Journal of Accountancy

Volume 43 | Issue 5 Article 5

5-1927

Income-tax Department

Stephen G. Rusk

Income-tax Department

EDITED BY STEPHEN G. RUSK

Senate resolution 304, adopted without comment by the 69th congress, reads, in part, as follows:

"Whereas it has become the usual practice of corporations, in order to protect stockholders from the payment of income taxes, to declare stock dividends; and

"Whereas this procedure enables corporations to acquire competing plants, and in this way avoid the provisions of the anti-trust laws; . . ."

As a result of such astute reasoning the federal trade commission was directed to ascertain and report to the senate the names and the capitalization of corporations that have issued stock dividends, together with the amount of such stock dividends since the decision of the supreme court holding that stock dividends were not taxable, as well as prior to said decision.

Congress, or at least a few of its members, apparently can not rid itself of the idea that the directors of corporations spend a great deal of their time in thinking up ways to avoid the distribution of accumulations of earnings to the stockholders for the sole purpose of protecting these stockholders from the payment of surtaxes on dividends.

It would be interesting to know how "usual" is the practice of declaring stock dividends with the purpose of evading the provisions of section 220 of the several revenue acts. It is probably more accurate to say that in cases of the declaration of most stock dividends the directors are actuated by purposes quite different from the protection of their stockholders from the payment of taxes on dividends. The usual reason is that because of the increase of the business the declaration of other than a stock dividend would so deplete the working capital as to render it necessary to borrow needed funds to carry on. When it is remembered, too, that an income made up largely of dividends sustains a total tax much less than income derived in any other way except from tax-free bonds, it will be readily apparent that it is not the "usual" practice of corporations to distribute stock dividends to avoid the taxation of dividends.

It is trite to say that the recipient of a stock dividend is no richer upon its receipt than he was before. If the market of the stock increases and he sells any of the stock so received, the stockholder then pays a normal tax as well as a surtax upon the profit of the sale. If he takes his stock so received, and borrows money on it, he is no richer. In view of these generally known facts it is a cause of wonder that some congressmen still consider the distribution of a stock dividend as a sinister move against the interests of the government and of the general public.

A review of the returns of corporations for the year 1925 revealed the fact that a surprisingly small percentage of them were conducted at a profit. If this is the case for many years and if the fact should become known to congress, it is barely possible that that body will look with more tolerance upon corporations and their activities and cease to believe it can judge all corporations by the acts of a few of them.

SUMMARY OF RECENT RULINGS

Collection by distraint of income taxes imposed by the revenue acts of 1916 and 1917 is barred by section 250 (d) of the revenue act of 1921 five years from the time the return was filed, although the taxes were duly assessed within the five-year period provided by section 250 (d) of the act.

Distraint is a "proceeding" as that term is used in section 250 (d) of the revenue act of 1921.

The intention of congress by section 250 (d) of the revenue act of 1921 was to protect taxpayers against any proceedings whatsoever for the collection of tax claims not made and pressed within five years of the time the return was filed. (United States supreme court, *Bowers* v. *New York and Albany Lighterage Company.*)

Real estate is part of the taxable estate of a decedent owner under the 1921 act, though the state statutes do not make it liable for expenses of administration. (Court of claims of the United States, *Steedman and Edmunds* v. *United States.*)

In the absence of a bill of exceptions and statement of the evidence, the judgment of the lower court, involving invested capital, was affirmed, its findings of fact and conclusions of law constituting a sufficient written opinion and supporting its judgment. (Circuit court of appeals for the seventh circuit, *P. H. and F. M. Roots Company,* v. *United States.*)

Amount received in 1919 on cashing in insurance policies on which all premiums had been paid before March 1, 1913, is taxable on excess only over value on latter date, being the then present value of what they would be worth at maturity, the amount paid from earned surplus being taxable as dividends, the remainder being subject to both normal and surtaxes. (United States district court, W. D. of Kentucky, *Alexander* v. *Lucas, collector.*)

Invested capital under the 1918 act may include cash value of notes paid for stock in good faith, although the state law provided that no stock should be issued for notes, such notes nevertheless being unforceable. (Circuit court of appeals for the second district, *Bowers, collector* v. *Max Kaufman & Co., Inc.*)

The interest accruing from sums received by a cemetery company from purchasers of lots and by it paid into a perpetual maintenance fund does not constitute taxable income to the cemetery company. (United States district court, W. D. of Missouri, *Troost Avenue Cemetery Company* v. *United States.*)

