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 Facebook, Inc. and Subsidiaries

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 9 UNITED STATES DISTRICT COURT
 10 NORTHERN DISTRICT OF CALIFORNIA
 11 SAN FRANCISCO DIVISION

12 FACEBOOK, INC. AND SUBSIDIARIES,
 13 Plaintiff,
 14 v.
 15 INTERNAL REVENUE SERVICE, and
 16 JOHN KOSKINEN, in his official capacity as
 17 Commissioner of Internal Revenue,
 18 Defendants.

Case No.: _____

**COMPLAINT FOR DECLARATORY
 AND INJUNCTIVE OR MANDAMUS-
 LIKE RELIEF**

1 **COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

2 1. Facebook, Inc. (“Facebook”) brings this action against the Internal Revenue Service
3 (the “IRS”) and the Commissioner of Internal Revenue, seeking declaratory judgment that the IRS
4 unlawfully issued Revenue Procedure 2016-22 and that the IRS unlawfully denied Facebook its
5 statutory right to access an independent administrative forum. Facebook also requests injunctive
6 relief from the IRS’s unlawful position, or action in the nature of mandamus to compel the IRS to
7 provide Facebook access to an independent administrative forum.

8 **JURISDICTION AND VENUE**

9 2. Jurisdiction is proper under 5 U.S.C. §§ 702-706 (Administrative Procedure Act), 28
10 U.S.C. § 1331 (federal question jurisdiction under Judicial Code of 1948), and 28 U.S.C. § 1361
11 (Mandamus and Venue Act of 1962), and this Court has authority to grant the relief requested under
12 28 U.S.C. §§ 2201, 2202. *See also Parola v. Weinberger*, 848 F.2d 956, 958 (9th Cir. 1988).

13 3. Venue is proper in this Court under 28 U.S.C. § 1391(e)(1) because the Defendants
14 are officers and agencies of the United States and a substantial part of the events or omissions giving
15 rise to the claim occurred in this judicial district.

16 **THE PARTIES**

17 4. Facebook is a corporation, organized under the laws of the state of Delaware.
18 Facebook’s principal place of business is located in Menlo Park, California.

19 5. Defendant Internal Revenue Service is an executive agency of the United States
20 within the meaning of the Administrative Procedure Act (“APA”), 5 U.S.C. §§ 551 and 701(b)(1),
21 and a bureau of the United States Department of Treasury, located in Washington, D.C.

22 6. Defendant John Koskinen is the Commissioner of the Internal Revenue Service. He
23 is being sued in his official capacity. He serves as the head of the IRS in Washington, D.C.

24 **THE STATUTORY REGIME AND PERTINENT ADMINISTRATIVE RULES**

25 Right to An Independent Review at the IRS Office of Appeals

26 7. A taxpayer’s right to obtain independent review of an IRS decision in an
27 administrative forum is grounded in multiple statutory provisions. The Commissioner is required to
28 ensure employees of the IRS act in accordance with a taxpayer’s “right to appeal a decision of the

1 Internal Revenue Service in an independent forum.” 26 U.S.C. § 7803(a)(3)(E). Further, the
2 Commissioner is required to establish procedures under which taxpayers may access alternative
3 dispute resolution mechanisms through the IRS’s independent Office of Appeals (“IRS Appeals”).
4 26 U.S.C. §§ 7123(b).

5 8. The Internal Revenue Service Restructuring and Report Act of 1998, specifically
6 required the Commissioner to “ensure an independent appeals function within the Internal Revenue
7 Service.” Pub. L. 105-206 § 1001(4), 112 Stat. 685, 689.

8 9. The IRS states the mission of IRS Appeals is to “resolve tax controversies, without
9 litigation, on a basis which is fair and impartial to both the Government and the taxpayer in a manner
10 that will enhance voluntary compliance and public confidence in the integrity and efficiency of the
11 Service.” IRS Website, Appeals – An Independent Organization, accessed March 14, 2017.

12 10. The Congressional mandate for an independent appeals function in the Internal
13 Revenue Service Restructuring and Report Act of 1998, or other statutes, did not distinguish
14 administrative tax controversies from litigated tax controversies docketed in the U.S. Tax Court.

