18 T.C. 710 (1952)

Income derived from participation in a fraudulent scheme is taxable, even if the scheme involves defrauding the taxpayer's employer.

Summary

Henry Boucher, an employee of International Paper Co., colluded with a pulpwood contractor, Smith, to defraud the company. Boucher manipulated company records to inflate Smith's deliveries, resulting in overpayments. Boucher received 40% of these overpayments. The Tax Court held that these amounts were taxable income to Boucher, rejecting his argument that they constituted proceeds of embezzlement and were therefore not taxable. The court also upheld fraud penalties against Boucher for failing to report this income.

Facts

Boucher worked for International Paper Co. as a wood clerk, responsible for calculating and recording pulpwood deliveries. He and Smith, a pulpwood contractor, agreed to inflate Smith's delivery records. Boucher manipulated the company records to indicate larger deliveries from Smith than actually occurred. Smith received overpayments from International Paper Co. and shared 40% of the excess with Boucher. Boucher did not report these amounts as income on his tax returns.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Boucher's income tax for the years 1943-1947, along with fraud penalties. Boucher challenged the deficiencies, arguing that the amounts received were proceeds of embezzlement and not taxable income. The Tax Court ruled in favor of the Commissioner, upholding the deficiencies and fraud penalties.

Issue(s)

1. Whether sums received by the petitioner from a third person as petitioner's participation in the proceeds of a fraudulent scheme practiced on petitioner's employer are exempt from tax under the doctrine of *Commissioner v. Wilcox*?

2. Whether part of the deficiencies are due to fraud with intent to evade tax under section 293(b) of the Internal Revenue Code?

Holding

1. No, because the petitioner's actions constituted participation in a fraudulent scheme, not embezzlement, and thus the income was taxable under *Rutkin v. United States*.

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2. Yes, because the petitioner failed to report large sums of income without a satisfactory explanation, demonstrating intent to evade tax.

Court’s Reasoning

The Tax Court distinguished this case from embezzlement, stating that Boucher actively participated in a fraudulent scheme. The court relied on *Rutkin v. United States*, which limited the scope of *Commissioner v. Wilcox*. The court found that the payments Boucher received were the proceeds of fraud, not embezzlement, and were therefore taxable income. The court also found clear evidence of fraud, noting Boucher’s failure to report substantial income without a valid explanation. The court stated: “Petitioner was concededly in receipt of large sums which he failed to report as income without any satisfactory explanation.”

Practical Implications

This case clarifies that income derived from fraudulent activities is generally taxable, even if the activities involve defrauding an employer or other third party. It highlights the importance of accurately reporting all income, regardless of its source. It emphasizes the distinction between embezzlement and participation in a fraudulent scheme for tax purposes. The decision serves as a reminder that the IRS can assess fraud penalties in cases where there is clear evidence of intent to evade tax through the deliberate omission of income. This ruling aligns with the broader principle that illegal income is still subject to taxation. Later cases cite this case for the proposition that unreported income, without a satisfactory explanation, is evidence of fraud.

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