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Armed Services - The Right to Pre-Induction Judicial Review - Oestereicb v. Selective Service System, 89 S. Ct. 414 (1968)

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decision of the Court of Appeals for the Sixth Circuit,[32] and held that avoidance of shareholder tax need be only "one" purpose of accumulation for the accumulated earnings tax to apply.[33] Because the statutory language was unclear, the Court turned to the congressional intent.[34] It intimated that any other test would be inconsistent with that intent[35] and would unduly weaken the presumption of a purpose of avoidance.[36] The Court stated, "[O]ur holding would [not] make purpose totally irrelevant. It still serves to isolate those cases in which tax avoidance motives did not contribute to the decision to accumulate." [37]

On the basis of this decision the accumulated earnings tax, if otherwise applicable, will be assessed against a corporate taxpayer which accumulates earnings with "a" purpose of avoiding personal income taxes regardless of other purposes or motives. As the dissent in *Donruss* suggests,[38] if the jury does not carefully weigh subtleties, then accumulation of earnings together with mere knowledge of the tax savings may satisfy the "one" purpose quantum requirement of the Supreme Court. The taxpayer must disprove *any* tax avoidance purpose.

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Armed Services—THE RIGHT TO PRE-INDUCTION JUDICIAL REVIEW. *Oestereich v. Selective Service System*, 89 S. Ct. 414 (1968).

A divinity student, unconditionally entitled to exemption from military service by statute,[1] was reclassified as delinquent,[2] and subsequently

32. 384 F.2d 292 (6th Cir. 1967)

33. 89 S. Ct. at 504. The Court recognized *Young* as a strong case in the taxpayer's favor, but rejected it.

34. *Id.* at 504-07.

35. *Id.* at 505.

36. *Id.* at 507.

37. *Id.* at 508.

38. *Id.* at 508-10.

1. Universal Military Training and Service Act of 1948, ch. 625, § 6(g), 62 Stat. 611 (now Military Selective Service Act of 1967, 50 U.S.C.A. APP., § 456(g) (1967)). This provision grants students enrolled in a theological school an exemption from training and service.

2. Plaintiff returned his registration certificate to the Government in expressing his dissent from United States participation in the Vietnam war. Every person must have his registration certificate in his possession at all times. 32 C.F.R. § 1617.1 (1968). The local Selective Service board has the authority to declare a registrant to be delinquent whenever he fails to perform any duty required of him, apart from the duty to obey an order to report for induction. 32 C.F.R. § 1642.4(a) (1968).

ordered to report for induction. A suit to enjoin his induction was dismissed by the district court[3] which found that under the applicable statute[4] judicial review prior to induction was beyond its jurisdiction. The court of appeals affirmed,[5] and the Supreme Court granted the registrant's petition for a writ of certiorari.[6]

The Supreme Court found no reasonable relationship between the denial of a valid statutory exemption and the conduct of a registrant.[7] In reaching its decision, the Court assumed that the legislative intent was not to enlarge the scope of authority of local boards at the expense of a guaranteed statutory right. Consequently, when no determination of fact is involved,[8] pre-induction judicial review is not precluded when the local board has clearly exceeded its statutory powers.[9]

The 1967 Military Selective Service Act[10] provides for judicial review only when certain requirements are satisfied. There must be no basis in

3. Oestereich v. Selective Serv. Sys., 280 F. Supp. 78 (D. Wyo. 1968).

4. Universal Military Training and Service Act of 1948, ch. 625, § 10(b)(3), 62 Stat. 620 (now Military Selective Service Act of 1967, 50 U.S.C.A. APP., § 460 (b) (3) (1967)). This provsion defines the limited availability of judicial review to the registrant:

> No judicial review shall be made of the classification or processing of any registrant by the local boards, appeal boards, or the President, except as a defense to a criminal prosecution instituted under section 12 of this title [section 462 of this Appendix], after the registrant has responded either affirmatively or negatively to an order to report for induction, or for civilian work in the case of a registrant determined to be opposed to participation in war in any form: *Provided*, That such review shall go to the question of the jurisdiction herein reserved to local boards, appeal boards, and the President only when there is no basis in fact for the classification assigned to such registrant.

