
Federal Taxation - The Determination of Wilfulness in Failure to Pay Tax Cases - United States v. Goodman, 190 F. Supp. 847 (N.D. Ill. 1961)

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the "claim [is] evidently *fictional* in character and alleged merely to create the jurisdictional amount. . . ." ³⁴ Only those claims involving an *unliquidated amount* that may be exaggerated so as to obtain federal jurisdiction require the application of the "legal certainty" doctrine to establish the legitimate value of the *unliquidated damages*; yet the doctrine is employed in the *Horton* case to determine whether to a legal certainty the insurance company's claim of \$14,035 is in violation to the *rules of pleading*. Clearly, the doctrine is only employed to resolve issues involving *factual* controversies of determining damages and not controversies involving *legal issues* such as whether or not the Court, in determining the amount in controversy, can look to Horton's claim before the Board, his subsequent state action, and his federal counterclaim.

Although the Court correctly interpreted 28 U.S.C. Sec. 1445 (c) prohibiting original Workmen's Compensation claims in the Federal District Court, it broke with precedent when it placed \$14,035 in controversy by: (1) recognizing the Board's action; (2) permitting the company to place facts in controversy that happened after the filing of the suit, and (3) allowing the plaintiff to allege and reply to a conjectural defense before the defendant answered the complaint. Finally, the Court apparently applied the "legal certainty" doctrine to an issue of law rather than to a factual controversy. Subsequent to this writing rehearing has been denied, ³⁵ and the departure from the well-established rule is now law.

³⁴ *Burks v. Texas Co.*, 211 F. 2d 443, 446 (5th Cir. 1959). (Emphasis added.)

³⁵ 30 U.S. L. WEEK 3115 (U.S. Oct. 9, 1961).

FEDERAL TAXATION—THE DETERMINATION OF WILFULNESS IN FAILURE TO PAY TAX CASES

Defendant Goodman filed a timely federal income tax return for 1953. He failed to pay his income tax liability for that year which he was required to pay on or before March 15, 1954. The tax due on his 1953 return was \$4,457.48. Beginning in 1955, the defendant made several payments on his 1953 tax liability. Goodman's personal debts exceeded his assets before and during the period of his tax liability. After extensive attempts at collection by the Internal Revenue Service, that agency informed the defendant that criminal prosecution was being recommended to the Department of Justice. Full payment of the unpaid balance of his income taxes for 1953, together with interest, was made by the defendant on January 8, 1957. The defendant was indicted on January 14, 1957 for wilful failure to pay income taxes at the time required by law.

This was the first prosecution ever brought under the "wilful failure to

pay" provision of section 145(a) of the Internal Revenue Code of 1939,¹ which is a predecessor of section 7203 of the Internal Revenue Code of 1954.² Sections 145(a) and 7203, which provide that wilful failure to pay shall be punished as a misdemeanor, state, as follows:

Any person required . . . to pay any estimated tax or tax or required . . . to make a return . . . who wilfully fails to pay such estimated tax or tax, (or) make such return . . . at the time or times required by law . . . shall in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than \$10,000.00 or imprisoned not more than one year, or both, together with the costs of the prosecution.

The District Court found Goodman not guilty, holding that there was not sufficient evidence to support a finding of wilfulness. *United States v. Goodman*, 190 F. Supp. 847 (N.D. Ill. 1961).

The only other case involving an indictment brought under the misdemeanor statute for wilful failure to pay income taxes, *United States v. Palermo*,³ proceeded earlier to trial and appeal, and furnishes the only appellate court opinion concerning a wilful failure to pay prosecution.

The only essential factual difference between the two cases is that while defendant Palermo had money available with which to pay his taxes and also engage in luxury spending during the general period of his tax liability, Goodman was insolvent as indicated above. Palermo had filed correct and timely tax returns for the years 1953 and 1954. He had been informed by the Internal Revenue Service, after collection efforts had proved unsuccessful, that criminal prosecution was being recommended. Palermo paid his taxes in full, together with interest and estimated tax penalties, prior to the return of a two count indictment charging wilful failure to pay income taxes for the calendar years 1953 and 1954. He was found guilty and sentenced to pay a fine of one hundred dollars on each count.

