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FEDERAL INCOME TAXATION:
TRANSACTIONS IN AID OF EDUCATION

By

JOHN C. CHOMMIE*

PART III**

The Payment: Is It A Business Expense?

The problems in the two previous parts of this study concerned the federal income tax consequences of transactions involving the aid of others than the payor. The central theme in this, the third part, might be said to consist of self aid. The motives of the payor here concern his own interests in some manner. A slightly different approach might be taken. The payments dealt with in this part are ordinarily considerational, whereas the previous discussion dealt with payments donative in character. These differences, it will be seen, have bred totally different legal criteria and a stricter judicial approach bearing on the question of tax benefit to the payor.

Congress has expressly furnished the basic criteria for two of the competing concepts of the problems here involved and implicitly provided for the third. Section 23(a)(1)(A) of the Code allows the taxpayer as a deduction from gross income for:

"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. . . ."

On the other hand, Congress has provided in section 23(a)(1) that "in computing net income no deduction shall in any case be allowed in respect of personal, living or family expenses, except extraordinary medical expenses deductible under section 23(x).

The third concept would seem to have its roots in the distinction drawn between income and capital. It is assumed that an expenditure that is characterized as capital is not to be also characterized as a business expense.180

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** (Editor's Note: Part's III, IV, and V herein constitute the final installment of a series begun in the January issue of the DICKINSON LAW REVIEW, the second installment appearing in the March issue.)


180 Cf., I.R.C. § 23(1) and § 24(a)(3).
A third Code provision might seem to bear upon the problems here involved. Section 23(a) (2), under the heading of "Non-Trade or Non-Business Expenses", allows a deduction:

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

This provision was congressional reaction to Supreme Court characterization of an investor's activities as not being embraced within the term "trade or business". It does not seem, however, to be directly involved in the judicial development of the problems here involved.

In short, the competing concepts involved are personal and capital expenditures, on the one hand, which are not deductible and business expenditures, on the other hand, which are deductible in computing net income.

The observation has often been made by the courts that deductions are matters of legislative grace. This is a questionable approach to statutory construction. However, generally, the taxpayer has the burden of proof to bring himself within the statute. Thus, the taxpayer claiming a deduction for an educational expenditure must show: (1) that it was an "ordinary and necessary" expense; (2) that it was paid or incurred during the taxable year; and (3) that it was incurred in the carrying on of a "trade or business".

Individuals

The individual most likely to be making an educational expenditure reasonably related to his trade or business would be a professional person. The case law bears this out. Almost without exception the problems here involved are the problems of the professional person. Therefore, it is with the lawyer, the teacher, the doctor and the like that we are here concerned.

From the standpoint of the three basic Code requirements, the case law does not reveal much conflict with the second and third requirements. The term "trade or business" has been given such a sufficiently broad interpretation, that few professional taxpayers have experienced difficulty here. In other words, a professional, whether self-employed or an employee, is usually treated for tax purposes as being engaged in a "trade or business". The broad issue is ordinarily whether

182 Mrs. Winthrop Rockefeller may have such a problem in connection with the preservation of her estate. "In the evenings, when she does not have guests, she reads about trusts and finance and tax laws, just as she has always boned up on anything that provoked her interest. 'Personal Estate Planning in a Changing World' by Rene Wormser is one of her current texts." Bergquist, "'Bobo As Seen by Her Oldest Friend", 36 Life No. 11, p. 106 at 122 (March 15, 1954). Presumably her expenditures for these educational pursuits would be deductible under § 23(a)(2). Perhaps also would be her expenses in attending the New York University Tax Institute. See Coughlin v. Commissioner, n. 221, infra. Cf., reg. 118, § 39.23(a)-15(f), infra. n. 186.
188 See e.g. Hill v. Commissioner, infra n. 211; I.T.2481, VIII-2 C.B. 292 (1929).
the particular expenditure is a personal, capital or "ordinary and necessary" expense of the taxpayer's professional activity.\footnote{184}

The Capital Concept. It now seems to be conceded that expenses incurred in "laying a foundation for the future" are in the nature of capital expenditures and that expenses incurred in obtaining formal training unrelated to an existing trade or business fall into this category. However, the courts have not always been consistent in classifying such expenditures. For example, in \textit{T. F. Driscoll},\footnote{185} an early Board case, the taxpayer, in anticipation of a singing career, incurred lesson and travel expense. The Board simply found that such expense "at the time made was for educational purposes and of a personal character". Drawing a distinction between personal and capital expenses is often immaterial because in neither event is a deduction allowable. Clarification, however, it will be seen, would aid considerably in the solution of many of the problems.\footnote{186}

A convenient starting point as regards the basic nature of formal educational expenditures is a dictum of Mr. Justice Cardozo in \textit{Welch v. Helvering}.\footnote{187} In the case, the taxpayer was a grain commission agent. He had been associated with a corporate bankrupt. In order to reestablish his customer relations and solidify his credit, he paid some of the discharged corporate debts. These amounts he claimed as business expenses. In upholding a denial of the deduction by the Board of Tax Appeals and the circuit court, Mr. Justice Cardozo said:

"We may assume that the payments... were necessary for the development of the petitioner's business, at least in the sense that they were appropriate and helpful... But the problem is not solved when the payments are characterized as necessary. Many necessary payments are charges upon capital. There is need to determine whether they are both necessary and ordinary. Now, what is ordinary, though there must be always a strain of constancy within it, is none the less a variable affected by time and place and circumstance. Ordinary in this context does not mean that the payments must be habitual or normal in the sense that the taxpayer will have to make them often. A lawsuit affecting the safety of a business may happen once in a lifetime. The counsel fees may be so heavy that repetition is unlikely. None the less, the expense is an ordinary one because we know from experience that payments for such

\footnote{184} The Second Circuit in Coughlin v. Commissioner, discussed infra n. 221, involving the claim of a lawyer that his expenses in attending a tax institute were business expenses, and expressed it thusly, "The expenses were deductible under section 23(a)(1)(A) if they were 'directly connected with' or 'proximately resulted from' the practice of his profession. Kornhauser v. United States, 276 U.S. 145, 48 S.Ct. 219, 72 L.Ed. 505. And if it were usual for lawyers in practice similar to his to incur such expenses they were 'ordinary’. Deputy v. DuPont, 308 U.S. 488,495, 60 S.Ct.363, 84 L.Ed.416. They were also 'necessary’ if appropriate and helpful. Welch v. Helvering, 290 U.S. 111, 54 S.Ct. 8, 78 L.Ed. 212.” 203 F.2d 307, 308-09. The three cited cases are considered the landmark cases in this area.

\footnote{185} 4 B.T.A. 1008 (1926).

\footnote{186} The precise statutory approach is perhaps § 23(a)(2), the non-trade or non-business provision. This perhaps accounts for the view of the Treasury expressed in § 59.23(a)-15 of the regulations that "expenses of taking special courses or training... and expenses such as expenses in seeking employment or placing oneself in position to begin rendering personal services for compensation” are not deductible under § 23(a)(2).

\footnote{187} 290 U.S. 111, 54 S.Ct. 8 (1933).
a purpose. . .are the common and accepted means of defense against attack."

"...the situation is unique in the life of the individual affected, but not in the life of the group. . . ."

"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. . . ."

"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. . . . 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 his 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 goodwill of an old partnership. . . . For many they are the only tools with which to hew a pathway to success. The money spent in acquiring them is well and wisely spent. It is not an ordinary expense of the operation of a business."\(^{188}\) (citations omitted)

This dictum of Mr. Justice Cardozo has been frequently echoed in the lower courts. A case in point is *James M. Osborn*.\(^{189}\) Here, the taxpayer was a non-salaried Yale University professor. In 1940, he expended some $7,000 on literary research in producing three books. One book was distributed free; another was published at the taxpayer's expense in a limited edition; and the third, unpublished, was expected to show a profit. However, the taxpayer testified that his purpose or motive in writing was to establish a scholarly reputation in order to increase his possibilities of obtaining a highly paid position in education.

The Tax Court denied the deduction. It pointed out that the taxpayer's work on his books was his principal occupation but that he was not engaged in writing primarily for profit. It was said that apparently his entire interest was "in laying a foundation for the future. His position was similar to that of any student preparing and training himself for a profession or lifework. . . . The expenses incurred in preparing himself are in essence the cost of a capital structure from which his future income is to be derived."\(^{190}\)

As stated above, the Treasury persists in using the term "personal" in characterizing educational expenses. With regard to preparatory educational expenses, here under discussion, it would seem that logically they could be classified under two headings: (1) personal-capital, and (2) personal-current. The first group might embrace tuition and other expenses in the acquisition of knowledge, and the second group, analogous to current business expenses, might embrace such items

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189 3 T.C. 603 (1944).
190 Ibid., 3 T.C. at 605.
as meals and lodging. Of course, at times a choice would have to be more or less 

arbitrary.\textsuperscript{191}

\textbf{Some "Ordinary and Necessary" Expenses of Professional People.} Once a 

trainee is established in a profession section 23(a)(1)(A) is available. However, 

if a taxpayer's status is that of an employee, he is somewhat restricted simply 

because as an employee he has but few "ordinary and necessary" expenses. 

In this area, there have been a number of rulings and decisions. However, 

the following listing is intended as but illustrative to point up the discussion in 

the following section dealing with the additional formal training of professional 

people.

(1) \textit{Dues:} The current regulations and a long continued administrative prac-

tice recognizes dues paid to professional societies and similar organizations as al-

lowable business expenses.\textsuperscript{192} The cases and the rulings do not reveal a conflict 
as regards such items.

(2) \textit{Cost of publications:} The regulations allow a professional person to de-

duct the costs of subscriptions of professional journals and amounts currently ex-

pended for books "the useful life of which is short."\textsuperscript{193} On the other hand, the 

Income Tax Unit has ruled that while teachers can deduct "the price of their 

subscriptions for educational journals connected with their profession", the "cost 
of technical books is a capital expenditure", and may be subject to a depreci-

ation deduction.\textsuperscript{194} Perhaps there is no intent to make a distinction here, in other 

words, that the costs of technical books "the useful life of which is short" would 

presumably be likewise allowed, and by necessary inference the professional man 

would be required to capitalize the cost of books of a longer useful life. This 

seems to be the standard administrative practice.

(3) \textit{Professional conventions:} The Service fought a ten year losing fight 

with regard to costs of travel, meals and lodging in attending professional con-

ventions and societies. In an early ruling, it was held that amounts expended by 

a physician in attending a medical convention were not deductible.\textsuperscript{195} However, 

after a series of reversals before the Board of Tax Appeals involving a variety of 

\textsuperscript{191} Not all preliminary expenses incurred in preparing for the production of income have been 
treated as personal or capital. E.g., the Service has long allowed fees paid in securing employment 
as business expense. O.D.579, 3 C.B. 130 (1920). It is arguable that such an item is a capital 

expenditure amortizable over the term of the employment secured. However, perhaps in the in-
terests of administrative convenience and the proximity to the actual production of income, a de-

duction is justified.

\textsuperscript{192} Reg.118, § 39.23(a)-5 (dues of professional person paid to professional societies); O.D. 
450, 2 C.B. 105 (1920) (union dues); I.T.3448, 1941-1 C.B. 206 (teacher's dues to professional 

\textsuperscript{193} Ibid. See also Irving L. Shein, ¶ 52,055, P-H T.C. Memo. Dec., allowing a salesman a de-

duction for the cost of a marketing service publication as an ordinary and necessary expense in 
carrying on his selling activities.

