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Some Suggestions for Revisions

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Personal Deductions and the Federal Income Tax--Some Suggestions for Revisions*

By Ray Trammell†

Enlightened tax laws, or for that matter any laws, are the result of continuous reappraisal and revision. On November 16, 1959, the Committee on Ways and Means, House of Representatives, United States Congress, began public hearings designed to gather information and materials as a basis for a substantial revision of the federal income tax statutes. According to the Committee the present income tax law was to be analyzed, by the witnesses appearing before it, in terms of certain stated criteria. These included achieving the following objectives: (1) a tax climate more favorable to economic growth; (2) greater equity through closer adherence to the principle that equal incomes should bear equal tax liabilities; (3) assurance that the degree of progression in the distribution of tax burdens accords as closely as possible with widely-held standards of fairness; (4) an overall tax system which contributes significantly to maintaining stability in the general price level and a stable and high rate of use of human and material resources; (5) a tax system which interferes as little as possible with the operation of the free market mechanism in directing resources into their most productive uses; and (6) greater ease of taxpayer compliance and administration by the government. This meant an appraisal of the so-called “loop-holes” or preferred treatments which have been added to the Internal Revenue Code from time to time for the benefit of selected groups of taxpayers in order to see whether the resulting erosion of the tax base is justified today in terms of the public interest.

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Every deduction, exclusion or credit which is granted upon special conditions to some, but not all, taxpayers serves to reduce the factor of "income" which is to be multiplied by the percentage "rates" in order to compute the tax. To the extent some taxpayers get preferred treatment in computing "income," the uniform rates produce a smaller tax for them than for their fellow citizens. This in turn means that the rates must be increased to produce sufficient revenues. The principle of taxation according to ability to pay, which has been written into the statutes through use of the progressive rate feature (tax brackets), is thereby undercut. Persons with large incomes are not necessarily paying more tax. All of us are aware of tax-sheltered forms of investment where the entire economic gain either escapes taxation or is taxed in a more advantageous manner. The Committee announced that it would investigate the practical possibilities of abolishing these preferences and thereby broadening the tax base sufficiently to permit significant reductions in individual and corporation income tax rates without sacrificing the revenues needed by the Government.¹

Congressman Mills (D., Ark.) and his Committee will hold public hearings on specific drafts of any tax revision bills which result from this study. As a first stage of the revision project, however, the Committee assigned specified portions of the Internal Revenue Code to certain professors of economics and of law, to lawyers and accountants, and to tax experts drawn from labor, business, agriculture and research organizations, for the preparation of detailed critical studies well in advance of the scheduled public hearings. Their product was then made available to the Committee in the form of both written and oral testi-

¹This quest is analogous to that which has, in recent years, been in process in Arkansas in the field of property taxation. Here, we have been increasing assessments to figures more nearly reflecting true market value of property with the objective of reducing the millage levied against this valuation to produce the tax payable. Although the tax "rates" are commonly understood to mean the percentages which are used in the multiplication process (as, "20% bracket," "2% sales tax," or "mill rate"), in theory and in result this so-called "rate" is significant only when considered in conjunction with the base against which it is multiplied ("income," "assessed value," etc.). The rate is the ratio between the two factors. In truth, both factors constitute the rate since "rate of" is meaningless unless the other factor be described. See, e.g., Morley v. Remmel, 215 Ark. 434 (1949), where this distinction resulted in a split decision. The same amount of revenue may be produced by reducing one and increasing the other. To the extent that inequities are eliminated, however, any individual taxpayer may contribute more or less of the total revenue than he formerly did.
The following constitutes the writer's testimony, prepared at the invitation of the Committee, on an assignment to investigate the area of individual personal deductions. In the presentation to the Committee it was prefaced by these remarks:

If the income tax is to be broadened—an announced goal of this Committee—it is appropriate to review the personal deductions and the possibility of placing some limitations upon those now recognized because these deductions reduce taxable income by an amount approaching forty billion dollars annually.

But I personally would not favor any restrictions on the deductions presently allowed unless this would be accompanied by a reduction in the percentage rates at each bracket together with the creation of a new bracket at a rate lower than the present twenty percent one and the shifting of a substantial number of taxpayers into that new bracket.

If the rates are to be lowered, for both high bracket and low bracket taxpayers, then the personal deductions could be revised by either (1) abolishing all of these deductions completely and reducing the rates proportionate to the gain in amount of revenues, or (2) if not possible or feasible to abolish all of them completely, present deductions could be more equitably extended through the imposition of “ceiling” and “floor” provisions where not now used, or by the substitutions of “credits” for deductions. The greatest possible parity between taxpayers would result from abolishing all these deductions. It is legally possible to abolish these deductions for they are not constitutionally assured.

If the deductions are to be retained, revision is required to point up the definitions of the deductible events and to clarify and terminate existing inequities. My research offers some twenty-nine definite suggestions to those ends.

One approaches the subject of income tax revision with some trepidation. Knowledgeable authorities have already spoken.

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2 The written research articles—some 2,500 pages in length—have been printed by the Government Printing Office in three volumes. House Comm. on Ways and Means, 86th Cong., 1st Sess., Tax Revision Compendium: Compendium of Papers on Broadening the Tax Base (Comm. Prnt 1959). The oral testimony will be published in the form of Committee Hearings.

3 This material is in substance the same as that submitted to the Committee and which appears in Tax Revision Compendium, supra note 2, v. 1 at 457. The introductory material and the footnotes have been added in this revised version.

Too, one cannot be optimistic about possible achievements flowing from tax revision attempts.5

Deductions of personal expenses to the extent now permitted are the privilege and the prerogative of certain groups and their disturbance quite naturally has political implications. Nevertheless, the suggestions to follow, made after study but modestly advanced, emanate from what is believed to be a disinterested source.

The largest single factor eroding the tax base involves the "grace-of-Congress" deductions for individuals. These expenditures are nonbusiness in character and not connected with profit-seeking transactions. They include, principally, extraordinary medical expenses, charitable contributions, interest on personal debts, personal taxes, casualty losses on nonbusiness assets, child care expense, and the payment of alimony. Their benefit is not always equitably distributed. Occasionally their form leaves hardship cases unbenefit.

The stated objectives of the Committee on Ways and Means are to broaden the base upon which the federal income tax is levied and by so doing be enabled to lower tax rates. This would make the rates more realistic, stopping leakage and favoritism which undercuts the stated rates when compared with the effective rates, and restore the ability-to-pay principle to full vigor through proper emphasis on the progressive rate feature of the tax statute. We are asked to investigate for equity and fairness and progression in distribution of the tax burden, yet so frame provisions as to allow for free play of the market in allocating resources, provide a climate for economic growth, and facilitate taxpayer compliance and Treasury Department policing.