15 11. The applicable U.S. Treasury Department regulations explicitly provide for IRS
16 Appeals settlement authority in both administrative and docketed tax controversies. 26 C.F.R.
17 § 601.106(a)(1).

18 12. The U.S. Treasury Department’s regulations provide that after the filing of a petition
19 in the Tax Court, IRS district counsel will refer the matter to IRS Appeals, and the IRS Appeals
20 office will have exclusive settlement jurisdiction, subject to certain specific exceptions, for a period
21 of four months, over cases docketed in the Tax Court. 26 C.F.R. § 601.106(a)(1).

22 13. The IRS Office of Chief Counsel (“IRS Counsel”) represents the IRS in litigation.

23 14. Effective May 5, 2012, the IRS issued Revenue Procedure 2012-18 which stated that
24 IRS Counsel and IRS Appeals share a responsibility to interact—in all circumstances—in a manner
25 that preserves and promotes IRS Appeals’ independence.

26 15. On March 23, 2016, the IRS released Revenue Procedure 2016-22, 2016-15 I.R.B. 1
27 (“Rev. Proc. 2016-22”) “to clarify and describe the practices for the administrative appeals process
28 in cases docketed in the United States Tax Court (Tax Court).” Rev. Proc. 2016-22 states that it

1 applies to all cases docketed in U.S. Tax Court pending on or after March 23, 2016, and supersedes
2 its predecessor, Rev. Proc. 87-24, 1987-1 C.B. 720.

3 16. Rev. Proc. 2016-22 changed IRS practice by, for the first time, providing IRS
4 Counsel the unilateral ability to deny a taxpayer access to IRS Appeals in a docketed tax case when
5 Division Counsel (a component of IRS Counsel) or a higher level IRS Counsel official “determines
6 that referral is not in the interest of sound tax administration.”

7 17. Rev. Proc. 2016-22 does not define “sound tax administration” or provide criteria to
8 be used by IRS Counsel to deny access to IRS Appeals, other than providing two examples:

9 (i) “cases involving a significant issue common to other cases in litigation for which it is important
10 to maintain a consistent position” and (ii) “cases related to a case over which the Department of
11 Justice has jurisdiction.”

12 18. Rev. Proc. 2016-22 does not include any language describing how IRS Counsel will
13 determine whether to deny a taxpayer access to IRS Appeals in a manner that is consistent with a
14 taxpayer’s right to appeal a decision of the Internal Revenue Service in an independent forum, or in a
15 manner that preserves and promotes IRS Appeals’ independence.

16 Relief Under the Administrative Procedure Act

17 19. The APA provides taxpayers a means for judicial review if they have been affected or
18 aggrieved by an unlawful agency action and have no other legal mechanism to challenge that action.
19 5 U.S.C. §§ 702-703.

20 20. Under the APA, the reviewing court shall hold as unlawful and set aside an agency
21 action, finding, or conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise
22 not in accordance with law, or in excess of statutory jurisdiction, authority, or limitations, or short of
23 statutory right. 5 U.S.C. §§ 706(2)(A), 706(2)(C).

24 Agency Actions That Exceed Statutory Authority Are Unlawful

25 21. The substantive validity of an agency action turns on whether it is “based on a
26 permissible construction of” the statute. *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*,
27 467 U.S. 837, 843 (1984).

28 22. The judiciary, not the agency, is the final authority on issues of statutory construction

1 and must therefore set aside any administrative constructions of the statute that violate clear
2 congressional intent. *United States v. Home Concrete & Supply LLC*, 566 U.S. 478, 488 (2012)
3 (noting that “[i]f a court, employing traditional tools of statutory construction, ascertains that
4 Congress had an intention on the precise question at issue, that intention is the law and must be
5 given effect.” (quoting *Chevron U.S.A., Inc.* 467 U.S. at 843, n. 9)).

6 Agency Actions Without Explanation Are Arbitrary, Capricious, and Unlawful

7 23. This Court is entitled to review an agency’s decision to ensure the agency’s fidelity to
8 its own regulations and congressionally mandated guidelines. *See California Human Development*
9 *Corp. v. Brock*, 762 F.2d 11044, 1048, N.28 (D.C. Cir. 1985). *See also Settles v. U.S. Parole*
10 *Comm’n*, 429 F.3d 1098, 1102-03 (D.C. Cir. 2005) (holding that the APA prohibits agencies from
11 treating similarly situated petitioners differently without providing a sufficiently reasoned
12 justification for the disparate treatment).

