No. 16-1197

In the Supreme Court of the United States

QINETIQ U.S. HOLDINGS, INC. & SUBSIDIARIES,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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INTRODUCTION

It is, or at least ought to be, "an elementary principle of administrative law that an administrative agency must provide reasons for its decisions." *Fisher v. Commissioner*, 45 F.3d 396, 397 (10th Cir. 1995) (citation omitted). Yet, more than 70 years after the passage of the Administrative Procedure Act (APA)—which demands that agency action be accompanied by just such an explanation, Pet. 2-3—the Internal Revenue Service (IRS) maintains that Americans are entitled to *no explanation* in one of the most common forms of agency action, an IRS Notice of Deficiency.

While longstanding, that position should be no less shocking. Yet the government whole-heartedly embraces it. It agrees that this case presents precisely that question. Opp. (I) (Question Presented). It acknowledges that the Fourth Circuit has held that IRS Notices of Deficiency are categorically exempt from the APA's reasoned-explanation requirement. *Id.* at 5-7. And far from trying to downplay the breadth or significance of that ruling, the government just doubles down on the Fourth Circuit's conclusion that the APA is wholly inapplicable to IRS Notices of Deficiency—agency orders that can result in the forfeiture of one's wages, benefits, or other property. Pet. 2-3.

Then, in urging this Court to deny review, the government asks this Court to ignore its own recent denunciation of such tax exceptionalism in *Mayo Foundation for Medical Education & Research v. United States*, 562 U.S. 44, 55 (2011), remarkably contending that *Mayo* has "*no bearing* on the question presented here." Opp. 13 (emphasis added). It asks this Court to disregard the Tenth Circuit's decision in *Fisher* for technical reasons, even though *Fisher*

clearly recognizes that the APA *does* apply to IRS Notices of Deficiency. Opp. 14. And when it comes to the merits, the government has to distort, disregard, and even erase (with the use of ellipses) the plain terms of the APA and Tax Code.

All of this just underscores the need for review.

ARGUMENT

The government does not, and cannot, deny the importance of the question presented. IRS Notices of Deficiency are among the most prolific forms of agency action, and are so consequential they can result in the seizure of one's wages, bank accounts, or other property. Pet. 2-3. And yet, as far as the government is concerned, taxpayers are not entitled to any reasoned explanation—none—when the IRS issues a Notice of Deficiency: "[T]he IRS need not provide a reasoned explanation for a determination that a deficiency in tax exists." Opp. 11.

Arguably, the importance of the question presented alone warrants certiorari. But here, all the conventional factors point to that conclusion.

I. THE CONFLICTS ARE REAL

1. Despite the government's attempt to bury it, the Fourth Circuit's decision implicates a square split over the applicability of the APA's reasoned-explanation requirement to Notices of Deficiency.

a. The decision below is directly at odds with the Tenth Circuit's decision in *Fisher*. Whereas the Fourth Circuit here held that the "requirement of a reasoned explanation in support of a final agency action does not apply to a Notice of Deficiency," Pet. App. 10a-11a, the Tenth Circuit there set aside a Notice of Deficiency

because it lacked such an explanation, *Fisher*, 45 F.3d at 397.

Even the government is forced to acknowledge (at 14) that *Fisher* "suggests that the APA's 'reasoned explanation' requirement applies to IRS notices of deficiency." (Indeed.) And it does not dispute that *Fisher* would come out differently under the Fourth Circuit's rule—which explains why, in the Fourth Circuit, the government simply argued that *Fisher* "should not be followed." U.S. CA4 Br. 37 n.11. But having formally non-acquiesced in *Fisher* and asked the Fourth Circuit to *reject* the Tenth Circuit's reasoning (Pet. 14), the government now asks this Court just to *ignore* that reasoning.

