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UNCLE SAM, YOUR SILENT PARTNER

H. SHIELDS MASON
of the Denver Bar

When you sit down at the end of the month to figure out what you have collected in fees and whether you have enough left in the bank to meet your next month's bills for office rent, stenographer, telephone, etc., not to mention your grocery bills and household expenses, it is easy to overlook the fact that whatever balance you may have on hand is far from being your own to spend or to do with as you please. If you are like many lawyers that I know, you will get a rude awakening once every three months, or an even heavier "jolt" once a year, when you have to distribute to the Director of Internal Revenue Uncle Sam's share of profits which you thought were yours to keep and which you and your wife may have long since spent.

If you are on a salary and your employer has been withholding a part of your earnings each month to distribute to Uncle Sam, it is even harder for you to realize to what extent he has had his hand in your pocket for his share of your profits, because you are taking your "anesthetic" in smaller doses and being gradually lulled into believing that the net you receive is all that you have coming for your sweat and worry anyway. Actually, however, you have earned or produced far more than you have gotten for your endeavors, but your silent partner—Uncle Sam, has been pushing down the "no sale" key of your cash register and steadily and stealthily relieving you of a very substantial part of the earnings and profits that your efforts, and yours alone, have produced.

When you take out your check book to settle up the accounts of your partnership and find that you have been relieved of approximately one-fourth of all your net earnings, whether by small monthly payments or larger quarterly payments, I am sure you will understand what is meant by the title that I have chosen. If this was all your silent partner got, it might not be so bad, but this is only the beginning, for the more you make the more he gets, until you finally reach a point where Uncle Sam's share is approximately 90% and yours is only 10%, yet you did nothing to bring about this unfair, uneven, confiscatory method of splitting your profits, except to work a little harder and sweat a few more buckets of blood, and wind up earning *too* much money according to Uncle's standards. If the average American wasn't always in quest of the almighty dollar and hell-bent with the idea of making more and more money, because his neighbor's wife's husband has a friend who makes \$50,000 or \$100,000 a year, Uncle might find himself in a position where you as his partner would change into a drone and decide not to produce so much honey. However, he knows that you are a sucker and a glutton for punishment, and

although you threaten to quit producing, you won't as long as you have a breath of life left in you.

Income taxation in theory is supposed to be the fairest method of taxing man's property, because it was based upon the taxpayer's ability to pay, i.e., the more a man has or makes, the more tax he is able to pay. However, in practice, it doesn't necessarily work this way.

In recent years it seems that the plan of the Government economists and so-called tax experts has changed considerably. The idea of income taxation no longer seems to be based principally on a man's ability to pay—for the rates are now so high that it is just as much a burden for the poor man to pay the tax as the rich man—but upon the idea that there should be a redistribution of wealth, by taking it away by taxation from those that have it, and giving it to those that don't have it, by means of Government doles, subsidies and old age pensions. Eventually, if this idea is continued, the vast majority of the people in their old age will be entirely dependent upon the Government for their support and means of livelihood. It has always been hard for the average person to save something to live on in his old age, but it is next to impossible now with the present cost of living and high rates of taxes. Now where does the lawyer fit into this scheme of things?

Income taxation has always been unfair so far as the professional man is concerned. An owner of an oil well is permitted to deduct annually an allowance for depletion, obsolescence and depreciation. A lawyer whose assets are primarily his time and his brain, receives no credit whatsoever for the rapid depletion of his time nor is he allowed to set up reserves against the obsolescence and deterioration of his physical and mental capacities. Furthermore he is not allowed to recover the costs of his education which is his chief tool. More and more wage earners are being covered and protected in their old age by social security and pension plans. But a lawyer has no social security except what he can make for himself by saving his money for old age or investing in insurance which will provide him with an income when he reaches a certain age. Most lawyers make a good living, yes, but you could always count the ones on the fingers of your two hands, who ever really got rich out of fees earned solely from the practice of law as such. So, what should we do to be saved, and before we go over the hill to the poorhouse?

The prospects, at the moment anyway, are none too bright. One thing that would help us greatly is the passage of certain legislation similar to what has been proposed in the House of Representatives in Washington. The general purpose and idea of House Bills 10 and 11 has been summarized in the testimony of Leslie M. Rapp of the New York City Bar as follows:

The purpose of this bill, the Keogh-Reed Bill (now

known as Jenkins-Keogh, re-introduced 1/3/53), is to remove the present discrimination against large groups of our citizens in regard to the establishment of private pension plans. It would accomplish this by the simple expedient of permitting the postponement of income tax with respect to a limited portion of earned income paid into a so-called restricted retirement fund. The amount so excluded, plus each participant's share of the earnings of the fund, would be taxed in later years when drawn down as pension benefits.

