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Bobby L. Dexter

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SHOCK, AWE, AND EXPROPRIATION: THE ACT OF STATE DOCTRINE AND LOSS DEDUCTIONS UNDER SECTION 165 OF THE INTERNAL REVENUE CODE

Bobby L. Dexter*

Though pre-empted briefly by a focused dispatch of Tomahawk missiles from warships stationed in the Red Sea and the Persian Gulf,1 the “shock and awe” attack promised by the Bush administration2 rained down on Iraqi targets in March of 2003 in a hellish firestorm of satellite-guided munitions.3 Within minutes, lavish presidential palaces, underground bunkers, military command posts, and other targets lay in ruins, and United States troops began what Pentagon officials had hoped would be a relatively resistance-free advance towards Baghdad.4 The troops encountered healthy opposition as they made their trek across the desert,5 but they eventually captured and occupied Baghdad,6 rooted out and imprisoned Saddam Hussein,7 and commenced the establishment of a democratic state.8

* Associate Professor of Law, Chapman University School of Law. I’d like to extend my sincere thanks to participants in the Chapman University School of Law Faculty Lecture Series and to Professor Scott Johns, in particular, for comments on an earlier draft of this article. Special thanks are in order for Dean Parham Williams not only for securing research support for this article but also (and more importantly) for leading the Chapman Law faculty (among others) across mountains and through storms. For decades.

1 See Romesh Ratnesar, Awestruck, TIME, March 31, 2003, at 38 (indicating that an “intelligence bonanza” led to an unplanned attack meant to kill Saddam Hussein).

2 This reference is to the presidential administration of George W. Bush, 43rd President of the United States of America.

3 See Ratnesar, supra note 1.

4 See Johanna McGeary, 3 Flawed Assumptions, TIME, April 7, 2003, at 58 (implying that the Pentagon’s plan was “a lightning drive on Baghdad to decapitate the regime and then liberate the rest of the country”).

5 See id. (noting that Saddam Hussein’s forces mounted a counterattack on advancing troops).


The adamant and incorrigible optimist would argue that the physical and political reconstruction of post-Saddam Iraq is under way. Who knows? Maybe the Sunnis, Shi’ites, and Kurds will ultimately form a government in which each has both a discernable voice and some degree of political influence. Assuming current civil unrest dissipates, the larger Iraqi citizenry can look forward to a bright future, complete with the long-term restoration of basic services as well as the opening of public and private institutions. Far beyond the country’s immediate borders, multinational corporations with a historically notable presence in the region (and individuals with business assets in Iraq) also stand ready to benefit as their respective outposts gradually return to productive operation. Yet, in light of the fact that Iraqi insurgents in different parts of the country launch regular, if not daily, attacks both on American soldiers stationed in the region and those Iraqis who happen to be (or are accused of being) of a different religious stripe, the vision of a peaceful and economically productive Iraq in the near term is turning out to be more grand apparition than true oasis on the horizon.

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9 Sunnis are the larger of the two principal groups adhering to the Muslim faith. In the wake of the death of Muhammad, the Arab founder of Islam, Sunnis argued that his successor should, per tradition, be chosen by election and consensus. See E. D. HIRSCH, JR., et al., THE NEW DICTIONARY OF CULTURAL LITERACY 101 - 02 (Houghton Mifflin Co. 2002). The Arabic word for “tradition” is “sunna.” See id.

10 Shi’ites are the smaller of the two principal groups adhering to the Muslim faith. In the wake of the death of Muhammad, the Arab founder of Islam, Shi’ites argued that his successor should be chosen from his family, starting with Muhammad’s son-in-law, Ali. See HIRSCH, et al., supra note 9, at 101 - 02. These partisan supporters of Ali took their name from the Arabic word “shia” which means partisan. See id.

11 Kurds are a linguistically and culturally distinct people inhabiting an amorphous geographic region including parts of Syria, Iran, Iraq, Turkey, and the former Soviet Union. See HIRSCH, et al., supra note 9, at 319. Most Kurds are Sunni Muslims. See 11 WORLD BOOK ENCYCLOPEDIA Kurds 392 (2002 Edition). Kurds have never had their own government, and efforts at obtaining independence and self-government have been thwarted. See id. at 392 - 93. In 1988, thousands of Kurds were killed by Iraqi forces using bombs containing poisonous chemicals. See id. at 393.

12 In light of ongoing civil unrest, it appears more likely that the three groups will not be able to co-exist peacefully. See Peter W. Gailbraith, The Case for Dividing Iraq, TIME, Nov. 5, 2006, at 28.

13 See Michael Ware, The Most Dangerous Place, TIME, May 21, 2006, at 36.

14 Some commentators note that the civil unrest in Iraq is not truly a religious war between Shi’ite and Sunni Muslims but a secular grab for power organized along religious lines. Supposedly, the common religious identity provides security for those in the troubled region. See Aparasim Ghosh, An Eye for and Eye, TIME, March 6, 2006, at 18; see also Noah Feldman, Power Struggle: Tribal Conflict or Religious War?, TIME, March 6, 2006, at 25.

15 See Bobby Ghosh, Why They Hate Each Other, TIME, March 5, 2007, at 29, 29 (stating that “[t]he war between Iraq’s Sunnis and Shi’ites has left the U.S.’s hope of building a stable Iraq in ruins”).
The ongoing conflict in Iraq serves as a handy and timely reference point for a common state of affairs, Americans suffering business and non-business losses in war-torn regions of the world\(^\text{16}\) (with or without the concomitant troop presence). Whether deliberately targeted or not, those who are not on the ground in such regions but have productive assets there suffer a silent but noteworthy impact ranging in severity from the wholesale loss of a business to a modest interruption in the healthy flow of daily commerce. And to be sure, war conditions alone are far from being the only problem; history has shown that on frequent occasions, new governments (or old governments under new management) actively expropriate the property of citizens and foreigners.\(^\text{17}\) Given the world’s rich history of armed international conflict (and more than occasional internecine strife), courts have had ample opportunity to assess the status of Americans holding (and losing) business and non-business assets in war-torn countries.\(^\text{18}\) And yet, from a federal income tax perspective, several key questions resist satisfactory resolution. When may affected taxpayers legitimately claim that such losses have, in fact, been sustained; how does the analysis change when a hostile foreign sovereign seizes or confiscates assets physically located in the region but owned by American taxpayers; and just how well do pervasive judicial doctrines or notions common in the world of international law translate in the federal income tax arena?

Americans have the distinct privilege of paying taxes on their world-wide income.\(^\text{19}\) And, of course, one readily assumes that the ability to deduct world-wide losses is a logically sound and eminently just corollary. Would that it were consistently so. While the Internal

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\(^\text{17}\) See, e.g., Colish v. Comm’r, 48 T.C. 711 (1967) (discussing the nationalization of a taxpayer’s property by the Czechoslovakian government); Schweitzer v. Comm’r, 24 T.C.M. (CCH) 1705 (1965) (discussing the confiscation of taxpayer property by the Hungarian government).

\(^\text{18}\) See, e.g., S.S. White Dental Mfg. Co., supra note 16; Colish, supra note 17; Schweitzer, supra note 17.
Revenue Code has, for some time, made provision for the deduction of business and non-business losses of individuals, courts have commonly denied or delayed foreign “war” or expropriation losses by appealing to well-established notions of international comity. Under the Act of State doctrine, for example, the expropriation of taxpayer property (even by a new revolutionary regime) is deemed not to constitute a “theft” for federal income tax purposes. Even if a loss deduction is ultimately allowed with respect to the seizure and nationalization of a taxpayer’s property, the loss is often deemed to occur not when the führer’s troops march in but later when the new government issues final mandates of nationalization. Except, that is, when the relevant court has a decidedly itchy trigger finger.

Several years ago, the Fourth Circuit Court of Appeals concluded that the affected taxpayers sustained their losses in the year in which militants (not formally associated with the nascent State) took possession of the taxpayers’ business properties. And while it might appear, at first glance, that the court worsened matters by taking various liberties with the Act of State doctrine, the court inadvertently presented an intriguing challenge to the presumptively three-branch-monolith approach to that doctrine’s application. In *Gouhari v. United States*, the court appealed to the Act of State doctrine -- an apparent comity-induced deferral to the foreign

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19 See 26 U.S.C. § 61(a) (2007) (indicating that gross income, part of which may constitute taxable income, includes “all income from whatever source derived”).
21 See § 165(c)(1) & (2).
22 See § 165(c)(3).
23 Note that § 165(c) only applies to “individuals.”
24 See, e.g., Farcasanu v. Comm’r, 50 T.C. 881, 890 (1968) (holding that the taxpayer’s losses due to expropriation of property by agents of the Communist government of Rumania were not “thefts”).
25 See id. at 889 - 90 (indicating that, consistent with the Act of State doctrine, the taxpayer’s loss was not a theft and noting Congress’s enactment of a provision allowing Cuban expropriation losses to constitute deductible losses under § 165 as “casualties” or “thefts”).
26 See, e.g., Colish, supra note 17, at 716 (holding that the taxpayer suffered a deductible loss when the Czechoslovakian government nationalized his property in 1948 (on the enactment of a law)). The property had been placed under national administration in 1945. See id. at 711.
sovereign -- in concluding that the expropriation of the taxpayers’ assets (by the militants) did not constitute a casualty\textsuperscript{29} or a theft.\textsuperscript{30} Without legitimate explanation, however, the court went on to refute various judgments handed down by the judicial branch of that State in concluding that business losses suffered by the American taxpayers occurred before the issuance of formal decrees from the new regime.\textsuperscript{31} So, in addition to accelerating taxpayer losses to coincide with the entry of (arguably) rogue henchmen, the court had its nasty way with the Act of State doctrine, using it to reach one conclusion while evading what would appear to be a logical ramification of that use when reaching a related conclusion, recognition of a decree from the State’s judicial branch. Was this judicial sleight of hand, or can a court somehow rationalize and thereby justify the apparent analytical impurity inherent in recognizing and ignoring the same foreign sovereign in the same judicial breath?

