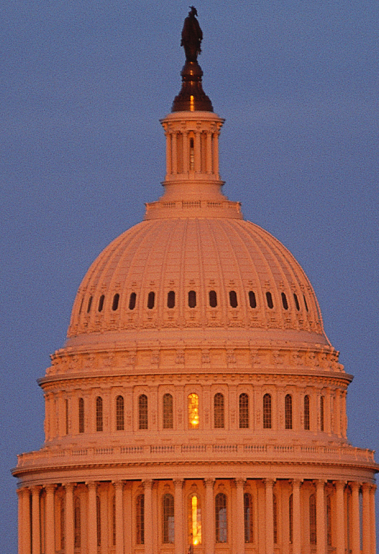




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Sixth Circuit: IRS failed to comply with notice-and-comment process in issuing Notice 2007-83 regarding “listed transactions”

The U.S. Court of Appeals for the Sixth Circuit today reversed a federal district court’s decision, finding that in issuing Notice 2007-83, the IRS had failed to comply with the notice-and-comment requirements under the Administrative Procedure Act. The Sixth Circuit, thus, set aside the notice and held for the taxpayers.

The case is: *Mann Construction, Inc. v. United States*, No. 21-1500 (6th Cir. March 3, 2022). Read the Sixth Circuit’s [decision](#) [PDF 167 KB]

Background

At issue in this case was a listed transaction.

In 2007, the IRS issued Notice 2007-83 that designates certain employee-benefit plans featuring cash-value life insurance policies as listed transactions. For these purposes, a cash-value life insurance policy combines life insurance coverage with a cash-value investment account.

From 2013 to 2017, the taxpayer-company established an employee-benefit trust that paid the premiums on a cash-value life insurance policy benefitting two of the company’s individual owners. The company deducted these expenses, while the individuals reported as income part of the insurance policy’s value. Neither the individuals nor the company reported this arrangement to the IRS as a listed transaction.

In 2019, the IRS concluded that this structure fitted the description identified in Notice 2007-83, and imposed penalties on the company (\$10,000) and on both of its shareholders (approximately \$8,600 and \$7,800) for failing to disclose their participation in the trust. All three paid the penalties for the 2013 tax year and sought administrative refunds, claiming the IRS lacked authority to penalize them. Eventually, the taxpayers filed a refund suit in federal district court.

In the district court action, the taxpayers challenged the validity of Notice 2007-83 on four grounds: (1) that Notice 2007-83 failed to comply with the notice-and-comment requirements of the Administrative Procedure Act (APA); (2) the IRS notice constituted unauthorized agency action; (3) it was arbitrary and capricious; and (4) even if Notice 2007-83 was valid, the arrangement at issue did not fall within its scope. The district court held for the government on all fronts.

Sixth Circuit's decision

The Sixth Circuit today agreed with the taxpayers that the IRS had failed to follow the law by skipping the notice-and-comment procedures established by the APA before issuing Notice 2007-83. Thus, the Sixth Circuit reversed the district court.

As the appeals court noted, the IRS did not follow the notice-and-comment procedures when it issued Notice 2007-83. On appeal, the government countered with two explanations for declining to follow the notice-and-comment process:

- The government argued that Notice 2007-83 was merely an interpretive rule (and thus did not require notice and comment) as opposed to a legislative rule (which does require notice and comment).
- The government asserted even if Notice 2007-83 amounted to a legislative rule, Congress exempted the IRS from the APA's requirements with respect to the disclosure rules.

The Sixth Circuit, however, found that Notice 2007-83 amounts to a legislative rule—it has the force and effect of law; it defines a set of transactions that taxpayers must report; and that duty did not arise from a statute or a notice-and-comment rule, but from the IRS's own initiative. The appeals court noted that taxpayers like the ones in this case had no obligation to provide information regarding listed transactions to the IRS before Notice 2007-83 and that they had such a duty after the notice. Further, as the court observed, obeying these new duties could "involve significant time and expense," and a failure to comply came with the risk of penalties and criminal sanctions—all characteristics of legislative rules.

The Sixth Circuit concluded that it must set aside the notice because the IRS's process for issuing Notice 2007-83 did not satisfy the notice-and-comment procedures for promulgating legislative rules under the APA.

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