Ninth Circuit No. 02-35599

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CHARLES ADAMS, ET AL.,	)	
	)	
Plaintiffs-Appellants,	)	
	)	
v.	)	Ninth Circuit No. 02-35599
	)	
THOMAS BALLARD, ET AL.,	)	Civ. No. CV99-1717-RE
	)	
Defendants-Appellees.	)	
______________________________	)	
	)	

OPENING BRIEF FOR PLAINTIFFS-APPELLANTS

Appeal from the United States District Court
District of Oregon

The Honorable James A. Redden
District Court Judge

PEARSON ♦ MERRIAM, P.C.
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TABLE OF CONTENTS

I. **STATEMENT OF THE CASE** 1

II. **STATEMENT OF JURISDICTION AND STANDARD OF APPELLATE REVIEW** 2

III. **STATEMENT OF ISSUES** 3

IV. **STATEMENT OF FACTS** 4

V. ARGUMENT 14

A. Appellants State a Cause of Action under *Bivens* for Violation of Clearly Established Constitutional Rights. 14

1. *Fifth Amendment Procedural Due Process Rights in Tax Cases Were Clearly Established and Knowingly Violated* 15
2. *Fifth Amendment Substantive Due Process Rights Were Clearly Established and Knowingly Violated.* 22
3. *Fifth Amendment Right to Conflict Free Representation Was Clearly Established and Knowingly Violated.* 26
4. *First Amendment Right of Access to Courts Was Knowingly Abridged.* 28

B. There Exists No Alternative Remedy Which Would Counsel Hesitation In Holding Government Defendants Responsible For Violation Of Appellants' Constitutional Rights. 29

1. *Wages v. IRS is Inapposite Because Statutory Remedies Were Purposefully Impaired and Defendants Have No Alternative Remedies.* 30

2. *The Damage Provisions of 26 U.S.C. § 7433 Are Unavailable.* 34
3. *Motion To Vacate Tax Court Decision is Unavailable.* 35
4. *The Alternative Remedies Are Inadequate In Any Event.* 36

VI. **CONCLUSION** 37

TABLE OF AUTHORITIES

CASES

Abatti v. Commissioner, 859 F.2d 115 (9th Cir. 1988) 36

Act Up!/Portland v. Bagley, 988 F.2d 868 (9th Cir. 1993) 14

Anderson v. Creighton, 483 U.S. 635, 639 (1987) 27

Bales v. Commissioner, T.C. Memo 1989-568. 4-6

Bill Johnson's Restaurants, Inc. v. NLRB, 461 U.S. 731 (1983) 29

Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics, 403 U.S. 388 (1971) . . . . *passim*

Boddie v. Connecticut, 401 U.S. 371 (1971) 34

Bothke v. Fluor Engineers & Constructors, Inc., 834 F.2d 804 (9th Cir. 1987) 3

Brady v. Gebbie, 859 F.2d 1543 (9th Cir. 1988), *cert. denied*, 483 U.S. 1020 (1987) 14

Branzburg v. Hayes, 408 U.S. 665 (1972) 18

Brinkerhoff-Faris Trust & Savings v. Hill, 281 U.S. 673 (1930) 15

Brookes v. Commissioner, 108 T.C. 1 (1997) 15

California Motor Transport Co. v. Trucking Unlimited, 404 U.S. 508 (1972) 29

Canton v. Harris, 489 U.S. 378 (1989) 21

Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau, Inc.,
690 F.2d 1240 (9th Cir. 1982), *cert. denied*, 459 U.S. 1227 (1983) 25

Collins v. City of Harker Heights, 503 U.S. 115 (1992) 22

Computer Programs Lambda, Ltd. v. Commissioner,
89 T.C. 198 (1987) 32

Computer Programs Lambda, Ltd. v. Commissioner,
90 T.C. 1124 (1988) 27

County of Sacramento v. Lewis, 523 U.S. 833 (1998) 22, 23

Daniels v. Williams, 474 U.S. 327 (1986) 22

Durham Farms #1 v. Commissioner, T.C. Memo 2000-159 6

Foxman v. Renison, 625 F.2d 429 (2nd Cir. 1980) 35

Giglio v. U.S., 405 U.S. 150 (1972) 19, 26

Goldberg v. Kelly, 397 U.S. 254 (1970) 26, 27

Hall v. City of Santa Barbara, 833 F.2d 1270 (9th Cir. 1986) 3

Harlow v. Fitzgerald, 457 U.S. 800 (1982) 2, 14, 15, 37

Harris v. Roderick, 126 F.3d 1189 (9th Cir. 1997) 26, 27

In re Miller, 174 B.P. 791 (BAP 1994), *aff'd*, 81 F.3d
169 (9th Cir. 1996) 28

Johnson v. Zerbst, 304 U.S. 458 (1938) 26

Kaplan v. U.S., 133 F.3d 469 (7th Cir. 1998) 33

Le Bid v. Hanson, 894 F.2d 1124 (9th Cir. 1990) 29

Logan v. Zimmerman, 455 U.S. 422 (1982) 36

Mathews v. Eldridge, 424 U.S. 319 (1976) 18, 26

Mullane v. Central Hanover Bank, 339 U.S. 306 (1950) 15

NAACP v. Button, 371 U.S. 415 (1963) 29

Nelson v. Silverman, 888 F. Supp. 1041 (SD Cal. 1995) 34

Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985) 27

Phillips v. Commissioner, 283 U.S. 589 (1931) 2, 15, 34, 37

River City Ranches #4 v. Commissioner, T.C. Memo 1999-209 6

Rutherford v. United States, 702 F.2d 580 (5th Cir. 1983) 22, 37

Schweiker v. Chilicky, 487 U.S. 412 (1988) 29

Shorthorn Genetic Engineering 1982-2, Ltd., et. al. v. Commissioner,
Docket Nos. 22003-89 to 28577-90 (Order dated 10 January 2001) . . . 17, 36

Thomas v. Carpenter, 881 F.2d 828 (9th Cir. 1989) 24

Thomas v. Collins, 323 U.S. 516 (1945) 29

Todd v. United States, 849 F.2d 365 (9th Cir. 1988) 16

Transpac Drilling Venture 1982-12 v. Commissioner,
147 F. 3d 221 (2d Cir. 1998) 28

United States v. Cross, Hoyt and King, CR 98-529-JO
(USDC Or. filed June 27, 2001) 17

