IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Adam Steele, Brittany Montrois, and Joseph Henchman, on behalf of themselves and all others similarly situated, *Plaintiffs*, v. United States of America, *Defendant*.	Case No. 14-cv-01523-RCL

PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

There must be a natural law of bureaucratic inertia: A bureaucracy, once set in motion, tends to stay in motion—even after its original reason for acting has disappeared or been discredited or, as in this case, been declared unlawful by the D.C. Circuit.

For decades, the IRS acknowledged that it lacked authority to regulate people who prepare tax returns on behalf of others. Then, in 2010, after many failed attempts to secure specific authority from Congress, the IRS issued regulations to do just that. Never before had the IRS assumed such authority. As part of this unprecedented regulatory effort, the IRS began requiring paid tax-return preparers to pass a qualifying exam and take annual continuing-education courses. The IRS also mandated—for the first time—that all preparers pay an initial $64.25 fee to obtain an agency-issued "preparer tax identification number" (or PTIN), as well as an annual $63 renewal fee. The idea was to have the PTIN application process incorporate the new eligibility requirements—meaning that only people who met those requirements would receive a PTIN—and to use the fees to cover the costs of implementing the new licensing regime.

But in 2014 the D.C. Circuit struck down the eligibility criteria—the backbone of the licensing regime—as a "vast expansion" of the IRS's authority, unauthorized by Congress. *Loving v. IRS*, 742 F.3d 1014, 1021 (D.C. Cir. 2014). The court held that the agency's asserted authority, a 125-year-old statute governing the "practice of representatives" before the Treasury, "cannot be stretched so broadly as to encompass authority to regulate tax-return preparers." *Id.* at 1015. And without such authority, the IRS could not impose *any* eligibility requirements on preparers, thus reinstating the traditional rule that anyone may prepare tax returns for compensation.

After *Loving*, only one vestige of the 2010 regulations remains in effect: the requirement that return preparers obtain and annually pay for a PTIN. But *Loving* removed the IRS's stated rationale for that requirement, declaring it outside the bounds of what Congress had authorized.

At this point, the IRS had a choice: It could have (and should have) abandoned the last remnant of its unsuccessful regulatory bid, refunded the unlawful PTIN fees to all who paid them, and restored the status quo ante. But instead of winding back the clock, the agency pressed forward. Despite *Loving*, the IRS has continued to charge the PTIN fees that were intended to fund its failed regulatory scheme. Yet it has not offered any legitimate reason why it has done so, nor has it ever provided a truly independent justification that can withstand *Loving*.

Because the IRS has failed to face up to the full consequences of *Loving*, the plaintiffs brought this case to obtain a refund of the PTIN fees. The case presents two issues: (1) Has the IRS acted unlawfully by collecting fees that were justified solely to support an unauthorized licensing scheme? (2) If not, do the fees exceed the costs of providing a PTIN?

This summary-judgment motion addresses the first issue. It demonstrates why the IRS's collection of PTIN fees violates two statutes: the Administrative Procedure Act, which prohibits "arbitrary" or "capricious" agency action, 5 U.S.C. § 706(2), and the Independent Offices Appropriations Act (or IOAA), which authorizes agencies to charge user fees only for providing a "service or thing of value" (and only as necessary "to be self-sustaining"), 31 U.S.C. § 9701.

Agencies must give reasons for their actions, and those reasons must be consistent with law. But here, the *sole* reason that the IRS gave for why it was requiring tax-return preparers to obtain and pay for a PTIN—after allowing them for decades to use their social security numbers, and to obtain an optional PTIN for free—was to facilitate and fund the now-invalidated licensing requirements. Because the IRS gave no other justification for the PTIN fees, those fees are unlawful under the APA. And although the IOAA permits agencies to charge licensing fees, Congress did not grant the IRS *any* licensing authority, so tax-return preparers receive no special benefit in exchange for the fees. Because the IRS's collection of the PTIN fees was unlawful, the Court should grant summary judgment and order the IRS to return the fees.

BACKGROUND

A. In 2010, after multiple failed efforts to obtain authorization from Congress, the IRS attempts for the first time to regulate tax-return preparers.

Before 2010, anyone could file a tax return on behalf of someone else for compensation. Rule 56(c) Statement ¶ 2.[1] Although the Justice Department could criminally prosecute tax-return preparers who committed fraud or other misconduct, and federal district courts could enjoin fraudsters from preparing returns, the IRS had no authority of its own to regulate who may prepare tax returns for others. *Id.* ¶¶ 4–5.

This was not for lack of trying. In the preceding decade, the IRS had supported nearly a dozen attempts in Congress to secure for itself the regulatory authority to create minimum eligibility criteria and "require the registration" of tax-return preparers. *Id.* ¶¶ 11–14. All failed. *Id.* Frustrated by these failures, the IRS took it upon itself to regulate tax-return preparers in 2010—the first attempt to do so in American history. An internal study determined that, despite the repeated rejection of "bills requiring the registration and regulation of tax return preparers," the agency did not actually need any "additional legislation" to exercise regulatory authority over preparers, because (in its view) the IRS had such licensing authority all along. IRS Publication 4832, *Return Preparer Review* (Dec. 2009), at 25, 33, http://bit.ly/2cmCkFW (Ex. 1). Based on this view, the agency claimed existing statutory authority and announced its intention to issue regulations that would impose mandatory registration and oversight of tax-return preparers. *Id.* at 33 (citing 26 U.S.C. § 6109(d) and 31 U.S.C. § 330(a)(1)).

The new regulations consisted of three interrelated parts. The first part, finalized in June 2011, formed the core of the regulatory scheme: It imposed eligibility requirements on preparers,

[1] Accompanying this motion is a statement of material facts as to which plaintiffs contend there is no genuine issue ("Rule 56(c) Statement"), which provides the most comprehensive summary of the relevant statutory and regulatory background. Exhibits attached to the statement are referred to in this motion as "Ex. #."

including competency testing and continuing education. *See Regulations Governing Practice Before the Internal Revenue Service*, 76 Fed. Reg. 32,286 (June 3, 2011); 31 C.F.R. §§ 10.4(c), 10.5(b), 10.6. Specifically, this regulation mandated that certain preparers—those who were not licensed attorneys, certified public accountants, or authorized tax practitioners known as enrolled agents—pass a qualifying exam and take 15 hours of continuing-education courses per year to be able to prepare tax returns on behalf of others for compensation. *Id.* at 32,287. As authority for these novel eligibility requirements, the IRS invoked a 125-year-old statute that it had "never interpreted . . . to give it the authority to regulate tax-return preparers," and that predated creation of the federal income tax. *Loving*, 742 F.3d at 1021 (discussing 31 U.S.C. § 330(a)(1)).

