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John H. Wahl Jr.

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THE ASSESSMENT AND COLLECTION OF FEDERAL INCOME TAXES

JOHN H. WAHL, JR.*

From November 1, 1898 to May 31, 1913 the Collector of Internal Revenue for the District of Florida was a Negro. His name was Joseph Lee and from all accounts he was a very competent public servant.

At that time the principal source of federal internal revenue in Florida was the excise tax upon the manufacture of cigars. Probably neither the salary of the office nor its importance made it an especially attractive plum of patronage—otherwise it is scarcely likely that in the deep South it would have been awarded to a colored man.

The fact is mentioned only because it rather effectively points up the tremendous increase in scope and importance of the functions of the Bureau of Internal Revenue. Today there is scarcely a citizen who is not rather substantially affected by its activities.¹

SCOPE OF DISCUSSION

The taxability of given transactions is not within the purview of this article. Its primary purpose is to discuss to some extent the mechanical procedures through which federal taxes are assessed and collected.

STRUCTURE OF INTERNAL REVENUE SERVICE

For a clearer understanding of the subject it seems not amiss to outline briefly, in the beginning, the field structure of the Internal Revenue Service. The term "field" relates to functions carried on outside the Bureau's headquarters at Washington.

The entire Internal Revenue Service is headed by the Commissioner of Internal Revenue who is appointed by the President.² In the field the Service

* The *Miami Law Quarterly* is privileged to present this basic and searching article on federal income tax procedure by an attorney who is thoroughly familiar with the federal tax structure. Mr. Wahl was with the United States Internal Revenue Service for seven years (1933-1940). A member of the Florida Bar, he is associated with the Miami law firm of Loftin, Anderson, Scott, McCarthy & Preston. On March 1, 1949, Mr. Wahl will become a member of the firm of Walton, Hubbard, Schroeder, Lantaff and Atkins of Miami.

1. It is rather interesting to note in passing, that this enormous growth has taken place more or less within the past 15 years. For the fiscal year ending June 30, 1933, federal taxes collected in Florida aggregated \$7,594,633.90. In fiscal 1937 collections had increased to \$35,760,297.79 and in the twelve months ending June 30, 1948 the "take" was \$392,217,125.55.

2. 53 STAT. 477, I.R.C. § 3900, 26 U.S.C.A. § 3900 (1946).

is divided into four principal branches. In the order of their usual appearance they are as follows:

- Collector of Internal Revenue and his deputies.
- Internal Revenue Agent in Charge and his agents.
- Intelligence Unit.
- Technical Staff.

The Collector's operations cover what is known as a Collection District, the territorial limits of which usually correspond to those of the particular state in which his office is located.³ The Collection District of Florida embraces the entire state. In New York, for example, there are multiple collection districts as is true in several other heavily populated states. The Collector's office in Florida is at Jacksonville, and he has zone offices located in the principal cities of the state.

The Collector, as his title implies, is primarily concerned with the collection of taxes and the reception of the returns upon which such taxes are reported.⁴ All returns are filed with his office and all taxes are paid to him. Generally speaking (and it should be understood that a subject of this scope must be rather general), the Collector does not interpret the tax laws. Primarily, he is charged with seeing that returns are filed by all persons required to do so; that taxes are paid and that on the basis of the facts recited on the returns the tax computations are mathematically correct. He does not examine the returns with an eye to their correctness in so far as proper accounting methods or conformity to the substantive tax laws are concerned.

This latter function rests initially upon the Internal Revenue Agent in Charge and his agents.⁵ They operate within the same Collection District as the Collector. Headquarters for Florida are in Jacksonville with local offices throughout the state. Because individual returns in the lower income brackets have been greatly simplified and deductions standardized, a relatively small percentage of them are referred to the agents for examination and verification. As a matter of fact, except for returns which, on their face, disclose complicated transactions, questionable treatment or more than substantial liability, the Collector's audit for mathematical correctness is the only examination given to the greater majority. The same generally is true of corporate and other forms of returns filed by various classes of taxpayers.⁶ Considering the vast quantity of returns filed, however, the exceptions to this general

3. 53 STAT. 445, I.R.C. § 3650, 26 U.S.C.A. § 3650 (1946).

4. 53 STAT. 399, I.R.C. § 3310, 26 U.S.C.A. 3310 (1946); 53 STAT. 446, I.R.C. § 3654, 26 U.S.C.A. 3654 (1946).

5. 53 STAT. 446, I.R.C. § 3654, 26 U.S.C.A. 3654 (1946).

6. As has been well advertised in the press, the Treasury Department has recently inaugurated a policy of rather carefully scrutinizing all returns filed by members of certain professional classes or particular types of business. For example, the medical profession has come in for rather extensive survey during recent years. Lawyers are rumored to be next on this list.

rule compose a considerable number; sufficient it might be said to keep the agents from three to five years behind most of the time.⁷

The agents first audit the returns by comparing their figures with the taxpayer's own books and records, and approve or reject the figures upon the basis of correct or improper accounting methods coupled with proper or incorrect treatment under the Code provisions relating to the particular transactions involved.

The Intelligence Unit is primarily concerned with fraud and evasion. Wherever such is suspected the Special Agents of that Unit move in. They operate in Divisions. These usually cover several collection districts, and headquarters of those in Florida are located in Atlanta. Special Agents are stationed at Jacksonville, Tampa, and Miami.

