INCOME TAX AND THE IOWA LAWYER

Marion Hirschburg†

Foreword

The Iowa lawyer constantly finds himself involved with income tax matters. He is not only plagued with the troubles of his clients in this particular area, but he also encounters tax problems in the management of his personal affairs. His competition is not restricted to other lawyers, as this is one field in which a great many individuals, ranging from insurance men to truck drivers, have set themselves up as qualified advisors. His source material is based upon the Internal Revenue Code—a legal hodge-podge commented upon by Justice Learned Hand as follows:

> [T]he words . . . dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that . . . leave in my mind only a confused sense of some vitally important, but successfully concealed, purport . . . .[1]

Thus, the *Why, What, When* and *Where* of income taxation have become a nightmare to him, professionally and personally, and it is usually solved by "jumping on his horse and riding off in all directions." If this article can ease some of the "saddle sores," then my time has been well spent. Just remember that the present dilemma is not something new, as our brethren in the days of long ago apparently faced the same situation as evidenced by the following:

> And it came to pass in those days, that there went out a decree from Caesar Augustus that all the world should be taxed. And all went to be taxed, everyone into his own city. (The Gospel according to St. Luke, Chapter 2.)

I. Dealing with the Internal Revenue Service

A. *General Comment*

Dark hints are constantly being tossed about by top authority in the Internal Revenue Service that we, as lawyers, will be taking up our clients' tax problems with computers in the not too distant future. True as this might be, we are now concerned with the present and must deal with "revenue agents," "review staff," "appellate staff," the "national office," "commissioner's letters," "rulings," and so-forth. Hence, it is incumbent upon us to be certain as to just how much we can rely upon a particular individual, a particular office, or a particular document in the area of income tax disputes.

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† Member of the Iowa Bar. B.A. 1929, J.D. 1931, S.J.D. 1933, University of Iowa. Partner of Hirschburg, Reynolds, Gilchrist, Nutty & Smith, Ames, Iowa.—Ed.

1 Hand, *Thomas Walter Swan*, 57 Yale L.J. 167, 169 (1947).

B. *The Revenue Agent*

1. *His Authority*

A revenue agent has exceedingly little authority. His sole duty is to audit accounts[2] and he is fairly free in the manner in which he performs this obligation but must, under any condition, adhere strictly to the order of his superiors.[3]

2. *He Cannot Waive Regulations or Statutes*

Many lawyers are imbued with the thought that the revenue agent can ignore or waive regulations or statutes pertaining to income tax situations. This fallacy was duly exploded early in the tax "game" by the *Ritter* case.[4] In this particular case, Daniel Ritter filed his tax return for 1917 on April 1, 1918, and paid the tax liability shown thereon on June 7, 1918. The return was examined and the examination disclosed an overpayment of tax. The taxpayer indicated a desire to file a written claim for refund but was advised by the examining agent that he need not do so. He was further advised that the overpayment would be refunded as a matter of course. As time passed and the refund failed to materialize, the taxpayer made inquiry and was informed that the claim for refund was barred by the statute of limitations because of taxpayer's failure to file a written claim within a given period of time. The taxpayer answered that he failed to do so because he relied upon the agent's advice in the matter. The court, in dismissing taxpayer's petition said:

> The field agent in the instant case was not authorized to waive the requirements of the statute or the regulations, nor to make rules and regulations in accordance with which overpayments should be refunded. . . . He therefore had no authority to tell the plaintiff that he need not observe the requirements of the statute and of the regulation.[5]

3. *His Reliability as a Tax Expert*

It seems to be a common practice for most lawyers to accept a statement made by a revenue agent as to the law upon a particular problem as "it." This is fine if the matter is not challenged later. On the other hand, if a challenge arises, you will get little comfort out of being able to say that you relied upon the agent as "the Government is not bound by an erroneous interpretation of the law made by [an] . . . agent."[6] For "to allow revenue agents, who are assisting taxpayers for their convenience, to bind the government on a question of law, would be plainly and clearly improper."[7]

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2 Ritter v. United States, 28 F.2d 265 (3d Cir. 1928).
3 Darling v. Commissioner, 49 F.2d 111 (4th Cir. 1931).
4 Ritter v. United States, 28 F.2d 265 (3d Cir. 1928).
5 *Id.* at 267.
6 Bookwalter v. Mayer, 345 F.2d 476, 478 (8th Cir. 1965).
7 Darling v. Commissioner, 49 F.2d 111, 113 (4th Cir. 1931).

