Thompson v. Commissioner, 148 T. C. 3 (2017)

In Thompson v. Commissioner, the U. S. Tax Court upheld the constitutionality of the President's authority to remove Tax Court judges and the accuracy-related penalties under I. R. C. § 6662A for undisclosed tax transactions. The court rejected claims that these provisions violated the separation of powers and the Eighth Amendment's Excessive Fines Clause, affirming that the penalties serve a remedial rather than punitive purpose and are not grossly disproportionate to the offense.

Parties

Douglas M. Thompson and Lisa Mae Thompson, as Petitioners, filed against the Commissioner of Internal Revenue, as Respondent, in the United States Tax Court.

Facts

Douglas and Lisa Mae Thompson, married during the taxable years 2003-2007, filed joint personal income tax returns. The Internal Revenue Service (IRS) issued a notice of deficiency on December 18, 2012, determining federal income tax deficiencies and penalties for those years, primarily stemming from a distressed asset debt transaction reported in 2005. This transaction, a listed transaction under Notice 2008-34, generated a loss that was carried back to 2003 and 2004 and forward to 2006 and 2007, shielding their income from taxation. The Thompsons failed to disclose the transaction, leading the IRS to impose a 30% penalty under I. R. C. §§ 6662A(c) and 6664(d)(2). The Thompsons resided in California at the time of filing the petition but later moved to Florida. On March 24, 2015, they conceded the disallowance of the bad debt deduction but contested the penalties.

Procedural History

The Thompsons filed a petition in the U. S. Tax Court challenging the penalties under I. R. C. §§ 6662(h) and 6662A. They also filed motions to disqualify the judge and declare I. R. C. § 7443(f) unconstitutional, arguing that the President's power to remove Tax Court judges for cause violated separation of powers principles. Additionally, they moved for judgment on the pleadings to declare I. R. C. § 6662A unconstitutional under the Eighth Amendment. The Tax Court, following its decision in Battat v. Commissioner, denied both motions, upholding the constitutionality of § 7443(f) and the penalties under § 6662A.

Issue(s)

Whether I. R. C. § 7443(f), allowing the President to remove Tax Court judges for cause, violates the Constitution's separation of powers?

Whether the accuracy-related penalties under I. R. C. § 6662A for undisclosed reportable transactions violate the Eighth Amendment's Excessive Fines Clause?

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Rule(s) of Law

I. R. C. § 7443(f) authorizes the President to remove Tax Court judges "after notice and opportunity for public hearing, for inefficiency, neglect of duty, or malfeasance in office, but for no other cause. "

I. R. C. § 6662A imposes a 30% penalty on any reportable transaction understatement if the transaction is not adequately disclosed, with no available defenses. If disclosed, the penalty rate is 20%, and defenses may be available under § 6664(d)(1) and (2).

The Eighth Amendment's Excessive Fines Clause prohibits the imposition of excessive fines as punishment for an offense.

Holding

The court held that I. R. C. § 7443(f) does not violate the Constitution and that the Tax Court judges do not need to recuse themselves on that basis. Additionally, the court held that the accuracy-related penalties under I. R. C. § 6662A do not violate the Eighth Amendment.

Reasoning

The court's reasoning for upholding § 7443(f) was based on its prior decision in Battat v. Commissioner, where it found the President's removal authority constitutional and consistent with separation of powers principles. The court rejected the Thompsons' arguments as they did not present new issues beyond those already addressed in Battat.

Regarding § 6662A, the court reasoned that civil tax penalties are remedial, not punitive, as they encourage voluntary compliance and serve a revenue-raising purpose. The court cited Helvering v. Mitchell and other cases to support the remedial nature of tax penalties. The Thompsons' contention that § 6662A's deterrent purpose made it punitive was rejected, as the Supreme Court in Department of Revenue of Mont. v. Kurth Ranch clarified that a deterrent purpose alone does not make a tax penalty punitive.

The court also applied the proportionality test from United States v. Bajakajian to assess whether the § 6662A penalty was grossly disproportional to the offense. It found that the penalty's calculation, which considers the full tax benefit obtained from the transaction, was proportional to the harm caused and thus not excessive.

Furthermore, the court rejected the argument that the higher penalty rate for undisclosed transactions violated the Excessive Fines Clause, emphasizing that Congress intended to incentivize disclosure as a key element in curbing tax shelter abuse.

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Disposition

The court denied the Thompsons' motion to disqualify the judge and their motion for judgment on the pleadings, affirming the constitutionality of I. R. C. § 7443(f) and the penalties under § 6662A.

Significance/Impact

Thompson v. Commissioner reaffirms the constitutional validity of the President's authority to remove Tax Court judges and upholds the stringent penalties for undisclosed tax transactions. This decision strengthens the IRS's enforcement mechanisms against tax shelters and reinforces the importance of disclosure in tax compliance. It also provides clarity on the application of the Excessive Fines Clause to civil tax penalties, likely influencing future challenges to similar penalties and reinforcing the remedial nature of such sanctions in tax law.

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