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Nonmutual Collateral Estoppel in Federal Tax Litigation

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I. INTRODUCTION

An issue decided in federal tax litigation[1] involving one taxpayer often may arise in a subsequent tax dispute involving another tax year, transaction, or taxpayer. For example, corporation *X* makes a distribution in year 1 to its similarly situated stockholders, *Y* and *Z*. Under the doctrine of collateral estoppel, a determination in a Tax Court or refund suit that the distribution was a nontaxable return of capital to *Y* in year 1 could not be relitigated by the government against *Y* if the issue arose in a subsequent action. Traditionally applied by federal courts in both tax[2] and nontax cases,[3] collateral estoppel precludes the relitigation by a party of an issue of fact or law decided against him in a prior proceeding based upon a different cause of action.[4] Under the much discussed[5]

1. Although the term "federal tax litigation" can encompass a broad variety of civil and criminal actions arising out of the administration of the tax laws, this Note will focus on taxpayer/government actions concerning disputed tax liability. These actions include proceedings in the Tax Court to contest income, estate, or gift tax deficiencies, and suits in either the Court of Claims or federal district courts for refunds of taxes paid. For a general discussion of taxpayer initiated litigation, see A. SANTA BARBARA, INTERNAL REVENUE SERVICE PRACTICE AND PROCEDURE 359-86 (1977).

2. During the formative years of federal taxation, doubt existed as to whether and to what extent the principles of judicial finality would apply in litigation involving tax disputes. The Supreme Court made it clear in 1933, however, that res judicata and collateral estoppel applied in tax cases. *See* Tait v. Western Md. Ry. Co., 289 U.S. 620 (1933). For a discussion of the uncertainty of the status of these doctrines in early cases, see Griswold, *Res Judicata in Federal Tax Cases,* 46 YALE L.J. 1320 (1937); Paul & Zimet, *Federal Tax Litigation—Selected Problems in Res Judicata,* 32 ILL. L. REV. 139 (1937).

3. *See, e.g.,* Cromwell v. County of Sac, 94 U.S. 351 (1876).

4. *See* Ashe v. Swenson, 397 U.S. 436, 443 (1970); Lawlor v. National Screen Serv. Corp., 349 U.S. 322, 326 (1955). *See generally* 1B MOORE'S FEDERAL PRACTICE ¶ 0.441 (2d ed. 1974); Scott, *Collateral Estoppel By Judgment,* 56 HARV. L. REV. 1 (1942). Courts have generally used the term "collateral estoppel" to describe the preclusive effect of a judgment upon a subsequent suit based upon a different cause of action. Several commentators, however, have used the term "issue preclusion" to refer to the same effect. *See, e.g.,* Vestal, *Preclusion/Res Judicata Variables: Parties,* 50 IOWA L. REV. 27 (1964). The drafters of the Restatement (Second) of Judgments have adopted the latter term. *See* RESTATEMENT (SECOND) OF JUDGMENTS §§ 68, 68.1 (Tent. Draft No. 4, 1977) [hereinafter cited as TD-4]. This Note will use the two terms interchangeably. Courts and commentators may also use the term "res judicata" to refer generally to the principles of judicial finality, including collateral estoppel. 1B MOORE'S, *supra* ¶ 0.441[2], at 3775. More frequently, however, res judicata refers to a bar of a second suit between the same parties (or those in privity with them) based on the same cause of action that was litigated in a former suit. *Id. See* Commissioner v. Sunnen, 333 U.S. 591, 597 (1948).

5. *E.g.,* Currie, *Civil Procedure: The Tempest Brews,* 53 CALIF. L. REV. 25 (1965); Currie, *Mutuality of Estoppel: Limits of the* Bernhard *Doctrine,* 9 STAN. L. REV. 281 (1957); Greenebaum, *In Defense of the Doctrine of Mutuality of Estoppel,* 45 IND. L.J. 1 (1969);

"mutuality rule," however, collateral estoppel would not preclude the litigation of the same issue by the taxing authorities against *Z*. The mutuality doctrine limits the application of collateral estoppel by precluding relitigation of a previously decided issue only when the prior judgment binds both parties in the second suit.[6] The doctrine in effect requires that the parties in the second suit be the same as or in privity with those in the first action. In the example above, *Z* could not assert the issue determination made in the action against *Y*. *Z* was not a party to that action and judgment against *Y* instead of for him could not have bound *Z*.[7]

Although firmly entrenched at common law,[8] the mutuality rule is dying a slow death in the federal courts. The Supreme Court expressed limited approval of "nonmutual estoppel"[9] in 1971,[10] although many lower courts had abandoned the mutuality rule prior to that date.[11] Despite the trend away from a rigid mutuality requirement and toward a flexible approach based on notions of fairness, both the Tax Court and other federal courts, notably the Second Circuit in *Divine v. Commissioner*,[12] have continued to retain the mutuality rule in federal tax cases.[13] The Supreme Court in

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Moore & Currier, *Mutuality and Conclusiveness of Judgments*, 35 TUL. L. REV. 301 (1961); Semmel, *Collateral Estoppel, Mutuality and Joinder of Parties*, 68 COLUM. L. REV. 1457 (1968). For a recent attempt to apply probability theory to the mutuality issue, see Note, *A Probabilistic Analysis of the Doctrine of Mutuality of Collateral Estoppel*, 76 MICH. L. REV. 612 (1978).

6. 1B MOORE'S, *supra* note 4, ¶ 0.412[1].

7. *See* Blonder-Tongue Laboratories, Inc. v. University of Ill. Foundation, 402 U.S. 313, 329 (1971); Hansberry v. Lee, 311 U.S. 32, 40 (1940); Humphreys v. Tann, 487 F.2d 666 (6th Cir. 1973), *cert. denied*, 416 U.S. 956 (1974). A judgment may bind a nonparty to the first action, however, if he actually controlled the prior litigation or was in privity with one of the parties. *See* Montana v. United States, 440 U.S. 147 (1979). For a general discussion of the limitations of due process on the preclusive effect of judgments on nonparties, see F. JAMES & G. HAZARD, CIVIL PROCEDURE § 11.22, at 575-76 (2d ed. 1977).

8. *See, e.g.*, Bigelow v. Old Dominion Copper Co., 225 U.S. 111 (1912); Stone v. Farmers' Bank, 174 U.S. 409 (1899); Litchfield v. Goodnow, 123 U.S. 549, 552 (1887); RESTATEMENT OF JUDGMENTS § 93 (1942).

9. "Nonmutual estoppel" will be used in this Note to characterize the assertion of a determination made in a prior action as preclusive of an issue in a subsequent action despite the fact that the party seeking preclusion was not a party, or in privity with a party, in the prior action.

10. Blonder-Tongue Laboratories, Inc. v. University of Ill. Foundation, 402 U.S. 313 (1971). For a discussion of *Blonder-Tongue*, *see* notes 39-52 *infra* and accompanying text.

11. *E.g.*, Berner v. British Commonwealth Pac. Airlines, Ltd., 346 F.2d 532 (2d Cir. 1965), *cert. denied*, 382 U.S. 983 (1966); Graves v. Associated Transp., Inc., 344 F.2d 894 (4th Cir. 1965); Bruszewski v. United States, 181 F.2d 419 (3d Cir.), *cert. denied*, 340 U.S. 865 (1950).

12. 500 F.2d 1041 (2d Cir. 1974). *See* text accompanying notes 79-84 *infra*.

13. Sparks Nugget, Inc. v. Commissioner, 458 F.2d 631 (9th Cir. 1972); Teitelbaum v. Commissioner, 346 F.2d 266 (7th Cir. 1965); Britt v. Commissioner, 114 F.2d 10 (4th Cir. 1940); Stewart Gammill, 62 T.C. 607 (1974) (dictum); Charles M. Bernuth, 57 T.C. 225

Parklane Hosiery Co. v. Shore[14] and the Ninth Circuit in *Starker v. United States*,[15] however, recently cast considerable doubt on the continuing viability of the mutuality principle in tax cases. The purpose of this Note is to examine the current status of the mutuality rule as an element of the law of collateral estoppel in the tax area. First, the Note briefly traces the demise of the mutuality rule in nontax cases. Second, the Note discusses the cases examining the rule in tax disputes and argues that courts should not require mutuality as an absolute rule before collateral estoppel can apply. Finally, the Note proposes a framework within which courts should analyze nonmutual estoppel claims in federal tax cases.

