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Repayment of Claim of Right Income by an Estate Under Section 1341

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COMMENTS

REPAYMENT OF CLAIM OF RIGHT INCOME BY AN ESTATE UNDER SECTION 1341

Under the "claim of right" doctrine a taxpayer is required to report income received by him, under a claim of right and without restriction as to its disposition, even though the taxpayer's claim to the income was invalid and even though he is required to repay the sum in whole or in part in a year subsequent to its receipt. The historical basis for the doctrine is found in *North American Oil v. Burnet.*[1] The Court stated by way of dictum, that if the taxpayer is required in a later year to repay the sum reported under a claim of right, he is entitled to a deduction in the year of repayment.[2] The repayment of a claim of right item was dealt with by Congress for the first time in section 1341 of the Internal Revenue Code of 1954. The purpose of this Comment is to review the question under section 1341 of the repayment of an amount of money by the estate of the taxpayer who received such amount under a claim of right.

The principle of a deduction in the year of repayment announced by way of dictum in *North American Oil* was solidified by *United States v. Lewis.*[3] The Court in *Lewis* held that where a taxpayer reported a bonus as income in one year and was required to restore the bonus to his employer in a later year, the taxpayer's only remedy was to take a deduction in the year of repayment. He could not recompute his income for the year in which he received the bonus. The prohibition against recomputation for the year of receipt is grounded on the principle that the tax system is based on an annual accounting period, requiring the determination of income at the end of the year without regard to subsequent events.[4]

The *Lewis* case and the principle on which it is based are quite sound, but in practice, quite inequitable. A taxpayer in a high tax bracket may be required to pay tax at a high rate on a substantial sum received under a claim of right. However, if the taxpayer is required to repay that sum in a later year, he may be in a lower tax bracket or have little or no income against which to apply the deduction. The benefit of the deduction is less than the tax paid on the item in the year of receipt. That Congress recognized this

1. 286 U.S. 417 (1932).
2. *Id.* at 424 (dictum).
3. 340 U.S. 590 (1951).
4. Haberkorn v. United States, 173 F.2d 587 (6th Cir. 1949).

obvious inequity is evidenced by the House and Senate committee reports.[5] The reports state that "the deduction allowable in the later year does not compensate the taxpayer adequately for the tax paid in the earlier year."[6] As a result, section 1341 was enacted,[7] allowing the taxpayer to pay as his tax for the year of restoration the lesser of (1) the tax for the year of repayment computed by deducting the amount of the repayment or (2) the tax for such year computed without deduction for the repayment minus the lesser tax he would have paid in the earlier year of receipt, if he had excluded the claim of right item from his income in that earlier year. If the decrease in the prior year's tax by excluding the item exceeds the tax for the year of repayment without the deduction, then the excess is refunded or credited as if it were an overpayment for the taxable year of repayment.[8] The section permits the taxpayer to offset the tax paid on the claim of right item against the tax assessed for the year of repayment.

Suppose, however, that a taxpayer receives a claim of right item, pays the tax thereon and dies. A third party then sues the estate on the ground that the decedent's claim to the amount was invalid. The third party is successful and the estate restores the item. May the estate avail itself of the relief provided by section 1341? That the estate may do so was announced in four recent decisions, *Killeen v. United States*,[9] *Estate of Kurt Koehler v. United States*,[10] *Estate of Samuel Stein*[11] and *Estate of Charles Good v. United States*.[12] The first two cases do not discuss the issue, the third only by way of dictum and the fourth, pregnant with errors, meets the issue squarely.

In the *Stein* case, certain stockholders of a corporation diverted sums from the corporation which were not reported as income by them or by the corporation. In prior proceedings,[13] it was determined that the payments from the corporation to the stockholders were taxable income to the corporation and corporate distributions taxable to the stockholders. It was further determined that the payments were received by the stockholders under a claim of right. The Government sought to reach the sums diverted to satisfy the corporation's tax on the ground of transferred liability. The court held that the Government was not estopped from asserting transferred liability by reason of the prior decision that the payments were corporate distributions