The fourth branch is the Technical Staff which likewise operates over several collection districts with local representatives. Its Division Headquarters are in Birmingham, and an office is maintained at Jacksonville. Its function is something in the nature of an appellate board to which a taxpayer may have his case referred in the event he and the Internal Revenue Agent in Charge cannot agree. This Staff is administrative and possesses no judicial powers. It does have authority to settle disputes by way of compromise, and its principal function is to reduce by such means the large number of cases which otherwise would be litigated. The Technical Staff was created in 1933 in a move to decentralize Bureau activities. Prior to that time negotiations with the Bureau at levels above the Internal Revenue Agent in Charge were conducted in Washington. Under decentralization the average taxpayer has little or no direct contact with the Bureau personnel at headquarters. It is extremely difficult to gain an audience there, and the exceptions are so rare as not to warrant discussion in this article.

These several branches, while integral parts of the same service, are, nevertheless, independent of each other, and none has authority to direct or control the activities or functions of the other.

Upon the foregoing general outline let us now proceed to follow the course of a typical tax case.

7. Generally speaking, a deficiency must be assessed or a proceeding in court for collection without assessment commenced within three years after the tax became due. (It may be made at any time where there is either a failure to file a return or the return as filed was false or fraudulent.) 53 STAT. 86, as amended, 54 STAT. § 1007, I.R.C. § 275 (1946); 53 STAT. 87, as amended, 59 STAT. 569, I.R.C. § 276, 26 U.S.C.A. §§ 275, 276 (1946). However, the taxpayer may waive this limitation and is frequently called upon to do so in order to avoid immediate assessment without opportunity for conference with the Internal Revenue Agent in Charge. 53 STAT. 87, as amended, 59 STAT. 569, I.R.C. § 276b, 26 U.S.C.A. § 276b (1946). Another exception to the three year limitation upon assessment exists in the case of a taxpayer who improperly omits from his reported gross income an amount in excess of 25% of the gross income stated in his return. In such case the period of limitation is five years. 53 STAT. 86, as amended, 54 STAT. § 1007, I.R.C. § 275c, 26 U.S.C.A. § 275c (1946).

A TYPICAL TAX CASE

A tax case has its inception when the return is filed,⁸ but it remains in a state of dormancy, more or less, until the Internal Revenue Agent's examination is commenced. It flowers after the agent has concluded his audit when the taxpayer receives a letter from the Internal Revenue Agent in Charge notifying him that the assessment of a tax deficiency is proposed in accordance with the attached agent's report. This communication is commonly known as a "30-day letter," because in it the taxpayer is informed that he has 30 days within which to file a protest against the agent's proposals if he is not willing to accept them.

At this point it should be stressed that a taxpayer's right to a judicial determination of the merits of his case is neither waived nor jeopardized by his dealings with the administrative forces of the Treasury Department. In other words, he does not have to file a protest in response to the 30-day letter, nor does he have to confer with the agent's office or the Technical Staff. Whether he does or not has no bearing upon his right to have the matter decided by the courts rather than administrative officials. He is, of course, bound by any statements or admissions of fact he may have made at that level, provided they were not the result of an honest mistake. The point emphasized is that if he decides not to protest⁹ he can, nevertheless, litigate the issues and even if he does protest he is not estopped either to litigate later or to adopt and proceed upon some theory other than that which he may have advanced¹⁰ in his negotiations at these intermediate stages.¹¹

Assuming that the taxpayer elects to file a protest, the following is an excerpt from Treasury Regulations as to its form and contents:

8. One of the plenary powers of the Collector is his authority to prepare and file a return if the taxpayer has refused to do so. 53 STAT. 437, I.R.C. § 3612, 26 U.S.C.A. § 3612 (1946). In such a case the Collector is not required to base the return upon any certainty as to the amount of taxable income. He can use his best judgment predicated upon such facts as he knows or reasonably suspects. A favorite method is to consider as income all amounts deposited in the taxpayer's bank account or found, perhaps, in his safe deposit box, and allowing him only the statutory exemptions and deductions. It then rests with the taxpayer to prove the Collector was wrong. *Paschal v. Bliedner*, 127 F.2d 398 (C.C.A. 1942); *cf. Kenny v. Comm'r*, 111 F.2d 374 (C.C.A. 5th 1940). In addition to the fact that such a return probably overstates income and resultant tax liability, this procedure is usually accompanied by the imposition of heavy penalties. 53 STAT. 88, as amended, 58 STAT. 235, I.R.C. § 291 (1946); 53 STAT. 437, I.R.C. § 3612, 26, U.S.C.A. §§ 291, 292, 293, 3612 (1946). And it can involve a term in prison. 53 STAT. 136, I.R.C. § 145, 26 U.S.C.A. § 145 (1946). The Collector has authority to examine witnesses, bank accounts and any books or records kept by the taxpayer or anyone else which may contain pertinent information. 53 STAT. 438, I.R.C. § 3614, 26 U.S.C.A. § 3614 (1946). In this connection, see *First National Bank of Mobile v. United States*, 160 F.2d 532 (C.C.A. 5th 1947); *Zimmerman v. Wilson*, 105 F.2d 583 (C.C.A. 3d 1939).

9. 53 STAT. 465, as amended, 56 STAT. 956, 957, I.R.C. 3772b, U.S.C.A. § 3772b (1946).

10. *M.T.K. Products Co.*, 1 B.T.A. 924 (1925); *United States Fidelity & Guaranty Co.*, 5 B.T.A. 23 (1926); see also, 9 MERTENS, LAW OF FEDERAL INCOME TAXATION 242 n.88.

