The Double Standard under Section 162: Why the Employee Business Deduction is No Longer for Employees

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NOTES

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INTRODUCTION

Section 162(a) of the Internal Revenue Code permits a deduction for "ordinary and necessary" expenses incurred in carrying on a "trade or business." The United States Supreme Court defined the terms "ordinary" and "necessary" in Welch v. Helvering. The Court stated that "ordinary" implies that the expenses are common to the business in which they occur, while "necessary" means "appropriate and helpful." However, the Internal Revenue Service, supported primarily by the Tax Court, has recently disallowed deductions for many expenditures incurred in the course of carrying on a trade or business, claiming that the expenditures are not "ordinary and necessary." Examination of these cases reveals a kind of "employment continuum," in which employees and middle management at the lower end are denied deductions, while those with "higher" positions, such as employers and self-employed persons, are often permitted to deduct essentially the same expenditures under section 162. Persons who are in higher management positions, such as the officers of a company, hold a status somewhere between employees and employers, depending on the facts of the particular case. Although one could question whether the availability of this

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2 290 U.S. 111 (1933).
3 Id. at 114-15.
4 Id. at 113.
5 BORIS I. BITTNER & MARTIN J. MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 10.3 (Supp. III 1993) (citing cases in which deductions for business-related expenditures were disallowed because the expenses were not ordinary and necessary).
6 See, e.g., Dunkelberger v. Commissioner, 64 T.C.M. (CCH) 1567, 1567 (1992) (denying an employee's deduction for expenses incurred in purchasing occasional meals, parties, doughnuts, and candy and flowers for the employees under her supervision).
7 Id. at 1569.
8 See, e.g., Noyce v. Commissioner, 97 T.C. 670, 682-85 (1991) (allowing vice-
particular deduction would make a significant difference, since taxpayers must itemize to take the deduction, the issue here is not one of amount, but of principle.

The emerging differences regarding the deductibility of business expenses indicate that courts are using conflicting interpretations of "ordinary and necessary," with lower-level management and employees being subjected to a stricter standard than employers and upper-level management. This Note discusses the development and possible implications of such a double standard. Part I of this Note examines the "ordinary and necessary" language of section 162 by analyzing the Supreme Court's definition in *Welch v. Helvering*, as well as enhancements of that definition offered by later courts and the regulations to the Internal Revenue Code. Part II discusses the cases exemplifying the courts' tendency to apply different standards for taxpayers' business deductions depending on the status of the individual taxpayer. Part III analyzes this recent trend in light of the definitions established by the Supreme Court, and proposes that the Internal Revenue Service and the Tax Court either clarify the meaning of "ordinary and necessary" by disregarding the Supreme Court's dicta in *Welch* or develop a new standard for use in applying section 162. This Note concludes that the Internal Revenue Service has wrongly disallowed business deductions to many "lower-level employees" by use of a double standard, and that this situation should be remedied by use of a single standard that would apply to employees, management, and employers.

I. THE HISTORICAL APPLICATION OF SECTION 162

The "ordinary and necessary" standard for allowing business deductions is not as simple as it appears. In order to determine whether the taxpayer may deduct the expense, one must first answer the question of whether a given activity is "ordinary and necessary" in relation to a chairman of a corporation to take a deduction for expenses incurred in use of a private airplane for business travel despite the corporation's policy of only reimbursing amounts paid for commercial coach air travel).

Itemized deductions such as this must equal at least two percent of the taxpayer's adjusted (gross) income, and even then only the excess over that amount is deductible. I.R.C. §§ 63, 67, 162 (1988 & Supp. IV 1992).


See infra notes 15-56 and accompanying text.

See infra notes 57-89 and accompanying text.

See infra notes 90-125 and accompanying text.

See infra notes 126-29 and accompanying text.
particular taxpayer's trade or business. The statute itself provides little help on this issue, stating only that "there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business . . . ."15 The Regulations that accompany section 162 offer some assistance. For instance, section 1.162-1(a) of the Treasury Regulations states that "business expenses . . . include the ordinary and necessary items directly connected with or pertaining to the taxpayer's trade or business . . . ."16 This section also describes items customarily classified as business expenses:

Among the items included in business expenses are management expenses, commissions, . . . labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business, . . . advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property.17

This list provides some guidance, but situations that the regulation does not address often arise. In such cases, the taxpayer must turn to the courts for interpretation.

