23 T.C. 818 (1955)

Income derived from illegal activities, such as black market sales involving forged documents, is taxable, even if the taxpayer claims the funds were embezzled; the burden of proving embezzlement rests on the taxpayer.

Summary

The taxpayer, Kurkjian, failed to report income from black market sugar sales in 1944. The Commissioner determined a deficiency and asserted a fraud penalty. Kurkjian argued the unreported income was either from accumulated savings or constituted embezzled funds from his employer. The Tax Court held that the income was taxable, rejecting the savings and embezzlement arguments, and upheld the fraud penalty due to Kurkjian's deliberate intent to evade taxes through his illegal activities and failure to keep records.

Facts

Kurkjian managed a wholesale establishment and engaged in black market sugar sales during 1944. He received income in excess of the ceiling price for sugar by using forged ration stamps and falsifying information. He did not report this income on his 1944 tax return. He invested $26,309.83 in real estate during the year, an amount corresponding to the unreported income. The taxpayer was convicted of making false representations on OPA envelopes and aiding and abetting in counterfeiting war ration sugar stamps.

Procedural History

The Commissioner determined a deficiency in Kurkjian's 1944 income tax and asserted a fraud penalty. Kurkjian petitioned the Tax Court for a redetermination of the deficiency and to contest the fraud penalty. The Tax Court upheld the Commissioner's determination.

Issue(s)

1. Whether the unreported income from black market sugar sales is taxable income to the taxpayer.
2. Whether the Commissioner properly assessed a fraud penalty against the taxpayer for failure to report the income.

Holding

1. Yes, because the income derived from illegal activities, specifically black market sales involving forged documents, is taxable income. The taxpayer failed to provide convincing evidence that the funds were either from savings or constituted embezzlement.
2. Yes, because the taxpayer deliberately failed to include the disputed income in his

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1944 return with a clear intent to evade the tax due.

Court's Reasoning

The court rejected Kurkjian's claim that the funds came from accumulated savings, finding the evidence unconvincing, especially the claim of keeping a large sum of cash at home while maintaining bank accounts. The court distinguished this case from *Commissioner v. Wilcox, 327 U. S. 404*, and *McKnight v. Commissioner, 127 Fed. (2d) 572*, because those cases involved established instances of embezzlement. Here, the court was not convinced that Kurkjian embezzled funds from his employer. The court reasoned that the money was paid for securing sugar by issuing forged ration stamps and making false certificates. Regarding the fraud penalty, the court emphasized that while the taxpayer bears the burden of proving the deficiency was incorrect, the Commissioner has the burden of proving fraud. The court found that Kurkjian's conviction, his black market operations, his attempts to evade tax by claiming embezzlement, and his failure to keep records all indicated a deliberate intent to evade taxes. The court noted, "On this record, we can not escape the definite conclusion that the failure of petitioner to include the disputed income in his 1944 return was deliberate, with a clear intent to evade the tax due."

Practical Implications

This case clarifies that income from illegal activities is taxable, reinforcing the principle that the source of income does not determine its taxability. Taxpayers cannot avoid tax liability by claiming that unreported income was derived from illegal activities or by vaguely alleging embezzlement without providing sufficient evidence. This case highlights the importance of maintaining accurate records, as the lack thereof contributed to the court's finding of fraud. It also emphasizes the government's ability to assess fraud penalties when there is clear evidence of intent to evade taxes, even in the context of illegal income. Later cases cite *Kurkjian* for the proposition that the Commissioner bears the burden of proving fraud to support a fraud penalty.

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