

12-18-2005

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### Recommended Citation

Danshera Cords, *Tax Protestors and Penalties: Ensuring Perceived Fairness and Mitigating Systemic Costs*, 2005 BYU L. Rev. 1515 (2005).  
Available at: <https://digitalcommons.law.byu.edu/lawreview/vol2005/iss6/2>

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## Tax Protestors and Penalties: Ensuring Perceived Fairness and Mitigating Systemic Costs

*Danshera Cords\**

*“For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in the uniform and vigorous enforcement of these laws.”*<sup>1</sup>

### I. INTRODUCTION

Each year hundreds of thousands of taxpayers use abusive schemes to avoid paying some or all of their federal income taxes.<sup>2</sup> Tax avoidance schemes include abusive tax shelters, fraudulent transactions, and

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1. John F. Kennedy, U.S. President, Special Message to the Congress on Taxation (Apr. 20, 1961), *quoted in* Mortimer Caplin, *The State of IRS Administration and Our Tax System in General*, 103 TAX NOTES 473, 473 (2004).

2. GOVERNMENT ACCOUNTING OFFICE, INTERNAL REVENUE SERVICE EFFORTS TO IDENTIFY AND COMBAT ABUSIVE TAX SCHEMES HAVE INCREASED, BUT CHALLENGES REMAIN, GAO-02-733, at 2 (2002). In tax-year 2000, approximately 740,000 returns were filed using one abusive scheme or another. GOVERNMENT ACCOUNTING OFFICE, INTERNAL REVENUE SERVICE ENHANCED EFFORTS TO COMBAT ABUSIVE TAX SHELTERS—CHALLENGES REMAIN, GAO-02-618T, at 1 (Testimony of Michael Brostek, Director, Tax Issues (2002)). In 2001, at least 152,000 individual income tax returns were filed by tax protestors. David Cay Johnston, *U.S. Discloses That Use of Tax Evasion Plans Is Extensive*, N.Y. TIMES, May 22, 2002, at C4 (citing Justice Department estimates of returns filed falsely claiming no taxes were due or using abusive schemes to receive a refund); *see also* Testimony of Micheal Brostek, *supra* at 6 (noting that 62,000 frivolous returns, 105,000 frivolous refund claims, and 65,000 abuse domestic trusts were claimed in 2000, for a total loss to the Treasury of \$6.8 billion). Because this number includes only filed returns, it does not include individuals who failed or refused to file a tax return. In addition, more than 1,500 businesses refuse to withhold taxes from their employees, some claiming that income taxes are voluntary. *Id.*; David Cay Johnston, *Boast of Refusal to Pay Taxes Leads to 27-Count Indictment*, N.Y. TIMES, June 22, 2003, at A1.

approaches based on an erroneous belief that the federal tax system either is illegitimate or is inapplicable to certain taxpayers. Those who believe that the tax system is illegal or inapplicable are commonly referred to as tax protestors. The following excerpt is typical of the written statements that tax protestors include frequently with their tax returns and court filings:

[THE TAXPAYER], UPON PRESENTMENT BY INTERNAL REVENUE, RETURNED AND REFUSED FOR CAUSE UCC 3-501 SAID PRESENTMENTS WITHOUT DISHONOR. IN ADDITION, [THE TAXPAYER], IS NOT A "U.S. CITIZEN" NEITHER IS HE A 'RESIDENT NOR INHABITANT' OF THE U.S. AND HAS NO INCOME EFFECTIVELY CONNECTED WITH THE UNITED STATES THAT [THE TAXPAYER] DID NOT KNOWINGLY OR VOLUNTARILY ENTER INTO ANY AGREEMENT OR CONTRACT TO BE LIABLE FOR THE NATIONAL DEBT, OR 'ELECTED' TO BE TREATED AS A RESIDENT OF THE UNITED STATES UNDER 26 CFR PART 5h; 26 USC, SECTION 6013(g) & (h) BY THE SIGNING OF FORM 1040 OR OTHER RELATED U.S. FORMS. [THE TAXPAYER] IS NOT A PARTY TO ANY TRANSACTION WITH THE U.S. LET THE U.S. PRODUCE THE ORIGINAL SIGNED CONTRACT [SEC.] 871 4(b) FURTHER PETITIONER SAYETH NOT.<sup>3</sup>

Fortunately, most people in the United States pay their taxes when and in the amount required. Between eighty and eighty-five percent of all taxes owed are timely paid.<sup>4</sup> Most Americans believe that tax

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3. Nagy v. Comm'r, 71 T.C.M. (CCH) 1854, 1854-55 (1996) (quoting from the taxpayer's petition) (capitals in original).

4. See, e.g., NATIONAL TAXPAYER ADVOCATE'S REPORT TO CONGRESS: FISCAL YEAR 2006 OBJECTIVES 6 (2005); Steve Johnson, *The 1998 Act and the Resources Link Between Tax Compliance and Tax Simplification*, 51 U. KAN. L. REV. 1013, 1015 (2003); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1459 (2003) [hereinafter Lederman, *Interplay*]; Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 973 (2003) [hereinafter Lederman, *The Reformed IRS*]; James Andreoni, Brian Erard & Johnathan Feinstein, *Tax Compliance*, 36 J. Econ. Lit. 818, 819 (1998). In fact, the tax compliance rate is even higher for amounts subject to mandatory withholding. The compliance rate for wage earners is estimated to be up to 98%, perhaps reflecting the relative lack of opportunity to avoid compliance. *The Reformed IRS*, *supra* at 975-76; Phil Brand, *IRS's Worker Classification Program—An Inside Look at New Ways to Resolve the Problems*, 85 J. Tax'n 17, 19 (1996) (citing unpublished IRS data suggesting that the compliance rate for wage earners may exceed 98%). For groups not subject to withholding, an estimated 42% of the tax due is voluntarily paid. Lederman, *The Reformed IRS*, *supra* at 976.

compliance is an important element of patriotism and personal integrity.<sup>5</sup> Compliance is important because when individuals and businesses fail to pay their taxes when due, compliant taxpayers must bear more than their fair share of the costs of government services. Moreover, businesses and sole proprietors that avoid or evade their tax obligations may be more competitive than their tax compliant counterparts because tax avoiders have lower costs.

Successful tax avoidance by some can undermine the confidence that compliant taxpayers have that the tax system fairly distributes its burden among all those who benefit from government services. Maintaining a high rate of compliance, however, requires that noncompliance have consequences.<sup>6</sup> Unless there are significant consequences to tax noncompliance, compliant taxpayers view the tax system as unfair because they are forced to assume more than their share of the tax burden.<sup>7</sup>

A subset of the larger group of tax avoiders are tax protestors. Tax protestors use frivolous and illegitimate arguments against the obligatory nature of government assessed taxes to justify their refusal to pay their taxes. Tax protestor schemes are often promoted in seminars, in books, and on the Internet.<sup>8</sup> The increased number of tax protestors may be attributable in part to the expansion of the Internet and the ease with which it allows tax protestors to spread their message. Although tax protestors constitute only a small percentage of all taxpayers, they are extremely vocal and are growing in number;<sup>9</sup> the number of tax protestor

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5. In response to the statement “[i]t is every American’s civic duty to pay their fair share of taxes,” 94% of the individuals surveyed in the 2004 Taxpayer Attitude Survey responded that they either “Completely Agree” (73%) or “Mostly Agree” (21%). INTERNAL REVENUE SERVICE OVERSIGHT BOARD, 2004 TAXPAYER ATTITUDE SURVEY, at 5, <http://www.treas.gov/irsob/documents/release040405.pdf>. Similarly, 91% of the respondents identified personal integrity as providing “[a] great deal of influence” (79%) or being “[s]omewhat of an influence” (12%) on their tax compliance. *Id.* at 7.

6. Lederman, *Interplay*, *supra* note 4.

7. *Id.*

8. See *infra* Section II; see also Testimony of Michael Brostek, *supra* note 3, at 2; Johnston, *infra* note 9.

9. David Cay Johnston, *Another Tax Denier Will Have His Day in Court*, N.Y. TIMES, Jan. 19, 2005, at C2.

returns filed increased from 7,123 in 1979<sup>10</sup> to 18,226 in 1980<sup>11</sup> and to more than 152,000 in 2001.<sup>12</sup>

Individuals who are dissatisfied with the government and its policies are more likely to be convinced that the tax system is illegitimate than are individuals who are satisfied with the government and its policies.<sup>13</sup> An even greater concern is the possibility that growing numbers of tax protestors will be deleterious to tax compliance. General tax compliance may be adversely affected by a perception or reality that others are successfully avoiding payment of part or all of their tax liability.<sup>14</sup>

As the number of tax protestors increases, the costs associated with collecting their taxes and prosecuting their tax avoidance also increase. To prevent compliant taxpayers from unfairly bearing these costs, these costs should be shifted back to the tax protestors. Although this approach would be inappropriate if it was applied to all tax disputes, it is nevertheless appropriate to shift the costs to tax protestors whose truly frivolous positions waste administrative and judicial resources.

Addressing the challenges raised by tax protestors who actively avoid their tax obligations increases the cost of tax collection. Although it would be possible to simply ignore all of the frivolous tax-protestor claims, tax protestor contentions must be reviewed. Even someone who does not acknowledge the government's power to collect taxes can have a legitimate challenge to the amount that the Internal Revenue Service ("IRS" or "the Service") asserts is the correct tax liability. If the courts and the Service dismiss all tax protestor claims without any consideration, some legitimate claims will be missed, which may reduce the public confidence in the fairness of the overall tax system eventually

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10. COMPTROLLER GENERAL OF THE UNITED STATES, *ILLEGAL TAX PROTESTERS THREATEN TAX SYSTEM*, GGD-81-83 app. II, at 46 (1981) (citing IRS statistics on tax protestor returns).

11. *Id.*

12. *See supra* note 2.

13. *See* Anthony C. Infanti, *Tax Protest, "A Homosexual," and Frivolity: A Deconstructionist Meditation*, 24 ST. LOUIS U. L.J. 1, 21 n.24 (2005); Marjorie E. Kornhauser, *Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America*, 50 BUFF. L. REV. 819, 906-07 (2002) [hereinafter Kornhauser, *Legitimacy*]; Marjorie E. Kornhauser, *For God and Country: Taxing Conscience*, 1999 WIS. L. REV. 939, 942 [hereinafter Kornhauser, *Taxing Conscience*]; Christopher S. Jackson, Comment, *The Inane Gospel of Tax Protest: Resist Rendering Unto Caesar—Whatever His Demands*, 32 GONZ. L. REV. 291 (1996-1997); Thomas J. Purcell, III, *An Analysis of the Formation of Federal Tax Policy*, 18 CREIGHTON L. REV. 653, 654-55 (1984-1985); Beryl N. Simpson, *Constitutional Protection for Creative Tax Shelter Promoters: Ninth Circuit Restricts the Government's Arsenal of Power—United States v. Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), *cert. denied*, 104 S. Ct. 2363 (1984), 59 WASH. L. REV. 927, 943 n.103 (1984).

14. *See infra* Part II.B.

reducing tax compliance. In addition, some inarticulate taxpayers with legitimate claims could be incorrectly identified as tax protestors, and in such cases dismissal without review would mean that legitimate claims would not be considered.

This Article argues that tax protestors impose significant, unwarranted costs on tax administration, and tax protestors are neither adequately deterred nor sufficiently punished under the current framework of civil and criminal penalties. This Article proposes that taxpayers putting forth identified tax protestor positions in support of a contention that an individual or entity is not subject to taxation should be required to pay a penalty equal to the costs incurred by the Service and the courts to collect legitimate tax liabilities.<sup>15</sup> In the interest of consistent treatment of similarly situated taxpayers and increasing the perceived fairness of the tax collection system, the penalty must be mandatory rather than discretionary. This penalty would effectively shift the costs of tax noncompliance from the compliant taxpayer back to the tax protestor who caused the cost in the first place.

This Article begins with an overview of the problem of tax noncompliance. Section A of Part II discusses the scope of the problem, and Section B discusses why some taxpayers comply while others do not.

Part III evaluates the rhetoric and arguments of tax protestors and concludes that these arguments, which the courts have uniformly rejected, cannot be disregarded without harming the perceived fairness of the tax system and without adversely impacting tax compliance rates.<sup>16</sup>

Part IV discusses the collection process and taxpayer rights, which include the rights created by the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998).<sup>17</sup> Part IV also considers how these rights may increase the perception of fairness yet also impose significant costs on the tax system when abused by tax protestors.

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15. This Article does not address tax underpayment resulting from aggressive positions. While such positions are of concern to the government and are often abusive, aggressive taxpayers usually acknowledge the legitimacy of government tax collection. Approaches designed to increase aggressive taxpayers' compliance rates will likely differ from approaches that increase tax protestor compliance and prevent the conversion of others to the tax protestor movement. Thus, the same approaches are unlikely to be successful in addressing these very different reasons for noncompliance.

16. Tax protestors frequently use quotations and excerpts out of context. *See, e.g.*, *Bell v. United States*, 414 F.3d 474, 477 (3d Cir. 2005). To the extent that mainstream taxpayers buy in to these arguments and begin to refuse to pay taxes, tax compliance will be harmed.

17. Pub. L. 105-206, 112 Stat. 685 (1998) (codified as amended in various sections of 26 U.S.C.) [hereinafter *RRA 1998*].

Part V discusses the current penalty structure, with an emphasis on the civil penalties available for taking and promoting frivolous positions. This Part also discusses recent proposals to discourage or penalize protestor behavior.

Part VI argues that a different approach to penalizing tax protestors is needed because the current penalty structure does not effectively deter tax protestor behavior. This Part proposes that nondiscretionary penalties equal to the cost of collecting taxes from tax protestors would increase the public's perception of fairness and minimize the likelihood that currently compliant taxpayers may cease to comply with their tax obligations.

This Article does not argue that citizens should not question the government, its powers, its programs, or its actions. The refusal to pay legitimate taxes is distinguishable from the use of legal methods to change the law including speaking out against the government or petitioning the government to change its policies.<sup>18</sup> This Article addresses the deleterious impact that tax protestors' unlawful actions can have on compliant taxpayers and suggests a means by which that impact can be overcome.

## II. TAX COMPLIANCE

A high rate of tax compliance is essential to the operation of the government. Without efficient collection of tax revenues, the government cannot function. While most people comply with their tax obligations with little resistance, not all people pay their taxes voluntarily or on time. This Section discusses the scope of the problem of noncompliance, as well as the reasons that have been proffered to explain both tax compliance and tax noncompliance.

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18. State initiatives have been very successful in limiting the ability of state governments to raise taxes. In California, Proposition 13 limited the ability of the government to levy property taxes. Tom Kenworthy, *Colorado Wrestles with Proposal to Overhaul Tax Limits*, USA TODAY Oct. 27, 2005, at A10. In Washington State, ballot measures have limited increases in government spending and have reduced the taxes that could be collected for registering an automobile. See, e.g., Mark Trahan, *Is I-695 A Chance to Reshape Government*, THE SEATTLE TIMES, Nov. 11, 1999, at A2 (discussing in part the passage of I-695 which reduced the amount the state could charge for vehicle licenses to \$30); James L. McIntire, *No Easy Answers in Choosing the Next Governor, Voters Must Be Wary of Candidates with Simplistic Solutions to Balancing the Budget*, SEATTLE POST-INTELLIGENCER, Sept. 15, 1996, at D1 (discussing I-601 which limited spending and tax increases). In addition, angry citizens challenging taxes and government regulations are recurring themes in the United States. Kornhauser, *Taxing Conscience*, *supra* note 13, at 940; Thompson Smith, Note, *The Patriot Movement: Refreshing the Tree of Liberty with Fertilizer Bombs and the Blood of Martyrs*, 32 VAL. U. L. REV. 269, 269 (1997).

### A. The Scope of the Tax Gap

All governments require a steady source of revenue, requiring efficient tax collection. In times of budget deficits, effective tax collection is even more important. Although tax compliance in the United States is estimated to be between eighty and eighty-five percent,<sup>19</sup> recent estimates of unpaid taxes put the amount at between \$312 and \$353 billion each year.<sup>20</sup> This is the gross tax gap<sup>21</sup> and is comprised of nonfiling, underreporting, and underpaying.<sup>22</sup> To compare, the tax gap is approximately equal to the amount that the federal government pays each year for Medicare<sup>23</sup> or the 2005 federal budget deficit.<sup>24</sup> Examined another way, the tax gap increases the tax burden on every compliant individual taxpayer by \$2,000.<sup>25</sup>

Enforcement efforts, including audits, liens, and levies, are used to reduce the tax gap. In 2001, for example, the net tax gap, which is the difference between the amount of tax owed and the amount of tax

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19. Preliminary results from the National Research Program, the first effort to collect taxpayer data since 1989, indicated that the 2001 voluntary compliance rate was approximately eighty-five percent. NATIONAL TAXPAYER ADVOCATE'S REPORT TO CONGRESS: FISCAL YEAR 2006 OBJECTIVES 6 (2005); *see also* Johnson, *supra* note 4, at 1015. However, others interpret the preliminary results of the National Research Program to show compliance rate to be significantly higher. Robert E. Brown & J. Mazur, *The National Research Program: Measuring Taxpayer Compliance Comprehensively*, 51 U. KAN. L. REV. 1255, 1258 (2003) (estimating ninety-eight percent voluntary compliance on individual income tax returns in recent years). These discrepancies demonstrate the difficulty in measuring compliance as adequate data is unavailable. Susan B. Long & Judyth A. Swingen, *Taxpayer Compliance: Setting New Agendas for Research*, 25 LAW & SOC'Y REV. 637, 655 (1991).

20. *New IRS Study Provides Preliminary Tax Gap Estimate*, I.R.S. News Release IR-2005-38 (March 29, 2005); *see also* George K. Yin, *JCT Chief Discusses the Tax Gap*, 107 TAX NOTES 1449 (2005) (discussing ways to close the tax gap).

21. *New IRS Study Provides Preliminary Tax Gap Estimate*, *supra* note 20; Yin, *supra* note 20.

22. *New IRS Study Provides Preliminary Tax Gap Estimate*, *supra* note 20. IRS National Headquarters Office of Research, *Tax Gap Map for Year 2001* (Feb. 24, 2004), *cited in* NATIONAL TAXPAYER ADVOCATE SERVICE, 2004 ANNUAL REPORT TO CONGRESS 211 (estimating the net tax gap, the gross tax gap reduced by the amount ultimately collected, to be \$255 billion a year). Underreported tax liabilities account for eighty percent (approximately \$249 to \$311 billion) of the gross tax gap. *Id.* at 214.

