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TIME TO PRUNE THE *FLORA*—PROCEDURAL DUE PROCESS, THE FULL PAYMENT RULE AND ASSESSABLE PENALTIES: *LARSON V. UNITED STATES*

FRANK G. COLELLA*

ABSTRACT

In Larson v. United States*, the Second Circuit Court of Appeals rejected the opportunity to limit the scope of the Flora "full payment" rule when its strict application in the instant case foreclosed judicial review of the underlying tax controversy. As a result, the decision rubberstamped the IRS's imposition of assessable penalties without any meaningful judicial review of those actions. The Article argues that the court's decision to blindly apply the full payment rule, without considering any form of a hardship exception, effectively denied John Larson his right to due process of law as guaranteed by the Fifth Amendment to the United States Constitution.*

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INTRODUCTION

In *Larson v. United States*,[1] the Second Circuit Court of Appeals rejected the opportunity to limit the scope of the *Flora*[2] full payment rule when the *de facto* consequence of its application to assessable penalties foreclosed judicial review of the underlying tax dispute. The practical consequence of *Larson's* rigid adherence to the full payment rule was to rubberstamp the Internal Revenue Service's (IRS) imposition of certain assessable penalties without any judicial review of the IRS's determination.[3] When considered in the context of procedural due process jurisprudence, the Second Circuit's refusal to limit the draconian impact of the *Flora* rule in *Larson* precluded any judicial review[4] and, effectively, denied Larson the right to due process of law guaranteed by the Fifth Amendment of the United States Constitution.[5]

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[1] Larson v. United States (*Larson II*), 888 F.3d 578, 583–84 (2d Cir. 2018), *aff'g*, No. 16-CV-00245, 2016 WL 7471338 (S.D.N.Y. Dec. 28, 2016) (*Larson I*).

[2] Flora v. United States (*Flora I*), 357 U.S. 63 (1958), *aff'd on reh'g*, 362 U.S. 145 (1960) (*Flora II*). In *Flora II*, a divided Supreme Court held that a federal court's jurisdiction to adjudicate taxpayer challenges to an IRS determination is premised upon the full payment of the underlying amount in dispute. 362 U.S. at 146. Subject to narrow exceptions, partial payment of the disputed amount denies the court subject matter jurisdiction to hear the claim. *See infra* notes 74–88 and accompanying text.

[3] *See Larson II*, 888 F.3d at 583.

[4] The opportunity for limited judicial review of the underlying liability following a Collection Due Process (CDP) hearing, I.R.C. § 6320 (Liens) & section 6330 (Levies), may have been foreclosed as a result of the administrative appeal. *See infra* note 207. However, judicial review of the tax liability may still be available in a bankruptcy court proceeding. *See, e.g.*, 11 U.S.C. § 505 (2012) (Determination of Tax Liability). While Larson may benefit from a bankruptcy proceeding, a detailed discussion of the Bankruptcy Code is beyond the scope of this Article. *See infra* note 243 and accompanying text.

[5] *See* U.S. CONST. amend. V ("No person shall be ... deprived of life, liberty, or property, without due process of law[.]"). The Larson decision was specifically cited by Nina E. Olsen, the National Taxpayer Advocate as part of the Legislative Recommendations included her report to Congress. Nina E. Olsen, National Taxpayer Advocate 2018 Annual Report to Congress (2019), https://taxpayeradvocate.irs.gov/Media/Default/Documents/2018-ARC/ARC18_Volume1.pdf [https://perma.cc/9SSC-G3JG] [hereinafter NTA 2018 Annual Report]. In Volume One of the report where Legislative Recommendation #3 Fix the *Flora* Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can from the Executive Summary is more fully discussed, Example 4,

Generally, meaningful pre-payment judicial review is available in the United States Tax Court via deficiency proceedings, where the taxpayer can challenge the IRS's assertion of additional tax liability and/or penalty imposition without first having to pay the sum so demanded.[6] However, the availability of pre-payment judicial review in the Tax Court is glaringly absent in certain assessable penalty cases.[7] In those cases, taxpayers may only obtain judicial review after the assessed penalty has been paid in full.[8] This outcome is not the result of any specific statutory directive; rather, it results from the Supreme Court's interpretation of the statute that authorizes federal courts to hear taxpayer refund actions against the IRS.[9]

The only judicial review in assessable penalty cases is available post-payment.[10] A taxpayer must first fully pay the penalty and then seek post-payment judicial review of the liability in federal district court (or the federal Court of Claims).[11] There is, generally, no opportunity for pre-payment judicial review.[12] There is, theoretically, an opportunity for limited judicial review in a Collection Due Process ("CDP") hearing at the end-stage of IRS efforts to collect the liability.[13] Unfortunately, IRS regulations,

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which considers assessable penalties too large to pay, is taken from the *Larson* fact pattern: "Example 4: Assessable Penalties That Are Too Large to Pay Are Not Subject to Judicial Review." NTA 2018 Annual Report, *supra*, Volume One at 366. "This hypothetical example was loosely inspired by *Larson v. United States*[.]" *Id*. at n.15.

[6] *See infra* note 41 and accompanying text. *See generally* MICHAEL I. SALTZMAN & LESLIE BOOK, IRS PRACTICE AND PROCEDURE, Ch. 10 (Assessment Procedures) (2019).

[7] See *infra* notes 62–67 and accompanying text.

[8] *Id*.

[9] *See Flora II*, 362 U.S. 145, 146 (1960).

[10] *See generally* SALTZMAN & BOOK, *supra* note 6, at Ch. 11 (Overpayment, Refund, Credit and Abatement).

[11] *See, e.g.*, *Larson II*, 888 F.3d 578, 583 n.5 (2d Cir. 2018) ("Federal district courts have original jurisdiction over such refund actions concurrently with the United States Court of Federal Claims." (citing 28 U.S.C. § 1346(a))). References to U.S. district courts in this Article, for purposes of refund litigation, also include the federal Court of Claims.

[12] In certain cases, Congress has authorized partial payment of certain assessable penalties. *See infra* note 143 and accompanying text. In others, where the assessable penalties are divisible, Courts require payment of just one penalty to secure the requisite jurisdiction. *See infra* notes 86–87 and accompanying text.

[13] *See* SALTZMAN & BOOK, *supra* note 6, at Ch. 14B (Collection Due Process).

and court decisions that have interpreted those regulations, have made even that limited review unavailable for taxpayers who have already had an administrative review of the liability in question.[14]

Remarkably, when the sheer size of the penalty imposed,[15] such as the initial $160 million assessed in *Larson*,[16] results in a situation where the taxpayer cannot, demonstrably, pay the full amount demanded by the IRS, the notion that post-payment judicial review is available to challenge the IRS determination is entirely illusory. That outcome, where a taxpayer is denied both pre- and post-payment access to the court system, results in a complete victory for the IRS. Not only is the IRS automatically victorious in those circumstances, but its actions also evade any judicial scrutiny whatsoever.[17]

Constitutional due process cannot mean that judicial review is available only to those taxpayers who are financially well-off enough to pay for it.[18] Not only does such a paradigm punish the

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[14] See *infra* notes 73 & 207 and accompanying text.

[15] See, for example, *Diversified Grp. Inc. v. United States*, where the initial assessed penalty under I.R.C. § 6707 was $42.1 million. 841 F.3d 975, 978–79 (Fed. Cir. 2016). That figure was subsequently reduced by $17.2 million to reflect payments made by additional joint tortfeasors. *Id.* at 979. *See also* I.R.S. Gen. Couns. Mem. 201150029 (Nov. 9, 2011) ("The Court [*Flora*] did recognize, however, that in some instances full payment may not be necessary, for example, in the case of excise taxes which 'may be divisible into a tax on each transaction or event.' From that recognition was born the "divisible tax" exception to the full payment rule. *Where a tax is considered a 'divisible tax,' the taxpayer need only pay a portion of the tax before instituting suit (assuming other jurisdictional prerequisites are met).*" (citations omitted) (emphasis added)).

[16] *Larson II*, 888 F.3d 578, 581 (2d Cir. 2018).

[17] *See* NTA 2018 Annual Report, *supra* note 5.

[18] The paradox that confronted Larson is not limited to high income taxpayers. The Legal Services Center of Harvard Law School's Federal Tax Clinic filed an amicus curiae brief in support of the Appellant. *See* Amicus Brief for the Appellant Supporting Reversal at 1, *Larson II*, 888 F.3d 578 (2d Cir. 2018) (No. 17-503) [hereinafter Harvard Amicus Brief] ("We write to describe to the court how applying the *Flora* full payment rule to assessable penalties harms low-income taxpayers."). *See, e.g.*, Kahn v. United States, 753 F.2d 1208 (3d Cir. 1985), discussed *infra* notes 119–21, in which the taxpayer was unable to pay a $500 assessed penalty.

See NTA 2018 Annual Report, *supra* note 5, Executive Summary at 65. "It can be difficult or impossible for some taxpayers to obtain judicial review of what the IRS says they owe, especially low-income taxpayers and those subject to "assessable" penalties (i.e., penalties that can be assessed without first giving the taxpayer a notice of deficiency)."

low-income taxpayer, but where a penalty assessment is an astronomically high figure, it can be beyond even the means of a supposedly "high-income" taxpayer—e.g., John Larson.[19] This unfortunate outcome denies procedural due process to taxpayers at both ends of the income spectrum; likewise, it ensures the finality of essentially unreviewable IRS penalty determinations.[20]

Courts and Congress have each recognized that the hardships and unfairness of this uniquely troubling outcome can result in a particularly insidious brand of inequity.[21] Accordingly, in certain circumstances, where judicial review would only be available via refund litigation, the courts and Congress have carved out limited exceptions to the full payment rule.[22] The judicial exceptions to the general rule allow for partial payment; Congress has, similarly, enacted partial payment mechanisms for certain (but not all) assessable penalties.[23] The taxpayer in those situations can proceed to federal court, via refund litigation, and challenge the underlying liability without having fully paid the amount in controversy.[24]

For example, courts employ the "divisibility doctrine" to provide taxpayers access to judicial review in certain cases where the deficiency process is not applicable and full payment of the amount due would be prohibitive.[25] In those instances, the court requires payment of just one of the divisible taxes and that partial payment of the total assessment serves as the predicate for subject matter jurisdiction.[26] Likewise, Congress has enacted statutory exceptions to the full payment rule for certain assessable

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[19] *See Larson II*, 888 F.3d at 586.

[20] *See* NTA 2018 Annual Report, *supra* note 5.

[21] *Id*.

[22] Notably, judicially defined "divisible penalties" and congressionally enacted partial payment provision for certain (but by no means all) assessable penalties.

[23] *See infra* notes 86–87 (judicial) & 143 (statutory) and accompanying text.

[24] *Id*.

[25] *See infra* notes 86–87 and accompanying text.

[26] *See, e.g.*, Diversified Grp. Inc. v. United States, 841 F.3d 975, 981–82 (Fed. Cir. 2016) ("If an assessment or penalty is merely 'the sum of several independent assessments triggered by separate transactions,' ... it is considered "divisible" such that" the taxpayer may pay the full amount on one transaction, sue for a refund for that transaction, and have the outcome of this suit determine his liability for all the other, similar transactions." (footnote omitted) (citations omitted)).

penalties.[27] Notably, those statutory exceptions permit a taxpayer to pay just 15 percent of the assessed penalty (if the other procedural requirements are met) and then seek judicial review of the full assessment via refund litigation.[28]

This Article briefly reviews the taxpayer opportunities for judicial review of IRS assessments, assessable penalties, the full payment rule, and the *Larson* opinions. The Supreme Court's procedural due process jurisprudence is also reviewed. This Article then analyzes how the Second Circuit's decision failed to consider the significant deprivation of a taxpayer's constitutional right to due process that results from a blind application of the full payment rule.[29] As a direct consequence of the Second Circuit's refusal to adopt a limited hardship exception in *Larson*, taxpayers who cannot pay extremely high assessed penalties remain at the mercy of what is, in essence, an unreviewable paradigm.[30] This one-sided outcome is especially unnecessary because the Supreme Court itself has recognized that judicial exceptions to the full payment rule are appropriate in some circumstances.[31]

One unintended consequence of the denial of pre-payment judicial review in these instances is that taxpayers, for lack of a meaningful alternative, will be forced to seek refuge in the bankruptcy court system.[32] Ironically, the abdication of judicial oversight by district courts, in these cases, in favor of proceedings

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[27] *See infra* note 143 and accompanying text.

