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SUMMARY PROCEDURE AGAINST TRANSFEREES OF ASSETS UNDER THE REVENUE ACTS OF 1926 AND 1928

IN matters of taxation, the problem of the government has always been to compel the gracious yielding of the unwilling taxpayer to its sovereign power. Each proposed tax measure is resisted vigorously by those upon whom the mounting burdens fall and, once the proposed tax does become law, each step in the administration of that law is met with further resistance by the embattled taxpayers. Nor will the taxpayer give up even when he feels the relentless arm of sovereignty tugging away at his pocket. In the conflict between the need of the government for increased revenue, and the necessity to exert its sovereign power to tax the source that can supply that need, the taxpayer set up so many legal difficulties in the way of easy collection, that it became necessary, as a measure of self-protection, to provide against any suit on the part of a taxpayer to restrain the assessment or collection of any tax.[1] The attempt on the part of the government to establish an income tax as part of its regular fiscal policy was beset with all these difficulties, in addition to others peculiar to the nature of a tax on incomes.

Among the administrative difficulties of the Income Tax Laws was the problem of collecting a tax assessed against a taxpayer where the taxpayer's property had been transferred to others, leaving nothing against which the government could distrain. Under such circumstances was the transferee under any obligation to pay the tax of the transferror? If so, how could the government proceed to enforce collection against such transferee?

So far as the statute is concerned, the government has spoken positively on the liability of the transferee for taxes assessed against a transferror. The Revenue Act[2] provides that a transferee of the property of a taxpayer may at law or in equity be liable for the tax imposed upon the transferror. The method of collection against the transferee is, in general,

[1] U. S. C. A., tit. 26, sec. 154.
[2] Rev. Act of 1928, sec. 311. See Appendix for section in full.

the same as in the case of the transferror, that is, by assessment and, following non-payment, distraint against transferee's property.

Certain basic legal and equitable principles have long permitted creditors to follow the transfer of property from one person to another and then to proceed against this property when found. In general, conveyances in fraud of creditors will be upset to protect creditors. That principles governing fraudulent conveyances are adequate justification for the summary procedure against transferees outlined in the Revenue Act is the contention of Dana Latham in two scholarly articles in the Illinois Law Review.[3] Courts have frequently established the liability of the transferee on the Trust Fund Doctrine that the capital stock of a corporation or the assets representing the capital stock is a trust fund for the benefit of creditors of the corporation.[4] While the government has always had the remedy of a suit against a person secondarily liable, this remedy compels the government to assume the burden of proof and also deprives the government of the benefit of administrative remedies.

Section 311[5] and, under the 1926 Act, section 280,[6] enables the government to proceed against those secondarily liable in the same manner as against those primarily liable. The effect of this section is to shift the burden of proof to the transferee and accomplishes the desirable purpose of speeding the collection of the tax. Both remedies are concurrent, and the summary procedure outlined in section 311 does not prevent the government from employing the remedy of suit.[7]

In addition to the trust fund theory and the principles underlying fraudulent conveyances, the federal statutes[8] provide that the tax after assessment and non-payment shall become a lien "upon all property and rights to property belonging to such person" against whom the tax is assessed. The lien attaches at the time the assessment list is received

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[3] (1927) 22 Ill. L. Rev. 233 and 397.
[4] U. S. v. Garbutt, 27 F. (2nd) 1000 (D. C., Wyo., 1928).
[5] *Supra* Note 2.
[6] Rev. Act of 1926, sec. 280.
[7] U. S. v. Greenfield Tap and Die 27 F. (2nd) 933 (D. C., Mass., 1928).
[8] Rev. Stat., sec. 3186; U. S. C. A., tit. 26, sec. 1115.

by the collector and, of course, the transferee who receives property even as a *bona fide* purchaser takes such property subject to the tax lien of the United States.