5. S. REP. No. 1622, 83d Cong., 2d Sess. 118 (1954).
6. *Ibid.*
7. The Internal Revenue Code of 1939 did not contain a comparable provision.
8. INT. REV. CODE OF 1954, § 1341(b)(1).
9. 63-1 U.S. Tax Cas. ¶ 9351 (S.D. Cal. 1963).
10. 63-1 U.S. Tax Cas. ¶ 9303 (D. Ore. 1962).
11. 37 T.C. 945 (1962).
12. 208 F. Supp. 521 (E.D. Mich. 1962).
13. Esther M. Stein, 25 T.C. 940 (1956).

taxable to the stockholders. One of the stockholders was deceased and his estate was a party to the suit. The estate sought to recover by equitable recoupment the amount of the taxes and additions to tax paid by the decedent on the diverted sums. The court denied equitable recoupment declaring that the remedy at law was adequate. Section 1341 could be used by the estate to recover the tax paid on the diverted sums. The court stated:

> If a taxpayer restored sums received under a claim of right and died, his estate could obtain the tax credit provided in section 1341 on behalf of the taxpayer. Since an estate is liable for its decedent's taxes, it is also entitled to credits owing to the decedent. We therefore find that the taxpayer's estate is entitled to the relief afforded by section 1341 if all the other requirements of that provision have been met.[14]

Although the above quoted statement was dictum, the court clearly took the position that the estate was entitled to the relief provided in section 1341.

In the *Good* case the taxpayer-decedent received certain salaries and expense reimbursements from his employer and paid the tax thereon in 1952 and 1953. In 1955 his employer notified him that a substantial part of the sums received were improperly paid to him and that he would be held liable for repayment. However, the decedent died before such repayment was made. The employer filed a claim against the estate and was paid in 1956. In the estate tax return filed for that year of repayment a deduction was claimed from the gross estate for the sum repaid to the employer. The deduction was allowed. The estate also filed its fiduciary income tax return and claimed a refund under section 1341 with respect to the tax paid on the amount it restored to the employer. The claim was rejected. The estate then brought suit for the refund under the authority of section 1341(b)(1).

The issue in the case was whether the estate of the taxpayer-decedent could avail itself of the benefits of 1341, having repaid the sum which the taxpayer-decedent had reported as income in 1952 and 1953. The court held that the estate was so entitled. It would seem that the result reached by the court is an equitable one; however, there seems to be no sound legal basis for it.

The first question raised by an objective interpretation of section 1341 is whether the plain language of the statute includes the estate of the taxpayer as well as the taxpayer himself. The language used in the section seems to contemplate *one* taxpayer. Section 1341(a)(1) reads in terms of "the taxpayer" including a claim of right item in his income and 1341(a)(2) in terms of "the taxpayer" obtaining a deduction in a later year because it was discovered that his claim was invalid. The section, reasonably interpreted, can be paraphrased as follows: (1) if taxpayer A includes a claim of right

14. 37 T.C. at 958 (dictum).

item in his income and, (2) if a deduction is allowable to taxpayer A because he discovered in a later year that his claim was invalid, then he is entitled to use section 1341 if all other requirements of the section are met. In other words, the taxpayer who intends to use section 1341 must be the same taxpayer who included the item in his income. For federal income tax purposes, estates of deceased persons are regarded as distinct and separate taxable entities.[15] When the decedent included the item in his income and the estate repaid it after his death, the acts of two separate taxpayers were involved. Furthermore, the estate as "the taxpayer" in section 1341(a)(2) could not be the same as "the taxpayer" in section 1341(a)(1) since the estate was not in existence in the prior year to include the item in its income. Therefore, since a taxpayer and his estate are two separate taxpayers and section 1341 contemplates one taxpayer, it would seem to follow that the estate is not entitled to the benefits of section 1341 because it did not include the item in its income.

It is doubtful that Congress intended to include the estate within the words "the taxpayer" as used in the section.[16] The court in the *Good* case admitted that the section "gives no specific indication whether the taxpayer's estate should be included within the meaning of the word taxpayer; and its legislative history is not illuminating."[17] It might be added that the Treasury Department Regulations are silent on the matter. Yet, in view of these arguments to the contrary, the *Good* case held the estate to be within the purview of the statute. The court's reason for so holding is not clear. Perhaps the court's reason for finding that the estate was included within the term "the taxpayer" may be found in the following statement: "I take the view that when Congress passed Section 1341 it did not intend to recognize a debt of the [G]overnment to the taxpayer during his lifetime and deny the same obligation to his personal representatives and to his estate."[18]

A second issue is raised by the language used in section 1341. Specifically, does section 1341(a)(2) itself provide a deduction, not otherwise provided by the Code, where it is established that the taxpayer did not have a valid claim to the item included in income in the prior year? It is believed that the section does not authorize a deduction.[19] The section states:

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15. 4 CCH 1958 STAND. FED. TAX REP. ¶ 3605.01.