The case of Welch v. Helvering offers an early Supreme Court examination of the phrase "ordinary and necessary."18 In Welch, the taxpayer, a former employee and part owner of a bankrupt company, undertook to repay the company's debts when he obtained a job in a similar capacity with another company.19 The taxpayer claimed that the expense of paying the bankrupt company's debts was a legitimate business expense because he needed to protect his business reputation as a grain broker.20 The Welch Court ruled that while the taxpayer's expenditures may have been "necessary," they were not "ordinary" and therefore were not deductible under section 162.21

The Court in Welch addressed a number of issues in reaching this result. One issue was whether an expense must be both "ordinary and

16 Treas. Reg. § 1.162-1(a) (as amended in 1988).
17 Id.
19 Id. at 112.
20 Id. at 112-13.
21 Id. at 116.
necessary” in order to qualify under section 162.\textsuperscript{22} The Welch Court did not expressly rule on this issue. Instead, the Court implied that both elements were needed since the Court denied the deduction on the basis that it was not “ordinary” although the Court had previously stated that the expense was “necessary.”\textsuperscript{23} It was not until the 1971 case of Commissioner v. Lincoln Savings & Loan Association\textsuperscript{24} that the Supreme Court expressly held that section 162 requires an expenditure to be both ordinary and necessary.\textsuperscript{25}

The next issue that the Welch Court faced was the proper interpretation of the terms “ordinary and necessary.” Adopting the taxpayer’s construction, the Court defined “necessary” as “appropriate and helpful.”\textsuperscript{26} The Court seemed to have more trouble defining “ordinary,” however. While the term “ordinary” signifies that which is customary in a given trade or business,\textsuperscript{27} “ordinary ... is ... a variable affected by time and place and circumstance.”\textsuperscript{28} This statement does little to clarify the meaning of “ordinary,” especially since the opinion arguably supports three additional definitions of “ordinary.”\textsuperscript{29} First, “ordinary” could be defined as “noncapital”\textsuperscript{30} in light of the Court’s reasoning that the taxpayer’s reputation was a capital asset similar to goodwill and that expenditures to create or protect it were capital in nature.\textsuperscript{31} Second, the Court could have intended “ordinary” to mean “not bizarre”\textsuperscript{32} by stating “that payment in such circumstances, instead of being ordinary is in a high degree extraordinary.”\textsuperscript{33} Finally, the term “ordinary” could mean “not personal”\textsuperscript{34} since the Court analogized the taxpayer’s expenditure to a personal expense such as restitution to restore a family’s good name.

\textsuperscript{22} Id.
\textsuperscript{23} Id. at 115.
\textsuperscript{24} 403 U.S. 345, 359 (1971) (denying a deduction for a premium paid to the Federal Savings and Loan Insurance Corp. by a state-chartered savings and loan association).
\textsuperscript{25} Id. at 352-53.
\textsuperscript{26} Welch, 290 U.S. at 113.
\textsuperscript{27} Deputy v. du Pont, 308 U.S. 488, 495 (1940) (defining the term “ordinary”).
\textsuperscript{28} Welch, 290 U.S. at 113-14.
\textsuperscript{30} Id.
\textsuperscript{31} Welch, 290 U.S. at 115 (“Reputation and learning are capital assets, like the good will of an old partnership.”).
\textsuperscript{32} Newman, supra note 29, at 235-36.
\textsuperscript{33} Welch, 290 U.S. at 114.
\textsuperscript{34} Newman, supra note 29, at 236.
or a culture-enriching educational expense.\textsuperscript{35} While the \textit{Welch} opinion seemed to state that an “ordinary” expenditure would be usual and normal in the course of business, the range of potential meanings for “ordinary” and the lack of decisiveness by the Supreme Court left room for different interpretations by later courts.\textsuperscript{36} The essential flaw in the \textit{Welch} opinion is Justice Cardozo’s apparent unwillingness to clearly state the standard for “ordinary” expenditures. Instead, the Court offered only dicta that permitted later courts to create their own interpretations.

