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TAXATION - FEDERAL INCOME TAX - CHOICE OF REMEDIES-TAX COURT OR DISTRICT COURT

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TAXATION — FEDERAL INCOME TAX — CHOICE OF REMEDIES — TAX COURT OR DISTRICT COURT—Plaintiff, in 1935, purported to set up a trust of $300,000 for the benefit of her infant daughter; and thereafter in 1936 paid the gift tax thereon.[1] She then borrowed from the trustees (herself and husband) $298,000 of the trust corpus. In 1938 she paid $35,760 interest to the trustees and attempted to deduct it as an expense. This deduction was disallowed and the plaintiff then filed in the Tax Court a petition for redetermination on the ground that the gift tax of 1936 had been erroneously paid and should now be allowed as a credit against the assessed deficiency which arose because the commissioner had denied deductibility of the alleged interest payment. The Tax Court held that it lacked jurisdiction to allow the erroneous tax payment as a credit.[2] Thereafter, the plaintiff paid the deficiency and brought suit in the federal district court to recover it. The district court held for the defendant.[3] On appeal, *held*, affirmed. *Elbert v. Johnson*, (C.C.A. 2d, 1947) 164 F. (2d) 421.[4]

The court held that under the provisions of section 322(c) of the Internal Revenue Code, recourse to the Tax Court after the taxpayer has been notified of a deficiency precluded resort to the district court. Section 322(c) had its genesis in section 284 (d) of the Revenue Act of 1926 [5] which was intended to give finality to decisions of the Board of Tax Appeals,[6] and to prohibit all suits for refunds if the taxpayer had previously petitioned the board.[7] The constitutionality of such a provision is not open to serious question, for inasmuch as the United States cannot be sued without its consent,[8] Congress has the power to prescribe the methods by which refunds and credits shall be made, and also to limit the right to sue for collection of taxes erroneously paid.[9] The courts have consistently held that this subsection gives the taxpayer two alternatives:

[1] In another proceeding involving the wife's income tax for 1936, the board held that the trust was not a real gift for income tax purposes; that the trust was a sham and that interest paid on the "loan" was not deductible as an expense. Elbert v. Commissioner, 45 B.T.A. 685 (1941).

[2] 2 T.C. 892 (1943).

[3] Elbert v. Johnson, (D.C. N.Y. 1946) 69 F. Supp. 59.

[4] Judge L. Hand concurred only in the result. It is quite likely that if the plaintiff had been in a better position to assert an equity, Judge Hand would have allowed recovery on the theory of the equitable recoupment doctrine of Bull v. United States, 295 U.S. 247, 55 S.Ct. 695 (1935), noted in 10 ST. JOHNS L. REV. 142 (1945).

[5] I.R.C., § 322 (c): "Effect of petition to board. If the commissioner has mailed to the taxpayer a notice of deficiency . . . and if the taxpayer files a petition with the Board of Tax Appeals within the time prescribed in such subsection, . . . no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court. . . ." There are several exceptions, none of which affect the case at bar.

[6] Section 284 (d), Revenue Act of 1926, H.R. 1, Public No. 20, 69th Cong., 1st sess., c. 27, 44 Stat. L. 9 (1926).

[7] ". . . Finality is the end sought to be obtained by these provisions of the bill, and the committee is convinced that to allow the reopening of the question of the tax for the year involved . . . would be highly undesirable." S. Rep. No. 52, 69th Cong., 1st sess., p. 26 (1926). Also see discussion by Senator Reed of Pennsylvania in 67 CONG. REC. 3528-3529 (1926).

[8] United States v. Sherwood, 312 U.S. 584, 61 S.Ct. 767 (1941).

[9] 10 MERTENS, LAW OF FEDERAL INCOME TAXATION 343, §58.44 (1943). But

(1) he may petition the Board of Tax Appeals before paying the tax, or (2) he may pay the tax and apply to the commissioner for a refund or credit, and if that is not allowed, he may bring suit in the federal district court to recover the overpayment. But if he elects the first alternative he is absolutely barred from recourse to the second.[10] This result is not based on a theory of res adjudicata; rather section 322 (c) of the code operates as a statute of limitations [11] which in effect ousts the jurisdiction of the district courts.[12] Thus it is immaterial why the board dismissed the appeal or whether or not a particular issue was litigated.[13] In view of the explicit statutory language and the apparent intent of Congress the result reached in the principal case seems sound.

Samuel N. Greenspoon, S. Ed.

see Graham & Foster v. Goodcell, 282 U.S. 409, 51 S.Ct. 186 (1931), where the court implied that withdrawal of the right to sue for overpayments would subject the collector to personal liability.

[10] 10 MERTENS, LAW OF FEDERAL INCOME TAXATION 345, 346, § 58.45 (1943) and cases collected.

[11] Merrill v. United States, (C.C.A. 2d, 1945) 152 F. (2d) 74.

[12] Brooks v. Driscoll, (C.C.A. 3d, 1940) 114 F. (2d) 426. But see Ohio Steel Foundry v. United States, 69 Ct. Cl. 158, 38 F. (2d) 144 (1930) to the effect that prior suit in the Court of Claims followed by notice of deficiency and appeal to the board does not oust the jurisdiction of the court.

[13] Worm v. Harrison, (C.C.A., 7th, 1938) 98 F. (2d) 977; Moir v. United States, (C.C.A. 1st, 1945) 149 F. (2d) 455; Bankers' Reserve Life Co. v. United States, (Ct. Cl. 1930) 44 F. (2d) 1000; Rubel Corp. v. Rasquin, (C.C.A. 2d, 1943) 132 F. (2d) 640; Continental Petroleum Co. v. United States, (C.C.A. 10th, 1936) 87 F. (2d) 91, cert. den., 300 U.S. 679, 57 S.Ct. 670 (1937).