This Article sets forth relevant law governing both domestic and non-domestic tax losses (including the impact of the so-called Act of State doctrine) before proceeding to a focused critique of the judicial application of that doctrine in the federal income taxation arena and beyond. After explaining and commenting on the basic statutory and regulatory rules concerning the availability and timing of taxpayer losses in Part I, I present Act of State doctrine essentials in Part II, discussing the origin and evolution of the doctrine, fleshing out its current discernable contours, explaining specific exceptions to its application, and briefly discussing selected scholarly commentary. With basic tax rules and relevant doctrine on the table, I address the

\textsuperscript{28} \textit{Id.}
\textsuperscript{29} As I will explain later, the court’s indirect application of the act of state doctrine to conclude that the loss was not an “other casualty” was erroneous, given that the act of state doctrine has traditionally been relied on only to reach the conclusion that a given expropriation loss was not a “theft.” This error may have resulted simply from reading specific language in Powers v. Comm’r, 36 T.C. 1191 (1961), out of context.
\textsuperscript{30} \textit{See} Gouhari, supra \textit{note} 27, at *1. The court appeals to the doctrine covertly by stating its legal conclusion and immediately citing Powers. The Tax Court has noted that the Powers decision is “in all ways consistent with the ‘Act of State’ doctrine.” \textit{Farcasanu, supra} note 24, at 889.
\textsuperscript{31} \textit{See} Gouhari, supra \textit{note} 27, at *1 - 2.
interaction of the two in Part III, shedding light on how courts have traditionally applied the Act of State Doctrine in contexts involving non-domestic losses resulting from sovereign-instigated seizures and expropriations. At that juncture, the Gouhari opinion enters the discussion and serves primarily as an analytical springboard for addressing various normative questions presented with respect to application of the Act of State doctrine in the tax arena and more generally. In Part IV, I assess the legitimacy vel non of trifurcating, bifurcating, or otherwise deconstructing the Act of State doctrine as justification for inter-branch discrimination. Part V contains a brief summary of my conclusions.

**Part I**

**Taxpayer Losses - In General**

Section 165 of the Internal Revenue Code provides a deduction for taxpayers suffering losses during the taxable year to the extent that such losses are not compensated for by insurance or otherwise. The basic rule has many exceptions and carve-outs. Individuals, in particular, may take the loss deduction only when (1) the loss is incurred in a trade or business, (2) the loss is incurred in a transaction entered into for profit, or (3) the loss arises from a fire.

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32 Taxpayers incurring losses in areas designated by the President of the United States as warranting specific federal assistance may elect to treat the loss as having occurred in the taxable year immediately preceding the taxable year in which the disaster actually occurred. See 26 U.S.C. § 165(i)(1). For the treatment of taxpayers ordered to demolish or relocate their residence because it has been rendered unsafe for residential use as a result of such a disaster, see § 165(k).

33 For losses described in § 165(c)(3), individuals must file a timely insurance claim (to the extent the property was covered by insurance) in order for such losses to be taken into account under § 165. See § 165(h)(4)(E).

34 See § 165(a). Treasury Regulations also indicate that in ascertaining the actual loss amount, the taxpayer must make proper adjustment for any salvage value and any insurance or other compensation received. See Treas. Reg. § 1.165-1(c)(4).

35 In the Code, the term “individual” is used to refer to a human being. The broader term, “person,” may apply to an individual, trust, estate, partnership, association, company, or corporation. See 26 U.S.C. § 7701(a)(1) (2007).

36 See § 165(c)(1).

37 Note that even though gambling transactions are commonly entered into for profit, gambling losses are allowed only to the extent of gambling gains. See § 165(d). The Code also limits the deduction of capital losses resulting from the sale or exchange of capital assets. See § 165(f). Cf. §§ 1211 and 1212.
storm, shipwreck, or other casualty or from theft. Deductions for losses in the last category (collectively, “casualty losses”) are subject to special limitations. Individuals may not deduct de minimis loss amounts, and the deduction for an individual’s aggregate casualty losses may be limited.

**Taxpayer Losses - Specific Regulatory Standards**

**Factual Prerequisites & Loss Timing**

In addition to restating basic statutory principles, the Treasury Regulations issued under § 165 set forth specific requirements with respect to the allowance of the loss deductions and the timing of such losses. In order to be deductible under § 165, a loss must be bona fide, evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. While factual prerequisites occasionally prevent prompt deduction of an apparent loss, timing issues can be particularly thorny, especially in the casualty loss context. Governing Treasury Regulations provide as follows:

If a casualty or other event occurs which may result in a loss and, in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of § 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received.

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38 See § 165(c)(2). Note that the loss may be allowed even if it was not connected with a trade or business. See id.

39 See § 165(c)(3). This rule applies regardless of whether the loss related to a trade/business or for-profit transaction. See id. Theft losses are deemed to be sustained during the taxable year in which the taxpayer discovers the loss. See § 165(e).

40 See § 165(h)(1) (allowing casualty loss deductions only to the extent the amount (with respect to each casualty or each theft) exceeds $100).

41 See § 165(h)(2) (indicating that if an individual’s personal casualty losses exceed his personal casualty gains, his loss deduction will be limited to an amount equal to the sum of (1) his personal casualty gains for the taxable year and (2) 10% of the amount by which his personal casualty losses exceed his personal casualty gains). For the definition of “personal casualty gain” and “personal casualty loss,” see § 165(h)(3).

42 See generally Treas. Reg. § 1.165-1. Specific rules governing the deduction of casualty and theft losses appear in Treas. Reg. § 1.165-7 and Treas. Reg. § 1.165-8, respectively.

43 See Treas. Reg. § 1.165-1(b).

44 Treas. Reg. § 1.165-1(d)(2)(i) (emphasis added). If a given casualty loss (or portion of a loss) is not covered by a claim for reimbursement with respect to which there is a reasonable prospect of recovery, the taxpayer
Thus, from a taxpayer’s perspective, the goal is to establish that the loss has been “sustained.” That status is achieved either (1) because there is no claim for reimbursement in the loss year or (2) because any actual claim lacks viability (e.g., because the taxpayer lacks a reasonable prospect of recovery or it can be readily ascertained that no reimbursement will be received). The Regulations go on to explain that whether a reasonable prospect of recovery exists with respect to a reimbursement claim is a question of fact to be determined on examination of all the facts and circumstances; taxpayers seeking to ascertain with “reasonable certainty” whether reimbursement for an asserted loss is forthcoming may rely on a settlement, adjudication, or abandonment of the claim. If a deduction is taken in accordance with the various rules set forth and unexpected reimbursement is received, the taxpayer is generally obligated to include the amount of the reimbursement in his gross income in the year of receipt.

As tax rules go, those governing the deduction of casualty and non-casualty losses are relatively straightforward. The provisions aim to ensure the accurate timing of losses and, ultimately, a clear reflection of the individual’s taxable income in a given tax year. Assuming the loss is properly timed, the individual need not concern himself with a potential recovery that would force the recognition of income in the future. Like all tax rules, however, the loss may be able to take an immediate loss deduction (for the appropriate portion of the loss) because that portion will be deemed to have been sustained during the taxable year in which the casualty or other event occurred. See Treas. Reg. § 1.165-1(d)(2)(ii). Note that Treas. Reg. § 1.165-1(d)(2)(i) and (ii) refer to “a casualty or other event.” Losses arising from “thefts” are treated as having been sustained during the taxable year in which the theft is discovered, but if (in that year) there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, the taxpayer may take the deduction only after the claim for reimbursement has been resolved. See Treas. Reg. § 1.165-1(d)(3). “Thefts” are deemed to include, but are not limited to, larceny, embezzlement, and robbery. See Treas. Reg. § 1.165-8(d). See Treas. Reg. § 1.165-1(d)(2). See Treas. Reg. § 1.165-1(d)(2)(i). See id. Taxpayers asserting the abandonment of a claim for reimbursement must produce objective evidence of abandonment (e.g., an executed release). See id. See Treas. Reg. § 1.165-1(d)(2)(iii). But cf. § 111 (indicating that if a previously-deducted amount did not give rise to a tax benefit in the year of the deduction, the amount need not be included in gross income in the year in which a related recovery is received).
provisions are subject to the intervention of public policy;\textsuperscript{49} individuals manufacturing their own catastrophes or casualties will not qualify for a deduction under § 165. But public policy is not the primary irritant in this context. It’s timing. The Treasury Regulations mean well, but they clearly enhance the likelihood that a taxpayer will either claim the loss before its ripe\textsuperscript{50} or delay to such an extent that the loss is simply no longer available. The problem of timing a given loss deduction is exacerbated when the loss is not at or near one’s doorstep. An individual suffering a loss of property, for example, in Iraq may simply not know that they have sustained a loss. Was their property destroyed in the shock and awe campaign, or is it likely that their property (not being a military target or located near one) was simply taken over by violent insurgents (who may have destroyed the property or simply taken over its operation)?\textsuperscript{51} It should come as no surprise that belated discovery of a foreign loss is no occasion for a sorrow-laden Hallmark moment with the IRS regarding a prior tax year. Here’s why. Taxpayers actually sustaining a remote loss in a given year (but not claiming it on their return) have a three-year time limit in which to amend the return and claim any refund due.\textsuperscript{52} So, the taxpayer may quickly run out of time before realizing that the loss has been sustained.\textsuperscript{53} Add to this potentially volatile mix of events, the Act of State doctrine.

\textsuperscript{49} See Blackman v. Comm’r, 88 T.C. 677 (1987) (holding that a taxpayer responsible for burning down his own home was not entitled to a loss deduction because allowing the deduction would frustrate public policy).

\textsuperscript{50} To take the common automobile accident as an example, State’s typically require that all motorists be insured. Thus, an individual may be unable to claim a given automobile-related loss immediately because in addition to proceeding against his own insurance company, he has the option (if not the obligation) of proceeding against the insurance company covering the other motorist(s) involved. The taxpayer may also have insurance providing coverage with respect to accidents with uninsured or underinsured motorists.

\textsuperscript{51} Generally speaking, losses arising from theft are deemed to be sustained in the year in which the taxpayer discovers the loss. See Treas. Reg. § 1.165-1(d)(3). If, however, in the year the taxpayer discovers the loss there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, the loss will be “sustained” when the claim is ultimately resolved. See id.

\textsuperscript{52} See 26 U.S.C. § 6511(a) (2007) (providing that a claim for credit or refund must be filed by the taxpayer “within 3 years from the time the return was filed”). It is also the case that the Internal Revenue Service must generally assess income taxes due within 3 years after the filing of the relevant return. See § 6501(a).