The Supreme Court attempted to clarify its definition of “ordinary” with its decision in \textit{Deputy v. duPont}.
\textsuperscript{37} In \textit{duPont}, a stockholder of a corporation borrowed shares to give the executive committee a financial interest in the corporation, agreeing to pay the lender an amount equal to dividends on the stock plus any taxes the lender would accrue due to the agreement.\textsuperscript{38} The Court, in disallowing the deduction because the expense was not “ordinary,” stated that “[o]rdinary has the connotation of normal, usual or customary”\textsuperscript{39} and that “[o]ne of the extremely relevant circumstances is the nature and scope of the particular business out of which the expense in question accrued.”\textsuperscript{40}

Although \textit{du Pont} seemed to settle the issue concerning the definition of “ordinary,” the Supreme Court offered an entirely different definition twenty years later in the case of \textit{Commissioner v. Tellier}.
\textsuperscript{41} The taxpayer in \textit{Tellier}, a securities trader, had incurred extensive legal fees in an unsuccessful defense against a criminal prosecution and attempted to deduct these expenditures as a business expense.\textsuperscript{42} Allowing the deduction, the Court stated that the principal function of the term “ordinary” was to clarify the distinction between expenses and capital expenditures\textsuperscript{43} and found that the taxpayer’s expenses were not capital in nature.\textsuperscript{44} The different standards enunciated by the Supreme Court in \textit{du Pont} and \textit{Tellier} have allowed lower courts, particularly the Tax Court, to create multiple interpretations of the single standard of “ordinary”\textsuperscript{45}.

\textsuperscript{35} \textit{Welch}, 290 U.S. at 115.
\textsuperscript{36} See infra notes 57-89 and accompanying text.
\textsuperscript{37} 308 U.S. 488 (1940).
\textsuperscript{38} \textit{Id.} at 490-92.
\textsuperscript{39} \textit{Id.} at 495.
\textsuperscript{40} \textit{Id.} at 496.
\textsuperscript{41} 383 U.S. 687 (1966).
\textsuperscript{42} \textit{Id.} at 688.
\textsuperscript{43} \textit{Id.} at 689-90.
\textsuperscript{44} \textit{Id.} at 690.
\textsuperscript{45} See, e.g., Trebilcock v. Commissioner, 64 T.C. 852, 853 (1975) (acq.), aff’d, 557 F.2d 1226 (6th Cir. 1977) (deduction partially denied for minister’s advising of taxpayer
and have left these courts confused regarding the true standard for "ordinary."

Although the interpretation of the term "necessary" does not seem as problematic as that of "ordinary," there is room for dissension, particularly by the lower courts. For example, the Tax Court in *Henry v. Commissioner*\(^4\) required the taxpayer to establish that the expense was actually "necessary" in the more common sense of the word, rather than merely appropriate and helpful.\(^4\) In *United States v. Tauferner*,\(^4\) the court stated that the term "necessity... has gradations from the absolute out in all directions to 'advisable,' to 'preferred,' or to 'convenient'... ."\(^4\)

The possible meanings for the term "necessary" are so numerous that the Sixth Circuit Court of Appeals has failed to apply the same standard in factually similar cases. In *Raymond Bertolini Trucking Co. v. Commissioner*,\(^5\) the Sixth Circuit permitted the taxpayer to deduct the expense of a bribe that the taxpayer had paid in order to retain a subcontract.\(^5\) Although the primary focus of the court's opinion was determining whether the expense was "ordinary" since the payment of kickbacks was allowed in that state, the court also found the expense to be "a cost of doing business like any other—an indispensable one here... ."\(^5\) By permitting this deduction, the court impliedly construed the expense to be "necessary." Less than a year later, the Sixth Circuit in *Car-Ron Asphalt Paving Co. v. Commissioner*\(^5\) held that a kickback paid to receive a subcontract was not "necessary."\(^5\) In *Car-Ron Asphalt*, the court recognized that the Supreme Court had established an "appropriate and helpful" interpretation of "necessary," but considered it to be only a

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\(^4\) 36 T.C. 879 (1961).
\(^4\) Id. at 884.
\(^4\) Id. at 246.
\(^5\) 736 F.2d 1120 (6th Cir. 1984).
\(^5\) Id. at 1121.
\(^5\) Id. at 1125.
\(^5\) 758 F.2d 1132 (6th Cir. 1985). This case is remarkably similar to the *Raymond Bertolini Trucking* case, especially since the same corporation, Forest City Enterprises, demanded the kickbacks in both cases. *Car-Ron Asphalt Paving Co.*, 758 F.2d at 1132; *Raymond Bertolini Trucking Co.*, 736 F.2d at 1121.
\(^5\) *Car-Ron Asphalt Paving Co.*, 758 F.2d at 1134.
"minimal requirement." Indeed, the court used a stricter standard when it affirmed the Tax Court's ruling that the expenses were not "necessary" because they were not essential. Although the "essential" standard and the "appropriate and helpful" standard may simply be different points along a continuum of definitions for the term "necessary," the above two cases demonstrate that the application of a given definition can change the outcome of a case.

