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Federal Procedure-Jurisdiction of District Court to Grant Declaratory Judgement to Nontaxpayer Whose Property Has Been Seized by District Director of Internal Revenue

Philip B. Bass
University of Michigan Law School

FEDERAL PROCEDURE—JURISDICTION OF DISTRICT COURT TO GRANT DECLARATORY JUDGMENT TO NONTAXPAYER WHOSE PROPERTY HAS BEEN SEIZED BY DISTRICT DIRECTOR OF INTERNAL REVENUE—Personal property of plaintiff, a delinquent taxpayer, was seized and sold by defendant district director of internal revenue. Defendant contended that the seized property actually belonged to plaintiff's corporation, which also was delinquent in its taxes; he planned to apply the proceeds of the sale of the property against the corporation's tax liability. Plaintiff sued in federal district court for a declaratory judgment that the property belonged to him, not the corporation, and that the proceeds should be applied against his own tax liability. Plaintiff and defendant were citizens of the same state. Plaintiff sought to base federal jurisdiction either on section 1340 of the Federal Judicial Code,[1] which grants judisdiction over all causes of action "arising under any Act of Congress providing for internal revenue," or on section 2463 of the Judicial Code,[2] which grants jurisdiction over property "taken or detained under any revenue law of the United States." The district court dismissed the complaint for lack of jurisdiction[3] on the ground that the Federal Declaratory Judgment Act does not permit the granting of declaratory relief in "controversies with respect to Federal Taxes."[4] On appeal, *held*, reversed. Plaintiff did not bring this action as a taxpayer qua taxpayer, but as a nontaxpayer seeking to prevent the application of his property against the tax liability of another, and the scope of the jurisdic-

1 "The district courts shall have original jurisdiction of any civil action arising under any Act of Congress providing for internal revenue . . . ." 28 U.S.C. § 1340 (1958).

2 "All property taken or detained under any revenue law of the United States shall not be repleviable, but shall be deemed to be in the custody of the law and subject only to the orders and decrees of the courts of the United States having jurisdiction thereof." 28 U.S.C. § 2463 (1958); *In re* Fassett, 142 U.S. 479 (1892).

3 Bullock v. Lathan, 198 F. Supp. 627 (W.D.N.Y. 1960).

4 "In a case of actual controversy within its jurisdiction, *except with respect to Federal taxes*, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought . . . ." 28 U.S.C. § 2201 (1958). (Emphasis added.)

tion conferred on the district courts by section 1340 and section 2463 of the Judicial Code exceeds the scope of the jurisdiction which the Declaratory Judgment Act withdraws from the district courts in matters involving federal taxes. *Bullock v. Latham*, 306 F.2d 45 (2d Cir. 1962).

The grant of jurisdiction under sections 1340 and 2463 is indeed broad. By section 1340 Congress has granted to the district courts original jurisdiction of "any civil action arising under any Act of Congress providing for internal revenue."[5] The scope of this grant is not limited by any requirement of a minimum amount in controversy[6] or diversity of citizenship.[7] Moreover, section 1340 confers on the district courts jurisdiction of suits by nontaxpayers to quiet title[8] to property which has been seized by the district director,[9] and of nontaxpayers' claims for money judgments.[10]

The federal courts have supplemented the scope of the district court's jurisdiction under section 1340 in a series of decisions construing the jurisdictional aspects of section 2463.[11] In *In re Fassett*[12] the Supreme Court held that the section of the Revised Statutes from which the present section 2463 was derived[13] conferred on the federal district courts jurisdiction of controversies concerning property seized by any person pursuant to "any revenue law of the United States." The holding of this case has been extended in several lower federal court decisions.[14] Government seizure or detention of the plaintiff's property, however, is a condition precedent to a court's exercise of section 2463 jurisdiction.[15] Thus the scope of jurisdiction under section 2463 is somewhat narrower than that under section 1340.

The exercise of district court jurisdiction under these two sections, however, has been sharply curtailed. A longstanding policy of the federal government has been to prohibit the taxpayer from challenging the assessment or collection of a federal tax until he has paid it.[16] Before 1867, the federal courts consistently refused to take jurisdiction of a claim for injunc-

5 28 U.S.C. § 1340 (1958), quoted note 1 *supra*.

6 Accardo v. Fontenot, 269 Fed. 447 (D. La. 1920), *aff'd*, 278 Fed. 871 (5th Cir. 1922).

7 City of Philadephia v. Collector, 72 U.S. (5 Wall.) 720 (1866).

8 28 U.S.C. § 2410(a) (1958) permits quiet title suits to be brought against the United States. It differs from the Declaratory Judgment Act in that it contains no exception with respect to actions involving federal taxes.