For 1957 taxable income was $149.4 billion. Itemized deductions totaled $25.7 billion. The amount of each separate deduction was not tabulated. The last such tabulation (1956 returns) showed these deductions:6

5 Blum, Simplification of the Federal Income Tax Law, 10 Tax L. Rev. 239 (1954).
6 Average deductions for returns having itemized deductions filed in 1958 are not available. Similar figures for returns in 1957 show these personal deductions:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>$260.00</td>
<td>74%</td>
</tr>
<tr>
<td>Taxes</td>
<td>$315.00</td>
<td>95%</td>
</tr>
</tbody>
</table>

(Continued on next page)
<table>
<thead>
<tr>
<th></th>
<th>1956</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>$5.8 billion</td>
</tr>
<tr>
<td>Interest</td>
<td>$4.8 billion</td>
</tr>
<tr>
<td>Contributions</td>
<td>$4.9 billion</td>
</tr>
<tr>
<td>Medical</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>Child Care</td>
<td>$0.1 billion</td>
</tr>
<tr>
<td>Casualty losses</td>
<td>$0.3 billion</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>$3.2 billion</td>
</tr>
</tbody>
</table>

TOTAL ...........................................$22.6 billion

In addition an estimated $13 billion or more was deducted through the standard deduction. Thus, the total personal deduction figure approached $40 billion.

In terms of average adjusted gross income, the largest deductions of this character at different income levels for 1956 were, in order of importance: 7

<table>
<thead>
<tr>
<th>Income Level</th>
<th>1. Interest</th>
<th>2. Taxes</th>
<th>3. Medical</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000-$10,000</td>
<td>1. Medical</td>
<td>2. Interest or contributions</td>
<td></td>
</tr>
<tr>
<td>$15,000-$100,000</td>
<td>1. Contributions</td>
<td>2. Taxes</td>
<td></td>
</tr>
<tr>
<td>$100,000 or over</td>
<td>1. Taxes</td>
<td>2. Medical</td>
<td></td>
</tr>
</tbody>
</table>

The first, and obvious, suggestion is to require taxpayers to use an optional standard deduction calling for a "flat" amount and abolish itemizing of deductions of this type in all cases. 8 (This, of course, would be roughly equivalent to increasing the personal exemptions or reducing the rates and abolishing all personal deductions completely.) At present the standard deduction, sections 141-45, 9 permits a subtraction of approximately 10% of adjusted gross income where income is less than $5,000, and the smaller of a flat $1,000 or 10% of adjusted gross where it is $5,000 or more. Taxpayers may elect its use in lieu of itemiz-

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(Footnote continued from preceding page)

7 See table showing itemized deductions taken by each of eleven income classes (average adjusted gross incomes) for 1956, CCH 1959 Stand. Fed. Tax Rep. 8786A.

8 E.g., for returns filed in 1957, taxpayers in the $4500-$5000 gross income bracket, who itemized, claimed total personal deductions, on the average, of $947.00. U.S. Treasury Department, Internal Revenue Service, op. cit. supra note 6.

9 Internal Revenue Code of 1954, §§141-45 [hereinafter referred to by section number alone].
ing and do where it is more generous in amount than the total of actual expenditures would be itemized.

For the taxable year 1954 it is estimated that 72% of the returns utilized the present standard deductions. For 1953, it is said, personal deductions totaled $34 billion of which $13 billion was through use of the standard deduction. Of the other $21 billion itemized, those taxpayers would have been permitted $10 billion if they had used the optional standard deduction. Hence this proposal would, for that year at least, have added $11 billion to the tax base and thus permitted a substantial rate reduction.

The mandatory standard deduction would be less equitable than itemized deductions since it would operate on a rough approximation of expenses in so-called average cases. The non-average hardship affecting ability to pay would go unrecognized. To be balanced against this would be the value of ease of compliance for taxpayers and a reduction in administrative costs for the Treasury. Ease of compliance intended by the present provision is mitigated by its optional character. The prudent taxpayer now makes both computations before electing the one making for the greater savings.

The Committee might consider fragmenting the standard deduction, in the event it is decided not to require its use by all, so that a flat figure becomes a floor provision on each type of deduction item. This would care for the hardship case as to any one deduction. It would reduce the homeowners' advantage (seen hereafter) in more easily exceeding the flat figure when these items are totaled.

Assuming that the standard deduction section remains substantially unchanged and continues to be elective in nature, some specific suggestions for revision follow

CONTRIBUTIONS: SECTION 170

1. The Committee might consider making it permissible to deduct a sum where the taxpayer has contributed his blood to a qualified non-profit organization. Under an interpretation of

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the language of Section 170, no deduction is at present allowed. While it is true that the human body is not property and hence there cannot be a "payment" of it as the statute requires, there is also some illogic in denominating this equivalent to the rendition of services to the organization. Some importance should be attached to the fact that something tangible changes hands, moving from the individual to the organization and being deflected by it to the benefit of persons in need in furtherance of a general charitable purpose. Existing inequity would be removed in allowing this deduction. This situation appears to be men- tironous in the extreme.

Solution: A specific amendment to section 170 expressly recognizing donations of taxpayers blood as within the definition of permitted "contribution." The deduction would be allowed according to fair market value as is now the rule as to donations of property.

2. Where a present gift of a future interest in property is made, the donation accelerates the deduction when compared to the time of enjoyment of the donee-charity. This lifetime transfer not only moves donations forward so that they offset the income tax rates rather than the lower estate tax rates, but moves them perhaps from the lower bracket retirement period to the current high bracket earning period. And, the taxpayer and his family can continue to enjoy the present interest in the property. This problem is best seen in the context of one who acquires a work of art and contemporaneously gives the future ownership of it to a qualified museum or educational institution. The current deduction for the future interest "funds" the acquisition, while he and his family and friends enjoy the


12 The possible cost of this new deduction in terms of revenue loss may be seen from the amount of blood donations. The American Red Cross, including affiliated hospitals, for the period July 1, 1958, through June 30, 1959, received donations of 2,367,525 pints of blood. American Red Cross, Office of Research Information, Report of July 27, 1959. In a study conducted by the American Association of Blood Banks in 1958, 26 large community blood banks and 22 large hospital blood banks reported that they averaged 34% of their blood supply from paid donors, and the remainder from contributors who replace blood used by friends or relatives. It is estimated that approximately 4 million pints are voluntarily contributed out of the 5½ million pints now being used annually in this country. Correspondence with Secretary, American Association of Blood Banks, Nov. 19, 1959.
possession of the object for the life of the taxpayer or for a stated number of years. It is recognized that any tightening of the statute here would remove or diminish an incentive for the adequate supplying of museums and educational institutions. Yet the area illustrated is one where a taxpayer may have his cake and get to eat it too. It would seem only fair to weigh the impact of all gifts equally and hence correlate the deduction with the time of enjoyment by the donee-organization. The proposal here might also remove present doubts which exist as to deductibility of gifts of a future right to income as well.