The other two regulations were complementary. Together, they would require tax-return preparers to obtain and pay for an IRS-issued number (a PTIN) instead of using their social security numbers to identify themselves on returns, while making the new eligibility requirements part of the PTIN application process. These two regulations are the central focus of this case.

1. The regulation requiring preparers to obtain a PTIN. The first of these two regulations established the requirement that preparers obtain and regularly renew a PTIN. 26 C.F.R. § 1.6109–2.

Until this regulation took effect, preparers had long been allowed to use their social security numbers as the required "identifying number" on the returns they prepared for others, as permitted by 26 U.S.C. § 6109(d). Rule 56(c) Statement ¶¶ 6–10. That statute provides that the social security number shall "be used as the identifying number," unless "otherwise . . . specified under regulations" issued by the IRS. 26 U.S.C. § 6109(d). The PTIN, introduced in 1998 as an optional alternative identification number, was provided at no charge, and with no requirement that a preparer apply for renewal of the number. *User Fees Relating to Enrollment and Preparer Tax Identification Numbers*, 75 Fed. Reg. 43,110 (July 23, 2010) (codified at 26 C.F.R. pt.

300). And, beginning in 2009, preparers could omit their identifying numbers—social security or PTIN—from the taxpayer's copy of the return. *Tax Return Preparer Penalties Under Sections 6694 and 6695*, 73 Fed. Reg. 78,430, 78,432 (Dec. 22, 2008).

This regime changed in 2010. For the first time, the IRS disallowed use of a return preparer's social security number as the identifying number, and mandated that each preparer obtain (and regularly renew) a PTIN. Relying on its authority under 26 U.S.C. § 6109, the IRS explained that the reason it changed its longstanding policy was "to address two overarching objectives." *Furnishing Identifying Number of Tax Return Preparer*, 75 Fed. Reg. 60,309, 60,310 (Sept. 30, 2010). The "first overarching objective" was "to provide some assurance to taxpayers that a tax return was prepared by an individual who has passed a minimum competency examination to practice before the IRS as a tax return preparer, has undergone certain suitability checks, and is subject to enforceable rules of practice." *Id.* The "second overarching objective" was "to further the interests of tax administration by improving the accuracy of tax returns and claims for refund and by increasing overall tax compliance." *Id.*; *see also Furnishing Identifying Number of Tax Return Preparer*, 75 Fed. Reg. 14,539, 14,540 (Mar. 26, 2010) ("[The PTIN requirement] will increase tax compliance and allow taxpayers to be confident that the tax return preparers to whom they turn for assistance are knowledgeable, skilled, and ethical.").

According to the IRS, the regulation would help achieve these twin goals by using the PTIN as an occupational license—a way "to administer requirements intended to ensure that tax return preparers are competent, trained, and conform to rules of practice," and thus "to aid the IRS's oversight of tax return preparers." 75 Fed. Reg. at 60,313. Unlike in the past, when anyone could obtain a PTIN or use their social security number, the agency would now create a host of "qualifications [and] other requirements necessary to obtain a valid number," and these requirements would be imposed "[a]s part of the process of applying for a PTIN." 75 Fed. Reg.

at 14,541–42. The IRS laid out how it envisioned this new licensing scheme working: "Under the final regulations and the additional guidance described, the IRS will establish a process intended to assign PTINs only to qualified, competent, and ethical tax return preparers. The testing requirements [imposed by parallel regulations] will establish a benchmark of minimum competency necessary for tax return preparers to obtain their professional credentials, while the purpose of the continuing education provisions is to require tax return preparers to remain current on the Federal tax laws and continue to develop their tax knowledge." 75 Fed. Reg. at 60,314–15. In this way, the PTIN requirement was "critical to effective oversight" of tax-return preparers. 75 Fed. Reg. at 60,313.

2. The regulation requiring preparers to pay for a PTIN. The second regulation established the requirement that preparers pay a fee to obtain and renew their PTINs. 26 C.F.R. § 300.13. These fees were originally set at $64.25 to obtain a PTIN, and $63 to renew it.

This policy, too, was a sharp departure from what the IRS had done in the past. Since creating PTINs in 1998, the IRS had issued them "without charging a user fee." 75 Fed. Reg. at 43,111. But now, "[t]he PTIN application, issuance, and renewal process" were set to "become significantly more expansive and intricate with the implementation of the registered tax return preparer program." *Id.* Thanks to that new regulatory regime, the IRS estimated that there would be "as many as 1.2 million [PTIN] applications," and that this "increase in demand" would "require the IRS to expend more resources." *Id.* at 43,111, 43,113. More importantly, processing these applications would entail far more work than before: "Federal tax compliance checks [would] be performed on all individuals who apply for or renew a PTIN. Suitability checks [would] be performed. The IRS [would] further investigate individuals when the compliance or suitability check suggest[ed] that the individual may be unfit to practice before the IRS. These checks were not previously performed as a prerequisite to obtaining a PTIN," and

they would "significantly increase the intricacy of the application process." *Id.* Given "the increased costs to the government to process the application for a PTIN," as well as "the anticipated increase in PTIN applications," the IRS determined that there was "no viable alternative to imposing a user fee." *Id.* at 43,113.

The IRS justified the fee under the Independent Offices Appropriations Act (or IOAA), which authorizes agencies to impose user fees for providing a "service or thing of value" to an identifiable individual, not to exceed the costs incurred by the agency in providing that service. 31 U.S.C. § 9701. The IRS explained why it thought that the statute applied here: "By limiting the individuals who may prepare all or substantially all of a tax return or claim for refund to individuals who have a PTIN, the IRS is providing a special benefit to the individuals who obtain a PTIN"—the ability "to prepare all or substantially all of a tax return or claim for refund." *User Fees Relating to Enrollment and Preparer Tax Identification Numbers*, 75 Fed. Reg. 60,316, 60,319 (Sept. 30, 2010) (codified at 26 C.F.R. pt. 300). "Because only attorneys, certified public accountants, enrolled agents, and registered tax return preparers are eligible to obtain a PTIN, only a subset of the general public is entitled to a PTIN and the special benefit of receiving compensation for the preparation of a return that it confers." *Id.* at 60,317.