[28] *Id*.

[29] An additional factor that raises both due process and equitable considerations was mentioned by the Second Circuit—but not addressed further in its opinion:

> *Eight years after the IRS notified Larson that he was under investigation*, it informed him via letter that it considered him a tax shelter organizer with respect to the tax shelters in question. The letter noted that Larson therefore had a duty to register the tax shelters and was subject to aggregate penalties of $160,232,026 for his failure to do so.

Larson II, 888 F.3d 578, 581 (2d Cir. 2018) (emphasis added) (footnote omitted). The fact that the IRS waited eight years before asserting that a taxpayer was liable for $160 million in tax shelter promoter penalties should, in and of itself, raise due process considerations.

[30] *See* NTA 2018 Annual Report, *supra* note 5.

[31] Most notably, the "divisible penalty" exception. *See infra* notes 86–87 and accompanying text.

[32] *See supra* note 4 and *infra* note 243 and accompanying text.

initiated in bankruptcy courts, seriously undermines IRS efforts to collect taxes and its ability to administer the tax code—the primary rationale that underpinned the *Flora* rule.[33] Moreover, the automatic stay in effect during the pendency of the bankruptcy action might prohibit any IRS collection efforts, which mirrors the similar halt to collection efforts that would be in place during any pre-payment judicial review in the Tax Court.[34]

I. TAX ADMINISTRATION AND JUDICIAL REVIEW

Generally, a taxpayer has two paths available for judicial review of IRS actions: deficiency proceedings in the Tax Court or refund actions in federal district courts.[35] A taxpayer who has received a statutory notice of deficiency may challenge the IRS's determination and avail herself of pre-payment judicial review in the Tax Court.[36] Alternatively, the taxpayer may, instead, pay the asserted deficiency and then seek post-payment judicial review in federal district court.[37] However, in certain cases, the IRS is not required to issue a statutory notice of deficiency, the necessary prerequisite for the Tax Court to have subject matter jurisdiction.[38] In those instances, taxpayers may not seek pre-payment review in the Tax Court.[39] A taxpayer must, instead, fully pay the assessment before judicial review is available, post-payment, via refund litigation in federal court.[40]

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[33] *See infra* note 88 and accompanying text.

[34] *See infra* note 243 and accompanying text.

[35] *See, e.g.*, *Larson II*:

> A deficiency is based on a determination that more tax is due. According to the Supreme Court, a deficiency "is the amount of tax imposed less any amount that may have been reported by the taxpayer on his return." Tax Court review is available for deficiencies and does not require payment of the deficiency prior to commencement of the action in Tax Court.

888 F.3d 578, 581 n.3 (2d Cir. 2018) (quoting Laing v. United States, 423 U.S. 161, 173 (1976)).

[36] I.R.C. § 6213(a) (2012).

[37] Before the taxpayer can proceed to federal court with the refund action, she must first file a claim for refund with the IRS. I.R.C. § 6511(a) (2012) (prescribing time limitations on filing refund claim).

[38] *See infra* notes 62–67 and accompanying text.

[39] *Id.*

[40] *Id.*

A. Deficiency Proceedings

In what most taxpayers will recognize as a familiar fact pattern, the IRS first audits a taxpayer and then, as a result of that examination, determines whether additional tax and/or a penalty is due (the deficiency).[41] This can result, for example, when the IRS asserts that a taxpayer has underreported income, overstated deductions, or some combination of both.[42] In addition, the IRS may assert various penalties as a result of the understated tax liability.[43] Those penalties would be treated as "additions to tax" and are also reviewable as part of the deficiency proceeding in the Tax Court.[44]

Certain procedural safeguards are built into the system. The taxpayer can be represented throughout the audit, typically by an accountant or lawyer. At the audit's completion, the IRS will issue a "30 day letter" and the taxpayer may then seek administrative review of the audit determination by an appeals officer; the taxpayer may also be represented at these administrative reviews.[45] It is the availability and adequacy of this administrative review, serving as a substitute for judicial review, which is the touchstone of the *Larson* due process analysis.[46]

Following the administrative appeal, or after the expiration of thirty days if no appeal is requested, the IRS will issue a formal statutory notice of deficiency, often referred to as the "90-day letter."[47] The statutory notice of deficiency is the basis for

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[41] *See* SALTZMAN & BOOK, *supra* note 6, at Ch. 8 (The Examination Function) *passim*. Following the proverbial "audit," the IRS will formally notify the taxpayer of the amount it believes it due and owing via a statutory notice of deficiency.

[42] These are generally factual determination that result from the examination. For example, if the IRS revenue officer discovers that the taxpayer neglected to include dividend or interest income, that resulting increase in taxable income will, likewise, result in a larger tax liability. The difference between the "new" higher liability and that reported on the tax return is the "deficiency" the IRS will seek to collect from the taxpayer.

[43] See SALTZMAN & BOOK, *supra* note 6, at Ch. 7B (Civil Penalties) *passim*.

[44] *Id*.

[45] *See* SALTZMAN & BOOK, *supra* note 6, at Ch. 9 (The Appeals Function) *passim*.

[46] *Larson II*, 888 F.3d 578, 585 (2d Cir. 2018).

[47] I.R.C. § 6212(a) (2012).

the Tax Court's jurisdiction.[48] The taxpayer has ninety days in which to file a petition with the Tax Court and seek a redetermination of the amount sought by the IRS.[49] The time limit is jurisdictional and failure to file a petition within the ninety-day window deprives the Tax Court of jurisdiction to review the deficiency.[50] Otherwise, the Tax Court can review all aspects of the liability asserted in the notice of deficiency.[51]

The taxpayer, following an adverse determination by the Tax Court, may then seek review of that decision in the court of appeals. When the taxpayer has exhausted the available judicial remedies, the IRS then proceeds with its collection efforts.[52] Statutory interest will accrue on the unpaid balance until the liability has been satisfied.[53]

B. Refund Litigation

In sharp contrast to deficiency proceedings, the taxpayer may opt to bypass Tax Court review and immediately pay the additional tax asserted by the IRS.[54] Under this procedure, statutory interest will no longer accrue on the asserted liability.[55] Instead, if the taxpayer succeeds in her refund action, the IRS will be liable for accrued interest on the amount refunded.[56] As a prerequisite to the post-payment judicial review, however, the taxpayer must first file an administrative claim for a refund with the IRS.[57] It is the IRS's denial of the taxpayer's claim for refund that then serves as the jurisdictional basis for federal court judicial review.[58] Just

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[48] I.R.C. § 6213(a) (2012).

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] After the IRS has filed a Notice of Federal Tax Lien and before the IRS forecloses on the lien, the taxpayer may seek a CDP hearing. Following that hearing, a limited judicial review is available in the Tax Court. I.R.C. § 6330(d) (2012). *See infra* note 207 and accompanying text.

[53] *See* SALTZMAN & BOOK, *supra* note 6, at Ch. 6 (Interest) *passim*.

[54] I.R.C. § 7422 (2012).

[55] Instead, if the taxpayer is the prevailing party in the refund litigation, the refund will include interest.

[56] *See* SALTZMAN & BOOK, *supra* note 6, at Ch. 11.

[57] I.R.C. § 7422(a).

[58] *Id.*; 28 U.S.C. § 1340 (2012).

as the notice of deficiency provides jurisdiction for the Tax Court, the denial of the taxpayer's refund claim is a jurisdictional requirement for post-payment review.[59]

The federal courts can, like the Tax Court, review the tax liability in dispute.[60] Similar to the post–Tax Court review process, a taxpayer may also seek judicial review of an adverse district court decision in the court of appeals. However, since the taxpayer has already paid the tax liability reviewed by the district court, following the exhaustion of judicial remedies, the IRS does not seek additional payments or institute collection efforts against the taxpayer.[61] Since both the Tax Court and district court decisions are reviewable by the court of appeals, which particular route is taken by the taxpayer is generally governed by the ability to pay the underlying liability.

C. Assessable Penalties

The IRS may, in limited circumstances, entirely bypass the deficiency process and assess certain penalties directly upon a taxpayer and demand that he make immediate payment.[62] These penalties must be paid "upon notice and demand"[63] and are not subject to pre-payment judicial review in the Tax Court.[64] They cannot be reviewed by the Tax Court because a statutory notice of deficiency is not required, nor is one issued.[65] It will be recalled that the statutory notice is the jurisdictional prerequisite for pre-payment judicial review in the Tax Court.[66] Since the assessable penalty is imposed directly, without a notice of

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[59] *See* § 7422.

[60] *Id.*

[61] If the refund action had involved a fully paid liability and the IRS prevailed, the matter is closed (unless an appeal is undertaken). However, if the jurisdictional predicate was based on a partial payment, or a divisible penalty, the IRS will then seek to collect the unpaid balance.

[62] I.R.C. § 6671 (2012) ("Rules for Application of Assessable Penalties").

[63] § 6671(a).

[64] Williams v. Comm'r, 131 T.C. 54, 58 n.4 (2008).

[65] *Id.* ("[T]he 'Assessable Penalties' ... fall outside the deficiency notice regime ... *and thus fall outside this Court's deficiency jurisdiction.*") (emphasis added) (citations omitted).

[66] *Id.* at 55.

deficiency, the taxpayer must seek judicial review in federal court rather than proceed in the Tax Court.[67]

When the Supreme Court decided *Flora* there were relatively few "assessable" penalties in existence.[68] "When the *Flora* rule was adopted, neither Congress nor the Court contemplated the large number of assessable penalties that exist today."[69] Perhaps the most significant assessable penalty in existence at that time was the 100 percent penalty (or "trust fund" penalty),[70] which was not subject to the full payment rule because it was deemed "divisible."[71] *Flora* was decided in an era when assessable penalties were the rare exception, and the Supreme Court correctly assumed that most taxpayers, regardless of income level, could—and would—avail themselves of pre-payment judicial review in the Tax Court.[72] That tax practice axiom may no

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[67] *Id.* at 58 n.4.

[68] Harvard Amicus Brief, *supra* note 18, at 3; *see also* NTA 2018 Annual Report, *supra* note 5.

> Moreover, the problems posed by assessable penalties have grown. When *Flora I* was decided, there were only four assessable penalties, but today there are over 50. This erosion of judicial oversight is particularly inconsistent with the taxpayer's *right to appeal an IRS decision in* an *independent forum* and *right to a fair and just tax system.*

Id. at Volume One, 365 (emphasis in original) (footnote omitted); *see infra* notes 110–11 and accompanying text.

[69] *Id.*

[70] I.R.C. § 6672 (2012). The Section provides:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, *shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.*

Id. (emphasis added). A recent decision by the Fifth Circuit highlights the starkly disparate outcomes when the "divisibility" exception to the full payment rule applies. In *McClendon v. United States*, the IRS assessed $4.3 million in section 6672 penalties against the taxpayer. 892 F.3d 775, 777 (5th Cir. 2018). He "*paid a nominal portion* of the penalties and then filed suit ... seeking a refund of the portion paid and abatement of the penalties assessed." *Id.* at 778 (emphasis added).

[71] *Flora II*, 362 U.S. 145, 175 n.38 (1960).

[72] *Id.* at 167 (quoting Flora v. United States, 357 U.S. 63, 69 (1958)).

longer be valid if the growing number of assessable penalties curtail access to the Tax Court.

Instead, the only mechanism generally available for judicial review of assessable penalties is the post-payment refund action in district court.[73] The taxpayer must pay the assessed penalty in full and then file a claim for refund with the IRS.[74] The denial of that claim by the IRS serves as the jurisdictional prerequisite for district court review of the tax liability.[75] If the taxpayer does not pay the full amount due, not only does the district court lack jurisdiction to review the assessed penalty, but also the IRS may proceed directly to collection efforts against the taxpayer.[76] As a result, there is no judicial review of any kind available when the taxpayer cannot afford to pay the assessed penalty in full. This is not due process.[77]

D. The Flora *Full Payment Rule*

Judicial review in district court is governed by the rules of refund procedure.[78] Thus, a taxpayer's ability to pay the assessed penalty is a paramount consideration in the quest to obtain judicial relief in federal court of an IRS determination. According to the Supreme Court's interpretation, however, to initiate that refund action in federal court first requires the taxpayer to fully pay the assessed penalty, followed by the IRS's subsequent denial of the taxpayer's claim for refund of the amount paid.[79] If the

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[73] A limited form of judicial review of the liability may be available following a Collection Due Process (CDP) hearing. However, if the taxpayer has had a "meaningful opportunity" to challenge the assessment prior to the CDP hearing, judicial review of the liability itself is foreclosed. I.R.C. § 6330(c)(2)(B) (2012). Hearings brought before the IRS Appeals Division constitute a "meaningful opportunity" for CDP hearing purposes. *See infra* note 207 and accompanying text.

