The Effect of Illegality on Tax Treatment of Items of Income and Deductions

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I. Introductory

After the Supreme Court's decision of Pollock v. Farmers Loan and Trust Co., 1) the Sixteenth Amendment, which provides "the Congress shall have power to lay and collect taxes on income, from whatever source derived, apportionment among several states, and without regard to any census or enumeration", was ratified and promulgated in 1913. The Internal Revenue Act of 1913, the first income tax statute passed after the Sixteenth Amendment, and all subsequent income tax statutes enacted by Congress through the Internal Revenue Code of 1939, contained a catch-all definition of "gross income" to subject to tax "gains or profits and income derived from any source whatever". 2) The Internal Revenue Code of 1954 provides the definition of gross income, which defines "except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including following items...." 3) However, in any Revenue Code there is no explicit exclusion of income derived from taxpayer's illegal activities, and whether such kind of income constitutes "gross income" under the Internal Revenue Code depends upon the meaning of income. In Eisner v. Macomber, 4) the Supreme Court defined the meaning of income "the gain derived from capital, from

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2) I.R.C. of 1939 Sec. 22 (a), et al.
3) I.R.C. of 1954 Sec. 61 (a).
4) 252 U.S. 189 (1920).
labor, or from both combined," adding that "it be understood to include profit gained through a sale or conversion of capital assets." However, under the Eisner ruling, the problem of gain from taxpayer's illegal activities was not solved, because of the presence of definite, unconditional obligation to repay or return that which would otherwise constitute a gain.

In 1946, the Supreme Court in Commissioner v. Wilcox, passed upon the taxability of proceeds of embezzlement, for the first time. Wilcox was a bookkeeper who collected miscellaneous amounts of money belonging to his employer, misappropriated them in gambling. The Court held that because the embezzler asserted no bona fide legal or equitable claim to the proceeds and was under a definite obligation to repay them, and because they were not received under a "claim of right," embezzled funds were not constituting income. In this case, Mr. Justice Burton, as the only one dissenter, strongly argued that there was no basis for reading the "claim of right" test into the "gross income" provision and reasoned that the readily realizable value derived from possession, dominion and enjoyment of embezzled funds was a sufficient basis for subjecting such funds to taxation.

Six years later, the Supreme Court in Rutkin v. United States, faced the extortion question as the basic issue of taxability of unlawful gains, again. Rutkin had extorted $250,000 in the taxable year and failed to report the proceeds as income. Mr. Justice Burton wrote the opinion of the majority in this time. The Court held that notwithstanding that Rutkin had no bona fide legal or equitable claim to the proceeds and that the victim had a clear right to sue for their recovery, the extortion receipts were taxable. In effect, the Rutkin adopted an economic test of gain, under which the illegality of the receipt, and hence, the taxpayer's obligation to repay were not controlling. The Rutkin did not overrule the Wilcox, but only distinguished the fact, noting that an extortioner, unlike an embezzler, obtains funds with the victim's contest.

However, in 1961, the Supreme Court in James v. United States, held that embezzled funds were includible in gross income of the embezzler for federal tax purposes in the year of misappropriation, and overruled the Wilcox. Before the James, certain illegal

5) Id. at 206.
6) Id. at 207.
7) 327 U.S. 401 (1946).
8) 343 U.S. 130 (1952).
gains were held taxpayer's gross income, for instance gain from unlawful gambling,\textsuperscript{10}\textsuperscript{10} bootlegging,\textsuperscript{11}\textsuperscript{11} and prostitution.\textsuperscript{12}\textsuperscript{12} Thus after the James, every kind of gains from illegal activities as gains from legal activities constitutes gross income under section 61(a) of the 1954 Code.

These gains from illegal activities, are kickbacks, commercial bribes, payola, bribes, embezzled funds, extorted money, defrauded property, gain from shorting, property by armed robbery, stolen goods, gambling gains, illegal bonuses, income from illegal businesses. If the taxpayer having paid tax on gains derived from illegal activities, repaid the amount of the gains to the legal owner, then he can deduct those amount as loss in the tax year he made the repayment.

Deductions are not a matter of right for a taxpayer, but a matter of legislative grace. The Internal Revenue Code allows some itemized deductions to individuals, corporations or both.\textsuperscript{13}\textsuperscript{13} It specifically deals with some items which are related to taxpayer's illegal activities, for instance, fines, bribes, kickbacks and antitrust damages. There is no clearcut criterion of the deductibility of expenses which are related to illegal activities. Thus, the deductibility of the other kind of expenses, which are related to illegal activities should be decided by the courts and the Internal Revenue Service. Some acts other then the Revenue Code provides nondeductibility of some kind of expenses, for instance, the Price Control Act of the World War II and its Executive Order.

In this paper, would like to trace some historical background of items which are related to taxpayer's illegal activities, enumerate those items of income and deductions, and mention about the effect of illegality of tax treatment of them. Furthermore, would like to mention the problem of illegally acquired basis, that of self-incrimination under the Fifth Amendment, and the public policy test.

II. Income

1. Historical Background

The first case which contained gains derived from taxpayer's illegal activities.

\textsuperscript{10} L. Weiner, 10 B.T.A. 905(1928).
\textsuperscript{11} Steinberg v. United States, 14 F. 2d 264(2d Cir. 1926); United States v. Sullivan, 274 U.S. 259(1927).
\textsuperscript{12} L.H. Burnett, 15 T.C.M. 1090, T.C. Memo. 1956—209.
\textsuperscript{13} I.R.C. of 1954 Part VI to VIII.
Article

decided by the Supreme Court was United States v. Sullivan.14 In this case, the Court held that a bootlegger's income was subject to tax notwithstanding the fact that it was generated in taxpayer's illegal activities. In 1936, the Internal Revenue Service ruled that funds misappropriated through embezzlement would be deemed taxable to the embezzler in the year of acquisition.15 After ruling, the Eighth Circuit in Kurrle v. Helvering,16 held that embezzled funds were taxable, but the Fifth Circuit in McKnight v. Commissioner,17 and the Ninth Circuit in Wilcox v. Commissioner,18 held that such funds were not taxable. A conflict of opinions in lower courts, ultimately, the Supreme Court reviewed the question in 1946. In Commissioner v. Wilcox,19 the Court held that which had been misappropriated by a bookkeeper who had been convicted of embezzlement did not constitute taxable income to him in the year of acquisition, because the embezzlement did not constitute taxable income to him in the year of acquisition, because the embezzler asserted no bona fide legal or equitable claim to the proceeds and was under a definite obligation to repay them, and because they were not received under a claim of right. In this case, Mr. Justice Burton dissented, and wrote his opinion:

"...such an ample enjoyment of them, use of them, dominion over them, disposition over them, and receipt of benefits from them, as to make them of obvious economic value... Such a readily realizable value presents no reasonable basis for exempting these funds from taxation..."20"

In United States v. Lewis,21 the Supreme Court held that money paid to a taxpayer under a mistake was taxable to the taxpayer, if he honestly believed he was entitled to it, even though he later had to return the money. In this case, the court reaffirmed "claim of right" and declared that each taxable period must be viewed separately and the taxpayer, therefore, realized income where he received the money and incurred a loss when he returned it.

Six years after the Wilcox, in Rutkin v. United States,22 the Supreme Court distin-

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14) 274 U.S. 259 (1927).
16) 128 F. 2d 723 (8th Cir. 1942).
17) 127 F. 2d 572 (5th Cir. 1942).
18) 148 F. 2d 933 (9th Cir. 1945).
19) 327 U.S. 404 (1946).
20) Id. at 411—412.
22) 343 U.S. 130 (1952).
guished Wilcox case and held that the extortioner was taxable under the income tax upon the proceeds of the extortion. Mr. Justice Burton, the dissenting Justice in the Wilcox stated in the opinion of the court:

"Petitioner’s control over the cash so received was such that, in the absence of Reinfeld’s unlikely repudiation of the transaction and demand for the money’s return, petitioner could enjoy its use as fully as though his title to it were unassailable... an unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it... allows the recipient freedom to dispose of it at will." 223

Despite the fact that the Court in Rutkin did not overrule Wilcox, lower courts followed Rutkin rather than Wilcox, and Wilcox was applied very narrowly only to clear cases of embezzlement. 224 In Macins v. Commissioner, 225 the Seventh Circuit stated:

"If (the rule of the Rutkin case) had been employed in Wilcox, we see no escape from the conclusion that the decision in that case would have been different. In our view the Court in Rutkin repudiated its holding in Wilcox; certainly it repudiated the reasoning by which the result was reached in that case." 226

The economic use and benefit test of Rutkin was applied to all unlawful gains, including funds misappropriated from a labor union by an employee, 227 and funds withheld by an employee from the proceeds of sales of property belonging to his employer. 228

In each case, the defendant contended his conduct amounted to embezzlement under state law, and that therefore under Wilcox their illicit gains were non-taxable. Nevertheless, the courts applied the Rutkin rule. Generally, the Tax Court and the district courts have applied the criterion of Rutkin rather than that of Wilcox to cases of unlawful gains.

In 1961, the Supreme Court in James v. United States, 229 held that embezzled funds were includible in the gross income of the embezzler for federal tax purposes in the year of misappropriation, and overruled the Wilcox decision. In this case, the defendant

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23) 327 U.S. 404(1946)
24) J.J. Div, Inc v. commissioner, 223 F. 2d 436(2d Cir. 1955).
25) 255 F. 2d 23(7th Cir. 1958).
26) Id. at 26.
27) Prokop v. Commissioner, 224 F. 2d 544 (7th Cir. 1955).
29) 366 U.S. 215(161).
who embezzled $738,000 during years 1951—1954 and failed to include these amounts in gross income for tax purposes in those years, was convicted of willfully attempting to evade federal income taxes. Mr. Chief Justice Warren wrote the opinion of the Court:

"The language of Section 22(a) of the 1939 Code, "gains or profits and income derived from any source whatever" and the more simplified language of Section 61(a) of the 1954 Code, "all income from whatever source derived" have been held encompass all "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion—... When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, or implied, of an obligation to repay and without restriction as to their disposition," he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent," North American Oil v. Burnet........... This standard brings wrongful appropriations within the broad sweep of "gross income"; it excludes loans."