Solution: Postpone the deduction to the year when the organization takes the whole of enjoyment and possession of the donated property. There is precedent in the gift tax law [Section 2503 (b)] for differentiation as to gifts of “future interests,” defined not in property law terminology but as gifts where enjoyment and possession are postponed due to restrictions placed on the gift by the donor (or a prior donor) and not due merely to the inherent nature of the type of property involved. Where the retained use-value is the chief purpose of ownership, a current transfer of naked title would give rise to no deductible contribution.

3. It is not completely clear whether the individual donor may benefit from a contribution, other than through publicity and self-satisfaction, and have it still qualify for deduction. The basic question is the public purpose of the contribution. A particularly foggy portion of this area is where the ultimate beneficiary is a third person rather than the donor and yet the

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14 The deduction has the effect of improving spendable after-tax income because the value of the reminder interest “bunches” into the year of the donation to offset income which would otherwise appear at the top of the income bracket. The tax saved is saved currently and may be freely spent. To the extent income offset includes capital gain, the net effective rate on capital gain is also reduced by the gift.
16 Cf. Rev. Rul. 54-565, 1954-2 Cum. Bull. 95: where the organization treats the contribution as “dues” and extends benefits and privileges to the payor personally by reason of the donation, it is indicated there is no deduction under section 170.
17 Cf. Restatement, Trusts §370, as to the charitable nature of a trust where the donor retains for himself, or severely restricts, the selection of the ultimate beneficiary.
donor himself selects or participates in the selection of the third person. This is held not to prevent the deduction at times.\textsuperscript{18} However, it is sometimes invoked to deny the deduction.\textsuperscript{19}

\textit{Solution}: Disallow a deduction where donor, either (1) through reservation, condition or qualification which he, or a donor prior to him, placed upon the donation, or (2) under a promise made by the organization (either before or after the date of the donation), or (3) is in fact allowed by the organization to so act, either appoints, selects or participates in the selection of ultimate beneficiaries, or benefits personally in a pecuniary sense not available to members of the public generally. This suggestion attempts to clarify deductibility in an area where it is not now clear and enhances predictability of tax result. It reinforces the idea of progression in rates by preventing deduction of gifts and grants made indirectly to members of the taxpayer's family or to his friends.

4. Section 170 permits deduction for contributions made to groups organized and operated \textit{exclusively} for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals and no \textit{substantial} part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation. (emphasis supplied).

The two flexible terms I have underlined have not operated consistently with equity among organizations due to indefiniteness of the standards. They are not correlated. The problem is the technical one of specification. While a university has, upon judicial notice, been held to be "exclusively" educational,\textsuperscript{20} the American Birth Control League was held not to be.\textsuperscript{21} If the organization is characterized by advocacy, the deduction is at times denied as to one not "exclusively" educational.\textsuperscript{22} The World League Against Alcoholism was held to be exclusively educa-

\textsuperscript{18} Otto T. Mallery, 40 B.T.A. 778 (1939) (\textit{non acq.}); cf. Estate of Agnes C. Robinson, 1 T.C. 19 (1952) (\textit{acq.}) (estate tax).
\textsuperscript{20} Porter v. Commissioner, 60 F.2d 673 (2d Cir. 1932).
\textsuperscript{21} Slee v. Commissioner, 42 F.2d 184 (2d Cir. 1930).
\textsuperscript{22} John H. Watson, Jr., 27 B.T.A. 463 (1932).
tional, and the Board of Temperance of the Methodist Church was held exclusively religious while advocating legislation pertaining to the liquor traffic. Many of these organizations from the nature of their distinctive character must seek legislation for the security and welfare of the organization qua organization. This is distinguishable from seeking legislation affecting others in order to further the stated goals of the organization.

Solution: The Committee might consider adding definitions which would particularize the type of organizations referred to and state a clearer guide concerning disqualifying advocacy or legislative activities.

5. The Committee is aware of the fact that the contributions deduction enables taxpayers at times to make money by giving away other money (It may be asked whether the contribution under a plan of that character meets the test of charitable motive which is what Congress no doubt intended to reward.) An instance of this may be seen where taxpayer creates a trust with the income to a qualified organization for a term of years, remainder (corpus) to his wife, child or friend. This removes the income from the top of his bracket for future years during the term so that the net cost of the gift is only the “take home” part of the dollar for each of those years. But, the commuted present value of the term-for-years gift is also at once deductible. This has a “bunching” effect which, because of his high bracket, can result in tax savings in excess of his part of the cost of the gift. The property (though not the whole income) is kept in the family In this instance, progressive rates themselves enable the taxpayer to escape their effect.

Solution: Require deductions to be allocated to the year of current enjoyment by the organization and thus prevent “bunching.” The Committee might, alternatively, consider a solution similar to the 5% reversionary rule in Section 170(b)(1)(D) phrased in terms of remainders to individuals generally

CHILD CARE EXPENSES. SECTION 214

1. The deduction for child care expenses is in need of technical amendment to remove a discrimination which was probably

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23 Cochran v. Commissioner, 78 F.2d 176 (4th Cir. 1935).
24 Girard Trust Co. v. Commissioner, 122 F.2d 108 (3d Cir. 1941).
not intended. Section 214(a) allows the deduction to "a taxpayer who is a woman or a widower." Section 214(c) states that "widower" includes an unmarried spouse who is separated from his spouse under a decree of divorce or of separate maintenance. To the same effect is Treas. Reg. Section 1.214-1(b)(1)
Since a widower, or a husband who is divorced or judicially separated, all postulate a once-married man, it follows that a "woman" may have the allowance but that it is extended to males only after they have once been married. The result is that a single man could not acknowledge his illegitimate child (by taking it into his custody and incurring this expense) and receive the benefit of this deduction. The same result would occur in those states which permit a single person (male) to adopt a child. The result undercuts that domestic relations law in practically all states which encourages acknowledgment of illegitimate children, and, by bastardy actions, forces expenditures for child care. Further, Congress is placed in a position of having enacted a double standard with reference to a question of morals.