Several aspects of this entire summary procedure have plagued the unhappy transferee struggling to resist the imposition of the tax levy. He first fought this procedure on the ground that it was unconstitutional in that it did not give him an opportunity for a fair hearing and, consequently, resulted in a taking of his property without due process of law. Lower federal courts have declared the provisions of section 280 unconstitutional[9] on this ground. The position the transferee took was that the assertion of a deficiency against him by the Commissioner left him only with a choice of appealing to the Board of Tax Appeals[10] within sixty days or paying the tax and then suing to recover.[11] If he appealed to the Board of Tax Appeals and the Board decided against him, he might file a bond and appeal on questions of law to a Circuit Court of Appeals and thence upon certiorari to the United States Supreme Court.[12] In this procedure the Board of Tax Appeals has power to determine finally all questions of fact relating to the liability of the transferee. Inasmuch as the Board of Tax Appeals is an executive agency and an executive agency has made a final judicial determination, the transferee has not had his day in court and, *ergo,* there has not been due process. So ran the argument on the brief filed by *Amicus Curiæ* in Nauts v. Clymer.[13] In the Tyroler case the Circuit Court of Appeals, Sixth Circuit, reversed the District Court[14] on the ground that the power of the Commissioner or the Board to decide whether "any liability at law or equity" exists against the transferee to pay the transferor's deficiency was subject to the power of the Circuit Court

[9] Owensboro Ditcher & Grader Co. v. Lucas, 18 F. (2nd) 798 (D. C. Ky., 1927); Mid-Continent Petroleum Corp. v. Alexander, 35 F. (2nd) 43 (D. C., Okla., 1929).

[10] U. S. C. A., tit. 26, sec. 1048.

[11] Rev. Act of 1926, sec. 1113; Rev. Act of 1928, sec. 617B; Elmhurst Investment Co. v. U. S., 24 F. (2nd) 561 (D. C., Kan., 1928).

[12] Rev. Act of 1926, secs. 1001–1003; Old Colony Trust Co. v. Com., 279 U. S. 716, 49 Sup. Ct. 499 (1929).

[13] *Supra* Note 9.

[14] Routzahn v. Tyroler, 36 F. (2nd) 208 (C. C. A., 6th, 1929), *certiorari denied* 281 U. S. 734, 50 Sup. Ct. 248 (1929).

of Appeals to review the whole matter.[15] In this case a corporation, in 1925, retired its preferred stock, the stockholders receiving cash from the corporation in payment for their stock. In November, 1925, a deficiency tax for the year 1919 was assessed against the corporation. In 1927, transferee assessments were made against the preferred stockholders. The transferees did not avail themselves of their right to a review of the proposed assessment before the Board of Tax Appeals.[16] Instead, they asked for an injunction restraining the Collector from enforcing collection. The District Court,[17] on the authority of the Owensboro case,[18] granted the injunction, in spite of the provision of the United States Code[19] that, "No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court. In the Owensboro case the Court held that the secondary liability of a transferee grew out of his relationship to the transferror and was not within the scope of the provision of the United States Code since the transferee's liability was not a tax. In the 1928 Act, a specific provision[20] prohibits the granting of injunctions against the enforcement of the liability of transferees. This provision has been held to be constitutional.[21] Had section 280 been declared unconstitutional, then section 604 would likewise be unconstitutional. But it appears that a transferee is a taxpayer, as contemplated by section 602, Revenue Act of 1928, giving a taxpayer a right of review.

In Nauts v. Clymer[22] the transferee was a legatee, but the term "transferee" is broad enough to include the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, or the successor of a corporation, a party to a reorganization.[23]

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[15] Rev. Act of 1926, sec. 1001.

[16] *Supra* Note 10.

[17] Routzahn v. Tyroler, *supra* Note 14.

[18] Owensboro Ditcher & Grader Co. v. Lucas, *supra* Note 9.

[19] *Supra* Note 1.

[20] Rev. Act of 1928, sec. 604.

[21] Felland v. Wilkinson, 33 F. (2nd) 961 (D. C., Wisc., 1928).

[22] 36 F. (2nd) 207 (C. C. A., 6th, 1929).

[23] Small, 16 B. T. A. 658 (1929).

