

On the Tax Meaning of "Ordinary": How the Ills of *Welch* Could Be Cured Through Christian Science

Joel S. Newman*

I. INTRODUCTION

Congress requires that business expenses must be "ordinary" if they are to be deductible.¹ Unfortunately, it has neither told us why expenses must be ordinary,² nor what that means. In *Welch v. Helvering*,³ the leading Supreme Court case on the meaning of "ordinary," Mr. Justice Cardozo started with an unknown concept and ended with a truly unfathomable opinion. The result has been incoherent doctrines and conflicting lines of cases that have left the deductibility of innovative, "extraordinary" business techniques in peril. This article will explain why the Supreme Court was wrong in *Welch* and will trace what has happened since that decision.

II. WELCH

In the early 1920's, Thomas Welch and his father operated E.L. Welch Company, a grain brokerage business in Minneapolis.⁴ Thomas Welch owned a nominal ten shares of stock, but functioned as the "outside" man, responsible for all customer contact.⁵ His father owned the bulk of the stock, but was the inside, financial man.⁶

The business did not prosper, and the Welches contemplated bankruptcy.⁷ Thomas Welch hoped to give the business another try, however,

* Professor of Law, Wake Forest University. J.D., University of Chicago; A.B., Brown University.

1. I.R.C. § 162(a) (1988).
2. See Wolfman, *Professors and the "Ordinary and Necessary" Business Expense*, 112 U. PA. L. REV. 1089, 1092 n.15 (1964), for the legislative history of "ordinary."
3. 290 U.S. 111 (1933).
4. *Welch v. Commissioner*, 25 B.T.A. 117, 117 (1932).
5. *Id.* at 117-18.
6. *Id.*
7. Record at 5, *Welch v. Helvering*, 290 U.S. 111 (1933) (No. 33).

and was concerned about the bankruptcy's effect on his business reputation.⁸ He sought the advice of a bank president, who advised that:

if a man went through bankruptcy with the idea of beating his creditors and avoiding paying his just debts that all bankers considered him absolutely crooked, but if a man went through bankruptcy with the idea of getting a new start and making up his claims, that they considered him 100 per cent.⁹

Two other bankers Welch questioned had the same opinion.¹⁰

The E.L. Welch Company declared bankruptcy in 1922.¹¹ In 1924, Thomas Welch did go back into business, purchasing grain on commission for the Kellogg Company.¹² He did not forget the bankers' advice, however. As soon as he was able, he began repaying the debts of the bankrupt E.L. Welch Company.¹³

Thomas Welch deducted these payments as business expenses, but the deductions were disallowed.¹⁴ The Commissioner's office noted that the repayments of legally discharged debts were in the nature of gratuities¹⁵ and that the "benefit anticipated from the repayments was improved credit reputation and standing and was in the nature of capital expenditures."¹⁶

Welch took the matter to the Board of Tax Appeals.¹⁷ The Fifth Circuit case of *A. Harris & Co. v. Lucas*¹⁸ appeared to support Welch's characterization of the deduction as a business expense. In *Harris*, a retailer reached a compromise with its creditors, in which they accepted fifty cents on the dollar in full satisfaction of their claims.¹⁹ After the composition, however, no one would sell goods to A. Harris & Co. except on a cash basis.²⁰ The retailer soon realized that it could not continue doing business on a cash basis.²¹ On the advice of its bankers,

8. *See id.*

9. *Id.* at 31.

10. *Id.*

11. *Welch v. Helvering*, 290 U.S. 111, 112 (1933).

12. *Id.*

13. *Id.*

14. *Id.* at 113.

15. Record at 6, *Welch v. Helvering*, 290 U.S. 111 (1933) (No. 33) (Statement attached to Notice of Deficiency, Aug. 2, 1928).

16. *Id.* at 10.

17. *Welch v. Commissioner*, 25 B.T.A. 117 (1932).

18. 48 F.2d 187 (5th Cir. 1931).

19. *Id.* at 187.

20. *Id.*

21. *Id.*

Harris & Co. repaid the debts that had been extinguished by the composition as the only way to re-establish credit.²² The repayments were held to be deductible business expenses.²³

The Board of Tax Appeals in *Welch* distinguished *Harris*: the bankruptcy had legally destroyed the E.L. Welch Company, while the composition with creditors had not destroyed A. Harris & Co.²⁴ Therefore, the repayments in *Welch* were to *establish* the credit of a brand new business—a nondeductible, capital expense, while those in *Harris* were to *re-establish* credit in a continuing business—a deductible, ordinary expense.²⁵

The Eighth Circuit affirmed but framed the issue as whether the payments were ordinary and necessary rather than as whether the payments were made for a new or continuing business.²⁶ The court noted that the payments might have been "necessary," according to some interpretations, but held that there was no possible basis for them to have been "ordinary."²⁷ In fact, they were extraordinary and not the expenses of a business at all.²⁸ The court distinguished *Harris*, curiously, because it considered the payments by Mr. Welch to have been more voluntary than those of Harris & Co.²⁹

On appeal to the Supreme Court, Welch again asserted an irreconcilable conflict between *Harris* and *Welch*, demonstrated in the petitioner's briefs by the unusual device of setting out language from the Eighth Circuit opinion in *Welch* in the left-hand column and the conflicting language from the Fifth Circuit opinion in *Harris* on the right.³⁰ Two conflicts were apparent. First was the conflict between the capital expense treatment in *Welch* and the ordinary deduction in *Harris*.³¹ Second was a conflict between the *Harris* view that the "ordinary" and "necessary" requirements were disjunctive, so that meeting one of the two would suffice, and the *Welch* view that both were needed.³²

22. *Id.* at 187-88.

23. *Id.* at 189.

24. *Welch v. Commissioner*, 25 B.T.A. 117, 119 (1932).

25. *Id.*

26. *Welch v. Commissioner*, 63 F.2d 976, 977 (8th Cir. 1933).

27. *Id.*

28. *Id.*

29. *Id.*

30. Petitioner's Brief at 8-9, *Welch v. Helvering*, 290 U.S. 111 (1933) (No. 33) (citing *Welch*, 63 F.2d at 977; *Harris v. Lucas*, 48 F.2d 187, 188 (5th Cir. 1931)).

31. *Id.*

32. *Id.*

Welch asserted that the repayments were not capital expenditures and were at least as business-related as other expenditures that had been held deductible, such as a business's charitable contributions.³³ He argued that the "ordinary" criterion required asking whether, "in the particular circumstances shown to have existed, it would be common, or usual, or 'ordinary' to have made the expenditure."³⁴ "Necessary" was argued to mean "convenient" or "suitable."³⁵ Based on these interpretations, Welch asserted that the repayments were both ordinary and necessary.³⁶

The government's brief again distinguished *Harris*, because that case involved a continuing business rather than a new one.³⁷ The *Welch* repayments were, therefore, capital expenditures, while the *Harris* payments were not.³⁸ Mere business expedience, the government argued, was not enough to make these payments sufficiently business-related for a business expense deduction.³⁹ The government would define "ordinary" as "common, usual, often recurring" and "necessary" as "essential, needful, requisite, or indispensable," conceding, however, that in some cases "necessary" had been construed more broadly.⁴⁰ Finally, the government repeated assertions it had made in the earlier stages of the litigation that the repayments were voluntary and gratuitous.⁴¹

Many issues, therefore, were presented to the Supreme Court. Mr. Justice Cardozo wrote the opinion, but he was not comfortable with the case. He wrote:

Here, indeed, as so often in other branches of the law, the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.⁴²

Cardozo accepted the taxpayer's broader construction of "necessary," finding it to mean "appropriate and helpful."⁴³ Moreover, he appeared

33. *Id.* at 13.

34. *Id.* at 15.

35. *Id.* at 17.

36. *Id.* at 16, 18.

37. Brief for the Respondent at 9-10, *Welch v. Helvering*, 290 U.S. 111 (1933) (No. 33).

38. *See id.*

39. *Id.* at 7.

40. *Id.* at 6.

41. *Id.*

42. *Welch v. Helvering*, 290 U.S. 111, 114-15 (1933).

43. *Id.* at 113.

to accept the taxpayer's construction of "ordinary" when he wrote: "Now, what is ordinary, though there must always be a strain of constancy within it, is none the less a variable affected by time and place and circumstance."⁴⁴ Yet, he found that the repayments were not "ordinary," and thus he held for the government.⁴⁵

Exactly what did Cardozo mean when he held that Welch's repayments were not ordinary? Were they capital, as opposed to an expense of continuing in business as the court had held the expenses in *Harris* to be? Were they simply too bizarre? Were they too personal, that is, insufficiently related to business? Were they all of these things or some of them?