\textsuperscript{194} I.T.3448, 1941-1 C.B. 206.

\textsuperscript{195} I.T. 1369, I-1 C.B. 123 (1922), revoked by I.T.2602, X-2 C.B. 130 (1931).
professional types, this ruling was revoked. These items now constitute recognized business expenses for all types of professional taxpayers including teacher-employees.

In one unusual set of circumstances, the Commissioner did salvage a victory. In *Ellis v. Commissioner*, the taxpayer, a lawyer, was allowed a deduction for his expenses in attending an American Bar Association convention, but was denied the costs of a trip to Europe as a member of an association committee studying criminal procedure and law enforcement. The court of appeals said that the trip had "no tendency to increase his professional income, which is apparently contemplated by the statute, unless we consider the too remote effect on his professional prestige of such recognition and activity". The Board of Tax Appeals using similar language had also said that "the purpose of the trip...was not to serve or educate himself but to secure information for the Bar Association".

(4) Research expenses: In this category, and in the others following, the effect of the taxpayer's status as an employee is noticeable. For example, the research expenses of a practicing attorney in connection with the preparation of a lawsuit would clearly be considered ordinary and necessary in his business. With the teacher-employee, however, it is different. An early administrative view was that a college teacher's research, while urged by his college and effecting his professional recognition, was a personal matter in as much as it did not effect the salary he received. This extreme view, however, was later modified by *G.C.M.* 11654. This ruling deals with the research work of a college teacher for which he receives no remuneration. It holds that depreciation on books and instruments used in research and travelling expenses to attend meetings of scientific societies are deductible. It also states that whether expenditures in connection with the publication of the results of investigation, such as plates and figures for illustrative purposes, are deductible will depend upon whether such expenses are ordinary and necessary or constitute capital expenditures. This latter holding is not too clear, but it does seem to constitute a major concession as regards research in general, recognizing such activity as a legitimate part of the teacher's trade or business. However, where the motive or purpose of the teacher in connection with his research is the acquisition of an academic degree, the Commissioner still adheres

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188 I.T. 3448, 1941-1 C.B. 206.

189 50 F.2d 343 (C.A.D.C. 1931).

190 I.T.1520, I-2 C.B. 145 (1922), revoked in so far as such expenditures are characterized as personal by I.T. 2688, XII-1 C.B. 251 (1933).

200 I.T.1520, I-2 C.B. 145 (1922), revoked in so far as such expenditures are characterized as personal by I.T. 2688, XII-1 C.B. 251 (1933).

201 XII-1 C.B. 250 (1933).
to the position that expenditures in connection therewith are personal. This view has recently been upheld by the Tax Court in *Richard Henry Lampkin*.202

(5) Traveling: In addition to allowance of traveling expenses in connection with attendance upon conventions and societies discussed above, the Service has ruled on several other travel expense situations. In *I.T. 2481*,203 such expenses incurred by a university professor spending fifty-six days on an out of town tutoring assignment were allowed in full. Similarly, traveling expenses to a summer assignment have been allowed.204 Also, traveling expenses incurred while on sabbatical leave where the taxpayer was required to report and was limited in the scope of his travels, have been allowed.205 On the other hand, where the purpose of a summer trip to Europe was simply to enrich a taxpayer-professor’s cultural background, his expenses were held by the Tax Court to be personal and expressly excluded by section 24(a)(1).206

(6) Other expenses: The regulations allow a professional person, who is self-employed, deductions for the cost of supplies, expenses and repairs in the use of an automobile used in making professional calls, office rent, the cost of utilities and the hire of assistants.207 Contrasted are the limitations on an employee. In *Chester C. Hand, Sr.*,208 the taxpayer was an employed teacher. He claimed deductions for depreciation on his car, expenses for its upkeep, a portion of his apartment rent, telephone expenses and other items. The court denied all deduction claims. The taxpayer was an employee, and these items did not constitute trade or business expenses nor were the car expenses to be treated as travel expenses as they were merely commuting costs.

The Service, however, has allowed a teacher-employee a deduction for the cost of paying a substitute on a per diem basis as an ordinary and necessary business expense.209

Additional Formal Training. The costs of additional formal training of a professional person command separate treatment. Here, the conflict between the personal and capital concepts on the one hand with the business expense concept on the other is most acute.

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204 G.C.M.10915, XI-2 C.B. 245 (1932), relating to railroad fare only but presumably applicable to meals and lodging as the ruling relies upon and follows I.T.2481, ibid. G.C.M.10915 was a reversal of a previous contrary view, I.T. 1238, 1-1 C.B.122 (1922), revoked by I.T.2640, XI-2 C.B. 246 (1932).
205 I.T.3380, 1940-1 C.B. 29.
206 Manoel Cardozo, 17 T.C. 3 (1951).
207 Reg.118, § 39.23(a)-5. For a unique, but unsuccessful, effort by a lawyer at splitting income via § 23(a)(1) by making payments to his son for the latter’s legal education in return for his future services, see George F. Lewis, 8 T.C. 770 (1947), aff’d. per cur., 164 F.2d 885 (C.C.A.2d 1947).
208 16 T.C. 1410 (1951).
The Service, from an early date, has maintained that formal educational costs are personal. This position it managed to maintain intact up to 1950, when school teacher Nora Hill opened a wedge in the Commissioner's line in Hill v. Commissioner.

In the Hill case, the taxpayer was a public high school English teacher. She was notified that her certificate would not be renewed unless she complied with regulations (state law) requiring either: (1) securing of college credits, or (2) an examination on five selected books. The taxpayer elected to attend Columbia University during a summer session. She enrolled in two courses, short-story writing and abnormal psychology. She claimed as a deduction her transportation expenses and a difference between what her board cost her in New York and what it would have cost in Virginia. The Tax Court denied the deduction. The rationale was that the taxpayer had not satisfied the term "ordinary" in that she did not show that the method she pursued was the "usual method followed" in obtaining certificate renewals, and there was no evidence that the taxpayer was to be retained in her employment.

The Fourth Circuit reversed. It stated that requiring a statistical showing as regards the method following was unreasonable and had not been followed in other cases. It said that it was sufficient to show "a response that a reasonable person would normally and naturally make under the specific circumstances". It pointed out that the taxpayer had not resigned and that she undertook the summer training "to maintain her position; to preserve, not to expand or increase; to carry on, not to commence" and that therefore the Treasury position that summer school expenses are personal was not applicable where, as here, the training is "essentially to enable a teacher to continue her (or his) career in her (or his) existing position".

The Hill decision seems to have had two major effects: (1) it has caused the Treasury to review its traditional position that all additional training costs are personal expenses; and (2) it has encouraged a number of other professional people, particularly school teachers, to attempt to broaden the narrow rule laid down in the case.

In I.T.4044, the Service reconsiders O.D.892, holding summer school expenses of teachers to constitute personal expenses, in light of the Hill decision.

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212 Nora Payne Hill, 13 T.C. 291 (1949).
213 Hill v. Commissioner, 181 F.2d at 909. The court also felt that the Thomas and Hempel cases, supra n.210, where professional singers were allowed deductions for expenses of singing coaches, were highly persuasive, and it also quoted with approval from Professor Maquire's critique of the Tax Court decision in "Federal Income Taxation in 1950", 35 Am. Assn. of Uni. Professor's Bull. 748.
214 1951-1 C.B. 16.
I.T.4044 is limited in application to public school teachers. In analyzing the *Hill* decision, the ruling states:

"In reaching its conclusion, the Court stressed the fact that the taxpayer incurred the expenses 'to maintain her position' . . . Thus, it is apparent that the Court did not hold that all teachers attending summer school may deduct their expenses as "ordinary and necessary business expenses." In cases in which the facts are similar to those present in the *Hill* case, the rule of that case will be applied. . . ."

"In general, summer school expenses . . . for the purpose of maintaining her position are deductible under section 23(a)(1)(A) . . . but expenses . . . for the purpose of obtaining a teaching position, or qualifying for permanent status, a higher position, an advance in the salary schedule, or to fulfill the cultural aspirations of the teachers . . . are personal."

This ruling certainly can not be said to expand on the precise rule of the *Hill* case. It does have some virtue in outlining broadly a number of areas where the Service will continue to litigate. It also raises a number of questions, particularly as regards the meaning of "qualifying for permanent status", and the effect on private school teachers required to have certificates under state law. 216 It does not seem to offer much hope for the teacher in the private school or in the college or university where certification is not required.

The second effect of the *Hill* decision has been to engender some taxpayer boldness. Perhaps the extreme is illustrated by *Chester C. Hand Sr.*, 217 discussed above, where a teacher-employee was denied deductions for depreciation on his automobile, its upkeep expense, a portion of his apartment rent, telephone expense and other items. In addition to the *Hand* case, the Tax Court has distinguished the *Hill* case in denying deductions for expenses in connection with additional formal training where the primary purpose of the taxpayer was the achievement of an academic degree. 218 In *Manoel Cardozo*, 219 discussed above, in denying the costs of a summer European trip to a college professor, the Tax Court commented that whether it followed the court of appeal’s decision in the *Hill* case where the maintenance of position was stressed or its own opinion in the same case the Commissioner must prevail. In a recent decision, however, the Tax Court has indicated that it will follow the Fourth Circuit decision. In *Rhoda Fennell*, 220 the taxpayer, a librarian, was allowed a deduction for expenses incurred in taking

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216 See discussion in Johnson, "Deducting Summer School Expenses", 29 Taxes 749 (1951). Professor Johnson also suggests that boards of education might use the compulsive features of the ruling and the *Hill* case as a device to raise teaching standards.

217 16 T.C. 1410 (1951), cited supra n.208. In all fairness it should be noted that the taxpayer was a non-practicing C.P.A. and perhaps felt that his status would be treated as equivalent to that of a practicing, self-employed, professional person where allowance of such deductions is standard practice. Reg.118, § 39.23(a)-5.


219 17 T.C. 3 (1951), cited supra n.206.

The latest development in this problem of advanced schooling of professional people is the Second Circuit decision in *Coughlin v. Commissioner*.\textsuperscript{221} In this case, the taxpayer, a lawyer, and his firm’s tax man, expended money for travel, tuition, board and lodging in attending a New York University Tax Institute. The Institute was designed for lawyers, accountants and others conversant with taxation. Students were warned away. The Commissioner denied the claim for deduction on the basis of *O.D.984*, a 1921 ruling providing that expenses of postgraduate courses taken by doctors are personal expenses. The Tax Court upheld the deficiency distinguishing the *Hill* decision as being limited to “the facts before the Court”, and concluded:

“The expenses incurred by the petitioner. . . are not deductible as ordinary and necessary business expenses because of the educational and personal nature of the object pursued by the petitioner.”\textsuperscript{228}

The Second Circuit reversed. Circuit Judge Chase noted “how dim a line is drawn between expenses which are deductible because incurred in trade or business. . . and those which are non-deductible because personal”. He rejected the Commissioner’s reliance on the regulations under section 23(a) (2) expressly precluding expenses of special courses or training\textsuperscript{224} and commented thusly on the *Welch* case:

“In *Welch v. Helvering*, . . . there is a dictum that the cost of acquiring learning is a personal expense. But the issue decided in that case is far removed from the one involved here. . . . The general reference to the cost of education as a personal expense was made by way of illustrating the point then under decision, and it related to that knowledge which is obtained for its own sake as an addition to one’s cultural background or for possible use in some work which might be started in the future. There was no indication that an exception is not to be made where the information acquired was needed for use in a lawyer’s established practice.”\textsuperscript{225}

The opinion also pointed out that the expenses under consideration were analogous to expenditures for dues to professional societies, costs of subscriptions to professional journals and books whose useful life is short all of which are allowable deductions under the regulations.\textsuperscript{226} He further said that the case “is closely akin” to the *Hill* case, the only difference being “in the degree of necessity which prompted the incurrence of the expenses”. The taxpayer here, it was said, was “morally bound to keep so informed”, and while the knowledge gained


\textsuperscript{222} 5 C.B. 171 (1921), cited supra n.210.