At the same time, the IRS explained why requiring a PTIN would "provide important benefits to the IRS." 75 Fed. Reg. at 43,113. These would include "allowing the IRS to track the number of persons who prepare returns, track the qualifications of those persons who prepare returns, track the number of returns each person prepares, and, when instances of misconduct are detected, locate and review returns prepared by a specific tax return preparer." *Id.*

To justify the amount of the fee—$50 to the government, plus a separate payment to a third-party vendor (set at $14.25 for the initial issuance, and $13 for a renewal)—the IRS listed all the compliance work it would now have to perform in implementing the licensing program. In

the preamble to the final rule creating the eligibility criteria, the IRS broke down the costs as follows: "The $50 annual fee is expected to recover the $59,427,633 annual costs the government will face in its administration of the PTIN registration program. This fee includes: (1) The costs the government faces in administering registration cards or certificates for each registered tax preparer, (2) costs associated with prescribing by forms, instructions, or other guidance which forms and schedules registered tax preparers can sign for, and (3) tax compliance and suitability checks conducted by the government." 76 Fed. Reg. at 32,296.[2] As for the vendor's fee, that would go to Accenture, whose contract with the government requires it to do (and who has in fact done) all the things necessary to issue and renew PTINs. Rule 56(c) Statement ¶¶ 37–38.

B. In early 2014, the D.C. Circuit invalidates the new eligibility requirements as a "vast expansion of the IRS's authority," unauthorized by Congress.

Two and a half years ago, in *Loving v. IRS*, the D.C. Circuit invalidated the heart of the IRS tax-return-preparer regulations: the attempt to impose competency-testing and continuing-education requirements on preparers. The court held that the IRS's asserted statutory basis for imposing these requirements—the 125-year-old statute permitting the agency to "regulate the practice of representatives of persons before the Department of the Treasury," 31 U.S.C. § 330—"cannot be stretched so broadly as to encompass authority to regulate tax-return preparers." *Loving*, 742 F.3d at 1015.

"If we were to accept the IRS's interpretation of Section 330," the D.C. Circuit reasoned, "the IRS would be empowered for the first time to regulate hundreds of thousands of individuals in the multi-billion dollar tax-preparation industry. Yet nothing in the statute's text or the

[2] Of these three categories, the IRS previously determined that the last category (compliance and suitability checks) would account for 74% of the estimated costs of administering the PTIN licensing scheme, and that the second category (forms)—for which the agency already receives appropriations from Congress—would account for only 0.25% of the estimated costs. Rule 56(c) Statement ¶¶ 35, 43. The first category (registration cards) has never been implemented.

legislative record contemplates that vast expansion of the IRS's authority." *Id.* at 1021. And, indeed, for more than a century "the IRS never interpreted the statute to give it authority to regulate tax-return preparers. Nor did the IRS ever suggest that it possessed this authority." *Id.* To the contrary, as recently as 2005, "the National Taxpayer Advocate—the government official who acts as a kind of IRS ombudsperson—stated to Congress that 'the IRS currently has no authority to license preparers or require basic knowledge about how to prepare returns.'" *Id.* The D.C. Circuit agreed. Finding that "[t]he IRS may not unilaterally expand its authority through such an expansive, atextual, and ahistorical reading of Section 330," the D.C. Circuit affirmed the district court's judgment "permanently enjoin[ing] the tax-return preparer regulations." *Id.* at 1016, 1022. (The plaintiffs had not sought monetary relief.) As a result, anyone may once again prepare tax returns on behalf of others for compensation.

Despite the fact that the D.C. Circuit invalidated the core of its regulatory program in *Loving*, the IRS has continued to charge PTIN fees—the lion's share of the money used to fund the failed licensing regime. And it has used some of these fees to fund a now-voluntary program similar to the one struck down in *Loving*. Rule 56(c) Statement ¶¶ 55–56. By contrast, the agency has issued refunds for all competency-testing fees that it had collected. *See* IRS, *Registered Tax Return Preparer Test Fee Refunds*, http://bit.ly/2c2rFf7.

C. In late 2014, tax-return preparers file this lawsuit to challenge the lawfulness of the PTIN fee and get their money back.

Because the IRS refused to refund the PTIN fees, tax-return preparers brought this lawsuit in September 2014, asserting jurisdiction under the APA and the Little Tucker Act. After appointing Motley Rice as interim class counsel, *see* ECF Nos. 37 & 38, this Court certified a class of all people (excluding counsel) who have paid a PTIN fee. ECF No. 55. But it initially did so only as to the plaintiffs' request for declaratory relief, concluding that the plaintiffs had "not yet

demonstrated that the Court has subject matter jurisdiction" over their request for monetary relief. *Id.* at 1. The Court stressed, however, that its decision was "subject to reconsideration." *Id.* at 23. Several months later, the Court granted the plaintiffs' request for reconsideration and held that there is subject-matter jurisdiction under the APA "over plaintiffs' request for monetary relief, or restitution." ECF No. 64, at 1–3 (citing *Am.'s Cmty. Bankers v. FDIC*, 200 F.3d 822, 830 (D.C. Cir. 2000)). The Court also noted that the IRS had not "directly dispute[d] jurisdiction under the Little Tucker Act," and reserved the question whether that statute also conferred justification. *Id.* at 3 n.2. The Court ultimately certified the class "for each of plaintiffs' two, alternative claims and for plaintiffs' request for both declaratory relief and restitution," and appointed Motley Rice as class counsel. ECF No. 63.

