First Circuit Reliance in a Cryptocurrency Summons Enforcement Case Widens the Crack Created in the Anti-Injunction Act by CIC Services, LLC, v IRS

By Sandra R. Brown and Gary Markarian*

I. Introduction

It was a long-held belief that the Anti-Injunction Act barred taxpayers from maintaining any lawsuit that had the effect of interfering with the assessment or collection of any tax. However, the recent Supreme Court decision in *CIC Services* created a crack in the Government's use of the Anti-Injunction Act to dismiss cases for lack of subject matter jurisdiction. The First Circuit, relying on the holding in *CIC Services, LLC v. IRS*, has now, in its ruling in *Harper v. Rettig*, further widened that crack.

II. Anti-Injunction Act—Background

The Anti-Injunction Act, Code Sec. 7421(a) (hereinafter "the AIA"), states that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."

The AIA's history is quite informative. When the United States' first income tax was adopted to finance the Civil War, some taxpayers, alleging the taxes illegal, sought to enjoin collection efforts—and some courts granted the requested relief. Congress, therefore, enacted the AIA in 1867, which protects the federal government's ability to collect a consistent stream of revenue by barring litigation to enjoin or otherwise obstruct the collection of taxes.

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While the AIA predates the Administrative Procedure Act (hereinafter "APA") by some 70 years, courts have long interpreted the AIA as an exception to the APA's waiver of sovereign immunity,[1] and therefore, suits barred by the AIA can be dismissed for lack of subject matter jurisdiction.[2]

Since its enactment in 1867, courts have consistently viewed the expanse of the AIA very broadly and, thus, rejected almost any attempt to challenge Internal Revenue Service ("IRS") actions, no matter how remote from tax collection or assessment such actions may seem to be. That changed with the Supreme Court's ruling in *CIC Services*.

III. *CIC Services* and *Harper*

A. *CIC Services, LLC v. Internal Revenue Service*[3]

The IRS has broad powers to require the submission of tax-related information that may be helpful in assessing and collecting taxes.[4] These reporting rules may also apply to "material advisors"—individuals or entities that earn income from providing taxpayers with certain kinds of "aid, assistance, or advice."[5]

Harper is the latest iteration of the legal fissure that has opened in what, prior to the ruling in CIC Services LLC, has long been viewed by the Government as an almost impenetrable wall created by the AIA.

CIC Services, LLC v. Internal Revenue Service began with the requirement that taxpayers and material advisors provide information about reportable transactions. The Internal Revenue Code (hereinafter "IRC") describes these transactions as ones that "have a potential for tax avoidance or evasion."[6]

Micro-captive transactions are one category of reportable transactions that the IRS deems as having a potential for tax avoidance. Therefore, the IRS issued Notice 2016-66, which compels taxpayers and material advisors associated with micro-captive transactions to "describe the transaction in sufficient detail for the IRS to be able to understand [its] tax structure" of the transaction. Noncompliance with this notice subjects a taxpayer or material advisor to penalties of up to $50,000.[7] Additionally, an advisor may incur a daily $10,000 penalty for failing to furnish, on request, a list of people it advised on a reportable transaction.[8] These penalties are deemed to be taxes for purposes of the IRC and the AIA.

CIC Services is a material advisor to taxpayers participating in micro-captive transactions. CIC Services asserted that the IRS violated the APA because it did not follow the notice-and-comment procedures.

The Government moved to dismiss the action based on the AIA, arguing that the requested relief would prevent the IRS from assessing a tax penalty against material advisors that disregarded the Notice's reporting requirements, as the Notice's reporting obligations are backed up by a statutory tax penalty. The District Court agreed, and the Court of Appeals for the Sixth Circuit affirmed the decision.

The Supreme Court had to decide whether the AIA barred CIC's suit which claimed that the Notice's reporting requirements violated the APA. If CIC's suit was for the purpose of restraining the assessment or collection of tax, the AIA would bar CIC's suit; if it wasn't for that purpose, the suit could go forward.

CIC and the Government disagreed as to the characterization of CIC's lawsuit. According to CIC, the suit was aimed at invalidating the Notice and eliminating the reporting requirements. The Government argued the suit's purpose was to stop the collection of the tax itself.