\textsuperscript{223} George G. Coughlin, 18 T.C. 528, 530 (1952).

\textsuperscript{224} Reg.118, § 39.23(a)-15, cited supra n.’s182,186.

\textsuperscript{225} Coughlin v. Commissioner, 203 F.2d at 309.

\textsuperscript{226} Reg.118, § 39.23(a)-5, cited supra n.’s 192,193,207.
may have increased his "fund of learning in general and, in that sense, the cost of acquiring it may have been a personal expense. ...the immediate over-all professional need to incur the expenses in order to perform his work with due regard to the current status of the tax so overshadows the personal aspect that it is the decisive feature". The opinion concluded:

"It (the professional need) serves also to distinguish these expenditures from those made to acquire a capital asset. Even if in its cultural aspect knowledge should for tax purposes be considered in the nature of a capital asset as was suggested in Welch v. Helvering. ...the rather evanescent character of that for which the petitioner spent his money deprives it of the sort of permanency such a concept embraces."  

The rule of the case seems to be an extension of the Hill case rule that the moral obligation to keep conversant with current tax developments overshadows "the personal aspect" as the "decisive feature". One can only wish that the court had been more explicit in either acceptance or rejection of the capital expenditure concept. In labeling tax knowledge as "evanescent", the court was echoing some fairly common sentiment, sentiment, however, that can hardly be taken seriously.

The decision in the Coughlin case raises a number of important questions. Will the Treasury review O.D.984 as it did O.D.892 after the Hill decision? Where stands the general practitioner handling only an occasional tax matter? The doctor, the dentist, the teacher? Illustrations are hardly needed with regard to the latter groups. All disciplines present knowledge of an "evanescent character" with regard to which there is a moral obligation to keep conversant.

Under the present developed case, at least four basic approaches are possible to the problem of additional formal training of professional people. First, would be an acceptance of the dictum in the Welch case as a basic principle that all expenses in the acquisition of knowledge by a formal type of training constitute capital expenditures. This position would render moot any conflict between the personal and business expense concepts, any determination as to whether the type of knowledge was of an "evanescent character" and any question of determining the taxpayer's purpose or motive. In short, its desirability would like in its simplicity and, perhaps, in the protection it would afford the revenue.

A second approach would be to reject completely the capital expenditure idea in this area and approach all problems from the viewpoint of the personal-business expense conflict. It would seem that a sound argument could be made that such an approach is more in accord with congressional intent and that if Congress had intended to inject the capital expenditure concept into the personal-business expense conflict, it would have expressly so provided. The desirability of such an approach, however, is questionable. While it would have a clarifying effect on analysis, it might invite a considerable amount of litigation.

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227 Coughlin v. Commissioner, 203 F.2d at 309.
228 Ibid.
A third approach would be a limited acceptance of the Welch dictum. For example, as limited to preparatory training and additional training of a cultural nature. Once this question is decided, the air would be clear for a determination of whether the expense was personal or an "ordinary and necessary" business expense. This approach might be desirable from the standpoint of a conceptual tax jurisprudence.

A fourth approach, and one which seems more in accord with current developments, would be the converse of the preceding one. In other words, a determination on the personal-business expense conflict, and then, if necessary, resolving the question of whether the expenditure is current or capital in nature. This approach would likewise be desirable from the viewpoint of a conceptual tax jurisprudence. However, it suggests a number of problems. How are reliable criteria to be established for distinguishing between the temporary and the more permanent type of learning? Would all expenditures be controlled by the basic characterization? However, this seems to be the present trend as suggested by the Coughlin and perhaps the Hill opinions. If so, additional litigation and a restatement of the Treasury position would seem to be a reasonable anticipation.

Corporations

Business corporations are governed by the same basic criteria of section 23(a)(1)(A) as individuals. However, the nature of a corporation as a business entity does not raise the problem as to whether it is engaged in a trade or business, and, of course, there is no competition with the personal expense concept. The basic problem is simply whether the payment is "ordinary and necessary".

Prior to 1936, contributions or gifts by corporations could be deducted from gross income only if they qualified as business expense. The 1936 Revenue Act added what is now section 23(q) permitting a corporation a charitable deduction limited to five per cent of net income before the deduction. In 1938, section 23(a)(1)(B) was added to provide that a gift qualifying under section 23(q) would automatically disqualify as a business expense under section 23(a). The purpose of this latter provision was to give substantial effect to the five per cent limitation of section 23(q). These provisions seem to have substantially reduced the volume of litigation on the question of whether a gift is an ordinary and necessary business expense.

In light of the foregoing provisions, classification would seem to command a distinction between payments made to qualifying section 23(q) organizations and those made to non-qualifying organizations. A third group of problems, growing in importance, results from payments made in aid of the education of corporate employees. A consideration of these problems will provide the final category discussed herein.

229 For the legislative history see 4 Mertens, § 25.96-25.97, n's. 51 and 52, pp. 497-498. For text of § 23(o)(2), similar to § 23(q)(2), see supra n.23.

280 Ibid. For current text of § 23(a)(1)(B) see infra n.232.
Payments Made to Section 23(q) Organizations. The major problems in connection with the character of a corporate gift as a deductible contribution were discussed in the second part of this study.\textsuperscript{281} Therefore, the scope of inquiry under this heading at this point is limited to a single broad problem of the payment to a section 23(q) organization supported by a consideration.

Section 23(a)(1)(B) makes no specific provision for the treatment of a payment to an educational, or other qualifying charity, under section 23(q) supported by a consideration.\textsuperscript{282} Implicit, however, would be its non-applicability where a payment is not, in fact, a gift. And the regulations so provide:

"The limitations provided in section 23(a)(1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23(q)) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied."\textsuperscript{283}

These provisions do not seem to have presented too many difficulties. The only litigated case is the relatively recent decision of the Tax Court in McDonnell Aircraft Corporation.\textsuperscript{284} Here, the taxpayer, a St. Louis aircraft manufacturer, made a $5,000 grant to Washington University. The corporate board resolution called the payment a "contribution". The payment was conditioned upon it being allowed as a donation for tax purposes and that the university would be able to obtain firm commitments to cover the engineering school budget and provide a course in aeronautical engineering. On the taxpayer's return the $5,000 was deducted as an educational contribution, and the total contributions were within the five per cent limit. However, upon application of a carry-back loss, the taxpayer's total contributions exceeded by some $3,500 the five per cent limitation. The taxpayer claimed this excess should be allowed as a business expense under the regulations set out above.

The Tax Court denied the deduction on grounds that the evidence failed to show that the university was bound to do anything in exchange for the money. The court admitted that there were some facts giving color to the taxpayer's claim, but it seemed highly impressed by the original characterization of the payment as

\textsuperscript{282} Sec.23(a)(1)(B) provides: "No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the requirement therein that payment must be made within the taxable year." The regulations illustrate its application thusly, "if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 per cent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000." Reg.118, § 39.23(a)-13(a).
\textsuperscript{283} Ibid., § 39.23(a)-13(b).
\textsuperscript{284} 16 T.C. 189 (1951), dismissed on consent, 191 F.2d 733 (C.A.8th 1951).
a gift. It also stated that "many...contributions to colleges are limited to support some particular phase of activity and many are in consideration of the gifts of others. But these facts do not automatically render such contributions business expenses."285

From a planning viewpoint, this situation presents some problems. Should the taxpayer attempt a "binding agreement" and fail, he runs the risk of a total loss of the deduction for want of donative intent. Perhaps this is borrowing trouble, but an administrative ruling could clarify this. With a growing recognition on the part of business corporations of a moral obligation to support private education,286 equity here would seem to demand clarity. A total loss of a deduction would not seem to be justified in such a situation.

Payments Made to Non-Qualifying Organizations. Payments made to educational organizations not qualifying under section 23(q) and, as indicated above, those founded upon a consideration must meet the basic criteria of section 23(a) in order to qualify as a business expense. Section 39.23(a)-13 of the current regulations provide in this respect:

"Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation’s business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q)) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars."

As indicated above, prior to 1936, a gift or contribution by a corporation to be allowed as a deduction at all must qualify as a business expense. Therefore, the decisions rendered on returns prior to 1936 would be in point here in determining whether the "ordinary and necessary" requirements are met.

Broadly, the test in determining whether a payment to an educational organization is "ordinary and necessary" is, as the regulations indicate, whether or not the payment bears a "direct relationship" to the corporate business. This, of course, furnishes no more aid in solving a particular problem than the use of the terms "ordinary and necessary". Of more help is an examination of the criteria that the courts have said indicates a direct or indirect relationship.

Most of the taxpayer victories in this area have resulted from a showing of some type of patronage received directly from the recipient. For example, in C. M.

285 Ibid., 16 T.C. at 199.
286 "All of these considerations must lead the reflecting mind to the conclusion that nothing conducive to public welfare, other than perhaps public safety is more important than the preservation of the privately supported institutions of learning which embrace in their enrollment about half the college-attending youth of the country." Stein, J.S.C., in A.P. Smith Mfg. Co. v. Barlow, 26 N.J.Super.106, 97 A.2d 186 (1953), aff'd, 13 N.J. 145, 98 A.2d 581 (1953), upholding a gift by an industrial concern to Princeton University against a claim that the gift was ultra vires. For a scholarship plan designed to meet the desires of industry to support education see 62 Time No.25, p.74 (December 21, 1953).
Guggenheimer, Inc., the taxpayer, a small town department store, contributed sums to three colleges, a Y.M.C.A., a Y.W.C.A., a hospital and several other charities. The Board of Tax Appeals allowed all of the contributions as business expense because the testimony of a corporate officer was said to support a showing of a direct benefit either through a prior understanding or through a known result of increased business from the various recipients. A similar result has been reached where an electric power company contributed to an endowment fund of a local college, a substantial patron of the taxpayer.

On the other hand, contributions motivated primarily by the fact that such gifts are "good business" or because the taxpayer felt some obligation to a college recipient because of the taxpayer's withdrawal as a tenant have not been allowed. Further, even where contributions to charitable organizations have been influenced in part by the amount of trade received, unless the correlation of gift to trade is reasonably close, the courts are not apt to be influenced in finding that a direct relationship exists.