The amended class complaint asserts two claims. *First*, "[t]he IRS lacks legal authority to charge" the PTIN fee because doing so "constitutes unlawful agency action under the Administrative Procedure Act, 5 U.S.C. § 706(2)," and because "preparers receive no specific or special benefit or thing of value in registering for and obtaining a PTIN," as required by the IOAA, 31 U.S.C. § 9701. ECF No. 41 ¶¶ 39, 41. *Second*, even if the IRS has legal authority, "the fees charged exceed the amount that can be charged under 31 U.S.C. § 9701, as they include costs attributable to the public benefit and do not reasonably reflect the value of the specific service for which they are charged." *Id.* ¶ 46.

In a joint scheduling proposal, the parties agreed that this first claim "can be decided as a matter of law and without further discovery" and, "should Plaintiffs be successful on this claim (after the conclusion of all appeals), the members of the putative class will be entitled to a refund of the PTIN fees they have paid to date, the IRS will cease charging fees in the future, and the case will be largely concluded." ECF No. 51, at 2. The second claim, by contrast, requires "a fact-intensive inquiry, involving substantial cost-based discovery of the IRS and its vendors

relating to direct and indirect costs, as well as expert discovery and testimony." *Id.* Accordingly, the parties have agreed—and this Court has ordered—that these proceedings should be bifurcated, through dispositive motions addressing the first count alone. ECF Nos. 51 & 52.

D. In late 2015, the IRS reduces the amount of the PTIN fee.

In October 2015—about a year after this case was filed—the IRS issued a temporary regulation reducing the total PTIN fee to $50. *Preparer Tax Identification Number (PTIN) User Fee Update*, 80 Fed. Reg. 66,792, 66,794 (Oct. 30, 2015). The IRS said that it had "re-calculated its cost of providing services under the PTIN application and renewal process" and "determined that the full cost of administering the PTIN program going forward has been reduced from $50 to $33 per application or renewal." *Id.* The IRS also explained that the "vendor fee is increasing from $14.25 for original applications and $13 for renewal applications to $17 for [either]." *Id.* The IRS issued a final regulation to the same effect just a few weeks ago, in August 2016. *Preparer Tax Identification Number (PTIN) User Fee Update*, 81 Fed. Reg. 52,766 (Aug. 10, 2016).

Among the reasons why the fee had been set too high, the IRS explained, was "the fact that certain activities that would have been required to regulate registered tax return preparers will not be performed. In particular, the determination of the user fee no longer includes expenses for personnel who perform functions primarily related to continuing education and testing for registered tax return preparers. Additionally, expenses related to personnel who perform continuing education and testing for enrolled agents and enrolled retirement plan agents were also removed from the user fee." 80 Fed. Reg. at 66,794. The IRS did not, however, provide a refund of the fees that it had already collected to reimburse these expenses. And it asserts that it has continued to use PTIN fees to fund activities related to tax compliance, background checks, and the voluntary certification program established after *Loving*. Rule 56(c) Statement ¶¶ 54–56.

ARGUMENT

I. The IRS has unlawfully collected PTIN fees.

The D.C. Circuit held in *Loving* that the IRS lacks statutory authority "to regulate tax-return preparers," and invalidated its broad attempt to do so. 742 F.3d at 1015. As the court put it: Congress did not remotely "contemplate[] that vast expansion of the IRS's authority," nor had the agency itself "ever suggest[ed] that it possessed this authority" in the 125 years before. *Id.* at 1021. The question in this case is whether the last vestige of this failed licensing scheme—the PTIN fee intended to fund it—may exist independently of that scheme.

For two reasons, it may not. *First*, the requirements that tax-return preparers obtain and pay for a PTIN were based entirely on the IRS's unauthorized attempt to regulate preparers more broadly, making the fee arbitrary and capricious under the APA. 5 U.S.C. § 706(2)(A). *Second*, even if the fee were not arbitrary or capricious, it is unlawful under the IOAA because Congress did not grant the IRS *any* licensing authority over tax-return preparers, so the fee does not confer a "service or thing of value." 31 U.S.C. § 9701(a). Because neither argument turns on any disputed facts, this Court should grant summary judgment in favor of the plaintiffs.

A. Because the IRS justified the PTIN program based entirely on the agency's unauthorized attempt to regulate tax-return preparers, its collection of PTIN fees is (and was) arbitrary and capricious.

A bedrock principle of "administrative rulemaking is that an agency must give adequate reasons for its decisions." *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2125 (2016). So when an agency changes an existing policy and adopts a new one—as the IRS did when it began requiring tax-return preparers to obtain and pay for a PTIN after doing neither for decades—it "must . . . show that there are good reasons for the new policy." *Id.* at 2126; *see also Williams Gas Processing–Gulf Coast Co. v. FERC*, 475 F.3d 319, 326 (D.C. Cir. 2006); *Brusco Tug & Barge Co. v. NLRB*, 247 F.3d 273, 278 (D.C. Cir. 2001). And those reasons must be "in accord with the

agency's proper understanding of its authority." *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 536 (2009) (Kennedy, J., concurring). If they are not—"if the agency has relied on factors which Congress has not intended it to consider"—then its action must be invalidated as "arbitrary and capricious." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins.*, 463 U.S. 29, 43 (1983).

That is true even if the agency could conceivably have offered some permissible justification for its action. "It is not the role of the courts to speculate on reasons that might have supported an agency's decision." *Encino Motorcars*, 136 S. Ct. at 2127. Quite the opposite: "an agency's action must be upheld, if at all, on the basis articulated by the agency itself." *State Farm*, 463 U.S. at 50; *see also SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947); *Nat'l Mining Ass'n v. Mine Safety & Health Admin.*, 116 F.3d 520, 534 (D.C. Cir. 1997). If a court finds that the agency's "stated rationale for its decision is erroneous, [it] cannot sustain [the agency's] action on some other basis the agency did not mention." *PDK Labs. Inc. v. DEA*, 362 F.3d 786, 798 (D.C. Cir. 2004); *see also MCI Telecomms. Corp. v. FCC*, 10 F.3d 842, 846 (D.C. Cir. 1993) ("A decision resting solely on a ground that does not justify the result reached is arbitrary and capricious."). Thus, a court must "set aside agency regulations"—even those that are "within the agencies' scope of authority"—if they "are not supported by the reasons that the agencies adduce," or if those reasons are impermissible. *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998).

