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NOTES

ASSESSING INTERNAL REVENUE SERVICE JEOPARDY PROCEDURES: RECENT LEGISLATIVE AND JUDICIAL REFORMS

RECENT EVENTS HAVE LED THOUGHTFUL citizens, jurists, and Congressmen to question the wisdom of allowing the Internal Revenue Service (Service) to assess and collect taxes without prior judicial hearing[1] in those instances in which the revenue is thought to be "in jeopardy."[2] Congress[3] and the Supreme Court[4] have made significant reforms which strengthen a taxpayer's rights[5] against Service intransigence or arrogance with respect to jeopardy assessments.[6] The reforms, the abuses which prompted them, and suggestions for future congressional action are the subject of this Note.

I. Description of the Jeopardy Provisions

A. *The Current Statutory Formula*

The jeopardy assessment provisions of the Internal Revenue Code

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[1] Among the events which have prompted the recent concern regarding the misuse of jeopardy provisions are the Watergate-related abuses involving the Internal Revenue Service, such as the "Enemies List," free-wheeling disclosure of return information, and unauthorized IRS intelligence operations. *See generally Proposals for Administrative Changes in Internal Revenue Service Procedures: Hearings on H.R. 10612 Before the Subcomm. on Oversight of the House Ways and Means Committee*, 94th Cong., 1st Sess. (1975) [hereinafter cited as the *Oversight Subcomm. Hearings*]. Prominent among the reasons for reform was the recent practice of using jeopardy procedures against suspected narcotic dealers. *See* United States v. Laing, 423 U.S. 161 (1976). *See also* Rosenthal, *Jeopardizing the Fourth Amendment: IRS Jeopardy Assessments After Laing and Hall*, 31 TAX L. REV. 317 (1976); Silver, *Terminating the Taxpayer's Taxable Year: How IRS Uses It Against Narcotics Suspects*, 40 J. TAXATION 110 (1974).

[2] Jeopardy tax procedures are found in I.R.C. §§ 6851, 6861, 6862, 6863, and 7429. This Note is primarily concerned with section 6861, which provides that a jeopardy assessment of past due taxes may be made whenever the Secretary or his delegate believes that there is a threat to the collection of revenue sufficient to find that the collection thereof is in jeopardy. Commissioner's Delegation Order No. 12 authorizes each of the 58 district directors to make that determination.

[3] Section 1204 of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, added I.R.C. § 7429, which allows for the first time judicial review of jeopardy assessments.

[4] Commissioner v. Shapiro, 424 U.S. 614 (1976), held that the IRS must substantiate in some reasonable fashion its reconstruction of a taxpayer's income from a prior taxable year.

[5] Strengthening taxpayers' rights was one of the principal reasons for the many administrative reforms of the Tax Reform Act of 1976. H. R. REP. No. 658, 94th Cong., 2d Sess. 7 (1976).

[6] Until the passage of the Tax Reform Act of 1976, the power of the IRS with respect to jeopardy assessments was virtually unfettered. *See* notes 45-52 *infra*. The tendency to become unresponsive in such circumstances is a usual phenomenon of human nature and agency development. As Lord Acton stated: "Power tends to corrupt and absolute power corrupts absolutely." As indicated, until recently the power of the IRS in respect of jeopardy assessments was virtually absolute.

(Code) are set forth in sections 6851, 6861, and 6862.[7] These infrequently-used sections[8] are designed to be short cuts to the normal, time consuming assessment process[9] during which the taxpayer may contest his tax liability both administratively[10] and judicially before the United States Tax Court.[11] Each remedy may, in normal circumstances, be fully pursued prior to payment.

There are two principal types of jeopardy procedures: termination assessments and jeopardy assessments. In termination assessments,[12] the Secretary or his delegate[13] is authorized to terminate a taxpayer's taxable year immediately and to assess and collect the tax for that part of the year which has elapsed. This provision is often used when a criminal suspect is arrested while in possession of a large amount of cash,[14] or when a person is caught fleeing the country under circumstances making it questionable whether he will return to pay tax on income earned in the United States.[15]

Jeopardy assessments are authorized by sections 6861 and 6862 of the Internal Revenue Code. By definition these sections permit the

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[7] Other non-assessment provisions involving jeopardy include I.R.C. §§ 6331(a), 6863-6864. The latter two sections deal with problems attendant upon jeopardy assessments. The former section deals with jeopardy collection, such as dispensing with the ten day period which taxpayers are ordinarily given to satisfy their tax liability before enforced collection action may commence. *See* note 23-24 *infra* and accompanying text.

[8] According to the REPORT OF THE ADMINISTRATIVE CONFERENCE OF THE UNITED STATES ON THE COLLECTION OF DELINQUENT TAXES 4 (1976) (forward by Charles Davenport), *reprinted in Collection of Delinquent Taxes: Hearings Before the Oversight Subcomm. of the House Ways and Means Comm., 94th* Cong., 2d Sess. 4 (1976) [hereinafter cited as ADMIN. CONF. REPORT], over eighty million tax returns were filed in 1975. During the same period, only 548 assessments were made under the jeopardy provisions of the Code. *See also* REPORT OF THE COMPTROLLER GENERAL TO THE JOINT COMM. ON INTERNAL REVENUE TAXATION ON THE USE OF JEOPARDY AND TERMINATION ASSESSMENTS BY THE INTERNAL REVENUE SERVICE 6 (1976) [hereinafter cited as GAO STUDY].

[9] I.R.C. § 6861(a) provides in pertinent part that "[i]f the Secretary believes that the assessment or collection of a deficiency . . . would be jeopardized by delay, he shall . . . immediately assess such deficiency . . . and notice and demand shall be made . . . for payment thereof."

[10] After the revenue agent makes his determination, a taxpayer may request review by the agent's group manager. If he is still not satisfied, he may request an informal conference with a conferee of the District Conference Staff. The final review is conducted by an appeals officer of the Appellate Division. *See* I.R.S., AUDIT OF RETURNS, APPEAL RIGHTS, AND CLAIMS FOR REFUND, PUBLICATION 556 (rev. ed. Oct. 1974).

[11] The normal assessment procedure is set forth in I.R.C. § 6213(a).

[12] I.R.C. § 6851.

[13] The term "Secretary" means the Secretary of the Treasury. I.R.C. § 7701(a)(11). The term "Secretary or his delegate" is defined in I.R.C. § 7701(a)(12).

[14] James v. United States, 366 U.S. 213 (1961), established that gain derived from illegal activities gives rise to taxable income. In the situation described, there are presumptions that the cash seized would never be reported as income and the money would be dissipated so that it would be uncollectable if immediate seizure were not made. *See* notes 88-95 *infra* and accompanying text. For a discussion of the effects of termination assessments creating multiple taxable years, see Harmelink & Schurtz, *Jeopardy and Termination Assessments: The Laing Case and the Tax Reform Act of 1976*, 7 TAX ADVISOR 708, 714 (1976).

[15] This section is also invoked whenever an alien leaves the country. *See* I.R.C. § 6851(d).

Secretary or his delegate to assess and collect a "deficiency."[16] An important distinction between a jeopardy assessment and a termination assessment lies in the fact that a "deficiency" can only exist with respect to a taxable period which has already closed.[17] Another vital distinction lies in the immediacy of the need and the amount of information which the Secretary or his delegate has at his disposal when making the assessment.

Within the category of jeopardy assessments, there are two subclassifications. Section 6861, which is the more frequently used of the two jeopardy assessment sections, deals with jeopardy assessments of income, estate, and gift taxes. Section 6862 deals with jeopardy assessments of all other taxes, principally employment and excise taxes. Both sections deal with already-closed taxable periods.[18] The difference between the two sections lies in the requirement that a statutory notice be issued subsequent to assessment. Assessments under section 6861 carry with them the requirement that a statutory notice, the so-called ticket to the Tax Court, be issued to the taxpayer within sixty days after the assessment.[19] Issuance of a deficiency notice allows the taxpayer to petition the Tax Court for a redetermination of his tax liability; collection is stayed during the pendency of the redetermination if bond is posted.[20] An assessment under section 6862 is not followed by a statutory notice because the assessment of employment and most excise taxes is not conditioned upon the issuance of statutory notice.[21] A taxpayer who is jeopardy assessed under section 6862 has only one remedy: to pay the tax assessed, file a claim for refund, wait six months unless the Commissioner denies the claim within that period, and then sue for refund in the Court of Claims or in an appropriate United States district court.[22]

Jeopardy assessments abbreviate the assessment process by permitting an assessment to be made prior to a Tax Court hearing. The jeop-

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[16] I.R.C. §§ 6861(a), 6862(a).

[17] I.R.C. § 6211(a).

[18] Treas. Reg. § 301.6862-1 (1957) would allow this section to be used to terminate a taxable year in respect of employment taxes. Such use would be extremely rare, however, as Treas. Reg. § 301.6205-1 (1960) allows for liberal and frequent adjustment without interest.

[19] I.R.C. § 6861(b).

[20] The bond requirement is discussed in notes 263-269 *infra* and accompanying text.

[21] *See, e.g.*, I.R.C. § 6205(b) and Treas. Reg. § 301.6205-2 (1960), which state that the amount of underpayment will be adjusted by the Secretary.

[22] The question of issuance of a statutory notice under jeopardy termination procedures was recently at issue in Laing v. United States, 423 U.S. 161 (1976). *Laing* involved a termination assessment under I.R.C. § 6851. That section does not by its terms require that a statutory notice be issued. The Supreme Court resolved the issue in favor of requiring the issuance of a statutory notice in termination cases. It is not clear how that decision might affect a jeopardy assessment under section 6862, as the taxes involved under that section are not taxes normally paid by persons on their personal income.

The requirement that the taxpayer pay the tax, wait six months and file suit for a refund in the district court or the Court of Claims is mentioned in the GAO STUDY, *supra* note 8, at 10. For a discussion of new remedies under I.R.C. § 7429, *see* notes 227-238 *infra* and accompanying text.

ardy collection provision short-cuts the customary procedure still further. Normally, after the tax liability is finally determined by compromise, default, or decision of the Tax Court, the taxpayer is served with notice and demand for payment.[23] The taxpayer is allowed ten days in which to satisfy the tax due. Section 6331(a) authorizes immediate collection of the tax assessed without regard for the ten-day waiting period, however, if a finding is made that the collection of such tax is in jeopardy.[24]

Other incidents of the jeopardy procedures include the Commissioner's authority to abate and a taxpayer's right to stay collection by posting bond. Thus, the Internal Revenue Code provides that the Secretary or his delegate may unilaterally abate the assessment in whole or in part if he finds that jeopardy does not exist.[25] Such abatement authority provides some measure of relief to the taxpayer, at least if he can establish that there exists no danger of losing the tax revenue. In addition, under section 6863(a) a taxpayer who has become the subject of a jeopardy assessment is allowed to file a bond as security to postpone collection until such time as the Tax Court has redetermined the deficiency. This section further provides that a taxpayer's property which has been seized pursuant to a jeopardy assessment will not be sold until the time for filing a petition with the Tax Court has expired, or if the taxpayer timely files a petition, until the decision of the Tax Court becomes final.[26] The only exceptions to the restriction on the sale of seized property involve situations in which the property is perishable, in which the expense of maintaining the property during the pendency of Tax Court proceedings would greatly reduce the net proceeds therefrom at a future sale, or when the taxpayer consents to the sale.[27]

Although all the jeopardy procedures are related, this Note is principally concerned with section 6861 jeopardy assessments. The other sections will be referred to only when necessary to supplement the reader's understanding.

B. *Origins of Jeopardy Provisions*

The statutory progenitor of all of the jeopardy provisions is the Revenue Act of 1924.[28] Because subsequent amendments have changed the

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[23] I.R.C. § 6331(a).

[24] *Id.*

[25] The current provision regarding abatement is I.R.C. § 6861(g), which provides in pertinent part: "*Abatement if Jeopardy Does Not Exist.* — The Secretary or his delegate may abate the jeopardy assessment if he finds that jeopardy does not exist." This subsection was added to the 1954 Code to make clear that the power to abate existed. Prior to that time it was not thought to be within the authority of the Commissioner to abate even an incorrect jeopardy assessment. S. Rep. No. 730, 83d Cong., 1st Sess. *reprinted in* [1953] U.S. Code Cong. & Ad. News, 2398, 2399.

[26] I.R.C. § 6863(b)(3).

[27] I.R.C. § 6863(b)(3)(B)(i)(iii). This section was added to the Code in 1954 to prevent unnecessary loss to the taxpayer caused by a forced sale of his property if it was ultimately determined that no tax or substantially less tax was due. S. Rep. No. 1662, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. Code Cong. & Ad. News 4621, 5247.

[28] Revenue Act of 1924, ch. 234, § 274(d), 43 Stat. 297.

thrust of the statute very little, it is appropriate to examine the earliest statutory formulation of jeopardy provisions.

As indicated, the statutory history of the current jeopardy assessment provisions began with the Revenue Act of 1924. The same Act created the Board of Tax Appeals, which is now known as the United States Tax Court.[29] That these two events occurred simultaneously is both interesting and significant. Prior to the inception of the Board of Tax Appeals (Board or BTA), the only impartial forum in which a taxpayer could contest his tax liability was a federal court. Payment in full of all tax alleged to be due was and still is a prerequisite to maintaining an action in a United States district court or the Court of Claims.[30] The only remedy dispensed by either court, therefore, was a refund. Prior law had allowed for review within the Bureau of Internal Revenue[31] before collection.[32] It was claimed, however, that such administrative review was insufficient to safeguard a taxpayer's interests in that nearly all disputes were resolved in favor of the government.[33] These hearings were conducted in Washington only, often making it impossible for taxpayers to take advantage even of the departmental hearing.[34]

Congress created the BTA in order to alleviate the hardships wrought by prior law. It acknowledged that "[t]he right of appeal after payment of the tax is an incomplete remedy, and does little to remove the hardship occasioned by an incorrect assessment."[35] Additionally, the Board was to conduct hearings in major cities, thus allowing taxpayers nationwide

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[29] Revenue Act of 1924, ch. 234, § 900(a), 43 Stat. 336.

[30] The existence of a refund remedy antedates even the graduated federal income tax. *See, e.g.*, Act of June 2, 1872, ch. 315, § 44, 17 Stat. 257, 258. The refund suit was necessitated, in part, because the Anti-Injunction Act prohibited a suit to enjoin collection of federal tax. Act of March 2, 1867, ch. 169, § 10, 14 Stat. 475 (now I.R.C. § 7421). Injunctive relief is discussed fully at notes 96-132 *infra* and accompanying text.