A finding of a direct relationship, however, is not limited to the increased trade pattern. For example, in Holt-Granite Mills Co., the taxpayer contributed $10,000 to a school district to assist it in erecting a badly needed school. Some eighty to ninety per cent of the students in the district were children of the taxpayer's employees, and there were other manufacturing plants within a five mile radius in school districts with superior facilities. The Board of Tax Appeals allowed the gift as a business expense on the grounds that it directly affected the taxpayer's business in that adequate school facilities would tend toward a reduced labor turnover and would improve employee morale.

A case that illustrates what might well be a growing trend in industry-education institution relationships, and similar to the McDonnell case pattern, is Times-Picayune Publishing Co. In this case, the taxpayer, a newspaper publisher, had experienced difficulty in procuring efficient reporters. He had attempted, without success, to get local Tulane University to establish a department

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240 J. A. Majors Co., 5 B.T.A. 260 (1926).
241 J. A. Majors Co., 5 B.T.A. 260 (1926); Adam, Meldrum and Anderson Co., 29 B.T.A. 419 (1933); Adam, Meldrum and Anderson Co., ¶ 34,021, P-H B.T.A. Memo. Dec.
242 1 B.T.A. 1246 (1925); cf., E. M. Holt Plaid Mills, Inc., 9 B.T.A. 1360 (1928), where the taxpayer contributed to three churches attended by its employees who composed twenty to thirty-five per cent of their membership, the Board stating that, "it has not been shown that these contributions were necessary in order to afford petitioner's employees church facilities."
243 An off-the-beaten-track type of direct relationship was found to exist in B. Manischewitz, 10 T.C. 1139 (1948). In this case, payments were made to a foreign Jewish seminary. Deductions were allowed upon a showing that the missionaries from the school aided the taxpayer in helping to overcome the impression that the taxpayer's machine made matzoth were not kosher, as required by Jewish dietary law. The court also said that the taxpayer's personal and religious motives did not prevent characterization as a business expense "provided there are reasonably evident business ends to be served and the intention to serve them appears adequately from the record."
244 27 B.T.A. 277 (1932).
or chair of journalism. The taxpayer then contracted with Tulane to pay them $6,000 a year for ten years, Tulane agreeing to maintain a school of journalism. The $6,000, the department's only income, was used solely for the chair. The Board of Tax Appeals allowed the deduction stating that it was clear that the payment was not intended as a gift but was a "cold-blooded business proposition".

While the Times-Picayune case involved a tax year prior to 1936, presumably the same result would be reached under the regulations set out above. Where a binding contract exists not only is the corporation free of the five per cent limitation, but also it would be able to justify to its shareholders a more extensive aid to education.\footnote{See supra n. 236.}

**Payments in Aid of Employees Education.** Payments in aid of employees education might take two forms: direct aid to individuals and aid granted an employee's welfare organization.

(1) **Direct aid:** Where an employee is aided directly, as a form of a fringe benefit, the payment would ordinarily have to qualify as "a reasonable allowance for salaries or other compensation for personal services actually rendered" under section 23(a)(1)(A) of the Code. How widespread is such a business practice is difficult to ascertain. The little authority on the matter might indicate that such a fringe benefit is not a common industrial practice or that such a transaction is clearly a payment of additional compensation. The latter would seem justified. With full time employees, the training in such situations would probably be limited to part time schooling of some type. In one early ruling, the Service held that where a corporation encouraged or required employee attendance at part time schools, it could deduct reasonable amounts paid as compensation to such employees during their absence from their employment.\footnote{O.D.850, 4 C.B. 30 (1921). The costs of outside speakers have been allowed as business expenses, Lewis-Hall Iron Works, 2 B.T.A. 788 (1925), as well as instruction costs of training apprentices, I.T. 3403, 1940-2 C.B. 63. In I.T.1304, 1-1 C.B. 72 (1922), supra n.15, corporate expenditures for books, tuition, etc. were ruled taxable income to their employees. Presumably deductions would be allowed the payor. See Hoffman, "Fringe Benefits For Employees," 31 Taxes 999, 1001-1002 (1953).}

Another type of full time employee educational training would be temporary absence in the taking of refresher courses and in attending educational institutes. In Pacific Grape Products Co.,\footnote{17 T.C. 1097 (1932).} the Tax Court allowed a deduction for the traveling expenses of two employee-chemists attending a refresher school. The taxpayer was a canner, and the courses were to acquaint the chemists with the new developments in the food processing industry. How far could an employer go in underwriting a long term leave of absence? While the requirement of "services actually rendered" might not be satisfied, it is arguable that a demonstrable need for such trained personnel might satisfy the "ordinary and necessary" criterion.

Another type of direct educational aid on which there seems to be a want of authority from the standpoint of a business expense is the corporate scholarship
award. While such payments can not as yet be deemed common, there is a growing recognition of the desirability of such programs from the long range standpoint of labor pools. Unless the recipient renders substantial services, such payments could hardly qualify as reasonable compensation. Could they qualify as ordinary and necessary expenses? If there were an immediate and acute personnel shortage in the particular industry and a binding contract of some type, by analogy to the *Times-Picayune* case, it is arguable that such an expenditure would be sufficiently direct as to so qualify. On the other hand, if the purpose was merely to fill the needs of a long range industry-wide labor pool, a taxpayer might find that he could not surmount arguments that the benefits were indirect or that the expenditure was of a capital nature.

(2) Employee welfare organizations: The second form that employee educational benefit might take is through the medium of an employees' welfare organization. Of course, if the organization qualifies under section 23(q), the corporation is subject to the five per cent limitation and the payment is governed by the charitable contribution criteria. However, an employee organization might well have the educational development of its members as simply one of many objectives without qualifying under section 23(q). This would seem to be representative of the typical situation. Therefore, if the organization does not qualify under section 23(q), would an employer contribution constitute an ordinary and necessary business expense? The *Weil Clothing Co.* decision would seem to be persuasive authority that it would.247

In the *Weil Clothing* case, the employee group, devoted primarily to the payment of sick and disability benefits, had been ruled a section 101(8) organization. In 1943, the taxpayer made one payment of $829.50, equal to the dues collected, in accordance with past practice, and made a special payment of $12,000 to improve the financial structure of the organization and to enable it to more adequately meet the anticipated demands on the organization's funds. The special payment constituted about six per cent of the taxpayer's annual payroll. The employee group had thirty-nine members, a majority of the taxpayer's personnel.

The Tax Court allowed the full amounts as ordinary and necessary business expenses. The Commissioner's position was evidently based on a line of cases denying similar expenditures as business expenses where the payor either retained a control over the payments or where the employees did not receive a present interest.248 These cases were distinguished. The court also rejected the Commissioner's capital expenditure argument on the grounds that while the taxpayer received a benefit, it was not one which should be capitalized.

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247 13 T.C. 873 (1949); cf., discussion in second part of this study, 58 DICKINSON LAW REVIEW 189, 207-210, e.g. T. J. Moss Tie Co., 18 T.C. 188 (1952), non-acq., 1952-2 C.B.5, supra, n. 143.

The little authority involving corporate payments in aid of employee's education as business expenses precludes a satisfactory synthesis. Further judicial and administrative developments might be anticipated. What authority that does exist, however, does not indicate a hostility in the courts toward a claim of such expenditures as business expenses.

PART IV
H.R.8300—THE 1954 INTERNAL REVENUE CODE

At this writing, H.R.8300, the proposed Internal Revenue Code of 1954, has passed the House. Changes can be anticipated in the Senate and in Conference. Whether the changes will affect the problems here under consideration may be doubtful. Two reasons can be advanced for this. The proposed legislation does not seem to depart materially from existing case law nor constitute a material invasion of the revenue. Further, the legislation is reported to have involved some two years of intensive technical study. It is not likely that too many of the technical changes will be summarily thrown overboard. With these reservations, the foregoing study will be effected as indicated.

The Receipt: Is It Income or a Gift?

Section 61(a) of the new Code, corresponding to section 22(a) of the 1939 Code, still expressly embraces "compensation for services, including fees, commissions and similar items", as one of the many income categories. Now explicit is the established judicial doctrine that the listing of income items is illustrative, not exclusive.

Section 102(a) of the new Code, corresponding to section 22(b)(3) of the 1939 Code, expressly excludes gifts from gross income. Therefore, superficially, there is no change in basic approach. However, the detailed Code provisions discussed below do indicate a substantial departure from the old norms.

The Contest Prize. Section 74(a) of the new Code is new. It provides that:

"Except as provided in subsection (b) and in section 117 (relating to scholarships and fellowship grants), gross income includes amounts received as prizes and awards."

The committee report states that this rule would overrule both the Washburn and the McDermott cases. However, the latter was overruled by the Supreme Court in the Robertson decision and the Washburn case has been rejected by the Treasury. This general rule, however, should remove any doubt in the minds of a few federal judges such as in the Bates case.

250 Supra n.4. For a recent decision holding a commercial prize (automobile) in a newspaper circulation contest taxable, see Reynolds v. United States, 118 F.Supp. 911 (D.C.N.D.Calif. 1954), distinguishing the Bates and Washburn cases, supra n.4. It might be noted that the Supreme Court has recently reversed the Federal Communications Commission ruling prohibiting radio and television give-away programs. Federal Communications Commission v. American Broadcasting Co., Inc., —U.S.—, 74 S.Ct. 593 (1954). But for the 1954 Internal Revenue Code the standing of the Washburn case would therefore again assume considerable importance.
It might be noted that the new provision is wider in scope than the decision in the Robertson case, limited as it was to the formal contest. No contract limitation is imposed upon the provision as it is now proposed.\(^251\)

The Scholarship Award and the Research Fellowship. Section 117 of the new Code has no corresponding provision in the 1939 Code.\(^252\) Section 117(a), stating the general rule, expressly excludes from gross income scholarship and fellowship awards for study at educational institutions as defined in section 151(e)(4),\(^253\) in short, at institutions where a regular faculty and student body is maintained.

\(^{251}\) The provision is not unlike that proposed by the American Law Institute Income Tax Project, draft of which was deposited with the Treasury and the Ways and Means Committee. See Surrey, "The Income Tax Project of the American Law Institute," 31 Tax Rev. 959 (1953). The influence of this project on H.R. 8300 is deserving of a separate study as an objective lesson in what can be accomplished by cooperative legal research in even so complex an area as federal taxation. It might be noted that one of the salient features of the project, correlation of the income, estate and gift taxes, does seem to have been rejected. This is said without a studied comparison. However, the project contemplated a common gift definition. This seems to have been rejected and the common law concept still retained for income tax purposes.