16. *Contra,* Samuel Stein, 37 T.C. 945 (1962). The court concluded that "Samuel's estate is encompassed within the term 'the taxpayer' as it appears in Section 1341." *Id.* at 958 (dictum).

17. 208 F. Supp. at 522.

18. *Id.* at 523.

19. *See* Webster, *The Claim of Right Doctrine: 1954 Version,* 10 TAX L. REV. 381 (1955); Cavanaugh, *Income Received Under Claim of Right As Affected By Section 1341,* P-H OIL & GAS TAXES ¶ 4013; 5 RABKIN & JOHNSON, FEDERAL INCOME GIFT AND ESTATE TAXATION, § 12.05(9) (1964).

(A) *General Rule.*—if—. . .

(2) a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item . . .[20]

The wording is conditional. In other words, a taxpayer may use section 1341 *if*, but only if, a deduction is allowable elsewhere in the Code. Also, the Regulations under section 1341 make it clear that no new deduction is granted by that section. They state that the section applies if ". . . the taxpayer is entitled under *other* provisions of . . . the Internal Revenue Code of 1954 to a deduction of more than $3,000 because of the restoration to another of an item which was included in the taxpayers gross income for a prior taxable year . . . under a claim of right. . . ."[21] Under prior law, it was beyond question that the repayment of a claim of right item gave rise to a deduction; however, such a deduction did not automatically lie, but would be allowed only where the item fitted into one of the established deduction sections.[22] It might be noted that many of the cases which state that a deduction is allowed upon repayment do not cite any deduction section, including the *North American Oil* case and the *Lewis* case.[23]

Both *North American Oil* and *Lewis* were decided before the enactment of section 1341. Since then, especially in view of the express requirement of the Regulations above quoted, it is quite clear that a taxpayer must seek his deduction for the repayment under a separate section of the Code. Assuming that the estate is entitled to use section 1341, it must look to another section of the Code for authority to deduct the repayment of a claim of right item. It seems that only section 691(b) provides a deduction for the estate. It provides that any deduction under sections 162, 163, 164, 212, or 611 which is not properly allowable to the decedent during his last taxable period shall be allowable to the estate, if it is liable to discharge the obligation.[24] If the repayment of a claim of right item is an expense, then it would be deductible under section 691(b), since that section includes section 162.

20. INT. REV. CODE OF 1954, § 1341(a)(2).
21. Treas. Reg. § 1.1341-1(a)(1) (1957). (Emphasis added.)
22. Webster, *op. cit. supra* note 19.
23. See Anderson v. Bowers, 117 F. Supp. 884 (W.D.S.C. 1954). It is interesting to note that the court in the *Anderson* case made the following statement:

> Therefore, when the Internal Revenue Code does not provide for the "claim of right" doctrine, but the courts decide that equitable considerations necessitate its use, equitable considerations should be entertained when sums are refunded after being received under the "claim of right" doctrine.

Id. at 892. In permitting a deduction for the repayment of a claim of right item, the court reasons that since authority for the inclusion of a claim of right item does not appear in the Code, statutory authority for its deduction upon repayment is unnecessary. The case was decided prior to the enactment of section 1341.
24. See INT. REV. CODE OF 1954, § 691(b)(1)(A).

If the estate seeks its deduction under section 691(b), then the Government's main contention in the *Good* case must be controverted. The Government argued that the estate could not use section 1341 because section 642(g) prohibits a double deduction.[25] An estate may not deduct an item under section 2053 or 2054 from both its estate tax and income tax. The estate in the *Good* case deducted the amount repaid to the employer from its estate tax under section 2053(a)(3) as a claim against the estate. The estate then sought to deduct the tax paid on the item from its income tax under 1341. The Government argued that the estate was taking a double deduction by seeking deductions from both its estate tax and income tax.