[31] Prior to 1939, the Internal Revenue Service was known as the Bureau of Internal Revenue (Bureau).

[32] There were general objections to the system of intra-Bureau review on the grounds that the taxpayer is entitled to "an impartial determination of the case" where the reviewer is not both "judge and advocate." H. R. REP. No. 179, 68th Cong., 1st Sess. (1924), *reprinted in* 1939-1 C.B. 247.

The review procedure called for the taxpayer to submit his claim in writing to the Income Tax Unit of the Bureau of Internal Revenue. The taxpayer was permitted a hearing in Washington at his request. Thereafter, the Commissioner notified the taxpayer of his decision, and, if favorable to the government, notice and demand was immediately issued. T.D. 3269, I-1 C.B. 304 (1922).

[33] An administrative ruling in the taxpayer's favor permanently barred an appeal by the government. It is not surprising, therefore, that most decisions were in favor of the government, with the taxpayers left to seek a refund remedy. H.R. REP. No. 179, 68th Cong., 1st Sess. (1924), *reprinted in* 1939-1 C.B. 254.

[34] *See* note 32 *supra*

[35] H.R. REP. No. 179, 68th Cong., 1st Sess. (1924), *reprinted in* 1939-1 C.B. 246. The report continues:

> The payment of a large additional tax on income received several years previous, and which may have, since its receipt, been . . . wiped out by subsequent losses . . . 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 recovery of the tax after this payment.

the opportunity to avail themselves of review of their liability by the BTA prior to payment of the tax.[36]

A concomitant of the creation of the BTA was a considerable extension of the time between the issuance of the notice of deficiency and payment, if any, of the tax.[37] To protect government interests during this extended period, the jeopardy assessment was conceived. The creation of a jeopardy procedure was, in effect, no more than a re-enactment of prior law, with the proviso that it was to be invoked only in exceptional circumstances.[38]

The need for a jeopardy provision was obvious. Once notified of the government's determination of a deficiency, a taxpayer would have ample time to leave the jurisdiction or effectively render himself judgment-proof. An intervening bankruptcy could also defeat the government's claim. In such circumstances, the prudent use of a jeopardy assessment could preserve a taxpayer's assets in order to satisfy a deficiency. Because of a finding that his tax was "in jeopardy," the jeopardy-assessed taxpayer was denied the opportunity to appeal to the Tax Court prior to payment. He remained at the mercy of the Bureau's procedures, with no right to appeal save a suit for refund.

The Revenue Act of 1924 attempted to alleviate this situation. Instead of requiring that the jeopardy taxpayer tender immediate full payment or suffer seizure and sale of his property in order to satisfy the alleged deficiency, the 1924 Act offered the option of filing a bond to stay collection. Upon posting bond, the taxpayer was permitted to file a claim for abatement with the Bureau.[39] The bond, twice the amount of the deficiency,[40] was forfeited if the claim was rejected and the taxpayer defaulted on payment.[41] Not only did this procedure serve to protect government interests, but it also allowed the taxpayer who could afford to

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[36] *Id.*

[37] Under prior law, collection could occur as quickly as forty days after the mailing of the deficiency notice. Revenue Act of 1921, ch. 136, § 250(d), 42 Stat. 265, 266, (repealed 1924). Even at that, the Commissioner was authorized to levy immediately if he believed that delay would hamper collection. *Id.* The Revenue Act of 1934 allowed a 60 day period for the taxpayer to appeal to the Board (since increased to 90 days). Then followed several months or years before the Board's decision was announced: all this prior to collection. Revenue Act of 1924, ch. 234, § 274(a), 43 Stat. 297.

[38] "The substance of these provisions is similar, with changes made necessary by provision for a Board of Tax Appeals, to those now contained in the second paragraph of subdivision (d) of § 250" of the existing law. H.R. REP. No. 179, 68th Cong., 1st Sess. (1924), *reprinted in* 1939-1 C.B. 259.

[39] In the Revenue Act of 1924, the two were dependent. Posting bond was a condition precedent to filing a claim in abatement. This is no longer true. A taxpayer may now request abatement even if he does not or cannot file a bond. I.R.C. § 6861(g); Treas. Reg. § 301.6861-1(f)(3) (1958).

[40] The amount of bond required was reduced in 1954 to an amount equal to the deficiency. I.R.C. § 6863. *See* S. REP. No. 1662, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 5247. *See* notes 263-269 *infra* and accompanying text for the most recent suggestions concerning the bond requirement.

[41] Revenue Act of 1924, ch. 234, § 279(a), 43 Stat. 300. It must be questioned whether a taxpayer all of whose assets were frozen by a jeopardy assessment greatly exceeding his net worth could raise such a bond.

file a bond the opportunity to postpone or avoid inconvenient, embarassing, or financially-disastrous collection.[42]

This short history of the jeopardy assessment provisions is offered to demonstrate that, at the time of its enactment, the jeopardy provision was part of a progressive reform package[43] which conferred valuable rights upon taxpayers which had not previously been enjoyed. It might be assumed that the jeopardy provision was universally hailed. In fact, it seems to have passed without comment.[44] The silence was short-lived, for within a few years a clamor arose for tighter control on the Commissioner's power to jeopardy assess as the problems and abuses related to expansive administrative discretion under the provision became apparent.

II. Parameters of Official Discretion: The Early Cases

A. *Jurisdiction of the BTA and Reviewability*

The early cases indicated one persistent source of problems: the lack of control over the Commissioner's power to impose jeopardy assessments. From the outset, the Board refused to pass on the reasonableness of the assessment or the likelihood that jeopardy actually existed. In *California Associated Raisin Co.*,[45] one of the earliest jeopardy cases, a notice of deficiency was issued to the taxpayer, an agricultural corporation. When the company filed a petition in bankruptcy, its trustee posted a bond for faithful performance. Nevertheless, the Bureau jeopardy assessed. The company claimed that the deficiency notice, as well as the trustee's bond, obligated the trustee or the surety to pay any deficiency which might ultimately be determined by the BTA and that government interests were thus fully protected. Accordingly, the company argued, the jeopardy assessment was unnecessary. The BTA ignored the logical appeal of the taxpayer's argument and declined to

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[42] Failure to file a bond, however, also precluded any appeal to the Bureau or the BTA. In *California Assoc. Raisin Co.*, 1 B.T.A. 1251, 1252 (1925) (emphasis added), the court stated:

> The taxpayer's *inability* to file a bond . . . and thus to lay a foundation of appeal creates a regrettable situation . . . [T]he insolvent, impecunious or unfortunate taxpayer, who is unable to file a bond with such sureties as will satisfy the collector, is deprived of an appeal. But we see no escape from the conclusion that this is the effect of the statute.

See note 39 *supra*. Under current law, the taxpayer may avail himself of a Tax Court determination of liability without posting bond. If the Tax Court finds that the tax due is less than the amount assessed and seized, the remaining assessment will be abated. I.R.C. § 6861(c); Treas. Reg. §§ 301.6861(c), 301.6861(d) (1958).

[43] No doubt the need for reform was brought home to Congress when, on the same day that the Revenue Act of 1924 was debated on the floor of the Senate, it was announced that prior tax measures had created a 300 million dollar surplus, 67 Cong. Rec. 3100 (1924) (statement of Sen. King). Several days earlier the Bureau had asked for a 149 million dollar appropriation to refund taxes which had been collected erroneously. 67 Cong. Rec. 6853 (1924). Congress could afford to be generous, and had direct evidence of the expensive sting of incorrect assessments.

[44] *See generally* Seidman, Legislative History of Federal Income Tax Laws (1938).

[45] 1 B.T.A. 1251 (1925).

review the assessment. The Board determined that it lacked the jurisdiction to review, stating that "[t]hese matters are not within our authority to adjudicate. Congress has expressly based the power of jeopardy upon the Commissioner's official belief, consistently with his responsibility for the protection and collection of revenue."[46]

California Associated Raisin Co. established that the reasonableness or propriety of the Commissioner's belief in imposing a jeopardy assessment was not open to question before the BTA or any other tribunal. Once payment was made or bond was filed the only issue for determination was the amount of the tax liability.[47] Moreover, without payment or posting of a bond, there was no opportunity prior to levy to appeal the Commissioner's determination of jeopardy.

Several other issues were established regarding jurisdiction during the first year of the BTA's existence: jurisdiction did not lie when the taxpayer had failed to file a claim in abatement accompanied by a bond;[48] jurisdiction did not lie until the time for the Commissioner's abatement action was exhausted;[49] and jurisdiction was extinguished by payment of the tax assessed.[50] The BTA viewed its authority narrowly and construed the statutes strictly. The results of these early determinations on jeopardy assessments are of concern to taxpayers today. The Commissioner still may act with impunity in imposing jeopardy assessments,[51] provided that he follows the statutory requirements.[52]

B. Phillips v. Commissioner: *A Constitutional Determination*

Taxpayers who might have hoped for a successful constitutional challenge to jeopardy assessments experienced a severe setback in 1931

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[46] *Id.*

[47] In Veeder v. Commissioner, 36 F.2d 342, 344 (7th Cir. 1929), the court specifically declined to inquire into the Commissioner's reasons for imposing a jeopardy assessment, limiting itself to a determination of the taxes due.

[48] California Assoc. Raisin Co., 1 B.T.A. 1251 (1925). The harshness of this provision has been decreased by the requirement that a 90 day letter, the so-called ticket to the Tax Court, be issued within 60 days after the imposition of a jeopardy assessment if it had not been previously issued. I.R.C. § 6861(b).

[49] Oakdale Coal Co., 1 B.T.A. 773 (1925). The Board pointed out that the taxpayer's day in court was merely being postponed until the Commissioner's decision on its claim in abatement was final.

[50] Northwestern Mutual Life Ins. Co., 1 B.T.A. 767 (1925). The corporate taxpayer paid the amount of the jeopardy under protest in order to halt the accumulation of interest. "There is . . . no decision which this Board can make [which] will serve the purpose of saving him from paying an unjust or unlawful tax." The suit was deemed a refund suit and dismissed. *Id.* at 769.

[51] The Service has imposed some internal controls, since none are specified in the statute. They are discussed at notes 200-215 *supra* and accompanying text.

[52] An omission of any part of the statutory formula is fatal to the jeopardy assessment. In Thornton v. United States, 493 F.2d 164 (3d Cir. 1974), the plaintiff alleged that the jeopardy assessment was not approved by the delegate of the Secretary, the District Director of Internal Revenue, but by a lesser official. The Third Circuit held that if it were factually demonstrated, improper approval would be grounds for invalidating the jeopardy assessment. In Schreck v. United States, 301 F. Supp. 1265 (D. Md. 1969), and United States v. Ball, 326 F.2d 898 (4th Cir. 1964), failure to issue a statutory notice after the jeopardy assessment caused the assessment to be invalidated.

because of the decision by the Supreme Court in *Phillips v. Commissioner*.[53] The *Phillips* case considered whether the collection of revenue by summary administrative proceedings violated procedural due process by depriving the taxpayer of the opportunity to be heard before a taking of his property has occurred. The Bureau sought to hold Phillips liable as a transferee[54] for a deficiency of the defunct Coombe Garment Company of which he had been a controlling shareholder and a distributee of the corporate assets.[55] Phillips raised questions of due process with respect to two additional matters directly related to his transferee status: the deficiency was that of the corporation rather than his own, and no attempt had been made to assert the deficiency against the corporation[56] or the other shareholders who had participated in the distribution.[57]

In order to appreciate Phillips' claim and the constitutional issues raised, it is necessary to understand the nature and effect of a determination of a deficiency and the subsequent assessment thereof. An assessment of taxes has, for all intents and purposes, the force and effect of a judgment.[58] That Congress has chosen to forego the collection of tax debts until after the taxpayer has had the opportunity to appeal to an impartial body is, for the moment, immaterial. If the taxpayer fails to file a petition with the Tax Court for a redetermination of the tax, the deficiency is assessed and is collectible by levy or otherwise ten days after notice and demand, unless a determination is made that collection of the tax is in jeopardy.[59] If the taxpayer appeals to the Tax Court, he bears the burden of proof; the Commissioner's determination that a deficiency exists is presumptively correct.[60] In *Phillips*, it was the assessment process in general which the taxpayer questioned. He argued that the assessment against him was invalid because no judgment had been obtained against him to bind him as a transferee.[61]

Despite Phillips' claims, the Court found that the constitutionality of tax assessment by "summary administrative proceedings"[62] had long

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[53] 283 U.S. 589 (1931), *aff'g* 42 F.2d 177 (2d Cir. 1930) (15 B.T.A. 1218 (1929)).

[54] Revenue Act of 1926, ch. 27, § 280, 44 Stat. 61 (now I.R.C. § 6901). The current Code section dealing with transferee liability is substantially the same.

[55] Since assessments against transferees follow in every regard the standard (non-jeopardy) assessment procedure, Phillips' claim was that the issue of liability must always be determined by the courts before any assessment is made.

[56] The questions of procedural due process are complementary to the questions of substantive due process involved in the nature of tax assessments in general.

[57] The transferee also claimed that if he was responsible for payment, he could be required to contribute no more than his pro-rata share. 15 B.T.A. 1218, 1220 (1929).

[58] *Compare I.R.C.* § 6212(a) *with* I.R.C. § 6213(a). The Secretary "determines" a deficiency and mails a statutory notice to the taxpayer who may petition the Tax Court for a "redetermination" of his tax liability.

[59] I.R.C. § 6213(c).

[60] I.R.C. § 7454(a) places the burden on the taxpayer, except in fraud, foundation manager, or transferee cases. The burden of proof in transferee cases is determined by I.R.C. § 6902(a), which places the burden on the Secretary to show that the petitioner is liable as a transferee. Once transferee status is shown, the burden shifts back to the petitioner.

[61] 283 U.S. 589, 594 (1931).

been settled. As early as 1880, the Supreme Court held in *Springer v. United States*[63] that it was not constitutionally imperative that the Collector of Internal Revenue obtain a prior judgment in order to seize and sell a taxpayer's property.[64] The novel twist which allowed Phillips to raise what appeared to be a previously settled issue was that he was not the party primarily liable for the tax deficiency but a transferee. Because a transferee has the opportunity for judicial review of the administrative determination of deficiency, the Court held that due process requirements were satisfied.