23. Yin, *supra* note 20, at 1449.

24. *See* CONGRESSIONAL BUDGET OFFICE, MONTHLY BUDGET REVIEW (October 6, 2005) (concluding that the preliminary Fiscal Year 2005 federal budget deficit was \$317 billion).

25. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, UNDERSTANDING TAX REFORM: A GUIDE TO 21ST CENTURY ALTERNATIVES 6, 29 (2005) (citing the National Taxpayer Advocate Service estimates, noting that there are approximately 130 million individual taxpayers).

ultimately paid, was between \$257 and \$298 billion.<sup>26</sup> In light of concerns about the current budget deficits and declining compliance, Commissioner of Internal Revenue Mark Everson has pledged to increase tax enforcement and tax compliance.<sup>27</sup>

### *B. Factors Affecting Tax Compliance*

#### *1. Reasons for Tax Compliance*

Notwithstanding the popular maxim that “taxes are what we pay for a civilized society,”<sup>28</sup> most people would rather not give money to the government. However, the federal income tax system in the United States depends on “voluntary compliance.”<sup>29</sup> In fact, our system of voluntary compliance does not mean that tax compliance is a matter of choice. Rather, the filing of self-reported tax returns and the paying of taxes is a “voluntary compulsion.”<sup>30</sup> That is, taxpayers are required to report their income and tax owed rather than the government undertaking the costly job of determining and collecting each taxpayer’s liability.<sup>31</sup> Attempting to determine each taxpayer’s liability without significant

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26. *New IRS Study Provides Preliminary Tax Gap Estimate*, *supra* note 20.

27. See, e.g., *Closing the Tax Gap and the Impact on Small Businesses Before the H. Comm. on Small Business*, 109th Cong. (2005) (statement of Mark W. Everson, Commissioner, Internal Revenue Service), available at <http://www.house.gov/smbiz/hearings/databaseDrivenHearingsSystem/displayTestimony.asp?hearingIdDateFormat=050427&testimonyId=306> [hereinafter *Everson Testimony*]; Nina E. Olson, the National Taxpayer Advocate, has expressed support for increased enforcement, but not at the expense of taxpayer services. Allen Kenney, *Déjà vu? Bush Wants \$500 Million for IRS to Toughen Up in 2006*, 106 TAX NOTES 747, 748 (2005).

28. *Compania General de Tabacos de Filipinas v. Collector*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

29. George W. Dent, Jr., *Race, Trust, Altruism and Reciprocity*, 39 U. RICH. L. REV. 1001, 1012 (2005) (noting the necessity of the tax system to rely on voluntary compliance because of the costs of auditing large numbers of returns) (citations omitted); see also Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323, 334 (1972); Steven Klepper & Daniel Nagin, *The Criminal Deterrence Literature: Implications for Research on Taxpayer Compliance*, in 2 TAXPAYER COMPLIANCE: SOCIAL SCIENCE PERSPECTIVES 126, 127 (Jeffrey A. Roth & John T. Scholz eds., 1989). In fact, the vast majority of all taxpayers pay their taxes as required without incident.

30. Lederman, *Interplay* *supra* note 4, at 1455 n.6 (citing George Guttman, *The Interplay of Enforcement and Voluntary Compliance*, 83 TAX NOTES 1683, 1685 (1999) (quoting former Commissioner of Internal Revenue Jerome Kurtz)); see also Jackson, *supra* note 13, at 318 (noting the fact that tax protestor claims that they need not pay taxes is based on a mistaken interpretation of the self-reporting nature of the tax system).

31. I.R.C. § 6001 (2000).

cooperation from those who pay the tax would be prohibitively expensive. Although the U.S. tax system is a very successful system of voluntary compliance,<sup>32</sup> government officials agree that the compliance rate is too low and may be declining.<sup>33</sup> In recent years, the IRS has undertaken several initiatives to increase compliance.<sup>34</sup>

An understanding of the motivations that lead to tax compliance is important to understanding how to improve tax compliance. Economic factors, legal consequences, social norms, and personal beliefs all influence tax compliance. However, none of the studies of tax compliance have been able to determine how to predict the causes of compliance in a particular case.<sup>35</sup>

From an economic perspective, an individual will likely comply with the requirements of the tax laws if the expected cost of tax compliance is less than the expected cost of noncompliance.<sup>36</sup> The expected cost of noncompliance depends on the likelihood of detection, the size of penalties available, and the nature of the penalties that may be imposed if noncompliance is discovered. Given that the audit rate is currently less than one percent<sup>37</sup> and penalties for noncompliance, which generally range from twenty to seventy-five percent of the amount of the

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32. See, e.g., Dan M. Kahan, *Reciprocity, Collective Action, and Community Policing*, 90 CAL. L. REV. 1513, 1520 (2002); Dan M. Kahan, *Trust, Collective Action and Law*, 81 B.U.L. REV. 333, 341 (2001).

33. See Everson Testimony, *supra* note 27 (stating that according to data collected by the National Research Program, in 2001 compliance was lower than in 1988, the last year for which detailed compliance data was available); GOVERNMENT ACCOUNTABILITY OFFICE, HIGH RISK SERIES: AN UPDATE, GAO-05-207, at 37 (2005); Allen Kenney, *Year In Review: Everson Evaluates State of IRS, Pledges Strong Agenda for 2005*, 106 TAX NOTES 40 (2004) (referring to Commissioner Everson's goal to increase collection); Marjorie Kornhauser, *Doing the Fully Monty, Will Publicizing Tax Information Increase Compliance*, 107 TAX NOTES 999, 1002 (2005); Martin A. Sullivan, *Economic Analysis: The Economic Cost of Bashing the IRS*, 103 TAX NOTES 791 (2004); David Cay Johnston, *Protestors Win a Case Over IRS*, N.Y. TIMES June 24, 2005, at C1.

34. *Written Testimony of Commissioner of Internal Revenue Mark Everson Before Subcommittee on Federal Financial Management, Government Information and International Security, Committee on Homeland Security and Government Affairs* (October 26, 2005), 2005 TAX NOTES TODAY 207-24.

35. See Joel Slemrod, *Why People Pay Taxes: Introduction*, in WHY PEOPLE PAY TAXES: TAX COMPLIANCE AND ENFORCEMENT, 2 (1992); Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1782 (2000).

36. See, e.g., Lederman, *Interplay*, *supra* note 4, at 1457.

37. In 2005, the audit rate for individual returns is about 0.9%, which is a 20% increase over 2004, and up from 0.49% in 2000. Allen Kenney, *High-Income Audits Contribute to Record IRS Enforcement Stats*, 2005 TAX NOTES TODAY 213.

underpayment, are not always imposed, economic analysis does not fully explain the high rate of tax compliance in the United States.<sup>38</sup>

The legal consequences of noncompliance may contribute to taxpayers' decisions to comply. These factors include the likelihood of detection, the amount and nature of penalties (e.g., monetary or criminal), the likelihood that severe penalties will be imposed, the cost of compliance, and third party withholding and reporting.<sup>39</sup>

Social norms and individual beliefs also influence tax compliance. The important factors relating to norms include: age, education, personal satisfaction with the government, perceptions that the tax system is fair, occupation, opportunity to not comply, taxpayer attitudes and beliefs, gender, and marital status.<sup>40</sup> In addition, taxpayers who believe that the government does not spend money wisely or spends money on programs with which the taxpayer disagrees are less likely to comply with their tax obligations.<sup>41</sup> For instance, individuals who are over the age of sixty-five, married, or in certain occupations are more likely to comply with the tax laws than members of other groups.<sup>42</sup>

Further, individual perceptions of the tax system strongly affect tax compliance. The perceived fairness of the tax system is influenced by the

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38. See Kornhauser, *supra* note 33 at 1000; Johnson, *supra* note 4 at 1013–14; GOVERNMENT ACCOUNTABILITY OFFICE, HIGH RISK SERIES: AN UPDATE, GAO-05-207, at 37 (2005); Sullivan, *supra* note 33; Kenney, *supra* note 33 (referring to Commissioner Everson's goal to increase collection).

39. See generally Lederman, *Interplay*, *supra* note 4; Long & Swingen, *supra* note 19, at 666; Slemrod, *supra* note 35; Loretta J. Stalans, Kent W. Smith & Karyl A. Kinsey, *When do We Think About Detection? Structural Opportunity and Taxpaying Behavior*, 14 LAW & SOC. INQUIRY 481 (1989) (considering the data gathered by the 1985 and 1988 Minnesota state department of revenue studies); Robert Kidder and Craig McEwen, *Taxpayer Behavior in Social Context: A Tentative Typology of Tax Compliance and Noncompliance*, in 2 TAXPAYER COMPLIANCE: SOCIAL SCIENCE PERSPECTIVES 47 (Jeffrey A. Roth & John T. Scholz eds) (1989); JAMES ALM, *ET AL.*, THE EFFECTS OF COMMUNICATION AMONG TAXPAYERS ON COMPLIANCE, available at <http://www.irs.gov/pub/irs-soi/04alm.pdf> (last visited Dec. 20, 2005).

40. See, e.g., Andreoni, Erard & Feinstein, *supra* note 4, at 840.

41. See, e.g., Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules*, 84 IOWA L. REV. 413; Robert Mason & Lyle D. Calvin, *Public Confidence and Admitted Tax Evasion*, 37 NAT'L TAX J. 489, 489 (1984).

42. See, e.g., Andreoni, Erard & Feinstein, *supra* note 4, at 840 ("Business filers in finance, real estate, and insurance; agriculture, forestry, and fishing; and wholesale trade industries understated taxes by the lowest percentages . . ."); Jackson, *supra* note 13, at 295 (describing converts to the protestor movement as generally being "conservative, middle-aged, white, Christian males who possess an above average education, an above average salary, a past history of tax compliance, and a growing dissatisfaction with government policies" (footnote omitted)); Chester N. Mitchell, *Willingness-To-Pay: Taxation and Tax Compliance*, 15 MEMPHIS ST. U. L. REV. 127, 129 (1985).

interaction of the government with taxpayers. This also may be influenced by the government and the IRS's treatment of tax protestors. Because tax protestors vocally oppose what they believe to be unfair treatment, they may influence perceptions on a large-scale basis. Moreover, because taxpayer confidentiality is required by law, in many cases the IRS will not have the means to effectively refute allegations of unfair treatment. Taxpayer perceptions are also closely related to and may be affected by other influences on tax compliance, which include audit rates, publicity about successful tax avoidance schemes, penalties, and social norms.

Audits affect taxpayers directly and indirectly. The audit directly affects the taxpayer by determining the taxpayer's correct tax liability. Indirectly, the audit increases future compliance by both the taxpayer and others who learn of the audit and its results. An audit may cause an increase of self-reported income by many times the amount of the adjustment proposed during the audit.<sup>43</sup> However, because audits are costly to both the government and the taxpayer, only a small percentage of returns are audited.<sup>44</sup> The low audit rate increases the odds of winning the "audit lottery" and, to the extent the rate is generally known, may decrease a taxpayer's willingness to fully report his or her income. Moreover, it is unlikely that the government will allocate significant additional funding to tax enforcement, including increased audit or collection efforts.<sup>45</sup>

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43. See Johnson, *supra* note 4, at 1027 (stating that the audit may increase collection by up to eleven times the amount of the adjustment); Brown & Mazur, *supra* note 19, at 1259; INTERNAL REVENUE SERVICE, THE DETERMINANTS OF INDIVIDUAL INCOME TAX COMPLIANCE, ESTIMATING THE IMPACTS OF TAX POLICY, ENFORCEMENT, AND IRS RESPONSIBENESS (2003) [hereinafter DETERMINANTS OF INDIVIDUAL INCOME TAX COMPLIANCE]; INCOME TAX COMPLIANCE, ESTIMATING THE IMPACTS OF TAX POLICY, ENFORCEMENT, AND IRS RESPONSIVENESS 1 (1996); *Reducing the Tax Gap: Hearing Before the Subcomm. on Federal Fin. Mgmt., Gov't Info., & Int'l Sec. of the S. Comm. on Homeland Sec. & Gov't Affairs*, 109th Cong. 11 (statement of Nina E. Olson, National Taxpayer Advocate (audit adjustment may increase tax collection by six to twelve times the proposed adjustment)); see also AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, *supra* note 26, at 29 (citing Jeffery A. Dubin, Michael J. Graetz & Lois L. Wilde, *The Effects of Audit Rates on the Federal Individual Income Tax*, 43 NAT'L TAX J. 395 (1990)). In addition, although the IRS has estimated that for every additional dollar allocated to tax enforcement it will collect over four dollars of tax due, the Treasury Inspector General for Tax Administration has questioned that estimate. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, A BETTER MODEL IS NEEDED TO PROJECT THE RETURN ON ADDITIONAL INVESTMENTS IN TAX ENFORCEMENT, TIGTA Ref. No. 2005-10-159 (2005), available at <http://www.treas.gov/tiga/auditreports/2205reports/200510159fr.html>.

44. DETERMINANTS OF INDIVIDUAL INCOME TAX COMPLIANCE, *supra* note 43, at 1.

45. Johnson, *supra* note 4, at 1013–14.

Studies show that people who believe the IRS will detect tax evasion or underreporting are more likely to correctly report their income.<sup>46</sup> The audit rate and the apparent risk of audit influence the perceived risk of detection.<sup>47</sup> Risk of audit may be influenced by the positions, credits, and deductions that a taxpayer reports. However, the factors used to select a specific return for audit are generally unknown. In addition, empirical research suggests that individual members of the general population are more likely to overestimate rather than underestimate their risk of audit.<sup>48</sup> Although taxpayers tend to overestimate their risk of audit, publicity about very low audit rates may cause an individual taxpayer to maintain a false belief that she is unlikely to be audited.

In addition, compliance is influenced by the likely consequences of detection,<sup>49</sup> which include civil penalties, criminal sanctions,<sup>50</sup> and social stigma.<sup>51</sup> The magnitude of sanctions that are likely to be imposed also influence the effect on tax compliance. A small chance of a large penalty, a large chance of a small penalty, or a large chance of a large penalty may have different consequences for expected tax compliance.

Notwithstanding the availability of sanctions, in some cases there will be little or no negative consequence from the tax avoidance, or the imposition of the penalty may be delayed, even in well-known cases of tax avoidance. For instance, despite a front-page story in the New York Times in 2000 that Al Thompson, the owner of Cencal Aviation Products, had decided not to withhold taxes from his employees because he believed that he was not legally obligated to do so, the IRS did not take any public action against Mr. Thompson until 2003.<sup>52</sup> During this period, Mr. Thompson showed many others the means by which he avoided taxes.<sup>53</sup> Although Mr. Thompson was ultimately convicted of

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46. Kornhauser, *supra* note 33, at 1000; Lederman, *Interplay*, *supra* note 4, at 1464–65.

47. ALAN H. PLUMLEY, IRS NAT'L HEADQUARTERS OFFICE OF RESEARCH, THE IMPACT OF THE IRS ON VOLUNTARY TAX COMPLIANCE: PRELIMINARY EMPIRICAL RESULTS (Nov. 14–16, 2002) <http://www.irs.gov/pub/irs-soi/irs/vct/pdf>.

48. Andreoni, Erard & Feinstein, *supra* note 4, at 844.

49. See, e.g., Richard C. Stark, *A Principled Approach to Collection and Accuracy-Related Penalties*, 91 TAX NOTES 115, 117 (2001). In studies conducted on individuals, people were more likely to overestimate the likely cost of penalties if presented with data on likelihood of audit and likely range of penalty separately.

50. See *infra* Part V.

51. See, e.g., Stark, *supra* note 49.

52. David Cay Johnston, *Tax Cheat Sentenced to 6 Years for Defying I.R.S.*, N.Y. TIMES, Apr. 14, 2005, at C3. Thompson was not convicted and sentenced until 2005. *Id.*

53. *Id.*

criminal conduct, his very visible and apparently successful tax avoidance over a period of years could cause the public to underestimate the likely consequences of tax avoidance. To some degree the steps taken to collect taxes from vocal tax protestors may go unnoticed because of the requirement that the IRS keep taxpayer information confidential.<sup>54</sup> Highly publicized examples like Al Thompson may contribute to an impression that even though the IRS may impose criminal and civil penalties for tax noncompliance, penalties are unlikely to outweigh the benefit of noncompliance.

Perhaps fortunately, fines or imprisonment are not the sole sanction that may result from tax noncompliance. Even if a taxpayer believes that a penalty is unlikely to be imposed, the taxpayer may comply because she anticipates that social stigma or feelings of guilt will be associated with noncompliance.<sup>55</sup> Thus, social stigma associated with tax evasion may increase compliance even if the economic benefit of tax noncompliance will outweigh monetary penalties or criminal sanctions associated with noncompliance. Similarly, the degree to which a taxpayer believes he would feel guilt about cheating on his taxes may influence compliance decisions.<sup>56</sup> Social stigma and feelings of guilt may flow from a taxpayer's belief in the legitimacy of the tax system and its fairness. While very important to tax compliance, social stigma and feelings of guilt are less easily quantified than monetary penalties.

In addition, taxpayers who believe that they are legally required to pay taxes are more likely to comply with their tax obligations.<sup>57</sup> However, taxpayers, especially those who are dissatisfied with the government or its policies, may be swayed by persuasive arguments against the tax system. Nonetheless, the idea that the payment of taxes is optional is an example of the adage that an idea that sounds too good to be true probably is.

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54. David Cay Johnson, *U.S. Warning to Business on Tax Protest*, N.Y. TIMES, June 7, 2001, at C1 (noting that although tax liens were filed, the liens were not discovered because the IRS used a variation of the company's name).

55. However, social stigma associated with noncompliance is likely to be minimized by the fact that a taxpayer who is not accused of a criminal tax violation may avoid any public disclosure of his or her tax noncompliance by settling the matter with the IRS without resort to court action. *See* I.R.C. § 6103 (2000).

56. Stalans, Smith & Kinsey, *supra* note 39, at 499.

57. Posner, *supra* note 35; DETERMINANTS OF INDIVIDUAL INCOME TAX COMPLIANCE, *supra* note 43 (1996). There is data available that suggests that overall taxpayers believe that it is wrong to cheat on their taxes. IRS OVERSIGHT BOARD, 2004 TAXPAYER ATTITUDE SURVEY (reporting that 86% of the respondents in 2004, 81% in 2003, 86% in 2002, and 87% in 1999 indicated that no amount of cheating on one's income taxes was acceptable).

