

# New York Law Journal



Web address: <http://www.nylj.com>

VOLUME 231—NO. 97

THURSDAY, MAY 20, 2004

## TAX LITIGATION ISSUES

BY JOHN J. TIGUE JR. AND JEREMY H. TEMKIN

### *What to Do When IRS Agents Misbehave?*

When the publisher of a newspaper, which focuses on matters of interest to the African-American community, ran an article highly critical of the Internal Revenue Service, the IRS responded within two weeks by instituting a retaliatory audit of the newspaper. The agent handling the audit made slurs about slavery reparations and the name of the newspaper, Hudson Valley Black Press, and twice used coercive tactics to try to get the newspaper to agree to the agent's false findings. Thereafter, another IRS agent caused tax liens to be filed against the newspaper, which led to the seizure of the newspaper's accounting records. As a result, the newspaper was unable to publish or otherwise conduct business. The publisher sued the agents in federal court in Manhattan for First Amendment and due process violations, and lost. Let's see why.

#### Options for Unhappy Taxpayers

A taxpayer seeking to resist an IRS audit faces the following limited and unattractive choices. First, the taxpayer can bring a suit to enjoin an IRS audit, but is unlikely to prevail. The Anti-Injunction Act provides that, except in a very narrow set of circumstances, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person."<sup>1</sup> Second, the taxpayer may decide not to voluntarily cooperate with the audit, thereby

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forcing the IRS to issue a summons and enforce it in a proceeding in district court.<sup>2</sup> While the taxpayer can then challenge the audit in that proceeding on constitutional grounds, he or she may choose not to go this route because of the cost and the risk of contempt charges in such a proceeding.<sup>3</sup> Third, a taxpayer may also apply to the National Taxpayer Advocate for relief from an audit. Such relief should be granted if "the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered."<sup>4</sup> Data suggests, however, that the Advocate rarely grants such relief.<sup>5</sup>

A taxpayer who finds those choices unacceptable may choose to proceed with the audit and challenge any alleged tax deficiency. The taxpayer will then have the following four options, all of which could take years and none of which are guaranteed to work in the taxpayer's favor. First, the taxpayer can contest the validity of the audit findings in an internal IRS appeal.<sup>6</sup> Second, the taxpayer can appeal directly to the tax court.<sup>7</sup> Third, the taxpayer can pay the alleged deficiency and bring suit for a refund in district court.<sup>8</sup> Fourth, the taxpayer can request a hearing before the IRS Office of Appeals and seek subsequent judicial review of any adverse determination.<sup>9</sup>

In addition, a taxpayer who believes he has been the subject of misconduct by one or

more individual IRS agents has a limited right under section 7433 of the Internal Revenue Code to sue the federal government for the misconduct of those agents. This provision, however, applies only "in connection with any collection of Federal tax" and not to audit activity.<sup>10</sup> A taxpayer can also appeal for relief from the Treasury Inspector General for Tax Administration — an entity separate and distinct from the IRS — whose duties include conducting investigations of claims of misconduct by IRS officials.<sup>11</sup>

A disgruntled taxpayer thus has many possible avenues of redress, but little chance of success, at least in the short term.

#### Why Not Sue the Agents?

The plaintiff newspaper in *Hudson Valley Black Press v. IRS*<sup>12</sup> tried a different approach — a "Bivens claim" — but its complaint failed to survive a motion to dismiss by the IRS agents. Based on the facts set forth above, Hudson Valley, appearing pro se, brought an action against the two agents seeking money damages to vindicate alleged violations of its First, Fourth and Fifth Amendment rights based on a Supreme Court case decided in 1971. Defendants moved to dismiss the complaint. In his opinion granting defendants' motion, U.S. District Judge William C. Conner, of the Southern District of New York, first examined *Bivens v. Six Unknown Fed. Narcotics Agents*,<sup>13</sup> where the Supreme Court held that the plaintiff could bring a civil suit against agent of the Federal Bureau of Narcotics seeking money damages to vindicate a deprivation of the plaintiff's Fourth Amendment right to be free from unreasonable searches and seizures. Judge Conner focused on the Supreme Court's

reasoning in *Bivens* that, though the Fourth Amendment is silent on the issue, a private action for money damages could be recognized because Congress had not prohibited such an action. As the *Bivens* Court stated, there were “no special factors counseling hesitation in the absence of affirmative action by Congress.”

Judge Conner found that Hudson Valley had not made allegations sufficient to bring its Fourth Amendment claim within *Bivens* and dismissed that claim without prejudice. While Hudson Valley had alleged that records were seized, it failed to allege either that its property was seized in the course of a warrantless search or that the agents seizing the property were acting under a defective warrant. If Hudson Valley is able to make either of these allegations in an amended complaint, it has a decent chance of surviving another motion to dismiss its Fourth Amendment claim.<sup>14</sup>

The Court then considered whether it “should infer a *Bivens* remedy to allow redress of the First Amendment and due process violations” alleged by the plaintiff. Judge Conner pointed out that the Second Circuit “has yet to reach this issue.” The United States District Court for the Southern District of New York, however, has previously considered and rejected extending *Bivens* to due process violations,<sup>15</sup> as have other circuits.<sup>16</sup> The U.S. Court of Appeals for the Fourth Circuit last year rejected a *Bivens* action in *Judicial Watch v. Rossotti*,<sup>17</sup> a case with facts very similar to *Hudson Valley*. There, the plaintiff alleged that it was subjected to a “retaliatory, politically-motivated, and unconstitutional” (on First and Fifth Amendment grounds) audit. After noting that “no appellate court has ever reached [the] question” of “whether a *Bivens* action is available for damages arising from an allegedly retaliatory audit,” the Fourth Circuit found that it is not. The U.S. Court of Appeals for the Tenth Circuit, however, in a 1994 case, *National Community & Barter Ass’n v. Archer*,<sup>18</sup> allowed a *Bivens* action to redress First and Fourth Amendment violations by IRS agents.

