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Taxation-Federal Income Tax-Enjoining Collection

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TAXATION—FEDERAL INCOME TAX—ENJOINING COLLECTION—Taxpayer sued to enjoin collection of federal insurance contributions and unemployment taxes[1] with respect to certain fishermen who worked on boats operated by the corporate taxpayer. The Government contended that under the Internal Revenue Code an injunction could not be sustained on a showing of non-liability.[2] The district court issued the injunction on the grounds that the tax was illegal because no employer-employee relationship in fact existed and that collection of the tax would ruin the corporation financially.[3] The court of appeals affirmed, holding that a taxpayer may enjoin the collection of a federal tax when he shows its illegality plus special and extraordinary circumstances.[4] On certiorari to the United States Supreme

1 INT. REV. CODE OF 1954, §§ 3121, 3306. A portion of the taxes were claimed to be owing under the earlier Int. Rev. Code of 1939, ch. 9, §§ 1426, 1607, 53 Stat. 177, 187.

2 INT. REV. CODE OF 1954, § 7421(a). "[N]o suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court." See Gouge v. Hart, 250 Fed. 802 (W.D. Va. 1917) (restraining used in the broad sense of hindering or obstructing); Calkins v. Smietanka, 240 Fed. 138 (N.D. Ill. 1917) (assessment includes preliminary investigation).

3 Williams Packing & Nav. Co. v. Enochs, 176 F. Supp. 168 (S.D. Miss. 1959).

4 Enochs v. Williams Packing & Nav. Co., 291 F.2d 402 (5th Cir. 1961). The decision of the court was based on Miller v. Nut Margarine Co., 284 U.S. 498, 509 (1932), where it was stated, "[I]n cases where complainant shows in addition to the illegality of an

Court, *held,* reversed. The collection of federal taxes may be enjoined only when under the most liberal view of law and fact the Government cannot establish its claim at the time of suit, and equity jurisdiction otherwise exists. *Enochs v. Williams Packing & Nav. Co.,* 370 U.S. 1 (1962).

Congress, in 1867, absolutely prohibited suits restraining the collection or assessment of taxes in language virtually identical to the present prohibition.[5] The ban against enjoining federal taxes has been justified on the theory that the judiciary and the taxpayer should not be able to impede the collection of the Government's revenue.[6] However, since the inception of the prohibition taxpayers, with the aid of the courts, have been tenacious and frequently successful in claiming injunctive relief. The federal courts began their gradual emasculation of the injunction-prohibiting statute within three years after its original enactment. In *Pullan v. Kinsinger,*[7] a case in which an injunction probably would not have been allowed at common law,[8] the court declared that the prohibition was merely a restatement of the common law, calling it "wholly unnecessary,"[9] and further stated that it would not apply when the tax was a "nullity." The court did not define "nullity," but its intent clearly was to preserve some judicial discretion despite the clear congressional prohibition. Other courts, accepting the "nullity" exception, defined it in terms of the assessor lacking jurisdiction when the subject matter was clearly not taxable or, alternately, as a situation in which by no legal possibility could a valid tax be assessed.[10] One court submitted hypothetically that a distilling tax assessed on one obviously not in the distilling business would be a "nullity."[11] In circumventing the prohibition by means of the "nullity" exception, emphasis was placed on the impropriety of the tax and no mention was made of the possible effect of any special circumstances, such as financial ruin

exaction in the guise of a tax there exist special and extraordinary circumstances to bring the case within some acknowledged head of equity jurisprudence, a suit may be maintained to enjoin the collector."

5 Revenue Act of 1867, ch. 169, § 10, 14 Stat. 475, as amended, REV. STAT. § 3224 (1875).

6 See Snyder v. Marks, 109 U.S. 189 (1883); Cadwalader v. Sturgess, 297 Fed. 73 (3d Cir. 1924). The statutory means of litigation are intended to be a complete system of corrective justice.

7 20 Fed. Cas. 44 (No. 11463) (C.C.S.D. Ohio 1870).

8 The collection of both federal taxes, before the prohibition statute was enacted, and state taxes could be enjoined under the common law. See Raymond v. Chicago Traction Co., 207 U.S. 20, 39 (1907); Shelton v. Platt, 139 U.S. 591 (1891); Dows v. City of Chicago, 78 U.S. 108 (1870); Cutting v. Gilbert, 6 Fed. Cas. 1079 (No. 3519) (C.C.S.D.N.Y. 1865); Magee v. Denton, 16 Fed. Cas. 382 (No. 8943) (C.C.N.D.N.Y. 1863) (dictum); Macklot v. Davenport, 17 Iowa 379 (1864); LeRoy v. East Saginaw City Ry., 18 Mich. 233 (1869).

9 Pullan v. Kinsinger, 20 Fed. Cas. 44, 48 (No. 11463) (C.C.S.D. Ohio 1870).

10 See Snyder v. Marks, 109 U.S. 189 (1883); Frayser v. Russell, 9 Fed. Cas. 728 (No. 5067) (C.C.E.D. Va. 1878); Kissinger v. Bean, 14 Fed. Cas. 689, 692 (No. 7853) (C.C.E.D. Wis. 1875); Delaware Ry. v. Prettyman, 7 Fed. Cas. 408, 409 (No. 3767) (C.C.D. Del. 1872).

