FEDERAL TAXATION: SECTION 7421 (a) OF INTERNAL REVENUE CODE LITERALLY CONSTRUED TO BAN ALL SUITS TO ENJOIN ASSESSMENT OR COLLECTION OF TAXES

SECTION 7421 (a) of the Internal Revenue Code of 1954 guards against judicial impairment of the prescribed system for summary collection of federal taxes[1] by providing (with stated exceptions) that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court."[2] On its face, this statutory language would appear categorically to remove equity jurisdiction from the courts and to require a protesting taxpayer to seek correction through the prescribed method of a refund suit.[3] Nevertheless, upon a showing of "exceptional and extraordinary circumstances," an exception occasionally has been read into the statute's unqualified provisions.[4] In the recent case of *Enochs v. Williams Packing & Nav. Co.*,[5] however, the Supreme Court appears to have eliminated this exception by literally construing the statute's prohibitive mandates.

The Williams Packing and Navigation Company petitioned a federal district court to enjoin the collection of social security taxes due on the wages paid to crews working aboard its fishing vessels.[6] The taxpayer's petition said: (1) there is no employer-employee relationship between the company and the crew to support imposition of the tax[7] and (2) there is no adequate remedy at law because

[1] Statutory methods for orderly tax collection are set out in INT. REV. CODE of 1954, §§ 6301-04. See also seizure provisions note 30 *infra*. See generally 3 P-H 1962 FED. TAX SERV. ¶¶ 19791-933.

[2] The prohibition is based on the theory that the revenue laws contain an integrated system of corrective justice which is intended to be used to the exclusion of all other remedies in settling disputes over tax matters. See Graham v. DuPont, 262 U.S. 234 (1923); Snyder v. Marks, 109 U.S. 189 (1883); Cheatham v. United States, 92 U.S. 85 (1876); *cf.* Phillips v. Commissioner, 283 U.S. 589, 595 (1931). *But see*, Kimmel v. Tomlinson, 151 F. Supp. 901 (S.D. Fla. 1957), which refutes this view.

[3] Statutory provision for a refund suit is contained in INT. REV. CODE of 1954, § 7422.

[4] See cases cited note 22 *infra*. See generally 9 MERTENS, FEDERAL INCOME TAXATION ¶ 49.212 (rev. ed. 1961).

[5] 370 U.S. 1 (1962).

[6] The taxes determined were the Federal Insurance Contributions Tax, INT. REV. CODE of 1954, §§ 3101-25; and the Federal Unemployment Tax, INT. REV. CODE of 1954, §§ 3301-08.

[7] The INT. REV. CODE of 1954, § 3121 (d) (2) defines an employee as "any individual who, under the usual common law rules applicable in determining the employer-

enforced collection of the tax would place the company in bankruptcy before a suit for refund could be brought. The district court rejected the Government's contention that section 7421 (a) removed the subject matter of tax collection from the court's jurisdiction and heard the petition on the ground that the taxpayer had shown an "extraordinary circumstance" justifying resort to equity.[8] After asserting its jurisdiction, the court found that the tax was invalidly determined and accordingly exercised its equity power to grant the injunction. The Court of Appeals for the Fifth Circuit affirmed the district court decree.[9] On a writ of certiorari, however, the Supreme Court reversed and ordered the petition to be dismissed on the ground that section 7421 (a) rendered federal courts powerless to hear suits to enjoin the assessment or collection of federal taxes.

At common law the power to hear petitions seeking injunctions against the assessment or collection of taxes was unquestioned.[10] However, before a court would issue an injunction, an aggrieved taxpayer had to show that the Government was seeking to collect an illegal tax and that his legal remedies were inadequate.[11] Consequently, when Congress enacted the injunctive prohibition now found in section 7421 (a),[12] taxpayers construed it to be merely a

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employee relationship, has the status of an employee." Under the common law, factors in determining one's status as an employee included degree of control, opportunity for profit or loss, investment in facilities, permanency of relation, and skill required, Schwing v. United States, 165 F.2d 518 (3d Cir. 1948); Atlantic Coast Life Ins. Co. v. United States, 76 F. Supp. 627 (E.D.S.C. 1948).

In the instant case, the taxpayer maintained that since it did not exercise sufficient control over the alleged employees, they were independent contractors and thus no taxes were owed.

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

[9] Enochs v. Williams Packing & Nav. Co., 291 F.2d 402 (5th Cir. 1961).

[10] See Miller v. Standard Nut Margarine Co., 284 U.S. 498, 509 (1932); Gorovitz, *Federal Tax Injunctions and the Standard Nut Cases*, 10 TAXES 446 (1932). See generally 4 COOLEY, TAXATION ¶¶ 1640-42 (4th ed. 1924).

