The Selective Enforcement Defense in Civil and Criminal Tax Cases

By Steve R. Johnson*

A recognized defense in non-tax prosecutions, both federal and state, is that the Government discriminatorily and invidiously targeted the defendant. Although it fails far more often than it succeeds, the defense has been accepted in many non-tax cases. *See, e.g.*, Annotation, *What Constitutes Such Discriminatory Prosecution or Enforcement of Laws as to Provide Valid Defense in Federal Criminal Proceedings*, 45 A.L.R. Fed. 732 (1979, as currently revised). The defense is constitutional in nature, implicating the Equal Protection and Due Process guarantees.

The selective enforcement defense often has been essayed in civil and criminal tax cases as well. This article discusses the defense in three contexts: criminal tax prosecutions; civil tax audits and litigation; and settlement of civil tax cases. A related issue—whether there is a subconstitutional, judicially enforceable duty of consistency on the Service—is beyond the scope of this article. Recent discussions of this possible duty include Stephanie Hoffer, *Hobgoblins of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 Utah L. Rev. 317, and Christopher M. Pietruszkiewicz, *Does the Internal Revenue Service Have a Duty to Treat Similarly Situated Taxpayers Similarly?,* 74 U. Cin. L. Rev. 531 (2005).

Criminal Tax Prosecutions

A frequently cited section 7205 (false withholding information) opinion stated: "It is fundamental that selectivity in the enforcement of criminal laws is subject to constitutional constraints. Nevertheless, the conscious exercise of some selectivity in enforcement is not in itself a federal constitutional violation so long as the selection was [not] deliberately based upon an unjustifiable standard . . . . [T]here is a presumption that prosecution for violation of the criminal law is in good faith." *United States v. Amon*, 669 F.2d 1351, 1355-56 (10th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982) (citations and some punctuation marks omitted).

More particularly, "[t]o support a defense of selective or discriminatory prosecution, a defendant bears the heavy burden of establishing, at least prima facie, (1) that, while others similarly situated have not generally been proceeded against because of conduct of the type forming the basis of the charge against him, he has been singled out for prosecution, and (2) that the government's discriminatory selection of him for prosecution has been invidious or in bad faith, i.e., based upon such impermissible considerations as race, religion, or the desire to prevent his exercise of constitutional rights." *United States v. Berrios*, 501 F.2d 1207, 1211 (2d Cir. 1974).

Selective enforcement defenses appear in scores of criminal tax cases arising in a wide variety of contexts. For example, too many lawyers and accountants have a less-than-enviable record of tax compliance, and the Service episodically launches enforcement initiatives directed at these groups. Two Iowa C.P.A.s who had been convicted of willful failure to file under section 7203 challenged on appeal their prosecution under the Service's Project ACE, which gave (at the time) "special priorities" to prosecuting tax crimes of attorneys, accountants, and enrolled agents in light of their special roles and responsibilities in our tax system. The appeal failed. The circuit court concluded: "Project ACE was based upon a rational classification and was not to be administered so as to accomplish purposefully some infringement of [the C.P.A.s'] constitutional rights." *United States v. Swanson*, 509 F.2d 1205, 1210 (8th Cir. 1975).

The difficulty proponents of the defense face is illustrated by the *Amon* case cited above. The defendant was an outspoken tax protestor. Evidence was presented "tending to show that the IRS has a formal policy of prosecuting individuals who are outspoken in their criticism of federal income tax laws." 669 F.2d at 1356 n.5. Indeed, the district court specifically found, and the circuit court agreed, that "the defendant has been selected for prosecution because he is an active and outspoken protestor." 669 F.2d at 1356. For one of the circuit judges, such selection was based on the defendant's exercise of his First Amendment rights, so was impermissible. *Id.* at 1363 (McKay, J., dissenting). The other two panel judges, however, rejected the defense.