See in this connection an excellent article by Earl S. MacNeill and Gordon T. Wallis, both of Irving Trust Co., New York, in April, 1953, issue of *Dicta* entitled "Tax Favored Pensions in Sight for the Self-employed." Both of our Bar Associations have adopted resolutions favoring this legislation.

A pension plan for lawyers has, I believe, been long ago suggested as a means of building up a savings fund in the form of a small monthly payment, which in time would be used as a pension to be returned to the participants when they reached the age where they are too old to practice. This would be an excellent method for you younger lawyers to built up an estate, but any such plan should go a step further and contemplate the amendment of the tax laws, to provide for the exclusion of the amount paid in, from earned income during the year in which it is paid. Thus such savings would be tax free until returned in the form of a pension in later years, when your income would not be so great, and the rate of tax correspondingly lower. I would seriously recommend to the consideration of you younger lawyers of the Junior Bar Conference, such a program, looking towards the amendment of the State Income Tax law in this connection. If legislation is passed in Congress and at the State level, the savings should prove far more valuable to you, than anything I have to offer you as to how we are to protect ourselves from further financial loss under the present tax set up.

The only way we have today of saving taxes, is by knowing what items are deductible from our gross receipts, so as to cut down our net taxable income, and to take the fullest advantage possible of these deductions when computing Uncle's share of our profits. After all, it's your money and you should be interested in keeping as much of it as possible. However, I am inclined to believe that a number of lawyers spend far more time figuring out their client's deductions than they do on their own deductions. A lawyer just naturally neglects his own business for his client's, and filling out his own income tax return is no exception, and is usually put off until the last minute when he is apt to overlook claiming some expense deductions to which he is entitled. I even know some attorneys who do not take the time to fill out their own returns and leave such matters to their office girl, or accountant.

The C.P.A. has already taken far too much of the lawyer's tax practice away from him, for him to turn his own personal tax business over also. If you do not know what your deductions are, then the chances are better than even that you haven't got them down in your books when you turn them over to your C.P.A. or office girl. They can only work with the figures you give them and upon which your tax return is based. Have you often wondered whether you have claimed all of the deductions you are entitled to? How do you know? Well take a little time gentlemen, to find out. Joe Blow's business is not that important, and in a night's time or part of day, you can learn what to claim as deductions and how much. But this is not all you have to do. Once you know what you can claim, you've got to start putting things down in a book, kept for that purpose. It might prove valuable in helping to convince Uncle Sam at a later date that you spent the money for that purpose.¹ If nothing else, keep your office bank account and your home bank accounts separate, remember to pay everything by check, not cash, unless you get a receipt for it. At the end of the year when you go over your checks, you will be surprised to learn that there are some items which you probably can claim as deductions on your income tax, and which you had long since forgotten about.

Be reasonable when you start to figure up the amount of your deductions. If you are reasonable with Uncle Sam, he will be reasonable with you. If nothing else, your own conscience will probably tell you when you are claiming too much for the operation of your car for business as against family use, or when you are including too much expense for entertainment of clients out of the total of your country club bill. Remember the burden of proving such items is on you. How are you going to prove them in the first instance if you haven't kept a record, and in the second place, unless they are reasonable? Each case varies on fact as you know, and yours may be an exceptional one. What is reasonable for me to claim for entertainment expense would not necessarily be the same for you. It depends on the facts. It is not a set figure, or a percentage of your gross earnings, it varies each year. If the amount you have claimed is high, don't be afraid to attach a statement to your return explaining why, so Uncle will not wonder too much and summon you over for a short conference in his chambers.

Here is a list of some of the things you may be able to claim, and which you may have overlooked in preparing your tax return, namely:

1. Cost of Supplies—i.e., postage, stationery, cards, legal blanks. *Don't pay cash* without a receipt.

2. Pro-rated Costs of operating an automobile used for business—including depreciation, garage or parking rent, gasoline, insurance, oil, repairs, tires, license fees, interest, etc., based on

¹ See note 1.

a percentage of mileage driven for business as against family use.