Finally, the taxpayer's belief regarding whether others do or do not pay taxes can influence the taxpayer's views on the necessity of tax compliance.<sup>58</sup> Information on others' tax compliance often comes from media reports. Media reports on the increasing tax gap, successful tax protestors, and tax avoidance schemes may create or increase the perception that others successfully avoid paying taxes.<sup>59</sup> This perception may cause otherwise honest taxpayers to be less likely to report and pay their taxes because no one wants to be a "chump."<sup>60</sup> This, in turn, may cause a cascading effect.<sup>61</sup> The stronger the perception that others do not pay taxes, the more likely an individual is to believe that he should not pay taxes, which may make that individual more willing to cheat on his taxes.<sup>62</sup>

## 2. *Reasons for noncompliance*

Another element of taxpayer perception relates to whether the tax system is viewed as being fair. An individual's perceptions that the tax system is unfair or treats similarly situated taxpayers differently may reduce compliance. Visible noncompliance by tax protestors may reduce general perceptions of tax fairness because the refusal to share in the cost of public goods means that the tax protestors' share of those costs must be borne by other members of society. To the extent that such refusal to pay and inaction by the government are known or publicized, general tax compliance may decline because the majority may be unwilling to support free-riding by tax protestors.<sup>63</sup>

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58. Kornhauser, *supra* note 33, at 1000; Lederman, *Interplay*, *supra* note 7, at 1470.

59. Stark, *supra* note 49, at 117. The reverse is also true. Reports of increased enforcement activity or audit rate may increase compliance. See, e.g., Lederman, *Interplay*, *supra* note 4, at 1486–87.

60. Stark, *supra* note 49, at 118; Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71, 87 (2003); Lederman, *Interplay*, *supra* note 4, at 1487.

61. See, e.g., Andreoni, Erard & Feinstein, *supra* note 4, at 851.

62. This is borne out in commentary suggesting that the perception that it is okay to cheat on taxes has been rising. See Curtis J. Berger, "Voluntary" Self-Assessment? *The Unwilling Extraction of Taxpayer Information*, 42 U. PITT. L. REV. 759, 759 & n.3 (1981); Johnson, *supra* note 4, at 1021. See generally Dan M. Kahan, *Signaling or Reciprocating? A Response to Eric Posner's Law and Social Norms*, 36 U. RICH. L. REV. 367, 378–80 (2002) (discussing how perceptions of cheating on taxes affects compliance); Mitchell, *supra* note 42, at 131 (1985) (discussing how undetected tax evasion encourages others to not comply).

63. See, e.g., NATIONAL TAXPAYER ADVOCATE SERVICE, 2004 ANNUAL REPORT TO CONGRESS 217; Jon S. Davis, Gary Hecht & Jon D. Perkins, *Social Behavior, Enforcement and Tax Compliance Dynamics*, 78 THE ACCT. REV. 39 (2003); Kahan, *supra* note 60, at 84 ("Auditing crackdowns and other high-profile modes of enforcement risk backfiring, the evidence suggests,

Notwithstanding the concern that tax protestors' failure to pay their share of taxes may harm the compliance rate, failure to provide an effective, accessible means to redress disagreements about the application of the tax laws can also make the tax system appear to be less fair, and therefore, less legitimate. To promote the perception that the tax system fairly addresses questions regarding individual liabilities, legal challenges to tax determinations must be permitted. However, not all challenges to individual tax liabilities or criticisms of the tax system are legitimate. Nonetheless, it is essential to remember that even a tax protestor can raise a legitimate claim that the law was misapplied in a particular instance. Without looking to the merits of each case, it is virtually impossible to determine with certainty that none of the claims raised have any legitimacy. Summary rejection of suits or claims that include typical tax protestor rhetoric, without at least some consideration of the merits, can create the impression that access to justice is being unfairly denied to some.

Thus, even though in most cases the resources used to process and decide tax protestors' claims could be devoted to more visibly productive activities, their claims must be given some consideration to avoid creating the perception that the tax system is unfair. Moreover, while disregarding any group of taxpayers may undermine the perception of the fairness of the tax system, tax protestors tend to be a vocal group and may produce more publicity about their inability to challenge the laws. This Article proposes, as explained in Part V, that tax protestors must be permitted to express their views and must have access to the administrative and judicial system, but such access must not be without cost when it is used only to avoid or delay payment of a legitimate tax liability.

Additionally, taxpayer confidentiality provides a challenge to influencing taxpayer perceptions. The law prohibits the IRS and its employees from disclosing individual taxpayer information.<sup>64</sup> This prohibition hinders efforts to increase tax compliance by triggering social stigma. Even when the IRS imposes penalties on a tax protestor, unless a public record is created by the filing of a lien or a court case, information about the identity of the taxpayer and penalties imposed is likely to be protected against disclosure. Thus, tax protestors and tax scheme

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because they function as a cue that evasion is widespread. . . . [Officials] should take advantage of the attention that high-profile prosecutions naturally attract to publicize positive information . . . ."); Lederman, *Interplay*, *supra* note 4.

64. I.R.C. § 6103 (2000).

promoters have an advantage: they may very vocally and publicly claim that the tax system is illegitimate and that they do not suffer consequences for failing to pay taxes. Yet the Service cannot reveal what it is doing with respect to individual tax protestors, or even whether specific allegations are true. As a result, only nonspecific information can be released. Thus, the incidence of detection of a particular evasion technique and the magnitude of the penalty likely to be imposed may not be well known. IRS Notices regarding transactions may increase public awareness of government enforcement efforts, but such notices may not be widely read outside the tax profession. Further, such notices may not provide sufficiently concrete information to alert taxpayers as to the likelihood that a particular approach to tax avoidance will be detected or the likely consequences of detection. Moreover, such notices cannot refer to individual taxpayers by name.

In addition, elected officials, politicians, and commentators frequently challenge the fairness of the tax system. Because public support of the tax system is essential to tax compliance, challenges to the tax system made by politicians and officials may reduce tax compliance. Recent examples of widely publicized challenges to the fairness of the system of tax administration include the widely publicized hearings conducted by the Senate Finance Committee in 1997 and 1998<sup>65</sup> and political campaigns calling for the abolition of income tax or institution of a “fairer” tax as a campaign platform issue.<sup>66</sup> Likewise, in recent years, bills have been introduced in both houses of Congress calling for the elimination of the Tax Code.<sup>67</sup>

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65. *IRS Oversight: Hearings Before the S. Comm. on Finance*, 105th Cong. (1998) (hearings conducted on Apr. 28, 29, 30 and May 1, 1998); *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. (1998) (hearings conducted on January 28, 29, and February 5, 11, and 25, 1998); *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. (1997) (hearings conducted on September 23, 24, and 25, 1997).

66. Steve Forbes challenged the current income tax system and the need for the IRS during his presidential campaign. See, e.g., Eric Schmitt, *In New Hampshire, Forbes Works to Win the Skeptics*, N. Y. TIMES, Dec. 6, 1999, at A27. Steve Forbes recently wrote a book, again advocating a flat tax and a postcard return as a means to eliminate the IRS. STEVE FORBES, *FLAT TAX REVOLUTION: USING A POSTCARD TO ABOLISH THE IRS* (2005).

67. See S. 1921, 109th Cong. (2005) (stating that the purpose of the Act was “[t]o promote freedom, fairness, and economic opportunity by repealing the income tax and other taxes, abolishing the Internal Revenue Service, and replacing such taxes with a national sales tax and a business tax”); Date Certain Tax Code Replacement Act, H.R. 278, 108th Cong. § 2 (2003) (“The purpose of this Act is to set a date certain for replacing the Internal Revenue Code of 1986 with a simple and fair alternative.”); Date Certain Tax Code Replacement Act, H.R. 4716, 107th Cong. (2002); Date Certain Tax Code Replacement Act, H.R. 4199, 107th Cong. (2001); Date Certain Tax Code Replacement Act, H.R. 4199, 106th Cong. (2000) (passing in the House and dying in the Senate);

Much of the testimony during the 1997 and 1998 Senate hearings questioned the integrity of the tax collection system. The hearings led to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998).<sup>68</sup> At these hearings, testimony was taken from priests, single mothers, business owners, and current and former IRS employees, many of whom testified behind a screen to protect their identity.<sup>69</sup> These hearings, investigating IRS activities, were televised, widely discussed in the media,<sup>70</sup> and conducted in a “circus-like atmosphere.”<sup>71</sup> Much of the testimony was later determined to be erroneous.<sup>72</sup> However, despite the publicity of the hearings leading to an outcry against the IRS, the subsequent discovery of inaccuracies was not as widely discussed.<sup>73</sup> Such public challenges to the tax system, its collection mechanisms, and the attention drawn to governmental ineffectiveness at preventing tax avoidance may lead more individuals and groups to question the fairness and validity of the tax system.<sup>74</sup>

Increasing confidence in the fairness of the tax system may be difficult.<sup>75</sup> The United States has a long history of tax revolts and tax protests, which include the Boston Tea Party, the Whiskey Rebellion, Shays’ Rebellion, the Second Whiskey Rebellion, and protests leading

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Tax Code Termination Act of 1998, H.R. 3097, 105th Cong. (1998) (passing in the House with a vote of 219 to 209, but dying in the Senate). The impetus for bills to repeal the income tax, to eliminate the IRS, or to repeal the current tax code stem largely from frustration with the complexity of the current law and a desire for reform. However, when viewed in isolation and from the perspective of individuals looking for a way to justify their own noncompliance, these proposals may provide the desired excuse for rejecting the tax system as unfair, abusive, or illegitimate. See Kornhauser, *Legitimacy*, *supra* note 13, at 891–92 (discussing the images associated with and effects of such proposals).

68. Pub. L. No. 105-206, 112 Stat. 685 (1998) (codified as amended in various sections of the I.R.C.).

69. *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. (1997).

70. Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 FLA. L. REV. 1, 81 (2004).

71. Joe Spellman, *Conference Panel Ponders Finance Hearing Horror Stories*, 83 TAX NOTES 1854, 1855 (1999) (quoting Cono R. Namorato of Caplin & Drysdale in Washington, D.C.).

72. See, e.g., Leslie Book, *CDP and Collection: Perceptions and Misperceptions*, 107 TAX NOTES 487, 487 (2005); Camp, *supra* note 70, at 81; Danshera Cords, *How Much Process Is Due? I.R.C. Sections 6320 and 6330 Collection Due Process Hearings*, 29 VT. L. REV. 51, 52 (2004).

73. See, e.g., NATIONAL TAXPAYER ADVOCATE SERVICE, 2004 ANNUAL REPORT TO CONGRESS 457; Bryan T. Camp, *Replacing CDP*, 107 TAX NOTES 1039, 1039 (2005).

74. Kornhauser, *Legitimacy*, *supra* note 13, at 906.

75. See, e.g., CHARLES ADAMS, *THOSE DIRTY ROTTEN TAXES: THE TAX REVOLTS THAT BUILT AMERICA* (1998) (explaining that America was built on a commitment to freedom from taxation).

up to the Civil War.<sup>76</sup> These incidents illustrate the historical importance of tax protests in the United States, which some view as a component of efforts to throw off the harness of government oppression. The freedom and willingness to express concerns about the government and its actions are important to a free society; however, there are important differences between questioning the government and refusing to obey the law.

Because high tax compliance rates are essential to the effective operation of the U.S. government, and because it is unlikely that significant additional resources will be devoted to tax enforcement, the government must maintain or even increase tax compliance through other means. Enhancing the general perception that the tax system is fair could encourage and possibly even increase tax compliance. The effect might be further enhanced by publicizing the magnitude of penalties imposed in cases where noncompliance is detected.

### III. PROTESTOR RHETORIC

Although tax protestors are like others tax avoiders and evaders in many respects, they differ from the norm in that they use a variety of arguments to justify their refusal to pay any taxes. The belief that there is legal justification for tax noncompliance distinguishes tax protestors from other noncompliant taxpayers who either have made errors in preparing their tax returns or have purposely violated the law.

This Section will analyze tax protestor arguments by discussing the individuals and groups that embrace these arguments, and then providing an overview of some of the most common constitutional and statutory challenges they raise against the income tax.

#### *A. Tax Protestors and Promoters of Tax Protest Approaches*

Tax protestors come from all walks of life. Tax protestors are not just lay individuals; they are often well educated. Among the prominent tax protestors are accountants,<sup>77</sup> business owners,<sup>78</sup> former IRS

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76. See, e.g., *id.*; Kornhauser, *supra* note 33.

77. See, e.g., *Rotzinger v. United States*, 165 F.3d 33 (7th Cir. 1998) (tax accountant counseled clients not to report income); *Stoecklin v. Comm'r* 865 F.2d 1221 (11th Cir. 1989) (taxpayer had been a certified public accountant for many years).

78. See, e.g., *United States v. Codner*, 210 F.3d 390, (10th Cir. 2000); David Cay Johnston, *Mistrial Declared in Tax Withholding Case*, N.Y. TIMES, Nov. 27, 2003, at C4 (discussing the case of Richard M. Simkanin, owner of Arrow Custom Plastics, who stopped withholding taxes from his employees in 2000); David Cay Johnston, *Tax Protestor Is Convicted on 13 U.S. Charges*, N.Y. TIMES, Jan. 29, 2005, at C11 (explaining that Al Thomson, owner of Cencal Aviation Products, was

employees,<sup>79</sup> chiropractors,<sup>80</sup> sheriff's deputies,<sup>81</sup> and airline pilots.<sup>82</sup> On many occasions, protestor positions have been used by attorneys on their own behalf and on behalf of their clients.<sup>83</sup>

Tax protestors use books, live seminars, and the Internet to share and promote their justifications for the nonpayment of taxes.<sup>84</sup> In addition, the sale of tax protestor schemes can be profitable. Some tax protestors, including organizations<sup>85</sup> and individuals, sell their ideas to others. For instance, Thurston Paul Bell made \$60,000 between 2000 and 2002 by selling packages that explain his tax protestor theory on his websites, [www.nite.org](http://www.nite.org) and [www.taxgate.com](http://www.taxgate.com).<sup>86</sup> Similarly, Irwin Schiff has written several books and sells his tax avoidance schemes on his website

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convicted of tax evasion and other charges for failing to withhold and pay employment taxes on his employees).

79. *See, e.g.*, *Laughlin v. Comm'r*, 117 F. Supp 2d 997 (S.D. Cal. 2000) (discussing the report that Joseph Banister made to the IRS concerning his belief that the government could not require the payment of taxes and that IRS procedures were unconstitutional; after making the report, he resigned his position as an IRS Criminal Investigation Division agent).

80. *See, e.g.*, *United States v. Sather*, 3 Fed. App'x. 725 (10th Cir. 2001) (chiropractor used trusts to divert income based on belief that he was not subject to tax); David Cay Johnston, *Hearing Ordered on Claim that IRS Influenced Jury*, N.Y. TIMES, June 12, 2004, at C4 (discussing case of Dr. Martin P. Rutherford).

81. *See, e.g.*, David Cay Johnston, *Tax Cheat Sentenced to 6 Years for Defying I.R.S.*, N.Y. TIMES, Apr. 14, 2005, at C3 (referring to Matthew J. Allen, a Marin County, California deputy sheriff and follower of former IRS CID agent Joseph Banister).

82. *See, e.g.*, *Cheek v. United States*, 498 U.S. 192 (1991); *United States v. Engh*, 330 F.3d 951 (7th Cir. 2003).

83. *See, e.g.*, *Roberts v. Comm'r*, 329 F.3d 1224, 1229 (11th Cir. 2003) (noting that although the attorney was representing himself in this case, he had lost on the same issue in a previous suit where he represented another taxpayer); *United States v. Collins*, 920 F.2d 619, 623 (10th Cir. 1990); *Charczuk v. Comm'r*, 771 F.2d 471 (10th Cir. 1985); *Ficarola v. Comm'r*, 751 F.2d 85, (2d Cir. 1984); *Takaba v. Comm'r*, 119 T.C. 285 (2002) (imposing penalties on both the attorney and the taxpayer); *Lunsford v. Comm'r*, 117 T.C. 183, 187 (2001) (noting Thomas W. Roberts, the attorney who had filed the petition, had raised such frivolous arguments before and had been disbarred from practice before the court); *Davis v. Comm'r*, 115 T.C. 35 (2000); Francis X. Sullivan, Comment, *The "Usurping Octopus of Jurisdictional/Authority": The Legal Theories of the Sovereign Citizen Movement*, 1999 WIS. L. REV. 785, 790 (citing *Charczuk*, 771 F.2d at 476).

84. *See supra* note 8.

85. Members of "We the People" have recently been successfully prosecuted for promoting bogus tax schemes that promised to limit income tax liability. Press Release, U.S. Attorney, Cent. Dist. of Cal., *Several Tax Fraud Promoters Sentenced to Prison for Falsely Promising to Protect Income From Taxes* (June 7, 2005), <http://www.usdoj.gov/usao/cac/pr2005/086.html>. Another organization that has promoted tax protestor schemes is Morningstar Consultants. *United States v. Raymond*, 228 F.3d 804, 811–12 (7th Cir. 2000).

86. *United States v. Bell*, 414 F.3d 474, 475 (3d Cir. 2005).

www.paynoincometax.com.<sup>87</sup> Schiff also owns a bookstore in Las Vegas that sells his books and materials.<sup>88</sup>

Publicity about efforts to stop tax protestors may make their positions appear successful and legitimate, which might undermine other taxpayers' beliefs that everyone pays their fair share of taxes. In addition, media attention may also make it easier for tax protestors to promote their positions and convince others that their nonpayment is legitimate.