4. *His Acts and the Doctrine of Estoppel*

It is true that when the sovereign becomes an actor in a court of justice, its rights must be determined upon the fixed principles of justice which govern between man and man in like situations.[8] Hence, the acts or omissions of a revenue agent, if he be authorized to bind the United States in a particular transaction, will work an estoppel against the government if the agent has acted within the scope of his authority.[9] These statements are high-sounding and the courts pay lip service thereto, but rarely apply them.

A classic example of the failure to apply the doctrine of estoppel can be found in the *Municipal Bond Corporation* case.[10] In that particular case, the examining agent had allowed installment payments to be treated as sales of capital assets in prior returns and now sought to treat similar payments as ordinary income in the returns under examination. The factual situation in all years was the same and the court, in refusing to apply estoppel said:

> The facts offer no basis for an estoppel. Respondent has not proposed any adjustment of petitioner's tax liability for the prior years. . . . Those years are admittedly barred by the statute of limitations. What respondent has done is to determine petitioner's tax liability on income received during the taxable years now under consideration. That in so doing he may have reversed his prior action with respect to the payments received on the installment sales in question or that, with even less significance, he accepted without question petitioner's earlier returns in which the payments were treated differently does not in any manner offset the validity of his present determination or afford any basis for estoppel.[11]

5. *His Acts and the Doctrines of Laches and Negligence*

Laches or neglect of duty on the part of a revenue agent is no defense to a tax claim. The theory behind this is that the United States is not bound by acts of its agents in causing to be done what the law does not sanction or permit.[12]

6. *Your Obligation*

As a practicing lawyer, you are obligated to know the extent of the revenue agent's authority. "He who deals with an agent of the government must look to his authority, which will not be presumed but must be established."[13]

This is so "even though . . . the agent himself may have been unaware

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8 Cooke v. United States, 91 U.S. 389 (1875); Walker v. United States, 139 F. 409 (C.C.M.D. Ala. 1905).

9 Sanders v. Commissioner, 225 F.2d 629 (10th Cir. 1955).

10 Municipal Bond Corp. v. Commissioner, 341 F.2d 683 (8th Cir. 1965).

11 Municipal Bond Corp., 41 T.C. 20, 32 (1963), *aff'd*, 341 F.2d 683 (8th Cir. 1965). In this regard, *see also* Automobile Club of Michigan v. Commissioner, 20 T.C. 1033 (1953), *aff'd*, 230 F.2d 585 (6th Cir. 1956).

12 Utah Light & Power Co. v. United States, 243 U.S. 389 (1917).

13 United States v. Willis, 164 F.2d 453, 455 (4th Cir. 1947).

of the limitations upon his authority."[14] For "[w]hoever deals with the government does so with notice that no agent can, by neglect or acquiescence, commit it to an erroneous interpretation of the law."[15]

C. *The Commissioner*

The Commissioner of Internal Revenue Service has been called many names such as *Mr. Big, Chief,* the *Nabob,* the *Source of Knowledge,* the *Fountainhead of Tax Knowledge,* and some others that might not look so well in print. It would seem plausible that, when he has "ruled," any taxpayer following the ruling would be immune from trouble at a later date. Such is not the case as "an advisory letter on a question of law written by . . . the Commissioner does not conclude the United States on a subsequent modification of the ruling or create equities in favor of the [taxpayer] requiring the judicial adoption of the first interpretation."[16] For "[a] contrary ruling would mean that a taxing official who, as a courtesy to a taxpayer, rendered him aid in such a situation, would thereby and to that extent effectually tie his official hands and render himself impotent to perform the duties placed on him by the taxing statutes."[17] And "neither the duty of consistency, nor the principles of equitable estoppel bind the Commissioner . . . nor preclude him from correcting mistakes of law in the imposition and computation of tax liability, including the power to retroactively correct his rulings, regulations and decisions *upon which taxpayers have relied.*"[18]