The Court agreed that the complaint contested the legality of the Notice, not the penalty that served as an enforcement tool for the reporting requirements. CIC asked for injunctive relief from the Notice's requirements, not from any impending or eventual tax obligation. The Court rejected the Government's argument that an injunction against the Notice was the same as one against the tax penalty.

The Court stated that three aspects of the regulatory scheme refuted the idea that the lawsuit was a tax action in disguise. First, the Notice imposed affirmative reporting obligations, inflicting costs separate and apart from the statutory tax penalty. Second, the reporting requirements and the statutory tax penalty were several steps removed from each other—CIC has to withhold required information, the IRS must determine that a violation occurred, and then must make the entirely

discretionary decision to impose a tax penalty. Third, violations of the Notice are punishable by a tax and a separate criminal penalty.

Ultimately, the Court found that CIC's suit was not to restrain the assessment or collection of tax and therefore was not barred by the AIA.

Upon remand, the District Court initially granted CIC's motion for a preliminary injunction and enjoined the IRS from enforcing Notice 2016-66 against CIC.[9] The District Court thereafter ruled the IRS had to return all documents and information produced pursuant to the Notice to taxpayers and material advisors.[10] Subsequently, upon the Government's motion for reconsideration, enter an amended judgment removing its order requiring the IRS to return to non-parties the documents produced pursuant to the Notice.[11]

B. *Harper v. Rettig*[12]

In 2013, James Harper opened an account with Coinbase and deposited Bitcoin into that account. In 2015, he liquidated a portion of his Bitcoin and transferred the remaining Bitcoin to a hardware wallet.[13] Harper reported all income from his Coinbase transactions between 2013 and 2016. In 2016, Harper sold Bitcoin through other digital exchanges and paid tax on his holdings between 2016 and 2019.

In 2016, the IRS filed an *ex parte* "John Doe" administrative summons to Coinbase and thereafter, upon approval by the District Court, received information about Coinbase accounts "with at least the equivalent of $20,000 in any one transaction type … in any one year during the 2013–2015 period."[14]

In August 2019, the IRS notified Harper that it possessed information about his virtual currency accounts and transactions and warned him that he could face civil or criminal enforcement action for inaccurately reporting such transactions.

In July 2020, Harper filed a complaint against the IRS which alleged that the IRS violated his Fourth and Fifth Amendment rights, as well as Code Sec. 7609(f) by acquiring his personal financial information from Coinbase through the third-party summons process. Harper's action sought, among other remedies, relief requiring the IRS expunge his financial records from the IRS database. The IRS filed a motion to dismiss Harper's claim arguing that the AIA represented an exception to the APA's waiver of sovereign immunity, and therefore, the District Court did not have subject matter jurisdiction to review the case. The District Court granted the Government's motion and Harper appealed.

Harper challenged the IRS' summons authority under Code Sec. 7602. Pursuant to Code Sec. 7602(a), the IRS, after notice to the taxpayer, may issue a summons: (1) to examine books and records; (2) to summon an individual with possession, custody, or care of books and records to produce such records to the IRS; and (3) to take testimony of the identified taxpayer concerned, under oath, as may be relevant or material to such inquiry. As such, the activities authorized by Code Sec. 7602 fall within the category of information gathering, rather than acts of assessment or collection. However, a John Doe summons, unlike an individualized IRS summons, permits the IRS to obtain information from a large group of unidentified taxpayers.[15] Additionally, unlike an individualized summons, no individualized notice is required, nor arguably would such notice be practical as the taxpayers' identities are unknown, for the issuance of a John Doe summons.

Time will only tell what other areas of IRS acts of gathering information, as opposed to acts of assessment and collection, might be the next to fall outside of the bar of the AIA.