Instead of engaging with *Fisher*'s reasoning, the government limits its treatment of *Fisher* to arguing that the decision is "factually distinguishable" because the Notice of Deficiency there also included a penalty. *Id.* But that is beside the point. Section 706 of the APA provides no basis for holding that the reasoned-explanation requirement applies to *some* Notices of Deficiency but not others—either it applies or it doesn't. Pet. 14 n.7. And in any event, the government is wrong in suggesting that a deficiency determination, unlike a penalty determination, is a purely ministerial act; it, too entails the exercise of considered judgment. *See, e.g.*, *Scar v. Commissioner*, 814 F.2d 1363, 1368-69 (9th Cir. 1987). There is no question that, had this case gone to the Tenth Circuit, the APA would have applied.[1]

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[1] The government also questions (at 15) *Fisher*'s "continuing vitality." But *Fisher*'s reasoning is not limited to the specific

b. The decision below also conflicts with *Cohen v. United States*, which held that "no exception exists shielding [the IRS]—unlike the rest of the Federal Government—from suit under the APA." 650 F.3d 717, 723 (D.C. Cir. 2011) (en banc). The government argues (at 15) that *Cohen* is "inapposite" because it concerned judicial review of IRS rulemaking rather than IRS deficiency determinations, but the inconsistency between the two cases is a more fundamental one: The Fourth Circuit here was willing to carve out an atextual exemption for the IRS from the APA's requirements, while the D.C. Circuit in *Cohen* was not. *See* Patrick J. Smith, *The APA's Reasoned-Explanation Rule and IRS Deficiency Notices*, Tax Notes, Jan. 16, 2012, at 331 (stating that *Cohen* "confirmed that the Administrative Procedure Act (APA) applies to the IRS no less than to any other agency").

c. Tellingly, the primary court of appeals decision on which the government relies (at 10)—*Olsen v. Helvering*, 88 F.2d 650 (2d Cir. 1937)—was decided nearly a decade *before* the APA was enacted. And even so, *Olsen* hardly supports the government's position that a taxpayer is not entitled to *any* reasoned explanation, because the notice in *Olsen*, unlike the one here, stated "the *reason* for the assessment." *Id.* at 651 (emphasis added). The court had no occasion to consider the stark situation presented here—where there is *no* explanation.

The *post*-APA lower court cases cited by the government (at 10), meanwhile, simply do not consider

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penalty provision it considered, and similar provisions remain in effect anyway (*e.g.*, 26 U.S.C. § 6712(b)).

whether Notices of Deficiency are subject to the APA's reasoned-explanation requirement. As one commentator has explained, that is because the court of appeals "cases in which these principles were originally established predate the APA and were apparently based on the fact that the terms of the predecessor provisions to section 6212(a) did not require any type of explanation." Smith, *supra*, at 341. *Fisher* and *Cohen* show that when courts *do* account for the APA, they correctly recognize that the IRS is not exempt from its requirements.

d. The government's reliance (at 9) on the Tax Court's decision in *Porter v. Commissioner*, 130 T.C. 115 (2008), underscores the problem. *Porter* is emblematic of the Tax Court's entrenched—and outmoded—position that "deficiency proceedings in the Tax Court . . . are not governed by the APA." 130 T.C. at 130. As the primary support for that position, the Tax Court has relied upon *O'Dwyer v. Commissioner*, 266 F.2d 575, 580 (4th Cir. 1959), which even the government has recognized was based on a "flawed assumption" concerning the APA. Pet. 17-18 (citation omitted); *see Porter*, 130 T.C. at 130. That position has been challenged by some members of the Tax Court. *See Porter*, 130 T.C. at 146-47 (Halpern & Holmes, JJ., dissenting); *Ewing v. Commissioner*, 122 T.C. 32, 56, 59-61 (2004) (same). But without this Court's intervention, there is no reason to think that the Tax Court will remove itself from this rut—and abide by the APA.

2. The Fourth Circuit's and the government's response to this Court's own decision in *Mayo* further demonstrate the need for that intervention. In *Mayo*, this Court admonished that it was "*not* inclined to

carve out an approach to administrative review good for tax law only." 562 U.S. at 55 (emphasis added). Yet, the Fourth Circuit simply ignored *Mayo*, and instead plodded along the path set down half a century ago by its misguided decision in *O'Dwyer*. Pet. 17-18. And the government, while acknowledging *Mayo*, argues (at 13) that *Mayo* has "no bearing" on this case—essentially arguing that, when it comes to the IRS, the APA is somehow only relevant to *rulemaking*. Such open defiance of this Court's decision in *Mayo* alone calls for review.

II. THE GOVERNMENT'S POSITION FLOUTS THE PLAIN TERMS OF THE APA

The government's arguments on the merits should only give this Court more pause about allowing the IRS to continue to ignore the APA.

