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Income Tax: Deductibility of Nonbusiness and Nontrade Expenses

Enid Wessman

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depletion of such assets incidental to the lapse of time, consumption, liquidation or exploitation; subject, however, to (1) notice to share-
holders that no deduction or allowance has been made for such deple-
tion, and (2) adequate provision for meeting debts, liabilities and the liquidation preferences of outstanding preferred shares by accumu-
\[\text{Marion A. Grimes.}\]

INCOME TAX: DEDUCTIBILITY OF NONBUSINESS AND NONTRADE EXPENSES

In 1942 Congress provided for a deduction of non-trade or non-
business expenses in computing one's net income: "In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."\(^1\) This constituted an amendment to section 23(a) of the Internal Revenue Code which had previously provided for a deduction of "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."\(^2\) The amendment also provided for a deduction for depre-
ciation of property held for the production of income. The new pro-
visions were expressly made applicable to all prior years.\(^3\)

\[\text{Higgins v. Commissioner,}^4\) decided in 1941, was responsible for the new provision. There a taxpayer with large investments had de-
voted a considerable part of his time and required the assistance of others in overseeing his securities, spending for this purpose $20,000 in 1932 and $16,000 in 1933. The Court held that the salaries and expenses were not incidental to carrying on a trade or business; hence they were nondeductible.

Before this decision, the Board of Tax Appeals and some courts had allowed a deduction for such expenses in some cases, holding that an investor was in business because of the extent of his own activities in managing his investment.\(^5\) Using the same test, other cases, finding the activities involved not extensive enough to constitute a

\(^3\) Supra note 1.
\(^4\) (1941) 312 U.S. 212, reh'g den. (1941) 312 U.S. 714.
trade or business, disallowed the expenses. The Court in the 
Higgins decision did not clarify the confused situation by stating that to de-
termine whether the activities of a taxpayer constituted “carrying on a business” depended upon the facts in each case.

The proposal for the 1942 amendment came from the Treasury, Mr. Randolph Paul stating before the Committee on Ways and Means: “Under existing law taxpayers are allowed to deduct expenses incurred in connection with a trade or business. Nontrade or non-business income, however, is also subject to tax. It would, therefore, be equitable to provide for the deduction of expenses incurred in the production of such nontrade or nonbusiness income.”

The concept of the Senate Finance Committee in respect to the scope and purpose of the amendment is shown in the Committee Report which states that “income” includes gain from the disposition of property as well as recurring income; that under the new section expenses of managing or conserving investment property are deduct-
able even though there is no likelihood that the property will be productive of income and even though the property is only held to minimize a loss. In pointing out the limitations of such deductions, it emphasizes that although expenses to be deductible are no longer required to be incurred in a trade or business, the new section is otherwise subject to the restrictions and limitations applicable to the business expense section. This view is repeated in the Regulations adopted under the new provision which state: “Except for the re-
quirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limi-
tations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business.” This means that all the restrictions surrounding the words “ordinary and necessary” and “expense” under the old section are still applicable and that under section 24 (a) (5) amounts allocable to tax-exempt income and amounts allowable under section 23 (a) (2) allocable to tax-exempt interest are nondeductible.

Legal Expenses:

The removal of the requirement that expenses to be deductible must have been incurred in carrying on a trade or business has led the courts in many instances to uphold the deductibility of attorney fees

7 I Hearings Before Committee on Ways and Means, Revenue Revision, 77th Cong., 2d Sess. 1942, p. 88.
9 U.S. Treas. Reg. 111 (1943) §29.23(a)-15.
and other legal expenses which would formerly have been nondeductible. It was so held as to legal expenses incurred to obtain damages for a copyright infringement,\(^{10}\) to reform a trust to obtain more income for petitioner,\(^{11}\) to enforce payment to petitioner under a contract of assignment of oil and gas leases,\(^{12}\) to protect a minor's salary against claims upon it,\(^{13}\) to have a bond issue declared valid and enforce payment,\(^{14}\) and to secure a reduction of taxes on one's income-producing real property and securities.\(^{15}\)