[74] *Flora II*, 362 U.S. at 177.

[75] *See* Harvard Amicus Brief, *supra* note 18, at 2–3.

[76] *Id.* at 2.

[77] *See id.* at 3 ("As a result [of the increased number of assessable penalties], we have arrived at an unfair set of circumstances in which the IRS has tremendous power to levy severe assessable penalties *and effectively deny taxpayers any judicial recourse due to their inability to fully pay the penalties before challenging them in court*." (emphasis added)).

[78] *See* 28 U.S.C. § 1346 (2012).

[79] I.R.C. § 7422(a) (2012). Section 7422(a) requires that a taxpayer must first file a claim for refund with the IRS before refund litigation may be commenced in

taxpayer's means only permit a partial payment, it is impossible to access federal court jurisdiction—and no judicial review can occur.[80]

The statutory authority for the federal court's refund jurisdiction is found in 28 U.S.C. § 1346(a)(1).[81] In its 1960 decision in *Flora v. United States*, the Supreme Court, in a sharply divided decision, held that to properly invoke the subject matter jurisdiction of 28 U.S.C. § 1346(a)(1), the taxpayer must first pay the entire amount of tax (inclusive of penalties) asserted to be due and owing by the IRS.[82]

In other words, a partial payment would prevent the district court from acquiring the necessary subject matter jurisdiction to adjudicate the claim for refund. The statute itself does not mandate that all-or-nothing outcome.[83] Instead, a majority of the Supreme Court construed it to require full payment before subject matter jurisdiction was acquired by the court.[84] A minority of the Supreme Court in *Flora II* would have permitted a taxpayer's refund action if less than full payment of the tax had been made.[85]

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district court. *Id.* The taxpayer must then wait six months, unless the claim is denied earlier, before the complaint can be filed. § 6532(a)(1).

[80] *See Flora II*, 362 U.S. 145, 177 (1960).

[81] 28 U.S.C. § 1346(a)(1) (2012) provides:

> (a) The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of: (1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws[.]

§ 1346(a)(1).

[82] *Flora II*, 362 U.S. 145, was a 5–4 decision. Justice Warren wrote the majority opinion for the Court and Justice Whittaker, with a short concurrence by Justice Frankfurter, wrote the dissenting opinion. *Id.* at 177, 178.

[83] *See* § 1346.

[84] *Flora II*, 362 U.S. at 177.

[85] *Id.* at 197 (Whittaker, J., dissenting) ("[T]here is no sound reason for implying into section 1346(a) a limitation that full payment of an illegal assessment is a condition upon the jurisdiction of a District Court to entertain a suit for refund. Inasmuch as no contradiction or absurdity is created by so doing, I think it is our duty to rely upon the words of section 1346(a), rather than upon unarticulated implications or exceptions. Particularly is this so in dealing with legislation in an area such as internal revenue, where countless

Despite the holding that full payment is required, the Supreme Court itself recognized a significant exception to the general rule it announced—for what are often referred to as "divisible" taxes.[86] If a particular tax is divisible (e.g., the sum of individual components), the payment of just one tax (rather than the total demanded) is sufficient to maintain a refund action in district court.[87] This significant exception to the general rule requiring full payment is a matter of judicial creation.

The primary rationale that animated the majority of the Supreme Court to adopt the *Flora* doctrine was the desire to protect the government's ability to administer the tax system:

> [T]he Government has a substantial interest in protecting the public purse, an interest which would be substantially impaired if a taxpayer could sue in a District Court without paying his tax in full. ... It is quite true that the filing of an appeal to the Tax Court normally precludes the Government from requiring payment of the tax, but a decision in petitioner's favor could be expected to throw a great portion of the Tax Court litigation into the District Courts. ... A full payment requirement will promote the smooth functioning of this system; a part payment rule would work at cross-purposes with it.[88]

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rules and exceptions are the subjects of frequent revisions and precise refinements."). A similar position was echoed by Justice Blackmun, also in dissent, sixteen years later in *Laing v. United States*, 423 U.S. 161 (1976). He observed that, "the full-payment rule applies only where a deficiency has been noticed, that is, only where the taxpayer has access to the Tax Court for redetermination prior to payment." *Id.* at 208–09 (Blackmun, J., dissenting). In *Larson II*, the Second Circuit was highly critical of his dissent in *Laing*: "Larson relies on Justice Blackmun's dissent, but Justice Blackmun's view did not garner majority support. No subsequent majority of the Supreme Court has adopted that understanding of the statute." 888 F.3d 578, 584 n.8 (2d Cir. 2018).

[86] Diversified Grp., Inc. v. United States, 841 F.3d 975, 981 (Fed. Cir. 2016) ("It [*Flora*] did, however, recognize that in cases such as those involving excise taxes where the tax 'may be divisible into a tax on each transaction or event,' satisfaction of 'the full-payment rule would probably require no more than payment of a small amount.' This is because each excise tax is, legally, its own assessment (e.g., if a person is taxed $100 per widget for 5000 widgets, they receive 5000 different assessments), so paying the "small amount" that is the excise tax for one good would satisfy the full payment rule for that good.") (citations omitted).

[87] *Id.*

[88] *Flora II*, 362 U.S. at 175 (footnotes omitted). One footnote the Court included in the above-cited text is instructive of its concern that a relaxation of

Whether *Flora* provided a correct interpretation of 28 U.S.C. section 1346(a)(1) is not at issue for purposes of this Article. Instead, the focus is whether a blanket adherence to the full payment rule in assessable penalty cases, when its direct consequence is no judicial review at all, denies the taxpayer her constitutional right to due process of law.

II. THE *LARSON* OPINIONS

The taxpayer, John Larson, was a remarkably unsympathetic plaintiff.[89] Larson was convicted for his role in the creation, promotion, and sale of abusive tax shelters and, as a consequence,

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the full payment requirement would open the floodgates of taxpayer abuse of the system:

> Permitting refund suits after partial payment of the tax assessment would benefit many taxpayers. Such a law would be open to wide abuse, and would probably seriously impair the government's ability to collect taxes. Many taxpayers, without legitimate grounds for contesting an assessment, would make a token payment and sue for refund, hoping at least to reduce the amount they would ultimately have to pay. In jurisdictions where the District Court is considered to be a 'taxpayer's court,' most taxpayers would use that forum instead of the Tax Court. Conceivably such legislation could cause ... chaotic tax collection situations ..., since there would be strong impetus to a policy of paying a little and trying to settle the balance.

Id. at 176 n.41 (quoting from Lowitz, *Federal Tax Refund Suits and Partial Payments*, 9 THE DECALOGUE J. 9, 10).

[89] In December 2008, John Larson was convicted of 12 counts of tax evasion after a 10-week jury trial. Four months later, he was sentenced to 121 months in prison, together with the imposition of a $6 million fine. *See* "*2 Ex-KPMG Managers Sentenced Over Tax Shelters*," N.Y. TIMES (Apr. 1, 2009), https://www.nytimes.com/2009/04/02/business/02kpmg.html [https://perma.cc/2KEK-NQLU] ("Upon handing down the sentence, Judge Kaplan called the men's behavior 'extremely offensive' and said their fraudulent tax shelter scheme, which focused on clients who earned more than $20 million a year, was a 'brazen act.' 'These defendants knew they were on the wrong side of the line,' he said, adding later they had cooked up 'this mass-produced scheme to cheat the government out of taxes for the purposes of enriching themselves.' *The losses through the scheme were estimated at more than $100 million*." (emphasis added)). Larson's conviction was affirmed by the Second Circuit in October 2010. United States v. Pfaff, 407 F. App'x 506, 511 (2d Cir. 2010). In a subsequent action, however, the fine imposed by Judge Kaplan was reduced. United States v. Pfaff, 619 F.3d 172, 175–76 (2d Cir. 2010).

received a ten-year prison sentence.[90] This post-conviction legal action concerns the civil penalties assessed against him by the IRS for the conduct that was the underlying basis of the criminal prosecution.[91]

As a tax shelter promoter, Larson had failed to register the two tax shelters he had marketed, as required by the Internal Revenue Code.[92] The IRS assessed penalties against him of approximately $160 million.[93] That figure was reduced to just over $67 million, following an administrative appeal.[94] Larson contended that the penalties were incorrectly calculated because loans and

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[90] For a broader discussion of Larson's role in the tax shelter industry, see generally TANINA ROSTAIN & MILTON C. REGAN, JR., CONFIDENCE GAMES: LAWYERS, ACCOUNTANTS, AND THE TAX SHELTER INDUSTRY (2014).

[91] No. 16-CV-00245, 2016 WL 7471338, at *1 (S.D.N.Y. Dec. 28, 2016).

[92] I.R.C. section 6111(a)(1), in effect at the time, provided: "Any tax shelter organizer shall register the tax shelter with the Secretary (in such form and in such manner as the Secretary may prescribe) not later than the day on which the first offering for sale of interests in such tax shelter occurs." *See Larson II*, 888 F.3d 578, 581 (2d Cir. 2018) ("At the time Larson was organizing the tax shelters, the [IRS] required organizers/promoters to register [them] 'not later than the day on which the first offering for sale of interest in such tax shelter occurs.' I.R.C. § 6111(a) (1997) (current version at I.R.C. § 6111(a) (2005))."); *see also Diversified Grp. Inc.*, 841 F.3d at 978 ("Treasury Department regulations provided that '[r]egistration is accomplished by filing a properly completed Form 8264 with the [IRS]. The [IRS] will assign a registration number to each tax shelter that is registered.' Temp. Treas. Reg. § 301.611-1T, A-1, A-47.").

[93] I.R.C. section 6707, which was in effect when the penalty was incurred, stated:

> The penalty imposed under paragraph (1) with respect to any tax shelter shall be an amount equal to the greater of—(A) $500, or (B) the lesser of (i) 1 percent of the aggregate amount invested in such tax shelter, or (ii) $10,000. The $10,000 limitation in subparagraph (B) shall not apply where there is an intentional disregard of the requirements of section 6111(a).

See also Diversified Grp. Inc., 841 F.3d at 977 n.1 ("This version of ... I.R.C. section 6707 ... [was] enacted on August 5, 1997 as part of the Taxpayer Relief Act of 1997, Pub. L. 105-34. [It was] repealed on October 22, 2004, when [it was] ... replaced with the American Jobs Creation Act of 2004, Pub. L. 108-357. Because the actions in question occurred before 2004, we will refer to the pre-2004 version[ ] of section 6707.").

[94] *Larson I*, 2016 WL 7471338, at *1. "In December 2012, the IRS Appeals Office reduced the total penalty due to $67,661,349 to reflect penalty payments that had been received from other taxpayers who were jointly and severally liable with Larson." *Id.* at *2.

loan premiums were included in the computation.[95] Correctly calculated, he asserted, the penalties should have been roughly $7 million.[96]

Larson made a partial payment of just over $1.4 million of the assessed penalties and then sought judicial review via refund litigation.[97] Since the entire assessed penalty was not paid, the IRS sought dismissal for lack of subject matter jurisdiction.[98] The district court agreed and held that the full payment rule was dispositive.[99] The Second Circuit affirmed the District Court's dismissal on the full payment rule and, in addition, concluded that between the administrative review provided and the post-payment judicial review available, Larson's due process rights were not violated.[100]

A. Southern District of New York

The District Court for the Southern District of New York was unpersuaded by Larson's arguments that it could properly hear his substantive claims against the imposition and calculation of assessed penalties without his first having fully paid the assessment.[101] While the total dollar figure assessed was astronomically high (even after that sum was reduced by the payments made to the IRS by the additional joint tortfeasors), the court held that it was, nevertheless, powerless to adjudicate the matter because of the full payment rule.[102] While the court expressed sympathy for

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[95] Brief for Plaintiff-Appellant at 4, *Larson II*, 888 F.3d 578 (2d Cir. 2018) ("In computing the penalties, the IRS interpreted the 'aggregate amount invested' language in section 6707(a)(2) to include loans and loan premiums that were never actually invested by the participants in these transactions. ... The effect of including these amounts was to grossly inflate the 1% penalties from approximately $7 million (if the loans and loan premiums were not included) to $160,232,026 (if the loans and loan premiums were included).").