The confusion surrounding the *Phillips* decision concerning its effect on jeopardy assessments arose in part because Justice Brandeis, who wrote the majority opinion, did not limit himself to affirming the constitutionality of assessments against transferees when the transferor was judgment-proof. Instead, he went further and endorsed the constitutionality of the assessment procedure in general. The opinion, referring to *Springer* and other cases, stated that a taxpayer's interests, including those of a vicariously liable transferee, were adequately safeguarded by paying the tax and then bringing suit for a refund.[65] The opinion also pointed out that the taxpayer could seek a forum before payment by filing a petition with the BTA.[66] Jeopardy assessments were mentioned only once in this context. The Court stated that "[t]his remedy [an appeal to the BTA] may be had before payment, without giving bond (unless the Commissioner in his discretion deems a jeopardy assessment necessary)."[67]

The *Phillips* Court analyzed the status of property rights in the hierarchy of government values. According to the Court, the rights to life and liberty must be fully protected at *all* times from any deprivation of due process. On the other hand, property rights occupy a somewhat secondary position:

> Where only property rights are involved, mere postponement of the judicial enquiry is not a denial of due process, if the opportunity given for the ultimate judicial determination of the liability is adequate . . . Delay in the judicial determination of property rights is not uncommon where it is essential that governmental needs be immediately satisfied.[68]

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[63] 102 U.S. 586 (1880).

[64] The impracticality of obtaining a judicial determination before notification of deficiency is apparent, even to the layman. The number of returns filed annually (80 million) and the number which require adjustments of some sort (4.6 million) would make such efforts prohibitively expensive. ADMIN. CONF. REPORT, *supra* note 8, at 11.

[65] 283 U.S. 589, 597 (1931).

[66] The right of pre-collection appeal was extended to all taxpayers except in bankruptcy and jeopardy cases by the Revenue Act of 1924, ch. 27, § 274(a), 44 Stat. 55. Jeopardy taxpayers must file a bond, or submit to immediate levy. It is clear that the Court felt the right of appeal to the BTA was not a necessary element for the finding of constitutionality, but merely an extra privilege for the taxpayer.

[67] 283 U.S. 589, 598 (1931).

[68] *Id.* at 596-97. The quotation emphasizes the point that the opinion considered the assessment process in general. Although the government's need for Mr. Phillips'

The Court then cited other situations in which important needs were commonly thought to justify a de-emphasis of property rights: destruction of property in public health emergencies, seizures of property in wartime, and condemnation of property under eminent domain. The comparisons suffer, however, because in the hypothesized situations, the government's need to seize private property is direct and immediate and no other means can be employed to accomplish the goal. Such is not the case when the collection of revenue is involved, at least if the question involves a particular individual's tax liability. While a governmental need exists, it is neither so direct nor so immediate as to justify abbreviated proceedings with curtailment of the taxpayer's rights. If, as the Court indicated, the question is the collection of revenue in general, the need is both direct and immediate. For policy reasons, however, Congress has chosen to forego collection before a hearing even though it is constitutionally acceptable to eliminate all remedies except a suit for refund. It is arguable that the Court should have analyzed the particular problems of the jeopardy taxpayer as they arose because policy decisions were made without serious consideration of either the consequences to such taxpayers, the possible uses of the jeopardy provisions or the reasons why jeopardy might be required. Since the Court neglected to do so, subsequent judges have simply accepted the jeopardy provisions as constitutionally sound, seeking support in the all-encompassing language of the *Phillips* decision.

For this reason, *Phillips* is frequently cited in support of the proposition that jeopardy assessments are constitutional.[69] While such a statement is a reasonable interpretation of the case, there are some distinctions between jeopardy and ordinary assessments which the Court did not consider. One such distinction concerns the existence of a deficiency. In *Phillips*, the deficiency was uncontested since an actual tax liability existed. The question was whether Phillips could be required to pay all or part of it. In the typical jeopardy case, the existence of an actual tax deficiency or the amount of the deficiency is hotly contested.[70] In fact, jeopardy assessments are often inflated[71] because of the wide discretion which the Commissioner enjoys under section 6861.[72]

$9,000 was not vital and did not need to be "immediately satisfied," the need to expeditiously collect tax revenues in general is essential to the functioning of government. It is the task of the courts and the Congress to strike an appropriate balance between these two competing interests.

[69] Virtually every jeopardy case since 1931 has cited *Phillips*. *See, e.g.*, Commissioner v. Shapiro, 424 U.S. 614 (1976); Continental Products v. Commissioner, 66 F.2d 434 (1st Cir. 1933); Kimmel v. Tomlinson, 151 F. Supp. 901 (S.D. Fla. 1957). This appears to have been done automatically, without serious thought given to the question of whether *Phillips* actually placed a constitutional sanction on the jeopardy provisions.

[70] Melvin Building Corp. v. Long, 262 F.2d 920 (7th Cir. 1958), involved a jeopardy assessment. The district court found "as a fact that substantial doubt exists whether the plaintiff is liable for a deficiency in Federal income tax," but this was not sufficient to "lift the jurisdictional bar" on reviewing jeopardy assessments. *Id.* at 922.

[71] The amounts actually collected in jeopardy cases, compared with the amount of the assessments, provide an indication of the tendency to inflate. For a further discussion, *see* notes 216-226 *infra* and accompanying text.

[72] Jeopardy assessments, unlike ordinary assessments may be wholly or partly

The other major distinction between a transferee case and a jeopardy case is that the transferee has recourse to a prepayment forum — the Tax Court. In contrast, the jeopardy-assessed taxpayer, in order to avoid immediate seizure of his property, must post bond and wait for an administrative determination on abatement while his appeal to the Tax Court is pending.[73] Failure to post bond in effect precludes an appeal, except with respect to a refund, because assets are frozen during the pendency of a Tax Court case. If the taxpayer has no access to the Tax Court, as in the case of a section 6862 assessment, and his assets are insufficient to satisfy the alleged deficiency, even a refund remedy is foreclosed.[74] The injustice is further compounded if the assessment is an inflated one and the taxpayer would have been capable of satisfying a reasonable estimate of his tax liability.[75]

Although *Phillips* is different from the ordinary jeopardy case, it became the touchstone case on the subject of the constitutionality of jeopardy assessments. In *Phillips*, the Supreme Court stated that the normal collection procedure[76] is constitutional. The Court neither specifically objected to jeopardy assessments nor recognized that they were an exception to the regular assessment process. Rather, the Court merely noted that in the case of jeopardy, a bond was required. The omission was not surprising, however, inasmuch as the case did not involve jeopardy assessments. From that tacit approval it may be inferred that the Court sanctioned summary assessment and collection proceedings as a method of securing revenue, and that it approved of the bond provision as a safeguard of the taxpayer's rights where jeopardy was found. Since

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abated by unilateral act of the Commissioner. I.R.C. § 6861(g). Once abated, a second assessment for a greater amount may be imposed. United States v. Teti, 75-2 U.S.T.C. (CCH) ¶ 9709 (D. Conn. 1975). In this respect, a jeopardy assessment is much more flexible than an ordinary assessment. Also, jeopardy assessments, which may be issued before or after a statutory notice, can be for a greater or smaller amount than that specified in the statutory notice, despite the prohibition in I.R.C. § 6212(c) on assessing additional deficiencies. This allows the Commissioner to correct an erroneously computed statutory notice by placing the additional amount under a jeopardy assessment.

[73] The Tax Reform Act of 1976 has modified the procedure somewhat. The jeopardy taxpayer still bears a greater burden. For a discussion of the Tax Reform Act, *see* notes 227-238 *infra* and accompanying text. This Act created I.R.C. § 7429, which provides for an expedited review of both the reasonableness and the amount of the assessment. The new section does not lift the requirement of posting bond, nor does it prevent improper assessments from being made or the embarrassment and financial hardship caused by having one's assets frozen, even for a short period of time.

[74] Adler v. Nicholas, 70 F. Supp. 514 (D. Colo. 1946), typifies the problem. The taxpayer could not raise bond, as all his assets had been seized, but his assets did not satisfy the total tax imposed by the jeopardy assessment. The court denied review, stating that "[t]he government . . . has provided . . . a complete system of corrective justice in regard to all taxes imposed . . . [which] is founded upon the idea of appeals within the executive departments. If the party aggrieved does not obtain satisfaction in this mode, there are provisions for recovering the tax after it has been paid. . . . But there is no place in this system for an application to a court of justice until after the money is paid." *Id.* at 517.

[75] The possibility that this situation might arise was noted early. *See Revenue Revision of 1928: Hearings on H.R. 1 Before the House Comm. on Ways and Means*, 69th Cong., 1st Sess. 521 (1928) (statement of Hugh Saterlee).

[76] I.R.C. § 6213(a) provides for assessment of the deficiency accompanied by a 90-day letter, and permits an appeal to the Tax Court.

the Court did not specifically analyze the constitutional implications of the jeopardy problem, it is difficult to draw any further conclusion.

The analysis of the jeopardy provisions lacking in the Supreme Court's opinion in *Phillips* continued in subsequent cases. The *Phillips* holding was first applied to the jeopardy assessment problem in *Continental Products v. Commissioner.*[77] The plaintiff corporation was the subject of a $245,000 jeopardy assessment imposed solely in order to prevent the expiration of the statute of limitations[78] and the loss of revenue which would have resulted without the assessment. *Continental* raised the question whether the prepayment remedy which Congress had created and which was available to the overwhelming majority of taxpayers could be constitutionally denied to the taxpayer who had been jeopardy assessed. It further questioned the propriety of the bond requirement as a prerequisite to an administrative review prior to seizure.[79] Noting that Continental had filed bond, had enjoyed an administrative review which had resulted in the denial of its request for abatement of the jeopardy assessment and had enjoyed a hearing on the merits[80] before the BTA which had affirmed the Commissioner's determination of deficiency,[81] the court questioned whether Continental could properly raise the issues of due process and prehearing seizure since it had exhausted both administrative and judicial reviews without having been required to pay the deficiency assessment.[82] In reaching its conclusion the *Continental* court, unlike the *Phillips* Court, followed the time-honored judicial practice of deciding the narrowest possible issue.[83] However, in its attempt to buttress its conclusion with judicial precedent, the court made a shallow and erroneous analysis of *Phillips* which has been the source of many problems since that time.

In *Continental,* the court mistakenly observed that *Phillips* dealt with the question of jeopardy assessments against transferees.[84] The court also mistakenly observed that the transferee provisions "closely resemble . . . jeopardy assessments of income taxes."[85] It then con-

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[77] 66 F. 2d 434 (1st Cir. 1933), *aff'g* 20 B.T.A. 818 (1930).

[78] *Id.* at 435.

[79] Note that the constitutional issues discussed in Phillips of substantive due process for the bonding requirement, and procedural due process for access to the court, were for the most part reiterated in *Continental.* The difference between the two cases lies in the fact that *Continental* squarely raised the question of jeopardy assessments when access to the BTA before collection is conditioned upon posting bond while *Phillips* did not.

[80] The hearing was limited to a factual determination of the correct amount of the deficiency. 20 B.T.A. 818 (1930). This is in accord with the jurisdictional principles discussed at notes 42-47 *supra* and accompanying text.

[81] *Id.* at 820.

[82] 66 F. 2d 434, 436 (1st Cir. 1933).

[83] It was exactly this judicial restraint which Justice Brandeis failed to exercise in the *Phillips* opinion and which delayed the resolution of questions concerning the constitutionality of jeopardy assessments from the beginning.

[84] There was no jeopardy assessment in *Phillips*; only the issue of transferee liability was before the Court. 283 U.S. 589 (1931).

[85] 66 F. 2d 434, 436 (1st Cir. 1933). For a discussion of the differences between a jeopardy and a transferee case, *see* notes 66 & 71-75 *supra* and accompanying text.

firmed the constitutionality of prehearing seizure in those cases where jeopardy is found.[86]

As time passed, the combination of *Phillips* and *Continental* became a kind of talisman in jeopardy cases. Until recently, no one had successfully challenged jeopardy assessments on due process grounds.[87]

The first case in forty years to examine the reasoning of *Phillips* and *Continental* with a view toward imposing responsibility on the Commissioner for his use of the jeopardy assessment power was *Commissioner v. Shapiro*.[88] The Supreme Court there held that the government was required, in response to a discovery request, to provide the taxpayer with information concerning the basis for the assessment, for without that information the taxpayer could not adequately contest the government's determination of the deficiency.

The facts of the *Shapiro* case reveal the taxpayer's dilemma. Pursuant to a finding of jeopardy, the Commissioner assessed $92,000 in tax against Shapiro on the basis of an arbitrary reconstruction of his alleged unreported income from narcotics sales. In refusing to provide substantiating data to the taxpayer, the Commissioner relied on prior case law which held that a determination of jeopardy was unreviewable at any time and a determination of the amount of the deficiency was unreviewable prior to payment or the posting of bond. The Commissioner also relied on the Anti-Injunction Statute which had been interpreted[89] to prevent a taxpayer from restraining the collection of federal taxes unless he first proved that the government could not establish its claim under even the most liberal view of the law and facts.[90]

In reaching its decision, the Court noted the inconsistency of requiring the taxpayer to prove the government's inability to prevail while at the same time denying him access to the information upon which the government's claim was based. The Court then held that injunctive relief was appropriate in such circumstances if the taxpayer had no adequate remedy at law.[91]

In attempting to harmonize its holding in *Shapiro* with its holding in *Phillips*, the Court noted the essential difference between the ordinary assessment process and the jeopardy assessment process, suggesting that whenever a taxpayer's right to the prepayment forum was foreclosed by the use of a jeopardy assessment, injunctive relief should be more liber-

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[86] A double mistake was actually involved — the assumption that *Phillips* involved a jeopardy assessment and the assumption that transferee liability is the same as a jeopardy assessment.

[87] *See, e.g.*, United States v. Johnson, 424 F. Supp. 631 (D. Ore. 1976). In *Johnson*, a challenge to IRS seizure practices was asserted on the basis of recent decisions barring pre-judgment relief by private citizens. The Court declined to apply this principle where the collection of revenue was involved. For a discussion of this question, *see* notes 140-154 *infra* and accompanying text.

[88] 424 U.S. 614 (1976).

[89] Enochs v. Williams Packing & Navigation Co., 370 U.S. 1 (1962). For a discussion of *Williams Packing, see* notes 108-110 *infra* and accompanying text.

[90] *Id.* For a full discussion of the Anti-Injunction Act, I.R.C. § 7421, and interpretive case law, *see* notes 96-154 *infra* and accompanying text.

[91] Commissioner v. Shapiro, 424 U.S. 614, 624-27 (1976).

ally available.[92] The Court acknowledged that *Phillips* confirmed the "statutory scheme created by Congress for the litigation of tax disputes and in so doing referred both to the jeopardy assessment provisions and the Anti-Injunction Act."[93] The Court concluded that both statutes were constitutional, at least if considered individually. However, when construed together in the jeopardy context, the statutes have the effect of creating an insoluble problem for the jeopardy taxpayer. The Court noted that a jeopardy taxpayer whose assets were frozen was entitled to a "*prompt* . . . resolution of the question of his liability by the Tax Court," and found this to be compatible with the dicta in *Phillips* concerning "an adequate opportunity . . . for a later judicial determination of the legal rights."[94] The Court implied that what would be an adequate remedy for an ordinary taxpayer would not be adequate for the jeopardy taxpayer. This implication may very well lead to further litigation.

