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Recent Developments: Thomas v. Commissioner: Addition to Tax Imposed on Unreported Income Obtained from Illegal Activities, Which Produced Criminal Sanctions, Is Not a Violation of the Fifth or Eighth Amendments

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*Thomas v.
Commissioner:*

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In *Thomas v. Commissioner*, 62 F.3d 97 (4th Cir. 1995), the United States Court of Appeals for the Fourth Circuit held that an addition to tax imposed on unreported income obtained from illegal activities, which produced criminal sanctions, was not a violation of the Double Jeopardy Clause of the Fifth Amendment or the Excessive Fines Clause of the Eighth Amendment. The court reasoned, first, that the violation of drug laws and failure to pay one's income tax were two separate offenses and, therefore, the addition to tax was not precluded by the Fifth Amendment. Second, the court determined that the addition to tax for civil tax fraud placed on the petitioner was remedial rather than punitive. Because the addition to tax was remedial rather than punitive, the Eighth Amendment was not implicated.

After investigations by the Internal Revenue Service and the Customs Service in 1986, Paul Thomas ("Thomas") was indicted for conspiracy to possess with the intent to distribute cocaine in violation of Title 21 of the United States Code, section 846, and for money laundering in violation of Title 21, section 1956. Pursuant to a plea agreement, Thomas pled guilty to and received prison sentences for both counts, forfeited the majority of his assets to the government, and was fined \$5,000. After the disposition of Thomas's criminal proceedings, the government instituted a civil action to

recover unpaid taxes totalling \$88,135 on income Thomas had received as a result of his illegal activities. In addition to these unpaid taxes, Thomas was assessed a fraud penalty of \$44,068. Thomas did not challenge the unpaid taxes determination but, instead, centered his challenge on the fraud penalty. He argued that its imposition constituted punishment and thus was in violation of the Double Jeopardy Clause, since he had already been punished for his drug activities. Additionally, Thomas argued that the tax fraud penalty was punitive in nature and violated the Excessive Fines Clause.

Thomas challenged the Commissioner's imposition of the additional tax fraud penalty in the United States Tax Court. The tax court held that the additional tax did not violate the Double Jeopardy Clause of the Fifth Amendment because illegal drug activities and failure to pay taxes are two distinct offenses. Addressing Thomas's excessive fines contention, the tax court acknowledged that fines in civil cases could be found punitive in nature, thus implicating the Eighth Amendment, *Thomas* at 99 (citing *Austin v. United States*, 113 S. Ct. 2801 (1993)), but determined that the addition to tax imposed in Thomas's case was remedial in nature and therefore constitutional. The United States Court of Appeals for the Fourth Circuit reviewed de novo the issues presented.

The court of appeals

began its analysis with Thomas' Fifth Amendment contention. *Id.* at 99. The court determined that the addition to tax imposed on Thomas did not place him in double jeopardy. *Id.* The court of appeals agreed with the tax court that engaging in drug activities and failing to pay income taxes were two distinct activities. *Id.* at 99. The court noted that it was possible for someone to engage in criminal activity and still pay his taxes or, in the alternative, refrain from unlawful conduct but at the same time fail to pay taxes. *Id.*

Historically, courts have viewed the addition to tax as largely remedial in nature, rather than punitive. *Id.* at 100. The court noted that such additions are imposed "primarily as a safeguard for the protection of the revenue and to reimburse the [g]overnment for the heavy expense of investigation and the loss resulting from the taxpayer's fraud." *Id.* (quoting *Helvering v. Mitchell*, 303 U.S. 391, 401 (1938)). The civil penalty imposed, however, may be considered punitive in nature "only if it bears no relation to the government's loss." *Thomas*, 62 F.3d at 100 (citing *United States v. Halper*, 490 U.S. 435 (1989)). The court of appeals determined that the addition to tax imposed on Thomas was reasonable and a fair representation of the government's monetary loss incurred from the investigations of Thomas's tax fraud. *Id.* The court refused to make a deter-

mination of whether the \$44,068 additional tax was the amount needed to adequately compensate the government stating that "the Government [was] entitled to rough remedial justice." *Id.* at 101 (quoting *Halper*, 490 U.S. at 446).

The court of appeals next addressed Thomas's assertion that the additional tax violated the Excessive Fines Clause of the Eighth Amendment. The court began its analysis by recognizing that in *Austin*, 113 S. Ct. 2801, the Supreme Court held that the Excessive Fines Clause of the Eighth Amendment applies to civil as well as criminal proceedings if the fine is punitive in nature. *Thomas* 62 F.3d at 102. The *Austin* decision involved United States forfeiture statutes, but the court of appeals noted that defendants have attempted to apply the holding to tax penalty cases. *Id.* (citing *McNichols v. Commissioner*, 13 F.3d 432 (1st Cir. 1993), *cert denied*, 114 S. Ct. 2705 (1994)).

In *McNichols*, a case involving identical facts as the case at bar, the defendant tried to make the same arguments as Thomas, using the *Austin* decision as a "springboard" to allow a punitive/remedial determination by the court in civil tax cases. *Id.* (quoting *McNichols*, 13 F.3d at 434). The court of appeals agreed with the *McNichols* court which "was unwilling to issue a holding that would have enabled a defendant to shield himself from tax liability by invoking the Ex-

cessive Fines Clause any time he obtained his income through a criminal enterprise for which he had been punished previously." *Id.* at 103. The court noted that Thomas was unable to point to any part of the *Austin* decision which suggested that its ruling could be expanded beyond the civil forfeiture arena. *Id.* To rule otherwise, the court stated, would result in "convicted criminals who are required to forfeit property as part of their punishment . . . , in effect, [being] insulated from having to pay taxes on income stemming from their illegal acts." *Id.* As a side note, the court added that even if the Excessive Fines Clause was implicated in this case, the addition to tax imposed on Thomas was not excessive since it was a fair representation of the government's cost in investigating Thomas. *Id.*

Thomas v. Commissioner ensures that persons obtaining income from illegal activities will not be able to avoid tax liability by arguing that they have already been punished by criminal penalties imposed for those same illegal activities. At the same time, however, the court of appeals has made a statement that civil fines are subject to Fifth and Eighth Amendment limitations. Fines that bear no relationship to governmental loss and are totally disproportionate to the remedial goals of the government, thus taking on a punitive characteristic, will be disallowed.

-Kevin Barth