\textsuperscript{53} The business context only improves matters slightly. If a given loss is large enough, it may result in a net operating loss for the year. Businesses can use such losses to offset prior net operating gains (resulting in taxable
Impact of the Act of State Doctrine and Other Factors on Certain Losses

While the act of state doctrine should have no real impact on the remote loss of an individual’s trade or business assets (or assets used in an income-producing activity), confiscation or seizure of assets (falling outside those categories) by a foreign sovereign will, per the doctrine, not qualify as a “theft” because, under the law of the expropriating sovereign, there is no criminal intent.\textsuperscript{54} Courts will often conclude that expropriatory losses also do not constitute “other casualties,” essentially because the loss by expropriation is not akin to a loss caused by an act of God.\textsuperscript{55} Thus, if the taxpayer is unable to establish that such property was used in a trade or business (or income-producing activity), the end result is the denial of judicial relief,\textsuperscript{56} even when the offending sovereign has violated international law, has (later) fallen from power, or has failed to secure de jure recognition from the United States.\textsuperscript{57} Viewed in that light, the Act of State doctrine becomes many things. It becomes a gracious bow to a foreign sovereign’s authority on its own soil.\textsuperscript{58} But is that bow too deep? We will see that the doctrine also becomes a domestic judicial genuflection to our own Executive Branch\textsuperscript{59} which, supposedly, has more

\textsuperscript{54} See, e.g., Powers, supra note 29, at 1192 - 93 (explaining that confiscation of the taxpayer’s property by the East German government under color of legal authority could not have been a theft because losses arising from theft require criminal intent).

\textsuperscript{55} See Powers, supra note 29, at 1193 (noting that the expropriation of the taxpayer’s car was not “like a ‘fire, storm, or shipwreck.’ * * * It did not embody the requisite element of ‘chance, accident or contingency’”)(citations omitted).

\textsuperscript{56} See Note, The Castro Government in American Courts: Sovereign Immunity and the Act of State Doctrine, 75 Harv. L. Rev. 1607, 1607 (hereinafter, “Castro Note”) (noting that “[v]ictims of foreign expropriations have in the past been effectively denied judicial relief by application of the principles of sovereign immunity and the act of state doctrine”). See, e.g., Alvarez v. United States, 431 F.2d 1261 (5th Cir. 1970) (holding that the right to installment payments lost by the taxpayer via nationalization did not constitute trade or business losses).

\textsuperscript{57} See Castro Note, supra note 56, at 1609.

\textsuperscript{58} See Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 432 (1964) (noting that foreign states may resent an American court’s refusal to accept the validity of that state’s acts within its own borders).

\textsuperscript{59} See First National City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 765 (1972) (noting that the application of the act of state doctrine reflects judicial deference to the “exclusive power of the Executive over
skill in dealing with delicate matters of foreign policy. But is such deference justified, or is it a subtle yet troubling violation of the separation of powers?\textsuperscript{60} Rounding out the triumvirate, the doctrine also becomes a weapon of deduction slaughter, denying taxpayers who pay taxes on their world-wide income what is undeniably a worldly loss. From a fairness perspective, can that possibly be right? Part II of this Article is devoted to fleshing out the Act of State doctrine. With that background, we can better assess whether the doctrine has a legitimate place in federal tax controversies and whether, in light of the doctrine’s pervasive applicability and weight, courts may justifiably deconstruct the doctrine or must adhere to a monolithic application mindset to steer clear of potential taxpayer whipsawing.

\textbf{PART II}

\textit{Act of State Doctrine - Background}

At root, recognition of or appeal to the Act of State doctrine is a generous display of comity.\textsuperscript{61} Classically stated, “it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard to both international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws.”\textsuperscript{62} Though the doctrine links inexorably with recognition of conduct of relations with other sovereign powers and the power of the Senate to advise and consent on the making of treaties”).

\textsuperscript{60} See Michael J. Bazyler, \textit{Abolishing the Act of State Doctrine}, 134 U. Pa. L. Rev. 325, 375 (1986) (arguing that the act of state doctrine violates the separation of powers and interferes with judicial independence).

\textsuperscript{61} See, e.g., Ricaud v. American Metal Co., 246 U.S. 304, 309 (1918) (indicating that in principle, the rule “requires only that when it is made to appear that the foreign government has acted in a given way on the subject-matter of the litigation, the details of such action or the merit of the result cannot be questioned but must be accepted by our courts as a rule for their decision”); Oetjen v. Central Leather Co., 246 U.S. 297, 303 – 04 (1918) (emphasizing that “[t]o permit the validity of the acts of one sovereign state to be reexamined and perhaps condemned by the courts of another would very certainly ‘imperil the amicable relations between governments and vex the peace of nations’”); Underhill v. Hernandez, 168 U.S. 250 (1897) (noting that “[e]very sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory”).

\textsuperscript{62} Hilton v. Guyot, 159 U.S. 113, 164 (1895).
sovereign authority, its development stems largely from actual or perceived limits with respect to the protective sphere of sovereign immunity in 17th-century England. While the States which gradually replaced monarchs as governing sovereign continued to enjoy full sovereign immunity, State officials (even when acting in their official capacities) did not enjoy such immunity. Necessarily, the Act of State doctrine arose to cover the shortfall. American courts are quick to note that nothing in the United States Constitution requires recognition of the Act of State doctrine, yet some commonly reason that the doctrine has constitutional underpinnings:

[The doctrine] arises out of the basic relationships between branches of government in a system of separation of powers. It concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations. The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country’s pursuit of goals both for itself and for the community of nations as a whole in the international sphere.

The U.S. Supreme Court first recognized the Act of State doctrine in 1812 in *The Schooner Exchange v. M’Faddon*. In later years, however, courts began to apply the doctrine outside the personal immunity sphere, extending it to include acts of the sovereign more generally. As one

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63 See *Sabbatino*, supra note 58 (indicating that the act of state doctrine is “compelled either by the inherent nature of sovereign authority . . . or by some principle of international law”).
64 See *Bazyler*, supra note 60, at 330 - 31.
65 See id.
66 See id.
67 See *Sabbatino*, supra note 58.
68 *Sabbatino*, supra note 58, at 423. Of course, there are those who disagree. See id. at 423 – 24 & n.22.
69 11 U.S. (7 Cranch) 116 (1812).
70 Apparently, the U.S. Supreme Court started this trend in *Underhill v. Hernandez*, 168 U.S. 250 (1897) (noting that “[e]very sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory”). Scholars have also noted a gradual shift from the use of comity as a vertical force (executive federal power/competence in foreign affairs relative to the states) to a horizontal force (executive federal power/competence in the foreign affairs arena relative to the federal courts and Congress). See Harold H. Koh, *Transnational Public Law Litigation*, 100 YALE L.J. 2347 (1991) (symposium). See generally *Oetjen v. Central Leather Co.*, 246 U.S. 297, 303 - 04 (1918) (emphasizing that “[t]o permit the validity of the acts of one sovereign state to be reexamined and perhaps condemned by the courts of another would very certainly ‘imperil the amicable relations between governments and vex the peace of nations’”); *Ricau v. American Metal Co.*, 246 U.S. 304, 309 (1918) (indicating that in principle, the rule “requires only that when it is made to appear that the foreign government has acted in a
might readily suspect, given the wide variability in countries around the world and the stark idiosyncrasies of individual leaders, problems were not far off the horizon. In *Bernstein v. Van Heyghen Freres Societe Anonyme*, 71 (*Bernstein I*), Learned Hand refused to examine an odious act of state involving confiscated property, despite the fact that Nazis had seized the property because the owner/victim was Jewish; 72 Judge Hand reasoned that there had been no expression from the Executive Branch indicating that such expropriation decrees should not be given effect.73 In direct response to *Bernstein I*, the Second Circuit was soon able to hand down *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 74 (*Bernstein II*), in which evidence of invalid expropriation was allowed because the court had been made aware of relevant correspondence from Jack Tate, then-Acting Legal Advisor to the State Department.75 Mr. Tate clarified that the Executive Branch would not object to an examination of the relevant Acts of State. Developmentally, these decisions gave rise to the well-known “*Bernstein exception*” to the application of the Act of State doctrine, but in doing so, they also signaled a conscious and clear deviation from the notion of rigid separation of powers. Three landmark decisions from the U.S. Supreme Court have made only modest improvement in terms of establishing a well-ordered and neatly-clipped doctrinal terrain.

**Modern Doctrinal Evolution**

In *Banco Nacional de Cuba v. Sabbatino*, 76 the Cuban government nationalized, by forced expropriation, sugar owned by a Cuban corporation whose primary shareholders were

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71 163 F.2d 246 (2d Cir. 1947).
72 See id. at 249 - 50.
73 See id.
74 173 F.2d 71 (2d Cir. 1949), amended by 210 F.2d 375 (2d Cir. 1954).
It was the hope of the Cuban government that the commodities broker in the United States purchasing the sugar (for resale) would ultimately pay the proceeds over to one of the government’s financial instrumentalities (“Banco Nacional”), but the shareholders of the original corporate owner intervened. Under court order, the broker ultimately paid the funds over to Sabbatino, a temporary receiver; Banco Nacional instituted an action in federal district court to recover the funds from the broker and to enjoin the receiver from exercising dominion over the proceeds.

The district court readily acknowledged the viability of the act of state doctrine but concluded that the doctrine did not apply in contexts in which the relevant foreign act violated international law. After carefully pointing out that State Department communiqués revealed no Executive Branch objections to a judicial “testing of the Cuban decree’s validity,” the court of appeals affirmed, reasoning that the cumulative effect of the Cuban government’s actions constituted a violation of international law. The United States Supreme Court, noting the impact of the issues both on foreign relations and on the proper role of the Judicial Branch in a “sensitive” area, saw fit to grant certiorari.

Over a single dissent, the Supreme Court reversed. Mr. Justice Harlan, writing for the majority, first disposed of the argument that Banco Nacional had no place in American courts as it was an instrumentality of a government that would not permit American nationals to sue in its

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77 See id. at 403.
78 See id. at 404 - 05 (indicating that the broker originally purchasing the sugar had to enter into additional contracts (later assigned to Banco Nacional) with an instrumentality of the Cuban government).
79 See id. at 405.
80 See id. at 406.
81 See id.
82 See id.
83 See id.
84 See id.
85 See id. at 439 (White, J., dissenting)
86 See Sabbatino, supra note 58, at 439.
courts. Noting that the privilege of suing in American courts was traditionally denied only to those governments at war with the United States (or those simply not recognized by the United States), the Court reasoned that short of war, it was ill-equipped to assess varying levels of friendliness or hostility and thus unwilling to close the courtroom door to Cuba’s instrumentalities. With respect to the seizure of the sugar, the Court went on to conclude that in recognition of the act of state doctrine, it would not assess the validity of the Cuban government’s nationalization of sugar by forced expropriation:

[T]he Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.

One commentator reasons that in *Sabbatino*, the Court held the power to embrace one of three versions of the act of state doctrine:

- Strict non-review, subject possibly to a *Bernstein* exception
- A qualified form of the doctrine, allowing examination of foreign acts alleged to violate international law; and
- A reverse-*Bernstein* rule, allowing adjudication unless the Executive Branch specifically objects.