One of the most important problems raised in the cases under section 23 (a) (2) has been the extent to which the restrictions conditioning deductibility under the old provision were applicable under the new. One important old restriction was that expenditures amounting to "capital charges" were not deductible as ordinary and necessary expenses. The comments of the Senate Finance Committee and the provisions of the Regulation, noted above, would appear to lend much support to the view that since the capital charge restriction was formerly applicable to the business expense section, the restriction was still applicable to the new section. For this reason legal expenses have been disallowed in many instances because under the circumstances of the particular case they constituted capital charges.\(^{16}\) One such case was *Bowers v. Lumpkin*\(^{17}\) in which the petitioner

\(^{10}\) Jack Rosenzweig (1942) 1 T.C. 24, *Acq.*

\(^{11}\) William J. Garland, T.C. Memo. Op., Dkt. 109902 (July 2, 1943).

\(^{12}\) Pierce Est. Inc. (1944) 3 T.C. 875 (*Nonacq.*).

\(^{13}\) Estate of Bartholomew (1944) 4 T.C. 349 (*The legal fees allowed as deductions in this case were incurred in connection with a variety of lawsuits: adoption proceedings by minor taxpayer's aunt, appointment of guardian and removal of guardian, obtaining new contract with employer and defense of an action to enjoin taxpayer from working for competing studios, defending suits brought by actor's agents for their commissions, defending suits brought by parents to obtain his earnings or estate. In reference to all of these the court stated: "It seems reasonable to hold that any litigation which sought to increase the production of income, or to protect the right to income produced, being produced, or to be produced, or to prevent others from acquiring a right, title, or interest therein would be proximately related to the 'production or collection of income'.") *Nonacq.* Appealed to C.C.A. 9th. Dismissed 151 F. (2d) 534 (1945).

\(^{14}\) Truman H. Newberry, T.C. Memo. Op., Dkts. 4122, 4123 (June 6, 1945).

\(^{15}\) R. C. Coffey (1943) 1 T.C. 579 (*Acq.*) *aff'd* (1944) 141 F. (2d) 204.

\(^{16}\) Bowers v. Lumpkin (C.C.A. 4th, 1944) 140 F. (2d) 927, 151 A.L.R. 1336, cert. *den.* (1944) 322 U.S. 755 (expenses of defending a suit brought to invalidate taxpayer's purchase of stock); Helvering v. Stormfelz (C.C.A. 8th, 1944) 142 F. (2d) 982 (expenses of a suit to recover from guardian funds of the minor which had been mismanaged; only those expenses allocable to the recovery of interest were allowed); Walker v. Com. (C.C.A. 6th, 1944) 145 F. (2d) 602 (maintenance expenses of a timber leasehold which taxpayer asserted was acquired for the production of income but the court found that the expenses were incurred as part of a plan to acquire the property as an accessory to his timber business); Burton-Sutton Oil Co. v. Com. (C.C.A. 5th 1945) 150 F. (2d) 621 (expenses incurred in a condemnation suit to protect oil rights of the petitioner); Mississippi Valley Trust v. U.S. (D.C. E.D. Mo., 1945) 61 F. Supp. 451 (expenses incurred in obtaining possession of leased premises on forfeiture of the lease); Raymond M. Hessert, T.C. Memo. Op., Dkt. 107336 (Apr. 22, 1943) (expenses of defending a
had successfully defended a suit brought to invalidate her purchase of stock; the attorneys fees and other expenses of the suit were disallowed by the court on the ground that since it had been established before 1942 that legal expenses incurred in defending or protecting title to property were capital charges, and not deductible expenses, that remained the rule under the new provision. The regulations under the new provision are in exact accord with this decision. Some inroad has been made upon this position. In the case of Walter S. Heller a taxpayer acting under a California statute allowing a proceeding to require a merging corporation to pay dissenting shareholders the market value of their stock, incurred legal expenses which were allowed as deductions. The court observed that it was "obvious that Congress intended that some expenditures pertaining to assets of a purely capital nature were to be allowed as deductions from gross income" because income had been defined as including not only recurring income but also gain from the disposition of property. The decision rested upon the fact that "The attorneys fees paid by petitioner, while relating to capital assets, bore a reasonable and proximate relation to the production or collection of income, and to the management of property held for that purpose." Under this theory legal expenses were held to be deductible which were incurred for securing an annulment of a transfer of stock, resulting in petitioner's receiving the value of the stock. In neither of these cases, however, did the court regard the suit as one to recover or perfect title to property.