D. *Revenue Rulings*

Ordinarily, an attorney usually relies upon a written opinion issued by an authoritative body. However, in the tax field, caution should be exercised as "[t]he rule that an administrative determination . . . does not constitute an estoppel against the Government, is a well-settled one."[19] On the other hand, this is not always the case as the court, in the *Stockstrom* case, refused to go along with the "rule" saying: "[I]t has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials."[20]

If you do rely upon a ruling, be sure that it is clear and unambiguous or you will be treading in deep waters. In the case of *W. Stanley Barrett,* the court said "[a]ssuming that the letter from [the Commissioner's] office was ambiguous in the minds of petitioner and his counsel, it was incumbent upon

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14 Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 384 (1947).
15 Schafer v. Helvering, 83 F.2d 317, 320 (D.C. Cir. 1936).
16 Yokohama Ki-Ito Kwaisha, Ltd., 5 B.T.A. 1248, 1255 (1927).
17 James Couzens, 11 B.T.A. 1040, 1174 (1928) (concurring opinion).
18 Massaglia v. Commissioner, 286 F.2d 258, 262 (10th Cir. 1961) (emphasis added), *aff'g* 33 T.C. 379 (1959).
19 Walker-Hill Co. v. United States, 162 F.2d 259, 263 (7th Cir. 1947).
20 Stockstrom v. Commissioner, 190 F.2d 283, 289 (D.C. Cir. 1951).

them to inquire further of [the Commissioner] before proceeding with their doubtful interpretation of the letter."[21]

You should also be cautioned not to rely upon rulings issued by any government agency besides the Internal Revenue Service when said agency is giving tax advice.[22]

E. *Conclusion*

"[O]ne accepts the advice of a revenue official at his peril."[23]

II. Arbitrary Action on Part of Agent

A. *General Comment*

As a rule, too common for citation, an agent's determination of a tax liability carries with it a presumption of correctness. On the other hand, if an agent's determination is *arbitrary*, the presumption disappears and the taxpayer is not required to establish what amount of taxes, if any, he owes.[24]

B. *Meaning of Word "Arbitrary"*

The term "arbitrary" as used in describing the actions or findings of an internal revenue agent does not seem to have any set definition. When the term is used by a court in its opinion, it would seem to be a catch-all word to indicate that the government's position is untenable. In some cases the agent's findings are held to be arbitrary in the light of the evidence produced by the taxpayer while in other cases the agent's findings show on their face that they are arbitrary. In a number of cases the word "arbitrary" was not used by the court but it was merely held that the taxpayer had made a sufficient showing to overcome the findings of the government.[25]

In *Black's Law Dictionary* the following definitions appear:

> Arbitrarily—Unreasonable
> Arbitrary—That which is decided by the judge on his own judgment and not according to law; without reason.
> Arbitrary Decision—A decision rendered by a court, or judge, or other officer exercising judicial functions which is based upon the will of the officer alone, and not upon any course of reasoning and exercise of judgment.

Webster's Collegiate Dictionary defines arbitrary as: (1) Depending on will or discretion; discretionary; as, an arbitrary decision. (2) Fixed or arrived at through will or caprice; decisive but

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21 W. Stanley Barrett, 42 T.C. 993, 1000 (1964), *aff'd*, 348 F.2d 916 (1st Cir. 1965).
22 United States v. Stewart, 311 U.S. 60 (1940); Bornstein v. United States, 345 F.2d 558 (Ct. Cl. 1965).
23 United Block Co. v. Helvering, 123 F.2d 704, 706 (2d Cir. 1941).
24 Helvering v. Taylor, 293 U.S. 507 (1935).
25 Thomas E. Reese, ¶ 54,240 P-H Tax Ct. Mem. (1954).

> unreasoned; as, too arbitrary as a critic. (3) Despotic; absolute; as, an arbitrary ruler.

Of the above dictionary definitions the one that best defines arbitrary for the purposes of this article would seem to be "unreasonable, without reason."