Some portions of the opinion suggest that the expenses were not ordinary because they were capital. Cardozo writes: "[T]he problem is not solved when the payments are characterized as necessary. Many necessary payments are charges upon capital."⁴⁶ Later in the opinion, he writes:

The Commissioner of Internal Revenue . . . found that the payments in controversy came closer to capital outlays than ordinary and necessary expenses in the operation of a business. . . . Unless we can say from facts within our knowledge that these are ordinary and necessary expenses according to the ways of conduct and the forms of speech prevailing in the business world, the tax must be confirmed. But nothing told us by this record or within the sphere of our judicial notice permits us to give that extension to what is ordinary and necessary. Indeed, to do so would open the door to many bizarre analogies. One man has a family name that is clouded by thefts committed by an ancestor. To add to his own standing he repays the stolen money, wiping off, it may be, his income for the year. The payments figure in his tax return as ordinary expenses. Another man conceives the notion that he will be able to practice his vocation with greater ease and profit if he has an opportunity to enrich his culture. Forthwith the price of his education becomes an expense of the business, reducing the income subject to taxation. There is little difference between these expenses and those in controversy here. *Reputation and learning are akin to capital assets, like the good will of an old partnership.*⁴⁷

Other portions of the opinion, however, suggest that the expenses were not ordinary because they were "bizarre" or "extraordinary."

44. *Id.* at 113-14.

45. *Id.* at 116.

46. *Id.* at 113.

47. *Id.* at 115 (citations omitted) (emphasis added).

Cardozo warns that holding for the Petitioner would “open the door to many bizarre analogies.”⁴⁸ He also wrote: “Indeed, if language is to be read in its natural and common meaning, we should have to say that payment in such circumstances, instead of being ordinary is in a high degree extraordinary. There is nothing ordinary in the stimulus evoking it, and none in the response.”⁴⁹

Cardozo’s opinion can also be read to suggest that Welch’s repayments were personal expenses. Remember Cardozo’s two bizarre analogies: repayment of money stolen by an ancestor to clear the family name, and payment of educational expenses to enrich the taxpayer’s culture and thus improve the practice of his profession.⁵⁰ Both are really personal expenses. Perhaps Cardozo was saying that Welch’s repayments could not be deductible because they were too personal, and to allow them would open the door for other, even more clearly personal expenses.⁵¹

And what of the irreconcilable conflict that brought the case to the Supreme Court? *Harris* is not mentioned at all in the body of the opinion.⁵² In an extended footnote, Cardozo lists a series of cases headed by “ordinary expenses” and a series headed by “not ordinary expenses.”⁵³ The *Harris* case is listed in the “ordinary” category with the curious description “payments of debts discharged in bankruptcy, but subject to be revived by force of a new promise.”⁵⁴ Did Cardozo

48. *Id.*

49. *Id.* at 114 (citations omitted).

50. *Id.* at 115.

51. Some of Welch’s creditors were, admittedly, personal friends of his. Record at 31, Welch v. Helvering, 290 U.S. 111 (1933) (No. 33).

52. *Welch*, 290 U.S. at 112-16.

53. *Id.* at 116 n.*.

54. The court in *Welch* divided the prior cases essentially as follows:

Ordinary expenses: Commissioner v. People’s-Pittsburgh Trust Co., 60 F.2d 187 [3d Cir. 1932], expenses incurred in the defense of a criminal charge growing out of the business of the taxpayer; American Rolling Mill Co. v. Commissioner, 41 F.2d 314 [6th Cir. 1930], contributions to a civic improvement fund by a corporation employing half of the wage earning population of the city where the payments were made, not for charity, but to add to the skill and productivity of the workmen, (*cf.* the decisions collated in [Note, Deductions from Gross Income for Charitable Contributions as Ordinary Business Expense,] 30 COLUM. L. REV. 1211, 1212 [(1930)], and the distinctions there drawn); Corning Glass Works v. Lucas, 37 F.2d 798 [D.C. Cir. 1929], donations to a hospital by a corporation whose employees with their dependents made up two thirds of the population of the city; Harris v. Lucas, 48 F.2d 187 [5th Cir. 1931], payments of debts discharged in bankruptcy but subject to be revived by force of a new promise. *Cf.* Lucas v. Ox Fibre Brush Co., 281 U.S. 115 [1930], where additional compensation, reasonable in amount, was allowed to the officers of a corporation for services previously rendered.

think that the debt in *Harris* was less fully discharged than the one in *Welch*?

It is difficult to see how the Supreme Court could have ruled against the taxpayer on two of the possible grounds. First, the repayments were neither bizarre nor extraordinary. Any business person in that community who needed new credit after a bankruptcy would have done the same. We know this because three prominent bankers gave identical advice.⁵⁵ Second, the repayments were clearly business, not personal. Thomas Welch went to the bankers—prominent businessmen in the community—with a business question, and they answered it.⁵⁶ Following that advice could hardly be anything but a business act.

The remaining ground on which the Court could have ruled against the taxpayer was the distinction between capital and ordinary expenses. It is hard to see how Welch's repayments could have been capital, if those of A. Harris & Co. were not. The distinction between a composition with creditors and a bankruptcy was a tenuous one at best in the 1920's,⁵⁷ not enough to support a holding that bankruptcy destroyed a business, while a composition kept it alive. This distinction becomes even less tenable when one realizes that neither the circuit court nor the Supreme Court seemed to rely on it.⁵⁸

The decision might be justifiable, however, if a more modern concept of capital expenditures is used. A modern lawyer would probably ignore the distinction between compositions and bankruptcies. Instead, she would ask whether the good will, and hence the income, generated by the repayments would last less than a year or more than a year.⁵⁹ If

Not ordinary expenses: Hubinger v. Commissioner, 36 F.2d 724 [2d Cir. 1929], payments by the taxpayer for the repair of fire damage, such payments being distinguished from those for wear and tear; Lloyd v. Commissioner, 55 F.2d 842 [7th Cir. 1932], counsel fees incurred by the taxpayer, the president of a corporation, in prosecuting a slander suit to protect his reputation and that of his business; 105 West 55th Street v. Commissioner, 42 F.2d 849 [2d Cir. 1930], gratuitous payments to stockholders in settlement of disputes between them, or to assume the expense of a lawsuit in which they had been made defendants; Blackwell Oil & Gas Co. v. Commissioner, 60 F.2d 257 [10th Cir. 1932], gratuitous payments to stockholders in settlement of disputes between them, or to assume the expense of a lawsuit in which they had been made defendants; White v. Commissioner, 61 F.2d 726 [9th Cir. 1932], payments in settlement of a lawsuit against a member of a partnership, the effect being to enable him to devote his undivided efforts to the partnership business and also to protect its credit.

Id.

55. See *supra* notes 9-10 and accompanying text.

56. *Id.*

57. See Ayer, *Rethinking Absolute Priority after Ahlers*, 87 MICH. L. REV. 963, 977 (1989).

58. See *supra* notes 26-29 & 42-45.

59. See *infra* note 60 and accompanying text.

the resulting income would have lasted more than a year, then the repayments should have been capitalized in order to match expenses with income.⁶⁰ This question was neither asked nor answered, however, in any of the *Welch* briefs or opinions.

Thus, the Supreme Court did not specify clearly the grounds for its holding in *Welch*. Of the three possible grounds discernible in the opinion, two of them were wrong. The third ground, that the expenses were capital, may have been correct, but one certainly could not tell that from Cardozo's opinion.

III. CASES SUBSEQUENT TO *WELCH*

Thirty-one years after *Welch*, a law review article commented: "Although the opinion in *Welch v. Helvering* struggles with the concept of 'ordinary' as polar to 'unique,' . . . the essence of the analysis is in its attempt to isolate the capital expenditure from the current."⁶¹ One year later, the Supreme Court stated: "The principal function of the term 'ordinary' in section 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures"⁶²

Despite these two pronouncements, the capital versus ordinary distinction is not the only issue that has survived the *Welch* decision. In fact, two pairs of parallel lines of cases have emerged. One pair highlights the capital versus noncapital distinction, with one line of cases tracking *Welch* in holding that repayments of legally unenforceable debts are nondeductible, capital expenses,⁶³ while the other line tracks *Harris* and holds that such expenses and other, similar expenses can be deductible, noncapital expenses.⁶⁴ The second pair highlights the bizarre versus ordinary distinction, with one line holding repayments and other expenses to be nondeductible if they are bizarre or extraordinary,⁶⁵ while the other holds that even unusual expenses are deductible if they are a common industry practice in a particular place.⁶⁶

60. See *Fall River Gas Appliance Co. v. Commissioner*, 349 F.2d 515 (1st Cir. 1965). Another modern view, however, would hold that only nonrecurring expenses should be capitalized. See *Encyclopedia Britannica v. Commissioner*, 685 F.2d 212 (7th Cir. 1982). On this view, perhaps the fact that *Welch* made recurring payments over four years would require that the payments be treated as ordinary.