Shapiro is thus important for two reasons: it established a ground for injunctive relief[95] for a jeopardy taxpayer, and it placed the Commissioner on notice that jeopardy assessments would have to bear a reasonable relationship to provable facts concerning the taxpayer's estimated or reconstructed income. Insofar as no court had previously attached any consequence to the imposition of a jeopardy assessment which was not specifically enumerated in the statute, the *Shapiro* case represents a significant step forward for jeopardy taxpayers.

III. Attempts to Restrain or Prevent Jeopardy Assessments

A. *Injunctive Relief*

Confronted with nearly insurmountable difficulties, and, like Shapiro, frantic to delay collection,[96] taxpayers faced with jeopardy assessments have often tried to enjoin levy. They have generally found the equitable remedy of injunction unavailable because of the Anti-Injunction Act of 1867, which provides that "[n]o suit for the purpose of restraining the assessment or collection of tax shall be maintained in any court."[97] Since the Act is not illuminated by legislative history,[98] the

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[92] *Id.* at 631.

[93] *Id.*

[94] *Id.*

[95] *See* notes 113-116 *infra* and accompanying text.

[96] The hardship and embarassment which a jeopardy assessment may cause a taxpayer can be readily seen in reading the many injunction cases. Forced liquidation of an ongoing business at a distress price, evaporation of sources of credit for the taxpayer's personal and other business use, and loss of funds to pay defense counsel in criminal tax or other pending litigation are but a few examples of the harsh effects of a jeopardy assessment.

[97] Act of March 2, 1867, ch. 169, 14 Stat. 475 (1867) (now I.R.C. § 7421). The provision was first codified as Rev. Stat. § 3224 (1975). The language of the section was modified in the 1939 and 1954 Internal Revenue Codes to allow for proceedings in the Tax Court.

[98] *See* Note, *Enjoining the Assessment and Collection of Federal Taxes Despite Statutory Prohibition*, 49 Harv. L. Rev. 109, 110 & n. 9 (1935).

case law must be relied upon to discover the extent and effect of the prohibition.[99]

In *Snyder v. Marks*,[100] the Supreme Court construed congressional intent as a desire to limit all prior review of tax assessments to the Treasury Department and to prohibit the courts from entertaining all tax suits except for refund litigation. In the years immediately following the passage of the sixteenth amendment, it became apparent that a much more complex and pervasive tax structure was developing, and the courts relented somewhat in this position.[101]

The first case to set forth guidelines defining situations in which an injunction would issue was *Miller v. Standard Nut Margarine Co.*[102] In *Standard Nut*, the taxpayer had secured a Treasury ruling which had determined that its product was not oleomargarine and that it was consequently not subject to the federal tax on oleo products. When the Bureau ignored the Treasury ruling and imposed a jeopardy assessment that would have forced the taxpayer into insolvency, the Supreme Court granted an injunction. The Court reasoned that because of the ruling, the attempt to assess amounted to "an exaction in the guise of a tax." The Court also found that "special and extraordinary circumstances [existed] sufficient to bring the case within some acknowledged head of equity jurisprudence."[103] *Standard Nut* established two elements required for an injunction: illegality[104] and special circumstances.

In the ensuing years many have tried, though few have succeeded in enjoining the collection of tax. Early successful cases involved transferees where assessments were improperly made[105] or where the collector

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[99] An excellent discussion of the history and development of case law under this Act can be found in Note, *Jeopardy Assessments: The Sovereign's Stranglehold*, 55 GEO. L.J. 701 (1967). *See also* Kaminsky, *Administrative Law and Judicial Review of Jeopardy Assessments*, 14 TAX L. REV. 545, 548 (1959). Kaminsky argues that the reason for the Anti-Injunction Act was eliminated by the creation of the Tax Court. Prior to its creation, if an injunction was issued to restrain the collection of federal taxes, a judicial vacuum would have resulted, since no court was empowered to determine actual tax liability.

[100] 109 U.S. 189 (1883).

[101] The Supreme Court, in Dodge v. Osborn, 240 U.S. 118, 122 (1916), recognized that circumstances might exist in which an injunction would be appropriate. Hill v. Wallace, 259 U.S. 44 (1922) was the first case to grant an injunction. The Court reasoned in *Hill* that the tax was so high as to cause widespread harm, and a post-payment remedy would be inadequate to prevent the destruction of an entire industry.

[102] 284 U.S. 498 (1932).

[103] *Id.* at 509.

[104] It must be noted that illegality is a very high standard to meet. It is not enough that the tax sought to be collected is unconstitutional. Bailey v. Drexel Furniture Co., 259 U.S. 20 (1922), held that the tax on goods manufactured by child labor was unconstitutional. However, in Bailey v. George, 259 U.S. 16 (1922), decided the same day as *Drexel*, the Court declined to enjoin the collection of the child labor tax.

[105] Shelton v. Gill, 202 F.2d 503 (4th Cir. 1953). The defendant was a bona fide purchaser of the delinquent taxpayer's business and was not liable as a transferee. In Rosenthal v. Allen, 75 F. Supp. 879 (M.D. Ga. 1948), the transfer took place prior to the accrual of the taxpayer's deficiency. The assessment against the transferee was held void. In Trinacia Real Estate v. Clarke, 34 F.2d 325 (2d Cir. 1929), there was no assessment against the delinquent taxpayer while the assessment directly against the transferee was found to be illegal.

(district director) wrongfully refused bond[106] or where the taxpayer's property was improperly sold.[107]

Even fewer injunctions were issued during the sixties, principally because of the decision in *Enochs v. Williams Packing and Navigation Co.*,[108] which modified the injunction formula established in *Standard Nut*. In *Williams Packing*, the Supreme Court held that the taxpayer had to prove that "under the most liberal view of the law and the facts, the United States cannot establish its claim."[109] *Standard Nut* spoke in terms of "illegality"; the construction of that term in *Williams Packing* related a confusing reference to a more familiar standard. In essence, the taxpayer must establish that he is entitled to the equivalent of summary judgment in order to obtain injunctive relief. The Court also emphatically stated that the question of special circumstances did not arise until the petitioner had established that the government could not prevail. In addition, the Court de-emphasized the "special circumstances" test, stating that "if Congress had desired to make the availability of the injunctive remedy . . . depend on the adequacy of the legal remedy, it would have said so explicitly."[110]

Inasmuch as it may be assumed that the Service does not involve itself in litigation unless it has at least a chance of prevailing under a liberal view of the law and the facts, it follows that injunctions will seldom be available. There have been some recent cases, however, in which the courts have concluded that an injunction might issue. Two such cases, *Commissioner v. Shapiro*[111] and *Pizzarello v. United States*,[112] involved the method by which deficiencies were computed.

In *Shapiro*, a taxpayer was about to be extradited to Israel to stand charges for securities fraud. The day before his departure a jeopardy assessment was imposed against him. Jeopardy apparently existed because of the likelihood of Shapiro removing funds from New York banks in order to make bail and to pay legal fees for his defense. On the basis of unexplained cash bank deposits, the Service estimated unreported income from sales of hashish amounting to $137,280.[113] Shapiro's

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[106] Yoke v. Mazzello, 202 F.2d 508 (4th Cir. 1953). Personal and real property of the taxpayer and friends, appraised at double the amount of the deficiency, was offered as security. An injunction was issued to require that the security be accepted and to forestall the sale of the taxpayer's property.

[107] Smith v. Flinn, 261 F.2d 781 (8th Cir. 1958), *modified*, 264 F.2d 523 (8th Cir. 1958). The IRS either ignored the statutory prohibition of I.R.C. § 6863(b)(3) against selling seized property while Tax Court proceedings were pending, or wrongly determined that the taxpayer's property was perishable as defined in I.R.C. § 6336. Smith's non-perishable corn and grain were consequently sold in an unfavorable market at a great loss. The injunction prevented the Commissioner from selling the remainder of Smith's grain in the same depressed market.

[108] 370 U.S. 1 (1962).

[109] *Id.* at 7.

[110] *Id.* at 6. Hence the ruination of the taxpayer's enterprise or other irreparable injury is not a sufficient reason to allow injunctive relief.

[111] 424 U.S. 614 (1976).

[112] 408 F.2d 579 (2d Cir. 1969).

[113] On the basis of periodic bank deposits, the IRS reconstructed Shapiro's income.

bank accounts were then seized. The Supreme Court held that an injunction was proper under the circumstances because the Service had failed to demonstrate that the reconstruction of the taxpayer's income had any basis in fact,[114] because the Commissioner had refused to provide Shapiro with information concerning the method used to compute the deficiency, and because irreparable harm[115] would have resulted from a denial of the funds.[116]

The facts and result in *Pizzarello*[117] were similar. The Second Circuit there indicated that an injunction would be appropriate in a jeopardy case in which the Service had reconstructed the taxpayer's income for five prior years from gambling activities. The basis of this estimate was $490 in cash and wagering slips found in Pizzarello's possession at the time of his arrest in his Mount Vernon, N.Y. luncheonette[118] and $126,000 found in a search of the premises. The Service then estimated Pizzarello's income from bookmaking at nearly three million dollars and jeopardy assessed $280,000. The government then seized the $126,000 to satisfy part of Pizzarello's tax debt.[119] The court held that it was improper to base the estimate of gambling income on the 126,000 because the search warrant for Pizzarello's luncheonette was voided for lack of probable cause and, as a result, the money was excluded from evidence at his criminal trial on gambling charges. The court then concluded that it was impossible to reconstruct Pizzarello's income from illegal wagering on the basis of the $490 and the 10 betting slips which were in his possession at the time of arrest, as these represented only three days' take. Further, the court stated that it was impossible to assess taxes on gambling income for a five year period because the criminal prosecution alleged wagering activities for a two week period and there was no evidence tending to indicate that Pizzarello had been engaged in taking wagers for any greater period of time.[120] The *Pizzarello* court upheld the issuance of an injunction under the *Williams Packing* rationale because

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There were six bank deposits totalling $14,900 made at irregular intervals over a six-month period. With very little other evidence, the Service concluded that Shapiro was dealing in at least two kilos of hashish per week, and, using the street and wholesale prices of hashish, estimated his costs and his profit.

[114] There was no conclusive proof that Shapiro was in fact a narcotics dealer, although some circumstantial evidence existed. He had never been indicted in the United States for drug charges nor had he been prosecuted in any other country for narcotics-related crimes.

[115] He would be unable to make bail or pay an attorney to defend him on pending criminal charges.

[116] In his dissent, Justice Blackmun stated that the majority opinion was a reaction "to administrative excesses" by the Service in dealing with "suspected narcotics operatives" and speculated that in "a more temperate and untroubled time" the decision, insofar as it modified *Phillips*, might be regretted. 424 U.S. at 635.

[117] Pizzarello v. United States, 408 F.2d 579 (2d Cir. 1969).

[118] *Id.*

[119] It is standard practice for law enforcement agencies to notify the IRS of arrests in which cash, narcotics, stolen goods, or the like are confiscated. *See* Silver, *Terminating the Taxpayer's Taxable Year: How IRS Uses It Against Narcotics Suspects*, 40 J. TAXATION 110 (1974); Tarlow, *Criminal Defendants and the Abuse of Jeopardy Tax Procedures*, 22 U.C.L.A. L. REV. 1191 (1975).

[120] 408 F.2d 579 (2d Cir. 1969). The criminal trial resulted in acquittal.

the estimates of the gambling income were completely unsupportable. In so doing, the court refrained from analyzing the impact of its decision on the long-standing rationale of *Phillips*.

Because most jeopardy assessments imposed against individuals involved in or suspected of criminal activity are made on a conclusory basis,[121] *Shapiro* and *Pizzarello* place a heavy burden on the Commissioner to establish the reliability of his reconstruction of income. This burden is not unreasonably heavy, however, in view of the consequences to the taxpayer who is subjected to a jeopardy assessment.

The issuance of an injunction was likewise upheld in *Sherman v. Nash*.[122] The Third Circuit stated that if, as the taxpayer alleged, a jeopardy assessment was imposed not out of a good faith concern for the protection of the revenue but to harass a taxpayer, the issuance of an injunction would be proper.[123] The court stated that "a jeopardy assessment made in good faith may have a myriad of incidental effects some of which may beneficially inure to other departments of government [in this case the Department of Justice which sought Sherman's testimony at hearings on organized crime]," but where the jeopardy assessment is used "as leverage to exert pressure on a taxpayer for non-tax purposes . . . such unauthorized acts [are not shielded] from judicial review."[124]

It should be noted that the availability of an injunction in these circumstances depends entirely upon a finding that the principal purpose of the assessment was not the collection of revenue. The same argument was advanced in *Bob Jones University v. Simon*[125] in which the Court held that an admission by the University that the revocation of its tax-exempt status would subject it to a tax liability of over one million dollars was clear evidence of the fact that the principal purpose of the suit was to collect revenue.[126] A companion case, *Commissioner v. Americans United, Inc.*,[127] raised substantially the same issue with substantially the same results.[128] While it can be argued that neither *Bob Jones* nor *American United* was a jeopardy case,[129] they might, nevertheless, present a barrier to the jeopardy taxpayer seeking injunctive relief.

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[121] Since those engaged in criminal activity usually do not keep records of their income from illegal endeavors, the IRS must make estimated reconstructions of their income from the available sources. *Shapiro* placed a burden on IRS officials to insure that such estimates have at least some basis in fact.

[122] 488 F.2d 1081 (3d Cir. 1973).

[123] Sherman testified that the IRS' motive was to harass him and to coerce his testimony before a New Jersey grand jury investigating racketeering and organized crime. A memorandum prepared by the federal agent who subpoenaed Sherman tended to confirm that allegation. 488 F.2d 1081, 1083 & n. 5 (3d Cir. 1973).

[124] 488 F.2d 1081, 1084 (3d Cir. 1973).

[125] 416 U.S. 725 (1974).

[125] 416 U.S. 725 (1974). The University's tax-exempt status was revoked because of its refusal to admit Negro students. Although no jeopardy assessment was involved in the case, the petitioner did raise the issue of the Service's good faith intent to protect revenue. It was alleged that the prime motive was to penalize the University for its segregationist policies.

[127] 416 U.S. 752 (1974).

