

Michigan Law Review

Volume 59 | Issue 1

1960

Taxation - Federal Income Tax- Full Payment a Prerequisite to Refund Suit

Stuart S. Gunckel
University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Jurisdiction Commons](#), [Taxation-Federal Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Stuart S. Gunckel, *Taxation - Federal Income Tax- Full Payment a Prerequisite to Refund Suit*, 59 MICH. L. REV. 141 (1960).

Available at: <https://repository.law.umich.edu/mlr/vol59/iss1/28>

This Recent Important Decisions is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

TAXATION — FEDERAL INCOME TAX — FULL PAYMENT A PREREQUISITE TO REFUND SUIT — A tax deficiency of \$28,908.60 including interest was levied by the Commissioner of Internal Revenue against the petitioner for a single

tax year. Petitioner paid \$5,058.54 but later filed a claim for refund¹ which was disallowed by the Commissioner. On suit by petitioner in a United States district court for the refund,² the court held the petitioner was not entitled to the refund because the claimed losses were actually capital in nature.³ The Court of Appeals for the Tenth Circuit reversed and dismissed the complaint on the ground that the district court could not have jurisdiction until there had been full payment of the assessed deficiency.⁴ On certiorari to the United States Supreme Court, *held*, affirmed, one justice dissenting.⁵ On rehearing,⁶ *held*, affirmed, four justices dissenting.⁷ Congress has erected a comprehensive structure of tax procedure premised upon the general understanding that full payment was a prerequisite to a refund; to rule otherwise now would produce disharmony within this structure and would obstruct tax collection. *Flora v. United States*, 362 U.S. 145 (1960).

Whether full payment of an assessed deficiency is required before a district court has jurisdiction of a refund suit is dependent upon the construction of the controlling jurisdictional statute. This statute states:

"The district courts shall have original jurisdiction . . . of . . . any civil action against the United States for the recovery of any *internal-revenue tax* alleged to have been erroneously . . . collected, or any *penalty* claimed to have been collected without authority or any *sum* alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws. . . ."⁸

Since no penalty was involved here, the questions raised are whether "tax" refers only to the full amount assessed and whether the meaning of "any sum" precludes the argument that the payment of part of the assessed tax could be regarded as the payment of "any sum."⁹

¹ Filing such a claim is a prerequisite to suit. INT. REV. CODE OF 1954, §7422 (a).

² Suit was brought pursuant to 28 U.S.C. §1346 (a) (1) (1958).

³ *Flora v. United States*, 142 F. Supp. 602 (D.C. Wyo. 1956).

⁴ *Flora v. United States*, 246 F.2d 929 (10th Cir. 1957).

⁵ *Flora v. United States*, 357 U.S. 63 (1958).

⁶ The rehearing was granted in *Flora v. United States*, 360 U.S. 922 (1959).

⁷ Justices Whittaker, Frankfurter, Harlan and Stewart dissented. They argued, *inter alia*, that enough cases had allowed a refund suit without questioning the fact of partial payment to preclude a finding of general understanding that full payment was required, and that allowing partial payment would not produce significant disharmony within the present collection system.

⁸ 28 U.S.C. §1346 (a) (1) (1958). (Emphasis added.)

⁹ The majority believed that "any sum" referred to amounts, such as interest, which were neither taxes nor penalty. The lower federal courts were split on this question. Full payment was not required in some district court cases brought at a time when the unpaid assessment could be concurrently litigated before the Board of Tax Appeals. *Brampton Woolen Co. v. Field*, 55 F.2d 325 (D.C. N.H. 1931) (ultimately decided in the government's favor on another jurisdictional ground); *Emery v. United States*, 27 F.2d 992 (W.D. Pa. 1928); *Old Colony R.R. v. United States*, 27 F.2d 994 (D.C. Mass. 1928). Full payment was expressly not required in *Bushmiaer v. United States*, 230 F.2d 146 (8th Cir. 1956); *Hanchett v. Shaughnessy*, 126 F. Supp. 769 (N.D. N.Y. 1954); *Sirian Lamp Co. v. Manning*, 123 F.2d 776 (3d Cir. 1941); *Coates v. United States*, 111 F.2d 609 (2d Cir. 1940). Full payment was required in *Rogers v. United States*, 155 F. Supp. 409 (E.D. N.Y. 1957); *Suhr v. United States*, 18 F.2d 81 (3d Cir. 1927).