After the decision income derived from taxpayer's illegal activities is included as his gross income for federal tax purposes.

2. Kickbacks, Commercial Bribes, "Payola"

Before the James decision, the Tax Court had held that the recipient of kickbacks must include them in taxpayer's gross income, because the law presumes that such kickbacks constitute income and the recipient failed the burden of proof to show the proceeds do not constitute income.\textsuperscript{31} Commissions in the form of kickback received by traffic managers and solicitors of bids from companies interested in doing business with the payee's employers were held taxable as income, because the Wilcox ruling was not applicable to the commercial bribes.\textsuperscript{32} The New York Penal Law distinguishes between embezzlement and commercial bribes, only the former requiring the actual taking or withholding of money or property from the true owner, but there is no indication that the kickbacks resulted in any loss to his employer in this case.

The amount taken by the taxpayer from a political trust fund were found to be in

\textsuperscript{30} Id. at 219.
\textsuperscript{31} Estate of Lawrence Harrison, 12 T. C.M 196(1953); Melancthon S. Somers, 14 T.C.M. 793.
\textsuperscript{32} T.C. Memo. 1955-199.
\textsuperscript{32} United States v. Bruswitz, 219 F. 2d 59(2d Cir. 1965).
fact kickbacks and were includible in his gross income even though he might be under a duty to return them under state law, because an unlawful gain as well as a lawful gain constitutes taxable income when its recipient has such control over it that as a practical matter he derives readily realizable economic value from it. 233

Business manager of labor welfare organization arranged with painting contractor to overstate his bills to the organization, then approved and paid the bills and finally received amount of overpayment from the contractor, such receipt of funds constituted kickbacks, and it was includible as taxpayer’s income. 241 The Eighth Circuit reasoned that the Rutkin expressly limited its holding in the Wilcox to the facts there existing, and the facts in the case was distinguishable from the Wilcox.

Percentage of sales paid to the taxpayer by a Mexican firm in exchange for his giving it the exclusive right to sell his employer’s products in Mexico were considered as kickbacks and includible in his income. 239 The Seventh Circuit followed the Rutkin and distinguished the Wilcox in this case.

Free liquor received by a member of a State Alcoholic Beverages Control Board from distillers, as a kickback, constituted taxable income to the taxable income to the taxpayer. 260 The Tax Court scrutinized the fact of the case and reasoned that the free beverages did not constitute gifts in the sense that term is used in the Revenue Code, but they fell within the broad concept of income as that term is defined by the Revenue Code and cases thereunder.

Extra payments received by the foreman of a municipal incinerator from local rubbish handling firms for providing for them special privileges are taxable to the foreman. 272

Under the present statute and its interpretation kickbacks and commercial bribes constitute recipients’ taxable income.

3. Bribery of Governmental Officials—"Gifts"

The statute neither directly defines “bribe” nor specifically includes bribes in gross income. Under Section 162 (c) (1) of the 1954 Code, which provides deductibility of

233 United States, v. Wyss, 239 F. 2d 658 (7th Cir. 1957).
241 Berra v. United States, 221 F. 2d 590 (8th Cir. 1955).
239 Macias v. Commissioner, 255 F. 2d 23 (7th Cir. 1958).
business expenses, any illegal payment, directly or indirectly, to an official or employee of any government, or any agency or instrumentality of any government would be bribes. Thus, the definition of "bribe" in gross income field would follow the definition of the section.

Under the James, bribes constitute income of the recipient, and nobody can contend the taxability of bribes. Only the government official can avoid the taxation, when he can prove such proceeds are made as a gift. If a member of a State Alcoholic Beverages Control Board receives free liquor from distillers, such liquor constitutes taxable income to the tax payer, because it does not constitute gifts in the sense that term is used in the statute, but it fell within the concept of income. However, it is not always easy to distinguish bribes from gifts.

In Dukehart-Hughes Tractor and Equipment Co. v. United States,\(^3\) an Iowa corporation engaged in the sale of construction equipment provided free trips, free tickets, dinners, and a golf tournament for the employee of Iowa State Highway Commission. The Court of Claims held those were not bribes, but gifts. It examined some fourteen Iowa statutes and concluded that one class as exemplified by a statute applicable to employees and officials of certain eleemosynary institutions, expressly forbade the taking of any kind of gifts, and the other class was interpreted as restricting the taking of gifts as kickbacks only with respect to particular business transactions.

4. Embezzled Funds

Under the James rule, embezzled funds are includable in gross income of the embezzler in the year in which the funds are embezzled. In C. M. Hill,\(^4\) the Tax Court held that taxpayer had received gain from embezzlement constituted income to the extent that taxpayer admitted embezzlement under the James. In Barbara M. Baily,\(^5\) embezzlement occurred when a bank employee misappropriated dormant funds in order to cover false deposits made to her own and her brother's account. The embezzler conceded the embezzled funds constitute taxable income, but contended that these funds are properly chargeable as income to his brother, who spent these funds and not to the embezzler. The Tax Court reasoned that the embezzler exercised complete

\(^{3}\) 341 F. 2d 613 (Cf. Cl. 1965).
\(^{5}\) 52 T.C. 115 (1969).
dominion and control over the embezzled funds and she beneficially enjoyed this income and, in effect, treated it as her own when she chose to place it at her brother's disposal, thus her exercise of control over these fundes is sufficient for them to constitute income to her.

In Ernestine K. Alcorn,\textsuperscript{41} the Tax Court held that although the taxpayer's husband did not use embezzled funds for his personal needs, they were inculdible as his income because of his actual command and dominion over them, and taxpayer-wife was liable for the deficiencies as a result of her voluntarily signing joint income tax returns albeit she had no knowledge of the embezzlement.

The Tax Court in Arnold G. Pessin,\textsuperscript{42} held that the James rule did not apply to that portion of funds collected by the taxpayer and turned over to a co-conspirator in accordance with their to divide the profits under a scheme to defraud the latter's principal, because such portion of the embezzlement constituted co-conspirator's income. However, it has been held that funds which is possessed only temporarily as a part of a check-kiting circle by the taxpayer, do not constitute his income, because the situation is to be sharply distinguished from the one where the wrongdoer is actually enriched by illegally obtained funds.\textsuperscript{43}

5. Extortion

In Rutkin v. United States,\textsuperscript{44} Rutkin had extorted $250,000 in the taxable year and failed to report the proceeds as income. Rutkin's conviction for tax evasion was affirmed and the extortion proceeds held inculdible in his income with four Justices dissenting. The majority of the Court held that notwithstanding Rutkin had no bona fide legal or equitable claim to the proceeds and that the victim had a clear right to sue for their recovery, the extortion receipts were taxable, because the extortionist's control over the cash so received is such that he can enjoy its use as fully as as though the title to it were unassailable, he has freedom to dispose of the cash at will, and he has such control over it that, as a practical matter, he derives readily realizable economic value from it. In effect, Rutkin adopted an economic test of gain, under which the

\textsuperscript{41} 28 T.C.M. 751, T.C. Memo. 1960-147,
\textsuperscript{42} 44 T.C. 590 (1965).
\textsuperscript{43} Emil M. Foster, 20 T.C.M. 1488, T.C. Memo. 1961-281.
\textsuperscript{44} 343 U.S. 130 (1952).
illegality of the receipt, and hence, the taxpayers' obligation to repay, were not controlling. This was a rejection of the rationale of the Wilcox, but the Court did not overrule the Wilcox, merely distinguishing the facts from the Wilcox.

In United States v. Moran,45 the defendant was a First Deputy of Fire Commission of New York City who received and failed to report a portion of extortion payments collected by members of the Division of Combustibles from contractors who needed permits for installing oil burners. The Second Circuit followed the Rutkin and held that the extortion receipts were clearly taxable to the defendant. Now, there is no doubt of taxability of the extortion proceeds.

6. Fraud

Defrauded funds are includible as taxpayer's gross income.46 After the Wilcox case, some shareholders, directors and officers of corporations who controlled practically owned corporations obtained funds through understatement of sales and other fraudulent manipulations, where taxpayers had never prosecuted for embezzlement. In such cases, the courts held that such funds were includible as taxpayer's income distinguishing the facts from the Wilcox case. The important distinction between the Wilcox and such cases, was the relationship of the taxpayers to their employers. Wilcox was merely a salaried employee of a corporation, but the taxpayers of such cases were shareholders, or officers of the corporations.

In Rollinger v. United States,47 the Eighth Circuit held that taxpayer who had obtained money from the sale of zircons which falsely represented as diamonds had income of such amount. In this case, the defendant contended that the funds so acquired by him were in the nature of embezzled funds and relied upon the Wilcox. However, the Court found that the funds were acquired in this case either as profits on sales or as funds acquired by fraud, and ruled that such funds must be considered as income for taxation purposes.

The Tax Court in Rozelle McSpadden,48 held that amounts received in transactions involving the discounting of notes in a fraudulent mortgage scheme were includible

45 236 F. 2d 361 (2d Cir. 1956).
46 Lyndon v. United States,351 F. 2d 539 (7th Cir. 1965), et al.
47 208 F. 2d 109 (8th Cir. 1953).
48 50 T.C. 478 (1968).
in the taxpayer's income in the year of receipt. The taxpayer contended such proceeds were received by her husband as loans, and it is not includible into income. In the finding fact, the Court held that her husband received as a loan, but she received the proceeds of a fraud, and held taxable.