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87 See id. at 410.
88 Id. at 428.
89 The lower courts in *Sabbatino* pointed to the illegality of the acts as justification for refusing to apply the act of state doctrine, however, at least one commentator reasoned, even at that stage, that rigid adherence to the doctrine had merit for several reasons: 1) judicial determinations may interfere with diplomatic efforts if the Department of State; 2) a court outside the legal and political context is not the proper tribunal to assess and evaluate the acts of another government managing affairs within its own territory; 3) municipal courts lacking experience (and possibly influenced by nationalistic prejudice) seem ill-suited to address questions and issues arising in the international law arena; and 4) in the case of nationalized property, adherence to the act of state doctrine quiets title. See Castro Note, *supra* note 56. The commentator goes on to acknowledge, however, that “[a] rule of international law which protects violations of international law is self-defeating. Titles acquired by illegal confiscation deserve no protection, and a willingness on the part of foreign courts to hold nationalizations to accepted international standards may induce governments to conform to legal norms lest their confiscated goods become unmarketable.” *Id.* at 1616.
In the end, the Court leans more so towards strict non-review, showing due regard to both “an obligation to avoid embarrassment to the [E]xecutive [Branch] in its conduct of foreign relations”91 and fundamental differences between traditional western attitudes on the one hand and essentially Communist notions on the other92 (i.e., “a responsibility to avoid adjudication, in light of the lack of an international consensus on the standards governing expropriation and the ideological sensitivity of the subject”93). Although Congress responded to Sabbatino by enacting legislation codifying the qualified form of the doctrine (i.e., the Hickenlooper Amendment),94 the Supreme Court had more to say with respect to controversial acts of state.

In First National City Bank v. Banco Nacional de Cuba,95 the Cuban militia seized various branches of First National City Bank (“FNCB”) located in Cuba.96 To retaliate, FNCB sold collateral securing a loan made to a predecessor of Banco Nacional de Cuba.97 The sale yielded an amount in excess of the outstanding loan balance, and Banco Nacional sued to recover the difference.98 Not surprisingly, FNCB counterclaimed, seeking to keep that portion of the excess that would compensate it for the loss of its Cuban branches.99 Both the District Court and the Court of Appeals struggled to determine, in light of the Hickenlooper Amendment, whether and to what extent Sabbatino applied.100 Ultimately, the U.S. Supreme Court resolved the matter, largely by firmly attaching the Bernstein exception to the general applicability of Sabbatino.

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91 Sabbatino, supra note 58.
92 See Sabbatino Comment, supra note 90.
93 Sabbatino, supra note 58.
94 Cf. 22 U.S.C. § 2370(e)(2) (2007) (prohibiting federal courts from declining (on act of state grounds) to make specific legal determinations in cases involving certain confiscations or other takings in violation of the principles of international law).
96 See id. at 760.
97 See id.
98 See id. at 761.
99 See id.
Then-Justice Rehnquist emphasized that where the Executive Branch “expressly represents to the Court that application of the act of state doctrine would not advance the interests of American foreign policy, that doctrine should not be applied by the courts.” Thus, a court is “free to decide the case without the limitations that would otherwise be imposed upon it by the judicially created act of state doctrine.” Under the established facts, the Department of State had, in fact, provided the requisite green light, and accordingly, FNCB’s counterclaim was not barred by the act of state doctrine. The plurality’s explicit embrace of the Bernstein exception was not altogether well-received.

Though concurring in the result, Justice Douglas preferred the Court’s approach in National City Bank v. Republic of China, arguing that reliance on the Bernstein exception was inappropriate and that the Court’s opinion should rest on the principle that a sovereign suing in an American court exposes itself to counterclaim or setoff that may reduce or possibly eliminate the sovereign’s claim. Justice Powell wrote separately to express his discomfort with any doctrine requiring that the judiciary receive the Executive’s permission before exercising jurisdiction. In his view, “[s]uch a notion, in the name of the doctrine of separation of powers, seems … to conflict with that very doctrine.” Finally, Justice Brennan, in full dissent, argued that regardless of the suggestions of a communiqué from the Executive branch, other factors may support application of the act of state doctrine, including the absence of consensus regarding the

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100 See id.
101 Id. at 768.
102 Id. The Court’s exhortation to adhere to established notions of inter-sovereign comity (unless otherwise guided by the Executive Branch) allows the judiciary to steer clear not only of the Executive Branch’s power to conduct foreign relations with other nations but also the Senate’s power to advise and consent in the treaty-making process. See id. at 765.
103 See id. at 764.
104 See id. at 768.
105 See id. at 770 (Douglas, J., concurring).
107 See 406 U.S. at 772 – 73 (Douglas, J., concurring).
applicable international rules and the exclusive ability of the Executive to effect a fair remedy for all affected American citizens.\(^{110}\) Four years after \textit{First National City Bank}, the Court saw the need to return to the Act of State arena in \textit{Alfred Dunhill v. Republic of Cuba}.\(^{111}\) This time, however, the goal was to ensure that the doctrine’s reach was analytically consistent with the prevailing restrictive theory of sovereign immunity.\(^{112}\)

Much to the chagrin of aficionados everywhere, the Cuban government confiscated the assets of various Havana cigar manufacturers in 1960.\(^{113}\) “Interventors” took possession of the businesses and proceeded to operate them on behalf of the Cuban government.\(^{114}\) Many of the Cuban nationals who had previously owned the cigar manufacturing companies fled to the United States,\(^{115}\) and once here, they sued various cigar importers, including Alfred Dunhill, to recover amounts owed with respect to cigars sold prior to intervention.\(^{116}\) Not to be left out, the interventors asserted claims of their own;\(^{117}\) they sought to recover not only amounts owed with respect to \textit{pre-intervention} cigar sales but also amounts due with respect to \textit{post-intervention} sales.\(^{118}\) Given that the importers had eventually paid the amounts due for pre-intervention sales,\(^{119}\) they claimed in litigation the right to offset amounts due for post-intervention sales by pre-intervention amounts erroneously paid.\(^{120}\)

\(^{108}\) See \textit{id.} at 773 (Powell, J., concurring).

\(^{109}\) Id.

\(^{110}\) See \textit{id.} at 788 (Brennan, J., dissenting); \textit{see also} Comment, \textit{The Supreme Court, 1971 Term, International Law, Act of State Doctrine}, 86 \textit{HARV. L. REV.} 284, 296 - 97 (1972) (hereinafter, “FNCB Comment”) (arguing that the final disposition in \textit{First National City Bank} gave rise to an inequitable result because it allowed FNCB to secure a “preference” relative to other claimants victimized by Cuban expropriations).

\(^{111}\) 425 U.S. 682 (1976).

\(^{112}\) See \textit{id.} at 705.

\(^{113}\) See \textit{id.} at 685.

\(^{114}\) Id.

\(^{115}\) See \textit{id.} at 685.

\(^{116}\) See \textit{id.} at 685 - 86.

\(^{117}\) See \textit{id.}

\(^{118}\) See \textit{id.}

\(^{119}\) See \textit{id.} at 686.

\(^{120}\) See \textit{id.} at 687.
The District Court appealed to the act of state doctrine to legitimize the nationalization of the cigar manufacturing businesses but ultimately concluded that the importers were entitled to offset amounts due the Cuban government by amounts paid in error. The court reached this conclusion over the objection of the Cuban government that its refusal to honor any obligation to repay amounts erroneously received constituted an act of state. The Court of Appeals bought the argument. In reversing the District Court, the Court of Appeals reasoned that “the obligation to repay . . . had been repudiated in the course of litigation by conduct that was sufficiently official to be deemed an act of state.”

Over a firm dissent spearheaded by Justice Marshall, the Supreme Court reversed. As an initial matter, the Court noted the absence of any official order, statute, decree, or other pronouncement indicating the Cuban government’s intent to repudiate its obligations. Highlighting the importance of distinguishing between a sovereign acting in its public capacity as sovereign and its commercial capacity as market participant, the Court proceeded to draw a sharp line in the sand:

We decline to extend that act of state doctrine to acts committed by foreign sovereigns in the course of their purely commercial operations. Because the act relied on by [the Cuban government] was an act arising out of the conduct by Cuba’s agents in the operation of cigar businesses for profit, the act was not an act of state.

See id. at 686.
See id. at 688.
See id. at 687.
See id. at 689.
Id.
See id. at 715 (Marshall, J., and Brennan, Stewart, and Blackmun, JJ., dissenting).
See id. at 706.
See id. at 695.

The use of the commercial/governmental distinction has been criticized. See Comment, The Supreme Court, 1975 Term, International Law, Act of State Doctrine, 90 HARV. L. REV. 265, 275 (1976) (hereinafter, “Alfred Dunhill Comment”) (arguing that a governmental/commercial distinction might deprive a court of the option of refusing to hear a case in which a particular commercial act was of substantial importance to another nation or in which adjudication would excessively entangle the court with American foreign policy).

406 U.S. at 706. The Court pointed out that there was no reason to assume that the interventors held governmental as opposed to commercial authority. See id. at 693. Logically, of course, there is no reason to assume that the interventors had commercial as opposed to governmental authority. This difficulty led Justice Powell to
In the Court’s view, the restriction on the application of the act of state doctrine follows necessarily from the United State’s abandonment of an absolute theory of sovereign immunity and its embrace of a restrictive sovereign immunity mindset whereby a foreign government may rightfully appeal to sovereign immunity only “with respect to causes of action arising out of a foreign state’s public or governmental actions and not with respect to those arising out of its commercial or proprietary actions.”

With his fellow brethren in dissent, Justice Marshall argued that an act of state need not take the form of a formal executive or legislative decree. In his view, such measures customarily evince acts of state because “duly constituted governments generally act through formal means.” He goes on to insist that the fact “[t]hat a foreign sovereign has issued no formal decree and performed no ‘affirmative’ act is not fatal, then, to an act of state claim. If the foreign state has exercised a sovereign power either to act or to refrain from acting there is an act of state.”

One could easily argue that the dissent’s view of the act of state doctrine is excessively if not breathtakingly broad. Arguably, a court looking to apply the act of state doctrine should be constrained to finding some ascertainable “act” lest the doctrine deteriorate to include everything along the continuum from Overt Acts of State to Mindless Omissions of State. And yet, it is difficult to dismiss summarily the notion that a sovereign need not reduce its every breath and blink to a formal writing to be deemed acting within sovereign authority. Perhaps the easier course to navigate is one in which courts readily acknowledge that states may, in fact, pursue a

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131 Id. at 715 (Powell, J., concurring).
132 Id. at 719 (Marshall, J., dissenting).
course of passive aggression, but those nations run the very real risk that in doing so they will fall on the blind spot of the international stage. Collectively, the existence of a host of possibly legitimate and arguably illegitimate distinctions (e.g., act/omission, governmental/commercial) paints the picture of a potentially-troubled doctrine,\(^\text{134}\) and court have notable difficulty in ascertaining and clarifying its precise contours.