61. Wolfman, *supra* note 2, at 1096.

62. *Commissioner v. Tellier*, 383 U.S. 687, 689-90 (1966).

63. See *infra* notes 67-74 and accompanying text.

64. See *infra* notes 75-91 and accompanying text.

65. See *infra* notes 100-28 and accompanying text.

66. See *infra* notes 92-99 and accompanying text; see also *Raymond Bertolini Trucking Co.*

A. Capital versus Noncapital Expenditures

One of the first business-expense cases after *Welch* was *Foye Lumber & Tie Co. v. Commissioner*.⁶⁷ In *Foye*, as in *Welch*, the taxpayer's predecessor had declared bankruptcy in the early 1920's, resulting in substantial losses to its lender banks.⁶⁸ When the taxpayer asked one of those banks for a line of credit, the bank responded that it would furnish one only if the taxpayer agreed to make extra payments to compensate the bank for its earlier losses.⁶⁹ The taxpayer deducted the extra payments and argued that the case was on all fours with *Harris*.⁷⁰ The government disallowed the deduction and claimed that the case was on all fours with *Welch*.⁷¹ The Board of Tax Appeals noted that *Welch* had contradicted *Harris* in at least one respect. *Harris* held that the words "ordinary and necessary" were to be construed as disjunctive, while *Welch* held them to be conjunctive.⁷² The Board held that *Welch* could not be distinguished from the case at bar and denied the deduction.⁷³

Foye Lumber may have wounded *Harris*, but it certainly did not kill it. Some later cases held that voluntary repayments of the debts of another were nondeductible, capital expenses.⁷⁴ Many more cases, however, held the repayments to be noncapital and deductible.⁷⁵

v. Commissioner, 736 F.2d 1120 (6th Cir. 1984).

Petitioner and the Commissioner advocate two distinct views of the meaning of "ordinary" in the statute. The Commissioner promotes the view that "ordinary" means "normal" or "habitual." Petitioner advances the view that the word "ordinary" is in the statute simply to distinguish between the expenditures which are ordinary, i.e., currently deductible, and those which must be capitalized and deducted over the life of the asset or benefit acquired.

.....

We believe that the confusion regarding the meaning of the word "ordinary" stems from the fact that the two views advanced here are both to a certain extent correct, and are not mutually exclusive.

Id. at 1122, 1124.

67. 33 B.T.A. 271 (1935).

68. *Id.* at 271.

69. *Id.* at 272.

70. *Id.*

71. *Id.*

72. *Id.* at 273.

73. *Id.* at 274.

74. *Portland Gasoline Co. v. Commissioner*, 181 F.2d 538 (5th Cir. 1950); *Carl Reimers Co. v. Commissioner*, 19 T.C. 1235 (1953), *aff'd*, 211 F.2d 66 (2d Cir. 1954); *Eskimo Pie Corp. v. Commissioner*, 4 T.C. 669 (1945), *aff'd*, 153 F.2d 301 (3d Cir. 1946); *Levitt & Sons, Inc. v. Commissioner*, 5 T.C. 913 (1944), *rev'd & remanded*, 142 F.2d 795 (2d Cir. 1945), *aff'd*, 160 F.2d 209 (2d Cir. 1947).

75. See *infra* notes 76-91 and accompanying text.

In *First National Bank of Skowhegan v. Commissioner*,⁷⁶ the taxpayer, a bank, owned securities in the Skowhegan Trust Company (Trust).⁷⁷ When Trust experienced financial difficulties, the taxpayer realized that its investment was in jeopardy.⁷⁸ The taxpayer refused to merge with Trust, but did pay \$10,000 to another bank to help persuade that bank to merge with Trust.⁷⁹ The taxpayer deducted the payment, but the Commissioner disallowed the deduction.⁸⁰ Before the Board of Tax Appeals, both sides cited *Welch*.⁸¹ The board, however, distinguished *Welch* and allowed the deduction, noting that the bank had "acquired no capital asset by the disbursement."⁸² *Harris*, although unmentioned in *Skowhegan*, lived on in spirit.

In *Miller v. Commissioner*,⁸³ the taxpayer was an independent insurance agent representing some twelve different companies.⁸⁴ When one of those companies failed, taxpayer paid the claims of his customers against the failed insurance company out of his own pocket in order to retain their business.⁸⁵ The Commissioner disallowed the claimed deduction.⁸⁶ The Board of Tax Appeals reinstated the deduction, distinguishing *Welch*, on the basis that: "There the expenditures were made to acquire, and not to retain or protect and promote the taxpayer's business. Cf. *First National Bank of Skowhegan*"⁸⁷

A number of other cases resulted in similar holdings. One case involving another insurance agent was on all fours with *Miller*.⁸⁸ Others involved a retail establishment bailing out its in-house savings bank,⁸⁹ a law firm bailing out its wholly-owned abstract company,⁹⁰ and a medical partnership bailing out its wholly-owned hospital.⁹¹

76. 35 B.T.A. 876 (1937).

77. *Id.* at 876-77.

78. *Id.* at 877.

79. *Id.* at 877-78.

80. *Id.* at 878.

81. *Id.* at 884.

82. *Id.* at 885; see also *Robert Gaylord, Inc. v. Commissioner*, 41 B.T.A. 1119 (1940).

83. 37 B.T.A. 830 (1938).

84. *Id.* at 831.

85. *Id.*

86. *Id.* at 830.

87. *Id.* at 833.

88. *McGee v. Nee*, 113 F.2d 543 (8th Cir. 1940).

89. *Scruggs-Vandervoort-Barney, Inc. v. Commissioner*, 7 T.C. 779 (1946).

90. *Snow v. Commissioner*, 31 T.C. 585 (1958).

91. *Dinardo v. Commissioner*, 22 T.C. 430 (1954); see also *Mountain Paper Prods. Corp. v. United States*, 287 F.2d 957 (2d Cir. 1961); *Dunn & McCarthy v. Commissioner*, 139 F.2d 242 (2d Cir. 1943); *Commissioner v. Macy*, 19 T.C. 409 (1952), *aff'd*, 215 F.2d 875 (2d Cir. 1954); *Cannon Valley Milling Co. v. Commissioner*, 44 B.T.A. 763 (1941), *aff'd*, 129 F.2d 642 (8th Cir. 1942).

B. Ordinary versus Bizarre

Cardozo's comment that "what is ordinary . . . is none the less a variable affected by time and place and circumstance,"⁹² when read with his other comment that "[u]nless we can say from facts within our knowledge that these are ordinary and necessary expenses according to the ways of conduct and the forms of speech prevailing in the business world,"⁹³ suggests that one can look to the custom of a particular industry at a particular time and place to determine what is ordinary.⁹⁴ This notion has been accepted by many courts.⁹⁵ Expenses are deductible, even if unusual⁹⁶ and even if they happen but once in the lifetime of a particular business,⁹⁷ as long as they are common industry practice.⁹⁸ This doctrine has even been applied to legally unenforceable debts.⁹⁹

Bizarre expenses, however, are still nondeductible.¹⁰⁰ Three cases, *Goedel v. Commissioner*,¹⁰¹ *A. Giurlani & Bros. v. Commissioner*,¹⁰² and *United Draperies v. Commissioner*,¹⁰³ illustrate how courts apply

92. *Welch v. Helvering*, 290 U.S. 111, 113-14 (1933).

93. *Id.* at 115.

94. Yet, how are we to deal with his comment: "No longer can we have recourse to any fund of business experience, to any known business practice." *Id.* at 114.

95. See *infra* notes 96-99 and accompanying text.

96. *Hill v. Commissioner*, 181 F.2d 906 (4th Cir. 1950) (expenses of attending summer school for maintaining teaching certificate allowed, even though most teachers in Virginia used a different, cheaper method for maintaining their certificates); *Salt v. Commissioner*, 18 T.C. 182 (1952) (attorney's fees incurred in connection with the appearance of a scriptwriter before the McCarthy Hearings); *Wakelee v. Commissioner*, 17 T.C. 745 (1951) (payments made pursuant to agreements between petitioner and client for trading in securities under which petitioner received all dividends and 25% of gain on sales, and client received an annual return on sums invested).

97. *Lawyers Title Co. v. Commissioner*, 14 T.C. 1221 (1950).