Under the facts of various cases, the word "arbitrary" would appear to mean that the agent had no basis for his findings;[26] that the findings were based on faulty logic;[27] that the agent disregarded what is common knowledge;[28] that the agent did not investigate the circumstances of the case to the extent required;[29] that he merely took a "shot in the dark;"[30] or he used the "pick and choose" doctrine.[31]

Since a general definition of the term will not fit all cases, the only course that is available is to set forth the facts of a particular case in which the court held that the action of the agent was arbitrary.

C. *Cases Involving Arbitrary Action*

In the *Michigan Cab Co. v. Kavanagh*[32] case, the agent advised the taxpayer that he was liable under the Social Security Act for his taxi driver employees. The agent was unable to collect the tax and had difficulty in obtaining any reports of earnings from the drivers. Finally the government assigned an agent to prepare and file a return for the taxpayer. After a brief check the agent estimated that the driver's pay was $6.00 per day.

In rejecting the agent's estimate the court said:

> On the facts shown by [the government] in this case, the assessment made was excessive and arbitrary and was considerably in excess of the amount which as a matter of common knowledge was being paid taxicab drivers at that time.[33]

In *Helvering v. Taylor*,[34] the United States Supreme Court held that it was not necessary for the taxpayer to introduce sufficient evidence to show the correct amount of the tax due but it was only necessary to show that the Commissioner's determination was invalid or arbitrary.

In its decision the court seemed to use a synonym for the word arbitrary when it used the phrase, "without rational foundation."

In *A. & A. Tool & Supply Co. v. Commissioner*,[35] the Commissioner,

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26 Maloney v. Hammond, 176 F.2d 780 (9th Cir. 1949); Long v. Kelly, 100 F. Supp. 235 (M.D. Ala. 1951); Leonard Cephus Hall, ¶ 53,314 P-H Tax Ct. Mem. (1953).

27 Laird v. Commissioner, 85 F.2d 598 (3d Cir. 1936) (on rehearing).

28 A. & A. Tool & Supply Co. v. Commissioner, 182 F.2d 300 (10th Cir. 1950); Michigan Cab Co. v. Kavanagh, 82 F. Supp. 486 (E.D. Mich. 1941); Jeff Rubin, ¶ 54,319 P-H Tax Ct. Mem. (1954).

29 Enoch A. Osborn, ¶ 53,332 P-H Tax Ct. Mem. (1953).

30 Leonard Cephus Hall, ¶ 53,314 P-H Tax Ct. Mem. (1953).

31 Holland v. United States, 348 U.S. 121 (1954).

32 82 F. Supp. 486 (E.D. Mich. 1941).

33 *Id.* at 487.

34 293 U.S. 507 (1935).

35 182 F.2d 300 (10th Cir. 1950).

among other things, had determined that there should be no deduction for commissions paid to a sales representative who had made sales in excess of $45,000 during the taxable year. The Tax Court upheld the Commissioner on the basis that the taxpayer had not introduced any evidence on the amount of the commission allegedly paid.

In reversing and remanding the circuit court held that the taxpayer had met his burden of proof when he showed that the Commissioner's determination was excessive.

> The Commissioner used the sale of the items in question to increase the income of the taxpayer. Certainly the taxpayer should be entitled to whatever costs, if any, it involved in making the sales.[36]

In *Long v. Kelly*,[37] the government had raided a still in Alabama and arrested four men. These four made affidavits which implicated the taxpayer in the operation of the still. Subsequently, during the criminal trial these affidavits were repudiated and the case against the taxpayer dismissed.

After this the Collector of Internal Revenue assessed the taxpayer tax and interest on distilled spirits. This suit was by the taxpayer to enjoin the collector from selling his home to pay the tax.

The government based its case on the affidavits of the four men but these again were repudiated by the men. In granting the taxpayer the relief sued for, the court held that the evidence plainly showed that the taxpayer never had any connection with the still.

> The evidence in the case connecting the plaintiff with any whiskey as a basis for the tax was fully and completely repudiated in the criminal trial and also at the present trial. There being no reasonable basis for the assessment of the tax, the assessment was arbitrary and capriciously imposed.[38]

In *Leonard Cephus Hall*,[39] the taxpayer was engaged in the "numbers" business in Tennessee. The daily slips were destroyed each week after the taxpayer had transferred the information to a weekly sheet and forwarded this information to his accountant. Of the amount bet on the numbers the writers received 7%, the pick-up men 30%, and the taxpayer 63%. The taxpayer paid all "hits." The percentage of hits to the total amount bet as shown by the taxpayer's books varied from 56% to 59%. The government accepted the taxpayer's books on all other points but contended that the ratio of hits should be 50%.