II. The Mutuality Rule in Federal Courts: Nontax Cases

A. *The* Bernhard *Doctrine*

Prior to 1942, courts uniformly accepted the mutuality rule as a principle of "general elementary law."[16] The following example further illustrates the operation of the rule. *B* was a passenger in a car driven by *A* that collided with a car negligently driven by *C*. If *A* prevailed in an action against *C*, *C* could still relitigate the issue of his negligence if he was later sued by *B*. Even if all the other requirements for the application of collateral estoppel were present,[17] mutuality of estoppel would not exist because *B* was not a party in the prior action and would not have been bound had *C* prevailed in the first action.[18]

(1971), *aff'd* 470 F.2d 710 (2d Cir. 1972); American Range Lines, Inc., 17 T.C. 764, *rev'd on other grounds*, 200 F.2d 844 (2d Cir. 1952); Robert D. Wray [1978] Tax Ct. Mem. Dec. (P-H) ¶ 78,488 (Dec. 11, 1978); William Albert Belcher, Jr., [1965] Tax Ct. Mem. Dec. (P-H) ¶ 65,001 (Jan. 8, 1965). *See* 3 L. Casey, Federal Tax Practice § 11.18, at 278-79 (rev. ed. 1977). *But see* Starker v. United States, 602 F.2d 1341 (9th Cir. 1979); Kurlan v. Commissioner, 343 F.2d 625 (2d Cir. 1965); United States v. Abatti, 463 F. Supp. 596 (S.D. Cal. 1978); Baily v. United States, 355 F. Supp. 325 (E.D. Pa. 1973).

14. 439 U.S. 322 (1979).

15. 602 F.2d 1341 (9th Cir. 1979).

16. Bigelow v. Old Dominion Copper Co., 225 U.S. 111, 127 (1912).

17. In order for collateral estoppel to apply even when the parties in both actions are identical, the issue must actually have been litigated, the determination generally must have been necessary to the prior judgment, and the controlling law and facts must be substantially identical in both actions. *See generally* 10 J. Mertens, Law of Federal Income Taxation § 60.19-29 (1976). Application of these requirements has proved especially difficult for courts in federal tax cases. *See, e.g.*, Montana v. United States, 440 U.S. 147 (1979); Commissioner v. Sunnen, 333 U.S. 591 (1948); Evergreens v. Nunan, 141 F.2d 927 (2d Cir.), *cert. denied*, 323 U.S. 720 (1944). *See generally* 3 L. Casey, *supra* note 13, § 11.18. This Note will assume (unless otherwise stated), however, that these requirements have been met and that collateral estoppel would apply but for the lack of mutuality.

18. It should be noted that *C* might be permitted to relitigate the issue in this situation even if mutuality were not required because most courts have recognized that collateral

Critics attacked the mutuality rule because it allowed a party to relitigate an issue as long as appropriate defendants were available.[19] The Supreme Court of California in 1942 was the first court to clearly repudiate the mutuality rule. In *Bernhard v. Bank of America*[20] Justice Traynor expressed the view that only the party *against* whom the plea of collateral estoppel is asserted must have been a party or in privity with a party to the prior action. In an often cited passage the court stated:

> There is no compelling reason . . . for requiring that the party asserting the plea of res judicata [or collateral estoppel] must have been a party, or in privity with a party, to the earlier litigation. No satisfactory rationalization has been advanced for the requirement of mutuality. Just why a party who was not bound by a previous action should be precluded from asserting it . . . against a party who was bound by it is difficult to comprehend.[21]

Abrogation of the mutuality requirement, generally referred to as the "*Bernhard* Doctrine,"[22] has gained substantial support in other states.[23] The influence of *Bernhard* has been so pervasive that, as early as 1967, one court proclaimed the mutuality doctrine a "dead letter."[24] That conclusion proved premature, however, since a few states have reaffirmed the mutuality rule in recent decisions,[25] and several commentators have continued to voice approval of the rule.[26] Nevertheless, the tentative drafts of the Restatement (Second) of Judgments[27] have adopted the *Bernhard* Doctrine, and it

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estoppel may be refused if the party asserting the plea deliberately refused to join as a party to the prior action. *See* note 118 *infra* and accompanying text.

19. *E.g.*, Cox, *Res Adjudicata: Who Entitled to Plead*, 9 VA. L. REG. 241 (1923).

20. 19 Cal. 2d 807, 122 P.2d 892 (1942).

21. *Id.* at 812, 122 P.2d at 894. One should note that Justice Traynor's use of the term res judicata was in its broader sense, including collateral estoppel. *See* note 4 *supra*.

22. *See, e.g.*, Currie, *Mutuality of Estoppel: Limits of the* Bernhard *Doctrine*, 9 STAN. L. REV. 281 (1957); Semmel, *supra* note 5, at 1466-71.

23. For a collection of cases in which courts have abandoned the rule, see Annot., 31 A.L.R.3d 1044 (1970 and Supp. 1979).

24. DeWitt v. Hall, 19 N.Y.2d 141, 147, 278 N.Y.S.2d 596, 601, 225 N.E. 2d 195, 198 (1967).

25. *E.g.*, Newport Div., Tenneco Chems., Inc. v. Thompson, 330 So. 2d 826 (Fla. App. 1976); Keith v. Schiefen-Stockham Ins. Agency, Inc., 209 Kan. 537, 498 P.2d 265 (1972), Atencio v. Vigil, 86 N.M. 181, 521 P.2d 646 (1974); Blake v. Norman, 37 N.C. App. 617, 247 S.E.2d 256 (1978).

26. *See, e.g.*, Note, *supra* note 5. The author of this Note lists four traditional criticisms of the *Bernhard* Doctrine: first, it is not necessary to prevent multiple harassment; second, it is inconsistent with the principles of in personam jurisdiction; third, it may increase the number of appeals despite decreasing the number of trials; and last, the abandonment of mutuality burdens litigation resources of the party subject to estoppel and prevents him from allocating them properly. *Id.* at 680-88.

27. *See* RESTATEMENT (SECOND) OF JUDGMENTS App. § 88 (Tent. Draft No. 3, 1976) [hereinafter cited as TD-3].

clearly represents the modern trend.[28]

B. *The* Bernhard *Doctrine in Federal Courts*

Bernhard has had a dramatic influence upon lower federal courts. Although the Supreme Court did not indicate approval of the *Bernhard* Doctrine until 1971, a number of lower federal courts, when left free to apply federal law,[29] applied collateral estoppel in the absence of mutuality. For example, in *Bruszewski v. United States*[30] a longshoreman brought a personal injury action against a steamship company that had operated a ship owned by the United States. The trial resulted in a directed verdict for defendant on the ground that plaintiff failed to establish lack of due care. When plaintiff sought to litigate the same claim against the United States, the Third Circuit affirmed the district court's dismissal of the second action on the ground that collateral estoppel barred plaintiff from relitigating the negligence issue. The court applied collateral estoppel despite the fact that the United States was not a party in the prior proceeding because "a party who has had one full and fair opportunity to prove a claim and has failed in that effort, should not be permitted to go to trial on the merits of that claim a second time."[31] *Bruszewski* illustrates "defensive" use of nonmutual collateral estoppel, in which a defendant seeks to prevent a plaintiff from asserting a claim that the plaintiff has previously litigated and lost against another defendant.[32]

Several early post-*Bernhard* decisions also recognized the "offensive" use of nonmutual estoppel. Offensive use describes the situation in which a plaintiff seeks to foreclose a defendant from relitigating an issue that the defendant has already litigated unsuccessfully in an action instituted by another party.[33] In *United States v. United Air Lines, Inc.*[34] a judgment had been rendered in favor of representatives of twenty-four victims of an airplane accident. In a second action by the representatives of ten other victims,

28. F. JAMES & G. HAZARD, *supra* note 7, § 11.24.

29. A federal court exercising its diversity jurisdiction may be required to apply the mutuality rule if applicable state law so provides. *See* Blonder-Tongue Laboratories, Inc. v. University of Ill. Foundation, 402 U.S. 313, 324 (1971). Since federal tax cases involve inherently federal claims, however, courts apply federal principles of collateral estoppel. *See generally* Vestal, *Res Judicata/Preclusion by Judgment: The Law Applied in Federal Courts,* 66 MICH. L. REV. 1723 (1968); Annot., 19 A.L.R. Fed. 709 (1974 and Supp. 1979).