On appeal, the Court of Appeals for the Third Circuit reversed the conviction of Palermo for wilful failure to pay income taxes due for the year 1953, ruling that there was insufficient evidence of "wilfulness" to sustain the conviction and ordered that a judgment of acquittal be entered by the trial court. Palermo's conviction for wilful failure to pay income taxes due for the year 1954 was also reversed and the case remanded to the trial court with instructions that a new trial be granted.⁴ To date, Palermo has not been retried.

Although, as indicated above, failure to make estimated tax payments is also punishable as a misdemeanor under the statute, Goodman and Palermo were not indicted for such an offense.

¹ 26 U.S.C.A. 145(a) (Supp. 1939).

³ 259 F.2d 872 (3rd Cir. 1958).

² 26 U.S.C.A. 7203 (Supp. 1960).

⁴ *Ibid.*

In commenting on the elements required to prove a wilful failure to pay income taxes, the court, in *Goodman*, cited the *Palermo* decision when it noted that wilfulness, being an essential element of such a crime, requires the existence of a specific wrongful intent, *i.e.*, evil motive, at the time the crime is committed. The court indicated that a series of defaults in payments, knowingly and intentionally made, which could be indicative of a pattern of behavior, might suggest the existence of an "evil motive." However, the court pointed out that "mere laxity, careless disregard of the duty imposed by law, or even gross negligence, unattended by 'evil motive' are not probative of 'wilfulness.'"⁵

The meaning of wilfulness has been considered by the Supreme Court in *United States v. Murdock*.⁶ Murdock had been convicted by a District Court under section 114(a) of the Revenue Act of 1926, a predecessor of section 145(a), for wilfully refusing to give testimony and supply information concerning deductions claimed on his 1927 and 1928 income tax returns for moneys paid to others. The conviction was reversed by a Circuit Court⁷ and certiorari was granted by the Supreme Court.⁸

The Court, in explaining the meaning of wilful commented that the word often denotes an intentional, as distinguished from accidental or unknowing, act. For the purpose of a criminal statute, the Court provided alternative definitions of wilful when it stated that the general meanings of the word are: "[a]n act done with a bad purpose . . . (or) without justifiable excuse . . . (or) stubbornly, obstinately, perversely . . . (or) a thing done without ground for believing it is lawful . . . (or) conduct marked by careless disregard whether or not one has the right so to act."⁹

As a means of better defining wilful, in the context of the fact situation in *Murdock*, the various other omissions which were deemed wilful under section 114(a) were discussed. Insofar as wilful failure to pay a tax is concerned, the Court remarked that though such conduct is criminal, Congress did not intend that a taxpayer, through an honest misunderstanding as to his tax liability, should be held a criminal by merely failing to measure up to a statutory standard of conduct.

Although *Goodman* and *Palermo* are the only prosecutions for wilful failure to pay income taxes under the misdemeanor statute, the Supreme Court commented at some length on the subject in *Spies v. United States*.¹⁰

⁵ *Ibid.*

⁶ 290 U.S. 389 (1933).

⁷ *Murdock v. United States*, 62 F.2d 926 (7th Cir. 1932).

⁸ *United States v. Murdock*, 290 U.S. 606 (1933).

⁹ *United States v. Murdock*, 290 U.S. 289, 394-95 (1933).

¹⁰ 317 U.S. 492 (1943).

Spies had been convicted under the felony statute, section 145(b),¹¹ for wilfully attempting to evade and defeat his income tax. The government contended that Spies had wilfully failed to file a return or pay his tax in order to accomplish a felonious purpose. The conviction was reversed.

The Court compared the offenses of wilful failure to file income tax returns and wilful nonpayment of taxes and noted that a voluntary and intentional failure to file an income tax return might be a wilful act. But in dealing with the meaning of wilful in a prosecution for wilful failure to pay income taxes, the Court took notice of our traditional aversion to imprisonment of debtors and said that without a precise expression of legislative intent, an intentional default in payment of taxes, of itself, where the taxpayer had not wilfully failed to disclose his liability, would not constitute a criminal offense. To constitute wilfulness in such a situation there must be "some element of evil motive and want of justification in view of all the financial circumstances of the taxpayer."¹²

There is authority for the limitation, by the courts in *Goodman* and *Palermo*, of the alternative definitions of wilfulness in *Murdock*. Appellate court opinions with respect to prosecutions for other criminal violations of the Internal Revenue Code, whether under the misdemeanor statute or the felony statute, have consistently limited the application of the *Murdock* decision.

