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THE PINK PANTHER MEETS THE GRIM REAPER: ESTATE TAXATION OF THE FRUITS OF CRIME

WILLIAM J. TURNIER*

Historically, scholars, courts, and the IRS have paid scant attention to the proper estate tax treatment of the fruits of criminal activity. This era has reached its end, however, with two recent determinations by the IRS that such property is to be included in a decedent-criminal's estate.

In this Article, Professor Turnier examines the position taken by the IRS regarding the estate taxation of stolen or contraband property, and evaluates the Service's treatment of the issues of includibility, valuation, and deductions based on forfeiture of the property or claims against the estate. While agreeing with the IRS that both property law and income tax law support includibility, Professor Turnier argues that value should be determined by the market in which the possessor would have sold the stolen or contraband goods, regardless of whether this results in the inclusion of the items' "highest value." Finally, Professor Turnier addresses the issue of deductibility, concluding that in many such cases decedents' estates should be allowed a deduction for forfeitures or claims against the estate.

"I hope they're going to pay taxes on all that money just like you and me would have to."¹

Two recent technical advice memoranda² have focused attention on the issue of the appropriate estate tax treatment of property that is the fruit

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1. William H. Honan, *Quedlinburg Treasures Are on View in Dallas*, N.Y. TIMES, Mar. 9, 1992, at C11 (quoting Mary Lou Thrasher, visitor at museum exhibit of the Quedlinburg treasure).

2. Technical advice is guidance furnished by the IRS National Office to one of its regional offices regarding the proper handling of a question that arises during an examination of a taxpayer. MICHAEL I. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 3.04[2][a] (2d ed. 1991). Technical advice is particularly useful where the issue in question has been handled inconsistently or is unusually complex. *Id.* ¶ 3.04[2][b]. The issuance of technical advice thus enables the IRS to maintain consistency among its regional offices. *Id.* ¶ 3.04[2][a].

of criminal activity. The issue of the income tax treatment of illegal income is reasonably well resolved, having received substantial scrutiny from the courts, the Internal Revenue Service (IRS), and scholars.³ Until recently, however, the estate tax treatment of such property has been largely ignored. During the fall of 1991, within a period of less than two months, the IRS issued two extensive technical advice memoranda (TAM) dealing with the treatment of property that was the fruit of criminal activity. Technical Advice Memorandum 91-52-005⁴ concerns stolen property and TAM 92-07-004⁵ deals with illegal drugs held by the deceased at death. This article will analyze and comment on the positions taken by the IRS in both of these TAM.

Both technical advice memoranda address three basic issues: (1) whether property that is the fruit of criminal activity is includible in the estate; (2) if includible, what value is properly includible; and (3) whether a deduction should be allowed the estate if such property is either recoverable by the true owner or confiscated by the state. This article will first discuss each of the TAM⁶ and will then analyze the Internal Revenue Service's suggested treatment of each of these three main issues.⁷ Because much of the authority in the area of the appropriate tax treatment of fruits of criminal activity is in the income tax area, considerable resort will be made to income tax authorities, although useful estate tax and property law authorities also will be discussed.

I. THE RECENT DECISIONS

A. TAM 91-52-005: *Stolen Property*

Technical Advice Memorandum 91-52-005, dealing with the estate tax treatment of stolen property, presents an extremely interesting set of facts

The effect of technical advice is somewhat limited, in that it applies only to the taxpayer for whom advice was requested. Rev. Proc. 93-2, 1993-1 I.R.B. 50, 65. As a practical matter, the regional office is bound to follow the National Office's advice and to apply it retroactively. SALTZMAN, *supra*, ¶ 3.04[2][d]. Exceptions to the retroactivity rule exist, however, where such application would be unfair to the taxpayer. *Id.*

For the current IRS release concerning technical advice, see Rev. Proc. 93-2, *supra*. Traditionally, the IRS has updated its rules regarding technical advice annually, as the second revenue procedure of the year.

3. See *infra* notes 99-111 and accompanying text.

4. Tech. Adv. Mem. 91-52-005 (Aug. 30, 1991) [hereinafter TAM 91-52-005].

5. Tech. Adv. Mem. 92-07-004 (Oct. 21, 1991) [hereinafter TAM 92-07-004].

6. See *infra* notes 8-48 (discussing TAM 91-52-005), 49-71 (discussing TAM 92-07-004) and accompanying text.

7. See *infra* notes 72-126 (analyzing includibility), 127-80 (analyzing valuation), 181-257 (analyzing deductibility) and accompanying text.

involving the theft of the famed Quedlinburg treasures.⁸ The deceased, Joseph T. Meador, while serving as a member of the United States military during World War II, successfully stole a number of works of art from the treasury of the Quedlinburg church in the German province of Saxony-Anhalt.⁹ He mailed these objects to himself at his home address in Whitewright, Texas, then moved on to France to continue his looting of Western European culture.¹⁰ While in France, Meador also stole several pieces of valuable silverware and china. When his activities were discovered, he was court-martialed and discharged from the military.¹¹

After returning to Whitewright, Meador supported himself as an elementary school teacher and as a manager of the family hardware store. Yet, he lived far beyond the station of a school teacher or small town merchant, acquiring significant interest in exotic plants and birds. He ultimately accumulated a greenhouse complex full of rare plants, which appears to have been worth more than \$2.4 million shortly before his death.¹²

At Meador's death in 1980 he, by will, left all his silver, china, and crystal to a nephew and two nieces, bequeathing the remainder of his property to his sister and brother. One month after Meador's death, his will was presented for probate. No estate tax was filed because the estate only listed assets worth approximately \$105,000 and a life insurance policy worth \$15,000.¹³ A Texas inheritance tax return filed in late 1980 listed these assets and showed a note for \$2727 to a local bank as the only claim against

8. The saga of the Quedlinburg treasure has been covered extensively in the international and national press. The following is a sampling of some of the best stories about it: Ian Ball, *GI's Looted Treasure Returned*, THE DAILY TELEGRAPH (London), May 2, 1990, Int'l Section, at 3; William H. Honan, *A Trove of Medieval Art Turns Up in Texas*, N.Y. TIMES, June 14, 1990, at A1; William H. Honan, *Bank in Texas Admits It Has Missing German Art Treasures*, N.Y. TIMES, June 19, 1990, at C18; William H. Honan, *Deal on Stolen German Art Meets with Mixed Reaction*, N.Y. TIMES, Jan. 9, 1991, at C13; William H. Honan, *Inventory in Texas Case Turns Up New Works*, N.Y. TIMES, June 25, 1990, at C14; William H. Honan, *It's Finally Agreed: Germany to Regain a Stolen Trove*, N.Y. TIMES, Feb. 26, 1992, at C15; William H. Honan, *New Facts and Lawsuits in the Tale of Art Thefts from German Church*, N.Y. TIMES, Sept. 10, 1990, at C15 [hereinafter Honan, *New Facts*]; William H. Honan, *Stolen Treasure: Three Stories*, N.Y. TIMES, June 30, 1990, § 1, at 11; *I.R.S. Rules on Estate of Stolen Treasures*, N.Y. TIMES, Jan. 10, 1992, at C12; Jo Ann Lewis, *On the Trail of Stolen Treasures; The Historian and the Quedlinburg Cache*, WASH. POST, July 11, 1990, at C1 [hereinafter Lewis, *Stolen Treasures*]; Jo Ann Lewis, *Texas to Return German Treasure*, WASH. POST, Jan. 8, 1991, at B1; *Relatives of Nimble-Fingered GI Return Treasure to Germany*, CHI. TRIB., May 3, 1992, at C24; *Stiftskirche-Domgemeinde of Quedlinburg v. Jack Meador, et. al.*, TEXAS LAW., Mar. 2, 1992, at 24.

9. J. Michael Kennedy, *German WWII Cache May Be In Texas Bank*, L.A. TIMES, June 15, 1990, at A16.

10. TAM 91-52-005, *supra* note 4, at 16,854.

11. *Id.*

12. *Id.*; Honan, *New Facts*, *supra* note 8, at C15-C16.

13. Meador, who was single, died of prostate cancer in 1980. During his hospitalization, all of his rare plants apparently died from lack of attention during a freeze in 1979. This explains

the estate. The assets listed on the estate inventory and on the Texas inheritance tax return consisted solely of real estate, stock, and the above mentioned life insurance policy. No mention was made of any of the works of art that were apparently still in the possession of Meador's estate. Some property held by the estate was distributed to his heirs in 1981, and the balance was distributed in early 1983. Shortly thereafter, the decedent's brother and sister obtained the services of an appraiser to examine the works of art. Meador's brother and an agent attempted first to sell some of the art objects in the legitimate art market.¹⁴

During the course of this effort, Meador's brother and sister were informed by individuals whom they contacted that the property in question had been stolen.¹⁵ They then moved some of the art works, consisting of ancient manuscripts, to Switzerland, and placed them in a safe deposit box. Meador's siblings next attempted to sell the manuscripts in the illicit art market.¹⁶ The entire Quedlinburg treasure in possession of Meador's heirs was recently estimated to be worth between \$50 million and \$100 million¹⁷ in the legitimate art market; a single manuscript, a ninth-century illuminated gospel, was worth \$9 million in the legitimate art market. Nevertheless, it and several other lesser items would bring only \$3 million in the illicit art market.¹⁸

Acting in part on the basis of information regarding these attempted sales, a free-lance detective traced the transactions down to their origin in Texas. The Quedlinburg church then commenced legal action to retrieve its property.¹⁹ When inventories were taken of various safe deposit boxes held in the name of the decedent's heirs, many of the works of art stolen from the Quedlinburg church were discovered. In addition, officials found a number of other works of art, which were most likely stolen from individuals and institutions in France and Germany. To date, no other individuals or organizations have come forward to claim these items.²⁰ The Quedlinburg

their exclusion from a listing of assets in Meador's estate. See TAM 91-52-005, *supra* note 4, at 16,854-55; Honan, *New Facts*, *supra* note 8, at C16.

14. TAM 91-52-005, *supra* note 4, at 16,855-56.

15. *Id.* at 16,855.

16. *Id.* at 16,856. For intriguing discussions of the stolen art market, see BONNIE BURNHAM, *ART THEFT: ITS SCOPE, ITS IMPACT, AND ITS CONTROL* (1978); Charles Koczka, *A Special Agent Speaks Out*, *ART & ANTIQUES*, Nov. 1986, at 59; Carl Nagin, *The Politics of Plunder*, *NEW ART EXAMINER*, Nov. 1986, at 22.

17. See *I.R.S. Rules on Estate of Stolen Treasures*, *supra* note 8, at C12 (estimating \$100 million value); Lewis, *Stolen Treasures*, *supra* note 8, at C1, C4 (estimating \$50 million value).

18. See TAM 91-52-005, *supra* note 4, at 16,856.

19. *Id.* Although the Quedlinburg church had conducted an extensive investigation to determine the whereabouts of the stolen art work, it was never able to learn anything about the property during Meador's lifetime. Lewis, *Stolen Treasures*, *supra* note 8, at C1, C4.

20. TAM 91-52-005, *supra* note 4, at 16,586.

church and a German cultural foundation eventually agreed to pay Meador's heirs a "finder's fee" of \$2.75 million for the return of the entire Quedlinburg treasure.²¹

In TAM 91-52-005 the IRS ruled that the stolen works of art Meador held at his death were includible in his estate.²² The IRS noted that, in determining whether property should be included in the estate, it had been concerned principally with the "economic equivalen[ce] of ownership rather than . . . possession of technical legal title."²³ Even if Meador lacked technical legal title, as long as he possessed the use and economic benefits of the property and was able successfully to transfer them to his heirs, the IRS indicated that the property should be included in the deceased's gross estate under § 2033 of the Internal Revenue Code (the Code).²⁴ In so holding, the IRS stressed the fact that the deceased apparently had successfully sold a portion of the stolen art work to support his lifestyle, and that his heirs apparently had attempted to dispose of the remaining art objects for their own profit.²⁵

The IRS also noted that, under Texas law, the decedent and his heirs possessed rights to the property that were superior to those of all parties other than its true owners.²⁶ For example, if any party other than the true owner lay claim to one of the art objects, a Texas court would undoubtedly conclude that the art object should be retained by the decedent or his heirs.²⁷

In resolving the issue of includibility of the property in the estate of the deceased, the IRS was influenced largely by *James v. United States*,²⁸ an income tax case in which a thief who did not have good legal title to property was nonetheless required to treat the stolen property as income for tax purposes.²⁹ The IRS similarly concluded that, for estate tax purposes, the includibility of such property should not be based on whether the possessor-thief had colorable legal title to the property in question.³⁰ If, at his death, the decedent-thief possessed the use of, and derived economic benefit from stolen property to the same extent as an owner, the IRS concluded

21. Honan, *It's Finally Agreed: Germany to Regain a Stolen Trove*, *supra* note 8, at C15; Lewis, *Texans to Return German Treasure*, *supra* note 8, at B1.

22. TAM 91-52-005, *supra* note 4, at 16,859.

23. *Id.* at 16,857.

24. *Id.* at 16,858.

25. *Id.*

26. *Id.*

27. *Id.*

28. 366 U.S. 213 (1961).

