bring an action in just this form, with the requested relief framed in just this manner.” *Id.,* at syllabus.

Notably, the Supreme Court referenced 5 U.S.C. §706, which specifically states that the appropriate relief under the APA is to “set aside” an agency rule. Although there has been some debate percolating amongst courts as to what the proper scope of an APA injunction should be[1], the Supreme Court has indicated *at least in this case*, that the proper remedy for CIC Services is a total vacatur of Notice 2016-66. At least one administrative law scholar observes that, in *CIC Services*, the *unanimous* Supreme Court signaled that it believes universal vacatur is the proper scope of relief under the APA. Mila Sohoni, *Do you C what I C? – CIC Services v. IRS and Remedies Under the APA*, Yale J. on Regulation (2021).[2] The language of the Supreme Court's decision in this case (“*CIC's complaint seeks to set aside the Notice itself*”) cannot be squared with the current injunction (“*The IRS is hereby ENJOINED from enforcing Notice 2016-66 against CIC Services*.”). While other scopes of relief may be appropriate in other cases, the Supreme Court has given clear guidance in this case. That guidance seems particularly well-suited to situations like this one where a plaintiff (and not merely third parties in unrelated cases) will continue to suffer irreparable harm so long as the rule can be enforced against third parties.

B. A national, outright injunction is the only sensible relief in this case.

Under the distinct circumstances and evidence in this case, a complete injunction against Notice 2016-66 is the only sensible result. That is, the Court should order:

> **For the pendency of this case or until such time as this Court may order otherwise, the United States is hereby enjoined from enforcing Notice 2016-66 (the "Notice") and any statutes triggered and made relevant to any given situation merely by virtue of the issuance of the Notice (the "Relevant Statutes") against CIC Services and against any person or entity (CIC Services and such other persons collectively being "Covered Persons"). No Covered Person shall, during the pendency of this case, be legally required to perform any act required by the Notice or Relevant Statutes.**
>
> **And the IRS is hereby enjoined for the pendency of this case (or until this Court may order otherwise) from demanding any document or record from any Covered Person that such Covered Person would, but for this order, otherwise be required to maintain or submit solely by virtue of the Notice or by virtue of the Relevant Statutes triggered and made relevant by the issuance of the Notice.**
>
> **And, for the pendency of this case (or until this Court may order otherwise) the Internal Revenue Service is hereby enjoined from (1) making use in the ordinary conduct of its affairs of any documents, data or records related to any Covered Person that are in the IRS's possession solely by virtue of such Covered Person's or it agents' compliance with Notice 2016-66 and the Relevant Statutes triggered and made relevant by virtue of the issuance of the Notice ("Covered Information"), and from (2) alleging in any enforcement action against any Covered Person that any microcaptive transaction described by the Notice is a "transaction of interest" or any other form of reportable transaction merely as a consequence of the Notice and Relevant Statues triggered and made relevant by issuance of the Notice.**

This conclusion is compelled for numerous reasons:

First, the Court's current order only preliminarily enjoins the IRS from *enforcing* Notice 2016-66 against CIC Services. It does not explicitly relieve CIC Services of the on-going and compulsory record-keeping that Notice 2016-66 requires. This raises difficult questions. Can CIC Services destroy or otherwise discard the records they are currently compelled to keep? Does it have to keep updating these records? Can the IRS still request the records? And recall that the IRS has recently argued that it doesn't actually enforce Notice 2016-66; the IRS claims the Notice "is not the source of the legal consequences or significant effects to which CIC objects. Instead, those consequences flow from a framework that pre-exists and underpins the Notice", specifically 26 U.S.C. §6707A. (Doc. 68, PageID #858). In other words, in the IRS's worldview, it doesn't "enforce" Notice 2016-66, it enforces 26 U.S.C. §6707A and §6707B.

Second, even after the injunction, Notice 2016-66 affects thousands — perhaps tens of thousands — of taxpayers. For each captive insurance company, the Notice requires duplicative reports by numerous persons involved with each captive. As this Court heard "not only [does the captive advisor] have to file, not only does the captive have to file, but each insured of the captive has to file.

And not only does each insured of the captive have to file, but if the insured is a pass-through entity, each owner of the insured has to file. And if that owner is likewise a pass-wise — a pass-through entity, each of its owners must likewise file." Testimony of Sean King, Doc. 41; PageID #641. What sense does it make to continue to force each of these entities to either comply with the illegal Notice or file their own "me-too" case? The undersigned counsel have already been contacted by others interested in bringing such suits. Judicial and litigant economy (including the tax-payer funded DOJ) require a uniform approach.

Third, multiplicity of such "me-too" suits run the risk of contradictory results. Although this Court's legal reasoning in its order on the preliminary injunction is — in CIC Services's view — absolutely correct, the IRS is sure to argue in other district courts that it is not. Lest the Court doubt that the IRS would really try argue the error of this Court's judgment in other courtrooms, consider the case of *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779 (6th Cir.2017) where the Sixth Circuit delivered a stern rebuke to the IRS's rejection of a family's tax plan. The IRS continued to litigate the same transaction against the same family (just different family members) who lived in the First and Second Circuits. See *Benenson v. Commissioner*, 910 F.3d 690, 697 (2d Cir.2018)(describing how the IRS forced three Circuits to review the same transaction). There is no reason to believe that the IRS would feel compelled to not enforce Notice 2016-66 against any other taxpayer (including CIC Services's clients and referral sources) in this district or in any other.