The principle of the Heller case appears to be more reasonable
than arbitrarily to disallow an expense as being a "capital charge." Under section 23(a)(1) there is a logical distinction between ordinary and necessary business expenses and capital expenditures; but so many of the usual expenses for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income partake of the nature of capital expenditures that it is difficult to believe, notwithstanding the general statement of the Committee, that Congress intended that none should be deductible under the new provision.

An example of the restriction that amounts allocable to tax-exempt income are nondeductible is the case of National Engraving Co. v. Commissioner22 where legal expenses incurred in defense of a suit brought against a corporation to obtain money it had received on a life insurance policy were held nondeductible.

Legal expenses incurred by trustees or executors in defending suits brought against them for mismanagement or for an accounting have been held not to come within the statutory purposes of section 23(a)(2).23

Legal and accounting expenses in connection with tax controversies and the preparation of tax returns have often been claimed as deductions by taxpayers. Prior to the enactment of section 23(a)(2) such expenses were allowed only if the taxpayer was found to be "in business";24 if the expense was incurred in a suit to contest the amount of one's income tax, it was also essential that the original transaction on which the controverted deficiency was based be connected with the trade or business. For example, the expense of contesting a deficiency which was assessed upon income received from the sale of stock was disallowed because the taxpayer was unable to prove that his business was that of a capitalist;25 legal expenses incurred by a taxpayer in obtaining a refund of income taxes arising out of an adjustment of distributable income from a trust were held nondeductible on the ground that the beneficiary of a trust or estate who does not actively engage in the business of the trust is not in a trade or business.26 In cases where such expenses were disallowed the courts occasionally without elaboration referred to them as "personal" expenses, e.g., in Cornelia Roebling:27 "The decided cases in which this question

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22 (1944) 3 T.C. 178.
26 Burnett v. Com. (C.C.A. 5th, 1941) 118 F. (2d) 659.
27 (1938) 37 B.T.A. 82 at 86.
have been discussed hold that fees paid in connection with tax matters are deductible as expenses where the taxes result from a business in which the taxpayer is engaged. J. W. Forgeus, 6 B.T.A. 291; Caroline T. Kissel, 15 B.T.A. 1270. Fees paid in connection with taxes on transactions not amounting to a trade or business are considered personal expenditures and not deductible.” It would appear that the principal reason for disallowing the expenses was that they were not found to come within any existing provision for deduction. As stated by Mertens: “Since deductions are essentially a matter of legislative grace, they will not be allowed unless there is specific provision in the statute therefor. The retention of the provision excluding personal, living or family expenses results largely from inertia rather than from any necessity.28

The Regulations enacted to cover the new section limited the situations in which these expenses could be deducted: “Expenditures incurred for the purpose of preparing tax returns (except to the extent such returns relate to taxes on property held for the production of income), for the purpose of recovering taxes (other than recoveries required to be included in income), or for the purpose of resisting a proposed additional assessment of taxes (other than taxes on property held for the production of income), are not deductible expenses under this section, except that part thereof which the taxpayer clearly shows to be properly allocable to the recovery of interest required to be included in income.”

In the case of John W. Willnott29 the petitioner had transferred a half interest in all his income-producing property to his wife in order to reduce his income taxes and then contested a deficiency assessment made by the Commissioner who contended that the transfer was invalid. The taxpayer attempted to deduct the litigation expenses on the ground that they were paid for the conservation of property held for the production of income since without the litigation the half interest held by his wife would have been subjected to a lien for an additional tax and his half interest would have been subjected to a lien for an increased surtax. The Tax Court rejected this argument and disallowed the expenses on the ground that the transfer to the wife was not for the purpose of producing income nor for conserving property held for the production of income, and therefore any tax litigation arising out of the transaction was not for these purposes; the expenses of defending a suit could not be deducted by the owner of property merely because a judgment lien might attach to it.30

29 (1943) 2 T.C. 321, Acq.
30 Ibid. at 326.
In *Stoddard v. Commissioner*, a decision of the second circuit, the court in very broad terms disallowed deduction of income tax litigation expenses: "To extend this language [of section 23(a) (2)] to make it possible for taxpayers to deduct not only expenses which resulted, or were intended to result, in the acquisition of taxable income but also the expense of litigation over the amount of their income taxes would be too great a stretch in the absence of anything to indicate that Congress intended so to encourage such litigation." In accord with these two decisions such expenses were disallowed in a series of cases.

