FILED

OCT - 1 2003

CLERK, U.S. DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,

Plaintiff,

No. CIV S-03-1531 DFL GGH

vs.

JAMES O. MOLEN and SANDRA L. MOLEN, d/b/a TOUCH OF CLASS FLORIST,

Defendants.

/

ORDER and FINDINGS & RECOMMENDATIONS

Introduction and Summary

The United States has brought this action against defendants[1] to obtain injunctive relief on account of defendants alleged failure to comply with the tax laws of the United States, inter alia, failing to withhold appropriate taxes from employees' pay, failure to make their own appropriate employer tax payments, and to file appropriate paper work regarding taxes that all

[1] Defendants believe the form of their names to be very significant to the outcome of this motion; that is, defendants demand that dashes and colons be utilized in their names, and the male defendant disclaims use of his last name, "Molen." The court does not share defendants' viewpoint on this matter, and is persuaded that no matter how called, the persons appearing before the undersigned on September 11, 2003 were in fact the defendants in the above captioned case. The court will simply utilize the term defendants, and this terms includes the defendants as named, as well as James-Orbin: and Sandra-Lyn:Molen, and any other combinations of punctuation marks used with such names.

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employers routinely do file. The United States seeks a preliminary injunction to compel defendants to pay all back taxes owed as well as orders to comply with all applicable provisions of tax laws. The United States has disavowed use of the ordinary IRS administrative remedies such as levy because "[l]ike Sisyphus with his boulder, absent an injunction the IRS will have to spend considerable resources in a never-ending cycle of preparing substitute returns, assessing taxes, and attempting to collect taxes through levies...."

This motion involves the request of the United States for a preliminary injunction compelling the ultimate relief requested pending final adjudication. After consideration of the unopposed motion,[2] the undersigned recommends that a preliminary injunction be entered as set forth below.

With respect to the Clerk's entry of default docketed on September 26, 2003, said entry of default is vacated as defendants' filing of September 11, 2003 ("Of the Specific Negative Averment by the Affidavit of One...") may have been perceived by defendants as their answer. Defendants will be given one more opportunity to answer in conformance with Fed. R. Civ. P. 8(b) (the answering party must specifically admit or deny the allegations in the complaint as well as raise affirmative defenses).

Facts

As defendants have not opposed the Motion for Preliminary Injunction on its merits, the court finds the facts as set forth by the United States.

> James O. and Sandra L. Molen are the sole proprietors of Touch of Class Florist. Although they have about four employees to whom they pay wages, the Molens have not withheld federal taxes from their wages, made federal employment tax deposits, or paid federal unemployment taxes since 1999. The last complete Employer's Quarterly Federal Tax Return (IRS Form 941) they filed was for the fourth quarter of 1999; the last Employer's Annual FUTA Tax Return (IRA Form 940) they filed was for 1999, and the last Forms W-2 they filed were for the year 1999.

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[2] Defendants appeared but offered no argument or evidence whatsoever on the merits of the motion.

The Molens announced to the IRS their intention to stop withholding and paying federal employment and unemployment taxes in a letter dated August 3, 2000. They explained that based on their patently frivolous misinterpretation of I.R.C. § 861, they did not consider the compensation they paid to their employees to be wages or gross income. The Molens summarized their position, known as the § 861 argument, to the IRS as follows:

> [T]he definition of gross income in the 16th Amendment and . . . [I.R.C. §] 61 both reveal that income must derived from a 'source.' . . . The U.S. Congress set forth a section of law at . . . [I.R.C.§] 861 to deal with the term 'source'. . . [T]he regulations for section 861 apply for the determination of income that is taxable for the purposes of the income tax. ...In light of the fact that Touch of Class Florist has no evidence that any of its vendors or suppliers were living abroad for the years 1997, 1998, 1999 ... and none of the remuneration was involved in any U.S. island possession, then Touch of Class Florist hereby claims that no gross income as paid, as defined by the Rules of the Secretary of the Treasury.

The Molens further argued that the compensation they paid their employees was not "wages," because "these individuals' remuneration [was] paid to them while living in the United States."

The Molens instructed their employees, in a letter dated January 31, 2001, "DO NOT REPORT any of your actual income from the Company [Touch of Class Florist] when filing your tax returns." They told their employees in this letter that because they are a "U.S. domestic employer hiring U.S. Citizens, all wages paid are exempt from Federal income taxes ... [and] State income taxes" as well as Social Security and Medicare taxes. The Molens advised their employees that if "the IRS, State, or Social Security tries to make a determination that you owe a tax on the income from the Company, rest assured that it is a fraudulent attempt." For the 2000, 2001, and 2002 tax years, the Molens have issued their employees IRS Forms W-2, Wage and Tax Statements, reporting that they paid their employees $0.