[96] *Id.*

[97] *Larson I*, 2016 WL 7471338, at *2. "In February 2015, Larson paid $1,432,735 toward the penalty. ... Larson did not make any further payments toward his assessed penalties." *Id.*

[98] *Id.* at *2.

[99] *Id.* at *6–7.

[100] *Larson II*, 888 F.3d at 588–89.

[101] *Larson I*, 2016 WL 7471338, at *6.

[102] *Id.*

the apparent dilemma that confronted Larson, it was convinced that the Supreme Court's *Flora* holding was dispositive.[103]

The district court refused to accept the challenge to carve out what is often referred to as a "hardship" exception to the *Flora* rule.[104] In so doing, it ignored that the original carve out to the full payment rule for divisible taxes was an exception of judicial creation. Instead, the district court insisted that the taxpayer's only recourse in this untenable situation was a Congressional solution.[105] According to the Southern District, Congress was more than capable of providing a legislative solution to help Larson.[106]

The district court was even less receptive to Larson's due process argument.[107] It was unconvinced that, despite the undeniable hardship, the full payment rule was a violation of the plaintiff's right to due process.[108] It observed that "courts have consistently rejected the argument that application of the full payment rule deprives the taxpayer of 'fundamental due process' in circumstances where the taxpayer is unable to pay the full amount."[109] The court, aside from a pair of citations, provided no analytical support for that conclusion.[110] It, unfortunately, did not

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[103] *Id.* at *1–2, 6.

[104] *Larson I*, 2016 WL 7471338, at *6. "Courts of appeals have also declined to carve a 'hardship' exception to the full-payment rule for taxpayers foreclosed from Tax Court review." *Id.* In support, the Southern District cited two decisions from sister circuits: *Curry v. United States*, 774 F.2d 852, 854 (7th Cir. 1985), and *Rocovich v. United States*, 933 F.2d 991, 995 (Fed. Cir. 1991). *Id.* Notably, those cases were arguably inapposite. In both *Curry* and *Rocovich,* the taxpayers were issued notices of deficiency and each had access to the Tax Court. Neither *Curry* nor *Rocovich* involved an assessable penalty. It also cited the Second Circuit's decision in *United States v. Forma*, 42 F.3d 759, 763 (2d Cir. 1994), which involved an even more obscure fact pattern. In *Forma*, the United States was the plaintiff; it was the taxpayer, as defendant, who sought the tax refund *as a counterclaim* against the IRS. Like *Curry* and *Rocovich*, *Forma* did not involve an assessable penalty.

[105] *Larson I*, 2016 WL 7471338, at *6 ("[A]ny amelioration of that hardship is for Congress, not the courts." (citations omitted)). *See also infra* note 235 and accompanying text for further discussion of the *Curry* decision.

[106] *Larson I*, 2016 WL 7471338, at *6.

[107] *Id. at* *5–6. "Larson's reading [that] *Flora I* and *Flora II* [only apply when Tax Court review is also available] strains to find due process arguments where none exists." *Id.* at *6.

[108] *Id.* (citing Johnston v. Comm'r, 429 F.2d 804, 806 (6th Cir 1980)).

[109] *Id.* at *5–6.

[110] *Id.* ("*See Johnston*, 429 F.2d at 806 ("'While we appreciate that the payment of taxes as a precondition to sue for their return places a burden on

conduct any analysis of the due process issues implicated by the lack on any judicial review of the IRS assessment as a consequence of its holding.[111]

B. Second Circuit Court of Appeals

At the outset, the Second Circuit Court of Appeals took note of the district court's "well-reasoned" decision that concluded the full payment rule was dispositive[112] and application of the rule did not violate Larson's right to due process.[113] That was an inauspicious lead-in to the Second Circuit's own consideration of Larson's argument that his right to due process of law was violated because he could not fully pay the assessed penalty and would be denied any judicial review whatsoever.[114] Instead, the Second Circuit concluded that Larson's administrative review before the IRS Appeals Division was sufficient due process and did not run afoul of constitutional procedural safeguards.[115]

While it devoted more attention to the due process argument than did the Southern District, the Second Circuit nevertheless agreed with the lower court that, regardless of the hardship

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the taxpayer, we do not believe that it is such as to deny him the fundamental processes of fairness required by the Fifth Amendment of the United States Constitution.'); *see also Pfaff*, 2016 WL 915738, at *4 [(D. Colo. 2016)] ('plaintiff's argument that required pre-payment of approximately $67.6 million violated his due process rights did not provide a basis for subject matter jurisdiction').."). *Johnston*, also cited in the Second Circuit's opinion, is discussed *infra* at notes 122–23 and accompanying text. The Southern District's citation to *Pfaff* was puzzling because of the summary disposition of the due process claim in that opinion. "Plaintiff does not include due process in his complaint. Plaintiff also fails to explain how an alleged due process violation confers subject matter jurisdiction over plaintiff's tax refund claims on this Court." *Pfaff,* 2016 WL 915738, at *4 (citations omitted) [sic]. Those two sentences immediately precede the sentence quoted by the Southern District.

[111] *Larson I*, 2016 WL 7471338, at *4–5.

[112] *Larson II*, 888 F.3d 578, 581–82 (2d Cir. 2018) ("The Government ... argued that requiring full payment of the assessed penalties prior to any judicial review of the assessment did not violate due process. In a well-reasoned opinion, the District Court agreed.").

[113] *Id.* at 582. ("The District Court concluded that the full-payment rule applied to Larson's § 6707 penalties and it therefore lacked subject matter jurisdiction").

[114] *See id.* at 585.

[115] *See id.*

imposed by the assessable penalties, Larson was not entitled to pre-payment judicial review—and it would not carve out a hardship exception to the full payment rule.[116] Instead, the Second Circuit found that the "strong governmental interest in the efficient administration of the tax system as crafted by Congress" was a sufficiently compelling interest to rule against Larson's due process claim.[117] Accordingly, "[t]hat interest allows courts to conclude that adequate summary or administrative pre-payment review of tax assessment—with adequate post payment judicial review—provides the required constitutional procedural protections."[118]

One irony of the Second Circuit's holding was its citation to *Kahn v. United States*[119] for the proposition that "in the tax context, the constitutionality of a scheme providing for only post-assessment judicial review is well-settled."[120] *Kahn*, a 1985 decision by the

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[116] *Id.* at 584. Quoting the Seventh Circuit's decision in *Curry v. United States*, 774 F.2d 852, 855 (7th Cir. 1985), the Second Circuit agreed that "'carv[ing] out a "hardship" exception to the *Flora* rule ... would endanger the "public purse" and disrupt the smooth function of the tax system[.]'" *Id.*

[117] *Id.* at 585.

[118] *Id.* Larson's due process challenge asserted that, despite the substantial penalty reduction to reflect payments from the joint tortfeasors, there was, nevertheless, no meaningful review afforded *to his arguments* by the Appeals Division. "Larson maintains that an administrative pre-payment review does not satisfy the requirements of due process." *Id.* at 585–86. The Second Circuit did not view this as a due process issue. Rather, it interpreted Larson's argument as a general dissatisfaction with the Appeals Division. This was not Larson's contention. Instead, Larson argued that his actual experience with the Appeals Division, *despite the penalty reduction*, did not provide a meaningful review. What review conducted at the Appeals Division, aside from the mechanical subtraction of funds received from others tax shelter promoters, was not reported.

> In any event, whether Appeals review is constitutionally adequate in a particular case depends on the facts and circumstances of that case, and here the *record is not sufficiently developed as to the adequacy of the Appeals review for the Court to make a finding that Appellant is not entitled to judicial review*.

Reply Brief for Plaintiff-Appellant at 16, *Larson II,* 888 F.3d 578 (2d Cir. 2018) (emphasis added).

[119] *Larson II*, 888 F.3d at 585 (quoting Kahn v. United States, 753 F.2d 1208, 1218 (3d Cir. 1985)).

[120] *Larson II,* 888 F.3d at 585 (citing *Kahn*, 753 F.2d at 1218 (citing Bob Jones Univ. v. Simon, 416 U.S. 725, 746–47 (1974))). While *Bob Jones University*

Third Circuit, may have been a poor choice as precedent to bolster the Second Circuit's view that there was no procedural due process violation. The staggering $60+ million section 6707 penalty assessed against Larson for failure to register two tax shelters was, simply stated, grossly disproportionate to the $500 penalty imposed upon Ms. Kahn for having filed a frivolous tax return.[121]

As if to compound the reliance on grossly disproportionate fact patterns, *Larson's* citation to the Sixth Circuit's decision in *Johnston v. Commissioner* (which was similarly relied upon by the district court in its opinion)[122] was even more inapposite than its reliance on *Kahn*. *Johnston* involved an accuracy-related penalty of $67.19—which, astonishingly, the taxpayer was *unwilling* to pay.[123] There was no averment that he was *unable* to pay the

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was a pre–*Mathews v. Eldridge* decision, it did include a significant admonition from the Supreme Court with respect to procedural due process and tax matters—which was not cited in either the *Kahn* or *Larson* opinions: "[T]his is not a case in which an aggrieved party *has no access at all to judicial review*. Were that true, our conclusion might well be different." *Bob Jones Univ.*, 416 U.S. at 746 (emphasis added).

[121] *Kahn*, 753 F.2d at 1211. In addition to the significantly disparate monetary penalties, *Kahn* was a poor precedent because it involved an assessable penalty that, by statute, permitted partial payment (15 percent of the assessed penalty)—a statutory *exception* to the full payment rule. Partial payment was not available in *Larson II*. *See* 888 F.2d at 585. The due process analysis conducted by the Third Circuit in *Kahn* focused solely on the validity of the 15 percent partial payment. The court had, and did in fact exercise, subject matter jurisdiction over the substance of Kahn's penalty challenge.

> She paid 15% of the penalty as required by section 6703(c) and as specified by the penalty notice. She then filed a claim for refund of the $75.00 portion [15%] of the assessed penalty of $500.00 ... [and] brought this suit for refund in the United States District Court for the Eastern District of Pennsylvania, alleging that the assessment of $500.00 and the collection of $75.00 was "improper, illegal and erroneous."

Kahn, 753 F.2d at 1211. The full payment rule was not applicable, *and not discussed*, in *Kahn*. While the reasoning may have been somewhat analogous, to the extent the due process analysis in *Kahn* was applied by *Larson II,* it relied on dicta—by no means precedent.

[122] Johnston v. Comm'r, 429 F.2d 804 (6th Cir. 1970), *aff'g* 52 T.C. 792 (1969). *See supra* note 110 and accompanying text.

[123] *Johnston*, 52 T.C. 792, 792 (1969) ("Attached to the petition was a Treasury Department Form 4188 ... headed 'Account Adjustment Bill For Tax Due.' Below the heading was what purports to be a computation of a penalty in the amount of $67.19 and a reference to various statements on the back of

penalty.[124] "Appellant acknowledges *that were he willing to pay* the asserted liability, *he would have full opportunity to an adjudication of the validity of the taxes imposed in the District Courts of the United States*."[125] Larson, conversely, was willing to, but could not, pay the assessed penalty at issue.[126]

Despite the large sum involved and the interplay of penalties imposed upon other joint tortfeasors, the Second Circuit held that the administrative review provided by the IRS appeals office was sufficient due process.[127] Aside from noting the dollar amount of the penalty was reduced by monies collected from other parties who were jointly and severely liable, the Second Circuit did not examine the scope and content of the appeals office review.[128] Given that the administrative review Larson received at the Appeals Division was its basis for concluding he had received sufficient due process,[129] the Second Circuit should have examined that review more stringently.

In addition, the Second Circuit discussed the three-factor test articulated by the Supreme Court in *Mathews v. Eldridge* to be used when faced with a due process claim.[130] There, the Court stated that courts should be flexible when considering the level of review that is appropriate.[131] Unfortunately, not only did the Second Circuit give each of the three factors a cursory analysis, it also concluded that in each instance, the factor weighed in favor of the IRS and the government's paramount interest in the administration of the taxation code.[132] Again, these conclusions were reached without

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the form for further explanations. The reference statements advised that ... this notice is not the result of an audit of 'your return.'").

[124] *Johnston*, 429 F.2d at 806.

[125] *Id.* (emphasis added).

[126] *Larson II*, 888 F.3d at 589.

[127] *Id.* at 585.

