Washington University Law Review

Volume 1974 | Issue 2

January 1974

Deductibility of Legal Fees for Tax Advice in Estate Planning, Sidney Merians, 60 T.C. 187 (1973)

DEDUCTIBILITY OF LEGAL FEES FOR TAX ADVICE IN ESTATE PLANNING

Sidney Merians, 60 T.C. 187 (1973)

Petitioners deducted an unitemized bill for legal services from their joint tax return, alleging that the fee was within the intendment of section 212(3) of the Internal Revenue Code of 1954[1] because it arose solely from advice and services on tax matters in connection with the development and implementation of the petitioners' estate plan. The Commissioner's brief acknowledged the "probability that some of the legal fees represented services which are deductible under section 212(3),"[2] but the Commissioner contended there was no evidence upon which to base an allocation and therefore disallowed the entire deduction as a nondeductible personal expense.[3] The Tax Court disagreed as to lack of evidence upon which to base an allocation, interpreted the Commissioner's statement as a concession on the issue of deductibility, and *held*: 20% of the fee was deductible as an expense for tax advice.[4]

Deductions are a matter of "legislative grace,"[5] Congress having the power to provide for or withhold deductions through legislation. Rev-

---

1. INT. REV. CODE OF 1954, § 212(3):

> Expenses for the production of income. 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.

2. Sidney Merians, 60 T.C. 187, 188 (1973).

3. The case would then be governed by INT. REV. CODE OF 1954, § 262:

> Personal, Living, and Family Expenses. Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

4. Sidney Merians, 60 T.C. 187 (1973). The Internal Revenue Service has acquiesced in the decision. 1973 INT. REV. BULL. No. 42, at 6. The decision was entered under Rule 50, indicating neither complete victory nor total defeat, and requiring recomputation of the amount in controversy by the Service. *See* Caldwell, *Tax Court Procedure: Problems but not Pitfalls*, N.Y.U. 27TH INST. ON FED. TAX. 1435, 1446 (1969); Greenberger, *Scope of Rule 50 Computation*, N.Y.U. 12TH INST. ON FED. TAX. 963 (1954); Miller, *Tax Court Pleadings and Rule 50 Settlements: Points to be Considered in the Petitioner's Behalf*, N.Y.U. 5TH INST. ON FED. TAX. 158, 179 (1947).

5. *See, e.g.*, New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934);

enue acts traditionally allow deductions for the "ordinary and necessary" business expenses incurred by a taxpayer in earning his yearly gross income on the premise that determinations of taxable income should realistically account for the costs of business operations.[6] Under one statutory version of this principle, section 23(a) of the 1932 Revenue Act,[7] the Supreme Court ruled that an individual's personal expenses for supervising his own securities investments were not deductible as "the carrying on [of] any trade or business."[8] Congressional response to this decision was to treat all income-producing activities, regardless of their source, as a business deduction.[9] The criter-

---

Lydon v. Commissioner, 351 F.2d 539, 546 (7th Cir. 1965); Zeddies v. Commissioner, 264 F.2d 120, 126 (7th Cir. 1959).

6. This concept has been followed in all federal revenue legislation to date. In the 1913 Revenue Act, the concept began to take the shape it has today:

> That in computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses . . . .

Act of Oct. 3, 1913, ch. 16, § II, 38 Stat. 167.

> Such net income shall be ascertained by deducting from the gross amount of income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any . . . .

Id. at 172. *See generally* Tax on Net Income of Corporations: Message from the President of the United States [President Taft], S. Doc. No. 98, 61st Cong., 1st Sess. 3 (1909): "The tax on net income is preferable to one proportionate to a percentage of the gross receipts, because it is a tax upon success and not failure."

7. Revenue Act of 1932, ch. 209, § 23(a), 47 Stat. 169:

> DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:
>
> (a) EXPENSES. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

8. Higgins v. Commissioner, 312 U.S. 212 (1941).

9. Section 121(a) of the 1942 Revenue Act, ch. 619, tit. I, § 121(a), 56 Stat. 819, expanded § 23(a) into two sections; only § 23(a)(2) is relevant here:

> NON-TRADE OR NON-BUSINESS EXPENSES.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management,

ia established in section 23(a)(2) were reiterated in sections 212(1) and (2) of the 1954 Internal Revenue Act.[10] Section 23(a)(2) had been consistently interpreted by the courts as permitting deduction of expenses incurred in determining income and estate tax liabilities,[11] but the Supreme Court subsequently held that expenses arising out of gift tax liabilities were not included.[12] Congress eliminated this inconsistency when section 212 was enacted by adding subsection (3) to allow deductions for expenses paid "in connection with the determination, collection, or refund of any tax."[13]

---

conservation, or maintenance of property held for the production of income.