However, in the recent Supreme Court decision, *Trust U/W of Mary Lily (Flagler) Bingham v. Commissioner*, the argument which had been rejected in the *Willnott* case prevailed, viz., that the expense of contesting an income tax deficiency constituted an expense of conserving property held for the production of income. In the *Bingham* case the Commissioner asserted a deficiency in income tax against trustees of a testamentary trust because they had not reported income from a transaction in which they paid a legacy in securities which had increased in value while in their hands. The trustees claimed a deduction for the legal fees incurred in contesting this asserted deficiency; the Supreme Court, affirming the Tax Court, allowed the deduction. The opinion of the Tax Court observed that the purpose of the litigation and of the expenses incurred therein was to relieve the estate from the payment of the additional income tax and "to give such relief to the estate was...obviously a factor in the conservation, management, and maintenance of the estate, concededly held for the production of income, since in resisting the imposition of the tax the trustees were performing the required duty of protecting and defending the trust property in their hands against any claim or lien for the tax." The Commissioner had relied upon the Treasury Regulation. In reference to this, the Supreme Court replied that if the Regulation purported to deny deduction of litigation expenses unless they were incurred for the production of income it was contrary to the plain wording of section 23(a) (2) which also makes provision for the deduction of expenses incurred for the management, conservation, or maintenance of property held for the production of income.

Relying upon the *Bingham Trust* decision, the Tax Court in the

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31 (C.C.A. 2d, 1944) 141 F. (2d) 76.
32 Ibid. at 80.
34 (June 4, 1945) 65 Sup. Ct. 1232.
35 2 T.C. 853 at 858, 859.
recent case of Howard E. Cammack allowed expenses allocable to
the recovery of income taxes. There the petitioners in their returns
had deducted as losses the cost of stock held for the production of
income which had become worthless in the taxable year because of
the bankruptcy of the company. The Commissioner disallowed the
deduction, whereupon the petitioners paid the additional tax, then
sued to recover. Previously when a taxpayer attempted to deduct un-
der section 23 (a) (2) legal expenses incurred in a suit for a refund
of previously paid income taxes, the courts, relying upon the above
Regulation, adopted the policy of allowing only the expenses allocable
to the recovery of interest on the taxes, not those expenses allocable
to the recovery of the taxes, the theory being only the interest con-
stituted income, so only the expenses allocable to the recovery of in-
terest came within the statutory purposes. However, in the Cammack
case, the Tax Court in holding the expenses of the suit to be deductible
stated that the petitioner's actions were as proximately connected
with "management" as the contest of the deficiency in the Bingham
case. The dissenting opinion remarked that the majority decision had
overruled the Wilmott case without mention. In Herbert Marshall the
tax court allowed the deduction of legal expenses incurred in
contesting a deficiency assessed on the Commissioner's contention
that petitioner was not entitled to report his income on the community
property basis. The court relied on the Bingham and Cammack
decisions and seemed to hold that legal expenses in connection with
any tax matters are deductible. The Bingham, Cammack, and Marshall
cases seem to indicate that all such expenses are deductible
whether or not the underlying tax transaction in dispute relates to the
production of income or to the management, conservation, or main-
tenance of property held for the production of income.

In Higgins v. Commissioner, decided in 1944, the first circuit was
presented squarely with the question of whether fees paid by an in-