29. TAM 91-52-005, *supra* note 4, at 16,858-59.

30. *Id.* at 16,859.

that the property in question should be included in his estate.³¹ The IRS distinguished *Estate of Bluestein*,³² in which the Tax Court ruled that misappropriated property held by the deceased, which was returned to its rightful owner immediately after death and during the course of administration of the estate, was not includible within the deceased's estate.³³ The IRS contrasted that factual situation with the present one, in which the heirs of the deceased held the property for their use and enjoyment, and attempted to exercise complete dominion and control over the property for more than a decade.³⁴

The second issue dealt with by the IRS in TAM 91-52-005 was the proper valuation of the stolen art work.³⁵ The IRS recognized that two distinct markets exist for art work, the legal market and the illicit market. In general, stolen property is virtually unsellable in the legal market and consequently has little or no value. In the illicit market, however, such art work typically has considerable realizable value, which, given proper circumstances, could constitute a significant percentage of the value that it would have were it not stolen.³⁶

In determining value, the IRS analogized from a number of income tax cases in which the IRS reconstructed the income of drug dealers based on the illegal market value of the narcotics that the dealers had possessed and disposed of during the course of the year.³⁷ The IRS apparently felt additionally justified in considering the illicit market value for works of art because of the decedent's successful disposal of many of the stolen art objects in this market, as well as his heirs' attempts to do the same.³⁸

To buttress its position, the IRS assigned to the property a ten-year term of years value, since the brother and sister had successfully possessed the objects for that period of time.³⁹ Using conventional valuation tech-

31. *Id.*

32. 15 T.C. 770 (1950). For a more thorough discussion of *Bluestein*, see *infra* notes 112-23 and accompanying text.

33. TAM 91-52-005, *supra* note 4, at 16,859.

34. *Id.*

35. *Id.* at 16,859-61.

36. For example, although the 1990 legitimate art market would have valued the Quedlinburg art treasure at between \$50 million and \$100 million, the fact that it was stolen property prevented its sale in that market. In the mid- to late 1980s the best of the cache would have brought \$9 million in the legitimate market where it proved unsellable. The heirs ultimately were able to arrange a sale for these few items in the illicit market for \$3 million. See *supra* notes 17-18 and accompanying text.

37. See TAM 91-52-005, *supra* note 4, at 16,860. On occasion the value chosen was the wholesale street market value, and on other occasions it was the retail street market value.

38. *Id.*

39. TAM 91-52-005, *supra* note 4, at 16,860-61.

niques⁴⁰ the IRS determined that the present value of the right to use the works of art for the ten-year period constituted 55.8395% of the full fair market value of the art objects.⁴¹ The IRS concluded that the fair market value of the property to be included in the estate was the highest price that would have been paid for the works of art by a willing buyer in either the illicit or the legitimate art market.⁴²

The remaining issue resolved by the IRS in TAM 91-52-005 was whether a deduction should be allowed under I.R.C. § 2053(a)(3),⁴³ for claims against the estate. Critical to the IRS analysis of this issue was the fact that § 2053(a)(3) permits a deduction for claims against the estate "allowable by the laws of the jurisdiction . . . under which the estate is being administered."⁴⁴ Upon examining the probate law of Texas, the IRS determined that claims against the estate by a rightful owner such as the Quedlinburg church would not be allowable if asserted more than one year after the granting of letters testamentary to an independent administrator, and after the distribution of the estate assets.⁴⁵ Under the facts of the case, no valid claim was thus allowable against the estate under § 2053(a)(3).⁴⁶

Although the Quedlinburg church did not have a valid claim against the estate under Texas probate law, it did have valid claims under Texas property law that it, as the true owner, could raise against the heirs who were holders of the stolen property.⁴⁷ The IRS noted that since these were not claims against the estate, they were thus not deductible claims described in § 2053(a)(3) of the Code.⁴⁸

B. TAM 92-07-004: *Illegal Drugs*

Less than eight weeks after the publication of TAM 91-52-005, the IRS published TAM 92-07-004, in which it dealt with the estate taxation of illegal drugs.⁴⁹ The decedent had long been suspected by local and federal law enforcement authorities of engaging in drug smuggling activities.⁵⁰ In January 1987, he arranged for two accomplices to meet him on an unused

40. The IRS used the actuarial valuation tables within Treas. Reg. § 20.2031-10 (as amended in 1984) to find the amount that, "[a]t a minimum, the decedent successfully transferred to his siblings." TAM 91-52-005, *supra* note 4, at 16,860.

41. TAM 91-52-005, *supra* note 4, at 16,860.

42. *Id.*

43. I.R.C. § 2053(a)(3) (1988).

44. *Id.*

45. TAM 91-52-005, *supra* note 4, at 16,861.

46. *Id.* at 16,864.

47. *See id.* at 16,858 (noting true owner's superior right to possession under Texas Law).

48. *Id.* at 16,864.

49. TAM 92-07-004, *supra* note 5.

50. *Id.* at 16,954.

stretch of interstate highway in Florida. He had intended to fly in at night in an airplane full of marijuana, land on the highway, and turn over the drugs to his accomplices. The accomplices were to have arranged emergency landing lights for the decedent's plane; however, a severe storm resulted in their late arrival at the designated spot. The decedent arrived on time, and the incomplete arrangements for lighting resulted in the decedent's fatal plane crash.⁵¹

When the police arrived at the crash site, they confiscated several bales of marijuana, weighing a total of 662.5 pounds, which had been smuggled into Florida by the decedent.⁵² The authorities found 459.5 pounds of baled marijuana at the site of the crash and an additional 204.9 pounds of baled marijuana in the back of a truck driven by the accomplices.⁵³ The police also found \$2841 in cash at the site of the crash. The accomplices indicated that the marijuana in their possession belonged to the decedent. All of the marijuana and the cash were ordered forfeited and confiscated under the drug enforcement laws of the State of Florida.⁵⁴

In TAM 92-07-004, the IRS addressed the following three issues: (1) whether the drugs in possession of the decedent were includible in his estate; (2) if includible, how to determine their fair market value; and (3) whether confiscation of the drugs and other property involved in drug smuggling activities should impact on the allowability of a deduction under either § 2053(a)(3)⁵⁵ or § 2054⁵⁶ of the Code.

The first issue the IRS resolved was whether the seized drugs were to be included in the estate of the decedent.⁵⁷ Since the two accomplices were found to be the decedent's agents, the drugs they held, as well as the drugs found at the crash site, were all deemed to be the decedent's property.⁵⁸ As it had in TAM 91-52-005, the IRS indicated that the economic equivalence of ownership of property that is in the possession and control of the decedent determines its inclusion in the estate.⁵⁹ Consequently, because the decedent possessed the economic equivalence of ownership of the marijuana, its value was to be included in his estate.⁶⁰ The IRS also noted that, just as

51. *Id.*

52. *Id.*

53. All figures are as reported in TAM 92-07-004. *Id.* Clearly 204.9 pounds plus 459.5 pounds add up to 664.4 pounds, not 662.5 pounds, of marijuana. TAM 92-07-004 offers no explanation for the 1.9 pound discrepancy. *Id.*

54. *Id.* at 16,954-55.

55. I.R.C. § 2053(a)(3) (1988).

56. I.R.C. § 2054 (1988).

57. TAM 92-07-004, *supra* note 5, at 16,955-56.

58. *See id.*

59. *Id.*

60. *Id.* at 16,956.

income from drug trafficking activities is to be taxed to the smuggler who possesses a controlled substance, so too should a controlled substance in his possession be included in his estate at death.⁶¹

The second issue addressed in TAM 92-07-004 was the appropriate value to be assigned to the marijuana that was included in the decedent's estate.⁶² Because the drugs in question were destroyed after being confiscated, there was no evidence of the marijuana's quality. Assuming that it was of average grade, the IRS assigned a value based on "retail street value" for average grade marijuana. The IRS selected retail street value because the intended buyers of the drug included street dealers as well as distributors to street dealers. It also selected the area of the city in which the intended sales were to take place as the appropriate geographic market in which to value the drugs.⁶³

Finally, the IRS addressed whether a deduction should be allowed to the estate under § 2053(a)(3)⁶⁴ or § 2054⁶⁵ of the Code, based on the confiscation of the narcotics.⁶⁶ Section 2053(a)(3) allows a deduction for claims against the estate allowable by the laws of the jurisdiction in which the estate is being administered.⁶⁷ Section 2054 allows a deduction for losses incurred during settling of the estate arising from fire, storm, shipwreck, other casualties, or theft.⁶⁸ Under Florida law,⁶⁹ the decedent's narcotics and cash were seized and the narcotics destroyed. Consequently, if its attempt to gain a deduction under § 2053(a)(3) failed, the decedent's estate apparently hoped to obtain a deduction for the seized cash and the value of the destroyed controlled substances under § 2054. Without addressing the issue of which, if either, of the two sections applied, the IRS held that to allow any deduction under either section would frustrate sharply defined public policies against drug trafficking.⁷⁰ As authority for this position, the IRS cited a number of income tax cases in which a deduction for

61. *Id.* at 16,955-56.

62. *Id.* at 16,956-57.

63. *Id.* No mention was made of the volume of seized drugs, whether it would be reasonable to sell this amount at retail on the street in one day, or the impact on street value of this quantity of marijuana. Because of the author's proposed analysis of the valuation issue, it will not be necessary to consider the appropriateness of the use of a blockage discount. *See infra* notes 131-80 and accompanying text.

64. I.R.C. § 2053(a)(3) (1988).

65. I.R.C. § 2054 (1988).

66. TAM 92-07-004, *supra* note 5, at 16,957-58.

67. I.R.C. § 2053(a)(3) (1988).

68. I.R.C. § 2054 (1988).

69. FLA. STAT. ANN. § 893.12(1) (West Supp. 1993).

70. TAM 92-07-004, *supra* note 5, at 16,957-58 (citing *Smith v. Commissioner*, No. 90-1143, 1991 U.S. App. LEXIS 18741 (4th Cir. Aug. 15, 1991) (*per curiam*); *Wood v. United States*, 863 F.2d 417 (5th Cir. 1989); *Gambina v. Commissioner*, 91 T.C. 826 (1988); *Holt v.*

a loss was denied to drug traffickers whose controlled substances had been seized and destroyed.⁷¹

II. INCLUDIBILITY

Section 2033 of the Code provides that "[t]he value of the gross estate shall include the value of all property *to the extent of the interest therein of the decedent* at the time of his death."⁷² It is well worth noting that the Code does not speak in terms of ownership or other well-established concepts of various property interests. Congress employed rather general language (i.e., "interest") in describing the reach of § 2033. The regulations indicate that mere beneficial, as opposed to legal, ownership of property is sufficient to result in its inclusion under § 2033.⁷³ Based on these two factors alone, one might be tempted to conclude that the fruits of crime that individuals acquire should be included in their estates. Moreover, once one recalls that the courts readily include the fruits of criminal activities in the incomes of criminals, the case for inclusion becomes beguilingly compelling.⁷⁴

Unfortunately, in construing the estate and gift taxes, the courts have tended to adopt a technical, mechanistic approach, rather than the substantive economic analysis that typically predominates in the income tax area.⁷⁵ Consequently, the courts' approach to estate and gift tax cases is vaguely

Commissioner, 69 T.C. 75 (1977); *Bailey v. Commissioner*, 58 T.C.M. (CCH) 1030 (1989), *aff'd*, 929 F.2d 700 (6th Cir. 1991)).

71. *Id.*

72. I.R.C. § 2033 (1988) (emphasis added).

73. Treas. Reg. § 20.2033-1(a) (as amended in 1992).

74. *See, e.g.*, *James v. United States*, 366 U.S. 219 (1961) (holding that embezzled funds are income); *Wood v. United States*, 863 F.2d 417, 419 (5th Cir. 1989) (holding that proceeds from drug smuggling are income). For a general discussion of this issue, see 1 BORIS BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 6.5 (1981).

As a prelude to the discussion of whether the fruits of criminal activity should be included in the estate, it is noteworthy that many great fortunes have been amassed, at least in part, by unscrupulous means. For example, many wealthy landowners in Oklahoma can likely trace the acquisition of their property to ancestors who surveyed and staked their claim to land prior to the official opening of the territory by the federal government for that purpose. Those who participated in this illegal act came to be known as "sooners," a nickname the state still bears proudly today. *See* STAN HOIG, *THE OKLAHOMA LAND RUSH OF 1889*, at 187-222 (1984).

In addition, some have suggested that the Rockefeller fortune, one of America's most famous, was significantly enhanced by any number of activities that were certainly ethically, if not legally, questionable. *See* JULES ABELS, *THE ROCKEFELLER BILLIONS* (1965). Most recently, violation of various securities laws has led to the rise, and fall, of any number of Wall Street "wizards" during the 1980s. *See, e.g.*, MARK STEVENS, *THE INSIDERS* (1987); JAMES B. STEWART, *DEN OF THIEVES* (1991).

75. *See, e.g.*, *United States v. Byrum*, 408 U.S. 125, *reh'g denied*, 409 U.S. 898 (1972); *Helvering v. Safe Deposit & Trust Co.*, 316 U.S. 56 (1942).

reminiscent of the formulaic approach to property law that is a hallmark of an area such as future interests.⁷⁶

One of the principal results of these contrasting approaches to tax legislation in the estate and income tax areas is that most of the study of estate tax consists of an exploration of various Code provisions⁷⁷ added to restore some vigor to § 2033,⁷⁸ which the courts have sapped of its potential strength. On the other hand, the courts have given § 61,⁷⁹ the income tax's equivalent of § 2033, a broad reading based on economic realities. As a result, much of Congress's efforts in the income tax area have dealt with providing exclusions and deductions that diminish the broad sweep of § 61.