5. 390 F.2d 100 (10th Cir. 1968). The jurisdictional question was particularly emphasized by the court of appeals.

6. 391 U.S. 912 (1968).

7. Oestereich v. Selective Serv. Sys., 89 S. Ct. 414, 417 (1968).

8. *Id.* at 416. Plaintiff was not contending that the local board acted with no basis in fact. The majority opinion stated:

> In such instances, as in the present one, there is no exercise of discretion by a Board in evaluating evidence and in determining whether a claimed exemption is deserved.

9. *Id.* at 417. The Court defined the special circumstances of the case before granting pre-induction judicial review:

> Since the exemption granted divinity students is plain and unequivocal and in no way contested here, and since the scope of the statutory delinquency concept is not broad enough to sustain a revocation of what Congress has granted as a statutory right, or sufficiently buttressed by legislative standards, we conclude that pre-induction judicial review is not precluded in cases of this type.

10. 50 U.S.C.A. APP. § 451-73 (1967).

fact for the board's classification[11] and the registrant, having exhausted all of his administrative remedies, must refuse to submit to induction.[12] Congress had firmly established the finality of local board classifications in prior legislation and this policy was continued in the 1967 Act.[13] Review was to be made available, if at all, at the induction stage. The means for obtaining review were twofold—by a writ of habeas corpus after induction or by a defense of improper classification in a criminal prosecution upon refusal of induction.[14]

The courts, however, have taken notice of irregularities and unfair treatment[15] and have allowed a registrant redress when a local board has

11. *See* Estep v. United States, 327 U.S. 114 (1946). *Estep* limited the scope of judicial review to whether there was any basis in fact for the classification. *Id.* at 123. "The new law codifies the rule that judicial review of a classification is to be limited to the question whether it had any basis in fact." Note, *The New Draft Law: Its Failures and Future*, 19 CASE W. RES. L. REV. 292, 301 (1968).

12. Falbo v. United States, 320 U.S. 549 (1944), set the general rule that a registrant cannot obtain judicial review until he has exhausted all his administrative remedies. In Estep v. United States, 327 U.S. 114, 123 (1946), the registrant had exhausted all his administrative remedies and the Court held that in such a case a registrant may obtain judicial review in his criminal prosecution by raising the defense that the local board exceeded its jurisdiction in classifying him. *Accord*, Gibson v. United States, 329 U.S. 338 (1946), showing the tendency of the Supreme Court to broaden the remedies of the registrant. *See also* Cox v. United States, 332 U.S. 442 (1947); Layton and Fine, *The Draft and Exhaustion of Administrative Remedies*, 56 GEO. L.J. 315, 334 (1967). Layton and Fine observe that "[u]nder the Act, the final remedy . . . to a registrant . . . is a discretionary appeal to the President." *See* Ashton v. United States, 404 F.2d 95, 96 (8th Cir. 1968), where the court states: "When administrative remedies are not exhausted, exceptional circumstances must exist for judicial review of the claimed erroneous classification."

13. The Selective Training and Service Act of 1940, ch. 720, 54 Stat. 885, while allowing for administrative appeals, provided that the classification of registrants by local boards shall be final. The Universal Military Training and Service Act of 1950, ch. 144, 65 Stat. 75, continued the basic provisions of the 1940 Act, and allowed a registrant to challenge a determination by his local board only after he actually reported for induction. *See* Layton and Fine, *supra* note 13, at 316-17.

14. *See* Witmer v. United States, 348 U.S. 375, 377 (1955), where the Court stated:

> There is no direct judicial review of the actions of Appeal Boards. Questions concerning the classification of the registrant may be raised either in a petition for habeas corpus or as a defense to prosecution for failure to submit to induction into the armed forces.