While some lower courts' rulings indicate disagreement concerning how strict the "necessary" standard should be (as opposed to a disagreement concerning the actual meaning of the term, as found in the dispute over the interpretation of "ordinary"), these differences still result in uncertainty for the courts and a lack of predictability for the taxpayer. The next section of this Note demonstrates how the lack of standard definitions for the terms "ordinary and necessary" has allowed recent courts to develop conflicting standards for taxpayers, depending on the taxpayer's position on the employment continuum.

II. CASES DEMONSTRATING THE DOUBLE STANDARD

The lack of a single interpretation for the phrase "ordinary and necessary" has created confusion for both the taxpayer and the courts. Initially, the problem arose from inconsistent rulings on whether expenditures at issue were "ordinary and necessary." One of the most salient examples of this is the ruling in Trebilcock v. Commissioner, in which the Tax Court partially denied a company's deduction for compensation that the company had paid to a minister who was kept on retainer to counsel employees on business as well as personal matters. Despite the ruling in Trebilcock, R.J. Reynolds has stated that the company has routinely deducted the expense of keeping both a chaplain on the payroll and a chapel in the company offices. While such inconsistencies still occur, the most troublesome trend has been the differing applications of the "ordinary and necessary" standard to the

55 Id. at 1133-34.
56 Id. at 1134.
business expenses of taxpayers, often based on the taxpayer’s level on the “employment continuum.”

Cases involving teacher expenses offer the clearest examples of the “double standard.” One such example is *Wheatland v. Commissioner.* In *Wheatland,* a sixth-grade teacher purchased electronic equipment and three sets of encyclopedias for use in his classroom. The court disallowed the deduction because the expenditures were not “necessary” to the taxpayer’s trade of being a teacher since the materials were not required for teaching the curriculum of his sixth grade science class. The Tax Court also found that the taxpayer’s expenses were not “ordinary,” stating that schoolteachers do not ordinarily purchase “equipment for [their] classroom[s] out of [their] own funds.” A somewhat different situation arose in *Patterson v. Commissioner,* where a teacher who set up a special classroom to enhance the educational and cultural exposure of deprived children in the area was denied a business expense deduction. The court found that although the taxpayer’s intentions were admirable, the expenditures incurred were neither ordinary nor necessary because they were not “directly or proximately related to the carrying on of his profession as a schoolteacher.”

Similarly, in the recent case of *Mann v. Commissioner,* the cost of items that a teacher purchased to supplement and augment classroom learning were held to be non-deductible as ordinary and necessary business expenses. The court stated that these expenditures did not benefit the teacher’s career and that such “expenditures generally are deductible only if related to the continuation (or advancement) of an employee’s employment.” The same result is found even within the ranks of higher education. In *Mathes v. Commissioner,* the Tax Court denied a college professor’s deduction for the cost of books because the books were available in the university library and, therefore, were not “necessary” expenses.

59 23 T.C.M. (CCH) 579 (1964).
60 *Id.* at 580.
61 *Id.* at 582.
62 *Id.*
63 30 T.C.M. (CCH) 1003 (1971).
64 *Id.* at 1008.
65 *Id.* at 1007.
67 *Id.*
68 *Id.* at 2602.
69 60 T.C.M. (CCH) 704 (1990).
70 *Id.* at 704.
In each of the above cases, neither the school nor the school system reimbursed the taxpayer for the purchase of the classroom materials. If, however, the schools had elected to reimburse the taxpayers or had incurred the expenses in their own right, such expenditures would have been considered a working condition fringe benefit under section 132. The cost of working condition fringe benefits is both excludible from the employee’s income and deductible to the employer. Although the school does not pay taxes and therefore could not use the deduction, the fact that the deduction would be available to the school as an employer and not to the teacher as an employee demonstrates the conflicting standards applied by the Internal Revenue Service and the Tax Court.