Transfer in trust, leaving no interest in grantor, made a few months before his death, to accumulate the income for thirty years, then principal and interest to be divided among grantor's children or their issue, not claimed made in contemplation of death, was not one to take effect at or after death. (Supreme court of the United States, *Executrices of estate of Gustav E. Shubert* v. *Allen, collector.*)

A bank, calling itself a partnership, having delectus personarum, having no entity other than its members, and managing its business through its cashier, who acted for himself and as the agent for his partners, is not taxable as a corporation under the 1918 act, although the retiring or death of a member, transfer of a member's interest, or the coming in of a new member does not cause a discontinuance of the business. (United States district court, S. D. of Illinois, *The Walnut Bank* v. *United States.*)

TREASURY DECISIONS

T.D. 3984, February 24, 1927

ARTICLE 1011: Compromise of tax cases.

Income and excess-profits taxes—Revenue acts of 1916 and 1917—Decision of circuit court of appeals

TAXES—COMPROMISE—SUIT

Where a taxpayer pursuant to section 3229 of the *Revised Statutes* offers a certain sum in compromise of taxes, penalties, civil

and criminal liability, and the offer is duly accepted by the authorized officers of the government, an action at law can not thereafter be maintained to recover back a part of the taxes alleged to have been illegally assessed and collected.

The following decision of the United States circuit court of appeals for the fifth circuit in the case of *Alexander S. Walker, formerly collector of internal revenue*, v. *Alamo Foods Co.* is published for the information of internal-revenue officers and others concerned.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Alexander S. Walker, formerly collector of internal revenue, plaintiff in error, v. *Alamo Foods Co., defendant in error*

Error to the district court of the United States for the western district of Texas

[January 4, 1927]

WALKER, circuit judge: This was an action by the defendant in error, the successor of the San Antonio Brewing Association (herein called the plaintiff), against the plaintiff in error, former collector of internal revenue (herein called the collector), for the recovery of the sum of $237,128.53 with interest thereon. By stipulation of the parties a jury was waived, and the court made findings of facts and conclusions of law, and thereon judgment for the amount sued for was rendered. The following statement indicates the circumstances of the payment of the principal amount sought to be recovered: In July, 1918, two criminal indictments were returned by the federal grand jury at Austin, Texas, charging C. T. Priest, plaintiff's vice-president and general manager, with knowingly participating in filing false and fraudulent tax returns on behalf of the plaintiff for the year 1917. Prior to August 14, 1919, the commissioner of internal revenue made an assessment against plaintiff in the sum of $370,184.53, for additional income taxes for the year 1916, for income and profits taxes for 1917, and for penalties. On the last-mentioned date the collector caused to be served on plaintiff notice demanding payment within 10 days of the amount of that assessment. Thereupon the plaintiff applied to the collector for an extension of time for payment to enable it to file claims for abatement and to secure hearings thereon before the commissioner of internal revenue. Upon the collector refusing to grant such extensions unless plaintiff executed a conveyance of all its property to a trustee, conditioned to pay the assessed taxes and penalties if the request for abatement was not granted, plaintiff executed such conveyance. Thereupon plaintiff filed claims for abatement of the taxes and penalties assessed. On November 13, 1919, the commissioner notified plaintiff that the sum of $27,486.78 was abated, and that the amount of the assessment was reduced to $342,697.75. Thereupon the collector demanded payment of the just stated amount. When this occurred the plaintiff requested the collector to postpone enforcement of the trust deed to enable plaintiff to communicate further with the commissioner with a view to the latter reconsidering the controversy. The collector complied with this request. During the period of several months thereafter representatives of the plaintiff had numerous conferences with the officials at Washington in the effort to bring about a reduction of the assessment. Even before that assessment was made a representative of the plaintiff notified the department that the plaintiff would prepare and submit a proposition to settle and compromise the matters in question, both criminal and civil. In November, 1919, after it was disclosed that plaintiff could not obtain a reduction of the assessment, at a conference in Washington between officials and the representative of the plaintiff who had knowledge of all the pertinent facts, it was agreed that plaintiff would make an offer of compromise and settlement on terms stated, which included a 50 per cent. reduction in the penalties assessed and a dismissal of the above-mentioned indictments. Pursuant to that understanding the plaintiff, in December, 1919, and January, 1920, made deposits, the aggregate of which

made up the amount proposed to be paid by plaintiff, and the plaintiff submitted the following written offer, dated February 1, 1920:

"COLLECTOR OF INTERNAL REVENUE,
Austin, Tex.:

"The undersigned, The San Antonio Brewing Association, seeking the benefits of section 3229, United States *Revised Statutes*, hereby tenders the sum of $318,039.70 in payment of all income and excess-profits taxes, and in compromise of all penalties and other civil and criminal liabilities of said association and its officers growing out of internal-revenue taxes due for the years 1916 and 1917.