11. An exception to this general rule exists in the case of a suit for refund which is discussed *infra*.

(a) The name and address of the taxpayer (in the case of an individual, the residence, and in the case of a corporation, the principal office or place of business);

(b) In the case of a corporation, the state in which incorporated;

(c) The designation by date and symbol of the letter advising of the determination with respect to which the protest is made;

(d) The designation of the year or years covered and a statement of the amount of tax liability in dispute for each year;

(e) An itemized schedule of the findings to which the taxpayer takes exception;

(f) A statement of the grounds upon which the taxpayer relies in connection with each exception; and

(g) In case the taxpayer desires a hearing, a statement to that effect.

Letters of protest and accompanying statements of fact, if any, must be executed by the taxpayer under oath.

In case the protest is prepared by an attorney or agent, it should be accompanied by a statement signed by such attorney or agent, showing that he prepared the protest and whether or not he knows of his own knowledge that the facts stated in the protest are true.

After this protest is received, the Agent in Charge will notify the taxpayer that a conference will be held at a specified time and place. The conference on a case involving a Miami taxpayer is usually held in Miami where the Agent in Charge maintains an office with a considerable staff. The conference is between the taxpayer and his attorney and accountant, on one hand, and, for the Government, the examining agent and one of his superiors. The obvious purpose of such a conference is to supplement the written protest by oral argument.

In order to represent a taxpayer before the Treasury Department, attorneys and accountants have to be registered with the Committee on Enrollments and Disbarments.¹² This is accomplished by filing an appropriate application obtainable from the Committee (which may be addressed in care of the Treasury Department in Washington). An attorney or accountant who is not enrolled may appear for himself personally, a member of his family (if no compensation is being paid for his services), or, on behalf of a firm or corporation of which he is a member, an officer or a regular employee. He must file a power of attorney (whether enrolled or not) in order to execute documents on behalf of a client. A rather careful investigation of applicants for enrollment is conducted by the Special Agents of the Intelligence Unit. One particular object of their investigation is to determine whether or not the applicant is up to date in respect of his own tax liability.

If as a result of conference the case is neither compromised nor otherwise disposed of, the taxpayer can request that it be submitted to the Technical Staff. Thereafter the taxpayer will receive a notice from the Technical Staff naming a time and date for the conference in the Staff office at Jacksonville.

12. TREAS. DEPT CIRCULAR NO. 230.

This letter suggests that if the taxpayer has any additional facts or legal authorities upon which he intends to rely, they should be submitted in advance so that the conferee to whom the case has been assigned will have an opportunity to review the entire case in advance of conference.

These conferences with representatives of both the Internal Revenue Agent in Charge and the Technical Staff are characterized by informality and usually are conducted as a sort of round table discussion. The taxpayer and his attorney should not overlook the fact, however, that these skilled and experienced conferees are making voluminous notes on the basis of which they will prepare exhaustive reports for their files and future reference. Any weakness in the taxpayer's case will be carefully noted in these reports and in the event litigation ensues the Treasury Department's attorney will be fully prepared to exploit these weaknesses at the trial.

Some practitioners profess to have no great confidence in these conferences, and the results to be accomplished. Their view in this respect is based fundamentally upon the proposition that a case which is strong enough to prevail in court can gain nothing by being conferred over with the opposition. Therefore, they ask, why discuss it? If, on the other hand, the case has certain weaknesses and might better be compromised, why publish such weaknesses at preliminary conferences, the full disclosure of which is required, if the desire to compromise is bona fide. Compromise, if you must, they say, after it is in the Tax Court and at issue; meanwhile don't lay your weaknesses out on a silver platter for the Treasury representative to note and pass on to the Commissioner's attorney who will try the case. In this connection, another school of thought reasons as follows: The Commissioner of Internal Revenue has officially directed his field agents to be just as fair to the taxpayers in pointing out overpayments as they are solicitous of the Government's interests in asserting deficiencies. The courts have likewise so admonished.¹³

Nevertheless, the fact remains that the efficiency ratings of the field personnel are determined in large part by reference to the amount of additional tax they produce. Wherever that situation exists, and more particularly, when a legal presumption of correctness attends his determinations, an agent, like almost any other human similarly situated, is tempted, at least, to be arbitrary.

Certain items, deductible from income, are defined in the Code in very

13. For example, in *Bohemian Breweries v. United States*, 27 F. Supp. 588, 592 (Ct. Cl. 1939), the court said, ". . . it is his (the Commissioner's) duty correctly to determine the income of the taxpayer and deductions to which the taxpayer is entitled." In *Miami Beach Bay Shore Co. v. Commissioner*, 136 Fed.2d 408, 409 (C.C.A. 5th 1943), the following is found: "Congress in conferring the deduction in the general terms of Section 23(f), and the Treasury in its Regulation 94, Revenue Act of 1936 did not set up a mere catch penny contrivance to be operated like a snare. It was expected that the loss thus allowed would be arrived at practically . . . not by methods which break the promise to the hope while they keep it to the ear . . ." (a case involving the inevitably disputed question of when corporate stock becomes worthless).

general terms. For example, business expenses including salaries, travel expense and depreciation must be "reasonable,"¹⁴ and the conflict between the Commissioner and the taxpayers as to what meets the test of reasonableness is a never ending one. Another prolific source of dispute is whether a given expenditure represented a capital investment or improvement, on one hand, or a repair or expendable item on the other.

These "stand bys" are all too frequently relied upon by Bureau personnel. In other words, if in a questioned transaction (concerning some other matter), the taxpayer appears reasonably certain of being able to justify his position, he often finds himself forced into a horse trade, because the agent has shifted the argument and questioned whether the taxpayer's treatment of one of these items was reasonable. Just as the taxpayer can adopt different theories at various stages in his negotiations at the administrative level, so also can the Commissioner.