These “teacher cases” represent only one of a number of situations in which the courts apply differing standards for employers, management, and employees under section 162. The “double standard” applied to employers and employees is also found in the corporate setting. In *Dunkelberger v. Commissioner*, the taxpayer, a lower-level supervisor, deducted the costs of periodic lunches that she provided for those she supervised as rewards for good work, a Christmas party, candy and doughnuts purchased to boost morale in the “stressful work environment,” and flowers sent to a sick employee. The court held that these unreimbursed expenditures could not be deducted as employee business expenses, because they were not a condition of the taxpayer’s employment and, therefore, were not “ordinary and necessary.” The court implied, however, that the company could have deducted the expenses if it had reimbursed the taxpayer. In order to take the deduction under section 132, the company would have been required to classify the expenditures as working condition fringe benefits or de minimis fringe benefits. One of the conditions for a working condition fringe benefit is that the expenses be such that the employee would have been able to deduct the expenses under section 162 if the employee had made the purchases himself. Since the taxpayer in *Dunkelberger* made the purchases with

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73 64 T.C.M. (CCH) 1567 (1992).

74 *Id.* at 1568.

75 *Id.* at 1568-69.

76 *Id.* at 1569.

77 I.R.C. § 132 (1988 & Supp. IV 1992). A de minimus benefit is also one that may be deducted by the company, although the definition of the term de minimus implies that such expenses might not be deductible to the employee who incurred the expenses but for
her own money, yet was not allowed to take a section 162 deduction, it would be illogical to permit the company to deduct the same expenses simply because the company made the expenditures rather than the employee. *Dunkelberger*, therefore, clearly exemplifies the "double standard" being applied to employers and employees.

The cases of *Associated Obstetricians and Gynecologists, P.C. v. Commissioner* and *Henderson v. Commissioner* also illustrate the double standard. In *Associated Obstetricians*, a corporation attempted to deduct the cost of decorating its new offices. The Tax Court allowed the taxpayer to deduct the depreciation of interior decorating services and office furnishings and implied that the taxpayer could have deducted the depreciation of works of art placed in its offices if the taxpayer had determined the useful life of the art. In contrast, the Tax Court in *Henderson* denied a government attorney's deduction for the costs of a framed print and a live plant purchased for her office.

A number of authorities have analyzed the problems that taxpayers encounter in attempting to deduct office furnishings. These authorities have found that executives and self-employed persons are often able to deduct the costs of office furnishings even if there are personal benefits to the taxpayer, because the expenditures are viewed as promoting morale. As one authority noted, "even the most puritanical definition of business expense is not likely to prevent self-employed taxpayers from deducting the cost of air-conditioning their offices, upholstering their swivel chairs, or adding gadgets to their telephones, even if they derive personal pleasure from these amenities."

The case of *Noyce v. Commissioner* is yet another example of the conflicting standards courts impose on employers and employees. In *Noyce*, the taxpayer, a vice-chairman of a corporation, deducted part of the expense of maintaining a private airplane that he used partly for business travel. The taxpayer's practice of using a private airplane conflicted with the corporation's policy of reimbursing employees for

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78 46 T.C.M. (CCH) 613 (1983), aff'd, 762 F.2d 38 (6th Cir. 1985).
79 46 T.C.M. (CCH) 566 (1983).
80 *Associated Obstetricians*, 46 T.C.M. (CCH) at 617.
81 Id. at 616-17.
82 *Henderson*, 46 T.C.M. (CCH) at 566.
84 Bittker, supra note 83, at 204.
86 Id. at 671.
commercial coach rates only, regardless of whether an employee could perform his duties more efficiently by using first class travel or a private plane. Nonetheless, the Tax Court allowed the taxpayer's deduction, finding that the airplane was a "necessary" expense because it was "appropriate and helpful" to the execution of petitioner's duties. The court also found that the expenses were "ordinary" because they were customary under the circumstances, considering the taxpayer's extensive travel and busy schedule. Had the same standards for "ordinary and necessary" been applied in Dunkelberger, it is likely that the taxpayer in Dunkelberger would have been allowed the deduction.

III. THE ERROR OF THE DOUBLE STANDARD

The cases described in the previous section indicate that taxpayers on the higher end of the employment continuum are often allowed section 162 deductions for certain expenses, while those at the lower end are denied deductions for the same or similar expenditures. If the Tax Court had employed the "customary within a trade or business" definition of "ordinary" and the "appropriate and helpful" interpretation of "necessary" in deciding the cases involving "low level" employees, the Tax Court would have allowed the deductions. An application of the Welch definitions to these cases illustrates the logical flaw committed by the Tax Court.