[11] See, *e.g.*, Miller v. Standard Nut Margarine Co., *supra* note 10, at 509; Hannewinkle v. Georgetown, 82 U.S. 547 (1872); Dows v. Chicago, 78 U.S. 108 (1870).

The common law distinction between the existence and exercise of jurisdiction is succinctly stated in 1 POMEROY, EQUITY JURISPRUDENCE § 130 at 156 (4th ed. 1918): "Equity jurisdiction . . . is the power to hear certain kinds and classes of civil cases according to the *principles* of the method and procedure adopted by the court of chancery, and to decide them in accordance with the doctrine and rules of equity jurisprudence. . . ."

[12] The prohibition first became law in 1867 as an amendment to a previous revenue act. Revenue Act of 1867, ch. 169, § 10, 14 Stat. 471. The amendment stated that "[N]o suit for the purpose of restraining the assessment or collection of tax shall be maintained in any court." Later this prohibition by itself became § 3224 of the 1875 Revised Statutes. Both § 3653 of the INT. REV. CODE of 1939 and § 7421 (a) of the INT. REV. CODE of 1954 substantially repeated the 1875 statute, except for the addition

codification of the common law.[13] Since the purpose of the provision was uncertain,[14] their interpretation appeared to be reasonable. However, when met with this contention in early cases, the Supreme Court rejected it and made it clear that the statute was meant to replace the common law and categorically proscribe equitable relief.[15] The new statutory provision was thus interpreted to be a jurisdictional limitation which deprived United States courts of the power to entertain any suits involving tax collections.

This literal construction was short-lived, however, and it was not long before dicta in two cases injected doubt into the previous pronouncements of unqualified prohibition.[16] In these cases it was stated, without adequate explanation, that while the statute generally prohibited maintenance of suits to enjoin collection of taxes, its provisions could be disregarded in cases involving "extraordinary and entirely exceptional circumstances." Shortly thereafter in *Hill v. Wallace*[17] the Supreme Court gave meaning to these words by holding that the prospect of financial ruin was such an "extraordinary and exceptional circumstance" as to allow a court to contravene the statute and entertain a taxpayer's petition for injunction. The efficacy of the *Hill* decision was somewhat mitigated, however, because the Court found that the tax as imposed by the Future Trading Act, was in essence a penalty to enforce the regulation of grain trades and not a proper exercise of the taxing power. On this

of the explicit redetermination exceptions which create a special statutory right to petition to the Tax Court for judicial determination of liability prior to payment of income, estate and gift taxes. For provisions of these redetermination exceptions, see note 28 *infra*.

[13] The taxpayers maintained that since the statute was declaratory of the common law, the prohibition against injunctive relief applied only to the *exercise* of equity jurisdiction and not to the *existence* of equity jurisdiction. Hence they claimed that it was a question for the court whether equity could act in view of the prohibition as applied to the circumstances of each particular case. See, *e.g.*, Graham v. DuPont, 262 U.S. 234 (1923); Bailey v. George, 259 U.S. 16 (1922); Snyder v. Marks, 109 U.S. 189 (1883); Gorovitz, *supra* note 10 at 447 n. 7; see generally 9 MERTENS, *op. cit. supra* note 4, at ¶¶ 49.210-12.

[14] Concerning the dearth of legislative comment and history, see Note, 49 HARV. L. REV. 109 n. 9 (1935).

[15] See, *e.g.*, Graham v. DuPont, 262 U.S. 234 (1923); Dodge v. Brady, 240 U.S. 122 (1916); Snyder v. Marks, 109 U.S. 189 (1883); 9 MERTENS, *op. cit. supra* note 4, at § 49.210 n. 24. See generally Gorovitz, *supra* note 10, at 446. *But see* Gall, *Enjoining the United States*, 10 VA. L. REV. 194, 203 (1923), where the author asserts that the statute did not change the common law.

[16] See Dodge v. Osborn, 240 U.S. 118 (1916) (income tax); and Bailey v. George, 259 U.S. 16 (1922) (Federal Child Labor Tax).

[17] 259 U.S. 44 (1922).

basis, *Graham v. DuPont*[18] distinguished the *Hill* case as involving a penalty and not a tax so as not to come under the provisions of the statute. Then, in *Miller v. Standard Nut Margarine Co.*,[19] the Supreme Court added further doubt as to the meaning of the statute by appearing to sanction the previously rejected view that the prohibition was, in fact, a codification of the common law.[20] After *Miller* the uncertainty surrounding the meaning of the statutory prohibition was reflected by a split among the lower courts. While many courts refused to hear petitions to enjoin the assessment or collection of a tax,[21] other courts entertained such petitions, but appeared to be uncertain as to when jurisdiction should attach.[22]

By unmistakably reaffirming its original interpretation that the statute operates as a complete bar to jurisdiction, the Supreme Court in the *Enochs* case finally settled the confusion surrounding section 7421 (a). In so holding, however, the Court did not overrule *Miller v. Standard Nut Margarine Co.*, but rather distinguished it on the ground that there the determination was patently illegal, hence only an "exaction in the guise of a tax" and thus not a proper subject of the statute.[23] The Court went on to emphasize, however, that so

[18] 262 U.S. 234, 258 (1923). [19] 284 U.S. 498 (1932).