13 24. If an agency action is not reasonably consistent with congressional intention to pursue
14 a goal, then the courts must invalidate it. *Robbins v. Reagan*, 780 F.2d 37, 44 (DC Cir. 1985).
15 Particular judicial scrutiny is placed on an agency action when the agency’s actions deviate from its
16 normal course or direction, to ensure the agency’s change of course was not based on “impermissible
17 or irrelevant factors.” *Id.* at 48.

18 25. The Supreme Court has stated that an agency, in order to survive the arbitrary and
19 capricious standard of review, must “articulate a satisfactory explanation” for its action, including a
20 “rational connection between the facts found and the choice made.” *Motor Vehicle Manufacturers*
21 *Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 42 (1983) (quoting
22 *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). The reviewing court must
23 also ensure that changes in policy are carried out “for rational reasons that are sufficiently
24 explained.” *Ventura Broadcasting Co. v. FCC*, 765 F.2d 184, 190 (D.C. Cir. 1985). If the agency
25 fails to do so, “the reviewing court should not attempt itself to make up for such deficiencies; [the
26 reviewing court] may not supply a reasoned basis for the agency’s action that the agency itself has
27 not given.” *See Motor Vehicle Manufacturers Association*, 463 U.S. at 42.

28 26. Rules promulgated by a federal agency which regulate the rights and interest of others

1 are controlling upon the agency. *Columbia Broad. Sys. Inc. v. United States*, 316 U.S. 407, 422
2 (1942).

3 27. Additional judicial scrutiny is required when the agency's action represents a
4 departure from prior agency policy or course. *See National Black Media Coalition v. FCC*, 775 F.2d
5 342, 348; *Robbins v. Reagan*, 780 F.2d 37, 48 (DC Cir. 1985). An agency's change in direction is a
6 "danger signal that triggers scrutiny to ensure that the agency's change of course is not based on
7 impermissible or irrelevant factors." *Robbins v. Reagan*, 780 F.2d 37, 48 (DC Cir. 1985).

8 STATEMENT OF FACTS

9 IRS Issuance of Rev. Proc. 2016-22

10 28. On October 15, 2015, the IRS published Notice 2015-72, 2015-44 I.R.B. 613, which
11 released a proposed revenue procedure that would update Rev. Proc. 87-24, 1987-1 C.B. 720 and
12 invited public comment regarding the proposed revenue procedure. Notice 2015-72 proposed that
13 IRS Counsel would be granted the authority to deny a taxpayer access to IRS Appeals in a docketed
14 case if IRS Counsel "determines that referral is not in the interest of sound tax administration."

15 29. The American Bar Association submitted public comment in response to Notice
16 2015-72, requesting the IRS elaborate and clarify the circumstances in which docketed cases will be
17 ineligible to be returned to Appeals because of sound tax administration.

18 30. Other public comments provided to the IRS in response to Notice 2015-72 noted
19 concern with the ambiguity of the term "sound tax administration" and the limited set of examples.

20 31. Upon issuing Rev. Proc. 2016-22, the IRS did not articulate an explanation for its
21 action, including not describing any connection between the facts it found, the choice made to
22 provide IRS Counsel the ability to deny access to IRS Appeals, and the choice to establish the
23 purported "sound tax administration" standard, without further definition and in contravention of the
24 comments submitted in response to Notice 2015-72.

25 32. Upon information and belief, the IRS issued Rev. Proc. 2016-22 without considering
26 the facts relevant to allowing IRS Counsel to deny to taxpayers access to IRS Appeals or the
27 comments provided to the IRS regarding providing IRS Counsel authority to deny access to IRS
28 Appeals.

1 33. Upon information and belief, in issuing Rev. Proc. 2016-22, the IRS did not consider
2 the ambiguity of the “sound tax administration” standard and the relationship of such an arbitrary
3 standard to the statutory and regulatory mandates that the IRS shall provide all taxpayers access to
4 an independent administrative forum.