United States v. Erne, 576 F.2d 212 (9th Cir. 1978) 19

United States v. Goodwin, 457 U.S. 368 (1982) 24

United States v. Ness, 652 F.2d 890 (9th Cir. 1981) 19

Usher v. City of Los Angeles

26 U.S.C. § 7408 19

26 U.S.C. § 7422 . . . . 30, 33

26 U.S.C. § 7433 . . . . 34, 35

28 U.S.C. § 1291 3

28 U.S.C. § 2107 2

RULES

Fed. R. App. P. 3 2

Fed. R. App. P. 4 3

Fed. R. Civ. P. 12 . . . . 1, 2

Fed. R. Civ. P. 54(b) 3

REGULATIONS

31 CFR § 10, et. seq. (Circular 230) 20

Treas. Reg. § 301.6231(c)-5T 8, 9, 21

OTHER AUTHORITIES

G.C.M. 37210, 1977 IRS GCM LEXIS 91 15

H.R. Conf. Rep. No. 97-760 (1982) 32

I.R.S. Manual 20.1.6 . . . . 19, 21

I.R.S. Manual 8.11.1.7.5.2.1 20

Rev. Proc. 83-78, 1983-2 C.B. 595 19

Rev. Proc. 84-84, 1984-2 C.B. 782. . . . . 9, 20, 21

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub. L. No. 97-248, 96 Stat 324 2

I. STATEMENT OF THE CASE

Appellants sued the appellees ("defendants") for violation of their constitutional rights in the federal tax audit of their partnerships. Certified Record ("CR") 3. Defendants moved the U.S. District Court for dismissal under Federal Rules of Civil Procedure 12(b)(2), (3) and (6) on the basis that appellants failed to state a claim for violation of constitutional rights, that the court lacked personal jurisdiction, and that venue was improper. CR 11. The District Court granted defendants' motion to dismiss. CR 30. The sole issue decided by the District Court was whether defendants are entitled to qualified immunity from the suit for violation of appellants' constitutional rights, and in that regard, whether appellants have shown violation of a clearly established constitutional right. CR 30, pp. 5-6. The Court's opinion did not address appellants' Fifth Amendment claims, but only their First Amendment claims in concluding that a violation of a clearly established constitutional right was not proved. CR 30, pp. 7-8.

The District Court erred in its determination that appellants failed to show violation of a First or Fifth Amendment constitutional right. Accordingly, the District Court erred in its holding that defendants are entitled to qualified immunity, because qualified immunity is defeated where defendants are alleged

to have violated clearly established First and Fifth Amendment rights about which a reasonable government official would recognize or know. *Harlow v. Fitzgerald*, 457 U.S. 800 (1982).

Further, the District Court erred in concluding that, notwithstanding a constitutional violation, appellants' *Bivens* action is precluded by reason of the

2001. CR 41. Upon appellants' motion, the District Court entered a final judgment pursuant to Fed. R. Civ. P. 54(b) as to appellants' claims against the federal defendants on or about 17 May 2002. CR 46, 47. Appellants timely filed their Notice of Appeal on or about 10 June 2002. CR 48. This Court has jurisdiction of this appeal. 28 U.S.C. § 1291; Fed. R. App. P. 4(a)(1) and (a)(4).

This court reviews *de novo* the District Court's dismissal of a *Bivens* action on the ground that the defendants have qualified immunity. *Bothke v. Fluor Engineers & Constructors, Inc.*, 834 F.2d 804, 809 (9th Cir. 1987). A motion to dismiss admits the factual allegations of the Complaint, but contends that those allegations are legally insufficient to state a claim for relief. *Hall v. City of Santa Barbara,* 833 F.2d 1270, 1274 (9th Cir. 1986).

III. STATEMENT OF ISSUES

1. Whether the District Court erred in concluding that appellants failed to state a claim for violation of clearly established constitutional rights under the First and Fifth Amendments of the United States Constitution.

2. Whether the District Court erred in concluding that meaningful alternative remedies exist.

IV. <u>STATEMENT OF FACTS</u>

Walter Jay Hoyt, III ("Hoyt") was well known in the cattle breeding business, having raised champion Shorthorn breeds since the early 1950's. CR 3, ¶¶ 52-53, 55; Ex. 3 at 3. Between 1971 and 1996, Hoyt organized and sold interests in hundreds of investment partnerships, which owned and raised the shorthorn cattle his family bred. CR 3, ¶¶ 25, 52-55 & Ex. 3 at 4, Ex. 6 at 1-2. The partnerships provided the investor a tax deduction for partnership operating losses in the early years with a promise for profit and gain in five to fifteen years from the sale of the investor's purebred shorthorn breeds. CR 3, Ex. 6 at 25. Hoyt lured thousands of investors; they were middle-income wage earners like teachers, seamen, firefighters, government agents and ranch hands who did not need to shelter income. CR 3, ¶ 55, Ex. 6 at 25. As defendants determined in their audit of the partnerships, appellants and other investors were looking for an investment for their retirement; they did not invest primarily to gain tax benefits. CR 3, ¶ 54, Ex. 6 at 25. Appellants were convinced upon their visit to the bustling cattle ranches spread across thousands of acres and hosting thousands of head of cattle that they were investing in a bonafide cattle business. CR 3, ¶¶ 52-55 & 128, Ex. 6 at 25. The U.S. Tax Court was convinced, as well. *Bales v. Commissioner*, T.C. Memo 1989-568.

In addition to being a famous cattle breeder, Hoyt earned the Federal Internal Revenue Service ("Service" or "IRS") accreditation as an enrolled agent (demonstrating special competence in tax matters). CR 3, ¶¶ 50, 126. The accreditation authorized him to prepare Federal Income Tax Returns and to represent investors in dealings with the IRS. *Id.* These talents made it easy for Hoyt to establish himself as the managing partner, tax return preparer and Tax Matters Partner ("TMP") for each of the appellants' partnerships and an attorney in fact for each of the appellants. CR 3, ¶¶ 25 & 45-51, 56-57, 71-73, Ex. 2 at 9 and Ex. 3 at 5. Indeed, appellants and other investors were wooed to invest, and remained invested, on Hoyt's claim that the defendants would revoke his enrolled agent status if he were doing anything unlawful or contrary to the Internal Revenue Code. CR 3, ¶¶ 50, 125, 126, Ex. 6 at 26.