Solution: The unintended hardship and sexual discrimination which appears in the statute might be solved by substituting "man" for "widower" in Section 214(a)

EXTRAORDINARY MEDICAL EXPENSES: SECTION 213

1. The Committee might consider statutory amendment to disavow the decision in Robert S. Bassett.26 There even though taxpayer met the statutory requirement (paid during) for the tax year, his medical expenses were held nondeductible since he paid for medical services to be furnished during a subsequent tax year. The taxpayer was on the cash receipts and disbursements method of accounting. In effect the decision reads "and incurred" into the statute where Congress has not so provided. The court was probably concerned with the distortion of income which could result from voluntarily prepaying substantial amounts of medical expenses. Yet the court indicated that if a bill for medical expenses furnished in a prior year was paid cur-

25 The extraordinary medical expense deduction was added to the Code in 1942 and justified by the desire to raise and maintain health standards during World War II, and in view of the heavy taxburdens of the war period. S. Rep. No. 1631, 77th Cong., 2d Sess. 6, 96 (1942).
26 26 T.C. 619 (1956).
rently, the current deduction was proper. This, too, would have a distorting effect upon income of the current year. Since this particular deduction is limited to the time when it is "paid," regardless of the method of accounting used, denial of a deduction in the Basset case robbed the taxpayer of the deduction completely. The decision appears to overlook the fact that the cash approach utilized in this section is always characterized by some distortion. It may be noted that prepaid interest is deductible.\textsuperscript{27} The convenience and simplicity of marking the deduction by payment is endangered by this decision. Although the newest regulation indicates that the Commissioner would not now follow the decision (see Treas. Reg. 1.213-1(a)—deduct those expenses paid regardless of when the event causing the expense occurred), future influence of the decision could be effectively laid by statutory amendment.

Solution: Insert in Section 213 "for medical services whenever rendered."  

2. It is apparent that existing law discriminates in favor of deductibility of expenses for medical services as against expenses for purchases of commodities and products which are health-incurred.\textsuperscript{28} Note the separate limitation (1%) on expenses for drugs. Who is to say that drugs are less essential to mitigation of condition than are services of the medical man? Recall also that deductibility subsidizes the activity to that extent. If drugs \textit{and} medical advice are essential for the cure, to prefer one over the other offers uneven subsidy to the druggist when compared to the physician, for example. It may be that the limitation on drugs grew out of the practice involving drug store charge accounts so operated that sundries and department store items were billed as "drugs" for reasons of substantiation of the deduction. If so, this


\textsuperscript{28} According to a study by the Social Security Administration released Dec. 23, 1959, the public paid nearly $4.4 billion in 1958 for medicines and medical appliances while only paying $4.3 billion for medical services (fees of physicians, dentists, etc.). Insurance companies paid nearly $1.3 billion of the bills for services. The total private health cost was $16.4 billion. Half of the $5.1 billion charge for hospital bills was covered by insurance. Social Security Administration, Bulletin (Dec. 1959). The Health Insurance Institute reported, Dec. 20, 1959, that more than 123,000,000 citizens were covered by health insurance and that these individuals spent an average of $95 per person for medical care during 1958. In ten states, more than half of the population had no health insurance, a condition which invites a direct subsidy approach rather than subsidy in the form of tax deductions for medical expenses.
is a rather arbitrary form of enforcement technique penalizing honest taxpayers in order to snare the dishonest ones.

While few sick persons would be motivated in incurring expenses for mitigation or cure solely by tax considerations as above discussed, discrimination against deductibility of the expense of medical products and major property improvements exists by reason of lack of clarity as to deductibility of what is essentially a capital outlay for the purpose. Is the hay fever victim's air conditioner, for example, to be expensed in a single year, amortized over a period of years, or denied deduction altogether by reason of the size of the expense? The problem assumes that the purchase is sufficiently related to the condition as to constitute a true medical expense. Will the fact that the expense is capital in nature then prevent the allowance? The cases and rulings appear to have, at times, emphasized the distortion of income aspect at the expense of allowing any deduction whatsoever. Other cases take refuge in the fact capital expenditures are not "expenses," or that a permanent improvement to property has been made.29

Solution: Medical expenses for drugs should be given parity with other medical expenses by removing the 1% floor provision. Medical expenses for products and improvements having a useful life in excess of the current year should be amortized over that period and a deduction be extended for each such year during which the item is used for the defined medical purposes. Some correlation with section 263(a)(1) concerning permanent improvements to property, might be desirable.


A capital expenditure for a permanent improvement or betterment of property shall not be deductible as an expenditure for medical care, even though it may have some relation to medical care. If related only to the sick person and not related to the permanent improvement or betterment of property, it shall, however, be deductible.
3. The medical deduction for persons 65 years of age and over appears to be highly preferential to these persons at the expense of other taxpayers. Ability to pay is directly affected by medical expenses in that they are not a matter of choice. Yet these persons may exclude Social Security benefits received, are given a retirement income credit, and are each granted an additional $600 personal exemption. And these concessions operate against what is usually a lower bracket income in the first instance. The medical deduction section does not apply the 3% "floor" provision to them. Justification for this treatment has referred to the fact of decreased earnings and increased medical expenses at this age. The concept that these are to be for extraordinary medical costs is violated here. Additionally, if one spouse is 65 years of age or more, the expense of his or her spouse who is under 65 years of age also becomes deductible without operation of the "floor" provision. This appears to make it questionable whether the real purpose was to recognize the years in excess of 65 as years of increased medical bills.

Solution: Abolish special medical provisions applicable to spouses where one or both is 65 years of age or over. This would simplify the computation and relieve the Internal Revenue Service from administering this additional complication on the medical deduction. It would increase the progressive effect of the rates. As to the person under 65 who is the spouse of a person 65 or over it would remove an unfair preference.