The problem of applying section 691(b) and 642(g) was solved by the court in *Good* by using a distinction which has very little merit and by misinterpreting section 1341. The court's misinterpretation of section 1341 is shown by the following statement: "Section 1341 gives the taxpayer the *option* of either receiving the sum that was actually overpaid in prior years or permitting the taxpayer to take the sum returned as a deduction. . . ."[26] The court is saying that the taxpayer has an option of choosing either section 1341(a)(5) (receiving the sum that was actually overpaid) or section 1341(a)(4) (taking the sum returned as a deduction). It would seem that the court misinterpreted the section. The provisions of 1341 are mandatory; they provide no option to the taxpayer.[27] The section reads that the tax for the taxable year (year of repayment) "shall be the lesser of"[28] the tax computed with such deduction *or* the tax computed without such deduction minus the decrease in tax for the year of receipt had the taxpayer not included the item in his income. The taxpayer must use the lesser of the taxes; he has no alternative.

However, the court distinguishes the two alternatives which it says the taxpayer has, stating that ". . . the deduction allowed under section 1341 is only an alternative to taking a straight tax credit, the relief sought in this case. Therefore, the tax credit given by section 1341 is not controlled by section 642(g) and 691(b)."[29] The first portion of the above quotation which reads "the deduction allowed under section 1341" is incorrect, because the section does not provide a deduction. The "tax credit" of which the court

25. INT. REV. CODE OF 1954, § 642(g). The section provides, in part:
DISALLOWANCE OF DOUBLE DEDUCTIONS. Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction in computing the taxable income of the estate. . . .

26. 208 F. Supp. at 523. (Emphasis added.)

27. Austin, Surrey, Warren, Winokur, *The Internal Revenue Code of 1954: Tax Accounting*, 68 HARV. L. REV. 257, 279 (1955); 2 MERTENS, THE LAW OF FEDERAL INCOME TAXATION, § 12.106a (1961).

28. INT. REV. CODE OF 1954, § 1341(a)(3).

29. 208 F. Supp. at 523.

speaks is the decrease in tax, computed under section 1341(a)(5)(B), which exceeded the tax imposed for the current year.[30] This excess may be refunded as an overpayment under section 1341(b)(1). The crucial error committed by the court was its finding that section 1341(a)(4) is a deduction while section 1341(a)(5)(B) is a tax credit.[31] On the basis of this distinction, the court further reasoned that since the estate was seeking relief under section 1341(a)(5) and (b)(1) it was seeking a tax credit and not a deduction.[32] Therefore, since a deduction was not involved, there could be no double deduction under section 642(g). Furthermore, since it was seeking a tax credit rather than a deduction, the estate was not required to use section 691(b).[33] On the basis of this reasoning, the court concluded that the issue of section 642(g) and 691(b) was not before it and therefore need not be decided.[34]

It is submitted that the court's analysis of the section is unsound. If the court's distinction were followed to its logical conclusion, then an estate required to use the deduction under section 1341(a)(4) would be exposed to the double deduction provision of section 642(g). On the other hand, an estate repaying an item and required to compute its tax under section 1341(a)(5) would not be prohibited by section 642(g) because it would not be seeking a deduction, but a tax credit. Furthermore, an estate seeking a deduction under section 1341(a)(4) would be required to meet the requirements of the deduction sections listed under section 691(b) since, according to the *Good* case, it would be seeking a deduction. However, another estate required to use 1341(a)(5) would find it unnecessary to utilize section 691(b) because it would be seeking a tax credit and not a deduction. Estates repaying claim of right items would be exposed to different tax consequences depending on whether they would be required to use section 1341(a)(4) or 1341(a)(5). Since the provisions of the statute are mandatory, estates performing the same acts and utilizing the same section would be treated differently. It is difficult to believe that Congress desired such an anomalous result. The section, the Regulations and the congressional committee reports make no mention of a "tax credit."

The fault in the reasoning of the *Good* case lies in the court's contention that section 1341 provides the taxpayer with an option and that a tax credit exists under its provisions. It is submitted that section 1341(a)(5), the court's supposed tax credit provision, merely provides a method of computa-

30. Whether such computation under section 1341(a)(5)(B) provides a "tax credit" is debatable.
31. 208 F. Supp. at 523.
32. *Ibid.*
33. *Ibid.*
34. *Ibid.*

tion whereby the tax for the current year is reduced by the tax paid on the item in the year of receipt. This computation method insures the taxpayer that he will receive a tax benefit from the reduction equal to the tax paid on the claim of right item when it was included in income, by taking into consideration the tax bracket for that year of inclusion. The very purpose for the section's enactment was to relieve taxpayers who under prior law could only take a deduction in the year of repayment, although tax rates may have been higher in the year of receipt than in the year of repayment.