9 United States v. Coson, 286 F.2d 453 (9th Cir. 1961).

10 Szerlip v. Marcelle, 136 F. Supp. 862 (E.D.N.Y. 1955) (section 1340 available to nontaxpayers where recovery sought is monetary, not proprietary).

11 See New Hampshire Fire Ins. Co. v. Scanlon, 362 U.S. 404 (1960); De Lima v. Bidwell, 182 U.S. 1, 179-80 (1901); *In re* Fassett, 142 U.S. 479 (1892); Long v. Rasmussen, 281 Fed. 236 (D. Mont. 1922); Treat v. Staples, 24 Fed. Cas. 161 (No. 14162) (C.C.D. Me. 1870).

12 142 U.S. 479 (1892).

13 REV. STAT. § 934 (1875).

14 See Seattle Ass'n of Credit Men v. United States, 240 F.2d 906 (9th Cir. 1957) (action to quiet title); Raffaele v. Granger, 196 F.2d 620 (3d Cir. 1952) (action to quash warrant of distraint issued pursuant to tax laws); Goldman v. American Dealers Serv., 135 F.2d 398 (2d Cir. 1943) (action to recover property seized by postal authorities).

15 *Cf.* Rutledge v. Riddell, 186 F. Supp. 552 (S.D. Cal. 1960).

16 See Gorovitz, *Federal Tax Injunctions and the Standard Nut Cases*, 10 TAXES 446 (1932); 45 HARV. L. REV. 1221 (1932).

tive relief against the district director where the tax was not patently illegal and where there were no extraordinary circumstances which would invoke traditional equity jurisdiction.[17] Since 1867, Congress has expressly prohibited the granting of injunctive relief which might restrict or restrain the assessment or collection of a federal tax.[18] Nevertheless, under the provisions of the Declaratory Judgment Act as originally enacted, taxpayers could legally employ the declaratory judgment as a device for contesting the validity of a federal tax in federal district court.[19] Consequently, within a few months of the original enactment, the act was amended to withdraw the declaratory judgment as a remedy in controversies involving federal taxes.[20] By the amendment Congress apparently sought to reconcile the Declaratory Judgment Act with the traditional policy of protecting the efficient collection and assessment of taxes.[21] It seems to have been accepted that this provision placed the availability of declaratory relief to taxpayers on a par with that of injunctive relief.[22]

The problem before the court in the principal case was that of reconciling the contradiction in statutory provisions arising from the confrontation of sections 1340 and 2463 with the prohibition against the granting of injunctions (hereinafter referred to as the "Prohibition") and the amendment to the Declaratory Judgment Act (hereinafter the "Amendment"). In order for a claimant to establish section 1340 jurisdiction, he must allege a controversy arising under an "Act of Congress providing for internal revenue." Yet such an allegation appears to classify the action as a controversy "with respect to federal taxes" within the meaning of the language of the Amendment. Or, should an injunction be demanded and granted, it would seem to impose on the collection of the revenue a restraint forbidden by the Prohibition. The court appears to have little choice but to dismiss the complaint for lack of jurisdiction to grant the relief sought. Similarly, should the complaint assert section 2463 jurisdiction, it must allege a taking or detention under a revenue law of the United States. Yet, if the complaint also prayed for either declaratory or injunctive relief, this allegation would also bring the action within the category seemingly barred by the Amendment and the Prohibition. It was this reasoning which prompted the trial court in the principal case to dismiss the complaint.[23]

The acceptance of the foregoing argument, however, requires that one ignore an established judicial exception to the Amendment and to the

17 See Gorovitz, *supra* note 16, at 447.

18 Revenue Act of 1867, c. 169, § 10, 14 Stat. 475, as amended, INT. REV. CODE OF 1954, § 7421(a).

19 *E.g.*, Penn v. Glenn, 10 F. Supp. 483 (W.D. Ky. 1935).

20 49 Stat. 1027 (1935), 28 U.S.C. § 2201 (1958), quoted note 4 *supra.*

21 See Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293 (1943); S. REP. No. 1240, 74th Cong., 1st Sess. 11 (1934). See generally BORCHARD, DECLARATORY JUDGMENTS 850 (2d ed. 1941).

