1000 Friends of Oregon v. McPherson
89-1 USTC 9217, 63 AFTR2d 89-563 (D. Oreg. 1988)

[89-1 USTC ¶9217] 1000 Friends of Oregon, Oregon Small Woodlands Association, Washington Farm Forestry Association, Forest Landowners of California, and National Woodland Owners Association, Plaintiffs v. M. Peter McPherson, acting in his official capacity as Secretary of the Treasury of the United States, and Lawrence B. Gibbs, in his official capacity as Commissioner of the Internal Revenue Service of the United States, Defendants U.S. District Court, Dist. Ore., Civ. CV 88-0702-PA, 12/20/88

[*Code Sec. 7421*]

Assessment and collection: Injunction: Anti-Injunction Act: Irreparable harm: Timber property: Passive activity loss regulations.--An action by timber associations seeking an injunction that would require the IRS to prepare an environmental impact study and to obtain court approval before adopting passive activity loss regulations was barred by the Anti-Injunction Act. The action questions the validity of a treasury regulation and affects the assessment and collection of taxes. The associations argued that they would not be considered as materially participating in timber operations, currently incurred timber expenses would not be recovered for 40 to 80 years when income is received from a timber harvest, and members would have to convert property to nontimber uses or discontinue necessary annual expenditures to the detriment of the environment. BACK REFERENCES: 89FED ¶5779.745

Neil S. Kagan, 300 Willamette Bldg., Kevin Q. Davis, Stoel, Rives, Boley, Jones & Grey, 900 S.W. Fifth Ave., Portland, Ore. 97204, for plaintiffs. Charles H. Turner, United States Attorney, Portland, Ore. 97205, Stuart D. Gibson, Celia Campbell-Mohn, John Gregory, Department of Justice, Washington, D.C. 20530, for defendants.

OPINION

PANNER, District Judge:

Plaintiffs 1000 Friends of Oregon, Oregon Small Woodlands Association, Washington Farm Forestry Association, Forest Landowners of California, and National Woodland Owners Association bring this action for declaratory, injunctive, and mandatory relief against defendants M. Peter McPherson, Acting Secretary of the Treasury, and Lawrence B. Gibbs, Commissioner of the Internal Revenue Service (IRS). Plaintiffs contend that IRS "passive activity" regulations will force their members who own forest land to convert their property to nontimber uses or discontinue management practices. Plaintiffs argue that because of these alleged environmental effects, defendants must prepare an Environmental Impact Statement (EIS) to comply with the National Environmental Policy Act of 1969 (NEPA), 42 U.S.C. §§4321--4370a.

Defendants move to dismiss, contending that the Anti-Injunction Act, 26 U.S.C. §7421(a), bars injunctive relief; the federal tax exception to the Declaratory Judgment Act, 28 U.S.C. §2201, bars declaratory relief; and neither the Administrative Procedures Act (APA), 5 U.S.C. §706, nor the mandamus statute, 28 U.S.C. §1361, confer jurisdiction. I grant defendants' motion

to dismiss for lack of subject matter jurisdiction.

BACKGROUND

Defendants' passive activity regulations are based on section 469 of the Internal Revenue Code, which eliminates the incentives for most traditional tax shelters. *United States v. Rosengarten*, 857 F.2d 76, 77 (2d Cir. 1988). Section 469 allows a taxpayer to deduct current "passive activity losses" only when (1) the taxpayer's passive activity produces net income, I.R.C. §469(b), or (2) the taxpayer "disposes of his entire interest" in the passive activity, *id.* at §469(g). A taxpayer cannot use passive activity losses to offset income from other sources such as salary or dividends.

> "Passive activity" is any activity
>
> (A) which involves the conduct of any trade or business, and
>
> (B) in which the taxpayer does not materially participate.

Id. at 469(c)(1). A taxpayer "materially participates" in an activity only if the taxpayer is involved in the operations of the activity on a basis which is

> (A) regular,
>
> (B) continuous, and
>
> (C) substantial.

Id. at §469(h)(1). A passive activity loss is the amount by which aggregate annual losses from all passive activities exceeds the aggregate income from all passive activities. *Id.* at §469(d)(1).

The disputed temporary regulations state that a taxpayer materially participates in an activity if:

> (1) The individual participates in the activity for more than 500 hours during [the taxable year];
>
> (2) The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year;
>
> (3) The individual participates in the activity for more than 100 hours during the taxable year, and such individual's participation in the activity for the taxable year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year;
>
> (4) The activity is a significant participation activity . . . for the taxable year, and the individual's aggregate participation in all significant participation activities during such

year exceeds 500 hours;

(5) The individual materially participated in the activity . . . for any five taxable years (whether or not consecutive) during the ten taxable years that immediately precede the taxable year;

(6) The activity is a personal service activity . . . and the individual materially participated in the activity for any three taxable years (whether or not consecutive) preceding the taxable years; or

(7) Based on all of the facts and circumstances . . . the individual participates in the activity on a regular, continuous, and substantial basis during such year.

Treas. Reg. §1.469-5T(a).

