

MLI #10 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

SUMMARY

From June 1, 2017, through May 31, 2018, the federal courts issued decisions in at least 19 cases involving the Internal Revenue Code (IRC) § 6673 “frivolous issues” penalty, and in at least three cases involving analogous penalties at the appellate level. These penalties are imposed for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.¹ In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future.² Nonetheless, we included these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

TAXPAYER RIGHT IMPACTED³

- *The Right to Appeal an IRS Decision in an Independent Forum*

PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.⁴ The maximum penalty is \$25,000.⁵ In some cases, the IRS requests that the Tax Court impose the penalty;⁶ in other cases, the Tax Court exercises its discretion, *sua sponte*,⁷ to consider whether the penalty is appropriate.

1 The Tax Court generally imposes the penalty under Internal Revenue Code (IRC) § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals are authorized to impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

2 See, e.g., *Fleming v. Comm’r*, T.C. Memo. 2017-120.

3 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the IRC. See IRC § 7803(a)(3).

4 IRC § 6673(a)(1)(A), (B), and (C). Likewise, the Tax Court is also authorized to impose a penalty against any person admitted to practice before the Tax Court for unreasonably and vexatiously multiplying the proceedings in any case. See IRC § 6673(a)(2). However, although we identified one case under this authority, we do not discuss it here as it is outside the scope of this most litigated issue. See *MacPherson v. Comm’r*, 702 Fed. App’x 621 (9th Cir. 2017), *aff’g* *May v. Comm’r*, T.C. Memo. 2016-43.

5 IRC § 6673(a)(1).

6 The standards for the IRS’s decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual. See CCDM 35.10.2 (Aug. 11, 2004). For sanctions of any attorney or other person authorized to practice before the Tax Court, under IRC § 6673(a)(2), all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. See, e.g., CCDM 35.10.2.2.3 (Aug. 11, 2004).

7 “*Sua sponte*” means without prompting or suggestion; on its own motion. BLACK’S LAW DICTIONARY (10th ed. 2014). Thus, for conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty. See, e.g., *Williams v. Comm’r*, T.C. Memo. 2018-50, *appeal docketed*, No. 18-60536 (5th Cir. Aug. 1, 2018).

Taxpayers who institute actions under IRC § 7433⁸ for certain unauthorized collection actions can be subject to a maximum penalty of \$10,000 if the court determines the taxpayer's position in the proceedings is frivolous or groundless.⁹ In addition, IRC § 7482(c)(4),¹⁰ §§ 1912 and 1927 of Title 28 of the U.S. Code,¹¹ and Rule 38 of the Federal Rules of Appellate Procedure¹² (among other laws and rules of procedure) authorize federal courts to impose penalties against taxpayers or their representatives for raising frivolous arguments or using litigation tactics primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in non-tax cases, this report focuses primarily on the IRC § 6673 penalty.

Although outside of our reporting period, we note the recent Tax Court decision in the case of *Williams v. Commissioner*.¹³ In *Williams*, the Tax Court considered whether IRC § 6751(b)(1) constrained the ability of the Tax Court to impose a penalty under IRC § 6673(a)(1). Section 6751(b)(1) generally prohibits the imposition of a penalty unless the penalty is approved, in writing, by the supervisor of the employee imposing the penalty or other higher level designee of the Secretary of Treasury.¹⁴ Section 6673(a)(1) gives the authority to impose the penalty solely to the Tax Court, and permits the Tax Court to impose it either at the request of the Commissioner or *sua sponte* (of its own accord). The Tax Court looked to the legislative history of § 6751(b)(1) and § 6673(a)(1) to determine whether the two sections can coexist or whether § 6751(b)(1) supersedes § 6673(a)(1). The Tax Court found that the legislative intent behind § 6751(b)(1) was to prevent the IRS from using the threat of a penalty as a bargaining chip when negotiating with taxpayers, whereas the intent of § 6673(a)(1) was to dissuade taxpayers from wasting judicial resources. Because the Tax Court is not mentioned in § 6751(b)(1) or its legislative history, the Tax Court held that § 6751(b)(1) does not apply when it imposes a penalty pursuant to § 6673(a)(1).

ANALYSIS OF LITIGATED CASES

We analyzed 19 opinions issued between June 1, 2017, and May 31, 2018, in which courts addressed the IRC § 6673 penalty. Eleven of these opinions were issued by the Tax Court and eight were issued by U.S. Courts of Appeals in cases brought by taxpayers seeking review of the Tax Court's imposition of the

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- 8 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer's federal tax liability.
- 9 IRC § 6673(b)(1).
- 10 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court's decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer's position in the appeal was frivolous or groundless.
- 11 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys' fees reasonably incurred because of his or her conduct.
- 12 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.
- 13 151 T.C. No. 1 (2018). This case will appear in the 2019 Most Litigated Issues section if Frivolous Issues is again a top ten issue, as the Tax Court imposed a penalty under § 6673(a)(1) for making frivolous arguments.
- 14 IRC § 6751(b)(2) provides an exception for additions to tax imposed under §§ 6651, 6654, or 6655. Or any other penalty automatically calculated through electronic means.

penalty. The Courts of Appeals sustained the Tax Court's position in all eight cases. Three decisions were issued by other courts on analogous penalties.¹⁵