The Service began auditing Hoyt partnerships in the late 1970's as an abusive tax shelter challenging: (1) the number and value of the cows owned and controlled by the partnerships, and (2) whether the partnerships were shams in which appellants invested without a profit motive. CR 3, ¶¶ 82-83, 95, Ex. 6 at 5. The U.S. Tax Court disagreed with the defendants' abusive tax shelter arguments in *Bales v. Commissioner*, T. C. Memo 1989-568, holding that the partnerships and their cattle business were not economic shams, but were legitimate ventures

entered for profit. In spite of the *Bales* decision, defendants continued to audit the Hoyt partnerships' subsequent tax years in an effort to prove they constituted abusive tax shelters. Over a span of 20+ years, defendants audited 24 distinct tax years of the partnerships until the partnerships went into bankruptcy in 1997. CR 3, ¶¶ 91-95, 164. The tax controversy continues to date and the U.S. Tax Court continues to decline to agree with defendants that the partnerships constitute abusive tax shelters. *River City Ranches #4 v. Commissioner,* T.C. Memo 1999-209 and *Durham Farms #1 v. Commissioner*, T.C. Memo 2000-159 (however, consistent with the conviction of Jay Hoyt for defrauding the investors of their assets, the Tax Court held that Hoyt did not transfer title to the livestock to appellants' partnerships, thus requiring the disallowance of tax claims related to the operation of those assets). Legitimized by his victory over the IRS in *Bales* and the long history of the Hoyt family cattle name, Hoyt sold ever more partnership interests. CR 3, ¶¶ 52-55, 94, Ex. 6 at 25-26. At the same time, defendants opened up an audit for every new partnership Hoyt created. CR 3, ¶¶ 82, 95-96. While facilitating their civil audit of the partnerships exclusively through Hoyt as appellants' TMP, defendants began investigating Hoyt in 1982, and continuing through approximately 1998, for criminal and civil liabilities relating to his promotion of the partnerships and preparation of partnership tax

returns. CR 3, ¶¶ 27-33, 59, 67-69 & 71-75, Ex. 2 at 1. Defendants' criminal investigation confirmed that Hoyt was defrauding investors because he kept reselling the same cattle which meant that investors unintentionally claimed more tax credits and deductions than permitted. CR 3, ¶¶ 60-62 & Ex. 2 at 4 & Ex. 6 at 19-20.

And, Hoyt admitted to defendants in the early 1990's that he misappropriated ranch land from the partnerships. CR 3, ¶ 106, Ex. 5. At the same time, defendants determined that the investors were "unwitting victims" of Hoyt's ruse. Defendants conceded that the partners were not given sufficient third party evidence to question the truth of Hoyt's representations as all tangible evidence available to investors supported Hoyt's statements. CR 3, Ex. 6 at 23, 25-27.

Similarly, defendants concluded that Hoyt had a "profound" conflict of interest which "grossly violated his fiduciary responsibilities to his investors and clients," about which investors were unaware. CR 3, Ex. 2 at 9. Nevertheless, defendants determined they would not disclose Hoyt's conflict of interest or fraud, or take any action to enjoin or remove Hoyt, because they could better achieve their audit goals through a conflicted TMP and they would not have to go through the hassle of processing the audits of hundreds of partnerships through

hundreds of different TMPs. CR 3, ¶¶ 35-43, 57, 59, 65-70, 86, 122 & 130. In fact, while the civil and criminal investigations of Hoyt were ongoing, appellants and other new investors called the IRS before investing and were told no investigation of the partnerships was pending. CR 3,¶ 58.

Defendants permitted Hoyt's fraud to proliferate. Defendants knew that taking no action against Hoyt to remove him as the TMP, enjoining his promotion of the tax shelters or preparation of appellants' tax returns, or revoking his license to represent appellants as an enrolled agent before the IRS was not only contrary to policy, it legitimized his operation. CR 3, ¶¶ 39-42, 74-79, 90, 96, 127-129 & Exs. 2, 6; Treas. Reg. § 301.6231(c)-5T; 26 U.S.C. § 6231(c). It also allowed Hoyt to continue selling partnership interests for years. Defendants understood that Hoyt was funded primarily by appellants' tax refunds that they would receive in their initial investment years from partnership operating losses. CR 3, ¶¶ 64, 79-80. Yet, contrary to their policy and regulations, defendants granted the refunds to appellants for over a decade, because they knew they would seek return of the refunds, with interest and penalties, from Hoyt's victims later. *Id.*

Defendants decided not to use their authority to remove Hoyt as the TMP while investigating him criminally, even though their regulations instruct that he

should (or must) be removed because it will otherwise interfere with the civil audit of the partnerships. CR 3, ¶¶ 40-42; Treas. Reg. § 301.6231(c)-5T. Similarly, defendants decided to ignore their policy and regulations that instruct them to enjoin a TMP (Hoyt), whom they believe is committing tax fraud and/or promoting an abusive tax shelter. CR 3, ¶¶ 75-77; Rev. Proc. 84-84, 1984-2 C.B. 782. Further, defendants knew at least by 1989 that appellants relied on Hoyt's status as an enrolled agent and that Hoyt used that status to promote his program. CR 3, ¶¶ 126-127. Nevertheless, defendants did not take any action to disbar Hoyt as an enrolled agent until 1997 despite having grounds to do so as early as 1984. *Id.*; Rev. Proc. 84-84, 1984-2 C.B. 782. Thus, the number of investors kept growing, the number of tax refunds kept growing, and the potential tax collection grew into hundreds of millions of dollars. CR 3, ¶¶ 60-66, 79-86, & 128-129.

To achieve the tax adjustments which they would collect against investors, defendants exploited Hoyt's conflict of interest for their own advantage. CR 3, ¶¶ 38-39, 42-51, 65, 67-73, 81, 116, 121, 123 & 125. Defendants knew that Hoyt's primary motivations were to cover up his own fraud and to defraud additional investors. Defendants knew that it was against Hoyt's personal interest to resolve appellants' tax claims in a manner that would eliminate the need for future audits

and litigation, because that would mean the end of his partnership promotions. CR 3,¶ 65. Keeping Hoyt as the TMP served defendants' purposes, because they leveraged agreements and concessions from a conflicted TMP and they only had to deal with one person (as opposed to hundreds) to gain audit adjustment goals from hundreds of partnerships. CR 3, ¶¶ 32, 97-101, 103-105, 110-115 & Ex. 4. For example, Jay Hoyt agreed to give defendants additional time to audit appellants' partnerships and asked, in return, that defendants drop proposed penalties against him personally; Hoyt was never assessed those penalties by defendants and defendants were given more time to make their case against appellants. CR 3, ¶¶ 97-101.

In 1992, several partners who were concerned about the delays by defendants in resolving the tax disputes, joined together to form a "settlement committee" to try and resolve all the pending tax audits through tax year 1991. CR 3, ¶ 102. Defendants demanded that, in order for them to consider any settlement, the settlement committee would have to secure Jay Hoyt's agreement to turn in his Enrolled Agent card and cease practice before the IRS and agree to an injunction, with significant penalties attached, that would prohibit future selling of any partnership. CR 3, ¶ 104.