30. 181 F.2d 419 (3d Cir.), *cert. denied,* 340 U.S. 865 (1950).

31. 181 F.2d at 421.

32. Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 n.4 (1979).

33. *Id.*

34. 216 F. Supp. 709 (E.D. Wash. and D. Nev. 1962), *aff'd,* 335 F.2d 379 (9th Cir.), *cert. dismissed,* 379 U.S. 951 (1964).

the district court granted summary judgment in favor of the representatives on the issue of liability, holding that the first judgment estopped the carrier from relitigating the issue of negligence. Another example of offensive use is *Zdanok v. Glidden Co.*[35] In *Zdanok* a group of employees successfully litigated a number of issues arising under a collective bargaining agreement concerning employment rights at the employer's relocated plant. That litigation eventually reached the Supreme Court on a procedural issue.[36] In a later suit by an identically situated group of employees, the Second Circuit held that the employer was collaterally estopped from relitigating the issues decided against him in the prior action. The court noted that the employer had "fully and fairly" litigated those issues in the prior action despite his defensive posture.[37] Although not all federal courts agreed that offensive use was proper,[38] the major area of disagreement in subsequent decisions was not whether nonmutual estoppel could ever be asserted, but rather under what circumstances it should be applied.

C. *The Supreme Court and Nonmutual Estoppel*

(1) *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*

The Supreme Court first expressed approval of defensive nonmutual estoppel in *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation.*[39] In *Blonder-Tongue* a patent assignee had sued an alleged infringer of the patent in the Southern District of Iowa. The district court found for the defendant on the ground that the patented invention was obvious to one ordinarily skilled in the art. The judgment was affirmed on appeal.[40] Prior to the appellate decision, plaintiff filed a second infringement suit against a different alleged infringer in the Northern District of Illinois. In the second action, the trial court held the patent valid. The Second Cir-

35. 327 F.2d 944 (2d Cir.), *cert. denied,* 377 U.S. 934 (1964).

36. *See* Glidden Co. v. Zdanok, 370 U.S. 530 (1962). The issue before the Supreme Court was the constitutionality of the affirmance of the lower court judgment; the defect claimed was that one member of the panel (the author of the opinion) was a member of the Court of Claims, sitting by designation.

37. 327 F.2d at 956.

38. *See, e.g.,* Capital Invs., Inc. v. Bank of Sturgeon Bay, 430 F. Supp. 534, 539 (E.D. Wis. 1977), in which the court stated that "[t]he doctrine of mutuality of estoppel is no longer in force in the Seventh Circuit, *at least where collateral estoppel is pleaded as a defense*" (emphasis added).

39. 402 U.S. 313 (1971).

40. University of Ill. Foundation v. Winegard Co., 271 F. Supp. 412 (S.D. Iowa 1967), *aff'd,* 402 F.2d 125 (8th Cir.), *cert. denied,* 394 U.S. 917 (1968).

cuit affirmed, relying on an earlier Supreme Court decision, *Triplett v. Lowell*,[41] which held that a determination of patent invalidity did not collaterally estop the patentee in subsequent litigation against a different defendant. The Supreme Court reversed, holding that "the uncritical acceptance of the principle of mutuality of estoppel . . . is today out of place [and that] *Triplett* should be overruled to the extent it forecloses a plea of estoppel by one facing a charge of infringement of a patent that has once been declared invalid."[42]

The Court in *Blonder-Tongue* clearly stopped short of announcing an absolute rejection of the mutuality rule.[43] The Court indicated its doubt, however, "whether it is any longer tenable to afford a litigant more than one full and fair opportunity for judicial resolution of the same issue."[44] The opinion discussed the mutuality principle in terms generally applicable to the defensive use of nonmutual estoppel in cases other than patent disputes:

> In any lawsuit where a defendant, because of the mutuality principle, is forced to present a complete defense on the merits to a claim which the plaintiff has fully litigated and lost in a prior action, there is an arguable misallocation of resources. To the extent the defendant in the second suit may not win by asserting, without contradiction, that the plaintiff had fully and fairly, but unsuccessfully, litigated the same claim in the prior suit, the defendant's time and money are diverted from alternative uses . . . to relitigation of a decided issue. . . . Permitting repeated litigation of the same issue as long as the supply of unrelated defendants holds out reflects either the aura of the gaming table or "a lack of discipline and disinterestedness on the part of the lower courts, hardly a worthy or wise basis for fashioning rules of procedure."[45]

In view of the Court's broad statements and the strong justifications for requiring mutuality in patent litigation,[46] courts generally regarded *Blonder-Tongue* as endorsing defensive use of nonmutual

41. 297 U.S. 638 (1936).

42. 402 U.S. at 350.

43. While noting the general trend away from the mutuality doctine, the Court framed the issue before it in narrow terms:

> [T]he court-produced doctrine of mutuality of estoppel is undergoing fundamental change in the common-law tradition. In its pristine formulation, an increasing number of courts have rejected the principle as unsound. . . . [T]bese mutations in estoppel doctrine are not before us for wholesale approval or rejection. But at the very least they counsel us to re-examine whether mutuality of estoppel is a viable rule where a patentee seeks to relitigate the validity of a patent once a federal court has declared it to be invalid.

Id. at 327.

44. *Id.* at 328.

45. *Id.* at 329.

46. *See, e.g.*, Triplett v. Lowell, 297 U.S. 638 (1936); Technograph Printed Circuits, Ltd. v. United States, 372 F.2d 969 (Ct. Cl. 1967).

collateral estoppel.[47] Instead of requiring mutuality as an absolute rule when a defendant used collateral estoppel defensively, lower courts looked to the facts of each case to determine whether the issue was fully and fairly litigated in the prior action and whether any reason compelled relitigation.[48]

Blonder-Tongue's acceptance of the rationale underlying the abrogation of the mutuality rule left two major questions unanswered. First, the Court did not address the issue of offensive use of nonmutual collateral estoppel. It declined to comment on the validity of criticisms advanced to limit the availability of offensive use even if the mutuality rule was rejected.[49] Second, the Court did not eliminate the possibility that the mutuality rule might continue to be a viable requirement in some classes of cases. One earlier case rejecting the mutuality rule argued that the rule should be retained when a party sought preclusion on an issue "subject to the varying appraisals of the facts by different juries."[50] Similarly, *Blonder-Tongue* also did not mention the numerous federal tax cases in which courts retained the mutuality rule long after *Bernhard*.[51] Thus, some courts have not read *Blonder-Tongue* as a blanket rejection of the mutuality rule.[52]

(2) *Parklane Hosiery Co. v. Shore*

The Supreme Court's recent decision in *Parklane Hosiery Co. v. Shore*[53] extended the Court's blessing to offensive use of nonmutual collateral estoppel and established a framework for analysis of all nonmutual estoppel pleas. The decision answered many of the questions not addressed by the Court in *Blonder-Tongue* and apparently sounded the death knell for the mutuality rule. In *Park-*

47. *See, e.g.*, Johnson v. United States, 576 F.2d 606 (5th Cir. 1978); Poster Exchange, Inc. v. National Screen Serv. Corp., 517 F.2d 117 (5th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976); Scooper Dooper, Inc. v. Kraftco Corp., 494 F.2d 840 (3d Cir. 1974); Cardillo v. Zyla, 486 F.2d 473 (1st Cir. 1973); P I Enterprises, Inc. v. Cataldo, 457 F.2d 1012 (1st Cir. 1972).

48. Courts allowing nonmutual estoppel have generally adopted a requirement that the disputed issue was "fully and fairly" litigated in a prior action. If the issue were so litigated, then collateral estoppel will normally apply unless the party against whom preclusion is sought can establish some compelling reason for allowing relitigation of the issue. *See* F. JAMES & G. HAZARD, *supra* note 7, § 11.25.

49. *See, e.g.*, Currie, *supra* note 22; Semmel, *supra* note 5; Note, *The Impacts of Defensive and Offensive Assertion of Collateral Estoppel by a Nonparty*, 35 GEO. WASH. L. REV. 1010 (1967).