It is for this reason that some practitioners favor a course of action which avoids protests and conferences. They contend that if the examining agent has not resorted to one of these old reliable disallowances in his report, the chances are that if the taxpayer takes no action in protest, the formal notice of deficiency will track the agent's report. After the taxpayer petitions the Tax Court, it is most unlikely that the Commissioner will seek to raise new issues, because, if he does, he will carry the burden of proof—a load which he is notoriously reluctant to assume. On the other hand, if there is a protest, followed by conferences, etc., there is always the possibility that resort will be had to questioning items of this character, which, as previously stated, can always be challenged as not conforming to someone's idea of what is "reasonable."¹⁵

In any event, assuming that all of these preliminary negotiations have failed (or have been avoided in the first instance by simply refusing either to file a protest or confer), the taxpayer next receives by registered mail a letter in which he is informed that the Internal Revenue Agent has determined that a deficiency exists in a stated amount, as indicated by the "Notice of Deficiency" next attached. This document sets forth the alleged errors on the part of the taxpayer out of which arose the asserted shortage and furnishes the taxpayer with a recomputation of his tax as it should be in the eyes of the Treasury Department. This communication is commonly called a "90-day letter," because within 90 days from the date of its receipt the taxpayer must

14. 53 STAT. 12, as amended, 59 STAT. 673, I.R.C. § 23a(1), 26 U.S.C.A. § 23 (1946).

15. In this general connection it should be borne in mind that if the taxpayer by language, acts or silence knowingly makes representations or conceals material facts intending or expecting them to be acted upon by taxing officials in determining the tax and the true or concealed material facts are unknown to the officials or they lack equal means of knowledge with taxpayer and act on his representation or concealment, and where to retrace their steps on a different state of facts would cause loss of taxes to the Government the taxpayer becomes subject to "equitable estoppel." *Robinson v. Comm'r*, 100 F.2d 847 (C.C.A. 6th 1939), *cert. denied*, 308 U.S. 567 (1939).

file a petition for redetermination in the Tax Court or the tax deficiency will be assessed and thereafter collected.¹⁶

This stage of the proceedings constitutes a crossroad. Here the taxpayer must decide whether he will litigate the matter in the Tax Court or pay the deficiency and, if a claim for refund is rejected, sue for its return.

Accordingly, at this point the taxpayer should carefully consider the relative merits of these alternative avenues of potential relief.

The Tax Court (formerly known as the Board of Tax Appeals) is an independent agency in the executive branch of the Government. It is an administrative tribunal with quasi-judicial functions.¹⁷ It is composed of sixteen judges, and while its headquarters are in Washington, the times and places for trials are required by law to be prescribed "with a view to securing reasonable opportunity for taxpayers to appear with as little inconvenience and expense as is practicable."¹⁸ In line with this requirement trials of Florida cases are usually held at Jacksonville, Tampa and Miami, normally in the early Spring.¹⁹ One judge presides. The trial is without a jury. The proceedings are conducted in accordance with the rules of evidence applicable in equity proceedings in the district courts prior to adoption of the Federal Rules of Civil Procedure.²⁰ While the Commissioner's determination is not conclusive, there is a presumption of its correctness, and the burden rests upon the taxpayer not only to prove it wrong,²¹ but also to establish essential facts from which a correct determination can be made.²² An exception to this rule exists where the Commissioner has charged fraud.²³ There are some very interesting cases involving procedure where fraud was asserted.²⁴ The Commissioner similarly carries the burden of proving additional deficiencies or other

16. 53 STAT. 82, as amended, 59 STAT. 673, I.R.C. § 272, 26 U.S.C.A. § 272 (1946). In this connection see also 53 STAT. 84, as amended, 56 STAT. 957, I.R.C. § 273, 26 U.S.C.A. § 273 (1946), relating to "jeopardy assessments." Under this section the Commissioner may make an immediate assessment and the Collector may promptly institute distraint proceedings whenever in the judgment of the Commissioner collection of the proposed deficiency might be jeopardized by the delay normally incident to the procedure prescribed by 53 STAT. 82, as amended, 59 STAT. 673, I.R.C. § 272, 26 U.S.C.A. § 272 (1946). A similar exception in cases of bankruptcy and receiverships is provided by 53 STAT. 86, as amended, 56 STAT. 957, I.R.C. § 274, 26 U.S.C.A. § 274 (1946). Note particularly that jurisdiction to determine the merits is then vested in the court before which the bankruptcy or receivership proceeding is pending.

17. 53 STAT. 158, as amended, 56 STAT. 597, I.R.C. § 1100, 26 U.S.C.A. § 1100 (1946). See also *West v. Comm'r*, 158 F.2d 723 (C.C.A. 5th 1945), *cert. denied*, 326 U.S. 795 (1946).

18. 53 STAT. 159, as amended, 56 STAT. 957, I.R.C. § 1105, 26 U.S.C.A. § 1105 (1946).

19. With his petition the taxpayer must file a request for hearing designating one of these places. Tax Court Rule 26.

20. Tax Court Rule 31.

21. Tax Court Rule 32; see *Welch v. Helvering*, 290 U.S. 111 (1933).

22. *Mahler v. Comm'r*, 119 F.2d 869 (C.C.A. 2d 1941), *cert. denied*, 314 U.S. 660 (1941).

23. 53 STAT. 160, I.R.C. § 1112, 26 U.S.C.A. § 1112 (1946).

24. *Kastel v. Comm'r*, 136 F.2d 530 (C.C.A. 5th 1943); *L. Schepp Co.*, 25 B.T.A. 419 (1932); *Snell Isle, Inc. v. Comm'r*, 90 F.2d 481 (C.C.A. 5th 1937).

affirmative matters asserted for the first time in his answer to the taxpayer's petition.²⁵

Attorneys representing taxpayers in the Tax Court must have been admitted to practice in accordance with its Rule 2.