The case of Phillips *et al.* v. Commissioner,[24] in addition to disposing of any doubt as to the constitutionality of section 280 of the 1926 Act (sec. 311 of the 1928 Act), emphasizes another aspect of the procedure against transferees, namely, the extent of this secondary liability. Plaintiffs contended that the liability of the transferee should be only for a *pro rata* share of the corporation's unpaid taxes. The Court held that the transferee is liable to the full extent of the assets received by him. If he pays more than his fair share, he has a right of action against other transferees for equitable contribution. The Court quotes numerous cases in support of this proposition,[25] holding, further, that the government is not concerned with the rights of contribution that the transferee may have against others. The contention that the liability is for the full amount of the assets received and not a proportionate one is admittedly harsh, and has received adverse criticism by such able commentators as Klein[26] and Montgomery.[27] It is submitted that if the basis for fastening a secondary liability against a transferee is correct, then such liability must be for the full amount of assets received. Courts of equity will, it is true, require the joining of all available transferees as defendants,[28] but the non-inclusion of all the transferees should not result in a diminution of the tax liability of the primary obligor. The Court in the Phillips case,[29] speaking of the Armstrong decision,[30] says, "If U. S. v. Armstrong * * * can be thought contrary to this conclusion [*i.e.*, that the liability is not proportionate], we cannot yield to it."

The Board of Tax Appeals has consistently held that each transferee is liable for the full amount of the tax of the transferror up to the value of the property he has received.[31]

[24] 42 F. (2nd) 177 (C. C. A., 2nd, 1930), *certiorari granted* by the U. S. Supreme Court on October 20, 1930.

[25] Bartlett v. Drew, 57 N. Y. 587 (1874); Hatch v. Dana, 101 U. S. 205 (1879).

[26] Klein, Federal Income Taxation, ch. 43, p. 1555, 1930 supp., p. 228.

[27] Montgomery, Income Tax Procedure, (1927) p. 277, (1929) p. 421.

[28] U. S. v. Armstrong, 26 F. (2nd) 227 (C. C. A., 8th, 1928).

[29] *Supra* Note 24.

[30] *Supra* Note 28.

[31] Grand Rapids National Bank, 15 B. T. A. 1166 (1929); Menger, 17 B. T. A. 998 (1929); Executors of the Estate of Bilton McDonald, 18 B. T. A. 800 (1930); Stoney Amick & H. H. Stallard, 20 B. T. A. 501 (1930).

The liability of the transferee has been spoken of as a secondary liability. It is necessary for the government, generally, to exhaust its remedies against the primary obligor[32] before proceeding against the transferee and, of course, the government must first prove the existence of a liability for tax on the part of the transferror.[33]

In the interest of speedy collection of the tax, the government is not required to proceed against the transferror where such an action is known in advance to be futile. The Board of Tax Appeals in the Thompson case[34] held that where a deputy collector in an endeavor to execute distraint warrants learned that there were no corporate assets, the Commissioner could proceed against the transferees, even though the transferror corporation had not been dissolved. In another case,[35] upon the termination of a trust and the distribution of the trust property, the Commissioner was not required first to exhaust any remedies he might have against the trustee personally before proceeding against the transferee. The District Court has ruled similarly on the question of exhausting remedies against the primary obligor.[36]

On the question of the constitutionality of the transferee provisions, the Board of Tax Appeals has maintained a rather unique and unsound attitude, namely, that a transferee who appeals to the Board is precluded from questioning the constitutionality of the statute.[37] The only method of raising this issue would then be to pay the tax and sue for a refund.[38] While the Circuit Court[39] has attacked the unsoundness of the unique doctrine of the Board in the Cappellini case,[39a] the Board has nevertheless consistently maintained its holding. and this question still awaits a final disposition by the Supreme Court.

It was not the purpose of Congress to give the taxpayer any advantage in its provisions for summary procedure under

[32] Wire Wheel Corp. of America, 16 B. T. A. 737 (1929).
[33] Rogers, 12 B. T. A. 816 (1928).
[34] Thompson, 20 B. T. A. 1 (1930).
[35] J. A. Kemp, 20 B. T. A. 875 (1930).
[36] U. S. v. Courts, D. C., E. D., Okla., June 13, 1929.
[37] Cappellini, 14 B. T. A. 1269 (1929); J. H. Johnson and F. W. Weaver, 18 B. T. A. 840 (1930); John Thomson, Jr., 20 B. T. A. 1 (1930).
[38] *Supra* Note 11.
[39] Routzahn v. Tyroler, *supra* Note 14.
[39a] *Supra* Note 37.

section 280 of the 1926 Act or section 311 of the 1928 Act. But the unfortunate transferee does get one "break." The Commissioner has the burden of establishing all facts necessary to show that the transferee is liable at law or in equity for the taxes of the transferror,[40] although in determining the primary liability of the taxpayer, the burden of proof is on the transferee. Where the evidence does not establish affirmatively that certain stockholders received assets of the taxpayer, directly or indirectly, the Commissioner has not established the liability of the transferee.[41] The value of the assets transferred must also be established by the Commissioner.