For instance, in each of the cases involving the purchase of classroom items by teachers, the expenditures were held to be neither ordinary nor necessary. If the court had applied the "customary in the particular trade or business" interpretation of "ordinary," however, the items would be deemed ordinary business expenses. Teachers customarily purchase items for their classrooms, particularly in smaller school districts with limited funds available for distribution among the schools. In fact, the teachers of Sand Gap Elementary School in Jackson County,
Kentucky, average spending from $500 to $700 per year of their own money on supplies for their classrooms, such as bulletin board materials, construction paper, school supplies and similar items. Since such expenditures seem to be a common practice of the profession, they should be classified as ordinary under the “customary to the trade or business” definition. Likewise, the expenditures of the teachers in the noted cases would be considered “ordinary” under this standard. The taxpayers in Mann and Mathes had also purchased supplies, which would certainly be a common expenditure, assuming that the example described above is representative of schools across the country. While the taxpayers’ expenditures in Wheatland and Patterson for encyclopedias and electrical equipment were not expenses that occur with great frequency in schools, the definition of ordinary does not require that the taxpayer incur the expenditure often, or even in every similar business. Rather, it must only be an expense that could reasonably be expected. Thus, under the Welch standard, the teachers’ expenses are “ordinary.”

The expenditures incurred by the teachers are also “necessary” based on the “appropriate and helpful” definition in Welch. The expenditures made by the teachers in the cases at issue consisted of books, supplies and educational equipment. All of the items are “appropriate and helpful” in promoting learning, which is the purpose of a teacher’s job. These expenses could also be classified as necessary in the customary sense of the word. In many poorer school districts, classroom materials are often unavailable unless the teacher purchases them. For instance, the teachers at Sand Gap Elementary School have no choice but to use their own money if they want to purchase items for their classrooms, because in 1992 each teacher only received $100 from the school board with which to purchase classroom supplies. Despite the obvious necessity of such teachers’ expenditures, under the case law the teachers cannot deduct these expenditures as business expenses. The teachers’ expenditures in the examples mentioned above were made in lieu of expenses generally incurred by the schools themselves and are business expenses in that they were incurred in the furtherance of the

95 Id.
96 Mann, 65 T.C.M. (CCH) at 2602; Mathes, 60 T.C.M. (CCH) at 709.
98 Patterson v. Commissioner, 30 T.C.M. (CCH) 1003, 1007 (1971).
100 Id. at 113.
101 See supra notes 59-72 and accompanying text.
102 Telephone Interview with Joyce A. McCowan, supra note 94.
103 Id.
104 See supra notes 59-72 and accompanying text.
schools', as well as the teachers'; trade or business. Since the expenditures are business expenses and could easily be classified as "ordinary and necessary" if the courts applied the original interpretation of Welch, the expenses should be deductible under section 162.105

In addition to the effect on the ability of teachers to deduct business expenses, application of the Welch definition of "ordinary and necessary" to expenses incurred in a business setting may also render these business expenses deductible. The Dunkelberger case provides an excellent example. In Dunkelberger, the Tax Court ruled that for an employee's business expenses to be "ordinary and necessary," the employee must show that the expenses were a condition of employment,106 even though the business could have deducted the expense had it reimbursed the employee.107 This requirement demonstrates the extent of the discrepancy between employer and employee deductions. Instead of applying the "appropriate and helpful" and "customary in the trade or business" standards, the court applied the "it keeps you from losing your job" standard. Surely this is not what Congress intended with section 162's "ordinary and necessary" language, especially since such a stringent standard is not uniformly applied to employers.108

The expenses incurred by the taxpayer in Dunkelberger were both "ordinary" and "necessary" under the Welch standard. Occasional lunches, Christmas parties, doughnuts, and candy and flowers for sick employees are all expenses frequently incurred in business and, therefore, should be considered "ordinary." If the business had made these expenditures, it would have at least been able to classify the expenditures as de minimis fringe benefits provided to employees under section 132.109 The Regulations to section 132 state that examples of de minimis fringe benefits include:

occasional cocktail parties, group meals, or picnics for employees and their guests; traditional birthday or holiday gifts of property (not cash) with a low fair market value; occasional theater or sporting event tickets; coffee,  

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105 An argument may be made that expenditures for school supplies and learning materials should be classified as charitable contributions and deducted in that manner. While this argument has some merit since section 170 includes contributions to school systems within its list of allowable charities, I.R.C. § 170 (Supp. IV 1992), there are also many problems with the argument, such as difficulties a teacher will encounter when classifying a particular class as a charity. See, e.g., Patterson v. Commissioner, 27 T.C.M. (CCH) 640, 643 (1968), rev'd on other grounds, 136 F.2d 359 (9th Cir. 1971). For this reason, this debate is beyond the scope of this Note.


