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PROFESSORS AND THE "ORDINARY AND NECESSARY" BUSINESS EXPENSE

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Professor Davis taught English at Pomona College. His work may have been little known except to his students and a limited number of scholars, but his embroilment in an income tax controversy¹ involving only \$683.50 became the cause of his profession.² For him the case resulted in victory.³ The extent and finality of the victory for his profession, however, remain to be seen.

Davis joined the English Department at Pomona in 1927, becoming a full professor in 1944 with tenure secured earlier. His special interest lay in the English Renaissance. In the summer of 1956 he went to England to complete a research project leading toward the publication of *A Critical Census of Translators and Translations into English from 1475 to 1640*. The primary source materials needed to complete his self-appointed task were available only in England: at the British Museum, the Bodleian Library at Oxford, and the Library of Lambeth Palace.

The research and travel took six weeks. Davis' expenses (air fare, meals, and lodging) amounted to \$2,116.19, and he deducted them on his 1956 income tax return although he had no expectation of profit from the sale of the book. He claimed the expenses under

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¹ Harold H. Davis, 38 T.C. 175 (1962).

² See note 6 *infra* and accompanying text.

³ *Ibid.*

section 162(a) of the Internal Revenue Code as the "ordinary and necessary" expenses of carrying on business which, for him, included advancing the knowledge of English Renaissance literature.

The Commissioner disallowed the deduction and the Tax Court sustained him because Davis, a salaried individual, had not been required by his employer, Pomona, to write the book or make the trip.⁴ Since he had tenure,⁵ he could not have been discharged for not pursuing his research. His expenses, the court concluded, were therefore not "necessary." The dissent supported the deduction on the ground that the statutory requirement of a "necessary" expense is met when it bears a direct relationship to the taxpayer's work and is helpful and appropriate to its performance.⁶

The *Davis* case was resolved when, on appeal to the Ninth Circuit, the Commissioner joined in a stipulation to vacate and remand the case to the Tax Court for entry of a decision of "no deficiency."⁷ About the same time, the Commissioner issued Revenue Ruling 63-275⁸ holding deductible the expenses of a professor engaged in research in an area of his professional competence whether or not he has tenure.⁹

⁴ Harold H. Davis, 38 T.C. 175, 177 (1962).

⁵ The concept, purpose, and function of tenure are discussed in notes 80-83 *infra* and accompanying text.

⁶ Harold H. Davis, 38 T.C. 175, 180 (1962).

⁷ The stipulation called for remand to the Tax Court for entry of decision pursuant to the "agreement of the parties." That "agreement," set forth in a Department of Justice letter to taxpayer's counsel, called for a stipulation of "no deficiency" to be filed with the Tax Court. Such a stipulation was filed with the Tax Court and decision entered in accordance therewith. Harold H. Davis, No. 85651, T.C., March 5, 1964. For the Ninth Circuit's order of remand, see *Davis v. Commissioner*, No. 18188, 9th Cir., Jan. 3, 1964.

As indicated in the text accompanying note 2 *supra*, the Tax Court's initial decision in *Davis* created widespread concern in the academic community. The appeal to the Ninth Circuit was financed by the American Association of University Professors and amicus curiae briefs were filed by that association, the American Association of Land Grant Colleges and State Universities, and the Walters Art Gallery. The Association of American Law Schools indicated to the court its accord with the brief filed by the American Association of University Professors. See Oliver, *The Deductibility of Expenses: A Professor's Research and a Study in His Home*, 50 AMERICAN A. UNIVERSITY PROFESSORS BULL. 14 (1964).

⁸ 1963 INT. REV. BULL. No. 52, at 13. The ruling was issued following a formal conference and subsequent informal communication between the Commissioner, his staff, officials of the Justice Department and counsel representing Davis, the amici curiae, and others in the field of education. Agreement to issue the ruling made possible the amicable disposition of the *Davis* appeal. The Department of Justice filed no appellate brief in *Davis*, having received repeated extensions of time pending the Commissioner's decision whether to issue the ruling. See Oliver, *supra* note 7, at 15.

⁹ The coming of Revenue Ruling 63-275 was heralded by Technical Information Release 525 (Dec. 9, 1963) [hereinafter Technical Information Releases cited as T.I.R.]. The Release, setting forth the proposed ruling *in extenso*, did not indicate the significance of tenure. To eliminate any doubt that tenure is irrelevant to the issue of deductibility, the phrase "with or without tenure" was included in the ruling as published in the Internal Revenue Bulletin.

The ruling is based on the fact that the duties of a professor, whether or not he has tenure, include "communication and advancement of knowledge through research

The narrow question posed by the Tax Court in *Davis*—whether a professor's research expenses could be "necessary" if not required of him by his college or university¹⁰—suggests a serious misconception of both the income tax statute and the business of a professor. In exploring the administrative and judicial history which spawned the *Davis* controversy and resolved it, this Article will suggest an analysis which may support a narrow circumscription of some of the areas of future dispute.¹¹

I. THE STATUTORY FORMULATION

The Code moves from gross toward net income by allowing a current deduction for the "ordinary and necessary" operating expenses of a business.¹² Nonoperating expenditures, those which result in the acquisition of a business asset having an extended but determinable useful life, are characterized as "capital" and are deductible through annual depreciation charges over the asset's productive life.¹³

and publication" as well as teaching. Deductibility of a professor's research expenses, including allocable travelling expenses, "incurred . . . for the purpose of teaching, lecturing, or writing and publishing in his area of competence" is thus based on a recognition that they are the ordinary and necessary business expenses of one carrying out the duties "expected of . . . a professor" although he has no "expectation of profit apart from salary." Rev. Rul. 63-275, 1963 INT. REV. BULL. No. 52, at 13.

A cautionary note in the ruling indicates that certain research expenditures may have to be capitalized, presumably a reference to research which is likely to lead to a saleable asset such as a commercially marketable book. It may also refer to assets purchased which will have value in the professor's research over several years (*e.g.*, books and typewriters). See also G.C.M. 11654, X-2 CUM. BULL. 130 (1931); note 27 *infra*. Acknowledgment that scholarly research does not usually lead to "a specific income-producing asset" dispels any notion that such research may itself be a capital asset or that the research expenses incurred, particularly for intangibles and short-lived tangibles, are to be capitalized. This acknowledgment makes less important a test of the validity of the Commissioner's interpretation of INT. REV. CODE OF 1954, § 174 (election to deduct currently or to amortize over sixty months research expenses of a capital nature) [hereinafter all sections cited refer to INT. REV. CODE OF 1954 unless otherwise indicated]. Without apparent basis in the statute or legislative history, he holds in Treas. Reg. § 1.174-2(a)(1) (1957) that the section is inapplicable to "literary, historical, or similar projects."

¹⁰ A subsidiary issue in the *Davis* case is discussed in note 76 *infra*.

¹¹ For a recent discussion of the tax problems of professors in special context, see Zucker, *Income and Expenses of Visiting and Traveling Professors*, 18 TAX L. REV. 379 (1963). See also, Oliver, *Sabbatical Leave Travel Expenses and the Federal Income Tax*, 43 AMERICAN A. UNIVERSITY PROFESSORS BULL. 507 (1957). See generally, Loring, *Some Tax Problems of Students and Scholars*, 45 CALIF. L. REV. 153, 153-57 (1957).

¹² Section 162(a) allows "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" The language of § 23(a)(1) of the 1939 Code was the same. Many of the cases to be discussed arose under the 1939 Code, but for the sake of simplicity all code references will be to § 162(a) of the 1954 Code. The Article will refer to "net" income to indicate the gross income less the allowable deductions on which tax is computed because it expresses the economic concept in a more familiar and perhaps meaningful way than does "taxable" income, substituted by the 1954 Code for the term "net" which had been used previously.

¹³ Section 263(a)(1) denies any deduction "for new buildings or for permanent improvements or betterments made to increase the value of any property or estate."

Expenditures unrelated to the taxpayer's "trade or business" are nondeductible and characterized as "personal."¹⁴

The issues which understandably arise in this statutory framework are (1) whether a taxpayer's expenditures are so concerned with consumption that they may not be treated as business expenditures, but must be disallowed as "personal," and (2) whether business expenditures are "current" and therefore currently deductible, or "capital" and therefore deductible, if at all, only through annual depreciation or amortization charges over the life of the acquired asset. The statutory language has also lent itself to the articulation of a third issue: whether a current expenditure, though business-related, is nevertheless nondeductible because not "ordinary and necessary."¹⁵

Subsection (2) disallows expenditures for "restoring property or in making good the exhaustion thereof for which an allowance is or has been made." Subsection (1) derives from the Revenue Act of 1864, ch. 173, § 117, 13 Stat. 281, and was probably intended originally to distinguish the building "repair" from the "improvement." Although the rule that capital expenditures are not currently deductible would exist without any express statutory provision therefor, § 263(a) is construable to support application of the rule as to any kind of "improvement." See Treas. Reg. §§ 1.263(a)-1, 1.263(a)-2 (1958).

Section 167(a) allows depreciation on "property used in the trade or business" or "held for the production of income." But see notes 16-17 *infra* and accompanying text.

¹⁴ Section 262 denies any deduction for "personal, living or family expenses." Like § 263(a) (1), this section is probably unnecessary. See note 13 *supra*.

¹⁵ The word "ordinary" was first used in a federal income statute to modify a deductible item, "repairs," in § 117 of the Revenue Act of 1864, ch. 173, 13 Stat. 281. Legislative history indicates no specific significance to be ascribed it. This modifier was reenacted by Joint Resolution No. 18 of Feb. 21, 1895, 28 Stat. 971, amending the Revenue Act of 1894, ch. 349, § 28, 28 Stat. 553. The 1894 Act also allowed "the necessary expenses . . . in carrying on any business . . .,"—the first time "necessary" appears in a federal income tax statute to modify a deductible item. Although no significant legislative history can be found for this innovation, a correlative section in the corporate portion of the Revenue Act of 1894, ch. 349, 28 Stat. 509, allowing a deduction for "actual operating and business expenses," evoked concern from several Senators who felt that the words "are made to carry too heavy a burden," 26 CONG. REC. 7133 (1894) (remarks of Senator Chandler), and would not include such expenses as cost of goods used or sold and insurance premiums. See 26 CONG. REC. 6887, 7131, 7133 (1894). However, Senator Vest, in charge of the bill on the Senate floor, felt that the language would be construed broadly and would, at least, include the expenses raised by the other Senators. See *id.* at 7133.