The Department of Justice has successfully undertaken criminal prosecutions of many tax protest promoters<sup>89</sup> and has obtained injunctions against the promotion of tax avoidance schemes.<sup>90</sup> These efforts have not significantly slowed the growth of the tax protestor movement. Promoters often challenge efforts to restrain the promotion of their approaches to tax avoidance by challenging the issuance of injunctions against selling tax avoidance schemes on First Amendment grounds,<sup>91</sup> asserting that the scheme being promoted contains protected political speech, that the injunction constitutes an unconstitutional prior restraint on speech, or both.<sup>92</sup> However, the courts reject these contentions because courts can draw an injunction narrowly enough to

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87. See *United States v. Schiff*, 379 F.3d 621, 623 (9th Cir. 2004). The Department of Justice has obtained an injunction preventing him from selling his most recent book. In addition, much to the chagrin of his followers, in response to a civil suit brought by the Justice Department for \$2.5 million in taxes, interest, and penalties, Mr. Schiff put forth the defense that he suffers from delusions. Stanley Bing, *Nuts to You!*, FORTUNE, Mar. 8, 2004, at 218; David Cay Johnston, *Tax Protestor Tells Federal Court That He Is Delusional*, N.Y. TIMES, Feb. 7, 2004, at C3 (noting that Mr. Schiff, through his girlfriend and partner in promoting tax protestor materials, sent an email to supporters alleging the claim of delusions was a ruse).

88. *Schiff*, 379 F.3d at 623.

89. Irwin Schiff has multiple convictions for avoidance and promotion of tax avoidance schemes. See *United States v. Schiff*, 801 F.2d 108 (2d Cir. 1986) (affirming a conviction for attempted tax evasion and willful failure to file a corporate tax return); *United States v. Schiff*, 612 F.2d 73 (2d Cir. 1979) (reversing conviction for willful failure to file an income tax return and remanding to lower court on evidentiary issue). George H. Jesson was another tax protestor who promoted tax avoidance and was later indicted and plead guilty to felony tax avoidance. Mr. Jesson bragged in interviews about the things he was able to afford because he did not pay taxes. David Cay Johnston, *Tax Protestor Pleads Guilty to Filing False Claim*, N.Y. TIMES, June 29, 2005, at C2. He and other businessmen who were featured as examples of the legality of avoidance by We the People Foundation are serving prison terms. *Id.*

90. See, e.g., *Schiff*, 379 F.3d at 621; see also David Cay Johnston, *Court Says Author Can't Sell His Book on Evading Taxes*, N.Y. TIMES, Aug. 10, 2004, at C5; *Court Blocks Antitax Book*, 35 AM. LIBR., Oct. 2004 at 20.

91. See, e.g., *United States v. Bell*, 414 F.3d 474, 481–85 (3d Cir. 2005); *Schiff*, 379 F.3d at 621; *United States v. Raymond*, 228 F.3d 804 (7th Cir. 2000).

92. *Bell*, 414 F.3d at 478, 481 (arguing that an injunction was both an unconstitutional prior restraint on speech a violation of the right to free political speech); *Schiff*, 379 F.3d at 626 (arguing that an injunction was an unconstitutional prior restraint on speech).

prevent prior restraint or restriction of political speech. Furthermore, courts have held that false commercial speech and statements designed to aid and abet a violation of the tax law are not protected speech.<sup>93</sup>

The protestors' frivolous arguments take a variety of forms, which are often summarily dismissed by the courts.<sup>94</sup> Many courts have reasoned that more than summary dismissal might encourage other people to use the protestor rhetoric to delay collection of their tax liability.<sup>95</sup> For instance, after having considered the frivolous positions in a number of cases, the Tax Court stated that the "time has arrived when the Court should deal summarily and decisively with such cases without engaging in scholarly discussion of the issues or attempting to soothe the feelings of the petitioners by referring to the supposed 'sincerity' of their wildly espoused positions."<sup>96</sup> Part B will discuss some of the specific contentions that promoters and tax protestors have advanced in furtherance of their efforts to avoid paying taxes.

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93. *Bell*, 414 F.3d at 480–83.

94. *See, e.g., Crain v. Comm'r*, 737 F.2d 1417, 1417 (5th Cir. 1984) ("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."); *McCoy v. Comm'r*, 76 T.C. 1027, 1029–30, *aff'd* 696 F.2d 1234 (9th Cir. 1981) ("The time has arrived when the Court should deal summarily and decisively with such cases without engaging in scholarly discussion of the issues or attempting to soothe the feelings of the petitioners by referring to the supposed 'sincerity' of their wildly espoused positions"); *Ketler v. Comm'r*, 77 T.C.M. (CCH) 1495 (1999) (following *McCoy v. Comm'r*, 76 T.C. 1027, 1029–30 (1981)).

95. *See, e.g., Stallard v. Comm'r*, 64 T.C.M. (CCH) 993 (1992) ("[Taxpayer's] arguments are no more than stale tax protester contentions long dismissed summarily by this Court and all other courts which have heard such contentions."); *Jackson v. Comm'r*, 62 T.C.M. (CCH) 920 (1991) (concluding after taxpayer filed both a petition and amended petition that raised only tax protester arguments that "no useful purpose would be served by affording the parties a further hearing in this matter"); *Havrilla v. Comm'r*, 62 T.C.M. (CCH) 919 (1991) ("We see no reason to again refute these arguments with somber reasoning and copious citation of precedent."); *Derksen v. Comm'r*, 84 T.C. 355 (1985) (granting a motion to dismiss for failure to state a claim on which relief could be granted in either the petition or the amended petition). In other cases, the court has noted that had the Service filed a motion to dismiss for failure to state a claim, that dismissal likely would have been granted. *See, e.g., Rodriguez v. Comm'r*, 47 T.C.M. (CCH) 1225 (1984); *Phillips v. Comm'r*, 47 T.C.M. (CCH) 1223 (1984); *Urban v. Comm'r*, 47 T.C.M. (CCH) 1130 (1984). These same claims have also been raised in less traditional fora, such as the bankruptcy court, and summarily dismissed. *See, e.g., Robnett v. United States*, 165 B.R. 272, 274 (B.A.P. 9th Cir. 1994) (affirming the bankruptcy court's dismissal for failure to state a claim upon which relief could be granted and imposing a \$1,500 sanction on the debtor for raising only frivolous issues on appeal).

96. *McCoy v. Comm'r*, 76 T.C. 1027, 1029–30, *aff'd*, 696 F.2d 1234 (9th Cir. 1983).

*B. Specific Tax Protestor Positions**1. Constitutional challenges*

Tax protestors use a wide variety of arguments to support their claims that they have no tax obligation or that the tax system is illegitimate. Many of the contentions raised by tax protestors relate to the constitutionality of the income tax. Constitutional challenges include arguments that the income tax reporting rules violate the Fifth Amendment right against self incrimination, that the collection of taxes is a taking without due process of law, that the creation of tax obligations violates the Thirteenth Amendment's prohibition on slavery, and that the Sixteenth Amendment was not properly ratified.<sup>97</sup> Like other tax protestor contentions, the courts have repeatedly rejected these and other constitutional challenges to the income tax.<sup>98</sup>

This Article does not reconsider tax protestor arguments in depth and does not attempt to identify all of the types of tax protestor rhetoric currently used.<sup>99</sup> However, this Article briefly describes a few of the more common tax protestor arguments to provide a context for the problems created by tax protestors.

One of the most enduring tax protestor contentions is the claim that the Sixteenth Amendment was not properly ratified. The ratification of the Sixteenth Amendment is challenged on several grounds.<sup>100</sup> The challenges to the ratification of the Sixteenth Amendment are popular not only among the tax protestors,<sup>101</sup> but also among the promoters of tax protest schemes.<sup>102</sup> One claim argues that the ratification of the

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97. See, e.g., INTERNAL REVENUE SERV., THE TRUTH ABOUT FRIVOLOUS TAX ARGUMENTS (2005), [http://www.irs.gov/pub/irs-utl/friv\\_tax.pdf](http://www.irs.gov/pub/irs-utl/friv_tax.pdf) [hereinafter THE TRUTH].

98. *Id.*

99. The Service published a fifty-six-page document, *The Truth about Frivolous Tax Arguments*, in which the Service discusses a number of such arguments, explains why the arguments are invalid, and identifies cases rejecting each position. *Id.* This document also identifies a number of bogus claims for credits or deductions, one of which is the "slavery reparation" credit or refund, which does not exist. *Id.*

100. The variations include claims that Ohio was not properly admitted as a state and therefore President Taft was not president, meaning that he could not convene Congress, and the Secretary of State whom the president appointed could not properly certify the ratification of the amendment. See *Knoblauch v. Comm'r*, 749 F.2d 200, 201 (5th Cir. 1984); Jackson, *supra* note 13, at 301.

101. Jackson, *supra* note 13, at 301-07.

102. *Miller v. United States*, 868 F.2d 236, 240 (7th Cir. 1989) (expressing concern about the number of taxpayers raising similar arguments, all based on a book, BILL BENSON & M.J. "RED" BECKMAN, THE LAW THAT NEVER WAS (1986)).

Sixteenth Amendment was invalid because the Amendment's language was slightly different during some of the states' ratification vote.<sup>103</sup> This claim relies on a memorandum written by then Secretary of State Knox outlining the differences, primarily spelling and grammatical errors.<sup>104</sup> The Solicitor of the Department of State concluded that the differences between versions were immaterial.<sup>105</sup>

Another argument against the Sixteenth Amendment's ratification posits that Ohio did not become a state until 1953; thus, Ohio was not a state at the time of ratification of the Sixteenth Amendment, and President Taft was not properly President and could not convene Congress.<sup>106</sup> This contention improperly uses Public Law 204, which Congress passed in 1953 to settle a dispute as to the precise date in 1803 that Ohio became a state.<sup>107</sup> This argument is clearly erroneous because the 1953 resolution did nothing more than confirm that Ohio became a state in 1803.<sup>108</sup>

Another common constitutional argument against the income tax is that it violates the Fifth Amendment.<sup>109</sup> These challenges come in two forms. The first variant argues that the income tax constitutes a taking by government without due process of law.<sup>110</sup> However, because the government cannot operate without revenue, it must collect taxes. Moreover, because the means of collecting taxes must be efficient, the courts have repeatedly allowed summary tax collection proceedings where they were followed by an opportunity for judicial review.<sup>111</sup> The second common contention relating to the Fifth Amendment is that mandatory income reporting is a violation of a taxpayer's right against

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103. See, e.g., THE TRUTH, *supra* note 97, at 24–26.

104. See, e.g., *Miller*, 868 F.2d at 240–41 (noting that these arguments are frivolous); Jackson, *supra* note 13, at 301–07; BENSON & BECKMAN, *supra* note 102.

105. See, e.g., *Miller*, 868 F.2d at 240–41 (noting that these arguments are frivolous); Jackson, *supra* note 13, at 301–03.

106. See, e.g., Jackson, *supra* note 13, at 305; *Johnson v. Comm'r*, 39 T.C.M. (CCH) 22 (1979); *Baker v. Comm'r*, 37 T.C.M. (CCH) 307 (1978).

107. Jackson, *supra* note 13, at 305.

108. See, e.g., *Bowman v. United States*, 920 F.Supp. 623, 624 n.1 (E.D. Pa. 1995).

109. See, e.g., THE TRUTH, *supra* note 97, at 21–23.

110. See, e.g., *Schiff v. United States*, 919 F.2d 830, 832 (2d Cir. 1990); THE TRUTH *supra* note 97, at 20–21; Jackson, *supra* note 13, at 307–08; Michael D. Riley, Comment, *The Fifth Amendment and Tax Protestors: Development and Present Status*, 31 LOY. L. REV. 357 (1985).

111. *Phillips v. Comm'r*, 283 U.S. 589, 595 (1931) (“Where, as here, adequate opportunity is afforded for a later judicial determination of the legal rights, summary proceedings to secure prompt performance of pecuniary obligations to the government have been consistently sustained.”); *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 24–25 (1916); see also THE TRUTH, *supra* note 97, at 2.

self-incrimination.<sup>112</sup> However, the filing of a tax return is not, by itself, an incriminating act.<sup>113</sup> Although in a particular instance, a taxpayer might successfully challenge the requirement that she make a specific disclosure on her tax return because that disclosure in and of itself would be incriminating, simply filling out a tax return will not lead to criminal sanctions.<sup>114</sup>

Tax protestors have also invoked the Thirteenth Amendment's prohibition on slavery and involuntary servitude.<sup>115</sup> This contention asserts that income taxes require an individual to work for the benefit of another, the government, without the individual's consent.<sup>116</sup> However, individuals are not required to work and tax is due only on income. Thus, an individual is not involuntarily laboring for another.<sup>117</sup> Moreover, even "if the requirements of the tax laws were to be classified as servitude, they would not be the kind of involuntary servitude referred to in the Thirteenth Amendment."<sup>118</sup>

Another popular tax protestor claim is that an individual is not a citizen who is subject to the income tax. This argument is based on the contention that the taxpayer is not a United States citizen but is instead the citizen of a state, a natural and freeborn person, or a nonresident alien.<sup>119</sup> This position often involves an assertion that the payment of income taxes is required only of federal employees and residents of the District of Columbia.<sup>120</sup> Tax protestors further reason that if they are not

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112. Tax protestors often assert a blanket Fifth Amendment privilege against self-incrimination; such risk of incrimination does not exist in most cases, although in limited cases disclosure of the source or amount of income or other specific information could be incriminating. *See, e.g.*, *Marchetti v. United States*, 390 U.S. 39, 41–42 (1968) (allowing a taxpayer to make a claim of privilege under the Fifth Amendment where the filing of the return would by itself be incriminating); *United States v. Sullivan*, 274 U.S. 263–64 (1927) (concluding that although there may be cases where completion of a return will constitute self-incrimination that would entitle the taxpayer to "plead the Fifth," a blanket assertion of privilege was not available); *United States v. Johnson*, 577 F.2d 1304, 1311 (5th Cir. 1978) (concluding that a taxpayer or a tax protestor did not have a right under the Fifth Amendment to not report income that was earned in an illegal activity); *Jackson*, *supra* note 13, at 308–09; *Riley*, *supra* note 110.

113. *See, e.g.*, *Sullivan*, 274 U.S. at 264; *United States v. Neff*, 615 F.2d 1235, 1240–41 (9th Cir. 1980); *United States v. Schiff*, 612 F.2d 73, 83 (2d Cir. 1979); *see also* THE TRUTH, *supra* note 97, at 22–23.

114. *Sullivan*, 274 U.S. at 274.

115. *See, e.g.*, THE TRUTH, *supra* note 97, at 22–23.

116. *Id.* at 23–24; *Jackson*, *supra* note 13, at 310.

117. *Jackson*, *supra* note 13, at 310.

118. *Porth v. Brodick*, 214 F.2d 925, 926 (10th Cir. 1954).

119. *See, e.g.*, *Jackson*, *supra* note 13, at 310.

120. *See, e.g.*, *United States v. Raymond*, 228 F.3d 804 (7th Cir. 2000).

citizens of the United States, they are not subject to the income tax. Some variants of this position require an individual to renounce all ties to the government and declare her status as a sovereign citizen.<sup>121</sup> However, there is no legitimate distinction between state citizenship and federal citizenship for tax purposes.

Some protestors argue that the income tax violates equal protection because it treats married taxpayers and single taxpayers differently.<sup>122</sup> Courts have rejected this argument as the income tax does not affect any fundamental rights or any suspect class of citizens.<sup>123</sup> These examples demonstrate some, but not all, of the frivolous claims that tax protestors raise relating to the validity and applicability of the income tax.

## 2. *Other challenges*

One of the most popular arguments that does not involve the Constitution is the argument that paying income tax is voluntary.<sup>124</sup> People asserting this position have misconstrued the description of our tax system as “voluntary” to mean that the payment of tax is “optional,” which the courts have concluded is clearly incorrect.<sup>125</sup>

Tax protestors also assert that wages are not income because they result from the individual’s labor.<sup>126</sup> They argue that the value of the labor provided is equal to the amount of money received and therefore the laborer has no gain and, consequently, no tax liability.<sup>127</sup>

Some protestors challenge the IRS’s authority to collect taxes, claiming that the IRS is not really a government agency.<sup>128</sup> These taxpayers claim that the IRS is a Delaware corporation without the legal

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121. THE TRUTH, *supra* note 97, at 1–4 (discussing Jonathan D. Luman’s “Tax Buster” program).

122. Jackson, *supra* note 13, at 309–10.

123. *Id.*

124. *See, e.g.*, THE TRUTH, *supra* note 97, at 1–4; *United States v. Marsh*, 144 F.3d 1229, 1231 (9th Cir. 1998); *United States v. Barnett*, 945 F.2d 1296, 1299–1300 (5th Cir. 1991); *see also* Jackson, *supra* note 13, at 318 (noting the fact that tax protestor claims that they need not pay taxes is based on a mistaken interpretation of the self-reporting nature of the tax system).

125. *See, e.g.*, *United States v. Middleton*, 246 F.3d 825, 840–41 (6th Cir. 2001) (concluding that the trial court had not erred by instructing the jury that “voluntary” was not the same as “optional”).

126. The courts have rejected this argument. *See, e.g.*, *Barnett*, 945 F.2d at 1298.

127. *See generally* *Comm’r v. Glenshaw Glass, Co.*, 348 U.S. 426 (1955); THE TRUTH, *supra* note 97, at 7–11; Jackson, *supra* note 13, at 314; John W. Wright, Note, *Taxation: Frivolous Tax Litigation: Pecuniary Sanctions against Taxpayers and Their Attorneys*, 39 OKLA. L. REV. 156, 156–57 (1986).

128. Jackson, *supra* note 13, at 313–14.

ability to collect taxes.<sup>129</sup> This argument clearly fails, however, because the Secretary of the Treasury has the authority to create the IRS and to delegate to the IRS the power to enforce the tax laws.<sup>130</sup>

Additionally, protestors claim that Federal Reserve notes are not legal tender because they cannot be redeemed for gold or silver,<sup>131</sup> despite the delegation in the Constitution to Congress to establish legal tender.<sup>132</sup> These protestors argue that when they are paid with Federal Reserve Notes they do not receive “real money” for their labor and, therefore, they have no income that can be taxed.<sup>133</sup> The tax protestors asserting this position claim that the currency became worthless when the United States moved off of the gold standard.<sup>134</sup> In addition, tax protestors reason that if there is no legal tender, they cannot be liable for a tax debt denominated in such a currency.<sup>135</sup>

Finally, a very common tax protestor claim is referred to as “the section 861 position.”<sup>136</sup> This argument looks to the language of I.R.C. section 861 through 865, and uses the language of those sections as the basis for a contention that wages and other earnings received by U.S. citizens in the U.S. are not income.<sup>137</sup> However, these are sourcing rules, used only to determine whether income is U.S. or foreign source income.<sup>138</sup> This position has been repeatedly rejected as frivolous.<sup>139</sup>

In addition, taxpayers who object to funding the military on moral, religious, or philosophical grounds have attempted to withhold payment of all or part of their taxes.<sup>140</sup> Such taxpayers generally claim a credit or

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129. *Id.*

130. *Id.*

131. *See, e.g.,* United States v. Wangrud, 533 F.2d 495 (9th Cir. 1976) (rejecting this argument); Wright, *supra* note 127, at 157.