See also H.R. REP. No. 2333, 77th Cong., 2d Sess. 46, 74-75 (1942); S. REP. No. 1229, 77th Cong., 2d Sess. 86 (1942) (remarks of Cong. Disney).

Judicial interpretation of the purpose of § 23(a)(2) is clearly stated in United States v. Gilmore, 372 U.S. 39, 44-45 (1963):

> Prior to 1942 § 23 allowed deductions only for expenses incurred "in carrying on any trade or business," the deduction presently authorized by § 23(a)(1). In *Higgins v. Commissioner*, [312 U.S. 212 (1941)], this Court gave that provision a narrow construction, holding that the activities of an individual in supervising his own securities investments did not constitute the "carrying on of a trade or business," and hence that expenses incurred in connection with such activities were not tax deductible. . . . The Revenue Act of 1942 (56 Stat. 798, § 121), by adding what is now § 23(a)(2), sought to remedy the inequity inherent in the disallowance of expense deductions in respect of such profit-seeking activities, the income from which was nonetheless taxable.

10. INT. REV. CODE OF 1954, § 212:

> Expenses for the Production of Income. 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—
> (1) for the production or collection of income;
> (2) for the management, conservation, or maintenance of property held for the production of income . . . .

Judicial understanding of §§ 212(1) and (2) is clearly stated in Meyer J. Fleischman, 45 T.C. 439, 445 (1966): "In connection with section 212(1) and (2), the legislative history specifically states that no substantive change is made from section 23(a)(2) . . . . Thus, the Code simply puts in separate paragraphs what was once one sentence."

11. For cases holding fees deductible as expenses incurred in connection with the management, conservation, or maintenance of property held for the production of income, see Trust of Bingham v. Commissioner, 325 U.S. 365 (1945) (legal fees paid by trustees to contest tax deficiency determination); Baer v. Commissioner, 196 F.2d 646 (8th Cir. 1952) (legal fees to prevent break-up of taxpayer's stockholding as result of divorce settlement which would cause him to lose control of corporation); Nancy Reynolds Bagley, 8 T.C. 130 (1947) (legal fees paid for investment advice and advice on selection of estate plan); Edward Mallinckrodt, Jr., 2 T.C. 1128 (1943) (accounting and auditing expenses in connection with investment activities).

12. Lykes v. United States, 343 U.S. 118 (1952).

13. H.R. REP. No. 1337, 83d Cong., 2d Sess. 29 (1954):

> Existing law allows an individual to deduct expenses connected with earning income or managing and maintaining income-producing property. Under

Initially, the Internal Revenue Service sought to restrict section 212 (3) deductions to actual tax controversies,[14] but has now acquiesced in the decisions of the courts that expenses for tax advice are deductible irrespective of their nature.[15] But the test which the courts will apply in defining what constitutes a deductible expense incurred "in

---

> regulations costs incurred in connection with contests over certain tax liabilities, such as income and estate taxes, have been allowed, but these costs have been disallowed where the contest involved gift-tax liability. A new provision added by your committee allows a deduction for expenses connected with determination, collection, or refund of any tax liability.

Id. at A59:

> Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a contested tax liability, whether the contest be Federal, State, or municipal taxes, or whether the tax be income, estate, gift, property, and so forth. Any expenses incurred in contesting any liability collected as a tax or as a part of the tax will be deductible.

The remarks of the Senate Finance Committee are identical with the second quoted paragraph. *See* S. REP. No. 1622, 83d Cong., 2d Sess. 218 (1954). *See also* notes 1 & 10 *supra.*

14. The Service has based this contention on the repeated use of the word "contest" in relation to tax liabilities in the legislative history of § 212(3). *See* note 13 *supra.* For cases in which the Service has argued in favor of this position, see cases cited note 15 *infra. See also* Kabaker, *Deductibility of Estate Planning Fees,* 54 ILL. B.J. 726, 727 (1966).