22 See Tomlinson v. Smith, 128 F.2d 808 (7th Cir. 1942).

23 Bullock v. Lathan, 198 F. Supp. 627 (W.D.N.Y. 1960).

Prohibition.[24] This exception provides that neither the Amendment nor the Prohibition bars a nontaxpayer's suit to restrain the district director from seizing his property to satisfy the tax liability of another.[25] Although the courts which have considered the problem are in almost unanimous agreement in their acceptance of this conclusion, the decisions reveal that they do not agree as to the rationale which best justifies the exception. One group of cases[26] rests its decisions on the holding of *Miller v. Standard Nut Margarine*.[27] In that case the Supreme Court held that the statutory Prohibition against the granting of injunctions was merely a codification of the common law existing prior to its enactment: an injunction might be granted where the seizure was patently illegal and extraordinary circumstances warranting equity jurisdiction were present.[28] This reasoning has not yet been applied in justification of a similar exception to the Amendment to the Declaratory Judgment Act. Nevertheless, because the Amendment was intended to accommodate the declaratory judgment to previous congressional policy, it seems only logical that, in defining the scope of the Amendment, the courts should refer to the case law delimiting the scope of the Prohibition.[29]

A second group of cases[30] rests the same conclusion on the rationale of *Long v. Rasmussen*.[31] The reasoning of the court in that case was that revenue laws apply only to taxpayers, not to nontaxpayers, and that therefore the Prohibition, which is basically a revenue law, does not apply to a nontaxpayer. The court is thus free to take jurisdiction under section 2463.[32] By analogy to this reasoning, nontaxpayers have also been permitted to seek declaratory judgments.[33] The problem with the *Long* reasoning,

24 *E.g.*, Shelton v. Gill, 202 F.2d 503 (4th Cir. 1953) (granting an injunction); Pettengill v. United States, 205 F. Supp. 10 (D. Vt. 1962) (granting a declaratory judgment).

25 "It is well settled that when property belonging to *A* is levied upon to satisfy the tax obligation of *B*, *A* is not without remedy but may seek redress in the federal courts." Fine Fashions, Inc. v. Moe, 172 F. Supp. 547, 549 (S.D.N.Y. 1959).

26 Botta v. Scanlon, 288 F.2d 504 (2d Cir. 1961); Holland v. Nix, 214 F.2d 317 (5th Cir. 1954); Shelton v. Gill, 202 F.2d 503 (4th Cir. 1953).

27 284 U.S. 498 (1932).

28 See Gorovitz, *supra* note 16, at 448; 45 HARV. L. REV. 1221, 1225 (1932). The holding of *Miller v. Standard Nut Margarine* has been given a number of interpretations, varying from restricting it to the facts of the case to reading it as permitting review of any tax resulting in harsh consequences to determine if the tax is in fact illegal. See Communist Party v. Moysey, 141 F. Supp. 332 (S.D.N.Y. 1956). In the recent case of Enochs v. Williams Packing & Nav. Co., 370 U.S. 1 (1962), the Supreme Court endeavored to obviate the difficulty, holding that the collection of federal taxes may be enjoined only if, under the most liberal view of law and fact, the tax is clearly illegal and if equity jurisdiction otherwise exists. See generally 30 GEO. WASH. L. REV. 758 (1962); 61 MICH. L. REV. 405 (1962).

29 See BORCHARD, *op. cit. supra* note 21, at 855.

30 See Raffaele v. Granger, 196 F.2d 620 (3d Cir. 1952); Tomlinson v. Smith, 128 F.2d 808 (7th Cir. 1942); *cf.* Adler v. Nicholas, 166 F.2d 674 (10th Cir. 1948).

31 281 Fed. 236 (D. Mont. 1922).

32 142 U.S. 479 (1892). See text following note 12 *supra*.

33 Tomlinson v. Smith, 128 F.2d 808 (7th Cir. 1942); Filipowicz v. Rothensies, 31 F. Supp. 716 (E.D. Pa. 1940).

of course, is this: if it is true that revenue laws do not apply to nontaxpayers, how can the court then rationalize the taking of jurisdiction under section 2463, which requires that the plaintiff's property have been seized or detained pursuant to a revenue law, for the revenue officer's seizure of the nontaxpayer's property was outside the ambit of any authority conferred on the officer by a revenue law?[34]

The court of appeals in the principal case took a third approach. It noted that under section 1340 and section 2463 the district court has broad powers to hear suits which involve the federal tax laws, and that under the *Miller* and *Long* arguments the Amendment and the Prohibition have been construed as not barring nontaxpayer claims for declaratory or injunctive relief. The court concluded that the scope of the jurisdiction conferred by either section 1340 or section 2463 must therefore simply exceed the scope of that taken away by either the Amendment or the Prohibition.