Not only did the Molens stop withholding and paying over employment and unemployment taxes, they sought to recover the taxes they had paid in 1997, 1998, and 1999. They filed IRS Forms 941c, Supporting Statement to Correct Information, changing the gross wages that they had previously reported for 1997 through 1999 to $0. They also filed IRS Forms 843, Claim for Refund and Request for Abatement, seeking refunds of federal employment and unemployment taxes for 1997 through 1999. The IRS erroneously refunded the Molens $30,698.03 for employment

> and unemployment taxes for 1997 through 1999.
>
> The Molens' failure to obey the tax laws causes injury to the United States Treasury. By refusing to withhold taxes from their employees' wages, refusing to pay over employment taxes to the IRS, and falsely claiming entitlement to a refund, the Molens have cost the United States an estimated $100,927.63 in lost revenue, excluding penalties and interest, as of June 30, 2003. For each new quarter in which they continue to flout the tax laws they cause an additional estimated loss exceeding $5,700 in federal income and FICA taxes, every year results in additional loss exceeding $3,700 in FUTA taxes. Recovering this lost revenue may prove impossible as the Molens' liabilities surpass their ability to pay, and because the IRS has limited resources available to determine and collect taxes.

Discussion

Save for one traditional injunctive relief criteria (irreparable harm), which will be discussed at length below, the court has no trouble with finding the traditional injunctive relief factors, success on the merits and balance of hardships, in favor of the United States. See Southwest Voter Registration Project et al. v. Shelley, __F.3d__, _____(9th Cir. 2003) (en banc) setting forth the traditional injunctive relief factors. Those factors are *unopposed* by defendants. Although the issue of irreparable harm is also unopposed, the court has more difficulty with this factor in that the United States concedes that it has available remedies at law, albeit remedies which the government would rather not utilize in this case.

Normally, a concession that adequate remedies at law remain to the party seeking an injunction would sound the death knell of any injunctive relief request, especially in a tax case. Sokolow v. United States, 169 F.3d 663, 665 (9th Cir. 1998). However, the United States relies on 26 U.S.C. 7402(a):

> The district courts of the United States at the instance of the United States shall have such jurisdiction to make and issue in civil actions, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws.

The undersigned acknowledges that the language: "The remedies hereby provided are in addition to and not exclusive of any an all other remedies of the United States," provides a strong indication that Congress was deleting the traditional irreparable harm criteria from injunctive relief actions brought by the United States. If an adequate remedy at law was sufficient to deny an injunction to the United States in tax matters, the quoted language would be rendered superfluous—and that is not something to be done lightly. On the other hand, one could validly question whether an injunction to collect tax monies is so encompassed by specific statutes and regulations that such an injunction would be "necessary or appropriate for the enforcement of internal revenue laws."

The court cannot find any authorized use of § 7402(a) in a published case ordering the payment of past due tax monies. The United States has submitted an ordered preliminary injunction (the form of which it prepared) in United States v. Thompson, CIV-S-03-1532 FCD GGH, which did so. Seminal cases with explained reasoning which have utilized § 7402(a) are ones such as: United States v. Ernst and Whinney, 735 F.2d 1296, 1300 (11th Cir. 1984) (district court had power to enjoin unlawful "tax adviser" services under § 7402(a), but also holding that traditional equitable principles are also at play in ultimate decision to issue injunction). Ernst determined:

> In addition to factual disputes that must be resolved, the decision to issue an injunction under § 7402(a) is governed by the traditional factors shaping the district court's use of the equitable remedy.

Ernst, 735 F.2d at 1301

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> Foremost among the principles governing the use of the injunctive remedy is the traditional requirement "that courts of equity should not act ... when the moving party has an adequate remedy at law and will not suffer irreparable injury if denied equitable relief." Younger v. Harris, 401 U.S. 37, 43-44, 91 S.Ct. 746, 750, 27 L.Ed.2d 669 (1971); O'Hair v. Hill, 641 F.2d 307, 310 (5th Cir.1981). In determining whether the IRS is entitled to an injunction in this case, it will be necessary for the district court to examine the extent to which its interests are protected by available legal remedies.

Ernst, 735 F.2d at 1301 (n.11).

Collection of past due tax monies, as the United States concedes, is encompassed by specific remedial statutes which govern the usual procedures to collect such monies. See e.g., 26 U.S.C. §§ 6201et seq. (assessments), 6321 et seq. (liens), 6330 et seq. (levy), 6751 (penalties). However, this case is one of those extraordinary cases in which the usual methods of collecting monies is not adequate. First, from their non-opposition on the merits, and the groundless arguments made on irrelevant technicalities, it appears to the court that defendants' main concern is simply to obstruct efforts of the IRS to perform its job and collect lawful revenue, rather than to litigate any bona fide tax law contention. Relegating the government to its usual remedies would simply feed into this plan in that obstruction would continue not only for past debts owed, but also future ones. Each year's levy or assessment would be subject to stall tactics and the like until such time, as the United States points out, the monies owed would dwarf any ability to pay by defendants. Moreover, the ordinary taxpayer would be penalized by having to fund such obstructionist tactics vis-a-vis non-ending activity on defendants' cases by government employees. Finally, it is not only the individual tax owed by defendants themselves which is at issue. Defendants are setting up a situation where their employees may be penalized, temporarily or permanently, by defendants' failure to pay the employees' payroll taxes (including Social Security). See Declaration of Joseph F. Schiendl, Jr.; see also authorities cited at page 9 of the United States' moving papers: taxpayers must pay all of their federal tax regardless of the employer's failure to withhold, social security records will become confused, and unaware employees may fail to pay quarterly social security taxes due and the like). Constant omissions of payment by defendants over the years will result in an administrative snafus at the very least. In light of the above, the undersigned does not believe that the usual remedies are adequate.