132. U.S. CONST. art. I, § 8, cl. 5.

133. *See* Zuger v. United States, 834 F.2d 1009, 1010 (Fed. Cir. 1987); United States v. Davenport, 824 F.2d 1511 (7th Cir. 1987); United States v. Condo, 741 F.2d 238 (9th Cir. 1984); United States v. Rickman, 638 F.2d 182 (10th Cir. 1980).

134. *Condo*, 741 F.2d at 238.

135. *See, e.g.,* United States v. Ware, 608 F.2d 400 (10th Cir. 1979).

136. Rev. Rul. 2004-30, 2004-1 C.B. 622 (discussing the so-called “section 861 position” and the possible civil and criminal penalties available to taxpayers asserting this position to deny their tax liability).

137. *Id.*

138. *Id.*

139. *See e.g., id.*; United States v. Bell, 414 F.3d 474 (3d Cir. 2005); Takaba v. Comm’r, 119 T.C. 18 (2002).

140. *See, e.g.,* Adams v. Comm’r, 170 F.3d 173, 174–75 (3d Cir. 1999) (discussing the taxpayer’s willingness to pay her taxes if they would be placed in a fund that did not pay for military spending, paying for which violated her religious beliefs, or if the government would otherwise

refund of the amount that they believe is attributable to the war effort.<sup>141</sup> Because the Constitution grants Congress the power to collect taxes and use revenues for the general good, courts have rejected taxpayers' refusal to comply with the tax laws on moral, religious, or philosophical grounds.<sup>142</sup>

As the sample of arguments discussed in this section has demonstrated, the arguments used by tax protestors are extremely varied. The one thing that all tax protestor arguments have in common is that they are frivolous. However, because tax protestors often use an amalgamation of these arguments with their filings or in their court filings, it may be difficult to identify whether a particular case includes legitimate claims along with the frivolous rhetoric. To provide a context within which to understand the need for a penalty equal to the costs associated with collection of tax from a tax protestor be imposed on tax protestors, it is first necessary to understand the opportunities available to taxpayers to challenge their tax liability. This context is important to clarify why tax protestors cannot be simply shut out of the system and how tax protestors impose significant costs on the government. The next Section discusses the tax collection process and the rights afforded to taxpayers during the collection process.

#### IV. TAX COLLECTION AND TAXPAYER COLLECTION RIGHTS

This Section provides a brief description of the tax collection and review process. This Section also provides a framework for understanding potential costs and the need for penalties to compensate for abuse of the tax system. Part A discusses tax collection generally. Part B discusses some of the new taxpayer rights created by Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998).<sup>143</sup>

##### *A. Tax Collection Generally*

There are three primary parts to the tax collection process: (1) determination of the tax liability, (2) payment of the tax liability, and (3)

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accommodate her beliefs); *see also* THE TRUTH, *supra* note 97, at 13–14 (explaining protestors' use of the rationale that there can be no tax imposed in an invalid currency); Kornhauser, *supra* note 13, at 943 (distinguishing conscientious tax protestors from tax protestors who do not have a moral objection, just a monetary objection, to paying taxes).

141. Wright, *supra* note 127, at 160.

142. *Id.* at 161 (citations omitted).

143. Pub. L. 105-206, 112 Stat. 685 (1998) (codified as amended in various sections of 26 U.S.C.).

challenge of the tax liability, which in some cases may occur before payment. At each stage, taxpayers have an opportunity to interact with the IRS and often with the courts. Thus, there are several opportunities for a taxpayer with legitimate concerns or challenges to an asserted tax liability to present her concerns or challenges and to arrive at a resolution. As a result, those who want to delay or frustrate the tax collection system also have numerous opportunities to do so, which can be very costly to the tax collection system and the courts.

### *1. Determination of tax liability*

Tax liabilities may be determined in two ways: (1) self-reporting and (2) IRS determination. The Service determines tax liabilities by conducting audits,<sup>144</sup> by matching self-reported returns with information returns,<sup>145</sup> and by identifying errors on filed returns.<sup>146</sup> With third-party information statements, the Service can match the amount reported by the payee to the amount reported by the payor to determine whether the taxpayer has properly reported taxable income.<sup>147</sup> Mandatory withholding and third-party information reporting eliminate the opportunity for most taxpayers to underreport their income without

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144. An audit may be conducted in several ways. First, an audit may be conducted by correspondence, with the Service requesting that the taxpayer provide documentation to the auditor by mail. Second, an audit may be conducted in the local IRS office. Third, an audit may be conducted at the taxpayer's residence or place of business. Finally, as in the case of many large corporations, the audit may be continuous and conducted on an ongoing basis at the taxpayer's place of business, by on-site IRS personnel. In addition, an audit of a taxpayer's liability may be either partial (examining only some of the taxpayer's reported items) or complete (examining the taxpayer's entire return). Audits are generally performed by examiners or auditors who work for the IRS in the examination division. *See generally*, INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL (CCH), pt. 4, available at <http://www.irs.gov/irm/index.html> (last visited Dec. 20, 2005) [hereinafter IRM].

145. Examples of information returns filed by third parties include Form W-2 Wage Statements, issued to employees by employers; and Forms 1099, which are issued by a variety of payors to payees of items such as interest, pensions, miscellaneous items, etc.

146. Such determination may result from a math error adjustment, I.R.C. §§ 6201, 6213 (2000), or from a determination on audit.

147. Some problems with matching have occurred. For instance, the Service temporarily discontinued a program that matched partnership items reported on a Form K-1 with items that are reported on the partner's tax return because of reported errors and problems with accurate matching. The "bugs" in this program had to be worked out, after which the program was restarted.

detection.<sup>148</sup> Even for taxpayers subject to withholding or third-party information reporting, a self-reported return must be filed.<sup>149</sup>

The Service may examine or audit a filed return regardless of whether there is a reported balance due. Based on the audit, the Service may determine that the taxpayer correctly reported, overreported, or underreported her tax liability. Audits have a positive effect on tax compliance but are costly and time consuming.<sup>150</sup> Currently less than one percent of all returns are audited.<sup>151</sup>

Taxpayers not subject to mandatory withholding, including domestic business entities, self-employed persons, and sole proprietorships, are those most likely to underreport their income.<sup>152</sup> Estimates suggest that approximately eighty percent of the tax gap is attributable to underreporting.<sup>153</sup> Thus, the majority of enforcement resources available should be used to detect underreporting among taxpayers not subject to mandatory withholding.<sup>154</sup>

## 2. *Payment of tax liability*

After the tax liability is determined, the tax due must be paid. Payment may already have occurred as a result of mandatory withholding or the payment of tax deposits. In fact, tax compliance begins and ends with a self-reported return for most wage earners and taxpayers whose income is subject to information reporting and withholding because there is little opportunity to underreport or avoid payment.<sup>155</sup>

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148. *See supra* note 4.

149. This is also often referred to as self-assessment, although that term is misleading. An assessment does not occur until it is made by the IRS. I.R.C. § 6201 (2000). *See Camp, supra* note 73, at 1551 (commenting on the inaccuracy of casual references to self-assessment and the confusions such references may cause).

150. *See supra* notes 43–44 and accompanying text.

151. *See supra* note 37 and accompanying text.

152. *See supra* note 4.

153. *Id.*

154. In 2002, 174,585,000 returns were filed. IRS REPORT TO CONGRESS: IRS TAX COMPLIANCE ACTIVITIES (July 2003). Also in 2002, the IRS made a total of 15,873,290 compliance contacts—13,315,765; 1,449,139; 242,637; and 823,749 contacts related to math error, underreporting, automated substitute returns, and examination, respectively. *Id.*

155. *See, e.g.,* Stalans, Smith & Kinsey, *supra* note 39, at 502 (concluding that not only do these taxpayers have greater opportunity to avoid taxes but also they are more likely to be involved in groups that are more accepting of tax avoidance, i.e., groups that have “less stringent norms against tax cheating”).

In other cases, a taxpayer's liabilities are not satisfied through withholding or tax deposits. Payment for any remaining liability is due at the time the taxpayer's tax return is due, without extensions.

However, some taxpayers do not pay their taxes at the time of filing. In these cases, the Service assesses the reported amount due. After assessment, the IRS may begin collection actions, which first require the Service to give notice of the unpaid liability and make a demand for payment.<sup>156</sup> Although a lien arises automatically for unpaid taxes,<sup>157</sup> to obtain priority over other creditors, the Service must file a Notice of Federal Tax Lien.<sup>158</sup> In addition, the Service may pursue collection by seizing or levying on the taxpayer's property.<sup>159</sup>

### 3. Challenge of tax liability

When the Service determines that additional amounts are due, the taxpayer sometimes has an opportunity to challenge the determination administratively and judicially before assessment.<sup>160</sup> After assessment, the taxpayer can pay the tax and request a refund, an administrative or judicial process.<sup>161</sup>

The opportunity to challenge a tax liability is not limited to challenges to IRS determinations of additional amounts due. Even taxpayers who self-report a liability or fail to challenge the determination of a deficiency have at least one opportunity to challenge. Taxpayers in the United States are entitled to more opportunities to challenge the amount of tax due than those of any other country.<sup>162</sup> First, after

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156. I.R.C. § 6303 (2000).

157. *Id.* § 6321.

158. *Id.* § 6323.

159. *Id.* § 6331. Prior to levy, a notice of intent to levy must generally be provided thirty days in advance. *Id.* In addition, the taxpayer must be given notice of the taxpayer's right to a Collection Due Process Hearing. *Id.* § 6330. This right is discussed below. *See supra* Part IV.B.1. Additional protections shield some property from levy. *Id.* § 6334. In addition, approval is required before the Service can collect by levy on a principal residence. *Id.* § 6334(e).

160. A judicial challenge is not available in all instances. I.R.C. § 6213 provides jurisdiction in the Tax Court only for deficiency redeterminations in income, estate, gift, and certain excise tax cases.

161. I.R.C. § 6523.

162. Although no proposal has ever been made to eliminate all judicial review and is unlikely to be seriously considered, it is unclear whether refund jurisdiction is constitutionally required for tax liabilities. *See* Harold Dubroff & Dan S. Grossman, *The United States Tax Court: An Historical Analysis, Part VI*, 42 ALB. L. REV. 191, 210 n.166 (1977) (citing *Rockwell v. United States*, 512 F.2d 882 (9th Cir. 1975)). No proposal has even been made to do this, and it would seem contrary to the United States' history of requiring process in tax collection.

payment of the liability, a taxpayer requesting a refund is entitled to consideration of the request and if the request is denied or is not answered within six months, the taxpayer may file suit in the United States District Court or the Court of Federal Claims.<sup>163</sup>

Another opportunity for judicial review may exist when the Service pursues collection of an unpaid liability. After a Notice of Federal Tax Lien or issuance of a Notice of Intent to Levy is filed, the taxpayer is entitled to challenge the collection action and, sometimes, the underlying liability, during a collection due process (CDP) hearing, which culminates in an opportunity for judicial review.<sup>164</sup> This right is discussed in the next Part.

In addition, even if the taxpayer is not at a stage where she is entitled to judicial review, there may be opportunities to challenge the liability administratively. Administrative challenges may involve discussions with a revenue officer or an auditor, appeal to the IRS employee's manager, or consideration by the IRS Office of Appeals.<sup>165</sup>

All taxpayers are given access to these processes. In most instances taxpayers are not required to raise or avoid particular arguments to gain access to review. However, the issues that may be raised are not unlimited. For instance, statute of limitations may limit the years that may be considered by a court.<sup>166</sup> In addition, the court's jurisdiction may

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163. The taxpayer is also entitled to judicial review if the taxpayer does not receive an administrative response to the refund claim within six months. *Id.* § 6532.

164. I.R.C. §§ 6320, 6330.

165. See IRM, *supra* note 144, at 8.1.1.2.2. The issues that the Appeals Office may consider include determinations of income, estate, gift, employment and excise taxes; liabilities and additions to tax and penalties; collection due process; offers-in-compromise; abatement of interest; administrative costs under I.R.C. § 7430; jeopardy levies; and recommendations concerning settlement offers in refund suits. *Id.*; see also MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 9.03[2] (rev. 2d ed. Supp. 2005). The IRS Office of Appeals is an independent department of the IRS, which is designed to address concerns raised by taxpayers about the actions taken by other IRS offices. IRM, *supra* note 144, § 8.1.1.1. The Appeals Office's mission begins,

The Appeals mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service. The Appeals program is designed to effectively carry out the Appeals mission.

*Id.* at 8.1.1.1.2. The independence of the Appeals Office was statutorily confirmed by RRA 1998, § 1001(a)(4). See generally H.R. REP. NO. 105-599 (1998) (Conf. Rep.); SALTZMAN, *supra*, ¶ 9.01, at 9-5 ("In the IRS Restructuring and Reform Act of 1998 . . . the Office of Appeals was not only acknowledged, but its independence was required to be protected."). Ex parte communications occurring after October 23, 2000 between the Appeals Officer and other IRS employees are limited. Rev. Proc. 2000-43, 2000-2 C.B. 404.

166. In most cases, the statute of limitations prevents assessment of a liability more than three years after the date on which the return was filed. I.R.C. § 6501(a). One important exception to this

be limited.<sup>167</sup> Finally, in a few instances, a statute may limit the issues that can be considered at an administrative proceeding.<sup>168</sup>

An additional limitation may be imposed when a particular taxpayer has repeatedly raised an argument that the courts have found to be without merit. In these cases, courts sometimes enjoin a taxpayer from bringing another action against the IRS or its employees until the taxpayer demonstrates that he is not raising the same frivolous arguments.<sup>169</sup> However, this is an extreme remedy that is not often imposed.

The number of opportunities to dispute a tax liability with the IRS and in court provide ample opportunity to ensure that the right amount of tax is collected. However, tax protestors may use the number of available opportunities to their advantage. These opportunities can be used to slow the collection process and are costly in terms of both the resources needed to pursue collection from intransigent taxpayers and the unpaid tax liability.

Notwithstanding the possibility that these processes can be abused, their availability is important to voluntary compliance. It would be easy, and often is tempting, to bar people who raise time-worn, repeatedly rejected, frivolous tax protestor claims from accessing the administrative and judicial systems.<sup>170</sup> Barring a particular group of taxpayers from challenging tax liabilities could harm the perception of the fairness of the tax system. First, in some cases legitimate issues could be buried in the tax protestor rhetoric. Because of this, simply dismissing the claims out of hand would likely increase both real and perceived unfairness.

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rule applies in cases of an omission of more than twenty-five percent of the gross income that should have been stated on the return, which will allow up to six years for the Service to make an assessment. I.R.C. § 6501(e). Moreover, if no return is filed, a false return is filed, or the taxpayer willfully attempts to defeat or evade the tax, an assessment may be made at any time. I.R.C. § 6501(c).

167. The Tax Court's jurisdiction is limited. *See* I.R.C. §§ 6213, 7442. Moreover, the district court and court of claims have jurisdiction only in refund requests and CDP appeals where the Tax Court would not have jurisdiction over the underlying liability. I.R.C. § 6330(d)(2).

168. *See, e.g.*, I.R.C. § 6330(c) (limiting the issues that can be raised in a CDP hearing); *id.* § 6404 (limiting the review of a denied request for abatement of interest to whether the IRS abused its discretion).

169. I.R.C. § 7421 (barring suits to prevent or restrain the assessment or collection of tax).

170. Recently, one court said that simply wishing to raise only frivolous tax-protestor arguments was not a valid reason to deny a CDP hearing. *Hinman v. Grzesiowski*, No. 3:05-CV-049 RM (N.D. Ind. May 10, 2005). *But see* *Lunsford v. Comm'r*, 117 T.C. 183 (2001) (concluding that it was unnecessary to remand a case back to the Appeals Office even though no hearing had been conducted because to do so would be "neither necessary or productive").

Second, barring some issues would present the challenge of determining which issues should be precluded and could create a fear that particular groups, rather than ideas, were being barred from access to relief. This could lead to a concern that people who are less pleasant to deal with might be barred access to the system. Finally, because tax protestors tend to be a vocal group, they would likely widely broadcast their exclusion from the system. This could signal to compliant taxpayers the possibility of exclusion, and the confidentiality of taxpayer information would prevent the Service from adequately answering charges that such exclusions were unfair. Many taxpayers, unaware of the strict nature of the legal prohibition against disclosure of taxpayer information by the Service, could interpret the Service's silence as a tacit admission that the tax protestors' allegations have merit. As a result, such silence could be deleterious to voluntary tax compliance.

The belief that the IRS acts unfairly in collecting taxes also affects the perceived fairness of the tax system. Concerns about the Service's collection practices were brought to the forefront in the Senate Finance Committee hearings conducted in 1997 and 1998.<sup>171</sup> The next Part discusses the changes to taxpayer rights and the tax collection system as a result of these hearings. Additional rights provide additional opportunities for tax protestors to avoid payment and increase the cost to the government of pursuing collection of taxes from tax protestors.

#### *B. Some Changes in Taxpayer Rights Resulting from RRA 1998*

After the 1997 and 1998 hearings, Congress enacted RRA 1998.<sup>172</sup> RRA 1998 was intended to combat the IRS abuses that were alleged during the hearings. However, concerns about the means used to collect taxes are certainly not new. Moreover, considering that over 130 million individual tax returns along with many other tax returns are filed each year, such concerns are inevitable; no matter how hard any agency that works with so many people tries, errors will occur. RRA 1998 made some necessary and some unnecessary or ineffective changes to the tax

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171. *Practices and Procedures of the Internal Revenue Serv.: Hearings Before the S. Comm. on Finance*, 105th Cong. (1997). These hearings were convened on September 23–25, 1997. Hearings on “IRS Restructuring” were held on January 28–29 and February 5, 11, and 25, 1998. *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 1 (1998). Hearings on “IRS Oversight” were held on April 28–May 1, 1998. *IRS Oversight: Hearings Before the S. Comm. on Finance*, 105th Cong. 1 (1998).