This phraseology first appeared not in a jurisdictional provision but in a statute of limitation¹⁰ concerned with the time for the initiation of a refund suit against the collector. The meaning of the disputed language is not illuminated by committee reports, for there were none at that time, nor by the congressional debates.¹¹ Thus, in the absence of any persuasive judicial interpretation¹² contemporary with its enactment, it was reasonable for the Court in interpreting this language to give weight to the fact that Congress had subsequently erected a comprehensive tax collection procedure which apparently assumed that full payment was required in order to obtain jurisdiction in a district court. For example, the primary motivation for the creation of the Board of Tax Appeals appears to have been the desire to relieve a taxpayer of the hardships which resulted from requiring full payment before permitting litigation of the correctness of the assessment.¹³ Furthermore, the Declaratory Judgment Act was amended to exclude tax disputes in order to preserve the principle of "pay first and litigate later."¹⁴ To allow part payment would, in effect, permit the taxpayer to circumvent this exclusion by paying \$5.00 on a \$1,000.00 assessment and then litigating the assessment in a district court.

In addition to wishing to prohibit part payment when it was apparent that later legislators intended a requirement of full payment, the Court was also of the view that to allow part payment now would disrupt the efficient operation of existing tax laws.¹⁵ It was feared that permitting partial payment might force widespread exercise of the discretionary power of distraint¹⁶ to collect the tax assessed and that the public indignation resulting from subjection to this treatment might operate to destroy the present

¹⁰ 17 Stat. 257 (1872).

¹¹ For reference to the complete congressional debates on the bill encompassing this provision, see *CONG. GLOBE*, 42d Cong., 2d Sess. at lvi, cxcii (1872) (bill H.R. 2322).

¹² The Court did argue that dictum in *Cheatham v. United States*, 92 U.S. 85 (1875)—a case involving a refund suit against the collector initiated under the 1866 claim for refund requirement, 14 Stat. 152, which required suit to be brought within six to twelve months after the claim arose—constituted authoritative interpretation of the disputed language. However, it was after that suit was begun, though before decision, that the statute of limitations was passed which initiated this disputed language. This latter statute provided a two-year limitation. *Supra* note 10. This dictum relied upon describes the tax procedures at that time, but it indicates no cognizance of the change in limitation; indeed, the dictum alludes to an "appeal," which was the terminology for the six to twelve months limitations.

¹³ 43 Stat. 336 (1924). See H.R. REP. NO. 179, 68th Cong., 1st Sess. 7 (1924); S. REP. NO. 398, 68th Cong., 1st Sess. 8 (1924); 65 CONG. REC. 2621, 2689, 8110 (1924); 67 CONG. REC. 525, 1144, 3529, 3755 (1925-1926). There is also some suggestion that this tribunal was created to obviate the anti-injunction provision now found in INT. REV. CODE OF 1954, §7421. See principal case at 158.

¹⁴ 48 Stat. 955 (1934), amended by 49 Stat. 1027 (1935), as amended, 28 U.S.C. §§2201, 2202 (1958). See S. REP. NO. 1240, 74th Cong., 1st Sess. 11 (1935); principal case at 164.

¹⁵ Principal case at 160, 176.