[128] *Id.* at 738.

[129] It should be noted, that the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1207,

While it is easier for the jeopardy assessed taxpayer to obtain injunctive relief since the decision in *Shapiro*, most taxpayers will still be frustrated in their attempts to secure equitable relief. Indeed, one of the ironies of the *Shapiro* decision is that it grants relief to the suspected racketeer who is subjected to a jeopardy assessment on the basis of arbitrarily reconstructed income, but leaves other taxpayers who are jeopardized without relief.[130] Although the unrestricted availability of injunctive relief would have been one way of limiting the power of the Service, this approach was not chosen by Congress.[131] Perhaps this was done because virtually every jeopardy taxpayer can show irreparable harm, and the equitable nature of an injunction remedy would put the Service at a disadvantage.[132]

B. *Declaratory Relief*

It is not uncommon for a jeopardy assessment to be imposed when the tax-exempt status of a non-profit organization is revoked. Such taxpayers have often attempted to obtain declaratory relief.[133] Such attempts proved unsuccessful, however, because the Declaratory Judgment Act[134] precluded declaratory relief in federal tax cases. The Tax Reform Act of 1976 created an exception to this prohibition, however, by permitting the granting of declaratory relief in order to determine the taxpayer's status. This remedy is available irrespective of whether the revocation of non-profit status is accompanied by a jeopardy assessment.[135] *Under the reform provision, declaratory relief is not available to an individual taxpayer or to an institutional taxpayer other than a tax-exempt charitable organization*[136] whose qualification or status is in question.

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90 Stat. 1520, (codified at I.R.C. § 7428), created the right of tax-exempt organizations, primarily those qualified under I.R.C. § 501, to seek a declaratory judgment to determine their status if it should be revoked by the IRS.

[130] While most jeopardy assessments are brought against known or suspected criminals, the ordinary taxpayer may also be jeopardy assessed. *See* GAO STUDY, *supra* note 8, at 6.

[131] For a discussion of the reforms, *see* notes 227-246 *infra* and accompanying text.

[132] The remedy created is an adversary proceeding in which the district court will make findings of fact as to the existence of jeopardy and the reasonableness of the assessment.

[133] The following cases are examples of unsuccessful attempts to obtain declaratory relief: Bob Jones University v. Simon, 416 U.S. 725 (1974); Commissioner v. Americans United, Inc., 416 U.S. 752 (1974); Paul Matthews v. United States, 74-1 U.S.T.C. (CCH) 9346 (S.D. Tex. 1974); Commonwealth Development Ass'n of Pa. v. United States, 365 F. Supp. 792 (M.D. Pa. 1973).

[134] 28 U.S.C. § 2201 (1970). This Act implemented a "[c]ongressional policy of guaranteeing the timely collection of national revenues, free from undue litigation outside of the Tax Court." Yannicelli v. Nash, 354 F. Supp. 143, 151 (D.N.J. 1973), S. REP. No. 1240, 74th Cong., 1st Sess. 11 (1935).

[135] By reason of new Code section, I.R.C. § 7428(a), jurisdiction for declaratory relief lies in the Tax Court and the Court of Claims. A taxpayer may appeal only after he has exhausted all administrative remedies.

[136] The declaratory judgment remedy is also extended to organizations qualified as charitable donees under I.R.C. § 170(c)(2), private charitable foundations under I.R.C. § 509, and private operating foundations under I.R.S. § 4942(j)(3).

The inclusion of this new section remedies a potential abuse: the revocation of tax-exempt status for political or other reasons.[137] Since revocation was frequently made retroactive and was accompanied by a jeopardy assessment,[138] this Code section represented an important reform in jeopardy procedures. As before, however, the individual faced with a jeopardy assessment is clearly foreclosed from declaratory relief.[139] The fact that the circumstances in which a declaratory judgment may be granted are strictly defined leads to the conclusion that Congress intended to preclude individuals faced with the prospect of a jeopardy assessment from seeking declaratory relief. Thus, the reform in this area is incomplete.

C. Sniadach *and Procedural Due Process Objections*

A tactic which jeopardy taxpayers have recently attempted has met with even less success than have the attempts to secure injunctive or declaratory relief. Inspired by such Supreme Court decisions as *Sniadach v. Family Finance Corp.*,[140] which held that pre-judgment relief is ordinarily not available to private parties, jeopardy taxpayers have argued that jeopardy assessments, like pre-judgment garnishment[141] and pre-hearing termination of welfare benefits,[142] violate basic notions of procedural due process. Such contentions have been universally rejected by the courts.[143] There are several reasons why the *Sniadach* reasoning has not been accepted in tax collection cases.[144] First, the United States Constitution specifically authorizes the Congress to "lay and collect [t]axes."[145] It is obvious that the power to collect taxes is essential to the proper func-

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[137] H. R. REP. No. 94-658, 94th Cong., 1st Sess. 282-87, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 2897, 3178-84. The Act would permit declaratory relief for an organization which was denied tax-exempt status. *See, e.g.*, Vietnam Veterans Against the War v. Voskuil, 389 F. Supp. 412 (E.D. Mo. 1974). The Act would grant declaratory relief, as well, to taxpayers whose exempt status was revoked. *See, e.g.*, Commonwealth Development Ass'n of Pa. v. United States, 365 F. Supp. 792 (M.D. Pa. 1973); Universal Life Church v. United States, 72-1 U.S.T.C. (CCH) 9467 (E.D. Cal. 1972) ("bogus" church and social welfare organization whose primary purposes were determined to be other than those claimed in securing tax-exempt status); Jolles Foundation v. Moysey, 250 F.2d 166 (2d Cir. 1957) (suspected communist affiliations).

[138] For example, the jeopardy assessment in Commonwealth Development Ass'n, 365 F. Supp. 792 (M.D. Pa. 1973), was over two million dollars. When dealing with such substantial amounts of money, the availability of declaratory relief is vital to the taxpayer. The taxpayer would be entitled to a concurrent hearing to determine the existence of jeopardy and the reasonableness of the assessment under I.R.C. § 7429.

[139] Prior to the creation of I.R.C. § 7428, it was at least arguable that an individual was entitled to declaratory relief. However, the limitation of that section to organizations clearly indicates congressional intent to exclude individuals from the scheme. *See* notes 135-136 *supra*.

[140] 395 U.S. 337 (1969); Goldberg v. Kelly, 397 U.S. 254 (1970).

[141] Sniadach v. Family Finance Corp., 395 U.S. 337 (1969).

[142] Goldberg v. Kelly, 397 U.S. 254 (1970).

[143] *See, e.g.*, United States v. Johnson, 424 F. Supp. 631 (D. Ore. 1976); Universal Life Church, 72-1 U.S.T.C. (CCH) 9467 (E.D. Cal. 1972).

[144] Some of these arguments are set forth in the discussion of *Phillips*. *See* notes 53-76 *supra* and accompanying text.

[145] U.S. CONST. art. I, § 8, cl. 1.

tioning of government. An adequate safeguard may lie in the fact that those responsible for the tax laws are the elected representatives of the people. While the framers of the Constitution may have failed to foresee the development of a multilayered system in which the responsibility for both policy making and administrative decisions would be shared between elected representatives, political appointees and career bureaucrats, it is clear that they intended plenary taxing power to rest with the Congress. Under such circumstances, it is difficult to quarrel with the way in which Congress has chosen to exercise its power, absent a finding of unconstitutionality.

Second, the propriety of the grant to the Treasury Department of the power to assess and collect taxes was settled in the early case of *Springer v. United States*,[146] in which procedural due process arguments on the issue of tax collection generally were advanced and rejected. In *Springer*, the Supreme Court held that it was not necessary for revenue claims of the United States to be reduced to judgment.[147] This holding was expressly confirmed in *Phillips* with respect to the ordinary assessment procedures and impliedly confirmed with respect to jeopardy assessment procedures.[148] The *Springer* and *Phillips* decisions represent practical, common-sense applications of the philosophy of the framers regarding the power to collect taxes.[149]

The Supreme Court acknowledged procedural due process arguments in *Fuentes v. Shevin*.[150] In passing upon the constitutionality of Florida's replevin statute, which allowed a merchant to repossess goods without a formal hearing, the Court stated that seizure had been allowed in limited circumstances in which there was a clear need for immediate action, the person executing the seizure was a government officer, and the seizure was essential to secure important governmental or public interests. "Thus, the Court has allowed summary seizure of property to collect the internal revenue. . . ."[151]

Sniadach and its progeny do not provide support for the proposition that jeopardy assessments are unconstitutional, but they do serve as a barometer by which one may predict the judicial climate and the mood of the American public.[152] It would seem that in the mid 1970's people on the whole are less willing to trust power and authority. They are more sensitive to abuses of official discretion, and more anxious to exercise some control over government agencies thought to be too powerful and

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[146] 102 U.S. 586 (1880).

[147] *See also* Tennessee v. Sneed, 96 U.S. 69, 75 (1877), in which the Court held that it would be unreasonable to impede tax collection to satisfy the whims of "every litigious man."

[148] 283 U.S. 589, 596 (1931).

[149] *See* note 64 *supra*.

[150] 407 U.S. 67 (1972).

[151] The Court then cited *Phillips* in support of this statement. 407 U.S. 67, 91-92 (1972).

[152] There is no reason why, despite the fact that such measures are constitutional, they must be continued unabated if their undisciplined use shocks and offends the American public.

intractible.[153] It is in this context that Congress and individual citizens are examining the practices of the Service in the execution of jeopardy assessments.

IV. Specific Abuses of the Jeopardy Provisions

A. *Tolling the Statute of Limitations*

The earliest abuse of the jeopardy provisions involved the imposition of a jeopardy assessment to prevent the expiration of the statute of limitations[154] and resulting loss of revenue.[155] This use of the procedure was particularly prevalent during the twenties. Under the early tax laws, the difficulty frequently encountered in determining the basis of stocks and other assets often resulted in staggering deficiencies,[156] so that the Bureau constantly ran several years behind in assessments. Under such circumstances, it became common practice to impose jeopardy assessments indiscriminately in order to prevent the limitation period from expiring.[157]

The outcry which resulted from this early practice was predictable. The American Bar Association (ABA), which offered an amendment specifically revoking the Bureau's authority to jeopardy assess for the purpose of tolling the statute of limitations, argued that the very existence of a statute of limitations constituted notice to all of the expiration date.[158] The ABA amendment also proposed that the taxpayer be given the opportunity to petition the United States district court or the BTA "to declare the jeopardy assessment void, if such tribunal finds that no jeopardy in fact existed."[159] The amendment was defeated after the Bureau assured the committee that since it was nearly current in its

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[153] Hence the renewed interest in congressional oversight committees such as the Subcommittee on Oversight of Internal Revenue Procedures of the House Ways and Means Committee.

[154] The current statute of limitations is found in I.R.C. § 6501. Assessments must be made within three years, with an extension to six years if the taxpayer has substantially understated his income. In the case of fraud, willful evasion or failure to file a return, no limitation exists.

[155] Prior law had, in fact, specifically provided that the imminent expiration of the statute of limitations constituted jeopardy. Revenue Act of 1921, ch. 136, § 250(d), 42 Stat. 266 (repealed 1924).

[156] One of the most spectacular of these cases involved James Couzens, a Michigan congressman and minority stockholder in the Ford Motor Company. In order to determine Couzens' gain on the sale of his Ford stock, it was necessary to determine his basis as of 1913. Shortly before the statute of limitations was to expire, the Commissioner revised his valuation downward from $9,000 to $3,000 per share, thereby increasing the taxable gain on the sale from two to eight million dollars. The Commissioner then jeopardy assessed Couzens for the additional tax. James T. Couzens, 11 B.T.A. 1040 (1928).

[157] *See Revenue Revision of 1928: Hearings on H.R. 1 Before the Ways and Means Comm.*, 69th Cong., 1st Sess. 532-33 (1928) (statement of Hugh Saterlee).

[158] *Id.* at 543.

[159] *Id.* at 466. The adoption of this amendment in 1928 would have prevented some of the hardships imposed on subsequent jeopardy taxpayers, but the amendment was defeated.

review of returns, it would no longer routinely impose jeopardy assessments for this purpose.[160]

The classic example of a jeopardy assessment imposed for the purpose of preventing the expiration of the statute of limitations can be found in the 1936 case of *Foundation Co. v. United States*.[161] The Service admitted that it did not know how much tax was due from the taxpayer, that it had not prepared a case against the taxpayer, and that it had not even formulated a theory under which to proceed. The statute of limitations, as extended by the taxpayer's waiver, was about to expire. Accordingly, the Commissioner imposed a jeopardy assessment of $450,000.[162] Because there was no question but that the taxpayer was a financially responsible corporation which could and would pay the amount assessed, it was argued that the Commissioner was required to issue the customary notice of deficiency, which would toll the running of the statute of limitations, in order to preserve the corporation's right to a prepayment appeal. The court brushed aside this claim by noting that the Commissioner was not required to issue a deficiency notice because his authority to impose a jeopardy assessment was discretionary. The court also refused, for the same reason, to comment on whether the Commissioner's action in imposing the assessment was reasonable or even necessary.[163]

As the court in *Foundation Co.* pointed out, the issuance of a notice of deficiency tolls the running of the statute of limitations, but the flexibility of a jeopardy assessment makes it a more desirable tool under the circumstances.[164] In current practice jeopardy assessments are infrequently used for this purpose, but the threat of a jeopardy assessment is sometimes used to coerce individual taxpayers or their representatives into extending the statute of limitations.[165]

That the Service should have the absolute, unlimited, and unreviewable power to cause substantial hardship by imposing or threatening to impose a jeopardy assessment because of its own failure to prepare an adequate case against a taxpayer prior to the expiration of the statute of limitations is unreasonable and objectionable. It is submitted that Congress should act to curtail this practice by statute. Without congressional action, each affected taxpayer would be required to contest the jeopardy assessment by suit in district court under section 7429. Such action would be an expensive, time-consuming, and frustration-ridden method of curtailing an undesirable practice.[166]

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[160] *Id.* at 532.

[161] 15 F. Supp. 229 (Ct. Cl. 1936). Though the case was decided in 1936, it involved a deficiency from 1918 and a jeopardy assessment made in 1925.

[162] *Id.* at 247. It may be assumed that the $450,000 assessment was the greatest possible tax liability which could have been asserted against the company.

[163] *See* notes 45-52 *supra* and accompanying text.

[164] *See* note 72 *supra*.

[165] *Taxpayer Assistance and Compliance Programs: Hearings Before the Subcomm. on Treasury, Postal Service and General Government Appropriations of the Comm. on Appropriations of the Senate Finance Comm.*, 93d Cong., 1st Sess. 366 (1974) (statement of Clyde Maxwell) [hereinafter cited as *Approp. Hearings*].