The court's finding that an option and a tax credit are provided for in section 1341 permitted it to completely bypass the crucial question of the interrelationship of sections 642(g), 691(b) and 1341. This Comment will now address itself to the problem of this interrelationship.

It is first necessary to assume, as the *Good* case held, that the language of section 1341 includes a taxpayer's estate. As was noted above, the language of 1341 requires that a taxpayer be entitled to a deduction under other provisions of the Internal Revenue Code. Therefore, the estate must seek its deduction elsewhere.

Section 691(b) provides such authority for an estate. Of the possibilities for deductions under section 691(b), the deduction for the estate could only lie in sections 162 or 212—business and non-business expenses. In *Grandview Mines v. Commissioner*,[35] a mineral lease provided that the lessee was to pay to the lessor-taxpayer royalties measured by a percentage of the sales value of the products extracted from mines. In 1950, the original lease was amended to provide that in lieu of the fixed royalties, the lessor would receive 50% of the net profits of operation. Thereafter, the lease was further amended to provide that the lessor's share be reduced to 46½%, which amendment was retroactive to January 1, 1950. To adjust for this retroactive amendment, the lessor paid $18,957.00 to the lessee as an overpayment to it of the 1950 royalties. This amount had been previously included in the lessor's income. It is significant that in this case the court indicated that the repayment had to qualify as a business expense to be deductible.[36] Admittedly, the court found that the lessor received the sum under an absolute right rather than a claim of right. However, nowhere in the *Good* case does the court indicate that the decedent received the amounts therein under a claim of right. From the facts as they appear in the *Good* case, it can be argued that the decedent received them under an absolute right, since it appears that there was no controversy in the year of receipt. Therefore, the court could have reasonably required the estate to seek its deduction as an expense item under 691(b). There is authority for the proposition that the repayment

35. 32 T.C. 759 (1959), *aff'd*, 282 F.2d 700 (9th Cir. 1960).
36. *Id.* at 771.

of a claim of right item could be an expense. In *United States v. Simon*,[37] three members of a partnership formed a corporation. The partnership and the corporation entered into a lease whereby the former leased certain premises to the latter at a rental of 6 percent of the corporation's gross sales. In 1943 the partnership orally agreed to refund to the corporation any amounts paid in excess of the amount allowed by the Commissioner as a deduction from the corporation's income. In 1944 the Commissioner disallowed rental expense in excess of 4¾ percent for the year 1943. The two parties then modified the lease to show the rental at 4¾ percent and the partnership in 1944 repaid the excess amount paid by the corporation in 1943. The court held that the refund was not deductible from the partnership's or the partners' 1944 income tax returns because the repayment was voluntary. The court pointed out that the agreement to make repayment (the modification of the lease) was made *after* the fiscal year in which the rentals had been paid, and could not operate to reduce the rental income based on 6 percent. Since the partnership was under no obligation to repay the rentals, the repayment could not be considered as a necessary expense in carrying on a business. It is clear that, had the agreements been in force in 1943, the repayment of the claim of right rentals would have qualified as an expense. Therefore, in any case where the repayment of a claim of right item by an estate is deemed to be an expense, it would be difficult for the Government to argue that there is a double deduction under section 642(g). Section 691(b) clearly provides authority for the deduction of business expenses. It is in effect an exception of the double deduction provisions of section 642(g).

The above approach could not be utilized by all estates repaying claim of right items. This is because many of the cases state that the claim of right item may be deducted as a loss.[38] However, this rationale is difficult to accept. If a taxpayer receives $10,000 in one year and is required to repay it in another, it would seem that such a transaction is a wash-out rather than a loss. A loss means a loss of property;[39] while in the above example, no property is lost.

37. 281 F.2d 520 (6th Cir. 1960).

38. See Sangston Hettler, 16 T.C. 528, 534 (1951); Maurice P. O'Meara, 8 T.C. 622, 634 (1947); Healy v. Commissioner, 345 U.S. 278 (1953). In the *Healy* case the issue was whether allowance for the repayment should be made by a recomputation of income for the year of receipt or a deduction in the year of repayment. The Government argued against the former method but conceded that the taxpayer was entitled to a deduction for a loss in the year of repayment.