4. The maximum deduction is allowed according to a "rough" approximation which is stated in terms of number of personal exemptions regardless of whether there were any expenses on each of these persons or not. Thus unduly high excessive expenses on one dependent child in a large family become deductible where the otherwise "ceiling" would prevent their deduc-

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30 On returns for 1957, 168 million personal exemptions were claimed. A total of 6.5 million exemptions due to age (for persons 65 years or older) or for blindness under section 151 were claimed. U.S. Treasury Department, Statistics of Income—1957, Individual Income Tax Returns (Sept. 1959).
31 The "floor" provision which denies deduction for amounts less than a stated percentage of adjusted gross, on the theory that these are "ordinary" medical expenses for a family unit, was formerly set at 5%. It was lowered to 3% when the 1954 Code was enacted. Recent studies indicate 58 percent of all families incur medical expenses under 5% of adjusted gross income during the average year. Anderson & Feldman, Family Medical Costs and Voluntary Health Insurance: A Nationwide Survey 935 (1956).
tion, while the same expenses on an only child are partially deductible. In terms of rough averages, the more persons perhaps the more medical expenses, but the provision may be discriminatory in operation.

Solution: The Committee might consider imposing a period-of-illness requirement to be applied before that person's personal exemption is made available in computing the "ceiling" figures.

INTEREST SECTION 163

1. As a general principle, certain values may be found in the proposition that income tax accounting and good accounting practice should correspond. On occasion, however, distinctions must be made to prevent unfairness and arbitrary results. Section 163 permits the deduction of interest if "paid or accrued." It is possible for an accrual basis taxpayer to deduct for accrued interest owed and later never pay it. The problem chiefly concerns businesses operating on accrual accounting, but is also a personal deduction problem in that individuals may account in that fashion. The judicial gloss appears to be that so long as a prospect exists that payment will ultimately be made the deduction is permissible. If there is no reasonable prospect of this, the court decisions are divided as to deductibility.

Solution: At least for individuals, provide that personal interest is deductible only when "paid." This will prevent deduction where the expense has not actually been sustained in some cases and in others will postpone the deduction until the expense has actually been paid.

2. It is not clear under present law whether the first payments on a loan discharge interest or principal. The situation arises where the loan agreement makes no provision as to this

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33 Section 446(c)(2).
34 For cases and rulings illustrative of this problem, see Fals v. Martin, 224 F.2d 587 (5th Cir. 1955); Keech v. Inc. v. Paschal, 188 F.2d 111 (8th Cir. 1951); Zimmerman Steel Co. v. Commissioner, 130 F.2d 1011 (8th Cir. 1942); Woodward Iron Co. v. United States, 159 F Supp. 54 (N.D. Ala. 1945); Albany & N.Iv. v. Allen, 84 F Supp. 606 (M.D. Ga. 1940); Panhandle Refining Co., 45 B.T.A. 651 (1941); Millar Brunard, 7 T.C. 1160 (1946); Butler Consol. Coal Co., 6 T.C. 183 (1946); Florence Pearlman, 4 T.C. 54 (1944); Nathan H. Gordon Corp., 2 T.C. 71 (1943) (acq.) (Commissioners appeal to CA-1 nolle pros)- I.T. 3635, 1944 Cum. Bull. 101.
problem. The judicial approach lacks proper guidance from the statute, and in some instances the result has turned on state law which opens up the opportunity for non-uniform results on this federal question.\(^{35}\)

**Solution:** Section 163 might be amended to make provision for proper allocation of payments to principal and interest. To what extent is the agreement of the parties to control?

3. In a few cases, of which *Dorzbach v Collison*,\(^ {36}\) may be an extreme example, it has been held that interest paid at an excessive rate may be deducted. In *Collison* this rate was 25%. While there was an alternative ground in the case for the decision, the court pointed out that there is no stated requirement that the amount be ordinary, necessary or reasonable. In *Collison* the amount was paid for money borrowed from taxpayer's wife. While the advantageous joint return makes the spouse a less likely recipient of excessive interest payments today (because of the split income concept), other family members may be so favored. In effect this permits the reallocation of one's income within the family while receiving a deduction for the allocation. The suggestion might be made that if the rate violates a usury statute it is to that extent a payment violating public policy. The states differ on permissible interest rates, however, both in terms of absolutes and relative to the size of the loan.\(^ {37}\) The judicial gloss as to personal deductions violating public policy is not itself completely clear.

**Solution:** The Committee might consider writing into the personal interest deduction, if it be retained at all, the limitation that the rate of interest be ordinary and be reasonable in amount. Further, that the American Law Institute suggestion concerning public policy might well be considered: Disallow any interest disbursement which is itself illegal or contrary to public policy.

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\(^{36}\) 195 F.2d 69 (3d Cir. 1952).

\(^{37}\) Ark., Calif., Okla., Tenn., and Texas have constitutional ceilings on permissible interest rates. All other states except Colo., Me., Mass., and N.H. have statutory ceilings. The most common maximum rates are 5% to 8% per year, but a few states permit up to 12%. There is also small loan legislation in forty-one states, permitting rates as high as 36% per year, applicable to amounts borrowed as large as $1,000.00.
or a disbursement of interest the deduction of which for tax purposes would frustrate a public policy. These changes would prevent avoidance of the progressive rate feature through rather artificial borrowings within the related taxpayer area, and prevent an undercutting of local concepts regarding a permissible "pound of flesh." Those who should not be rewarded would no longer be rewarded, leakage would be stopped and the tax base maintained. 38

4. The statute makes all interest deductible. Interest on tax deficiencies is therefore deductible. This creates differences of opinion as to proper year of deduction. There is a question whether it should be deductible in any event. Deductibility has required definition and distinction between "penalty" and "interest." That problem would disappear. So would the problem of whether a lump sum tax settlement "paid" interest as a part thereof. To some extent the interest on an overdue tax is an incentive device; to some extent a penalizing factor. 39 Some blurring of concept may be seen; e.g. if paid for delay in filing a return it is penalty and not interest, as are all "additions to tax."

Solution: The suggestion is that "interest" be defined as excluding interest paid in connection with tax liabilities.

5. There is still leakage from the tax base through the interest deduction where the deductible amount is paid on loans to buy insurance, endowment or annuity. The Commissioner has resisted deduction of interest where the money was borrowed for non-income producing purposes. 40 The Treasury has proposed that a deduction not be allowed for any amount paid as interest under these personal insurance plans. Your Committee has acted several times to tighten up this area. 41 The latest amendment prevents deduction where a substantial number of future premiums are deposited with the company, treating this as a single premium contract. The Commissioner has ruled that "interest" payments are really just premium payments where the purchase was loan-inspired. 42 Court decisions conflict on whether

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40 See, e.g., Preston v. Commissioner, 132 F.2d 763 (2d Cir. 1942).
41 Section 264.
this is "interest," and have led to a judicial requirement of a bona fide borrowing purpose.

