OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR DISTRICT COUNSEL, PACIFIC NORTHWEST

FROM: Lawrence H. Schattner
Chief, Branch 3 (General Litigation)

SUBJECT: I.R.C. § 7433 Claim

This responds to your memorandum to the Office of Assistant Chief Counsel (Field Service) requesting advice with respect to your proposed response to issues raised in the administrative claim filed pursuant to I.R.C. § 7433 by some investors in A. The claim for damages allege that the Service recklessly or intentionally violated the provisions of I.R.C. §§ 7214, 6304, 6331(d), and 6301 when it collected late filing penalties from investors in A who did not settle their A-related tax liabilities with the Service, and by transferring payments made on behalf of one partnership to the account of another partnership. [redacted]

Legend

A
B

C
Amount A
Date A
Date B
Date C
Date D

Statutory Background of I.R.C. § 7433

I.R.C. § 7433 provides in part as follows:

(a) IN GENERAL. - If, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title, such taxpayer may bring a civil action for damages against the United States in a district court of the United States.

(b) DAMAGES. - In any action brought under subsection (a) or petition filed under subsection (e), upon a finding of liability on the part of the defendant, the defendant shall be liable to the plaintiff in an amount equal to the lesser of $1,000,000 ($100,000 in the case of negligence), or the sum of -

(1) actual, direct economic damages sustained by the plaintiff as a proximate result of the reckless or intentional or negligent actions of the officer or employee, and

(2) the costs of the action.

(d)(3) PERIOD FOR BRINGING ACTION. - Notwithstanding any other provision of law, an action to enforce liability created under this section may be brought without regard to the amount in controversy and may be brought only within 2 years after the date the right of action accrues.

Treas. Reg. § 301.7433-1(g)(2) provides that a cause of action under section 7433(a) accrues when the claimant has had a reasonable opportunity to discover all essential elements of a possible cause of action.

Section 7433 is a waiver of the United States' sovereign immunity and, although placed in the Internal Revenue Code, Congress could have placed such waiver in the Federal Tort Claims Act, 28 U.S.C. § 2401, which currently allows the United States to be sued for tort but excepts tax matters from its scope. Indeed, tort terms are used in section 7433. Also, its legislative history, which describes when a cause of action accrues under section 7433, is the same as the rule under the Federal Tort Claims Act. See H.R. Rep. 100-1104, at 29. The essential elements of a cause of action for tort that must be established by a plaintiff are: (1) that there is a duty on the part of the defendant; (2) that there has been a breach of duty by the defendant; (3) that the defendant's negligent or intentional action caused damages to the plaintiff; and (4) that the plaintiff suffered damages in a specific amount. See William Prosser, The Law of Torts, § 30, p. 143 (4th Ed. 1971). Under section 7433, the essential elements are: (1) that the Internal Revenue Code and regulations prescribe what conduct Service personnel are required to follow in connection with collection activities; (2) that there was a breach of that duty by the

Service; (3) that the breach was the result of "reckless, intentional, or negligent disregard" of the Code or the regulations issued thereunder; and (4) that the claimant suffered damages in a specific amount. The claimant has the burden of proof with regard to each of these elements.

Before discussing whether the allegations in the A-related administrative claim satisfies each element under section 7433, we make some general observations concerning the definitions of "reckless and intentional disregard" and "causation."

Neither section 7433 nor the regulations thereunder define the tort terms "reckless," "intentional," or "negligent." However, these terms have generally accepted common law definitions. One who is guilty of intentional disregard or misconduct intends the harm caused by his acts or omissions. In order for disregard or misconduct to be reckless, the actor must have intentionally acted or failed to act either knowing, or knowing facts that would lead a reasonable person to realize, that it is highly probable that harm will result. See 57 Am. Jur. 2d., Negligence §§ 290-304 (1989). Reckless misconduct differs from negligence. Negligence consists of mere inadvertence or failure to take precautions while reckless misconduct involves a conscious choice of a course of action or inaction. Conduct cannot be in reckless disregard unless the conduct itself is intended. See 57A Am. Jur.2d, Negligence §§ 300, 302 (1989). Whether conduct or failure to act constitutes reckless, intentional, or negligent disregard of the law will depend on the facts and circumstances of each case.

The claimant must establish that the Service's actions were the proximate cause of the claimant's damages. Economic damages are the proximate result of an employee's reckless or intentional conduct if the damages are caused in fact by and are a foreseeable result of such actions. Economic damages that are not attributable directly to an employee's reckless or intentional conduct, but that result substantially from an unforeseeable intervening cause, are not compensable under section 7433, even if such damages would not have been sustained but for the employee's actions. See Information Resources, Inc. v. United States, 996 F.2d 780 (5th Cir. 1993) (the Service recklessly or intentionally disregarded its regulations when it failed to release liens against a computer software company. However, the company was not entitled to recover damages allegedly lost due to the action because no direct causal relationship was shown between the liens and the corporations's loss of business).

The claimant must incur actual, pecuniary damages. Injuries such as inconvenience, emotional distress and loss of reputation are compensable only to the extent that they result in actual pecuniary damages. Treas. Reg. § 301.7433-1(b)(1); Amoco Prod. Co. v. Aspen Group, 1999 U.S. Dist. LEXIS 12713 (D. Colo. 1999).

The A Cases [1]

In order to recover under section 7433, the claimants must first be able to prove that the Service violated some provision of the internal revenue laws or regulations during the process of collecting the late filing penalties. The claimants allege that the Service's collection of the penalties was an attempt to coerce non-settling partners to accept the substantive tax settlement in violation of section 7214, and to harass, oppress and abuse the non-settling partners in violation of section 6304. The claimants also allege that the Service's method of applying some of the levied funds violated section 6331(d) and section 6301.

Litigation Hazards

[1] RRA 98 amended section 7433 to add a cause of action for negligent disregard of the internal revenue laws. The amendment is effective for actions of officers or employees of the Service after July 22, 1998. The collection activity in these cases took place prior to July 22, 1998. Therefore, the reckless or intentional standard applies to these cases.