11 Kissinger v. Bean, *supra* note 10.

which would be wrought by collection of the tax.[12] The Supreme Court tacitly recognized the "nullity" exception in a case where it first announced broadly that the word "tax" in the statutory prohibition included those taxes which were alleged to be erroneously or illegally assessed.[13] However, this statement was qualified to the extent that the statute was said to apply only where the Government had jurisdiction over the subject matter, citing all the earlier cases which had recognized the "nullity" exception. By means of this treatment the Court impliedly distinguished an illegal tax and a "nullity." The distinction was merely one of degree, an illegal tax being declared as such only after being judged on the merits, while a "nullity" related to a tax invalid on its face.

While this limited exception was being developed with regard to federal taxes, the continued impact of decisions holding inapplicable state prohibitions of tax collection injunctions solely upon the presence of special circumstances soon became evident.[14] In 1916 the Supreme Court, although denying an injunction, stated that "extraordinary and entirely exceptional circumstances," would make the prohibition inapplicable.[15] In 1932 the Court affirmed the enjoining of collection of an oleomargarine tax in *Miller v. Nut Margarine Co.*,[16] the leading decision on this subject prior to the principal case. The Court held that an injunction would be proper since the tax was illegal and there existed requisite special and extraordinary circumstances.[17] The Court described the tax in *Miller* as "illegal," though meaning no more than unlawful as applied to the particular taxpayer. Even in this limited sense, the word "illegal" is particularly unenlightening, since it is susceptible of several meanings, ranging from mathematically incorrect to something as restrictive as a situation involving obvious lack of jurisdiction. However, in finding "illegality" the Court considered the following factors which the taxpayer-manufacturer had relied on as indicia of nonliability: a recovery of taxes paid by a competitor making a similar product,[18] an injunction obtained by the competitor when his product was again taxed three year later,[19] and a ruling by the Commissioner that the taxpayer's product was not subject to the oleomargarine tax.[20] The special and extraordinary circumstance present in *Miller* was the financial ruin

12 *Cf.* Frayser v. Russell, 9 Fed. Cas. 728 (No. 5067) (C.C.E.D. Va. 1878). Here an injunction was granted, following the "nullity" exception, although that particular word was not used.

13 Snyder v. Marks, 189 U.S. 189 (1883).

14 See, *e.g.*, Raymond v. Chicago Traction Co., 207 U.S. 20, 39 (1907); Dows v. City of Chicago, 78 U.S. 108 (1870). See also Shelton v. Platt, 139 U.S. 591 (1891), where the court stated at 596: "Irreparable injury is the sole ground upon which jurisdiction in equity can be regarded as invoked in this case."

15 Dodge v. Osborn, 240 U.S. 118, 122 (1916).

16 284 U.S. 498 (1932). Petitioner made a cooking product containing no animal fat. The tax was assessed under Oleomargarine Act, ch. 784, §§ 1-7, 32 Stat. 193 (1902).

17 See note 4 *supra*.

18 Higgins Mfg. Co. v. Page, 297 Fed. 644 (D.R.I. 1924).

19 Higgins Mfg. Co. v. Page, 20 F.2d 948 (D.R.I. 1927).

20 III-1 CUM. BULL. 507 (1924).

which would result from collection of the assessed tax, since it is a general assumption that a business taxpayer cannot be restored to his former position by a successful refund suit after he has sacrificed business assets to obtain the necessary tax money. Thus, *Miller* required essentially two factors —illegality and special circumstances—to provide the basis for enjoining tax collection.

Subsequent to the *Miller* decision these two factors were not always judicially applied in a consistent manner. A fundamental split developed between those courts which interpreted the "illegality" requirement of that case in the traditional and restricted sense of a "nullity," and those which have more recently equated "illegal" with a tax for which the taxpayer, after a full consideration on the merits, is found to be not liable. The tax denominated as "illegal" in *Miller* seemed to be what courts had previously defined as a "nullity."[21] However, the differences in approach in interpreting "illegality" resulted in substantially variant applications of *Miller*. Courts which liberally chose to equate the "illegal" of *Miller* with any tax for which the taxpayer ultimately was found to be not liable quite naturally found a significantly greater number of such taxes than those which equated *Miller*'s "illegality" with the older "nullity" concept. The nature of the injunction suit, under the liberal approach, became essentially one to determine ultimate tax liability, quite different from the approach taken by other courts whose only concern was with whether the tax could by any legal possibility be valid.