In the famous *Dobson*, case²⁶ it was held that the appellate courts on review of Tax Court decisions were bound by its findings of fact and could only correct mistakes of law. This rule was alleviated in 1948 when Congress amended 26 U.S.C.A. 1141(c) to provide that such review shall be "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury."

In electing to proceed in the Tax Court the taxpayer does not try his case to a jury of local citizens and before a local judge, with whose temperament, views, etc., he may have some familiarity. Instead he must present it to whichever of sixteen strange judges may be assigned to hear it and the other cases tried at that particular term. In addition, he submits his case to a tribunal whose sole concern is the highly specialized field of tax law. This may or may not be to his advantage. Sometimes experts are more technical than practical.²⁷

But if he elects that course his petition must be filed within 90 days after the Notice of Deficiency is received. The general requirements of the petition are set forth in Tax Court Rule 6, and a comprehensive idea of the entire Tax Court procedure is contained in its Rules of Practice.²⁸

Before the case actually goes to trial the Technical Staff usually makes another effort to compromise or persuade the taxpayer that he should agree to the whole deficiency. Members of the Technical Staff follow the Tax Court judge from place to place, and if the taxpayer agrees to attend this conference he will find the Commissioner's attorney present also. At these conferences the Government attorney learns everything about the case (particularly any weaknesses) which he has not already gleaned from the reports in the file. Many cases are settled or otherwise disposed of at these last minute conferences. The groundwork for many to be lost at the trial has also been laid there.

From an adverse decision by the Tax Court either the Commissioner or the taxpayer may appeal to a circuit court of appeals and thence, by petition for certiorari, to the Supreme Court.

A deficiency finally determined to exist must be paid,²⁹ and the taxpayer

25. Tax Court Rule 32.

26. *Dobson v. Comm'r*, 320 U.S. 489 (1943).

27. Quite obviously these considerations would not affect the case on appeal, but appellate courts are usually more inclined to affirm than to reverse the judgment of the lower court.

28. These Rules are set forth in 26 U.S.C.A.

29. 272b, *supra* note 16.

has no other means of challenging its legality.³⁰ It is not subject to refund or a suit therefor, and the assessment will carry with it, and include as a part of the amount due, interest at the rate of 6% per annum computed from the date the return was filed (or should have been filed) until the tax is paid.³¹ In view of the fact that it is not at all unusual for a tax case to extend over as many as five years and frequently longer, this item of interest is an important one and can reach very substantial proportions. That is similarly an element to consider in electing which course to follow, because if it is decided not to petition the Tax Court but to pay the tax and seek its refund, the interest situation is reversed. Instead of accruing against the taxpayer during the pendency of the claim and while litigation is in process if the claim is rejected, interest at 6% accrues in favor of the taxpayer if he prevails.³² Of course, if he loses, there is no interest charge after the date the deficiency was paid.

If the taxpayer elects this latter course, he should ask for the prompt issuance of a Notice of Deficiency³³ and pay the tax to the Collector. He then should file a claim for refund on the form which any Collector's office will make available to him. (He may, if he chooses, take as long as two years after payment of the tax to file the claim.)³⁴

Extreme care should be exercised in the preparation of this claim. As has been previously pointed out, negotiations with the agent's office and the Technical Staff and the theories advanced at those stages do not control the basis of the taxpayer's petition to the Tax Court nor prevent him from adopting an entirely new theory in his pleadings and proof. In the case of a claim for refund, however, the reverse is true. Subsequent proceedings in a suit for refund must conform to the grounds of his claim as filed. The taxpayer can, of course, amend his claim or file a new one stating different grounds but only before the statute of limitations tolls the period within which it must be filed. Thereafter he can base his suit upon the amended or new claim.³⁵

After filing his claim the taxpayer must wait until it has been rejected, or

30. The one avenue of relief still remaining open to the taxpayer is to compromise the liability. 53 STAT. 462, I.R.C. § 3761, 26 U.S.C.A. § 3761 (1946). Generally speaking, this can be accomplished only upon a showing by the taxpayer that the amount he has offered in settlement of his liability is equivalent to the sum which the Government could realize if all of his assets were seized and sold subject to such liabilities as have precedence over the lien of the tax.

31. 53 STAT. 88, as amended, 59 STAT. 523, I.R.C. § 294, 26 U.S.C.A. § 294 (1946).

32. 53 STAT. 465, as amended, 59 STAT. 525, I.R.C. § 3771, 26 U.S.C.A. § 294 (1946).

33. By executing the waiver provided in 26 U.S.C.A. 272d.

34. 53 STAT. 91, as amended, 59 STAT. 569, I.R.C. § 322b(1), 26 U.S.C.A. § 322b(1) (1946); see also 53 STAT. 471, as amended, 58 STAT. 246, I.R.C. § 3801, 26 U.S.C.A. § 3801 (1946).

35. *Davis v. United States*, 46 F.2d 377 (Ct. Cl. 1931). On the question of amendment, see also *United States v. Andrews*, 302 U.S. 517 (1938).

six months, whichever is the lesser period, before he can institute a suit.³⁶

The forum of his suit for refund will depend upon the following:

(1) If the amount sued for is \$10,000 or less, he can sue in a United States district court.³⁷ The Collector, as such, is the defendant, and any judgment obtained against him will be paid by the United States unless personal malfeasance on the part of the Collector is made to appear.³⁸ The trial will be by jury if demanded under the Federal Rules of Civil Procedure.