*Act of State Doctrine - Scholarly Commentary*

Scholars charge that courts habitually misapply the act of state doctrine\(^\text{135}\) and routinely appeal to it to avoid deciding difficult international transaction cases.\(^\text{136}\) In going so far as to call for the doctrine’s abolition,\(^\text{137}\) one commentator argues that its application has resulted in violation of the separation of powers,\(^\text{138}\) diluted the effectiveness of various federal laws,\(^\text{139}\) and arrested the development of international law in the United States.\(^\text{140}\)

Stopping short of calling for the outright abolition of the act of state doctrine, Professor Burley calls for a fundamental change of mindset (i.e., a “liberal internationalist” revision of the act of state doctrine). In her view, there are two basic interpretations of the act of state doctrine:

One is a ‘legal’ interpretation of the doctrine as a doctrine of conflicts of law that directs courts to apply the law of a foreign state in accordance with recognized exceptions for violations of fundamental public policy and international law. The other is a ‘political’ interpretation of the doctrine as a doctrine of delimitation of judicial competence, directing courts to refrain from adjudication in politically charged cases to permit resolution of the dispute by the political branches.\(^\text{141}\)

\(^{133}\) *Id.* at 720 (Marshall, J., dissenting).

\(^{134}\) See generally Bazyler, *supra* note 60, at 344 (concluding that in light of three U.S. Supreme Court landmark decisions in the act of state arena, the doctrine is in a confused state because “[t]he Justices cannot agree on the meaning of the doctrine, on the role the Executive should play in its application by the courts, or on the status of the various exceptions to the doctrine”).

\(^{135}\) See, e.g., Bazyler, *supra* note 60, at 328 - 29.

\(^{136}\) See *id*.

\(^{137}\) See *id.* at 384 - 85.

\(^{138}\) See *id.* at 328 - 29.

\(^{139}\) See *id*.

\(^{140}\) See *id*.

Professor Burley reasons that ultimately, it was *Sabbatino* that transformed the act of state doctrine from a legal doctrine (relying on conflict of law principles) to a political doctrine (relying on separation of powers principles). That transformation, she concludes, was necessary to avoid adjudicating the act of a given state without applying the law of that state as “law” (and thereby inadvertently validating it in the liberal sphere). Professor Burley hypothesizes that liberal states operate in a “zone of law” (resulting in a potential judicial examination of their acts of state in accord with “general pluralist principles of mutual respect and interest-balancing”) and that non-liberal states operate in a “zone of politics” (resulting in either no examination of their acts of state or deference to the directives of the domestic political branches). A liberal internationalist revision of the act of state doctrine, she asserts, might induce “non-liberal” states to move closer to the “liberal” model by linking judicial deference to the act of a given state with legal ostracism and judicial examination of the act of a given state with “confirmation of [the given state’s] participation in the liberal international economy and an emerging political consensus on basic rights under law.” Such an approach has considerable merit in a context in which participation in the liberal international economy has strong appeal. Today, however, one cannot assume that a non-liberal state in the zone of politics has any real or even peripheral interest in a zone of law persona. Assuming, for example, that the United States is in the zone of law, one need not look far to find a state with boiling anti-American, anti-zone-of-law sentiments. Such a state will adamantly embrace its zone of politics orientation and, given the option, vehemently insist that its acts not be subject to judicial examination or commentary. The problem, as I see it, is not in convincing non-liberal states to appreciate and

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142 See id. at 1911.
143 See id.
144 See id. at 1910.
145 Id. at 1912 - 13.
obey the zone of law gospel but ensuring that in deciding when and how to apply the act of state doctrine, American courts do not allow liberal states to enjoy more deference than non-liberal states (or branches thereof). That tendency, in my view, is what led to the Gouhari conundrum discussed in Part III of this Article. To better understand that conundrum, however, it is necessary to get a sense of how and why courts typically dispose of foreign expropriation cases involving individuals. Those cases lie squarely at the intersection of the act of state doctrine and the aforementioned federal tax loss rules.

**Part III**

*Acts of State and the Tax Arena*

As was mentioned earlier, individuals sustaining losses during a given taxable year may deduct such losses (assuming fulfillment of regulatory requirements) only if one of the following applies:

- The losses were sustained in a “trade or business” of the taxpayer;
- The loss was sustained in an activity the taxpayer engaged in for the production of income (i.e., an “income-producing activity”); or
- The taxpayer suffered the loss in a fire, shipwreck, storm, or “other casualty” or from “theft.”

At the most basic level, courts commonly apply the act of state doctrine simply to rule out the notion that a foreign expropriation loss constitutes a “theft” because, as was noted earlier, the element of criminal intent is missing under the foreign sovereign’s law. Allowing a domestic court to assess the legitimacy of the taking would allow the courts of one government to “sit in judgment on the acts of the government of another, done within its own territory.”

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147 See, e.g., Farcasanu, supra note 24, at 889 - 90.
148 See id. (noting that the “‘Act of State’ doctrine . . . would appear to preclude us from deciding that an act of a foreign government or of a revolutionary regime later recognized as a foreign government was a ‘theft’ regardless of how despotic or arbitrary such an act might be”) (Emphasis added).
149 Underhill, supra note 61.
also ruled out “other casualty” characterization because the expropriatory act is commonly considered non-sudden and premeditated. Logically, then, a taxpayer suffering a foreign expropriation loss must prove either that it was the result of a fire, storm, or shipwreck (i.e., a force majeur loss) or that the loss was a “business/income loss” (i.e., either a “trade or business” loss or a loss incurred with respect to an “income-producing activity”). Those taxpayers able to prove that the loss was a business/income loss must still deal with the issue of timing. And, of course, here’s where things get interesting. Per the Treasury Regulations, losses are not “sustained” for deduction purposes unless they are evidenced by closed and completed transactions, fixed by identifiable events, and (generally speaking) not subject to a reasonable prospect of recovery with respect to available reimbursement claims. Over the years, courts looking to time a foreign expropriation loss properly have pointed to or considered various landmark events: 1) the placement of property under some form of national administration, 2) the issuance of a formal decree, and 3) the transfer of title to the property.

In United States v. S.S. White Dental Manufacturing Co., the Court concluded that the taxpayer’s losses were sustained in 1918 at the time the sequestrators appointed by the German government took over the property. Noted the Court, “[i]t would require a high degree of optimism to discern in the seizure of enemy property by the German government in 1918 more than a remote hope of ultimate salvage from the wreck of war. The taxing act does not require the taxpayer to be an incorrigible optimist.” The Court, in reaching this conclusion, explicitly

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150 See Alan Epstein, Foreign Expropriation Losses of Personal Assets: Should a Deduction be Allowed under Internal Revenue Code Section 165(c)(3)?, 40 TAX LAW. 211, 212 (1986).
151 See 26 U.S.C. § 165(a) (2007) (allowing the deduction of losses “sustained during the taxable year and not compensated for by insurance or otherwise”)(Emphasis added); see also Treas. Reg. § 1.165-1(d)(2)(i) (indicating that a loss is not sustained for purposes of § 165 if there is a claim for reimbursement with respect to which there is a reasonable prospect or recovery)
152 See Treas. Reg. § 1.165-1(d).
154 Id. at 403.
rejected the notion that the placement of property under some form of national administration was not a closed and completed transaction.\textsuperscript{155} Other courts look to a more definitive act of state such as the issuance of a formal decree. \textit{Schweitzer v. Commissioner}\textsuperscript{156} involved property confiscated by the Hungarian government.\textsuperscript{157} The Tax Court held that in light of the issuance of a decree, the taxpayer had no reasonable prospect of recovery that would justify postponing the loss deduction to a future year.\textsuperscript{158} Similarly, the Tax Court concluded in a subsequent case, \textit{Colish v. Commissioner},\textsuperscript{159} that the affected taxpayer suffered a deductible loss when the Czechoslovakian government nationalized his property;\textsuperscript{160} the court reasoned that the taxpayer did not, in fact, have a claim for reimbursement or anything more than an expectancy or hope that he would recoup his losses.\textsuperscript{161}

Considered together, the cases of relevance indicate that in the foreign expropriation context, an overt government act (whether formally placing property under national administration, issuing expropriatory orders by decree, or formally nationalizing the property by enacting a statute) definitively establishes the year in which a given loss has been sustained. And whatever the prevailing level of hope or optimism, Supreme Court precedent instructs that a taxpayer’s subjective expectations merit non-exclusive consideration at best.\textsuperscript{162} Difficult enough

\textsuperscript{155} See id.
\textsuperscript{156} 24 T.C.M. (CCH) 1705 (1965).
\textsuperscript{157} See id.
\textsuperscript{158} See id.
\textsuperscript{159} 48 T.C. 711 (1967).
\textsuperscript{160} See id. at 715.
\textsuperscript{161} See id. at 718. From a timing perspective, \textit{Colish} is intriguing in that it reveals inconsistent posturing (or a fundamental change in philosophy) by the IRS. Although the taxpayer’s property was placed under national administration in 1945 (by decree) and nationalized (by law) in 1948, title was not transferred until 1950. See id. at 711. Oddly, the Service argued in \textit{Colish} that the loss occurred in 1948 rather than focusing on the placement of property under national administration by decree in 1945. See id. at 715. Title to the property did not transfer until 1950. In timing foreign expropriation losses, courts do not typically look to the final transfer of title. The court in \textit{Colish} appears to have concluded that the loss occurred in 1948 (at the time of formal nationalization) but noted that the loss did not occur, in any event, later than 1950. See id. at 716.
\textsuperscript{162} See Boehm v. Comm’r, 326 U.S. 287 (1945) (noting that “a determination of whether a loss was in fact sustained in a particular year cannot fairly be made by confining the trier of facts to an examination of the taxpayer’s
in their own right, timing issues take on enhanced significance when one considers the impact of rules governing the amending of prior-year returns.