3. Dues ² to professional societies but not to strictly social clubs, i.e., golf, athletic, etc., except to the extent such a club is used for professional purpose, i.e., entertainment of clients.

4. Office rent.

5. Cost of fuel, light, water, telephone, telegraph.

6. Salaries of office assistants, i.e., stenographer, clerk.

7. If useful life of furniture, equipment or books is short (less than one year) amounts currently expended are deductible in the year of payment or accrual. The cost of information services, such as Federal or State Tax Reporters, Unemployment Reporters, Labor and Law, Trade Regulation Reporters, Inheritance Tax Reporters, and other law reporters, is deductible by lawyers who must buy such services in connection with the performance of their duties. Where the life of such services or books is over one year, or such volumes have a more permanent value to the profession of the taxpayer, their cost should be capitalized and made the subject of a depreciation allowance. In this connection the U. S. Treasury Department has published in Bulletin "F" a list of Estimated Useful Lives and Depreciation Rates. This bulletin is readily available in tax services or you can write to the Government Printing Office and obtain one. Some of the more common items found in lawyer's offices are:

Safes	50 years
Furniture, fixtures & filing cases.....	20 years
Adding machines	10 years
Book Cases	20 years
Check Writers	8 years
Clocks	15 years
Dictating machines	6 years
Electric fans	10 years
Rugs, carpets, mats.....	10 years
Scales - mail.....	10 years
Typewriters	5 years

You divide the "useful life" into 100 to obtain the depreciation rate. Used items do not have as long a life as new ones. Another suggestion is the amortizing of office structural improvements, such as partitions, etc., over the term of your lease which may be less than the expected useful life of the leasehold improvement.

8. Expenses incurred in attending Bar Conventions or legal institutes.³

9. Flowers for funerals of deceased clients.

10. Accountant's fees.

11. Bad debts—but only if you have reported the income for services rendered on an accrual basis.

12. Contributions.

² See note 3.

³ See note 3.

13. Cost of successful defense of disbarment proceedings.
14. Entertainment of clients.⁴
15. Interest paid on business indebtedness.
16. Cost of professional journals, magazine subscriptions for your office waiting room.
17. Repairs to your business property.
18. Business safe deposit box rental.
19. Travel expenses not reimbursed by client.
20. Split fees.
21. Taxes and insurance on business property.
22. Cost of announcements.
23. Chamber of Commerce dues if you belong for business reasons.
24. Theft or fire loss not compensated by insurance.

There is one further so-called "break" for lawyers in the income tax laws as presently devised. Section 107 of the Internal Revenue Code allows an individual who has performed services over a 36 month period and who receives a full payment or substantially a full payment for those services all in one year, to spread such income back over the 36 months period instead of reporting the full payment as income during the year of its receipt. It frequently happens, for example in the handling of estates, or in long and protracted cases involving several trials, appeals, etc., that a lawyer's services will extend over a period of years, and although he may get a small retainer to start with, or during the handling of the matter, the main bulk of his fee will be paid to him at the end of the performance of his duties. To take advantage of the relief as afforded by Section 107, you must show that the following requirements are satisfied:

- (a) The income in question is compensation for personal services.
- (b) There was a period of 36 calendar months from the beginning to the completion of such services.
- (c) At least 80% of the total compensation for such services was received or accrued in one tax year.

In order to gain any advantage in this method of reporting your income, it will be necessary to first, find the increase in your tax for the year of receipt caused by the inclusion in gross income of the sum you received and secondly, to compare such increase with the total taxes that would have been payable, if the compensation had actually been received and taxed in the prior years to which it is allocated. It may work out that it is cheaper for you to include all of your fee in the year actually received or accrued, and therefore, this provision may not always work to your advantage.

In conclusion let me again caution you to keep records of everything you spend if you do not wish Uncle Sam to get more than his fair share of your profits.

⁴ See note 9.

NOTES

1. PROOF AND RECORDS

An Attorney's business expense deductions were disallowed, when he asked deduction for each of the four years of more than \$36,000, represented by personal checks cashed by him in those years and the proceeds carried in pocket and expended for obligations calling for cash expenditures, no record being kept of such expenditures and petitioner being unable to state in any instance the amount of the payment or to whom made. (Noell, 21 BTA 1107, Dec. 6617).