In spite of the fact that the settlement committee obtained these

concessions and agreements from Hoyt which would have put an end to the audits (and unbeknownst to them at that time, the fraud as well), defendants decided nevertheless to continue dealing exclusively with Hoyt to reach audit agreements. And through Hoyt, defendants secured a settlement (the "Memorandum of Understanding" or "settlement") which allowed Hoyt to continue promoting the partnerships and keep his enrolled agent status. CR 3, Ex. 4. The defendants, in turn, obtained tax adjustments against appellants' partnerships that were the result of Hoyt conceding issues that a non-conflicted representative would not have conceded. CR 3, ¶¶ 105-117. For instance, although Hoyt and federal defendants knew Hoyt was defrauding appellants by selling "phantom" cows to them (i.e., showing them cows that were available for sale, when in fact they had already been purchased by one or many other partnerships formed by Hoyt), the Memorandum of Understanding did not permit the appellants' partnerships to claim a contemporaneous theft loss deduction of their investment. CR 3, Ex. 5 at 8. And, Hoyt did not disclose the settlement or information about the cattle count so that appellants could be alerted to take a personal loss, as that would have required Hoyt to reveal his fraudulent activities to appellants. CR 3, ¶¶ 105-107, Exs. 2 and 6. Appellants ended up with large tax liabilities from the settlement which defendants are presently seeking to collect by levy and seizure, while Jay

Hoyt personally obtained a favorable tax adjustment and eluded full collection by buying his house back from the defendants at a fraction of its value. CR 3 ¶¶ 107, 112-115, Ex. 3 at 8, Ex. 5 at 4.

To discourage appellants from seeking court review of their case and to increase tax collections, defendants engaged in the selective use of their collection authority against appellants whom they considered "active" partners (those still supporting the partnership defense). CR 3, ¶¶ 143-144, 149-158. In the early 1990's, Hoyt filed certain partnership returns late, which subjected each of the general partners to joint and several liability for late filing penalties that totaled over $1 million. CR 3, ¶ 150. Defendants threatened "active" partners with 100% of the partnerships' late-filing penalty and levied their personal assets. CR 3, ¶¶ 140, 145, 150-158. However, if the threatened appellant or partner would agree to settle their substantive tax case for tax years unrelated to the late-filing penalty tax year, then appellants would agree not to hold them liable for any portion of their partnership's late-filing penalty. CR 3, ¶ 156. Leveraging settlements made it easier to achieve tax adjustments. CR 3, ¶¶ 140-158.

Defendants concede that at least one of their motives was to make it easier to achieve tax adjustments, regardless of whether the partners' opportunity to be heard was being impaired. CR 3, ¶ 86. A Service spokesman stated in reference

to the Hoyt case, "it is easier to go after the people who have been duped, than to go after the promoters of the scheme." CR 3, Ex. 3 at 9.

As a result, appellants like Helen Foy, (a seventy year old widow whose husband invested their savings and not just the tax refund received) face the loss of their investment, along with huge tax bills amounting to more than $200,000.00 and comprised largely of interest and penalty assessments. CR 3, p. 31, Ex. 3 at 8. Appellants relied to their detriment on defendants' silence about evidence defendants possessed concerning Hoyt's breach of fiduciary duty and evidence of his misappropriation of appellants' partnership property. CR 3, ¶¶ 129, 131-137, 169-171. Sadly, appellants were unaware that Hoyt's fraud and conflict of interest resulted in the assessment of taxes, interest, and penalties that would not have been assessed against them had they known the evidence against them and received a full and fair opportunity to be heard. *Id.* In 1998, defendant William McDevitt concluded that the partners had no reason not to believe Hoyt as all tangible evidence available to investors up to that point supported Hoyt's statements. CR 3, Ex. 6 at 26-27.

V. ARGUMENT

A. Appellants State a Cause of Action under *Bivens* for Violation of Clearly Established Constitutional Rights.

Government officials may be held personally responsible for violating the constitutional rights of citizens. *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971). Appellants must meet a two-pronged test to maintain an action for constitutional violations against government officials: (1) showing that the law governing the conduct was clearly established and (2) a reasonable person should have known his/her conduct was unlawful. *Harlow v. Fitzgerald*, 457 U.S. 800 (1982); *Act Up!/Portland v. Bagley*, 988 F.2d 868 (9th Cir. 1993). Under the first prong, binding precedent is not required to show a clearly established law. *Brady v. Gebbie*, 859 F.2d 1543 (9th Cir. 1988), *cert. denied*, 483 U.S. 1020 (1987).

Based upon all available law, it is obvious that defendants knew or should have known that their conduct violated appellants' clearly established constitutional rights. *Id.* And, although the District Court did not reach the second prong of the test, the objective reasonableness of defendants' conduct cannot be established as a matter of law. When the constitutional rights are clearly established, government officials are deemed to recognize a constitutional violation and qualified immunity should ordinarily fail. *Harlow v. Fitzgerald*, 457 U.S. at 818-819.

1. Fifth Amendment Procedural Due Process Rights in Tax

Cases Were Clearly Established and Knowingly Violated.

A person's right to notice and opportunity to be heard is fundamental to due process and defendants must attempt to provide that right. *Mullane v. Central Hanover Bank*, 339 U.S. 306 (1950). The right of taxpayers to due process in the assessment and collection of taxes is immutable and well-established. *Brinkerhoff-Faris Trust & Savings v. Hill*, 281 U.S. 673 (1930); *Phillips v. Commissioner*, 283 U.S. 589 (1931); *Brookes v. Commissioner*, 108 T.C. 1, 4 (1997). Citing the 1931 case of *Phillips v. Commissioner*, IRS counsel have instructed agents that "the 5th amendment due process clause will apply in tax cases if a taxpayer does not receive at least one full and fair hearing before his property is taken by collection of a tax." G.C.M. 37210, 1977 IRS GCM LEXIS 91. Thus, defendants' conduct was informed by long-established law.

Defendants argued below that there can be no Fifth Amendment violation in tax cases. CR 12, p. 9. The cases relied upon by defendants do not support this conclusion. The courts that have addressed this issue do not hold that due process is inapplicable to tax cases, but rather the summary collection proceedings or post-deprivation proceedings satisfy the dictates of due process. *Wages v. IRS*, 915 F.2d 1230, 1235 (9th Cir. 1990) (post-deprivation right to sue for refund

satisfies the dictates of due process); *Todd v. United States*, 849 F.2d 365, 369 (9th

Defendants knowingly facilitated Hoyt's concealment of his fraud and conflict of interest by allowing him to continue to promote the partnerships for more than twenty years. CR 3, ¶¶ 74-78. This only ceased when another government agency indicted him in 1998.[1] Defendants created his conflict of interest, in part, by placing him under criminal investigation and lording civil penalties over him throughout the tenure of the 20-year audit. As a result, they extracted agreements from him when he was motivated to curry favor from them. CR 3, ¶¶ 28-33, 89-90. The improper agreement between Hoyt and defendants to conceal his conflicts of interest obviated any ability for appellants to have a meaningful voice in their case, which is necessary to due process. *Mathews v. Eldridge*, 424 U.S. 319 (1976). This violated appellants' reasonable expectation that government defendants will not collude with the TMP and exploit his conflicts of interest. 26 U.S.C. § 7214(a)(4) (it is a violation for an employee or officer of United States to conspire or collude with any other person to defraud the government).