\(^{252}\) SEC. 117. SCHOLARSHIPS AND FELLOWSHIP GRANTS. (a) General Rule.—In the case of an individual, gross income does not include—(1) any amount received as a scholarship (including the value of contributed services and accommodations) at an educational institution (as defined in section 151(e)(4), or as fellowship grant; and (2) any amount received to cover expenses for—(A) travel, (B) research, (C) clerical help, or (D) equipment, which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient. (b) Limitations.—(1) Teaching or research services.—Subsection (a) shall not apply to that portion of any amount received which represents payment for teaching or research services in the nature of part-time employment required as a condition to receiving the scholarship or fellowship grant. (2) Individuals not candidates for degrees.—In the case of an individual who is not a candidate for a degree, subsection (a) shall not apply to amounts received as scholarships or as fellowship grants if the annual amount of the scholarship or fellowship grant (excluding amounts described in subsection (a)(2)) plus sabbatical year compensation from the recipient’s employer prior to receiving the scholarship or fellowship is seventy-five per cent or more of the recipient’s salary, if employed, or earned income (as defined in section 911(b)), if not employed, in the twelve month period ending with the month preceding the month in which the scholarship or fellowship is granted. It might also be noted that indirect aid to education was also provided in sec. 152(d) of the new Code in that for purposes of the dependency allowance of sec. 152(a) it is provided: "(d) Special Support Test in Case of Students.—For the purposes of subsection (a), in the case of any individual who is—(1) a son, stepson, daughter or stepdaughter of the taxpayer (within the meaning of this section), and (2) a student (within the meaning of section 151(e)(4), amounts received as scholarships for study at an educational institution (as defined in section 151(e)(4)) shall not be taken into account in determining whether such individual received more than half his support from the taxpayer.”

\(^{253}\) Sec. 151(e)(4) in defining “educational institution” provides that it “means only an educational institution which normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on.” The committee report amplifies this, “It means primary and secondary schools, preparatory schools, colleges, universities, normal schools, technical and mechanical schools and the like, but does not include non-educational institutions, correspondence schools, on the job training, night schools and the like.” Ways and Means Committee Report No. 1337, 83rd Cong., 2d Sess., 4 P-H Tax Ser., ¶ 66,000, 137-138, hereinafter cited to tax service. The exclusion of “night schools” seems questionable in light of the wording of the Code.

The committee report also explains the application of § 117(a) to faculty children tuition remittance plans. "If an educational institution . . . maintains or participates in a plan whereby the tuition of a child of a faculty member of any such institution is remitted at any other participating educational institution . . . attended by such child, the amount of tuition so remitted shall be considered to be an amount received as a scholarship under this section.” Ibid., ¶ 66,000.134. Perhaps the fair import of such plans is the award of a scholarship, but it is also arguable that such comment constitutes rule making by committee report.
The exclusion expressly extends to amounts received, to the extent actually expended, for travel, research, clerical help and equipment.

This general rule is more precise, but, in effect, could be said to bring about the same result obtained by I.T.4056 that a grant made to further the individual training of an individual, no services being required, is a gift.254

Section 117(b), however, contains two important limitations on the general rule. First, section 117(b)(1) expressly provides that the general rule is inapplicable where the grant or award is, in effect, a working fellowship. This seems to be but a codification of the Tax Court position taken in the Banks and Doerge cases.255 Second, section 117(b)(2) imposes a qualified limitation on non-degree research awards. This provision seems to be intended to apply to situations where the recipient is, in effect, simply continuing his previous activities now funded by a scholarship or fellowship grant. Apparently realizing that grants are sometimes small in relation to previous working salaries, an arbitrary test of seventy-five per cent is applied. In other words, if the award is in excess of seventy-five per cent of salary (or earned income as defined in section 911(b))256 for the previous twelve months, the general rule of exclusion does not apply.

In computing the amount of the award, amounts received for travel, research, clerical help or equipment are excluded, and amounts received representing "sabbatical year or other compensation from the recipient's employer prior to receiving the scholarship or fellowship grant" are included. (Emphasis added) The antecedent to the term "prior" is the term "employer". An annualization of the awards seems to be provided by the use of the term "annual amount of the scholarship or fellowship grant", and has been so illustrated by example in the committee report.257

254 Supra n.13.
255 Supra n.17.
256 Sec.911(b) in defining "earned income" excludes corporate distribution "which represents a distribution of earnings or profits rather than a reasonable allowance as compensation", and also establishes an arbitrary rule where "both personal services and capital are material income-producing factors" of a "reasonable allowance as compensation for personal services" but not in excess of thirty per cent of net profits.
257 "A and B are research chemists employed by the X company at salaries of $10,000 per annum. On September 1, 1954, B receives a fellowship grant of $5,400 to engage in research for the academic year (9 months) but is not a candidate for a degree. He also receives $50 a month from X company during the term of the fellowship as an inducement to accept the fellowship. The annualized amount of the fellowship is twelve-ninths of $5,400 or $7,200. B also receives $450 from X, his previous employer, during the term of the fellowship. The total of these two amounts is $7,650. The fellowship grant would not be excluded from income. Assume the above facts with respect to B except that he receives no compensation from X during the term of the fellowship and, upon completion of the fellowship, he returns to his job with X and is paid $1,000 per month. In such case, the annual amount of the fellowship is $7,200, no compensation is received from X during the term of the fellowship and hence, the $7,200 is excludable from gross income by B, unless subsection (b)(1) applied." 4 P-H Tax. Ser., ¶ 66,000.135. Computation is hardly necessary to demonstrate that the $50 a month payment to B could hardly be labeled an "inducement" in the usual situation. If B were married with two dependents and took the standard deduction, his tax on $5,850 would be $570 on a twenty per cent base rate. In such situations, "inducements" will undoubtedly be deferred until a return to employment.
The statute does not expressly provide for treatment of award renewals, but the language seems to justify the rule for computation stated by the committee:

"It is intended by your Committee that the extension or renewal shall be treated as a separate scholarship or fellowship grant but that the income in the 12 preceding month's period used in the seventy-five per cent test shall be the income in the 12-month period prior to the grant of the original scholarship or fellowship." 268

To the extent that research scholarship and fellowship awards do not exceed seventy-five per cent of the previous twelve month's salary, section 117(b)(2) constitutes a rejection of the Service position taken in I.T.4056. 259 Where the awards do so exceed seventy-five per cent, it constitutes an acceptance of the ruling, perhaps the result of a compromise with the Treasury.

The Achievement Award. Section 74(b) of the new Code expressly excludes from the application of the general rule that gross income includes prizes and awards, that is "amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational artistic, or civic achievement". 260 This exception is applicable only if the recipient has not taken steps to enter the contest and is not required to render substantial future services as a condition to its receipt. The committee report indicates that such awards as the Nobel prize would be thus excluded, and also amplifies the section's application:

"Subsection (b) is not intended to exclude prizes or awards from an employer to an employee in recognition of some achievement in connection with his employment, such as having the largest sales record or best production record during a certain period. Amounts received from radio and television giveaway shows, or as door prizes, or in any similar type contest would also not be covered by subsection (b)."

Section 74(b) seems to be but a codification of previous administrative practice and is in accord with the dictum of Mr. Justice Douglas in the Robertson case. 261

Summary. Generally, these new Code provisions codify existing administrative practice and judicial rule. The principal departure is the exclusion of the research fellowship award not meeting the seventy-five per cent test. However, these new provisions suggest a number of perplexing questions. Where now stands donative intent? Would it be impossible for an employer to make a gift to an employee taking a leave of absence to engage in research? Would the recipient of a scholarship contest prize be governed by section 74(a) or section 117(a)?

268 Ibid.
259 1951-2 C.B. 8, discussed supra n.15.
260 Sec.74(b) provides: "(b) Exception.—Gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if—(1) the recipient was selected without any action on his part to enter the contest or proceeding; and (2) the recipient is not required to render substantial future services as a condition to receiving the prize or award." It might be noted that the Treasury has now ruled that a Pulitzer prize, discussed supra n.21, is a gift. Rev. Rul. 54-110, 1954-14 I.R.B. 4.
261 Supra n.20.
it be impossible for the sponsor of a contest to manifest donative intent toward the entrants and award prizes in addition to those competed for?

The answer to some of the difficulty may, perhaps, lie in considering whether or not the new provisions constitute a change in approach. Under existing case law and administrative ruling, the basic approach is simply: Has the taxpayer established a donative intent on the part of the payor? Do these new Code provisions now focus on the new criteria leaving section 102(a) (donative intent) hovering in the background? If the answer is yes, the new provisions should have a decided clarifying effect. But, donative intent has proved to be a tough, elastic concept. Attempts to confine it are perhaps worthy of the effort. However, how it will manifest itself now must await administrative and judicial development.

The Payment: Is It A Charitable (Educational) Contribution?

Section 170 of the proposed Code, using the committee report term, “consolidates” sections 23(o), 23(q) and 120 of the 1939 Code. The significant

262 For a recent discussion of the intent factor in federal income taxation see Fischer, “Intent and Taxes”, 32 Taxes 303 (1954).

263 SEC.170 CHARITABLE, ETC. CONTRIBUTIONS AND GIFTS. (a) Allowance of Deduction.—(1) General rule.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowed as a deduction only if verified under regulations prescribed by the Secretary or his delegate. (2) Corporations on accrual basis.—(b) Limitations.—(1) Individuals.—In the case of an individual the deduction provided in subsection (a) shall be limited as provided in subparagraphs (A), (B), (C), and (D). (A) Special rule.—Any charitable contribution to—(i) a church, a convention or association of churches, or a religious order, (ii) an educational organization referred to in section 503(b)(2), or (iii) a hospital referred to in section 503(b)(5), shall be allowed to the extent of ten per cent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172. (B) General limitation.—The total deductions under subsection (a) for any taxable year shall not exceed twenty per cent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172. For purposes of this subparagraph, the deduction under subsection (a) shall be computed without regard to any deduction allowed under subparagraph (A) but shall take into account any charitable contributions to the organizations described in subparags (i), (ii), and (iii) which are in excess of the amount allowable as a deduction under subparagraph (A). (C) Unlimited deduction for certain individuals.—(D) Denial of deduction in case of certain transfers in trust.—No deduction shall be allowed under this section for the value of any interest in property transferred after March 9, 1954, to a trust if—(i) the grantor has a reversionary interest in the corpus or income of that portion of the trust with respect to which a deduction would (but for this subparagraph) be allowable under this section; and (ii) at the time of the transfer the value of such reversionary interest exceeds five per cent of the value of the property constituting such portion of the trust. For the purposes of this subparagraph, a power exercisable by the grantor or a non-adverse party (within the meaning of section 672(b)), or both, to revest in the grantor property or income therefrom shall be treated as a reversionary interest. (2) Corporations.—In the case of a corporation, the total deductions under subsection (a) for any taxable year shall not exceed five per cent of the taxpayer's taxable income computed with regard to—(c) Charitable Contributions Defined.—For the purposes of this section, the term “charitable contribution” means a contribution or gift to or for the use of—(1) A State, a Territory, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes. (2) A corporation, trust, or community chest, fund, or foundation—(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State or Territory, the District of Columbia, or any possession of the United States; (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, for the prevention of cruelty to children or animals, or for the benefit of any government referred to in paragraph (1); (C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (D) no substantial part of the
substantive change pertinent to this study is contained in section 170(b)(1)(A), characterized as a "special rule", providing an additional ten per cent deduction for contributions paid directly to a special group of charities. One of these is "an educational organization referred to in section 503(b)(2)". In short, an educational institution maintaining a regular faculty and student body. The general twenty per cent limitation for individuals is maintained, and it is provided that any amount in excess of the ten per cent allowed under the "special rule", is to be taken into account under the general limitation. The committee report illustrates the computation:

"For example, if an individual pays a charitable contribution of $2,000 to a university and $1,200 to an organization not described in subsection (b)(1)(A), and if such individual's adjusted gross income is $10,000, then the deduction allowed under section 170(a) would be $3,000. The first $1,000 paid to the university is allowed under the special rule... However, the second $1,000 is taken into account under subparagraph (B) (the general limitation) with the $1,200 paid to the organization not described in subparagraph (A); by applying the twenty per cent limitation of subparagraph (B), only $2,000 of the $2,200 is allowed as a deduction."  