Why is estate taxation typically characterized by a technical, mechanistic construction and income taxation characterized by a substantive economic analysis? Perhaps it is because much of the early scholarship in the estate tax area and many of the estate planning practitioners drew heavily on the work of the property bar, in an area of the law where form often is more important than substance. In contrast, much of the early scholarship in the income tax area drew on the work of business lawyers, economists, and experts in public finance who regularly encounter the realities of the market place. Whatever the reason, it is important to keep in mind this distinction, lest we be too confident of the value, to estate tax analysis, of a whole host of scholarship and learning on the income taxation of the fruits of crime.

76. See, e.g., *Knetsch v. United States*, 364 U.S. 361 (1960); *Helvering v. Clifford*, 309 U.S. 331 (1940). These differences between the two areas are illustrated by several cases and authorities. For example, in *Helvering v. Safe Deposit & Trust Co.*, the Supreme Court held that § 2033 did not reach a combination life estate and testamentary general power of appointment, which had been left to the decedent by his parents and resulted in his substantial ownership of the property in question. 316 U.S. at 59. This result can be contrasted profitably with "ownership of income" cases such as *Helvering v. Clifford* and *Commissioner v. Culbertson*, 337 U.S. 733 (1949), in the assignment of income area, in which the Court was basically concerned with the possession of substantive economic interests. Similarly, the Court in *Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274 (1958), applied § 2036 to include in the decedent's estate property in which the decedent retained a life estate. However, the Court held that § 2036 did not reach an annuity-life insurance combination, purchased by a 76-year-old from the same insurer, without the requirement that the insured undergo a physical. *Id.* at 280. The Court refused to follow the suggestion that the case be analyzed by combining the two policies. *Id.* This case should be contrasted with Rev. Rul. 65-57, 1965-1 C.B. 56, and *Kess v. United States*, 451 F.2d 1229, 1231 (6th Cir. 1971), in which the IRS and the court refused to treat an annuity-life insurance combination as insurance under I.R.C. § 101 (1988), which excludes life insurance proceeds from income, since the combined purchase deprived the taxpayer's life insurance purchase of the risk-spreading characteristic of insurance.

77. See, e.g., I.R.C. §§ 2036-2041 (1988 & Supp. III 1991).

78. I.R.C. § 2033 (1988).

79. I.R.C. § 61 (1988).

A. *Property Law as Authority for Inclusion*

In *Morgan v. Commissioner*,⁸⁰ the Supreme Court stated that “[s]tate law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.”⁸¹ Thus, to determine if holding property that constitutes the fruit of criminal activity creates any transferrable rights in the decedent that can be taxed under § 2033, it is helpful to examine basic state property law with respect to stolen property and contraband.

In determining whether the possessor of such goods has sufficient rights in that property to justify inclusion in the estate, the IRS, in both TAM 91-52-005 and TAM 92-07-004, resorted to the basic rule that the possessor of property, even one who lacks legal title, has valuable economic interests in that property.⁸²

According to classic hornbook law, the possessor of property generally has a claim to the property that is superior to that of all but the true owner.⁸³ In actuality, one who wishes to deprive a possessor of property does not need to show that she is the “true owner” of the property; she merely needs to show that she has a better claim to it than the possessor. For example, although a purchaser of a stolen painting might have to return it to the individual from whom she unlawfully took it, she nonetheless could recover it from a thief who stole it from her. This idea is best described as the theory of relativity of title.⁸⁴ For simplicity, however, this paper will refer to parties with a superior claim to title as “true owners.”

Cases involving claims to allegedly stolen property typically involve two critical issues: (1) the relative superiority of the claims of the competing parties; and (2) when the statute of limitations commences running against an individual whose claim to the property is superior to that of the possessor.⁸⁵ Typically, cases involving stolen works of art do not involve

80. 309 U.S. 78 (1940). For a general discussion of the role of state and federal law in the process, see RICHARD STEPHENS ET AL., *FEDERAL ESTATE AND GIFT TAXATION* ¶ 4.05[2] (5th ed. 1983 & Supp. 1990).

81. *Morgan*, 309 U.S. at 80.

82. See TAM 91-52-005, *supra* note 4, at 16,857-58; TAM 92-07-004, *supra* note 5, at 16,955.

83. See RAY A. BROWN & WALTER B. RAUSHENBUSH, *THE LAW OF PERSONAL PROPERTY* § 11.11, at 311 (3d ed. 1975), which states: “[E]ven a convertor who tortiously holds the goods of another has been held able to recover their value from a third person who, while the goods were in the plaintiff’s possession, damaged or converted them.” *Id.* (footnote omitted).

84. See JESSE DUKEMINIER & JAMES E. KRIER, *PROPERTY* 65 (2d ed. 1988); ROGER A. CUNNINGHAM ET AL., *THE LAW OF PROPERTY* § 1.3 (1984).

85. See Patty Gerstenblith, *The Adverse Possession of Personal Property*, 37 *BUFF. L. REV.* 119, 126-27 (1988/89) (citing, *inter alia*, *Trust Co. Bank v. Union Circulation Co.*, 245 S.E.2d 297, 298 (Ga. 1978); *Christensen Grain, Inc. v. Garden City Coop., Equity Exch.*, 391 P.2d 81, 84-85 (Kan. 1964)); John G. Petrovich, Comment, *The Recovery of Stolen Art: Of Paintings*,

defendants who are thieves, but rather individuals who, with varying degrees of good faith, have purchased art works from thieves or their confidants. Plaintiffs from whom the property was stolen are typically drawn from the ranks of artists, private collectors, gallery owners, and museums. The law holds that even in a sale to a bona fide purchaser, a thief cannot convey title that will defeat the claim to property of the true owner.⁸⁶

Plaintiffs can typically prove the superiority of their title quite easily; they find that their biggest burden is satisfying the statute of limitations in an action for replevin of converted assets. In essence, the defendant possessors assert that, although they may not originally have had superior title to the art work, they have acquired such title through adverse possession.

A statute of limitations commences running from the time a cause of action accrues.⁸⁷ Under the old law regarding conversions, the cause of action accrued when the property changed possession.⁸⁸ This rule operated as a great hardship on the victims of art thefts because, due to the portable nature of the property, they often had difficulty knowing whom to sue. Many foreign countries, nonetheless, continue to follow this rule. As a result, the game in international art theft involves a mad rush to place hot items within these countries' borders.⁸⁹ American jurisdictions have developed rules regarding the running of the statute of limitations based on the concept that a cause of action cannot accrue until the facts or events that permit maintenance of a lawsuit have occurred.⁹⁰

Two principal rules delay the running of the statute of limitations in theft actions: the demand and refusal rule⁹¹ and the discovery rule.⁹² Although the demand and refusal rule is the minority rule, it is the rule in

Statutes, and Statutes of Limitations, 27 UCLA L. REV. 1122, 1128-32 (1980) (citing, *inter alia*, *Scroggin Farms Corp. v. McFadden*, 165 F.2d 10, 18 (8th Cir. 1948); *Jackson v. American Credit Bureau, Inc.*, 531 P.2d 932, 934 (Ariz. Ct. App. 1975)).

86. The classic statement of this principle is provided by *Basset v. Spofford*, 45 N.Y. 387, 391 (1871):

By the larcenous taking of chattels the owner is not divested of his property, and a transfer to a purchaser does not impair the right of the true owner. A purchase of stolen goods either directly from the thief or from any other person, although in the ordinary course of trade and in good faith, will not give a title against the owner. In the case of a felonious taking of goods, the owner may follow and reclaim them wherever he may find them.

87. See *Petrovich*, *supra* note 85, at 1128-29.

88. See *Gerstenblith*, *supra* note 85, at 126.

89. See TAM 91-52-005, *supra* note 4, at 16,857 (citing Fox Butterfield, *Boston Museum Says It Was Uninsured for Theft*, N.Y. TIMES, Mar. 20, 1990, at A1, C20 (naming South America and Japan as favorable locations to possess stolen art)).

90. See *Petrovich*, *supra* note 85, at 1128-32.

91. *Id.* at 1133-40.

92. *Id.* at 1149-57.

New York, which dominates the American art market. Consequently, it is of some importance. Under this rule, an action for replevin cannot commence until after the "true owner" has made a demand to the possessor for return of the property, and the possessor refuses its return. Until that has been done, the statute of limitations does not begin to run. Moreover, under the demand and refusal rule an innocent holder becomes a wrongdoer only after refusal and, until that moment, is considered to be in lawful possession of the property.⁹³ Under the discovery rule, in contrast, the statute of limitations does not commence running until the "true owner" discovers, or by exercising due diligence could have discovered, the whereabouts of the stolen object with such specificity as would enable him to commence a suit for replevin.⁹⁴

The above general discussion of the law regarding stolen property amply demonstrates that holders of stolen property do possess valuable rights. Even a thief possesses rights to the property that are superior to those of many other parties. For example, as the possessor of the property, a thief has rights in it that are superior to those of all but a few potential claimants (e.g., the "true owner"). Until the "true owner" asserts his claim to the property, the thief will at least enjoy possession of the property. Given the proper circumstances (e.g., a nondiligent "true owner,") a thief's rights in the property could even eventually supersede those of the "true owner."

Given these principles, it is apparent that the possessory interest of a thief represents a valuable property interest that should be included in his estate. Thus, the real issue in such cases should be the value to be assigned to the thief's interest. For example, a thief who holds a \$1 million stolen painting has at least the fair market value of the potential enjoyment of the painting for a limited period of time, a benefit that is admittedly far less than the full fair market value of the property itself. The thief also has the potential to realize the property's full fair market value if he is able to transport the property to a jurisdiction with a favorable statute of limitations, or if the true owner merely lacks due diligence. It should not be forgotten that, even after the Quedlinburg church lay claim to its treasures, Mr. Meador's heirs remained in possession of a number of works of art to which the estate apparently had a dubious title, but for which there was no other claimant.⁹⁵

93. See, e.g., *Kunstsammlungen zu Weimar v. Elicofon*, 678 F.2d 1150, 1161 (2d Cir. 1982); *Menzel v. List*, 267 N.Y.S.2d 804, 809 (Sup. Ct. 1966), modified as to damages, 279 N.Y.S.2d 608 (App. Div. 1967), rev'd as to modifications, 246 N.E.2d 742 (N.Y. 1969). If the "true owner" fails to exercise "due diligence" in searching for his missing property, laches can bar his action to recover the property. *DeWeerth v. Baldinger*, 836 F.2d 103, 107-08 (2d Cir. 1987).

94. See, e.g., *Autocephalous Greek-Orthodox Church of Cyprus v. Goldberg & Feldman Fine Arts, Inc.*, 917 F.2d 278, 288-89, reh'g denied, en banc, 1990 U.S. App. LEXIS 20398 (7th Cir. 1990); *O'Keeffe v. Snyder*, 416 A.2d 862, 869-70 (N.J. 1980).

95. See TAM 91-52-005, supra note 4, at 16,856.

Thus, the critical issue in the case of stolen property should be that of determining the value of the rights held by the possessor, and not the mere verification of the existence of rights in the property that the possessor can pass to his heirs.

After a careful search of cases dealing with property disputes over contraband, this author found only cases involving disputes between so-called "true owners" and governmental agencies laying claim to the property.⁹⁶ Media accounts do report occasional disputes between governmental agencies that assert competing claims to contraband, although none of these disputes appear to have resulted in any reported litigation.⁹⁷ It should come as no surprise that private citizens with disputed claims over contraband do not resort to the courts. Nonetheless, despite a lack of judicial consideration of the property interests in contraband, it seems safe to conclude that the same basic principles that apply to stolen property in general also apply to contraband, with the result that even its illegal possession should be held to give rise to a valuable property interest taxable under § 2033.⁹⁸

B. *Income Tax as Authority for Inclusion*

As the IRS noted in TAM 91-52-005 and TAM 92-07-004, the income tax treatment of income derived from illegal activities is now quite well established.⁹⁹ After struggling with the issue in several cases,¹⁰⁰ the

96. For some interesting cases involving disputes over ownership of contraband between governments and individuals from whom the goods were seized, see, e.g., *United States v. Martinson*, 809 F.2d 1364, 1365 (9th Cir. 1987) (addressing situation in which individual sought return of antique guns that had been seized at the time of his improper arrest); *People v. Rautenkranz*, 641 P.2d 317, 318 (Colo. Ct. App. 1982) (dealing with plaintiff seeking return of a seized Jeep claiming it was not "contraband"); *State v. Carassa*, 549 A.2d 458, 459 (N.J. Super. Ct. App. Div. 1988) (involving plaintiff seeking return of various items of jewelry that had been seized as a result of his arrest for possession of cocaine with intent to distribute).

97. See John D. Cramer, *Supervisors to Sue Sheriff Duffy Over Drug Funds*, L.A. TIMES, Nov. 7, 1990, at B1; Fred Strasser & Marcia Coyle, *DEA and Customs Spar Over Drug Forfeitures*, NAT'L L.J., Feb. 20, 1989, at 5; Sam Enriquez, *Seized in Raids; Police Seek Bigger Share of Drug Cash*, L.A. TIMES, Apr. 20, 1986, § 2, at 1.