There are, however, occasional taxpayer-defendant victories. In one case, the taxpayer was convicted under section 7206(1) of making false tax returns. She was an attorney who had sued her former employer, the EEOC, for sex discrimination. The appellate court held that she was entitled to pursue discovery as to her claim that she had

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been selectively and vindictively prosecuted because of her suit against the EEOC. The taxpayer's prima facie showing included the fact that taxpayers who voluntarily amended their returns and paid their deficiencies rarely were prosecuted and testimony by a former Special Agent that the Service typically handles such cases civilly, not criminally. *Adams v. United States*, 870 F.2d 1140 (6th Cir. 1989).

Adams' victory was only temporary, however. On remand, the district court held both a nonevidentiary hearing and an evidentiary hearing involving 16 witnesses over three days. In a 28-page opinion, the district court weighed the evidence and held against the taxpayer's defense. *United States v. Adams*, 832 F. Supp. 1138 (W.D. Tenn. 1993), *aff'd per curiam*, 38 F.3d 1217 (6th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995).

Civil Tax Audits and Litigation

Taxpayers sometimes challenge Service deficiency notices on selective enforcement grounds. In analyzing such challenges, the Tax Court and other courts have imported from criminal cases the two-part standard described above.

For example, in a leading civil selective enforcement case, the taxpayer corporation argued that the Service "in [its] approach to and conduct of audits, settlement discussions, and litigation involving the issue of deductibility of reasonable compensation paid to shareholder-employees of closely held corporations has practiced invidious discrimination to the extent that [the corporation's] rights to equal protection and due process of law have been violated." *Penn-Field Inds., Inc. v. Commissioner*, 74 T.C. 720, 720 (1980). The corporation argued that, on this issue, the Service "practiced invidious discrimination against it, in particular, and against small closely held corporations in general." *Id.* at 723.

The corporation sought to conduct discovery in support of its claim of discriminatory enforcement. However, the court granted the Service's motion for a protective order under Tax Court Rule 103 because the interrogatories were unduly burdensome and irrelevant. The corporation was not entitled to discovery prior to establishing a colorable claim under the two-part standard, which the corporation had failed to do. *Id. See also United States v. Kahl*, 583 F.2d 1351, 1354-55 (5th Cir. 1978).

Among the most famous of the civil tax cases involving selective enforcement is *Hernandez v. Commissioner*, 490 U.S. 680 (1989). The Service disallowed claimed section 170 charitable contribution deductions for payments to the Church of Scientology. The Scientologists claimed that the payments were not essentially distinguishable from payments to other churches which the Service had allowed as deductions. The *Hernandez* dissent accepted this discrimination argument. *Id*. at 707-13 (O'Connor, J., dissenting). The *Hernandez* majority avoided the argument on the disingenuous ground that the record was insufficiently developed to allow comparison of the various payments. *Id.* at 700-03. The discrimination argument has continued to be troubling in post-*Hernandez* section 170 cases. *E.g., Sklar v. Commissioner,* 282 F.3d 610, 618-20 (9th Cir. 2002); *Powell v. United States*, 945 F.2d 374, 377-78 (11th Cir. 1991); *Sklar v. Commissioner*, 125 T.C. 281, 298-99 (2005).

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Civil Tax Settlements

As noted above, one aspect of the *Penn-Field* case entailed settlements. In another case, the taxpayer conceded deductions he had claimed through many tax shelters but wanted deductions for cash invested in the shelters. The taxpayer maintained that the Service had discriminatorily denied such a settlement to him while granting it to others. The court rejected the contention, holding that the taxpayer had satisfied neither of the two parts of the test. *Fresoli v. Commissioner*, T.C. Memo. 1988-384 (involving tax years preceding the effectiveness of the TEFRA unified partnership audit rules, including the consistent settlement provision in section 6224(c)(2)). *See also Estate of Campion v. Commissioner,* 110 T.C. 165 (1998), *aff'd in unpub. op. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999), *and aff'd in unpub. op. sub nom. Drake Oil Tech. Partners v. Commissioner*, 211 F.3d 1277 (10th Cir. 2000), *cert. denied*, 531 U.S. 875 (2000). For a selective enforcement settlement case outside the shelter context, see *Bunce v. United States*, 28 Fed. Cl. 500 (1993), *aff'd per curiam*, 26 F.3d 138 (Fed. Cir. 1994), *cert. denied*, 513 U.S. 1043 (1994). ■