A. The APA Is Clear And Unambiguous

Section 706(2)(A) of the APA—the provision from which the reasoned-explanation requirement comes, *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 513-14 (2009)—applies whenever a "reviewing court" is asked to "set aside agency action" as "arbitrary" or "capricious." 5 U.S.C. § 706(2)(A); *see Dickinson v. Zurko*, 527 U.S. 150, 154 (1999) (where "agency action" is challenged before a "reviewing court," the "reviewing court *must* apply the APA's court/agency review standards in the absence of an exception" (emphasis added)); Pet. 11-12.

As a matter of plain text, Section 706(2)(A) thus applies to Tax Court review of Notices of Deficiency:

- The IRS is an "agency." *See* 5 U.S.C. § 551(1).
- A Notice of Deficiency is "agency action." *See* 5 U.S.C. § 551(6); Pet. 2-3, 12 n.5.
- And the Tax Court is a "reviewing court." 5 U.S.C. § 706; *see* Pet.16-17.

The government does not dispute any of these steps. Instead, it tries to rewrite the statute.[2]

B. The Government's Contrary Position Distorts And Ignores The APA's Text

1. Rather than grappling with Section 706, the government starts (at 8) with Section 556(b). Quoting that provision, it asserts that "[t]he APA sub-chapter pertaining to judicial review 'does not supersede the conduct of specified classes of proceedings, in whole or in part, by or before boards or other employees specifically provided for by or designated under statute.'" Opp. 8 (quoting 5 U.S.C. § 556(b)). But that argument—the government's lead textual argument—is unmistakably wrong.

Section 556(b) states that "*[t]his subchapter* does not supersede the conduct of specified classes of proceedings. . . ." 5 U.S.C. § 556(b) (emphasis added). But the government omits the italicized language—a critical oversight. Section 556(b) appears in the APA subchapter devoted to "Administrative Procedure" *before agencies themselves*—subchapter II of Chapter 5. The APA's provisions for judicial review, meanwhile, appear in Chapter 7. Section 556(b)'s reference to the circumstances in which "*[t]his*

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[2] The government does not embrace the Fourth Circuit's head-scratching suggestion that a Notice of Deficiency might not be a *final* agency determination. Opp. 6-7; Pet. 12 n.5.

subchapter" does or does not govern thus has nothing to do with the judicial review provisions of the Act. 5 U.S.C. § 556(b) (emphasis added). The government's contrary position is flatly refuted by the text.

2. The government next argues that the Tax Court's *de novo* review of Notices of Deficiency was "grandfathered" under Section 559 of the APA, and therefore displaces the standards of judicial review set out in Section 706. Opp. 8-9 (quoting *Dickinson*, 527 U.S. at 155); *see also id.* at 12. The text forecloses this argument, too. Section 559 provides that "chapter 7 . . . do[es] not limit or repeal *additional* requirements imposed by statute or otherwise recognized by law." 5 U.S.C. § 559 (emphasis added). This time, the government (at 8) glosses over the word "additional." Yet, that qualifier is crucial: it means that preexisting requirements apply *in addition* to the APA's uniform requirements, not *in place* of them. *See Dickinson*, 527 U.S. at 155 ("The APA was meant to bring uniformity to a field full of variation and diversity.").

3. Of course, in theory, Congress *could* choose to exempt the IRS, or Notices of Deficiency, from the APA—but it hasn't. Certainly Congress has not *expressly* exempted the IRS from any provision of the APA. That is the end of the ballgame. Section 559 of the APA specifies that agency-specific exceptions cannot be inferred, but can only be made "expressly." 5 U.S.C. § 559. The government fails to identify any statute that "expressly" exempts the IRS from the APA's standards of judicial review, or any other APA requirement. Because there is none.

The government never directly confronts—or even acknowledges the existence of—Section 559's "expressly" requirement. Implicitly, though, it

suggests that the requirement is met by Section 7522 of the Internal Revenue Code, a provision that does not mention the APA at all. It claims (at 12-13) that Section 7522 "provide[s] that a notice of deficiency will not be invalidated based on an inadequate description of the basis for the deficiency." Again, however, the government just omits a key phrase of the statute—here, "under the preceding sentence." *See* 26 U.S.C. § 7522(a) ("An inadequate description *under the preceding sentence* shall not invalidate such notice." (emphasis added)).