[166] *See* INTERNAL REVENUE SERVICE, POLICY STATEMENT P-4-88 (Mar. 24, 1960), for the

B. *The Jeopardy Assessment As A Penalty For Illegal Acts*

The jeopardy assessment at times has been used by the government as a weapon to penalize criminals or unpopular elements. A recent case, *Lenske v. United States*,[167] illustrates this practice. Reuben Lenske, a politically-active Portland, Oregon attorney who had been affiliated with left-wing causes, was jeopardy assessed $508,000 shortly after his conviction for criminal tax fraud.[168] The jeopardy assessment and criminal conviction involved the same taxable year. While it seemed reasonable to assume that an individual who attempted to evade taxes would be likely to remove or dissipate the assets, thereby creating the classic jeopardy situation, the assessment was not made for that reason. Rather, the investigating revenue agent recommended the jeopardy assessment because of Lenske's "unorthodox social and political views."[169]

The Ninth Circuit Court reversed Lenske's criminal conviction.[170] The defendant also succeeded in obtaining an abatement of the jeopardy assessment, primarily because of the statement made by the revenue agent. A recomputation of his income resulted in a $2,000 refund for the tax year.[171]

Another example of the use of jeopardy provisions to attain non-revenue goals involves the Narcotics Traffickers Program. Until 1974, the Service conducted an active program aimed at harassing and interfering with individuals engaged in narcotics trafficking. The *Shapiro* case[172] is an example of the manner in which the program functioned. The Narcotic Traffickers Program entailed the extensive use of jeopardy and termination assessments[173] to deprive narcotics dealers of their

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use of jeopardy assessments. *See also* INTERNAL REVENUE SERVICE, HANDBOOK FOR INTERNAL REVENUE AGENTS, which specifically prohibits the threat of a jeopardy assessment for the purpose of extending the statute of limitations. These materials were entered into the public record by Donald C. Alexander then Commissioner of Internal Revenue during his testimony at the *Oversight Subcomm. Hearings*, *supra* note 1, at 379.

[167] 66-2 U.S.T.C. (CCH) ¶ 9686, *rev'd*, 383 F.2d 20 (9th Cir. 1967).

[168] *See generally Approp. Hearings*, *supra* note 165, at 353-74 (statement of Reuben Lenske).

[169] *Id.* at 355.

[170] 383 F.2d 20 (9th Cir. 1967).

[171] *Approp. Hearings*, *supra* note 165, at 356 (statement of Reuben Lenske).

[172] For a discussion of *Shapiro*, *see* notes 88-95 *supra* and accompanying text.

[173] I.R.C. § 6851. This section provides for immediate seizure of property to satisfy tax liability. In a termination case, the Commissioner declares the taxpayer's current taxable year terminated and assesses tax for that short year on the basis of the income received prior to the termination. *See* Silver, *supra* note 113; Tarlow, *supra* note 113. The Narcotics Traffickers Program was initiated in 1971 as a part of President Nixon's efforts to combat drug abuse. Statistics from the GAO STUDY, *supra* note 8, at 6, for the fiscal years 1972 to 1975 show the number of assessments made during the height of the program:

	Fiscal year 1972	1973	1974	1975	Total
Jeopardy assessments (note a):					
Narcotics Traffickers Program	98	141	113	60	412
Other	200	358	413	150	1,121
Total	298	499	526	210	1,533

operating funds.[174] When the Program was discontinued amidst strong criticism,[175] then Commissioner Donald Alexander announced that the administration believed that the expenditure of time and money on the Narcotics Traffickers Program was not justified by the amount of revenue it produced; accordingly, it would no longer be entitled to disproportionate emphasis or funding.

It is universally accepted that drug abuse must be reduced, and that the illegal drug business produces taxable income which necessarily leads to the intervention of the Internal Revenue Service. It is objectionable, however, to permit a financial penalty to be imposed which is so severe as to render a taxpayer indigent overnight, merely because the individual was suspected of income producing criminal activity. Such action contradicts the fundamental concept of substantive due process.

In *United States v. Hall*[176] drug enforcement officers searched Mrs. Hall's Kentucky residence following the arrest of her estranged husband on narcotics charges in Texas. The officers found one gram of marijuana and one amphetamine crystal hidden on the premises. Mrs. Hall maintained that the drugs belonged to her husband and that she had been unaware of their presence in her home. Nonetheless, Internal Revenue agents recommended termination of her taxable year and a jeopardy assessment of $52,000 for the month of January was issued. Her income for the month was reconstructed in the same manner as Shapiro's, based on estimates of volume, and wholesale and street prices of narcotics. Pursuant to the assessment, Mrs. Hall's car was seized and sold, causing her substantial hardship and embarrassment.[177] These

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Termination assessments:					
Narcotics Traffickers Program	999	2,448	1,523	304	5,274
Other	73	143	125	34	375
Total	1,072	2,591	1,648	338	5,649
Combined assessments:					
Narcotics Traffickers Program	1,097	2,589	1,636	364	5,686
Other	273	501	538	184	1,496
TOTAL	1,370	3,090	2,174	548	7,182

It should be noted that the increase in jeopardy assessments against narcotics suspects was accompanied by a significant increase in the number of other jeopardy assessments made. These comparisons indicate an attitude of increased zeal, or callousness depending on the reader's point of view, regarding the collection of revenue by this extraordinary method.

[174] *See Oversight Subcomm. Hearings, supra* note 1, at 379 (statement of Donald C. Alexander). A serious problem with the program was that an IRS "conviction" was often based on flimsy or circumstantial evidence, and that the resulting "sentence" was an assessment far beyond the taxpayer's ability to pay. For an example of this practice and its effect, *see, e.g.*, Laing v. United States, 423 U.S. 161 (1976).

[175] Speech to the Tax Section of the American Bar Ass'n. *reported in* 41 J. TAXATION 315 (1974).

[176] United States v. Hall, was consolidated with Laing v. United States, 423 U.S. 161 (1976).

[177] The items, found in a film canister in the piano, belonged to the taxpayer's estranged husband. A thorough search of the house yielded no other drugs or narcotic para-

actions were all taken in the absence of even a criminal charge of possession or distribution against Mrs. Hall. The Supreme Court held that in the circumstances, Mrs. Hall was entitled to injunctive relief and to a hearing before the Tax Court on the issue of her tax liability.[178]

C. *The Prima Facie Case*

Among the reforms advocated by those who seek to limit the authority of the Service to impose jeopardy assessments is the declaration that there must be objective standards by which to determine when jeopardy exists. No specific standards are enumerated in the Code. By policy statement, however, the Service has set forth reasonable, objective standards. Unfortunately, the application of these standards has been overly broad.

Under the terms of the policy statement, a jeopardy assessment may only be imposed if one of three conditions exists:[179] the taxpayer is or appears to be[180] preparing to flee the United States or to conceal himself; the taxpayer is or appears to be preparing to place his property beyond the reach of the Government by removing it to another country or by transferring, concealing, or dissipating it; or the taxpayer's financial solvency is or appears to be threatened.[181]

These three conditions represent situations in which the imposition of a jeopardy assessment is an appropriate response because the ultimate payment of tax reasonably appears to be in doubt. Except for the uncomfortable vagueness of the phrase, "appears to be," the standards are simple, to the point, and capable of consistent administration. However, instead of clarifying the quantum of evidence necessary for a revenue agent reasonably to determine whether jeopardy exists, and thereby narrowing the circumstances in which jeopardy may be found, the Internal Revenue Manual (IRM or Manual) set forth situations held to constitute prima facie cases of jeopardy.[182] The prima facie case

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phernalia. For the testimony of Mrs. Hall's attorney, *see Oversight Subcomm. Hearings, supra* note 1, at 245, 247 (statement of Donald M. Heavrin).

[178] 423 U.S. 161 (1976). Prior to this case, the Service had maintained that it was not required to issue a statutory notice in termination assessment cases under I.R.C. § 6851.

[179] INTERNAL REVENUE SERVICE, POLICY STATEMENT P-4-88 (Mar. 24, 1960), was inserted into the public record during the *Oversight Subcomm. Hearings, supra* note 1, at 378. The conditions are not contained in the statute. They represent the Service's interpretation of jeopardy situations and are subject to change and revision at any time without notice to or consent of Congress.

[180] The *intial judgment as to* what constitutes jeopardy or an appearance of jeopardy is left to the revenue agent, who makes the decision after consulting with the Intelligence Division. The agent's recommendation is then reviewed and personally approved by the district director.

[181] As was pointed out by Professor William T. Plumb, Jr., this third criterion should be clarified to indicate that a jeopardy assessment should be issued only when a delay would result in probable loss of tax revenues. *Oversight Subcomm. Hearings, supra* note 1, at 263.

[182] The approval and review procedures are set forth in Rev. Proc. 60-4, 1960-1 C.B. 877; the conditions are specified in INTERNAL REVENUE MANUAL II (CCH) § 4584.5 (1971). The prima facie case provisions have been abandoned. *See* note 202 *infra*.

has since been abandoned. The provisions are discussed here to give historical context to reformers' demands.

According to the Manual, a district director[183] may authorize a jeopardy assessment without further approval any time a prima facie case exists.[184] It is submitted that the prima facie case policy had the effect of inducing careless or unnecessary jeopardies, and of significantly broadening the instances in which jeopardy may be found. Jeopardy assessments, according to the Manual, are warranted if the taxpayer: is a "major operator" in the criminal field;[185] has a prior history of activity in illegal enterprises, even if he is currently engaged in a "so-called legitimate business;"[186] is engaged in activity which is generally regarded as illegal, if there is a possibility of large unexpected losses caused by the interference of other criminal elements;[187] is a frequent gambler who wagers large amounts;[188] is engaged in taking wagers;[189] or is known or suspected of designing to leave the United States without providing for tax payments.[190]

The Manual further sets forth situations in which a jeopardy assessment may be used in order to secure tax revenue to the detriment of other creditors. Thus, jeopardy exists when the taxpayer is engaged in a legitimate business but consistently suffers business or personal losses,[191] is in a difficult financial position or has doubtful ability to make good the tax deficiency in the future,[192] or has a large damage suit pending or threatened against him.[193] The reasoning behind these

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[183] INTERNAL REVENUE MANUAL II (CCH) § 4584.5 (1971).

[184] If the jeopardy is based on other than a prima facie case, the district director must secure prior approval from the Director, Audit Division in Washington, D.C. *See* note 202 *infra* for the recent modification of this policy.

[185] "Major operator" is nowhere defined. This omission may lead to confusion as to who is a "major" and who is a "minor" operator.

[186] This reflects a presumption that all persons with records of convictions should be subject to jeopardy assessments, as the "major operator" criterion is not mentioned here.

[187] Examples given are blackmailers and hijackers. It should be noted that legitimate businesses, too, are subject to large unexpected losses due to criminal acts such as robbery, kidnapping, and extortion.

[188] No attempt is made to define "frequent" or "large amounts" or to indicate what type of proof would be necessary to demonstrate that the taxpayer is a known gambler. For example, would anyone who receives a Form 1099 at the racetrack automatically be suspect?

[189] Apparently, bookmakers are not "major operators" in the criminal field.

[190] While it seems sensible to do so, the Internal Revenue Manual does not limit this provision to those who are leaving the country permanently. Vacationers and tourists are all leaving the country under the specified circumstances.

[191] A jeopardy assessment made against an individual in this position would quite possibly force the taxpayer into insolvency, thus permanently depriving the government of the desired tax revenue.

[192] This situation permits the revenue agent to make a recommendation of a jeopardy assessment on the basis of his opinion of the taxpayer's future financial condition. While there are many situations in which such findings would clearly be warranted, the potential for abuse is substantial.

[193] The merit or the possibility of settlement of the suit apparently need not be considered; its mere existence is sufficient to indicate that jeopardy exists.

provisions is based on the fact that federal taxes do not necessarily enjoy first priority in a bankruptcy proceeding.[194] However, if an assessment is made and a notice of federal tax lien is filed prior to bankruptcy, the United States is entitled to first priority with respect to real property.[195] The United States is also entitled to first priority with respect to personal property provided that the personalty has been seized prior to bankruptcy.[196] Through the use of a jeopardy assessment prior to bankruptcy, the United States may satisfy its own claims from available assets, thus defeating other creditors.[197]

The final instance involving a prima facie case of jeopardy concerns the taxpayer who has a history of avoiding or resisting the payment of taxes. This provision could conceivably be used against any individual who had at any time in the past been indebted for taxes, despite the fact that a good faith dispute may actually have existed as to the liability. If the criterion is meant to apply only to those who have been convicted of criminal fraud or willful failure to file a return, the Manual does not so state.

As has been suggested, the criteria for a prima facie case are subject to manipulation, principally due to overbreadth and the failure to define precisely the operative terms. Such manipulation constitutes an abuse of discretion granted for the sole purpose of protecting the revenue. That such abuse has not frequently occurred[198] is no defense.[199] It is submitted that Congress should confine the exercise of discretion by setting forth in the Code those situations in which the Secretary or his delegate may exercise his discretion.

D. *Ineffective Internal Controls*

Because of the general nature of the standards for determining the existence of jeopardy, and the potential for abuse, it would appear necessary to implement meaningful internal controls to prevent overzealous-

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[194] Bankruptcy Act § 64a, 11 U.S.C. § 104(a) (1970).

[195] *Id.* § 67b, 11 U.S.C. § 107(b) (1970).

[196] *Id.* § 67a(3), 11 U.S.C. § 107(a)(3) (1970).

[197] In an impending damage suit, the jeopardy assessment is imposed before a final judgment in the suit is entered. *See, e.g.,* United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950).

[198] *See Oversight Subcomm. Hearings, supra* note 1, at 409 (statement of Donald C. Alexander). The Commissioner indicated that if the agency functioned properly, such incidents would seldom occur. However, it is impossible to demonstrate abuse of discretion in a system which, until recently, declined to review even clearly outrageous discretionary acts. *See* notes 45-52 *supra* and accompanying text.