Swindled funds cannot be considered as proceeds of loans for income tax purposes even though the swindler intended to make full restitution and had legally enforceable agreements with the third parties to make repayments.\textsuperscript{49} In this cases consensual agreement was absent and it should be treated as income. A payment to a practicing gypsy palmist, as an offering to certain offended spirits, which the palmist fraudulently appropriated her own use was income, because money obtained by various frauds have been constitute income, even though they were not lawfully obtained.\textsuperscript{50}

A taxpayer who had complete control of assets, which she acquired through fraud and undue influence, was taxable on the income from such assets, even though she had no legal claim to the assets and later had to make restitution to the estate of legal owner, because she had present enjoyment in the year of receipt.\textsuperscript{51}

7. Stolen Goods Sold

A corporation engaged in the business of printing and dying fabrics, retained certain portion of goods without the consent of the owners and sold them to a third party, the proceeds of such sales were income to the corporation, because the proceeds derived from dealings in property growing out of the use of such property.\textsuperscript{52}

Money received by the taxpayer from the sale of goods which he had stolen from his employer was includible in his gross income, since the money was not embezzled by him from employer.\textsuperscript{53}

The taxpayer received two-thirds share of the proceeds derived from the sale of scrap metal belonging to and taken from his employer has tax liability upon those proceeds, since such proceeds constituted his income under the James and he failed to

\textsuperscript{49} Moore v. United States, 412 F. 2d 975 (5th Cir. 1969).
\textsuperscript{50} Joe Marks, 27 T.C.M. 80, T.C. Memo. 1963-104.
\textsuperscript{52} United States v. Iozia, 104 F. Supp. 846 (S.D.N.Y. 1952).
\textsuperscript{53} Mathias Schira, 15 T.C. Memo. 1956—35.
prove the proceeds were not received by him.\textsuperscript{54} The taxpayer unknown to his employer, entered into arrangements with other individuals to work on drill bits which belonged to his employer and received 50 percent of profits from them after payment by the employer should include that amount to his income, because he convicted the theft, not embezzlement.\textsuperscript{55}

8. Forgery

Taxpayer, one of a partnership converted and unlawfully negotiated Treasury Department Series E Bonds for a third party, and convicted forgery, was taxable on bond proceeds that were deposited in his personal account, and he and his partner were equally taxable on proceeds that were deposited in the partnership account.\textsuperscript{56}

9. Misappropriation

An employee of a union collected fees from provisional permit workers, failed to account for the fees and misappropriated the funds, was held taxable on the amount misappropriated under the Rutkin and cohan rule.\textsuperscript{57} An attorney wrongfully appropriated the amounts received for the purpose of obtaining additional qualified attorney from his client was held taxable on the amount appropriated, even though he promised to repay wrongfully acquired property or money inwritten from, which arose from the wrongful appropriation, was not sufficient to render such funds nontaxable as borrowed money.\textsuperscript{58}

10. Punitive and Exemplary Damages

Income should be reported by the taxpayers, which covers almost everything except items which are specifically excluded by law. The recovery of damage may or may not be included in gross income depending upon its nature. Compensatory damages for personal injury are not taxable, but punitive or exemplary damages, such as for defamation or for violation of the antitrust laws, are taxable income. These kinds of

\textsuperscript{54} Stewart F. Ramsey, 27 T.C.M. 358, T.C. Memo. 1968—68.
\textsuperscript{55} Estate of R.D. McDaniel, 20 T.C.M. 1511, T.C. Memo. 1961—302.
\textsuperscript{56} Cass Sunstein, 25 T.C.M. 247, T.C. Memo. 1966—43.
\textsuperscript{57} Prokop v. Commissioner. 254 F. 2d 544 (7th Cir. 1958).
\textsuperscript{58} Arther H. Bichan, 28 T.C.M. 125, T.C. Memo 1969—17.
income are not related to taxpayer’s illegal activities, but to the third parties’ illegal activities. In this respect these kinds of income are different from income which has been got from illegal activities. However, these are related to the illegality and mention in this paper.

Compensatory damages received in settlement of a suit for defamatory statements are not income, because the amount received was wholly by way of general damages for the personal injury suffered by reason of the defamatory statements made.\textsuperscript{59} Income tax is primarily an application of the idea of measuring taxes by financial ability to pay, as indicated by the net accretions to one’s economic wealth during the year, but the compensation for personal injury is not accretions to whom was injured. An amount received in a settlement of a libel suit, for both compensatory and exemplary damages, is income to the extent that such amount represents satisfaction of exemplary damages.\textsuperscript{60} Taxation of amounts received for defamation results in injury to the personal reputation of an individual as distinguished from slander and libel which injures business or professional reputation to an extent which may affect income.\textsuperscript{61} Although the taxpayer might have thought that a settlement received by him upon resignation from his employment was in response to threatened litigation for personal injuries suffered by him as a result of abuse by company personnel, the company intended the payments to be extra compensation and the settlement should have been reported as income.\textsuperscript{62}

In Commissioner v. Glenshaw Glass Co.,\textsuperscript{63} the taxpayer had recovered treble damages in a private suit under the antitrust laws and contended that the two-thirds punitive damages did not constitute income. The Supreme Court held that “the mere fact that the payments were extracted from wrongdoers as punishment for unlawful conduct cannot detract from their character as taxable income to the recipient.”\textsuperscript{64}

Similarly, the Court held taxable as gross income a payment received by a corporation pursuant to the “insider profit” provisions of the Securities Exchange Act of 1934.

\textsuperscript{59} C. A. Hawkins, 6B.T.A. 1023 (1927).
\textsuperscript{62} Agar v. Commissioner, 290 F. 2d 253 (2d Cir. 1961).
\textsuperscript{63} 348 U.S. 426 (1955).
\textsuperscript{64} Id. at 431.
and the Investment Company Act of 1940. After these decisions, punitive damages for fraud and antitrust violation have been held taxable.

When a plaintiff recovers damages in an antitrust suit, it is important to know that how much is punitive damages, and the compensatory damages must be broken down between loss of profits and loss to business property. Because punitive damages and recovery for loss of profits are both taxes as ordinary income, but compensation for loss to business property is a return of capital, and the amounts realized in excess of an amount equal to adjusted basis constitute gain. If a lumpsum settlement is made without allocation, the following presumption will apply; if the total amount of the settlement is less than total losses actually suffered, no part is presumed to be for punitive damages; but the compensatory damages still must be broken down into loss of income and loss to business property.

11. Gambling

Gains from illegal transactions such as gambling, bookmaking, card playing, illegal prize fight, illegal lotteries, illicit traffic and similar gambling gain are taxable.

The gross income derived from bookmaking operations is determined by applying against the total receipts therefor, the sums of amounts bettors, and it was held taxable, because the words of the Code from any source whenever were broad and comprehensive as it is possible for language to be and there is no limitation that the gains, profits and income must be legally received. Amounts received from an illegal lottery were held taxable under the same reason. Income from the operation of poker game, which was illegal under Mississippi, was held taxable, since there is no reason to exempt the tax on gain from illegal business.

The taxpayer carried on the interstate transportation of the fight pictures being in violation of law, should report as income profits received, even though he believes he may later incur expenses equal to such profits the lawyer's fee and fines necessitated by

68) James P. McKenna, 1 B.T.A. 326(1925).
69) A.L. Voyer, 4 B.T.A. 1192(1926).
70) L. Weiner 10 B.T.A. 905(1928).
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indictments growing out of the enterprise from which the profits arose.\textsuperscript{71)}

Horse and dog track winnings were included in gross income even though losses were disallowed for want of substantiation.\textsuperscript{72)} Although the operation of slot machines was unlawful under a state law, taxpayers was taxable only upon the income which he received beneficially where, under agreement, part of the proceeds collections was shared with others.\textsuperscript{73)} Fees paid to a municipality on slot machine pursuant to an agreement between taxpayer and the mayor were neither excludible from gross income nor deductible as ordinary business expenses, because the city never participated and the payments were in the nature of an unauthorized fee for allowance to operate each machine.\textsuperscript{74)}

12. Illegal Bonuses

An unlawful bonus obtained by a director at his company's expense was held to be income, since the payment was never refunded.\textsuperscript{75)} Illegally retained bonus which belonged to taxpayer's corporation was held taxable to the taxpayer, because his actions when the bonus was received indicated that he intended to keep it.\textsuperscript{76)}

13. Illegal Liquor Transaction

In Steinberg v. United States,\textsuperscript{77)} the Second Circuit held that profits from the sale of liquor in violation of National Prohibition Act were taxable, because Congress intended to levy a contribution upon every species of gain, no matter how immoral or vicious the method of acquiring the same might be.

The Supreme Court in United States v. Sullivan,\textsuperscript{78)} declared gains derived from business in violation of National Prohibition Act were subject to tax. Mr. Justice Holms wrote the opinion of the Court:

\textsuperscript{71)} George L. Rickard, 15 B.T.A. 316 (1929).
\textsuperscript{72)} D.J. Fiaschetti, 26 T.C.M. 169, T.C. Memo. 1967—214.
\textsuperscript{73)} Horace Mill, 5 T.C. 691 (1945).
\textsuperscript{74)} Charles A. Clark, 9 T.C. 48 (1932).
\textsuperscript{75)} Board v. Commissioner, 51 F. 2d 73 (6th Cir. 1931).
\textsuperscript{76)} National City Bank of New York v. Helvering, 98 F. 2d 93 (2d Cir. 1938).
\textsuperscript{77)} 14 F. 2d 564 (2d Cir. 1926).
\textsuperscript{78)} 174 U.S. 259 (1927).
"By section 213 (a)…gross income includes 'gains, profits, and income derived from… the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.' These words are also those of the earlier Act of October 3, 1913, c. 16, section II, B, except that the word "unlawful" is omitted before "business" in the passage just quoted. By section 600, and any another Act approved on the same day Congress applied other tax laws to this forbidden traffic…We see no reason to doubt the interpretation of the Act, or any reason why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay."