Thus the court in the principal case rejected the questionable *Long* theory, yet based its holding on the conclusion which had theretofore been reached by the courts employing the *Long* and *Miller* theories. This suggests that the supposedly different rationales of *Miller* and *Long*[35] are in fact no more than two different explanations for what is fundamentally a single determination. The first, that of *Miller*, rests on the premise that the Prohibition was not intended to bar suits to restrain the district director where the tax is patently illegal and where a refusal to grant the relief sought would result in unusually harsh consequences.[36] Similarly, the court in the principal case was admittedly balancing the competing arguments for and against the conclusion that Congress could not have intended to bar the court from taking jurisdiction over such a claim. The second rationale, that of *Long*, apparently rests on the broad principle that, by definition, nontaxpayers are excluded from the scope of revenue laws, including the Prohibition and the Amendment. Superficially, the *Long* court was taking a definitional approach. However, the court made no attempt to trace the historical development of any definition which would exclude nontaxpayers from the scope of the Amendment and the Prohibition. Instead, the court merely concluded that such a nontaxpayer's claim is sufficiently concerned with the tax laws to warrant the court's taking

[34] Long v. Rasmussen, 281 Fed. 236, 237 (D. Mont. 1922); see Raffaele v. Granger, 196 F.2d 620, 622, 623 (3d Cir. 1952).

[35] *Cf.* Fine Fashions, Inc. v. Moe, 172 F. Supp. 547 (S.D.N.Y. 1959); Szerlip v. Marcelle, 136 F. Supp. 862 (E.D.N.Y. 1955).

[36] The test for determining the intended breadth of the statute under Enochs v. Williams Packing & Nav. Co., 370 U.S. 1 (1962), would be to determine whether the tax is patently illegal and whether equity jurisdiction otherwise exists. See 61 MICH. L. REV. 405 (1962). The conclusion that equity jurisdiction exists for such nontaxpayer claims would seemingly turn on the view that no other form of relief is made available for the nontaxpayer. *Cf.* Adler v. Nicholas, 166 F.2d 674 (10th Cir. 1948). The illegality of such an exaction would stem from the allegation that the district director had seized property belonging to *A* to satisfy the tax liability of *B*. *Cf.* Shelton v. Gill, 202 F.2d 503 (4th Cir. 1953).

jurisdiction under section 2463, yet also sufficiently removed from the tax laws to fall outside the scope of the Prohibition and the Amendment. This form of reasoning is basically the same balancing approach employed by the court in *Miller*. Both holdings must rest on the assumption that the Prohibition and the Amendment were not intended to bar all claims which have some points of contact with "federal taxes" and which may result in restraining the revenue collection process. Further, both conclusions are undoubtedly prompted by the belief that no specific statutory provisions have been made available under the tax laws for remedying such a harm to a nontaxpayer.[37] Under either theory, therefore, the court is making the same determination: that of defining the intended scope of the Prohibition or the Amendment by judicially balancing, in light of the probable legislative intent, the competing arguments for and against the taking of jurisdiction. A realization of the fundamental unity of these two theories and of the inconsistency in the reasoning by the court in *Long* is necessary because, in all but one of the cases where, as in the principal case, the claimant has been unable to acquire diversity jurisdiction and must rely on either section 1340 or section 2463, the courts have taken jurisdiction under section 2463 pursuant to the reasoning of *Long*.[38] Once it is understood that the argument of the court in *Long* on the one hand stands for the same balancing determination used by the court in *Miller*, and on the other is at best an unpersuasive explanation for the conclusion reached, the prevalent use of section 2463 jurisdiction in order to employ the *Long* rationale becomes unnecessary. In holding that the district court may also take jurisdiction of the nontaxpayer's suit under section 1340, the court in the principal case has fashioned a foothold for a more effective use of the declaratory judgment for the resolution of difficulties between the nontaxpayer and the district director. The declaratory judgment was intended to provide a device by which the parties to a controversy might have their differences settled at an early stage in the dispute, prior to the commission by either party of an act harmful to the other.[39] However, if section 2463 were the only basis for taking jurisdiction, a plaintiff would not be permitted to bring suit until his property had actually been seized or detained. But, by taking jurisdiction under section 1340, the court can permit a nontaxpayer to bring suit for a declaratory judgment before the actual seizure of his property. Thus the fact that the court took jurisdiction of such claims under the less conditioned grant of jurisdiction in section 1340 is entirely consistent with the purpose of the declaratory judgment.

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37 *Cf.* Adler v. Nicholas, *supra* note 36.

38 See Raffaele v. Granger, 196 F.2d 620 (3d Cir. 1952); Rothensies v. Ullman, 110 F.2d 590 (3d Cir. 1940) (both taking jurisdiction under § 2463). *But see* Pettengill v. United States, 205 F. Supp. 10 (D. Vt. 1962) (taking jurisdiction under § 1340).

39 See BORCHARD, *op. cit. supra* note 21, at 277-313.