The combined phrase "ordinary and necessary" first appeared in the corporation income tax of 1909, Tarriff Act of 1909, ch. 6, § 38, 36 Stat. 113, providing for the determination of "net income" after allowance of "all the ordinary and necessary expenses." Again, there is no legislative history for the phrase.

The Revenue Act of 1913, ch. 16, § IIG(b), 38 Stat. 172, allowed a corporation "all the ordinary and necessary expenses . . . in the maintenance and operation of its business" in determining its net income, but for noncorporate taxpayers, "the necessary expenses . . . in carrying on any business." § IIB, 38 Stat. 167. The committee reports and debates shed no light on any special meaning to be accorded these phrases. See S. REP. NO. 80, 63d Cong., 1st Sess. (1913); H.R. REP. NO. 5, 63d Cong., 1st Sess. (1913). See also 50 CONG. REC. 421, 506, 5679 (1913).

In 1919 the 65th Congress rewrote the sections to read as they do today, allowing the "ordinary and necessary" expenses of "carrying on" a business. 40 Stat. 1066, 1077 (1919). The only help that can be derived from the Committee Report, H.R. REP. NO. 767, 65th Cong., 3d Sess. (1918), is in the lack of any suggestion that these words were meant to effect a substantive change.

It is doubtful that this issue has a substantial claim to recognition independent of the other two; indeed, the third issue may not have been an inevitable aspect of the statutory scheme. It is these three issues, however, often unclosely fused by the courts and Commissioner, and particularly the third, that form the nucleus of this discussion.

Another issue which arises in this statutory context, one which is for the most part beyond the scope of this Article, concerns expenditures which result in the acquisition of an intangible capital asset (for example, professional education) whose useful life has not been thought estimable by customary measures. Because of this presumed difficulty in estimating useful life, the law has not provided for the recovery of those costs through the annual depreciation or amortization charge.¹⁶ The result is controversy in which the taxpayer feels an extraordinary pressure to establish that his expenditures for intangibles are not capital, but current. However, the revenue agent who can support a finding that the expenditures are capital and not recoverable by annual charges has won a substantial victory in terms of the values inspired by the adversary system in which the income tax is administered.¹⁷ Although this "victory" in the case of an intangible asset of indeterminate life has meant disallowance of the expenditures as a current deduction, the courts and Commissioner have often failed to specify its capital nature as the ground for disallowance, confusing it with a "personal" asset. This failure underlies much of the history which led to the *Davis* case.

II. EARLY HISTORY

A. To 1933

The Commissioner first published his position on the deductibility of a professor's research expenses in 1922, holding in I.T. 1520

Mildly put, the statutory language "has induced a considerable amount of fuzzy and circuitous judicial thinking." 1 RABKIN & JOHNSON, *FEDERAL INCOME, GIFT AND ESTATE TAXATION* § 3.02(4), at 312 (1964).

See also *Deputy v. du Pont*, 308 U.S. 488 (1940); note 97 *infra*. See generally Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142, 1145-46 (1943).

¹⁶ Treas. Reg. § 1.167(a)(3) (1956). *But cf.* § 248 (corporate organizational expenditures), § 174 (research and experimental expenditures, see note 9 *supra*), § 177 (trademark and tradename expenditures), § 615 (exploration expenditures). See generally notes 66, 92 *infra*.

¹⁷ Where the usefulness of a business asset is likely to decline or dissipate over a period of time, the law's failure to provide a fair and workable method of cost recovery against recurrent income is a serious deficiency, one to which writers and policymakers should direct some attention. See notes 43, 66, 92 *infra*.

that a salaried college teacher who, with his colleagues, was "urged" by his college to engage in research, could not deduct his research expenditures.¹⁸ Noting that the taxpayer's research was "necessary from the point of professional recognition and standing," but that it did "not affect . . . salaries . . ." or produce other income, the Commissioner ruled the expenses "personal" and therefore nondeductible.¹⁹ A year later, however, the Reverend Shutter, a Universalist minister from Minneapolis, attended his church's biannual convention in Providence, and the Board of Tax Appeals directed that his travel expenses be allowed because Reverend Shutter's "attendance at [the] convention was essential to his standing and position in the church"²⁰

Although I.T. 1520 viewed "professional recognition and standing" as indicia of a "personal" expense in the case of a college teacher, "standing and position" were the keys to deduction for the minister before the Board of Tax Appeals.²¹

Later, in *Alexander Silverman*,²² the Board relied on *Shutter* to allow a chemistry professor to deduct expenses incurred in attending meetings of his professional societies. It regarded the expenditures as "ordinary and necessary" business expenses because the professor was "expected . . . to keep abreast in his particular field of work," and attendance at meetings was "expected and necessary [for this purpose] and . . . to advance the interests of the university, though his contract of employment [did] not specifically make mention of any such activities"²³

¹⁸ I-2 CUM. BULL. 145 (1922).

¹⁹ The ruling also denied deductions for depreciation on the taxpayer's books and instruments used in his research work and for expenses incurred in traveling to meetings of scientific societies. The "personal" label was ascribed to all of the items, presumably because no income was traceable to them.

In 1921 the Commissioner had ruled that "amounts expended by a physician for railroad and pullman fares and hotel bills in attending a medical convention were not ordinary and necessary expenses incurred in the pursuit of his profession and did not constitute allowable deductions in his return." I.T. 1369, I-1 CUM. BULL. 123 (1921). At this point, at least, the employed and self-employed were treated alike.

²⁰ Marion D. Shutter, 2 B.T.A. 23 (1925).

²¹ In *Shutter*, *supra* note 20, the Board made no reference to either I.T. 1520, see text accompanying note 18 *supra*, or to I.T. 1369, I-1 CUM. BULL. 123 (1921), note 19 *supra*, nor did it address itself to the "ordinary and necessary" phrase. "Standing and position," resulting in a deduction in *Shutter* and their substantial equivalent resulting in disallowance in I.T. 1520, were years later to be viewed again as the damning indicators of a personal expenditure or perhaps a capital one. See note 30 *infra*.

²² 6 B.T.A. 1328, *acq.*, VI-2 CUM. BULL. 6 (1927). The decision is *contra* to I.T. 1520. See text accompanying note 18 *supra*. For revocation of I.T. 1520, see note 25 *infra*.

²³ *Alexander Silverman*, *supra* note 22, at 1328-29.

After a series of similar defeats,²⁴ the Commissioner revoked I.T. 1520 and ruled in G.C.M. 11654²⁵ that expenditures incurred in publishing research results were not "personal," and that the current deductibility of research expenditures depended "upon whether such expenses are ordinary and necessary or . . . capital expenditures."²⁶ He thus appeared to recognize that research expenditures incurred in the performance of one's work are business expenses (nonpersonal) although not traceable or directed to the realization of specific income; and he read the "ordinary and necessary" phrase as meaning only "noncapital."²⁷

B. Welch v. Helvering

If the Commissioner had followed the principles underlying G.C.M. 11654, the scope of future controversy would have been narrow indeed. In 1933, however, the year the G.C.M. was issued, the Supreme Court decided *Welch v. Helvering*,²⁸ holding with the Commissioner that payments made by a commission agent to the

²⁴ In Cecil M. Jack, 13 B.T.A. 726 (1928), *acq.*, VIII-1 CUM. BULL. 22 (1929), and J. Bentley Squier, 13 B.T.A. 1223 (1928), *acq.*, VIII-1 CUM. BULL. 43 (1929), the Board overturned the Commissioner's refusal to allow a physician the cost of attending medical meetings; in *Squier, supra*, where the taxpayer was both a professor and a practicing physician, the Board permitted a deduction for repairs to the portion of the taxpayer's residence used exclusively for professional purposes. *Cf.* note 76 *infra*. See also Robert C. Coffey, 21 B.T.A. 1242 (1931), *acq.*, X-2 CUM. BULL. 14 (1931) (physician's expenses in attending medical conventions to deliver paper deductible as "ordinary and necessary business expenses") where the Board relied on *Silverman, supra* note 22 (the employed chemistry professor), and *Jack, supra* (the self-employed physician).

²⁵ XII-1 CUM. BULL. 250 (1933). Revocation of I.T. 1520 was called for by G.C.M. 11654, and occurred in I.T. 2688, XII-1 CUM. BULL. 250 (1933). I.T. 1369, I-1 CUM. BULL. 123 (1921), note 19 *supra*, had been revoked by I.T. 2602, X-2 CUM. BULL. 130 (1931), ruling deductible the expenses of a member of an association of business concerns in sending a representative to attend the group's annual convention if the "sole purpose [was to further] . . . the business interest of such member." *Cf.* Rev. Rul. 59-316, 1959-2 CUM. BULL. 57; Rev. Rul. 63-266, 1963 INT. REV. BULL. No. 51, at 9 (current administrative position on deductibility of convention expenses of a "delegate").

²⁶ G.C.M. 11654, XII-1 CUM. BULL. 250 (1933). As to problems in the recovery of intangible capital costs, see note 17 *supra*; notes 43, 66, 92 *infra*.