Lacking proof of any exact or even approximate amount expended by an attorney for taxi cab fare from his office to various courts in which he practiced, cost of entertaining clients and witnesses in course of trial and cost of preparing his cases, but being convinced that he did spend something for such expenses, the tax court allowed \$200 instead of \$780 claimed as ordinary and necessary business expense. (Lavin, T C memo., 3 T C M 228, Dec. 13, 808 (M)).

Taxpayer used his office in connection with his practice of law and for other business activities. His gross income from the practice of law in 1936 was \$400, being applied to his rent of the office. The Circuit Court allowed additional office expenses, but refused to allow claimed expenses, aggregating \$1,458.45 because of lack of proof. The Circuit Court also disallowed \$83, for automobile insurance as a business expense because of lack of proof that the automobile was used for business purposes. Bennett v. Com (CCA-8) 44 - 1 V S T C Par. 9152, 139 Fed. (2d) 961.

2. AUTOMOBILE EXPENSE

A lawyer may deduct cost of carrying his card in newspapers, cost of listing his name with credit and collecting agencies, and cost of upkeep, including depreciation of an automobile based upon the proportion of time used for business, but not in going from his home to his office and returning (II. 1933, III-1 CB 122).

3. DUES

Bar Association dues are deductible by attorneys as professional expenses (Keith, T C memo, op., 1 TCM 184, Dec. 12, 908-G).

In 1941, a case was brought before the District Court for the Southern District of California (Todd W. Johnson vs. U. S. (DC) 42-1 USTC, Par. 9180, 45 Fed. Supp. 377); wherein taxpayer, an attorney, apparently proved all the facts necessary to constitute the "substantial" evidence necessary to establish a right to claim a deduction for Club dues. He testified that he did not enjoy playing golf himself because he felt he should be working at the office; that green fees and food for his prospective clients constituted the largest items on his monthly club bill; that the club dues and expenses were charged as business expenses on the books of

the partnership; that large fees were collected by means of contacts made at the club; and that several clients would not come to the office; that three estates were obtained through his contacts, from which fees were obtained in the aggregate of over \$50,000; that he visited the country club only when he felt it absolutely necessary; and that his membership was discontinued whenever this method of obtaining business became unprofitable. The Court held that under the facts of this particular case, the plaintiff should be allowed as a deduction for business expense, the amount paid for club dues.

When the purpose of a lawyer in joining several social clubs was to have available facilities for entertainment of his clients, deduction was allowed of 50% of the membership dues and 50% of the house bills (Armstrong, Par. 47, 245 P-H. Memo T C). Apportioned deductions for dues and entertainment expenses at golf club also allowed attorneys in (Hussey, Par. 52, 039 P-H Memo TC, 11 TCM 141, Dec. 18, 1970 (M); Guggenheimer, 18 TC - (No. 10)).

4. DAMAGES - ORDINARY AND NECESSARY EXPENSES.

Includes damages paid by lawyer to client whose interest he failed to protect (Cochrane, 23 BTA 202). However, an attorney cannot deduct \$5,000.00 voluntarily paid on behalf of a bankrupt client, by reason of a moral obligation to vindicate representations made to the client's creditors and compromise claims. (Lee M. Friedman v. Delany (CA-i) 49 - 1 U.S.T.C. 9106, 171 Fed. 2d, 269. Cert. denied, 336 U. S. 936).

5. COSTS ADVANCED ON BEHALF OF A CLIENT

Are they deductible as an ordinary and necessary business expense during the years paid out, if included in income when you are reimbursed for them? The answer is, no. Such disbursements are in the nature of loans and hence are not deductible. The repayment of costs advanced do not constitute taxable income.

Sums expended to develop political influence, on which taxpayers law business was mainly dependent, are not deductible as ordinary and necessary expenses. (McGlue, 45 BTA 761, Dec. 12, 173 (Acq)).

6. SALARIES.

A lawyer may not offset against his income from his profession the salaries of assistants and other expenses of his business of making and registering bets at licensed race tracks from which he realized no gain. (Silberman, 44 BTA 600, Dec. 11, 832.)

7. PUBLICATIONS.

Cost of "Current legal publications of short life," and portion of upkeep and expenses of car used partly in business were allowed an attorney (Julius I. Peyser, TC memo Op. 1 TCM 807, Dec. 13, 076 (M)).

8. CONVENTION EXPENSES - DEDUCTIBLE.

Lawyer attending American Bar Association (Ellis, 15 BTA 1075, aff. 50 F. (2d) 343, 9 AFTR 1662) but not a trip to Europe to investigate criminal procedure.

