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COLLECTION AND COMPROMISE OF PENALTIES UNDER THE INCOME TAX LAW

Probably the most manifest phenomenon today resulting from the break-down of the American legal system for the prevention of crime is that tendency of the legislative branches of the government to place into the hands of an administrative, rather than a judicial officer the summary and arbitrary power for the collection of penalties and the enforcement of forfeitures. One may understand the scepticism of the layman or more progressive lawyers upon the results of any reform of judicial procedure in criminal law when one reflects upon the treatment which the code reform of common law pleading received a few generations ago at the hands of those men who interpreted the law. The purpose of penalties and forfeitures is preventative and punitive in the same character as any criminal action. An individual should be given the same constitutional safe guards in such cases as in a criminal action.¹ It may prove interesting to examine a recent case upon this question.

Walker v. The Alamo Food Company was decided in 1927 by the Federal Circuit Court of the Fifth District.² The facts deserve special notice. In 1918 two criminal indictments were returned by the federal grand jury charging the officers of the plaintiff corporation with making false and fraudulent tax returns. In 1919 the commissioner of internal revenue made an assessment against the plaintiff for \$370,000 for income taxes and penalties for the years of 1916 and 1917, giving ten days notice to pay the amount or a distress warrant would issue against the property of the plaintiff and a sale be made by the revenue officer without any court action. Plaintiff applied to the collector for time and was granted such extension only upon the condition that all its property be conveyed to a trustee to await the determination of the request of abatement. Plaintiff, after the refusal to abate the assessment, took advantage of the provision of the federal statute and submitted "a proposal of compromise" to the collector.³ The proposal included a fifty per cent reduction

¹ Chancellor Kent said that an administrative officer should not be given the power to enforce penalties and forfeitures for the person is deprived of a trial by jury in a case that is "highly penal". 1 Kent's Com. (13ed) 372, 376.

Also see Mr. Justice Field's remarks in *U. S. v. Chouteau* (1880), 102 U. S. 603.

² 16 Fed. (2) 694.

³ U. S. C. 26-158; R. S. 3229 (Comp. Stat. 5952).

of the penalty and full payment of the tax. The common practice in such cases is that the "proposal" must come from the taxpayer, but the terms, which would be "acceptable" are actually suggested or hinted by the collector.⁴ This fact is extremely important in determining the character of the transaction, whether it is in reality a demand and coerced payment or an offer and a free and voluntary payment by the party. The proposal included the dropping of all criminal prosecutions under the revenue laws against the officers of the plaintiff.

This compromise was accepted and plaintiff paid the money and then brought suit for the sum alleging that it was exacted illegally and under protest and coercion. The court held that neither the tax nor the penalty could be recovered giving as its reason that the payment was voluntary and a compromise. There are a number of points raised by this case. The Supreme Court has not passed upon a case of this kind although it has in numerous cases announced principles which if applied to this case would reverse the lower court.⁵ Let us take the points up separately.

1. A distinction should be noted between the payment of the tax which was in full and the penalty which was compromised by the revenue officer. This is of the highest importance.⁶ A

⁴ The writer has found this to be the common practice. Hence the proposal really comes from the government.

⁵ But see the anomalous and well known case of *Oceanic Navigation Co. v. Stranahan* (1909), 214 U. S. 320, 29 S. Ct. 671.

⁶ There is an immense practical importance in this distinction as will readily be seen upon reflection of the method of collection of taxes and the enforcement proceedings. The designation of the amount to be paid as a "tax" is not conclusive. (See *Dukrich v. Blair* (1925) 3 Fed. (2) 302), nor is it if designated a "penalty", if the money is really for revenue. See State ex rel. *Auban School District v. Boyd*, 63 Neb. 829, 89 N. W. 417. If the collection is for the purpose of compensating for an injury to a private individual it is debt. See *State v. Public Service Commission* (1917) 94 Wash. 274, 162 Pac. 523. But if the purpose is to prevent and punish for an act which is in statutory declaration stated to be illegal, it is penal. Especially is this so if the sum is recoverable by the government. *Dukrich v. Blair*, 3 Fed. (2) 302.