"SAN ANTONIO BREWING ASSOCIATION,
[Signed] "By C. T. PRIEST, *Vice-president.*"

That offer was received in the office of the solicitor of internal revenue in May, 1920. After the acceptance of this offer had been recommended by the commissioner of internal revenue and that recommendation had been approved by the secretary of the treasury and by the attorney general, the solicitor of internal revenue, on August 23, 1920, by the following written communication, advised the plaintiff of its acceptance:

"SAN ANTONIO BREWING ASSOCIATION,
San Antonio, Tex.:

"SIRS: The commissioner of internal revenue has considered the proposition submitted by you on May 14, 1920, through the collector of internal revenue at Austin, Tex., as a compromise of liabilities on account of filing false and fraudulent income and excess-profits tax returns for the years 1916 and 1917, and has decided, with the advice and consent of the secretary of the treasury and the concurrence of the attorney general, to close the case by the acceptance of the following terms:

"$318,039.70 in payment of all income and excess-profits taxes and in compromise of all penalties and all civil and criminal liabilities of the San Antonio Brewing Association and its officers growing out of internal-revenue taxes due for the years 1916 and 1917.

"Respectfully,
[Signed] "WAYNE JOHNSON,
"*Solicitor of Internal Revenue.*"

Thereupon the above-mentioned indictments were dismissed. In August, 1923, claims for the refund of the additional taxes and penalties involved in the above-mentioned compromise and settlement were filed. In December, 1923, those claims for refund were rejected for the reason that the controversy as to the subject of them had been settled. This suit was brought on June 10, 1924, the principal amount sued for being the amount paid as above stated less the part thereof which was admitted by plaintiff to have been properly paid. The court's conclusions of law included one to the effect that said payments by plaintiff and said attempted compromise were made under duress, and that, because of such duress neither the payments nor the compromise are binding on the plaintiff. It is disclosed that the only finding of fact upon which the just mentioned conclusion was based was the following:

"That the proposal of compromise hereinbefore found, was not made voluntarily and that the taxes and penalties paid in pursuance thereof were not paid voluntarily, but that such proposal and the payment of such taxes and penalties were made only by reason of the threat made by the collector to distrain the property of the association if the taxes and penalties were not paid within ten (10) days after the notice by the collector demanding such payment, and because of the threat of the collector to make sale of the association's property under the deed of trust or mortgage given by the association to secure the payment of such taxes and penalties if not promptly paid, and because of the

pendency of the indictments against C. T. Priest and the threat to prosecute the same."

The facts of this case do not call for the application of the rule that money paid to prevent the enforcement of process for the collection of taxes not legally due or owing may be recovered if the making of such payment was accompanied with notice that the party making it did not do so voluntarily. (*Ward* v. *Board of County Commissioners of Love County*, 253 U. S., 17; *Gaar, Scott & Co.* v. *Shannon*, 223 U. S., 468; *United States* v. *New York & Cuba Mail S. S. Co.*, 200 U. S., 488; *Railroad Co.* v. *Commissioners*, 98 U. S., 541.) There is a material difference between a payment so made and a payment made pursuant to an agreement of compromise of the matters in dispute. A party against whom taxes have been assessed is at liberty to make or accept or to refrain from making or accepting an offer of compromise. The making of an offer of compromise is a voluntary act, and the contract resulting from its acceptance is binding on a party unless his consent to the contract was illegally obtained. (*Ostrum* v. *City of San Antonio*, 71 S. W., 304; *Palomares Land Co.* v. *Los Angeles County*, 146 Calif., 530; *Lee* v. *Inhabitants of Templeton*, 13 Gray, 476.) The opinion in the case of *Swift Co.* v. *United States* (111 U. S., 22), which was invoked by counsel for the plaintiff, and the opinion in the same case on a previous appeal (105 U. S., 691), recognize the distinction between a coerced payment and a payment made pursuant to a contract or agreement. It clearly appears from those opinions that the plaintiff in that case would not have been entitled to recover if an agreed settlement of the matters in controversy had been proved. Furthermore, a material difference between that case and the instant one is indicated by the following statement made in the opinion rendered on the second appeal.