50. Zdanok v. Glidden Co., 327 F.2d at 956.

51. *See* notes 12-13 *supra* and accompanying text.

52. *See, e.g.*, United States v. Anaconda Co., 445 F. Supp. 486, 495 (D.D.C. 1977) (court stated "it is clear that *Blonder-Tongue* is not a wholesale rejection of the requirement of mutuality.").

53. 439 U.S. 322 (1979).

lane Hosiery the Securities and Exchange Commission sought injunctive relief against Parklane Hosiery and twelve of its officers and directors, alleging that defendants had issued a materially false and misleading proxy statement in connection with a proposed merger.[54] Prior to the filing of the SEC action, private stockholders filed a class action against the same defendants based upon the same transaction. The district court granted the SEC relief and the Second Circuit affirmed.[55] Plaintiffs then moved for summary judgment on the issue of the materiality of the alleged defects in the proxy statement. The trial court denied the motion on the ground that the use of collateral estoppel would violate defendants' right to jury trial.[56] The Second Circuit reversed the trial court, holding that the use of collateral estoppel under the circumstances presented did not violate the seventh amendment.[57] The Second Circuit did not view the lack of mutuality as rendering the doctrine inapplicable, stating summarily that mutuality was no longer required.[58]

The Supreme Court affirmed the Second Circuit's holding that a determination made in an equitable action could preclude relitigation of that issue in a subsequent legal action brought by a nonparty to the first action.[59] Before addressing that issue, however, the Court first determined "whether a litigant who was not a party

54. The complaint alleged: (1) that the proxy statement issued to stockholders failed to disclose that the president of the company would benefit from the merger; (2) that certain negotiations had not been disclosed; and (3) that appraisal of the Parklane stock was not based on sufficient information. *See id.* at 324 n.1.

55. SEC v. Parklane Hosiery Co., 422 F. Supp. 477 (S.D.N.Y. 1976), *aff'd* 558 F.2d 1083 (2d Cir. 1977).

56. *See* Parklane Hosiery Co. v. Shore, 439 U.S. 322, 325 (1979). The district court denied the requested relief in a one sentence order, citing a decision of the Fifth Circuit, Rachal v. Hill, 435 F.2d 59 (5th Cir. 1970), which held the use of collateral estoppel under similar circumstances violative of the seventh amendment. For a critical commentary on *Rachal,* see Shapiro & Coquillette, *The Fetish of Jury Trials in Civil Cases: A Comment on* Rachal v. Hill, 85 HARV. L. REV. 442 (1971).

57. Shore v. Parklane Hosiery Co., 565 F.2d 815, 818 (2d Cir. 1977), *aff'd,* 439 U.S. 322 (1979). For a discussion of the confiict on the jury trial issue betwen *Rachal* and the Second Circuit in *Parklane Hosiery,* which is beyond the scope of this Note, see Note, *Right to Jury Trial and Collateral Estoppel in Securites Litigation,* 42 ALB. L. REV. 733 (1978); Note, Shore v. Parklane Hosiery Co.: *The Seventh Amendment and Collateral Estoppel,* 66 CALIF. L. REV. 861 (1978); Note, *Nonmutual Collateral Estoppel and the Seventh Amendment,* 47 FORDHAM L. REV. 75 (1978); Note, *Collateral Estoppel and the Right to a Jury Trial,* 57 NEB. L. REV. 863 (1978). *See also* Note, *Mutuality of Estoppel and the Seventh Amendment: The Effect of* Parklane Hosiery, 64 CORNELL L. REV. 1002, 1018-29 (1979).

58. 565 F.2d at 818-19.

59. The Court held that "if . . . the law of collateral estoppel forecloses the petitioners from relitigating the factual issues determined against them in the SEC action, nothing in the Seventh Amendment dictates a different result." 439 U.S. at 337.

to a prior judgment may nevertheless use that judgment 'offensively' to prevent a defendant from relitigating issues resolved in the earlier proceeding."[60] The Court recognized that offensive collateral estoppel presents somewhat different considerations than defensive use. First, the Court noted that offensive use might actually increase litigation by encouraging plaintiffs not to intervene in pending actions in anticipation of another plaintiff's favorable judgment.[61] Second, the Court recognized the unfairness of offensive use when the prior action involved a small amount, was inconsistent with another prior judgment, or foreclosed a plaintiff from exercising procedural opportunities unavailable in the first action that were available in the second.[62] Refusing to preclude the offensive use of collateral estoppel in the absence of mutuality, the Court held that trial courts should exercise "broad discretion to determine when it should be applied."[63] Announcing a rule to govern the exercise of a court's discretion, the Court stated that "in cases where a plaintiff could easily have joined in the earlier action or where . . . the application of offensive estoppel would be unfair to a defendant, a trial judge should not allow the use of offensive collateral estoppel."[64] The Court implicitly endorsed the view that when such countervailing considerations are not present, courts should prohibit a litigant from relitigating an issue that he has fully and fairly litigated in a prior action with a different party. Applying this standard to the facts in *Parklane Hosiery*, the Court held that defendants had received a full and fair opportunity to litigate the issues in question in the SEC injunctive action and were therefore collaterally estopped on those issues in the private action.[65]

The *Parklane Hosiery* decision represents an approval of the

60. *Id.* at 326.

61. *Id.* at 330.

62. *Id.* at 330-31.

63. *Id.* at 331 (footnote omitted).

64. *Id.* In dissent, Justice Rehnquist refused to sanction this test. The dissenting Justice disagreed with the majority on the jury trial issue and stated that "[b]ecause I believe that the use of offensive collateral estoppel in this particular case was improper, it is not necessary for me to decide whether I would approve its use in circumstances where the defendant's right to a jury trial was not impaired." *Id.* at 339 n.1.

65. The Court noted that since private actions are foreseeable following most SEC actions, defendants had every incentive to litigate the issues in the prior action. The Court also noted the absence of any prior inconsistent determination of the disputed issues and the availability of equivalent procedural opportunities in both actions. The Court mysteriously refused to recognize the absence of a jury trial right as such a procedural opportunity, however, stating that "the presence or absence of a jury as factfinder is basically neutral, quite unlike, for example, the necessity of defending the first lawsuit in an inconvenient forum." *Id.* at 332 n.19.

retreat from the mutuality requirement rather than a significant change in the law. Nevertheless, the decision is instructive for examining the current status of the mutuality rule in federal tax cases. First, the Court's holding removes any doubt that the reasoning behind *Blonder-Tongue's* limited sanction of defensive nonmutual estoppel also supports the application of offensive use. Second, *Parklane Hosiery* confirmed that an absolute mutuality rule no longer exists in federal courts. Thus, *Parklane Hosiery* represents the culmination of a trend initiated by the California Supreme Court in *Bernhard* and augmented by *Blonder-Tongue*. Federal tax cases, however, did not reflect this trend; the vast majority of courts continued to require mutuality as an essential element of collateral estoppel.[66] The next section of this Note will discuss the application of the mutuality rule to federal tax cases and will analyze the impact of the *Parklane Hosiery* decision on tax litigation.

III. The Mutuality Rule in Federal Courts: Tax Cases

A. *Traditional Approach*

The mutuality rule could prevent the application of collateral estoppel against either the government or a taxpayer in federal tax cases. In perhaps the most typical case, the rule would prevent taxpayer *A* from asserting issue determinations decided against the government in a case involving taxpayer *B*. Although the government was a party to both suits (regardless of whether the prior action was a refund or Tax Court suit),[67] taxpayer *A* does not satisfy the mutuality requirement because he was not a party to the action against taxpayer *B*. Normally, a decision cannot bind a taxpayer unless he was a party to the action or in privity with a party.[68] The mutuality rule, however, also prevents the application of collateral estoppel in favor of federal taxing authorities if a taxpayer raises an issue that he unsuccessfully litigated in a state or federal court against state taxing authorities or a private party.[69] The taxpayer

66. *See* notes 12-13 *supra* and accompanying text.

67. The United States, the Commissioner of Internal Revenue, and the district directors are all treated as the same party for the purposes of applying the rules of res judicata and collateral estoppel. I.R.C. § 7422(c).

66. *See* note 7 *supra* and accompanying text.