²⁷ G.C.M. 11654, XII-1 CUM. BULL. 250 (1933), removes from the "personal" category where they had been placed by I.T. 1520, I-2 CUM. BULL. 145 (1922), (1) expenses of publishing research results, "such as plates and figures for illustrative purposes, (2) depreciation on books and instruments purchased for use in research work, and (3) expenses incurred when traveling [to] . . . meetings of scientific societies" G.C.M. 11654, XII-1 CUM. BULL. 250, 251 (1933). Items (2) and (3) were ruled "deductible from gross income"; item (1) "may or may not be deductible, depending upon whether such expenses are ordinary and necessary or constitute capital expenditures." *Ibid.* See also I.T. 3448, 1941-1 CUM. BULL. 206, ruling deductible (1) dues paid by teachers to their professional organizations, (2) subscription cost of educational journals connected with the profession, and (3) travel expenses (including meals and lodging) of attending teachers' conventions in this country; the cost of technical books was held to be capital and recoverable only through depreciation. As to capitalization under Rev. Rul. 63-275, 1963 INT. REV. BULL. No. 52, at 13, see note 9 *supra*.

²⁸ 290 U.S. 111 (1933).

creditors of his bankrupt corporation after discharge were not deductible.²⁹ Since the taxpayer had made the payments "to re-establish his relations with customers . . . and to solidify his credit and standing [they] were not . . . ordinary and necessary expenses, but were rather in the nature of capital expenditures, an outlay for the development of reputation and good will."³⁰ Speaking for a unanimous Court, Mr. Justice Cardozo did not dispute that the payments were "necessary for the development of the [taxpayer's] . . . business, at least in the sense that they were appropriate and helpful . . . ," but cautioned that "the problem is not solved when the payments are characterized as necessary. Many necessary payments are charges upon capital."³¹

For Justice Cardozo the word "ordinary" posed the question whether the expenditure was capital or current. Expenditures reasonably common to the operation of a business are, he said, "ordinary"; expenditures to acquire "the only tools with which to hew a pathway to success," like "reputation," "learning," and "goodwill," are "akin to capital assets," and the "money expended in acquiring them . . . is not an ordinary expense of the operation of a business."³²

Although the opinion in *Welch v. Helvering* struggles with the concept of "ordinary" as polar to "unique," noting that "there must always be a strain of constancy" with the "instance . . . not erratic, but . . . brought within a known type,"³³ the essence of the analysis is in its attempt to isolate the capital expenditure from the current. The customariness of an expenditure was viewed as an index of the "ordinary," but Justice Cardozo did not suggest that if an expense were not "ordinary," it was "personal."³⁴ The Commissioner and the Tax

²⁹ See also *Friedman v. Delaney*, 171 F.2d 269 (1st Cir. 1948), *cert. denied*, 336 U.S. 936 (1949) (lawyer's payment to creditors of bankrupt client disallowed).

³⁰ "Standing," treated as an element of a capital asset in *Welch v. Helvering*, 290 U.S. 111, 112-13 (1933), contributed to deductibility in *Marion D. Shutter*, 2 B.T.A. 23 (1925), but had been ruled "personal" in I.T. 1520, I-2 CUM. BULL. 145 (1922). See note 21 *supra*.

³¹ 290 U.S. at 113.

³² *Id.* at 115-16.

³³ *Id.* at 113-14.

³⁴ If expenses are incurred in a business context, the effect of a finding that they are not ordinary should be to treat them as capital. But if expenses are incurred in a not-so-clearly business context, with heavy overtones of consumption, the customariness of the expenses for others in carrying on their business activities may be a helpful criterion in deciding whether the expenses are "business" or "personal." Customariness thus becomes a factfinder's measure, helping to assay the taxpayer's credibility and the proof offered. In Justice Cardozo's view of "customary" as an index of the "ordinary," however, it is helpful if taken to mean ongoing or recurrent, but even then not as the *sine qua non* of the operating expense as opposed to the capital, since there may be one-shot, nonrecurrent expenditures which do not produce long-lived assets and should therefore be written off currently. Cf. *Deputy v. du Pont*, 308 U.S. 488 (1940).

Court, however, inferred other meaning from the opinion, and this was to become apparent in their treatment of educational expenses.

III. EDUCATIONAL EXPENSES

When the Commissioner revoked his early ruling that a college teacher's research expenses were "personal,"³⁵ he did not disturb O.D. 892, a 1921 ruling that expenses incurred by school teachers in attending summer school were not deductible because they were "in the nature of personal expenses incurred in advancing their education" ³⁶ This unreasoned ruling became the basis for three decades of an unbending administrative policy which disallowed all educational expenses, brooking no distinctions.

A. The Hill Case

In 1949 the Tax Court, in deciding *Nora Payne Hill*,³⁷ placed its imprimatur on O.D. 892. In that case a public school teacher was required by the State of Virginia, as a condition of maintaining her teaching certificate, either to pass an examination on selected books or to perform satisfactorily in a university summer school program. She chose the summer school alternative, and the Tax Court sustained the disallowance of her school expenses. Referring to O.D. 892 while paying lip service to *Welch v. Helvering*,³⁸ the court stressed that only "ordinary" expenses are deductible; that an expense is not ordinary unless it is of a "common" or "frequently occurring" type; and that it would not "assume that public school teachers *ordinarily* attend summer school to renew their certificates when alternative methods are available." ³⁹ Finding that the expenses were not "ordinary," the Tax Court called them "personal" despite Justice Cardozo's characterization of the nonordinary as capital.⁴⁰ If the Tax Court had disallowed the expense as capital, and not personal, the result for the taxpayer would have been the same, but education would have been recognized as at least sometimes having a business nexus. Such

³⁵ See note 25 *supra* and accompanying text.

³⁶ 4 CUM. BULL. 209 (1921). See also O.D. 984, 5 CUM. BULL. 171 (1921) (providing that "expenses incurred in taking postgraduate courses are deemed to be in the nature of personal expenses and not deductible").

³⁷ 13 T.C. 291 (1949).

³⁸ 290 U.S. 111 (1933). The Tax Court purported to rely also on *Deputy v. du Pont*, 308 U.S. 488, 494-96 (1940).

³⁹ 13 T.C. 291, 294 (1949).

⁴⁰ Earlier, in *T. F. Driscoll*, 4 B.T.A. 1008 (1926), the Board of Tax Appeals characterized expenses incurred for instruction in voice by one anticipating vocal engagements as "personal" and therefore nondeductible, but made no reference to O.D. 892, 4 CUM. BULL. 209 (1921). Cf. *Marshall*, 14 CCH Tax Ct. Mem. 955 (1955) (cost of piano lessons held "educational and personal" for a businessman).

recognition would have avoided language in the opinion on which the Tax Court and Commissioner seemed later to rely when noncapital research expenses, classified loosely as "education," were disallowed as personal. As it happened, the Tax Court's "personal" characterization for education in *Hill* survived even the reversal of that decision.

In reversing *Hill*⁴¹ the Fourth Circuit rejected the view that the expenses were "personal," that they were not incurred in connection with the taxpayer's business. Although the taxpayer had failed to prove that school teachers ordinarily go to summer school, a fatal failure before the Tax Court and Commissioner, the Fourth Circuit held that the state's inclusion of summer school attendance as an appropriate means of meeting its requirements provided adequate business nexus to justify the deduction. For this court, if a "particular course adopted by the taxpayer is a response that a reasonable person would normally and naturally make under the specific circumstances,"⁴² it is sufficient. But if education were undertaken to secure promotion or a new position, the expense might not be "ordinary"—it could be capital; the court therefore declined to state flatly that a teacher's summer school expenses are ipso facto deductible. But because in *Hill* the expense was incurred "in carrying on" the taxpayer's business, and not for the purpose of establishing a business or moving into a new position, the expenses were ordinary, not capital, and clearly not "personal."⁴³ And so for the first time an educational expense was held deductible.

⁴¹ *Hill v. Commissioner*, 181 F.2d 906 (4th Cir. 1950).

⁴² *Id.* at 908.

⁴³ For the Tax Court in *Hill*, "customariness" went to "ordinariness"; failing to find this, the court held the expense was not capital, but "personal." The business context was established for the Fourth Circuit by the state requirement. In light of that requirement, although summer school was stated as an alternative, it is doubtful that "customariness" could add anything of probative value, and clear that its absence should not be conclusive. See note 34 *supra*. See also *J. S. Watson*, 31 T.C. 1014 (1959).

On the heels of the Fourth Circuit's reversal in *Hill*, the Tax Court decided *Knut F. Larson*, 15 T.C. 956, 958 (1950), denying a deduction to an employed mechanic for the cost of evening engineering courses leading to a bachelor's degree in administrative engineering. The education resulted in employment as an industrial engineer and in higher pay. Citing O.D. 892, 4 CUM. BULL. 209 (1921), O.D. 984, 5 CUM. BULL. 171 (1921), *Welch v. Helvering*, 290 U.S. 111 (1933), *T. F. Driscoll*, 4 B.T.A. 1008 (1926), and *Hill*, the court declined to identify its basis for disallowance ("personal" or "capital") since "the result would be identical." *Knut F. Larson*, *supra* at 958. In *United States v. Patrick*, 372 U.S. 53 (1963), legal fees connected with a property settlement growing out of a divorce were disallowed as "personal," the court not reaching the Government's alternative contention that they were "capital" because "it makes no difference for present purposes whether they are personal expenses or capital expenditures; in either case they would not be deductible." *Id.* at 57; see *United States v. Gilmore*, 372 U.S. 39, 52 (1963); notes 16-17 *supra* and accompanying text; text accompanying note 40 *supra*; notes 66, 92 *infra*.

B. Post-Hill Administration

After the appellate decision in *Hill*, the Commissioner modified O.D. 892, agreeing in I.T. 4044⁴⁴ that

summer school expenses incurred by a teacher for the purpose of maintaining her position are deductible . . . as ordinary and necessary business expenses, but [asserting that] expenses incurred for the purpose of obtaining a teaching position, or qualifying for permanent status, a higher position, an advance in the salary schedule, or to fulfill the general cultural aspirations of the teacher, are . . . *personal* expenses⁴⁵

This ruling could have been the occasion for the Commissioner to distinguish the current business expense from the capital, and both of them from the personal, but he chose instead to lump the capital⁴⁶ indiscriminately with the personal⁴⁷ and to call them all "personal." Thus, a new groundwork of confusion was laid for more controversy and, indeed, injustice.⁴⁸

C. The Cardozo Case

Professor Manoel Cardozo had been on the faculty of the Catholic University of America for a number of years, first as assistant professor of history and romance languages and then as associate professor. During the summer of 1947 he went to Europe at his own expense for research and study. The Commissioner disallowed the trip expenses and the Tax Court sustained him shortly after I.T. 4044 was issued.⁴⁹ Paraphrasing the taxpayer's testimony, the court found that "the purpose of his trip was to increase his prestige, improve his reputation for scholarship and learning, and to better fit him to perform the duties for which he was employed and which he was performing at the university."⁵⁰ But since the court also found that the university had not required the professor to make

⁴⁴ 1951-1 CUM. BULL. 16.