The educational institution thus secures an additional benefit. The donor whose charity would exceed the twenty per cent limitation but who could not meet the rigid requirements of the ninety per cent rule of the unlimited deduction provision, is thus furnished with additional incentive to contribute. It should be noted, however, that the new Code liberalizes the unlimited charitable deduction. Section 170(b)(1)(C) provides that the ninety per cent test is to be satisfied where the contributions exceed ninety per cent of net income for nine of the ten preceding years instead of for each of the ten preceding years as section 120 currently provides.

activities of which is carrying on propaganda, or otherwise attempting to influence legislation. A contribution or gift by a corporation to a trust, chest, fund or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). (3) A post or organization of war veterans, or an auxiliary unit or society of, or trust or foundation for, any such post or organization—(A) organized in the United States or any of its possessions, and (B) no part of the net earnings of which inures to the benefit of any private shareholder or individual. (4) In the case of a contribution or gift by an individual, a domestic fraternal society, order, or association, operating under the lodge system, but only if such contribution or gift is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. (d) Disallowance of Deductions in Certain Cases.—(e) Other Cross References.—The new Code provision for the trust and estates' charitable contribution deduction is found in § 642(c) (§ 162(a) of the 1939 Code); the Estate Tax in § 2055(a)(2) (§ 812(d) of the 1939 Code); the Gift Tax in § 2522(a)(2) (§1004 of the 1939 Code). The § 101 exempt organizations are now listed in § 501 of the new Code. Supra n.'s 23, 24, 25, and 67.

264 Sec.503(b)(2) defines an "educational organization" in terms similar to an "educational institution" defined in § 151(e)(4), supra n. 253.

265 4 P-H Tax Ser., ¶ 66,000.149 (1954). "It is to be noted that such charitable contributions must be paid to the organization and not for the use of the organization. Accordingly, payments to a trust (where the beneficiary is an organization described in said clauses (i), (ii), or (iii)) are not included under this special rule." Ibid., p 66,000.148.

266 Supra n.64.
Subject Matter and Mode of Transfer. The significant contribution in this area is a loophole plugging provision designed to meet an abuse not embraced within the subject matter of this study, viz, the short-term charitable trust, a blood relative to the short-term or Clifford trust.\(^\text{267}\)

The loophole provision is understandable only in light of the new provisions dealing with the so-called Clifford trusts. Section 673 of the new Code deals with reversionary interests, a matter covered only in the Clifford regulations under the 1939 Code. Section 673(a), stating the general rule, taxes the income of reversionary trusts of less than ten years duration to the grantor. However, section 673(b) provides a liberal exception:

"Subsection (a) shall not apply to the extent that the income of a portion of a trust in which the grantor has a reversionary interest is, under the terms of the trust, irrevocably payable for a period of at least 2 years (commencing with the date of the transfer) to a designated beneficiary, which beneficiary is of a type described in section 170(b)(1)(A)(i),(ii), or (iii)."

Under this provision, a taxpayer could create a three year trust for the benefit of any special rule organization, and secure a deduction for the year of creation for the present value of the three year term. At the same time he would not be taxable on the trust income during the term of the trust. In this manner, he could, in effect, increase his charitable contributions beyond the section 170 limitations. With the Treasury efforts to apply the Clifford regulations to the short-term charitable trust largely unsuccessful, it is apparent that section 673(b) would invite still further abuse of the charitable limitations provisions. To curtail what has been labeled "in effect a double deduction", section 170(b)(1)(D) was added to H.R.8300 on the floor of the House.\(^\text{268}\)

This provision proposes to deny a deduction "for the value of any interest in property transferred after March 9, 1954, to a trust if the grantor has a reversionary interest in the corpus or income...and at the time the value of such reversionary interest exceeds five per cent of the value of the property..."\(^\text{269}\) A reversionary interest includes a power to revest in the grantor "exercisable by the grantor or a nonadverse party...or both".\(^\text{267}\)

\(^{267}\) See e.g. Commissioner v. Clark, 202 F.2d 94 (C.A.7th 1953); Rev. Rul. 54-48, 1954-6 I.R.B. 5. For a discussion of the cases on short term charitable trusts see Note, 1954 Wis. L. Rev. 164.

\(^{268}\) In introducing the amendment on the floor of the House, it was said: "This amendment was unanimously adopted by the Committee and its purpose is to plug the loophole which has been in existing law. The loophole was made more apparent at the time the Committee adopted the liberalization policy in regards to charitable trusts created for a term of years with reversionary rights to the grantor. Under existing law, by means of these charity trusts, a grantor was able in effect to get two deductions, first for the amount which was deducted from his gross income, and then the same amount as a charitable deduction. This amendment simply provides that only the deduction from gross income is granted and the charitable deduction is not granted." Cong. Record, March 18, 1954, p 3356.

\(^{269}\) Full text cited supra n.263. The technique was probably suggested by the 1949 Technical Changes Act provision providing the test for inclusion of reversionary interests in a decedent's gross estate. I.R.C. § 811(c)(2) and (3), now provided for in new Code § 2037.
It will be noted that it is limited to transfers in trust, and to situations where there is a power to re vest in the grantor alone. It probably suggests a number of other limitations of an avoidable nature. However, where applicable, it seems to have a much more drastic effect than would the application of the Clifford regulations to the short term charitable trust for the purposes of an allowable deduction.

What Is Education? A Social Organization? A Propaganda Organization? The proposed Code contemplates no substantial changes in the foregoing areas. However, it should be noted that an educational propaganda organization such as Facts Forum, discussed in the second part of this study, would not be embraced within the application of the new "special rule". Therefore, the sponsors or donors of such an organization will still be subject to the twenty per cent limitation.

What Is A Business Organization? The proposed Code contemplates no substantial changes in this area. Section 502 of the new Code now embraces the feeder organization provision separately from the general listing of exempt organizations in section 501, section 101 of the 1939 Code. It should be noted that the term "supplement U income" has been eliminated, being replaced by the term "unrelated business taxable income"; the term "supplement U lease" is replaced by the term "business lease".271

What Is A Private Purpose? No substantial changes are proposed in this area germane to the problem here under survey.272 The prohibited transactions of the 1950 Revenue Act are now found in section 503, section 3813 of the 1939 Code. The non-deductibility sanctions pertinent here, are now found in section 681(b) (5), section 162(g) (2) (E) of the 1939 Code; and in section 503(e), section 3813(e) of the 1939 Code. Section 503(b) lists the excepted organizations provided for in section 3813(a) of the 1939 Code. Section 503(c), section 3813(b) of the 1939 Code, and section 681(b) (2), section 162(g) (2) (B) of the 1939 Code, list the prohibited transactions that give rise to the loss of and the limitations on the deductions.

One minor change is proposed. Section 681(b) (1), corresponding to section 162(g) (2) (A) of the 1939 Code, brings the trust's deduction to the twenty per cent level from the fifteen per cent level, when the prohibited transaction sanctions have been imposed. The committee report indicates that the purpose of the increase was to "correlate the limitation with the charitable deduction allowed to individuals under section 170(b) of this bill".273

Summary. In general, the most significant changes proposed by the new Code as regards the problem of educational deductions, are the increased allowance of ten per cent under the "special rule" and the loophole provision of section 170(b) (1) (D). The effect of the former proposal is to create two classes of edu-

270 supra n.105.
271 Sec.511-515 incl. of the proposed Code.
272 It might be noted that certain employee pension trusts are now expressly made subject to the prohibited transactions provisions. Sec.503(a) (1), referring to § 501(e). See also § 503.
rational organizations, the preferred "special rule" organization and the general limitation organization. In time to come perhaps some litigation may be anticipated as to whether a particular organization falls within the special rule. It is to be noted that the deduction limitation refers to the definition contained in section 503, a carry-over definition from the 1950 Revenue Act, while the scholarship and fellowship limitation refers to the definition contained in section 151. The committee report is silent on the former, but as regards the section 151 definition of an educational institution comments:

"The term 'educational institution' means a school maintaining a regular faculty and established curriculum and having an organized body of students in attendance. It means primary and secondary schools, preparatory schools, colleges, universities, normal schools, technical and mechanical schools and the like, but does not include noneducational institutions, correspondence schools, on the job training, night schools and the like."

It should be pointed out that the language of section 151(c)(4), which is substantially equivalent to the language in section 503(b)(2), does not justify the distinction made in the committee report based on the time of the day in which instruction is offered. Perhaps the term "night schools" in the report is an inadvertence.

The Payment: Is It A Business Expense?

Section 162(a)(1) and (2) of the proposed Code is substantially equivalent to the portion of section 23(a)(1)(A) of the 1939 Code set out in Part III above. No substantial changes are proposed. The new Code retains the same basic "ordinary and necessary" criteria for both individuals and corporations. Similarly, section 262 of the proposed Code adopts in substance the terminology of section 24(a)(1) of the 1939 Code by simply providing that "except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses".

In a relocation move, the non-trade and non-business expense provision of section 23(a)(2) of the 1939 Code, was removed from the general classification of business expense to an area covering additional deductions for individuals. However, no substantive change is proposed and section 212(1) and (2) corresponds to section 23(a)(2) of the 1939 Code.

While no change in basic approach is contemplated, the new Code does propose one significant change. As discussed above in connection with corporate deductions, section 23(a)(1)(B) of the 1939 Code provides that a corporate pay-
ment qualifying as a charitable contribution under section 23(q) is disqualified
from any further consideration as a business expense deduction. This provision un-
der section 162(b) of the proposed Code is now extended to embrace indi-
viduals.277 The committee report indicates that "no substantive change is made
in the application of this rule".278

PART V
TAX POLICY TOWARD EDUCATION—TWO PROPOSALS

Long before the excitement engendered by the proposed 1954 Internal Reve-
nue Code has died down,279 the mundane task of amending it will have com-
menced. Adjusting tax legislation to a complex and dynamic economic structure
will always be a never-ending task. In this process, experience seems to indicate
that most improvements of lasting worth as may result from the legislative process
will be, however labeled, patchwork. Of necessity then, attention must be cen-
tered on economic groups and institutions. Only when clear cut policy toward such
bodies has been established can they be properly integrated into the whole tax
structure.

The foregoing study, including the proposed Code changes, hardly reveals a
clear cut, comprehensive tax policy toward private education. It does reveal, how-
ever, a number of irritants. To two of these the balance of this study is devoted with
the suggestion that satisfactory solutions will be a step forward in working out
a definite and workable tax policy toward private education. These two irritants or
problems may be characterized as: (1) the problem of the propaganda organi-
zation; and (2) the problem of individual deductions for educational purposes.

The Problem of the Propaganda Organization.