In five cases, the Tax Court imposed penalties under IRC § 6673, with the amounts ranging from \$1,000 to \$10,000. In three cases, taxpayers prevailed when the IRS asked the court to impose a penalty. In most of these cases, the court warned the taxpayers not to bring similar arguments in the future.¹⁶ All taxpayers appeared *pro se* (represented themselves) before the Tax Court, while one taxpayer was represented at the appellate level.¹⁷ The taxpayers presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner*:

We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.¹⁸

In the cases we reviewed, taxpayers raised the following issues that the courts deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1) or other appellate level sanctions (or, in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same positions):

- **Taxes and procedures to collect taxes are unconstitutional:** We identified two cases this year where taxpayers made arguments that taxes or how they are collected are unconstitutional.¹⁹ The taxpayer in *Schneider v. Commissioner* advanced common arguments regarding the constitutionality of the income tax and procedures to collect it, including that the income tax is an unconstitutional direct tax. The Court of Appeals for the Eighth Circuit affirmed the Tax Court's imposition of the IRC § 6673 penalty, and also imposed appellate level sanctions. In *Gardner v. Commissioner*, the taxpayer argued that the courts and the Commissioner of the IRS conspired to deny her First Amendment rights to free speech and freedom of religion.²⁰ In imposing a penalty of \$10,000, the Tax Court warned the taxpayer that if she continued to engage in similar tactics in the future, she would face a much larger penalty.
- **Taxpayers are not United States persons, they are exempt from the income tax, or wages are not income:** Taxpayers in at least five cases presented arguments that they are not United States persons subject to tax, they are exempt from tax for various reasons, or that wage income

15 We identified one decision in which the Court of Appeals addressed both the Tax Court's imposition of the IRC § 6673 penalty and an analogous appellate level penalty. *Schneider v. Comm'r*, 697 F. App'x 474 (8th Cir. 2017) (affirming a § 6673 penalty of \$2,500 and imposing an additional \$5,000 penalty). For purposes of the total number of cases reviewed for this report, we counted this case once. We reviewed a total of 21 cases for this reporting cycle.

16 See, e.g., *Lorusso v. Comm'r*, T.C. Memo. 2018-3. In declining to impose a penalty, the Tax Court noted that although the taxpayer had a history of litigation, the Tax Court had declined to warn the taxpayer in the past.

17 *Best v. Comm'r*, 702 F. App'x 615 (9th Cir. 2017), *aff'g* T.C. Memo. 2014-72, *reh'g, en banc, denied*, 2018 U.S. App. LEXIS 3452 (9th Cir., Feb. 14, 2018), *cert. denied*, 138 S. Ct. 2691 (June 25, 2018).

18 *Crain v. Comm'r*, 737 F.2d 1417, 1417-18 (5th Cir. 1984). See, e.g., *Jagos v. Comm'r*, T.C. Memo. 2017-202.

19 See *Schneider v. Comm'r*, 697 F. App'x 474 (8th Cir. 2017), *aff'g* No. 017566-14 (T.C. Sept. 1, 2016) and No. 029122-14 (T.C. Aug. 24, 2016), *cert. and reh'g denied*, 138 S. Ct. 1708 (2018); *Gardner v. Comm'r*, T.C. Memo. 2017-107.

20 See *Gardner v. Comm'r*, T.C. Memo. 2017-107. The taxpayers in this case were tax shelter promoters and the taxpayer wife argued that she could not receive income because she had taken a vow of poverty.

is not taxable.²¹ In *Jagos v. Commissioner*, a taxpayer argued that only federal employees must pay income tax.²² The court imposed a penalty of \$1,500.

CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year, which the courts routinely and universally reject.²³ Taxpayers avoided the IRC § 6673 penalty in only three cases where the IRS requested it. In these cases, the courts often warned the taxpayers not to bring similar arguments in the future, demonstrating the willingness of the courts to penalize taxpayers when they offer frivolous arguments or institute a case merely for delay. Where the IRS has not requested the penalty, the court may nonetheless raise the issue *sua sponte*, and in all cases identified either imposed the penalty or cautioned the taxpayer that similar future behavior will result in a penalty.²⁴

As indicated in Appendix 3, Table 10, the penalty amount varies, regardless of the type of frivolous argument being raised. The Tax Court has indicated, however, that it can be lenient when it is the taxpayer's first court appearance.²⁵ Moreover, if the taxpayer has previously been sanctioned, the Tax Court may impose a higher penalty, but not necessarily close to the maximum.²⁶

Finally, the U.S. Courts of Appeals have shown their willingness to uphold the penalties imposed by the Tax Court without fail in the cases analyzed for the period between June 1, 2017, and May 31, 2018, continuing a trend of upholding all penalties in cases we have analyzed since June 1, 2005.

21 See, e.g., *Blair v. Comm'r*, T.C. Memo. 2017-153.

22 See *Jagos v. Comm'r*, T.C. Memo. 2017-202, *reh'g denied*, No. 18-1087 (6th Cir., Oct. 9, 2018).

23 See, e.g., National Taxpayer Advocate 2016 Annual Report to Congress 503-506.

24 See, e.g., *Zentmyer v. Comm'r*, T.C. Memo. 2017-197, *appeal docketed*, No. 18-72116 (9th Cir. July 26, 2018) (court raised the issue *sua sponte* and warned the taxpayer not to assert similar arguments in the future).

25 See, e.g., *Hawkbey v. Comm'r*, T.C. Memo. 2017-199.

26 See, e.g., *Fleming v. Comm'r*, T.C. Memo. 2017-155 (court imposed \$5,000 penalty after imposing \$1,500 in an earlier case).