5 IRS Audit of Facebook

6 34. In November 2011, the IRS initiated an audit of Facebook’s tax years ended
7 December 31, 2008 (“Tax Year 2008”), and December 31, 2009 (“Tax Year 2009”). In January
8 2013, the IRS expanded its audit to include Facebook’s tax year ended December 31, 2010 (“Tax
9 Year 2010”).

10 35. During the audit, Facebook produced thousands of pages of documents in response to
11 more than 200 IRS requests, voluntarily extended the statute of limitations five times, and made
12 employees available for interviews.

13 36. On January 25, 2016, after years of audit, the IRS requested that Facebook agree to an
14 additional extension to the statute of limitations. During the period from February through May
15 2016, Facebook and the IRS discussed whether Facebook would further extend the statute of
16 limitations with certain conditions, including that the IRS would agree to issue a 30-day letter that
17 would give Facebook an opportunity to appeal adjustments proposed by IRS Examination personnel
18 to IRS Appeals.

19 37. Facebook and the IRS did not reach agreement regarding conditions pursuant to
20 which Facebook would provide a further extension of the statute of limitations.

21 38. On July 26, 2016, the IRS issued a Statutory Notice of Deficiency to Facebook.
22 Among the income adjustments proposed in the Statutory Notice of Deficiency was an adjustment
23 related to the value of intangible property transferred from Facebook Inc. to Facebook Ireland
24 Holdings Unlimited (“Facebook Ireland”) effective September 15, 2010 (the “License Adjustment”).

25 IRS Decision to Deny Facebook Access to IRS Appeals

26 39. Throughout the audit process, Facebook has made clear to the IRS its desire to avail
27 itself of IRS Appeals once a determination had been made by the IRS Exam team.

28 40. As of May 2016, the IRS had not made any decision to deny Facebook access to IRS

1 Appeals. *See* Decl. of Nancy Bronson in Support of Reply to Facebook’s Opposition to Amended
2 Petition Enforce Internal Revenue Service Summonses, Case No. 3:16-cv-0377-LB, ECF No. 23-1,
3 ¶¶ 6, 7, 10, 11.

4 41. Facebook seeks access to IRS Appeals to resolve its tax controversy, without
5 litigation, on a basis which is fair and impartial to both the IRS and Facebook, which is the stated
6 purpose of IRS Appeals.

7 42. On March 16, 2017, the IRS sent a letter to Facebook stating that the IRS will refuse
8 to transfer the matter to IRS Appeals, pursuant to Rev. Proc. 2016-22, stating that referral to IRS
9 Appeals “is not in the interest of sound tax administration.”

10 43. Facebook requested that the IRS reconsider its decision denying Facebook access to
11 IRS Appeals, and on August 2, 2017, the IRS sent a letter to Facebook stating the decision to retain
12 settlement jurisdiction was made by IRS Counsel pursuant to Rev. Proc. 2016-22, and that the IRS
13 would not reconsider this decision.

14 44. The IRS has never provided Facebook an explanation of why IRS Counsel concluded
15 providing Facebook access to IRS Appeals is not in the interest of sound tax administration.

16 45. Upon information and belief, the IRS denied Facebook access to IRS Appeals for
17 reasons unrelated to sound tax administration.

18 46. Facebook is entitled to an independent administrative forum, and upon information
19 and belief, the IRS decision to deny Facebook access to IRS Appeals was made by individuals in
20 IRS Counsel who were charged with litigating against, or overseeing litigation against Facebook,
21 and were thus not independent.

22 47. Upon information and belief, one of the reasons the IRS denied Facebook access to
23 IRS Appeals was to retaliate against Facebook for not providing an additional extension of the
24 statute of limitations.

25 48. Upon information and belief, one of the reasons the IRS denied Facebook access to
26 IRS Appeals was because the IRS economic analysis supporting the License Adjustment was
27 arbitrary, capricious, or unreasonable.

28 49. Upon information and belief, prior to the issuance of Rev. Proc. 2016-22, the IRS

1 regularly provided access to IRS Appeals for taxpayers for which the IRS had proposed income
2 adjustments pursuant to Treas. Reg. §§ 1.482-4 or 1.482-7, the transfer pricing regulations relevant
3 to the License Adjustment.