The problem of the propaganda organization is primarily the problem of
the public dissemination organization claiming and receiving educational status.
The question then might be whether or not there is any evidence that these doc-
trinal groups have or are engaged in activities inconsistent with their preferred
status as educational organizations, activities that are abusive or unfair. Of course,
what is abusive and unfair is but a question of degree and but broadly reflects cur-
rent tax morality. But Congress, in reflecting this current tax morality, treats edu-
cation—not doctrine—preferentially. The underlying theory is that private edu-
cation is performing a function that would otherwise be performed by govern-
ment in the interest of all the people. Therefore, unless doctrine (propaganda)
and education are synonomous as used in this context, the focus is and should be
on the meaning of the term "education", not upon the principle of freedom of

277 Sec... 162(b) provides: "No deduction shall be allowed under subsection (a) (supra n.275)
for any contribution or gift which would be allowable as a deduction under section 170 were it not
for the percentage limitations, or the requirement as to the time of payment, set forth in such section."
278 4 P-H Tax Ser., ¶ 66,000.140 (1954).
279 Say, in two or three hundred years.
Tested abstractly by the meaning of the term "education" the question then is whether the doctrinal group qualifies. In so far as objectivity is associated with education, the doctrinal group does not qualify. However, in the broad sense, the individual's assimilation of doctrine (propaganda) is educational, and in the realities of rule making, the courts have accepted this, inconsistent as it may be with basic theory and popular conception. To this extent, education and doctrine are not distinguishable. John Harvard, Karl Marx, Henry George, and H. L. Hunt lie in the same tax bed. In so far as they have a doctrine, however, we have drawn the line when any of them take active steps to induce the legislature to impose their doctrine on others. We have also drawn the line at a second place. Doctrine based on a use of force and violence is likewise disqualified as educational. This is commanded by an overriding policy of public safety. Now, the recent investigation of Facts Forum, as outlined in the second part of this study, raises the question as to whether the line should not also be drawn at still a third place.

Facts Forum is represented as a public dissemination organization commanding a large audience. It pursues a variety of mass communication methods. These include the Facts Forum News with a circulation of 60,000, television programs, a public opinion poll and a "both sides" radio program, its principal technique and medium, carried coast-to-coast over some 222 stations, largely on free time.

In the basic investigation of Facts Forum conducted by reporter Bagdikian, it is revealed that the organization qualifies under section 101(6) and 23(o)(2) as an educational organization. The principal tax benefits under the latter section seem to flow to the organization's "angel", H. L. Hunt, of Dallas, Texas. Mr. Hunt is represented to be one of the richest men in America with an estimated gross income of $200,000 daily. Mr. Bagdikian also writes:

"Facts Forum has existed for 30 months. During the first—and relatively quiet—half of its life Facts Forum spent about $200,000 of tax-free dollars, and the Hunts gave Facts Forum $219,000 tax-free dollars. Facts Forum will not say what its current budget is. But in the second 15 months of its operations it has expended enormously. It has added at least four regional offices with paid organizers (one in Hunt's birthplace, Vandalia, Ill.), and entered network radio and television activities on a coast-to-coast scale. So there is reason to believe that the $200,000 expenditures of the early months of Facts Forum is only a fraction of the current budget. In those early months, the Hunts supplied more than 95 per cent of the listed contributions."

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281 Supra n.105.


283 Ibid. at p. 2.

284 Ibid. at p. 3.
One of the principal announced purposes of *Facts Forum* is that of combating communism. Under this banner, however, reporter Bagdikian concludes that it advances a political philosophy or doctrine of its own using a variety of techniques in the field of mass communications. In the concluding part of his eight part series, reporter Bagdikian summarizes the criticisms that have been leveled at *Facts Forum*. The first eight he classifies as minor, the ninth as a major danger from this educational organization:

1. *Facts Forum*’s presentation of ‘both sides’ of national issues for purposes of educating the voter appears to be heavily biased on the side of isolationism, ultraconservatism and McCarthyism.

2. *Facts Forum* uses its powerful facilities of free radio time and the 60,000 circulation of its News, plus news releases to newspapers, radio stations and every member of Congress, to express the personal political philosophy of H. L. Hunt and the chief *Facts Forum* moderator, Dan Smoot.

3. (Despite the Code stricture against propaganda organizations) the facilities of *Facts Forum* are used to conduct a ‘public opinion poll’ which it admits is not a cross-section poll but merely a device to...
exert a powerful psychological force" which is then applied through
news releases and membership pressure on organs of public opinion and
on Congress.\footnote{288}

4. Despite this same rule, the funds of Facts Forum are used to sub-
sidize expressions in newspapers which are ostensibly merely individual
opinions but for which Facts Forum pays, with a 9-to-1 preponderance
of the rewards going to those expressing isolationist, ultra-conservative
and McCarthyist views.

5. The activities of Facts Forum have attracted known race-hate
agitators who have led and addressed local Facts Forum meetings.\footnote{289}
The works of known religious agitators have been distributed by Facts
Forum as 'voter education'.\footnote{290}

6. (Despite the \textit{Code} enurement clause). . . . Facts Forum has used
its public relations machinery for the unusual promotion of the company
of one of its national officers, Gen. Robert E. Wood. . . . Sears, Roebuck
has used the commercial facilities of its organization to distribute the
literature of Facts Forum, notably in Washington, D.C., but also in other
localities.\footnote{291}

\footnote{288} Mr. Bagdikian says, "Each month Facts Forum mails out 120,000 postcards with poll ques-
tions on them. It says it gets about 12,000 back. All signed cards are counted in the poll. Facts Forum
suggests that members fill out the cards together at their meetings. "The results are then incorporated
into a news release which goes to 1,800 newspapers all over the country, 500 radio stations and to
all members of Congress. The news release refers to it only as a 'public opinion poll'. However,
in its own publication, the Facts Forum News, it is described not as a cross-section poll—which
most editors, radio newsmen and Congressmen would assume a 'public opinion poll' to be—but a
poll of 'informed' (that is, Facts Forum membership) opinion. Ibid. at p. 15. Some of the ques-
tions, requiring either a "yes" or "no" answer, not only require the illogical acceptance of two
major premises, but also contain highly emotional terms. They appear almost absurd. e.g., "Are
internationalists less tolerant of Communism than the average citizen?". . . Would destruction of
Christianity from within be worst of all treason?". . . "Is the inroad of Communism in Latin America
more dangerous to us than our tolerance of Communists in the United States?". . . "Is Congress in-
advisably abdicating its Constitutional powers?". . . "Are the pink segments of the press losing
their power?". . . "Can the pinks filch the word FREEDOM as they have others of fine U.S. tra-
dition?". Ibid. at p. 16.

\footnote{289} Bagdikian says, "Early this year when a new Facts Forum unit was formed in the New York
City church of a national adviser to Facts Forum, Dr. Norman Vincent Peale, the first speaker to
address the group was Allen A. Zoll. Zoll attacked the United Nations as a device to permit the
colored races to rule the white races and charged that UNESCO is an alien conspiracy to teach sex
delinquency to American school children. A protest to Dr. Peale from a parishioner brought no
disapproval of Zoll but praise for Facts Forum." Ibid. at p. 12.

\footnote{290} E.g. S.M.U. Professor John O. Beatty's book, "Iron Curtin Over America" (1951), later
withdrawn by Facts Forum from its circulating library under formal protest of the Anti-Defamation
League. Ibid. at p. 12. Mr. Bagdikian says, "The highly respected Protestant magazine Zions
Herald, has this to say of the author and this book: 'Beatty is a recent "intellectual" addition to the
lengthening list of outspoken bigots across the country, and his volume appears to be the most
extensive piece of racist propaganda in the history of the anti-Semitic movement in America.'"
Ibid. A recent review of the same book by "a group of S.M.U. law professors . . . denounced it as
a collection of 'spurious doctrines and bigoted theories of racial and religious prejudice.'" 63

\footnote{291} Bagdikian says, "A page one article of the Facts Forum News, a tax-free publication sent
to 60,000 persons including all members of Congress, declared in part, 'It is very appropriate that
Sears, Roebuck should be sponsoring Facts Forum. For Sears, Roebuck and its mail order business
is as American as the town hall meeting itself. 'Since Sears, Roebuck is helping us in our fight to
overcome apathy and indifference, it might behoove us to express our appreciation and friendship
for Sears whenever possible.'" Ibid. at p.22.
7. There has been participation by associates of Sen. Joseph R. McCarthy in the planning and operations of Facts Forum which surpasses the realm of coincidence. Senator McCarthy also has been the beneficiary of unusual treatment in the basic programs of Facts Forum.

8. The grass roots operations of Facts Forum have often exhibited a spirit which is the opposite of free debate in good faith...

9. But, the major criticism that can be made of Facts Forum is that its net effect is to disseminate fear, suspicion and divisive propaganda. The consistent pattern of its 'both sides' broadcasts is to reduce all national issues to isolationism, ultra-conservatism and McCarthyism—versus—treason or stupidity.

The results of this, if carried into the entire field of mass communications, could be to increase the pressures dividing segments of American society, to increase group hatreds, and to implant suspicions which did not exist before...

To this impressive list of criticisms might be added a tenth and that is a tendency to increase in the popular mind a distrust of the tax policy that accords the educational organization a preferred place in the federal income tax structure. This could be a serious threat to private education dependent as it is upon private beneficence. Measured by any popular conception of the proper functioning of an educational organization, the Facts Forum type of organization is little more than an educational masquerade. To contend that Facts Forum is performing a quasi-governmental service in disseminating the personal philosophy and doctrine of H. L. Hunt and Facts Forum seems incredible.

There are two possible approaches to meet this threat to sound tax policy: (1) administrative and judicial reappraisal of the established test of legislative activity as indicative of the propaganda organization; or (2) congressional redefinition by amendment to the Code.

Judicial Reappraisal. Reporter Bagdikian suggests that Facts Forum violates the enurement clause in the Code in its promotion of Sears, Roebuck and Com-

292 Bagdikian says, "In Dallas a few months ago, the YMCA-YWCA at Southern Methodist University held an open debate on the subject: "UNESCO Under Fire". From a pro-United Nations organization it obtained a speaker to defend UNESCO. From a pro-United Nations organization it obtained a speaker to defend UNESCO. The students applied to the headquarters of Facts Forum for an anti-United Nations speaker and Facts Forum supplied one. The results of this student meeting were commented upon by an editorial in the student newspaper, "The S.M.U. Campus". Speaking of supporters who accompanied the Facts Forum speaker, the editorial declared, "Using fascist tactics, a group of adults invaded and gained control of the meeting. Before the debate started, around 30 adults entered the meeting, and scattered themselves through the audience. They tried to twist opinion to their side by loud applause of their speaker and in some cases by laughing at the opposing speaker. They monopolized the question and answer period, reading from material they brought, made character assassinations, and used guilt by association as their most powerful weapon. Although the meeting was not closed to outsiders, the members of the 'Y' were surprised that the organization asked to furnish one of the speakers had also supplied an audience and some additional speakers. As the question and answer period became more heated a young woman who had been sitting on the front row jumped up and viciously attacked one of the speakers. The 'Y' members who had gathered for Christian fellowship and information about an important topic were a bit shocked. The sentiments of the audience were best expressed the next day by a student who before the discussion had taken no side in the matter: "I couldn't sleep last night for thinking I had been in a meeting of the German-American Bund." "Ibid.
pany. However, what he offers would probably be insufficient to satisfy a court, under existing doctrine, that anything but an incidental benefit is enuring to the benefit of a private person.\textsuperscript{293} This leaves for consideration the suggestion, as outlined in his third and fourth criticisms above, that its "public opinion poll" and its subsidies of "letters to the editor" constitute legislative activity.