98. I.R.C. § 2033 (1988).

99. As a cautionary prelude to using the income tax to analyze the estate tax, it should be noted that the estate, gift, and income taxes, while partially integrated, are separate taxes that cannot be expected to yield consistent results. The spirit of this state of affairs was best captured by Judge Jerome Frank in *Commissioner v. Beck's Estate*, 129 F.2d 243, 244 (2d Cir. 1942), in which the court dealt with the seeming inconsistency of results under the income, estate, and gift taxes in the tax treatment of an allegedly completed gift. Judge Frank indicated that the inconsistent results might be easier to abide if Congress had used the terms "gift," "gaft," and "geft" to describe gratuitous inter vivos conveyances under each of the taxes. *Id.* at 246.

100. See *Rutkin v. United States*, 343 U.S. 130, 137-39, *reh'g denied*, 343 U.S. 952 (1952); *Commissioner v. Wilcox*, 327 U.S. 404, 406-10 (1946); *United States v. Sullivan*, 274 U.S. 259, 262-63 (1927). For a good discussion of the history of the taxation of income derived from illegal

Supreme Court determined in *James v. United States*¹⁰¹ that income derived from an illegal activity, such as embezzlement, was to be included in the taxable income of the recipients of such income.¹⁰² In so holding, the Court overruled an earlier decision, *Commissioner v. Wilcox*,¹⁰³ in which the Court had held that because an embezzler is under a legal obligation to pay back the embezzled funds, they do not constitute income.¹⁰⁴ In *Wilcox*, the duty to repay had been viewed as the equivalent of a liability, which negated the accretion represented by the value of the embezzled funds.¹⁰⁵ The Court, in rejecting its earlier decision, held:

When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express 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."¹⁰⁶

Since *James*, it has been well settled that the fruits of criminal activities are taxable as income.¹⁰⁷ Drug dealers, perpetrators of mail fraud, and others whose assets were seized under RICO¹⁰⁸ recently have sought to avoid tax liability on the ground that, because RICO effects a technical legal forfeiture of assets *ab initio*, the holders of these illegally derived goods never technically owned the fruits of their crimes.¹⁰⁹ The courts have rejected this argument¹¹⁰ on the ground that "the test for taxable income is not title. The test is actual dominion and control."¹¹¹

activities, see Boris I. Bittker, *Taxing Income From Unlawful Activities*, 25 CASE W. RES. L. REV. 130, 131-37 (1974).

101. 366 U.S. 213 (1961).

102. *Id.* at 213-22.

103. 327 U.S. 404 (1946).

104. *Id.* at 408.

105. *Id.*

106. *James*, 366 U.S. at 219 (quoting *North Am. Oil v. Burnet*, 286 U.S. 417, 424 (1932)).

107. See 1 BITTKER, *supra* note 74, ¶ 6.5.

108. Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1988 & Supp. III 1991).

109. See *Wood v. United States*, 863 F.2d 417, 419 (5th Cir. 1989); *Ianniello v. Commissioner*, 98 T.C. 165, 172 (1992); *Gambina v. Commissioner*, 91 T.C. 826, 828 (1988).

110. *Wood*, 863 F.2d at 419; *Ianniello*, 98 T.C. at 172-74; *Gambina*, 91 T.C. at 828-29.

111. *Wood*, 863 F.2d at 419.

C. *Bluestein Distinguished*

The *Bluestein*¹¹² case, which the IRS distinguished from the facts in TAM 91-52-005,¹¹³ represents a rather special set of facts with little general application to the basic problem under analysis. Lena Bluestein died in Port Arthur, Texas, in 1919.¹¹⁴ By will, she appointed her husband Alec executor of her estate, which consisted of both her separate property and community business assets held with Alec. Lena's will divided her separate and community property equally among her three minor sons. Alec, in probating his wife's estate, only informed the court of her ownership of separate property that was distributed to his minor children. He never informed the probate court of the existence of considerable community assets that were held in his name. Moreover, during the minority of his children, Alec appropriated to himself the sales proceeds of separately held assets that the children had inherited from their mother.¹¹⁵

Alec never informed his children of the existence of their mother's will or of their ownership of any property inherited from her. Throughout his life he held himself out as the sole owner of the community business property.¹¹⁶ At his death in 1944, Alec left these assets to two of his sons who worked in the businesses. Shortly after Alec's death, a third son, Edward, discovered the existence of his mother's will and brought suit in Texas District Court to obtain a one-third interest in one-half of the community business interests held in Alec's name.¹¹⁷

The Texas District Court determined that Alec owned only one-half of the business interests held in his name and that the balance, representing the community interest of Lena, was owned one-third by each of the sons and presumably held by Alec as a trustee for the children.¹¹⁸ Consequently, Lena's assets held by Alec were not to be included in Alec's estate. The entire proceeding was completed within less than seven months of Alec's death.¹¹⁹

The sole issue raised by the Commissioner in *Bluestein* was whether the Tax Court was obliged to follow the decisions of the Texas courts as to

112. Estate of Bluestein v. Commissioner, 15 T.C. 770 (1950).

113. See *supra* notes 32-33 and accompanying text.

114. *Bluestein*, 15 T.C. at 773.

115. *Id.* at 774-75.

116. *Id.*

117. *Id.* at 776-77.

118. *Id.* at 777-78.

119. See *id.* at 771, 777. A party with an interest adversely affected by the Tax Court's decision unsuccessfully sought to have it set aside by the Texas Court for Civil Appeals. *Born v. Bluestein*, 220 S.W.2d 345 (Tex. Civ. App. 1949).

the extent of Alec's estate. Operating under the pre-*Bosch*¹²⁰ rule of *Freuler v. Helvering*,¹²¹ the Tax Court decided that it was so bound.¹²²

Several points should be made about *Bluestein*. First, the Tax Court never really addressed the issue raised by TAM 91-52-005. Following the *Freuler* rule, the Tax Court, probably erroneously, never felt free to explore *de novo* the real issue of the includibility of the property originally held by Lena. For example, although a Texas state court determined that Lena was the owner of one-half of the family businesses, the Tax Court never discussed the propriety of considering whether Alec's conflicting claim to that property constituted a valuable property right held by him at his death. Second, the prompt determination of the true nature of Alec's property interest in the business operated under his name makes this case factually distinguishable from the situation described in TAM 91-52-005. Third, the result in *Bluestein* is completely consistent with the inclusion of the misappropriated interests in Alec's estate, followed by the allowance, based on the Texas judicial proceedings, of a claim against the estate under § 2053(a)(3)¹²³ for the value of the misappropriated interests.

This is, in fact, what happened in *Russell v. United States*,¹²⁴ a case that is factually similar to *Bluestein*. There the decedent, a trustee of assets held for the benefit of her children, never informed the beneficiaries of the existence of the trust and treated the assets as her own. After her death, an estate tax return was filed that included the trust assets as being owned by the decedent. During pendency of probate, the children discovered the existence of the trust. They filed a claim in probate for the trust assets,

120. *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967). In this case, the Supreme Court determined how federal courts hearing estate tax cases should deal with state court determinations of the ownership of property potentially includible in the estate. The court indicated that in such circumstances proper regard, not finality, should be given to state trial court determinations in bona fide adversary proceedings. Decisions of intermediate state appellate courts should not be disregarded unless the federal court is convinced that the state's highest court would decide the matter otherwise. Decisions of a state's highest court regarding ownership of property rights potentially included in the estate were to be followed, the Supreme Court indicated. *Id.* at 465.

121. 291 U.S. 35 (1934). *Freuler* is a poorly written opinion by Justice Roberts that lower courts concluded, probably erroneously, indicated that state trial court determinations regarding property interests were binding on federal courts in tax cases. See Gilbert P. Verbit, *State Court Decisions in Federal Transfer Tax Litigation: Bosch Revisited*, 23 REAL PROP. PROB. & TR. J. 407, 414-17 (1988) (describing the interpretation of *Freuler* by Illinois courts).

122. *Bluestein*, 15 T.C. at 783-84. It is fair to guess that the Commissioner smelled a hint of collusion in the above scenario. Since Alec's estate was taxed at a marginal rate substantially in excess of 33%, even the two brothers active in the business stood to benefit from the above result; the net loss of a one-sixth interest in "their mother's half" of the business by each of the two sons active in the business was more than offset by the fact that the one-third interest thus passing to each of them from their mother would escape any estate tax if it was found not to be a component of their father's estate.

123. I.R.C. § 2053(a)(3) (1988).

124. 260 F. Supp. 493 (N.D. Ill. 1966).

which apparently were paid to them. The executor then amended the estate tax return, claiming a refund for the amount paid to the children as a claim against the estate under § 2053(a)(3). The district court allowed the claim as a deduction.¹²⁵

The dispute in *Russell* involved the allowance of a deduction.¹²⁶ Although the plaintiff could have based his claim for refund on the allegedly erroneous inclusion of misappropriated property, he chose not to do so. Consequently, the court in *Russell*, like the court in *Bluestein*, was never called upon to address squarely the issue of the includibility of misappropriated property in the estate of the wrongdoer.

D. Summary

Federal income tax law, as well as substantive property law, indicate that both contraband and stolen property over which the decedent exercised dominion and control should be included in the decedent's estate. This most certainly should be the case where, as in TAM 91-52-005, the heirs also sought to assert dominion and control over the assets for a number of years after the assets came into their hands. The decedents in both TAM 91-52-005 and TAM 92-07-004 held valuable property interests in the assets that they possessed. Their deaths effected a transfer of their interests in these assets to their respective heirs. The requirements of § 2033 and of the estate tax have been satisfied. The next issue in need of discussion is the value to be assigned to those interests.

III. VALUATION

Under § 2031 of the Code, the gross estate of the decedent consists of "the value at the time of his death of all property" includible in his estate.¹²⁷ The statute does not indicate how value is to be determined, but the relevant regulations provide that the value of property is its fair market value, defined as "[t]he price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."¹²⁸

125. *Id.* at 496-501.

126. The IRS objected to the deduction on the ground that it violated standards promulgated in Rev. Rul. 60-247, 1960-2 C.B. 272. The district court rejected the interpretation of I.R.C. § 2053(c)(3) given by the IRS in Rev. Rul. 60-247 and allowed the deduction. *Russell*, 260 F. Supp. at 499-500. The opinion in *Russell*, like the opinion in *Bluestein*, is hardly a model of clarity.

127. I.R.C. § 2031 (1988).

128. Treas. Reg. § 20.2031-1(b) (as amended in 1965).

The need to determine fair market value under the Code is not limited to this one application in the estate tax, but extends to the gift tax¹²⁹ and income tax¹³⁰ as well. Because the same definition of fair market value is used in these taxes, relevant authorities involving gift and income taxes will also be used throughout the following discussion.

A. Valuation of Stolen Property

In addressing the valuation issue with respect to the stolen property involved in TAM 91-52-005, the IRS indicated that it is appropriate to value the stolen works of art in both the legitimate and illicit art markets, and that the appropriate value for estate tax purposes is "the highest price that would have been paid at that time whether in the discreet retail market or in the legitimate art market."¹³¹ It also backstopped the valuation issue by determining a minimum term-of-years value based on the ten-year period of time during which the decedent's siblings held the art works.

1. Consideration of Illicit Market Valuation

In justifying the propriety of considering the illicit market value of stolen property, the IRS cited several income tax cases in which it had estimated drug dealers' taxable incomes based on the receipts that they would have reaped from their activities in the illegal drug market.¹³² Use of such data in assigning value in TAM 91-52-005 appears to be justified, partly because the decedent apparently used the illicit market to dispose of stolen art works, and because the heirs themselves also sought to use this market to realize the illicit market value of the property. Moreover, as previously noted, the decedent's heirs received from him a thief's possessory interest in the works of art, which concededly is of some value.¹³³ It grants to the owner an interest in the property which is superior to that of all the world other than the "true owner." If this possessory interest's highest value exists in the illicit market, then that is where it should be valued.

129. I.R.C. § 2512(a) (1988). The gift tax regulations contain a definition of value identical to that provided by the estate tax regulations. See Treas. Reg. § 25.2512-1 (as amended in 1992).

130. Fair market value must be determined under the income tax for the purpose of measuring the value of in-kind receipts as income and for the purpose of measuring the amount of permitted deductions. I.R.C. § 170 (1988 & Supp. III 1991), which allows a deduction for gifts to charities, provides one of the most common of such opportunities. The regulations under § 170 contain a definition of fair market value identical to that found in the estate and gift tax regulations. See Treas. Reg. § 1.170A-1(c)(2) (as amended in 1990).

131. TAM 91-52-005, *supra* note 4, at 16,861.

132. See *Browning v. Commissioner*, 61 T.C.M. (CCH) 2053, 2062 (1991); *Jones v. Commissioner*, 61 T.C.M. (CCH) 1721, 1736 (1991); *Caffery v. Commissioner*, 60 T.C.M. (CCH) 807, 816 (1990). The facts of *Jones* and *Caffery* are discussed *infra* note 176.