According to government agents, other numbers operators in Tennessee showed percentages varying from 48% to 61%. The government also put a gambler on the stand as an expert witness who testified that if $1.00 was placed on every number from 000 to 999 and the odds were 500 to 1, the

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[36] *Id.* at 305.
[37] 100 F. Supp. 235 (M.D. Ala. 1951).
[38] *Id.* at 236.
[39] ¶ 53,314 P-H Tax Ct. Mem. (1953).

winning number would receive $500 and the numbers operator $500. He further testified, however, that he, himself, had paid out sums in excess of the amount bet on certain days while on other days the wins had been less than average. This was due, of course, to the fact that certain numbers were bet more heavily than others.

In reaching a decision for the taxpayer the court stated:

> This mathematical hypothesis on which respondent and his expert witness have attempted to establish a 50% ratio for a numbers operator offering odds of 500 to 1, is, at best, little more than imaginary.
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> We think the record amply justified our conclusion that the respondent's assertion of deficiencies was arbitrary and without authority.[40]

The *Hall* case is only one of the fairly numerous cases involving the government on one hand and either a numbers operator or a bookie on the other. In a great many of the cases the government steps in, accepts the taxpayer's books and records for the purposes of determining the amount bet but then claims the pay out percentages are too high and proceeds to determine an adequate percentage by the "guess" method and assesses a deficiency accordingly. Generally the courts have held that in cases of this sort the Commissioner's determination is arbitrary.[41]

In *W. F. Carpenter, Ray Nichols and Edith Nichols*,[42] the taxpayers operated a "bookmaking" business. The records were kept in a day book from which an accountant prepared the tax returns. Initially the government determined that adequate books and records were not kept and attempted to use the net worth method. This method failed for lack of a satisfactory opening net worth. The agent then recomputed the taxpayer's income by taking the gross receipts as reported by the taxpayers and determining that 10% of that figure should be the net income. The deductions taken by the taxpayers on their returns were not questioned by the government.

In rejecting the government's computations the court pointed out that a net receipt figure could easily have been obtained by subtracting the deductions, which were unchallenged, from the gross receipts, which were accepted and used by the government. The net receipt figure as computed in this manner was not 10% in any year nor was it the same percentage in any two years.

> [I]t seems to us that in this case the failure to compute any figure, still less a consistent percentage, for net receipts, sustains petitioner's contention that the determination was not only arbitrary but unreasonable.[43]

In *Durkee v. Commissioner*,[44] the taxpayer had previously brought suit

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40 *Id.* at 967.
41 Melvin Clark, ¶ 55,252 P-H Tax Ct. Mem. (1955).
42 ¶ 54,217 P-H Tax Ct. Mem. (1954).
43 *Id.* at 682.
44 162 F.2d 184 (6th Cir. 1947).

against various other parties alleging loss of good will on the grounds of restraint of trade. The case had been settled out of court and the taxpayer had received $25,000. This sum had been shown on the tax return but had not been considered as income but had been considered as a return of capital. At the time of the settlement the taxpayer had dismissed his case and had signed a discharge and release for all debts, claims, demands, etc.

It was conceded that if the settlement represented damages for lost capital the money received was a return of capital and not taxable; however, if the money received represented lost profits then it was taxable.

The taxpayer contended that the money was received in settlement of the suit and was for damages to good will. The government contended that the money paid the taxpayer was not only in settlement of the suit but was also a settlement of all other claims which could include loss of profits. The Commissioner held that the entire $25,000 was taxable and then contended that it was up to the taxpayer to prove either that the entire recovery was non-taxable income or the proper allocation between taxable and non-taxable income.