Subsequent to *Miller* and prior to the principal case, the manner of viewing the "illegality" requirement largely determined the relative importance of the remaining requirement of "special and extraordinary circumstances." Since the courts which took the traditional view of "illegality" seldom found such a tax, this other requirement served as little more than a makeweight when such a tax was found.[22] Even so, the taxpayer could sometimes successfully claim illegality in these courts, either by showing that the tax was patently inapplicable, or by suggesting, as in *Miller*, that prior cases settled what may have been initially a close question. On the other hand, the courts which adopted the more liberal definition of "ille-

21 The Court intimated this when it stated that "a valid oleomargarine tax could by no legal possibility have been assessed against respondent . . . ." 284 U.S. at 510. Indeed, this is the very language used in previous cases to distinguish a merely erroneous tax from a "nullity." See, *e.g.*, Kissinger v. Bean, 14 Fed. Cas. 689 (No. 7853) (C.C.E.D. Wis. 1875).

22 See Arnold v. Cobb, 57-2 U.S. Tax Cas. ¶ 9711 (N.D. Ga.); Long v. United States, 148 F. Supp. 758 (S.D. Ala. 1957); Long v. Kelly, 100 F. Supp. 235 (M.D. Ala. 1951); Strang v. Maloney, 43-1 U.S. Tax Cas. ¶ 9294 (D.N.J.); Driscoll v. Jones, 19 F. Supp. 792 (N.D. Okla. 1937); *cf.* Burke v. Mingori, 128 F.2d 996 (10th Cir. 1942). *Contra*, Long v. Grey, 130 F. Supp. 194 (W.D. Ky. 1955). However, the "illegality requirement could be rigidly applied, as in one case where $500,000 in liens destroyed a taxpayer's business under a jeopardy assessment. The court held that the tax was "legal" since, admittedly, $1,700 was due. Melvin Bldg. Co. v. Long, 262 F.2d 920 (7th Cir. 1958). See also Mensik v. Long, 261 F.2d 45 (7th Cir. 1958), *reversing* 58-2 U.S. Tax. Cas. ¶ 9794 (N.D. Ill.).

gality" found the "special circumstance" requirement a more suitable device for restricting the issuance of injunctions.[23] Illustratively, one court following this approach conceded that the tax might be "illegal," thus evading trying the merits of the tax, but denied the injunction because of an absence of "special circumstances."[24] It characterized an allegation of loss of home, business and all worldly possessions as involving a mere hardship. Seemingly a disbelief in the claim of illegality colored the court's interpretation of "special circumstances." However, another court taking the liberal approach to "illegality" issued injunctions in two cases on the strength of "special circumstances" found in the destruction of the respective business and intangible business assets which would have resulted from the tax collection.[25]

In the principal case, the Supreme Court upheld the more restricted "nullity" interpretation of *Miller*, doing so carefully and without using the ambiguous term "illegal." The order granting an injunction was reversed when the Court found that under the most liberal view of law and fact the Government had some chance of prevailing.[26] The Court made it quite clear that a suit for injunctive relief in a district court is not to be utilized as a non-statutory method for trying the merits of a tax liability controversy. This rule seems just in those cases where the Code allows the diligent taxpayer to try his tax liability in the Tax Court prior to payment.[27] However, where the Code makes no provision for a Tax Court proceeding prior to payment, as in the principal case, legislative reform may be needed to relieve the taxpayer of the often damaging results of prior collection.

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23 In some recent cases, the courts have abandoned the "illegality" requirement, and have granted injunctions on the strength of the "special circumstances." These cases all involved a violation of the Internal Revenue Code in the process of collection. Although the cases themselves cited *Miller*, they could have rested on the ground that collection may be enjoined when proper procedure is not followed. The cases have not been cited as authority for generally abandoning the "illegality" requirement of *Miller*. See Smith v. Flin, 261 F.2d 781 (8th Cir. 1958), *modified per curiam*, 264 F.2d 523 (8th Cir. 1959); Yoke v. Mazzello, 202 F.2d 508 (4th Cir. 1953); Yoshimura v. Alsup, 167 F.2d 104 (9th Cir. 1948); Mrizek v. Long, 187 F. Supp. 830 (N.D. Ill. 1959).

24 Morton v. White, 174 F. Supp. 446 (E.D. Ill. 1959).

25 Midwest Haulers, Inc. v. Brady, 128 F.2d 496 (6th Cir. 1942). See also John M. Hirst & Co. v. Gentsch, 133 F.2d 247 (6th Cir. 1943). *But see* Martin v. Andrews, 238 F.2d 552 (9th Cir. 1956); Reams v. Vrooman-Fehn Printing Co., 140 F.2d 237 (6th Cir. 1944); Communist Party U.S.A. v. Moysey, 141 F. Supp. 332 (S.D.N.Y. 1956), all of which cast doubt on the allegation of business ruin as a special circumstance.

26 For a case where a court of appeals held the fishermen were not employees, see Gulf Coast Shrimpers & Oyster Ass'n v. United States, 236 F.2d 658 (5th Cir. 1956). This may be an unarticulated reason for that court calling the tax "illegal," even in the sense of the *Miller* definition.

27 The jurisdiction of the Tax Court has generally been limited by the Internal Revenue Code of 1954 and other statutes to three general types of taxes: income and profits taxes, estate taxes, and gift taxes. 9 MERTENS, LAW OF FEDERAL INCOME TAXATION § 50.08 (rev. ed. 1958). It appears that the Tax Court has never had jurisdiction over cases involving excise taxes. *Id.* at § 50.14.