Plaintiffs allege the following. Plaintiffs' members spend up to $20 per acre annually on "site preparation, seedling release, thinning, road maintenance, depreciation of equipment, insurance, taxes, consulting fees, attorney fees, and tax preparation fees." Plaintiffs incur timber-related expenses each year but must wait 40 to 80 years before receiving income from a timber harvest. Plaintiffs' members usually work fewer than 100 hours a year on their property and often hire consultants and contractors. Under the passive activity regulations, their timber-related expenses are not deductible until they receive income from a harvest. Defendants' regulations will force many landowners to convert forest land to other uses or abandon sound management. This will cause degraded water supplies, reduced wildlife diversity, and increased risk of fire on almost 10 million acres of private forest land.

Plaintiffs request declaratory judgments that (1) defendants have violated NEPA by promulgating the passive activity regulations and (2) the regulations are inconsistent with section 469; and injunctions (1) requiring that defendants prepare an EIS on the effect of the regulations and (2) prohibiting defendants from adopting permanent regulations until they show compliance with NEPA.

DISCUSSION

I. The Anti-Injunction Act

Plaintiffs request injunctions requiring defendants to prepare an EIS and to obtain court approval before adopting permanent passive activity loss regulations. Defendants contend that such relief would violate the Anti-Injunction Act, I.R.C. §7421(a).

The Anti-Injunction Act provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person." *Id.* (omitting exceptions not relevant here). Congress drafted the Anti-Injunction Act "to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to disputed sums be determined in a suit for refund." *Enochs v. Williams Packing & Navigation Co.* [62-2 USTC ¶9545], 370 U.S. 1, 6 (1962). A suit barred by the Anti-Injunction

Act "may not be entertained merely because collection would cause an irreparable injury, such as the ruination of the taxpayer's enterprise." *Id.*

Courts have created two exceptions to the Anti-Injunction Act. First, the Act does not apply when the government cannot prevail under any circumstances and the plaintiff has shown irreparable harm. *Roat v. Commissioner* [88-1 USTC ¶9364], 847 F.2d 1379, 1383 (9th Cir. 1988). Second, the Act does not apply when Congress has not given the plaintiff a legal remedy to challenge the tax's validity. *South Carolina v. Regan* [84-1 USTC ¶9241], 465 U.S. 367 (1984).

Plaintiffs do not contend that judicial or statutory exceptions to the Anti-Injunction Act apply. Rather, they argue that the Act itself does not apply because the injunctive relief they seek will not restrain the collection or assessment of any tax. Plaintiffs contend that the injunctions they request would prevent only the promulgation of *permanent* passive activity regulations, while leaving the temporary regulations unaffected. Plaintiffs argue that defendants could collect and assess taxes under the temporary regulations while defendants prepare an EIS on the effect of permanent regulations.

However, plaintiffs also state that their claims for injunctive relief "are related to the claim for declaratory relief with respect to NEPA." Plaintiffs' Memorandum in Response at 10 n.2. Plaintiffs request a judgment declaring that defendants have violated NEPA. If I were to grant plaintiffs' claims for injunctive and declaratory relief under NEPA, defendants could not assess and collect taxes under either the temporary or the permanent regulations. Several cases, though not directly on point, have addressed similarly ingenious attempts to attack Treasury regulations while dodging the Anti-Injunction Act.

In *Educo, Inc. v. Alexander* [77-2 USTC ¶9542], 557 F.2d 617 (7th Cir. 1977), the plaintiff designed and administered employee education programs. When the IRS issued revenue rulings that effectively eliminated the market for the plaintiff's services, the plaintiff brought an action to require the IRS to withdraw or modify its rulings. The plaintiff contended that the Anti-Injunction Act did not bar its action. The court disagreed, holding that the plaintiff's attempt

> to define the relief it seeks in terms permitted by the Anti-Injunction Act ignores the ultimate deleterious effect such relief would have on the Government's taxing ability. If Educo were successful in obtaining an injunction, numerous taxpayers would benefit by receiving a reduction of their tax liability. Indeed, Educo would not be interested in obtaining injunctive relief if that relief did not effectively restrain the taxation of its clients under Revenue Ruling 75-448. While the end sought by this action is not directed expressly at assessments, the means to the end, *i.e.*, the withdrawal of the Revenue Ruling, would have this result. Therefore, Educo's argument that this suit is not precluded by the Anti-Injunction Act must be rejected.

Other courts also have interpreted the reach of the Anti-Injunction Act broadly. In *McCarthy v. Marshall* [84-1 USTC ¶9141], 723 F.2d 1034 (1st Cir. 1983), the plaintiffs, pension trustees, sought a declaration invalidating a Department of Labor regulation that required the Secretary of Labor to give credit to employees for hours worked even though their employers had not contributed to the fund. The regulation affected the status of plaintiffs' pension fund under the

tax code. The court held that the Anti-Injunction Act barred the plaintiffs' claim because the claim "called into question a specific provision of the Internal Revenue Code, or . . . a ruling or regulation issued under the Code." *Id.* at 1037. See also *Zimmer v. Connett* [81-1 USTC ¶9223], 640 F.2d 208, 209-10 (9th Cir. 1981) (plaintiffs' action to compel the IRS to hold a hearing before inspecting the plaintiffs' books barred because it "could very well have the effect of interrupting the process of assessment of taxes by the Service, an effect similar to that of an injunction").