69. Generally, if the United States was not a party in a prior state court proceeding or a federal suit involving private parties, the mutuality rule prevents application of collateral estoppel against a taxpayer as to issues decided against the taxpayer in that prior action. Since state law may be at issue in a tax case, however, the forum in a federal tax dispute may be bound by the state court decision if it was appealed to the highest court of the state. *See* Commissioner v. Estate of Bosch, 387 U.S. 456 (1967). Furthermore, if the issue was decided in an action not appealed to the highest court in the state in which it was decided, a

seeking to use nonmutual collateral estoppel has his choice of forums. He would be the plaintiff in a refund suit and the petitioner in a Tax Court suit. Because in both situations the taxpayer must overcome the presumption that the Commissioner's assessment is correct, the taxpayer would apparently seek offensive preclusion.[70] Conversely, the government would act defensively in asserting collateral estoppel against a taxpayer on issues decided against the taxpayer in a prior suit not involving disputed federal tax liability.

Early federal tax decisions mirrored the view in other contexts that mutuality was an essential requirement for the application of collateral estoppel. For example, in *Appeal of Suhr*[71] the taxpayer contested a deficiency based on the valuation of certain stock on the date of its acquisition by the taxpayer. The taxpayer argued that two earlier federal court decisions holding the taxpayer's valuation proper collaterally estopped the Commissioner from litigating the issue. The Board of Tax Appeals noted that the taxpayer had not been a party to those actions and summarily rejected the contention that collateral estoppel applied.[72]

As some courts began to relax or reject the mutuality principle in other contexts, the Tax Court and other courts maintained the rule in tax cases without questioning its soundness. In *Elsie K. Mathisen*[73] the taxpayer contested deficiencies based upon the Commissioner's contention that the income from a certain limited partnership was separate property taxable to her in full, rather than community property as alleged by the taxpayer. The taxpayer argued that an earlier Tax Court decision involving the general partners collaterally estopped the Commissioner from relitigating the issues decided against the government. The court rejected the taxpayer's contention, stating that "[i]t cannot be questioned that petitioner was not, in terms, a party to the . . . case upon which she relies for her plea of . . . estoppel by judgment [collateral estoppel]. Identity of parties is a prerequisite to the success of that contention."[74] As in *Suhr,* the court did not base its decision on any factors peculiar to tax litigation, but simply applied without ques-

federal tax court may nevertheless give proper regard to the state court decision in deciding a matter of state law. Thus, the state court decision could he "hinding" on the taxpayer, although not by reason of collateral estoppel.

70. *See* Harold S. Divine, 59 T.C. 152, 157 n.5 (1972), *rev'd,* 500 F.2d 1041 (2d Cir. 1974).

71. 4 B.T.A. 1198 (1926).

72. *Id.* at 1200.

73. 22 T.C. 995 (1954).

74. *Id.* at 998.

tion the common law mutuality rule.

B. Divine v. Commissioner

The Tax Court's decision in *Harold S. Divine*[75] marked the first attempt by a tax court to reconcile the retention of the mutuality rule in tax cases with the opposite trend endorsed in *Blonder-Tongue*. In the Tax Court proceeding Divine contested the Commissioner's determination that a certain corporate distribution was a taxable dividend. Another stockholder in the same corporation had successfully argued in an appeal to a different circuit that the same distribution was a nontaxable return of capital.[76] That determination involved the complex issue of the effect of bargain sales of company stock on the earnings and profits of the corporation.[77] The Tax Court refused to apply collateral estoppel to preclude relitigation of the issue by the government in Divine's case. Although the court stated that it was "mindful of the judicial trend which has undermined the principle of mutuality,"[78] the court concluded that a number of policy considerations required retention of the rule in tax cases.

The Second Circuit in *Divine v. Commissioner*[79] affirmed the Tax Court's refusal to apply collateral estoppel in the absence of mutuality, relying primarily on two of the factors identified by the Tax Court. After distinguishing *Blonder-Tongue* and the circuit's prior acceptance of offensive nonmutual estoppel in a nontax case,[80] the court emphasized that the mutuality rule was necessary in tax cases to promote further inquiry into issues subject to confiict between the different circuits. Because of the complex nature of many tax issues[81] and the Supreme Court's reluctance to grant cer-

75. 59 T.C. 152 (1972), *rev'd on other grounds*, 500 F.2d 1041 (2d Cir. 1974).

76. *See* Luckman v. Commissioner, 418 F.2d 381 (7th Cir. 1969), *rev'g* 50 T.C. 619 (1968).

77. A corporate distribution is taxable as a dividend to the extent that it comes out of "earnings and profits" accumulated in a taxable year after 1913. *See* I.R.C. §§ 301(c), 316. *See generally* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS § 7.01 (4th ed. 1979).

78. 59 T.C. at 158.

79. 500 F.2d 1041 (2d Cir. 1974), *rev'g* 59 T.C. 152 (1972). *Divine* is noted with approval in 60 IOWA L. REV. 1420 (1975) and criticized in 73 MICH. L. REV. 604 (1975).

80. 500 F.2d at 1050. The court rested its decision on "policy grounds" because it did not regard either *Blonder-Tongue* or its earlier decision in Zdanok v. Glidden, 327 F.2d 944 (2d Cir.), *cert. denied*, 377 U.S. 934 (1964), as controlling. For a discussion of *Zdanok*, see text accompanying notes 35-37 *supra*. The court rejected the premise that *Blonder-Tongue* totally abrogated the mutuality rule and viewed *Zdanok* as applying only to cases in which the disputed issue was not subject to "varying appraisals." 500 F.2d at 1051.

81. In discussing this fact, the court in *Divine* stated:

> More so than most laws the tax statutes are far reaching and affect or might affect

tiorari in tax cases, the court reasoned that nonmutual estoppel would delay the development of circuit conflicts and diminish the chances for Supreme Court review of an issue.[82] The court also justified its refusal to allow nonmutual estoppel by stating that a contrary holding "could with little difficulty be extrapolated to estop the Commissioner from relitigating a tax issue when the facts are quite dissimilar."[83] The court apparently viewed such a possibility as a usurpation of the function of stare decisis. A concurring judge agreed with the specific holding of the court on the collateral estoppel issue, but implied that he might approve the use of nonmutual estoppel in tax cases that "turned on the resolution of a complex common issue of fact."[84]

In its policy analysis of the need for the mutuality rule, the Second Circuit correctly recognized that tax litigation presents factors not considered by courts rejecting the mutuality rule in nontax cases. The court did not clearly state, however, that mutuality should be required as a matter of law in any tax case in which a litigant asserts collateral estoppel.[85] Nevertheless, several courts subsequently interpreted *Divine* as simply retaining the mutuality rule for all tax cases. The Tax Court in *Stewart Gammill*[86] referred to its decision in *Divine* as an example of its consistent adherence to the mutuality rule.[87] Thus, the mutuality rule in tax cases survived *Blonder-Tongue,* and the effect of *Divine* was largely to reaffirm the mechanical approach taken by earlier courts.

C. *Early Decisions Accepting Nonmutual Estoppel*

A small minority of courts prior to *Parklane Hosiery* accepted the view that collateral estoppel could apply in a tax case in the absence of mutuality. In *Kurlan v. Commissioner*[88] the Second Cir-

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millions of citizens. The issues which arise in the course of administering these laws are thus of importance not only to the particular litigants but also to the general public. Moreover, because of the sheer extent of the subject matter of the revenue laws and their intricate language, the issues will often be pure issues of law concerning the interpretation of novel and cryptic sections of the Code. Thus, because of the unusual complexity of the tax laws, judicial conflicts over interpretations of law, as opposed to disagreement as to how the law should be applied to specific facts, are much more apt to occur than in other areas of judicial concern.

500 F.2d at 1048-49.

82. *Id.* at 1049.

83. *Id.* at 1050.

84. *Id.* at 1057 (Friendly, J., concurring and dissenting).

85. *But cf.* Winters v. Lavine, 574 F.2d 46, 57 n.11 (2d Cir. 1978) (court cited *Divine,* stating that the mutuality requirement was not totally eliminated in the Second Circuit).

86. 62 T.C. 607 (1974).

87. *Id.* at 615.