Reporter Bagdikian suggests that the actual handling of the Facts Forum "public opinion poll" may constitute legislative activity. He states that in Facts Forum's own literature it is admitted to be not a poll at all. He quotes Facts Forum:

"'The purpose of the poll is to focus the attention of large numbers of people in all walks of life and in all parts of the nation on a carefully selected group of important questions.\textsuperscript{294} By thus causing thousands of people to consider the same group of questions at the same time, the poll may be invoking a powerful psychological force for good.'"\textsuperscript{295}

(footnotes supplied)

Mr. Bagdikian then states that Facts Forum instructs its members in the Facts Forum News:

"'Call your newspaper for poll results... ask your friends to write letters to the editor on poll questions... Call the results of Facts Forum polls to the attention of public officials. They will pay more attention to them as they appear in the Congressional Record... Write your members of Congress the results of poll questions you wish them to remember... Explain to friends that when they vote a poll card it takes the place in some measure of writing every member of Congress a letter.'"\textsuperscript{296}

This "public opinion poll" is stated by Mr. Bagdikian to be closely allied to Facts Forum's "letters to the editor" payments. The letters sent to various newspapers are on subjects current in the poll. Mr. Bagdikian's analysis of 193 letters for which Facts Forum paid, after eliminating about twelve per cent on non-political subjects, indicated payment of $3,630 "for isolationists, or anti-United Nations, or pro-McCarthy, or uncontrolled-economy views, and $439 for opposing views".\textsuperscript{297}

The key statutory words, unchanged in the proposed Internal Revenue Code of 1954, that would eliminate Facts Forum and similar organizations from the educational category, are whether or not the organization is "carrying on propaganda, or otherwise attempting to influence legislation". The courts, it has been pointed out,\textsuperscript{298} have tested such an organization's status by the degree of legislative activity in which it has engaged. In so doing, they seem to be influenced by whether or not the organization has a legislative program.\textsuperscript{299} Do these activities of Facts Forum constitute a legislative program? This is perhaps debatable. However, it

\textsuperscript{293} Supra n.291.
\textsuperscript{294} For the type of "carefully selected" question see supra n. 288.
\textsuperscript{295} Bagdikian at p.16.
\textsuperscript{296} Ibid. at p. 17.
\textsuperscript{297} Ibid. at p. 15.
\textsuperscript{298} \textit{58} DICKINSON LAW REVIEW 189 at 197-200.
\textsuperscript{299} E.g. supra n. 95.
should be pointed out that should Facts Forum actively support the political candidacy of any person or actively lobby for particular legislation, their status as an educational organization would be lost. Can they thus do indirectly what they are prohibited from doing directly? Again it is perhaps debatable.

A bold court might take a new look at what constitutes influencing legislation and hold that taking the whole Facts Forum program into consideration, there would be sufficient evidence of "otherwise attempting, to influence legislation". However, boldness can not be anticipated in an area commonly associated with extreme judicial liberality. Reality would seem to demand that reform must depend upon Congress.

**Congressional Definition of the Propaganda Organization.** It is difficult to charge either the courts or Congress with delinquency in the matter of control of such masquerading educational organizations as Facts Forum, that is, up to this time. Nothing in the history of the income tax seems comparable to the Facts Forum situation with its millions of dollars of free radio and television time.\(^{800}\) However, it is suggested, that the time is now ripe for reappraisal.

Several methods could be pursued in amending the Code. One might be to simply add the term "directly or indirectly" after the term "attempting". Thus the appropriate sections would deny educational status where the organization is "carrying on propaganda, or otherwise attempting, directly or indirectly, to influence legislation". In other words, where there is a substantial amount of propaganda activity it would be a matter for the courts to determine whether in a given case the object was to influence legislation "directly or indirectly".

Such a provision would have the advantage of informing the courts that the simple legislative program test would not suffice for all cases. However, it would have a decided disadvantage in establishing a standard of such generality as to be valueless from the standpoint of predictability until after years of ruling and litigation.

A second method might be to re-cast the language of the various sections, denying educational status to a "propaganda organization", and defining such an organization as one presenting controversial matter in other than an objective manner. In such case it might be desirable to limit the application of such a defined organization to organizations other than educational institutions now defined for purposes of the special rule of section 170 of the 1954 Code and the prohibited transactions provisions.

The result of such an approach would be to cast upon the courts the task of determining what matter is controversial and whether it was objectively presented. This would hardly be an indelicate problem. However, it would seem to offer more hope for predictability than the previous suggestion. Also, it should offer the public dissemination organization truly dedicated to public education no cause

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\(^{800}\) Mr. Bagdikian makes several references to "over a million dollars annually", and The Reporter, supra n. 282, estimates $5 million dollars annually.
for alarm. And of overriding importance, it would establish a rule that comports with popular concept and with basic tax policy that gives the educational organization its preferred status because it performs what would otherwise be a governmental function.

The Problem of Individual Deductions For Educational Purposes.

The plea for the second reform, wholly unrelated to the first, rests largely upon what has been suggested to be a muddled state of the law dealing with individual deductions for educational expenditures.

The necessity for clarification seems evident. The tax concepts of personal, capital and business expenses have not served well in this area. The Treasury attempts to hold the line to treatment as personal expense, until recently, it is true, have lent some degree of stability to the problem. But the Hill decision and its acceptance by the Treasury, followed by the Coughlin case, suggests now that a policy clarification is needed. The shadowy line between the compulsion required by the Treasury in its acceptance of the Hill decision wavering over into the moral compulsion of taxpayer Coughlin and stopping at the point where a teacher, for example, continues to invest in additional training in discharge of a moral obligation to keep informed or merely to broaden his base of knowledge, is too nebulous on which to justify difference in tax treatment and predict tax liability. A new approach is needed.

The Treasury. The Treasury has yet to indicate its reaction to the Coughlin case. It should be forthcoming. However, even acceptance is apt to be limited. It is unlikely that the Treasury will recognize a moral duty upon the part of all professional people as the basis of an ordinary and necessary business expense. This means a continuation of the discrimination between taxpayers in substantially similar positions.

The Courts. The question here may be simply whether it can be anticipated that the courts will widen the breach established by the Hill and Coughlin cases. This is highly debatable. The Tax Court has already clearly indicated that it is unwilling to expand on the Hill case. It has fairly intimated its distaste for this type of a deduction. Until this all important tribunal is won over, no great progress can be expected.

The courts as a whole can not be charged with misdirection of congressional policy in an area where Congress itself has been largely silent. The long continued administrative view, of which it can not be assumed Congress was ignorant, does not justify wholesale judicial expansion of the Hill and Coughlin cases. The best that can be expected is continued litigation and the usual long process of judicial refinement based on prevailing tax concepts. Tax equity, therefore, can not be expected to exert an overriding influence.

Congress. Tax equity demands that deductions be justified. Is there justification for according a deduction for educational expenditures? Approaching the problem from the viewpoint of the basic tax concepts here involved, it might be
suggested that Congress provide the criteria for distinguishing between capital, personal and business expenditures. Would this be desirable? A measure of clarity might be afforded, yet, it would seem that the criteria would have to be in some detail both as to the groups to be covered, and the types of expenditures embraced under each group. Such an approach, it is suggested, is not desirable either from the standpoint of predictability or tax equity.

A second approach, and one that would seem to be more desirable, would be to abandon the basic concepts in the interest of the end result. For example, starting with the basic premise that all such expenditures are non-deductible whether they might be considered ordinary and necessary business expenses or not, Congress might grant a limited educational deduction to all individual taxpayers. Such a provision would be applicable independent of any relationship to a trade or business. It might be desirable to limit the total annual deduction to, say ten per cent of adjusted gross income, or $500 whichever is the lower. It would be desirable to define "educational expenses" for the purpose of this deduction. However, limiting such expenditures to those incurred in attending educational institutions as defined for purposes of the new special rule would not be desirable in this case. But, limitations would still have to be made. The provision should be framed to embrace such expenditures as the costs of summer schooling, institute and refresher course attendance, correspondence courses and night school training.

There is ample precedent for the handling of personal expenses on such a basis. For example, section 23(x) of the Code allows a deduction for extraordinary medical expenses. The underlying theory for such an allowance is recognition of hardship in situations where such extraordinary expenses are incurred. On what basis would a similar educational expense be justified? There are a number of considerations that would commend such treatment.

In the first place, it would treat all taxpayers desiring to avail themselves of it, equally. This is hardly a small consideration in itself. Of course, it is arguable that it would discriminate against the taxpayer who does not desire to improve himself under the statutory terms. This, however, can hardly be characterized as inequitable where freedom of choice exists. All that can be possibly expected in the name of tax equity is that taxpayers similarly situated are treated equally for tax purposes.

In the second place, it might offer a larger measure of certainty in a fairly muddled area. Of course, the criteria established might well result in some initial confusion, but this is largely a matter of draftsmanship and clarity in expression of policy. Much more difficult matter has been successfully codified.

Finally, and what seems to be the overriding consideration, is the encouragement it would offer the individual taxpayer in undertaking formal training. This, of course, would be expressive of long range tax policy toward education and would be a complement to congressional policy as regards educational institutions, their donors and the recipients of scholarships and fellowships.
What would be the objections to the allowance of such a deduction? Aside from the loss to the revenue, which would seem to be small, the principle objection would seem to be that the income tax structure is being used to further a non-tax policy. This, of course, is not a minor criticism. Some highly respectable thinking would limit the income tax structure purely to the matter of raising revenue equitably. It is argued that this task is difficult enough without saddling the structure with the carrying out of non-tax policies and that the fact that the income tax structure is so used, for example, in subsidizing foreign commerce and the exploration of gas and oil, is no reason that it should be so used. On the other hand, there is also respectable thinking that the income tax structure should be used in the interests of the whole community when its interest so dictates. For example, it is often suggested that the exemption and dependency provisions afford a convenient vehicle to control business activity and to contract or increase consumer buying.

Perhaps the answer to such an argument on policy as concerns the Code amendment here suggested is that in a large measure the proposal is a clarification of existing law and that in as much as some educational expenses are now allowed as business expenses, it is a compromise in the interests of tax equity and predictability.

Conclusions

The adoption of these two proposals by Congress, it is submitted, would go a long way toward the clarification and complementation of a sound income tax policy toward private education.

With regard to the first proposal, the unchecked and uncontrolled propaganda organization masquerading as an educational organization represents a serious threat to taxpayer morale and the necessary financial support needed by private educational institutions. Such practices as evidenced by the activities of Facts Forum, for example, are so contrary to the policies underlying the deduction and exemption privileges that their elimination as educational activities should be forthcoming.

With regard to the second proposal, Congress, the courts and even the Treasury have exhibited an extreme kindliness toward both the educational institution and its benefactors. In the further interest of long range policy, some consideration for the individual in his efforts to provide educational training for himself would seem to be in order. This does not seem to be expecting too much in light of the benefits that flow to the whole community from an informed citizenry.

\footnote{See e.g. exchange of correspondence on the policy of subsidizing oil and gas exploration between Dean Griswold, Harvard Law School, and Rex Baker, Esq., General Counsel, Humble Oil Co., Houston, Texas, in "Percentage Depletion—A Correspondence", 64 Harv. L. Rev. 361 (1951).}