Conclusion

Having found that the United States has shown that it will likely succeed on the merits, that defendants do not dispute that the balance of hardships tips squarely in favor of the

United States, and that the United States and third parties will suffer irreparable harm because the remedies at law are inadequate, therefore, the undersigned recommends that a preliminary injunction issue in the following form:

1. That defendants fully comply with the tax payment, withholding and reporting requirements set forth in 26 U.S.C. § § 3101, 3102, 3111, 3301, 3402, 6011 and 6041;

2. No actual *past* payment of taxes, interest and penalties allegedly due will be ordered paid in this preliminary injunction;

3. No security need be posted by the United States;

4. Defendants (individually and doing business as Touch of Class Florist or any other name or using any other entity), and their representatives, agents, servants, employees, attorneys, and those persons in active concert or participation with them, are enjoined from failing to withhold and pay over to the IRS all employment taxes, including federal income, FICA, and FUTA taxes, required by law.

5. Defendants shall file timely employment tax returns, including Forms 940 and 941, with the IRS, and file timely Forms W-2 with the Social Security Administration (SSA) and send copies of such returns and Forms W-2 to counsel for the United States at the same time that he files the originals.

6. Effective immediately, pending final adjudication of this action, within three days of each business payroll, defendants shall make employment tax deposits with their bank and send by fax to IRS Revenue officer Charles Delao at 530-343-2438, a receipt for each employment tax deposit;

7. Defendants shall amend and correct their Form 941 for all quarters of 2000-2003.

8. Defendants shall file with the SSA and issue to his employees amended Forms W-2 for 2000 and send copies of these Forms W-2 to counsel for the United States at the same time that he files the originals.

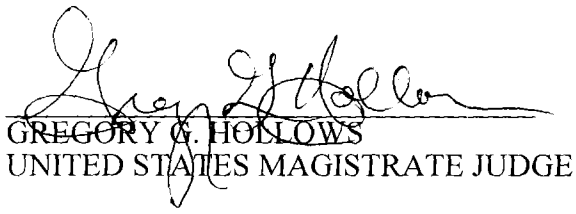
9. Defendants shall within ten days of the date of this Order deliver to all of his current employees, and any former employees employed at any time since January 1, 2000, a copy of this court's findings and preliminary injunction. Defendants shall bear all expenses associated with this mailing. He must file a sworn certificate of compliance, swearing that he has complied with this portion of the order, within twelve days of the date of this Order.

10. Defendants shall within ten days of the date of this Order post and keep posted in one or more conspicuous places on his business premises where notices to employees are customarily posted, a copy of this court's findings and preliminary injunction.

These findings and recommendations are submitted to the United States District Judge assigned to the case, pursuant to the provisions of 28 U.S.C. § 636(b)(l). Within twenty days after being served with these findings and recommendations, any party may file written objections with the court and serve a copy on all parties. Such a document should be captioned "Objections to Magistrate Judge's Findings and Recommendations." Any reply to the objections shall be served and filed within ten days after service of the objections. The parties are advised that failure to file objections within the specified time may waive the right to appeal the District Court's order. Martinez v. Ylst, 951 F.2d 1153 (9th Cir. 1991).

The court further ORDERS that the default entered against defendants is vacated and that defendants shall file an answer specifically admitting or denying the allegations of the complaint within ten days of the filed date of this order.

DATED: September 30, 2003.



GREGORY G. HOLLOWS
UNITED STATES MAGISTRATE JUDGE

GGH:gh:035
molen.pi

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United States District Court
for the
Eastern District of California
October 1, 2003

* * CERTIFICATE OF SERVICE * *

2:03-cv-01531

USA

v.

Molen

I, the undersigned, hereby certify that I am an employee in the Office of the Clerk, U.S. District Court, Eastern District of California.

That on October 1, 2003, I SERVED a true and correct copy(ies) of the attached, by placing said copy(ies) in a postage paid envelope addressed to the person(s) hereinafter listed, by depositing said envelope in the U.S. Mail, by placing said copy(ies) into an inter-office delivery receptacle located in the Clerk's office, or, pursuant to prior authorization by counsel, via facsimile.

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Jack L. Wagner, Clerk

by Deputy Clerk