[128] The same "offset" (or credit) for § 6707 penalty amounts paid by other joint tortfeasors was applied in *Diversified Grp., Inc.,* 841 F.3d at 979. ("On January 16, 2014, the IRS reduced the amount due to $24,920,904 because the other $17,188,579 had been '[p]aid by [o]thers.'") The initial penalty asserted against the Diversified Group was $42.1 million. *Id.* See also *Pfaff v. United States*, 2016 WL 915738 at *3, where the IRS initially sought $160.2 million in section 6707 penalties, before offsets.

[129] *Larson II*, 888 F.3d at 585.

[130] *Id.* at 586–87; *see* Mathews v. Eldridge, 424 U.S. 319, 334–35 (1976).

[131] *Mathews*, 424 U.S. at 334.

[132] The Second Circuit's entire consideration of the three *Mathews* factors filled slightly less than one page of its 11-page opinion. *Larson II*, 888 F.3d at 586–87.

a meaningful application of the *Mathews* factors to the actual facts presented by *Larson II*.[133]

III. PROCEDURAL DUE PROCESS JURISPRUDENCE

The Fifth Amendment to the United States Constitution provides for "due process of law" before any person can be "deprived of life, liberty, or property."[134] What amount of due process is required to satisfy that constitutional mandate is entirely dependent upon context.[135] For example, the due process required in a criminal case is significantly greater than that afforded in a civil matter.[136] In Larson's criminal case, the prosecution's burden of proof was "beyond a reasonable doubt."[137] Equally important, in criminal prosecutions, the government must prove its case before a judicial tribunal—and, if appeals are taken from that verdict, the subsequent appellate review is also provided by judicial tribunals.[138] When fundamental liberty interests are at stake, nothing less will suffice.

However, at the other end of the legal spectrum, the Supreme Court has held that administrative tribunals and review are sufficient to satisfy the requirements of due process.[139] This is often the case when property interests, as contrasted with individual liberties, are at stake.[140] In the civil tax context, for example, the Supreme Court typically balances the government's

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[133] *See id.*

[134] U.S. CONST. amend. V.

[135] In *Mathews*, the Supreme Court explained that "'due process' ... is not a technical conception with a fixed content unrelated to time, place and circumstances." 424 U.S. at 334 (quoting Cafeteria & Rest. Workers Union, Local 473 v. McElroy, 367 U.S. 886, 895 (1961)). Instead, as Justice Powell, for the majority of the Court, observed, it is "'flexible and calls for such procedural protections as the particular situation demands.'" *Id.* (quoting Morrissey v. Brewer, 408 U.S. 471, 481 (1972)).

[136] *See* Sullivan v. Louisiana, 508 U.S. 275, 277–78 (1993) (stating the Due Process Clause requires a finding of guilt "beyond a reasonable doubt" in a criminal prosecution).

[137] United States v. Pfaff, 619 F.3d 172, 174 (2d Cir. 2010) (quoting Apprendi v. New Jersey, 530 U.S. 466, 490 (2000)).

[138] U.S. CONST. amend. VI; *see id.* art. I, § 8.

[139] *Mathews*, 424 U.S. at 348–49.

[140] *See id.* at 348; *see also* Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123, 162–63 (1951) (Frankfurter, J., concurring).

interest in the administration of the tax system and collection of tax revenues against an individual's right to judicial review of the tax authority's conduct.[141] In the vast majority of those instances, a taxpayer has the opportunity for judicial review prior to the government's commencement of collection efforts over the taxes asserted to be due and owing.[142] Against the general scheme of taxation, there are relatively few instances when a taxpayer does not have an opportunity for pre-payment (or partial payment) judicial review.[143]

In balancing the competing due process interests, the Supreme Court has instructed courts to examine three factors:

> (1) "the private interest that will be affected by the official action"; (2) "the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards"; and (3) "the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail."[144]

Ultimately, "balance involves a determination as to when, under our constitutional system, judicial-type procedures must be

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[141] *Flora II*, 362 U.S. 145, 175–77 (1960).

[142] Frank G. Colella, *Ninth Circuit Holds Section 6694(c) Deadline for Review of Tax Preparer Penalties is Jurisdictional and Affirms Dismissal of Refund Action*, 94 TAXES MAGAZINE, No. 1, 19, 20 (Jan. 2019).

[143] Notably, Congress has created partial payment provisions for certain assessable penalties. Thus, while the full payment rule still applies, full payment of the partial amount is sufficient to invoke federal subject matter jurisdiction. For example, I.R.C. section 6694 imposes assessable penalties upon tax preparers who understate their client's tax liabilities. I.R.C. § 6694(b) (2012). Section 6694(c) permits partial payment (just 15 percent) of the entire assessed section 6694 penalty. § 6694(c). While this is a significant statutory exception to the full payment rule, other procedural requirements must be met for federal court jurisdiction. *See, e.g.*, Colella, *supra* note 142, at 20 (taxpayer failed to comply with shorter statute of limitations applicable to partial payment rule); Frank G. Colella, *Partial Payment Rule of Code Section 6694(c) Continues to Trap the Unprepared Tax Preparer*, 21 J. TAX PRAC. & PROC., 2, 23 (2019).

[144] *Larson II*, 888 F.3d 578, 586 (2d Cir. 2018) (quoting *Mathews*, 424 U.S. at 335). The *Mathews* decision was a refinement of the Supreme Court's earlier due process jurisprudence. The Court had previously considered due process in connection with the tax system in *Bob Jones Univ. v. Simon*, 416 U.S. 725, 737, 748–49 (1974), where it articulated a two-factor examination. *See supra* note 120 and accompanying text.

imposed upon administrative action to assure fairness."[145] In *Larson II* the Second Circuit held that an analysis of those three factors "militates against" against Larson and held that he was not denied due process of law.[146]

IV. ANALYSIS

While it may be difficult to muster sympathy for Larson's untenable position, especially given the extent to which his actions contributed to one of the largest tax fraud prosecutions in United States history,[147] the procedural due process issue raised by his case required a much more detailed and thoughtful analysis than that provided by either the Southern District or the Second Circuit Court of Appeals. While the courts placed significant reliance on the penalty reduction provided by the Appeals Division, no evidence was introduced as to whether the Appeals Division actually considered Larson's substantive arguments against the penalty imposition.[148]

More importantly, however, the Second Circuit's analysis of the *Mathews* due process factors was cursory, at best. The court

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[145] *Larson II*, 888 F.3d at 586 (quoting *Mathews*, 424 U.S. at 348).

[146] *Id.*

[147] Stein v. KPMG, LLP, 486 F.3d 753, 756 (2d Cir. 2007) ("The underlying criminal prosecution is said to be the largest criminal tax case in American history. Nineteen defendants are charged with conspiracy and tax evasion, including the appellees, who are former partners or employees of the accounting firm KPMG. The defendants are alleged to have, *inter alia,* devised, marketed, and implemented fraudulent tax shelters that caused a tax loss to the United States Treasury of more than $2 billion. In connection with the alleged tax shelters, KPMG entered into a deferred prosecution agreement with the government, agreeing to cooperate fully with the government and to pay $456 million in fines and penalties." (citation omitted)). Larson was one of the original 19 defendants charged in the indictment. *See supra* notes 89 and 90.

[148] *Larson II*, 888 F.3d at 585 n.10. "Larson's appeal to the IRS Office of Appeals resulted in a nearly $100 million reduction. Larson doesn't take issue with his substantial victory at the IRS Office of Appeals; he does not adequately contend that it was neither an effective nor meaningful review of his complaints." *Id.* at 585. The Second Circuit seemingly conflates the penalty reduction in and of itself, which was required by IRS regulations, with a "meaningful review." *Id.* at 598. In fact, Larson argued that "*Appeals never considered his challenges to the assessment*," beyond the statutory reduction itself. Appellant-Petitioner's Petition for Rehearing and Rehearing En Banc at 2, *Larson II*, 888 F.3d 578 (2d Cir. 2018) (No. 17-503) [hereinafter Petition for Rehearing] (emphasis added).

did not conduct a meaningful examination of the trio of factors and attempt to balance the competing interests at stake.[149] Instead, it simply concluded the government's interest was paramount.[150] For example, the Second Circuit completely ignored the impact of bankruptcy on Larson, personally, or the impact that such a filing would have had on the government's overall administration of the tax system.[151] Those additional considerations, while not dispositive, would certainly have been relevant to a more thoughtful analysis of the *Mathews* factors.

V. SCOPE OF THE APPEALS DIVISION REVIEW

The Second Circuit gave undue weight to the result of the administrative review of the imposed penalties. "Larson's appeal to the IRS Office of Appeals resulted in a nearly $100 million reduction."[152] But that single factual observation, *ipso dixit*, does not dispose of the procedural due process question. Instead, Larson contended that the administrative review he received at the Appeals Division "was neither an effective nor meaningful review of his complaints."[153] His primary contention, the substantive issue for which he sought judicial review, was that the IRS had incorrectly calculated the entire penalty assessed initially.[154] He contended that the $100 million reduction (which had certainly inured to his benefit) had been required by law and IRS regulations,[155] as an offset of the amounts already paid by other joint tortfeasors, and thus such a decrease in the penalty had been a required ministerial act.[156]

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[149] *See Larson II*, 888 F.3d at 586–87.

[150] *Id.*

[151] *See id.*

[152] *Id.* at 585.

[153] *Id.*

[154] *Id.*

[155] *See* Petition for Rehearing, *supra* note 148, at 7 (emphasis added):

> [Larson] was entitled to credit for payments from other jointly and severally liable co-promoters under 26 C.F.R. section 301.6707-1T. *The IRS credited him with such payments during the Appeals process, but the IRS would have done this whether [Larson] appealed the assessment or not*, as this was merely a mechanical application of the Treasury Regulation.

[156] *Larson I*, No. 16-CV-00245, 2016 WL 7471338, at *2 (S.D.N.Y. Dec. 28, 2016).

Larson's overarching contention that the penalty itself was improperly calculated—and therefore unjustly imposed—by the IRS was simply ignored by the Appeals Division.[157] According to Larson's computations, the penalty should have amounted to roughly $7 million.[158] That figure, while still substantial, was theoretically possible for him to fully pay and then seek judicial review via refund litigation.[159] The $160 million, or even the $60 million reduced figure, was an impossible sum to "fully" pay before having an opportunity to avail himself of judicial review.[160] As a consequence, the only review available to Larson was at the administrative hearing conducted by the IRS Appeals Division.[161]

The Second Circuit's opinion was critical of Larson's reliance on *Phillips v. Commissioner*[162] for the proposition that "an administrative pre-payment review does not satisfy the requirements of

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> During the appeals process, the IRS conceded that it had not credited Appellant for payments made by co-promoters. Liability under § 6707 is joint and several, such that all assessed persons or entities are liable for 100% of the liability, and payments of the assessed penalty by one liable party offset the liability owed by other liable parties. Treas. Reg. § 301.6707-1T. Consistent with this rule, after collecting payments from co-promoters, the IRS reduced the assessed penalty against Appellant from $160,232,026 to $67,661,349.

Brief for Plaintiff-Appellant, *supra* note 95, at 5 (citations omitted).

[157] The same methodology was also employed by the IRS in the computation of the section 6707 penalty in *Diversified Grp., Inc. v. United States*, 841 F.3d 975, 979 (Fed. Cir. 2016) ("The IRS calculated each penalty by, pursuant to section 6707(a)(2)(A), computing the 'aggregate amount invested' by each client, multiplying this number by 1%, and summing this result across clients."). However, in *Diversified Group, Inc.*, the *methodology* of the computation itself was not at issue. Instead, only the question of whether the section 6707 penalty was "divisible" for purposes of the full payment rule was before the court—and the court held the penalty was not divisible. Accordingly, the full payment rule applied to the section 6707 penalty. *Id.* at 980. See also Pfaff v. United States, No. 14-cv-03349-PAB-NYW, 2016 WL 915738, at *3 (D. Colo. Mar. 10, 2016), which also held section 6707 penalties were not "divisible."

[158] *Larson II*, 888 F.3d at 581 n.1. "Larson claims that the IRS incorrectly interpreted 'aggregate amount invested' in I.R.C. section 6707(a)(2) to include loans and loan premiums not actually invested by the transaction participants, resulting in substantially larger penalties than the approximately $7 million the penalties would have totaled otherwise." *Id.*

[159] *See id.* at 581 n.1, 585.