Premiums received by an individual for writing insurance contracts later held to be unlawful were taxable income, because it is fundamental principle of law that a person may not advantage of his own wrong.\(^{80}\)

15. Misuse of Corporate Entities

Taxpayer was in receipt of taxable income where he arranged remodeling work in a bank which he controlled, made gross over-payment for the work, and had the excess amounts transferred back to himself.\(^{81}\)

In Elmer J. Benes,\(^{82}\) the Tax Court held that taxpayer realized taxable income to the extent that the corporation (of which he was president and owner of 500 of its 503 shares of stock outstanding) paid or incurred expenses in the election of his residential home. Because the residential home which he intended from the beginning should be the personal, private residence of him and his family and for which he had no intention of making payment to the corporation at any time, while the residence was being constructed or the construction was completed.

The economic gain asserted to be flowing to him was not in the form of cash or checks, but his benefit was a series of improvements made to real property which belonged to his wife, and it was conferred upon him by the expenditure of funds by his

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79) Id. at 263.
81) Mensik v. Commissioner, 328 F. 2d 147 (7th Cir. 1964).
82) 42 T.C. 358 (1964).
16. **Prostitution**

Taxpayer was a prostitute and the keeper of a house of prostitution, derived income from these activities together with the legitimate rental of part of her premises. She contended that "the wages of sin" were exempted from taxation, but the Tax Court held that such income is subject to income tax.\(^3\)

### III. Deductions

1. **In General**

Deduction is a matter of "legislative grace", but not a right of taxpayer. If deductions are not provided in Code sections, no one can claim deductions. Section 161 of the Code provides for the allowance as deductions in computing taxable income under Section 63(a), of the items specified in part VI (Section 161 and following), subject to the exceptions provided in part IX (Section 261 and following, relating to items not deductible). A taxpayer who is engaged in trade or business is allowed to deduct all ordinary and necessary business expenses of reasonable amounts which are incurred in that business.\(^4\) The definition of business includes services of an employee so that any expenses incurred by an employee may be deducted if they meet the requirements. Although the concept of "trade or business" contained in Section 162(a) is broad, embracing both employees and professionals, the Supreme Court in 1941 restricted its meaning as applied to an investor who maintained an office for handling his security and property investments.\(^5\) Congress enacted Section 212 which an individual who are not engaged in a trade or business may deduct similar expenses paid or incurred "for the protection or collection of income" and "for the management, conservation, or maintenance of property held for the protection of income." Generally we can say, Sections 162(a) and 212 are complementary. Partnerships and corporations are deemed

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3) Blanche E. Lane, 15 T.C.M. 1088 (1956).
4) I.R.C. of 1954, Sec. 162(a).
business entities, and their expenses are deducted by Section 162(a), not but Section 212.

Even though the Code provides items of deductions and nondeductibles, it is very difficult to decide whether expense should be deductible or not. Especially trade or business is related with illegality or the expenses of trade or business has occurred illegality. Those are kickbacks, commercial bribes, bribes to governmental officials, repayment of embezzlement, extortion, fraud and theft, antitrust damages, punitive and exemplary damages, wagering loss, fines, penalties, forfeited bail, legal and accounting fees, overceiling price, entertainment expenses, lobbying and political expenses, proxy-fighting expenses, and other illegal business expenses.86)

2. Kickbacks and Commercial Bribes

In Lilly v. Commissioner,87) the taxpayer sought to deduct payments made to doctors when the prescriptions for glasses were filed by the taxpayer's optical business. The Supreme Court held that the payments were ordinary in that they were customary in that line of business and were necessary in that it was through such payments that the taxpayer could establish and retain the business and income. The Court noted that if the taxpayer had ceased making such payments, he would almost certainly have lost business to his competitor who was also making such payments. The payments were not illegal, but they had been deemed unethical by certain professional organizations. The Court said that even if if assumed certain expenses might be ordinary and necessary and yet be disallowed because they frustrated sharply defined national or state policies proscribing certain types of conducts, the customs and actions of organized professional groups do not constitute sharply defined defined national or state policies. The policies frustrated must be national or state policies evidenced by some governmental declaration of them.88)

In Welch v. Helvering,89) the Supreme Court held that ordinary expenses within provision for deductions in computing net income are not necessarily habitual or normal expenses in sense that same taxpayer will have to make them often. The Court said:

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86) Several of those general classes do not describe expenses ipso facto illegal.
87) 343 U.S. 90 (1952).
88) Id. at 97.
89) Welch v. Helvering, 290 U.S. 111 (1933)
"...But the problem is not solved when the payments are characterized as necessary. Many necessary payments are charges upon capital. There is need to determine whether they are both necessary and ordinary. Now, what is ordinary, though there must always be a strain of constancy within it, is none the less a variable affected by time and place and circumstances."913

It was generally held that an expense which is itself inherently contrary to public policy was not deductible even though it was necessary to produce the illegal income.913 A hospital supply company could not deduct salary paid to a full-time hospital official so that he would influence purchases.923 In United Draperies, Inc. v. Commissioner,933 a taxpayer engaging in manufacturing and selling draperies made kickbacks to customer’s employees, and claimed deductions for these amount as commissions and sales promotion expenses, but the Seventh Circuit disallowing on the ground that such payments were not ordinary and necessary to the drapery manufacturer or its supplier. The Court said:

"As a matter of common knowledge we are convinced that the mores of the market place of this nation is not such that “kickbacks” by vendor-suppliers to the officers or employees of customers, while they do occur, are an ordinary means of securing or promoting business, and the record reveals nothing inherent in the nature of petitioner’s drapery enterprise which serves to endow such payments with a character of ordinariness they would not otherwise possess."941

Secret payments to an officer of a loan association to influence the granting of loan were not allowed as business expenses.953 Because the transaction which gives rise to such expense must be of common or frequent occurrence in the type of business involved, but the instant payments having been paid secretly, the receipt which was unauthorized, the nature thereof is other than normal, usual, and customary in the business in which the taxpayer is engaged.963 Also undisclosed payments to employees and purchasing agents of customers induce purchases by the taxpayer, who is subject

90) Id. at 114, 115.
91) G.A. Comeans 10 T.C. 201 (1948); Cohen v. Commissioner. 176 F. 2d 394 (10th Cir. 1949).
93) 340 F. 2d 936 (7th Cir. 1964).
94) Id. at 938.
96) Id. at 64.
to Federal Trade Commission Act, were not allowed.\textsuperscript{97} Section 5 of the Federal Trade Commission Act provides that when the payments or gifts be made to induce the employees or principals from the sellers making the payments or gifts or to induce the employees or agents to influence their employers or principals to refrain from purchasing from competitors of the sellers making the payments or gifts, and when the payments or gifts be made without the knowledge or consent of the employers or principals of the employees or agents, then such payments or gifts to employees or agents of customers or prospective customers are an unfair method of competition. Payments to union officials in violation of the Labor Management Relations Act were held non-deductible as a frustration of clearly defined national policy.\textsuperscript{98}

In a ruling on “payola” in the music and entertainment field, the Service held that payments to disc jockeys of radio and television stations were not deductible because of the “sharply defined federal policy” announced by the Federal Trade Commission.\textsuperscript{99} Also, the Tax Court denied deductions for “payola” as a violation of the New York commercial bribery statute without deciding whether proof of the universal practice of making such payments would constitute proof of knowledge and consent of the employer, thereby precluding any violation of law.\textsuperscript{100} Commissions paid to the masters of ships under foreign registry was not deductible, because the payments were in violation of statute, and the universality of the practice and shipowner’s consent were not shown.\textsuperscript{101}

However, some decisions and Revenue Rulings allowed kickbacks as deductible business expenses, when those payments were proved as a universally recognized customs, and it was not contrary to public policy. Percentage payments to customers’ employees for their performance of administrative work for the taxpayer were not treated as “kickbacks” where satisfactory services were actually rendered.\textsuperscript{102}

The 1969 Tax Reform Act provided a general statutory provision to disallow illegal

\textsuperscript{97} Rev. Rul. 54-27, 1954-1 C.B. 44.
\textsuperscript{98} Basil Christodoulou, 21 T.C.M. T.C. Memo. 1962-4.
\textsuperscript{100} Coed Records, Inc. 47 T.C. 422 (1967).
\textsuperscript{102} Roy M. Stone Trust, 44 T.C. 349 (1965).
kickbacks. The Senate Report of Tax Reform Act of 1969 explained the provision:

"The provision added by the committee amendments denies deductions for four types of expenditures: fines or similar penalties paid to a government for the violation of any law, a portion of treble damage payments under the antitrust laws following a related criminal conviction (or plea of guilty or nolo contendere), deductions for bribes paid to public officials (whether or not foreign officials), and other unlawful bribes or "kickbacks". The provision for the denial of the deduction for payments in these situations which are deemed to violate public policy is intended to be all inclusive. Public policy, in other circumstances, generally is not sufficiently clearly defined to justify the disallowance of deductions. ...The fourth category for which deductions are not to be available are illegal bribes or kickbacks to other than government officials and employees."

Under Section 162 (c) (2), no deduction is allowed for any "illegal bribe or kickback," but only if the taxpayer is convinced in a criminal proceeding of making such payment. A plea of guilty or nolo contendere is equivalent to a conviction for this purpose. If the statute applies, it covers also any "related payment" made before the final judgment in the criminal case. The statute of limitations for assessment with respect to this item is extended to one year after the final decision in the criminal action. This section is effective for payments made after December 30, 1969.