36 (July 19, 1945) 5 T.C. No. 52.
37 Percival E. Foerderer, T. C. Memo. Op., Dkt. 109076 (Feb. 27, 1943), aff'd (C.C.A.
3rd, 1944) 141 F. (2d) 53; James L. McFaddin (1943) 2 T.C. 395, Acq., remanded on other
grounds (C.C.A. 5th, 1945) 148 F. (2d) 370, gov't will not appeal; Ralph J. Green
(1944) 3 T.C. 74, Nonacq., rev'd on other grounds (C.C.A. 8th, 1945) 146 F. (2d) 352,
(C.C.A. 9th, 1945) 148 F. (2d) 157; Samuel Thorne, T. C. Memo. Op., Dkt. 1331 (June
7, 1944), Dkt. 4064 (Oct. 6, 1944). The burden rests upon the taxpayer to prove that
portion of the expense allocable to the recovery of the interest; if he fails in this respect,
no deduction is allowed: Hord v. Com. (C.C.A. 6th, 1944) 143 F. (2d) 73; Williams v.
Op., Dkt. 112513 (Sept. 17, 1943) Frank G. Hogan (1944) 3 T.C. 691, Acq. The taxpayer
also has the burden of proving the expenses allocable to taxable income when they are
incurred for producing both taxable and nontaxable income: Claire S. Strauss, T. C.
38 5 T.C., No. 126.
39 (C.C.A. 1st, 1944) 143 F. (2d) 654.
individual for tax advice and preparation of income tax returns were deductible under section 23(a) (2); the court refused to allow the deduction on the ground that the expense was personal. In an early case considered under the 1942 amendment the Tax Court allowed as reasonable and proper expenses a deduction for amounts paid to an accountant for keeping books which showed income and expenses of her income-producing property and for preparing her tax returns.\textsuperscript{40} However, in a series of cases since that decision, accountant fees for preparation of tax returns have been disallowed.\textsuperscript{41} The language of the sixth circuit in \textit{Hord v. Commissioner}\textsuperscript{42} was very explicit on this point stating that such expenses were "incontrovertibly" nondeductible under section 23(a) (2). In view of the \textit{Bingham} and \textit{Cammack} decisions, the courts' attitude toward this item of expense will probably change.

With the enactment of section 23(a)(2) the requirement that an expense be incurred in a trade or business no longer exists; inasmuch as expenses of tax litigation and preparation of returns were allowable deductions under section 23(a) (1) in determining net income derived from a business, and the incentive for enacting section 23(a) (2) was to place taxpayers having a nonbusiness income on the same footing as those engaged in a business, it would seem that such expenses should be deductible under the new provision. The \textit{Bingham}, \textit{Cammack}, and \textit{Marshall} decisions indicate the court's recognition of this.

\textbf{Investment Expenses:}

The enactment of section 23(a) (2) accomplished, as it was designed to do, a complete reversal of the \textit{Higgins} case\textsuperscript{43} and the policy there adopted toward disallowance of the deduction of investors' expenses. Such expenses are now deductible whether or not the taxpayer who seeks to deduct them is engaged in the "business" of investing. Accordingly, expenses of investors incurred for salaries, investment counsel, collection service, bookkeeping service, trustee and custodian fees, statistical service, telephone bills, and office maintenance have been held deductible under section 23(a) (2).\textsuperscript{44} A regulation was en-

\textsuperscript{40} Myrhl Frost, T. C. Memo. Op., Dkt. 112333 (March 31, 1943).
\textsuperscript{41} \textit{Hord v. Com.}; R. C. Coffey; James S. Floyd; Frank G. Hogan; Samuel Thorne, all \textit{supra} note 37; \textit{Higgins v. Com.}, \textit{supra} note 39; Don A. Davis (1944) 4 T.C. 329, \textit{aff'd} (C.C.A. 8th, 1945) 151 F. (2d) 441.
\textsuperscript{42} \textit{Supra} note 37 at 76.
\textsuperscript{43} \textit{Supra} note 4.
\textsuperscript{44} Barbara S. Kirkland, T. C. Memo. Op., Dkt. 107313, 107314 (Nov. 25, 1942) (general office expenses for handling taxpayer's investments); M. A. P. Coolidge, T. C. Memo. Op., Dkts. 103648-103653 (Dec. 31, 1942) (fees for custodian of securities); Winifred L. Milner, T. C. Memo. Op., Dkts. 107151, 108673 (Jan. 30, 1943) (expenses in connection with buying, selling, managing securities except commissions on sales of securi-
acted to cover the deductibility of investment expenses of guardians, administrators, executors, and trustees under the new section.45

Expenses of a corporation which a stockholder pays because he is thereby protecting his own investment in the corporation are usually disallowed as being expenses of the corporation, not of the taxpayer;46

45 "Fees for services of investment counsel, custodian fees, clerical help, office rent, and similar expenses paid or incurred by a taxpayer in connection with investments held by him are deductible under section 23(a)(2) only if (1) they are paid or incurred by the taxpayer for the production or collection of income, or for the management, conservation, or maintenance of investments held by him for the production of income; and (2) they are ordinary and necessary under all the circumstances, having regard to the type of investment and to the relation of the taxpayer to such investment."