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[1] The FBI and the Postal Inspector were investigating Hoyt in 1995. The investigation resulted in an indictment and on 2/12/01, a jury convicted Jay Hoyt on 52 counts of fraud for defrauding the Hoyt investors, including appellants, of over $100 million from the late 1970's through 1998. *See* CR 3 ¶ 167, Ex. 7 at 1-3; *United States v. Cross, Hoyt and King*, CR 98-529-JO (USDC Or. filed June 27, 2001).

Further, defendants knew that Hoyt was withholding evidence from appellants to cover up his fraud and, consequently, the appellants could not have known the evidence against them:

> Bales seemed to affirm the propriety of most of the Hoyt program. Investors - kept in the dark about all the partnerships' business dealings - couldn't have known that the Hoyts had conspired to raise prices for cattle transferred from Ranches to the investor partnership to unreasonable levels.

CR 3, Ex. 6, p. 26. Every person has a right to know the evidence against them, and that law was clearly established. *Branzburg v. Hayes*, 408 U.S. 665 (1972). Whether the evidence of Hoyt's fraud (or conflict of interest) that served as the basis for assessments against appellants was concealed by negligence or design,

it still impairs the judicial process and results in a violation of constitutional rights. *Giglio v. United States*, 405 U.S. 150 (1972).

Further evidence that defendants intended to impair appellants' rights of due process is found in the fact that defendants bypassed normal audit procedures with respect to appellants' partnerships. Evidence that normal procedures have been bypassed gives rise to an inference that defendants intended to deny appellants their constitutional rights. *United States v. Ness*, 652 F.2d 890 (9th Cir. 1981)

(*citing United States v. Erne*, 576 F.2d 212, 216 (9th Cir. 1978)). Contrary to established IRS policies and procedures, and applicable law, defendants took none of the authorized and/or mandated actions against Hoyt, as follows:

a. Defendants did not enjoin Hoyt's promotion of an "abusive tax shelter" or enjoin his preparation of false returns in connection with that shelter. CR 3, ¶¶ 74-78, 96. The standard policy of the IRS is to take action against the promoter, including injunction actions which were authorized specifically by Congress to prevent the perpetuation of fraud on the government. 26 U.S.C. §§ 7407, 7408; I.R.S. Manual 20.1.6; Rev. Proc. 83-78, 1983-2 C.B. 595.

b. Defendants did not disbar Hoyt as an enrolled agent so that he could no longer represent the partners, as federal regulations instruct them to do. 31 CFR § 10, et. seq. (Circular 230). The IRS commonly disbars enrolled agents to prevent abuse of the tax system by certified representatives. An enrolled agent's license is regulated by the IRS, and when an IRS employee becomes aware of actions by an enrolled agent that warrant referral to the Director of Practice for violation of any Circular

230 standards, the revenue agent is required to report it. I.R.S. Manual 8.11.1.7.5.2.1.

c. Defendants did not stop the perpetuation of fraud by withholding claimed refunds, as is the IRS general procedure in tax shelter cases. Rev. Proc. 84-84, 1984-2 C.B. 782. For over a decade and in violation of their procedures for auditing alleged abusive tax shelters, defendants did not stop the issuance of refunds based on these false and fraudulent claims until the mid-1990's.

d. Defendants did not pursue all civil and criminal penalties against Hoyt. Defendants never pursued indictable offenses against Hoyt after their investigation of him for numerous years. CR 3, Ex. 2. Potentially millions of dollars in preparer and promoter penalties against Hoyt were also foregone. 26 U.S.C. §§ 6700 & 6701; I.R.S. Manual 20.1.6; Rev. Proc. 84-84, 1984-2 C.B. 782.

e. Defendants did not remove Hoyt as the TMP when he was under criminal investigation. The rules and regulations governing special procedures in TEFRA audits instruct that a criminal investigation of the TMP *will* interfere with the

administration of the audit. 26 U.S.C. § 6231(c); Treas. Reg. § 301.6231(c)-5T (2 Mar 1987). Whether or not defendants believe the pertinent regulations require, or simply allow, them to remove the TMP under those circumstances, their deliberate indifference to the conflict of interest created by their criminal investigation of Hoyt and the statutory presumption that it will interfere with the audit, is sufficiently culpable conduct to cause constitutional harm. *Canton v. Harris*, 489 U.S. 378, 388-389 (1989) (deliberate indifference by a municipality is an actionable standard of culpability for constitutional harms caused by an employee they failed to train). It is only this concealed conflict of interest that permitted defendants to assess taxes against appellants beyond the normal statutory

the procedures used to implement them." *Daniels v. Williams*, 474 U.S. 327, 331 (1986). Substantive due process is intended to prevent government officials from abusing their power, or employing it as an instrument of oppression. *Collins v. City of Harker Heights*, 503 U.S. 115, 125 (1992); *County of Sacramento v. Lewis*, 523 U.S. 833 (1998). Abusive conduct in a tax case is actionable under *Bivens*. *Rutherford v. United States*, 702 F.2d 580 (5th Cir. 1983) (the court acknowledged that the substantive aspects of the Due Process Clause can create in taxpayers a liberty interest to be free from abusive behavior of IRS officials); *White v. Boyle*, 538 F.2d 1077 (4th Cir. 1976). Defendants conduct to obviate appellants' procedural due process rights constituted an egregious abuse of power.

Defendants' conduct is particularly egregious when considered in light of the fact that only defendants and Hoyt could have ensured that appellants were receiving a full and fair opportunity to be heard, because only they knew that Hoyt was breaching his fiduciary duty to investors. It was impossible for appellants to meaningfully participate in the defense of their own case because the information necessary for them to conclude their rights were not being adequately represented (i.e., Hoyt's conflict of interest and fraud) was concealed from them by both defendants and Hoyt. As the District Court noted, their conduct shocks the conscience:

> [I] find nothing praiseworthy in the IRS's cynical use of

> a TMP tainted by conflicts of interest to obtain advantages against the plaintiffs in tax cases. If the plaintiffs' allegations are accurate, the federal defendants' conduct brings discredit upon the IRS and upon the United States.

CR 30, p. 8; *County of Sacramento v. Lewis*, 523 U.S. 833, 846 (executive abuse of power is that which shocks the conscience).