(2) If the Collector to whom the tax was paid is either dead or has been succeeded in office, the suit, regardless of amount, may be brought in a district court with the United States as the defendant.³⁹

(3) If the Collector is still in office and the amount sued for exceeds \$10,000, the suit must be brought, naming the United States as defendant, in the United States Court of Claims^{39a} at Washington, D.C., where it will be tried with a jury.⁴⁰

In all such suits the burden of proof is the same as in the Tax Court.⁴¹

INJUNCTIONS

At this juncture, between the discussion relating to assessment, and that portion relating to collection, it seems appropriate to direct attention to the statute⁴² prohibiting injunctions against either the assessment or collection of federal taxes. With the exceptions noted in the statute itself, relief by way of injunction cannot be invoked unless there be such extraordinary circumstances as, for example, existed in the famous *Nut Margarine* case.⁴³ There an injunction was entered, because the product sought to be taxed was conclusively shown not to be the substance defined in the taxing act. As will be observed, that case did not involve income tax, and generally speaking the old familiar phrase "adequate remedy at law" completely blocks off this avenue of relief.

THE COLLECTION OF TAX

Few people either realize or appreciate the summary character of the Collector's authority in the matter of collecting taxes.

36. 53 STAT. 465, as amended, 56 STAT. 956, 957, I.R.C. § 3772, 26 U.S.C.A. § 3772 (1946).

37. See 28 U.S.C.A. § 41(20).

38. *Moore Ice Cream Co. v. Rose*, 289 U.S. 373 (1933).

39. See 28 U.S.C.A. § 41(20) (1946).

39a. See 28 U.S.C.A. § 250 (1946).

40. The taxpayer can waive any excess over \$10,000 in order to invoke the jurisdiction of the district court. *Hammond-Knowlton v. Hartford, etc.*, 26 F. Supp. 292 (D. Conn. 1939), *rev'd on other grounds*, 121 F.2d 192 (C.C.A. 2d 1939).

41. *United States v. Anderson*, 269 U.S. 422 (1926); *Continental Illinois National Bank v. United States*, 18 F. Supp. 229 (Ct. Cl. 1937); *McMahon, Inc. v. United States*, 61 Ct. Cl. 559 (1926); *Helvering v. Taylor*, 293 U.S. 507 (1935).

42. 53 STAT. 446, I.R.C. § 3653, 26 U.S.C.A. 3653 (1946).

43. *Miller v. Standard Nut Margarine Co. of Florida*, 49 F.2d 79 (C.C.A. 5th 1931), *aff'd*, 284 U.S. 498 (1932).

The Collector proceeds by way of distraint,⁴⁴ and an inkling of his plenary powers will be gained from an inspection of the statute⁴⁵ which specifically prescribes the items of property which are not subject to seizure and sale. Briefly described they consist of the following: family wearing apparel and school books; personal firearms; one cow, two hogs and five sheep (and their wool) valued at not more than \$50; fodder for such livestock adequate for 30 days; \$25 worth of fuel; \$50 worth of provisions; \$300 worth of household furniture, and finally the books, tools and implements of the taxpayer's trade or profession to a value not greater than \$100. All other property and rights to property are subject to the lien of the unpaid tax and to distraint by seizure and sale or levy.⁴⁶

The collection machinery is set in motion when the Collector issues a notice of the unpaid tax and makes a demand for its payment. This notice and demand is mailed to the taxpayer and if not complied with, the Collector issues a warrant for distraint. A tax claim is not like an ordinary claim requiring court proceedings for the entry of judgment before collection. The assessment is the "judgment." The warrant for distraint is the "writ of execution."⁴⁷

In the normal course of events the notice and demand issue in from 10 to 30 days after the assessment has been certified to the Collector by the Commissioner, and another 30 days usually passes before the distraint warrant is issued. Even then the taxpayer is given additional grace because the collector's Chief Field Deputy writes a letter to the delinquent taxpayer advising him that the warrant has been placed in his hands for execution and suggesting a prompt remittance. The Government can afford to be generous as to time because the unpaid tax is earning 6% interest.⁴⁸

Within a few days thereafter, the taxpayer will be visited by a local deputy collector who will exhibit the distraint warrant and personally demand payment.

The collector has the discretionary authority to withhold actual distraint by seizure and sale and to permit the taxpayer further time within which to pay.⁴⁹ But this authority is exercised very sparingly and in order to obtain such consideration the taxpayer must furnish a statement of his assets and liabilities. If this statement discloses a situation which warrants lenience and the taxpayer can demonstrate that within the extended period he can discharge the tax, the Collector will usually accommodate him by permitting the account to be paid in regular installments. Many deserving cases are handled

44. 53 STAT. 451, I.R.C. § 3690, 26 U.S.C.A. § 3690 (1946).

45. 53 STAT. 451, I.R.C. § 3690, 26 U.S.C.A. § 3691 (1946).

46. 53 STAT. 488, I.R.C. § 3670, 26 U.S.C.A. § 3670 (1946); 53 STAT. 451, I.R.C. § 3690, 26 U.S.C.A. § 3690 (1946); 53 STAT. 452, I.R.C. § 3692, 26 U.S.C.A. § 3692 (1946).

47. *United States v. Morris & Essex R. Co.*, 135 F.2d 711 (C.C.A. 2d 1943), cert. denied, 320 U.S. 754 (1943).

48. 53 STAT. 88, as amended, 59 STAT. 523, I.R.C. § 294, 26 U.S.C.A. § 294 (1946).

49. 53 STAT. 82, as amended, 59 STAT. 673, I.R.C. § 272j, 26 U.S.C.A. § 272j (1946).

in this manner, but prompt payment on the dates agreed is a continuing requirement. Interest, of course, still accrues at 6% on the unpaid balances.