172. Pub. L. 105-206, 112 Stat. 685 (1998) (codified as amended in various sections of 26 U.S.C.).

collection system, including the creation of collection due process rights and the prohibition against designating a taxpayer to be an illegal tax protestor. These changes are discussed below.

### *1. Collection Due Process*

One of the new taxpayer rights created by RRA 1998 was the right to a Collection Due Process (CDP) hearing.<sup>173</sup> CDP hearings are conducted by an impartial appeals officer<sup>174</sup> when a CDP hearing is requested within thirty days of the issuance of a Notice of Federal Tax Lien<sup>175</sup> or a Notice of Intent to Levy.<sup>176</sup> Except in limited cases, a timely request for a CDP hearing stops a levy during the administrative and judicial processes.<sup>177</sup> While CDP is an important right, and judicial review is a necessary component, it is also subject to abuse. Tax protestors in particular may use CDP as a means of delaying tax collection and frustrating their obligation to timely pay their share of the cost of government.

During a CDP hearing, the appeals officer verifies the tax assessment and the Service's compliance with the applicable laws, considers collection alternatives, and balances the need for efficient collection against the taxpayer's interests.<sup>178</sup> The appeals officer then issues a notice of determination stating whether collection may proceed.<sup>179</sup> If the taxpayer is not satisfied with the determination, the taxpayer may seek judicial review, which is generally conducted to determine whether the appeals officer abused her discretion.<sup>180</sup>

The availability of CDP hearings and review may cause the public to perceive the system as being fairer. That perception would be consistent

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173. I.R.C. §§ 6320, 6330 (2000).

174. *Id.* § 6330(b)(3).

175. *Id.* § 6320(a).

176. *Id.* § 6330(a)(3), (b). There is a right to a CDP hearing when either event occurs.

177. Levy is not precluded if tax is in jeopardy. *Id.* § 6330. Levy may also occur during a judicial appeal if the underlying liability is not at issue and the IRS shows good cause for collection to proceed. *Id.* § 6330.

178. *Id.* § 6330(c)(2). In cases where a notice of deficiency was not issued and there was no prior opportunity to challenge the underlying liability, the taxpayer may also challenge the underlying liability at the CDP hearing. *Id.* § 6330(c)(2)(B).

179. *Id.* § 6330(c)(3).

180. *Id.* § 6330(d). Appeal is to the Tax Court if it would have jurisdiction over the underlying liability and to the district court if the Tax Court would not have jurisdiction over the underlying liability. Review of a challenge to the underlying liability, if permitted by I.R.C. section 6330, is de novo.

with Congress' intent, which was expressed in the committee report as follows:

The Committee believes that taxpayers are entitled to protections in dealing with the IRS that are similar to those they would have in dealing with any other creditor. Accordingly, the Committee believes that the IRS should afford taxpayers adequate notice of collection activity and a meaningful hearing before the IRS deprives them of their property. . . . The Committee believes that following procedures designed to afford taxpayers due process in collections will increase fairness to taxpayers.<sup>181</sup>

However, some have argued that CDP is a waste of resources that is potentially, if not actually, harmful to taxpayers.<sup>182</sup> If the taxpayer has multiple tax liabilities but has sought a CDP hearing and review of only selected tax liabilities, the taxpayer's assets will not actually be protected because the bar on levy that results from the CDP hearing request will halt collection only of the particular years', period, and tax liabilities that are the subject of that CDP notice.<sup>183</sup> However, many taxpayers who seek a CDP hearing will not have unpaid liabilities relating to years that are not included in the CDP notice, or for which the time to request a CDP hearing has expired.

Further, CDP requires the use of significant judicial and administrative resources.<sup>184</sup> The examination and collection functions participate in the CDP hearing, which the appeals office conducts. If the taxpayer appeals a CDP determination, the Service or the Department of Justice attorneys will have to answer the petition, prepare or respond to motions and, in some cases, prepare for and conduct a trial. Judicial resources used include the time spent on motions and trials.<sup>185</sup>

Although many CDP cases are resolved at the appeals office level, those that are appealed to the courts disproportionately involve frivolous

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181. S. REP. NO. 105-174, at 67 (1998).

182. Camp, *supra* note 73.

183. *Id.* Camp notes that once the house is gone, it does not really matter whether it was taken to pay the taxes for year X or for year Y; the effect is the same.

184. Bryan T. Camp, *The Failure of CDP, Part 2: Why It Adds No Value*, 104 Tax Notes 1567, 1570-72 (2004).

185. Chief Counsel defends the Service in cases heard by the United States Tax Court. The United States Department of Justice defends the Treasury Department and the Commissioner of Internal Revenue in cases brought in the United States district courts and in the United States Court of Federal Claims.

tax-protestor claims.<sup>186</sup> Thus, in the CDP context, the consumption of administrative and judicial resources by frivolous positions remains a particularly important concern.<sup>187</sup> The number of litigated CDP cases that involved frivolous issues dropped from fifty percent in 2003 to twenty-three percent in 2005; however, this level is still too high.<sup>188</sup> Some believe that the proper response to such a high rate of frivolous claims (and other problems with CDP) is to eliminate judicial review of CDP.<sup>189</sup>

This conclusion is inadequate because it fails to acknowledge the benefits that CDP and judicial review of the CDP determination provide to tax administration. First, taxpayers may be able to successfully negotiate mutually satisfactory resolutions by working with a different representative of the Service, the appeals officer.<sup>190</sup> Many tax collection issues are resolved in the appeals office during the CDP hearing; most CDP cases do not involve judicial review.<sup>191</sup> As noted by the National Taxpayer Advocate in her 2004 Annual Report to Congress, “[t]hese safety valves make taxpayers feel that the tax system is, after all, ultimately fair and balanced.”<sup>192</sup> However, judicial review is a necessary component of CDP. The availability of judicial review not only provides assurances that the Appeals Office will properly perform its functions, but it likely increases the perceived fairness of the process.<sup>193</sup>

Just as with other aspects of tax collection, tax protestors cannot be barred from using CDP without adversely impacting general perceptions of fairness. Therefore, a solution short of shutting tax protestors out of the system is needed. As discussed below, this can be done by requiring

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186. Camp, *supra* note 73. Only about five percent of the CDP hearing requests raise frivolous claims; however, those claims account for a disproportionate amount of resources and appeals. STAFF OF JOINT COMMITTEE ON TAXATION, 2003 REPORT OF THE JOINT COMMITTEE ON TAXATION RELATING TO THE INTERNAL REVENUE SERVICE AS REQUIRED BY THE IRS REFORM AND RESTRUCTURING ACT OF 1998, appendix 1, 22–23 (JCX-53-03).

187. Camp, *supra* note 73, at 1047.

188. *Id.* (citing the 2004 Annual Report of the National Taxpayer Advocate).

189. *Id.*; Danshera Cords, *Reforming, Not Replacing, CDP*, 108 TAX NOTES 817 (2005).

190. I.R.C. §6330(c) (2000); *see also* Cords, *supra* note 189, at 818.

191. Some practitioners have reported that it is often easier to establish an installment agreement or an offer in compromise when working with an Appeals Officer than when working with a revenue officer. These practitioners often seek to move the collection process along to the issuance of the CDP notice.

192. NATIONAL TAXPAYER ADVOCATE SERVICE, 2004 ANNUAL REPORT TO CONGRESS, Preface at vii (2004).

193. Cords, *supra* note 189, at 821–22.

people raising only tax protestor positions to pay for the cost of those challenges at both the administrative and judicial level.

## 2. *Illegal tax protestor designation*

Another concern raised during the 1997 and 1998 Senate hearings was a concern that the IRS's practice of labeling some taxpayers as "Illegal Tax Protestors," or ITPs, created stigma for taxpayers.<sup>194</sup> There were also concerns that after a taxpayer was identified as an ITP, the designation might remain, even if the taxpayer subsequently came into compliance.<sup>195</sup> As a result of this concern, RRA 1998 bars the IRS from designating a taxpayer as an illegal tax protestor.<sup>196</sup> As required by section 3707 of RRA 1998, the IRS has expended significant effort to eliminate all references to illegal tax protestors in the Internal Revenue Manual, employee training, and taxpayer master files.<sup>197</sup>

However well-intentioned banning the use of the ITP label was, it may frustrate efficient tax administration. In addition, this is another example of a reaction to a concern expressed during the hearings that may impede the IRS's ability to collect taxes from some taxpayers. Such a designation can provide important information to tax collectors. It identifies the types of arguments that are likely to be presented and allows tax officials to prepare for the likely responses to collection efforts. In addition, section 3707's bar of the "ITP" designation simply means that different, possibly less accurate or informative labels, are used. Instead of identifying tax protestors or tax protestor arguments, the IRS now identifies the much broader categories of abusive tax schemes or scams.<sup>198</sup> The tax schemes and scams that are identified include those

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194. S. REP. NO. 105-174, at 105 (1998).

195. *Id.*

196. RRA 1998, Pub. L. No. 105-206, § 3707, 112 Stat. 685, 778 (1998) (uncodified).

197. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, FISCAL YEAR 2005 STATUTORY AUDIT OF COMPLIANCE WITH LEGAL GUIDELINES PROHIBITING THE USE OF ILLEGAL TAX PROTESTER AND SIMILAR DESIGNATIONS, REP. NO. 2005-40-104 (2005). In its most recent report on IRS compliance with section 3707 of RRA 1998, the Treasury Inspector General for Tax Administration concluded that the IRS was largely in compliance. *Id.* The report identified only 309 instances in which it found references to illegal tax protestors. *Id.* at 2. Primarily these references were made in case narratives prepared by IRS personnel. *Id.*

198. On its web site, the IRS has a page devoted to links that help a taxpayer identify "tax scams." <http://www.irs.gov/businesses/small/article/0,,id=106788,00.html> (last visited Dec. 20, 2005). Included in the information available is a fifty-six-page document, *The Truth About Frivolous Tax Arguments*, *supra* note 97. The IRS also changed the designation of the taxpayers. *See, e.g.*, IRS Fact Sheet 2005-15, IRS Obtains More Than 100 Injunctions Against Tax Scheme Promoters (Apr.

that would have resulted in an ITP designation before RRA 1998 as well as other aggressive positions such as tax shelters.

Even assuming that banning the ITP label addresses a real problem, lumping tax protestors and tax shelters together may reduce the IRS's ability to target enforcement resources effectively. An effective means of pursuing collection from a tax protestor may not be as effective to collect a tax liability from someone who purchased a tax shelter and vice versa. Barring the Service from using the ITP designation is an incomplete solution. In addition, the courts are not impacted by section 3707. Because they are not prevented from using the ITP designation, courts continue to apply this label.<sup>199</sup> This leads to inconsistent descriptions of the same behavior.

Prohibiting the IRS from identifying some taxpayers as tax protestors does not promote effective tax administration, as it does nothing to stop their arguments or bring them into compliance. On the other hand, this prohibition may make it harder to identify and efficiently interact with tax protestors. More effective means of addressing the concerns of stigma or the possibility of an unreasonable refusal to remove an ITP designation are needed.

As tax collection relates to tax protestors, RRA 1998 may make it even harder to ensure collection. However, because perceptions of fairness are critical to tax administration, such rights may be necessary, and exclusion of tax protestors as a group would be ill advised. Therefore, a means of recovering from tax protestors the additional cost of collection that stems from their illegal acts is necessary.

## V. TAX PENALTIES

This Section will first consider the justifications for the imposition of penalties. Next, it will look at the types of tax penalties that are currently available. The Internal Revenue Code distinguishes between additions to tax<sup>200</sup> and penalties;<sup>201</sup> however, both are relevant in this context and will collectively be referred to as penalties. Although the focus of this

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2005), *available at* <http://www.irs.gov/newsroom/article/0,,id=137831,00.html>.

199. *United States v. Bell*, 414 F.3d 474, 475 (3rd Cir. 2005); *Izen v. Catalina*, 398 F.3d 363, 365 (5th Cir. 2005).

200. I.R.C. §§ 6651–6658 (2000).

201. *Id.* §§ 6662–6663 (discussing accuracy and fraud-related penalties); *Id.* §§ 6671–6720 (discussing assessable penalties); *Id.* §§ 6721–6723 (relating to penalties for failure to provide information reports).

Article is on civil penalties imposed on frivolous claims, this does not suggest that civil and criminal penalties are, or should be, mutually exclusive. Both criminal and civil penalties can be imposed on a single act,<sup>202</sup> and civil penalties are often used in conjunction with criminal sanctions.<sup>203</sup>

This Section provides background for the Article's proposal that additional penalties need to be imposed on tax protestors, despite the fact that penalties do not appear to deter tax protestors' behavior. Such penalties are needed to reimburse the government's costs of collection and to provide a fair result to both compliant taxpayers and tax protestors.

#### *A. Justifications for the Imposition of Tax Penalties*

Some commentators have suggested that lower compliance may result if penalties are too high,<sup>204</sup> while other commentators have suggested that current penalties are adequate to deal with both tax protestors and their attorneys.<sup>205</sup> However, the appropriate level of penalty depends on the reason for imposing penalties and how those penalties interact with the tax administration system.

Tax penalties address a variety of tax noncompliance situations. Possible justifications for imposing penalties include deterrence, punishment, and reimbursement or compensation for the costs imposed on or incurred by the government. Although most tax penalties are intended to deter tax avoidance,<sup>206</sup> remediation and compensation have also been used to explain the imposition of civil tax penalties.<sup>207</sup> The Supreme Court has stated,

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202. *Helvering v. Mitchell*, 303 U.S. 391, 399 (1938) ("Congress may impose both a criminal and a civil sanction in respect to the same act or omission; for the double jeopardy clause prohibits merely punishing twice, or attempting a second time to punish criminally, for the same offense."). However, civil penalties can only be added to criminal sanctions if the civil penalties are remedial rather than deterrent or retributive in nature. *See United States v. Halper*, 490 U.S. 437, 449 (1989).

203. *See, e.g., Badarraco v. United States*, 464 U.S. 386, 396 (1984).

204. *See, e.g., Lederman, Interplay, supra* note 24, at 1485 (questioning Professor Kahan's conclusion that high penalties might reduce compliance).

205. Wright, *supra* note 127.

206. *See, e.g., Mitchell*, 303 U.S. at 399 (1938) ("To ensure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil."); Donald Arthur Winslow, *Tax Penalties—"They Shoot Dogs Don't They?"*, 43 FLA. L. REV. 811, 857-63 (1991); *see also Kennedy v. Mendoza-Martinez*, 372 U.S. 144, 168-69 (1963) (noting that deterrence and retribution are traditional reasons for punishment in criminal cases).

207. *Mitchell*, 303 U.S. at 401.

The remedial character of sanctions imposing additions to tax has been made clear by this Court in passing upon similar legislation. They are provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud.<sup>208</sup>

Criminal sanctions, which have a much higher standard of proof and may result in incarceration, are less frequently imposed, but nonetheless have a significant deterrent effect.<sup>209</sup> Criminal penalties may be imposed for certain types of willful tax avoidance.<sup>210</sup> Civil penalties are imposed more frequently but their deterrent effect may be less than that of criminal penalties. More important in deterring tax noncompliance are a taxpayer's internalized norms regarding the importance of tax compliance.<sup>211</sup>

The penalties that are frequently used against tax protestors, including the frivolous filing penalty<sup>212</sup> and the frivolous litigation position penalty in the Tax Court,<sup>213</sup> may be relatively small compared to the resources needed to pursue collection. In addition, monetary penalties may not deter the tax avoidance behavior of tax protestors.

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208. *Id.*

209. Stark, *supra* note 49, at 117 (noting that jail is a consequence that many are unwilling to risk).

210. I.R.C. § 7201 (2000) (making it a felony to willfully evade or defeat tax); *id.* § 7202 (making it a felony to willfully fail to collect or pay over tax); *id.* § 7206 (making it a felony to commit fraud or make false statements); *id.* § 7207 (making it a crime to willfully file a fraudulent return or file a false statement); *id.* § 7212 (making it a crime to attempt to interfere with the administration of the tax laws by forcible interference or forcible rescue of seized property).

211. Stark, *supra* note 49, at 119; Stalans, Smith & Kinsey, *supra* note 39, at 482.

212. I.R.C. § 6702 (2000) (imposing a \$500 penalty on returns filed that do not contain information allowing determination of the correctness of a self-assessment or that on its face is incorrect and is based on frivolous positions or a desire to delay or impede tax administration).

213. *Id.* § 6673 (allowing the Tax Court to impose a penalty of up to \$25,000 against a taxpayer who litigates a position solely for delay). Other civil penalties are also available. *Id.* § 6651(a)(2) (imposing a civil penalty for failure to pay tax due); *id.* § 6654 (imposing a civil penalty on an individual for failure to pay estimated taxes); *id.* § 6656 (imposing a penalty for failure to make required tax deposits); *id.* § 6662 (imposing a penalty on underpayments); *id.* § 6663 (imposing a penalty on underpayments attributable to fraud); *id.* § 6672 (imposing a penalty for failure to collect and pay over tax or attempting to evade tax); *id.* § 6682 (imposing a penalty of \$500 for each false statement an individual makes with respect to withholding); *id.* § 6700 (imposing a penalty for promoting abusive tax shelters); *id.* § 6701 (imposing a penalty for aiding and abetting the understatement of a tax liability); *id.* § 6702 (imposing a penalty for the filing of a frivolous tax return); *id.* § 6704 (imposing a penalty for failure to maintain the required tax records); *id.* § 6721 (imposing a penalty for failure to file correct information returns); *id.* § 6722 (imposing a penalty for failure to provide correct payee statements); *id.* § 6723 (imposing a penalty for failure to comply with other information reporting requirements). Criminal sanctions are also available.