4 50. During calendar years 2012 through 2014 the IRS conducted 213 taxpayer
5 examinations that included at least one transfer pricing issue and proposed adjustment amounts that
6 totaled approximately \$10.5 billion. IRS Appeals reduced the originally proposed adjustments by
7 more than \$8.5 billion, and IRS records show that after the IRS Appeals process only \$321 million
8 of the original proposed \$10.5 billion in adjustments for 2012-2014 were posted to taxpayer
9 accounts. Treasury Inspector General for Tax Administration, *Barriers Exist to Properly*
10 *Evaluating Transfer Pricing Issues* 24-25 (2016).

11 51. Upon information and belief, by denying Facebook access to IRS Appeals the IRS
12 has treated Facebook differently than similarly situated taxpayers for which the IRS had proposed
13 similar income adjustments prior to the issuance of Rev. Proc. 2016-22.

14 52. Facebook is harmed by IRS Counsel unilaterally denying Facebook access to IRS
15 Appeals pursuant to Rev. Proc. 2016-22 because doing so requires Facebook to incur the cost of
16 litigating an issue without first pursuing an independent administrative resolution with IRS Appeals.

17 53. As a result, Defendants' actions in denying Facebook access to IRS Appeals
18 exceeded statutory jurisdiction, authority, or limitations, or were short of statutory right, or were
19 arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. The IRS has
20 unlawfully denied Facebook access to IRS Appeals in violation of statute and based on
21 impermissible and irrelevant factors.

22 **FIRST CAUSE OF ACTION**

23 **(Administrative Procedure Act)**

24 54. All preceding allegations are incorporated here as if set forth in full.

25 55. The actions of the defendants in issuing Rev. Proc. 2016-22, including but not limited
26 to granting authority to IRS Counsel to deny taxpayers access to IRS Appeals for "sound tax
27 administration," were arbitrary, capricious, an abuse of discretion, or not in accordance with the law,
28 or exceeded statutory jurisdiction, authority, or limitations, or were short of statutory right, under

1 5 U.S.C. §§ 706(2)(A) or (C).

2 56. Facebook has no adequate or available administrative remedy. In the alternative, any
3 Facebook effort to obtain an administrative remedy would be futile.

4 57. Facebook has no adequate remedy at law, outside of a claim under 5 U.S.C. § 706.

5 58. The action of the IRS, in issuing Rev. Proc. 2016-22, imposed a harm on Facebook
6 that warrants relief.

7 **SECOND CAUSE OF ACTION**

8 **(Administrative Procedure Act)**

9 59. All preceding allegations are incorporated here as if set forth in full.

10 60. The actions of Defendants, in denying Facebook access to IRS Appeals pursuant to
11 the purported “sound tax administration” standard established in Rev. Proc. 2016-22, were arbitrary,
12 capricious, an abuse of discretion, or not in accordance with the law, or exceeded statutory
13 jurisdiction, authority, or limitations, or were short of statutory right, under 5 U.S.C. §§ 706(2)(A) or
14 (C).

15 61. Facebook has no adequate or available administrative remedy to address the agency’s
16 unlawful action. In the alternative, any Facebook effort to obtain an administrative remedy would be
17 futile.

18 62. Facebook has no adequate remedy at law, outside of a claim under 5 U.S.C. § 706.

19 63. The action of the IRS, in denying Facebook access to IRS Appeals, imposed a harm
20 on Facebook that warrants relief.

21 **THIRD CAUSE OF ACTION**

22 **(Mandamus-Like Relief)**

23 64. All preceding allegations are incorporated here as if set forth in full.

24 65. Defendants have a plainly defined, ministerial duty to provide taxpayers access to an
25 independent administrative forum.

26 66. Defendants have failed to carry out their mandatory statutory obligations under
27 the Internal Revenue Service Restructuring and Report Act of 1998, 26 U.S.C. § 7803(3)(E), or
28 26 C.F.R. § 601.106(a)(1), to provide Facebook access to an independent administrative forum.

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Dated: November 8, 2017

BAKER & McKENZIE LLP

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