Applying these principles here, the requirements that tax-return preparers obtain and pay for a PTIN may be sustained only if the IRS identified in its rulemaking an acceptable reason for those requirements that is consistent with its delegated authority. It did not come close to doing so. The IRS justified the requirements as necessary only to support its broader effort to regulate tax-return preparers, which Congress did not authorize. *See Loving*, 742 F.3d at 1021–22. Because the requirements that tax-return preparers obtain and pay for a PTIN were "*solely* grounded in" implementing an invalid regulatory scheme—and the IRS did not "articulate *some* valid reason

for the continued application" of the requirement apart from the larger scheme itself—the fees are "arbitrary and capricious under the APA." *Haw. Longline Ass'n. v. Nat'l Marine Fisheries Serv.*, 281 F. Supp. 2d 1, 28–29 (D.D.C. 2003).

1. The only reason the IRS gave for imposing a PTIN requirement was based on the unauthorized regulatory scheme.

Begin with the PTIN requirement. When the IRS created that requirement in 2010, it departed from its four-decades-long policy of allowing tax-return preparers to use their social security number as the identifying number. The reason it did so is no mystery. The IRS imposed the requirement as part of (and in aid of) its unauthorized attempt to regulate the practice of tax-return preparation—an impermissible consideration under the APA.

Even the most deferential reading of the administrative record makes clear that the IRS viewed the requirement as serving only this purpose. Throughout the rulemaking process, the agency repeatedly explained why a new identification system was necessary in light of the new eligibility standards and continuing-education requirements (standards and requirements that have now been struck down as unlawful). Whereas preparers could previously use their social security numbers as identification, the creation of eligibility criteria triggered a need for a number that "only individuals who satisfy the eligibility standards may obtain and use." 75 Fed. Reg. at 14,541. That is why the PTIN requirement was seen as "critical to effective oversight" of tax-return preparers. 75 Fed. Reg. at 60,313. By functioning as a license, it would allow the IRS to monitor and regulate the practice of tax-return preparation, "assign[ing] PTINs only to qualified, competent, and ethical tax return preparers." *Id.* at 60,314–15.

That was the sole impetus for the PTIN requirement, and the sole justification offered by the IRS in creating it. Indeed, in the preamble to the final rule, the IRS identified "two overarching objectives" of the requirement—neither one of which is legitimate under *Loving*. *Id.*

at 60,310. "The first overarching objective," said the agency, was "to provide some assurance to taxpayers that a tax return was prepared by an individual who has passed a minimum competency examination to practice before the IRS as a tax return preparer, has undergone certain suitability checks, and is subject to enforceable rules of practice." *Id.*; *see also* 75 Fed. Reg. at 14,540 (explaining that the PTIN requirement would "allow taxpayers to be confident that the tax return preparers to whom they turn for assistance are knowledgeable, skilled, and ethical"). But *Loving* held that Congress didn't authorize this objective because it did not give the IRS the authority to impose any of these requirements. *See* 742 F.3d at 1015 ("[T]he IRS's statutory authority under Section 330 cannot be stretched so broadly as to encompass authority to regulate tax-return preparers."). Quoting congressional testimony from the National Taxpayer Advocate, the D.C. Circuit explained that the IRS simply "has no authority to license preparers or require basic knowledge about how to prepare returns." *Id.* at 1021. And it wasn't a particularly close call: The court chided the IRS for attempting to assert regulatory power over "hundreds of thousands" of people "through such an expansive, atextual, and ahistorical reading" of its authority, and affirmed the district court's order "permanently enjoin[ing] the tax-return preparers regulations" that imposed the eligibility requirements. *Id.* at 1016, 1021–22. So this first factor, however desirable it might be, lies well outside the bounds of what the agency could permissibly consider in its rulemaking.

The same is true of the "second overarching objective," which the IRS articulated as "further[ing] the interests of tax administration by improving the accuracy of tax returns and claims for refund and by increasing overall tax compliance." 75 Fed. Reg. at 60,310; *see also* 75 Fed. Reg. at 14,540 (explaining that PTIN requirement would "increase tax compliance"). The only way a PTIN could advance this objective, however, is if the IRS had the authority to regulate the practice of tax-return preparation. If so, mandatory PTIN registration would serve

as a mechanism to help exclude preparers deemed unqualified and thus improve the quality of return preparation. But if not (and *Loving* says that the answer is not), then how does the bare issuance of an identifying number in any way improve the accuracy of tax returns or increase compliance? The IRS did not say, and it is hard to imagine how it would. Courts "do not defer to [an] agency's conclusory or unsupported suppositions." *McDonnell Douglas Corp. v. U.S. Dep't of the Air Force*, 375 F.3d 1182, 1186–87 (D.C. Cir. 2004); *see United States Telecom Ass'n v. FCC*, 227 F.3d 450, 460 (D.C. Cir. 2000) ("It is well-established that 'an agency must cogently explain why it has exercised its discretion in a given manner,' and that explanation must be 'sufficient to enable us to conclude that the [agency's action] was the product of reasoned decisionmaking.'"). In short, neither of the IRS's two overarching justifications for the PTIN requirement has any continuing force after *Loving*. And neither can be relied on as a proper basis for exercising rulemaking authority.

Nor has the IRS ever supplied an adequate alternative ground for the requirement. True, a careful reader might note that the preamble contains a passing reference to how PTINs might "help maintain the confidentiality of SSNs." 75 Fed. Reg. at 60,309. But that is all it says. The IRS did not elaborate, let alone explain how the old regime—allowing preparers to use *either* their social security number *or* a PTIN, and to omit this number from the taxpayer's copy of the return—failed adequately to safeguard the confidentiality of social security numbers. At any rate, a stray snippet cannot save a rule from invalidity when its two "overarching justifications" are plainly impermissible. A court will sustain a regulation that includes an impermissible justification only when there is a valid ground for the rule, and the record shows that "the agency would clearly have acted on that ground even if the other were unavailable." *Williams Gas*, 475 F.3d at 330 (quotation marks omitted); *see also Int'l Union, United Mine Workers v. Dep't of Labor*, 358 F.3d 40, 44–45 (D.C. Cir. 2004). The record in this case, if anything, shows the converse. The *only*

reasonable inference is that the IRS would not have required preparers to obtain and pay for a PTIN—consistent with decades of past practice—had the agency been operating on a proper understanding of its authority.