98. *Commissioner v. Tellier*, 383 U.S. 687 (1966); *Deputy v. DuPont*, 308 U.S. 488 (1940); *Locke Mfg. v. United States*, 237 F. Supp. 80 (D. Conn. 1964).

99. *M.L. Eakes Co. v. Commissioner*, 686 F.2d 217 (4th Cir. 1982); *Harold L. Jenkins, T.C.M. (P-H) ¶ 83,667* (1983).

Curiously, in *Eakes*, both sides argued the case on the issue of whether the repayment established the good will of a new business, a capital expense, or maintained the good will of an existing business. The Tax Court had held that the repayments maintained the good will of an existing business. *M.L. Eakes Co.*, 686 F.2d at 219. This holding was insupportable in light of the distinction between *Harris* and *Welch*, in that the corporation whose debts were repaid had been liquidated pursuant to state law and therefore could not be said to have maintained a continuing existence. See *M.L. Eakes Co.*, T.C.M. (P-H) ¶ 81,429 (1981). The Fourth Circuit rejected this formulation of the issue, and resolved the case on the ground that such repayments were common industry practice. *M.L. Eakes Co.*, 686 F.2d at 220-21.

100. See *infra* notes 101-28 and accompanying text.

101. 39 B.T.A. 1 (1939).

102. 41 B.T.A. 403 (1940), *aff'd*, 119 F.2d 852 (9th Cir. 1941).

103. 340 F.2d 936 (7th Cir. 1964), *cert. denied*, 382 U.S. 813 (1965).

the rule. In *Goedel*, the taxpayer, a partner in a large New York brokerage house, bought a large amount of stock in 1933, convinced that President Roosevelt would boost the economy.¹⁰⁴ The taxpayer feared that if President Roosevelt were to die, the stock market would decline precipitously as it had upon the deaths of Presidents McKinley and Garfield.¹⁰⁵ To protect his interest, he purchased life insurance through a British broker on the life of President Roosevelt.¹⁰⁶ The Board of Tax Appeals denied a deduction for the premium payments.¹⁰⁷ The board was not impressed with the taxpayer's reference to *Harris*, noting that *Welch* was contrary to *Harris*.¹⁰⁸ The insurance premiums were not ordinary in the sense of being customary or usual.¹⁰⁹ Further, the board distinguished *Skowhegan*,¹¹⁰ as the payment there represented an attempt to deal with a current emergency, while the insurance in *Goedel* was purchased to protect against a very remote contingency.¹¹¹

The board decided *Giurlani* the very next year.¹¹² That case involved four Giurlani brothers, two of whom were the principal shareholders of Gaetano Giurlani, S.A., an Italian corporation, and the other two the principal shareholders of the taxpayer, a California corporation.¹¹³ More than one-third of the taxpayer's business was derived from the sale of Star Brand olive oil, supplied exclusively by the Italian corporation.¹¹⁴ When Star Brand olive oil became unavailable during a strike, the taxpayer corporation tried to substitute another olive oil.¹¹⁵ The attempted substitution caused problems, and many customers angrily demanded a return of their money.¹¹⁶ Thus, the taxpayer corporation had reason to believe that Star Brand olive oil was unique and crucial to its business.¹¹⁷ Accordingly, when the Italian corporation faced bankruptcy, the taxpayer corporation paid almost \$33,000 to the Italian

104. *Goedel*, 39 B.T.A. at 1-2.

105. *Id.* at 2-3, 7.

106. *Id.* at 4-5.

107. *Id.* at 5.

108. *Id.* at 7.

109. *Id.* at 8.

110. *First Nat'l Bank of Skowhegan v. Commissioner*, 35 B.T.A. 876 (1937); *see supra* notes 76-82 and accompanying text.

111. *Goedel*, 39 B.T.A. at 12.

112. *A. Giurlani & Bros. v. Commissioner*, 41 B.T.A. 403 (1940), *aff'd*, 119 F.2d 852 (9th Cir. 1941).

113. *Id.* at 404.

114. *Id.*

115. *Id.* at 405.

116. *Id.*

117. *See id.* ("Star Brand olive oil has a distinctive aroma and flavor and body and color recognizable by merchants, cooks, and other users thereof. There is no other exactly the same . . .")

corporation's creditors to relieve the corporation of its financial difficulties.¹¹⁸ The taxpayer asserted that it made this payment to prevent being cut off from its supply of Star Brand olive oil, which it believed would "reduce the [taxpayer] corporation to an inconsequential corporation."¹¹⁹ The board denied the deduction on the ground that payment was "distinctly out of the ordinary."¹²⁰ The slight difference in the product did not impel the distributee to pay the supplier corporation's debts to stave off its bankruptcy.¹²¹ The board again distinguished *Skowhegan*, this time on the basis that the Depression had not caused the strain in *Giurlani* as it had in *Skowhegan*.¹²²

In *United Draperies*, the taxpayer corporation attempted to deduct kickbacks paid to purchasing agents.¹²³ The court denied the deduction.¹²⁴ The court might have applied the doctrine that immoral or illegal practices that violate public policy are not ordinary per se,¹²⁵ but it was loath to do so, because the Supreme Court had held similar kickbacks to be deductible expenses in the optical industry in *Lilly v. Commissioner*.¹²⁶ The court in *United Draperies* distinguished *Lilly* instead on the ground that while the practice described in *Lilly* was widespread in that industry, in the case at bar, there was "nothing to show that the practice was a normal incident to the drapery manufacturing industry or to suppliers of mobile home manufacturers generally."¹²⁷ Unlike the ordinary kickbacks in *Lilly*, the kickbacks in *United Draperies* were extraordinary and thus nondeductible.¹²⁸

C. Cases Combining Capital/Noncapital and Bizarre/Common

At least four cases have mentioned both the capital/noncapital distinction and the bizarre/common distinction. Two of them held for the government, and two for the taxpayer.¹²⁹

118. *Id.* at 406.

119. *Id.*

120. *Id.* at 407.

121. *Id.*

122. *Id.* But see M. VISSER, *MUCH DEPENDS ON DINNER* ch. 7 (1986), for valuable insights on why all olive oils are not created equal.

123. *United Draperies v. Commissioner*, 340 F.2d 936, 936-37 (7th Cir. 1964), *cert. denied*, 382 U.S. 813 (1965).

124. *Id.* at 936.

125. See, e.g., *Tank Truck Rentals v. Commissioner*, 356 U.S. 30 (1958). Although the case law public policy doctrine is relevant to the definition of "ordinary," it is considered tangential to the issues discussed in this article.

126. 343 U.S. 90 (1951).

127. *United Draperies*, 340 F.2d at 937.

128. *Id.* at 938.

129. *Friedman v. Delaney*, 75 F. Supp. 568 (D. Mass.) (holding for government), *aff'd in*

1. Two Government Victories

In *Friedman v. Delaney*,¹³⁰ a lawyer for a respected Boston firm represented in a composition with creditors that his client would make certain payments.¹³¹ Later, when his client did not make those payments, the lawyer made them himself, in part because he felt morally obligated to do so.¹³² The district court denied his deduction primarily for two reasons: first, the payment "was closer to a capital outlay,"¹³³ and second, "in the absence of any evidence as to what is the custom in the legal profession, there is no basis for a court assuming or finding that it is usual."¹³⁴ The First Circuit affirmed.¹³⁵

In *Polak's Frutal Works, Inc. v. United States*,¹³⁶ the taxpayer, a New York corporation, was formed as a subsidiary of a Dutch parent to handle the parent's United States sales.¹³⁷ During World War II, the taxpayer took over the parent's business, receiving its secret formulae, technical know-how, and customer list.¹³⁸ In 1944, it decided to pay its parent for the use of these assets, even though it was under no obligation to do so.¹³⁹ The district court denied a deduction for the payment, because it was "most extraordinary and completely unnecessary. . . . If more were necessary we agree with the government that even if the accrual was legitimate it represented the payment for a capital asset."¹⁴⁰ The Second Circuit affirmed, commenting that "payments must be tested by normal business standards and practices."¹⁴¹

2. Two Taxpayer Victories

In *Canton Cotton Mills v. United States*,¹⁴² the taxpayer paid a tax pursuant to the Agricultural Adjustment Act (AAA) on the processing

part & vacated in part, 171 F.2d 269 (1st Cir. 1948), *cert. denied*, 336 U.S. 936 (1949); *Polak's Frutal Works, Inc. v. United States*, 176 F. Supp. 521 (S.D.N.Y. 1959) (same), *aff'd*, 281 F.2d 261 (2d Cir. 1960); *Canton Cotton Mills v. United States*, 94 F. Supp. 561 (Ct. Cl. 1951) (holding for taxpayer); Harold L. Jenkins, T.C.M. (P-H) ¶ 83,667 (1983) (same).