The regulations state that administrators or executors are entitled to deduct expenses incurred for the production or collection of taxable income of the estate such as fees for collecting rents, interest or dividends, and expenses of management, conservation, or maintenance of property of the estate held for the production of income such as insurance or repair bills. They cannot deduct expenditures incurred to secure court orders, to collect assets of the estate except taxable income of the estate, to adjust claims against the decedent, nor in conserving the assets for distribution and distributing the assets to the beneficiaries. Expenditures incurred in the performance of the ordinary duties of a receiver or trustee in bankruptcy are not deductible. Reasonable amounts paid for trustees' fees and other ordinary and necessary expenses in connection with production or collection of trust income or with the management, conservation, or maintenance of trust property held for the production of income are deductible even though the trust is not engaged in a trade or business. Ordinary and necessary expenses of guardians in connection with the production or collection of income inuring to a minor or in connection with the management, conservation, or maintenance of property held for the production of income, belonging to the minor are deductible.

46 Raymond M. Hessert, T. C. Memo. Op., Dkt. 107336 (Apr. 22, 1943) (expenses paid by taxpayer for legal services rendered in defending a patent infringement suit against the corporation of which he was the principal stockholder); Aldo R. Balsam Trust, T. C. Memo. Op., Dkt. 2479 (Nov. 17, 1944) (taxpayer owning 14% and 25% interest in two chain store corporations paid for the services of two experienced chain store real estate men to advise the corporations).
however, in one situation where a taxpayer owned surplus certificates of an insurance company which had no market value unless the remaining certificates could be sold, and the insurance company was prohibited by law from incurring expense for their sale, the taxpayer was allowed to deduct the expenses of disposing of all the certificates since he was primarily benefited.

Selling commissions incurred in connection with disposition of securities have been disallowed on the authority of 

Spreckels v. Helvering, a case decided under section 23(a) before the amendment, which held that such expenses were to be treated as an offset against the sales price and not deductible as an ordinary and necessary expense except to dealers.

The Bingkam case considered the problem of whether the expenses of a trust, holding income-producing property, incurred in paying a legacy and distributing the estate to the beneficiaries were deductible under section 23(a) (2). The Tax Court stated that the right to the deduction was clear “since one, if not the most vital duty imposed upon those trustees was to make proper distribution of such property, and in making it they were performing one of the principal functions of the management of such property.” The Supreme Court affirmed the Tax Court, observing that the property “did not cease to be held for the production of income” when the trust expired and the trustees were required to distribute the assets to the beneficiaries.

Real Estate Upkeep:

By the plain wording of the statute, when property is held for the production of income, the expenses of management, conservation and maintenance are deductible. The difficulty arises in determining if the property is held for the production of income.

Before the enactment of section 23(a) (2) the problem had been to determine when deductions might be taken on property as “business property” expenses, or as losses incurred in a transaction entered into for profit [section 23(e)]. Cases decided under those provisions had held that residential property did not become property used in a trade or business by abandonment of its use as a residence and an unsuccessful effort to rent even if the property was listed with a real

48 Don A. Davis, supra note 41; Winifred L. Milner, supra note 44. A Telegraphic Ruling of March 30, 1944, states that federal stamp taxes paid on securities producing taxable income are deductible under section 23(a)(2) and are not an adjustment of the selling price.
49 (1942) 315 U.S. 626.
50 Supra note 34.
51 2 T.C. 853, 859.
52 65 Sup. Ct. at 1236.
estate agent. For example, in *Rumsey v. Commissioner* the petitioner attempted to obtain deductions for caretaker's expenses and a loss incurred in the sale of his houseboat which he had used as a summer residence for several years, and then placed in brokers' hands for sale or rental, selling it at a loss ten months later. The court disallowed the deduction, saying: "If an owner rents, his decision is irrevocable, at least for the term of the lease; and if he remodels to fit the building for business purposes, he has likewise made it impossible to resume residential uses by a mere change of mind. When, however, he only instructs an agent to sell or rent the property, its change of character remains subject to his unfettered will; he may revoke the agency at any moment."