The Government must meet the following factors to obtain authority to issue a John Doe summons:

1. The John Doe summons relates to the investigation of a particular person or ascertainable group or class of persons;
2. There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law;
3. The information sought to be obtained from the examination of the records or testimony (and identity of the person(s) with respect to whose liability the summons is issued) is not readily available from other sources; and

4. The summons must be narrowly tailored to information that pertains to the failure or potential failure of the group or class of persons to comply with one or more provisions of the internal revenue laws that have been identified.[16]

In response to Harper's assertions that the IRS' continuing retention of his financial information was illegal, the Government argued that the purpose of Harper's suit was to restrain the assessment or collection of taxes, thereby bringing it within the scope of the AIA. The Government claimed that Harper's suit was "a preemptive suit to foreclose tax liability" and, thus, sought to enjoin a tax assessment or collection that could result from the information obtained about Harper under the John Doe summons to Coinbase.

The First Circuit found that Harper's case was one seeking to set aside illegal information gathering and retention of such information by the IRS. As such, following the holding in *CIC Services*, the Court held that Harper's action fell outside the AIA because the injunction requested did not run against a tax at all. Rather, the suit contested, and sought relief from a separate legal wrong—the allegedly unlawful acquisition and retention of Harper's financial records.

Ultimately, the Court held that because Harper's claim was not a dispute about a tax rule, the AIA did not bar his suit, vacated the district court's dismissal for lack of subject matter jurisdiction, and remanded the case for further consideration, including whether Harper has stated a claim, as required by Federal Rule of Civil Procedure 12(b)(6), which was not previously addressed by the court.

IV. Conclusion

Harper is the latest iteration of the legal fissure that has opened in what, prior to the ruling in *CIC Services LLC*, has long been viewed by the Government as an almost impenetrable wall created by the AIA.

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ENDNOTES

* Ms. Brown specializes in representing individuals and organizations who are involved in criminal tax investigations, including related grand jury matters, court litigation and appeals, as well as representing and advising taxpayers involved in complex and sophisticated civil tax controversies, including representing and advising taxpayers in sensitive-issue audits and administrative appeals, as well as civil litigation in federal, state, and tax courts.

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[1] The principal of sovereign immunity, which states that the government cannot be sued without its consent, provides that the government is generally immune from suit. (*Alden v. Maine*, SCt, 527 US 706, 713, 119 SCt 2240 (1999)).

[2] Where sovereign immunity applies, a court is deprived of subject matter jurisdiction, thereby shielding the government from suit. (*Robbins v. U.S. Bureau of Land Mgmt.*, CA-10, 438 F3d 1074, 1080 (2006)).

[3] *CIC Services, LLC*, CA-6, 2021-1 USTC ¶50,150, 141 SCt 1582 (2021).

[4] Code Sec. 6011(a).

[5] Code Sec. 6111(b)(1)(A); *see* Code Sec. 6111(a).

[6] Code Sec. 6707A(c)(1).

[7] Code Sec. 6707(b); Code Sec. 6707A(b).

[8] *See* Code Sec. 6708(a); *see* Code Sec. 6112(a).

[9] *CIC Servs., LLC*, No. 3:17-CV-110, 2021 WL 4481008, at *6 (E.D. Tenn. Sept. 21, 2021), *reconsideration denied sub nom. CIC Servs., LLC*, No. 3:17-CV-110, 2022 WL 985619 (E.D. Tenn. Mar. 21, 2022), *on reconsideration*, No. 3:17-CV-110, 2022 WL 2078036 (E.D. Tenn. June 2, 2022).

[10] *CIC Servs., LLC*, No. 3:17-CV-110, 2022 WL 985619, at *8 (E.D. Tenn. Mar. 21, 2022), *on reconsideration*, No. 3:17-CV-110, 2022 WL 2078036 (E.D. Tenn. Jun. 2, 2022).

[11] *CIC Servs., LLC*, No. 3:17-CV-110, 2022 WL 2078036, at *3–4 (E.D. Tenn. Jun. 2, 2022).

[12] *Harper v. Rettig et al.*, CA-1, No. 21-1316, 2022 (Aug. 18, 2022).

[13] A hardware wallet is a "secure offline" version of a virtual currency wallet that "can be used securely and interactively."

[14] *See Coinbase, Inc.*, No. 17-cv-1432 JSC, 2017 WL 5890052, at *1 (N.D. Cal. Nov. 28, 2017).

[15] *See* Code Sec. 7609(f).

[16] Code Sec. 7609(f) and Pub. L. No. 116-25, §1204(a), 133 Stat. 988 (2019) (Taxpayer First Act of 2019).