⁴⁵ I.T. 4044, 1951-1 CUM. BULL. 16, 17. (Emphasis added.)

⁴⁶ *E.g.*, "obtaining a teaching position, or qualifying for permanent status" *Ibid.*

⁴⁷ *E.g.*, fulfilling "general cultural aspirations." *Ibid.*

⁴⁸ See Knut F. Larson, 15 T.C. 956 (1950), where the Tax Court said it was unimportant to distinguish between "capital" and "personal." See also text accompanying note 40 *supra*; notes 66, 92 *infra*.

⁴⁹ Manoel Cardozo, 17 T.C. 3 (1951).

⁵⁰ Manoel Cardozo, 17 T.C. 3, 6 (1951).

the trip, it held the trip was not "necessary," and disallowed the expenses as "personal."⁵¹

An examination of the sparse record in *Cardozo* leaves much to be desired. The precise relationship between the taxpayer's work and the trip is not made clear, and the court's opinion would be understandable if the disallowance had been sustained for that reason. It rests, however, on the absence of a strict, employer-created necessity to make the trip. Evidence that the university gave favorable consideration in its promotion policy to "publications [which] shall have made noteworthy contributions to the advancement of knowledge . . ." ⁵² was thought immaterial "to the necessity of [the] . . . trip in the taxable year, since it obviously deals with future promotion and advancement."⁵³

The court saw its support for a rule of strict, employer-created compulsion in *Hill*, both in its own decision and the Fourth Circuit's, reading that case to permit deductibility only where an expenditure was a prerequisite to the taxpayer's maintenance of his current position. It denied any inference from the appellate opinion which would allow a deduction for a *voluntary* expense, though incurred only to maintain position and not to advance.

If the court in *Cardozo* had bottomed its decision on the taxpayer's failure to prove a direct connection between his work and the trip, the case might have been forgotten. If the court had held that the expenditures were capital because the taxpayer was concerned primarily with advancement of position and promotion, the case would be seen only as an extreme application of the dictum of *Welch v. Helvering*.⁵⁴ The errors of significance in the case lay, however, in (1) the court's assumption that a decision as to educational expenses

⁵¹ *Ibid.* But cf. Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7, 10, allowing travel expenses of teacher on sabbatical where "travel had a direct relationship to the skills required in his teaching position and was expected to result in . . . benefit to him as a teacher holding such position," revoking Rev. Rul. 55-412, 1955-1 CUM. BULL. 318, and modifying I.T. 3380, 1940-1 CUM. BULL. 29.

⁵² Manoel Cardozo, 17 T.C. 3, 6 (1951).

⁵³ *Ibid.*

⁵⁴ 290 U.S. 111 (1933). In *James M. Osborn*, 3 T.C. 603 (1944), the expenses incurred by an unpaid research professor at Yale "for services incident to the preparation and publication of scholarly and literary matter" were disallowed because there was no expectation of profit from the publications and his objective was to gain from these the recognition which would help him secure a remunerative professional appointment or a position as a college president. Since he received no compensation for his work on the Yale faculty, the decision is justifiable on the ground that "the expenses . . . are in essence the cost of capital structure from which his future income is to be derived. They are not the ordinary and necessary expenses of carrying on a trade or business." *James M. Osborn*, *supra* at 605. Unlike Professors Cardozo and Davis, Osborn does not appear to have been in business, but was making an investment for future professional opportunity. See note 86 *infra*; cf. *Brooks v. Commissioner*, 274 F.2d 96 (9th Cir. 1959); *Cornelius Vanderbilt, Jr.*, 16 CCH Tax Ct. Mem. 1081 (1957).

(*Hill*) necessarily governed expenses related, at least in part, to research which was a part of the taxpayer's ongoing work as a professor;⁵⁵ (2) the derivation from *Hill* of a rule of strict necessity, and this despite the fact that *Hill* relied on *Welch v. Helvering* in which Justice Cardozo noted that generally an expense was "necessary" if in the taxpayer's judgment it was helpful to the performance of his work;⁵⁶ and (3) the conclusion that a voluntary expense was "personal" if concerned with advancement, professional prestige, and reputation.⁵⁷

D. Post-Cardozo Administration

The Commissioner followed I.T. 4044, *Hill*, and *Cardozo* with a narrow and rigid audit policy. Unless a teacher (or other employed individual) could prove that an educational expense had been incurred under employer compulsion, it was not "necessary," was incurred for enhancement (professional or cultural), and was disallowed as "personal." The patent discrimination between the self-employed and the employed was ignored. Although a self-employed individual was ordinarily trusted to judge what was helpful and appropriate to his business, and his discretionary, business-related expenses were deductible, the only safeguard deemed sufficient to the protection of the public fisc in the case of an employed person was the compelling mandate of his employer.⁵⁸ This view was to last even longer in practice than it did as avowed government policy.⁵⁹

⁵⁵ It would seem that if research is to be broadly categorized as "education," it is at least relevant to ask *whose* education. If the research is to educate the taxpayer, problems of capitalization and, perhaps, of the personal expense are present; but if it is to educate others, the professor, as in *Davis* (and perhaps in *Cardozo*), is just doing his job. See notes 62-63 *infra* and accompanying text.

⁵⁶ In 1921 the Commissioner presumed, through the application of a rule of strict necessity, to judge whether an ambassador's entertainment activity was "necessary" to his work. Because Congress does "not require it as one of the duties of the position [his] . . . expenditures are personal . . . and not business . . ." O.D. 1020, 5 CUM. BULL. 172 (1921). The principle and reasoning underlying Rev. Rul. 63-275, 1963 INT. REV. BULL. No. 52, at 13, justify revocation of O.D. 1020, if it has not passed into oblivion as a result of its own weightlessness.

⁵⁷ *Welch v. Helvering*, 290 U.S. 111 (1933), viewed these as elements of a capital expenditure, as did James M. Osborn, 3 T.C. 603 (1944), note 54 *supra*. See note 30 *supra*.

⁵⁸ The case frequently cited to indicate the liberality afforded corporations in the deductibility of their executives' expenses is *Sanitary Farms Dairy, Inc.*, 25 T.C. 463 (1955), *acq.*, 1956-2 CUM. BULL. 8 (expenses of sending officers on African game hunt deductible). The self-employed lawyer may deduct the cost of keeping current on developments in the tax field, *Coughlin v. Commissioner*, 203 F.2d 307 (2d Cir. 1953), *reversing* 18 T.C. 528 (1952), he alone judging necessity.

For some of the history of the post-*Hill-Cardozo*-I.T. 4044 period, see Loring, *supra* note 11, at 153-57; Maguire, *Individual Federal Income Tax in 1950*, 35 AMERICAN A. UNIVERSITY PROFESSORS BULL. 748 (1953); 44 A.B.A.J. 1097 (1958); 58 COLUM. L. REV. 1097 (1958).

⁵⁹ See Loring, *IRS Denying Educational Expense That Would Be Ordinary and Necessary for Business*, 9 J. TAXATION 280 (1958).

IV. THE 1958 REGULATIONS

In 1958 the Treasury promulgated regulations codifying the rule of the *Alexander Silverman* case,⁶⁰ holding that convention travel expenses are deductible if reasonably related to a taxpayer's business, and concluding that,

No distinction will be made between self-employed persons and employees. . . . The allowance of deductions for such expenses will depend upon whether there is a sufficient relationship between the taxpayer's trade or business and his attendance at the convention or other meeting so that he is benefiting or advancing the interests of his trade or business⁶¹

At the same time, regulations⁶² were issued to lift the rule of strict necessity in the case of educational expenses. Expenditures "for education (including research activities)" were said to be deductible if undertaken either for "maintaining or improving skills" which the taxpayer requires "in his employment or other trade or business" or for meeting a requirement of his employer. And educational expenses are of the "maintaining or improving skills" variety where "it is customary for other established members of the taxpayer's trade or business to undertake such education" ⁶³

The educational expense regulations were followed with Revenue Ruling 60-97⁶⁴ in which the Commissioner sought to explain their

⁶⁰ *Alexander Silverman*, 6 B.T.A. 1328 (1927).

⁶¹ Treas. Reg. § 1.162-2(d) (1958). (Emphasis added.)

⁶² Treas. Reg. § 1.162-5 (1958).

⁶³ The regulations under the 1939 Code, Treas. Reg. 118, § 39.23(a)-15(f) (1953), listed "expenses of taking special courses or training" among its nondeductible items. As originally proposed in 1956, the 1954 Code Regulations would have permitted an employed individual a deduction for educational expense only if his employer required him to undertake the study. Proposed Treas. Reg. § 1.162-5(d), 21 Fed. Reg. 5093 (1956). The less restrictive approach of the final version is believed to have resulted largely from pressures brought by educational interests and the United States Department of Health, Education, and Welfare.

Although the regulations under § 212 (nonbusiness expenses for income production) make general reference to the regulations under § 162 (presumably intending § 1.162-5), they continue to disallow "expenses of taking special courses of training" and "expenses paid or incurred in securing admission to the bar, and corresponding fees and expenses paid or incurred by physicians, dentists, accountants, and other taxpayers for securing the right to practice their respective professions." Treas. Reg. § 1.212-1(f) (1957).

