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TAXATION—INCOME TAX—REFUND FOR OVERPAYMENT—EQUITABLE DEFENSE BY GOVERNMENT WHEN COLLECTION OF DEFICIENCY BARRED BY LIMITATIONS — Petitioner's deceased sold stock under an installment contract and made a large profit thereon. The deceased died in 1928. Under Sections 44 (d) and 113 of the Revenue Act of 1928 the executor made an underpayment for 1928, and overpayments for 1929, 1930, and 1931.¹ The amount of the 1928 deficiency exceeded the aggregate of the overpayments for the three subsequent years. Petitioner filed a claim for refund of the overpayments. The government was barred by limitations from recovering the tax deficiency for 1928. *Held*, the petitioner was entitled to recover the overpayments. The government could not assert the unpaid tax liability for 1928 tolled by the statute of limitations as an equitable defense in light of Sections 607 and 609 (a) of the Revenue Act of 1928, and there were no circumstances creating an estoppel against the taxpayer. *McEachern v. Rose*, 302 U. S. 56, 58 S. Ct. 84 (1937).

The problem involved in the above case is whether a taxpayer can recover taxes erroneously paid in a subsequent year or years if he has previously made an underpayment and the government is barred by limitations from collecting or assessing the deficiency due for the year of the underpayment. The right to a refund of taxes erroneously paid, while expressly provided for under the revenue laws, is deemed by the courts to be of an equitable nature, i. e., based on a theory of unjust enrichment of the government at the expense of the taxpayer, and therefore controlled by equitable principles extrinsic to the statute, provided that the statutory provisions do not expressly or impliedly negative the application of these equitable principles.² Thus, it is ordinarily an equitable defense to an action for refund of overpayments that the government is barred by limitations from collecting a deficiency for the year when the tax should have been paid. In such a case the court reasons that the taxpayer is not really damaged and there is no unjust enrichment for the government. This doctrine was applied in the recent case of *Stone v. White*.³ There testamentary trustees had paid from income a tax upon it which should have been paid by the beneficiary, and it

¹ Under Sections 44 (d) and 113 of the Revenue Act of 1928 (45 Stat. L. 791) the capital gain representing the difference between the market value of the unpaid installments at the time of decedent's death and the unrecovered cost was income taxable to decedent's estate for the year of his death, 1928. In the determination of income tax liability on installments paid subsequent to decedent's death, taxable gain was to be ascertained by taking the difference between the amount of the installment and the properly allocated amount of the market value of the remaining installments at the time of decedent's death. Petitioner did not follow this procedure but instead did not pay the tax on the capital gain which was to have been paid in 1928 and continued to pay the income taxes on the installments paid in 1928, 1929, 1930, and 1931 by allocating to the installments for each of those years its share of the profit on the original contract, as measured by the difference between the contract price and the original cost to decedent, which is the way the income would have been taxed if decedent had not died.

² *Moses v. Macferlan*, 2 Burr. 1005, 97 Eng. Rep. 676 (1760); *J. W. Carter Music Co. v. Bass*, (D. C. Tex. 1927) 20 F. (2d) 390; *Hartwell Mills v. Rose*, (C. C. A. 5th, 1932) 61 F. (2d) 441.

³ 301 U. S. 532, 57 S. Ct. 851 (1937).

was held that the trustees were not equitably entitled to recover the tax after the statute had barred collection from the beneficiary. In the principal case, however, the court refused to allow the usual equitable defense on the ground that such a defense was negated by the intention of Congress as manifested in Sections 607 and 609 (a) of the 1928 Revenue Act. Section 607 provided that the payment of a tax against which the limitations period had run was to be considered an overpayment with a right in the taxpayer to a refund or credit from such overpayment. Section 609 (a) further provided that a tax liability tolled by the statute of limitations could not be used to offset a credit to the taxpayer's account.⁴ These provisions made it clear, as the court points out in its opinion, that Congress intended to require refunds to the taxpayer of an overpayment, even though he had failed to pay taxes for other periods, whenever their collection was barred by limitations. This intent would be defeated by permitting the usual equitable defense. The court distinguished *Stone v. White* on the ground that Sections 607 and 609 (a) did not by their terms apply to a situation where the taxpayer suing for the refund and the person whose unpaid tax liability tolled by the statute was asserted as an equitable defense were not the same persons. It is certainly conceivable that the policy expressed in Sections 607 and 609 (a) could have been extended by the court to cover the trustee-beneficiary case. Perhaps the real explanation of the court's failure to reach a contrary result in *Stone v. White* based on these sections is that the full implications of the sections were not adequately argued before or considered by the court until the principal case came before it. While the decision in the principal case based on the statute negatives an equitable defense arising simply out of the government's inability to collect a deficiency, it should not be assumed that this decision negatives the equitable defense of estoppel where the taxpayer suing for a refund has by his own conduct misled the government to its detriment in failing to assess a deficiency within the statutory period.⁵ In the principal case

⁴ Revenue Act of 1928, 45 Stat. L. 804, §§ 607, 609 (a).

⁵ *Stearns v. United States*, 291 U. S. 54, 54 S. Ct. 325 (1934), is usually cited by the federal courts as the leading case on the doctrine of estoppel. In this case there was in effect a request by the taxpayer to delay the assessment of a particular tax and in recognizing this request the government's claim finally became barred by limitations. In its opinion the Court relied heavily on the request, saying (291 U. S. at 59), "There was here more than a waiver, an abandonment of a privilege to insist upon the fulfillment of a condition; there was a positive request, which till revoked upon reasonable notice had the effect of an estoppel." In all the cases cited by the *Stearns* case there was a written waiver of some sort [*Imperator Realty Co. v. Tull*, 228 N. Y. 447, 127 N. E. 263 (1920); *Stange v. United States*, 282 U. S. 270, 51 S. Ct. 145 (1930); *Randon v. Tobey*, 11 How. (52 U. S.) 493, 13 L. Ed. 784 (1850); and *Florsheim Bros. Co. v. United States*, 280 U. S. 453, 50 S. Ct. 215 (1929)], although the *Stearns* case has been used by later courts to find an estoppel even though there was no written waiver. For example, see *Bothwell v. Commissioner of Internal Revenue*, (C. C. A. 10th, 1935) 77 F. (2d) 35, where the act of the taxpayer on which the court based the estoppel was an error in reporting the income as capital gain and it was held that the taxpayer could not now claim that the income was compensation for services. Also see *Shamrock v. Commissioner of Internal Revenue*, (C. C. A. 5th, 1935) 77 F. (2d) 553, where a consolidated association which had dealt with the

there was no factual basis for estoppel inasmuch as the government's failure to assess the appropriate tax for 1928 was not shown to be attributable to the erroneous statements made in the return for the later years, and since it was not necessary for the petitioner to prove underpayment in 1928 in order to prove overpayments in subsequent years.

government for several years on the assumption that it was the taxpayer was estopped to assert it was not the true taxpayer when there were limitations on the government's claim against the real taxpayer for unpaid taxes. For other citations, see opinion of the Circuit Court of Appeals in *Rose v. McEachern*, (C. C. A. 5th, 1936) 86 F. (2d) 231.

In a number of cases referred to in this note the court used "equitable defense" and "estoppel" interchangeably as though they were the same thing. It is obvious, in the light of the principal case, that the distinction between these two defenses has become important.