[20] Justices Stone and Brandeis dissented on the ground that the statute precluded injunctive relief "whatever the equities alleged." *Id.* at 511.

For support of the view that the *Miller* decision adopted the common law, see Gorovitz, *supra* note 10, at 446; Note, 27 GEO. L.J. 237 (1938); Note, 49 HARV. L. REV. 109, 112 (1935); *cf.* Shelton v. Platt, 139 U.S. 591, 594 (1891); 9 MERTENS, *op. cit. supra* note 4 at ¶ 49.212; *compare* Miller, *Restraining the Collection of Federal Taxes and Penalties by Injunction*, 71 U. PA. L. REV. 318, 339 (1923), where the author concludes that all courts considered the statute to be merely a declaration of the common law.

[21] See, *e.g.*, Homan Mfg. Co. v. Long, 242 F.2d 645 (7th Cir. 1957) (courts should not deviate from the clear Congressional direction expressed in § 7421 (a)); Kaus v. Huston, 120 F.2d 183 (8th Cir. 1941) (a suit may be maintained only to enjoin the collection of a pseudo tax); Communist Party v. Moysey, 141 F. Supp. 332 (S.D.N.Y. 1956) (exceptions are more logically and properly catalogued as cases based upon factual situations in which § 7421 (a) is not applicable).

[22] Some cases appeared to follow the common law view and hold that jurisdiction pre-existed and would be exercised upon a showing of an inadequate legal remedy and proof of illegality. See, *e.g.*, Allen v. Regents, 304 U.S. 439 (1939); Lasoff v. Grey, 266 F.2d 745 (6th Cir. 1959); Shelton v. Gill, 202 F.2d 503 (4th Cir. 1953); Huston v. Iowa Soap Co., 85 F.2d 649 (8th Cir. 1936).

Others, however, appeared to follow the approach used in Hill v. Wallace, 259 U.S. 44 (1922), and did not allow jurisdiction to be asserted until a taxpayer had first shown an "extraordinary and exceptional circumstance" that compelled resort to equity. See, *e.g.*, John M. Hirst & Co. v. Gentsch, 133 F.2d 247 (6th Cir. 1943) (collection would force the closing of coal mines); Midwest Haulers v. Brady, 128 F.2d 496 (6th Cir. 1942) (collection would result in cessation of trucking business and forfeiture of common carrier certificate).

[23] 370 U.S. at 7.

long as there is some theory by which the Government can establish its claim, the determination is considered a *tax* within the prohibition of the statute, and regardless of the equities alleged, a court is powerless to look any further.[24] To allow otherwise, reasoned the Court, would frustrate the central purpose of section 7421 (a) which is to assure the United States of prompt collection of its lawful revenue.

In reaching the decision in the instant case, the Court did not take notice of the fact that the central purpose which it imputes to the statute has been abrogated in the three major fields of taxation. At an early date Congress recognized that allowing an appeal for judicial determination only after payment of a tax often subjected taxpayers to an undue hardship.[25] Therefore, it established the Board of Tax Appeals (now the Tax Court)[26] where a petition for judicial redetermination of income, estate, and gift taxes was expressly allowed prior to payment.[27] Section 7421 (a) explicitly provides for this exception by exempting from its general provisions any redeterminations properly before that court.[28]

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[24] "[T]he question of whether the Government has a chance of ultimately prevailing is to be determined on the basis of the information available to it at the time of the suit. Only if it is then apparent that, under the most liberal view of the law and the facts, the United States cannot establish its claim, may the suit for an injunction be maintained." *Ibid.*

[25] See H.R. REP. No. 179, 68th Cong., 1st Sess. 7 (1924) where it is stated that "although a taxpayer may, after payment of his tax, bring suit for the recovery thereof and thus secure a judicial determination on the questions involved, he can not in view of section 3224 of the Revised Statutes [now § 7421 (a) of the Int. Rev. Code of 1954] which prohibits suits to enjoin the collection of taxes, secure such a determination prior to the payment of the tax. The right of appeal after payment of the tax is an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment. The payment of a large additional tax . . . sometimes forces taxpayers into bankruptcy and often causes great financial hardship and sacrifice. These results are not remedied by permitting the taxpayer to sue for the recovery of the tax after payment. He is entitled to an appeal and to a determination of his liability for the tax prior to payment." The Senate Committee on Finance filed a similar report. See S. REP. No. 398, 68th Cong. 1st. Sess. 8 (1924).