As indicated previously, "bad purpose" was included in *Murdock*¹³ as a definition of wilfulness. *United States v. Martell*¹⁴ limited the use of this phrase in regard to wilfulness. Martell had been convicted of tax evasion under the felony statute. The trial judge had instructed the jury that filing of a false return for personal gain was a bad purpose which provided the requisite degree of wilfulness. The conviction was reversed. To illustrate the imprecise meaning of the phrase, the Appellate Court raised the hypothetical question of whether good purpose would be demonstrated by failing to pay income taxes in order to pay needed expenses of a dependent while bad purpose would result from a failure to pay taxes so as to use the money to engage in gambling.

In *Bloch v. United States*,¹⁵ which was decided subsequent to *Martell*,

¹¹ Section 145 (b) of the 1939 Code and section 7201, its successor under the 1954 Code, provide in part that "(A)ny person who wilfully attempts in any manner to evade or defeat any tax . . . or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than \$10,000.00, or imprisoned for not more than five years or both, together with the costs of prosecution."

¹² *United States v. Spies*, 317 U.S. 492, 498 (1943).

¹³ *United States v. Murdock*, 290 U.S. 389, 394 (1933).

¹⁴ 199 F.2d 670 (3rd Cir. 1952), *cert. denied*, 345 U.S. 917 (1952).

¹⁵ 221 F.2d 786 (9th Cir. 1955).

the defendant was convicted under the felony statute. The trial court had instructed the jury that wilfulness included the doing of an act with a bad purpose. In reversing the conviction, bad purpose was revived as a definition but given a narrow construction when the court held that "[t]he bad purpose must be to evade or defeat the payment of the income tax that is due."¹⁶

*Yarborough v. United States*¹⁷ and *Haskell v. United States*¹⁸ involved prosecutions for failure to file income tax returns under the misdemeanor statute. The court in *Haskell*, in commenting on bad purpose quoted the earlier *Yarborough* decision:

"[T]he only bad purpose or bad motive, which it is necessary . . . to prove . . . is the deliberate intention not to file returns which the defendant knew ought to have been filed, so that the Government would not know the extent of . . . liability."¹⁹

Gross negligence, which was noted in *Murdock* as being definitive of wilfulness has been held insufficient to constitute wilfulness in prosecutions for tax evasion under the felony statute²⁰ and failure to file under the misdemeanor statute.²¹

From an analysis of the cases discussed, an authoritative definition of wilfulness with respect to failure to pay income taxes cannot be given. However, the Internal Revenue Service will presumably employ, in investigations of cases of alleged wilful failure to pay taxes, substantially the same investigative procedures and devices used in wilful failure to file and tax evasion cases. In order to anticipate the means by which evidence of wilfulness will be established in a failure to pay situation, consideration should be given to these investigative techniques.

The general rule is that on prosecution for a particular crime, when the guilt of a party depends upon the intent with which an act was done, evidence of other similar acts and conduct by the same person at or near the time of the crime charged or connected with the same subject matter is admissible to establish wilfulness.²² Therefore, evidence concerning the execution and filing of proper returns on time and the payment or failure

¹⁶ *Id.* at 789.

¹⁷ 230 F.2d 56 (4th Cir. 1956).

¹⁸ 241 F.2d 790 (7th Cir. 1957).

¹⁹ *Haskell v. United States*, 241 F.2d 790, 794 (7th Cir. 1957).

²⁰ *United States v. Glascott*, 216 F.2d 490 (7th Cir. 1954).

²¹ *Litman v. United States*, 246 F.2d 209 (3rd Cir. 1957), *cert. denied*, 335 U.S. 869 (1957).

²² *Brickey v. United States*, 123 F.2d 344 (8th Cir. 1941); *United States v. Bridell*, 180 F. Supp. 273 (N.D. Ill. 1960); *Malone v. United States*, 94 F.2d 287 (7th Cir. 1938), *cert. denied*, 304 U.S. 562 (1938).

to pay taxes in years prior to the tax years in question is admissible to show that a taxpayer clearly knew his income tax was due, when it was due and that taxes were to be paid in conformity with such returns in order to establish or negate the defense of innocent intent.