130. 75 F. Supp. 568 (D. Mass.), *aff'd in part & vacated in part*, 171 F.2d 269 (1st Cir. 1948), *cert. denied*, 336 U.S. 936 (1949).

131. *Id.* at 568-69.

132. *Id.* at 569.

133. *Id.* at 570.

134. *Id.* at 571 (citations omitted).

135. 171 F.2d 269 (1st Cir. 1948). See S. SURREY, P. MCDANIEL, H. AULT & S. KOPPELMAN, *FEDERAL INCOME TAXATION: CASES AND MATERIALS* 393 (successor ed. 1986), for a suggestion that the real explanation of the decision was that the voluntariness of the payment evidenced a "personal rather than business relationship."

136. 176 F. Supp. 521 (S.D.N.Y. 1959), *aff'd*, 281 F.2d 261 (2d Cir. 1960).

137. *Id.* at 522.

138. *Id.*

139. *Id.* at 523.

140. *Id.*

141. 281 F.2d 261, 263 (2d Cir. 1960).

142. 94 F. Supp. 561 (Ct. Cl. 1951).

of its denim products and passed the amount of the taxes on to its customers.¹⁴³ Because there was considerable doubt as to the legality of the AAA, most of taxpayer's contracts with its customers provided that if the processing tax were invalidated by the United States Supreme Court, the taxpayer would credit its customers' accounts for processing taxes paid with respect to goods invoiced within ninety days prior to the invalidation.¹⁴⁴

The tax subsequently was invalidated by the Supreme Court.¹⁴⁵ Pursuant to its contracts, the taxpayer credited its customer accounts in the amount of \$79,300, and the Commissioner did not dispute the deductibility of those credits.¹⁴⁶ The taxpayer also credited the accounts with an additional \$26,300, however, for processing taxes paid with respect to goods not invoiced within the ninety day period described in the contract and for taxes on goods sold to customers who did not have the tax credit clause in their contracts.¹⁴⁷ The taxpayer credited these amounts, first, to resolve administrative difficulties and potential arguments with the customers, and second, to compete with its competitors, who were crediting the taxes whether or not contractually obligated to do so.¹⁴⁸

The court, citing *Welch*, noted that payments to establish goodwill are generally nondeductible, capital expenditures.¹⁴⁹ The court then pointed out, however, that payments meant to maintain existing goodwill are ordinary and deductible.¹⁵⁰ The Government argued that the payments were not ordinary because they were intended to establish rather than to maintain goodwill.¹⁵¹ The court pointed out, however that: "As a matter of commercial reality plaintiff had no alternative to following the course taken by its competitors."¹⁵² A payment that might have been extraordinary in other circumstances was thus made ordinary by common industry practice, and the court allowed the deduction.¹⁵³

Harold L. Jenkins,¹⁵⁴ chronicling the affairs of one better known as Conway Twitty, actually considers capital expenses, bizarre expenses,

143. *Id.* at 562-63.

144. *Id.*

145. *Id.* at 563 (citing *United States v. Butler*, 297 U.S. 1, 53, 78 (1936) (invalidating the Agricultural Adjustment Act)).

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.* at 564.

150. *Id.*

151. *Id.*

152. *Id.* at 565.

153. *Id.*

154. T.C.M. (P-H) ¶ 83,667 (1983).

and personal expenses, thus touching every factor that might have been important in *Welch*.¹⁵⁵ Conway Twitty, a popular country music entertainer, formed a chain of fast food restaurants called "Twitty Burger."¹⁵⁶ During 1968 and 1969, Twitty persuaded some seventy-five of his friends in the country music business to invest in the enterprise.¹⁵⁷ By 1971, the venture was deemed a failure, and the last Twitty Burger restaurant was closed.¹⁵⁸ Twitty was not obligated to pay back his investors.¹⁵⁹ Nevertheless, Twitty, concerned about adverse publicity and feeling a moral obligation to his investors, reimbursed them for their losses.¹⁶⁰

The Tax Court allowed the deduction.¹⁶¹ Its analysis began: "The general rule is that a shareholder may not deduct a payment made on behalf of the corporation but rather must treat it as a capital expenditure. However, the payment may be deducted if it is an ordinary and necessary expense of a trade or business of the shareholder."¹⁶² The court went on to note: "There is no suggestion in the record that any of the payments were made in order to protect petitioner's investment in Twitty Burger or to revitalize the corporation."¹⁶³ Although the court did not cite *Harris*, it did cite *Scruggs-Vandervoort-Barney*,¹⁶⁴ which is in the *Harris* line of cases.¹⁶⁵

In fact, as the court held, the situation was much closer to *Harris* than to *Welch*. Twitty's payments were not made to re-establish credit or goodwill in the fast food franchise business. Such a repayment may well have been a nondeductible, capital expenditure under *Welch*. Instead, Twitty's repayments were to maintain his goodwill in his continuing business as a country music entertainer. Thus, *Welch*'s views on capital expenditures are easily distinguishable, and *Jenkins* can be justified by following the *Harris* line.

155. *Id.* at 83-2759 to -2765.

156. *Id.* at 83-2761.

157. *Id.*

158. *Id.* at 83-2758 ("except for one franchise that had been sold to a group of doctors who, as of the date of trial, continue to operate a restaurant in Hemphill, Texas"). The restaurant is still open under the name of "Twitty's." Telephone interview with Twitty's employee Connie Mason (Mar. 23, 1990).

159. *Id.* at 83-2762.

160. *Id.* at 83-2762 to -2763 & n.13 ("Petitioner's counsel aptly remarked in his opening statement: 'Imagine trying to keep a band together where somebody had stiffed the drummer's mother.'").

161. *Id.* at 83-2764.

162. *Id.* at 83-2759 (citations omitted).

163. *Id.* at 83-2762.

164. *Scruggs-Vandervoort-Barney, Inc. v. Commissioner*, 7 T.C. 779 (1946), cited in Harold L. Jenkins, T.C.M. (P-H) ¶ 83,667, at 83-2760 n.11.

165. See *Scruggs-Vandervoort-Barney*, 7 T.C. at 787.

The *Jenkins* opinion, however, had a lot more to say about the proximate relationship of the repayment to Twitty's business, and delved at great length into the peculiarities of the country music business. More than a page of the opinion is devoted to a lengthy quotation from a report by William Ivey, Director of the Country Music Foundation in Nashville, Tennessee.¹⁶⁶ The thrust of this report is that moral reputation is much more crucial to the business success of a country music entertainer than it might be in some other field.¹⁶⁷ The only conceivable reason for the Tax Court to have included such a lengthy quotation in its opinion is that it considered the question of what is "ordinary" to depend on the peculiarities of each business in each time and place. This case, therefore, clearly touches on what is common and what is bizarre.

Finally, this case touches upon the personal-business dichotomy in a very curious way. The Tax Court ended its opinion with the following Ode to Conway Twitty.

Ode to Conway Twitty

Twitty Burger went belly up
But Conway remained true
He repaid his investors, one and all
It was the moral thing to do.

His fans would not have liked it
It could have hurt his fame
Had any investors sued him
Like Merle Haggard or Sonny James.

When it was time to file taxes
Conway thought what he would do
Was deduct those payments as a business expense
Under section one-sixty-two.

In order to allow these deductions
Goes the argument of the Commissioner
The payments must be ordinary and necessary
To a business of the petitioner.

Had Conway not repaid the investors
His career would have been under a cloud.
Under the unique facts of this case
Held: The deductions are allowed.¹⁶⁸

166. Harold L. Jenkins, T.C.M. (P-H) ¶ 83,667, at 83-2763 to -2764 (1983).

167. *Id.*

168. *Id.* at 83-2764 n.14.

The IRS raised the business-personal distinction in its non-acquiescence:

Ode to Conway Twitty: A Reprise

Harold Jenkins and Conway Twitty
They are both the same
But one was born
The other achieved fame.

The man is talented
And has many a friend
They opened a restaurant
His name he did lend.

They are two different things
Making burgers and song
The business went sour
It didn't take long.

He repaid his friends
Why did he act
Was it business or friendship
Which is fact?