15. Kaufmann v. United States, 227 F. Supp. 807 (W.D. Mo. 1963) (fees paid to accountant for preparing statement submitted to Service for ruling on taxability of exchange of shares in corporation held deductible); Munn v. United States, 455 F.2d 1028 (Ct. Cl. 1972) (one-third of amount paid in attorney's fees in divorce proceeding deductible as tax advice and services); George v. United States, 434 F.2d 1336 (Ct. Cl. 1970) (where attorney's fees in divorce proceeding were based upon value of property acquired by client according to fee schedule recommended by state bar association and not upon extent of tax advice, only 10% of fee deductible); Carpenter v. United States, 338 F.2d 366 (Ct. Cl. 1964) (fees paid to attorney for advice relating to tax consequences of divorce settlement held deductible); James A. Collins, 54 T.C. 1656 (1970) (fees paid to attorney for tax advice in connection with purchase of apartment building, preparation of income tax returns, and litigation arising out of those returns held deductible); George L. Schultz, 50 T.C. 688 (1968), *aff'd per curiam on other grounds,* 420 F.2d 490 (3d Cir. 1970). There is some debate whether this is in accord with the position taken by the Service in Treas. Reg. § 1.212-1(1) (1957):

> 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. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of his tax liability or in contesting his tax liability are deductible.

See Sidney Merians, 60 T.C. 187, 194 (1973) (Withey, J., dissenting).

connection with the determination, collection, or refund of any tax"[16] is still uncertain. Under section 212(2) of the 1954 Code[17] and its predecessor in the 1939 Code, section 23(a)(2),[18] the Supreme Court derived two complementary tests for deductibility. In *Trust of Bingham v. Commissioner*[19] the Court held that deductions were allowable if there was a "direct connection" between the expense sought to be deducted and the management, conservation, or maintenance of the property in question, in this case a trust. This standard created a split in the lower courts for nearly twenty years as to whether deductibility could be predicated on the "*consequences* that might result to a taxpayer's income-producing property from a failure to defeat the claim."[20] The conflict was resolved by the articulation of the "origin" test in *United States v. Gilmore*.[21] Maintaining that the "consequences" test would create inequalities based on the type of assets the taxpayer owned when claims asserted against him could be satisfied from income- rather than non-income-producing property, *Gilmore* held that the "origin and character of the claim" were controlling.[22] *Gilmore* eliminated the "consequences" test while not specifically foreclosing reliance on the "direct connection" test stated in *Bingham*. Although section 212(3) was enacted to override the limitations of section 212(2),[23] whether either the direct connection or origin test is to be used in determining deductibility under section 212(3) remains unresolved because the only post-*Gilmore* case that has mentioned the

16. INT. REV. CODE OF 1954, § 212(3).
17. *See* note 10 *supra*.
18. *See* note 9 *supra*.
19. 325 U.S. 365, 374 (1945).
20. United States v. Gilmore, 372 U.S. 39, 48 (1963) (emphasis original).
21. 372 U.S. 39 (1963).
22. Justice Harlan's full statement is as follows:

> But it was manifestly Congress' purpose with respect to deductibility to place all income-producing activities on an equal footing.
>
> . . . [W]e resolve the conflict among the lower courts on the question before us . . . in favor of the view that the *origin and character* of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was "business" or "personal" and hence whether it is deductible or not . . . . We find the reasoning underlying the cases taking the "consequences" view unpersuasive.

Id. at 49 (emphasis original). *See also* United States v. Patrick, 372 U.S. 53 (1963) (companion case to *Gilmore*) (principles governing *Gilmore* held applicable to deny taxpayer deduction for legal fees paid in connection with property settlement incidental to divorce proceedings).

23. *See* notes 11-13 *supra* and accompanying text.

problem looked to "tax consequences" to settle the deductibility issue.[24]

Once a deduction has been provided for by statute, the taxpayer claiming the deduction is required to satisfy two burdens of proof. First, the taxpayer must establish that he is entitled to the deduction.[25] To qualify for deductibility under section 212(3), an "ordinary and necessary" expense[26] must be both reasonable in amount[27] and bear a reasonable and proximate relation to the determination, collection, or refund of any tax.[28] The proximate relation and reasonable amount criteria have been found to allow a deduction for expenses incurred in the preparation of any tax return,[29] as well as the settling of any kind of tax controversy with the Government.[30]

24. Carpenter v. United States, 338 F.2d 366, 367 (Ct. Cl. 1964) (emphasis added):

> Although [the Commissioner] disputes the validity of a good faith allocation made by plaintiff's attorney, the evidence establishes that at least seventy percent of the total bill . . . represented the fee properly allocable to services and advice as to the *tax consequences* flowing from the divorce and separation.