This question arises quite often in cases of violation of Federal liquor laws, under which congress placed a "tax" upon illegally manufactured liquor. The point was urged before the Supreme Court that this was in reality a penalty, but the court held quite logically that if the amount payable is the same as that against legally manufactured spirits it is a tax, for a criminal should not be relieved of the burdens of supporting the government which are assumed by those acting legally. See *U. S. v. One Ford Coupe*, 47 S. Ct. 154 (1926). But if the amount levied is greater than that against legally manufactured spirits, it is a penalty. *Lipke v. Lederer*, 259 U. S. 557, 42 S. Ct. 549, 66 L. Ed. 1061.

penalty is a punishment. Has an administrative officer the arbitrary power to decide the amount of the punishment and when it shall be visited upon a violator of the law? This statement needs no authority to deny it. Constitutional provisions say that a person shall not be deprived of his property without due process. Today only the Federal Government and the State of New York use the summary distress warrant for the collection of revenue.⁷ The theory originated in the idea that the government should be saved from any financial embarrassment in the collection of its revenue by the quick remedy of putting a person's property up for sale without any court action. Certainly there is no need for the collection of penalties in the same summary manner. The government should wait until a court has tried the person for his crime and not leave it to the discretion of an administrative officer to decide whether there has been a violation or not and the amount of penalty. But the tenderness of the courts for the financial feelings of the government has gone so far as to relieve it of any of its obligations when it does not care to be sued.⁸

The state courts seem to be unanimous in not permitting the enforcement or collection of any penalties by an administrative officer, even when the proceedings are quasi-judicial and notice and hearing is given, which if it were not for the penal nature of the proceedings would be quite legal.⁹

2. If an administrative officer has no power to collect a penalty should an officer have the power to compromise or forgive

⁷ See Cooley on Taxation, p. 438; *McMurray v. Hoboken* (1855), 18 How. 272; *Ross v. Holtzman* (1828) Fed. Case No. 12,075 (3 Cranch C. C. 391).

⁸ The leading cases are: *Langford v. U. S.* (1879), 101 U. S. 341, 25 L. Ed. 1010; *Levy v. Mayor* (1848), 1 Sandf. (N. Y.) 465. The propriety of the rule that a state is not liable for its torts may be doubted in recent times, since a government is operated for the good of the people and the people should sustain by taxation any injury or unusual hardships inflicted in the functioning of the government for the common good.

⁹ The revocation of a license is ordinarily not penal in character, but if the statute provides that upon violation of the law the individual shall be fined and in the same provision of the criminal code, states that his licenses shall also be revoked, the courts have said that this is part of the punishment and an administrative body cannot revoke the license but the court must so act if it sees fit and make it part of the punishment. *Wichita Electric Co., v. Hinckley* (1910), — Texas Civ. App. 131 S. W. 1192. But if the regular licensing act provides among other causes for revocation that of a violation of the law, an administrative body may act after conviction or before, if on notice and hearing, and revoke the license. See *Spiegler v. City of Chicago* (1905), 216 Ill. 114, 74 N. E. 718, *Higgins v. Talty* (1900), 156 Mo. 280. Removal from office ordinarily is not penal in character.

a penalty? Punishment is strictly a judicial function and an individual should have his constitutional privileges guaranteed. Logically if an administrative officer cannot exercise the affirmative power he should not be given the negative. An administrative tribunal may not be granted the power to pardon except by a constitutional provision.¹⁰ In compromising penalties there is as wide a field for abuse as in enforcing them without judicial process, considering the inconvenience to which an innocent individual may be placed by the whim of some over-zealous officer.

3. The court in the instant case found that there was no protest or coercion in the payment of the money, with the threat of the sale of the property in ten days and two indictments held over the corporate officers' heads. One wonders what would be coercion in such a case. The court does not tell us. It may be assumed without argument that one never endures punishment without protest. Then may one be expected to pay a penalty without coercion or protest? No such assumption need exist in the case of a tax, for it is not a penalty or punishment.¹¹

The question then arises whether a compromise may be paid under protest and coercion; or must one pay the full amount demanded in order to argue that the amount was exacted under coercion? It seems this should not be necessary. One would naturally seek to pay as small an amount as necessary particularly if he thought that the penalty was illegal or not applicable to him. The fact that he pays a compromised or smaller amount is not evidence of no coercion or protest.¹² In natural justice he should have the right to recover any sum paid the government by mistake or illegally although not under protest at the time. Yet this is not the law in the case of taxes.¹³ Certainly the government should be as lenient to an individual who pays a

¹⁰ A very interesting case on this point is *Allen v. Board of State Auditors* (1899), 122 Mich. 324, 81 N. W. 113.

¹¹ "The parties were not on equal terms. The appellant had no choice. The only alternative was to submit to an illegal exaction or discontinue business. It was in the power of the officer of the law and could only do as he required. Money paid or other value parted with under pressure has never been regarded as a voluntary act within the meaning of the maxim *volenti non fit injuria*" *Swift Co. v. U. S.* (1884), 111 U. S. 22, 4 S. Ct. 244.

¹² The writer intentionally employed the double negative here because an affirmative statement would not convey the correct meaning.

¹³ Authorities in point are too numerous to mention. Shaw C. J. says: "When therefore a party not liable to a taxation is called upon peremptorily to pay upon such a warrant and he can save himself and his property in no other way than by paying the illegal demand, he may give notice that he so pays it by duress and not voluntarily, and by showing that he is not liable recover it back for money had and received." *Preston v. Boston*, 12 Pick. 14.

sum willingly as he who is protesting and finally establishes his right. At least the propriety of such a rule is doubtful and should not be extended to penal cases where there was in reality a protest and coercion but a smaller amount was paid by compromise.

