

Mann Construction Plaintiffs Take IRS Back to Court

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A Michigan couple who successfully challenged a listed transaction notice claims in a new lawsuit that the IRS is refusing to issue penalty refunds for later tax years, despite the Sixth Circuit's holding that the notice is invalid.

Lee and Debbie Coughlin are entitled to refunds of [section 6707A](#) penalties they paid for tax years 2014 through 2016, the couple asserts in a [March 18 complaint](#) (*Coughlin v. United States*) filed in the U.S. District Court for the Eastern District of Michigan.

The dispute is related to an earlier refund suit, *Mann Construction Inc. v. United States*, filed by the Coughlins and another couple, Brook and Kimberly Wood, that addressed [section 6707A](#) penalties for tax year 2013.

The couples [prevailed against the IRS](#) in the Sixth Circuit's [March 3 opinion](#) in *Mann*, which held that [Notice 2007-83](#), 2007-45 IRB 960, is invalid because the IRS issued it without notice or comment as required by the Administrative Procedure Act (APA).

That October 2007 notice designated cash value life insurance trusts as listed transactions requiring disclosure by transaction participants. According to the IRS, an arrangement involving a death benefit trust and a restricted property trust that Mann Construction Inc. established in 2013 fit the description of the transaction flagged in the notice.

The company and its owners, Lee Coughlin and Brook Wood, therefore should have disclosed their participation in the transaction, the IRS said. After the agency assessed [section 6707A](#) penalties against Mann and its owners for tax years 2013 through 2017, the taxpayers paid the penalties for 2013 and in May 2020 filed a refund suit in the Michigan district court.

In a [May 2021 decision](#), the district court rejected the taxpayers' claim that the IRS had no authority to impose penalties because Notice 2007-83 was invalidly promulgated under the APA. The court agreed with the Justice Department that the legislative history of [section 6707A](#) and associated Treasury regulations showed that Congress clearly intended to create a reporting regime for the IRS to combat abusive transactions without subjecting the agency to APA notice and comment requirements.

Reversing the district court, the Sixth Circuit's March 3 opinion held that the Justice Department failed to show that Congress "expressly" exempted the IRS from complying with APA rulemaking, as required by 5 U.S.C. section 559. "Because the IRS's process for issuing Notice 2007-83 did not satisfy the notice-and-comment procedures for promulgating legislative rules under the APA, we must set it aside," the opinion said.

Refunds: Part Two

In the Coughlins' March 18 complaint, the couple notes that penalties for tax year 2013 were the only ones at issue in the *Mann* litigation.

The complaint says that after the IRS failed to respond to the couple's August 2019 qualified offer under [section 7430](#), the Coughlins paid the penalties for tax years 2014 through 2016 and filed a Form 843 refund claim.

"Despite the Sixth Circuit's ruling entitling Plaintiffs to a refund of the [section 6707A](#) penalty for Tax Year 2013, the IRS refuses to issue Plaintiffs a refund for the [section 6707A](#) penalties for Tax Years 2014-2016," the complaint says. "The IRS's refusal to issue this refund is not substantially justified, as defined in [26 U.S.C. section 7430](#)."

The complaint asks the court to issue an order requiring the IRS to refund the penalty amounts the Coughlins paid for 2014 through 2016, as well as an order directing the IRS to rescind a penalty assessed for 2017. The filing demands a jury trial on all triable issues.

Press Pause?

Given that the Justice Department hasn't announced whether it plans to appeal the Sixth Circuit's *Mann* opinion, it is unlikely that the IRS will immediately issue a refund to the plaintiffs for 2013, Mary E. Wood of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP told *Tax Notes*.

In turn, the Justice Department may ask the district court to stay the new refund suit pending a final determination regarding any challenge of the circuit court's ruling, said Wood, who isn't involved in the case.

If the government decides not to appeal, or if it is ultimately unsuccessful in any challenge, the IRS will be required to refund the penalties at issue in *Mann* for tax year 2013 — minus any offset issues — and "the district court will almost certainly rule in favor of the plaintiffs in the later years," Wood said.

"It would not be surprising if the IRS continues to vigorously oppose APA-related defenses until additional circuit courts rule on the issue or the Supreme Court grants a petition for certiorari and renders an opinion," Wood said.

While the ramifications of the *Mann* opinion and the Justice Department's March 21 [district court loss](#) in *CIC Services LLC v. IRS* play out, taxpayers and advisers "would be wise to preserve APA arguments in connection with any pending listed transaction penalties and to timely file refund claims or protective refund claims for listed transaction penalties previously paid," Wood said.

The plaintiffs in *Coughlin v. United States*, No. 1:22-cv-10583 (E.D. Mich.), are represented by Matthew C. Miller of Weston Hurd LLP.