88. 343 F.2d 625 (2d Cir. 1965).

cuit held that a taxpayer was collaterally estopped from relitigating issues decided against him in a state court action. The state court had decided several issues that the Tax Court held determinative of the capital asset status of certain television techniques. The taxpayer argued that since the Commissioner was not a party to the state court proceeding, the mutuality rule should have rendered collateral estoppel inapplicable. The court noted that the taxpayer had overlooked the abrogation of the mutuality rule and rejected the contention that the taxpayer could relitigate the issues decided against him in the state court action.

A district court also invoked nonmutual collateral estoppel in favor of the government in *Baily v. United States*.[89] In *Baily* the taxpayer sued to recover amounts levied upon by the Service for failure of a business, in which the taxpayer was allegedly a partner, to pay withholding taxes. Subsequent to the assessment, the taxpayer filed suit in state court seeking to recover money advanced to the business on the ground that the money had been intended as a loan. The state court held that the money was advanced pursuant to a partnership agreement. The district court then granted summary judgment for the government in the tax proceeding, holding that Baily was collaterally estopped from relitigating the question of whether he was a partner in the business. The court noted that the issue had been fully and fairly litigated in the state court action. Refusing to follow *Divine,* the court held that "mutuality of parties is not required for the application of collateral estoppel in a tax case provided that the party sought to be estopped has had a 'full and fair' opportunity to try the factual issue in the first proceeding."[90]

Nonmutual collateral estoppel was applied in favor of a taxpayer in *United States v. Abatti*.[91] Although *Abatti* was a criminal tax fraud case, the district court framed its opinion in terms broad enough to include civil tax litigation as well. In *Abatti* the government brought tax evasion charges against Abatti and charged his accountant, Macklin, with aiding in the preparation of false tax returns. Prior to the institution of the criminal proceedings, the Commissioner had asserted deficiencies against Abatti and several relatives for the same years at issue in the criminal proceeding. The Tax Court in the civil case ruled in favor of Abatti, and both Abatti and Macklin moved to dismiss the indictments in the criminal case on the ground that the Tax Court had decided the defi-

89. 355 F. Supp. 325 (E.D. Pa. 1973).
90. *Id.* at 328.
91. 463 F. Supp. 596 (S.D. Cal. 1978).

ciency issue. The district court granted the motions as to both parties, despite the fact that Macklin had not been a party to the Tax Court case.[92] The court stated that it could see "no good reason for a *per se* rule of mutuality in tax cases."[93] Although recognizing the concern expressed in *Divine* that mutuality was needed to stimulate resolution of legal issues,[94] the court determined that relitigation of the issues in *Abatti* could not resolve uncertainties in the tax laws.

The decisions in *Kurlan, Baily* and *Abatti* did not reflect the majority view that mutuality was a prerequisite for the application of collateral estoppel in any tax case. The facts of these cases, however, presented the courts with situations in which application of the principles of judicial finality would not burden the administration of the tax laws or cause inequitable results. Despite these anomalous decisions, *Divine* clearly has remained the governing approach.

D. Starker v. United States: *Death of the Rule?*

The first case to consider the impact of *Parklane Hosiery* on the law of collateral estoppel in the tax area was *Starker v. United States*.[95] In *Starker,* the taxpayer, his son, and his daughter-in-law entered into a "land exchange agreement" with Crown Zellerbach Corporation to convey certain land in Oregon to the corporation. In exchange, the corporation agreed to deed certain property to the taxpayers over a period of five years. The agreement also provided for a "growth factor" under which the corporation would add six percent to the value of land to be transferred each year to the father. The taxpayers reported no gain on the transactions on the ground that the series of conveyances qualified as like-kind exchanges.[96] The Service asserted deficiencies of over $300,000 against the father and over $35,000 against the son and daughter-in-law, contesting the applicability of the like-kind exchange provisions and regarding the growth factor as income. Both taxpayers paid the tax and sued for a refund in an Oregon district court. The court first tried the case of the son and daughter-in-law and entered a judgment for the taxpayers.[97] The government appealed, but voluntarily dismissed the appeal. The trial court then rejected the fa-

92. *Id.* at 604. Macklin also claimed no privity relationship with Abatti. *Id.* at 602.
93. *Id.* at 603.
94. *Id. See* note 82 *supra* and accompanying text.
95. 602 F.2d 1341 (9th Cir. 1979).
96. *Id.* at 1343. *See* I.R.C. § 1031.
97. *See* Starker v. United States, 35 A.F.T.R.2d ¶ 75-1550 (D. Or. 1975).

ther's argument that the first decision collaterally estopped the government from relitigating the issues decided against it, partly because the father was not a party in the first case.[98] The Ninth Circuit, however, reversed the trial court on the mutuality issue, holding that collateral estoppel could apply in the absence of mutuality.

The government failed to convince the *Starker* court that the mutuality rule should be retained in federal tax cases. The court distinguished *Divine* by noting that both of the relevant actions in *Starker* arose in the same circuit, unlike the situation in *Divine*.[99] The court also questioned the reasoning of *Divine* and expressed doubt whether the *Divine* rationale survived *Parklane Hosiery* even in cases arising in different circuits.[100] Applying *Parkland Hosiery*'s "new analysis for cases presenting offensive collateral estoppel,"[101] the court concluded that the government's opportunity to litigate the issues in the first case precluded relitigation of those issues in the second case. First, the court noted that the size of the refund in the first action gave the government adequate incentive and opportunity to fully litigate the issues in that suit. Second, the decision in the first action was not inconsistent with any prior authority. Third, the second action did not offer procedural advantages unavailable in the first action. Finally, the first action afforded a full and fair opportunity for the government to argue the disputed issues. The court further noted that while the father technically could have joined in the other action,[102] there were numerous explanations for his choosing not to do so.

The Service has not yet indicated whether and to what extent it will continue to urge the retention of the mutuality rule after *Starker*. Other courts may not agree with the Ninth Circuit that *Parklane Hosiery* mandates rejection of the mutuality rule in tax

98. The father was not in privity with the parties in the first suit, and there was no evidence that he controlled or financed the action. 602 F.2d at 1348.

99. *Id.* at 1348-49 n.5.

100. The court stated:

> [E]ven as to tax cases arising in different circuits—a situation we do not have before us—we question the reasoning in *Divine*. . . . [T]he only parties who can invoke collateral estoppel are those whose transactions are so similar to those of previously victorious taxpayers that there is no question that the result under prior cases would have been identical. Thus, the abandonment of mutuality of estoppel in multiple-circuit situations could cause no undue decrease in the ability of the Internal Revenue Service to enforce the tax laws equitably. It would simply require the Service to accept similar results for similarly situated taxpayers, and heighten the incentive for it to litigate all aspects of tax cases vigorously the first time around.

Id.

101. *Id.* at 1349.

102. *Id.* *See* note 117 *infra*.

cases. Although the Court in *Parklane Hosiery* mentioned no exceptions to its rejection of an absolute mutuality rule, some courts may be unwilling to extend the Court's holding in a securities action to federal tax litigation. Furthermore, some courts could accept the *Parklane Hosiery/Starker* analysis that mutuality is not an *absolute* requirement for collateral estoppel in tax cases, but rarely exercise their discretion to allow nonmutual estoppel. This approach would retain a de facto mutuality rule and finds some support in the tentative drafts to the Restatement (Second) of Judgments.[103] Finally, some courts may accept the *Starker* court's suggestion that mutuality should not be required in intra-circuit cases, but maintain *Divine's* preclusion of nonmutual estoppel in cases appealable to different circuits.

The probable result, however, is that after *Parklane Hosiery* federal courts in tax controversies cannot dismiss a collateral estoppel claim solely on the basis of lack of mutuality. *Parklane Hosiery* rejected several of the grounds advanced in *Divine* and other cases as limitations on the scope of nonmutual estoppel. The court in *Divine* had not interpreted *Blonder-Tongue* as a total abrogation of the mutuality rule,[104] but this possible limitation did not find renewed support in *Parklane Hosiery*. Instead, the Court extended its endorsement to offensive as well as defensive use, and, as noted previously, did not suggest any class of cases in which it would retain the mutuality rule. The Court's application of nonmutual collateral estoppel to a securities fraud action also suggests that any distinction based upon issues "not subject to varying appraisals"[105] is no longer viable.[106] Disapproval of these limitations does not require that courts disregard any of the factors noted in *Divine* and liberally allow nonmutual estoppel in a variety of circumstances. Courts should recognize, however, that *Parklane Hosiery* has replaced a rigid rule with a discretionary approach. Courts should allow nonmutual collateral estoppel when, as in *Kurlan, Baily* and *Abatti,* preclusion will serve the purposes of judicial finality without disrupting the administration of the tax laws. Courts could still deny nonmutual collateral estoppel when the issue was purely legal and the action from which preclusion is sought concerned an unrelated transaction or was appealable to a different circuit.