Treas. Reg. § 1.162-5 was adopted on April 3, 1958. To permit a taxpayer to take advantage of the provisions as far back as 1954 for which the statute of limitations would ordinarily bar refund claims after April 15, 1958, Congress enacted special legislation permitting such claims to be filed up to November 3, 1958. Technical Amendment Act § 96, 72 Stat. 1672 (1958), 26 U.S.C. § 6511, note at 4820 (1958). See *Devereaux v. Commissioner*, 292 F.2d 637, 639 (3d Cir. 1961).

The regulation's parenthetical inclusion of "research activities" under "education" fails to make relevant and significant distinctions. See note 55 *supra*.

⁶⁴ 1960-1 CUM. BULL. 69.

impact, particularly on the teaching profession. He stated explicitly that no distinction would be drawn between an employed person and one self-employed. The view that deductibility is dependent upon employer-compulsion was eliminated.⁶⁵ Customariness, not legal obligation, was made the test.⁶⁶

Revenue Ruling 60-97 and the regulations, both as to travel and educational expenses, are interpretive of section 162(a), establishing criteria for the "ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business" They pin deductibility on the relationship of the expense item to the taxpayer's business—its appropriateness and helpfulness^{66a}—and on its customariness. Absence of the business relationship would seem to connote a personal expense; given the business nexus, however, the absence of customari-

⁶⁵ The elimination of any distinction between the employed and self-employed is stated as to travel expenses in Treas. Reg. § 1.162-2(d) (1958). See text accompanying note 61 *supra*. Rev. Rul. 60-97, 1960-1 CUM. BULL. 69, emphasized that Treas. Reg. § 1.162-5 (1958), has the same effect as to educational costs. See also speech by Virginia Wraase, Tax Rulings Division, Internal Revenue Service, National Education Association Convention, July 2, 1958.

⁶⁶ The weight placed upon customariness has been questioned previously. See notes 34, 43 *supra*. In *J. S. Watson*, 31 T.C. 1014 (1959), *nonacq.*, 1963-1 CUM. BULL. 5, an internist practicing "psychosomatic medicine" was allowed the expenses incurred in undergoing psychoanalysis against the objection that it was not customary and so not ordinary for a physician to take the training (education) provided by psychoanalysis. The court said the absence of customariness was not fatal since the taxpayer's purpose was to maintain or improve his skills, and this, not whether others did so, was controlling. Although the Commissioner relied for his position on Treas. Reg. § 1.162-5(a) (1) (1958), the court found support for the taxpayer in example 2 of Treas. Reg. § 1.162-5(e) (1958).

Psychiatrists have been denied deductions under the 1958 regulations for the costs of their psychoanalysis and tuition at a psychoanalytic institute where the purpose was to enable them to qualify as psychoanalysts. *Namrow v. Commissioner*, 288 F.2d 648 (4th Cir. 1961), *cert. denied*, 368 U.S. 914 (1961); *Grant Gilmore*, 38 T.C. 765 (1962). In both *Namrow* and *Gilmore* the "educational" expenses were regarded presumably as capital because undertaken "to meet the minimum requirements for qualification [in a] . . . specialty" Treas. Reg. § 1.162-5(b) (1958). But the regulations continue to fudge the ground for disallowance, lumping minimum requirements with "other personal purposes of the taxpayer." Until there is sharper demarcation and some basis provided for recovery of such substantial intangible capital costs as were involved in *Namrow* and *Gilmore*, injustice will persist and litigation will continue. See notes 16-17 *supra* and accompanying text; notes 43 *supra*, 92 *infra*.

The expenses of securing a legal education have been held deductible where helpful in taxpayer's current occupation as an accountant, *Walter T. Charlton*, 23 CCH Tax Ct. Mem. 420 (1964), but not where the objective was to gain livelihood as a lawyer, *Sandt v. Commissioner*, 303 F.2d 111 (3d Cir. 1962). The number of cases involving the deductibility of the expenses of a legal education are growing and they divide on a *Watson-Namrow* factual line, providing either full current deductibility or none. Compare *United States v. Welsh*, 329 F.2d 145 (6th Cir. 1964) (costs allowed), with *Condit v. Commissioner*, 329 F.2d 153 (6th Cir. 1964) (costs disallowed). The courts have divided on a somewhat similar line where the costs were incurred to secure nonlegal graduate degrees. Compare *Devereaux v. Commissioner*, 292 F.2d 637 (3d Cir. 1961), and *Marlor v. Commissioner*, 251 F.2d 615 (2d Cir. 1958) (costs allowed), with *Albert R. Killips*, 22 CCH Tax Ct. Mem. 845 (1963) (costs disallowed).

^{66a} The "regulations in effect recognize the principle that the term 'necessary' as used in section 162 is broad enough to cover expenditures voluntarily made which are 'appropriate and helpful.'" *Cosimo A. Carlucci*, 37 T.C. 695, 699 (1962). See Rev. Rul. 60-97, 1960-1 CUM. BULL. 69, 70.

ness or an employer-requirement would appear to denote a capital expenditure, but the employer-requirement is an alternative test only. Although research activities should have been treated separately, with recognition of the fact that research may be either part of one's educational program or a function of one's job, they were not.⁶⁷ Nevertheless, the regulations and Revenue Ruling 60-97 could have led to an intelligent administration of the law, free of discrimination against the employed individual. But they did not.⁶⁸

V. THE DAVIS CASE

In *Davis*⁶⁹ the Tax Court ignored the 1958 Regulations and Revenue Ruling 60-97. Disallowance was sustained because the professor's expenses were not "necessary." The evidence showed that Professor Davis had academic tenure, a status which made dismissal or salary reduction permissible only for "adequate cause"; failure to engage in research would not constitute such cause. Pomona College required neither that Davis engage in his research project nor that he complete it once begun. The evidence did indicate, however, that research and publication were expected generally of the Pomona faculty and that members of the faculty customarily engaged in research. But the conferring of tenure and the absence of an enforceable obligation to do research were enough for the Tax Court to hold that since the research was voluntary, not "necessary" to his continued employment, the expenses were nondeductible. Then, emphasizing testimony to the taxpayer's presumed detriment that his research might increase his prestige as a scholar, the court cited *Welch v. Helvering* and relied on the *Cardozo* case to bring its decision under the generalization that "expenditures made to acquire reputation and learning are not ordinary and necessary business expenses."⁷⁰

The dissenting opinion⁷¹ of Judge Raum struck hard at the majority's failure to isolate the issues. For the dissent, the first issue

⁶⁷ See note 55 *supra*; notes 62-63 *supra* and accompanying text.

⁶⁸ See Loring, *supra* note 59.

⁶⁹ Harold H. Davis, 38 T.C. 175 (1962).

⁷⁰ *Id.* at 179. The court said its finding that the taxpayer's purpose was to "increase his prestige as a scholar" made it unnecessary to decide whether the cost was deductible as an educational expense. *Ibid.* The voluntariness of the taxpayer's conduct showed that the trip and research were not "necessary" and therefore "personal."

The heavy precedential weight placed on *Manoel Cardozo*, 17 T.C. 3 (1951), is strange. The controversy in that case involved only \$229.03; the taxpayer was not represented by counsel; the record is sparse; prestige and reputation as the taxpayer's motive were suggested and accepted in cross-examination without the explanation which would have been forthcoming on redirect if taxpayer had had counsel. Government counsel in *Cardozo* was William M. Fay, who, as Judge of the Tax Court, wrote for the majority in *Davis*. The *Davis* case was decided by a court split 8 to 6; Judge Raum, who wrote the dissent, and not Judge Fay, was the hearing judge.

⁷¹ 38 T.C. at 180.

was whether Davis's expenditures were incurred in carrying on his trade or business, and Judge Raum both accepted and explained the fact that research is of the essence of a professor's business. He resolved the second question, whether the expenditures were "necessary," by finding them helpful and bearing a direct relationship to the job to be done. Except in the *Cardozo* case, he noted, compulsion had never been the test, and he rejected it in *Davis* as unreasonable, discriminatory vis-à-vis the self-employed, and contrary to precedent.⁷²

A. Revenue Ruling 63-275

In my not-wholly-detached view⁷³ the Commissioner and the Department of Justice demonstrated a commendable concern for sound tax policy and even-handed administration when they surrendered their Tax Court victory in *Davis* and issued Revenue Ruling 63-275.⁷⁴ This ruling returns to the principles of G.C.M. 11654⁷⁵ and *Welch v. Helvering*.⁷⁶

Like the dissent in *Davis*, the ruling acknowledges the relationship of the expenditure to the taxpayer's business to be the point of first inquiry. If the relationship is direct, and if the expense is incurred to help the taxpayer carry out his work, it is recognized as a business expense, and not a personal one.

B. The Business of a Professor

The underlying question is the nature of the taxpayer's business, and in the case of a professor it is seen to be twofold: to teach and to

⁷² *Id.* at 185-86. Judge Raum referred to *Blackmer v. Commissioner*, 70 F.2d 255 (2d Cir. 1934), for authoritative and longstanding acceptance of the fact that "necessary" meant "appropriate" or "helpful" and not "indispensable" or "required"; he pointed to *Waring Prods. Corp.*, 27 T.C. 921, 929 (1957), and *Commissioner v. Pacific Mills*, 207 F.2d 177, 180-81 (1st Cir. 1953), for express rejection of a concept of strict legal necessity. To him, the Tax Court's decision in *Alexander Silverman*, 6 B.T.A. 1328, *acq.*, VI-2 CUM. BULL. 6 (1927), should have controlled *Davis*.

⁷³ My objectivity should be tested against my potential economic interest (I am in the business) and my service as special counsel for the American Association of University Professors in the *Davis* appeal and the negotiations which led to the issuance of Rev. Rul. 63-275, 1963 INT. REV. BULL. No. 52, at 13. See Oliver, *supra* note 7, at 15 n.6. Professors Ernest J. Brown and Clark Byse of the Harvard Law School were with me on the association's amicus curiae brief to the Ninth Circuit.

⁷⁴ Note 8 *supra*.

⁷⁵ Note 25 *supra*.

⁷⁶ 290 U.S. 111 (1933).

