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The Reluctant Taxpayer - His Remedy by Injunction

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THE RELUCTANT TAXPAYER

HIS REMEDY BY INJUNCTION

THERE are few of us who are not reluctant taxpayers, but some of us wish to voice that reluctance by enjoining the collection of taxes, rather than paying and then suing for a refund. It is for those who wish to employ the injunction that this article is written, to show the taxpayer what he may expect at the present time, in view of the vacillating course the courts have run in the past. The situation as to Federal taxes will be considered first and then the situation as to Colorado taxes.

In 1867, as an amendment [which is still effective today] to the Revenue Act of 1866, a statute was passed of a prohibitory nature providing, "And no suit for the purpose of restraining the assessment or collection of a tax shall be maintained in any courts."[1]

The courts immediately commended the policy behind the enactment of this statute, but in several early cases denying an injunction, the court began its policy of distinction and reservation under the statute and indicated that the reluctant taxpayer's action would be successful if the actions of the collector were so capricious that the court would regard the threatened imposition as a nullity rather than a tax.[2]

A later distinction was approved by the Supreme Court in *Lipke v. Lederer*,[3] where the court denied that the statute forbade an injunction against penalties as distinguished from taxes. The use of this distinction should be confined to cases where the punitive element of the statute clearly appears, otherwise the statute would lose its significance.

These cases, however, throw no light on the question as to how a tax expressly within the prohibitory law will be treated. *Pullan v. Kinsinger*,[4] the second case decided under the statute, treated it as merely a reenactment of the old equity rule, denying relief where there was an adequate remedy at law.[5] This construction was later urged on the Supreme Court in *Dodge v. Osborn*.[6] In that case the court found no grounds for equitable jurisdiction and clearly indicated that equity jurisdiction alone was not sufficient to nullify the statute. It concluded with the significant statement that the provisions could not be avoided, "Unless by some extraordinary and entirely exceptional circumstance, its provisions are not applicable."

Six years later these words were repeated in *Bailey v. George*,[7] which also denied injunctive relief. Late in the same year a case of great hardship, *Hill v. Wallace*,[8] was presented. It arose under the Future Trading Act, whereby grain exchanges were forced to submit to regulation by

[1] 14 Stat. 475 (1867), 26 U. S. C. A. 154 (1928), R. S. Sec. 3224.
[2] Pullan v. Kinsinger, 20 Fed., Case No. 11,463 (C. C. S. D. Ohio 1870); Kinsinger v. Bean, 14 Fed., Case No. 7853 (C. C. E. D. Wis. 1875).
[3] 259 U. S. 557, Accord; Regal Drug Corp. v. Wardell, 260 U. S. 386.
[4] 20 Fed., Case No. 11,463 (C. C. S. D. Ohio 1870).
[5] 1 Stat. 82 (1789), 28 U. S. C. A. 384 (1928).
[6] 240 U. S. 118 (1910).
[7] 259 U. S. 44 (1922).
[8] 259 U. S. 16, 20 (1922).

the Secretary of Agriculture or sustain a prohibitive tax.[9] Any action which the exchanges could have taken, aside from obtaining an injunction, would practically have ruined their futures business. Impressed by this fact, the court seized on the hitherto lifeless phrase, and granted an injunction on the grounds that the circumstances were "exceptional and extraordinary." The court considered as one element in the conclusion the multiplicity of suits incident to recovering taxes on each of numerous daily transactions. An analysis of this case in a Harvard Law Review article indicated that the court treated "exceptional circumstances" as being synonymous with multiplicity of suits.[10]