2. Bribes to Governmental Officials or Employees

Generally, bribes to governmental officials or employees are disallowed as business expenses on the ground that it violates sharply defined public policy of federal or state before 1969 Tax Reform Act. However, the Tax Court had refused to find that the use of a manufacturer's representative to obtain government contracts violated public policy, at least where contracts were obtained on the merits rather than by undue influence of public officials. The Court found that the compensation was reasonable for the services performed, and therefore it was deductible. The Court of Claims permitted deduction for gifts, trips, meals, and entertainment furnished to state employees where such "niceties" were given to buyers both in and out of government without distinction based on past or anticipated future purchases, and where
the practice did not violate any sharply defined public policy after examining fourteen kinds of state statutes.\(^{107}\)

The 1969 Tax Reform Act provided Section 162 (c) to curb those lenient court decisions or Revenue Rulings. Under the section, any payment which is illegal bribe or kickback made to any government officials or employees or any payment which would be unlawful under the laws of the United States shall not be allowed as business deduction. The illegality of bribes and kickbacks to the governmental officials or employees means criminal conviction of the taxpayer as opposed to the other kind of bribes. The burden of proof on the illegality issue is on the Commissioner to the extent as with fraud.\(^{108}\) This section is retroactively applicable to all 1954 Code years.

3. Repayment of Embezzlement and Fraud

If an embezzler repays earlier embezzled funds in later year, he has some loss in the year he repays. However, losses are subject to public policy limitations as expenses. Generally, repayment of embezzled funds by the embezzler was held deductible as a loss from adjusted gross income.\(^{109}\) In Francis T. Norman,\(^{110}\) a taxpayer embezzled employer's fund and when his wrongdoing was discovered, he and his employer entered into a "trust agreement" designed to assure full repayment of misappropriated sums. The Tax Court held such agreement neither purported to nor could change the original legal character of taxpayer's earlier conduct from embezzlement to borrowing and allowed deductions for such repayment.

Under Section 1341, a taxpayer who repays an amount because of restoration to another is allowed to deduct the repayments in the year in which they are made. However, if the repayments exceed income for the year of repayment, or if the income is substantially lower in the year of repayment, than in the year of receipt, the deduction does not compensate adequately for the tax paid in the earlier year. However, such provisions are not applicable in the computation of embezzler's income tax liability with respect to such repayment, because the embezzled funds were not

\(^{108}\) I.R.C. of 1954 Sec. 162 (c) (1).
\(^{110}\) 27 T.C.M. 181, T.C. Memo. 1968—40.
received under a claim of right.111 In O'Brien v. Commissioner,112 taxpayer claimed false and fraudulent fire damages to the insurance company and received, but the insurer company initiated the suit against him and recovered. The Court held such repayment is deductible.

4. Loss by Theft

One of the type of casualty loss specifically included in the statute is theft.113 However, loss from armed robbery, fraud, forgery, embezzlement or extortion should be deducted as casualty loss.

Whether the taxpayer's loss was from theft depends upon the penal law of the place in which the loss occurred; and theft may thus include the act of obtaining funds by false pretenses.114 The cost of recovering stolen property is deductible as a theft loss.115 A taxpayer who was a victim of armed robbery, was held he is entitled to a deduction as a loss by theft.116 Reasonable amount of attorney's fees to recover proceeds converted by forgery was entitled to deduct as loss by theft.117 The victim of a swindle through deceit and forgery is entitled to a theft loss, even though he expected to participate in a get-rich quick scheme.118 A loss has been allowed for building contractor upon his false representation that the funds were being used to pay a subcontractor, where under a local law that construed as a theft.119 A theft loss was allowed for out-of-pocket expenses incurred in a tax avoidance scheme, where the money was obtained on the false representation that bonds and notes would actually be acquired; since the taxpayers were swindled out of what they bargained for; it was immaterial that the scheme would not have worked and that they did not intend to get their money back.120 However, taxpayer's payment as endorser of notes for a company which has fraudulently overstated its assets was not deductible as a theft.

112) 321 F. 2d 227 (6th Cir. 1963).
113) I.R.C. of 1954 Sec. 165 (c) (2), Reg. Sec. 1. 165–8.
115) Vincent v. Commissioner, 219 F. 2d 228 (9th Cir. 1955).
117) Katherine Ancier, 47 T.C. 592 (1967).
loss, because whether a theft loss has been sustained by a taxpayer depends upon the law of the jurisdiction in which the particular loss occurred, and under Alabama Code the company’s action was not theft.\textsuperscript{121)}

Taxpayer who paid a building contractor, who feloniously absconded with the money after doing only a small part of the work of constructing their residence was entitled to deduct such amount as a theft loss, because the deduction is not limited to theft since embezzlement has frequently been held sufficiently like theft to give rise to a deduction.\textsuperscript{122)} Also, deduction has been allowed for funds withdrawn and improperly appropriated from a joint bank account where such misappropriation constituted an embezzlement.\textsuperscript{123)} Taxpayer sustained a loss from the fraudulent misappropriation of funds delivered for investment is deductible as a theft loss.\textsuperscript{124)}

The payment and transfer of an interest in property to an extortioner was not an ordinary and necessary expense either in relation to the practice of law or to taxpayer’s functions as a corporate executive.\textsuperscript{125)} The Tax Court held that there is no theft where the taxpayer’s wife took jointly owned U.S. savings bonds in connection with a separation.\textsuperscript{126)} No deduction is allowed when wife took absent husband’s property and ran off with paramour, because wife’s such action does not constitute larceny or embezzlement under New York common law doctrine.\textsuperscript{127)} The confiscation of an automobile by officials of a foreign country is not considered as a theft, nor deductible.\textsuperscript{128)}

5. Antitrust Damages

Before the enactment of the Tax Reform Act of 1969, the Internal Revenue Service took lenient position to the antitrust damages paid by taxpayer. Amounts paid or incurred in satisfaction of treble damages under Section 4 of Clayton Act and legal expenses including attorney’s fees paid or occurred in the defense of prosecution for

\[ \text{References:} \]
\textsuperscript{121)} F.R. Ingram, 20 T.C.M. 1447, T.C. Memo. 1961—277.
\textsuperscript{122)} Thomas Miller, 19 T.C. 1045 (1933).
\textsuperscript{123)} Saul M. Weingarten 28 T.C.75 (1962).
\textsuperscript{124)} Frank DeGoff, 25 T.C.M. 492, T.C. Memo. 1966—89.
\textsuperscript{125)} Samuel Towers, 24 T.C. 199 (1955); Bonny v. Commissioner, 247 F. 2d 237 (2d Cir. 1957).
\textsuperscript{126)} Grover Tyler, 13 T.C. 186 (1949).
\textsuperscript{127)} Ungar v. Commissioner, 204 F. 2d 322 (1953).
violation of the Sherman Antitrust Act or in the defense of claims of the United States under Section 4 A of the Clayton Act or the Federal False Claims Act are deductible as business expenses. However, where the action brought by the United States under antitrust law, the damages paid by taxpayer were not deductible.\textsuperscript{129)} Legal expenses incurred in pursuing a claim for damages under Section 4 of the Clayton Act are deductible as business expenses.\textsuperscript{130)} However, Congress enacted some restriction upon such lenient deductions.\textsuperscript{131)} If a taxpayer is convicted of a criminal violation of the antitrust laws, or enters a plea of guilty or nolo contendere to a charged violation, no deduction will be allowed for punitive two thirds of any judgment for damages under Section 4 of the Clayton Act, or two-thirds of any settlement of such action. This is effective only for amounts paid or incurred after December 31, 1969. This does not apply to any conviction, or plea of guilty or nolo contendere before January 1, 1960, or to any conviction, or plea of guilty or nolo contendere on or after that date in a new trial following an appeal of a conviction before that date.

6. Punitive and Exemplary Damages

Apart from the punitive two-thirds damages for antitrust law damages, civil suit damages are deductible when they are involving the taxpayer’s business. Thus, deductions has been allowed to a publisher and editor for a libel judgment incurred in the course of his business.\textsuperscript{132)} A compromise payment in a civil action for assault has been held deductible where the activity was proximately related to taxpayer’s business.\textsuperscript{133)} An amount paid to compromise a civil suit is deductible, even though the taxpayer believed the suit had no chance of success, where he had a reasonably founded fear of the effect of the litigation upon his business.\textsuperscript{134)} A corporation has been permitted to deduct an amount paid on a judgment on account of fraud committed jointly with its shareholders, even though the liability was not related to its normal and

\textsuperscript{131)} I.R.C. of 1954 Sec. 162 (g).
\textsuperscript{132)} Cornelius Vanderbilt, 16 T.C.M. 1081, T.C. Memo. 1957–235.
\textsuperscript{133)} John W. Clark, 30 T.C. 1330 (1958).
\textsuperscript{134)} Levitt & Sons, Inc., v. Nunan, 142 F. 2d 795 (2d Cir. 1944).
legitimate business operation.\textsuperscript{135)}

The repayment of fire insurance received under a fraudulent claim has been disallowed as a loss even though the taxpayer had reported the proceeds as income in the prior year.\textsuperscript{136)}

7. Gambling Losses

Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.\textsuperscript{137)} Gambling losses may be offset against gambling gains, whether or not the losses were incurred in business or in a transaction entered into profit.\textsuperscript{138)} Net gambling losses may not be used as a carryback or carryover against gambling gains of prior or proceeding year, even though gambling is the taxpayer's business.\textsuperscript{139)} In the case of a husband and wife making a joint return for the taxable year, the combined losses of the spouses from wagering transactions shall be allowed to the extent of the combined gains of the spouses from wagering transactions.\textsuperscript{140)}

8. Fines and Penalties

The public policy limitation upon expense deductions was an administrative and judicial invention, founded upon a combined premises that deductions are a matter of legislative grace, and that Congress could not have intended to grant a tax subsidy to illegal or immoral practices, and that ordinary and necessary is tinged with a moral flavor. In Tank Truck Rentals, Inc. v. Commissioner,\textsuperscript{141)} the company was engaged in leasing trucks and drivers to motor carriers for transportation of bulk liquids in a number of Northeastern states. Among the Northeastern states, Pennsylvania's maximum truck weight was 45,000 pounds, but the others permitted 60,000 pounds; and its operations were so hindered by the Pennsylvania limits that it deliberately ope-

\textsuperscript{135) Caldwell & Co. v. Commissioner, 234 F. 2d 660 (6th Cir. 1956); Mitchell v. United States, 408 F. 2d 435 (Ct. Cl. 1969).}
\textsuperscript{136) Casey O'Brien, 36 T.C. 957 (1960).}
\textsuperscript{137) I.R.C. of 1954 Sec. 165 (d).}
\textsuperscript{138) Humphrey v. Commissioner, 162 F. 2d 853 (5th Cir. 1947).}
\textsuperscript{139) Aaron Greenfeld, 25 T.C.M. 471, T.C. Memo. 1966–83.}
\textsuperscript{140) Skeeeles v. United States, 95 F. Supp. 242 (Ct. Cl. 1951).}
\textsuperscript{141) 356 U.S. 30 (1958).}
rated over-weight in that state, thus it incurred 718 willful violations and 28 innocent
violations of the weight law during a tax year. It claimed an expense deduction
for the amount of the fines, but the Supreme Court disallowed the fines as deductions
on both the willful and innocent violations based upon above mentioned premises.