The court held that it was apparent from the record that the Commissioner's determination was arbitrary and excessive and that in such a case the taxpayer is not required to establish the correct amount that might lawfully be charged against him and he is not required to pay a tax which he obviously does not owe. It is sufficient to show that the Commissioner's determination is invalid. The court further stated that it was obvious that a large portion, if not all, of the $25,000 was received in settlement of the lawsuit and was not taxable.

In *Enoch A. Osborn*,[45] the taxpayer owned a bakery and restaurant and employed her husband as manager of the restaurant. During the year in question the taxpayer had withdrawn money from her savings account and deposited it in the business account to meet outstanding obligations. In making his audit, the agent, although informed of the source of this money, disregarded such explanation and included the money as part of the sales of the bakery. Also in recomputing the taxpayer's income tax the agent arbitrarily used the standard deduction while the taxpayers had itemized their deductions on their return.

In reaching a decision for the taxpayers the court pointed out that it was impossible for them to determine from the information presented by the government how the figures were arrived at. It was further held that on the basis of the record the court was not able to determine one adjustment that was made by the agent which was proper and justified.

In *Jeff Rubin*,[46] the taxpayer operated a grocery store. In determining the deficiency the government disallowed all of the claimed cost of goods sold and the business deductions and placed the reported gross receipts in income.

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[45] ¶ 53,332 P-H Tax Ct. Mem. (1953).
[46] ¶ 54,319 P-H Tax Ct. Mem. (1954).

The reason given was that the taxpayer's returns contained many estimated round figures not substantiated by the books and records.

In reaching its decision the court pointed out that while the government may employ a reasonable method to compute the taxable income of a taxpayer, he also has the burden of adopting a method that will clearly reflect income.

> We think it is well established that in figuring business income, involving the sale of goods, the cost of goods sold must be deducted from gross sales in order to arrive at gross income. . . . In the instant proceeding respondent has determined that gross sales constitute gross profit which, in turn, constitute net income. We think such determination is arbitrary and without authority. . . . Although we sustain respondent's denial of the claimed business deductions for lack of substantiation, we think it wholly unrealistic to determine that petitioners incurred no expenses in deriving their gross receipts from their small retail grocery business.[47]

The foregoing cases are by no means all of the cases in which the Commissioner's determination has been held to be arbitrary. As previously stated, the term "arbitrary" has been used as a catch-all word by the courts frequently and under varying circumstances. The cases presented in this article are merely a cross-section showing the general usage of the term arbitrary. I also commend for your reading the *Axelroad* case[48] and the *Reyer* case.[49]

D. *Conclusion*

There is a limit beyond which the presumptive correctness of an agent's determination may not be stretched in order to defeat a taxpayer or create a fictitious tax deficiency.

III. Personal Tax Problems of a Lawyer

A. *General Comment*

If there exists an Iowa lawyer who is not desirous of reducing his own income tax, then I suggest an insanity hearing. As I am fully certain that no such "animal" exists, then let us give some consideration to ways and means, legal of course, of minimizing your own income taxes. Since practically all lawyers of my acquaintance are on a cash basis, my efforts will be devoted to that particular category.

B. *Income*

In view of the fact that the matter of income of lawyers is primarily a problem of timing (as you do control the billing), I suggest that you investi-

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47 *Id.* at 1005.
48 Daniel H. Axelroad, ¶ 62,118 P-H Tax Ct. Mem. (1962).
49 Rosalie Lala Reyer, ¶ 62,240 P-H Tax Ct. Mem. (1962).

gate the possibilities of calendar versus fiscal year, income averaging and income spreading. Also please keep in mind that attorney fees can be spread over a period of years on a particular case if a proper agreement is reached prior to the undertaking of the assignment.[50]

C. *Deductions*

1. *Authority*

Internal Revenue Code of 1954, section 162 covers business expenses and Treasury Regulation, section 1.162-6 (1958) issued in connection therewith is as follows:

> *Section 1.162-6 Professional expenses*
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> A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid or accrued in the operation and repair of an automobile used in making professional calls, dues to professional societies, and subscriptions to professional journals, the rent paid or accrued for office rooms, the cost of fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently paid or accrued for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted.