4. No case cited in the opinion involved a compromise of a penalty by an administrative officer. The cases cited were either contracts with the government which were compromised¹⁴ or cases of taxation.¹⁵ Only one was of a penal nature, and it was not compromised by an administrative officer but was paid in full before demanded and voluntarily at the time the delinquent tax was paid.

5. The compromise agreement had the added feature of the dropping of criminal prosecutions. This savors very much of the purchasing of justice through an administrative officer.

A federal statute authorizes this dubious action along with the uncertain "pardoning power" by compromising penalties.¹⁶ If a person is guilty he deserves the full penalty as decided by a court of criminal jurisdiction. If he is not guilty he should not be punished especially at the whim of an officer who wields an arbitrary power in his hands, which he may exercise or compromise at his discretion. One may well imagine a case in which an innocent individual might feel the economy of paying what is hinted would be "acceptable" in a "proposal of compromise" in order to keep his business and property free and in operation or to forego the possibility of an indictment being returned against him or an action for taxes and penalties the outcome of which would be uncertain. In such a case he should have the same remedy as one who paid the full amount and recover all which was illegally taken. The rule against the recovery of money paid voluntarily need not be extended to an absurdity especially in view of the doubtful advisability within the sphere in which it is now working.

If an administrative officer may not enforce a penalty, logically he should not have the power to forgive or compromise a

¹⁴ *Swift Co. v. U. S.* (1884), 11 U. S. 22, 14 S. Ct. 244; *Savage Executric v. U. S.*, 92 U. S. 382, 23 L. Ed. 66; *Little v. Bowers* (1890), 134 U. S. 547, 10 S. Ct. 620; *Ostrum v. City*, 30 Tex. Civ. App. 462, 71 S. W. 304; *Lee v. Inhabitants* (1859), 79 Mass. 476, 13 Gray 476; *Ward v. Love*, 253 U. S. 17, 40 S. Ct. 419; *Gear Scott and Co. v. Shannon*, 223 U. S. 468, 32 S. Ct. 236; *U. S. v. New York and Cuba S. S. Co.*, 200 U. S. 488, 26 S. Ct. 327; *Railroad Co. v. Commissioners*, 98 U. S. 541, 25 L. Ed. 196.

¹⁵ *Palomares Land Co. v. Los Angeles County* (1905) 146 Cal. 530, 80 Pac. 3.

¹⁶ See U. S. C. (1926), 26-158; R. S. 3229 (Comp. Stat. 5952).

penalty. Particularly is this so when terms of the compromise includes the abatement of other criminal prosecutions against the individual. The federal courts, however, do not seem to have given much consideration to the constitutional question arising in inflicting and compromising of penalties outside the courts. The few cases that have been brought to the attention of the courts upon the question of compromises have been by parties wishing to take advantage of the statutory terms and the duty was placed upon the government officials to urge the unconstitutionality of such provisions, who would not be very prone to do so. The cases have dealt mainly with the interpretations of the statutes as a result. In *Dorsheimer v. United States* (1866) a revenue collector objected to a compromise agreement because it reduced the amount to be received by him as a reward for discovering the illegal act of the taxpayer.¹⁷ The compromise was held valid. In *United States v. Chouteau* (1880) there was an action on a bond for a penalty, and a compromise agreement was pleaded.¹⁸ It was held a good defense.

Federal administrative officers have an unusual latitude in the exercise of arbitrary and summary powers, it will be seen upon investigation or contact with them in matters of immigration, revenues, and prohibition laws. They are in a class by themselves. Just why the federal courts should see fit to deviate from the established principals regarding judicial trials, particularly in penal cases, while all the states are quite conservative in permitting any officer to exercise such summary powers is worth considering. One wonders if bureaucracy tends towards these principles. There seems to be less reason for federal officers exercising such powers than for state officers since ones remedies in federal cases are not as complete and convenient.¹⁹

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¹⁷ 7 Wall. 166; 74 U. S. 166.

¹⁸ 102 U. S. 603; In *Rau v. U. S.* (1919), 260 Fed. 131, the same question arose and a compromise agreement was held to be a good defense to an action brought for violation of the act for which the penalty was paid.

¹⁹ Many extraordinary remedies against federal officers can be sought only through courts of the United States and in some cases only in the District of Columbia, since the court in that district alone, of all federal courts, has the common law jurisdiction of the King's Bench, necessary for the writ of mandamus. *Kendall v. U. S. ex rel Stokes* (1838), 12 Pet. 524, 9 L. Ed. 1181; See also *Bath County v. Amy* (1871), 13 Wall 244, 20 L. Ed. 539.