25. *See, e.g.*, Helvering v. Taylor, 293 U.S. 507 (1935); New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1933); Lydon v. Commissioner, 351 F.2d 539 (7th Cir. 1965); Ashcraft v. Commissioner, 252 F.2d 200 (7th Cir. 1958).

26. Treas. Reg. § 1.212-1(d) (1957):

> Expenses, to be deductible under section 212, must be "ordinary and necessary". Thus, such expenses must be reasonable in amount and bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

27. *See, e.g.*, Trust of Bingham v. Commissioner, 325 U.S. 365 (1945); Jones v. United States, 279 F. Supp. 772 (D. Del. 1968); Alex H. Washburn, 33 T.C. 1003, *aff'd*, 283 F.2d 839 (8th Cir. 1960). *See also* note 26 *supra*.

28. *See* notes 14-24 *supra* and accompanying text.

29. Kaufmann v. United States, 227 F. Supp. 807 (W.D. Mo. 1963); James A. Collins, 54 T.C. 1656 (1970); Michael J. Ippolito, 24 CCH Tax Ct. Mem. 894 (1965).

30. Kaufmann v. United States, 227 F. Supp. 807 (W.D. Mo. 1963); Carpenter v. United States, 338 F.2d 366 (Ct. Cl. 1964); *cf.* Trust of Bingham v. Commissioner, 325 U.S. 365 (1945). Judge Davis' dissenting opinion in *Carpenter* challenged the deductibility of expenses arising out of tax matters irrespective of their nature. Premising his argument on the legislative history of § 212(3) and the Supreme Court's avoidance of the issue in United States v. Davis, 370 U.S. 65 (1962), he stated:

> The ultimate consequence of the wider view of the regulation, adopted by this court, is that individual taxpayers will be able automatically to deduct counsel fees paid for the general planning of their holdings and estates so as to minimize income, estate, or gift taxes in the years ahead, or for arranging marital or family affairs with the same end of tax-minimization in the future, or for planning charitable or foundation gifts (and allocation of assets) for such a purpose. Hitherto, the large share of these costs which fall outside section 212(1) and (2) have been personal expenses, barred from deduction by Section 262 of the 1954 Code.

Secondly, the taxpayer must meet the burden of allocation, that is, separating his expenses into deductible and nondeductible categories. According to the courts, the taxpayer meets this burden by making a good faith, reasonable allocation.[31] Moreover, since the 1930 decision in *Cohan v. Commissioner*,[32] the courts have estimated the appropriate deduction when allocations made by the taxpayer have not been reasonable, either because of the excessiveness of the amount deducted or the lack of specificity in calculating the deduction. Under the *Cohan* rule, courts will consider any evidence, offered either by testimony[33] or taken from the taxpayer's incomplete records,[34] and use that information to estimate a reasonable deduction. In so doing, the courts bear heavily against the taxpayer because the "inexactitude is of his own making;"[35] the *Cohan* rule, however, has consistently been

---

338 F.2d at 372 (Davis, J., dissenting) (footnote omitted). *See* notes 3 *supra* & 55 *infra* and accompanying text.

The Court in *Davis* explicitly limited its holding to finding that the husband's payments for his former wife's attorney's fees as required by state law in a divorce proceeding were not deductible under § 212(3) since "we read the statute . . . to include only the expenses of the taxpayer himself and not those of his wife." 370 U.S. at 74. Since there was no challenge by the Service to the husband's deductions for the same type of services, the Court expressly left that question open.

31. Munn v. United States, 455 F.2d 1028 (Ct. Cl. 1972); George v. United States, 434 F.2d 1336 (Ct. Cl. 1970); Carpenter v. United States, 338 F.2d 366 (Ct. Cl. 1964). *See also* Rev. Rul. 72-545, 1972-2 CUM. BULL. 179 (if reasonable basis exists for allocating as tax advice a portion of legal fee incurred in connection with divorce proceeding such portion is deductible under § 212(3)). The majority opinion in *Merians* cited this Revenue Ruling in support of the court's expansive reading of § 212(3). 60 T.C. at 188.

