

Taxation - Deduction of Attorney's Fees, *Parker v. Commonwealth*, 365 F.2d 792 (8th Cir. 1966)

Joseph L. Howard

Repository Citation

Joseph L. Howard, *Taxation - Deduction of Attorney's Fees, Parker v. Commonwealth*, 365 F.2d 792 (8th Cir. 1966), 8 Wm. & Mary L. Rev. 453 (1967), <https://scholarship.law.wm.edu/wmlr/vol8/iss3/11>

years.¹¹ These authorities reason that the Federal Interpleader Act and Rule 22¹² were designed to protect stakeholders from multiple liability and the expense of multiple litigation, and it should be liberally construed to accomplish this. Such a construction of federal interpleader also provides equal treatment of claimants. Thus, one claimant could not fortuitously get the first judgment and exhaust the fund.

The conflict between the two above views appears to be complete. On the very same day this decision was rendered by the eighth circuit, the ninth circuit issued a decision with the opposite result.¹³ The equities appear equal and both statutory constructions are reasonable. The possibility exists that, rather than rejecting either view, the courts will eventually compromise along the lines suggested by Professor Chaffee.¹⁴

F. Prince Butler

Taxation—DEDUCTION OF ATTORNEY'S FEES. In *Parker v. Commissioner*,¹ petitioner was the "prime functionary" of a religious organization known as the foundation for Divine Meditation (F.D.M.). He claimed the right to exclude from his income legal fees paid by F.D.M. for his defense in a criminal prosecution for contributing to the delinquency of a minor, and for fees used in bringing a civil suit for slander against those charging him with this crime. Relying on *Commissioner v. Tellier*,² the Court of Appeals refused to uphold the Tax Court and de-

11. *Accord*, Commercial Union Ins. Co. v. Adams, 231 F. Supp. 860 (S. D. Ind. 1964).

12. See *supra* note 2.

13. Tashire v. State Farm Fire and Casualty Co., 363 F. 2d 7 (9th Cir. 1966). See note 5 *supra*.

14. See *supra* note 9.

1. 365 F.2d 792 (8th Cir. 1966). The court also found that the foundation for Divine Meditation (F.D.M.) did not qualify under section 501 of the Internal Revenue Code as a tax-exempt organization based on religious purposes. Generally, where there are profit-making ventures, the Internal Revenue Service will look beyond the purposes of the organization to the substance of its transactions and tax the organization where such profits appear excessive. *Accord*: Marcella v. Commissioner, 222 F.2d 878 (8th Cir. 1955); Saint Germain Foundation v. Commissioner, 26 T.C. 648 (1956); Scripture Press Foundation v. United States, 285 F.2d 800 (Ct. Cl. 1964).

2. 383 U.S. 687 (1966). Held that where attorney's fees were paid in defending a criminal action arising out of one's trade or business, the expenses could be deducted in spite of the fact that taxpayer was convicted of the crime.

clared the exclusion valid because of the intimate interrelationship between F.D.M. and petitioner as the founder and "prime functionary" of the organization.³ This relation was found to be so vital that any judgment rendered against petitioner would adversely affect the very existence of the organization.⁴ The court held that the benefit petitioner received from the payment of the legal fees inured to the benefit of F.D.M.⁵ Not only were the fees held not to be income to the petitioner, but they were also found to be an ordinary and necessary business expense deductible by the corporation, F.D.M.⁶

As evidenced by decisions of the Supreme Court the law with respect to the deduction of attorney's fees has not been clearly settled.⁷ These decisions do, however, illustrate a progressing pattern toward a more liberal treatment of the deduction. It has been held that legal expenses incurred in the scope of one's trade or business are deductible,⁸ whereas the same expenses are not allowable as a deduction in personal litigation.⁹ In the past, courts have held that attorney's fees expended in contests over gift taxes were not deductible,¹⁰ but more recently section 212 (3) of the Internal Revenue Code has been interpreted to allow such a de-

3. *Supra* note 1, at 799.