The arrangement in question is to finance by borrowing against the cash value of the policy in order to buy the insurance and pay premiums thereon. An interest-deductible loan is used to purchase an asset the earnings of which are not currently taxable and may never be taxed. At the heart of the problem is the rule that these premium payments are a personal expense and not deductible. The advantage is for the high bracket taxpayer. The deduction which is created saves tax dollars for him to the extent that the net cost of the policy is less than the amount accruing to his cash surrender value and he also receives the insurance protection. By reason of the deduction against high bracket income, he can borrow at an interest rate which, after the deduction, is less than what the policy will earn for him. Thus at a 50% bracket, 4% interest has a net cost to the taxpayer of 2%. The borrowed sums may be placed so that the policy accumulates a 2½% rate of return. One-half percent is clear gain (not all credited to surrender value, however, since cost of insurance coverage and company overhead must be paid from this amount) This shelter also shows advantages when the gain is taken down at maturity Where the cash surrender value is collected or at maturity, the basis to be subtracted from the amount received is the premium cost not including interest. Since the premium rate includes the insurance cost (agent's fees, e.g.) often the cash surrender amount does not exceed the basis (premiums paid) Further, section 72(e)(3) permits the gain to be averaged over a three-year period. If the policy is one of life insurance and collected only by reason of death, the appreciation is never taxed under the income tax law These tax advantages encourage the promotion of a sale for a small cash payment and a loan for the balance. The interest deduction reduces the net cost to less than the added value produced by the policy

While the depositing of a substantial number of future payments with the company is treated as if a single premium con-

44 Section 101(a).
tract had been acquired there is no restriction on a deduction of interest for funds borrowed to pay current premiums. This problem was before the Committee at the time of consideration of the Technical Amendments Bill of 1957. The suggestion that interest be disallowed if the policy was obtained under a plan which contemplated that a substantial number of premiums be paid through indebtedness was rejected because of the subjective nature of the test proposed. The problem remains where money is borrowed to carry an annual payment policy.

Insurance policies have been rewritten and recomputed in order to facilitate the use of these policy-stripping plans. Higher initial cash surrender values have been provided so that the collateral will support the loan. There is evidence that not all companies agree that these plans are in the best interest of the industry. There is some actuarial danger in spreading the cost of the insurance coverage over longer periods of time in order to create higher initial cash surrender values. I have no specific information as to current figures on incidence of these plans. Recent increases in interest rates on conventional loans affect the problem, but may merely shift the loan from bank loan to company-carried plans. If disallowance is decreed some thought must be given to the occasional hardship case where insured must borrow in order to meet a current premium though this was not necessarily contemplated when the policy was purchased. There is evidence from the latest cases that the Commissioner is making progress in attacking these profitable arrangements effected through the deduction for interest by urging the form-substance dichotomy of Gregory v Helvering. That solution, however, requires litigation and the result is unpredictable in individual cases without it.

Solution: The Committee might draft through force along these lines: "Interest on personal loans shall be disallowed if the taxpayer's tax bracket is such that a deduction for interest
would so mitigate the cost of credit that increment from investment of the borrowed money in life insurance exceeds the cost of his credit." Or, the cost of the policy computed on surrender or at maturity might be reduced in the amount of interest paid to acquire or carry it to the extent allowed or allowable, giving a postponed effect to the disallowance. 49 This might be accompanied by an amendment to section 101(a) treating the disallowed interest as income received from a decedent where unsurrendered life insurance is collected at death. This approach is similar to section 170(b)(4) reducing the amount of a deductible contribution by the amount of interest required in order to make it. Some attention might also be given to defining "indebtedness" in section 163(a) if motive in borrowing is to be considered.

INTEREST AND TAXES FOR HOME OWNERS:
SECTIONS 163-164

1. In Treas. Reg. section 1.212-1(h) it is provided that ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. Interest and taxes on this investment, the increment from which (right to occupy) is tax-free are, however, deductible. Code treatment is that, in general, disbursements offsetting items the income from which is not includible are ordinarily denied deduction. 50 In lieu of disallowance of these items, the compensating approach would be to include the imputed income resulting from occupancy of one's home. The British do so in their tax law.

There is a lack of equity here when the home owner's position is compared to that of the taxpayer who rents a residence. Rent, for him, is a personal expense paid from his after-tax dollars and not deductible. Yet the home owner's capital invested in the house might otherwise be invested and income-producing. His gain from its use is apparent. Further, statistics prove

50 E.g., 322 F.2d 607 (6th Cir. 1954) (if occupied by relatives rent-free, expenses connected with house owned by taxpayer are not deductible).
that the incidence of home ownership increases directly with increases in income. The number of persons benefiting is therefore greater among the higher tax brackets thus blunting the progression intended by the rate schedule adopted. If the deduction of mortgage interest and real property taxes is intended as a subsidy to encourage home ownership it is inefficient in the sense that aid in acquiring a home is most needed by persons in the lower brackets.

The size of this problem appears when it is shown that over ten percent of consumer expenditures are made for housing and that an estimated four billion dollars is the excluded imputed income from home ownership.\textsuperscript{51}

The difficulties in taxing this imputed income are several, including the unanswered question of whether the Supreme Court would uphold the attempt to do so.\textsuperscript{52} Some method of valuing the rental value of these millions of structures would have to be adopted.\textsuperscript{53}

Not to be overlooked is the advantage that the home owner has in being able to itemize deductions rather than to take the standard deduction. It is easier for him to accumulate enough deductions, starting with his sizeable interest and tax deductions on the house, to make it advantageous to itemize deductions totaling in excess of the standard deduction. This makes this group the primary beneficiary of the other permissible personal deductions.

Solution: Tax imputed income arising from one's right to occupy his own home, or, limit deductions for interest or taxes on personal residences. These expenses are not only personal in nature and completely foreign to business activities, but are unrelated to an income tax-producing asset. A provision dis-


\textsuperscript{52} In Helvering v. Independent Life Ins. Co., 292 U.S. 371 (1934), a case which was limited to the tax problem of an insurance company, the Supreme Court stated that rental value of owner-occupied buildings was not income to such taxpayers, and indicated that a constitutional issue might exist if the statute tried to tax this amount as income. But the Court upheld disallowance of the tax deductions on the building. Their allowance was conditioned on inclusion of rental value. The theory was that since Congress could have denied these deductions completely they could so condition them.

\textsuperscript{53} They have been evaluated: For a recent year the estimate of the net rental value of owner occupied dwellings in the United States was $3.8 billion. U.S. Department of Commerce, \textit{National Income} (1951).
allowing these as deductions could be introduced over a period of years through the use of gradually increasing ceiling limitations.