The court in *Hudson Valley* was determined to “proceed cautiously” because, since extending *Bivens* in two cases in 1979 and 1980,<sup>19</sup> the Supreme Court has “consistently refused to extend *Bivens* liability to

any new context or new category of defendants.”<sup>20</sup> As examples, Judge Conner cited *Bush v. Lucas*<sup>21</sup> and *Schweiker v. Chilicky*.<sup>22</sup> In *Bush*, the Supreme Court refused to find an implied *Bivens* remedy for federal employees alleging that their supervisors violated their First Amendment rights because the claims arose out of a relationship “governed by comprehensive procedural and substantive provisions giving meaningful remedies against the United States.” The remedial measures available were “special factors counselling hesitation in the creation of a new remedy.” In *Schweiker*, the Supreme Court declined to find a new *Bivens* remedy for claimants whose social security disability benefits had been improperly terminated in violation of their due process rights. The Court found that, even though Congress had failed to provide for “complete relief” for the

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disability claimants, Congress had provided some “meaningful safeguards or remedies.”

Judge Conner seized on this language, also noting that the U.S. Court of Appeals for the Second Circuit has held, in *Sugrue v. Derwinski*,<sup>23</sup> “that *Bush* and *Schweiker* preclude the creation of a new *Bivens* remedy where Congress has adopted a ‘comprehensive remedial structure to address disputes’ between the relevant government agent and the aggrieved party even where that mechanism fails to provide ‘complete relief.’” For the *Hudson Valley* court, the question became “whether the Code provides for a ‘comprehensive remedial structure to address disputes’ between individual IRS agents and taxpayers” alleging First Amendment and due process violations in connection with an allegedly retaliatory audit.

After reviewing the remedial system provided under the Internal Revenue Code, the court concluded “that the existence of a comprehensive remedial framework enacted by Congress governing disputes between taxpayers and the IRS and individual IRS agents ‘suggests that Congress has provided what it considers adequate remedial mechanisms for constitutional violations that may’ occur during the performance of the IRS’s

duties.” In response to the “minority view” of *Archer* — premised on the fact that *Bivens* is justified because the taxpayer has no remedy — the court recited the following facts. First, Congress has provided relief, though not “complete relief” from retaliatory audits. Second, Congress has provided for a variety of ways to appeal the findings of a retaliatory audit. Third, there are also safeguards within the IRS to police misconduct by its individual agents. Fourth, whether the court believes that Congress has adopted the best policies is not relevant because the “comprehensive scheme” already in place “suggests that Congress has provided what it considers adequate remedial mechanisms.”

1. 26 USC §7421(a); see *Enoch v. Williams Packing & Navigation Co.*, 370 US 1 (1962) (recognizing exception to Anti-Injunction Act where taxpayer demonstrates that “under no circumstances could the Government ultimately prevail” and “equity jurisdiction otherwise exists”).

2. See 26 USC §7604.

3. See 26 USC §7604(b).

4. 26 USC §7811(a)(1)(A).

5. See Michael G. Tanner, “IRS Misconduct in an Audit: Is There a Civil Remedy?” 55 Tax Law 107 (2001) (citing data indicating that in given period assistance was granted in only five out of over 92,000 requests).

6. See 26 CFR §601.106.

7. See 26 USC §6213(a).

8. See 26 USC §7422.

9. See 26 USC §6330(b).

10. See *Judicial Watch v. Rossotti*, 317 F3d 401, cert. denied, 124 S Ct 179 (4th Cir 2003).

11. See 5 USC app. 3 §2.

12. 307 FSupp2d 543 (SDNY 2004).

13. 402 US 388 (1971).

14. See, e.g., *G.M. Leasing Corp. v. United States*, 429 US 338 (1977) (holding that IRS agents violated Fourth Amendment when they seized taxpayer property during warrantless search); *Castro v. United States*, 34 F3d 106 (2d Cir 1994) (Fourth Amendment violation properly pled where complaint alleged federal agents, acting without search warrant or probable cause, entered and searched plaintiff’s home).

15. See *Colon v. Maddalone*, No. 95 Civ. 0008, 1996 WL 556924 (SDNY 1996) (holding that plaintiff could not bring *Bivens* action against IRS agents for alleged due process violations).

16. See, e.g., *Fishburn v. Brown*, 125 F3d 979 (6th Cir 1997), (declining to create *Bivens* action against IRS agents for alleged due process violations); *Vennes v. An Unknown Number of Unidentified Agents of the United States*, 26 F3d 1448 (8th Cir. 1994), cert. denied, 513 US 1076 (1995) (same).

17. 317 F3d 401.

18. 31 F3d 1521 (10th Cir. 1994).

19. See *Carlson v. Green*, 446 US 14 (1980) (finding *Bivens* remedy for federal prisoner who was allegedly deprived of potentially life-saving treatment in violation of Eighth Amendment); *Davis v. Passman*, 442 US 228 (1979) (finding *Bivens* remedy for alleged violation of due process rights because of gender discrimination by U.S. Congressman in terminating petitioner’s employment). Judge Conner noted that *Davis* involved an equal protection violation but found that “[n]o facts giving rise to a claim based on an equal protection violation have been alleged here.”

20. *Correctional Services Corp. v. Malesko*, 534 US 61 (2001).

21. 462 US 367 (1983).

22. 487 US 412 (1988).

23. 26 F3d 8 (2d Cir 1994).

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