

1939

TAXATION - INCOME TAX - DEDUCTIONS - ORDINARY AND NECESSARY BUSINESS EXPENSES - COMMISSIONS PAID TO SENATOR FOR SECURING PUBLIC CONTRACTS

Ralph E. Helper
University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Government Contracts Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Ralph E. Helper, *TAXATION - INCOME TAX - DEDUCTIONS - ORDINARY AND NECESSARY BUSINESS EXPENSES - COMMISSIONS PAID TO SENATOR FOR SECURING PUBLIC CONTRACTS*, 37 MICH. L. REV. 984 (1939).

Available at: <https://repository.law.umich.edu/mlr/vol37/iss6/27>

This Regular Feature is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

TAXATION — INCOME TAX — DEDUCTIONS — ORDINARY AND NECESSARY BUSINESS EXPENSES — COMMISSIONS PAID TO SENATOR FOR SECURING PUBLIC CONTRACTS — Taxpayer, a gravel company, employed as salesman a state senator, who obtained several contracts with the State Highway Commission of Louisiana. The Board of Tax Appeals disallowed deductions for the commissions paid therefor, on the ground that the payments were for using personal influence with a governmental department, pursuant to a contract which is contrary to public policy. *Held*, in absence of evidence that the state senator

agreed to or attempted to use any personal or political influence, the commissions paid to him are deductible business expenses. *Alexandria Gravel Co., Inc. v. Commissioner of Internal Revenue*, (C. C. A. 5th, 1938) 95 F. (2d) 615, reversing 35 B. T. A. 323 (1937), one judge dissenting.

In computing net income, deductions are allowed for "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." ¹ While in general the courts have been quite liberal in interpreting "ordinary and necessary" to mean almost any non-capital expense incurred in connection with the occupation or business, ² the line has been drawn where the outlay is for an illegal purpose or is an affront to public policy. The only explicit provision of the statute concerns wagering losses, allowing deductions "only to the extent of the gains from such transactions." ³ But in two other situations the courts have refused to condone any expenditures: payment of fines and costs incident thereto, ⁴ and payments made under contracts which would not be enforced because of public policy factors. ⁵ The instant case turned on a close interpretation of the evidence, obtained from a single witness, the taxpayer's president. The record showed that the salesman employed was "friendly with the administration," had "good personal contacts," and was "a good mixer," that competitive bids were submitted, and that the contracts were awarded "to a great extent" to the lowest bidder. The Board of Tax Appeals held that this evidence showed that the agent was employed to use his personal influence, citing the famous case of *Oscanyan v. Arms Co.*, ⁶ in which the Court refused to allow damages on a contract to use personal influence to sell arms to the Turkish government, and *Easton Tractor & Equipment Co. v. Commissioner of Internal Revenue*, ⁷ where it was brought out on cross-examination that a particular salesman was employed to handle

¹ Revenue Act of 1938, 52 Stat. L. 460, 26 U. S. C. A. (1938), § 23 (a) (1).

² *Welch v. Helvering*, 290 U. S. 111, 54 S. Ct. 8 (1933); *Stacey v. United States*, (D. C. Ill. 1932) 60 F. (2d) 1061; *Columbus Bread Co. v. Commissioner*, 4 B. T. A. 1126 (1926).

³ Revenue Act of 1938, 52 Stat. L. 460, 26 U. S. C. A. (1938), § 23 (h). See *McKenna v. Commissioner*, 1 B. T. A. 326 (1925); *Frey v. Commissioner*, 1 B. T. A. 338 (1925).

⁴ For list of authorities, see short note on "Unlawful Expenditures and the Income Tax," 31 COL. L. REV. 1344 at 1346, notes 16, 17 (1931).

⁵ *Lorraine Corp. v. Commissioner*, 33 B. T. A. 1158 (1936) (bootleg liquor expense); *Kelley-Dempsey & Co. v. Commissioner*, 31 B. T. A. 351 (1934) ("graft" payments to inspectors to get contractor's performance approved); *Easton Tractor & Equipment Co. v. Commissioner*, 35 B. T. A. 189 (1936), and *New Orleans Tractor Co., Inc. v. Commissioner*, 35 B. T. A. 218 (1936) (contracts to use personal influence to sell tractors to state); *Cavanagh v. Commissioner*, 2 B. T. A. 268 (1925), *National Concrete Co. v. Commissioner*, 3 B. T. A. 777 (1926), *Adler Co. v. Commissioner*, 10 B. T. A. 849 (1928), and *Reed v. Commissioner*, 13 B. T. A. 513 (1928) (political expenditures); *Simms v. Commissioner*, 28 B. T. A. 988 (1933) (betting by operator of racing stable); *Gano v. Commissioner*, 19 B. T. A. 518 (1930) (payment to compromise gambling debt).

⁶ 103 U. S. 261 (1880).

⁷ 35 B. T. A. 189 at 191 (1936).

state orders because "he had some sort of inside connection or 'pull' with the administration, which others did not have." The Circuit Court of Appeals in the principal case reversed the finding because "There was no testimony that Dore [the salesman] agreed to use any personal or political influence in dealing with the Highway Department or contractors, or that he ever attempted to."⁸ Apparently the members of the board took a less judicious approach in interpreting the record than did the court, but the court seems right in insisting upon a clear showing that the transaction was tainted before it will deprive the taxpayer of the deduction. The effect of the previous decisions has been to use a revenue statute to impose a penalty not strictly within the purview of the law. While the deterrent effect of such rulings is extremely doubtful, there is no perturbing injustice from the double taxation which results since the recipient of the illegal disbursement must include such income in his return.⁹

Ralph E. Helper

⁸ 95 F. (2d) 615 at 615-616.

⁹ It is clear that gains from an illegal trade or business are subject to income tax, even though the recipient may be criminally liable for his conduct in acquiring them. *United States v. Sullivan*, 274 U. S. 259, 47 S. Ct. 607 (1927); *Steinberg v. United States*, (C. C. A. 2d, 1926) 14 F. (2d) 564; *Minister of Finance v. Smith*, [1927] A. C. 193, 51 A. L. R. 1023 at 1026, reversing [1925] 2 Dom. L. Rep. 1137; *Graham v. Green*, [1925] 2 K. B. 37.