TAXES: SECTION 164

1. Discrimination among cigarette smokers is found due to the variation in deductibility of the cigarette taxes from state to state. Cigarette taxes are shifted forward to the ultimate consumer almost without fail, although not always as a tax. The rigid requirements that the tax must be placed on the consumer as a tax or that it must be separately stated, have led a number of states to restructure their local tax laws to gain this advantage for their citizen-smokers. The result is to frustrate traditional local tax patterns which have usually placed the tax on the wholesale distributor. The smaller number of wholesalers than retailers has centralized tax enforcement efforts of the states. This factor has led to the veto of proposed revisions in cigarette taxes designed to gain the federal advantage. This was Arkansas' experience, for example.

Solution: Specify that cigarette tax borne by a taxpayer who is the consumer either in the form of a tax or an increased sale price shall be deductible by him, or, provide that no cigarette or tobacco taxes shall be deductible as taxes.

2. Sub-sections 164(b)(5)(A)-(B) have all the earmarks of "sacred cow" legislation designed to aid a particular taxpayer or small group of taxpayers. While written in general terms the tailored requirements make such provisions highly discriminatory. Permitting deduction of special assessments for maintenance

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55 H.B. 115, introduced during the 1959 session of Arkansas General Assembly, would have declared that the impact of the cigarette tax was on the user of cigarettes. The retailer would have been required to list the tax separately and collect it from each user. The measure passed but was vetoed by the Governor because "the burden of administering the collection of cigarette taxes under this measure would be insurmountable, both from the standpoint of the state and the seller."
56 The effect upon the revenues is seen from these figures: 442,928,000,000 cigarettes were manufactured in 1957. U.S. Bur. Census, Statistical Abstract of the U.S., 1959. In one-fourth of the states the tax is on the smoker; in three-fourths of the states it is deductible by the dealer. At a tax rate of $3 per 1,000 cigarettes (Arkansas rate), the person who smokes a package a day pays approximately $22.00 a year in state tax.
or repair on non-income producing assets, as here provided, is strange. Most of these are for the creation or maintenance of betterments to real property and would ordinarily show a postponed effect through being added to capital account. Further, any bond interest is owed by the improvements district, not by the taxpayer. At one time rulings and decisions were to that effect. Later cases like Lee Wilson & Co., Andrew Little, and Harwell v Commissioner, allowed deduction on a theory that amounts of tax used for repair, interest and maintenance are not to be capitalized since the value of the property was not increased by the expenditures.

It is difficult to reconcile this deduction with Section 263(a)(1) which provides for capitalizing betterments made to increase the value of any property or estate. If the more proper analogy be to expenses for incidental repairs and maintenance, as distinguished from capital improvements, it may still be stated that no improvement district expense or interest should be deducted where the property bettered is not income-producing.

Section 164(b)(5)(B) is applicable only where a special taxing district covers the whole of at least one county and at least 1,000 persons are subject to the taxes levied by the district. The tax must be ad valorem at a uniform rate and utilize the same value as is used for purposes of the real property tax. Rev. Rul. 55-284, 1955-1 Cum. Bull. 25, discovered an improvement district which would fit these tailored qualifications at an early date after adoption of this provision by the 1954 Code.

Solution: Repeal section 164(b)(5)(B) which has the discriminatory effect of making certain improvement taxes deductible where as a general rule they are not. The phrase justifying the disallowance of improvement taxes generally—"of a kind

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58 25 B.T.A. 840 (1932) (acq.).
59 21 B.T.A. 911 (1930) (acq.).
60 170 F.2d 517 (10th Cir. 1948).
61 Taxes paid to an improvement district and used for maintenance and interest payments were recognized as deductible in the Revenue Act of 1928. Pub. Law 562, 70th Cong., 1st Sess., ch. 852, 45 Stat. 791. U.S. Treas. Regs. section 1.164-4(b)(1) recognizes them as deductible. All personal interest is deductible so there is no problem there. Where the amount goes for maintenance charges and the payor is a business it may be a business expense deduction. Section 162(a). But where the taxpayer is an individual not engaged in business it would appear that these sums should be made non-deductible.
tending to increase the value of the property assessed"—causes confusion and might be taken out of the statute. Change treatment of items in section 164(b)(5)(A) so that, to the extent incurred in betterment of non-income producing property, these expenditures must be capitalized.

3. Any state or local transfer taxes on property payable by stamps or otherwise should be required to be capitalized, and should not be deductible as a current expense under section 164.62

Solution: Amend section 164 to so provide.

4. The committee might undertake the disallowance of deductions for all state and local sales and excise taxes.63 For many years now federal excises have not been deductible. The statute would be easier to enforce if this were done due to the reasonable estimate approach which must now be used.64 There is probably a great deal of leakage here, along with disparity in amounts allowed to be deducted by taxpayers similarly situated. The move would make the statute more uniform in application because the rate of present sales and excise taxes vary from state to state in a rather substantial manner. This would also remove the less-than-successful test used to determine upon whom the tax is imposed where it has been originally imposed on the retailer and shifted forward by price manipulation.65 The amount

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62 Federal stamp taxes (transfer tax) are not deductible as taxes. Section 164(b)(3). They do enter the computation of gain or loss on the sale of assets as a part of the expense of sale, however. I.T. 3806, 1946-2 Cum. Bull. 41.

63 State estate, gift, and inheritance taxes were, by the Revenue Act of 1934, made non-deductible on the justification that they are charges imposed on the transfer of capital and are expenses not incurred in the production of income. H.R. Rep. No. 704, 73d Cong., 2d Sess. 22. Yet the other state and local levies also of a personal nature remain deductible.

64 It was reported on Nov. 4, 1959, that District Directors of the Internal Revenue Service have been given new authority to release guidelines to be used by taxpayers in deducting estimated amounts for state and local sales taxes. Office Memo., Public Information Division, Int. Rev. Serv., Oct. 26, 1959, referring to Memo of Oct. 19, 1959, sent Regional Commissioners by Director of Audit Division. The guidelines would indicate whether amounts proposed to be deducted are reasonable and acceptable to the Service. Unfortunately use of the authority given is discretionary with the individual District Directors.

65 The sales or use tax is deductible by the consumer if he pays the tax or where, though not imposed upon him by law, the amount is separately stated and he pays it. Section 164(c)(1). In 16 states the general sales tax statute places the tax on the consumer. In 17 states it is levied against the retail merchant and deductible by the consumer only where separately stated. Two states (Penna. and Wash.) have recently increased the rate of their tax to 4% making the question of deductibility even more important.
of this deduction is sufficiently great to affect the progression problem.  