There is yet another right that the transferee is granted, and that is to inspect records and documents of the transferror taxpayer.[42] Application may be made to the Board of Tax Appeals for a preliminary inspection whereupon a subpœna is issued by the Board to the taxpayer to produce the record[43] and the Courts will compel obedience to the subpœna.[44]

Is the transferee aided by the statute of limitations? The Revenue Act of 1928[45] provides that the liability of a transferee must be assessed within one year after the expiration of the period of limitation for assessment against the taxpayer.[46] In the case of a second transferee the assessment must be made within one year after the expiration of the period of limitation for assessment against the preceding transferee.[47]

These provisions are for the benefit and protection of the transferee and are liberally construed in his favor.[48] The transferee must plead his contention that the limitation provisions have outlawed the claim of the government against him or the Board will not pass upon that issue.[49] The burden is then shifted to the Commissioner to show waiver of the

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[40] Temoyan, 16 B. T. A. 923 (1929). Rev. Act of 1928. sec. 602.
[41] Joseph A. Stenile, 19 B. T. A. 325 (1930).
[42] Rev. Act of 1928, sec. 602.
[43] Rev. Act of 1928, sec. 617.
[44] Brownson v. U. S., 32 F. (2nd) 844 (C. C. A., 8th, 1929).
[45] Rev. Act of 1928, sec. 311 (b) (1); Gideon Anderson Co., 20 B. T. A. 106 (1930); O'Brien *et al.*, 20 B. T. A. 167 (1930).
[46] U. S. v. Updike, 281 U. S. 489, 50 Sup. Ct. 367 (1930).
[47] Rev. Act of 1928, sec. 311 (b) (2).
[48] U. S. v. Updike, *supra* Note 46.
[49] Stanfield *et al.*, 8 B. T. A. 787 (1927).

limitation sections or other special circumstances.[50] The limitation aspects of transferee assessments are dealt with thoroughly in a recent issue of The National Tax Magazine.[51]

Summarizing the procedure against transferees as above outlined, it cannot yet be stated definitely that section 280 of the Revenue Act of 1926 and section 311 of the 1928 Act are constitutional. The Supreme Court has refused to review the decision in Routzahn v. Tyroler,[52] which held the transferee provisions to be constitutional, although it has granted a writ of certiorari in the Phillips case,[53] which also confirmed the constitutionality of section 280. In the latter case there was also determined the collateral problem of the extent of the transferee's liability. It may be that the Supreme Court is not yet satisfied that such liability should extend to the full value of the assets received, but should be prorated. It is the opinion of the writer that the Supreme Court will sustain the constitutionality of section 280 as well as the several liability of transferees to the full extent of the assets received.

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[50] White Eagle Oil & Refining Co., 19 B. T. A. 185 (1930); J. A. Kemp, *supra* Note 35.

[51] Schwertner, Assessment of Income Taxes Against Transferees, Vol. 8. No. 11 (November, 1930), p. 397.

[52] *Supra* Note 14.

[53] *Supra* Note 24.

§ 311. Transferred Assets.

(a) Method of Collection. The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) Transferees. The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.

(2) Fiduciaries. The liability of a fiduciary under section 3467 of the Revised Statutes in respect of the payment of any such tax from the estate of the taxpayer. Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) Period of Limitation. The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer—within one year after the expiration of the period of limitation for assessment against the taxpayer;

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer—within one year after the expiration of the period of limitation for assessment against the preceding transferee, but only if within three years after the expiration of the period of limitation for assessment against the taxpayer; except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the taxpayer or last preceding transferee, respectively,—then the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

(3) In the case of the liability of a fiduciary—not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later.

(c) Period for Assessment Against Taxpayer. For the purposes of this section, if the taxpayer is deceased, or in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

(d) Suspension of Running of Statute of Limitations. The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in section 272(a), be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

(e) Address for Notice of Liability. In the absence of notice to the Commissioner under section 312(b) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this title, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this title even if such person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(f) Definition of "Transferee." As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.