A subsidiary issue in *Harold H. Davis*, 38 T.C. 175 (1962), *remanded*, No. 18188, 9th Cir., Jan. 3, 1964, involved the deductibility of \$290 a year for depreciation (§ 167(a)) and the costs of use and upkeep (§ 162(a)) of a home study built and used by Davis exclusively for preparation of his lectures, grading papers, storing materials, student conferences and research. The Tax Court denied the deductions because Pomona had provided Davis with a "cubicle" on campus and did not require him to provide his own facilities. Seeing the home study only as a matter of "personal

advance knowledge. Each of these may involve research. Since research in his field of competence is therefore part of a professor's work, expenses incurred to facilitate that research are business expenses. "Employer-requirement" for a particular research project is not part of the test. Implicit in Revenue Ruling 63-275 is an understanding of some of the realities of the academic environment out of which the research expense and the tax question grow, and those "realities" need to be stated.

Specific requirements by the professor's employer as to how or when or where to go about the job of advancing knowledge, the aspect of his function in which research plays its major role, are likely to be self-defeating. The best research and writing are the result of individual initiative, inner spark, and personal drive to contribute and achieve recognition. If a professor fails to move in the direction his interests indicate, if he fails to pursue his ideas to the point of truth, he has failed in his job.

The university's appointment of a professor is an expression of confidence and expectation that he will direct his capacities, his energies, and his judgment and discretion to achieving excellence in the performance of his work. In many instances the exercise of discretion may dictate a research expenditure.

convenience," the costs were not "necessary." 38 T.C. at 179-80. The dissent would have allowed them on the same theory that it would have permitted the travel, *i.e.*, the study was "helpful" to Davis in his work and "appropriate" to its performance. The "convenience" it provided was not, to Judge Raum and his dissenting colleagues, "inconsistent with its proximate relationship to his work." 38 T.C. at 186-88.

Although this "home study" issue is not mentioned in Rev. Rul. 63-275, 1963 INT. REV. BULL. No. 52, at 13, the principle underlying the ruling controls it, and it, too, was conceded by the Government in the *Davis* appeal. See Oliver, *supra* note 7, at 16-17. The Tax Court has itself held *contra* to *Davis* on this issue (without citing *Davis*) in Clarence Peiss, 40 T.C. 78 (1963), in an opinion by Judge Mulroney (his position, if any, in *Davis* is unknown), to be compared with his earlier opinion in Morris S. Schwartz, 20 CCH Tax Ct. Mem. 725 (1961).

Rev. Rul. 62-180, 1962-2 CUM. BULL. 52, purports "to furnish guidelines for determining the amount of the deduction to which an individual is entitled for the ordinary and necessary expenses attributable to the portion of his personal residence which he uses in the performance of his duties as an employee." It is less than clear in its concept of "duties as an employee." It may be read restrictively to permit a deduction only where the employer requires the employee to use his own facilities, a position *contra* to Peiss, the dissent in *Davis*, and the principle underlying Rev. Rul. 63-275, or it may be read consistently with these authorities to allow the deduction where the facility has a reasonable relationship to the employee's work and the requirements of the work, as determined reasonably by the employee, call for the facility. Cf. INTERNAL REVENUE SERVICE, U.S. TREASURY DEPT., DOC. No. 5014, EMPLOYEES' EXPENSES—EDUCATIONAL EXPENSES 2-3 (Dec. 1963). See also Rev. Rul. 60-97, 1960-1 CUM. BULL. 69. Rev. Rul. 62-180 should be clarified with an unequivocal statement in bar of any inference that the "employer-requirement" test persists. See note 96 *infra*. Whatever evidentiary safeguards may be necessary should be enunciated to restrict the potential for abuse and deception present whenever a business facility is carved out of or tacked onto a personal residence. See note 78 *infra*. For the self-employed's recognized right to recover costs in connection with a home study, see, *e.g.*, Beaudry v. Commissioner, 150 F.2d 20 (2d Cir. 1945).

C. Factfinding

It is often difficult to isolate the expenditure for consumption—for pleasure or social diversion—from the business expense, especially when it involves travel to lands which beckon the vacationer and researcher alike.⁷⁷ Indeed, in many cases the purpose of the expenditure may be mixed. But factfinding and linedrawing are required in the case of the entrepreneur, and they are no more difficult in the case of the employed individual.⁷⁸ The merit in the “employer-requirement” test was the relief it might provide from the unsure task of linedrawing in a substantial number of cases. But the discrimination vis-à-vis the self-employed that is inherent in such a test would be rank in the case of a professor whose work requires that there be no “employer-requirement,” and it is not justified by the lighter burden it would provide for court and Commissioner.⁷⁹

D. Academic Tenure

Revenue Ruling 63-275 not only rejects “employer-requirement” as the necessary condition of deductibility, but neutralizes the effect

⁷⁷ See, e.g., *Dennehy v. Commissioner*, 309 F.2d 149 (6th Cir. 1962), where a mathematics professor appears to have gone on a personal jaunt, and the court properly disallowed the expenses of the trip to which he had urged a teaching relationship. Cf. *Cross v. United States*, 63-2 U.S. Tax Cases ¶ 9762 (S.D.N.Y. 1963), *appeal filed*, 7 CCH 1964 STAND. FED. TAX. REP. (U.S. Tax Cas.) 70753 (2d Cir. 1964) (an assistant professor of romance languages was allowed costs of a European trip which he thought necessary to maintain and improve skills in his field); Rev. Rul. 64-176, 1964 INT. REV. BULL. No. 23, at 7; Note 88 *infra*.

⁷⁸ Since enactment of the Revenue Act of 1962, the deduction for meals and lodging away from home has been limited to amounts not “lavish or extravagant under the circumstances.” Section 162(a)(2). The “abuse” cases which led to this provision were among the self-employed and the corporate expense-account jockeys, not the professor or the lower-level corporate employee spending his own money. Strict accounting for expenses is called for by § 274(d), and rules for allocating travel expense between the personal and the business portion of a trip are set forth in § 274(c), both added by the Revenue Act of 1962, with § 274(c) liberalized by § 217(a) of the Revenue Act of 1964.

⁷⁹ As Mr. Justice Holmes said in a discussion of “line-drawing” in another context, “the constant business of the law is to draw such lines.” *Dominion Hotel, Inc. v. Arizona*, 249 U.S. 265, 269 (1919). And this is not to suggest drawing lines “simply for the sake of drawing lines.” *Pearce v. Commissioner*, 315 U.S. 543, 558 (1942) (Frankfurter, J., dissenting).

A professor is an “employee” in form only. As Judge Charles E. Wyzanski stated to his board while President of the Board of Overseers of Harvard University:

A University is the historical consequence of the mediaeval studium generale—a self-generated guild of students or of masters accepting as grounds for entrance and dismissal only criteria relevant to the performance of scholarly duties. The men who become full members of the faculty are not in substance our employees. They are not our agents. They are not our representatives. They are a fellowship of independent scholars answerable to us only for academic integrity.

Wyzanski, *Sentinels and Stewards*, HARVARD ALUMNI BULL. 316 (Jan. 23, 1954). See also SNOW, *THE MASTERS* 371-87 (1951) (App.: Reflections on the College Past).

In a community of scholars which operated without a university corporate-employer superstructure, professors might not be “employees”; they are in our society, however, because it is most convenient and workable. Would it not then be ironic if the evolution of a form found conducive to a professor’s performance should result in the disallowance as “personal” of expenses brought on by his work?

of academic tenure.⁸⁰ Tenure had provided the Tax Court majority in *Davis* with its affirmative basis for concluding that the professor's research expenses were "personal." It regarded tenure as inconsistent with an obligation to do research, and for an employed individual only obligatory expenses were "necessary."

Under the ruling, a professor "with or without tenure" may deduct the expenses he incurs in areas of his professional competence. This recognizes that tenure is not a license for indolence and leisure as the *Davis* opinion implies.⁸¹ It is rather an institution developed to enable those who have demonstrated their responsibility and competence to carry on their work and perhaps achieve new levels of performance, enhanced by a freedom of spirit that results from the knowledge that their status and economic security will not be terminated on arbitrary or discriminatory grounds.⁸²

The principal justification for academic tenure is that it enables a faculty member to teach, study, and act free from a large number of restraints and pressures which otherwise would inhibit independent thought and action.

. . . . This deserves emphasis: Academic freedom and tenure do not exist because of a peculiar solicitude for the human beings who staff our academic institutions. They exist, instead, in order that society may have the benefit of honest judgment and independent criticism which otherwise might be withheld because of fear of offending a dominant social group or transient social attitude.⁸³

⁸⁰ See note 9 *supra*.

The most generally accepted and widely adopted statement of principles of an academic tenure is that adopted by the American Association of University Professors and the Association of American Colleges in 1940 (the "1940 Statement of Principles"). 49 AMERICAN A. UNIVERSITY PROFESSORS BULL. 192-93 (1963).

⁸¹ Professor Boris I. Bittker states that *Davis* was decided on the "theory that a professor with lifetime tenure has it made and can relax." BITTKER, FEDERAL INCOME ESTATE AND GIFT TAXATION (2d ed. Supp. 1963, at 52).

⁸² As the testimony in the *Davis* case put it, the conferring of tenure is an "act of faith." Record, p. 68, *Davis v. Commissioner*, No. 18188, 9th Cir., Jan. 3, 1964. In this singular act the university recognizes responsibility and declares its continued expectation of performance.

⁸³ BYSE & JOUGHIN, TENURE IN AMERICAN HIGHER EDUCATION: PLANS, PRACTICES AND THE LAW 2, 4 (1959). The purpose and function of tenure has also been stated succinctly in REPORT OF THE SPECIAL COMMITTEE ON LAW SCHOOL ADMINISTRATION AND UNIVERSITY RELATIONS OF THE ASSOCIATION OF AMERICAN LAW SCHOOLS, ANATOMY OF MODERN LEGAL EDUCATION 205-06 (1961):

Unless a school of higher learning can assure its faculty members a free and independent environment in which to carry on their work, it cannot satisfactorily perform its function in society as purveyor of existing knowledge, critic of our current institutions, *seeker of new truths*, and leader in the search for social progress. The existence of such an environment depends in the first instance upon adequate procedures for tenure and termination.