The leading case of *Mary Laughlin Robinson* set the standard for determining under section 23(a) (2) when property previously used as a residence is deemed to change its character and become property held for the production of income. There the taxpayer had abandoned her home, listed it for rent or sale with real estate brokers without result, then claimed the caretaker's expenses and depreciation as deductions. The Tax Court observed that it was no longer necessary that the home be converted into business property or that a loss be sustained on the property in a transaction entered into for profit in order that the property expenses be deductible; the taxpayer need only demonstrate by some affirmative act that the property had been appropriated to income-producing purposes. In this case the abandonment of the residence and listing it with brokers met the requirement, and the expenses were held to be deductible. Although this case achieves a different result from *Rumsey v. Commissioner*, upon comparable facts, it is perhaps not a departure from the provision in the Regulations that all the restrictions of the business expense section are applicable to the new section but rather is based upon a distinction between the wording of the old section requiring property to be *used* in a trade or business and that of the new provision requiring only that property be *held* for the production of income.

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54 Supra note 53.

55 Ibid. at 159, 160.

56 (1943) 2 T.C. 305 (Acq.).

57 Accord: W. E. Buck, T. C. Memó. Op., Dkt. 111091 (July 8, 1943); Eleanor Saltonstall (1943) 2 T.C. 1099, Gov't will not appeal); Charles S. McVeigh (1944) 3 T.C. 1246 (Acq.); Anna C. Newberry, T. C. Memo. Op., Dkts. 3901, 3926 (Feb. 27, 1945); apparently contra S. Wise, T. C. Memo. Op., Dkt. 5721 (Sept. 25, 1945) (petitioner moved into a new house, put his old house up for sale, advertised and gave keys to agents; no deduction was allowed for advertising and upkeep of the property).
all events, the Treasury acquiesced in the Robinson decision and subsequently changed the language of the Regulations accordingly.  

But the Tax Court has refused to hold that the mere fact that the owner is ready and willing to sell if he receives a suitable offer, or that real estate dealers are aware that such is the case is a sufficient demonstration that the property is held for production of income.

The Committee Report and the Regulations state that expenses of a taxpayer in carrying on a transaction not amounting to a trade or business and not coming within the statutory purposes of section 23(a) (2) but carried on primarily as a sport, hobby, or recreation are nondeductible. Where the court concluded that the purpose of maintaining a timber leasehold was part of a plan to acquire the property as an adjunct to his surrounding investment property, and that a citrus grove was maintained not to produce income but merely as an accessory to his country estate, the taxpayer was not allowed to deduct the maintenance expenses in spite of the contention that the property was held solely to produce income. The observations made by the circuit court in the case involving the citrus grove are indicative of the factors considered in determining whether property is held for production of income or merely for recreation or as a hobby: “Considering the taxpayer’s regular occupation and financial position, the size and character of the orchard, and the record of its operation over a four-year period, we think the Board correctly concluded that the greater emphasis was upon the cultivation of the orchard as an adjunct to the country estate rather than as a business venture.”

Traveling Expenses:

Before the enactment of the 1942 amendment the law allowed the deduction of “ordinary and necessary expenses paid or incurred dur-
ing the taxable year in carrying on any trade or business, including . . . traveling expenses . . . while away from home in the pursuit of a trade or business." 64 Under this statute a controversy arose as to whether commuters' expenses were deductible.

The case of Frank H. Sullivan, 65 decided in 1924, first laid down the rule that expenses of going to and from one's home to his place of business are nondeductible. It relied on an existing Treasury ruling to that effect and upon an English case which had so held. The reasoning of the court in support of this rule is not convincing; it is said that the business expenses which one may deduct are those "necessarily incurred in the performance of his business duties, and not those incurred by the individual for his personal comfort or convenience" and that commuters' expenses come within the latter description because they are the result of a decision to live away from one's business and so are based upon personal convenience. The hiring of an assistant when the taxpayer could take care of the business himself might also be said to be a decision based upon personal convenience but he is not thereby prevented from treating the assistant's salary as a business expense. It seems highly unrealistic to say that going to and from one's work is a matter of personal enjoyment rather than a business necessity. Nevertheless, the courts consistently disallowed such expenses under section 23(a)(1), 66 and the Supreme Court appears to have approved these cases by way of dicta in the recent decision of Commissioner v. Flowers 67 which dealt only with section 23(a)(1) and not 23(a)(2).