Business the court held
It's deductible they feel
We disagree with the answer
But let's not appeal.¹⁶⁹

D. Doctrine Established by the Welch Line of Cases

What, then, has *Welch* wrought? *Welch* and its progeny leave us with three doctrines. First, expenditures designed to create goodwill or credit at the beginning of an enterprise are capital and therefore nondeductible, while similar expenses to maintain the goodwill or credit of a continuing enterprise are ordinary and deductible.¹⁷⁰ The capital versus ordinary distinction, although necessary to our system of tax laws, has always been very difficult to define and apply, and the courts in *Welch* and cases following *Welch* have probably defined and applied it incorrectly. Second, business deductions will be unavailable for personal expenses. This doctrine also is appropriate and even necessary, but again, it was incorrectly applied in *Welch*. Finally, expenses must

169. TAX NOTES, Apr. 9, 1984.

170. Compare *supra* notes 24-25 and accompanying text with *supra* notes 149-50 and accompanying text.

be ordinary, in the sense of being common practice for the particular industry at the particular place and time. Such expenses are to be distinguished from bizarre expenses, which are nondeductible. The validity of this doctrine depends upon how "bizarre" is to be defined.

Unfortunately, the five cases in which the taxpayer lost because the court considered the expense to be too bizarre¹⁷¹ do not furnish any discernible guidance as to the actual meaning of "bizarre." The expenses disallowed in these cases were no more bizarre than other expenses that were allowed in other cases.¹⁷² Moreover, a fair reading of these cases requires a rejection of the proposition that a finding of "bizarre" is merely a euphemism for a finding of "personal" or "capital."¹⁷³ The doctrine that "bizarre" business expenses are nondeductible is separate and independent of the other characteristics. Evaluated independently, the doctrine is both incoherent and wrong. The cases of *Amend*¹⁷⁴ and *Trebilcock*¹⁷⁵ illustrate how pernicious this doctrine can be.

IV. AMEND AND TREBILCOCK

A. Amend

Fred W. Amend (Amend) founded the Fred W. Amend Company, an Illinois corporation, in 1921.¹⁷⁶ The business started with \$7,000 in second-hand machinery and \$1,800 in cash.¹⁷⁷ By 1964, the corporation, manufacturing and distributing "Chuckles" jellied candies, had net sales of over \$4,000,000, and a net worth of \$1,298,616.¹⁷⁸ Amend was president and treasurer of the corporation until 1956, when his son-in-law became president.¹⁷⁹ Amend continued as treasurer and became

171. See *supra* notes 101-28, 130-41 and accompanying text.

172. See *supra* notes 76-91 and accompanying text.

173. See S. SURREY, P. MCDANIEL, H. AULT & S. KOPPELMAN, *supra* note 135, at 393; Wolfman, *supra* note 2, at 1096. For an argument similar to the one made in this article, see *Kopp's Co. v. United States*, 636 F.2d 59, 61 n.1 (4th Cir. 1980) (Ervin, J., dissenting). One might argue that the expenses of *Giurlani* were personal due to the family relationship, or that the expenses of *Friedman v. Delaney* were personal as resulting from the lawyer's personal morality. I am unpersuaded by these arguments. Moreover, I see no possibility of arguing for personal or capital expenses in *Goedel*, *Polak*, or *United Draperies*.

174. *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971).

175. *Trebilcock v. Commissioner*, 64 T.C. 852 (1975), *aff'd per curiam*, 557 F.2d 1226 (6th Cir. 1977).

176. *Fred W. Amend Co. v. Commissioner*, 55 T.C. 320, 321 (1970), *aff'd*, 454 F.2d 399 (7th Cir. 1971).

177. Petitioner-Appellant's Brief at 4, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248).

178. *Id.*

179. *Amend*, 55 T.C. at 321.

chairman of the board in 1959, remaining in these offices at least through 1965.¹⁸⁰

In 1954, Amend began using the services of R.H. Halverstadt.¹⁸¹ Halverstadt, holder of an economics degree from the University of Chicago, had been a Christian Science practitioner since 1923¹⁸² and was on the national list of practitioners maintained by the Mother Church.¹⁸³ To be listed, Halverstadt had to have three successful cures, whether cures of medical problems or business problems, certified by investigators from the Mother Church.¹⁸⁴ Amend at first consulted with Halverstadt only on personal matters, but later began consulting with him on business problems as well.¹⁸⁵ The business consultations became frequent enough so that, in 1961, the corporation's board of directors adopted a resolution putting Halverstadt on a monthly retainer.¹⁸⁶ This retainer covered the business consultations and Halverstadt's daily, prayerful intercessions on behalf of the corporation.¹⁸⁷ Amend continued to pay Halverstadt out of his own pocket for consultations about personal matters.¹⁸⁸

Examples of the specific business problems discussed with Halverstadt include:

matters of freight charges in relation to the territory served and package sizes; of the shrinking market and introduction of a new product line; of a new union contract and labor negotiations, particularly women's wage scales relative to men's; of offers from other businesses; of machine production in relation to large packages; of adopting a new costing method and machine production schedules; [and] of internal harmony and dissatisfactions among executive personnel.¹⁸⁹

180. *Id.*

181. *Id.* at 322.

182. *Id.*; Petitioner-Appellant's Brief at 4, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248).

183. Telephone interview with Marcia Kopang, Legal Department, First Church of Christ, Scientist, Boston, Massachusetts (Oct. 13, 1988).

184. *Id.*

185. Petitioner-Appellant's Brief at 7, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248).

186. *Amend*, 55 T.C. at 323.

187. Petitioner-Appellant's Brief at 10-11, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248).

188. *Amend*, 55 T.C. at 323-24.

189. Petitioner-Appellant's Brief at 10, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248) (citations omitted).

Because Christian Science practitioners never give specific advice,¹⁹⁰ Halverstadt would ask a series of questions designed to clarify the issues.¹⁹¹ Through a combination of questions and prayer, Halverstadt invoked the presence of the Divine Mind, so that Amend, through God, was able to reach the proper solution himself.¹⁹² According to Amend, it worked.¹⁹³ Amend testified before the tax court as to Halverstadt's consultations with respect to a machine production problem:

Well, I can tell you what I was bellyaching about, but I cannot give you his (Halverstadt's) reply. We were getting about 325 cases a day out of one of those big machines and we should have been getting 700. Every time we did everything, we would just about get it up to running right and then something would happen. I don't know whether we had a jinx or not. I kept going to him on that, and I know within a short, a very short time, we were getting out 800 cases a day.¹⁹⁴

This author reached Mr. Halverstadt by telephone.¹⁹⁵ The above quotation was read to Mr. Halverstadt, and he was asked if it would be fair to characterize the improvement in the machine's performance as a miracle.¹⁹⁶ Halverstadt replied that it was not a miracle as non-Christian Scientists would define the term.¹⁹⁷ For those not within the Christian Science faith, a miracle is something unnatural or supernatural.¹⁹⁸ According to Mr. Halverstadt, what happened to Mr. Amend's machine was the most natural thing in the world: the workings of the machine were simply realigned with the Divine Mind.¹⁹⁹

The Tax Court disallowed the corporation's claimed deductions for the retainers paid to Halverstadt for tax years 1964 and 1965.²⁰⁰ The court conceded that the origin of the expense was business rather than personal and that Halverstadt's consultations had helped Amend arrive at his business decisions, but noted that "some expenses are so inher-

190. Telephone interview with Marcia Kopang, *supra* note 183; Interview with Mrs. Marjorie Parkinson, Christian Science Practitioner, Winston-Salem, North Carolina (Oct. 10, 1988); Telephone interview with R.H. Halverstadt (Jan. 13, 1989).

191. *Amend*, 55 T.C. at 322.

192. *Id.* at 322-23.

193. *Id.* at 323.

194. Petitioner-Appellant's Brief at 24, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248).

195. Telephone interview with R.H. Halverstadt (Jan. 13, 1989).

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. *Amend*, 55 T.C. at 328.

ently personal that they simply cannot qualify for section 162 treatment irrespective of the role played by such expenditures in the overall scheme of the taxpayers' trade or business.''²⁰¹

[T]he very function served by these meetings—that of imparting spiritual equanimity to the person seeking assistance so that he might pursue matters common to all men with a greater awareness and understanding—militates against their being treated as something particularly suited to the business, in this case, of manufacturing candy. At no time during his consultations with Fred did Halverstadt even offer an observation or solution to a given problem. Instead, his function was served by asking questions calculated to heighten Fred's level of awareness. With new awareness thus imbued, Fred, it was hoped, would then be able to call upon business skills already possessed, and tackle Amend's problems with a greater sense of clarity and understanding.