107 Id.

108 See supra notes 73-77, 85-89 and accompanying text.

doughnuts, and soft drinks; local telephone calls; and flowers, fruit, 
books, or similar property provided to employees under special 
circumstances (e.g. on account of illness, outstanding performance, or 
family crisis).  

Since the expenditures made by the taxpayer in Dunkelberger are among 
those listed in the Treasury Regulations, the authors of the Regulation 
must have found these expenses to be common in business. Accordingly, 
such expenses are “ordinary.”

The taxpayer’s expenses in Dunkelberger are also “necessary” in that 
they were “appropriate and helpful” in carrying out the taxpayer’s job. 
The taxpayer was a supervisor to employees who were often under a lot 
of stress due to the nature of their work. The taxpayer made the 
expenditures to help boost morale and possibly increase the produc-
tivity of the employees under her, thereby helping the taxpayer in the 
performance of her job. Had the Tax Court applied the “appropriate and 
helpful” definition of “necessary” to this case, the taxpayer would have 
had a section 162 deduction for these expenses.

Application of the actual standard that the Dunkelberger court used 
to a few hypotheticals demonstrates the problems inherent in that court’s 
definition. For example, if a court applied the Dunkelberger standard to 
all cases, an attorney employed by a law firm could not deduct the cost 
of American Bar Association dues because it is a voluntary association. 
Although American Bar Association dues are “appropriate and helpful” 
to an associate in a law firm, dues paid to a voluntary association are not 
“necessary” under the Dunkelberger standard because they are not a 
condition of the associate’s employment. However, if a partner in that 
firm paid these dues as a self-employed person, the partner would 
probably be able to deduct the expenditure as a “necessary” expense. 
Similarly, if the firm paid the dues for the associate, the firm could 
deduct the expense by classifying it as a section 132 working condition 
fringe benefit.

Another example of the problem with the Dunkelberger court’s 
interpretation of “necessary” lies with the medical profession. Suppose a 
physician employed at the Veterans’ Administration Hospital incurs 
expenses for continuing medical education, only part of which the

111 Dunkelberger, 64 T.C.M. (CCH) at 1568.
112 Id.
American Medical Association requires. Although the non-mandatory portion of the education is clearly "appropriate and helpful," the expense would not be classified as "necessary" under the Dunkelberger standard.115 Because the education was not a requirement of the physician's continued employment, the expense would be non-deductible. The Dunkelberger court's failure to use the Welch v. Helvering interpretation of "ordinary and necessary" would clearly affect the deductibility of these common expenditures.

Use of the Welch Court's definition of "ordinary and necessary" would also have affected the result in Henderson v. Commissioner.116 The taxpayer's expenditures for a live plant and a framed print117 should have been deductible in light of the ruling in Associated Obstetricians, which allowed a depreciation deduction for the expense of decorating the corporation's office.118 While the Henderson case may not be as clear-cut as some of the other cases, it seems that the taxpayer's expenditures were "ordinary" in the sense that people in the business world often purchase items with which to decorate their offices.119 Since the taxpayer's expenses in Henderson presumably enhance morale, they are also "necessary" in that the expenses would be "appropriate and helpful,"120 or at least as "appropriate and helpful" as the office decor in Associated Obstetricians.

Use of different standards than "customary in trade or business" and "appropriate and helpful" for determining the deductibility of office furnishings could lead to a number of problems. For example, suppose a pediatrician purchases toys, children's books and magazines, and child-size furniture for the waiting room of his office. These expenditures, although found in many pediatricians' offices, are not directly related to the pediatrician's practice since they are not a prerequisite to the providing of medical treatment to children. Therefore, if the "necessary" standard utilized by the courts is the "traditional" definition of that which keeps you from losing your job, these expenditures for pediatricians' offices would not be deductible. If such a result appears to be beyond the intended scope of section 162, then perhaps, based on the intended scope of section 162, the taxpayers in Associated Obstetricians should have

117 Id. at 567.
120 See id. at 256.
been denied a deduction. Once again, the use of a single, clear standard by the courts would have prevented a great deal of confusion.