However, State Bar Examination fees and traveling expenses incident thereto (O D 452, 2 C B 157) are not deductible. Expenses incurred by a lawyer in attending a conference on Federal taxation at N. Y. University is deductible (Geo. C. Coughlin, 18 TC - No. 64, Dec. 19, 034). Claimed loss on an unsuccessful attempt to gain admission to a State Bar was disallowed (Banigan, Par. 51, 177 P-H Memo TC.)

9. ENTERTAINMENT - Includes home expenses and caterers.

Entertainment expenses of an attorney in obtaining new clients allowed in (Johnson vs. U. S. 45 F. Supp. 377, 29 AFTR 841).

Cost of entertaining clients allowed (Jacobson, 6 TC 1048).

10. TRAVELING EXPENSES.

Expenses incurred in connection with professional business and expenses of entertaining clients are deductible (Earl King, 9 BTA 502, Dec. 3177 (Acq.)).

However, the tax Court will not take judicial notice that it is advisable from a business viewpoint for one engaged in the practice of law to entertain clients from time to time. (Lorenz, TC memo. 8 TCM 720, Dec. 17, 155 (M)).

LAWYERS TO EXAMINE THE COLORADO REVISED STATUTES, 1953

In 1951 the 38th General Assembly of the State of Colorado provided for the creation of the Office of the Revisor of Statutes and authorized a new compilation of all Colorado Laws. Thereafter, Mr. Charles M. Rose, an attorney of Pueblo, Colorado, was appointed Revisor of Statutes. Mr. Rose was successful in obtaining a highly competent staff of assistants and completed a compilation in time for presentation to the 39th General Assembly in January of 1953. This report was contained in eight volumes and was adopted by the legislature which provided that the compilation should be known as the "Colorado Revised Statutes, 1953". In an answer to interrogatories filed by the House of Representatives the Colorado Supreme Court has declared that this compilation of laws, when it becomes effective, will be the law rather than prima facie evidence of the law as were previous compilations.

The compiling and revising of all of the laws of any states is a monumental undertaking and it is inevitable that in any work of such a size some error, typographical or otherwise, must exist however competent and careful the revisor and proof readers

might be. Since the Revisor's report was adopted by the legislature earlier this year, some errors have been called to the attention of the Bar Association or the Revisor and it is felt that every lawyer in the state should have an opportunity to inspect this eight volume report and examine it for other possible errors. The printing of the Colorado Revised Statutes, 1953, will not begin until after the next short session of the legislature in January, 1954, and an opportunity will be provided for legislative correction of all errors which might be contained in the Revisor's report. Each lawyer should make an effort to examine the report and such statutes as might be of particular interest to him and to report all possible errors to Mr. Charles M. Rose, Revisor of Statutes, State Capitol Building, Denver 2, Colorado.

Arrangements have been made to have copies of the Revisor's eight volume report available in the District Court Houses in 23 counties throughout the state. In some counties these will be found in the District Court library and, in others, in the office of the Clerk of the District Court. The clerk will be able to inform each lawyer where the report is on display during this period.

The Colorado Bar Association expresses its appreciation to the members of the 39th General Assembly, the District Judges of Colorado, and Mr. Rose for their cooperation in this project and for making available to Colorado lawyers copies of the Revisor's report. These reports will be available from August 1, 1953 to November 1, 1953 in District Court Houses at the following locations:

- First Judicial District—Brighton, Golden, Littleton
- Second Judicial District—Denver (District Court Law Library)
- Third Judicial District—Trinidad, Walsenburg
- Fourth Judicial District—Colorado Springs
- Fifth Judicial District—Leadville
- Sixth Judicial District—Durango
- Seventh Judicial District—Grand Junction, Montrose
- Eighth Judicial District—Boulder, Fort Collins, Greeley
- Ninth Judicial District—Glenwood Springs
- Tenth Judicial District—Pueblo
- Eleventh Judicial District—Canon City
- Twelfth Judicial District—Alamosa
- Thirteenth Judicial District—Sterling, Fort Morgan
- Fourteenth Judicial District—Steamboat Springs
- Fifteenth Judicial District—Lamar
- Sixteenth Judicial District—La Junta

Each lawyer is urged to examine the report as carefully as possible and to inform Mr. Charles M. Rose of errors which need correction. Bear in mind that the report has already received legislative approval and will become law without further legislative action.