4. *But see*, *Pantages-Theater Co. v. Welch*, 71 F.2d 68 (9th Cir. 1934), which involved the president of the company being convicted of rape; the court holding the crime personal and the attorney's fees not deductible.

5. *Robert S. Howard v. Commissioner*, 32 T.C. 1284 (1959), held that legal fees were deductible as ordinary and necessary business expenses where the employer and employee were closely tied together in the business. Since any conviction would make the business falter, the employer could deduct the expense of defending the employee even though the defense might be unsuccessful.

6. INT. REV. CODE OF 1954, § 162 (a):

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . .

7. Deductions not allowed: *Aaron Michaels v. Commissioner*, 12 T.C. 17 (1949); *Sans-Knit-Ary Textile Mills, Inc.*, 22 B.T.A. 754 (1931); *Van Wart v. Commissioner*, 295 U.S. 112 (1935); *Lykes v. United States*, 343 U.S. 118 (1952); *Cobb v. Commissioner*, 173 F.2d 711 (6th Cir. 1949).

Deductions allowed: *Komhauser v. United States*, 276 U.S. 145 (1928); *Commissioner v. Heininger*, 320 U.S. 467 (1943); *Bingham's Trust v. Commissioner*, 325 U.S. 365 (1945); *Robert S. Howard v. Commissioner*, 32 T.C. 1248 (1959); *Commissioner v. Tellier*, 383 U.S. 687 (1959).

8. *Supra* note 2.

9. *Supra* note 4.

10. *Lykes v. United States*, 343 U.S. 118 (1952), held that employing an attorney to get a refund on gift tax paid is not a "collection of income" and hence not deductible; *Cobb v. Commissioner*, 173 F.2d 711 (6th Cir. 1949), held an individual cannot deduct attorney's fees in conserving money on a gift tax, because the gift is voluntary.

duction.¹¹ This trend toward liberality in allowing the deduction of attorney's fees has its present culmination in *Parker v. Commissioner*, which goes beyond *Commissioner v. Tellier*,¹² and the earlier case of *Commissioner v. Heininger*,¹³ where deductions for legal expenses were allowed despite criminal convictions.

The distinguishing factor in the *Parker* case is that the deduction is allowed to a separate organization which paid the fees for the individual, while at the same time the individual was allowed to exclude the value of the expenses from his income. This result is due to the fact that the individual and organization were so closely interconnected that they were actually one, thus allowing the exclusion to the individual as well as the organization. It has been the practice of the Internal Revenue Service to separate an individual and an organization in determining the proper allocation of income. It may be inferred from the present result that legal fees are deductible in defending any criminal action against a "prime functionary" where the relation between the organization and the individual is so interconnected that the life of the organization would become tenuous by an adverse judgment against the individual.

Joseph L. Howard

Constitutional Law—CIVIL LIBERTIES. In *Adderley v. Florida*,¹ petitioners, Harriet Louise Adderley and thirty-one other persons, apparently all students at Florida A. & M. University in Tallahassee, were convicted by a jury in a joint trial in the County Judge's Court of Leon County, Florida, on a charge of trespass upon the premises of the county jail, with a malicious and mischievous intent, in violation of section 821.18 of the Florida Statutes.²

11. INT. REV. CODE OF 1954, § 212:

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year . . . (3) in connection with the determination, collection, or refund of any tax.

Int. Rev. Reg., § 1.212 (1):

Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State or municipal, and whether the tax be income, estate, *gift*, property or any other tax, are deductible. [Emphasis added.]

12. *Supra* note 8.

13. 320 U.S. 467 (1943), held deductions claimed by a dentist for lawyer's fees in defending him on a criminal charge of fraud order of the Postmaster General, were upheld, even though the dentist was convicted.

1. 87 S.Ct. 242 (1966).

2. FLA. STAT. § 821.18 (1965), "Every trespass upon the property of another, com-