A taxpayer should realize that these trained deputy collectors are usually well informed concerning his financial situation before they contact him. They have the authority to examine not only his books but also any records kept by third persons which may contain information relative to property or rights to property about to be distrained upon.⁵⁰ From long experience banks, for example, are familiar with this statutory provision and in only a matter of minutes the Deputy Collector can ascertain the status of a bank account as well as the existence of a safe deposit box and whether or not the customer has posted any collateral for loans—if so, its value over and above the unpaid balance.

Assuming a case where distraint goes forward, the Collector, of course, prefers to collect in the least difficult manner, and in order to avoid seizure of property which will have to be sold, he usually concentrates upon liquid assets which, though they usually are not in the possession of the taxpayer, can be reached in the hands of third persons by levy.

His first step is to file a notice of tax lien with the clerk of the circuit court for the county in which the taxpayer resides. This protects the lien against all other claims such as judgments, mortgages, etc., not previously recorded.⁵¹

At the same time he prepares a notice of levy for service upon any person whom he finds to be in possession of the taxpayer's property or rights to property, including stocks, securities, bank accounts and evidences of debt as specifically enumerated in the statute.⁵² Among other things not described but held by the courts to fall within the purview of the statute as subject to levy are the cash surrender value of life insurance policies,⁵³ trust income⁵⁴ and accrued salaries.⁵⁵

It should be understood that where federal taxes are concerned, state exemption laws are inapplicable.^{55a} Any person holding such property or rights to property must surrender or pay it to the Collector in response to the notice of levy under penalty of becoming liable for its value if not so surrendered.⁵⁶

If personal property so levied upon is not cash, then it must be sold by the

50. 53 STAT. 456, I.R.C. § 3711, 26 U.S.C.A. § 3711 (1946).

51. 53 STAT. 449, as amended, 56 STAT. 957, I.R.C. § 3672, 26 U.S.C.A. § 3672 (1946).

52. 53 STAT. 451, I.R.C. § 3690, 26 U.S.C.A. § 3690 (1946).

53. *Columbian v. Welch*, 88 F.2d 333 (C.C.A. 1st 1937). Cf. *United States v. Penn Mutual*, 130 F.2d 495 (C.C.A. 3d 1942); *United States v. Trout*, 46 F. Supp. 484 (S.D. Cal. 1942); *United States v. Metropolitan*, 130 F.2d 149 (C.C.A. 2d 1942).

54. *Mercantile Trust Co. v. Hofferbert*, 56 F. Supp. 701 (D. Md. 1945).

55. *United States v. Long Island Drug Co.*, 115 F.2d 983 (C.C.A. 2d 1940).

55a. *Cannon v. Nicholas*, 80 F.2d 934 (C.C.A. 10th 1935); *United States v. Heffron*, 158 F.2d 657 (C.C.A. 9th 1947); *United States v. Dallas National Bank*, 152 F.2d 963 (C.C.A. 4th 1941).

56. 53 STAT. 456, I.R.C. § 3710, 26 U.S.C.A. § 3710 (1946).

Collector and the proceeds applied in partial or full payment of the delinquent tax.⁵⁷ Such sales after notice to the taxpayer and due advertisement are at public outcry.⁵⁸ The Collector is required to offer the property at a minimum price and if there are no bids for that amount it is declared purchased for the account of the United States to be thereafter resold.⁵⁹

The owner may redeem such personalty prior to sale by payment of the tax.⁶⁰ If sold, the Collector issues a certificate of sale to the successful bidder which transfers the taxpayer's title and interest therein to the buyer.⁶¹

The Collector may seize and sell real estate if he cannot find sufficient personalty to satisfy the tax,⁶² but he is not absolutely required to sell personalty before resorting to realty.⁶³

Any realty is subject to seizure and sale, including a homestead.⁶⁴ As a matter of fact, attempts have been made to distrain against the interest of a tax delinquent spouse who was a tenant by entireties. In an administrative ruling the General Counsel of the Treasury Department held that the interest in such an estate existing under the laws of Oregon could be reached.⁶⁵ The courts have held, however, that similar interests created by the laws of Michigan⁶⁶ and Pennsylvania⁶⁷ were not subject to the lien.

When real estate is distrained against, it is likewise sold at public auction, at an upset price, after appropriate notice and advertisement. If no person offers the minimum bid it is declared purchased for the account of the United States. The sale may be adjourned, in the discretion of the Collector.⁶⁸

Before the actual sale the owner may redeem his property by payment of the tax and costs. Even after such a sale within one year the owner may redeem by paying to the purchaser the amount of his successful bid plus interest from the date of purchase at 20% per annum.⁶⁹

After the sale the Collector issues a certificate of sale⁷⁰ to the purchaser and upon expiration of the one year period of redemption he executes a deed, which operates as a conveyance of title.⁷¹ As long as any portion of the tax and costs remains unpaid the Collector may continue to seize and sell property

57. 53 STAT. 452, I.R.C. § 3694, 26 U.S.C.A. § 3694 (1946).

58. 53 STAT. 452, I.R.C. § 3693, 26 U.S.C.A. § 3693 (1946).

59. 53 STAT. 452, I.R.C. § 3695, 26 U.S.C.A. § 3695 (1946).

60. 53 STAT. 453, I.R.C. § 3696, 26 U.S.C.A. § 3696 (1946).

61. 53 STAT. 453, I.R.C. § 3697, 26 U.S.C.A. § 3697 (1946).

62. 53 STAT. 453, I.R.C. § 3700, 26 U.S.C.A. § 3700 (1946).