In Ralph D. Hubbart 68 the taxpayer attempted to deduct commuters' expenses under section 23(a)(2), but the Tax Court, in accord with the Regulations, 69 stated that that provision did not change

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64 I.R.C., 1938 Act, sec. 23(a)(1); 1936, 1934, 1928 Acts, sec. 23(a); 1926, 1924, 1921 Acts, sec. 214(a); Reg. 103, sec. 19.23(a)-1; Reg. 101, 94, 86, Art. 23(a)-1; Reg. 77, 74, Art. 121; Reg. 69, 65, 62, 45, Art. 101. 65 (1924) 1 B.T.A. 93. 66 Reg. 103, §19.23(a)-2; Reg. 101, 94, 86, Art. 23(a)-2; Reg. 77 and 74, Art. 122; Reg. 69, 65, Art. 102; Reg. 62, Art. 101(a); S.M. 1048, CUM. BULL. 1, p. 101; Frank H. Sullivan (1924) 1 B.T.A. 93; Mort L. Bixler (1927) 5 B.T.A. 1181; Charles H. Sachs (1927) 6 B.T.A. 68; Abraham W. Ast (1927) 9 B.T.A. 694; Walter Schmidt (1928) 11 B.T.A. 1199; Jennie A. Peters (1930) 19 B.T.A. 901. 67 (January 2, 1946) 66 Sup. Ct. 250, holding non-deductible under section 23(a)(1) the expense of a lawyer in traveling from his home in Jackson, Mississippi, where he maintained his law office and Mobile, Alabama, where he frequently had to be in connection with his duties as general counsel for a railroad. 68 (1944) 4 T.C. 121 (Acq.). 69 The regulations provide: "Among expenditures not allowable under section 23(a)(2) are the following: commuters' expenses; expenses of taking special courses or training; expenses for improving personal appearance; the cost of rental of a safe-deposit box for storing jewelry and other personal effects; and expenses such as expenses in seeking employment or in placing oneself in a position to begin rendering personal services
the principle declared before 1942 that such an expense is personal and nondeductible. It is submitted that the courts should re-examine this matter in the light of the Bingham, Cammack and Marshall cases, for it is difficult to think of an expense more ordinary and necessary to the production of income.

Travel expenses for the inspection of income-producing property and compensation paid to a chauffeur by a motion picture actor for driving an automobile and trailer dressing room were held to come within the statutory purposes of section 23(a) (2).

Conclusion:

A comparison of the Bingham decision, previously discussed, with the only other Supreme Court case decided under section 23(a) (2), McDonald v. Commissioner, seems to indicate the development of a more liberal attitude in the interpretation of the amendment. In the McDonald case the Court disallowed the campaign expenses of a judge who had accepted a temporary appointment with the understanding that he would be a candidate at the next general election for the judgeship. Justice Frankfurter, writing an opinion concurred in by three other justices, stated that the 1942 amendment was adopted for the restricted purpose of correcting the inequitable result of the Higgins case which had revealed that under existing law there was no provision for allowable deductions from profitable transactions not covered by the statutory concept of "business income". He concluded that the petitioner could not claim this deduction under section 23(a) (2) since in performing the functions of a judge he was in a trade or business; that since the holding of public office had been a trade or business by express statutory provision before 1942 and, notwithstanding, campaign expenditures had been held nondeductible before then, the amendment in 1942 brought about no change. This was a five-four decision, one of the nine justices concurring in the result without opinion. The dissenting opinion by Justice Black, also concurred in by three other justices, pointed out that the language used in section 23(a) (2) was broader than was required to meet the problem presented by the Higgins case inasmuch as the clause relating to expenses for the "management, conservation, or maintenance of property held for the production of income" would have covered that

for compensation, campaign expenses of a candidate for public office, bar examination fees and other expenses incurred in securing admission to the bar, and corresponding fees and expenses incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions".

70 R. C. Coffey, supra note 15.
71 Estate of Frederick C. Bartholomew, supra note 13. (Acq.).
72 (1944) 323 U.S. 57.
73 Supra note 4.