In *Graham v. Dupont*[11] the circumstances were again unusual. The taxpayer's remedy for a refund was barred by the statute of limitations. The court denied the injunction and stated that the Hill case was not in point because in that case a penalty was involved. But the more recent decision of *Miller v. Standard Nut Margarine Company*[12] indicates that there may be other situations in which the court will be unwilling to apply the restriction of the statute. The tax involved in the Margarine case was of a prohibitory nature similar to that in *Hill v. Wallace*, hence on its facts it might seem to go no further than *Hill v. Wallace*. Justice Butler, however, in granting the injunction, asserted that the statute was merely declaratory of the pre-existing common law. In the absence of statutes, courts of equity would not enjoin the collection of a tax merely on the grounds of illegality, but if an independent basis of equity jurisdiction existed, relief would be granted. What the Federal courts consider to be the common law on this subject is shown by their decisions in cases where they have enjoined the collection of state taxes, in states where there were no statutes. They have enjoined the collection of an illegal tax if the taxpayer had no adequate remedy at law, or if the collection would lead to a multiplicity of suits[13] or throw a cloud on title to realty.[14]

If the implications of the Margarine case are followed and the statute treated as merely declaratory, the result may be a considerable enlargement of the field in which the reluctant taxpayer may succeed by way of injunction against the collection of a Federal tax.

In this state of the authorities, Congress passed the Agriculture Adjustment Act[15] authorizing the collection of processing taxes, which resulted in more than 1,600 cases in the courts seeking injunctions. When Congress passed an amendment to this Act[16] which would deny recovery for taxes already due, there was an unprecedented rush for injunctive relief. In acting upon these bills, no courts went so far as to say that Section 3224 was without exception. Some U. S. District Court

[9] 42 Stat. 187 (1921).
[10] 37 Harv. Law Review 255, 258.
[11] 262 U. S. 234 (1923).
[12] 284 U. S. 498 (1932).
[13] Travis v. Yale and Towne Mfg. Co., 252 U. S. 60 (1920).
[14] Union Pacific Ry. Co. v. Cheyenne, 113 U. S. 516 (1885).
[15] 48 Stat. 31 (1933), 7 U. S. C. A. 601-22 (1934).
[16] 79 Cong. Rec., June 18, 1935, at 1991.

judges thought that *Miller v. Nut Margarine Company* required more than ordinary grounds of equitable jurisdiction before Section 3224 could be disregarded, and since complainants could not show impending ruin, injunctive relief was refused.[17] To others the same case defined Section 3224 as a restatement of the old equity rule and upon a showing of a threatened multiplicity of suits or other inadequacy of the legal remedy, they granted the injunction.[18] A third group of district courts cited the Margarine case for the proposition that injunctions would issue only in extraordinary and exceptional cases and then proceeded to restrain collection upon mere proof of inadequacy of the legal remedy.[19]

The policy of the Federal Government in collecting taxes of all types has been to require payment before the determination of the validity of the taxing law. The law provides that Federal taxes are collectible by distraint without resort to the courts.[20] Hence, the taxpayer's only remedy was to pay under protest and then sue for the refund. The necessity for payment under protest was generally adhered to.[21] This practice justifies the position of the reluctant taxpayer and tends to work a very great hardship, because deficiency assessments are so large as to cause bankruptcy or a sale of a large portion of the taxpayer's assets before validity of the tax is determined, and in any case a refund would not compensate for the damage occasioned by collection of the illegal tax. There is no sound reason for this policy of government, since it obtains no advantage in making collections it is going to return later.

These objections became the more forceful when income and estate taxes became the principal source of government revenue, since complexities involved made disputes more numerous. To meet this situation, in 1924 a separate tribunal named the Board of Tax Appeals was created[22] to pass upon the validity of deficiency assessments, before payment was demanded, although either party could have a later review by the courts. The Board's findings were in most cases accepted by the court. Popularity of the Board led to the extension of its powers.[23] Collection of the assessed tax was made subject to injunction at the suit of the taxpayer, pending the Board's decision. This is a specific exception to Section 3224. The Board's decisions were made final, though either party had the right to a review of the record by the Circuit Court of Appeals or the Court of Appeals of the District of Columbia, from which the case might be carried to the Supreme Court on certiorari.