133. See *supra* notes 80-98 and accompanying text.

2. Selection of the Correct Value

The IRS's use of the highest value in either the legitimate or illicit markets merits some discussion. When it refers to the legitimate art market value of stolen property, TAM 91-52-005 is unclear as to whether it is referring to the value realizable in that market by the "true owner" or the value realizable in that market by the thief.¹³⁴ If the IRS seeks to assign the true owner's legitimate market value to the thief's possessory interest, this is clearly a wrong result, as the following discussion will bear out.¹³⁵ If the IRS, in its reference to "the highest price . . . in the discreet retail market or the legitimate art market," is referring to the highest price which would be paid in either market for a thief's possessory interest, with all parties fully informed as to its nature, then this author and the authorities discussed below are in full accord with that position.

Although the legitimate art market, circa 1990, assigned a value to the Quedlinburg art treasure ranging between \$50 million and \$100 million,¹³⁶ the decedent's siblings were unable to obtain more than \$3 million in the illicit market for the most valuable piece alone. They ultimately realized only \$2.75 million on the entire Quedlinburg treasure.¹³⁷ Leaving aside for the time being the issue of changes in the value of the property from the time of the decedent's death in 1980 to 1990, the first issue to resolve is the relevance of the art objects' legitimate market value of between \$50 million and \$100 million. This value is irrelevant because it (or its comparable 1980 value) represents the "true owner" fair market value, not the thief's possessory interest value that the decedent had and transferred to his heirs. The thief's possessory interest is reflected by the value range of \$2.75 to 3 million that the heirs developed in the illicit market and the reward market. As that value is all the decedent's heirs could hope to receive for the art, it represents the value of the interest conveyed by the decedent to his heirs.¹³⁸

In essence, the use of an illicit market value or the reward value for such property provides a workable mechanism for obtaining a value for the limited property interest which the possessor has in the stolen goods. It is comparable to establishing a discounted fair market value for a situation where the possessor holds property under a clouded title.

134. See TAM 91-52-005, *supra* note 4, at 16,859-61.

135. See *infra* notes 136-49 and accompanying text.

136. See *supra* note 17 and accompanying text.

137. See *supra* notes 18, 21 and accompanying text.

138. After resolving the need to dismiss the "true owner" value in the legitimate art market from consideration in this case, it would then be necessary to determine the 1980 date-of-death illicit market value or reward value for the stolen treasure to determine the value to be included in the decedent's estate.

The judiciary has long dealt with clouded titles in tax valuation cases and has had no difficulty in including such interests in the estate subject to a discount representing the cloud on the title. For example, in *Adams v. Commissioner*,¹³⁹ the taxpayer donated the original prototype of the famed Norden bombsight to the Smithsonian Museum, claiming a value of \$75,000.¹⁴⁰ Because there was some dispute as to whether the taxpayer, the inventor's donee, had good title to the prototype or whether it belonged to the U.S. government for whom it was developed, the court decided that a reduction in value was called for to reflect this cloud on title.¹⁴¹

*Porter v. Commissioner*¹⁴² involved a set of facts similar to those in *Bluestein*.¹⁴³ The decedent had previously been divorced from her spouse in a community property state.¹⁴⁴ The former husband held all property in his name and maintained that all was his separate property.¹⁴⁵ At the decedent's death, her surviving issue who were the sole legatees under her will,¹⁴⁶ instituted suit to obtain one-half of such property based on it actually being community property.¹⁴⁷ They ultimately prevailed at trial.¹⁴⁸ The Tax Court held that, at the mother's death, her estate should include the value of her community interest minus a significant deduction to reflect the cloud over title produced by the husband's claim that the property was separate and not community property.¹⁴⁹

3. In the Alternative: Term-of-Years Valuation

The last issue worthy of discussion is the appropriateness of the IRS's use of the discounted term of years value as a backstop to the valuation issue. Using standard valuation tables prescribed under Regulation section 20.2031-10,¹⁵⁰ the IRS determined that, since the decedent, at a minimum, had successfully transferred to his siblings a ten-year undisturbed term-of-years in the stolen art works beginning in 1980, 55.8395% of the 1980 fair market value of that property should be included in his estate.¹⁵¹

139. 50 T.C.M. (CCH) 48 (1985).

140. *Id.* at 49.

141. *Id.* at 50-52.

142. 49 T.C. 207 (1967).

143. See *supra* notes 112-23 and accompanying text.

144. *Porter*, 49 T.C. at 209.

145. *Id.* at 211.

146. *Id.* at 209.

147. *Id.* at 211.

148. 49 T.C. at 213 (citing *Porter v. Porter*, 331 P.2d 360 (N.M. 1958)).

149. *Id.* at 219-24. For a more concise exposition of the thrust of the decision, see the concurring opinion of Judge Raum. *Id.* at 227 (Raum, J., concurring).

150. Treas. Reg. § 20.2031-10 (as amended in 1984).

151. TAM 91-52-005, *supra* note 4, at 16,860.

Several criticisms can be made of this approach. First, it is based on ten years' worth of hindsight, and as such is of no value in establishing a 1980 fair market value. Second, even if employed, all the decedent actually transferred to his siblings was the right to enjoy the art works for ten years. They in essence received 55.8395% of the right to enjoy the collected manuscripts, reliquaries, coins, and the like. There is no evidence of the value of the right to enjoy only, exclusive of the right to sell the stolen works of art. Presumably, the right to enjoy such items is only a fraction of their illicit market sale value.

B. Valuation of Seized Contraband

Analysis of the valuation issue with respect to contraband is closely related to the valuation analysis of stolen property. Much of this section will reinforce conclusions drawn above. In TAM 92-07-004, the IRS concluded that the 662.5 pounds of marijuana held by the drug-smuggling taxpayer at his death should be valued for inclusion in his estate at the "retail street value" of average grade marijuana in the city area near the crash site.

Determining the appropriate market for valuation of goods is often difficult. The regulations provide that property is not to be valued in "a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate."¹⁵² Where property "is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item . . . would be sold at retail."¹⁵³ The regulations then give the example of an automobile, and indicate that because it is commonly obtained by the public in the retail market, that market should be used in assigning value to a car in the decedent's estate.¹⁵⁴ This language is arguably the best justification for the IRS's use of retail street value in assigning value to several bales of marijuana in the hands of a drug dealer/smuggler.

Under the facts of TAM 92-07-004, however, the use of retail street value is inappropriate, because that is not the market in which a wholesale distributor would sell his drugs. Although the above-mentioned use of retail values is appropriate for household possessions such as a used automobile, which would be purchased at retail value from a vendor of used cars, it is inappropriate where the items or their composition represent goods an individual would not purchase in the retail market. For example, although a decedent's personal automobile should be valued at retail, if the decedent were also a wholesaler of used automobiles, those cars should be valued in

152. Treas. Reg. § 20.2031-1(b) (as amended in 1965).

153. *Id.*

154. *Id.*

the market in which they would be sold—the wholesale used car market.¹⁵⁵ Consistent with this conclusion, the regulations state that where a party gives property to a charity, the market to be used for purposes of determining the amount of an income tax deduction is the market in which the donor normally would sell the property.¹⁵⁶ Moreover, the quantity of the property given should also be considered in determining such value.¹⁵⁷ The regulation states that “[t]he usual market of a manufacturer or other producer consists of the wholesalers or other distributors to or through whom he customarily sells, unless he sells only at retail in which event it is his retail customers.”¹⁵⁸

In *Anselmo v. Commissioner*,¹⁵⁹ a classic bulk gem purchase tax shelter case, the Tax Court was called on to value 461 low grade unset gems that the taxpayer had purchased in bulk for \$15,000 and, nine months later, had given to the Smithsonian Museum, claiming a charitable contribution deduction under I.R.C. § 170¹⁶⁰ based on their alleged \$80,680 retail value.¹⁶¹ The Tax Court first acknowledged that the same principles applied to determining valuation for estate, gift, and income tax purposes.¹⁶² It then sought to explain the apparent conflict between the retail market reference in Regulation section 20.2031-1(b) and the reference to wholesale values in Regulation section 1.170A-1(c)(2).¹⁶³

The IRS anxiously pressed the use of wholesale bulk values for § 170 purposes, based largely on the reference in Regulation section 1.170A-1(c)(2) to such values.¹⁶⁴ The Tax Court noted that the use of such values was appropriate where the donor was a dealer who normally sold such property in bulk at wholesale to other dealers.¹⁶⁵ Because *Anselmo* was a lawyer and not a dealer in gems, that regulation was not controlling concerning the market in which his goods were to be valued.¹⁶⁶

155. See Treas. Reg. § 20.2031-3 (as amended in 1992) (indicating that business assets are to be valued at their appraised value). This presumably means that business inventory is to be valued as inventory and not at its retail value. See also Rev. Proc. 77-12, 1977-1 C.B. 569, which, by using the cost of reproduction method as one of the acceptable methods for valuing inventory, most clearly indicates that producers and wholesalers are not expected to value inventory at retail. *Id.* at 569.

156. Treas. Reg. § 1.170A-1(c)(2) (as amended in 1990).

157. *Id.*

158. *Id.* § 1.170A-1(c)(1).

159. 80 T.C. 872 (1983), *aff'd*, 757 F.2d 1208 (11th Cir. 1985).

160. I.R.C. § 170 (1988 & Supp. III 1991).

161. *Anselmo*, 80 T.C. at 873-76.

162. *Id.* at 881.

163. *Id.* at 881-84.

164. *Id.* at 883.

165. *Id.* at 884.

166. *Id.*

In discussing the application of Regulation section 20.2031-1(b), the Tax Court noted that unset gems of the quality the taxpayer bought were rarely, if ever, sold to individual customers in jewelry, discount, or department stores.¹⁶⁷ Such stones were typically sold to manufacturing or retail jewelers who set the stones for eventual sale to retail customers.¹⁶⁸ The court found that the appropriate market for valuing the taxpayer's unset low quality gems was the wholesale market, because that market was the nearest thing to a "'market . . . in which such item is most commonly sold to the public.'"¹⁶⁹

Applying the reasoning of *Anselmo* to the facts in TAM 92-07-004, a strong argument can be made that the use of "retail street value" is inappropriate for valuing a bulk supply of 662.5 pounds of baled marijuana in the hands of a smuggler.¹⁷⁰ At retail these goods are not sold in bales, but in small packets of an ounce or less.¹⁷¹ Presumably the baled marijuana was to be sold to suppliers who were to sell it to others in the chain of distribution. Regulation section 1.170A-1(c)(2) indicates that in such a case the value to the taxpayer's customers is the appropriate value to use.¹⁷² Since vast mark-ups occur with contraband as it makes its way from smuggler to eventual retail customers,¹⁷³ use of retail street value results in a vast overstatement of the fair market value of these assets in a decedent's estate.

Use of retail street value for valuing the marijuana in TAM 92-07-004 should be rejected as inconsistent with the Tax Court's disposition of *Anselmo*. Since sale of marijuana to the public at retail requires its division into small packages, the bales of marijuana in the possession of the decedent were much like the unset gems in the hands of taxpayer *Anselmo*. Their only real market for sale to customers was the wholesale drug market, where they would be sold at a fraction of their retail street value.¹⁷⁴ To

167. *Id.* at 877.

168. *Id.* at 876-78, 882.

169. *Id.* at 881 (quoting Treas. Reg. § 20.2031-1(b) (as amended in 1965)).

170. In TAM 92-07-004, *supra* note 5, at 16,954, the IRS noted that federal and local law enforcement authorities had long suspected the taxpayer of drug smuggling. *Id.* Furthermore, although he was never arrested for drug smuggling, the decedent, on several occasions, had been arrested and convicted of offenses "involving airplanes and airplane equipment used in drug smuggling." *Id.*

171. Given that in 1991 an ounce of marijuana was selling for as much as \$550, U.S. DEP'T OF JUSTICE, ILLEGAL DRUG PRICE/PURITY REPORT 5 (1992), one can readily infer that most users of marijuana will not purchase more than one ounce at a time.

172. See Treas. Reg. § 1.170A-1(c)(2) (as amended in 1990).

173. See *infra* note 174.

174. The mark-up in the illicit drug market from wholesale to retail can be considerable. It appears to be greatest in the case of diazepam (Valium), where the mark-up can be as much as tenfold. See U.S. DEPT. OF JUSTICE, *supra* note 171, at 11. The Department of Justice's report compares marijuana prices at pound quantities and ounce quantities, rather than at wholesale and

value these bales at their retail street value would be comparable to valuing inventory in the hands of a manufacturer at retail value, or valuing a large tract of undeveloped land at its value as subdivided building lots.¹⁷⁵

The Treasury states in TAM 92-07-004 that it is under no obligation to assume that a taxpayer will sell drugs in the lowest market; rather, it is free to presume that the drugs will be sold in the market that will yield the highest price.¹⁷⁶ A problem with the use of this approach to justify resort to retail values on the facts of the TAM is that marijuana is not sold in bales in retail street transactions. Furthermore, TAM 92-07-004 characterizes the decedent as a smuggler and not as a street-level dealer.¹⁷⁷ One possible explanation for the IRS's approach to the issue is its desire to force estates like that involved to disclose fully the nature of the decedent's activities—as a smuggler at wholesale—to avoid retail valuation. This disclosure might result in the forfeiture of all of the decedent's other property holdings

retail. In 1991, the price of one ounce at the "ounce level" was as much as three times greater than an ounce at the "pound level." See *id.* at 5.

175. Although the IRS, in the absence of specific statutory mandate to the contrary, *e.g.*, I.R.C. § 2032A (1988 & Supp. III 1991) (detailing rules for qualifying real property for valuation purposes), is obliged to tax a decedent's estate at its highest and best use, there is no justification for its recasting the form and character of the owned interests subject to tax. For example, although the IRS, in the absence of the applicability of § 2032A, is free to value farm land at its value as residential property, it is not free to value farm land at its subdivided improved value where such subdivision and improvement has not occurred.