Some people will engage in disobedient behavior even though there is a strong likelihood of being fined. For instance, people have engaged in war protests, even when they knew that there would be a fine for failure to obtain a proper permit. They still protest because they believe that their message is more important than the possible sanction.<sup>214</sup>

*B. Civil Penalties Assessed by the IRS for Frivolous Positions*

There are several civil penalties that the Service may assess against taxpayers. One penalty frequently assessed against tax protestors is the frivolous return penalty, which authorizes the Service to impose a \$500 penalty when a return is filed that:

(A) does not contain information on which the substantial correctness of the self-assessment may be judged, or

(B) contains information that on its face indicates that the self-assessment is substantially incorrect; and

(2) the conduct referred to . . . is due to—

(A) a position that is frivolous, or

(B) a desire (which appears on the purported return) to delay or impede the administration of Federal income tax laws.<sup>215</sup>

The Service often imposes the frivolous return penalty when taxpayers file zero returns, indicating that they have no taxable income and are entitled to a refund of any tax withheld.<sup>216</sup> Congress enacted this penalty because of its concern about increasing numbers of tax protestors.<sup>217</sup>

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214. See, e.g., *Galvin v. Hay*, 374 F.3d 739 (9th Cir. 2004) (affirming the denial of a march permit where the applicant had not satisfied the requirement to agree not to engage in civil disobedience in the days following the Rodney King verdict and dismissing the claims under the Federal Tort Claims Act and a *Bivens* claim resulting from the demonstrators arrest). See generally Robert P. Lawry, *Ethics in the Shadow of the Law: The Political Obligation of a Citizen*, 52 CASE W. RES. L. REV. 655 (2002) (discussing the moral obligation of an individual in light of unjust or unethical laws).

215. *Id.* § 6702(a).

216. See, e.g., *Ray v. United States*, 291 F. Supp. 2d 1179 (2003); see also I.R.M. 20.1.10.9; *Turner v. Comm’r*, 88 T.C.M. (CCH) 412 (2004).

217. S. REP. NO. 97-494, at 74, 277 (1982), as reprinted in 1982 U.S.C.C.A.N. 781, 1023–25. The Senate Finance Committee report indicates the following:

The committee is concerned with the rapid growth in deliberate defiance of the tax laws by tax protestors. The Internal Revenue Service had 13,600 illegal protest returns under examination as of June 30, 1981. Many of these protestors are induced to file protest

Unlike most other current civil tax penalties, the frivolous return penalty can be imposed in addition to other penalties.<sup>218</sup> Because it does not adequately deter the assertion of frivolous positions,<sup>219</sup> proposals have been introduced during recent Congressional sessions that would increase the frivolous return penalty to \$5,000.<sup>220</sup> Another proposal would impose a \$5,000 penalty on frivolous submissions.<sup>221</sup> The proposals do not go far enough.

Another penalty often applied to tax protestors' returns is the accuracy-related penalty of I.R.C. section 6662. This is a twenty percent penalty that is imposed when there is an understatement of tax on a return that is due to negligence or disregard of rules or regulations, or a substantial understatement of tax.<sup>222</sup> A substantial understatement is an understatement of more than ten percent of the tax or \$5,000.<sup>223</sup> A taxpayer is not subject to the accuracy-related penalty if the taxpayer can establish that he or she had reasonable cause for the understatement and acted in good faith.<sup>224</sup>

In more egregious cases of underreported tax liability, a civil fraud penalty may be imposed. The civil fraud penalty is a seventy-five percent penalty applied to the portion of the underpayment that is attributable to fraud.<sup>225</sup> Imposition of the fraud penalty requires a much higher level of culpability than does imposition of the negligence or substantial understatement penalty; it requires proof of intent to evade tax.<sup>226</sup>

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returns through the criminal conduct of others. These advisors frequently emphasize the lack of any penalty when sufficient tax has been withheld from wages and encourage others to play the "audit lottery." The committee believes that an immediately assessable penalty on the filing of protest returns will help deter the filing of such returns, and will demonstrate the determination of the Congress to maintain the integrity of the income tax system.

*Id.*

218. I.R.C. § 6702(b).

219. Many tax protestors repeatedly file tax returns taking frivolous positions, despite the imposition of the frivolous return penalty on each return. *See, e.g., Lovell v. United States*, 755 F.2d 517 (7th Cir. 1984).

220. *See, e.g., United States Tax Court Modernization Act*, S. 661, 109th Cong. (2005).

221. Tax Relief Act of 2005, S. 2020, § 523, 109th Cong. (2005). This penalty would apply to frivolous submissions in CDP and Offers in Compromise, among other areas. *Id.*

222. I.R.C. § 6662(a).

223. *Id.* § 6662(d). The accuracy related penalty is not available for substantial understatement if the taxpayer had substantial authority for the position or the position was disclosed on the tax return. *Id.* § 6662(d)(2)(B).

224. *Id.* § 6664(c).

225. *Id.* § 6663(a).

226. SALTZMAN, *supra* note 165, ¶ 7B.02.

Another difference between the civil fraud penalty and other civil penalties is that the Service bears the burden of proof.<sup>227</sup>

In addition to the penalties that may be imposed on a taxpayer for her return positions, penalties can be imposed on promoters of frivolous positions. A \$1,000 penalty per document may be imposed against a person

- (1) who aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,
- (2) who knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and
- (3) who knows that such portion (if so used) would result in an understatement of the liability for tax of another person.<sup>228</sup>

In addition to the penalties that can be asserted by the Service, as discussed below, the courts can also assert a number of penalties against taxpayers who take frivolous positions and use the judicial system to delay collection of their taxes.

### *C. Civil Penalties Imposed by the Courts*

Courts can impose penalties on vexatious litigants, including tax protestors, pursuant to statutory authority, judicial rule, and the court's inherent powers. Even courts of limited jurisdiction, such as the Tax Court, have inherent power to impose sanctions on frivolous litigants.<sup>229</sup> The inherent power to impose sanctions promotes "the due and orderly administration of justice and [maintains] the authority and dignity of the court."<sup>230</sup> Although it is not a common remedy, courts can charge a frivolous litigant for the costs incurred by her opponent when the litigation was instituted "in bad faith, vexatiously, wantonly, or for oppressive reasons."<sup>231</sup>

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227. *Id.*

228. I.R.C. § 6701.

229. *Charczuk v. Comm'r*, 771 F.2d 471, 475 (10th Cir. 1985).

230. *Roadway Exp., Inc. v. Piper*, 447 U.S. 752, 764 (1980) (quoting *Cooke v. United States*, 267 U.S. 517, 539 (1925)).

231. *Id.* at 766 (quoting *F.D. Rich Co. v. United States ex rel. Indus. Lumber Co.*, 417 U.S. 116, 129 (1974)).

The courts are often understandably reluctant to impose penalties on *pro se* litigants. However, many courts have overcome this reluctance in the case of tax protestors because of the burden they place on the courts.<sup>232</sup> Many courts have warned current and future litigants that certain positions will be penalized in future cases.<sup>233</sup> Unfortunately, the willingness to impose penalties does not address the problem of inconsistent application.

### 1. *The Tax Court*

The Tax Court is authorized to impose a penalty of up to \$25,000 on taxpayers

(1) Whenever it appears to the Tax Court that—

(A) proceedings before it have been instituted or maintained by the taxpayer primarily for delay,

(B) the taxpayer's position in such proceeding is frivolous or groundless, or

(C) the taxpayer unreasonably failed to pursue available administrative remedies<sup>234</sup>

These penalties have been regularly imposed on tax protestors.<sup>235</sup> Before imposing a section 6673(a) sanction in a particular context, the Tax Court often warns future litigants that it will impose penalties.<sup>236</sup>

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232. See, e.g., *Parker v. Comm'r* 117 F.2d 785, 787 (5th Cir. 1997) (imposing the requested \$2,000 sanction after stating that “[a]lthough some latitude may be afforded to *pro se* taxpayers who misunderstand the nature of the tax laws, *pro se* status is not a license to litter the dockets of the federal courts with allegations that the Internal Revenue Code is the product of an illegal conspiracy.”); *Miller v. United States*, 868 F.2d 236, 242 (7th Cir. 1989) (affirming the district court's imposition of sanctions and imposing more for the filing of a frivolous appeal); *Connor v. Comm'r*, 770 F.2d 17, 20 (2nd Cir. 1985) (imposing Rule 38 sanctions); *Depew v. United States*, 50 F. Supp. 2d 1009 (D. Colo. 1999); *Birth v. United States*, 782 F. Supp. 289, 292 (M.D. Pa. 1992) (imposing \$3,000 in Rule 11 sanctions).

233. See, e.g., *Marino v. Brown*, 357 F.3d 143, 147 (1st Cir. 2004) (noting a prior warning and issuing a further warning); *Roat v. Comm'r*, 847 F.2d 1379, 1384 (9th Cir. 1988); *Zuger v. United States*, 834 F.2d 1009, 1010 (Fed. Cir. 1987); *Lefebvre v. Comm'r*, 830 F.2d 417, 421 (1st Cir. 1987) (warning future *pro se* litigants against making the same arguments); *Steward v. Comm'r*, 90 T.C.M. (CCH) 269 (2005) (warning specifically directed to taxpayer against future frivolous arguments).

234. I.R.C. § 6673(a) (2000).

235. See, e.g., *Keene v. Comm'r*, 121 T.C. 8 (2003); *Nestor v. Comm'r*, 118 T.C. 162 (2002).

236. *Pierson v. Comm'r*, 115 T.C. 576, 581 (2000) (warning future CDP litigants of the availability of section 6673(a) penalties). Copies of *Pierson* have been provided to many taxpayers pursuing CDP claims and asserting tax protestor positions.

Even when a court dismisses a case for lack of jurisdiction, the court can impose penalties,<sup>237</sup> which may be important when a tax protestor institutes proceedings for purposes of delay.

While this penalty is substantial, it is discretionary in both application and amount. Such discretion means that similarly situated taxpayers may ultimately receive different results. More uniform application could increase the perception of fairness.

## *2. The district courts and federal court of claims*

The penalty for frivolous litigation available under I.R.C. section 6673(a)(1) is limited to imposition by the Tax Court. This means that the district courts are left solely with their inherent power and Federal Rule of Civil Procedure 11 to sanction intransigent taxpayers. Because many tax protestors are *pro se* litigants, the courts may be hesitant to impose Rule 11 sanctions. This is particularly the case where the government fails to ask the court to impose Rule 11 sanctions.<sup>238</sup> As with I.R.C. section 6673 penalties, Rule 11 sanctions can be imposed even if a case is later dismissed for lack of jurisdiction.<sup>239</sup>

It is important that the district courts and the federal court of claims have the ability to impose significant penalties on tax protestors even though these courts' jurisdiction over tax litigation is generally limited to refund jurisdiction. In addition to refund claims, tax protestors often file suit in district courts when the IRS asserts a deficiency,<sup>240</sup> claiming that the United States Tax Court is not a legitimate court. The burden on the judicial system is also increased by claims filed by tax protestors seeking to enjoin tax collection, which are often filed despite the Anti-Injunction Act's prohibition against such suits.<sup>241</sup>

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237. *See, e.g., Willy v. Coastal Corp.*, 503 U.S. 131 (1992).

238. *See, e.g., Lindsey v. United States*, 91 A.F.T.R.2d 2003-2257 (D. Nev. 2003) (upholding determination to proceed with collection of frivolous return penalties and granting the requested \$1,242 in attorneys fees as a sanction under the court's inherent power, but noting that a \$2,500 sanction would have been appropriate); *Carrillo v. United States*, 91 A.F.T.R.2d 2003-1608 (D. Nev. 2003); *Waller v. United States*, 90 A.F.T.R.2d 2002-6759 (D. Nev. 2002); *Blanchard v. United States*, 90 A.F.T.R.2d 2002-6640 (D. Nev. 2002). In many cases before the district courts, the IRS has not asked the court to impose sanctions on a taxpayer who has only sought delay or raised frivolous arguments.

239. *See Willy*, 503 U.S. at 132.

240. *See, e.g., Purk v. I.R.S.*, 1990 WL 10692 (6th Cir. 1990).

241. *See, e.g., Hezel v. United States*, 82 A.F.T.R.2d 98-6405 (6th Cir. 1998).

Because I.R.C. section 6673(a)(1) penalties cannot be imposed by the district courts or the court of claims,<sup>242</sup> the amount and nature of the penalties imposed by the court may depend on whether a taxpayer brings a prepayment suit in the Tax Court or a refund claim in the district court or court of claims. Since the jurisdiction of these courts is not coextensive, this difference in treatment, based entirely on the court in which the case is brought, may result in the perception that taxpayers are treated differently. This may seem unfair to some taxpayers.

### 3. *The courts of appeals*

By statute, the courts of appeals can impose sanctions on litigants and attorneys.<sup>243</sup> The party losing an appeal may be required to pay “just damages” and single or double costs resulting from the delay.<sup>244</sup> An additional statute provides that

[a]ny attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys’ fees reasonably incurred because of such conduct.<sup>245</sup>

Both statutes have been used against tax protestors.<sup>246</sup>

Federal Rule of Appellate Procedure 38 allows the court of appeals to impose sanctions on litigants who bring frivolous appeals. These sanctions are often imposed on tax protestors.<sup>247</sup> Although in some cases

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242. I.R.C. section 6673 has limited application outside the Tax Court. Other courts may assess an I.R.C. section 6673 penalty of up to \$10,000 only for frivolous or groundless proceedings under I.R.C. section 7433, which permits actions for certain unauthorized collection actions. I.R.C. § 6673(b)(1) (2000).

243. 28 U.S.C. §§ 1912, 1927 (2000).

244. *Id.* § 1912.

245. *Id.* § 1927.

246. *See, e.g.,* Raft v. Comm’r, 95 A.F.T.R.2d 2005-2652 (6th Cir. 2005) (applying 28 U.S.C. § 1927 and FED. R. APP. P. 38 to impose sanctions on the attorney in a tax protestor case); Sawukaytis v. Comm’r, 102 Fed. Appx. 29 (6th Cir. 2005) (granting sanctions against a tax protestor under 28 U.S.C. § 1912, even after noting the desire to use sanction sparingly to avoid chilling possibly meritorious appeals); Marino v. Brown, 357 F.3d 143 (1st Cir. 2004) (imposing sanctions on a tax protestor under 28 U.S.C. § 1912 and FED. R. APP. P. 38); Stoecklin v. United States, 865 F.2d 1221 (11th Cir. 1989) (imposing sanction against a tax protestor under 28 U.S.C. § 1912).

247. *See, e.g.,* Stafford v. United States, 208 F.3d 1177 (10th Cir. 2000) (awarding the government \$4,000 in sanctions against a tax protestor); United States v. Ins. Consultants of Knox, Inc., 187 F.3d 755 (7th Cir. 1999) (ordering \$2,000 sanction against tax protestor and corporation for

the courts of appeals have been willing to impose significant sanctions, including attorneys fees awards on taxpayers whose entire arguments are based on tax-protestor rhetoric,<sup>248</sup> the amount of the sanction is likely to be low compared to the cost to the system resulting from a frivolous appeal.

Even more troubling is the fact that the amounts are likely to be inconsistent from one tax protestor to the next and from one circuit to another, depending on nothing more than the court or judges before which the case is presented. Sanctions are discretionary, and therefore, the court of appeals is not required to impose sanctions in any particular case.<sup>249</sup> Although there may be less willingness on the part of the courts of appeals to impose penalties because tax protestors often represent themselves, the courts of appeals have imposed sanction in tax protestor cases with some frequency.<sup>250</sup>

#### *D. Effect of Penalties on Tax Protestor Behavior*

There is little data on the effect that civil penalties generally have on tax compliance.<sup>251</sup> However, case after case demonstrates that the current penalties do not deter the tax-protestor arguments. That the current penalties do not adequately deter tax protestors is demonstrated by the fact some tax protestors engage in multiple litigations, undeterred by prior failed litigation.<sup>252</sup> Even summary disposition of these cases imposes significant systemic cost.

In addition to the imposition of penalties, the IRS and the Department of Justice have a number of initiatives designed to slow the

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which protestor served as an officer unless they could show cause why such a sanction should not be imposed).

248. *See, e.g., Hudson v. United States*, 766 F.2d 1288, 1292 (9th Cir. 1985) (awarding the IRS attorneys fees and double costs).

249. 16 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3984.1 (3d ed. 2005).

250. *Id.*

251. *See Stark, supra* note 49, at 116.

252. *See, e.g., Miller v. United States*, 868 F.2d 236, 239 (1989) (noting that this was an appeal from previous challenges brought by the same taxpayer that raised the same tax protestor arguments relating to the ratification of the Sixteenth Amendment, despite the prior imposition of sanctions); *Wright v. Comm'r*, 59 T.C.M. (CCH) 546 (1990) (noting that the same taxpayer had brought the same frivolous tax protestor claims to the Tax Court on four prior occasions, in each of which the Tax Court awarded the government \$5,000 damages under I.R.C. section 6673); *Trohimovich v. Comm'r*, 57 T.C.M. (CCH) 1109 (1989) (referencing *Trohimovich v. Comm'r*, 776 F.2d 873 (9th Cir. 1985), which states that the taxpayers had "filed at least fifteen tax-related appeals in this court since July, 1979"); *see also Trohimovich v. Comm'r* 77 T.C. 252 (1981).

growth of the tax protestor movement. One approach uses judicial action against the promoters of tax protestor schemes. Sanctions against promoters include civil remedies (primarily injunctions) and criminal charges.<sup>253</sup> Injunctions have been successful in preventing specific individuals from promoting abusive tax schemes.<sup>254</sup> Between 2001 and April, 2005, the IRS obtained over 100 injunctions against promoters of illegal tax schemes.<sup>255</sup>

Another approach is education. The Service is using a number of methods to educate the public about illegal tax schemes, such as making a variety of resources available on the IRS website<sup>256</sup> and appealing to the media and other public outlets. However, such efforts have not sufficiently reduced the number of illegal tax schemes or tax protestor filings. Therefore, additional mechanisms and initiatives to reduce the spread of illegal tax schemes and the promotion of tax protestor rhetoric are needed.

## VI. PENALTIES AS SYSTEMIC COMPENSATION

### A. *The Costs and the Problem*

As has been demonstrated, conventional approaches do not stop tax protestors from delaying tax collection and tying up the courts.<sup>257</sup> Neither civil penalties nor criminal prosecution have slowed the growth of the tax protestor movement. Moreover, penalties are often imposed inconsistently. A different approach is needed to compensate the system for the costs imposed by tax protestors' frivolous arguments and to deter others from converting to the tax protestor movement. In addition, the justification of deterring such behavior as the reason to impose penalties

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253. Criminal indictments in 2005 against promoters of tax scams are up fifty-seven percent. Press Release, Dep't of Justice, Justice Department Notes Increase in Tax Enforcement (April 26, 2005), available at <http://www.usdoj.gov/tax/txdv05167.htm> (last visited Dec. 20, 2005).