63. *United States v. Curry*, 201 Fed. 371 (D. Md. 1932).

64. *Shambaugh v. Scofield*, 132 F.2d 345 (C.C.A. 5th 1942).

65. General Counsel's Memorandum No. 1310, Vol. VI-I, Treasury Department Cumulative Bulletin, p. 101.

66. *United States v. Nathanson*, 60 F. Supp. 193 (E. D. Mich. 1945).

67. *Rothensies v. Ullman*, 110 F.2d 590 (C.C.A. 3rd 1940).

68. 53 STAT. 453, I.R.C. § 3701, 26 U.S.C.A. § 3701 (1946).

69. 53 STAT. 454, I.R.C. § 3702, 26 U.S.C.A. § 3702 (1946).

70. 53 STAT. 454, I.R.C. § 3703, 26 U.S.C.A. § 3703 (1946).

71. 53 STAT. 454, I.R.C. § 3704, 26 U.S.C.A. § 3704 (1946).

belonging to the taxpayer⁷² even though it may be situated in another collection district within the same state as that embracing the Collector's own district.⁷³

The period of limitations within which income taxes may be collected by distraint is six years after the date of the assessment unless extended in writing by mutual agreement between the taxpayer and the Commissioner.⁷⁴ For computing time, distraint proceedings in respect of personal property are commenced when the levy is made and, in the case of real estate, when notice of the time and place of sale is given to the taxpayer.⁷⁵ Shortly prior to expiration of this six year limitation, if the circumstances warrant,⁷⁶ the Attorney General, in the name of the United States, will institute suit against the taxpayer in the United States district court for the district where the tax liability was incurred.⁷⁷ A judgment so obtained is collectible at any time within 20 years in the same manner as any other judgment obtained in Florida.

The Government has another course of action available in these cases where it appears that the summary remedy of distraint may be too drastic and, perhaps, have the result of ruining the taxpayer's business and wiping out claims which are unsecured or junior to the tax lien. In such cases suit may be brought in a United States district court (in the name of the United States) to enforce the lien. In such suits all parties having liens upon or claiming interest in the taxpayer's property are joined as parties to the proceedings and upon certification by the Commissioner that it is in the public interest a receiver may be appointed.⁷⁸ The action may be brought either before or after distraint proceedings have been commenced. Such proceedings are comparatively rare.

COLLECTION FROM TRANSFEREE

It frequently occurs, particularly in the case of corporations, that by the time distraint proceedings are instituted the taxpayer is insolvent and has no assets which can be levied upon. The Commissioner has full authority in such a case to examine any person having knowledge and to inspect any and all books or records of any person to determine what disposition was made of the taxpayer's assets⁷⁹ and to assess and collect the tax from the transferee of such assets.⁸⁰ This is a statutory application of the equitable trust fund doctrine, i.e., a man must be just before he is generous, and transferee

72. 53 STAT. 457, I.R.C. § 3715, 26 U.S.C.A. § 3715 (1946).

73. 53 STAT. 456, I.R.C. § 3713, 26 U.S.C.A. § 3713 (1946). This section would not apply to Florida because this state contains only one collection district.

74. 53 STAT. 87, as amended, 59 STAT. 569, I.R.C. § 276c, 26 U.S.C.A. § 276c (1946).

75. 53 STAT. 456, I.R.C. § 3714, 26 U.S.C.A. § 3714 (1946).

76. 53 STAT. 460, I.R.C. § 3740, 26 U.S.C.A. § 3740 (1946).

77. 53 STAT. 460, I.R.C. § 3744, 26 U.S.C.A. § 3744 (1946).

78. 53 STAT. 450, I.R.C. § 3678, 26 U.S.C.A. § 3678 (1946).

79. 53 STAT. 438, I.R.C. § 3614b, 26 U.S.C.A. § 3614b (1946).

80. 53 STAT. 90, as amended, 56 STAT. 957, I.R.C. § 311, 26 U.S.C.A. § 311 (1946).

liability exists wherever it appears that one has received the assets of a delinquent taxpayer in exchange for anything less than an adequate consideration, provided that as a result of such exchange the taxpayer was rendered insolvent. The courts have held that this statute does not impose a tax on the transferor or the transferee but merely provides a new remedy for enforcing existing liability of the transferor and treats his transferee as the taxpayer would be treated for procedural purposes.⁸¹

Similar liability is created in those cases wherein the purchaser buys the taxpayer's assets and assumes all of his liabilities.⁸² Where a corporation purchased all assets of another and assumed "all existing liabilities" the purchaser was held liable for tax liability existing at the time although it was not included in the itemized list of liabilities assumed and was determined by the Commissioner subsequent to the transfer.⁸³ The same principle has been applied on the equitable side, i.e., in determining the question of insolvency. A liability for taxes, though unknown at the time, must be considered.⁸⁴

CONCLUSION

This discussion necessarily has been general in character and in respect of certain aspects merely scratches the surface. Perhaps, however, it will spur greater interest in a field of law which has hitherto engaged the attention of too few practitioners.

81. *Tooley v Comm'r*, 121 F.2d 350 (C.C.A. 9th 1941).

82. The governing statute, 53 STAT. 90, as amended, 56 STAT. 957, I.R.C. § 311a(1), 26 U.S.C.A. § 311a(1) (1946), specifically refers to "the liability, at law or in equity."

83. *Continental Baking Co. v. Helvering*, 75 F.2d 243 (App. D.C. 1934), *cert. denied*, 295 U.S. 756 (1935).

84. *Hankins v. United States*, 316 U.S. 674 (1942); *Scott v. Comm'r*, 117 F.2d 36 (C.C.A. 8th 1941).