Hence, it can be seen that it was not Fred's skills as a businessman which Halverstadt sought to enhance. Rather, what was sought was a state of harmony in which Fred's business thinking would be brought into conformity with an ordered universe governed by the Christian Science Church's concept of the Divine Mind. . . . [W]e see little difference between the services provided by Halverstadt and those regularly provided by the duly ordained representative of any other faith whose task it is to bring spiritual understanding to man in his temporal surroundings.²⁰²

The corporation argued in the alternative that Halverstadt's services were a fringe benefit for the employees.²⁰³ As such, they should have been deductible to the corporation as salary and taxable to those employees who used them.²⁰⁴ The Tax Court rejected this argument as well, noting that only the supervisory staff was told of Halverstadt's services, and of them, only Amend actually used them.²⁰⁵

The Tax Court held that the corporation had not met its burden of showing that it had intended Halverstadt's services to be a salary benefit.²⁰⁶ In addition, the court surmised that, even had such an intent been shown, Amend's cash salary plus the value of Halverstadt's services probably would have been unreasonably high compensation in view of Amend's limited activities for the corporation in his later years.²⁰⁷ The

201. *Id.* at 326.

202. *Id.* at 326-27.

203. *Id.* at 327.

204. *Id.*

205. *Id.* at 323-24.

206. *Id.* at 328.

207. *Id.*

court concluded that Halverstadt's services were probably a constructive dividend to Amend, a major shareholder of the corporation.²⁰⁸ The Seventh Circuit affirmed, agreeing with the Tax Court on all points.²⁰⁹

B. Trebilcock

Lionel Trebilcock founded Litco Products, a sole proprietorship engaged in the industrial lumber business, in 1962.²¹⁰ Trebilcock operated the business out of the basement of his home in Girard, Ohio, near Youngstown.²¹¹ In 1969, the firm's gross receipts were \$980,000.²¹² By the time the case went to trial five years later, the firm was grossing a million dollars a month.²¹³

Reverend James Wardrop, an ordained minister of the Open Bible Standard Churches, a Pentecostal denomination, moved to Youngstown in about 1950.²¹⁴ Reverend Wardrop frequently left Youngstown to go on missionary trips and Lionel Trebilcock's father and brothers conducted services for Wardrop in his absence, even though the Trebilcocks were not formally members of his church.²¹⁵

The Trebilcocks began consulting Wardrop on business and personal problems, continuing these consultations even after Wardrop moved to the New York area in 1963.²¹⁶ On occasion, consultations by telephone were insufficient, and Reverend Wardrop flew back to Youngstown at the Trebilcocks' expense.²¹⁷ By 1968, it had become apparent that Reverend Wardrop was spending enough time consulting with the Trebilcocks and Litco Products that it would make sense for him to move back to Youngstown.²¹⁸ Litco offered to employ him at \$585 a month, and Reverend Wardrop accepted.²¹⁹

Essentially, Reverend Wardrop was on retainer for Litco Products, its employees, and the Trebilcock family.²²⁰ He conducted approximately

208. *Id.* at 327-28.

209. *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971).

210. Record at 49-50, *Trebilcock v. Commissioner*, 557 F.2d 1226 (6th Cir. 1977) (No. 76-1387) (statement of Lionel Trebilcock before the U.S. Tax Court, May 14, 1974).

211. *Id.* at 49.

212. *Id.* at 51.

213. *Id.*

214. *Id.* at 64-65, 68 (statement of Reverend James Wardrop before the U.S. Tax Court, May 14, 1974).

215. *Id.* at 65, 68.

216. *Id.* at 65-66.

217. *Id.* at 66, 69.

218. *Id.* at 69-70.

219. *Id.* at 70.

220. *Id.* at 71.

two prayer meetings a week for Litco employees in the basement of the Trebilcock home.²²¹ Although these prayer meetings were voluntary, all five Litco employees attended them frequently.²²² Reverend Wardrop spent five to ten hours per week at Litco holding prayer meetings, consulting with employees on business or personal problems, and occasionally doing errands.²²³ In addition, he went on some ten to twenty business trips with Litco employees, attending trade shows and visiting sawmills and factories during 1969 and 1970.²²⁴

All of the Litco employees consulted with Reverend Wardrop on both business and personal matters.²²⁵ Virginia Crain, a secretary for Litco, testified:

Many times I have terrible headaches, I'd ask him [Wardrop] to pray for me, to God, because I believe that God is the healer and he can do anything and if I had the faith to believe that he would, you know, heal me and take my headache away so I could be a better employee to "Corky" [Lionel Trebilcock] and to Litco Products to do my work.²²⁶

Albert Thomas, a salesman for Litco Products, testified:

Q: . . . In direct examination, you testified that you contacted Reverend Wardrop with respect to customers that you were concerned about. You also spoke of lost customers. What sorts of advice or help would Reverend Wardrop give you when you contacted him about those subjects?

A: Well, I'd call him and I'd ask him to reach out and touch God, to look for answers, for guidance and give me through his prayer, help in answering the problem to regain that lost customer or to better do my work. To face my day with more confidence.

. . . .

Q: When you posed a business or a personal problem, to Reverend Wardrop, did he offer a specific solution, a course of action that you should take?

A: You must understand, that when I would ask him, I would tell him about a specific problem, he would not give me an answer,

221. *Id.* at 55-56.

222. *Id.* at 58-59 (statement of Lionel Trebilcock); *id.* at 84 (statement of Albert Thomas, salesman for Litco Products Company).

223. *Id.* at 56-57.

224. *Id.* at 57 (statement of Lionel Trebilcock).

225. *Id.* at 67.

226. *Id.* at 79 (statement of Virginia Crain).

he would take it to God in prayer. The next day or later on in the week, he would give an answer, advice through his prayer. He might be on his knees, several hours seeking for an answer.²²⁷

The Tax Court found that Reverend Wardrop had performed four types of services: conducting prayer meetings, counselling employees about personal problems, counselling employees about business problems, and specific, secular duties such as running errands and accompanying employees on business trips.²²⁸ As to the portion of Wardrop's salary allocable to conducting prayer meetings, the Tax Court held that its opinion in *Amend* was controlling and disallowed the deduction. "Halverstadt tried to induce a new spiritual awareness in Amend, and Wardrop did essentially the same for petitioner and his employees. The benefits that petitioner and his employees received are personal in nature and so the proscription of section 262 must be invoked."²²⁹ The Tax Court disallowed the deduction for personal counselling on the same theory.²³⁰

As to business counselling, the tax court noted that the weight of *Amend* was uncertain, because Halverstadt had not given specific advice, while Wardrop had.²³¹ The Court noted however that "the solutions Wardrop offered were not based upon his expertise in the brokerage of wood products; he admits he had no such expertise. Rather, his solutions came through prayer from God."²³² The Court held that the petitioner had not met his burden under *Welch* to show that it was ordinary in this industry to get business advice in this fashion and denied the deduction.²³³

The Tax Court did allow a deduction for Wardrop's performance of specific, secular duties.²³⁴ The court allocated \$1,000 of the salary payments in each of the two tax years to this activity, and allowed deductions in those amounts.²³⁵ The Tax Court's opinion was affirmed by the Sixth Circuit in a per curiam opinion.²³⁶

227. *Id.* at 86-87 (statement of Albert Thomas).

228. *Trebilcock v. Commissioner*, 64 T.C. 852, 854-55 (1975), *aff'd per curiam*, 557 F.2d 1226 (6th Cir. 1977).

229. *Id.* at 854.

230. *Id.* at 854-55.

231. *Id.* at 855.

232. *Id.*

233. *Id.*

234. *Id.*

235. *Id.* at 855-56.

236. *Trebilcock v. Commissioner*, 557 F.2d 1226, 1227 (6th Cir. 1977) (per curiam).

C. *Why Amend and Trebilcock Are Wrong*

Amend was wrong on two grounds. First, the fact that Halverstadt did not give specific advice does not mean that he did not render valuable service as a business consultant. Ask any law professor about asking questions without giving answers.²³⁷ Second, Halverstadt's consultations put Amend in a better frame of mind, which made him a more productive employee. Indeed, the Tax Court so found: "with the insight provided by Halverstadt's counsel, Fred was often able to return to his business or private affairs, and approach problems with detachment and new understanding."²³⁸ Yet, the Tax Court found that such conceded business benefit was still too personal.²³⁹

Granted, certain expenditures that are likely to increase employee morale and productivity are so personal that they would be nondeductible to the business, unless they were salary substitutes. Food, clothing, and shelter come to mind, subject, of course, to the limited exceptions in section 119.²⁴⁰ Other expenditures that provide an element of personal benefit to the employee, however, are still deductible by the employer. One example is an on-premises athletic facility such as a company swimming pool or baseball diamond. Such a facility can have no business benefit other than the same sort of increase in employee morale and productivity which was concededly present in *Amend*. Yet, such facilities are deductible by the employer and not taxable to the employee.²⁴¹

Office furnishings are another example. A lavish office may afford a business executive a great deal of personal satisfaction, but also may increase her productivity and create a favorable impression on business customers as well. The personal enjoyment that an executive derives from having an office in a nicer part of town, in a nicer building, or with better than average furnishings does not preclude the business from deducting all of these costs.²⁴²

237. See Petitioner's Reply Brief at 2, *Fred W. Amend Co. v. Commissioner*, 454 F.2d 399 (7th Cir. 1971) (No. 71-1248) ("It has long been recognized that the Socratic method for throwing light on a problem lies in the ability to ask the right questions.).