2. *Where Deducted*

(a) Law partnerships should file a partnership return and set forth therein all business deductions. If a partner is expected to incur expenses for the partnership and not be reimbursed, the partnership agreement should so state. Unless this is done, the paying partner might lose this deduction.[51]

(b) An attorney practicing alone will claim all his expenses on Schedule C.

(c) An attorney working for another attorney may make deduction of certain expenses if he itemizes his deductions.

3. *Some Particular Deductions for Lawyers*

(a) All automobile expense is deductible as it pertains to business expense.[52] If you have one car, then keeping of records as between personal and business is a must. If you have two cars, then assign one to personal and one to business. These can be switched around at the attorney's convenience.

If you wish to simplify, then you may deduct 10¢ per mile for the first 15,000 miles of business use and 7¢ per mile in excess of 15,000 miles. This deduction can be changed over each year to a cost system, but if used, it is a substitute for all operating costs of the car except parking fees and tolls.[53]

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50 Ray S. Robinson, 44 T.C. 20 (1965).
51 Frederick S. Klein, 25 T.C. 1045 (1956).
52 Welch v. Helvering, 290 U.S. 111 (1933).
53 Rev. Proc. 10, 1966-1 Cum. Bull. 622.

Please keep in mind that no deduction is allowed for traveling to and from your office.[54] Also, lack of records will defeat such a business deduction as the *Cohan* rule[55] will no longer apply to this situation.

(b) Expenditures for membership in social clubs, civic organizations, veteran organizations, and like groups, are deductible by a lawyer to the extent that such expenditures are made for the purpose of maintaining and increasing his practice and are reasonably calculated to accomplish that end. "Such practices are hardly novel or unusual, particularly in those professions in which soliciting or advertising are forbidden by ethical concepts."[56]

(c) An attorney may deduct the expense of tuition, travel, board and lodging incurred in connection with attending a Tax Institute. In so allowing the court said:

> It may be that the knowledge he thus gained incidentally increased his fund of learning in general and, in that sense, the cost of acquiring it may have been a *personal expense*; but we think that the immediate, over-all professional need to incur the expenses in order to perform his work with due regard to the current statutes of the law so overshadows the personal aspect that it is the decisive feature.[57]

(d) A law partnership paid certain individuals the sum of $65,750. This was to repay the individuals for losses sustained in loans made upon the recommendation of said partnership. The partnership deducted the amount so paid as a business expense and predicated the deduction upon the basis of the money being paid in order to protect its trade or business. In allowing the deduction the court stated:

> We must first determine whether these expenses arose out of petitioners' trade or business, for if they did not, whether they were ordinary and necessary is immaterial. . . .
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> . . . .
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> Based on the entire record before us, we conclude that the payments made by petitioners were an ordinary expense of their trade or business. Expenditures by a taxpayer to protect an established business are fully deductible as ordinary business expenses.[58]

(e) The *Garlove* case[59] presents an unusual situation in that a lawyer was entitled to deduct a loan as a business bad debt. Ordinarily, such a loan is not placed in such a category,[60] the taxpayer thus being denied a considerable tax advantage. The key to the decision lies in the fact that the loan was

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54 Robert R. Williams, Jr., ¶ 55,109 P-H Tax Ct. Mem. (1955).
55 Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930).
56 Robert R. Williams, Jr., ¶ 55,109 P-H Tax Ct. Mem. (1955).
57 Coughlin v. Commissioner, 203 F.2d 307, 309 (2d Cir. 1953) (emphasis added); *but see* Welch v. Helvering, 290 U.S. 111 (1933).
58 C. Doris H. Pepper, 36 T.C. 886, 892, 894 (1961).
59 Frank A. Garlove, ¶ 65,201 P-H Tax Ct. Mem. (1965).
60 Putnam v. Commissioner, 224 F.2d 947 (8th Cir. 1955).

made to a regular client so that said client could continue as one of the taxpayer's fee paying clients.

(f) Entertainment expenses, as well as travel expenses, are deductible under given circumstances. No attempt will be made herein to review this problem as it can be and has been the subject of many articles. It is suggested that you investigate the provisions of section 274, Internal Revenue Code, said section setting forth the rules and guideposts relating to the matter.

(g) In the case of *Rupert and Elsie Stuart*,[61] one of the questions involved pertained to whether or not the taxpayers were entitled to a deduction for maintaining an office in their home. The question was answered in the affirmative.