The government leaves out the italicized text each time it refers to Section 7522 in the body of its brief, quoting it instead as follows: "[a]n inadequate description * * * shall not invalidate such notice." Opp. 7, 11 (alterations in government brief). But pay attention to the ellipses. The elided text—"under the preceding sentence"—shows that Congress was specifically *not* addressing the effect of pre-existing procedural or judicial-review requirements, including the APA's, but instead simply specifying an *additional* requirement. Especially given Section 559's requirement that any APA exemptions be made "expressly," there is no basis for holding that Section 7522 *also* repeals or limits the APA's application in any way.[3]

4. Finally, the government points (at 9) to Section 703 of the APA, which states that when Congress has

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[3] Section 7522's "description" and the APA's reasoned-explanation requirement also call for different things. For example, a Notice of Deficiency could flunk Section 7522—*e.g.*, by omitting the amount of interest due—while still complying with the APA's reasoned-explanation requirement.

created a "special statutory review proceeding," that designated forum provides "[t]he form of proceeding for judicial review." 5 U.S.C. § 703. Citing *Bowen v. Massachusetts*, it argues that "Congress did not intend for the APA to duplicate 'previously established special statutory *procedures* relating to specific agencies.'" Opp. 9 (quoting 487 U.S. 879, 903 (1988)) (emphasis in government brief). But here, there is no dispute that Congress has created a "special statutory review proceeding," 5 U.S.C. § 703, for Notices of Deficiency—it has, in the form of the Tax Court. The question, instead, is whether the standards for judicial review set out in Section 706 apply *within* that proceeding.

And the APA answers *that* question unambiguously. Section 706 states that "the reviewing court *shall*" apply its standards. 5 U.S.C. § 706 (emphasis added). The fact that Congress created a special statutory review proceeding for Notices of Deficiency—in the Tax Court—does not exempt those Notices from the APA's standards of judicial review, any more than the special statutory proceeding for direct review of FCC orders in the courts of appeals exempts *them* from the APA's requirements. *See* 28 U.S.C. § 2342(1); *Fox Television Stations*, 556 U.S. at 513 (recognizing applicability of arbitrary-and-capricious standard in such proceedings). Whatever the "reviewing court" may be, the standards by which it is to conduct its review of agency action are set out in Section 706.[4]

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[4] Nor does the existence of *de novo* review displace arbitrary-and-capricious review. *See* Pet. 19; *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 284 (1974).

In the end, the government's attempt to defend the Fourth Circuit just lays bare what it did—carve out a judge-made exception to the APA .

III. THIS CASE IS AN IDEAL VEHICLE

Without disputing that the Notice of Deficiency in this case lacked a reasoned explanation (Pet. 23), the government suggests (at 16-17) this case is a "poor vehicle" because the lack of any reasoned explanation was "harmless." That is wrong too—and not just because the government waived any harmless-error argument by failing to raise it below.

The existence of a reasoned explanation is a bedrock component of sound decision-making. Among other things, requiring an agency to explain its decision "ensure[s] that agencies follow constraints *even as they exercise their powers*." *Fox Television*, 556 U.S. at 537 (Kennedy, J., concurring in part and concurring in the judgment) (emphasis added). Particularly in light of recent history (*see* Pet. 20), telling the IRS that it does not have to explain *why* it took a particular action—*when* it acted—is an invitation for the abuse of power.

The government points to the "back-and-forth" (Opp. 17) between the IRS and the taxpayer before the IRS issued its Notice of Deficiency. But such a preliminary exchange of positions is common in situations where the reasoned-explanation requirement applies—and in no way obviates the need for an explanation *in the decision itself*. That is particularly true where, as here, numerous different considerations or factors are in play. Requiring the IRS to explain which factor, or factors, it actually relied on can shift the burden of proof—and result—in cases like this. Pet. 22.

Even more fundamentally, a taxpayer should not have to "haul [the IRS] into Tax Court"—a costly endeavor—just "to discover what the rationale is for its decision." *Fisher*, 45 F.3d at 397. Yet, that is exactly what QinetiQ had to do here.

* * * * *

IRS Notices of Deficiency can upset the lives—and livelihoods—of their recipients. Taxpayers are at least entitled to the benefit of a reasoned explanation when the IRS issues such a Notice. The APA requires no less. The Fourth Circuit's contrary decision perpetuates an entrenched misconception about whether the IRS must abide by the same rules as any other agency under the APA. This Court should grant the petition and level the playing field.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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