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103. *See* TD-3, *supra* note 27, App. § 88 & comment i.

104. *See* note 80 *supra* and accompanying text.

105. *See* note 50 *supra* and accompanying text.

106. One should categorize the issue on which plaintiffs asserted collateral estoppel in *Parklane Hosiery,* the materiality of a defect in a proxy statement under the securities laws, with those issues subject to varying determinations by the courts. *See* Fink v. Coates, 323 F. Supp. 988 (S.D.N.Y. 1971).

The court in *Starker* properly applied the two-step inquiry adopted in *Parklane Hosiery* to govern the exercise of judicial discretion in allowing nonmutual collateral estoppel. First, future courts should determine whether an issue raised in a federal tax case was fully and fairly litigated by the taxpayer in a prior case not involving the government (if the government asserts defensive use), or by the government in a tax dispute with another taxpayer (if a taxpayer seeks offensive collateral estoppel against the government). Second, courts should determine whether some compelling circumstance warrants relitigation of the disputed issue even if it was fully litigated in a prior action. In applying both of these tests, courts should consider the unique aspects of tax litigation and the policies of efficient but equitable administration of the tax laws. The next section of this Note will attempt to examine those factors that courts should consider in determining whether to exercise their discretion in favor of allowing nonmutual estoppel in an individual case.

IV. A Suggested Analysis

A. The "Full and Fair Opportunity to Litigate" Test in Tax Cases

In examining a nonmutual estoppel plea in a tax case, courts must first determine whether the disputed issue was "fully and fairly" litigated in a prior action by the party against whom collateral estoppel is asserted. As in nontax cases, no specific rules can be formulated for making this determination. Factors identified by courts in other contexts, however, are particularly significant in tax disputes. First, if a taxpayer seeks preclusion against the government and if the the prior action concerned only a small amount, relitigation may be warranted.[107] The court in *Starker* might have asserted that the amount of the deficiency in the prior case was minimal compared to the amount in the action in which collateral estoppel was asserted.[108] Similarly, if a taxpayer litigated an issue in a state court proceeding concerning a small amount, application of collateral estoppel against him on that issue in a federal tax matter might be inappropriate. In either case the party arguing against preclusion may have had insufficient incentive to litigate fully or to appeal the prior case.

Procedural aspects of the first action may also warrant relitiga-

107. *See* TD-4, *supra* note 4, § 68.1 & comment j.
108. *See* text accompanying notes 96-97 *supra*.

tion of a previously decided issue. For example, if the party against whom estoppel is asserted could not have appealed the decision, then the court may refuse to apply collateral estoppel.[109] The first action may have offered procedural disadvantages, such as severely limited discovery, that would make a court reluctant to preclude relitigation of the issue in an action affording greater procedural opportunities.[110] The availability of a jury trial in the second action may weigh in favor of refusing collateral estoppel if such a right was unavailable in the original action.[111] The problem of greater procedural opportunities would arise more frequently, however, in cases of defensive estoppel by the government than in offensive use by the taxpayer.

The Court in *Parklane Hosiery* indicated that although courts now have discretion to allow offensive nonmutual estoppel, they may require a "stronger showing that the prior opportunity [to litigate the disputed issue] was adequate" in cases of offensive use than in cases of defensive use.[112] Thus, courts in tax cases may properly require that taxpayers asserting prior judgments demonstrate convincingly that the government litigated the prior action to the fullest extent possible, that the government was aware of the potential for or existence of the second taxpayer's claim, and perhaps that application of collateral estoppel would result in a reduction in the time spent in litigation. Courts should not use this factor, however, as an excuse to routinely allow nonmutual estoppel in favor of the government while denying it in favor of taxpayers.

A final consideration in applying the fairness test is the forseeability of subsequent litigation. If the party against whom preclusion is asserted could not anticipate that the issue litigated and lost in a prior action would arise in a later action against another party, the court should consider whether the issue merits relitigation.[113] The question of forseeability is less relevant in cases of defensive use by the government because businessmen plan many transactions that give rise to nontax litigation with the tax consequences of the transaction in mind. In some situations, however, the tenuous relationship between the subject matter of nontax litigation and the tax consequences of the transaction could warrant relitigation of the issue by the taxpayer.

These factors are by no means an exclusive list. The basic in-

109. *See* TD-4, *supra* note 4, § 68.1(a) & comment a.

110. TD-3, *supra* note 27, App. §§ 68.1(c), 88(2).

111. *Id.* App. § 88(2), comment d. *But see* note 65 *supra.*

112. 439 U.S. at 331 n.16. *See* TD-3, *supra* note 27, App. § 88, Reporter's Note at 171.

113. TD-4, *supra* note 4, § 68.1(d)(ii). *See* Mosher Steel Co. v. NLRB, 568 F.2d 436, 440 (5th Cir. 1978).

quiry should be whether the issue on which a party seeks preclusion was adjudicated in a forum under procedural conditions approximating those in the federal tax proceeding and under circumstances providing the litigant with an adequate opportunity to vigorously litigate the issue.

B. The "Compelling Circumstances" Exception

Courts recognizing nonmutual estoppel in nontax cases have acknowledged that certain compelling circumstances may require relitigation of a decided issue even if the previous determination was the result of full and fair litigation. The Restatement (Second) of Judgments lists seven such circumstances,[114] although the list is not intended to be exclusive.[115] Several of these "exceptions" are particularly relevant to courts faced with nonmutual estoppel pleas in tax cases. For example, a court may refuse preclusion if the party asserting the prior judgment could have joined in the prior action.[116] Joinder of taxpayers is technically possible in many cases,[117] although, as the *Starker* court noted, courts should not pe-

114. The Restatement (Second) provides in part:

A party precluded from relitigating an issue with an opposing party, in accordance with [general rules of issue preclusion] is also precluded from doing so with another person unless the fact that he lacked full and fair opportunity to litigate the issue in the first action or other circumstances justify affording him an opportunity to relitigate the issue. The circumstances to which consideration should be given include . . . whether:

(1) Treating the issue as conclusively determined would be incompatible with an applicable scheme of administering the remedies in the actions involved;

(2) The forum in the second action affords the party against whom issue preclusion is asserted procedural opportunities in the presentation and determination of the issue that were not available in the first action and could likely result in the issue being differently determined;

(3) The person seeking to invoke favorable preclusion, or to avoid unfavorable preclusion, could have effected joinder in the first action between himself and his present adversary;

(4) The determination relied on as preclusive was itself inconsistent with another determination of the same issue;

(5) The prior determination may have been affected by relationships among the parties to the first action that are not present in the subsequent action, or was based on a compromise verdict or finding;

(6) Treating the issue as conclusively determined may complicate determination of issues in the subsequent action or prejudice the interests of another party thereto;

(7) The issue is one of law and treating it as conclusively determined would inappropriately foreclose opportunity for obtaining reconsideration of the legal rule upon which it was based.

TD-3, *supra* note 27, App. § 88(1)-(7).

115. The drafters of the new Restatement have provided that "other compelling circumstances" may make issue preclusion inappropriate. TD-3, *supra* note 27, App. § 88(8).

116. *See, e.g.*, Nevarov v. Caldwell, 161 Cal. App. 2d 762, 327 P.2d 111 (1958).

117. The Federal Rules of Civil Procedure provide for permissive joinder of all persons asserting a right to relief "arising out of the same transaction, occurrence or series of trans-

nalize the taxpayer when there are valid reasons for not joining.[118] Thus, a court might properly refuse to allow offensive estoppel by a taxpayer when it is obvious that the taxpayer did not join the prior action because he hoped for a favorable judgment without losing the chance to litigate the matter for himself.