Solution: Amend section 164 disallowing deduction for state or local political subdivision sales or excise taxes except where the expense is a business expense (section 162) or section 212 expense in its entirety.

CASUALTY LOSSES. SECTION 165(c)

1. The nature of the occurrence which gives rise to possible deduction under this section is not always clear. Justification for the allowance is for the supplementing of low personal exemption figures for involuntary-incurred, unexpected, necessary, personal expenses due to loss of property. The statute refers to loss from fire, storm, shipwreck, or other casualty or from theft.  

The phrase "other casualty" has been held to be construed under the rule *ejusdem generis* in some cases and as an independent type of recognizable loss in others. Blasting and other human-caused losses have been allowed. In general the courts have read into the statute the common elements of fire, storm or shipwreck, and have held that the loss must be characterized by a sudden, unexpected or unusual cause from an event of nature or at least from some external violent force. Confusion in the requirement is seen from the handling of drought losses. A drought is not, by nature, a sudden event. Therefore, if allowed it may be that the result and not the cause is recognized as making the loss an allowable one. This in turn has led to cases which tried to determine whether the requirement of suddenness is satisfied by a sudden discovery of the loss. The statutory listing offers some support for recognizing consequences as well as causes. "Shipwreck" is a consequence of some event and

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66 For 1957, state tax collections from general sales and use taxes totaled approximately $3.3 billion. In addition, $5 billion were collected from selective sales taxes on items such as gasoline, alcoholic beverages, tobacco, and insurance. Council of State Governments, The Book of the States, 1958-59, 190 (1960). A part of this was paid by business entities and would be deductible in any event as a business expense.

67 The Act of Mar. 2, 1867, 14 Stat 471, 477, is the source of the original phrase which read: "from fires, shipwreck." The phrase "other casualty and from theft" was added in 1916 without Committee comment as to intention. Pub. Law 271, 64th Cong., 1st Sess., ch. 463, 39 Stat. 756.

68 See Shearer v. Anderson, 16 F.2d 995 (1927), holding that there are no words in the statute and no legislative history limiting the event to an act of nature.
occasion for a loss. "Fire" is a cause. "Other casualty" expresses the result rather than the cause.69

Solution: Amend section 165 to eliminate reference to specific types of causes and consequences, and provide instead that unexpected "causes and consequences" arising from identifiable events which result in loss to the taxpayer's property are deductible, i.e., adopt a more general description of the situation creating the loss, or describe the required result which qualifies the loss.

2. There is some question about the meaning of "theft" as used in section 165(3) In cases such as Edwards v Blomberg,70 Bordon v Commissioner71 Earle v Commissioner,72 and Curtis H. Muncie,73 it has been held that "theft" is to be defined according to the law of the state or nation where the event occurs. In Edwards, Georgia criminal law defined theft as including any criminal appropriation of another's property, including embezzlement.

The result here should not be made to turn on state criminal laws. There was a distinction at common law between larceny, which involved a wrongful taking of possession, and embezzlement. In the latter, possession was by right but the property was then intentionally converted. This distinction still exists in state law On the other hand, the victim may think either situation results in a "theft" of his property

Solution: Define "theft" in section 165(c)(3) so that it includes any criminal appropriation of another's property including, but not limited to the following: larceny, embezzlement, swindling, obtaining property under false pretenses, or other wrongful and permanent deprivation of the taxpayer's property.

3. The Committee might consider placing a "floor" on casualty loss deductions. This would eliminate consideration of minor losses which may be absorbed by the taxpayer without great economic sacrifice, but retain the deduction to compensate for loss of ability to pay tax as the result of a major disaster. This would make the deduction easier to administer since effort could

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69 Ibid.
70 232 F.2d 107 (5th Cir. 1956).
71 101 F.2d 44 (2d Cir. 1939).
72 72 F.2d 866 (2d Cir. 1939).
73 18 T.C. 839 (1952).
be concentrated upon verifying a fewer number of deductions. It would mitigate the fact that a benefit is received by the government under insurance policies against loss which are carried by the taxpayer, premiums on which are not now allowed to be deducted. (Note the contrary approach in the medical deduction section.)

LEGAL EXPENSES IN ALIMONY ACTIONS.

SECTIONS 212 & 262

The legal expenses incurred in connection with a divorce are deemed to be personal expenses—section 262—and not deductible. But legal expenses in relation to alimony (which is taxable as income) present a problem. Under the principle that the expense be deducted (section 212) the wife or ex-wife is allowed to deduct the costs of obtaining alimony or an increase in alimony, thus encouraging her to do so by subsidizing the act. There is real doubt, however, concerning the husband's right to deduct the cost of defending the same legal action. If the expense is based on his attempt to avoid liability generally, there is no deduction. Where he relates the possible liability on his part to his property which is held for the production of income, however, some cases have allowed the expense under section 212. This is particularly true where the controversy deemphasizes the liability itself and emphasizes the issue of how to discharge it. Four recent cases allowing him a deduction are Baer v Commissioner,74 McMurdy v United States,75 Bowers v Commissioner,76 and J A. Fisher v United States.77 It appears that the Tax Court will not apply the rule developed in this line of cases. It holds all expenses in connection with divorce and its incidents to be personal expenses. Cf also, Lykes v United States,78 which indicates that the expense of minimizing a liability is not deductible. There the court said deductibility is tested by the immediate purpose and not the remote consequence of the expenditure.

Treas. Reg. 1.212-1(m) disallows deduction where property would be required to be sold or used to satisfy the liability. This

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74 196 F.2d 646 (8th Cir. 1952).
75 132 F Supp. 114 (Ct. Cl. 1955).
76 243 F.2d 904 (6th Cir. 1957).
78 343 U.S. 118 (1952).
appears contrary to the cases cited above. It is not yet apparent whether the Commissioner will, in this manner, be able to over- come judicial decisions which have developed a contrary view.

Solution: Amend section 262 to specify that all expenses for legal fees and court costs in connection with actions for alimony, divorce, or separate maintenance constitute a personal expense which shall be non-deductible. This will place the participants upon an equal footing as to the net cost of maintaining such actions. It will remove the necessity for allocating alimony portions of the cost where both divorce and alimony are elements of the same action, as is usually true. It will clarify section 212 so that at least for expenses of this variety the resulting effect upon property held does not control. Property is always taken to satisfy judgments and decrees awarded in terms of money regardless of the nature of the legal action.