176. The Treasury cited several income tax cases as supporting its position that "retail street value" should be used in valuing the stolen marijuana. See *Jones v. Commissioner*, 61 T.C.M. (CCH) 1721, 1727 (1991); *Caffery v. Commissioner*, 60 T.C.M. (CCH) 807, 809-10 (1990); *Costa v. Commissioner*, 60 T.C.M. (CCH) 1178, 1180 (1990). TAM 92-07-004 appears to have misconstrued and misapplied these cases. In *Jones*, the taxpayer was a distributor of cocaine who purchased from smugglers and sold to wholesalers. In estimating the taxpayer's income from a 42 kilo purchase of cocaine, the Tax Court found that the selling price "to a wholesale dealer for a pound of cocaine ranged from approximately \$32,000 to \$44,800." It thus approved a value of \$40,000 per pound in estimating the taxpayer's receipts for the sale of the 42 kilos of cocaine, erroneously characterizing this as a "retail street-value." *Jones*, 61 T.C.M. (CCH) at 1727. The IRS has seized on this misuse of the term "retail" in characterizing sales to wholesalers to justify use of retail values. See TAM 92-07-004, *supra* note 5, at 16,956-57. Similarly, in *Costa*, retail versus wholesale value and the position of the wrongdoer within the illegal drug industry was never really at issue. The taxpayer in that case was a woman married to a drug dealer. The court held that she escaped tax liability for her husband's drug dealings under the innocent spouse rule. *Costa*, 60 T.C.M. (CCH) at 1190-92. In *Caffery*, the taxpayer in question purchased marijuana for \$230 per pound and had his income from its sale determined based on an estimated \$250 per pound "street value." *Caffery*, 60 T.C.M. (CCH) at 809. The Tax Court, it should be noted, did not use the term "retail," and indeed, its characterization of the taxpayer's activity is insufficient to enable one to determine exactly his place in the chain of distribution. *Id.* at 808-09. The modest mark-up of his drugs does indicate that the case did not involve an attempt to calculate the taxpayer's income by determining his receipts based on placing him at an inappropriate level in the chain of distribution.

177. See *supra* notes 50-51, 170 and accompanying text.

under state and federal forfeiture laws.¹⁷⁸ Laudable as such a goal may be, it does not justify inappropriate valuation methods. Where, as in TAM 92-07-004, the facts as recited by the IRS indicate the status of the decedent to be that of a smuggler of marijuana in a form that can only be sold at wholesale, those drugs should be valued in the wholesale market.¹⁷⁹

C. Summary

The following general observations with respect to valuation of the fruits of crime includible in an estate are in order. First, because of their nature as "hot property," these assets are valued in their own special markets. In the case of stolen property, its lack of clear title will most likely result in its having a market value a good deal less than its value in the legitimate market to a holder with good title. In the case of contraband such as narcotics, the illicit market value may in many circumstances vastly exceed legitimate market value. For example, cocaine can be purchased by pharmaceutical companies operating in the legal pharmaceutical market for a fraction of its value in the illicit market.¹⁸⁰

Another point that these TAM make clear is that, in valuing property in the illicit marketplace, it is essential to determine at what stage in the distribution chain the goods are to be valued. Determination of the appropriate level requires one to determine the customer base for goods of the character and form held by the decedent. Thus, in determining value for the fruits of criminal activity, we should be applying the same valuation principles used to value other comparable property legally held by the taxpayer.

178. For a discussion demonstrating the vastness of the scope of forfeiture legislation at the federal and state levels, see DAVID SMITH, PROSECUTION AND DEFENSE OF FORFEITURE CASES (1985).

179. In closing this discussion of the IRS's insistence on use of the highest market value (either retail or wholesale), it is worth noting the inconsistency of its presumption that the marijuana was "average" and not highest grade. Compare TAM 92-07-004, *supra* note 5, at 16,956-57 (arguing that the marijuana should be valued at its highest price) with *id.* (citing *Kent v. Commissioner*, 51 T.C.M. (CCH) 1605 (1986), and arguing that the marijuana should be presumed to be of average quality). Perhaps the Service feels compelled to adopt this more lenient posture on the quality issue, since governmental authorities, by their destruction of the contraband, had effectively precluded the taxpayer's estate from introducing evidence as to quality.

180. The reason illegal drugs are so expensive is that they are illegal. Consumers pay high prices for such drugs not because of high production costs, but because suppliers must endure considerable risk to provide the drugs. Because pharmaceutical companies need not fear losing entire shipments to drug enforcement officials or facing criminal prosecution, they can afford to accept a much smaller profit margin than their outlaw counterparts. See James Cook, *The Paradox of Antidrug Enforcement*, FORBES, Nov. 13, 1989, at 110.

IV. DEDUCTIBILITY AFTER RETURN OR FORFEITURE

Both TAM 91-52-005 and TAM 92-07-004 deal with the issue of whether a deduction should be allowed under either § 2053¹⁸¹ or § 2054¹⁸² when an estate that includes the fruits of crime returns such property to its rightful owner, or surrenders it to authorities who seize it acting pursuant to forfeiture legislation. As this article has noted, in TAM 91-52-005 the IRS ruled that because, under Texas law, claims could no longer be filed against the decedent's estate, no deduction could be allowed under § 2053 when the stolen property was returned to the "true owner."¹⁸³ In TAM 92-07-004, the IRS disallowed a deduction under either § 2053 or § 2054 on the basis that allowing a deduction for the loss of confiscated marijuana would undermine national public policy against trafficking in controlled substances.¹⁸⁴ This section discusses the appropriateness of the IRS's resolution of these issues. The application of the public policy doctrine will be explored first, since its broad applicability will often moot discussion of other issues.

A. *A Brief History of the Public Policy Doctrine*

The use of a public policy rationale to disallow deductions has a somewhat checkered history.¹⁸⁵ Prior to the Supreme Court's decision in *Tank Truck Rentals, Inc. v. Commissioner*,¹⁸⁶ the Court flirted with, but never fully embraced, the idea of denying deductions based squarely on the ground that allowance of a deduction for a particular expenditure under the income tax would violate public policy.¹⁸⁷ In *Tank Truck Rentals* the taxpayer, an interstate shipper of liquids, intentionally operated trucks that exceeded Pennsylvania weight limits.¹⁸⁸ For reasons of safety and

181. I.R.C. § 2053 (1988).

182. I.R.C. § 2054 (1988).

183. See *supra* notes 44-48 and accompanying text.

184. See *supra* notes 64-71 and accompanying text.

185. See Andrew Shoemaker, Note, *The Smuggler's Blues: Wood v. United States and the Resulting Horizontal Inequity Among Criminals in the Allowance of Federal Income Tax Deductions*, 11 VA. TAX REV. 659, 665-75 (1992); Robert Peace & Carl Messere, *Tax Deductions and Criminal Activities: The Effects of Recent Tax Legislation*, 20 RUTGERS L.J. 415, 418-429 (1989); Cathryn Deal, *Reining in the Unruly Horse: The Public Policy Test for Disallowing Tax Deductions*, 9 VT. L. REV. 11, 17-38 (1984); George Tyler, *Disallowance of Deductions on Public Policy Grounds*, 20 TAX L. REV. 665 *passim* (1965).

186. 356 U.S. 30 (1958).

187. See, e.g., *Clarke v. Haberle Crystal Springs Brewing Co.*, 280 U.S. 384, 386-87 (1930); *United States v. Sullivan*, 274 U.S. 259, 264 (1927).

188. *Tank Truck Rentals, Inc. v. Commissioner*, 26 T.C. 427, 433 (1956) *aff'd*, 356 U.S. 30 (1958).

economy,¹⁸⁹ the taxpayer chose to pay occasional fines rather than to operate trucks that complied with state law. In denying a business expense deduction under § 162¹⁹⁰ for the fines, the Court observed:

Petitioner's failure to comply with the state laws obviously was based on a balancing of the cost of compliance against the chance of detection. Such a course cannot be sanctioned, for judicial deference to state action requires, whenever possible, that a State not be thwarted in its policy. We will not presume that the Congress, in allowing deductions for income tax purposes, intended to encourage a business enterprise to violate the declared policy of a State. To allow the deduction sought here would but encourage continued violations of state law by increasing the odds in favor of noncompliance. This could only tend to destroy the effectiveness of the State's maximum weight laws.¹⁹¹

Unfortunately, the Court in *Tank Truck Rentals* provided no clear standard for determining when an illegal payment or a payment related to illegal activities should be disallowed based on a public policy rationale. In the years that followed, this resulted in a series of uneven decisions by lower court judges.¹⁹²

Dissatisfaction with these results led Congress in 1969 to enact specific statutory guidelines disallowing deductions in prescribed circumstances. Congress provided specific guidance with respect to the deductibility of antitrust treble damages,¹⁹³ fines and penalties,¹⁹⁴ as well as illegal bribes and kickbacks.¹⁹⁵ This legislation originated in the Senate.¹⁹⁶ The Senate Finance Committee, in explaining the reasons for the change, noted the lack of congressional guidance for application of the public policy

189. Because of the weight of some of the liquids transported in the taxpayer's trucks, the only way to have complied with the weight limits would have entailed operating trucks that were only partially full. *See id.* Such a practice was undesirable "by reason of the unsafe and hazardous condition which the surge in such partially loaded tanks created in stopping the motor vehicles and in negotiating the equipment around the curves of the highways." *Id.* at 434.

190. I.R.C. § 162 (West Supp. 1993).

191. *Tank Truck Rentals*, 356 U.S. at 34-35.

192. *See* Tyler, *supra* note 185, at 675-96 (comparing, *inter alia*, National Outdoor Advertising Bureau, Inc. v. Helvering, 89 F.2d 878 (2d Cir. 1937), *overruled by* Tellier v. Commissioner, 342 F.2d 690 (2d Cir. 1965), and Dixie Mach. Welding & Metal Works, Inc. v. United States, 315 F.2d 439 (5th Cir.), *cert. denied*, 373 U.S. 950 (1963); with Kirtz v. United States, 304 F.2d 460 (Ct. Cl. 1962); United States v. Winters, 261 F.2d 675 (10th Cir. 1958), *cert. denied*, 359 U.S. 943 (1959); and Stacy v. United States, 231 F. Supp. 304 (S.D. Miss. 1963)).

193. I.R.C. § 162(g) (1988).

194. I.R.C. § 162(f) (1988).

195. I.R.C. § 162(c) (1988).

196. *See* CONF. REP. NO. 782, 91st Cong., 1st Sess. 331, 332 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2392, 2447.

doctrine.¹⁹⁷ The foregoing changes, the Committee noted, were intended to rectify that situation.¹⁹⁸ The Committee then stated that “[t]he 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.”¹⁹⁹

The Treasury subsequently amended its regulations to indicate that, except as provided by Congress in §§ 162(c), (f), and (g), the public policy doctrine would no longer be used to disallow otherwise allowable deductions under § 162.²⁰⁰ The IRS, however, has taken the position that the 1969 Congressional restriction of the public policy doctrine applies only to deductions under § 162.²⁰¹ It asserts, with the support of the judiciary, that the public policy doctrine is alive and well in other sections of the Code.²⁰² For example, in *Holt v. Commissioner*,²⁰³ the IRS had stipulated that a drug dealer taxpayer should be allowed a deduction for the cost of goods sold (marijuana), as well as various business expenses such as sales commissions, drivers expenses, and legal and professional fees. The taxpayer

197. See S. REP. NO. 552, 91st Cong., 1st Sess. 274 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2311.

198. *Id.*

199. *Id.* The Senate Finance Committee restated its position in 1971 when amending I.R.C. § 162. S. REP. NO. 437, 92d Cong., 1st Sess. 72 (1971), reprinted in 1971 U.S.C.C.A.N. 1918, states that “the determination of when a deduction should be denied should remain under the control of Congress.” *Id.* at 1979.

200. See Treas. Reg. § 1.162-1(a) (as amended in 1988), stating: “A deduction for an expense paid or incurred after December 30, 1969, which would otherwise be allowable under § 162 shall not be denied on the grounds that allowance of such deduction would frustrate a sharply defined public policy.”

201. See Rev. Rul. 77-126, 1977-1 C.B. 47.

202. See, e.g., *Wood v. United States*, 863 F.2d 417, 420-22 (5th Cir. 1989) (disallowing a deduction claimed under I.R.C. § 165 for forfeited drug smuggling proceeds); *Bob Jones Univ. v. United States*, 639 F.2d 147, 157 (4th Cir. 1980) (Widener, J., dissenting) (suggesting that the public policy doctrine could, theoretically, be used to revoke a charitable organization's tax-exempt status under I.R.C. § 501(c)(3) (1988)); *Blackman v. Commissioner*, 88 T.C. 677, 682-83 (1987) (holding that the taxpayer was not entitled to a § 165(c)(3) casualty loss deduction where the taxpayer had deliberately ignited a pile of his wife's clothes, thus causing his residence to burn, on the ground that to allow such a deduction would violate Maryland's public policies against arson and domestic violence, and stating that “[w]e refuse to encourage couples to settle their disputes with fire”); *Holmes Enters., Inc. v. Commissioner*, 69 T.C. 114, 115-18 (1977) (holding that the taxpayer was not entitled to a deduction under either § 165(a) or § 1231(a) when the taxpayer's sole shareholder was convicted of marijuana possession and forced to forfeit an automobile because allowing such a deduction would frustrate public policy).