D. *Conclusion*

To paraphrase Plato; When there is an income tax, the wise man will pay less and the unwise man will pay more on the same amount of income.

IV. Deductibility of Legal Fees

A. *General Comment*

Lawyers are plagued with the one question most every client persists in asking—"Can I deduct this fee?" In as much as there are many conflicting and confusing decisions[62] involving the deductibility of legal fees paid for various kinds of services, it is suggested that each inquiry be judged separately on the underlying facts.

B. *Statutes Involved*

> Internal Revenue Code of 1954, section 162. Trade or business expenses
> (a) In general.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . .
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> Section 212. Expenses for production of income
>
> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
> (1) for the production or collection of income;
> (2) for the management, conservation, or maintenance of property held for the production of income. . . .
>
> Section 263. Capital expenditures
>
> (a) General rule.—No deduction shall be allowed for
> (1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

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61 ¶ 61,186 P-H Tax Ct. Mem. (1961).
62 Peters, *Confusion in Tax Litigation*, 48 Marq. L. Rev. 29 (1962).

C. *A Few of the Cases*

(1) Legal fees and costs incurred in a stockholders' derivative action and assessed against and paid by the corporation, are deductible as ordinary and necessary expenses of the business.[63]

(2) Legal fees expended in defense of an accounting action are deductible.[64]

(3) An amount paid in discharge of a judgment for legal fees is deductible.[65]

(4) Legal fees paid to recover lost or stolen property are deductible.[66]

(5) Legal fees paid in recovering the value of a building, held as rental property, from a tort-feasor, are deductible.[67]

(6) Legal fees incurred in successful litigation to recover over-payment of income taxes are deductible.[68]

(7) Legal expenses incurred in securing a refund of processing and floor stock tax are deductible.[69]

(8) Legal expenses incurred in recovering funds wrongfully seized are deductible.[70]

(9) Legal fees incurred in the recovery of war risk insurance premiums were deductible as ordinary and necessary business expense.[71]

(10) Legal fees paid to effect a settlement of a fire loss are deductible.[72]

(11) Legal fees incurred in defense of a criminal matter arising out of a business problem are deductible.[73]

(12) Legal fees incurred in contesting a tax deficiency are deductible.[74]

(13) Legal fees incurred in estate tax planning are deductible.[75]

(14) Legal fees incurred in anti-trust matters are deductible.[76]

D. *Conclusion*

The present tendency of the courts is to allow a deduction for attorney fees. This is a complete swing-around from the prior position of disallowance.

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63 B. T. Harris Corp., 30 T.C. 635 (1958); Charles Kay Bishop, 25 T.C. 969 (1956).

64 Kornhauser v. United States, 276 U.S. 145 (1928).

65 James E. Caldewell & Co. v. Commissioner, 234 F.2d 660 (6th Cir. 1956), *rev'g* 24 T.C. 597 (1955).

66 Vincent v. Commissioner, 219 F.2d 228 (9th Cir. 1955); Vesta Peake Maxwell, B.T.A. Mem. Op. Docket No. 86186 (1940).

67 United States v. Pate, 254 F.2d 480 (10th Cir. 1958).

68 Kales v. Commissioner, 101 F.2d 35 (6th Cir. 1939), *rev'g* 34 B.T.A. 1046 (1936).

69 California & Hawaiian Sugar Refining Corp., Ltd. v. United States, 311 F.2d 235 (Ct. Cl. 1962).

70 Commissioner v. Spever, 77 F.2d 824 (2d Cir. 1935).

71 Alexander Sprunt & Son v. Commissioner, 64 F.2d 424 (4th Cir. 1933).

72 Ticket Office Equipment Co. v. Commissioner, 20 T.C. 272 (1953).

73 Commissioner v. Tellier, 86 S. Ct. 1118 (1966).

74 Trust of Bingham v. Commissioner, 325 U.S. 365 (1945).

75 Nancy R. Bagley, 8 T.C. 130 (1947).

76 Noall & Troxell, *Tax Aspects of Antitrust Proceedings*, 18 TAX L. REV. 213 (1963).