The Court reasoned that the taxpayer violated Pennsylvania State Statute which
was enacted to protect its highways from damage and to insure the safety of all per-
sons using them, and incurred a fine or penalty he has not been permitted a tax
deduction for its payment.

The Court in the companion case of Hoover Motor Express Co. v. United States,\(^{142}\)
disallowed a motorcarrier's deductions for fines paid inadvertent violations of maximum
highway weight laws. The Court reasoned that the taxpayer violated sharply
defined Tennessee and Kentucky public policy and the payment of fines was not
necessary to the operation of taxpayer's business.

After those decisions, lower courts disallowed deductions for fines paid to the gov-
ernment based upon frustration of sharply defined public policy test.\(^{143}\) Bookmakers
engaged in the business of taking bets on horse races, which business was unlawful
under an ordinance of a city may not deduct fines and court costs paid to the city.\(^{144}\)
If a taxpayer disobeyed the injunction to prevent a suit on the same cause of action
and refiled a suit on the subject matter, and was found in contempt of court, then
the amount covering the fine, the transcript and the court costs were not deduct-
ible.\(^{145}\) Fines paid for violation of federal statutes, including amounts paid or incurred
in satisfaction of damage claims of the United States under Clayton or False Claims
Act, and the hours of service law, and cost of defense are not deductible.\(^{146}\) Amounts
paid by taxpayer in settlement of penalties arising out of a violation of federal
regulations imposed upon wholesale liquor dealers and attorney's fees incurred in
connection therewith are not deductible.\(^{147}\) The deduction for a compromise of child

\(^{143}\) I.T. 4042, 1951—1 C.B. 15; Burroughs Building Material Co. v. Commissioner, 47 F. 2d
178 (2d Cir. 1931).
\(^{144}\) Harry Wiedetz, 2 T.C. 1262 (1943).
\(^{145}\) Merritt M. Meredith, 47 T.C. 441 (1967).
\(^{146}\) Great Northern Ry. Co. v. Commissioner, 40 F. 2d 372 (8th Cir. 1930).
\(^{147}\) Helvering v. Superior Wings & Liquors Inc., 134 F. 2d 373 (8th Cir. 1943).
labor violation claim was disallowed. The deduction of penalties for wartime price-control violations was disallowed.

However, liquidated damages for minimum wage and overtime violations paid to the United States under the Walsh-Healy Public Contracts Act were held deductible. Congress enacted these decisions by the courts in the Tax Reform Act of 1969. No deduction shall be allowed as a business expense for any fine or similar penalty paid to a government for the violation of any law. This is retroactively applicable to all years subject to the 1954 Code. The Senate report states: "This provision is to apply in any case in which the taxpayer is required to pay a fine because he is convicted of a crime (felony or misdemeanor) in a full criminal proceeding in an appropriate court." If the Code allows such deductions, then it will be the subsidy to whom has violated the law.

9. Legal and Accounting Fees

Generally, litigation expenses and accounting fees are not treated by the public policy disallowance statute. Only the denial of such expenses and fees were made on the absence of proximate cause between the expense and the taxpayer's business under the basic ordinary and necessary rule for the expense deduction. In Commissioner v. Heininger, the taxpayer was a dentist who sold false teeth by mail. Finding that his representations were misleading, the post office issued a fraud order which threatened to ruin his business. The taxpayer thereupon engaged in extensive litigation to enjoin this order, but ultimately lost his case. The Supreme Court allowed the deduction, principally upon the ground that there was not sufficient proximity between the fraudulent conduct and the contested item of expense, because the litigation was initiated by him not merely to continue the right to use his old advertisement, but to save his entire business from destruction.

Deduction to a partnership for expenses of a defense of a criminal action for filing false documents with F.C.C., even though the action was against a partner personally.

151) I.R.C. of 1954 Sec. 162(f).
152) 320 U.S. 467 (1943).
because the defense directly involved the right to the radio license used in the business.  

A movie script writer has been allowed a deduction for counsel fees for advice in connection with his testimony before a Congressional committee investigating Communism in the industry. Attorney's fees incurred in the defense of a criminal action for assault, where the charges grow out of a business visit, has been allowed. An expense of defending a prosecution for conspiracy to obstruct justice by a lawyer, where the acts arose out of his practice, has been permitted. An army officer has been permitted deduction for the defense of a court martial proceeding, because he was defending his source of income. A corporation may deduct the cost of defending a fraud action, even where the alleged fraud was in the organization of the corporation and its acquisition of assets.

However, doctor's expenses of defending a prosecution for criminal abortion was not allowed, on the ground that the expenses were not related to his profession even though his license was revoked as a result of the conviction. Also, physician's cost of defense in a suit for loss of consortium and medical expenses caused by the doctor's making narcotics available to his office nurse was disallowed, since doctor's professional conduct was not involved. The expense of defending a murder trial stemming from a business altercation was not allowed relying partly upon the absence of proximate cause and partly upon illegality. An airline pilot's legal fees for the defense of assault and larceny charges were not deductible, even though conviction would have resulted in revocation of his license, where the origin of the charges was a personal dispute with his former wife.

Although the Heininger case seemed to indicate that no public policy is ever frustrated by a person's attempt to defend himself against a penalty, the lower courts were for long in general agreement that a successful defense was an essential factor for the

153 Carlos Marcello, 23 T.C.M. 1847, T.C. Memo. 1964-299.
154 Waldo Salt, 18 T.C. 182 (1952).
155 John W. Clark, 30 T.C. 1320 (1958).
156 Morgan S. Kaufman, 12 T.C. 1114 (1949).
158 Kanne v. American Factors, Ltd., 190 F. 2d 135 (9th Cir. 1955).
159 Peckham v. Commissioner, 327 F. 2d 855 (4th Cir. 1964).
162 Nodziak v. Commissioner, 356 F. 2d 911 (2d Cir. 1966).
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deductibility of legal expenses involving a charge of wrongful conduct. A deduction for unsuccessful defense would "subsidize the obduracy of those offenders who were unwilling to pay without a contest and who therefore add impenitence to their offense".\footnote{163} Where the taxpayer was ultimately convicted, even the cost of obtaining a reversal of an earlier conviction was held non-deductible.\footnote{164} The Service’s position was no deduction was ever allowable when the taxpayer was found guilty in a criminal proceeding.\footnote{165} However, the Supreme Court approved the deduction of legal expenses for an unsuccessful defense of a criminal prosecution originating from business activities. Distinguishing the cases involving fines and penalties where the deduction would, under the old frustration of policy test, dilute the punishment, the Court found that no public policy is offended when an individual exercises his constitutional right to have counsel.\footnote{166} After this decision, the Service allowed deduction for legal fees of unsuccessful defense.\footnote{167} Where expenses are incurred in tax litigations, the factor of proximate cause is of less importance than in other litigation in the determination of any tax.\footnote{168} Therefore, a deduction is allowed even when the expenses are incurred in criminal tax litigation are deductible only if the charge involves the defendant’s own tax liability, thus a husband charged with filing a wife’s fraudulent separate return may not deduct the expenses in his defense.\footnote{169}

10. Overceilng Price of Goods Sold

The World War II Price Control Act and the Defense Production Act of 1950 provided ceiling of the price, and wage and salary of the employees of the manufacturing company. A common violation of this problem was the case of "black market" purchases, which violated O.P.A. price ceilings during the World War II. The courts consistently recognized the full purchase price as cost of goods sold, despite the Service’s attempt to invoke the tax law as a supplementary penal statute, thus the

\footnote{163} Rossman Corp. v. Commissioner, 175 F. 2d 711 (2d Cir. 1949).
\footnote{168} Commissioner v. Shapiro, 178 F. 2d 556 (7th Cir. 1960).
\footnote{169} Raymond A.Biggs, 27 T.C.M. 1177, T.C. Memo. 1968-240.
Service finally acquiesced in this result.\footnote{170} However, the Price Control Act authorized the President to prescribe the extent to which overceiling wage and salary payments should be disregarded “in determining the costs or expenses of any employer” and pursuant to this authorization the President issued an Executive Order providing that such payments should not be allowed as deductions under the Internal Revenue Code. When the overceiling wage and salary were paid by the taxpayer, such excess payments of the ceiling were not allowed as cost of goods.\footnote{171} The Defense Production Act of 1950 precisely authorized a disallowance of overceiling payments in calculating taxpayer’s tax liability.\footnote{172}

11. Illegal Business Expenses

Income tax is not imposed on gross income of the taxpayer, and it is imposed upon income from illegal business. Thus, generally the expense of illegal business has been allowed to deduct. In Commissioner v. Sullivan,\footnote{173} the Supreme Court allowed a bookmaker to deduct salaries and rent paid in the course of his illegal business despite the tenuous arguments that the employees and landlord may have been equally guilty, because there was no indication that Congress ever intended to impose a gross income tax on this type of business. Lower courts allowed deductions for illegal business expenses on the same ground.\footnote{174}

12. Proxy-fighting Expenses

All expenses incurred by a corporation in a proxy fighting, including legal fees, proxy solicitors’ fees and fees paid a public relation consultant, were deductible business expenses, only in connection with questions of corporate policy rather than the benefit of the interests of individual shareholders.\footnote{175} Payment of the new management’s proxy solicitation expenses like expenses of ousted management were deductible since such

\footnote{170} Sullenger v. Commissioner, 11 T.C. 1076 (1948); Commissioner v. Weisman, 197 F. 2d 221 (1st Cir. 1952); Johns v. Herven, 195 F. 2d 544 (10th Cir. 1952); I.T. 401, 1956-2 C.B. 71.
\footnote{171} Weather-Seal Mfg. Co. v. Commissioner, 16 T.C. 312 (1951).
\footnote{172} I.T. 4105, 1952-2 C.B. 93
\footnote{173} 356 U.S. 27 (1958).
\footnote{174} English v. Commissioner, 249 F. 2d 432 (7th Cir. 1957); Louis Cohen, 17 T.C.M. 284, T.C. Memo. 1958-55.
13. Entertainment Expenses

Expenses of entertainment which are related to taxpayer's business, are deductible. However, if they are related to some kind of illegality, generally such expenses are not deductible because of the frustration of sharply defined public policy. The expenses of the entertainment for the government officials or employees are deductible only when such entertainments are not made in violation of the laws or contrary to any defined public policy.