238. *Fred W. Amend Co. v. Commissioner*, 55 T.C. 320, 322 (1970), *aff'd*, 454 F.2d 399 (7th Cir. 1971).

239. *Id.* at 327.

240. See I.R.C. § 119 (1988).

241. I.R.C. §§ 132(h)(5), 274 (1988); S. REP. NO. 1881, 87th Cong., 2d Sess., § IV(C)(6)(e), at 37 (1962), 1962-3 C.B. 711, 744.

242. "[E]ven the most puritanical definition of business expense is not likely to prevent self-employed taxpayers from deducting the cost of air-conditioning their offices, upholstering their swivel chairs, or adding gadgets to their telephones, even if they derive personal pleasure from

A final example is the office chaplain. R.J. Reynolds has maintained a chapel in its offices for many years, and has kept a chaplain on the payroll.²⁴³ Both the expenses attributable to the office space used for the chapel and the chaplain's salary have been routinely deducted by R.J. Reynolds.²⁴⁴ Other companies are probably deducting similar expenses.²⁴⁵

The expenses in *Amend* had at least as strong a connection to business as those of an employee gym, a company chaplain, or an elegant office. The consultations at issue in *Amend* concerned non-personal decisions about such matters as a machine not producing up to capacity and expansion into a new product line.²⁴⁶ Even if it were conceded that all Halverstadt did was to put *Amend* in a better frame of mind by doing so, he enabled *Amend* to tackle purely *business* problems. As such, there should be no question about their deductibility.

Trebilcock also erred on at least two grounds. First, *Trebilcock* was wrong to deny deductions for prayer and personal counselling on the strength of *Amend*. In *Amend*, the taxpayer offered two alternative grounds for deductibility.²⁴⁷ The court rejected the first ground, that

these amenities." Bittker, *Income Tax Deductions, Credits, and Subsidies for Personal Expenditures*, 16 J.L. & ECON. 204 (1973).

In *LeRoy W. Gillis*, T.C.M. (P-H) ¶ 73,096 (1973), the taxpayer was allowed to depreciate the cost of furnishings that he purchased and used in the office provided for him by his employer. *Id.* at 73-427. Admittedly, the taxpayer would not have had to incur this expense but for the fact that he had a personality conflict with the man responsible for furnishing the new building. *Id.* The Court did note, however, "the obvious necessity of maintaining his 'image' as a successful district sales manager." *Id.*

In *Associated Obstetricians & Gynecologists, P.C.*, T.C.M. ¶ 83,380 (1983), *Alexis M. Hawkins*, T.C.M. (P-H) ¶ 82,451 (1983), *D. Joseph Judge*, T.C.M. (P-H) ¶ 76,282 (1972), and *John R. Thompson Co. v. United States*, 477 F.2d 164, 167-69 (7th Cir. 1973), the proposition that the expenses of hanging works of art in a business office can be deductible business expenses was accepted. In *Associated Obstetricians*, the Commissioner did not dispute taxpayer's deductions for the depreciation of the frames. In all three cases, however, the art works themselves were held not to be depreciable assets.

But see Hoke F. Henderson, Jr., T.M.C. (P-H) ¶ 83,372, at 83-1503 (1983) (lawyer employed by the government denied a deduction for the costs of a framed print and a live plant in her office).

243. Telephone interview with R.J. Reynolds audit staff person (Jan. 10, 1989).

244. *Id.*

245. See *Bernish, Company Chaplain Becomes a Fixture in the World of Mammon; More Concerns Hire Ministers for Prayer and Counseling; Some Clergymen are Critical*, Wall St. J., Dec. 29, 1969, at 1, col. 4.

246. Remember that *Amend's* payments to Halverstadt for personal consultations were not at issue in the case; *Amend* paid for those consultations out of his own pocket, and made no attempt to deduct them. *Fred W. Amend Co. v. Commissioner*, 55 T.C. 320, 324 (1970), *aff'd*, 454 F.2d 399 (7th Cir. 1971).

247. *Id.* at 325, 327.

the payments were deductible as salary, partly because the sole user of Halverstadt's services was a dominant shareholder of the corporation.²⁴⁸ These benefits, therefore, appeared to be constructive dividends.²⁴⁹ In *Trebilcock*, the employer was not a corporation²⁵⁰ and thus the constructive dividend rationale did not apply. Furthermore, Wardrop's services were used by all employees.²⁵¹ The salary argument thus should not have been dismissed so lightly.

On the second and more important ground, business counselling, the court's finding that Wardrop had no expertise was irrelevant. Hiring a consultant to render business advice generally is deductible.²⁵² The court's objection that this particular consultant had no business expertise thus had to stem from one of two concerns: that hiring a business consultant with no expertise was imprudent, or that it was bizarre. As to imprudence, once a court decides that an expenditure is for business, then whether or not that expenditure is prudent cannot be the court's concern. The tax courts have neither the time nor the knowledge to second-guess the business decisions of business enterprises. Moreover, the penalty to the taxpayer in making the wrong business decision—here, arguably hiring the wrong employee to do the job—should be that she will lose money, not that she will lose deductions. It simply cannot be the province of the courts to inquire into the prudence of an otherwise deductible category of expenses.

The other possibility is that Trebilcock's choice of consultant was too bizarre. I submit that this concern is at the core of both *Amend* and *Trebilcock*. The courts were searching for a way to deny the deductions in the two cases, and they found one. Because ministers are not normally hired to give business advice, the deductions could not be protected by business custom. Therefore, the line of cases from *Welch* through *Goedel*, *Giurlani*, *Friedman v. Delany*, and *United Draperies* was used to characterize such deductions as bizarre. What is more, no one could argue with their finding, because no one actually knows what "bizarre" means.

Perhaps bizarre business expenses should be nondeductible on the theory that denying such deductions will provide one more protection

248. *Id.* at 327-28.

249. *Id.*

250. *Trebilcock v. Commissioner*, 64 T.C. 852, 853 (1975), *aff'd per curiam*, 557 F.2d 1226 (6th Cir. 1977).

251. *Id.*

252. *See, e.g., W.D. Haden Co. v. Commissioner*, 321 F.2d 169 (5th Cir. 1963).

against tax evasion.²⁵³ Although bizarre business behavior is more likely than ordinary business behavior to be a disguise for tax evasion, not all bizarre business behavior is illegitimate. Policing tax evasion by barring all bizarre business expenses, therefore, is like policing drunk driving by barring all males under the age of fifty from driving. Both might be effective remedies, but at what cost?

The cost of the nondeductibility of bizarre business expenses is the damage to the creative spirit of the American business community. Every great business idea was once the idea of one, or at most a few, individuals and companies. Such a new innovation could not possibly have been deemed a common business practice when it was first tried out. The expenses incident to the innovation were thus in peril of being held bizarre and therefore nondeductible. What is worse, deciding what is bizarre has been totally at the whim of the court.²⁵⁴

As argued in Petitioner's Brief in *Welch*:

It will not, we think, be disputed as a general proposition that business men should have a free hand to adopt such means as will result in increased business and increased income, resulting in increased revenue to the Government, and that the Government should not exercise a supervisory power over the methods adopted, or determine after the event whether the course adopted was wise or unwise, advisable or inadvisable, prudent or imprudent, so long as no law is violated. It is the taxpayer, whose investment is at stake, who should determine ways and means and not the Government.²⁵⁵

Justice Cardozo admittedly faced a difficult case in *Welch*, but he could have written a better opinion. Adopting the rationale of the Board of Tax Appeals, namely that repayments of debts discharged in bankruptcy are capital while repayments of debts discharged by a composition with creditors are ordinary, may have been incorrect, but the error would have been much narrower, and much of the resulting confusion would have been avoided. Cardozo's short opinion continues to weave a tangled web of capital, ordinary, common, bizarre, personal, and business. The opinion resulted in the development of the sort of incoherent case law that gives judges more power than they should have and gives American businesses considerably less room for flexibility and creativity than they need. A better rule would be that "ordinary" means the opposite of "capital" and nothing more.

253. One would have thought that there was enough protection already. Statutory examples include I.R.C. §§ 183, 262, 263, 465, and 469 (1988).

254. See generally *THE POLITICS OF LAW* 1-10 (D. Kairys ed. 1988).

255. Petitioner's Brief at 10, *Welch v. Helvering*, 290 U.S. 111 (1933) (No. 33).