In addition to defendants' actionable conduct in exploiting the TMP's conflict of interest, they engaged in other conduct that the law clearly establishes as impermissibly abusive and oppressive. For example, it is clearly established law that government defendants are not entitled to extort settlements and agreements from defendants or their representatives. 18 U.S.C. § 1951 ("Hobbs Act," extortion by public officers); 26 U.S.C. § 7214. Defendants' exploitation of Hoyt's conflict of interest to leverage agreements and concessions detrimental to appellants is tantamount to extortion.

It is clearly established law that government defendants are not entitled to penalize taxpayers for choosing to challenge the government's tax adjustments in a court of law. *United States v. Goodwin*, 457 U.S. 368, 372 (1982) (conduct motivated by an intent to discourage or punish exercise of constitutional rights is unlawful); *Thomas v. Carpenter*, 881 F.2d 828 (9th Cir. 1989). Here, the facts plead show that if appellants chose to exercise their right to have a court review their case, defendants would assert "tax-motivated" penalties that they believed to

be otherwise unnecessary and unwarranted. CR 3, Ex. 6, pp. 25-30. Defendants decision to impose "tax-motivated" penalties against appellants, and not other similarly situated taxpayers, operates to penalize them for pursuing their right to full administrative and judicial review. *White v. Boyle*, 538 F.2d 1077 (a retaliatory IRS investigation gives rise to a *Bivens* action).

Defendants colluded with Hoyt to allow him to continue to promote the partnership tax shelter and did not enforce potential return preparer penalties, injunctions of abusive tax shelters, or injunction of the preparation of false returns. Defendants' deliberate indifference to Hoyt's actions and selective prosecution of them, improperly permitted him to perpetuate his fraud against the government and appellants in violation of 26 U.S.C. § 7214. Defendants' actions permitted them to increase their audit adjustments against his unwitting victims, which constitutes a selective use of audit and collection powers to an improper end. *Clipper Exxpress v. Rocky Mountain Motor Tariff Bureau, Inc.*, 690 F.2d 1240 (9th Cir. 1982), *cert. denied*, 459 U.S. 1227 (1983) (A constitutional claim lies for abuse of administrative, as well as, judicial processes).

In effect, defendants colluded to shift the blame for Hoyt's fraud of the government to his victims. Defendants essentially admit it was their intent to go after Hoyt's victims to collect from them the money Hoyt defrauded from the government. CR 3, ¶¶ 79-83, Ex. 3, pp. 1, 9. Defendants never put a halt to

Hoyt's promotions or fraudulent activity. And, it was fully expected by defendants that Hoyt would continue to make false tax claims for unwitting victims and that federal defendants would in turn assess tax, interest, and penalties against those victims (appellants) based on the disallowance of those false claims. All the while, the process accorded appellants ensured that they would never learn the underlying reason for disallowance of their cattle investment claims - i.e., Hoyt misappropriated their assets. In a case where a plaintiff alleged that federal agents' efforts to shift blame to him resulted in deadly force being improperly used against him, this court held that those federal

agents were not protected by qualified immunity since the harm to the plaintiff was foreseeable. *Harris v. Roderick*, 126 F.3d 1189 (9th Cir. 1997).

It is clearly established law that defendants are not permitted to conceal material evidence, whether by negligence or design, as doing so will impair the judicial process and result in violation of constitutional rights. *Giglio v. United States*, 405 U.S. 150 (1972). Here, defendants knew that there was evidence to permit appellants partnerships to claim theft losses (due to Hoyt's fraud) in the tax years at issue, yet they deliberately disallowed a theft loss deduction and no defendant disclosed this essentially exculpatory evidence to appellants. Defendants were intentionally pursuing excessive adjustments that they knew the

partners could ameliorate if they knew all the facts.

3. *Fifth Amendment Right to Conflict Free Representation Was Clearly Established and Knowingly Violated.*

It has been long established that a person has a right to conflict-free representation in civil actions. *Johnson v. Zerbst*, 304 U.S. 458 (1938); *Goldberg v. Kelly*, 397 U.S. 254 (1970). The right to be heard in a meaningful manner is a touchstone of due process, and that right is impaired if one's representative breaches his fiduciary duty of ensuring the litigant a meaningful voice in his case. *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976). This right of uncompromised representation applies equally outside the attorney-client context, and imposes likewise an obligation on a named representative for a class of litigants to impartially and adequately represent their interests in the action. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). A TEFRA proceeding is the statutory analog to a class action suit. *Computer Programs Lambda, Ltd. v. Commissioner*, 90 T.C. 1124 (1988). The *Computer Programs Lambda* court recognized that the TMP is the statutory representative of the class of litigants (partners in the partnership) who owes a fiduciary duty to them and his "initiative during the proceeding as well as the execution of his statutory duties will have a substantial effect upon the rights of all partners." 90 T.C. at 1126. It is clear that if a litigant's representative, here the partner's TMP, breaches his fiduciary duty or is not conflict-free, then the litigant is deprived of representation and necessarily a

meaningful opportunity to be heard. *Id; Goldberg v. Kelly*, 397 U.S. at 271.

Defendants contended in the lower court that appellants have not alleged a violation of clearly established law with respect to conflicts of a TMP, because they have not presented any case involving similar circumstances. CR 22, p. 6. This court has held that appellants need not present a factually similar case in order to show that their constitutional rights were clearly established. *Harris v. Roderick,* 126 F.3d 1189, 1204 (9th Cir. 1997), (*citing* Anderson v. Creighton, 483 U.S. 635, 639 (1987)). Thus, binding precedent is not required specifically to show that a TMP with a conflict of interest creates an infraction of constitutional proportions. Taken together, all of the above-cited cases establish the right to conflict-free representation in a TEFRA proceeding. The Second Circuit recently opined that a TMP with a debilitating conflict of interest may present a constitutional claim for deprivation of due process. *Transpac Drilling Venture 1982-12 v. Commissioner*, 147 F. 3d 221 (2d Cir. 1998). Defendants argued below that *Transpac* is not instructive because a court of law has not found Hoyt to have a conflict of interest. Their argument is of no avail, because defendants themselves conceded that Hoyt had a "profound conflict of interest." CR 3, ¶¶ 28-32, 39 & Ex. 2 at 9.[2]

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[2] Additionally, the bankruptcy court rulings cited by defendants that purport to bind certain partners to Hoyt's actions as TMP do not establish as a matter of fact that Jay Hoyt had no conflict of interest. CR 22, p. 6. Those courts did not have

4. *First Amendment Right of Access to Courts Was Knowingly Abridged.*

The District Court ruling that the First Amendment does not encompass appellants' claims cuts too narrow a swath from the "cloth" of expressive rights embodied in the First Amendment. CR 30, p. 7. This is not a case like the *WMX* case cited by the court where claimants were simply applying for a municipal use permit. *WMX Technologies, Inc. v. Miller*, 197 F.3d 367 (9th Cir. 1999). Rather this case involves appellants' attempt to secure meaningful access to courts to hear their partnership tax claims. It is recognized that the First Amendment protects vigorous advocacy against governmental intrusion. *Thomas v. Collins*, 323 U.S. 516, 537 (1945); *NAACP v. Button*, 371 U.S. 415, 429 (1963). The right of access to courts is an aspect of the right to petition. *Bill Johnson's Restaurants, Inc. v. NLRB*, 461 U.S. 731, 741 (1983); *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972).