"No formal protest, made at the time, is, by statute, a condition to the present right of action, as in cases of action against the collector to recover back taxes illegally exacted."

The payments now in question were made, not in compliance with any official demand or statutory requirement, but in pursuance of an agreement to which the plaintiff was a party, and without protest or notice that in making or complying with that agreement the plaintiff acted otherwise than voluntarily. The making of that agreement was authorized by the statute providing for the compromise of any civil or criminal case arising under the internal-revenue laws. (R. S. 3229, Comp. Stat., sec. 5952.) A compromise by which the authorized representatives of the government agreed to take, and the plaintiff agreed to pay, a less sum than had been assessed against the latter had the effect of extinguishing the controversy between the parties to the contract. (*Little* v. *Bowers*, 134 U. S., 547, 556.) The matters which were in controversy between the parties to the compromise before it was made are not subject to be reopened if the compromise was binding on the parties, and the question whether it was binding is determined by rules applicable to contracts generally. A payment made pursuant to a contract can not be recovered back without annulling or canceling the contract, and that can not be done unless the payer's consent to the contract was illegally obtained, or without his taking prompt action to annul or avoid the contract and restoring the status which existed before the payment was made. The party seeking to get back what he has paid can not retain the benefits of the contract and escape its burdens. (*McLean* v. *Clapp*, 141 U. S., 429; *Grymes* v. *Sanders*, 93 U. S., 55; *Multnomah County* v. *Title Guarantee & Trust Co.*, 46 Oregon, 523.) The indictment mentioned having been dismissed pursuant to the compromise agreement, it is obvious that it was impossible to restore the status which existed before that agreement was made. In the situation which existed between the date of the making of the demand that plaintiff pay the amount of the assessment finally made and the date of the compliance with the compromise agreement it was open to the plaintiff either to pay under protest the amount assessed and sue for the whole or any part thereof claimed to have been erroneously or illegally assessed or collected. (Comp. Stat., sec. 5949), or to avail itself of an opportunity to settle by compromise the matters in controversy. It chose the last-mentioned alternative. By this suit it claims that it was as free to attack the assessment

as it would have been if it had chosen the other alternative. No finding made indicates that in making the compromise the plaintiff acted without full knowledge of all the circumstances, or that it was influenced by any constraint except such as resulted from the facts that when the agreement was made the above-mentioned indictments against one of its officers was pending and the collector had means of promptly enforcing collection of the assessment made. It well may be inferred that when the statute authorizing the compromise of any civil or criminal case arising under the internal-revenue laws was enacted it was contemplated by the lawmakers that it would frequently happen that at the time of the making and acceptance of an offer of compromise an assessment of taxes claimed to be due would be presently enforceable and there would be pending a charge of criminal misconduct with reference to such taxes against the party claimed to be liable therefor or a representative of such party. Officials rarely would be justified in exercising the power to compromise criminal cases if the pendency of a duly made criminal charge sought to be included in a proposed compromise has the effect of enabling the party seeking the compromise to repudiate the compromise or treat it as a nullity except as to its result in getting rid of the criminal charge. Certainly a compromise agreement to pay a stated sum is not kept from being binding on the party agreeing to make such payment by the fact that that party knew that the payment by him of a greater sum could and would have been coerced if he had not so agreed. (*Savage, Executrix*, v. *United States*, 92 U. S., 382.)

The court's ruling was to the effect that the plaintiff was entitled to treat the compromise agreement as a nullity and to maintain an action to recover back the amount wrongfully assessed, because at the time that agreement was made plaintiff was subject to be coerced to pay a larger sum than the one it agreed to pay and its representative was subject to be tried under the indictments against him, though the plaintiff did not promptly take action to avoid or annul the compromise agreement and could not restore the status which existed before that agreement was made and complied with. We are of opinion that the ruling was erroneous, and that on the state of facts found plaintiff was not entitled to recover back the whole or any part of the sum it paid in pursuance of the compromise agreement. The just stated conclusion makes it unnecessary to consider other grounds on which the judgment under review was challenged.

The judgment is reversed, and a judgment will be here rendered dismissing the suit, with costs against the defendant in error.

Reversed and remanded.