But this procedure was only applicable to income and estate taxes. The statutory procedure for the collection of other Federal taxes remains unaltered except as changed by judicial decision.

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[17]Colo. Mill and Elev. Co. v. Nicholas (D. Colo. July 23, 1935).
[18]Gold Medal Foods, Inc. v. Landy, 11 F Supp. 65 (D. Minn. 1935).
[19]Danahy Packing Co. v. McGowan, 11 F Supp. 920 (W. D. N. Y., July 27 1935).
[20]26 U. S. C. A. 116, 20, 25.
[21]Cheesebrough v. U. S., 192 U. S. 253 (1904).
[22]26 U. S. C. A. 1048-54, 1100-4, 1211-22 (1926).
[23]26 U. S. C. A. 1224-28 (1928).

A practical evasion of Section 3224 by our reluctant taxpayer has resulted by the indirect method of a court's issuing an injunction restraining payment of the tax at the suit of a stockholder against a corporation.[24] Since a suit for a refund can rarely be maintained unless the payment was made under protest, equity will lend its aid to prevent a voluntary payment which would be in the nature of a breach of trust. This same principle was applied in the case of the beneficiary of a trust enjoining a trustee from paying an illegal tax voluntarily.[25] The legality of the tax is one of the issues involved in such a suit. These cases are reconcilable only on the theory that they restrict "payment" rather than "assessment" or "collection," the practical result being to evade the Act.

In Colorado, as in the Federal courts, the right to an injunction has revolved around the interpretation of a statute but, unlike the Federal statute, Colorado provides a mode of recovery rather than denying injunctive relief.[26]

"Each county is responsible to the state for the full amount of tax levied for state purposes, excepting such amounts as are certified to be unavailable, double or erroneous assessments, as provided in the Revenue Act of 1902, and in all cases where anyone shall pay any tax, interest or cost, or any portion thereof, that shall thereafter be found to be erroneous or illegal, whether the same be due to erroneous assessment, to improper or irregular levying of the tax, or clerical, or other error or irregularities, the Board of County Commissioners shall refund the same without abatement or discount to the taxpayer."

From the beginning, Colorado equity courts have held that this statute furnished an adequate legal remedy.[27] They said the statute created a completely new statutory right for the purpose of testing the legality of all types of taxing statutes. This remedy is available in Federal courts as well as state courts,[28] since it has been interpreted to create a new substantive right in the taxpayer. In fact, the Federal courts have gone so far as to say it supplanted the remedy equity previously afforded the reluctant taxpayer.[29]

While on its face this statute seems broad enough to relieve the reluctant taxpayer, yet in its interpretation the express wording has been afforded little significance, so that the errors and irregularities have come to mean simple illegality.[30] Hence, when the question is one as to whether or not an assessment is too high, the statute is not of much help and efforts should be made to obtain relief from various administrative bodies, including the assessor, the county commissioners, and the tax commission, as provided by statute.

The necessity for exhausting administrative remedies is emphasized in *City and County of Denver v. Boettcher*,[31] where pleading under Sec-

[24]Pollock v. Farmers Loan and Trust Co., 157 U. S. 429 (1895).
[25]Weeks v. Sibley, 269 Fed. 155 (N. D. Tex. 1920).
[26]35 C. S. A., Ch. 142, Sec. 281.
[27]Price v. Kramer, 4 Colo. 546.
[28]Singer Sewing Mach. Co. v. Benedict, 229 U. S. 481.
[29]Idem.
[30]South Broadway National Bank v. Denver, 51 Fed. (2d) 703.
[31]99 Colo. 408.

tion 281 was held defective because of petitioner's failure to state that administrative remedies had been exhausted. What constitutes exhausting administrative remedies, however, is explained in *Goldsmith, County Treasurer v. Standard Chemical Co.*,[32] where it is said that the statutory procedure need only be followed through the administrative officer as, in that case, the assessor; and if he refuses relief, appeal to a court need not be taken from his ruling, but a suit may be brought directly under Section 281, previously quoted. This will no doubt be followed by our Supreme Court.