32. 39 F.2d 540 (2d Cir. 1930). Congress placed some limits on the availability of the *Cohan* rule in the Revenue Act of 1962 by specifically requiring substantiation of certain deductions arising out of entertainment expenses. Pub. L. No. 87-834, § 4(a)(1), 76 Stat. 974 (1962) (codified at INT. REV. CODE OF 1954, § 274).

33. Thomas v. Commissioner, 266 F.2d 297 (6th Cir. 1959); Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930); Herbert Schellenbarg, 31 T.C. 1269 (1959), *rev'd on other grounds*, 283 F.2d 871 (6th Cir. 1960). But the court is not required to accept even uncontradicted testimony if it appears highly improbable or manifestly unreasonable. *See, e.g.*, Oliver v. Commissioner, 364 F.2d 575 (8th Cir. 1966); United States v. Lease, 346 F.2d 696 (2d Cir. 1965); Factor v. Commissioner, 281 F.2d 100 (9th Cir. 1960); Clark v. Commissioner, 266 F.2d 698 (9th Cir. 1959); Carter v. Commissioner, 257 F.2d 595 (5th Cir. 1958); Winters v. Dallman, 238 F.2d 912 (7th Cir. 1956).

34. *See, e.g.*, Welch v. Commissioner, 297 F.2d 309 (4th Cir. 1961); Gordon v. Commissioner, 268 F.2d 105 (3d Cir. 1959); Herbert Schellenbarg, 31 T.C. 1269 (1959), *rev'd on other grounds*, 283 F.2d 871 (6th Cir. 1960).

35. Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930). The opinion, written by Judge Learned Hand, stated:

applied even in the face of challenge by the Commissioner.[36]

Congress has authorized the Internal Revenue Service to assess a deficiency when either the burden of deduction or the burden of allocation has not been met.[37] Courts treat these deficiency determinations as presumptively correct,[38] regardless of the absence of particulars or explanations as to how the assessment was made.[39] The taxpayer has the burden of proving that the Commissioner's determination was either erroneous[40] or arbitrary and unreasonable.[41] Prior to

---

> Absolute certainty in such matters [business expenses sought to be deducted] is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. . . . [T]here was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any . . . . It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence.

Id. at 543-44. *But cf.* note 32 *supra.*

36. *See, e.g.*, Earl Vest, 57 T.C. 128 (1971); George L. Schultz, 50 T.C. 688 (1968), *aff'd per curiam*, 420 F.2d 490 (3d Cir. 1970); Estate of A.P. Steckel, 26 T.C. 600 (1956), *aff'd per curiam*, 253 F.2d 267 (6th Cir. 1958).

37. INT. REV. CODE OF 1954, § 6201. *See also id.* §§ 6211-16 (additional procedural rules applicable to deficiency assessments).

38. *See, e.g.*, Welch v. Helvering, 290 U.S. 111 (1933); Lydon v. Commissioner, 351 F.2d 539 (7th Cir. 1965); Hord v. Commissioner, 143 F.2d 73 (6th Cir. 1944). *See also* George v. United States, 434 F.2d 1336 (Ct. Cl. 1970) (court allowed 10% deduction for tax advice and counsel on basis of Commissioner's concession that at most 10% of fee could be deductible).

This position is further substantiated by TAX CT. R. 32:

> BURDEN OF PROOF. The burden of proof shall be upon the petitioner, except as otherwise provided by statute, and except that in respect of any new matter pleaded in his answer, it shall be upon respondent.

In fraud cases, however, the Commissioner must establish the fraud by clear and convincing proof. INT. REV. CODE OF 1954, § 7454(a); *see* Steiner v. Commissioner, 350 F.2d 217 (7th Cir. 1965); Mensik v. Commissioner, 328 F.2d 147 (7th Cir.), *cert. denied*, 379 U.S. 827 (1964); Orkin, *Duty of Going Forward in Civil Tax Fraud Cases*, 42 A.B.A.J. 967 (1956).