The appellants claim that their right of access to the courts was effectively impeded by defendants. As described above, defendants' conduct obviated appellants' meaningful opportunity to be heard by reason of their exploitation of

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evidence of the IRS internal memoranda conceding the conflict, along with other evidence of conflict alleged in the instant case. Also, those rulings were limited to a determination whether the criminal investigation alone created the conflict of interest. *See, e.g.*, *In re Miller*, 174 B.P. 791 (BAP 1994), *aff'd*, 81 F.3d 169 (9th Cir. 1996).

Hoyt's conflict of interest and their efforts to discourage appellants from seeking court review of their case.

A. There Exists No Alternative Remedy Which Would Counsel Hesitation In Holding Government Defendants Responsible For Violation Of Appellants' Constitutional Rights.

The remedy of damages against government officials for violation of constitutional rights is not generally permitted if a statutory mechanism for meaningful alternative remedies exist. *Schweiker v. Chilicky*, 487 U.S. 412 (1988); *Le Bid v. Hanson*, 894 F.2d 1124 (9th Cir. 1990). Appellants do not argue that the statutory mechanism for partnership audits does not, in and of itself, provide an adequate remedy to challenge impermissible government exaction. However, defendants' purposeful conduct obviated the statutory remedies available to appellants. Appellants were deprived of any alternative remedies accorded them by the Internal Revenue Code. And, any additional alternative remedies that defendants suggest are now available, such as an opportunity to vacate the Tax Court decision or sue for collection damages under the Internal Revenue Code, are inadequate.

1. Wages v. IRS is Inapposite Because Statutory Remedies Were Purposefully Impaired and Defendants Have No Alternative Remedies.

The defendants cite to non-TEFRA cases, namely *Wages v. IRS* and its progeny, for the proposition that the Internal Revenue Code offers appellants their

exclusive and sufficient remedy to challenge the assessment and collection of taxes. *Wages v. IRS*, 915 F.2d 1230 (9th Cir. 1990). Indeed, in non-TEFRA cases, the deficiency procedures of 26 U.S.C. §§ 6211-6216 and the refund procedure of 26 U.S.C. § 7422 may provide an adequate opportunity for aggrieved taxpayers to be heard. Appellants do not complain that the statutory remedy of a refund suit or deficiency proceeding are constitutionally inadequate. Rather, that those remedies are unavailable under TEFRA. Further, the only statutory remedy accorded them under TEFRA for review of their case was purposefully impeded and obviated by defendants. These seminal facts set this

case apart from the *Wages* case relied upon by the District Court in holding that alternative remedies in tax cases preclude a *Bivens* action. CR 30, pp. 6-7.

In *Wages*, a pro se taxpayer complained that she was forced to quit her job when the IRS garnished her wages. She complained that the IRS collection action, along with the audit of her tax returns for ten years, resulted in the deprivation of her 1st, 4th, 5th, 7th, 8th, 9th and 14th amendment rights. 915 F.2d at 1230. The taxpayer in *Wages* did not allege specific, identifiable actions by the federal defendants connected with the articulated right to be free from those actions; and certainly, the *Wages* plaintiff alleged no facts akin to those plead by appellants in this case. Without further elaboration, the court stated that prior decisions had not

clearly established any of the constitutional rights alleged, whatever they were. 915 F.2d at 1235. More to the point, the *Wages* court relied on the taxpayers' right to a refund suit to preclude the *Bivens* action and stated:

> [Moreover], even were we to find that some sort of constitutional right is at stake here...the remedies provided by Congress, particularly the right to sue the government for a refund of taxes...foreclose a damage action under Bivens in this situation.

915 F.2d at 1235.

Thus, the predicate to a conclusion that a *Bivens* claim is precluded, is a finding that the remedies provided by Congress through the Internal Revenue Code are adequate. Those remedies are adequate where the taxpayer has the opportunity to pay the taxes and sue for refund (post-deprivation hearing), or challenge the proposed adjustments in Tax Court (pre-deprivation hearing). Neither remedy is available to appellants.

Under TEFRA, refund suits and deficiency proceedings are inapplicable and unavailable. The partnership audit rules, enacted in 1981, provide that the tax treatment of partnership items of income, gain, loss, deduction, and credit would be determined in a unified partnership proceeding, rather than in separate administrative and judicial proceedings for each partner. H.R. Conf. Rep. No. 97-760, at 599 (1982); 26 U.S.C. §§ 6221-6234. Under the partnership audit rules, a designated and qualified partner, the TMP, acts as the liaison between the

IRS and the partnership to facilitate the audit and judicial review of the partnership case. 26 U.S.C. §§ 6223(g) & 6231(a)(7). TEFRA contemplates that the partners will receive notice and a full and fair opportunity to be heard through the TMP, who owes a fiduciary duty to the partners. *Computer Programs Lambda, Ltd. v. Commissioner*, 89 T.C. 198 (1987); 26 U.S.C. § 6223(g). Once the partnership level proceedings are complete, the Internal Revenue Service may assess tax against a partner without issuing a Notice of Deficiency by making "computational adjustments" attributable to the partnership items. 26 U.S.C. §§ 6229, 6230(a)(1) & 6231(a)(6). At this stage, a partner may only file a claim for refund on the ground that the IRS erroneously computed the computational adjustments. The partner cannot challenge the substantive basis for the adjustment; the treatment of partnership items under any settlement agreement or resolution through the TMP is conclusive and not subject to substantive review. 26 U.S.C. §§ 6230(c)(1), (c)(4) & 7422(h). Contrary to the remedies available to the *Wages* plaintiff, here there is no right to later sue for refund. 26 U.S.C. § 7422(h).