Fourth, limiting the geographic scope of the injunction is unworkable. CIC Services has a national practice advising captive insurance companies. Notice 2016-66 is national in scope. Many of their clients and prospective clients (and their affiliated entities and customers) live outside the Eastern District of Tennessee and the Sixth Circuit. For example: CIC Services testified it services captives in North Carolina (Doc. 41, PageID #635), but the owners and insureds of those captives could be *anywhere*. It's already perverse that the IRS requires duplicative filings from numerous parties to the same transaction (one of the reasons why Notice 2016-66 is arbitrary and capricious), but limiting the geographic scope could lead to the bizarre result that some parties to a transaction are exempt from Notice 2016-66, but other parties to the same transaction, perhaps even related to those who are exempt, still have to file the same informational return. If the IRS has the ability to issue a national Notice, this Court — as a coequal branch of government — has the same authority to order a national injunction.

Fifth, the current injunction does little to ameliorate the harm CIC Services is suffering. CIC Services still must assist all of its clients with complying with Notice 2016-66 at great expense to CIC Services. See Dec. of Sean King, ¶¶3-7, Doc. 59-3, PageID #812-13. Moreover, the current injunction does not address the continuing harm to CIC Services by driving away potential clients, scaring current clients into discontinuing their captives, and deterring referral sources (other potential "material advisors") from directing business towards CIC Services. *Id*. at ¶¶8-9.

Finally, the current injunction sends the wrong message regarding the IRS's abuse of their regulatory rulemaking power. As the Sixth Circuit majority panel noted, the IRS does "not have a great history of complying with APA procedures, having claimed for several decades that their rules and regulations are exempt from those requirements." *CIC Services, LLC v. IRS*, 925 F.3d 247, 258 (6th Cir. 2019)(quoting Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683, 1712-13 (2017)). Such a limited injunction tells the IRS that they can flout the APA and achieve 99.9% of its aims. And it tells other citizens that, if they have the "intestinal fortitude"[3] to square off against the IRS, they can spend tens of thousands of dollars, four years in Court, suffer a retaliatory investigation by the IRS, and only achieve a Pyrrhic victory just for themselves. This

cannot be the result Congress intended for the APA, and it cannot be result in a true court of justice.

If CIC Services indeed prevails on the merits, in this Court's final judgment we will also be seeking additional reparative injunctive relief as further equitable relief which is noted in the Verified Complaint. The so-called propensity rule which is operative in every equitable setting requires that the realistic threat from the IRS of future harm or future injury from past harm should be addressed by the federal courts in recognition of their both equitable powers.

For these reasons, Plaintiff respectfully requests that the Court reconsider the scope of the current preliminary injunction to enjoin the enforcement of Notice 2016-066 *in toto*.

Respectfully submitted,

Kenneth A. Lazarus (admitted *pro hac vice*)
LAZARUS & ASSOCIATES
1055 Thomas Jefferson St., NW, Suite M-100
Washington, D.C. 20007
Tel: (202) 295-2330 (Direct Line)
E-mail: lazaruslaw@aol.com

-and-

Adam R. Webber (admitted *pro hac vice*)
ELLIOTT FAULKNER & WEBBER, LLC
4244 Indian Ripple Road, Suite 150
Beavercreek, Ohio 45440
Tel: (937) 264-8719
E-mail: awebber@elliottfaulknerlaw.com

-and-

John M. Kizer (TN Bar No. 029846)
Gentry, Tipton & McLemore, PC
900 South Gay Street, Suite 2300
Knoxville, TN 37902
Tel: (865) 525-5300
E-mail: jmk@tennlaw.com
COUNSEL FOR PLAINTIFF

FOOTNOTES

[1]This Court's sister district courts have struggled to define the proper scope of APA injunctions. Compare, e.g. *Averett v. United States HHS*, 306 F. Supp. 3d 1005, 1022-1023 (M.D.Tenn.2018) (invalidating a Medicare payment rule "*in toto*"); with *Biggs v. Quicken Loans, Inc.*, 990 F.Supp.2d 780, 786 (E.D.Mich.2014)(questioning whether injunctions can be issued other than on a circuit-by-circuit basis); and *Skyworks, Ltd. v. CDC*, 2021 U.S. Dist. LEXIS 103928, at *37 (N.D. Ohio June 3, 2021)(bemoaning that the Sixth Circuit has not provided more guidance on §706 of the APA, and

ultimately invalidating the CDC's COVID-19 eviction moratorium against the plaintiffs and "their [trade group] members, wherever they may be").

Other courts have not been so reticent. See, e.g. *E. Bay Sanctuary Covenant v. Garland*, 994 F.3d 962, 987 (9th Cir.2021)(holding that only total vacatur is the only sensible way to interpret "set aside" for APA purposes); and *New Mexico Health Connections v. United States Dep't of Health & Hum. Servs.*, 340 F. Supp. 3d 1112, 1183 (D.N.M. 2018)(holding that "the Court cannot, in an intellectually honest manner, limit vacatur of the rules to [just one state]. The Court does not know how a court vacates a rule only as to one state, one district, or one party."); and *Harmon v. Thornburgh*, 878 F.2d 484, 494 (D.C. Cir. 1989)("When a court finds that an agency regulation is invalid in substantial part, and that the invalid portion cannot be severed from the rest of the rule, its typical response is to vacate the rule and remand to the agency."*).*

Available at https://www.yalejreg.com/nc/do-you-c-what-i-c-cic-services-v-irs-and-remedies-under-the-apa-by-mila-sohoni/.

[3]*CIC Servs., LLC v. IRS*, 925 F.3d 247, 263 (6th Cir.2019)(Nalbandian, J. dissenting).

END FOOTNOTES