This is not to say that the IRS would necessarily have lacked authority to require a PTIN had it put forth some legitimate reason for doing so. Congress, to be sure, authorized the agency to require preparers to include an "identifying number" on any returns that they prepare. 26 U.S.C. § 6109(a)(4). And, although Congress set the default identifying number as a person's social security number, it authorized the IRS to modify that policy by issuing regulations. *Id.* § 6109(d). But that does not mean that the agency can submit any old reason for exercising its authority. Courts have a duty to "set aside agency regulations" that lack a permissible justification *even if* they are "well within the agencies' scope of authority." *Allentown Mack Sales*, 522 U.S. at 374. By predicating the PTIN requirement on an incorrect "understanding of its authority" to regulate preparers, *Fox*, 556 U.S. at 536 (Kennedy, J., concurring), the IRS relied on factors that Congress did not authorize and hence did not "intend[] it to consider," *State Farm*, 463 U.S. at 43. The PTIN requirement is therefore "arbitrary and capricious" and cannot justify imposition of the fee. *Id.*

2. The IRS offered no justification for imposing a PTIN fee that exists independently of its failed regulatory regime.

The separate regulation authorizing the fee also is inextricably tied to the IRS's failed bid to regulate tax-return preparers. *See* 26 C.F.R. § 300.13. To see why, consider the two main reasons the agency identified for why it decided to begin charging a fee after not doing so in the past. The first was that more people would register for a PTIN because it was now mandatory. Here's how the IRS explained this rationale in its notice of proposed rulemaking: "While the IRS previously issued PTINs to tax return preparers without charging a user fee, the registered tax

return preparer program and the issuance of the new regulations under section 6109 will increase the number of PTIN applications to as many as 1.2 million applications." 75 Fed. Reg. at 43,113. This "increase in demand for PTINs will require the IRS to expend more resources." *Id.* at 43,111. As a factual matter, that is probably right. Creating the requirement after not doing so before would no doubt increase the "demand for PTINs," and this would likely increase the costs. But as a legal matter, the problem is that this justification simply assumes that the PTIN requirement was a valid exercise of the agency's rulemaking authority in the first place. As just discussed, it was not. The IRS cannot use an unauthorized regulatory scheme to bootstrap a registration requirement, and then use that registration requirement to bootstrap a fee. No, the fee must rest on its own bottom.

The second asserted justification confirms why it cannot do so. The IRS intended the fee to fund the larger (unlawful) regulatory regime, expressly relying on the fact that the agency would have to "perform Federal tax compliance checks and perform suitability checks prior to issuance of a PTIN," which would "significantly increase the intricacy of the application process," and thus the cost. *Id.* at 43,113. The IRS elaborated: The process for obtaining a PTIN would "become significantly more expansive and intricate with the implementation of the registered tax return preparer program. Federal tax compliance checks [would] be performed on all individuals who apply for or renew a PTIN. Suitability checks [would] be performed. The IRS [would] further investigate individuals when the compliance or suitability check suggest[ed] that the individual may be unfit to practice before the IRS. These checks were not previously performed as a prerequisite to obtaining a PTIN." *Id.* at 43,111; *see also* 76 Fed. Reg. at 32,296 (breaking down costs the IRS sought to recover with the fee); Rule 56(c) Statement ¶ 35 (showing that 74% of estimated costs recovered by fee would go to background and compliance checks). But the *reason* those checks were not previously performed, *Loving* tells us, is that Congress did not

condone "that vast expansion of the IRS's authority." 742 F.3d at 1021. So any reliance on this factor as justification for the fee is impermissible under the APA. And because the fee lacks any other justification, so is the fee itself.

The Eleventh Circuit's decision in *Brannen v. United States* is not to the contrary. 682 F.3d 1316 (11th Cir. 2012). That case predated *Loving*, and did not involve a challenge to the larger regulatory regime, as *Loving* did. The Eleventh Circuit thus had no occasion to consider the question here: whether the fee could lawfully be charged in the absence of the IRS's attempt to regulate preparers more broadly. Instead, after concluding that the agency had statutory authority to require a PTIN, the Eleventh Circuit simply held that the IOAA granted the IRS the power to charge a PTIN fee, on the theory that the agency "is conferring a special benefit upon the recipient, i.e., the privilege of preparing tax returns for others for compensation." *Id.* at 1319. That theory may have merit if the licensing requirements are taken as a given (as they apparently were in *Brannen*) because then only some people could obtain a PTIN. But take those licensing requirements away—as the D.C. Circuit did in *Loving*—and the IRS's justification for the fee vanishes along with them. That's because, even setting aside the question whether the IRS had *statutory* authority under the IOAA to charge a PTIN fee on the ground that a PTIN provides a "service or thing of value" (a question to which we will next turn), the APA imposes a *separate* requirement that the IRS exercise its authority in a reasonable manner. Once again, the IRS flunked this test. It took the view that, "[b]y limiting the individuals who may prepare all or substantially all of a tax return or claim for refund to individuals who have a PTIN, the IRS is providing a special benefit to the individuals who obtain a PTIN." 75 Fed. Reg. at 60,319. That logic cannot withstand *Loving*. Thus, neither *Brannen* nor the IOAA can rescue the agency from its failure to provide a permissible justification for the fee.

Nor did the IRS even provide a permissible justification when it recalculated the fee after this suit was filed. Although it tried to downplay the original rationale for the PTIN regulations—a means to an unlawful end (occupational licensing)—the IRS did not submit a satisfactory reason for why it required preparers "to provide an identifying number on the return that is not an SSN" and then started charging for it. 80 Fed. Reg. at 66,793. And the agency's attempt to justify the fee is a model of bureaucratic obfuscation. Here it is in its entirety:

> The PTIN user fee is based on direct costs of the PTIN program, which include staffing and contract-related costs for activities, processes, and procedures related to the electronic and paper registration and renewal submissions; tax compliance and background checks; professional designation checks; foreign preparer processing; compliance and IRS complaint activities; information technology and contract-related expenses; and communications. The PTIN user fee also takes into account various indirect program costs, including management and support costs.

Id. at 66,794.