¹⁶ INT. REV. CODE OF 1954, §6331 provides for the seizure and sale of taxpayer's property for failure to pay the tax within ten days of notice and demand. This power is not available during Tax Court litigation. See note 18 *infra*.

practice of voluntary payment and assessment.¹⁷ On the other hand, it was argued by the dissent that any delay in payment resulting from part payment suits should not necessitate exercise of the distraint power, for there is also delay in collection when the taxpayer litigates in the Tax Court.¹⁸ While this will remain a speculative issue, it should be noted that there would probably be more delay with a district court disposition due to clogged dockets.¹⁹ Moreover, a multiplication of such delay would be likely because the allowance of partial payment suits might induce many taxpayers to litigate in the district courts in order to take advantage not only of the longer limitation period applicable to refund suits²⁰ but also of what many practitioners apparently believe to be the more favorable treatment afforded taxpayers in the district courts.²¹ While such delay might not be enough to force the exercise of the distraint power, it would at least contribute to lesser efficiency in tax collection. Also, part payment could necessitate making an investigation in each case in order to decide whether the financial condition and integrity of the particular taxpayer made it advisable to exercise the power of distraint. Thus, more man-hours might be required to collect the same amount of tax dollars.

The only significant positive argument in favor of permitting part payment is premised upon the belief that a full payment requirement will work hardships on some taxpayers.²² Nevertheless, in view of the mani-

¹⁷ Principal case at 176.

¹⁸ Principal case at 194. INT. REV. CODE OF 1954, §6213 (a) prevents assessments or collections until the Tax Court reaches a final decision and any appeals are final. The total amount of refund suits pending as of June 30, 1959, was \$500,619,000; as of the same date the Tax Court had before it, not subject to immediate collection, \$810,057,000 in tax deficiencies, \$108,515,000 in penalties and \$640,664,000 in overpayments. 1959 COMM'R. INT. REV. ANN. REP. 128, 130, tables 17, 20.

¹⁹ It appears that in the more congested centers, at least, the district court is a slower tribunal than the Tax Court. Emmanuel, *Federal Tax Refund Procedure*, 5 FLA. L. REV. 133, 136 (1952).

²⁰ In refund suits, INT. REV. CODE OF 1954, §6511 (a) provides a limitation on filing the claim for refund of 3 years from the time the return was due, or 2 years from the time the tax was paid, whichever is greater; this is followed by a two-year statute of limitation on suit in the district court. INT. REV. CODE OF 1954, §6532 (a) (1). In comparison, following the notice of deficiency, the taxpayer has only 90 days within which to bring suit in the Tax Court. INT. REV. CODE OF 1954, §6213 (a).

²¹ See Dockery, *Refund Suits in District Courts*, 31 TAXES 523 (1953).

²² See "Morrison Lecture" of Dean Griswold, Mass. L.Q., Oct. 1958, pp. 98, 109; also 3 RABKIN AND JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION §72.04(6) (1956). Full payment can produce hardships for the taxpayer who, through ignorance of the consequences, does not file suit before the Tax Court in time and who does not have the resources to make full payment. There are also hardships for taxpayers who are not able to determine within 90 days if they will have enough assets to cover the assessment when the assets are liquidated, or the taxpayer who chooses to sue for refund and starts liquidating only to find, more than 90 days later, that his assets are not marketable or that the market value is substantially less than anticipated. One answer to these hardships is that they could have been avoided by going to the Tax Court and that when he elects to sue for a refund these are the risks which he knowingly undertakes. Full payment also creates hardships for those taxpayers who do not have recourse to the Tax Court and so must pay the full assessment if they ever wish to challenge the correctness and legality of the

festated congressional intent, the additional administrative problems, and the absence of persuasive proof of widespread, substantial hardships incident to full payment, the Court's decision is a reasonable one. However, this decision does indicate that it is time for Congress to consider in depth and detail the extent of hardship caused by requiring full payment and to ponder whether some statutory relief is appropriate.

Stuart S. Gunckel

¹ CAL. UNEMP. INS. CODE §1262 states: "An individual is not eligible for unemployment compensation benefits, and no such benefits shall be payable to him, if he left his work because of a trade dispute."