39. *See, e.g.*, Barnes v. Commissioner, 408 F.2d 65 (7th Cir.), *cert. denied*, 396 U.S. 836 (1969); Estate of Grace M. Scharf, 38 T.C. 15 (1962), *aff'd*, 316 F.2d 625 (7th Cir. 1963); Meldrum & Fewsmith, Inc., 20 T.C. 790 (1953), *aff'd on other grounds*, 230 F.2d 283 (6th Cir. 1956); Standard Oil Co., 43 B.T.A. 973 (1941), *aff'd*, 129 F.2d 363 (7th Cir.), *cert. denied*, 317 U.S. 688 (1942).

40. *See, e.g.*, Helvering v. Taylor, 293 U.S. 507 (1934); Welch v. Helvering, 290 U.S. 111 (1933); Lydon v. Commissioner, 351 F.2d 539 (7th Cir. 1965); Zeddies v. Commissioner, 264 F.2d 120 (7th Cir. 1959); Hord v. Commissioner, 143 F.2d 73 (6th Cir. 1944). *See also* Cohen v. Commissioner, 266 F.2d 5, 11 (9th Cir. 1959) (court held Commissioner's determination "erroneous in substantial respects"). Once

trial, concessions by the Commissioner as to deductibility do not destroy the presumption of correctness given to his deficiency determinations.[42] Concessions are incorporated into this presumption and are then treated as stipulations; the courts, however, do not hesitate either to modify[43] or reject completely[44] any stipulation by either party when evidence of "manifest injustice" is present.[45] When the Commissioner concedes that some portion of the expense is deductible and the courts concur that a concession is justified as a matter of law, the issue narrows to a determination of whether the taxpayer has effected his burden of allocation between deductible and nondeductible categories.[46]

---

the Tax Court has sustained the Commissioner's determination, it is up to the taxpayer to show that the court's finding was "clearly erroneous." *See, e.g.*, Gromacki v. Commissioner, 361 F.2d 727 (7th Cir. 1966); Lockwood Realty Co. v. Commissioner, 264 F.2d 241 (6th Cir. 1959).

41. *See, e.g.*, Helvering v. Taylor, 293 U.S. 507 (1934); Lucas v. Kansas City Structural Steel Co., 281 U.S. 264 (1930); James E. Caldwell & Co. v. Commissioner, 234 F.2d 660 (6th Cir. 1956); Munn v. United States, 455 F.2d 1028 (Ct. Cl. 1972). Some courts have held it is sufficient to show that the Commissioner's determination was invalid. *See, e.g.*, Weir v. Commissioner, 283 F.2d 675 (6th Cir. 1960); Polizzi v. Commissioner, 265 F.2d 498 (6th Cir. 1959); Federal Nat'l Bank v. Commissioner, 180 F.2d 494 (10th Cir. 1950).

42. *See, e.g.*, United States Holding Co., 44 T.C. 323, 328 (1965); Charles Oran Mensik, 37 T.C. 703, 725 (1962), *aff'd*, 328 F.2d 147 (7th Cir.), *cert. denied*, 379 U.S. 827 (1964); Fada Gobins, 18 T.C. 1159, 1168-69 (1952), *aff'd per curiam*, 217 F.2d 952 (9th Cir. 1954).

43. *See, e.g.*, South Bay Corp. v. Commissioner, 345 F.2d 698 (2d Cir. 1965); Clark v. Commissioner, 266 F.2d 698 (9th Cir. 1959); Davis v. Commissioner, 241 F.2d 701 (7th Cir. 1957). *See also* TAX CT. R. 31(b)(6):

> No evidence received to alter or contradict.—The Court may set aside a stipulation in whole or in part where justice requires, but otherwise will not receive evidence tending to qualify, change, or contradict any fact properly introduced into the record by stipulation.

But see Henry v. Commissioner, 362 F.2d 640 (5th Cir. 1966).

44. *See, e.g.*, Logan Lumber Co. v. Commissioner, 365 F.2d 846 (5th Cir. 1966); Brinson v. Tomlinson, 264 F.2d 30 (5th Cir. 1959); Lewis v. Commissioner, 47 F.2d 32 (3d Cir. 1931); Ohio Clover Leaf Dairy Co., 8 B.T.A. 1249 (1927), *aff'd per curiam*, 34 F.2d 1022 (6th Cir.), *cert. denied*, 280 U.S. 588 (1929).