As was mentioned earlier, taxpayers seeking to amend a tax return for a prior year (to claim a refund or credit) must do so within three years after filing date of the return; if the prior return is not amended in a timely manner, the year is deemed “closed.” Thus, if a taxpayer suffers a substantial loss in 2007 but is not aware of it, he will not take the deduction on the return filed April 15, 2008. If the taxpayer realizes on April 16, 2011 that the 2007 loss was sustained, tax year 2007 will be closed to amendment, and the loss deduction would be lost forever. Taxpayers out of touch with their financial affairs of their own accord for such a substantial time period generate little sympathy, but it must be understood that the same ultimate result follows if a court appreciating and considering a larger, more complicated factual context deems that a loss was, in fact, sustained in a year closed to taxpayer amendment. Thus, one will occasionally find the IRS curiously enamored with the prospect of timing a given loss in a particular tax year, despite the obvious presence of equally gorgeous timing alternatives. More intriguing is the fact that one will occasionally detect what appears to be a court willing to take substantial liberties (or entertain novel interpretations) with respect to well-established doctrines to justify (or at least hobble its way to) a given result.

*The Gouhari Conundrum*

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belief and actions”); see also *S.S. White Dental Mfg. Co.*, supra note 16 (noting that “[i]t would require a high degree of optimism to discern in the seizure of enemy property by the German government in 1918 more than a remote hope of ultimate salvage from the wreck of war. The taxing act does not require the taxpayer to be an incorrigible optimist.”); Estate of Fuchs v. Comm’r, 413 F.2d 503 (2d Cir. 1969) (holding that the taxpayer did not have had a reasonable prospect of recovering her loss to the Czechoslovakian government, despite her reliance on the thin hope that the United States would, in some way, intercede on her behalf); Patterson v. United States, 459 F.2d 487 (Cl. Ct. 1972) (refusing to consider only subjective factors regarding whether the individual was operating the farm with the intent of producing a profit).


164 See id.
While *Gouhari v. United States* is not landmark precedent, the case does give rise to an important question: If a court relies on the act of state doctrine to justify its resolution of a given sub-issue, to what extent, if any, is the court analytically obligated to give due regard to the executive, legislative, or judicial acts of that state in resolving related issues or reaching related conclusions? Given that the act of state doctrine can arise in tax cases as well as any other case involving a foreign sovereign (even if the sovereign’s role is peripheral), the answer will certainly yield notable repercussions. *Gouhari* provides an excellent factual backdrop for thorough analysis of this question.

*Gouhari v. United States*

Prior to Ayatollah Ruhollah Khomeini’s rise to power in Iran in 1979, Mohammad Reza Pahlavi ruled the country as shah (*i.e.*, king). General Gouhari, it is believed, served in the shah’s secret police force, the Savak. As the revolution against the shah gained force and the Ayatollah’s influence mounted, the shah and various high-ranking officials in his administration fled the county. Although the Gouhari family made it safely out of Iran, they were forced to leave their residential and business properties in the hands of agents. In due course, these properties were nationalized, but the process occurred in two distinct phases.

First, the properties were taken over by the so-called Bonyad. At the time of their entry, the Bonyad served as revolutionary agents of the Ayatollah, and to date, the Bonyad continue to operate outside the formal Iranian state structure (*i.e.*, they are not accountable to the

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165 *Gouhari, supra* note 27.
166 See 10 *WORLD BOOK ENCYCLOPEDIA Iran* 406a (2002 Edition).
167 See *Gouhari*, supra note 27, at *1.
168 See *id.*
169 See *id.*
170 See *id.*
171 See *id.*
executive, legislative, or judicial branch of the state). Second, by order of Iranian courts, the Iranian government confiscated the business and residential properties of the Gouharis.

By the time the properties were seized by the Bonyad (in 1980), General Gouhadi had passed away, and the properties had been inherited by his sons who had relocated to the United States. As American taxpayers suffering losses abroad, it was they who attempted to claim a deduction for the loss of their business properties in Iran. Though conceding that the Bonyad took control of the properties in 1980, they argued that the actual loss was not sustained until 1991, the year in which an Iranian court issued a final order of confiscation thereby extinguishing any reasonable prospect of recovery.

The district court concluded that the taxpayers had not suffered a deductible loss. Though the Act of State doctrine relates specifically to the characterization of a foreign expropriation as a “theft,” the court misapplied the doctrine in relying on it to conclude that the loss was not an “other casualty” or a “theft.” To dispose of the argument that the taxpayers suffered a loss related to a “trade or business” or “income-producing activity,” the court took two steps. First, the court reasoned that with the seizure of the property in 1980 by the Bonyad, the taxpayers lost any reasonable prospect of recovery and, thereby, inherited nothing more than some nominal property interest in the confiscated land. Second, the court opined that this

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172 The Bonyad are accountable solely to the Leader, the highest authority in the Islamic Republic. Although one could argue that the Bonyad are loosely associated with the Iranian state, they are currently thought of as overstaffed, corrupt, and unprofitable. See http://en.wikipedia.org/wiki/Bonyad (last visited February 17, 2007). For purposes of this discussion, they will not be treated as state actors given that they have never been part of a “duly constituted government[] . . . act[ing] through formal means.” Alfred Dunhill, supra note 111 (Marshall, J., dissenting) (Emphasis added).

173 See Gouhari, supra note 27, at *1.

174 See id.

175 The Gouhari personal residence was not at issue in the litigation.

176 See id.

177 See id. at *2.

178 See id.
nominal interest was neither an asset held in a trade or business nor an investment entered into for profit.\textsuperscript{179}

The Fourth Circuit Court of Appeals agreed.\textsuperscript{180} Before articulating its basic agreement with the district court concerning the nature of the nominal property interest, however, the court carefully notes that “[b]ecause expropriation is not a casualty loss or theft, the [Gouharis] must establish that their losses were either incurred in a trade or business or in a for-profit transaction.”\textsuperscript{181} In support of this conclusion, the court cites \textit{Powers v. Commissioner},\textsuperscript{182} but in doing so, the Fourth Circuit repeats the error of the district court by extending the act of state doctrine beyond the Tax Court’s intended scope. In \textit{Powers}, the taxpayer argued that the expropriation constituted a “theft” and, in any event, a “casualty.” The Tax Court first applied the act of state doctrine to rule out theft characterization. It then dismissed the “casualty” argument by emphasizing that the expropriation was not like a fire, storm, or shipwreck in that it lacked the element of chance, accident, or contingency. Having addressed both of the taxpayer’s arguments, the court proceeded to set forth a collective conclusion, “[t]he [loss] deduction was not permissible either as a theft or as a casualty.”\textsuperscript{183}

While unfortunate, the Fourth Circuit’s misapplication of the Act of State doctrine is of only passing interest. More intriguing is the fact that rather than rely directly and explicitly on the act of state doctrine in the full light of day to justify at least one of its conclusion, the court

\textsuperscript{179} See id.
\textsuperscript{180} See id.
\textsuperscript{181} \textit{Id.} at *1.
\textsuperscript{182} 36 T.C. 1191 (1961).
\textsuperscript{183} While the Tax Court in \textit{Powers} does cite to \textit{Weinmann v. United States}, 278 F.2d 474 (2d Cir. 1960), in support of this contention, that decision simply indicates that it is “common ground” that nationalization is not a casualty or theft without any explanation as to why such a conclusion is “common ground.” The language from \textit{Powers}, makes sense as a collective conclusory statement made on the heels of separate, distinct, and independent reasoning processes, not as a prophylactic application of the act of state doctrine. If \textit{Weinmann} had (in 1960) effectively disposed of both the “other casualty” and “theft” arguments (even as purely persuasive authority), it
No matter. The Tax Court (which issued Powers in 1961) confirmed in 1968 that “[its] decision in [Powers] is in all ways consistent with the ‘Act of State’ doctrine . . . which would appear to preclude us from deciding that an act of a foreign government or of a revolutionary regime later recognized as a foreign government was a ‘theft’ regardless of how despotic or arbitrary such an act might be.”¹⁸⁵ So, albeit indirect and a bit ham-handed, the Fourth Circuit relies on the act of state doctrine to conclude that the taxpayer’s loss was not an “other casualty” or “theft” but goes on to ignore a judicial decree which would effectively time the loss in 1991. As an unpublished per curiam decision, the opinion does not stand as Fourth Circuit precedent.¹⁸⁶ Even so, the court’s disposition of the case is unsettling for several reasons.

Arguably, the act of state doctrine has no relevance under the existing facts, given that the sovereign, Iran, was not a party to the action. At least one commentator is of the view that characterization of a foreign expropriation as a theft in a domestic tax case would do no harm:¹⁸⁷

The declaration of the confiscatory act as a “theft” solely for purposes of federal income taxation should not interfere with international relations because it does not require the imposition of Western ideologies upon non-Western nations. The expropriating nation will not be affected by this characterization because it will still be able to establish the internal economic order that it prefers.¹⁸⁸

That argument works, of course, only if one assumes that a given nation will not object to the characterization of its acts as official thievery. Presumably, theocracies will take offense. Consider also, however, the fact that the Gouhari court demonstrates a degree of disregard for

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¹⁸⁴ See Gouhari, supra note 27, at *1.
¹⁸⁵ Farcasanu, supra note 24, at 889 - 90 (1968).
¹⁸⁶ See Jason B. Binimow, Annotation, Precedential Effect of Unpublished Opinions, 105 A.L.R.5th 499 (noting that “[t]he rules and holdings of many state and federal courts provide that unpublished opinions cannot be considered to have precedential effect”).
¹⁸⁷ See Epstein, supra note 150, at 229.
¹⁸⁸ Id.
the teachings of *Alfred Dunhill* in which the U.S. Supreme Court adopted as prerequisite to the application of the act of state doctrine the requirement that there be a *sovereign* actor acting in its *governmental* as opposed to its commercial capacity,\(^\text{189}\) one could hardly analogize the entry of the Bonyad to the acts of Banco Nacional at the clear behest of the Cuban government in *Sabbatino*. And yet that is exactly what the Fourth Circuit did, elevate the Bonyad to the status of state actor and turn a blind eye to Treasury Regulations which encourage the use of court orders and the like in timing the termination of reasonable prospects of taxpayer recovery with respect to asserted losses.\(^\text{190}\)

More disturbing, in my view, is the apparent analytical impurity of applying the act of state doctrine to reach one set of judicial conclusions while ignoring the judicial branch of the same state in reaching related conclusions. The Fourth Circuit appealed to the act of state doctrine to conclude that the Gouhari’s loss was not an “other casualty” or “theft”\(^\text{191}\) but rather than adhere to the logical ramification of that doctrinal application and accept the judicial decrees of the Iranian courts (ordering the confiscation of business properties in 1991),\(^\text{192}\) the Fourth Circuit chose to side with the domestic district court in concluding that the confiscation occurred in 1980 and not 1991.\(^\text{193}\) This approach is all the more surprising because the Fourth Circuit itself had previously embraced a tripartite notion of comity, defining it as “the recognition which one nation allows within its territory to the legislative, executive, *or judicial* acts of another nation, having due regard both to international duty and convenience, and to the rights of its *own citizens* or of other persons who are under the protection of its laws”\(^\text{194}\) Thus,
we now have the conundrum: Can a court ever fully justify applying the act of state doctrine (whether deferring to the acts of the sovereign acting in its capacity as sovereign or deferring to special executive branch competence) and yet, in the same context, proceed to ignore individual executive, legislative, or judicial acts of that same state? A presumptively monolithic approach has considerable appeal. But the world we now live in may well require rethinking and potentially restructuring the contours of long-standing doctrines, especially those with the potential for widespread application (or abuse). Is the Fourth Circuit on to (or simply up to) something here?