Our court has recognized that there might be exceptions to the statute[33] which would give the reluctant taxpayer the right to go into equity. "We do not hold that this section affords an adequate remedy to the taxpayer, in all cases founded upon an erroneous or illegal tax. We readily conceive that a case might arise in which complainant would not have an adequate remedy by an action at law based on this section." The court went on to say that, "In addition to illegality, hardship or irregularity the case must be brought within some of the recognized foundations of equitable jurisdiction, and mere errors or excess in valuation or hardship or injustices of the law, or any grievances which can be rendered in a suit at law, either before or after payment of taxes, will not justify a court of equity to interpose by injunction to stay collection of a tax."

It has been held that the mathematical difficulty of giving the case to a jury was no grounds for equity to act by injunction, though it might properly hear the case.[34]

There are circumstances under which the enforcement of the right given by this section would lead to results against which equity will grant relief.[35] An example is found in the situation wherein the Boards of Equalization were about to certify to a large number of counties, taxes which were shown to be illegal. When thus certified it became the duty of local officers to enforce their payment. Complainants, to avail themselves of this section, would have been compelled to maintain a large number of independent suits at law, and the right to go into equity is based upon grounds of preventing this multiplicity of suits.

When a statute like that in Colorado exists, complainants seeking to restrain the collection of a tax must do more than show some of the equitable circumstances which would support resort to equity if there were no statute. It seems necessary to make out a case of an exceptional character such as appears in *Cummings v. National Bank*,[36] which is cited with approval in many decisions under our statute. The Supreme Court said that compliance with the statute in that case would have resulted in "irreparable injury."

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[32]23 F (2nd) 313.
[33]Board of County Commissioners v. A. T. & S. F. R. R. Co., 52 Colo. 609, 614.
[34]Union Pac. v. County Commissioners, 222 Fed. 651.
[35]Taylor v. Louisville, etc. R. Co., 88 F 350 and Fargo v. Hart, 193 U. S. 490, as quoted in 222 F at 657 in U. P. v. Board of Commissioners.
[36]101 U. S. 153.

Tallon v. Vindicator Consolidated Gold Mining Company[37] laid down the general principle that with few exceptions a tax must be prima facie void before equity will act by granting an injunction.

The latest expression by our Supreme Court on the subject was in *Fairlamb v. Bowle*,[38] in which the court held the method of assessment proper and denied the injunction, saying that the remedy at law was adequate.

The question arises as to whether or not it is still necessary, as it was at common law, to pay taxes under protest in order that the taxpayer will be entitled to sue for a refund in case of illegality. It would seem unnecessary under the statute and was so held in a circuit court case,[39] but as yet our Supreme Court has not ruled upon the question, except incidentally,[40] where the court allowed recovery though there had been no protest, but the case did not comment upon the lack of "protest" as a grounds of defense. On the other hand, in *Holly Sugar Corporation v. Board of Commissioners*,[41] the Federal court in commenting on the procedure under the statute, says it is the duty of a property owner, where there has been a levy of an excessive tax, to pay under protest and bring an action against the county to recover the same. Colorado cases are cited in accord.[42] Since the question of protest was not involved in these cases, it would seem that what the court says is only directory and would represent a safe procedure to follow, and one which is followed in most cases.

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[37]59 Colo. 316, 339.
[38]101 Colo. 135.
[39]Union Pacific v. Board of Commissioners, 222 F 651.
[40]City of Denver v. Evans, Administratrix, 35 Colo. 490.
[41]10 F (2nd) 506.
[42]Spaulding Mfg. Co. v. Board of Commissioners, 63 Colo. 438; Kendrick v. A. Y., etc. Milling Co., 63 Colo. 214.