39. See Giurlani & Bros. v. Commissioner, 119 F.2d 852 (9th Cir. 1941); 5 MERTENS, THE LAW OF FEDERAL INCOME TAXATION, § 28.05 (1961); Walker v. Thomas, 75 F.2d 667 (D.C. Cir. 1935); Boney v. Central Mut. Ins. Co., 213 N.C. 543, 196 S.E. 837 (1938).

The court in the *Boney* case stated that "a loss to a person as understood in business is either a decrease in the value of his resources or an increase in his liabilities." *Id.* at 546, 196 S.E. at 841. Also, the court in the *Walker* case stated: "[B]ut ordinarily where the thing itself—the property—is held intact, undiminished in quantity and unchanged in

If, however, the repayment by the estate were considered a loss, then the estate could not deduct it under section 691(b), since section 165 losses are not covered under 691(b). The anomalous situation could arise where the taxpayer, had he lived to repay the item, could take the deduction as a loss, while his estate under the same set of facts could not. Yet, an estate repaying a claim of right item deemed to be an expense could take the deduction. An approach which provides a deduction only where the repayment is considered an expense, but not a loss, is hardly an adequate solution for estates repaying claim of right items. Whether the restoration is an expense or a loss is immaterial. What is important is that the estate is repaying an item of income which was not included in its own income.

It is important to note that the Government has not appealed the decisions in any of the four recent cases above mentioned ruling in favor of estates. Apparently, the Government has conceded the point that estates are entitled to the benefits of section 1341. Therefore, an approach must be found which will provide equal treatment to all estates repaying claim of right items. This approach could be accomplished by an amendment to the Regulations under section 1341. The purpose of such an amendment would be to provide that an estate, or any other taxpayer repaying the item, may utilize section 1341 in all cases where the decedent-taxpayer would have been so entitled had he lived to repay the item. As a condition precedent to the estate utilizing the section, the court would first have to decide whether the decedent-taxpayer could have met all the requirements of section 1341. If the decedent could have deducted the item either as an expense or loss and therefore, utilize the section, then the estate would also be so entitled. This approach would apply the same principles regardless of who repaid the amount and regardless of whether it was considered an expense or a loss. It would eliminate the requirement that the estate must first seek its deduction under section 691(b). Such an approach would also eliminate the double deduction problem under section 642(g). It would provide an exception to the double deduction prohibition, just as section 691(b) does now.[40] Since the same principles would be applied in all cases, the amendment would provide for simple and uniform application, a most desirable characteristic. It would be fair to both the estate and the Government. Certainly, the estate, as the taxpayer's successor in interest, should not be denied the benefit of

character (and that is true here), no loss can be properly said to have occurred." 75 F.2d at 669.

40. Good v. United States, 208 F.2d 521 (E.D. Mich. 1962). The court stated: "Section 642(g) of the Internal Revenue Code of 1954 . . . permits an item to be deducted both on the estate tax return and on the estate's fiduciary income tax return *only* if such a deduction is permitted under section 691(b) of the Code of 1954." *Id.* at 523. (Emphasis added.)

section 1341 simply because the taxpayer's death intervened between the receipt and the repayment of the item.

The court in the *Good* case pointed out that if section 1341 applies to an estate, certain adjustments would have to be made. The court stated that "if the estate is successful in this action, the sum recovered will be included in the taxable estate of Charles E. Good."[41] The sum recovered in *Good* was $6,873.97 computed under section 1341(a)(5) and refunded under section 1341(b)(1). That this adjustment is necessary may be illustrated by the following example. Assume that a taxpayer includes $10,000 in his income under a claim of right and pays tax thereon at the rate of 20%. When he dies, the full $10,000 is not poured into his gross estate, but only $8,000 is included because he paid $2,000 tax on the item. This $8,000 will then be added to the other assets in the decedent's gross estate. In the *Good* case, the estate deducted from the gross estate the full amount of the claim of right item and the deduction was allowed. If the same is permitted in our example, the estate will deduct the full $10,000 upon its repayment. However, this results in reducing the gross estate by $2,000 from what it would have been had the decedent never received the item. If the estate had no income in the year of restoration, the $2,000 tax paid on the item in the year of receipt would be refunded to the estate under section 1341(b)(1). This amount would then be added to the gross estate to increase it to what it would have been had the decedent never received the item. The *Good* case makes this adjustment by including the $6,873.97 refund in the gross estate. The principle involved herein requires that whenever the repayment is allowed as a deduction from the gross estate, the value of the benefit derived from the application of section 1341 must be included in the gross estate. This will prevent the estate from being in a better financial position than it would have been had the decedent never included the item in income. This coincides with the underlying principle of section 1341, namely, to restore the taxpayer to the status quo without an unwarranted gain to either the taxpayer or the Government.