254. Monica Langlely, *Consultant Leads Secret Double Life as Internet Sleuth*, WALL ST. J., Dec. 10, 2004, at A1 (discussing the role of an individual in ferreting out tax protestor schemes and the role she played in calling into question Irwin Schiff's insanity defense).

255. Press Release, Internal Revenue Service, FS 2005-15, IRS Obtains More Than 100 Injunctions Against Tax Scheme Promoters (April 2005), available at <http://www.irs.gov/newsroom/article/0,,id=137831,00.html>. Because of increased efforts to prevent the promotion of tax scams, in 2004 the number of indictments against promoters of illegal tax schemes increased fifty-seven percent over the prior year. *Id.*

256. See Internal Revenue Service, Tax Scams—How to Recognize and Avoid Them, <http://www.irs.gov/businesses/small/article/0,,id=106788,00.html> (last visited Dec. 20, 2005).

257. See *supra* Part IV.D.

does not stand up to the evidence that the current penalties do not adequately deter. However, care must be taken to avoid signaling that others may ignore their tax obligation without consequence, which might reduce the incentive to comply with tax obligations.<sup>258</sup> As the Tax Court has noted, “[B]y filing cases of this type, the protesters add to the caseload of the Court . . . and such cases increase the expenses of conducting this Court and the operations of the IRS, which expenses must eventually be borne by all of us.”<sup>259</sup>

To effectively deter tax protestor behavior without reducing incentive to comply with tax obligations, when costs are incurred because an individual is pursuing a truly frivolous and repeatedly rejected position, the costs should be borne by the person who caused them. Compliant taxpayers should not bear the costs of protestors’ refusal to pay tax; this may make the system appear less fair and cause some currently compliant taxpayer to stop complying. As the Seventh Circuit Court of Appeals noted, “When the legal system depends on honest compliance as much as the income tax system does—and when disobedience is potentially rewarding to those affected by the rule—it is often necessary to impose steep penalties on those who refuse to comply.”<sup>260</sup> Penalties should be imposed on tax protestors who make frivolous arguments, not only to punish them but also to compensate for the damage their actions cause to the tax system and its public perception. Before examining this proposal in depth, consider the following costs associated with the tax protestor movement.

Systemic costs resulting from tax protestor tactics include the use of IRS collection and litigation resources and the diversion of attention from legitimate issues of tax administration. IRS resources are used to identify, pursue, and often litigate cases against taxpayers raising frivolous positions; thus, the IRS is prevented from directing those resources to identify tax shelters, find tax evaders, and properly administer the tax laws. Furthermore, cases that are litigated in the district courts also require the involvement of the Department of Justice.

When tax protestors litigate, judicial resources are diverted from legitimate cases, causing delays in justice for litigants in legitimate cases. In the Tax Court, this delay means that the delayed taxpayers with a

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258. Kornhauser, *supra* note 33, at 1000.

259. Pierson v. Comm’r, 115 T.C. 576, 581 (2000) (quoting Hatfield v. Comm’r, 68 T.C. 895, 899 (1977)).

260. Coleman v. Comm’r, 791 F.2d 68, 69 (7th Cir. 1986).

colorable claim will be subject to greater interest accruals.<sup>261</sup> The district courts, which have refund jurisdiction in tax cases,<sup>262</sup> also have jurisdiction over a wide variety of civil and criminal cases. Time taken by tax protestors prevents the courts from expeditiously deciding other cases. This is unfair to criminal defendants and can be costly to civil litigants.

Although the cost of the use of judicial, IRS, and Department of Justice personnel can be reduced to a monetary value, not all costs can be measured in dollars. For instance, it is impossible to determine the cost to other litigants whose cases may be indirectly delayed as a result of the pursuit of frivolous claims by others. However, this is a common problem in compensating victims for wrongs—money is often an imperfect measure of damages, but it is often the only measure available.

Tax protestors impose enormous costs on the tax system, and their behavior is not deterred by current penalties. As previously noted, two similar tax protestors may be penalized differently; such inconsistent consequences result in horizontal inequity, and this inequity may cause other taxpayers to question the fairness of the system. In addition, current penalties do not compensate the system for the costs imposed by the tax protestors.

#### *B. Penalizing Protestors for Costs to the Tax System*

To increase the equality of treatment and improve the systemic results, a penalty should be imposed on tax protestors in the amount of the costs that they cause. These may include costs of administrative proceedings at the appeals office, time spent by the IRS or Department of Justice attorneys in preparing and trying cases in the Tax Court or district court and the court of appeals, and less tangible harm to other taxpayers. Moreover, because many tax protestors are *pro se* litigants, which makes courts uncomfortable with imposing heavy penalties, such penalties should be mandatory as long as the taxpayer raises an issue that is identified as a frivolous tax protestor argument.

A reasonable solution to the problem associated with tax protestors and the costs that they impose on the government, the courts, and the

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261. A taxpayer may stop the running of interest by making a deposit to the Treasury prior to assessment of the tax. I.R.C. § 6603 (2000). In many cases the taxpayer will be unable or unwilling to make a deposit, which often is the reason that taxpayers seek prepayment review of a deficiency determination.

262. 28 U.S.C. § 1346(a)(1) (2000) (granting refund jurisdiction to the district courts and the United States Court of Federal Claims).

public is the use of nondiscretionary, significant civil penalties that are large enough not only to compensate the system for any revenue lost and resources expended in collection of properly owed taxes, but also to deter others from engaging in similar behavior. Tax protestors often raise frivolous arguments at every possible opportunity.<sup>263</sup> Courts have recognized that simply allowing the tax protestor an opportunity to voice his or her objections once will not prevent the tax protestor from coming back again and again with the same arguments. For instance, the Tax Court has noted that while “this Court . . . has in the past bent over backwards to indulge conscientious tax protestors with their legally frivolous claims, such indulgence has not served to dissuade the very same protestors from instituting a second frivolous suit on the same stale issues.”<sup>264</sup> Therefore, deterrence alone does not justify the imposition of civil penalties on tax protestors. Civil penalties that allowed the government to recover the costs associated with pursuing collection from a tax protestor, which would otherwise be borne by compliant taxpayers,<sup>265</sup> would justify the imposition of penalties.

However, a penalty equal to the cost of pursuing collection and litigation should not be assessed in all cases. The complexity of the tax code means that there will inevitably be disputes as to its meaning and application. Raising legitimate challenges to the code, even if ultimately unsuccessful, should not be penalized. The proposed penalties should be imposed to address the costs imposed on the tax system and society as a result of tax protestors’ claims.

Making penalties mandatory in cases where protestor arguments are used would mitigate the courts’ reluctance to impose sanctions on *pro se* litigants. The court and the Service would have the ability to warn the individual at the outset that the penalties would be imposed if the taxpayer continued to present tax protestor arguments, providing some flexibility and a safeguard against overzealousness.

The contours of tax protestor rhetoric must be defined to allow imposition of the proposed penalty. An approach similar to that used against tax shelters should be used. To combat tax shelters, certain

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263. See *supra* note 252 and accompanying text.

264. *Senesi v. Comm’r*, 43 T.C.M. (CCH) 143, 145 (1981) (imposing I.R.C. § 6673 penalties and citing to prior cases where protestors had returned with the same arguments in later cases); see also *supra* notes 87–88 and accompanying text (discussing the repeated litigation involving Irwin Schiff).

265. See, e.g., *Snyder v. Comm’r*, 74 T.C. 864, 872–73 (1980), *aff’d*, 647 F.2d 813 (8th Cir. 1981).

transactions are “listed.”<sup>266</sup> The IRS already identifies of frivolous and meritless schemes and positions to inform taxpayers of positions that may not be taken without risk of penalty.<sup>267</sup> In addition, the courts have identified numerous frivolous positions. The IRS’s list of identified schemes should be combined with the judicially identified frivolous positions to create a comprehensive list of frivolous arguments, which would be subject to penalties. Using such a list would provide notice to taxpayers of the circumstances in which they would be subject to the proposed penalty and would allow guidance as to the types of positions that are discouraged.

Taxpayers who simply pursue aggressive positions do not pose the same threat to the tax system as tax protestors. One of the costs to society is the maintenance of the judicial system. Legitimate, but ultimately unsuccessful, challenges to tax issues are an appropriate use of the judicial and tax administration systems. Moreover, to the extent that tax shelter or aggressive positions are taken only because they result in a tax benefit that would not exist without the transactions, the available penalties, including the penalties that were added to the Code as a result of the American Jobs Creation Tax Act of 2004,<sup>268</sup> reduce the profitability of these transactions and may deter many taxpayers from engaging in these transactions. Only those positions that are completely without merit and have no basis in law, i.e., the truly frivolous positions, should be subject to this new penalty. In other words, taxpayers should not be subject to these penalties simply because they do not succeed at audit, in the IRS Office of Appeals, or in court. Rather, only taxpayers who raise and pursue frivolous positions should be subject to additional penalties.

The proposed penalty is analogous to allowing taxpayers to recover litigation costs from the IRS when the taxpayer has established that she exhausted all administrative remedies and that the IRS’s position was not

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266. I.R.S. Notice 2004-67, 2004-41 I.R.B. 600 (identifying thirty transactions that must be reported if engaged in by a taxpayer during the tax year).

267. A number of resources and information on abusive tax scheme and frivolous arguments are available on the IRS web site, *available at* <http://www.irs.gov/businesses/small/article/0,,id=106788,00.html> and <http://www.irs.gov/compliance/enforcement/article/0,,id=121259,00.html> (last visited Dec. 20, 2005). These could be compiled into one or more notices to identify the arguments that will be pursued and subject to additional penalties as tax protestor arguments.

268. American Jobs Creation Tax Act of 2004, Pub. L. 108-357, §§ 811, 812, 818, 821; 118 Stat. 1418, 108th Cong. 2nd Sess. (2004) (codified in various sections of the I.R.C.).

substantially justified.<sup>269</sup> The proposed penalty would allow the government to recover its costs, both administrative and judicial.

As Part III demonstrates, the arguments that are used by tax protestors are not supported by legitimate legal arguments. However, it is possible for tax protestors to have a colorable claim for no imposition of tax mixed in with frivolous positions. Additionally, simply judging a claim on its face to be a protestor claim may result in treating inarticulate taxpayers as tax protestors, which is problematic if the claims made by protestors are dismissed out of hand.

Maintaining a high compliance rate requires that the majority of the affected population believe that the system is fair so that they will continue to self-report their tax liability. Coupling the possibility of a legitimate claim mingled with tax protestor rhetoric, or inarticulate claims that appear to be tax protestor claims, with the need for the tax system to appear to be fair, suggests that simply dismissing tax protestor claims without consideration would be ill-advised. Notwithstanding the need to allow a reasonable review of all claims, even if they appear to be protestor claims, the costs of that review should not be borne by the majority of taxpayers who do not subscribe to such views and who voluntarily comply with their tax obligations.

Tax protestors must be permitted to have access to the administrative and judicial review functions of the tax administration system. However, to the extent that the claims that they raise are identified as frivolous, meritless tax protestor positions, the individual raising and pursuing such claims should bear the burden of those claims. Therefore, penalties equal to the costs of personnel and overhead to pursue collection both judicial and administrative should be mandatorily imposed on tax protestors when their claims are, indeed, frivolous.

### *C. Application of New Penalties to Tax Protestors*

Tax-enforcement resources are limited and not all tax protestors will be able to pay their tax liabilities, let alone penalties. However, to the extent possible, resources should be directed to collecting taxes from all taxpayers with liabilities who can pay. As noted above, many protestor converts have above-average income and education.<sup>270</sup> Thus, for many protestors imposing additional penalties will not be meaningless. It will

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269. I.R.C. § 7430(a), (b) (2000).

270. *See supra* notes 42, 77–83 and accompanying text.

only be meaningless if the Service cannot or will not pursue collection of their tax liabilities.<sup>271</sup>

Of concern is the number of opportunities that are available for tax protestors to put forward frivolous positions. Not only do tax protestors have the traditional forums in which they can raise frivolous arguments, post-RRA 1998, tax protestors can use a CDP hearing as another opportunity to present frivolous claims.<sup>272</sup> However, CDP hearings and appeals should be dealt with expeditiously, with additional penalties imposed for frivolous arguments.<sup>273</sup>

Litigation or administrative appeals brought by tax protestors should not be automatically dismissed. However, many tax protestor cases can be concluded expeditiously through a motion either to dismiss for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6) or for summary judgment. Although in most tax protestor cases it is unlikely that there will be a meritorious issue, tax protestors can raise legitimate claims.<sup>274</sup> However, if no legitimate issue is present, rapid disposition of tax-protestor cases will reduce the amount of judicial resources needed but will not make these cases cost-free. The Service will still need to expend a substantial amount of time to draft, serve, and present motions and responses. This time takes away from the efforts the Service can direct to other areas of tax administration. Imposing significant penalties that make up for the costs imposed by tax protestor arguments will solve concerns both that the tax protestor is unfairly burdening the tax collection and judicial systems and that the tax collection and judicial

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271. Immediately following the enactment of RRA 1998, enforcement activity declined substantially. Internal Revenue Service Statistics of Income, 1999 IRS Data Book Table 21, available at <http://www.irs.gov/pub/irs-soi/99db21co.xls> (last visited Dec. 20, 2005) (reporting that in fiscal year 1998, before RRA 1998 became effective, IRS enforcement activity consisted of 383,000 Notices of Lien issued, 2,503,000 Notices of Levy on third parties issued, and 2,259 seizures conducted; and in fiscal year 1999, following effective date of RRA 1998, IRS enforcement activity consisted of 168,000 Notices of Lien issued, 504,000 Notices of Levy on third parties issued, and 161 seizures conducted). Recently, enforcement has been increased and the IRS intends to increase enforcement even more. Internal Revenue Service Statistics of Income, from 2004 IRS Data Book, tbl. 16, available at <http://www.irs.gov/pub/irs-soi/04db16co.xls> (last visited Dec. 20, 2005) (reporting that in fiscal year 2004 the IRS enforcement activity consisted of 534,392, 2,029,613, and 440, Notices of Lien issued, Notices of Levy issued to third parties, and seizures, respectively).

272. I.R.C. § 6330 (entitling taxpayers to a CDP hearing prior to levy on their property).

273. See Danshera Cords, *Collection Due Process: The Scope and Nature of Judicial Review*, 73 U. CIN. L. REV. 1021 (2005).

274. See *Lunsford v. Comm'r*, 117 T.C. 183 (2001) (challenging the appeals officer's failure to conduct a hearing, in addition to raising more of the traditional tax protestor arguments); Cords, *supra* note 72, at 65, 101.

systems must listen to the concerns of taxpayers, even if they are unlikely to warrant action.

Because one of the concerns that this proposal addresses is the concern that the tax system must be perceived as fair, warning should be given to taxpayers who assert the identified tax protestor claims before the imposition of penalties. After that warning is given, penalties should include the cost of administrative and court personnel as well as overhead used to pursue collection of the tax liability. In addition, because there is always a cost-benefit analysis required in deciding how to allocate resources, more resources should be devoted to those that have sufficient assets to pay their liability.

As has been demonstrated, current penalties have not effectively deterred tax protestors. In addition, a new penalty is also unlikely to convert dedicated tax protestors. However, if penalties are high enough, other, compliant taxpayers may not be tempted to convert. In addition, compliant taxpayers will not bear the burden of both the unpaid share of the government's revenue and the cost of pursuing collection. Individuals who have assets with which to pay their taxes will bear the cost that they impose on the government for their illegitimate refusal to pay taxes.

#### *D. Use of Penalties Collected*

Identifying and pursuing collection from more tax protestors may require that additional resources be directed to tax enforcement. Using enforcement to increase compliance requires a greater enforcement budget. Without a significant and unlikely increase in the Service's budget, additional funds will come out of existing budgets, which may reduce customer service.<sup>275</sup> New sources of revenue will be needed. The proposed penalties could be used for this purpose. Although there would be significant benefits, there are also several concerns. First, allowing penalties imposed on tax protestors to go directly to the Service may cause disproportionate resources to be directed to tax protestors. Second, in some instances the penalties could be high relative to the liability, which may cause courts to resist imposing or upholding the penalties. Finally, providing another revenue source for the IRS could result in dangerous funding cuts for this unpopular but essential agency.

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275. NATIONAL TAXPAYER ADVOCATE SERVICE, 2004 ANNUAL REPORT TO CONGRESS, Preface at vii, 8 (2004). The IRS responds that it is not compromising service for compliance and enforcement activities. *Id.*

Because of these concerns, the revenue raised by penalties imposed on tax protestors should be treated like other penalties and included in tax revenue. This would not fund additional efforts to increase tax compliance but would alleviate the concerns generated by directing penalties to the Service, which could cause a perception of unfairness and undermine the purpose of the penalty.

## VII. CONCLUSION

Voluntary compliance is essential to the efficient and effective collection of revenue by any government. Allowing certain members of the society to avoid their obligation to contribute to the government, simply because they engage in dilatory tactics, is not an acceptable option. If some succeed, and their success is known, others may be encouraged to engage in the same behavior. Moreover, it is unfair that the majority bear the costs to the system resulting from tax protestors' use of frivolous positions.

Tax protestors cannot be shut out of the system entirely because others might then fear that they too would be excluded. Tax protestors will, on occasion, raise valid complaints. Shutting protestors out of the tax dispute systems would diminish the perception of fairness of the system. Because fairness of the system is an essential component to voluntary tax compliance, it should be encouraged, even at a cost. On the other hand, it is unfair to impose the costs of frivolous positions on those who comply.

The current penalty provisions do not adequately deter tax protestor behavior and tax protestors cannot be shut out of either the administrative or judicial system; therefore, additional penalties must be imposed. Tax protestors impose costs at the administrative level when they demand that the IRS and its employees prove to them that income taxes are constitutional, legally enforceable obligations. These costs are exacerbated when the tax protestor seeks review of the liability, either before payment by petitioning the Tax Court, or after payment, which may have occurred through seizure or mandatory withholding, in the district courts. Judicial review expends administrative resources defending the Service's determinations and collection actions and judicial resources in addressing motions and trying cases. The costs that may be incurred in pursuing collection and defending tax deficiency determinations and collection decisions have been increased with the adoption of CDP rights. Imposing nondiscretionary penalties on frivolous arguments will protect the system from both the concerns that

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some will be shut out of the system and that others will have to bear the cost of the frivolous arguments. The amount of the penalty should be the amount of the costs incurred by the Service and the courts to collect the taxes, interest and other penalties owed.