[160] *Id.* at 582.

[161] *Id.*

[162] 283 U.S. 589 (1931).

due process."[163] As the court pointed out, "*Phillips* acknowledged that the two methods of review available in that case ... [pre- and post-payment review] satisfied due process, but *Phillips* did not conclude that due process required both."[164] The Second Circuit observed that:

> The Supreme Court in *Phillips* was clear. ... "The right of the United States to collect its internal revenue by summary administrative proceedings has long been settled. Where ... 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. Property rights must yield provisionally to government need ... [to promptly] secure its revenues."[165]

Whether either or both methods of review were available is an entirely different question from whether due process is denied if there is *no judicial review* whatsoever available to the taxpayer. The *Phillips* holding was premised on some form of judicial review: "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."[166] Providing an opportunity for "later determination of the legal rights" when the courthouse door is not only closed—but nailed shut—as a result of the taxpayer's inability to fully pay an otherwise unreviewable assessed penalty is, simply, an illusory opportunity.[167]

In addition, the broad reading of governmental interest cited by the Second Circuit was not absolute; it was subject to limitation.[168] In *Commissioner v. Shapiro*, the Supreme Court was critical of overstating the scope of *Phillips*.[169]

> This Court has recently and repeatedly held that, at least where irreparable injury may result from a deprivation of

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[163] *Larson II*, 888 F.3d at 585–86.

[164] *Id.* at 586 (citing *Phillips*, 283 U.S. at 597–98) (internal citations and footnote omitted by *Larson II* Court).

[165] *Id.* (quoting *Phillips*, 283 U.S. at 595–96).

[166] *Phillips*, 283 U.S. at 595 (emphasis added).

[167] *Id.* at 589.

[168] *See Larson II*, 888 F.3d at 586.

[169] Comm'r v. Shapiro, 424 U.S. 614, 629–31 (1976).

> property pending final adjudication of the rights of the parties, the Due Process Clause requires that the party whose property is taken be given an opportunity for some kind of predeprivation or prompt post-deprivation hearing at which some showing of the probable validity of the deprivation must be made.[170]

If "some kind of ... post-deprivation hearing" is constitutionally required to satisfy the due process clause, it cannot be premised on the taxpayer's ability to pay—if the Fifth Amendment is to be given any meaningful application.[171]

Moreover, the Second Circuit did not examine the actual scope of administrative appeal that was conducted and whether it was "meaningful," beyond noting that it yielded a "substantial" penalty reduction.[172] Likewise, the alternative, a prompt post-deprivation hearing is simply illusory if one cannot access the judicial system as a result of the full payment rule. Where a taxpayer is demonstrably unable to fully pay the assessed penalty, the notion she has access to post-deprivation judicial review is simply disingenuous. Under those circumstances, the taxpayer cannot receive pre-payment review (the Tax Court has no jurisdiction) and no post-payment review is available because the federal court will not exercise that jurisdiction.[173]

If *only* pre-payment administrative review is sufficient for due process protection, as the Second Circuit maintained it was in *Larson II*, then the very scope of the review conducted by the IRS Appeals Division must be reviewed to determine whether it met constitutional standards.[174] The outcome of that review should not be conflated with the process of conducting the review. As Larson argued, "the Panel treated it [the substantial penalty reduction] *as evidence that [he] received meaningful pre-deprivation review* at the Appeals conference."[175]

At a minimum, if the adequacy of the administrative review served as the linchpin of the Second Circuit's reasoning, the court should have remanded the case back to the Southern

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[170] *Id.* at 629 (emphasis added); *see id.* at 629 n.11 (citing cases concerning deprivation of property).

[171] *Id.* at 629.

[172] *Larson II*, 888 F.3d at 586.

[173] *See id.* at 588.

[174] *See id.* at 586–87.

[175] Petition for Rehearing, *supra* note 148, at 7 (emphasis added).

District for additional fact-finding on that sole issue.[176] Not only would jurisdictional discovery benefit the instant case—namely, it would permit a determination of the scope of the Appeals Division review of the *Larson* penalties—but also the court's discussion would serve as model for future cases.

In any event, it would be a meaningful addition to the record of the instant case if it were known that the Appeals Division had considered—*and simply rejected*—Larson's computation of the penalty. If that particular fact was before the district court, or the Second Circuit panel, it would immeasurably bolster the determination of whether Larson received *any* consideration of his substantive argument (or whether the Appeals Division merely implemented a statutory offset).

A. The Mathews *Factors*

The 1976 Supreme Court decision in *Mathews v. Eldridge* considered the appropriateness of a decision by the Social Security Administration that terminated a claimant's disability benefits prior to its completion of a final evidentiary hearing.[177] Eldridge, the claimant, challenged the termination as a violation of his constitutional right to due process.[178] In a six-to-two decision, the Court held in favor of the SSA and concluded that a pretermination hearing was not required.[179] In so holding, it reversed the decision of the two lower courts that had held Eldridge was entitled to an evidentiary hearing prior to the termination of his benefits.[180]

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[176] For example, see Haber v. United States, 823 F.3d 746, 753 (2d Cir. 2016), in which the Second Circuit held that parties can obtain discovery related to jurisdiction. In *Haber*, the Second Circuit affirmed the trial court's denial of jurisdictional discovery because the judge found the "plaintiff 'failed to show how the information [she] hoped to obtain from this discovery would bear on the critical issue' for jurisdiction." *Id.* (quoting Gualandi v. Adams, 385 F.3d 236, 245 (2d Cir. 2004)) (citations omitted). Larson should be afforded, albeit belated, an opportunity to conduct jurisdictional discovery and expand the record. This would provide the court with the information necessary to determine whether the review was "meaningful" or otherwise.

[177] 424 U.S. 319, 323 (1976).

[178] *Id.* at 325.

[179] Justice Powell wrote the majority decision. Justice Brennan, with whom Justice Marshall joined, dissented. Justice Stevens took no part in the decision. *Id.* at 322.

[180] *Id.* at 325–26.

In reaching the decision, the majority adopted the three-factor test which it employed to analyze the impact of the SSA conduct, relative to Eldridge's right to due process.[181] In a dissenting opinion, two Justices argued that the lower courts had correctly held that a pretermination evidentiary hearing was required.[182] The dissent gave serious consideration to the harm Eldridge would suffer in the short-term, even if his benefits were subsequently restored.[183] The trio of *Mathews* factors has, thereafter, served as the template for procedural due process analysis.

B. The Private Interests Affected

It was to the first *Mathews* factor—the private interest that will be affected—that the Second Circuit gave a mere perfunctory nod: "Larson's interest is not insignificant; the IRS has imposed onerous penalties that Larson claims he cannot pay.[184] But, as we previously noted, the IRS Office of Appeals review resulted in a substantial reduction of Larson's penalties."[185] Aside from noting his due process interest in judicial review of the assessed penalty was not insignificant, the court conducted no further examination into this factor.[186] Moreover, because the penalty was substantially reduced as a result of the Appeals Division's decision, the Second Circuit concluded that the issue of Larson's interest was sufficiently addressed.[187]

While the Second Circuit cited *Morrissey v. Brewer* for the proposition that "due process is flexible" and requires examination of the "particular circumstance[s]" to determine what level of protection is due,[188] it overlooked a more compelling admonition from the *Morrissey* opinion: "Whether any procedural protections are due depends on the extent to which an individual will be '*condemned to suffer grievous loss*.'"[189] Simply noting that

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[181] *Id.* at 334–35.

[182] *Id.* at 349–50 (Brennan, J., dissenting).

[183] *Id.* at 350 (Brennan, J. dissenting).

[184] *Larson II*, 888 F.3d 578, 586 (2d Cir. 2018).

[185] *Id.*

[186] *Id.*

[187] *Id.*

[188] *Id.* at 585 (citing Morrissey v. Brewer, 408 U.S. 471, 481 (1972)).

[189] *Morrissey*, 408 U.S. at 481 (citing Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123, 168 (1951) (Frankfurter, J., concurring) (emphasis added) (quoted in Goldberg v. Kelly, 397 U.S. 254, 262–63 (1970))).

that Mr. Larson's interest is "not insignificant" does not examine the harm that would befall him without the benefit of pre-payment judicial review.[190] In Larson's own words: "The private interest affected is that Appellant is faced with a massive penalty that he is, and likely forever will be, unable to pay, and which bears no relationship to money ever earned by him."[191] Given the significant penalty imposed by the IRS and the dire consequences of Larson's inability to pay it, a more detailed examination of this factor should have been conducted by the Second Circuit.

Moreover, not discussed was the likelihood that the imposition of a $60 million penalty and his inability to pay it would necessitate Larson seeking bankruptcy court protection.[192] The court's refusal to permit judicial review under these circumstances would permit the IRS to commence collection efforts and allow for the attendant consequences to ensue.[193] Initially, Larson could avail himself of a Collection Due Process hearing in the Tax Court; that would, seemingly, permit limited judicial review of the assessed penalty.[194] However, the CDP hearing would not, in fact, permit an examination of the underlying liability.[195] Accordingly, the IRS would then continue with its efforts to secure payment.

Whether Larson could obtain judicial review in bankruptcy court, and whether that review would inure to his benefit, does not alter the wholesale disruption to one's life (and perhaps stigma) that a forced bankruptcy filing would likely generate. To put this outcome in context, in *Mathews*, Justice Brennan, writing in dissent, observed that:

> I would add that the Court's consideration that a discontinuance of disability benefits may cause the recipient to suffer only a limited deprivation is no argument. It is speculative. ... Indeed, in the present case, it is indicated that because disability benefits

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[190] *Larson II*, 888 F.3d at 586.

[191] Reply Brief for Plaintiff-Appellant, *supra* note 118, at 13.

[192] *See* Flora v. United States (*Flora II*), 362 U.S. 145, 159 (1960) (quoting H. R. Rep. No. 68-179, at 7 (1924)) (discussing the possibility of financial hardship created by the pre-payment rule).

[193] Chaim Gordon, *The Disjunctive Test for Challenging a Liability in a CDP Hearing*, 159 TAX NOTES 1615 (2018).

[194] *Id.*

[195] *See infra* note 207 and accompanying text.

> were terminated there was a foreclosure upon the Eldridge home and the family's furniture was repossessed, forcing Eldridge, his wife, and their children to sleep in one bed.[196]

Given the exponentially larger deprivation involved in *Larson*, relative to the Social Security disability payments before the Court in *Mathews*, and Larson's demonstrable inability to make full payment of the penalties, the Second Circuit had an affirmative duty to more fully examine the impact of the "private interests affected" factor.[197] Had it conducted a more thorough analysis, it is unlikely the Court would have concluded that factor had been sufficiently addressed, without more, by the Appeal Division's statutory reduction of the penalty.

C. The Risk of Erroneous Deprivation

In refund litigation, the risk of an erroneous deprivation is redressed by federal court review.[198] A finding in favor of the taxpayer results in a refund of the amounts paid, together with any applicable interest.[199] That would restore the parties to the *status quo ante*. However, the Second Circuit addressed this factor summarily: "We are satisfied that the current procedures [administrative review] effectively reduced the risk of an erroneous deprivation and gave Larson a meaningful opportunity to present his case."[200] While similar, it is a slightly different consideration from Larson's argument that he did not receive a "meaningful" review at the Appeals Division.[201] In considering the second *Mathews* factor, the Court was more concerned with the structural availability of administrative review than the more qualitative question of how meaningful the review was to the taxpayer's case.[202]

The Second Circuit cited *Our Country Home Enterprises*[203] as authority for the proposition that administrative review is a "significant protection[ ]."[204] Ironically, this case actually undermines

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[196] Mathews v. Eldridge, 424 U.S. 319, 350 (1976) (Brennan, J., dissenting).
[197] *Id.* at 334.
[198] SALTZMAN & BOOK, *supra* note 6, at 10–83.
[199] *Id.* at 11-147–11-148.
[200] Larson v. United States (*Larson II*), 888 F.3d 578, 586 (2d Cir. 2018).
[201] Petition for Rehearing, *supra* note 148, at 2.
[202] *Id.* at 7.
[203] *Larson II*, 888 F.3d at 586.
[204] *Id.*

the very point the Second Circuit sought to bolster. *Our Country Home Enterprises* increased, not decreased, the possibility of erroneous deprivation because it held the taxpayer *was not* entitled to a more thorough review of his assessment in the Tax Court, following a CDP hearing.[205] It actually foreclosed meaningful judicial review of the substance of the taxpayer's liability because his arguments had already been considered by the Appeals Division.[206]

Our Country Home Enterprises dealt with a Collection Due Process hearing and whether the taxpayer in that instance could challenge the underlying penalty assessment in the Tax Court following the outcome of the CDP hearing.[207] Interestingly, it anticipates the lack of judicial review Mr. Larson can also expect when, and if, he sought his own CDP hearing in the wake of the unsuccessful efforts to secure judicial review via the present litigation.[208] Since he already presented his case before the Appeals

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[205] Our Country Home Enters., Inc. v. Comm'r, 855 F.3d 773 (7th Cir. 2017).