What exactly this means is anyone's guess. Is the IRS continuing to conduct suitability testing even after *Loving*? If so, what gives it the statutory authority to do so? If not, and the vast majority of PTIN fees previously went to professional certification and suitability checks, then what is the IRS now doing with the money? And what is it doing with the information it collects? And if Accenture does everything necessary to issue a PTIN, then what benefit is the government providing to tax-return preparers? Regardless, courts may not accept "*post hoc* rationalizations for agency action"—particularly those offered once litigation is underway. *State Farm*, 463 U.S. at 50.[3] And because the PTIN program was clearly created to effectuate an unlawful licensing scheme, that program cannot satisfy the APA.

[3] Here, the IRS's explanation is not only a *post hoc* attempt to rewrite history, but a deliberately opaque one—emblematic of what one writer has described as the IRS's strategic use of "verbless bureaucratese." *See* David Foster Wallace, *The Pale King* 83–84 (2011) ("It is impossible to overstate the importance . . . from the Service's perspective of the dull, the arcane, the mind-numbingly complex. The IRS was one of the very first government agencies to learn

The IRS itself has acknowledged the interdependency of the PTIN fees and its failed tax-preparer licensing scheme. Indeed, the IRS thought that the natural consequence of invalidating the licensing scheme in *Loving* was to invalidate the PTIN program created to facilitate and finance that scheme. As the IRS emphasized in *Loving*, "[t]he PTIN program and the registered tax-return-preparer program are closely linked," Ex. 11 at 18, in that they were created by "overlapping regulations" and share a common origin, purpose, computer system, and operating budget, Ex. 10 at 6–7. Although the injunction in *Loving* did not formally cover the PTIN program, that was because the plaintiffs in that case disavowed any challenge to the "requirement that each tax-return preparer obtain" and pay for a PTIN. *Loving v. IRS*, 920 F. Supp. 2d 108, 109 (D.D.C. 2013). Even with that disavowal, however, the IRS told the D.C. Circuit that affirming the district court's injunction would require the agency to "shut[] down the PTIN application system" and rebuild it. Ex. 16, ¶ 7. A sworn declaration from the director of the Return Preparer Office went further, saying that "[t]he combined PTIN and competency testing user fees" could "only be spent on *the registered tax return preparer program*." *Id.* ¶ 12 (emphasis added). That program effectively no longer exists; the fees shouldn't either. Just as the IRS refunded the competency-testing fees after *Loving*, it should now be made to do the same for the PTIN fees.

B. Because Congress did not grant the IRS *any* licensing authority over tax-return preparers, the PTIN fee does not confer a "special benefit" and is unlawful under the IOAA.

The PTIN fee is unlawful for a second, independent reason: It is unauthorized by the IOAA, which permits agencies to charge a user fee for "each service or thing of value provided by [the] agency." 31 U.S.C. § 9701(a). In interpreting this statute, the Supreme Court has "read

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that such qualities help insulate them against public protest and political opposition, and that abstruse dullness is actually a much more effective shield than is secrecy.")

the Act narrowly to avoid constitutional problems." *Nat'l Cable Television Ass'n, Inc. v. United States*, 415 U.S. 336, 341–42 (1974); *see Fed. Power Comm'n v. New England Power Co.*, 415 U.S. 345 (1974); *see also Nat'l Ass'n of Broadcasters v. FCC*, 554 F.2d 1118, 1129 n.28 (D.C. Cir. 1976). Because agencies cannot impose taxes on their own—that is the job of Congress, and Congress alone—any user fee that an agency charges under the IOAA must be "for a service that confers a specific benefit upon an identifiable beneficiary," as opposed to the public at large, and must be strictly limited to the costs of providing that service. *Engine Mfrs. Ass'n v. EPA*, 20 F.3d 1177, 1180 (D.C. Cir. 1994). As the Supreme Court long ago explained, a fee (unlike a tax) "connotes a 'benefit,'" and "is incident to a voluntary act"—the paradigmatic example being "a request that a public agency permit an applicant to practice law or medicine or construct a house or run a broadcast station." *Nat'l Cable Television Ass'n*, 415 U.S. at 340–41. Under the IOAA, the agency that provides those specialized services "normally may exact a fee" because it "bestows a benefit on the applicant, not shared by other members of society." *Id.* But an agency may not impose fees solely to fund its general operations, for that would take the agency "far from its customary orbit and put[] it in search of revenue in the manner of an Appropriations Committee of the House." *Id.* at 341. The IOAA's goal is to make agency programs conferring benefits on recipients "self-sustaining to the extent possible." 31 U.S.C. § 9701(a). It is not to turn them into profit centers to fund agency activities more broadly.

In the context of licensing, the D.C. Circuit has laid down the governing framework for courts to apply when "deciding whether an agency may exact a fee" under the IOAA. *Seafarers Int'l Union of N. Am. v. U.S. Coast Guard*, 81 F.3d 179, 185 (D.C. Cir. 1996). The court should first "turn to the relevant statute to determine the substantive requirements underlying the license. Then, the proper inquiry is whether the actual licensing procedures adopted by the agency are

sufficiently related to the statutory criteria to justify assessing a fee." *Id.* If so, the agency may charge "a user fee for license applicants." *Id.* at 186. Otherwise, it may not. *Id.*

Under this framework, an agency "charged with ensuring that all those receiving licenses meet certain job-related eligibility criteria . . . may exact a fee for administering any procedures reasonably necessary to ensure that those particular eligibility criteria have been met." *Id.* at 185; *see also Engine Mfrs. Ass'n*, 20 F.3d at 1180 ("In a regulated industry, a certificate of approval is deemed a benefit specific to the recipient."). And, sure enough, that is what the IRS was trying to do when it created the tax-preparer licensing regime. It justified the PTIN fee by pointing to the fact that "only a subset of the general public is entitled to a PTIN and the special benefit of receiving compensation for the preparation of a return that it confers." 75 Fed. Reg. at 60,317. The agency was clear on this score: "By limiting the individuals who may prepare all or substantially all of a tax return or claim for refund to individuals who have a PTIN, the IRS is providing a special benefit to the individuals who obtain a PTIN." *Id.* at 60,319; *see also id.* at 60,317 ("Having a PTIN is a special benefit that allows *specified* tax return preparers to prepare all or substantially all of a tax return or claim for refund for compensation.") (emphasis added). In other words, by creating eligibility criteria, the agency would use the PTIN as a licensing requirement that would bestow on certain people "the ability to prepare all or substantially all of a tax return or claim for refund." 75 Fed. Reg. at 43,112.