**Noyce** exemplifies the different standards that are applied to upper-level management. In **Noyce**, a former chief executive officer and current vice-chairman of the corporation's board of directors was allowed a deduction for a portion of the purchase and upkeep of a private airplane.\(^{121}\) Since the taxpayer's purchase of a private airplane appeared to be a capital expense (particularly since the taxpayer attempted to deduct depreciation), the court in **Noyce** apparently used the "customary in trade or business" definition of "ordinary" rather than the "noncapital" definition. The taxpayer's purchase also appeared to be a personal expense because the company reimbursed employees for commercial flights.\(^ {122}\) Applying the traditional **Welch** standard to the taxpayer's expenditures, which were quite extensive, the **Noyce** court found the taxpayer's expense to be necessary because "the airplane was 'appropriate and helpful' to the execution of [taxpayer's] duties."\(^ {123}\) **Noyce**, therefore, is a clear example of the fact that a different set of standards is used for business expenses of corporate management.

In many of the cases above, the courts held lower level employees' expenditures to be non-deductible in spite of the fact that these expenses appear to be "ordinary and necessary" under any definition. In contrast, other cases previously mentioned support the ability of employers and management to deduct remarkably similar expenses. The primary cause of this discrepancy is the courts' use of different definitions for the phrase "ordinary and necessary" depending on the type of taxpayer at issue. The Supreme Court could alleviate much of this confusion if it simply reaffirmed and clarified its original interpretation of "ordinary and necessary." Since this will not occur until the Supreme Court grants certiorari to another "ordinary and necessary" case, however, the Internal Revenue Service or Congress should take the initiative to establish a single, clear meaning for the phrase "ordinary and necessary." The **Welch** Court's interpretation offers the best approach because most courts are familiar with it. Adoption of the **Welch** approach would also avoid both the capital/noncapital issue that section 263(a)\(^ {124}\) covers as well as the issue of whether an expenditure is "too personal," which section 262\(^ {125}\)


\(^{122}\) *Id.* at 677.

\(^{123}\) *Id.* at 686.

\(^{124}\) I.R.C. § 263(a) (1988) (denying deductions for expenditures made in the acquisition, protection or improvement of property).

addresses. Nevertheless, the adoption of any standard that is not open to the multitude of interpretations possible under the current standard would have the advantages of lessening the discrepancy between taxpayers and making the deduction of business expenses under section 162 more predictable.

CONCLUSION

Over the years, courts have developed multiple definitions for a single phrase in the Internal Revenue Code—"ordinary and necessary"—as a result of the lack of clarity in the Supreme Court's decision in Welch v. Helvering. Although the Welch Court intended "ordinary" to mean "customary in trade or business," lower courts and even the Supreme Court have interpreted "ordinary" to mean "noncapital," "not personal," and "not bizarre." Likewise, "necessary" has often been defined in the "traditional" sense of the word, that is, "it keeps you from losing your job," even though the Court in Welch ruled that "necessary" should mean "appropriate and helpful." The lack of a single definition of "ordinary and necessary" has created confusion and discrepancy among taxpayers and courts.

Numerous cases provide evidence of the growing trend toward different interpretations of "ordinary and necessary." The courts in these cases generally applied their own interpretations of the terms "ordinary" and "necessary" to employees and low-level management, while applying the traditional Welch standard to employers, self-employed persons and upper management. This practice has resulted in a "double standard" that continues to cause uncertainty for the employee taxpayer who is often denied a deduction of a given expenditure as a business expense under section 162, while his employer takes the deduction with little or no trouble.

In many, if not all, of the cases in which a court denied the taxpayer a deduction on the basis that the expenditure was not ordinary and necessary, the use of the "customary in trade or business" and "appropriate and helpful" standards for "ordinary and necessary" would have changed the result. These definitions should be applied to taxpayers on both ends of the employment continuum, thereby resolving a great deal of confusion by courts and taxpayers. If, however, it is not feasible to use

126 See supra note 27 and accompanying text.
128 See supra note 26 and accompanying text.
129 See supra notes 37-89 and accompanying text.
the Welch definitions, the courts or Congress should establish a clear standard that applies equally to employers, self-employed persons, management, and employees.

The trend toward a "double standard" for business deductions under section 162 has deprived many taxpayers of what should have been legitimate deductions. The standard being applied to taxpayers at the lower end of the employment continuum is different from that being applied to those at the higher end, even though the decision to permit or deny the deductions is based on the same provision of the Internal Revenue Code. Principles of fairness and equity require that the situation be remedied by use of a single, clear definition of the phrase "ordinary and necessary."

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