(Emphasis added.)

According to the 1940 Statement of Principles, *supra* note 80, once tenure is attained, dismissal or reduction in salary is permissible only for "adequate cause."

Tenure then is the technique of the academic world for creating and safeguarding an environment most congenial to research and teaching. The Commissioner's abandonment of the Tax Court's view that tenure negates the business nexus for a professor's research expenses dispels the paradox which is inherent in that view.

VI. IN FUTURO

A. *The System*

One could devise a net income tax system which allowed only those expenses incurred specifically to generate income or, more pristinely, only those traceable to income thereby generated. But that is not our system. It is too rigid and could unwisely counter prideful impulses for innovation and experiment.

Our system allows expenses incurred in carrying on one's business. The expenses and income of taxpayers will differ as will the measure and method of their performance, although the degree of difference is not likely to vary proportionately. In some areas of endeavor like university teaching and research, income tends to be relatively stable and predetermined, based on prior performance and future expectation. A professor working within such an institutional pattern ought not be ruled maverick, beyond the pale of the net income system, when his measure of performance demands excellence and his method, though self-determined, requires expenditure. To disallow his research expense is to classify it "consumption." Our tax system does not call for this result; a reasonably enlightened social and educational policy condemns it.

B. *The "Business" of a Taxpayer*

With Revenue Ruling 63-275 on the books, one hopes I have been beating a dead horse. History indicates, however, that this horse has a marked feline bent for resurrection. Several days after the ruling was published (and presumably without knowledge of it) the Tax Court decided *Corliss Lamont*,⁸⁴ disallowing expenses incurred by a freewheeling "author, writer, teacher, and lecturer." The ground of decision was the avocational nature of the taxpayer's activities, not

"[T]he essential characteristic of tenure . . . is continuity of service, in that the institution in which the teacher serves has in some manner—either as a legal obligation or as a moral commitment—relinquished the freedom or power it otherwise would possess to terminate the teacher's services." BYSE & JOUGHIN, *op. cit. supra* at 2. "Adequate cause" usually includes professional incompetence and immorality. *Id.* at 45-46, 69.

⁸⁴ 23 CCH Tax Ct. Mem. 3 (1964), *appeal filed*, 7 CCH 1964 STAND. FED. TAX REP. (U.S. Tax Cas.) 70725 (2d Cir. 1964).

the absence of "necessity" as in *Davis*. Although it appears that the bulk of Lamont's time was spent in writing and lecturing, with some part-time teaching at universities, his investments and not these activities were his source of income. On the record, therefore, the court may well have been justified in finding that the taxpayer's expenses, which he deducted from his very substantial investment income, were not incurred in carrying on a business.⁸⁵ Because the taxpayer's teaching, lecturing, and writing activities were not "engendered by the motive or intent of realizing profits," his activities did not constitute a business, and therefore the expenses of those activities were not deductible.

The language of the *Lamont* opinion is careful, but a wary vigilance will be needed to avoid its leading to less care.⁸⁶ The expenses were not disallowed merely because they were not incurred to make money, but because they were not incurred in the taxpayer's business. The holding and court's reasoning, therefore, should not result in disallowance in the case of one who is in the business of researching or writing (be he professor or free lance) because the particular expenses are not traceable to additional income or because they are unnecessary in the sense that they were not compelled.

In maintaining an administrable line between Professor Davis and Mr. Lamont, as I propose, the Commissioner and the courts must inquire as to the nature of the work in which the taxpayer earns his income—his "business." They must learn not only the minimum requirements for receipt of the income, but the function which the taxpayer is expected to perform. In the case of a professor the academic community expects research; the broader community depends upon it. If the taxpayer is "in business," he is on the *Davis*, and not the *Lamont*, side of the line.

C. The Necessary Expense

When the scope and function of the taxpayer's business are understood, a second inquiry must be made, one to determine whether the

⁸⁵ Nor were they incurred in a nonbusiness, but nevertheless income-producing, activity which would have justified a deduction under § 212(1). Expenses allocable to occasional honoraria or lecture fees would be deductible under § 212(1).

⁸⁶ I assume that the court in *Lamont* did not mean that a taxpayer's activities are not "business" activities whenever motivated in part by the "personal satisfaction of obtaining and holding the respect of others recognized as qualified in those fields," 23 CCH Tax Ct. Mem. at 7, but that a "business" also "necessitates a substantial profit motivation on the part of the person who is conducting an activity." *Ibid.* See *Doggett v. Burnet*, 65 F.2d 191 (D.C. Cir. 1933). The counterinference would restore shades of Manoel Cardozo, 17 T.C. 3 (1951), and the undue emphasis it placed on prestige and reputation as evidence of "personal" activity. Cf. *Brooks v. Commissioner*, 274 F.2d 96 (9th Cir. 1959); *Cornelius Vanderbilt, Jr.*, 16 CCH Tax Ct. Mem. 1081 (1957); *James M. Osborn*, 3 T.C. 603 (1944) (where expenses of one's seeking to create a reputation to break into teaching were held capital).

taxpayer incurred the expense at issue in furtherance of his business. The answer depends upon whether the expense bore a direct relationship to the execution of the taxpayer's business task, self-assigned or not, and whether it was thought helpful and appropriate to that end. An affirmative conclusion should satisfy the statutory test for the "necessary" expense.⁸⁷ However, an activity very slightly related to the taxpayer's work and having the attributes of consumption, though not wholly devoid of business context, may be nondeductible as not "necessary." This result is anticipated only where, despite a sufficient business nexus to prevent characterization of the expense as entirely "personal," (1) the evidence does not provide a rational or workable basis for allocating the expense between its personal and business aspects, and (2) it adds little to the taxpayer's ability to perform.⁸⁸

D. The "Ordinary" Expense

If the results of both inquiries indicate the expenditure was business-related, not part of a hobby or personal lark, a third inquiry is called for, one which will distinguish the expense incurred in "carrying on" a business from the capital investment. It will distinguish the research expenses of a practicing professor from those of a hopeful who seeks to enter the ranks but has not yet done so.⁸⁹ In a word it

⁸⁷ The administrative and judicial attempt to disallow illegal expenses and those which are against public policy, a venture of doubtful merit at best, demonstrates an inherent weakness when it pins disallowance on the theory that such expenses are not "necessary." See Note, *Business Expenses, Disallowance, and Public Policy: Some Problems of Sanctioning With the Internal Revenue Code*, 72 YALE L.J. 108 (1962); But cf. *United Draperies, Inc.*, 41 T.C. 457 (1964) (taxpayer's rebates to customer's employees not deductible; Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142, 1145 (1943). And surely the disallowance of a rental deduction in a sale and lease-back transaction between taxpayer and himself, as trustee for his children, does not hinge on a conclusion that the rent was not "necessary" if the transaction is "in reality a camouflaged assignment of income." *I. L. Van Zandt*, 40 T.C. 824, 830 (1963). See note 97 *infra*.

⁸⁸ Where possible, an allocation should be made.

An individual is . . . regarded for tax purposes as having two personalities: one is a seeker after profit who can deduct the expenses incurred in that search; the other is a creature satisfying his needs as a human and those of his family but who cannot deduct such consumption and related expenditures. But since the individual remains one individual, where is that dividing line? Moreover, is it an absolute line in the sense that an expenditure belongs entirely to one or the other of the personalities, or may an expenditure be allocated between them?

SURREY & WARREN, *FEDERAL INCOME TAXATION—CASES AND MATERIALS* 272 (1960).

For evidentiary safeguards where allocation is appropriate, see note 78 *supra*.

⁸⁹ See note 54 *supra*. Compare *Leonard A. Peto*, 17 CCH Tax Ct. Mem. 139, *aff'd per curiam*, 262 F.2d 342 (2d Cir. 1958) (deduction of expenditures to gain employment through promotion of business ventures denied), with *Paul H. Pazery*, 22 CCH Tax Ct. Mem. 1814 (1963) (expenses of trip to Europe in connection with proposed but never consummated transaction deductible). In *Kaufman v. United States*, 64-1 U.S. Tax Cas. ¶9397 (E.D. Pa. 1964), the costs incurred by a disbarred

determines whether the expense is "ordinary." This determination must be made because the statute requires that the operating expense be distinguished from the capital. However, the history of the confusion of which this is the tale makes clear that the statutory test of the "ordinary" is helpful and meaningful only when limited to drawing that distinction.⁹⁰ This essentially is the teaching of *Welch v. Helvering*: that "ordinary" is the obverse of capital, not personal.

In the case of a professor, academic research is part of his business. His research expenses are "ordinary" when, as in the usual case, they are not directed to the production of a specific, income-producing asset. Only research directed to the creation of a commercially marketable book or a saleable product or process requires capitalization of the expenses, these to be recovered over the period of income production.⁹¹

Although today disallowance is the probable consequence for both the personal expense and the outlay producing an intangible capital asset of "indeterminable" useful life (such as most professional education), it is imperative to differentiate between them. The distinction should help avoid the compounding of error which led to *Davis*, and someday the cost of an intangible capital asset such as business-related education may be recoverable.⁹²

VII. CONCLUSION

The Tax Court and Commissioner have not been analytical in their gross conception and tax treatment of education. They have too rarely differentiated between the capital educational expenditure and the personal. They have been unmindful of Justice Cardozo's analysis in *Welch v. Helvering* which suggested that some types of education may be business-related, and that when the purpose of such education is to get started in business, the cost must be capitalized. In disallowing

lawyer in securing his reinstatement were held nondeductible, relying on *McDonald v. Commissioner*, 323 U.S. 57 (1944), *Shoyer v. United States*, 290 F.2d 817 (3d Cir. 1961), and *Henry G. Owen*, 23 T.C. 377 (1954), for doctrine denying current recovery of costs of prospective business. See *Treas. Reg. § 1.212-1(f)* (1957). See also *Frank B. Polachek*, 22 T.C. 858 (1954); *Morton Frank*, 20 T.C. 511 (1953).