[199] IRS does not keep separate records on the number of jeopardy assessments, the reasons for the finding of jeopardy, or the disposition of jeopardy cases by abatement, posting bond, etc., or the final amount assessed by the Tax Court in each case. This lack of documentation makes it more difficult to determine whether the provisions are being abused. The GAO Study, which examined jeopardy assessments in two IRS districts, indicated that most jeopardy assessments were imposed on those with criminal affiliations, and that those jeopardy assessments actually issued during the period examined were justified and reasonable in amount. However, the Study is limited and does not provide information on procedures used prior to 1974, or on procedures used in the 56 other IRS districts. GAO Study, *supra* note 8, at 9.

ness by IRS agents and to guarantee greater uniformity between internal revenue districts.[200] Present guidelines are limited, however, and internal controls are virtually nonexistent. The "safeguards" which have been built into the system by the Service consist of the requirements that the district director personally approve each jeopardy assessment, and that jeopardy assessments are to be used sparingly.[201]

A recent directive requires that the IRS Regional Counsel review proposed jeopardy assessments.[202] The review is for the purpose of determining whether a successful defense could be made if the jeopardy assessment were challenged by the taxpayer.[203] The statement itself, however, provides an exception to the general rule of pre-assessment review by indicating that "in many situations there will be insufficient time" to obtain the opinion of Regional Counsel before making a jeopardy assessment.[204] This means that the district director is empowered to make the decision to impose a jeopardy assessment without securing prior advice of counsel if he believes that the exigency of the situation demands immediate action.[205] The palliative of Regional Counsel review is thus seriously undercut by this exception.

Post-assessment review remains unchanged from that prescribed in 1960,[206] except for the addition of post-assessment review by Regional Counsel in those situations in which prior review is not obtained. Review of all jeopardy assessments, including closed cases, is conducted at the Regional Office in order to insure that policy and procedure are followed, and to recommend corrective measures when the assessment is considered unnecessary or excessive.[207] Moreover, a selected number of jeopardy assessment cases are post-reviewed in the Audit Division at the National Office in order to evaluate and coordinate jeopardy procedure.[208] Current procedure calls for the completion of the review within sixty days in order to allow for the timely filing of an accurate statutory notice of deficiency.[209]

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[200] Uniform administration was a continuing concern of congressional investigators. *See generally Oversight Subcomm. Hearings, supra* note 1; *Approp. Hearings, supra* note 165.

[201] Rev. Proc. 60-4, 1960-1 C.B. 878; INTERNAL REVENUE SERVICE POLICY STATEMENT P-4-88 (Mar. 24, 1960), entered in the public record in *Oversight Subcomm. Hearings, supra* note 1, at 378.

[202] INTERNAL REVENUE MANUAL II (CCH), Supplement 45G-272, § 3.01 (Nov. 5, 1976).

[203] *Id.* The review is to concentrate on justification for the belief as to the existence of jeopardy and the reasonableness of the computation of the deficiency, based upon information available at the time of assessment.

[204] *Id.* § 7.01. In such cases, the file will be referred to Regional Counsel for review immediately following the assessment.

[205] If one is to believe the testimony of Meade Whitaker, then Chief Counsel of the IRS, regarding the need for nearly instantaneous action in the vast majority of jeopardy cases, including the necessity of assessment on the basis of an insufficient and incomplete investigation, this would mean that the District Director would be in substantially the same position as before. *See Approp. Hearings, supra* note 165, at 614 (statement of Meade Whitaker).

[206] Rev. Proc. 60-4, § 3.01-02, 1960-1 C.B. 878.

[207] *Id.* § 3.01.

[208] *Id.* § 3.02.

[209] INTERNAL REVENUE MANUEL II (CCH), Supplement 45G-272, § 4.03 (Nov. 5, 1976).. I.R.C. § 6861 (b) requires the issuance of a statutory notice within 60 days.

Review by the National Office suggests that the taxpayer's appeal[210] may result in full or partial abatement, which would be reflected in the statutory notice[211] unless one had been issued prior to the jeopardy assessment.[212] However, such review does not appear to influence the district director's decision in the majority of cases, perhaps because the proof offered by nefarious characters who are the most likely targets of jeopardy assessments[213] is itself suspect.[214]

Irrespective of other reforms which may be instituted, stronger internal controls, including a mandatory preassessment review by Regional Counsel,[215] are necessary so that the jeopardy power cannot be used indiscriminately.

E. *Inflated Assessments*

Despite the limitations imposed by *Shapiro*[216] and the Tax Reform Act of 1976,[217] the Commissioner's judgment with respect to the

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[210] The intra-department review is prescribed by I.R.C. § 6861(g) and Treas. Reg. § 301.6861-1(e)-(f) (1957).

[211] It is important that the amount assessed in the statutory notice be accurate for two reasons. The amount finally assessed cannot be increased if the taxpayer files a timely petition with the Tax Court. I.R.C. § 6212 (c). If the deficiency claimed is found to be arbitrary and excessive, the burden of proof shifts from the taxpayer to the government. Helvering v. Taylor, 293 U.S. 507 (1935).

[212] Although the IRS keeps no records on this subject, the testimony of Meade Whitaker and other IRS officials before congressional committees indicate that jeopardy assessments are often made hastily with incomplete information. An attempt is made to maximize the assessment in order to protect government interests. The haste with which jeopardy assessments are made frequently causes substantial errors in the nature of over-assessments. *See* note 205 *supra*; *Approp. Hearings*, *supra* note 165, at 613. The feeling in the past has been that such errors must be tolerated in order to accomplish the goal of securing revenue. As the court noted in Homan Mfg. Co. v. Long, 242 F .2d 645, 650 (7th Cir. 1957), nothing in the Code requires that "jeopardy assessments be based upon computations fitted together with the accuracy of Dutch tiles."

[213] The taxpayer may show at the agency review level, with the full facts at his disposal, that the assessment is too high or is unnecessary. The fact that many jeopardy assessments are litigated and that the ultimate tax liability is often much lower than the assessment is an indication that the IRS is less than responsive to the taxpayer's proof presented at the administrative review. *See* Note, *Jeopardy Assessments: The Sovereign's Stranglehold*, 55 GEO. L.J. 701 (1967).

[214] Control over the decision to abate is not as important as control over the initial decision to assess because the immediate seizure which accompanies assessment can cause severe problems for the taxpayer despite the fact that the assessment may later be abated. As Mr. Justice White stated the quintessential due process quandry in Stanley v. Illinois, 405 U.S. 645, 647 (1972), noting that it is incorrect to assert as a "general proposition that a wrong may be done if it can be undone."

[215] The speed can be preserved by putting the review on a highest-priority basis. Speed in a jeopardy assessment is a somewhat relative consideration because a jeopardy assessment under I.R.C. § 6861 arises only in the context of an on-going audit. The situation in which the taxpayer is at the airport with $500,000 in a suitcase is unlikely to occur without the prior knowledge provided by surveillance and intelligence activities.

[216] 424 U.S. 614 (1976). The case allows an injunction to issue where the Commissioner can show no reasonable basis in fact for the amount of a jeopardy assessment and the taxpayer is able to show that he would otherwise suffer irreparable harm. *See* notes 88-95 *supra* and accompanying text.

[217] For a discussion of I.R.C. § 7429 concerning the administrative and judicial review of jeopardy assessments, *see* notes 227-246 *infra* and accompanying text.

amount of the deficiency is still paramount.[218] It is evident in cases petitioned to the district court under Code section 7429 that the Commissioner's determination will be presumed correct, because the taxpayer has the burden of proof as to the reasonableness of the amount of the assessment.[219]

Examples of inflated assessments are found in the Report of the Administrative Conference of the United States on the Collection of Delinquent Taxes.[220] The report cites a case involving an assessment of over three million dollars against a taxpayer whose net worth was no more than $40,000.[221] In another case, "*every bit* of property . . . of both taxpayers . . . [was] seized."[222] According to the report, the average jeopardy assessment in recent years has been well over $200,000, and the tendency to inflate is a serious concern to Service management.[223]

In testimony before the Oversight Subcommittee on Internal Revenue Taxation, William T. Plumb stated that "theoretically the jeopardy assessment is supposed to be supportable, but they can assess any amount . . . and sometime, years later perhaps, you may get the Tax Court to find you didn't owe it after all."[224] Still another witness, a former Service attorney now in private practice, stated that "any jeopardy assessment I have ever seen has always been grossly inflated. . . . I believe these jeopardy assessments are deliberately made so because they do not want the assets seized under the jeopardy assessment released under the bonding procedure. . . ."[225]

While subjecting jeopardy assessments to judicial scrutiny will most likely eliminate the clearly arbitrary and excessive assessments,[226] there is still the probability that inflated assessments will persist in the substantial gray area in which the Service will enjoy its traditional freedom. The district court, in reviewing the assessment, will probably not wish to assume the role of the Tax Court in determining the final tax liability. The best hope for judicial scrutiny is that the Service will be influenced to moderate its assessments through the taxpayer's access to a public forum.

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[218] For a discussion of how the district courts will handle the reasonable assessment cases, *see* notes 219-232 *infra* and accompanying text.

[219] I.R.C. § 7429(g)(2). A presumption exists that the assessment is reasonable, even if the government fails to meet its burden to prove that jeopardy exists.

[220] ADMIN. CONF. REPORT, *supra* note 8, at 63-66. The Administrative Conference's Taxation Section has some distinguished members, including Sheldon S. Cohen, Commissioner of Internal Revenue under the Johnson Administration.

[221] Anthony J. Petrone, 18 T.C.M. (CCH) 787 (1959).

[222] Kimmel v. Tomlinson, 151 F. Supp. 901, 902 (S.D. Fla. 1957) (emphasis in original).

[223] ADMIN. CONF. REPORT, *supra* note 8, at 63.

[224] *Oversight Subcomm. Hearings, supra* note 1, at 258 (statement of William T. Plumb).

[225] *Approp. Hearings, supra* note 165, at 366 (statement of Clyde Maxwell).

[226] Assessments such as the conclusory ones in *Shapiro* and *Pizzarello, supra* notes 111-112 will almost certainly be invalidated. Other assessments will probably stand the test of judicial scrutiny.

V. The Impact of the Tax Reform Act of 1976

A. *New Code Section 7429: Judicial Review of Jeopardy*

The principal reform provision of the Tax Reform Act of 1976 affecting jeopardy taxpayers[227] is Code section 7429. This section was added to the Code in response to demands for legislative controls over the jeopardy procedure. The demands were not new. Similar proposals were made by the ABA in 1928 and 1957.[228] It became clear in the post-Watergate era, however, that the time for reform had finally arrived.

Section 7429 grants to the jeopardy taxpayer the following rights: the right to a complete statement within five days of the assessment indicating the reasons for the determination that the revenue is in jeopardy and the computation of the deficiency,[229] and the right to an administrative review upon request within thirty days after the written statement is issued.[230] The Code characterizes the Secretary's review of the jeopardy assessment as a "redetermination." The use of that term indicates that the assessment is to be re-examined completely, taking into consideration information supplied by the taxpayer and other information which was unavailable at the time of the assessment.[231] This review must be completed within fifteen days.[232]

If the taxpayer is not satisfied with the results of the administrative review, he may file a petition with the district court for the district in

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[227] Less sweeping reforms dealt with correction of errors and declaratory relief. Under prior law a taxpayer could not object to a Service finding that mathematical or clerical errors of the taxpayer had resulted in a deficiency in tax until the additional tax had been collected. I.R.C. § 6213(b)(1). The 1976 Tax Reform Act inserted a new provision to allow the taxpayer an opportunity to appeal a redetermination of the tax prior to levy. I.R.C. § 6213(b)(2). A provision allowing declaratory judgments for tax-exempt organizations was added: I.R.C. § 7428. *See* notes 133-139 *supra* and accompanying text.

[228] *See* text at note 159 *supra* for a discussion of the 1928 ABA amendment. The 1957 proposals of the ABA Section on Taxation were embodied in H.R. 5043, 86th Cong., 1st Sess. (1960). The bill was not enacted. The proposals are also contained in ABA Report 221-23 and in the ABA Section on Taxation, 1958 Program and Committee Reports, 159-60 (1957). *See also Approp. Hearings, supra* note 165, at 237 (testimony of William T. Plumb).

[229] I.R.C. § 7429(a)(1). Under prior law the taxpayer could, on request, have access to the Revenue Agent's Report (RAR) concerning the recommendation of a jeopardy assessment. This is a standard one page worksheet that states the amount of the deficiency and the reason for the recommendation. The backup information and intelligence reports were unavailable to the taxpayer. *Oversight Subcomm. Hearings, supra* note 1, at 404, 409 (statement of Donald Alexander).

[230] I.R.C. § 7429(a)(2). Previous procedure, Treas. Reg. § 301.6861-1(d) (1957), required the taxpayer to file a bond with the District Director within 10 days of notice and demand. The reform provision gives the taxpayer more time to prepare his arguments and to make an informed appraisal of the validity of the IRS' jeopardy claim.

[231] I.R.C. § 7429(a)(3). Even if the taxpayer has no evidence to offer tending to show that jeopardy does not exist, the District Director must re-examine the assessment on request. This was not the case under prior procedure. Treas. Reg. § 301.6861-3 (1957).

[232] On the sixteenth day the taxpayer may appeal to the district court. I.R.C. § 7429(b)(1)(B). Under previous practice, the review did not have to be concluded speedily. The only requirement was the Service's self-imposed regulation that internal review should be complete before issuance of the statutory notice (60 days after the assessment). *See* Internal Revenue Manual II (CCH), Supplement 45G-272 (Nov. 5, 1976).

which he resides[233] within thirty days of notification of the Secretary's decision or within forty-five days after submission of his review request, whichever comes first.[234] The district court may then make a final, unreviewable determination[235] whether the jeopardy assessment was reasonable and whether the amount assessed was appropriate. Both determinations are to be made with reference to the facts and circumstances of each case.[236]

Remedies which might be awarded by the court include ordering complete or partial abatement of the assessment, redetermination of the deficiency, and such other relief as is appropriate.[237] Presumably this latter alternative could include a requirement that the Service notify creditors and lending institutions that the dispute had been resolved in the taxpayer's favor, hopefully to restore the flow of credit needed to keep the taxpayer's business afloat. Other remedies could include compelling a release of funds to provide for the maintenance of a taxpayer's property during the pendency of the Tax Court litigation. This procedure has been suggested as a means of protecting the interests of both the government and the taxpayer[238] in a jeopardy assessment.

Code section 7429 could prove to be very useful to jeopardy taxpayers depending on the degree of innovation and flexibility which the district courts manifest when confronted with actions of this nature. Certainly the fact that district court decisions are final and unreviewable will have some tendency to influence the nature of decisions under this section.[239]

Also to be considered is the quantum of evidence which will be required by the district courts in order for the taxpayer to meet the burden of proof. It is logical to assume that the standard will be the same as that required by the Administrative Procedure Act,[240] inasmuch as an ac-

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[233] I.R.C. § 7429(e). In the case of a corporation, the action may be commenced in the district court in the district in which the principal place of business is found. 28 U.S.C. §§ 1402(a)(I)-(2) (1970).

