Shriver v. Commissioner, 85 T. C. 1 (1985)

The burden of proof in tax cases involving unreported income from illegal activities remains with the taxpayer unless the notice of deficiency is shown to be arbitrary and without foundation.

Summary

In Shriver v. Commissioner, the U. S. Tax Court addressed the burden of proof in tax cases involving unreported income from illegal activities, specifically the sale of methamphetamine. Thomas Shriver challenged the IRS's notice of deficiency claiming over $4 million in unreported income. The court held that the notice was not arbitrary as there was substantive evidence linking Shriver to the illegal activity, and thus, the burden of proof remained with him. Shriver's attempt to introduce DEA reports was denied due to hearsay issues, and the court found he earned $254,240 from drug sales, rejecting his cost of goods sold deduction claim due to lack of evidence.

Facts

During 1977 and 1978, Thomas H. Shriver, while in graduate school, sold methamphetamine to four individuals, including a government informant. Shriver did not file federal income tax returns for these years. The IRS issued a notice of deficiency based on information from the informant, asserting Shriver had unreported income of over $4 million from drug sales. Shriver objected to the use of DEA reports as evidence, claiming they were inadmissible hearsay.

Procedural History

The IRS issued a notice of deficiency to Shriver on November 8, 1982, for unreported income from 1977 and 1978. Shriver challenged this in the U. S. Tax Court, claiming the notice was arbitrary and erroneous. The court heard the case, with Shriver arguing against the admissibility of DEA reports and asserting a lower income figure. The court ultimately decided on July 1, 1985, that the notice was not arbitrary and calculated Shriver's income from drug sales at $254,240.

Issue(s)

1. Whether the notice of deficiency issued by the IRS was arbitrarily issued.
2. Whether the IRS's determination of Shriver's tax liability was incorrect.

Holding

1. No, because there was substantive evidence linking Shriver to a tax-generating activity during the years in question, making the notice of deficiency not arbitrary.
2. Yes, because Shriver failed to prove the IRS's determination was incorrect, but the court found his income from drug sales was $254,240, not the $4 million claimed

© 2025 SCOTUSreports.com. All rights reserved.

by the IRS.

Court’s Reasoning

The court applied the general rule that a presumption of correctness attaches to a statutory notice of deficiency, placing the burden of proof on the taxpayer unless the notice is shown to be arbitrary or without foundation. The court referenced cases like *Welch v. Helvering* and *Helvering v. Taylor* to support this principle. It rejected Shriver’s argument that the notice was arbitrary, citing substantive evidence of his drug sales, including his own testimony, his conviction for dealing drugs, and corroborating testimony from a buyer. The court also ruled DEA reports inadmissible due to hearsay concerns, as they lacked trustworthiness based on the informant’s background and the circumstances of their creation. Shriver’s claim of a cost of goods sold deduction was dismissed for lack of credible evidence about the drug’s origin and cost.

Practical Implications

This decision reinforces that taxpayers must substantiate their income from illegal activities and cannot shift the burden of proof without proving the IRS’s notice of deficiency is arbitrary. It underscores the importance of direct evidence in tax disputes involving illegal income and the limitations on using hearsay evidence like DEA reports. Practitioners should advise clients engaged in illegal activities to accurately report income and be prepared to substantiate any deductions claimed. This case also illustrates how courts will not look behind a notice of deficiency if there is substantive evidence of the taxpayer’s involvement in the income-generating activity, impacting how similar cases should be approached in legal practice.

© 2025 SCOTUSreports.com. All rights reserved.