[206] *Id.* at 788.

[207] A Collection Due Process (CDP) hearing is an additional procedural safeguard, enacted in 1998, to review IRS issuances of Notices of Federal Tax Liens and subsequent efforts to levy on that property. Following a CDP hearing, the taxpayer may seek limited judicial review of that decision in the Tax Court. Instead of the Notice of Deficiency, the jurisdictional predicate is the Notice of Determination, issued after the CDP hearing. Taxpayers have just 30 days following issuance of the Notice of Determination to request Tax Court review.

While a taxpayer is entitled to have the underlying liability reviewed during this process—if she had not, earlier, been afforded a "meaningful" opportunity to challenge the assessment—any prior administrative review would negate that right. *Our Country Home Enterprises* (and a similar line of cases) held that review by the Appeals Division constituted a "meaningful opportunity" to challenge the assessment, and thus it denied the taxpayer's effort to challenge the underlying liability. *See generally* Chaim Gordon, *The Disjunctive Test for Challenging Liability in a CDP Hearing*, TAX NOTES 1615 (2018) ("Because the IRS typically gives taxpayers facing assessment of taxes or penalties that are not subject to deficiency procedures ... an opportunity to dispute the liability with IRS Appeals before assessment, these cases [*inter alia*, *Our Country Home Enterprises*] *effectively deprive taxpayers facing assessable taxes and penalties of any opportunity to obtain pre-payment judicial review of the assessments*.") *Id.* at 1615 (emphasis added). *See generally* SALTZMAN & BOOK, *supra* note 6, at 14B-2–14B-90.

[208] *Our Country Home Enters.*, 855 F.3d at 784 ("Our Country Home and the government offer competing interpretations of what a prior 'opportunity to dispute' means. Our Country Home contends that a prior opportunity means a prior judicial opportunity; this interpretation would ensure Our Country Home a prepayment judicial opportunity to challenge its liability before paying the

Division, he received the "meaningful review" that would vitiate his efforts to have the liability reviewed in the Tax Court.[209]

Specifically, the Second Circuit cited its sister circuit's *Our Country Home Enterprises* opinion for the proposition that: "Indeed, the Seventh Circuit recently observed that the IRS Office of Appeals 'is an independent bureau of the IRS charged with impartially resolving disputes between the government and taxpayers,' and that 'Congress has determined that hearings before this office constitute significant protections for taxpayers.'"[210]

What the Second Circuit did not point out in its opinion was that the *adequacy* of the Appeals Division review provided to the taxpayer in *Our Country Home Enterprises* was not at issue.[211] Rather, at issue was whether a taxpayer who took advantage of administrative review via the Appeals Division would, by that very action, thereafter be precluded, post-CDP hearing, from judicial review of that liability in the Tax Court.[212] While that precise scenario may, in fact, unfold for Larson, it was not the issue that confronted the Second Circuit.[213] In considering the second *Mathews* factor, the question presented was, instead, whether an appearance before the Appeals Division mitigated the risk of "erroneous deprivation."[214]

As for the level of scrutiny at a CDP hearing, it should be noted that the Seventh Circuit, in *Our Country Home Enterprises, sua sponte*, went on to observe that:

> Although CDP hearings provide taxpayers with additional procedural safeguards, *calling the proceeding a "hearing" is somewhat misleading* in that "there is no obligation to conduct a face-to-face hearing, no formal discovery, no requirement for either testimony or cross-examination, and no transcript."

$200,000 penalty. On the other hand, the government argues that a prior opportunity encompasses all opportunities—judicial and administrative alike; *this interpretation eliminates the right to prepayment judicial review through the CDP process for taxpayers like Our Country Home who have already received prepayment administrative opportunities to contest liability*.") *Id.* (emphasis added).

[209] *Larson II*, 888 F.3d 578, 585 (2d Cir. 2018).

[210] *Id.* at 586 (citing *Our Country Home Enters.*, 855 F.3d at 789).

[211] *Our Country Home Enters.*, 855 F.3d at 780–82.

[212] *Id.* at 782.

[213] *Larson II*, 888 F.3d at 582.

[214] *Id.* at 586.

> Moreover, a taxpayer has no right to subpoena documents or witnesses. And a CDP hearing need not include every party in interest. Indeed, far from constituting a formal hearing, a CDP hearing provides a taxpayer with nothing more than an opportunity for an informal oral or written conversation with the IRS before he must pay a tax.[215]

This is hardly a ringing endorsement, nor a satisfactory description of what one would demand for procedural due process, *even if the CDP hearing presupposes that an earlier level of administrative review had already been provided to the taxpayer*. But it is this very limited second nibble at the proverbial apple that would be foreclosed for Larson, should he raise a similar argument at his own CDP hearing—because he had already gone before the Appeals Division.[216] There would be no opportunity to reverse an erroneous determination nor even to consider whether an erroneous deprivation had occurred.

In fact, some commentators have applied a similar description to the very contours of the level of review provided by the Appeals Division.[217]

> Appeals is a division of the IRS, and it has proven to be a valuable and effective alternative dispute resolution mechanism within the agency. While a high percentage of cases at Appeals settle without resort to litigation, *Appeals falls woefully*

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[215] 855 F.3d at 780 (internal citations omitted) (emphasis added).

[216] *See supra* note 207 and accompanying text.

> The opportunity for judicial review of the assessable penalty usually does not exist in CDP cases because, in almost every case, the IRS affords the persons assessed an assessable penalty the opportunity for administrative review. *According to the IRS, taxpayers may not contest the liability in the CDP hearing that could serve as a gateway to judicial review, even where no judicial review existed prior to the collection proceeding.*

Harvard Amicus Brief, *supra* note 18, at 12–13 (emphasis added). *See also* Our Country Home Enters., Inc. v. Comm'r, 855 F.3d 773, 784 (7th Cir. 2017) ("We acknowledge that the government's interpretation effectively closes the door to prepayment judicial relief for taxpayers in Our Country Home's position. Nevertheless, we uphold the government's interpretation[.]").

[217] Lawrence M. Hill & Richard A. Nessler, *IRS Penalty Assessments Without Due Process?*, TAX NOTES 1763 (2018) (reprinted by Winston & Strawn LLP), https://www.winston.com/print/content/1014819/irs-penalty-assessments-without-due-process.pdf [https://perma.cc/8YRC-2KDU].

> *short of providing administrative due process to taxpayers*. Although designed to be impartial, its impartiality is suspect when the decision-maker is an employee of the adversary. Appeals officers are employees of the IRS, and as mentioned, the chief of Appeals reports directly to the IRS commissioner.[218]

Also, *the hallmarks of administrative due process are not envisaged at Appeals*.[219] Appeals officers are not administrative law judges—often they are not even lawyers—and there is effectively no accountability if they make erroneous decisions.[220] *There is no transcript of the proceedings at Appeals*, no witnesses, no sworn testimony, no cross-examination, no reviewable record, *and no written findings of fact or conclusions of law provided to the taxpayer or subject to review under any recognized standard, including abuse of discretion*.[221]

None of procedural shortcomings listed above, all of which are specific to the administrative review afforded taxpayers by the Appeals Division, was considered, discussed, or even mentioned in the Second Circuit opinion.[222] More importantly, each of the above is a hallmark of procedural due process.[223] While the absence of any one might be excusable, denying the taxpayer all of the above tools to contest a liability is unimaginable. The Second Circuit's view that the Appeals Division is a forum that can minimize the risk of erroneous deprivations is unsupported by both the barebones structure of the hearing and the facts.

A more accurate view of the Appeals Division was offered by the Ninth Circuit:

> Despite the division's name, proceedings before the IRS Appeals Office more closely resemble a settlement conference than a hearing before an administrative tribunal. The governing regulations refer to the proceedings as a "conference" rather than a "hearing," describe them as "informal," and focus on the "settlement" of disputes and the "settlement authority" of the Appeals Officers. ... The Internal Revenue Manual likewise describes the Appeals Office as the IRS's "dispute resolution

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[218] *Id.*
[219] *Id.*
[220] *Id.*
[221] *Id.*
[222] Larson v. United States (*Larson II*), 888 F.3d 578, 578 (2d Cir. 2018).
[223] Hill & Nessler, *supra* note 217.

> forum" with the "authority to consider and negotiate settlements," ... and provides that its mission is "to resolve tax controversies, without litigation[.]" ... Accordingly, the Appeals Officer or Settlement Officer does not act as a fact-finder or preside over adversarial proceedings in the model of an administrative law judge. ... There are no provisions for taxpayer discovery or for witnesses to be subpoenaed, testimony under oath is not taken (although affidavits may be required), and there are no provisions requiring that the proceedings be recorded or that any particular evidentiary rules be followed.[224]

The above description of the Appeals Office hardly comports with the procedural due process a taxpayer can expect from the Tax Court or a federal district court. Similarly, regardless of comparisons to the Tax Court or district court, the protections afforded by the Appeals Division are decidedly unlike those provided by review before an administrative law judge.[225]

Given the significant stakes involved, a more in-depth analysis of the second *Mathews* factor was required. As *Mathews* counseled, "to be considered here is the fairness and reliability of the existing pretermination procedures, and the probable value, if any, of additional procedural safeguards.[226] *Central to the evaluation of any administrative process is the nature of the relevant inquiry.*"[227] In short, the relevant question is: what opportunity did the Appeals Division provide to Larson to argue his case?

In *Larson,* there simply was not enough information in the record to determine what sort of review was conducted by

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[224] Central Valley AG Enters. v. United States, 531 F.3d 750, 758 (9th Cir. 2008) (citations omitted). *Central Valley* concerned whether the Bankruptcy Court could exercise jurisdiction to review the tax liabilities before the court. There, the Ninth Circuit stated: "A conference with ... the IRS Appeals Office do[es] not satisfy the statutory requirements that a tax matter be 'contested before and adjudicated by a judicial or administrative tribunal' within the meaning of the statute." *Id.* at 757–58.

[225] Hill & Nessler, *supra* note 217.

[226] Mathews v. Eldridge, 424 U.S. 319, 349 (1976).

[227] *Id.* (emphasis added). Not only did the Second Circuit fail to examine the thoroughness of the Appeals Division process, it faulted Larson for failing to document the shortcomings, where no record of the proceedings existed, stating: "he does not adequately contend that it was neither an effective nor meaningful review of his complaints." *Larson II*, 888 F.3d at 585. Given that the lack of a record was entirely due to the inadequacies of the hearing conducted in the Appeals Division, the Second Circuit could have remanded the case for that exact purpose—a limited determination of what transpired at the Appeals Division.

the Appeals Division. If, as he contended, all that was done was a mechanical subtraction of the additional § 6707 penalties collected from the other joint tortfeasors, can that be considered a procedural safeguard that mitigated the risk of erroneous deprivation? The Appeals Division review certainly resulted in a substantial reduction of what was allegedly owed, pursuant to the IRS's own computations.[228] But in Larson's view, the computation of the penalty itself was erroneous.[229] Since there was no record of what was considered, rejected, or adopted by the Appeals Division, it was misleading for the Second Circuit to say the existence of administrative review, in and of itself, satisfied the second *Mathews* factor.

D. The Government's Interest

The final *Mathews* factor requires balancing the cost of any additional procedural safeguards against the public interest sought to be protected.[230] "In striking the appropriate due process balance the final factor to be assessed is the public interest."[231] The Second Circuit held the government's interest in the collection of tax paramount to all other factors.[232] "Lastly, the governmental interest here is singularly significant due to the careful structuring of the tax system and the Government's 'substantial interest in protecting the public purse.'"[233] However, aside from the bare citation to the *Flora II* decision, it once again provided no discussion or analysis for this factor of the *Mathews* trio.[234]

How the extension of judicial due process safeguards to Larson, or by extension, a broader "hardship" exception to the full payment rule in certain limited circumstances, would negatively impact the government's administration of the tax system was simply left unstated.[235] While the data was not reported, it is

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[228] Petition for Rehearing, *supra* note 148, at 7.

