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Income Tax—Funds Received by Extortion as Income

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The argument for the deductibility of the legal expense in the instant case is that the gift tax deficiency, if uncontested, would have consumed property held by the taxpayer for the production of income, hence the legal expense was for the conservation of property held for the production of income. This approach does not consider the nature of the activity to which the expense relates but considers only the result of incurring the expense. The legal expenses incurred in defending any claim which could be asserted against a taxpayer would be expenses for the conservation of the taxpayer's property, hence, following this approach, all legal expenses would be deductible. It is submitted that this goes far beyond the intent of Congress in the enactment of § 23(a)(2) and that the preferable result is that reached in the instant case.

In the recent case of *Baer v. Commissioner,* 196 F. 2d 646 (C.A. 8th 1952), it was held that a taxpayer's legal expenses incurred in arranging a property settlement following the taxpayer's divorce were deductible expenses under § 23(a)(2). There the court considers the *Lykes* case as clearly a family transaction which had nothing to do with the conservation or maintenance of property held by the taxpayer for income producing purposes. The legal expenses in the *Baer* case are distinguished as being directed to the conservation and maintenance of property held by the taxpayer for income producing purposes. It is submitted that the majority there adopts the approach unsuccessfully urged in the *Lykes* case and, as the dissent points out, the two cases should turn on the same principle. The *Baer* case indicates an apparent lack of sympathy with the interpretation of § 23(a)(2) employed in the *Bingham* and *Lykes* cases. Conceding that it may be inequitable to forbid the deduction of legal expenses such as those incurred by Baer and by Lykes, the remedy should come from further amendment of the Internal Revenue Code by Congress, not an unwarranted interpretation thereof by the courts.

WILLIAM S. STINNETTE

Income Tax—Funds Received by Extortion as Income. *T* was an associate of *X* during prohibition when they were bootlegging liquor. After the partnership split up, *T* demanded money from *X*. When *T* threatened the lives of *X* and his family, *X* paid *T* $250,000. *Held:* The extorted funds are taxable to *T* as income since they were obtained under a "semblance of a bona fide claim of right" and in effect, without obligation to repay since *X* was not likely ever to press demand for a return of the money. *Rutkin v. United States,* 343 U.S. 130 (1952).

In 1916 the word "lawful" was omitted from the then existing definition of net income in section 22(a) of the Internal Revenue Code. Since that time there has been a constant stream of cases determining which income resulting from unlawful activities may be taxable and which may not. On the one hand are the cases which hold the funds not taxable since it is like a loan due to the obligation to repay the owner, *Wilcox v. Commissioner,* 148 F. 2d 933 (C.A. 9th 1945) (embezzlement); *McKnight v. Commissioner,* 127 F. 2d 572 (C.A. 5th 1942) (embezzlement). On the other hand, there are the cases in which the funds are held taxable because they were received under a claim of right, *U.S. v. Currier Lumber Co.,* 70 F. Supp. 219 (App. D.C. 1947) (majority stockholder theft of company checks); *Kurrle v. Helvering,* 126 F. 2d 723 (C.A. 8th 1942) (profits from embezzled funds); *Moore v. Thomas,* 131 F. 2d 611 (C.A. 5th 1942) (excessive fees charged); *Barker v. Magruder,* 95 F. 2d 122 (App. D.C. 1937) (usurious interest); *North American Oil Consolidated v. Burnet,* 286 U.S. 417 (1932) (litigated funds); or because legal title had been passed by the owner having given over the funds "voluntarily" although by reason of fraud, *Akers v. Scofield,* 167 F. 2d 718 (C.A. 5th 1948) (swindling); *Humphreys v. Commissioner,* 125

F. 2d 340 (C.A. 7th 1942) (ransom money); *National City Bank v. Helvering*, 98 F. 2d 93 (C.A. 2d 1938) (illicit bonus); *Droge v. Commissioner*, 35 BTA 829 (1937) (Irish sweepstakes); *U.S. v. Sullivan*, 274 U.S. 259 (1927) (bootlegging); or because the funds are not subject to recovery by the owner under applicable law, *Chadick v. U.S.*, 77 F. 2d 961 (C.A. 5th 1935) (graft); *Greenfeld v. Commissioner*, 165 F. 2d 318 (C.A. 4th 1947) (receipt of stolen bonds).

Although the *Rutkin* case is discussed by the court as being an example of the "claim of right" group, it is a very weak case for such a theory. Under the modified claim of right theory as exemplified in this case, it would seem that any funds received by a gangster would be taxable no matter how weak or untenable his claim, as long as some claim was found to exist in however minuscule degree. The case weakens the stringent rule given by the *Wilcox* case which required a bona fide claim of right plus an absence of obligation to repay in order to hold the funds taxable. By so doing, the *Rutkin* case goes a long way toward extending the claim of right doctrine farther into the income of the underworld. Through it, the road may be opened to finding some of the incomes derived from larceny and embezzlement to be taxable which, prior to this case had been held not taxable, *McKnight* case, *supra* and *Wilcox* case, *supra*, respectively. It should be noted that the case could easily have been decided on the alternative doctrine of "voluntary" passage of title. Rutkin did not take the money; it was given to him, albeit under pressure, and just as the ransom money in the *Humphreys* case, *supra*, was taxable because title had passed, so the Rutkin funds could be held taxable. Alternatively, the case could have been determined on the theory of *Greenfeld, supra*, which held that, even if no title had passed, the money is taxable in the hands of the racketeer if the true owner cannot recover it under state law. This theory would be applicable in the *Rutkin* case because the statute of limitations had run on the extortion although the court did not emphasize that fact.

The theoretical fallacy inherent in the cases which hold the funds taxable is that the one who should have all the money is the true owner; while the extortioner has no right to any of the money and, *a fortiori*, the United States has less right to taxes levied thereon. Since such theoretical niceties run into the practical consideration that the owner actually will not get it back, the cases sometimes result in hair splitting. The practical argument by the government is that at least the gangsters should be taxed (and jailed for income tax evasion if they persist in nonpayment of taxes), while the countervailing argument is that, as such jailing is a subterfuge used to punish gangsters for violation of the state criminal law, it is therefore an invasion of the criminal jurisdiction of the state.

Regardless of the above variance in theoretical bases it would seem that there are now three circumstances in which the courts plug the illegal income tax evasion gap or punish for failure to pay such taxes: (1) when money is obtained under neither claim of right nor title but the owner has no remedy so that the funds are irretrievably passed to the gangster; (2) when money is obtained by transfer of voidable title by the owner; and (3) when money is obtained under any semblance of a claim of right from the owner. Until Congress amends the Internal Revenue Code to cover specifically all illegal income with provision for refund in case of recovery by the owner, such patchwork by the courts is a necessity.

ELEANOR H. EDWARDS

Unemployment Compensation—Quitting Work for Good Cause—Question of Law or Fact. *A* was working on an "inside job" for $1.63 per hour plus $.10 for working the second shift when he was told that he was to be transferred to an "outside job" at $1.43 per hour without an opportunity for the shift differential. *A* refused to accept the