Another recognized exception to nonmutual estoppel provides that an applicable scheme of remedies may limit the preclusive effect of judgments. The clearest example of this limitation occurs in the area of antitrust enforcement. Section 5(a) of the Clayton Act provides that government obtained decrees in civil and criminal antitrust proceedings constitute prima facie evidence in subsequent private actions based on the same violations.[119] Some federal courts have construed the statute as preempting the common law concept of collateral estoppel.[120] Although the Internal Revenue Code contains no similar provision limiting the preclusive effect of judgments in tax litigation, the Restatement (Second) of Judgments espouses the view that the basic nature of the federal tax structure constitutes an inherent limitation on the scope of collateral estoppel.[121] In particular, the so-called Golsen rule, under which the Tax Court is bound only by decisions of the court of appeals to which appeal would lie,[122] constitutes a complicating factor in determining the scope of collateral estoppel in tax disputes.[123] Widespread application of nonmutual collateral estoppel could distort application of the Golsen rule by allowing taxpayers to take advantage of a favorable determination in one circuit, even though the court of appeals in the taxpayer's circuit had rejected the taxpayer's view of the issue in question.[124] The Golsen rule does not support absolute

actions or occurrences and if any question of law or fact common to all of them will arise in the action." FED. R. CIV. P. 20(a). The rules of the Tax Court and the Court of Claims contain similar provisions. U.S. TAX CT. R. PRAC. & PROC. 61(a); U.S. CT. CL. R. 63(a).

118. *See* text accompanying note 102 *supra*.

119. 15 U.S.C. § 16(a) (1976).

120. *See, e.g.*, Sam Fox Publishing Co. v. United States, 366 U.S. 683, 690 (1961) (dictum); Purex Corp. v. Procter & Gamble Co., 308 F. Supp. 584, 589-90 (C.D. Cal. 1970), *aff'd*, 453 F.2d 288 (9th Cir. 1971), *cert. denied*, 405 U.S. 1065 (1972). *But see* McWilliams, *Federal Antitrust Decrees: Should They Be Given Conclusive Effect in a Subsequent Private Action?*, 48 MISS. L.J. 1 (1977); Note, *The Use of Government Judgments in Private Antitrust Litigation: Clayton Act Section 5(a), Collateral Estoppel, and Jury Trial*, 43 U. CHI. L. REV. 338 (1976).

121. *See* TD-4, *supra* note 4, § 68.1 & comment c.

122. I.R.C. § 7482 governs venue for appeals from Tax Court decisions. For a general discussion of the appellate process in tax proceedings, see 9 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 51.03 (1977).

123. *See* Jack E. Golsen, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971).

124. *See* Note, *Collateral Estoppel: Loosening the Mutuality Rule in Tax Litigation*, 73 MICH. L. REV. 604, 614-15 (1975).

rejection of nonmutual estoppel in multiple circuit cases, notwithstanding *Divine*.[125] Application of nonmutual estoppel to a factual issue in a multiple circuit case would not conflict with the Golsen rule; courts should not promote circuit conflict on purely factual matters. Courts should be reluctant to grant collateral estoppel, however, on issues which have generated conflict among the circuits.

Courts should be most reluctant to apply issue preclusion in favor of a nonparty to a prior action when the issue is primarily a pure question of law that arose in a factually unrelated case. Although this exception would apply regardless of the mutuality issue,[126] it should be important, if not controlling, to a court considering a nonmutual estoppel plea. Allowing nonmutual estoppel in such cases could promote an overabundance of suits by taxpayers seeking to bring themselves within the scope of erroneous, but favorable, decisions.[127] Courts should limit nonmutual estoppel to cases in which the disputed issue is either one of fact or a mixed question of fact and law decided in the context of transactions factually related to those at issue in the tax proceeding. Such cases would be limited in number and would have little effect on the application of the Golsen rule.

C. Policy Considerations

After determining whether the disputed issue was fully and fairly litigated in a prior proceeding and whether the case falls within some recognized exception to the rule against relitigation of a decided issue, courts should also consider the proposed result in light of policy considerations peculiar to federal tax litigation. First, it is a well-established rule that courts narrowly construe the doctrine of collateral estoppel in tax cases. In the leading case of *Commissioner v. Sunnen*[128] the Supreme Court sharply limited the availability of the doctrine to cases in which a party sought to relitigate a previously decided issue "where the controlling facts and applicable legal rules remain unchanged."[129] Although courts have had difficulty applying the *Sunnen* rule[130] and have questioned its

125. *See* notes 99-100 *supra* and accompanying text.

126. *See* United States v. Moser, 266 U.S. 236, 242 (1924). *See also* TD-4, *supra* note 4 § 68.1(b)(i).

127. *See* 60 IOWA L. REV. 1420, 1431 (1975).

128. 333 U.S. 591 (1948).

129. *Id.* at 599-600.

130. *See generally* Branscomb, *Collateral Estoppel In Tax Cases: Static and Separable Facts*, 37 TEX. L. REV. 584 (1959).

requirements,[131] the *Sunnen* Court's admonition that the doctrine of collateral estoppel should be applied sparingly in tax cases has become a fixture of the law. Applied to the mutuality issue, the doctrine counsels courts in close cases to allow relitigation of an issue which has been previously litigated.

A second policy consideration is the extent to which the application of nonmutual estoppel would burden the collection of the national revenue.[132] Although courts addressing the mutuality rule in tax cases have not discussed this factor directly,[133] some courts view nonmutual estoppel as simply a new "weapon" for the taxpayer. For example, the court in *Divine* addressed only the justifications for prohibiting a taxpayer from using collateral estoppel offensively against the government.[134] Courts should exercise some restraint in applying nonmutual estoppel in favor of taxpayers because widespread application of the doctrine could force the Service to settle more cases prematurely or to appeal more decisions; such application would burden the system and increase the size of appellate dockets.[135]

Balanced against the two foregoing policy considerations, which may weigh in favor of refusing nonmutual estoppel in a given case, are the policies of terminating repetitious litigation and of treating similarly situated taxpayers in an equitable fashion. In many cases, particularly those in which the disputed issue is a factual one, application of nonmutual estoppel would significantly conserve both judicial and litigant resources. The court's refusal to allow nonmutual estoppel in such a case would simply allow the party against whom estoppel was asserted to try again. Furthermore, application of collateral estoppel in cases of offensive use by taxpayers could in many cases help to insure that parties to transactions receive more uniform tax treatment.

As the Supreme Court noted in *Blonder-Tongue,* "no one set of facts, no one collection of words or phrases, will provide an automatic formula for proper rulings on estoppel pleas."[136] Nevertheless, federal courts are equally competent in tax cases to consider

131. *See* Montana v. United States, 440 U.S. 147, 158-62 (1979).

132. Although this Note has stated that the mutuality rule can operate in some cases to refuse the benefits of collateral estoppel to the *government,* it is likely that taxpayer attempts to use nonmutual estoppel offensively against the government would be far more frequent.

133. *But cf.* Divine v. Commissioner, 59 T.C. 152, 160 (1972) (court stated that "the total removal of the mutuality principle from tax cases [would place] a far greater burden on respondent [the Commissioner] than on private parties").

134. 500 F.2d at 1048-50.

135. *See* 60 IOWA L. REV. 1420, 1432 (1975).

136. 402 U.S. at 333-34.

the relevant factors of each case in determining whether collateral estoppel will apply in the absence of mutuality. This section has attempted to identify some of the factors that courts should consider in order to reflect the policies of judicial finality and of equitable administration of the tax laws.

V. Conclusion

The problems of overcrowded court dockets and increases in the expense and time involved in litigation have grown steadily in recent years. Because of these developments, the principle that courts should give a party no more than one full and fair opportunity to litigate an issue has gained wide approval. The retention of the mutuality rule as an absolute requirement for the application of collateral estoppel is inconsistent with this "one chance to litigate" formula. This Note has argued that the Supreme Court's decision in *Parklane Hosiery* and the Ninth Circuit's decision in *Starker v. United States* have sounded the death knell for the mutuality rule in its final stronghold—federal tax litigation. Courts can apply the principles of "nonmutual estoppel" in some tax cases consistently with the often conflicting goals of fairness, efficient administration of the tax laws, and elimination of needless litigation. With the discretion afforded courts in *Parklane Hosiery* and illustrated in *Starker,* federal tax forums should refuse to allow the mutuality rule to govern them from its grave.

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