⁹⁰ See Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142 (1943).

⁹¹ See Rev. Rul. 63-275, 1963 INT. REV. BULL. No. 52, at 13; note 9 *supra*.

⁹² See text accompanying note 17 *supra*; notes 43, 66 *supra*; cf. note 54 *supra*. An effort directed to taxing no more than net income should produce a practical method for recovery of educational costs incurred in a business context. See BOULDING, *THE ECONOMICS OF PEACE* 83 (1946); VICKERY, *AGENDA FOR PROGRESSIVE TAXATION* 123-24 (1947); Goode, *Educational Expenditures and the Income Tax*, in *ECONOMICS OF HIGHER EDUCATION* (1962); Musgrave, *Growth with Equity*, 53 AM. ECON. REV. 323, 329 (1963); Shaw, *Education as an Ordinary and Necessary Expense in Carrying on a Trade or Business*, 19 TAX L. REV. 1, 29-30 (1963).

The need for attention to the problem of recovering the cost of intangibles of a presumed indeterminable life is not limited to education and did not originate there.

educational costs, including those which are business-related, they have generally done so by calling them "personal,"⁹³ but have nevertheless cited *Welch v. Helvering* as authority. The expenses of scholarly research, caught up in the broad category of "education,"⁹⁴ have been victim to this opaqueness. Having determined the tax consequences of expenses falling in that category, the Tax Court and Commissioner disallowed the costs of research as "personal." No attention was paid to the object of the research or its beneficiary; no factual inquiry was made to determine whether the research was part of the education of the researcher (enabling him to undertake or carry on his work), or was part of the job which the researcher was employed to perform, with the results of the research intended largely for others.⁹⁵

In striving to find specific statutory warrant for the uncritical treatment which had been afforded education, the Tax Court placed extraordinary emphasis on the word "ordinary," finding, as in its opinion in *Hill*, that summer school expenses were nondeductible as "personal" because the taxpayer had not proved that it was "ordinary" for school teachers to take summer courses. When appellate disagreement was voiced on the ground that an employer-requirement of summer school work or a stated alternative was a sufficient basis for deduction, the Commissioner and Tax Court thereafter concluded that the commonness of that expense might in some cases be accepted without specific proof, thus satisfying their view of "ordinary," but they then also concluded that an employer-requirement was prerequisite to deduction. In the absence of such a requirement the expense was not "necessary." This interpretation of the statute created an unjustified distinction between the self-employed individual, whose judgment as to the business wisdom of an expense was normally accepted, and the employee, whose employer's judgment was required, although it was the employee's money that had been spent. The *Davis* case grew out of this "logic."

See Treas. Reg. § 1.167(a)-3 (1960). The Tax Court appears to be making a beginning: *Compare* *Indiana Broadcasting Corp.*, 41 T.C. No. 76 (March 13, 1964), and *KWTV Broadcasting Co.*, 31 T.C. 952, *aff'd per curiam*, 272 F.2d 406 (5th Cir. 1959), with *WDEF Broadcasting Co. v. United States*, 215 F. Supp. 818 (E.D. Tenn. 1963), and Rev. Rul. 56-520, 1956-2 CUM. BULL. 170, and T.I.R. 556 (March 20, 1964).

⁹³ See, e.g., I.T. 4044, 1951-1 CUM. BULL. 16, notes 44-47 *supra* and accompanying text, disallowing as "personal" the expenses incurred for "obtaining a teaching position, a higher position [and] an advance in the salary schedule" as well as to "fulfill . . . general cultural aspirations . . ." And in *Manoel Cardozo*, 17 T.C. 3, 4 (1951), expenses were disallowed as "personal" where incurred to "increase . . . prestige, improve . . . reputation for scholarship and learning . . . and to better fit [the taxpayer] to perform the duties for which he was employed."

⁹⁴ The 1958 Regulations, e.g., cover "education (including research activities)." Treas. Reg. § 1.162-5 (1958); see text accompanying notes 62-63 *supra*.

⁹⁵ Even writers who have criticized the Tax Court's decision and rationale in *Davis* have uncritically accepted the education category for the expenses there involved. See, e.g., *Shaw*, *supra* note 92, at 26; Note, 4 WILLIAM AND MARY L. REV. 55 (1963).

If education had been treated critically, the costs of business-related education would have been disallowed as a current expense in those cases where they were of a capital nature; they would have been allowed if, as the regulations now indicate appropriate, they served to keep the taxpayer current. Had this occurred, research—even though inaccurately categorized as education—might, in the case of a professor, have been allowed as a current deduction. But surely recognition that a professor's research was part of his job, not his education, would have led to allowance.

Of broader significance than the problems of the professor is the body of precedent that built up misinterpreting the words "ordinary" and "necessary." Once used as supposed statutory support for results logically and factually indefensible, they took on an independence of their own. The Commissioner and Tax Court assumed that current business expenses would be nondeductible if they were not *also* "ordinary and necessary," ignoring the fact that the only function to which those words can make legitimate claim is in aiding the determination whether an expenditure is in furtherance of a business pursuit and current. Failure so to limit the impact of those words has led to unnecessary controversy, has frequently diverted inquiry from the real point and even concealed it, and has subjected employed individuals to discriminatory tax treatment.⁹⁶

Revenue Ruling 63-275 brings a new understanding to the problem—and without in any case requiring surrender to tax avoidance.⁹⁷ To preserve this perception and to avoid retracing the tortuous high-toll route by which it was attained, "ordinary and necessary" must be

⁹⁶ Despite the reversal by stipulation of the *Davis* case, some Tax Court judges have not abandoned the rule of strict necessity in the case of employed individuals. In *Neil M. Kelly*, 23 CCH Tax Ct. Mem. 472, 473 (1964), an airline pilot was denied a deduction for allocable expenses of a home study used in part to store flight manuals because it was not "necessary for him to have an office"; automobile expense for travel between airports was denied as it was "neither ordinary nor necessary" although an automobile is "faster and more convenient" than transportation provided by the airline. In *Valentine J. Anzalone*, 23 CCH Tax Ct. Mem. 497 (1964), a sales engineer was denied allocable home-maintenance expenses, although the home was used for business telephone conversations and preparation of reports, since the employer had an available office and the home office was not required by the employer as a condition of employment. The opinion in *Anzalone* was written by Judge Mulroney whose position on this issue is unpredictable. See note 76 *supra*. If "employer-requirement" is no longer the appropriate test, see, e.g., *Treas. Reg. § 1.162-2(d)* (1958); *Rev. Rul. 60-97, 1960-1 CUM. BULL. 69*; *cf. Rev. Rul. 62-180, 1962-2 CUM. BULL. 52*, the Commissioner should cease urging it, particularly where, as in *Kelly* and *Anzalone*, the taxpayers appeared pro se. In *Rev. Proc. 64-22, 1964 INT. REV. BULL. No. 22*, at 74, the Internal Revenue Service admonished its personnel to exercise care "not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position." Care was apparently not exercised in those recent cases.

⁹⁷ "Ordinary and necessary" has been the handy phrase on which the courts have sometimes relied, or say they have, in disallowing "disguised dividends" paid by closely-held corporations for the benefit of their shareholders and payments between related taxpayers that would not have been made at arm's length. The words "ordinary and

read in lower case. Such a reading will be facilitated if the courts and Commissioner set as their goal the taxing of no more or less than net income, employ the words "ordinary and necessary" only in their limited capacity as aids to that end, and avoid prescribing an independent substantive content for words that should have none.

necessary" are not needed, however, to disallow and treat as a dividend corporate payment for the construction and upkeep of a boat which bore a direct relationship to the shareholder's hobby but none to the corporation's business. *American Properties, Inc. v. Commissioner*, 262 F.2d 150 (9th Cir. 1958). Nor are they required to disallow corporate payment of a shareholder's wedding expense, *Haverhill Shoe Novelty Co.*, 15 T.C. 517 (1950), or payments not in fact for the use of property, despite the tag of "rent," *Warren Brekke*, 40 T.C. 789 (1963). "Examination of the items is open to the Commissioner." *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 596 (1943) (Jackson, J., dissenting). See Griswold, *supra* note 90.

As facile as the phrase is, "ordinary and necessary" was not up to the job of disallowance (as acute factfinding might have been) when the costs of an African safari were claimed. *Sanitary Farms Dairy, Inc.*, 25 T.C. 463 (1955), *acq.*, 1956-2 CUM. BULL. 8. Yet it has been said elsewhere that even an "ordinary and necessary" expense is not deductible unless it is also "reasonable." *Commissioner v. Lincoln Elec. Co.*, 176 F.2d 815 (6th Cir. 1949), *cert. denied*, 338 U.S. 949 (1950), *on remand*, 17 T.C. 1600 (1952).

Section 162(a)(1) ("reasonable allowance for salaries") has been thought to provide special warrant for the disallowance as "unreasonable" of excessive salary payments. But the fact is—and should be recognized and stated—that salary payments are disallowed when they are found to be for something other than services, *e.g.*, to cover a living or hobby expense of a shareholder-employee or just a "salary" so much in excess of competitive requirements that it is recognized as a distribution to a shareholder-employee of corporate earnings. Literal subservience to a presumed requirement of "reasonableness" has led, however, to wholly unjustified disallowance in an arm's-length employer-employee situation, *Patton v. Commissioner*, 168 F.2d 28 (6th Cir. 1948), and ignores legislative history. See Griswold, *New Light on "A Reasonable Allowance for Salaries,"* 59 HARV. L. REV. 286 (1945).

Today the concept of the "unreasonable," to test whether payments which purport to be for services are so, is deeply imbedded and can be kept within bounds, but the "ordinary and necessary" phrase has been mischievous. It should be discarded as a substitute for explicit findings when payments are not what they are said to be.

Section 274, see note 78 *supra*, should help defeat claims for expenses which are essentially consumption, and sloppy records should no longer be a taxpayer boon.