15. *See* United States v. Bellmer, 404 F.2d 132 (3rd Cir. 1968), where plaintiff suffered a denial of basic procedural fairness; United States v. Tichenor, 403 F.2d 986 (6th Cir. 1968), where it was decided that a classification based on an erroneous view of law falls within the purview of judicial review; Townsend v. Zimmerman, 237 F.2d 376 (6th Cir. 1956), where a local board ignored its own regulations and denied procedural rights; Schwartz v. Strauss, 206 F.2d 767 (2d Cir. 1953), where although the plaintiff's suit was denied on the grounds of no jurisdiction, Judge Frank in the concurring opinion stated that judicial relief should be available immediately where

abused its discretion. The test of "exhaustion of all administrative remedies" prior to review was temporarily set aside upon a showing of "imminent danger of irreparable harm." [16] After the application of first and fourteenth amendment rights to other federal agencies had been established,[17] judicial review was available when statutes patently abridging free expression were challenged.[18] Yet, prior to *Wolff v. Selective Service System*[19] review of local board decisions was available only after a registrant had responded to an order to report for induction.[20]

Wolff provided a new basis for judicial review. Where irreparable injury to an individual's rights was likely to result, the test of justiciability and ripeness of controversy would apply.[21] Under extremely narrow circumstances,[22] one federal court departed from a long-

"the Board's lack of jurisdiction is manifest." *See also* Sicurella v. United States, 348 U.S. 385 (1955); McCoy v. United States, 403 F.2d 896 (5th Cir. 1968); Glover v. United States, 286 F.2d 84 (8th Cir. 1961); Batterson v. United States, 260 F.2d 233 (8th Cir. 1958); United States v. Close, 215 F.2d 439 (7th Cir. 1954).

16. In *Ex parte Fabiani*, 105 F. Supp. 139 (E.D. Pa. 1952), the court ignored the exhaustion of remedies doctrine where a medical student was classified as delinquent for failure to report for a physical examination as scheduled. The court found the local board's action to be without any basis in fact and contrary to regulations. *Id.* at 143. The majority recognized the registrant's dilemma and stated:

> On such a strong showing, this Court does not feel justified in compelling the registrant either to undergo the ignominy of a criminal prosecution, with the consequent possible destruction of his medical career, or to submit himself to induction amid the notoriety and humiliating and defamatory comment inevitably spewed forth in a situation of this kind. *Id.* at 145.

See also Hammond v. Lenfest, 398 F.2d 705 (2d Cir. 1968).

17. *See* Dombrowski v. Pfister, 380 U.S. 479, 498 (1965); United States v. Wood, 295 F.2d 772 (5th Cir. 1961), *cert. denied*, 369 U.S. 850 (1962). *See also* Estep v. United States, 327 U.S. 114, 126 (1946), where Justice Murphy stated in a concurring opinion:

> Before a person may be punished for violating an administrative order due process of law requires that the order be within the authority of the administrative agency and that it not be issued in such a way as to deprive the person of his constitutional rights.

18. Dombrowski v. Pfister, 380 U.S. 479, 489-90 (1965).

19. 372 F.2d 817 (2d Cir. 1967).

20. *See* Layton and Fine, *supra* note 13, at 328.

21. Reclassification in *Wolff* was held to have the effect of an immediate curtailment of first amendment rights, thus creating a justiciable controversy. 20 ALA. L. REV. 130 (1967). *See also* Wolff v. Selective Serv. Sys., 372 F.2d 817, 825 (2d Cir. 1967). The court found nothing in the exhaustion or jurisdiction precedents to prevent judicial intervention where immediate deprivation of first amendment rights was clearly presented.

22. 372 F.2d 817, 824 (2d Cir. 1967). The court created an exception to case law in order to prevent local boards from hindering the exercise of free speech. Judicial

established policy of non-intervention in Selective Service affairs and granted pre-induction review of a classification at the local board level. Under similarly narrow circumstances courts could now review a challenged classification irrespective of the stage in the administrative process[23] at which the action was brought.

The rationale of the Court in *Oestereich*, in extending pre-induction judicial review to those cases where there is a clear denial of a registrant's statutory rights,[24] recognizes that a local board cannot ignore what Congress has granted as a valid exemption from service, and cannot deprive a registrant of his liberty without the prior opportunity of presenting his claim to a competent forum.[25] Whether or not the scope of this decision is to be limited to the narrow circumstances of the principal case is yet to be determined.[26] Where local boards proceed in blatant disregard of their jurisdiction, the courts can exercise direct review of that action.[27] Where the local boards act within their statutory authority, the trend seems to be against any further extension of review.[28] However, in light of an increasing number of classification

review is justified only when the local board's action unconstitutionally impairs first amendment rights.