On occasion, the Tax Court has expressed the concern that congressional action in 1969 might have, in essence, terminated the public policy doctrine not just in § 162, but in all other sections of the Code. See *Medeiros v. Commissioner*, 77 T.C. 1255, 1262 n.8 (1981). Still, the Tax Court has never embraced this position in its opinions, which are to the contrary.

203. 69 T.C. 75 (1977).

claimed a deduction under either § 162²⁰⁴ or § 165²⁰⁵ for forfeited drugs and a forfeited truck and trailer used to transport the drugs. The Tax Court found that the drugs and transportation equipment could not qualify as deductible expenditures under § 162.²⁰⁶ The Court also denied a deduction for their loss under § 165 based on the fact that allowance of such a deduction would frustrate a well-defined national policy against trafficking in controlled substances.²⁰⁷ Similarly, in *Wood v. United States*,²⁰⁸ the Fifth Circuit Court of Appeals denied a loss deduction under I.R.C. § 165 to a drug dealer who was required to forfeit profits from drug-dealing conducted in past years.²⁰⁹ The court rested its decision squarely on the public policy rationale of *Tank Truck Rentals*.²¹⁰ Given the well defined public policy against dealing in drugs as embodied in the nation's drug laws, the court denied the taxpayer's claim for an income tax loss under § 165 due to the forfeiture of the fruits of his drug smuggling operation.²¹¹

The most recent chapter in the legislative history of the public policy doctrine was written in 1982, when Congress belatedly discovered that the 1969 amendments to § 162 compelled the IRS to allow drug dealers business deductions for items such as telephone, automobile, and rental expenditures.²¹² It reacted sharply by adding § 280E to the Code, which disallows a deduction for amounts paid or incurred in carrying on a trade or business consisting of trafficking in controlled substances.²¹³

One may infer from the foregoing brief history of the public policy doctrine that the judiciary is likely to sustain the Commissioner's application of the doctrine to deny a deduction under § 2053 or § 2054 in drug forfeiture situations. Presumably, application of the doctrine will not be limited to forfeitures involving controlled substances and the instrumentalities of trafficking in them, but will, if *Wood* is a guide, extend to forfeitures of legal goods that are purchased with the profits from dealing in controlled substances.

One of the real difficulties with the public policy doctrine is determining the precise extent of its application. For example, should the doctrine

204. I.R.C. § 162 (West Supp. 1993).

205. I.R.C. § 165 (1988).

206. *Holt*, 69 T.C. at 78.

207. *Id.* at 79-81.

208. 863 F.2d 417 (5th Cir. 1989).

209. *Id.* at 420-22.

210. *Id.*

211. *Id.*

212. See S. REP. NO. 494, 97th Cong., 2d Sess. 309 (1982), reprinted in 1982 U.S.C.C.A.N. 781, 1050; cf. *Holt v. Commissioner*, 69 T.C. 75, 77 (1977) (denying a § 165 deduction to drug-dealers for tools of their trade that the government had confiscated).

213. See I.R.C. § 280E (1988).

be applied in the case of all forfeitures²¹⁴ (e.g., those resulting from illegal gambling, racketeering, moonshining, and dealing in narcotics) or just those involving trafficking in controlled substances? Similarly, does it undermine national policy against theft and dealing in stolen property to allow a deduction to holders of stolen property who are compelled to return the property to its rightful owner?

Application of the doctrine in other areas of the Code involves the same issues that were raised by its application under § 162. The lack of clearly articulated standards as to what types of illegal activities are worthy of the added sanction of deduction disallowance results in arbitrary judicial outcomes.²¹⁵ For example, although the Tax Court found that allowing a deduction for restitution of embezzled funds would undermine a national policy against embezzlement,²¹⁶ the Second Circuit Court of Appeals did not share the Tax Court's finely honed sense of moral outrage over this crime and allowed the deduction.²¹⁷ Why embezzlement does not trigger disallowance of a loss deduction under § 165 based on a public policy analysis but illegal gambling,²¹⁸ dealing in stolen property,²¹⁹ and arson²²⁰ do is hard to explain.²²¹

The arbitrary imposition of the public policy disallowance doctrine is compounded by the fact that, once imposed, the impact of the sanction largely depends on a variety of other factors, such as the tax bracket of the

214. For a good discussion of the extensiveness of the forfeiture laws, see SMITH, *supra* note 178.

215. See Tyler, *supra* note 185, at 675-96.

216. See *Stephens v. Commissioner*, 93 T.C. 108, 112-13 (1989), *rev'd*, 905 F.2d 667 (2d Cir. 1990).

217. See *Stephens v. Commissioner*, 905 F.2d 667, 670-74 (2d Cir. 1990).

218. See *Farris v. Commissioner*, 50 T.C.M. (CCH) 412, 415-17 (1985), *aff'd*, 823 F.2d 1552 (9th Cir. 1987) (disallowing losses relating to FBI's seizure of cash and gambling equipment).

219. See *Lincoln v. Commissioner*, 50 T.C.M. (CCH) 185, 188-89 (1985) (disallowing loss where taxpayer paid money to purchase stolen money at a discount, but was swindled, and never received any stolen money).

220. See *Blackman v. Commissioner*, 88 T.C. 677, 682-83 (1987), *aff'd*, 867 F.2d 605 (1st Cir. 1988). For a brief description of this case, see *supra* note 202.

221. A proponent of Critical Legal Studies might suggest that the lenient treatment of embezzlement has more to do with the class background of most perpetrators of this white collar crime than it does with any substantive distinctions one can develop. For a discussion of various recurring themes in Critical Legal Studies writing, see MARK KELMAN, *A GUIDE TO CRITICAL LEGAL STUDIES* (1987).

A second explanation of the difference in treatment could be that the Supreme Court in *James*, by way of dictum, indicated that an embezzler who included the fruits of his crime in income and then returned embezzled funds would presumably be entitled to a deduction for the returned funds. See *James v. United States*, 366 U.S. 213, 220 (1961). The Second Circuit, however, did not refer to this distinction in a recent decision, in which it allowed an embezzler to deduct amounts repaid to the rightful owners. See *Stephens v. Commissioner*, 905 F.2d 667 (2d Cir. 1990).

taxpayer and the availability of other deductions. For example, take the hypothetical case of an estate that holds \$300,000 of legally derived assets and \$200,000 of illegal drugs which were seized by the government at the decedent's death. Since this is a non-taxable estate,²²² application of the public policy doctrine to disallow a deduction for the seized assets would result in no added sanction. If, however, the estate, in addition to the \$300,000 of legally derived assets, held \$1,200,000 of seized drugs, payment of the resulting net \$363,000²²³ in estate tax due would totally bankrupt the estate.²²⁴

Nonetheless, despite any such concerns with arbitrariness, so long as the judiciary's sense of indignity is offended, the history of the public policy doctrine does not indicate that the courts are likely to reject its application outside of the confines of § 162. Moreover, given Congress's passage of § 280E²²⁵ to deny the allowance of a business expense deduction for traffickers in controlled substances, and the judiciary's consistently tough treatment of drug dealers under § 165,²²⁶ it is fair to assume that, although inconsistent judicial dispositions might be obtained in the case of other crimes, a fairly well articulated and consistent policy is in place with respect to those who deal in controlled substances. The judiciary, thus, can at least be expected to use the public policy doctrine to deny deductions in all cases involving drug trafficking.²²⁷

B. Section 2054: Deduction for Losses

Let us assume that fruits of criminal activity are properly included in the estate at the correct value and that: (1) stolen property is returned to its rightful owner or (2) property associated with criminal activities is forfeited

222. The availability of the \$192,800 unified credit under I.R.C. § 2010 in essence creates a \$600,000 exemption, with the result that no tax is due. I.R.C. § 2010 (1988 & Supp. III 1991).

223. Under I.R.C. § 2001 (1988), a total tax of \$555,800 would be due on the \$1,500,000 estate, which after subtracting the \$192,800 unified credit provided by I.R.C. § 2010 (1988 & Supp. III 1991) would result in a net tax liability of \$363,000. This amount would have to be paid out of the \$300,000 of legally acquired assets remaining after forfeiture.

224. This should in no way be viewed as an unusual phenomenon when dealing with forfeitures. See Christine Meyer, *Zero Tolerance for Forfeiture: A Call for Reform of Civil Forfeiture Law*, 5 NOTRE DAME J.L. ETHICS & PUB. POL'Y 853, 857 (1991) (observing that the forfeiture penalty for purchasers of marijuana can vary considerably depending on whether the customer drives a luxury car, a jalopy, or walks).

225. See *supra* notes 212-13 and accompanying text.

226. See, e.g., *Wood v. United States*, 863 F.2d 417, 420-22 (5th Cir. 1989); *Holt v. Commissioner*, 69 T.C. 75, 79-81 (1977), *aff'd*, 611 F.2d 1160 (5th Cir. 1980). For discussion of these cases, see *supra* notes 203-11 and accompanying text.

227. It is interesting that the disallowance of some expenses previously deductible under § 162 and the requirement that they be capitalized under § 263A might result in the disallowance of any claim for deduction under § 263A, on public policy grounds, for amounts that would have been allowed as a deduction under § 162.

to governmental authorities. It is then appropriate to determine if a deduction should be allowed under § 2054, which provides a deduction for "losses incurred during the settlement of estates arising from fires, storms, shipwrecks, or other casualties, or from theft, when such losses are not compensated for by insurance or otherwise."²²⁸ Only the term "other casualties" could ever remotely be construed as applying to such returns or forfeitures of property. Since scant authority exists under § 2054 construing the meaning of this term,²²⁹ one must resort to authorities that construe the term under § 165(c)(3), which provides an identical deduction under the income tax.²³⁰

It is well established under § 165(c)(3) that, in order for events to be deemed "other casualties," they must possess characteristics that are similar to those of fires, storms, shipwrecks, and thefts.²³¹ The courts and the IRS have generally required that for an act to be deemed a casualty, it must be sudden, unexpected, and unusual.²³² Using such a standard, it is difficult to characterize as a casualty the return of stolen property to the true owner by a possessor who is discovered to be holding such goods. Moreover, it is generally agreed that confiscations of property by a foreign government acting under color of law²³³ and forfeitures of illegally held goods to lawful authorities²³⁴ do not constitute "casualties" as that term is used in § 165(c)(3).²³⁵ For example, in *Powers v. Commissioner*²³⁶ the taxpayer's car was confiscated by East German officials because he allegedly lacked proper documentation necessary for export of the vehicle from West Berlin

228. I.R.C. § 2054 (1988).

229. STEPHENS, *supra* note 80, ¶ 5.04[2].

230. Section 165(c)(3) provides a deduction for "losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft." I.R.C. § 165(c)(3) (1988).

231. See 2 BITTKER, *supra* note 74, ¶ 34.2.

232. For a list of relevant cases, including *Fay v. Helvering*, 120 F.2d 253 (2d Cir. 1941), see 2 BITTKER, *supra* note 74, ¶ 34.2 n.4. The IRS's position is best set forth in Rev. Rul. 72-592, 1972-2 C.B. 101.

233. See *Mozayeny v. Commissioner*, 53 T.C.M. (CCH) 566, 568 (1987); *Richter v. Commissioner*, 24 T.C.M. (CCH) 461, 462 (1965); *Powers v. Commissioner*, 36 T.C. 1191, 1192-93 (1961); *Gurry v. Commissioner*, 27 B.T.A. 1237, 1238 (1933).

234. See *Formel v. Commissioner*, 9 T.C.M. (CCH) 782, 786-87 (1950); *Hughes v. Commissioner*, 1 B.T.A. 944, 945-46 (1925). The opinions in both *Formel* and *Hughes* imply that even illegal seizures by authorities are not casualties. *Id.*

235. Although confiscations of investment assets or property used in a trade or business cannot qualify for deduction under the income tax under § 165(c)(3), they can qualify for deduction under § 165(c)(1) or § 165(c)(2) as losses incurred in a transaction entered into for profit or in a trade or business. I.R.C. § 165(c)(1)-(3) (1988); see *Benichou v. Commissioner*, 29 T.C.M. (CCH) 1156, 1162-65 (1970). Section 2054 provides no deduction for such losses. I.R.C. § 2054 (1988).

236. 36 T.C. 1191 (1961).

through East Germany to the West. The Tax Court, though characterizing the East German action as despotic, rejected a claimed casualty loss deduction because the confiscation lacked the requisite element of "chance, accident or contingency" that the court determined characterized a casualty.²³⁷

In light of *Powers* and other similarly narrow readings of the casualty loss deduction in the cases of confiscations and forfeitures,²³⁸ it is hard to conceive of a forfeiture of the instrumentalities of crime or of the fruits of criminal activities that would qualify for casualty loss treatment. Such seizures, though they might be sudden, can hardly be deemed unexpected or unusual. Because forfeitures should not qualify for deduction under § 2054, it is surprising that the IRS even considered the possibility of its application in TAM 92-07-004 before disposing of the deduction issue by resorting to the public policy doctrine.²³⁹

C. Section 2053(a)(3): Deduction for Claims Against the Estate

Section 2053(a)(3) of the Code provides that "the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts . . . for claims against the estate . . . as are allowable by the laws of the jurisdiction . . . under which the estate is being administered."²⁴⁰ It is beyond the scope of this paper to discuss all the possible applications of § 2053(a)(3) to forfeitures and returns of stolen property. This paper shall therefore concentrate on one of the most interesting issues regarding § 2053(a)(3) as it applies to such returns and forfeitures.