Part IV

Deconstructionist Options

Given that the governments of several (if not most) foreign countries have executive, legislative, and judicial branches, the act of state doctrine has long been interpreted as applying to acts of a given state originating in either branch, notwithstanding the fact that litigated cases typically involve displays of executive power. Although the Gouhari court slipped the act of state doctrine in through the back door (and ultimately ignored Iranian judicial decrees), the approach taken ultimately presents the question whether it makes sense for a given court to deconstruct the act of state doctrine and defer only to the acts of a given branch, even if prior courts have traditionally espoused a general belief in the propriety of a sovereign-as-monolith paradigm.

Take, as a single historical example, the case of Cambodia during the rise and fall of Pol Pot. In March of 1970, Lieutenant General Lon Nol overthrew the government previously
headed by Prince Sihanouk.\footnote{See 3 WORLD BOOK ENCYCLOPEDIA Cambodia 73 (2002 Edition).} Lon Nol effected an Executive substitution by proclaiming himself president in 1971 and then proceeded to dissolve the legislature.\footnote{See id.} In a matter of years, Khmer Rouge Communists led by Pol Pot took control of Cambodia,\footnote{See id.} though they too were eventually thrown from power in 1979 by Vietnamese troops and allied Cambodian Communists.\footnote{See id.} Eventually the United Nations took control of the government as the country made it way through a harsh transition. Democratic, multiparty elections for a 120-member legislative assembly were not held until May of 1993,\footnote{See id. at 74.} and ultimately, a new government with two prime ministers (and a king) emerged.

Does transitional Cambodia, with its violently-shifting Executive branch and summary legislative branch evaporation (with a long-delayed re-materialization), make the case for doctrinal deconstruction? A regime undergoing radical political change certainly does not, without more, merit demotion to non-sovereign. Then again, maybe a radical revolutionary like Pol Pot provides the “more” or at least some justification for considering a deconstructionist alternative. Where should a court start? A traditional, functional three-branch government would present the following options:

**Trifurcation of the Act of State Doctrine**

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<tr>
<th>Paradigm</th>
<th>Executive</th>
<th>Legislative</th>
<th>Judicial</th>
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<tbody>
<tr>
<td>Accept All</td>
<td>Accept</td>
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<tr>
<td>Only Reject Executive</td>
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\footnote{196} See id.
\footnote{197} See id.
\footnote{198} See id. at 74.
\footnote{199} See id.
In the transitional regime context, a foreign jurisdiction may be faced with the absence of a given branch (e.g., the legislative, though it could easily be the executive or the judicial); accordingly, a deconstructionist approach would only require doctrinal bifurcation.

Bifurcation of the Act of State Doctrine (Executive Absence or Struggle)

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Bifurcation of the Act of State Doctrine (Legislative Absence or Struggle)

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Bifurcation of the Act of State Doctrine (Judicial Absence or Struggle)

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Obviously, if the foreign government has only one functional branch, the domestic court must only decide whether it will accept all, part, or none of the pronouncements of that functional branch.

Interestingly, Iran and governments like it present an imposing challenge to the merits of a deconstructionist approach to the act of state doctrine. In addition to having an executive, legislative, and judicial branch, the government has the Leadership Branch. The Leader, as the supreme religious and political authority, is, in fact, the chief of state. Thus, a non-Iranian court deciding whether to accept or reject acts of the Iranian state outside a monolithic mindset has a stunning array of options. Assuming, for the sake of demonstration, that the Bonyad is an arm of the Leader Branch, one could explain the Gouhari result as a reflection of one of the four highlighted paradigms.

**Quadrification of Act of State Doctrine (All Branches Functional)**

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<tr>
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201  See id.
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It is, of course, possible to repeat the analysis removing one or more branches of government (e.g., the Leader position is vacant and has yet to be filled), in large part, such a three-branch (or two-branch) analysis would mirror the trifurcation and bifurcation analyses presented previously. Similarly, a government may incorporate more than 4 branches, but there are practical limits; at some point, an excess of government branches (with a meaningful separation of powers) would result either in anarchy or effective paralysis.

**The Merits (and the Madness) of the Deconstructionist Approach**

Concerning the force and effect of foreign judgments, the *Hilton v. Guyot* Court opined that the “most certain guide, no doubt, for the decision of such questions is a treaty or a statute of [the United States].” Yet, not every international relationship the United States has with a foreign sovereign is formalized by treaty or other international agreement. And even in those situations in which the United States and another country have entered into a treaty, there is no guarantee that the other country (or the United States) will not lapse into a revolutionary state and be replaced by a new regime (with adamant objection to fulfilling any treaty- or agreement-based obligations of the former sovereign). Historically, the fact that a particular government is in a revolutionary state has not consistently proven fatal to recognition of its acts as acts of

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202 Consider the potential problem presented if Fidel Castro were to die suddenly.

203 *159 U.S. 113 (1895).*

204 *Id.* at 163.
state. In an era of Executive volatility, uncertainty, and idiosyncrasy, maybe the doctrine now compels heightened scrutiny. Saddam Hussein was a harsh and merciless dictator, but if the act of state doctrine is to be applied consistently, his executive orders (were he still alive and in power) would have merited the same basic act-of-state regard as those of Prime Minister Tony Blair of the United Kingdom, Emperor Akihito of Japan, Prime Minister Singh of India, and President Omar al-Bashir of Sudan. To be sure, that regard is not now nor should it ever be absolute, but justice would seem to dictate that the level of domestic judicial deference not vary solely based on the source of the edict. The Fourth Circuit, in *Gouhari*, made no real effort to explain its act of state methodology, but it may well be that the court’s acceptance of an arguably quasi-executive act of the Iranian state while rejecting a judicial act of the same state is somehow inherent in the very nature of comity.

[Comity is, and ever must be, uncertain; that it must necessarily depend on a variety of circumstances which cannot be reduced to any certain rule; that no nation will suffer the laws of another to interfere with her own to the injury of her citizens; that whether they do or not must depend on the condition of the country in which the foreign law is sought to be enforced, the particular nature of her legislation, her policy, and the character of her institutions; that in the conflict of laws it must often be a matter of doubt which should prevail; and that, whenever a doubt does exist, the court which decides will prefer the laws of its country to that of the stranger.]

For the *Gouhari* court, this simply does not work. While no domestic court should be bound to give weight to a foreign decree, order, enactment, or judgment fundamentally at odds with

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205 See Farcasanu, supra note 24, at 889 - 90 (indicating that the “‘Act of State’ doctrine . . . would appear to preclude us from deciding that an act of a . . . revolutionary regime later recognized as a foreign government was a ‘theft’ regardless of how despotic or arbitrary such an act might be”).


207 See Ricaud v. American Metal. Co., 246 U.S. 304 (1918) (pointing out that “a court need not give effect to the penal or revenue laws of foreign countries or sister states”); Guinness PLC v. Ward, 955 F.2d 875 (4th Cir. 1992) (setting forth various provisions from the Uniform Foreign Money-Judgments Recognition Act that would preclude the recognition of a foreign judgment (e.g., judgments based on causes of action repugnant to the public policy of the State)); see also Willis L. M. Reese, *The Status In This Country of Judgments Rendered Abroad*, 50 COLUM. L. REV. 783 (1950) (noting that “judgments of foreign courts are denied conclusive or prima facie effect where the judgment is based on a statute unenforceable in the forum, where the procedures of the rendering court markedly depart from our notions of fair procedure, and generally where enforcement would be contrary to the public policy of the forum”).
American public policy, the Iranian court ordering the confiscation of property was, in its view, reclaiming property rightfully belonging to the Iranian state as an initial matter. Such an act is akin to an order authorizing the reclamation of public property stolen from the United States. So, acknowledging the decision would not have been at odds with prevailing American public policy. Add to this the fact that the domestic federal courts in Gouhari would have been doing little more than acknowledging that the Iranian courts formally confiscated the properties in 1991, not examining whether and to what extent the property actually represented proceeds from the looting of the Iranian treasury under the shah. That type of inquiry is prima facie violative of the act of state doctrine, while a mere acknowledgement of the timing of an official decree of confiscation (and simple acceptance of the Iranian court’s view that it was taking more than a nominal property interest) would have been fully consistent with recognition of the branch’s activity without associated judgment as to the ultimate merits of the state’s position. Instead, the Fourth Circuit’s deconstructionist route turns the act of state doctrine squarely on its head. In pointing to 1980 as the time of the taxpayer’s loss, the court either elevates a non-state actor to state-level status or defers to the (supposedly religious-based) actions of a branch of government which openly represents a perfect blending of church and state. Further, rather than obligate itself to give due regard to executive, legislative, and judicial acts of the Iranian state, it trots the act of state doctrine out long enough to foreclose one route of taxpayer deduction and moves on immediately to deciding, in essence, that the Iranian courts got both the real property and

\[\text{See id. (pointing out that “[r]e-examination of [foreign] judgments, in principle, reduces rather than enhances the possibility of injustice being done in a particular case).}\]

\[\text{See Mann, The Sacrosanctity of the Foreign Act of State, 59 L.Q. REV. 42 (1943) (noting that “[t]he expression ‘act of State’ usually denotes ‘an executive or administrative exercise of sovereign power by an independent State or potentate, or by its or his duly authorized agents or officers.’ The expression, however, is not a term of art, and it obviously may, and is in fact often intended to, include legislative and judicial acts such as a statute, decree or order, or a judgment of a superior Court”).}\]
inheritance law of Iran wrong! Such a disposition represents a quintessential evisceration of the act of state doctrine.\textsuperscript{210}