45. *See, e.g.*, Associated Beverages Co. v. P. Ballantine & Sons, 287 F.2d 261, 263 (5th Cir. 1961); Brinson v. Tomlinson, 264 F.2d 30, 34 (5th Cir. 1959).

46. *See* Munn v. United States, 455 F.2d 1028 (Ct. Cl. 1972) (attorney's fees for tax advice); George v. United States, 434 F.2d 1336 (Ct. Cl. 1970) (attorney's fees for property settlement resulting from divorce action); Carpenter v. United States, 338 F.2d 366 (Ct. Cl. 1964) (legal fees for tax advice in arranging property settlement in divorce action). Failure to submit sufficient evidence of deductibility will result in the entire amount being disallowed. *See, e.g.*, Anderson v. United States, 131 F. Supp. 501 (S.D. Cal. 1955); Arthur D. McDonald, 52 T.C. 82 (1969). *See generally* Balter, *Relief from Abuse of Administrative Discretion*, 46 MARQ. L. REV. 176 (1962); Mar-

In *Merians* the majority broadly construed the effect of the Commissioner's concession[47] as satisfying the taxpayers' burden of proof of deductibility.[48] Despite the Commissioner's contention that there was no basis in the record for making an allocation, the majority resolved the allocation issue. Recognizing that estate planning has tax implications,[49] the court relied on the testimony of petitioners' attorney as the basis for applying the *Cohan* rule to determine the amount deductible under section 212(3).[50]

---

cosson, *The Burden of Proof in Tax Cases*, 29 TAXES 221 (1951); Ness, *The Role of Statutory Presumptions in Determining Federal Tax Liability*, 12 TAX L. REV. 321 (1957); Rice, *Tax, Fact and Fiction: Presumptions in Tax Cases*, 1 S.D.L. REV. 56 (1956); Taylor, *Tax Controversies: Some Administrative and Litigative Aspects*, U. So. CAL. 1962 TAX INST. 257.

47. *See* note 2 *supra* and accompanying text.

48. It is important to note that in two of the four concurring opinions it was stated that concurrence was based solely on the fact of the Commissioner's concession. 60 T.C. at 190 (Scott, J., concurring); *id.* at 192 (Sterrett, J., concurring). Judge Scott's opinion goes so far as to say that "respondent's concession . . . lulled petitioners into offering proof only as to the portion of attorney's fees allocable to 'tax advice' . . . ." *Id.* at 190.

49. The services rendered to the taxpayer were: (1) preparation of a worksheet with respect to the petitioner's present taxable estate; (2) drafting of wills for both petitioner and his wife, taking into consideration the current requirements for the marital deduction; (3) establishment of an irrevocable trust for the primary benefit of the wife; (4) transfer of certain corporate stock to that trust; (5) dissolution of petitioner's corporation; (6) creation of a partnership, with the trust as a limited partner, to hold the real estate previously owned by the dissolved corporation; (7) creation of an irrevocable life insurance trust for the primary benefit of the wife and the transfer of life insurance policies to that trust (concluded after holding a conference with a second attorney); and (8) preparation of gift tax returns by the principal attorney regarding transfers to the trusts. *Id.* at 187-88.

In its opinion the court made the following analysis of estate planning:

> A complete analysis of an estate involves more than a consideration of tax consequences; in fact, it is basically concerned with transferring the client's property to the persons he wishes to receive it. The client's financial condition, the nature of his property, the extent to which he wants various persons to share in his estate, the needs and capacity of each intended beneficiary, the details of State law, and the need for flexibility are among the multitude of factors which are considered in establishing a plan to dispose of a client's wealth.

Id. at 189. *See generally* A. CASNER, 1 ESTATE PLANNING (3d ed. 1961); R. HOLZMAN, ESTATE PLANNING (1967). For a discussion of the possible tax consequences of estate planning services, see Kabaker, *supra* note 14; Note, *Income Tax Deductions for Estate Planning Fees*, 23 VAND. L. REV. 104, 124 (1969).