But as *Loving* makes clear, Congress never "authorized a license requirement." *Seafarers*, 81 F.3d at 186; *see Loving*, 742 F.3d at 1021 ("[T]he IRS currently has no authority to license preparers or require basic knowledge about how to prepare returns."). And "it should be clear that an agency is not free to add [unauthorized] licensing procedures and then charge a user fee merely because the agency has general authority to regulate in a particular area." *Seafarers*, 81 F.3d at 186. That is what happened here. As the IRS concedes, there are now *no* "requirements

or restrictions" on who may obtain a PTIN. *See* ECF No. 50, at 10. So it is no longer the case that "only a subset of the general public is entitled to a PTIN and the special benefit of receiving compensation for the preparation of a return that it confers." 75 Fed. Reg. at 60,317. *Anyone* can get a PTIN. And they can do so in a matter of minutes. *See* IRS, *PTIN Requirements for Tax Return Preparers*, http://bit.ly/2bMMUUG ("Most first-time PTIN applicants can obtain a PTIN online in about 15 minutes.").

Although the IRS issued an updated regulation last month reducing the amount of the fee (apparently in response to this lawsuit), it did not put forth an intelligible justification for the fee—much less one that could survive *Loving*. The final updated regulation said simply: "The ability to prepare tax returns and claims for refund for compensation is a special benefit, for which the IRS may charge a user fee to recover the full costs of providing the special benefit." 81 Fed. Reg. at 52,766. But, again, the IRS has no power to confer this "ability" because it has no licensing authority. *Cf. Horn Farms, Inc. v. Johanns*, 397 F.3d 472, 479 (7th Cir. 2005) ("[W]hen no agency stands as a gatekeeper to a proposed private activity, there is no 'license' either."); 5 U.S.C. § 551(8) (defining "license" under the APA as "an agency permit, . . . approval, . . . *or other form of permission*.") (emphasis added). At most, the IRS may have the authority to require preparers to include an "identifying number" on the forms that they prepare, and to switch this number from the default number (social security) to something else, so long as there is good reason for doing so. But even assuming that the IRS had managed to muster a good reason here (and it did not), that reason would benefit only the agency and the general public that it serves, not the individual preparer. As the IRS put it during the rulemaking process: PTINs would "be used to collect and track data on tax return preparers," which "will provide important *benefits to the IRS*." 75 Fed. Reg. at 43,113 (emphasis added); *see also id.* at 43,110 ("Requiring registration through the use of PTINs *will enable the IRS* to better collect and track data on tax return

preparers."). Of course, now that the licensing scheme has been invalidated, it is doubtful that requiring preparers to obtain and pay for a PTIN provides any benefit to anyone. But to the extent that it does, the benefit is the IRS's alone. That makes the fee impermissible under the IOAA.

II. Should the Court conclude that the IRS lawfully charged a PTIN fee, the case would then proceed to a determination of the amount by which the fee exceeded the costs of issuing a PTIN.

For all the reasons given above, the IRS's collection of PTIN fees was unlawful. If the Court agrees, then the next step is obvious: the IRS has already conceded that every class member "will be entitled to a [full] refund of the PTIN fees they have paid to date." ECF No. 51, at 2. The IRS issued refunds for the testing fees after *Loving*, *see* IRS, *Registered Tax Return Preparer Test Fee Refunds*, http://bit.ly/2c2rFf7, and there is no reason not to follow a similar course here.

But should the Court disagree and conclude instead that the IRS lawfully charged the PTIN fee, the case would then proceed to discovery on our alternative theory that the fee (even if lawfully imposed) unlawfully exceeded the costs of providing a PTIN. Whatever special service the IRS supposedly confers on people who pay PTIN fees, the agency "may not charge more than the reasonable cost it incurs to provide [that] service." *Engine Mfrs. Ass'n*, 20 F.3d at 1180; *see Seafarers*, 81 F.3d at 185 ("[T]he measure of fees is the cost to the government of providing the service."). "Once agency charges exceed their reasonable attributable cost they cease being fees and become taxes levied, not by Congress, but by an agency," which is "prohibited." *Nat'l Ass'n of Broadcasters*, 554 F.2d at 1129 n.28. The IRS was thus under an obligation to "calculate the cost basis for the fee by allocating its direct and indirect expenses to the smallest practical units of service provided," *Engine Mfrs. Ass'n*, 20 F.3d at 1181, and to provide a "public explanation of the specific expenses included in the cost basis for a particular fee, and an explanation of the criteria used to include or exclude particular items." *Electronic Indus. Ass'n v. FCC*, 554 F.2d 1109, 1117

(D.C. Cir. 1976). On this point, the IRS has already effectively acknowledged that the fee was too high, issuing an "updated" regulation after this case was filed lowering the fee to $50 total. So the case would focus more on damages than liability, and the IRS would have to show that even this new amount is necessary to recoup the costs of issuing a number.

Fortunately, however, there is a much more straightforward path, and it is the one the Court should follow here: Because the IRS left no doubt about why it wanted to create a new requirement that preparers obtain and pay for a PTIN—to effectuate a regulatory program that it had no power to erect in the first place—this Court should declare the fees unlawful and order the IRS to send them back to whom they belong.

CONCLUSION

The plaintiffs' motion for summary judgment should be granted. The Court should declare the PTIN fee unlawful and issue an injunction preventing its continued collection, as well as award the plaintiffs a refund of the full amount that they have paid in PTIN fees to date. The Court should also order the parties to meet and confer and to prepare a plan regarding subsequent proceedings in this case, including a plan to determine the amount owed to each class member.

Respectfully submitted,

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September 7, 2016

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CERTIFICATE OF SERVICE

I hereby certify that on September 7, 2016, I electronically filed this motion for summary judgment through this Court's CM/ECF system. I understand that notice of this filing will be sent to all parties by operation of the Court's electronic filing system.

/s/ William H. Narwold
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