Thus, if a partner is to be accorded a meaningful opportunity to be heard, it must occur in the pre-deprivation TEFRA audit and review process. And significantly, if that opportunity is impeded, TEFRA still binds the partner to the outcome. 26 U.S.C. § 6230(f). TEFRA does not permit appellants to avoid the

outcome of a partnership proceeding even if their TMP may have breached his fiduciary duties to them. *Kaplan v. United States*, 133 F.3d 469 (7th Cir. 1998) (the question of whether the TMP lacked authority to extend the statute of limitations cannot be addressed at the partner level and must be raised in the partnership proceeding). In appellants' partnership proceeding, Hoyt did not raise the issue of his legal capacity to extend the statute of limitations or otherwise represent their interests, because it was obviously contrary to his own interests given that he was trying to cover up his fraud. CR 3, ¶¶ 42-51, 67-73, 81, 116, 121, 123 & 125. Similarly, defendants' concealment of evidence of Hoyt's conflict of interest prevented appellants from raising the issue themselves at the partnership proceeding. In addition, defendants' and Hoyt's concealment of his fraud from the partners prevented them from raising timely claims in the partnership proceedings for loss of their investment through fraud. They are now precluded from raising those claims in tax years that have already been finally determined pursuant to the TEFRA proceedings.

As a result, the TEFRA process as applied in the instant case resulted in abridgement of appellants' due process rights. They were precluded from a meaningful voice in the single proceeding granted them and are statutorily precluded from any meaningful opportunity to challenge the government's tax adjustments. Where facts show that a taxpayer's rights to statutory remedies are

impaired by defendants' conduct or activities, then those statutory remedies are insufficient as a matter of law. *Phillips v. Commissioner*, 283 U.S. 589, 597 (1931); *Nelson v. Silverman*, 888 F. Supp. 1041 (SD Cal. 1995) (post-deprivation hearings in tax collection are sufficient, as long as there is no evidence in the record to suggest that Plaintiff's rights to post-collection remedies were impaired). It is well recognized that an otherwise constitutional process, as applied in a particular case, can violate a taxpayer's constitutional due process rights. *Boddie v. Connecticut,* 401 U.S. 371, 378 (1971).

2. *The Damage Provisions of 26 U.S.C. § 7433 Are Unavailable*.

Defendants mischaracterize this *Bivens* action as a collection suit and argue that the collection damage provisions of the Internal Revenue Code provide alternative remedies for these wrongful collection actions. CR 12, pp. 6-7, *citing* 26 U.S.C. § 7433; CR 22, p. 7. The wrongful conduct in this case was not limited to collection action. An action for damages under 26 U.S.C. § 7433 is limited to redress for actions "in connection" with the collection of a federal tax. There is no collection action involved in defendants' procurement of concessions of partner and partnership tax adjustments by exploiting Hoyt's conflict of interest. Further, defendants' unlawful collection actions in the instant case were part of a plan to coerce appellants to give up administrative and judicial rights of review by targeting "active" partners with 100% of the assessment of partnership late-filing

penalties. CR 3, ¶¶ 146-160. Appellants' remedy under 26 U.S.C. § 7433 would be simply to return the late filing penalties wrongfully collected. Selective audits and collection cannot be redressed by return of the monies, but instead posit a constitutional claim. *Usher v. City of Los Angeles*, 828 F.2d 556, 562 (9th Cir. 1987); *Foxman v. Renison*, 625 F.2d 429 (2nd Cir. 1980).

3. Motion To Vacate Tax Court Decision is Unavailable.

Defendants suggest also that the partners can vacate the Tax Court decision that they believe was fraudulently acquired. CR 22, pp. 6-7. Appellants' opportunity to reopen a final Tax Court Decision is narrowly circumscribed to essentially proving fraud on the court, and disposition of the motion is wholly within the discretion of the Tax Court. *Abatti v. Commissioner*, 859 F.2d 115 (9th Cir. 1988). Appellants were prevented from making a timely motion to vacate, because defendants and Hoyt concealed the grounds for the motion from the appellants. And, their motion to file their motion to vacate out of time was denied by the U.S. Tax Court. *Shorthorn Genetic Engineering 1982-2, Ltd., et. al. v. Commissioner,* Docket Nos. 22003-89 to 28577-90 (Order dated 10 January 2001) (this is not part of the record below as it was decided later, but is a matter of public record).

4. The Alternative Remedies Are Inadequate In Any Event.

Even if an action for collection damages or vacation of judgment were

available to appellants in this case, the remedies are constitutionally inadequate. The adequacy of any purported alternative remedy must be considered. *Logan v. Zimmerman*, 455 U.S. 422 (1982). In *Logan*, the court found that a claimant had a Due Process right not to have his access to an adjudicatory procedure impeded. The court ruled that an independent tort action for damages due to unlawful termination of employment was a constitutionally unsatisfactory remedy for such deprivation, because reinstatement was not an available remedy through the tort action. *Logan*, 455 U.S. at 1157-58. Similarly, the purported alternative remedies in this case do not redress the harm suffered by these appellants due to defendants depriving them of their Due Process right to a full and fair hearing. The remedies suggested by defendants fail to compensate appellants for the interest accruals on their tax liability, during the period they were unable to discover the fraud or conflict, lost opportunity costs, and mental anguish resulting from the defendants' wrongful conduct. *Rutherford v. United States*, 702 F.2d 580 (5th Cir. 1983) (*Bivens* damages cognizable because the statutory mechanisms for refund make no allowance for mental anguish or recovery of legal fees needlessly expended). Moreover, the remedies are presumed inadequate where the conduct of the government official impairs the pre-deprivation remedies. *Phillips v. Commissioner*, 283 U.S. at 597; *Harlow v. Fitzgerald*, 457 U.S. 800 (1982) (in situations involving an abuse of office, a *Bivens* action for damages may offer the

only realistic avenue for vindication of constitutional guarantees).

VI. CONCLUSION

Defendants are not immune from a damages suit under *Bivens*, and there is no alternative to this action that redresses the harm suffered by appellants from the abuse of their constitutional rights in the audit of their partnerships.

Dated: ____________ Respectfully submitted,

____
Wendy S. Pearson
Attorney for Plaintiffs-Appellants

STATEMENT OF RELATED CASES

Statement of Related Cases

Pursuant to Ninth Circuit Rule 28-2.6 Appellant's counsel states that there are no pending related cases.

CERTIFICATE OF COMPLIANCE PURSUANT TO
FED. R. AP.32(A)(7)(C) AND CIRCUIT RULE 32-1
FOR CASE NUMBER 02-35599

I certify that:

____X______ 1. Pursuant to Fed. R. App. P..32(a)(7)(C) and Circuit Rule 32-1, the attached Appellant Opening Brief is

________X____ (a) Proportionately spaced, has a type face of 14 points or more and contains less than 14,000 words.

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Dated:____________

____
Wendy S. Pearson
Attorney for Plaintiffs-Appellants

CERTIFICATE OF SERVICE

This is to certify that (2) copies of the Opening Brief Fc has been made on counsel for the appellees; and (1) copy of Plaintiffs/Appellants by mailing thereof on _____________ i addressed as follows:

ANTHONY SHEEHAN
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Dated:_____________

____
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Attorney for Plaintiffs-Appellants