50. Petitioner's attorney testified that he spent a "great deal of time doing tax work" and that the plan adopted was specifically chosen "for tax implications only." 60 T.C. at 189. This is in accord with the position taken in the cases cited in note 33 *supra*. The court, however, rejected petitioner's claim that the entire fee was for tax

In the first of two dissenting opinions in *Merians*, Judge Withey challenged the presumptive correctness of the Commissioner's concession[51] and maintained that the taxpayers had satisfied neither the burden of deductibility nor allocation. Judge Withey interpreted the Commissioner's statement[52] as conceding that the cost of preparing and filing the gift tax returns was the only deductible portion of the fee. Judge Quealy, on the other hand, felt that no concession had been made by the Commissioner[53] and adopted the Commissioner's position that the record was devoid of any basis for allocating a deduction.[54] Citing the legislative history,[55] both dissenting opinions concluded that fees for estate planning services were never intended to be within the parameters of section 212(3) as expenses incurred in the determination, collection, or refund of any tax.

Merians is a significant case in that it evoked a response from all sixteen members of the Tax Court, yet produced only a plurality of opinion rather than a clear-cut majority stand on the issues presented.[56] Inasmuch as the tax laws are based on voluntary compliance with the system, great weight is justifiably given to determinations by the Commissioner. The potential harshness of such a presumption has consistently been mitigated by holding the taxpayer only to a good

---

advice:

> We do have the attorney's testimony, and it convinces us that a significant portion of his services consisted of tax advice. Yet, because of the vagueness of such testimony and the lack of specificity, the allocation must be weighted heavily against the petitioners. We find that 20 percent of the fee was for tax advice.

60 T.C. at 190.

51. "It has long been settled that a concession or stipulation of parties litigant with respect to law will not bind the Court when it does not agree with their construction thereof." 60 T.C. at 192 (Withey, J., dissenting). *See also* note 44 *supra* and accompanying text.

52. *See* note 2 *supra* and accompanying text.

53. 60 T.C. at 198 (Quealy, J., dissenting) (emphasis added): "The opinion of the majority is based on the *supposed* concession by the respondent . . . ."

54. Judges Withey, Hoyt, and Irwin agreed with this opinion. *Id.* *See also* note 48 *supra.*

55. Judge Withey further stated that he agreed with the position taken by Judge Davis in his dissent in Carpenter v. United States, 338 F.2d 336 (Ct. Cl. 1964). *See* note 30 *supra.* *See also* notes 11-13 *supra* and accompanying text.

56. Predicting future determinations by the Tax Court on these issues is further complicated by the contradictions arising from the two dissenting opinions. Judge Withey would have allowed a deduction for the gift tax, 60 T.C. at 194, whereas Judge Quealy held there was no evidence upon which to base any allocation, *id.* at 198. Judges Hoyt and Irwin agreed with both these opinions, and Judge Withey further allied himself with Judge Quealy.

faith standard for meeting his two burdens of proof,[57] and by the liberality of the courts in applying the *Cohan* rule.[58] *Merians* seems to add another weapon to a taxpayer's arsenal when rebutting the presumptive correctness of the Commissioner's deficiency determination; by holding the Commissioner to his own statements when challenging a taxpayer's claim of deductibility and his allocations under that claim, the court has construed the Commissioner's admission of the probability of deductibility as a concession as a matter of law.[59]

Judicial construction of the scope of section 212(3) is still uncertain. The few cases available indicate that the trend is to allow deductions for tax matters irrespective of their nature,[60] but whether fees for estate planning services, either in their entirety or only in part, fall within the exemption allowed by section 212(3) cannot be ascertained. The flurry of opinions *Merians* produced may be no more than a signal from the Tax Court to the Commissioner to try again for a determination that estate planning fees are not deductible.[61] Thus attorneys and accountants who wish to give their clients immediate tax benefits for their rendering of estate planning services should specifically allocate their bills into deductible and nondeductible categories. Such itemization should preclude the need for litigation and serve to pinpoint the problem areas when conflicts do arise.

57. *See* note 31 *supra* and accompanying text.

58. *See* notes 32-36 *supra* and accompanying text.

59. This contradicts the limitations placed on the use of the Commissioner's concession in Judge Withey's dissenting opinion. *See* text accompanying notes 44 & 51 *supra.*

60. *See* note 15 *supra* and accompanying text.

61. This raises the question whether the Commissioner's acquiescence was for the concession the majority said he made or whether it was directed to the deductibility of estate planning fees. *See* note 4 *supra* and accompanying text.