Proof of such extra indictment transactions need not show or indicate that they involved criminality.²³ A defendant's previous delinquencies and their motives may therefore be considered relative to the question of intent prior to a determination that the indictment delinquency was ill-motivated.

Investigations concerning allegations relative to wilful failure to pay income taxes are conducted by Special Agents of the Internal Revenue Service's Intelligence Division.²⁴ This division makes recommendations as to the disposition of cases investigated. The Special Agents have available data relative to the subject of the investigation maintained in the files of the Internal Revenue Service such as, for example, prior income tax returns and records pertaining to payments and examinations or investigations which have been made with respect to such returns. In the course of such investigations, an analysis of the taxpayer's bank records will be made and third parties with whom the taxpayer did business, such as the preparer of his income tax returns, will be interviewed.

The use of evidence concerning payment of taxes, in years prior to the years for which wilful failure to pay is charged, has been referred to as the "tax assessment method."²⁵ The Internal Revenue Service maintains a permanent record of pertinent tax assessment information. The relevant data, for a particular year, is transmitted on Internal Revenue Service Form 899, Certificate of Assessments and Payments, and contains such information as class of tax, taxable period, account number, and amounts assessed and paid.

A taxpayer's knowledge concerning his income taxes in extra indictment years, while he was earning the income upon which a tax liability was attaching, is admissible in evidence on the issue of wilfulness, as previously shown. Therefore, evidence that he spent sums up to and beyond his reported income in disregard of his tax responsibility during the years for which he is charged with wilful failure to pay income taxes is also admissible to establish wilfulness.

A binding definition of wilfulness will be determined in the course of future decisions involving wilful failure to pay income taxes. It is submitted

²³ *Ibid.*

²⁴ See, Murphy, *The Investigative Procedure For Criminal Tax Evasion*, 27 *FORD-HAM L. REV.* 48 (1958).

²⁵ See, Greenside, *The Importance Of The Original Tax Return In Civil Fraud Cases*, 36 *TAXES* 322 (1958).

that the courts will continue to reject the alternative definitions in *Murdock* and instead adhere to the standard set forth in *Goodman* and *Palermo*, *i.e.*, that a specific wrongful intent not to pay income taxes must be established.

REAL PROPERTY—REDEMPTION RIGHTS OF STRANGER TO RECORD TITLE

Smith, highest bidder on certain real estate at a tax foreclosure sale and to whom a certificate of purchase was issued, petitioned the circuit court of Cook county to expunge the record of an attempted redemption by one Lyons, undisclosed agent for Western National Bank of Cicero as trustee, on the grounds that Lyons had no redeemable interest. The court granted the petition and entered an order finding that Smith was the purchaser at the tax sale and that Lyons had no interest entitling him to redeem. Western National Bank then made a motion to vacate the order. It attempted to show that it had actual title to the property through various mesne conveyances, and therefore had an interest which would entitle it to redeem. The circuit court denied the motion and an appeal was taken to the Supreme Court of Illinois¹ which held that Western National Bank was precluded from redeeming because one of the deeds in its chain of title was not recorded. *Weiner v. Jobst*, 22 Ill. 2d 11, 174 N.E. 2d 561 (1961).

An important part of real estate taxation is the body politic's authority to divest an owner of his property and sell it at a tax redemption sale.² The right of redemption from such sales is protected by the Illinois Constitution which provides:

The right of redemption from all sales of real estate, for the non-payment of taxes or special assessments of any character, whatever, shall exist in favor of owners and *persons interested* in such real estate, for a period of not less than two years from such sales thereof.³

Furthermore, Illinois redemption statutes repeatedly refer to the rights of "owners" and "persons interested" to redeem. Often these "persons interested" are referred to as "unknown owners."⁴

¹ Jurisdiction to the Supreme Court is invoked pursuant to ILL. REV. STAT. ch. 110, § 75 (1959) which provides in part that: "Appeals shall be taken directly to the Supreme Court (a) in all cases in which a franchise or freehold . . . is involved. . . ."

² For an excellent discussion on the whole problem of state taxation and redemptions in Illinois see Corby, *Developments in Real Estate Taxation—1950—1960*, 10 DE PAUL L. REV. 596 (1961).

³ ILL. CONST. art IX, § 5. (Emphasis added.)

⁴ ILL. REV. STAT. ch. 120, §§ 697-752 (1959).