Strict adherence to a monolithic mindset regarding the act of state doctrine has considerable merit, especially in a context where the court appeals to the doctrine to reach at least one significant conclusion. Such an approach demonstrates due regard for all components of a foreign government, including its judicial tribunals.\textsuperscript{211} Courts have long emphasized that such deference need not be absolute,\textsuperscript{212} but deference should, in fact, be deferential, even where the foreign law on which a given judgment is based differs (possibly materially) from our own (though falling short of violating domestic public policy).\textsuperscript{213} Leaving the courts free to pick and choose the branch of a foreign government they will defer to in reliance on the act of state doctrine sanctions judicial whim and thereby enhances the potential for whipsawing domestic litigants who are often hardworking, taxpaying citizens. Allowing such discretion also compounds the problem of IRS inconsistency in the foreign expropriation context. In \textit{S.S. White Dental Manufacturing Co.}, the Service argued that seizure by appointed sequestrators of the German government was \textit{not} a closed and completed transaction and thus that the taxpayer could not deduct the loss at that time.\textsuperscript{214} Similarly, in \textit{Colish}, the Service placed no importance on the

\begin{footnotes}
\footnotetext[210]{See Ricaud v. American Metal Co., 246 U.S. 304, 309 (1918) (indicating that in principle, the act of state doctrine "requires only that when it is made to appear that the foreign government has acted in a given way on the subject-matter of the litigation, the details of such action or the merit of the result cannot be questioned but must be accepted by our courts as a rule for their decision").}
\footnotetext[211]{See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) (holding that a Puerto Rican company would be required to arbitrate its antitrust claims because such actions would show "respect for the capacities of foreign and transnational tribunals"); see also Reese, \textit{supra} note 207, at 784 - 85 (arguing that adherence to the doctrine of res judicata ultimately serves as the basis for American courts giving due regard to judgments of foreign courts but that such adherence may be overcome if 1) the foreign jurisdiction’s courts are non-reciprocal in their treatment of the judgments of American courts, 2) the foreign judgment is contrary to natural justice (or has been procured by fraud), or 3) the American court feels that disavowal of the foreign judgment is necessary to protect the interests of American citizens or to preserve American institutions).}
\footnotetext[212]{See Hilton, \textit{supra} note 62 (quoting Story, Conflict of Laws, § 28 and emphasizing that “no nation will suffer the laws of another to interfere with her own to the injury of her citizens”).}
\footnotetext[213]{See Reese, \textit{supra} note 207, at 797.}
\footnotetext[214]{See \textit{S.S. White Dental Mfg. Co.}, \textit{supra} note 16, at 399 - 400.}
\end{footnotes}
fact that the taxpayer’s property was placed under national administration in 1945; rather, the Service reasoned that the taxpayer’s loss actually occurred when the property was nationalized (by law) in 1948.\(^\text{215}\) Those cases notwithstanding, in \(\text{Gouhari}\), the Service chose to ignore official judicial decrees and, instead, to call attention to the entry of those only loosely associated (and not truly accountable to) the Iranian state.\(^\text{216}\)

**Toss It Out Altogether?**

In light of the apparent ease of judicial abuse (or, as we have seen, misapplication) of the Act of State doctrine and the shifting litigation posture of the Service, it may be time to punch the “easy” button,\(^\text{217}\) toss the Act of State doctrine out of the tax arena. As others have noted, the Act of State doctrine has no legitimate place in the domestic tax arena\(^\text{218}\) because in cases pitting a taxpayer against either the United States or the Commissioner of Internal Revenue, no foreign sovereign appears as a party.\(^\text{219}\) \(\text{Sabbatino}\), its predecessors, and its progeny have made it clear that the core justification for applying the doctrine is to defer either to the acts of a foreign sovereign with respect to acts taken on its own soil or to our own executive branch so as not to interfere with the conduct of foreign policy.\(^\text{220}\) And if \(\text{Alfred Dunhill}\)’s principal teaching is that a foreign sovereign may rely on the act of state doctrine only when it acts in its governmental as opposed to its commercial capacity, then surely appeal to the doctrine when the sovereign is barely on-radar (less the more acting in any capacity) smacks of judicial overreaching.

\(^{215}\) See \(\text{Colish, supra note 17, at 715.}\)

\(^{216}\) See \(\text{Gouhari, supra note 27, at *1 - 2.}\) Even if one argues that the Bonyad is an arm of the Iranian state by virtue of its association with the Leader, a court still cannot justify acknowledging one branch of state while ignoring the other, especially if the final directive of each branch calls for the same result.

\(^{217}\) This phrase is intended as a creative reference to the service mark of Staples, Inc., the world’s largest office products company. See [http://investor.staples.com/phoenix.zhtml?c=96244&p=irol-homeprofile](http://investor.staples.com/phoenix.zhtml?c=96244&p=irol-homeprofile) (last visited February 23, 2007).

\(^{218}\) See \(\text{Epstein, supra note 150, at 228 - 29.}\)

\(^{219}\) See \(\text{id. at 229.}\)

\(^{220}\) See also \(\text{Epstein, supra note 150, at 228 - 29.}\)
If the doctrine must apply in the tax arena, then its scope should be more explicitly confined, so as to prevent judicial footfault or overreach. Rather than allowing the doctrine to trump characterization of a foreign expropriation as either an “other casualty” or a “theft,” the doctrine’s scope should be emphatically limited such that it will be clear that it applies only to the latter and not the former. Also, while it is true that domestic courts traditionally characterize events as “other casualties” only when they are sudden, unpredictable, and unexpected (i.e., in the same way that storms and fires are), a foreign expropriation may well satisfy those requirements. Even if not, there’s no inescapably logical reason for reading a force majeur requirement into “other casualty.” Another alternative would be to create a new loss category for individuals, “foreign expropriation loss.”

Prior to its amendment, Section 172 of the Code (governing net operating losses) used to contain a definition of “foreign expropriation loss.” Such language could easily serve under § 165(c)(3) to flesh out the meaning of a new loss category separate and distinct from § 165(c)(3)(a), (b), or (c). Under prior § 172(h)(1), that definition read, in pertinent part, as follows:

The term “foreign expropriation loss” means, for any taxable year, the sum of the losses sustained by reason of the expropriation, intervention, seizure, or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing. Ideally, statutorily-mandated Treasury Regulations interpreting this provision would clarify that such losses are generally to be timed in the same manner as theft losses are timed, not because such losses are theft-like but because the foreign locus (and possibly the political climate) may well serve to introduce unexpected delay in discovering that a loss has, in fact, occurred. To the extent that a bright line rule is needed, the regulations could justifiably require that such losses

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221 See id. at 223 - 24.
be deemed sustained on the issuance of a formal decree from a recognized branch of the foreign sovereign.

**Part V**

One could rationally criticize the act of state doctrine as “confused” given that even in the wake of three U.S. Supreme Court landmark decisions, “[t]he Justices cannot agree on the meaning of the doctrine, on the role the Executive should play in its application by the courts, or on the status of the various exceptions to the doctrine.”223 To worsen matters, the Executive’s position on the applicability of the act of state doctrine is inconsistent.224 Indeed, the Executive’s only consistent act of state posture is to encourage the Judiciary to adhere automatically to its recommendations.225

With the enhanced globalization and the world economy and the growing sophistication of its political participants, almost every international transaction will implicate, at least indirectly, a foreign sovereign.226 Courts, by inclination or default, may find reason to rely on the act of state doctrine227 even when such reliance is inappropriate, yet even in doing so, the likelihood is that they will struggle in ascertaining the level of sovereign involvement which merits invocation of the act of state doctrine.228 There is little room for comfort.

One of the most alarming aspects of the doctrine is the potential breadth of its application to American jurisprudence. The decisions of the lower federal courts illustrate that the act of state doctrine might be invoked whenever a claim arises that

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223 Bazyler, supra note 60, at 344.
224 See id. at 362.
225 See id. at 364 - 65.
226 See id. at 365 - 66.
227 See id.
228 See id. at 366 (emphasizing that courts have often attempted to find substantial foreign government involvement before applying the act of state doctrine but noting the difficulty courts encounter in determining how much involvement is sufficient to trigger application). Difficulty in ascertaining the proper level of involvement to trigger application of the doctrine has led to a mechanical approach, erring on the side of application unless a recognized exception applies (e.g., the Bernstein exception, the commercial activity exception, treaty exception, the fraud exception, the U.S. property situs exception, and possibly a human rights exception). See id.
involves events outside of the United States. * * * Unlike the doctrine of sovereign immunity, the act of state doctrine may be applied even if a foreign government is not a party in a case.\textsuperscript{229}

Bearing those doctrinal facts in mind, it is paramount that “Act of State” “not be invoked cavalierly whenever some foreign governmental involvement looms in the background.”\textsuperscript{230} The need is especially pressing in the federal income taxation context where the foreign sovereign is not a party to the suit and where, as a result, the doctrine should neither preclude characterization of a given expropriation loss as a “theft” nor prevent a case-by-case assessment of whether the expropriation loss qualifies as an “other casualty.”\textsuperscript{231} Exercise of this form of judicial restraint in the foreign expropriation context would serve as an effective and just counterweight for taxpayers subject to prompt taxation on their world-wide income.

As we have it, the current statutory/common law scheme yields a troubling elevation of loss mechanics over practical loss impact. Trade or business losses (both foreign and domestic) are deductible, as are losses sustained in for-profit activities. Losses due to fire, storm, shipwreck, or other casualty or from theft are generally deductible so long as they were sustained in the United States. In fact, “other casualties” and “thefts” with respect to personal property are generally deductible if sustained abroad, so long as the “casualty” was sufficiently sudden or the theft was effected by true thieves or non-official rogues. A taking of such property by the hand of the foreign sovereign, however, renders the personal loss non-deductible, despite the existence of an undeniable loss, clearly realized, and over which the taxpayer truly had neither dominion nor control.\textsuperscript{232} Thus, a taxpayer losing personal property by other casualty or theft in the United

\textsuperscript{229} Id. at 344 - 45.
\textsuperscript{230} See Bazyler, supra note 60.
\textsuperscript{231} See Epstein, supra note 150.
\textsuperscript{232} Part of this sentence plays on language from Comm’r v. Glenshaw Glass Co., 348 U.S. 426 (1955) (noting, with respect to punitive damages received by the taxpayer, that the funds constituted “undeniable accessions to wealth, clearly realized, and over which the taxpayers [had] complete dominion”).
States (or abroad under the appropriate circumstances) enjoys a tax fate more favorable that a taxpayer suffering a similar loss at the hands of an expropriating foreign sovereign. Such a result is fundamentally inconsistent with notions of horizontal equity which dictate that similarly-situated individuals bear the same tax burden. That result inspires no awe, but the theoretical purist in me certainly finds it a tad bit shocking.