[234] I.R.C. § 7429(b)(I)(A)-7429(b)(1)(B).

[235] *Id.* § 7429(f).

[236] *Id.* § 7429(b)(2)(A)-7429(b)(2)(B).

[237] *Id.* § 7429(b)(3).

[238] *See* Recommendations of the Admin. Conf. of the U.S., 41 Fed. Reg. 1867, 1869 (1976). Logically, if the taxpayer's property is permitted to deteriorate, the amount it will bring at a subsequent sale is reduced; likewise, the value of the property is reduced if the taxpayer resumes possession after a judgment in his favor.

[239] I.R.C. § 7429(f) states that the district court's decision "shall not be reviewed by any other court." There is some doubt whether immunity from appellate review would extend to a situation in which a district court fashioned a novel remedy which conflicted with another part of the statute. For example, if a district court ordered the IRS to accept something other than the standard bond as security to delay collection under I.R.C. § 6863, or in the instance where the factual determination of the district court is clearly erroneous, the decision might be subject to review. In any event, the IRS is certain to test the extent of the prohibition at the earliest opportunity.

[240] Ch. 324, 60 Stat. 237 (1946) (current version at 5 U.S.C. §§ 701-706 (1970)). In administrative hearings, the standard of proof is met if the claim is supported by substantial evidence on the record as a whole. This is somewhat less demanding than the traditional preponderance of the evidence test.

tion pursuant to Code section 7429 resembles a challenge to agency action which is arbitrary, capricious, and an abuse of discretion.[241] The possible application of the standards of the Administrative Procedure Act for judicial review of jeopardy assessments was advocated over fifteen years ago.[242] The argument was based on the grounds that the determination of jeopardy is purely an agency decision based on findings of fact, not unlike a decision by the Federal Communications Commission to withhold a broadcasting license. Thus, the argument concluded, the decision should be reviewable in the same manner as other agency action.[243]

Because the quantum of proof is not specified in section 7429, a court might require that another standard, such as the usual preponderence test, be satisfied.[244] On the other hand, the Service might be held to a more relaxed standard to establish the existence of jeopardy, while a heavier burden could be placed on the taxpayer to establish the unreasonableness of the assessment. Such different standards could result from the assumption that the existence of jeopardy,[245] once established, implies bad faith on the part of the taxpayer.[246]

Because no cases have been reported under section 7429, the preceding considerations amount to mere speculation. Because appellate review is foreclosed, however, it is unlikely that a single standard will be forged. For this reason, the failure of Congress to specify completely the procedure to be followed may work to the detriment of many taxpayers. Congress should, therefore, supplement section 7429.

B. *Further Reforms Needed*

Although some of the shortcomings of the judicial review formula instituted for the benefit of jeopardy taxpayers have already been discussed, it should be reiterated that the Tax Reform Act of 1976 has provided a significant advancement of the rights of the jeopardy taxpayer. While reform is still under consideration, Congress should take

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[241] 5 U.S.C. § 706(2)(A) (1970).

[242] Kaminsky, *Administrative Law and Judicial Review of Jeopardy Assessments Under the Internal Revenue Code of 1954*, 14 Tax L. Rev. 545, 563-566 (1959).

[243] *Id.* Kaminsky's proposition was rebutted in Gould, *Jeopardy Assessments: When They May Be Levied What to Do About Them*, N.Y.U. 18th Inst. on Fed. Tax 937, 948-49 (1960). In his rebuttal, Gould pointed to the plenary taxing power of Congress, granted by the Constitution. Since Congress has now chosen to allow judicial review of jeopardy assessments, however, it seems logical to apply the ready-made standards of the Administrative Procedure Act.

[244] It is doubtful that the court could or would apply *ab initio* the clear and convincing standard used in fraud and transferee cases even if bad faith were alleged.

[245] If the Commissioner fails to show to the court's satisfaction that jeopardy exists, the taxpayer need not present evidence as to the reasonableness of the assessment. The Commissioner's only alternative at that point is to issue a 90-day letter provided that one has not already been issued, for the same or a greater or lesser amount, and to wait for an adjudication by the Tax Court.

[246] *See* text at note 179 *supra*, enumerating the three circumstances in which a jeopardy assessment may be imposed. Bad faith could be found where a taxpayer is fleeing the country or disposing of assets. However, bad faith could not be found where the jeopardy was prompted by the taxpayer's doubtful financial solvency.

additional steps to protect more fully the interests of those subject to jeopardy assessments.

1. An Action for Damages

Smith v. Flinn[247] is an example of a case in which a damage remedy could appropriately be afforded to the jeopardy taxpayer. Acting under a jeopardy assessment, the Service seized grain stored in Smith's silo. The Service then erroneously determined that the grain was perishable,[248] and proceeded to sell it, under the provisions of Code section 6863(b)(3), prior to a decision by the Tax Court. At the time of the sale, the market was in a depressed state, and the taxpayer lost a substantial amount which could have been obtained if the grain had been stored until conditions became more favorable. The Eighth Circuit Court subsequently granted an injunction to prevent the sale of additional grain at a loss.[249]

Whatever the final decision of the Tax Court in *Smith*, the taxpayer suffered a loss.[250] Because the loss was occasioned by the government's error in determining the property to be perishable, an action in tort to recover actual pecuniary damages would seem to be justified. The Federal Tort Claims Act, however, precludes suits "arising in respect of the assessment or collection of any tax."[251] This exception in the Act embodies the practical policy considerations of allowing revenue to be collected without interference, and of allowing public officials to exercise their responsibilities without fear of personal liability.[252] Still, it would seem that an "exception to the exception" is needed to protect the interests of jeopardy taxpayers.

Whenever the government seizes a taxpayer's property, under any of the jeopardy provisions, before a decision of the Tax Court is rendered, the United States should be liable in damages for the misuse of or damage to the property caused by its negligence. The damages would include deterioration of the property due to failure to adequately maintain, repair or protect it,[253] or for conversion, such as occurred in *Smith v. Flinn*.[254]

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[247] 261 F.2d 781 (8th Cir. 1958) *modified* 264 F.2d 523 (8th Cir. 1959).

[248] Perishable goods are defined in I.R.C. § 6336. The list clearly excludes storable agricultural products.

[249] 261 F.2d 781 (8th Cir. 1958), *modified*, 264 F.2d 523 (8th Cir. 1959).

[250] If he were ultimately found to owe tax, a larger total quantity of grain would have to be sold to satisfy his debt; if no additional tax were imposed, he would have lost profit and some of his expenses due to the improvident sale.

[251] 28 U.S.C. § 2680(c) (1970). The exclusion precludes both agency level and judicial relief.

[252] *See* Plumb, *Federal Liens and Priorities*, 77 YALE L.J. 1104, 1150-55 (1968).

[253] In Young v. United States, 75-2 U.S.T.C. (CCH) ¶ 9574 (S.D.N.Y. 1975), the Service jeopardy assessed a construction company and mistakenly seized a building belonging to the plaintiff which was a construction company located on the banks of the Saw Mill River. The United States Meterological Service notified residents of an approaching tropical storm and the possibility of flooding near the river. Sandbagging was advised. The Service did not sandbag and when the building was returned to the plaintiff after the mistake was discovered, storm damage and lost rents amounted to nearly $10,000. A damage suit was foreclosed by the Federal Tort Claims Act, 28 U.S.C. § 2680(c) (1970).

[254] 264 F.2d 523 (8th Cir. 1959).

Recovery of damages should of course be limited to cases in which seizure precedes the opportunity for a Tax Court determination of liability, and should further be limited to recovery of pecuniary losses actually suffered. Clearly, no taxpayer should be able to make a claim for pain and suffering or infliction of mental distress.[255] Moreover, damages awarded should be strictly compensatory and not punitive.[256]

Another aspect of damages involves the recovery of attorney's fees incurred in pursuing judicial relief. In 1974, the American Bar Association recommended that when a taxpayer's property is wrongfully sold, the taxpayer should be entitled either to the services of a government attorney to recover the property from the tax-sale purchaser, or to reimbursement for the fees of counsel privately retained for the same purpose. Failing recovery, the government should, according to the ABA proposal, be required to restore to the taxpayer the difference between the sale price and the fair market value of his property.[257]

The ABA proposal seems unreasonable in this latter demand. Whenever conversion is claimed, the taxpayer should be required to elect his remedy — recovery of the property or money damages. It hardly seems fair to allow both. The ABA based its recommendation on the argument that amounts which a taxpayer must expend in order to recover property wrongfully converted by the government result in an unconstitutional taking of property without due process.[258] This due process argument appears questionable, though the underlying equity of the proposal, that the government restore a wronged taxpayer to his original position, has much to recommend it.

Congress has recently taken action with respect to attorney's fees in tax cases. In an amendment to the civil rights laws,[259] a provision was inserted into the section entitled "Proceedings in Vindication of Civil Rights" which provides that if an action is brought "by or on behalf of the United States, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code . . . " and if the taxpayer prevails, then, "the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs."[260]

The provision appears to promise to all taxpayers the right to recover attorney's fees, but the Service can be expected to take the position that cases in the Tax Court and litigation for refunds in the district courts or the Court of Claims represent actions initiated by the taxpayer and not by the United States. If the courts adopt this position, the provision would apply only to criminal prosecutions and to suits in

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[255] Plumb, *Federal Liens and Priorities*, 77 YALE L.J. 1104, 1155 (1967).

[256] Awards of punitive damages in general are prohibited by the Federal Tort Claims Act, 28 U.S.C. § 2674 (1970).

[257] *See Approp. Hearings*, *supra* note 165, at 389 (statement of Robert Soled).

[258] *Id.*

[259] 42 U.S.C. § 1988 (1970), *as amended by* Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94-559, § 2, 90 Stat. 2641.

[260] *Id.*

which the government actually initiates the court proceedings, such as suits to foreclose federal tax liens.[261] The provision would not provide much relief to the ordinary taxpayer.

Congress should consider granting discretion to the district courts in the award of attorney's fees to taxpayers who prevail in actions under section 7429.[262] Such awards could be justified on the ground that an unsupportable or grossly exorbitant jeopardy assessment constitutes harassment of the taxpayer.

2. Revision of the Bond Requirement

Among the recommendations made in the Administrative Conference Report,[263] presented to the Oversight Subcommittee when it was drafting the House version of the Tax Reform Act of 1976, was a proposal that the amount of bond required to stay collection be lowered.[264] Presently, the amount of the bond is equal to the amount of tax assessed.[265] If the amount assessed greatly exceeds the value of the taxpayer's property, it will be virtually impossible for him to secure a bond from any commercial bonding company.[266] This situation is not at all uncommon for a jeopardy taxpayer because of the tendency toward inflated assessments.[267]

The Administrative Conference Report recommended that the amount of bond required to stay collection be reduced to an amount equal to the "net proceeds expected to be realized at a forced sale of any or all such property the release of which is sought."[268] Such a reduced bonding requirement would provide security equal to the amount that the government could ultimately hope to recover, while at the same time making a stay of collection possible for most jeopardy assessed taxpayers.

A drawback to this proposal is that a taxpayer's property would have to be appraised in order to determine its forced-sale value. If the proposal were adopted, it would be necessary to determine who would

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[261] A prevailing defendant's recovery would be further limited to situations where the government's suit was frivolous, vexatious, or brought in bad faith for the purpose of harassment. According to Congressman Kastenmeier, attorney's fees would be awarded so rarely that, "[i]t is expected that the cost to the Federal Government will be negligible." 122 CONG. REC. H12161-12162 (daily ed. Oct. 1, 1976) (remarks of Rep. Kastenmeier).

[262] I.R.C. § 7429 allows the district courts to review the existence of jeopardy and the reasonableness of the assessment if the taxpayer so requests by filing a petition within 45 days of the assessment.

[263] *See* note 8 *supra*. The recommendations were printed in 41 Fed. Reg. 1867, 1868 (1976).

[264] I.R.C. § 6863(a).

[265] *See* notes 39-42 *supra* for a history of the bond requirement.

[266] Although it was established in Yoke v. Mazello, 202 F.2d 508 (4th Cir. 1953), that the Service must accept adequate security if such is provided by friends of the taxpayer and not a commercial bondsman, such instances are rare. Most taxpayers must rely on commercial sureties.

[267] For a discussion of inflated assessments *see* notes 202-212 *supra* and accompanying text.

[268] 41 Fed. Reg. 1867, 1869 (1976).

appraise the property and who would bear the expense. These matters should be specified by statute or by a supporting Treasury regulation in order to avoid confusion and delay. A simple compromise would be to have each party secure an appraisal at his own expense,[269] and to average the two in order to determine the amount of the bond. Other compromises are possible. The problems involved are miniscule compared to the hardships incurred by a taxpayer who faces immediate seizure and is unable to make bond. It is important that Congress act on the Conference's proposal in order to make the availability of a bond to stay collection a real safeguard of the jeopardy assessed taxpayer's interests.

VI. Conclusion

It is apparent that jeopardy procedures are necessary for effective administration and collection of taxes by the Internal Revenue Service. Jeopardy procedures serve to protect all taxpayers from the additional burdens which they would have to bear if certain taxpayers were permitted to abscond with or conceal funds which rightfully should be paid in taxes to the government. It has been demonstrated, however, that the Service has at times abused the jeopardy power to the detriment of individual taxpayers. Recent internal reforms, such as the abolition of the prima facie case, hopefully evidence a new responsiveness to taxpayer rights and a commitment to the responsible use of jeopardy procedures. The impact of the Tax Reform Act of 1976, especially in creating the right to judicial review of jeopardy assessments, will undoubtedly be another factor motivating the Service to use the jeopardy provisions providently. The availability of a damage remedy would also undoubtedly result in a more circumspect use. A lowered bond requirement would permit taxpayers to retain their property during the litigation of the tax claim, greatly reducing the government's exposure to damage claims.

It is vital that these reforms be completed as soon as possible. The existence and use of revenue procedures which are considered to be oppressive and unfair serve to undermine the public's confidence in the federal tax structure and the self-assessment system upon which the country so heavily depends for the collection of its revenue.[270] Prudent and restrained use of jeopardy procedures would help to restore the public's confidence in a system in which the power to tax truly "entails the power to destroy."[271]

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[269] The taxpayer might be required to use the services of a member of the Society of Real Estate Appraisers or another professional organization in order to insure that a reasonable estimate of value is obtained.

[270] *See, e.g.*, Holtzman & Dear, *Needed: New Curbs on the IRS*, Reader's Digest, January 1977, at 87.

[271] McCulloch v. Maryland, 17 U.S. (4 Wheat) 316, 431 (1819).