[26] Revenue Act of 1924, ch. 234, § 900, 43 Stat. 336 (now INT. REV. CODE of 1954, §§ 7441-93).

[27] For the jurisdiction of the Tax Court, see INT. REV. CODE of 1954, § 7442. See generally 9 MERTENS, *op. cit. supra* note 4, at ¶ 50.08 n. 68.

[28] Section 7421 (a) is inapplicable where the Commissioner has determined a deficiency of income, estate or gift taxes under §§ 6212 (a), (c) of the 1954 Code providing the taxpayer has filed a timely petition for redetermination of such deficiency by the Tax Court, as provided in § 6213 (a). In such situations no assessment or collection of a tax is to be made until a final determination is rendered by the Tax Court. Section 6213 (a) expressly provides that the making of an assessment or levy prior thereto may be enjoined unless under § 6861 the Secretary of the Treasury or his delegates believe that the assessment or collection of a deficiency will be jeopardized by delay.

A taxpayer without recourse to the Tax Court may even have methods available by which to litigate the issue of his liability without first making full payment of a determination. While generally full payment is necessary in order to institute a refund suit,[29] if the determination is divisible into a series of separate, identifiable transactions or events, the taxpayer may pay a portion of the tax, institute a suit for refund and litigate the issue of his liability for the whole determination.[30] Another possible method of avoiding the full payment rule in the case of a social security tax would be for one of the taxpayer's alleged employees to pay his portion of the tax himself, then personally institute suit for a refund on the ground that he was not an employee and thus did not owe any tax.[31] If the decision should result in a finding that the necessary employer-employee relationship was lacking, then the alleged employer could conceivably use this finding as a basis for showing that the determination was patently invalid and thus establish equitable jurisdiction within the rule in *Enochs*.[32] Such a decision could also result in an abatement of the determination against the employer.[33]

[29] See Flora v. United States, 362 U.S. 145 (1960).

[30] See Flora v. United States, *id.* at 171-75 nn. 37 & 38; Steele v. United States, 280 F.2d 89 (8th Cir. 1960).

Since the decision in the instant case, the Williams Packing and Navigation Company has sought to invoke this exception by making payment of the amount claimed to be due for one quarter and suing for a refund. Both the Internal Revenue Service and the Department of Justice have informed petitioner, however, that they plan to challenge the divisibility of social security taxes. Respondent's Petition for Rehearing, p. 5. Also, the Government will probably contend that the tax in the instant case is not divisible because it is subject to credits and exemptions due to the nature of the taxpayer's business which make it impossible to determine accurately the amount due for a single quarter. Brief for Respondent, p. 15. For a case supporting the position that a tax subject to credits and exemptions is not divisible, see Jones v. Fox, 162 F. Supp. 449, 468 (D. Md. 1957).

[31] The Federal Insurance Contributions Act, INT. REV. CODE of 1954, §§ 3101-25, imposes a like tax on both the employer and the employee. While the employer is the collection agent for the tax on the employee and is liable for the tax regardless of whether or not it is collected, there does not appear to be any reason why the employee could not pay his portion of the tax himself and seek to establish his own non-liability. See INT. REV. CODE of 1954 § 3121.

[32] The prior judgment could be viewed as establishing that the tax was patently invalid so as not to be subject to the provisions of § 7421 (a). Therefore the Government could conceivably be collaterally estopped to deny the illegality of the tax in a subsequent petition for an injunction brought by the alleged employer and the patent illegality test would be met in the pleadings. Concerning the effect of such a prior judgment as collateral estoppel against the Government, see *Developments in the Law—Res Judicata*, 65 HARV. L. REV. 818, 840-65 (1952); *cf.* Bernhard v. Bank of America, 19 Cal. 2d 807, 122 P.2d 892 (1942); Coca-Cola Co. v. Pepsi-Cola Co., 36 Del. 124, 132-34, 172 Atl. 260, 263-65 (Super. Ct. 1934). See generally 1 MOORE, FEDERAL PRACTICE ¶ 0.401 (2d ed. 1961).

[33] Provisions for abatement are found in the INT. REV. CODE of 1954, § 6404.

However, these alternatives to full payment are dependent upon failure of the Government to make immediate collection,[34] and they are at best only possibilities which do not cover all situations. Consequently, by removing recourse to equity in determinations not within the statutory jurisdiction of the Tax Court, the *Enochs* decision may deny to a taxpayer access to both equitable relief and legal process until after an irreparable injury has been inflicted.

[34] If payment is not made within ten days after notice and demand the tax authorities are entitled to seize the taxpayer's property in order to satisfy the claim. INT. REV. CODE of 1954, §§ 6331-44. For collection by distraint, see generally 3 P-H 1962 FED. TAX SERV. ¶¶ 19801-28.