One major unresolved issue under § 2053(a)(3) is whether the use of the word "allowable," as contrasted with "allowed," indicates that actual payment of the claim is not essential for deduction of a claim under § 2053(a)(3).²⁴¹ With a degree of judicial approval, the IRS takes the position, as it did in TAM 91-52-005, that actual payment is required for deduc-

237. *Id.* at 1193.

238. An exception to this appeared in I.R.C. § 165(i) (repealed 1976), under which certain confiscations by the Castro government in Cuba qualified for casualty loss treatment. Moreover, casualty losses that occur in the course of a trade or business are allowed as a deduction, not under § 165(c)(3), but rather under § 165(c)(1), which allows a deduction for trade or business losses. I.R.C. § 165(c)(1) (1988); see *Benichou*, 29 T.C.M. (CCH) at 1162-65. Section 2054 provides no such deduction for trade or business losses experienced by the estate after the decedent's death. I.R.C. § 2054 (1988).

239. See *supra* notes 185-227 and accompanying text.

240. I.R.C. § 2053(a)(3) (1988).

241. Deductions for funeral and administration "expenses" that are allowed under § 2053(a)(1) and § 2053(a)(2) do not provoke this controversy. Use of the word "expense" in those sections has insured that deductions for funeral and administration expenses will be permitted only for actual outlays of money or property for these items. See STEPHENS ET AL., *supra* note 80, ¶ 5.03[3].

tion of a claim under § 2053(a)(3).²⁴² In Revenue Ruling 60-247, the IRS articulated its position on this issue:

A deduction . . . will not be allowed for claims against the estate which have not been paid or will not be paid because the creditor waives payment, fails to file his claim within the time limit and under the conditions prescribed by applicable local law, or otherwise fails to enforce payment.²⁴³

Several scholars, also with judicial support, take the contrary position that payment is not a prerequisite for deduction of a claim under § 2053(a)(3).²⁴⁴ These authorities assert that, unless the Code provides otherwise, the estate tax is generally intended to be imposed on a "snapshot" of the net value of the decedent's estate at date of death. Thus a deduction should be permitted for claims allowable at death even if they are never paid, or are satisfied for an amount less than their perceived value at death.

While it is beyond the scope of this article to attempt to resolve this dispute, it might be useful to make several observations regarding the treatment, under both of these schools of thought, of claims for return of stolen property and forfeitures of the instrumentalities and fruits of criminal activity. First, it should be noted that there are circumstances where resolution of the deduction issue does not turn on whether one believes that payment of a claim in full is a prerequisite for deduction of the full amount of the claim. For example, application of the public policy doctrine will work to disallow a deduction under § 2053(a)(3) for both forfeited and "forfeitable" illegal drugs and the fruits of drug trafficking. Second, if one is dealing with a return or forfeiture of property where there will be no disallowance based on public policy considerations, a deduction should be allowed if the return or forfeiture was required by local law and was actually accomplished during administration of the estate. For example, a deduction should be allowed for the timely return of stolen property to the "true

242. See, e.g., Rev. Rul. 60-247, 1960-2 C.B. 272; *Gowetz v. Commissioner*, 320 F.2d 874, 876 (1st Cir. 1963); *Estate of Courtney v. Commissioner*, 62 T.C. 317, 322-23 (1974); *Estate of Haggmann v. Commissioner*, 60 T.C. 465, 467-69 (1973), *aff'd per curiam*, 492 F.2d 796 (5th Cir. 1974); *Estate of Shedd v. Commissioner*, 37 T.C. 394, 398 (1961), *aff'd*, 320 F.2d 638 (9th Cir. 1963).

243. Rev. Rul. 60-247, 1960-2 C.B. 272.

244. See STEPHENS ET AL., *supra* note 80, ¶ 5.03[5]; Craig S. Palmquist, *The Estate Tax Deductibility of Unenforced Claims Against a Decedent's Estate*, 11 GONZ. L. REV. 707, 717-19 (1976). Several cases also support this proposition. See *Estate of Van Home v. Commissioner*, 720 F.2d 1114, 1116-17 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984); *Propstra v. United States*, 680 F.2d 1248, 1254-57 (9th Cir. 1982); *Wilder v. Commissioner*, 581 F. Supp. 86, 88 (N.D. Ohio 1983); *Greene v. United States*, 447 F. Supp. 885, 894-95 (N.D. Ill. 1978); *Russell v. United States*, 260 F. Supp. 493, 499-500 (N.D. Ill. 1966); *Winer v. United States*, 153 F. Supp. 941, 943-44 (S.D.N.Y. 1957).

owner" during administration of the estate. The same result should follow if, for example, the decedent died possessing goods that were subject to claims by customs authorities who, at the decedent's death, were seeking to have the property destroyed for violation of customs rules involving criminal sanctions. If property is confiscated and destroyed during the administration of the estate, a deduction should be allowed under § 2053(a)(3).

Substantial variations in results could occur, however, where claims that do not fall under the public policy disallowance doctrine go unpaid by the estate, or are settled for less than their full value. The IRS and other adherents of the "allowed" school would then limit deduction to the amount the estate paid on the claim. The result in TAM 91-52-005 is consistent with this position, since the Meador estate never returned the stolen art works to their rightful owner during the administration of the estate under Texas law. Under the "allowable" doctrine, however, it might be possible to assert that at the decedent's death he held the stolen property that was subject to an "allowable," but not "allowed," claim for its return by the true owner, and hence a deduction should be permitted.²⁴⁵

There are several criticisms one could make of this suggestion. First, since knowledge of the stolen property's location by the "true owner" is a prerequisite to his or her attempting by law to recover it, an essential fact necessary for the very existence of the claim as an allowable claim under state law arguably would not be present. Allowance of a deduction in such circumstances would be akin to the estate of a surgeon claiming a deduction for several botched operations that were undetected by patients. Second, even if one accepts the above line of reasoning, the claim could be valued at its true "snapshot" value in light of the facts existing at the date of death. Doing this, we might value the claim as virtually worthless since the "true owner's" ignorance and the heirs' and executor's seeming determination to maintain that condition results in the "allowable" claim having a negligible value. When this negligible value is subtracted from the value of the possessory interest in the stolen property held by the estate, a substantial positive net value will remain. Given heirs or an executor of an honest disposition, a dramatically larger value would be assigned to any such claim. Where the public policy doctrine is not invoked to disallow a claimed deduction, a similar valuation-centric analysis could be made in the case of forfeitable fruits of other illegal activities.

An additional interesting issue TAM 91-52-005 presents is the IRS's assumption that, because the Quedlinburg church did not present its claim

245. Cf. *Wilder*, 581 F. Supp. at 87-88 (citing *Greene v. United States*, 447 F. Supp. 885, 894 (N.D. Ill. 1978), for the proposition that claims against decedent's estate, paid after the formal claims period, were deductible under § 2053).

during the one-year period following the court's issuance of letters testamentary in 1980 and before distribution of the property, no enforceable claim existed against the estate in 1990.²⁴⁶ The certainty of this conclusion is questionable in light of the Supreme Court's decision in *Tulsa Professional Collection Services, Inc. v. Pope*.²⁴⁷ In April of 1979, H. Everett Pope, a resident of Oklahoma, died after a hospitalization of approximately five months. His estate was probated in Oklahoma. Pursuant to state law, his wife, as executrix, twice ran a notice to creditors in a Tulsa newspaper advising them that they had two months from publication of notice to submit claims. The hospital did not submit a claim.²⁴⁸ Then-existing Oklahoma law barred creditor claims not submitted to the executor within two months of the publication of notice.²⁴⁹ The Supreme Court held that, where a creditor's identity is known to the executor, newspaper notice is inadequate to satisfy due process requirements.²⁵⁰ Rather, the Court maintained that, in such circumstances, a procedure that is better calculated to alert the creditor, such as mail notice, is essential.²⁵¹ The Court noted that such due process considerations would not arise under a conventional self-executing statute of limitations,²⁵² but went on to hold that due process would be a factor where state action, such as the involvement of the probate court, is a necessary element for activation of the time bar on claims.²⁵³

Returning to the Meador case, assuming that the Texas time bar provisions are triggered only by judicial state action and assuming that the decedent's sister, who served as executrix, knew the identity of the true owner of the stolen treasure, one could conclude that the estate's failure to satisfy due process requirements with a procedure such as providing mailed notice to the Quedlinburg church results in the church's claims still being enforceable under Texas law. If that were the case, although the stolen art works were included in Meador's estate, the allowance of a claim under § 2053(a)(3) would eliminate all tax liability resulting from inclusion.²⁵⁴

If one concludes that, pursuant to the "allowable" analysis a deduction should be permitted under § 2053(a)(3) to the estate of a thief, even if the property is not returned to the "true owner" during probate, one might con-

246. TAM 91-52-005, *supra* note 4, at 16,861-62.

247. 485 U.S. 478 (1988).

248. *Id.* at 482.

249. *Id.* at 479 (construing OKLA. STAT. tit. 58, § 333 (1981)).

250. *Id.* at 491.

251. *Id.*

252. *Id.* at 486-87.

253. *Id.* at 487.

254. The facts presented in TAM 91-52-005 are not sufficient to enable one to conclude with any certainty whether any deficiencies existed in the administration of the estate that would result in the estate still being open for the filing of valid claims.

clude that this would result in taxable income to the estate in an amount equal to the value of the property. Inclusion could be sought under either a tax benefit,²⁵⁵ forgiveness of indebtedness,²⁵⁶ or windfall analysis,²⁵⁷ although any such efforts by the IRS would face their own statute of limitations problems. Exploration of these income tax issues is beyond the scope of this article.

V. CONCLUSION

Substantive property law and existing income tax law support the conclusion that the fruits of crime to which the estate has a possessory claim should be included in the taxable estate. Valuation of the interests so included presents a special challenge that can be met by careful application of existing theory. In the case of stolen property, this might mean that only the thief's possessory rights to property in the illicit market are to be valued, and not the "true owner's" rights to the property in the legal market. In the case of forfeitable property, the value should be determined by comparing it with the value of property of a similar character in the markets in which such property could be expected to be sold by the holder. Although there is some possibility that the estate whose value is so enhanced might be

255. The possibility is suggested in 5 BITTKER, *supra* note 74, ¶ 131.4.2 n.18. It is this author's opinion that, because the claimed deduction which is unpaid is an estate tax and not an income tax deduction, the tax benefit rule is not applicable.

256. The forgiveness of indebtedness doctrine requires that a borrower whose debt is discharged for less than its face value include in his income the amount forgiven. See 1 BITTKER, *supra* note 74, ¶ 6.4. This doctrine, codified in I.R.C. § 61(a)(12) (1988), is consistent with the widely accepted "Haig-Simons" definition of income: income equals the sum of consumption and change in net worth. See 1 BITTKER, *supra* note 74, ¶ 3.1.1. Because any debt forgiven by a lender increases the borrower's net worth, the borrower has received income. See also I.R.C. § 108 (1988 & Supp. III 1991) (relating to discharge of indebtedness income); *United States v. Kirby Lumber Co.*, 284 U.S. 1, 3 (1931) (holding that a company which issues bonds and then repurchases them at a lower price receives income equal to the price difference).

Opportunities for application of a true forgiveness of indebtedness rationale would seem to be quite limited in this context, however. Presumably it should apply only in situations where return of stolen property or forfeiture was a virtual certainty if a claim was asserted, and those capable of claiming the property from the estate knew of its location and their right to it, but preferred, in a non-gift context, not to claim the property.

257. Section 61(a) provides that gross income includes "income from whatever source derived." I.R.C. § 61(a) (1988). Consistent with both the § 61(a) definition and the Haig-Simons definition, mentioned *supra* note 256, is the rule that a taxpayer who receives a "windfall" has received taxable income when such windfall is reduced to "undisputed possession." 1 BITTKER, *supra* note 74, ¶ 5.5 (citing *Treas. Reg. § 1.61-14(a)* (as amended in 1965)). A taxpayer experiences a windfall when she finds valuable property, such as treasure trove, thus acquiring an asset without an offsetting liability. See *id.*; see also *Cesarini v. United States*, 296 F. Supp. 3, 4-7 (N.D. Ohio 1969) (holding that money found hidden in used piano was gross income and thus subject to taxation), *aff'd*, 428 F.2d 812, 814 (6th Cir. 1970).

It is this author's opinion that the windfall analysis will, in most cases, provide the IRS with its best chance for subjecting such property to income taxation.

able to claim a deduction for claims that are asserted or assertable against the estate, failure to comply with the terms of § 2053 or the public policy doctrine could often stand in the way of such an effort. Moreover, existing case law renders the casualty loss deduction of the estate tax inapplicable to forfeitures of the fruits of crime.

The proper treatment under the estate tax of the products of criminal activity is an issue that has received scant attention until recently. Yet, given the likely future growth in criminal enterprises, particularly in the area of trafficking in controlled substances, one can expect to see greater application of the estate tax to the fruits of crime.