14. Lobbying and Political Expenses

Generally, lobbying expense deductions are not allowed on the grounds of public policy. Internal Revenue Code Section 162(e)(1) (A) provides "direct interest" test on lobbying expenses. It does not permit deduction if it only remotely or speculatively affects the taxpayer's business, if it affects only business in general, or if it relates with only the taxpayer's personal activities.

Nevertheless an employees' group may deduct appearance costs for a bill to improve a community school system, because of the increased possibility of attracting prospective employees. 177)

Internal Revenue Code Section 162(e) (1) allows deduction for the taxpayer's own expenses and dues attributable to such expenses, in communicating information between a member and his organization with respect to legislation or pending legislation in which the taxpayer and the organization have a direct interest. Dues and payments to action organizations otherwise exempt as employee's associations or civic or business leagues are deductible only to the extent not attributable to the organizations' activities to influence legislation. 178)

Internal Revenue Code Section 162 provides no deduction for any expenses, contributions, etc., for participation in or intervention in any political campaign on behalf of any candidate for public office. The Internal Revenue Service allows to deduct expe-

177) Reg. Sec. 1.162—20 (c) (2) (ii) (b) (1).
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nditures of any business firm in encouraging the public and their own employees to register and vote, if such encouragement is practically impartial and reasonably related to their expected future public patronage. Allowable expenditures include those incurred in advertising to encourage registering, voting and contributing to campaign funds, sponsoring political debates, granting employees time off with pay for registering, and voting, and maintaining a voluntary payroll deduction plan for employee's political contributions.\textsuperscript{179}

IV. Effect of Illegality

1. In General

Under the Internal Revenue Code and its interpretation by the courts, every kind of taxpayer's income derived from his illegal activities is included in his gross income as income derived from his lawful activities. Thus, it can be said that the principles of taxability of illegal income and nondeductibility of illegal expenses have been established under the present statute. The taxability of illegal income covers all income sources from embezzled funds to earnings from prostitution, that means those all kinds of illegal income are included to taxpayer's gross income, but nondeductibility of illegal expenses can not cover all of the business expenses which have been occurred or related to illegal activities. The Internal Revenue Code codified only some nondeductibility of such kind of expenses, and the others are relied upon public policy test which has been established by the courts.

A taxpayer who has any kind of illegal income should file a tax return of such kind of income, and if he repays those amounts to the real legal title holder later, then he will deduct that amount as a loss. If a taxpayer has some gain from armed robbery, then what is his of illegally acquired property? Can he deduct the price of guns and other materials which were used in the robbery as his gainseeking expenses? If he files his illegal income in the return, is it not the violation of self incrimination under the Fifth Amendment? In this part, would like to mention about these kinds of problems.

2. Basis of Illegally Acquired

The basis of property for the purpose of determining gain or loss from the sale or other disposition of property and for the purpose of determining the deduction for depreciation is its unadjusted basis subject to certain adjustments under Section 1016. The usual unadjusted basis is the cost of the property. However, in some cases, the taxpayer has no cost basis, such as in the case of theft, embezzlement, fraud, and extortion. If a taxpayer has kickbacks, bribes, or gambling gains, there is no cost of acquisition. Sometimes, a taxpayer who robbed, stole or embezzled, had invested some amount to prepare such wrongdoing. In those cases, the cost of the property acquired cannot be considerable, because of the contrary to public policy and the laws.

In the cases of illegal business, the cost of the income from illegal business would be allowed to deduct as business expenses which are ordinary and necessary.

3. Self-Incrimination Problem

Problems relating to self-incrimination arise when the Internal Revenue Service seeks to elicit information and the taxpayer resists it, because a taxpayer who has income derived from his illegal activities, still he should file that income in his tax return. In this situation, the taxpayer can invoke the privilege against self-incrimination of the Fifth Amendment. This is a rule that information can be withheld if there is a reasonable probability that it might furnish a link in a chain of evidence which could subject the taxpayer to criminal prosecution, and under this rule a taxpayer may refuse to reveal his assets or the source of his income.\(^{180}\) He can withhold any document describing any transaction which might raise the possibility of prosecution of fraud. The taxpayer must file a tax return and indicate the amount of income he has received in all the cases.\(^{181}\) Thereafter, he can refuse to fill in particular items on the return and may invoke the privilege when he is called to explain his failure to answer in a subsequent investigation. The restriction upon the use of the Fifth Amendment is that the privilege is only to those who may be incriminated by the disclos-


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ure. Therefore, the taxpayer is the only person who can refuse to give incriminating information about himself. A corporation may not invoke this right. The third parties such as banks or people with whom the taxpayer does business could not refuse to answer on the fact that might incriminate the taxpayer. A person does not lose his constitutional right as an individual merely because being a corporate officer, only his purely personal records. Thus, the taxpayer who has income derived from illegal activities files such illegal income only as "commissions", "fees", "other income" and the like, and then he can invoke to the self-incrimination privilege when he is compelled to answer further detail about them. However, in Shapiro v. United States, it was held that the privilege does not extend so far as to permit the taxpayer to withhold from the government "records required to be kept by a valid regulation under the Price Control Act" at least "when there is a sufficient relation between the activity sought to be regulated and the public concern so that the government can constitutionally regulate or forbid the basic activity concerned, and can constitutionally require the keeping of particular records, subject to inspection by the Administrator". Section 6001 of the Code provides "every person liable for any tax imposed by this title or for the collection thereof, shall keep such records". Thus, the law precisely requires to keep the records and books and taxpayer cannot refuse to submit those materials or to answer the question.

4. Public Policy Test

One of the earliest decision of the Supreme Court touching the area of public policy is Clarke v. Haberle Crystal Springs Brewing Co. The taxpayer sought to write off the good will of a brewery business made worthless by the prohibition legislation. The Court disallowed the deduction and said:

"It seems to us plain...that when a business is extinguished as noxious under the Constitution the owners cannot demand compensation from the Government, or a partial compensation in the form of an abatement of taxes otherwise due. It seems to us no less plain

184) 335 U.S. 1 (1948).
185) 290 U.S. 384 (1939).
that Congress cannot be taken to have intended such a partial compensation to be provided for by the words 'exhaustion' or 'obsolescence'.

In 1958, the Court came out with three closely related decisions dealing with the area of public policy. In Tank Truck Rentals, Inc. v. Commissioner, the Court held that a deduction may be denied even if there is no statutory provision or Treasury Regulations requiring it. The Court said that the policy of the penal statute of Pennsylvania was to protect the highways from damage and insure the safety of persons using them. The Court first determined that the state fines could not meet the "ordinary and necessary" requirement of Section 162 (a). The fines in Tank Truck would at least least on the surface, appear to meet the "ordinary and necessary requirements of both Heininger and Lilly set out. The Court recognized that it was economically unfeasible for the taxpayer to operate in any manner different than it was, and therefore determined that the taxpayer's failure to comply with the state laws must be based on a balancing of the cost of compliance against the chance of deduction. The Court's decision might be viewed as imposing an additional penalty on the taxpayer by the disallowance of the deduction. The Court then proceeded to find that the allowance of the fines would frustrate public policy by reducing the sting of the penalty.

In companion case decided the same day, Hoover Motor Express Co. Inc. v. United States, the Court held that fines paid for inadvertent violations were not deductible, because the allowance of such deduction would severely and directly frustrate public policy. However, in the third case decided on the same day, the Court allowed the deduction for wages and rent by the illegal bookmaker. The Court relied on the fact that the Treasury Regulations made the federal excise tax on wagers deductible that as an ordinary and necessary expense, because the Court felt this was a recognition of a gambling enterprise as a business for wages and rent would result in this type of business coming close to being taxed on gross receipts, and that expenditures for wage and rent bore only a remote relation to an illegal act.

The Internal Revenue Code enumerates in Section 261-276 certain nondeductible

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186) Id. at 386.
items of expenses. In Section 162 (c), (e), (f) and (g) bribes to public officials, other unlawful bribes and kickbacks, fines and penalties, lobbying expenses, and treble antitrust damages are specifically made nondeductible. In Section 165 (d), wagering losses are deductible only to the extent of wagering gains. However, the other kind of illegal business expenses are disallowed on the ground of public policy test established by the courts.

In Commissioner v. Tellier,190 the Supreme Court set out the criteria for "ordinary and necessary" expenses within the context of Section 162(a). It said that the principal function of the term "ordinary" is to clarify the distinction between those expenses which are currently deductible and those which are more in the nature of a capital expenditure, if deductible at all. The term "necessary" is held to impose only the minimal requirement that the expense be appropriate and helpful for the development of the taxpayer's business.191

The Court held that these legal expenses met the requirement of being both ordinary and necessary and that no public policy was frustrated when a taxpayer employed counsel.