23. In cases involving infringement of constitutional rights, registrants should be permitted to challenge their classifications immediately. 31 ALBANY L. REV. 349, 355 (1967). The registrant does not have to face a criminal prosecution or court martial before he may challenge the board's decision, at least where first amendment rights are involved.

24. Oestereich v. Selective Serv. Sys., 89 S. Ct. 414, 416 (1968).

25. *Id.* at 416-17. *See also* Petersen v. Clark, 285 F. Supp. 700 (N.D. Cal. 1968).

26. Oestereich v. Selective Serv. Sys., 89 S. Ct. 414, 417 n.7 (1968). The circumstances of the prinicpal case involved a clear statutory exemption granted by Congress. where no question or determination of fact was required. The Court itself, in noting the unique circumstances of the present controversy, gave an indication as to the true import and possible extension of this decision:

> We would have a somewhat different problem were the contest over, say, the quantum of evidence necessary to sustain a Board's classification. Then we would not be able to say that it was plain on the record and on the face of the Act that an exemption had been granted and there would therefore be no clash between § 10 (b)(3) and another explicit provision of the Act.

27. *Id.* at 416-17.

28. *See* Clark v. Gabriel, 89 S. Ct. 424 (1968), an opinion which was handed down the same day as *Oestereich*, but in which pre-induction judicial review was not granted where a local board denied a registrant's application for classification as a conscientious objector. The Court upheld § 10(b)(3) in stating that judicial review of a classification was precluded except as a defense to a criminal prosecution.

For recent decisions adhering to the "basis in fact" test in supporting local board classifications and denying review, *see* McCoy v. United States, 403 F.2d 896 (5th Cir. 1968); Matyastik v. United States, 392 F.2d 657 (5th Cir. 1968); Jones v. United States,

cases, the scope of the "clear conflict" test is a question which will be presented in the future.

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Federal Taxation—PROFESSIONAL SERVICE CORPORATION—CORPORATE v. PARTNERSHIP STATUS. *Empey v. United States*, — F. 2d — (10th Cir. 1969).

During the first ten months of 1965, Empey was a lawyer-employee of a professional service organization.[1] On November 1 of that year he became a ten percent shareholder. In his federal income tax return for 1965 he reported the salary he received for the first ten months, and in addition reported ten percent of the net income of the organization for November and December although he actually received no part of such income. This was done in the apparent belief that the organization was taxable as a partnership. Later, contending that the organization should be taxed as a corporation rather than as a partnership, Empey filed a timely claim for refund of the tax paid by him on the difference between his salary and his share of the corporate net earnings for November and December. Through inaction, the Internal Revenue Service rejected the claim, thereby tacitly ruling that under Treasury regulations the professional service corporation was a partnership for purposes of taxation.[2] Empey brought suit in the federal district court[3] to

387 F.2d 909 (5th Cir. 1968). *But see* Carey v. Local Bd., Civil No. 12,966 (D. Conn., filed Feb. 13, 1969) where pre-induction judicial review was granted. The requirements for review established in the *Oestereich* decision were invoked to grant registrant's petition for classification.

1. The corporation was organized under the Colorado Corporation Code. COLO. REV. STAT. ANN. ch. 31, art. 1-10 (1963). Lawyers had been permitted to so organize by a 1961 special ruling of the Colorado Supreme Court. COLO R. CIV. P. 265.

2. Professional service corporations and associations, organized under local statutes, vary in their characteristics from state to state. Normally, this type of organization falls somewhere between a corporation and a partnership depending upon the possession or non-possession of corporate attributes.

One such attribute, that of continuity of existence, is found in most professional corporations but is restricted by the requirement that shareholders be members of the profession practiced by the organization, *e.g.* medicine or law. Many states require that the stockholder also be an employee. Dissolution and reformation of the enterprise are not necessary after the death or departure of a shareholder, however, as is often the case with a partnership.

Centralization of management is a characteristic found in varying degrees among partnerships as well as corporations and professional associations. Of course, the man-