I conclude that plaintiffs' claims are barred by the Anti-Injunction Act. As in *Educo,* plaintiffs would not have brought this action if the relief sought would not prevent defendants from assessing and collecting taxes. As in *McCarthy,* plaintiffs' claims question a specific ruling or regulation issued under the Internal Revenue Code. Even if I considered the claim for injunctive relief separately from the claim for declaratory relief, I would still find that both claims are barred by the Act. Both claims question the validity of a Treasury regulation.

Plaintiffs have camouflaged an attempt to enjoin the assessment and collection of taxes as an NEPA action. Plaintiffs' allegations of environmental harm are inextricably linked to defendants' assessment and collection of taxes under the disputed regulations. Plaintiffs' remedies are to bring a refund action, claim a deduction and contest it, or lobby Congress for an exemption from the passive activity statutes.

At oral argument, plaintiffs argued that members of plaintiff 1000 Friends who do not own timber property could not bring an action for a refund or contest a denied deduction. However, the Anti-Injunction Act will bar an action even if the plaintiff is not the taxpayer. See *California v. Regan* [81-1 USTC ¶9335], 641 F.2d 721, 722 (9th Cir. 1981).

II. Declaratory Judgment Act

Plaintiffs request declaratory judgments that the IRS violated NEPA by promulgating the passive activity regulations, and that the temporary regulations are inconsistent with I.R.C. §469.

The Declaratory Judgment Act grants federal courts jurisdiction to declare the rights and legal relations between parties to an actual controversy "except with respect to Federal taxes." 28 U.S.C. §2201. The Anti-Injunction Act and the Declaratory Judgment Act have the same reach. See *California v. Regan,* 641 F.2d at 723.

In *Califorina v. Regan,* California challenged a federal statute that required it to file an annual information return with the IRS pursuant to the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§1001-1461. The IRS contended that the suit was barred by the Anti-Injunction Act and by the federal tax exception to the Declaratory Judgment Act, 28 U.S.C. §§2201-2202. The Ninth Circuit stated that the case concerned

> a controversy with respect to federal taxes within the meaning of the Declaratory Judgment Act. The required information return includes data which allows the IRS to determine whether a pension plan is "qualified" under 26 U.S.C. §401(a). . . . A qualified plan confers favorable tax treatment on its beneficiaries. . . . The filing requirement will have an impact

on the assessment of federal taxes.

Id. at 722 (citations omitted). Because California's challenge to the reporting requirement would have indirectly affected the assessment of taxes, the district court lacked jurisdiction to issue a declaratory judgment.

Similarly, plaintiff's action here would affect the assessment and collection of taxes. I lack subject matter jurisdiction to issue a declaratory judgment.

III. Administrative Procedure Act (APA) Claims

Plaintiffs contend that subject matter jurisdiction exists under the APA, 5 U.S.C. §706, and 28 U.S.C. §1331(). The parties agree that if the Anti-Injunction Act bars this action, the APA will not create jurisdiction.

IV. Mandamus Claims

Plaintiffs request a mandatory injunction requiring defendants to prepare an adequate EIS and an injunction prohibiting defendants from adopting permanent passive activity regulations until defendants show that they have complied with NEPA.

Under 28 U.S.C. §1361,

> The district courts shall have original jurisdiction of any action in the nature of mandamus to compel an officer or employee of the United States or any agency thereof to perform a duty owed to the plaintiff.

The court may grant mandamus relief when "(1) the plaintiff's claim is clear and certain; (2) the duty is 'ministerial and so plainly prescribed as to be free from doubt'; and no other adequate remedy is available." *Agcaoili v. Gustafson*, 844 F.2d 620, 625 (9th Cir. 1988) (quoting *Fallini v. Hodel*, 783 F.2d 1343, 1345 (9th Cir. 1986)).

Defendants argue that plaintiffs have adequate alternative legal remedies because plaintiffs can file tax returns claiming deductions, and bring an action in the Tax Court when the IRS disallows their deductions, or pay their taxes and bring an action for a refund.

Plaintiffs contend that the legal remedies defendants suggest are inadequate because those remedies will not compel the IRS to consider the environmental effects of the regulations as soon as possible, and because the complaint covers not only landowners who will lose their deductions, but also landowners who will convert forest land to nonforest uses rather than lose deductions.

I agree with defendants that plaintiffs' legal remedies are adequate. If plaintiffs successfully challenge the passive activity regulations, they will achieve the result they seek here.

CONCLUSION

Defendants' motion to dismiss plaintiffs' claims for injunctive, declaratory, and mandamus relief for lack of subject matter jurisdiction is granted.

ORDER

Defendants' motion to dismiss plaintiffs' claims for injunctive, declaratory, and mandamus relief for lack of subject matter jurisdiction is GRANTED.

IT IS SO ORDERED.