Provisions for the same adjustment found necessary in the *Good* case would be necessary in any amendment to the Regulations discussed above. The same principle would apply for the same reasons. However, the Regulations would also have to provide that *no* adjustment is necessary if the estate tax return had not been previously filed. This was not the situation in the *Good* case since the estate tax return had been filed prior to the suit. For example, assume that a taxpayer has no claim of right item but a salary of $50,000. He pays tax thereon at the rate of 20%. As a result, $40,000 will be poured into his estate at his death. If the value of his other assets

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41. *Id.* at 523.

are $50,000, the gross estate will be $90,000. On the other hand, assume that the same taxpayer receives $10,000 under a claim of right in addition to the $50,000 salary. He pays 20% tax on the total $60,000, resulting in $48,000 being poured into his estate at his death. The gross estate stands at $98,000 but the estate tax return has not been filed. To eliminate the necessity of an adjustment by adding the benefit of the value derived under section 1341, the estate would be permitted to deduct only $8,000 from the gross estate ($10,000 claim of right item minus $2,000 tax paid thereon). This deduction reduces the gross estate to $90,000, what it would have been had the taxpayer never received the claim of right item. No refund, or any other value derived from the application of section 1341 need be included in the decedent's gross estate. The principle is that the sum deducted from the gross estate is the amount of the claim of right item reduced by the tax attributable to it. In either case, whether or not an adjustment is necessary, the estate as the "taxpayer" in section 1341 is restored to its previous financial position, resulting in a solution fair to both the Government and the decedent's estate.

Conclusion

Several conclusions may be drawn from the above discussion of the *Good* case's application of section 1341 to estates. It would seem that every consideration which prompted Congress to enact section 1341 to give relief to taxpayers repaying claim of right items, dictates the application of the section to estates. An estate repaying a claim of right item is certainly in no better financial position after having restored the item. However, a denial of the benefits of the section would place an estate in a worse financial position, since the tax paid on the item would never be poured into the gross estate. The allowance permitted by the Commissioner prior to the *Good* case was a deduction from the value of the gross estate. This did not fully compensate the estate for its restoration. It relegated the estate to the remedy available under prior law, as dictated by the *Lewis* case. Therefore, it may be concluded that the decision in the *Good* case was an equitable one.

However, had the court in the *Good* case decided that section 1341 was not applicable to estates, it would have been on much stronger legal ground. There is no language in the section, its legislative history or the Treasury Regulations indicating that Congress intended to include estates within its coverage. It would have been a simple matter for Congress to state that for the application of section 1341, the term "taxpayer" includes the taxpayer's estate. It could have been that the legislature failed to foresee the importance of the section to an estate making a repayment. This oversight would be understandable, considering that the section is most frequently utilized by the gas and oil industry. Furthermore, the reasoning of the court in the *Good* case appears to be unsound. There is no evidence to support the court's finding that an option and a "tax credit" exist under the provisions of the section. The court's decision would have been on solid legal ground if the estate was denied the benefit of using section 1341 or required to seek a deduction under 691(b). If either of these alternatives had been adopted, the Government may have been prompted to amend the Treasury Regulations, since the estates plight would have been clearly illustrated.

In light of the recent decisions adverse to the Government, and the fact that no appeal was taken in any of them, it may be concluded that the Government has accepted the position that the section has application to the estate of a taxpayer. As discussed above, an amendment to the Regulations would solve the problem of the application of sections 691(b) and 642(c). Also, by providing for proper adjustments to be made on the estate tax return, the amendment would prevent any unjust enrichment which might occur by the application of section 1341. The holding in the *Good* case *and* a proper amendment to the Regulations would provide for the smooth operation of section 1341.

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