[229] *Id.* at 14.

[230] *See Mathews*, 424 U.S. at 347.

[231] *Id.*

[232] *Larson II*, 888 F.3d at 586.

[233] *Larson II*, 888 F.3d at 586–87 (quoting Flora v. United States (*Flora II*), 362 U.S. 145, 175 (1960)).

[234] *Id.*

[235] The Second Circuit echoed the District Court when it also cited *Curry v. United States*: "'carv[ing] out a "hardship" exception to the *Flora* rule ... would endanger the "public purse" and disrupt the smooth functioning of the

unlikely that there exists a significant number of tax shelter promoters who have been assessed multiple tens of millions of dollars in § 6707 penalties. Given the relatively small universe of assessable § 6707 penalties, any impact on the IRS's ability to administer the tax code in this particular case, or all abusive tax shelter promoter cases, would be minimal. In contrast, the benefit to the individual taxpayer of pre-payment judicial review would be substantial.

In addition, the § 6707 penalty is a not a self-reported tax; it is not included on a taxpayer's tax return as part of the regular payment and filing compliance requirements.[236] It is not an income tax.[237] Thus, it is not what one considers part of the normal administration of the tax system. Moreover, it is a penalty that is not based on the taxpayer's ability to pay—a typical metric for calculating penalties.[238] Instead, the § 6707 penalty is calculated based on the "aggregate amount invested" in the tax shelters at issue and not based on a percentage of the taxpayer's own income or assets.[239]

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tax system.'" *Id.* at 589 (citing Curry v. United States, 774 F.2d 852, 855 (7th Cir. 1985)). Unfortunately, the Second Circuit glaringly failed to note that, in *Curry*, the Seventh Circuit *did in fact entertain the possibility of creating a "hardship" exception* to the full payment rule—but the Court concluded it would be a futile gesture, in this particular instance, because the statute of limitations would, nevertheless, bar the refund action—even if the federal court could properly hear the refund claim. "*Even if we were to carve out an exception to the pre-payment rule*, the Currys would be barred from obtaining a refund by I.R.C. section 6511 [the statute of limitations applicable to taxpayer refund actions]." *Curry*, 724 F.2d at 855 (emphasis added). If the Seventh Circuit in *Curry* considered, and albeit rejected, a hardship exception when the taxpayers could not pay ("the Currys had not prepaid the approximately $60,000 in taxes shown to be owed on their original returns"), *id.* at 854, the Second Circuit was presented with a seemingly more compelling case and simply refused to discuss, much less consider, the possibility of carving out a hardship exception.

[236] I.R.C. § 6707(a)(1) (2012).

[237] Larson himself owed no income taxes. The sole liability at issue was for the § 6707 penalty. *Larson II*, 888 F.3d at 589.

[238] I.R.C. § 6707(a)(2).

[239] *See* Reply Brief for the Plaintiff-Appellant, *supra* note 118, at 12.

> The IRS calculated the penalties as a percentage of the "aggregate amount invested" in the transactions at issue, and not based on any percentage of Appellant's income or assets. *Thus, the penalties bear no relationship to Appellant's ability to pay, unlike most penalties that are computed on a percentage of the underlying tax owed.*

More interestingly, however, the impact on the public fisc was completely ignored.[240] If Larson is forced to file for bankruptcy protection, judicial review will occur in the context of bankruptcy protection.[241] Given the automatic stay that is put into place during the pendency of the bankruptcy proceeding, the IRS might not be able to undertake collection efforts until the matter is ultimately resolved and the stay lifted.[242] Moreover, there exists the real possibility that the § 6707 penalty could be discharged as a result of the bankruptcy[243]—which would leave the IRS with little or nothing left to collect."

Viewed in this context, the additional fact-finding a remand would permit to determine the scope of administrative review is hardly a significant imposition on government resources. In fact, if the Second Circuit decided to craft a limited "hardship" exception

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Id. (emphasis added).

[240] *Id.* at 14.

[241] *Id.* at 21.

[242] Central Valley AG Enters. v. United States, 531 F.3d 750, 757 (9th Cir. 2008).

[243] While the bankruptcy court's exercise of jurisdiction pursuant to 11 U.S.C. § 505 is discretionary, this is the precise situation where the court's review of the tax liability is critical. "A bankruptcy court 'may' review certain tax liabilities, including unpaid assessable penalties that have not been contested and adjudicated in another tribunal. However, the court's authority to determine a refund is limited, and the court may abstain from determining tax issues for various reasons." NTA 2018 Annual Report, *supra* note 5, Volume One at 372 (footnotes omitted). *See, e.g.*, *Central Valley AG Enters.*, 531 F.3d at 755:

> One of the purposes of § 505, and in particular the purpose of the requirement that the tax matter be "contested," *is to "protect[ ] a debtor from being bound by a pre-bankruptcy tax liability determination that, because of a lack of financial resources, he or she was unable to contest."* And correspondingly, § 505 protects a debtor's creditors "from the dissipation of an estate's assets in the event that the debtor failed to contest the legality and amount of taxes assessed against it." *Such protections are particularly relevant in the instant case, as the Government's tax claim far exceeds [taxpayer's] assets and has priority over nearly all of its other liabilities, which predominantly consist of unsecured, nonpriority claims.*

Id. (citations omitted) (emphasis added). A more fulsome discussion of the bankruptcy code and its specific application to the discharge of assessable penalties, or income taxes in general, is beyond the scope of this Article, but refer to SALTZMAN & BOOK, *supra* note 6, at Ch. 16, Part C (Collection of Tax Claims in Bankruptcy) and note 4 and accompanying text.

to the *Flora* full payment rule when the scope of administrative review falls short of constitutionally mandated procedural due process, the additional cost may tax the judiciary's resources, but it would hardly imperil the IRS and its ability to administer the tax system.[244] Alternatively, one could question the fairness of outsourcing "pre-payment" judicial review of assessable penalties to the bankruptcy court because district courts continue to dismiss such cases for lack of subject matter jurisdiction.

CONCLUSION

While it is not easy to articulate a bright-line test that would permit pre-payment judicial review in situations where the *Flora* full payment rule would otherwise preclude it, procedural due process requires just that precise remedy in some limited circumstances. As the Supreme Court has often stated, "flexibility" is a hallmark of due process analysis and, accordingly, courts must be open to fashioning an appropriate exception to the full payment rule—especially in cases that could not have been envisioned when the *Flora* doctrine was announced.[245]

Unfortunately, not only was the Second Circuit unwilling to exercise that flexibility and fashion a limited remedy—or unwilling to permit a remand for limited jurisdictional discovery—but it seemed that every factor the court examined inured to the benefit of the IRS.[246] Perhaps most disappointing, the court repeatedly

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[244] Larson v. United States (*Larson II*), 888 F.3d 578, 584 (2d Cir. 2018). This particular point, that relaxing the full payment rule would not imperil the government, was specifically addressed by National Taxpayer Advocate in her report:

> Congress must have deemed the risk of pre-payment review ... to be minimal by 1924 when it established the Board of Tax Appeals (BTA) (*i.e.*, the predecessor of the Tax Court) as a pre-payment forum to hear most tax disputes—or at the latest by 1969 when it established the Tax Court as an Article I court, independent from the executive branch. In 1998, when Congress established the right to a CDP hearing, it increased access to pre-payment judicial review by the Tax Court. *Thus, Congress must not have been concerned that increasing pre-payment review by the Tax Court could threaten the existence of government*.

NTA 2018 Annual Report, *supra* note 5, Volume One at 376 (emphasis added).

[245] Reply Brief for Plaintiff-Appellant, *supra* note 118, at 19.

[246] *Larson II*, 888 F.3d at 583.

cited cases that were simply not germane to the due process inquiry; its decision incorporated cases that did not involve assessable penalties,[247] cases that involved relatively small sums[248] (and, in one instance the taxpayer refused to pay—although that sum was easily within his financial means[249]), and cases that interpreted the Collection Due Process provisions.[250] Perhaps most glaringly, the Second Circuit failed to distinguish precedents—cases in which the taxpayer had recourse to the Tax Court[251] or could make a statutory partial payment.[252] While any one of those authorities could have been distinguished in a straightforward manner, the cumulative number of inapposite cases underscored the impression that the Second Circuit would never have found a due process violation in the denial of judicial review of Larson's § 6707 penalties.

It should be noted that the present-day wide-ranging assessable penalty paradigm, where pre-payment review in the Tax Court is statutorily unavailable because the IRS does not need to issue a statutory notice of deficiency, simply did not exist when the Supreme Court decided *Flora*.[253] But regardless of whether

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[247] *See* Phillips v. Comm'r, 283 U.S. 589 (1931); United States v. Forma, 42 F.3d 759, 763 (2d Cir. 1994); Rocovich v. United States, 933 F.2d 991 (Fed. Cir. 1991); Curry v. United States, 774 F.2d 852 (7th Cir. 1985); *supra* text accompanying note 162.

[248] *See* Kahn v. United States, 753 F.2d 1208, 1208–10 (3d Cir. 1985); *supra* notes 119–21 and accompanying text.

[249] *See* Johnston v. Comm'r, 429 F.2d 804, 806 (6th Cir. 1970); *see supra* note 110 and accompanying text.

[250] *See* Our County Home Enters., Inc. v. Comm'r, 855 F.3d 773 (7th Cir. 2017); *supra* note 203 and accompanying text.

[251] *See Rocovich*, 933 F.2d at 993; *Curry*, 774 F.2d at 854; *supra* note 116 and accompanying text.

[252] *See Kahn*, 753 F.2d at 1211; *see supra* notes 119–21 and accompanying text.

[253] SALTZMAN & BOOK, *supra* note 6, at 10–31.

> The gaps in pre-payment judicial review have grown. When *Flora II* was decided in 1960, there were only four assessable penalties, two of which were divisible[.] Today, by contrast, [the IRC] contains over 50 different assessable penalties (*i.e.*, the penalties between IRC §§ 6671 and 6725). As the number of assessable penalties has risen, the fact that they cannot be contested in court before they are assessed and fully paid has become increasingly problematic.

NTA 2018 Annual Report, *supra* note 5, Volume One at 377.

the Supreme Court could have anticipated that the full payment doctrine would have applied prospectively to the voluminous expansion of assessable penalty cases,[254] a taxpayer's fundamental constitutional right to due process of law and the case law articulating the contours of that right make abundantly clear that the rule cannot be applied blindly.[255]

It would be ideal if Congress had provided a solution that, perhaps, provided for limited partial payment of all assessable penalties. But the absence of a Congressional solution does not justify the denial of due process. The Second Circuit noted: "While Congress decided to provide pre-payment review in some situations, its failure to do so when the penalty is beyond the taxpayer's resources is not a due process defect. *We know of no case that supports that view*."[256] But the question presented to the Second Circuit was different: Did the failure to provide *any* judicial review deny Larson his constitutional right to due process of law? Unfortunately, Congressional inaction, or silence for that matter, simply cannot be used as a pretext to uphold the abridgement of a taxpayer's right to some form of accessible judicial review.

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[254] As well-stated by the Legal Services Center of Harvard Law School's Federal Tax Clinic in their amicus brief supporting reversal, "[w]ere *Flora* decided fifty years later, we believe that the Court would have restricted the full payment requirement to those taxpayers *who had the option of pre-payment litigation in the Tax Court*." Harvard Amicus Brief, *supra* note 18, at 2 (emphasis added).

[255] Indeed, the Supreme Court has noted that, while a post-payment procedure did not violate due process, it may have decided differently if *no* judicial review at all were available. *See* Bob Jones Univ. v. Simon, 416 U.S. 725, 746–47 (1974); *supra* note 120. If a taxpayer cannot pay the assessed penalty, the notion that she has access to any post-payment judicial review is a demonstrable illusion. There will not be, ultimately, any judicial review of the IRS's assessment for that taxpayer.

[256] Larson v. United States (*Larson II*), 888 F.3d 578, 586 (2d Cir. 2018) (emphasis added). That view, unfortunately, may result in the availability of due process for only those well-off enough to pay for it. "Accordingly, taxpayers who are wealthy enough to fully pay can access these courts, whereas poor taxpayers and others subject to unreasonably large assessments *are generally out of luck*." NTA 2018 Annual Report, *supra* note 5, Executive Summary at 65 (emphasis added).