"No public policy is offended when a man faced with serious criminal charges employs a lawyer to help in his defense. That is not 'prescribed conduct'. It is his constitutional right. ... In an adversary system of criminal justice, it is a basic of our public policy that a defendant in a criminal case have counsel to represent him."192

A general outline of those items which may meet the "ordinary and necessary" criterion and still be disallowed may be traced from the court's opinion: (1) Those deductions disallowed by specific legislation; (2) Those prohibited by a precise and longstanding Treasury Regulation; (3) As to any others, only where the deduction would frustrate sharply defined national or state public policies prescribing particular types of conduct as evidenced by some governmental declaration of them. The public policy test in deductions is very important except some codified disallowances.

V. Conclusion

The purpose of this paper is to enumerate some items of income and deductions

191) Id. at 699.
192) Id. at 694.
which are related to illegality, and to mention about those tax treatments. Under the present statute and its interpretation by the courts and the Service, every kind of income derived from taxpayer's illegal activities should be included in his gross income as legal ones. Some items of illegal expenses are nondeductible because of Code sections and sharply defined federal and state public policy, but some are deductible, because they are ordinary and necessary for the business and not contrary to the public policy test. There is no clearcut criterion of the public policy, and it relied upon adhoc approach by the courts and the Service.

Taxation should be equitable for every taxpayer even to the violators of laws. It should not be used as a device of punishment, nor be a tool of personal discrimination. However, it is very difficult to establish equitable taxation to all of the taxpayers, especially for the violators of law. Thus the Code provided some sections of equitable taxation, present statute and its interpretation is comparatively reasonable, but they need more efforts for the adjustments for the equitable taxation, for instance, to codify clear criteria of public policy test, self-crimination problems, and the adjustments of the difference tax burden on the wrongdoers like Section 1341.
アメリカ聯邦租税法上所得과 経費控除에 있어서 違法性이 미치는 效果

1. 序 論

アメリカ聯邦 第16修正 憲法에 의하여 聯邦議會는 모든 源泉에서 發生한 一切所得에 대하여도 所得税를 賦課・徴収할 수 있게 되었고, 이에 따라 1913年에 制定된 1913年租税法上에 所得에 대한 定義를 규정함에 있어서 “所得이라 함은 모든 源泉에서 發生된 利得과 收入”이라고 包括的으로 규정하였고, 1954年租税法에 있어서는 “所得이라 함은 本條에서 特別히 규정한 것 을 除外하고 次に 그 규정をするものを 合併한 모든 源泉에서 發生된 所得으로서”라고 包括的으 로 규정하였다. 그와 같이 이 法에서 발하는 所得의 概念上 一切所得이 課税對象所得로서 분 간하지 않도록, 특히 不法하게 연산所得 또는 違法性이 聯繫된 所得으로 본 법인가의 問題이이고, 아울러 違法所得도 所得으로 본다면 経費控除에 있어서 違法性이 聯繫된 所得을 연 기 위한 経費控除에 수여하여야 할 것이라도, 各問題가 될 것이므로, 美國聯邦租税法上 所得과 経費控除에 있어서 違法性이 미치는 效果를 살펴 보기로 한다.

 먼저 違法性이 聯繫된 所得으로는 kickback, 強制한 借, 借給으로 받은 借, 虐殺한 財物, 偷 取한 財物, 賭博收入, 違法한 bonus, commission, 娼妓의 收入 등을 들 수 있다. 経費控除에 있어서 問題가 되는 것은 項目義務者가 支出한 項目金, Anti-trust法에 의한 賠償金, 傚賭物, 賭博損失 등을 들 수 있다.

2. 收 入

1927年에 美國 聯邦 大審院은 U.S. v. Sullivan事件에서 禁酒令에 違反하여 얻은 所得도 課税
所得이라고 判示하여 三法所得是 課税對象所得에 包含하였으나, 그 후 下級審은 横領全 金錢도 横領者의 當該 年度 所得計算에 있어서 이를 所得으로 포함시켜야 하느나에 대하여 式로 相衝
되는 判示을 하여, 1946년 Wilcox 事件에서 大審院은 이 問題을 다루었는데, 당시 9名의
Justice 중 오직 Justice Burton만이 그러한 所得는 課税對象이 된다고 反對意見을 박력하였
고, 나머지 8名의 Justice들은 横領者는 그 金錢에 대하여 法律상 또는 衛生法上 負責할請求
權이 없고, 또한 그 横領全 金錢은 返還할義務가 있기 때문에 그러한 所得는 課税所得이 아
니다고 判示하였다. 다시 1952年 Rutkin v. U.S.事件에서 大審院은 Wilcox事件의 判示を 反
対하지 아니한석 전事件과는 事實이 다르다고 하여, 5對 4로서 Wilcox事件에서의 少數意見이
있던 Justice Burton의 意見을 받아들여 横領全 金錢은 其 納税義務者가 이를 現實로 自己意
思에 따라 使用하고 領収하고 處分하고 經濟的인 效用을 얻으므로, 이는 本法所定
所得과 같이 그의 所得이 된다고 判示하였다. 此 判例에 따라 下級審은 Wilcox事件의 判示보다는
Rutkin事件의 判示에 따라 모든 返還所得이 課税對象이라고 判示하고, 오직 Wilcox事件과 事
實이 즉 같은 경우에도나 Wilcox事件의 判示을 따랐다.

그러나 1961年에大審院은 James v. U.S.事件에서 Wilcox事件의 判例를 反対하여 横領全
金錢도 課税對象이라고 判示하였는데, 大審院長 Warren은 이事件에서 1954年租稅法 第61條
所得의 定義에 따르면 이한 所得도 所得에 包含된 것이며, 비록 事務に 이를 返還할義務
가 있다 하더라도 現實로 이에 대하여 完全한 支配権을 行使할 수 있으므로, 이는 所得으로
보아야 하며, 다만 借用金貸이 除外되는 것이라고 判示하였다.

此 判例에 따라 現在 거의 모든 違法收入은 課税對象所得으로 取扱되고 있다.

3. 経費控除

美國聯邦租稅法上 經費控除을 認定하느냐의 與否는 納稅義務者の 權利가 아니고, 이는 立法
上の 意思이므로 納稅義務者は 法律上에 規定되지 아니한 經費控除을 主張할 수는 없는 것이
다. 1951年租稅法은 第61條 이하에 經費控除을 定義하여 事實에 對する 納稅義務者는 그 事
業으로 인하여 發生된 正常의이고 必要한 經費는 이를 控除한다고 규정하였으며, 事實中에는
事業者が 급한 他人에게 募集한 사님도 含包된 것이나, 1941年 大審院이 事務室을 가지고
その 證券과 財産投資를 하는 投資家에게는 同様이 適用되지 않는다고 判示하여, 議會는 1951
年 稅法에 이와 같은 사례들도 敘課하기 위하여 제212조를 规定하였다.

그러면 모든 納稅義務者は 그의 租税計算에 있어서 正常의이고 必要한 經費는 全部 拘除할
수 있겠는가? 事業者が 收入을 얻기 위하여 支出하였다 하더라도, 그것은 法律上 禁止되었거나
나ieux 法律上 禁止되지 아니하였도로 公共政策에 反하는 것은 情事에되지 않는다.
1955年 大審院은 Tank Truck Rentals, Inc. v. Commissioner事件에서 罰科金이 비록 그 事業에 있어서必要不可缺하다 하더라도 이는 経費로控除할 수 없다고 判示하였다. 本案은 Tank Truck Rental은 美國東北部에 있어서 油類輸送을 하는데, 全部 車輛이 Pennsylvania州를 通過하여아어되는데 Pennsylvania州의 最高積荷量은 45,000 pound이고, 나름 每車는 60,000 pound이므로, 全車両이 New York에서 60,000 pound의 燃料을 싣고 Washington D.C.로 감에 있어서 Pennsylvania州를 거쳐야 하는데, 그州 경제선에 응하여 積荷量을 제한 15,000 pound超過로 罰科金을 물게 되는데 그럴다고 하여 油類를 그곳에서 15,000 pound을 물 수도 없으므로, 이 罰科金은 必要한 것이라고 주장하였으나, 大審院은 Pennsylvania州가 그 주인에 있는 道路的損傷을保護하고 그 道路를 使用하는 모든 사람의 安全을保護하려는 公共政策에 反하므로 이는 経費로控除할 수 없다고 判示하였다.

1960年 租税法改正으로 同法 제162조(C)항 등에 違法한贈賄物 또는 kickback 등은 経費控除에서 除外된다.

4. 結論

現在 美國聯邦租税法上 所得에 있어서는 이의한 源泉에서 發生된 이의한 所得이든지 警税할 수 있으므로, 비록 違法한 行為로 인하여 얻은 所得이라도 모두 稅税對象 所得으로 當然으로, 稅税義務者が 이의한 所得을 自進申告하느냐, 만약, 自進申告하느냐면 그의 違法行為가 단순가나서 處罰받게 되고, 그렇기에 되면 이는 第5修正憲法上保障된 自己負罪禁止原則에 經歷되지 않겠느냐는 문제는 생기고, 또한 違法한 所得을 自進하여 支出한 経費를控除할 수 있겠는가가 문제이며, 이에 대하여 稅税義務者が 自進申告하지 않으면 刑事上 處罰되고 稅法上 罰科金을 넣다는 것은 무택하고, 이 경우 稅税義務者は 그 額多分 申告하며, 이에 稅務當局에서 그 稅源을調查하면 그에 기여 調查에 대하여 質疑을 하지 않을 수 있는 것이므로, 第3者는 이의한 演繹이 없는 것이고, 一般 違法所得을 所得으로 認定하는 데, 그러한 所得을 연계 위한 必要한 経費는 이를控除하여야 할 것이지만, 그것이 公共政策에 反하면 이를 許可할 수는 없는 것이다.