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66-SBE-039

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
REUBEN MERLISS)

Appearances:

For Appellant: Joseph Taback, Attorney at Law

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Reuben Merliss against a proposed assessment of additional personal income tax in the amount of $196.31 for the year 1960.

The sole issue raised by this appeal concerns the deductibility of legal expenses incurred in connection with an action for divorce.

Appellant is a doctor of medicine, practicing in Los Angeles, California. In 1960, after a number of years of marriage, he and his wife were divorced. Among the assets which they had acquired as community property was a sizeable quantity of stock.

Appellant engaged an attorney to represent him in the divorce proceedings, including negotiations for division of the community property. In his California personal income tax return for 1960, appellant deducted $5,367.42 which was designated as "Legal fees and other costs of divorce incurred for the conservation of property." This appeal was taken from respondent's disallowance of that entire deduction.

Section 17252, subdivision (b) of the Revenue and Taxation Code allows an individual to deduct all ordinary and necessary expenses paid or incurred for the management, conservation or maintenance of property held for the production of income. Appellant argues that the legal expenses which he incurred and paid in 1960 are deductible under this provision, since the major part of the attorney's fees were attributable to time spent in examining the income-producing properties which appellant and his wife held and advising appellant as to which stocks should be held by each spouse, which should be sold, and when such sales should be made, in order to maximize financial gain to both spouses and to insure appellant's ability to meet future expenses.

Section 17282 of the Revenue and Taxation Code states generally that "no deduction shall be allowed for personal, living or family expenses." Respondent contends that legal expenses such as those incurred by appellant are of a personal nature and are therefore nondeductible.

The United States Supreme Court recently dealt with this issue when it arose under similar provisions of the Internal Revenue Code. In United States v. Gilmore, 372 U.S. 39 [9 L. Ed. 2d 570], the Supreme Court held that legal fees incurred by the husband in divorce proceedings while resisting his wife's claim that certain of his assets constituted community property, were nondeductible personal expenses. In reaching that decision the Court stated:

> ... the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was "business" or "personal" and hence whether it is deductible or not .... (372 U.S. at 49.)

In a second decision rendered the same day, United States v. Patrick, 372 U.S. 53 [9 L. Ed. 2d 580], the Supreme Court again applied this test and determined that legal fees paid by the husband for services rendered in connection with a property settlement agreement were nondeductible personal expenses, having arisen out of the taxpayer's marital relationship rather than from his profit-seeking activities.

In support of his argument for deductibility appellant relies on the rationale in a series of earlier federal cases. Those cases indicated that a husband's legal expenses were deductible by him when the controversy between

the spouses went not to the question of liability, but to the manner in which it was to be met, and at the same time the wife demanded a part of the husband's income-producing property, control over which affected his general income-earning capacity. (Baer v. Commissioner, 196 F.2d 646; Dallman v. United States, 191 F. Supp. 478; McMurtry v. United States, 132 F. Supp. 114.) Appellant contends that his attorney's services were aimed primarily at determining how he could best meet his liabilities with regard to the divorce and further, his future liabilities. In United States v. Gilmore, supra, 372 U.S. 39 [9 L. Ed. 2d 570], and United States v. Patrick, supra, 372 U.S. 53 [9 L. Ed. 2d 580], however, the Supreme Court expressly rejected the reasoning of this line of cases.

Applying the test stated in the Gilmore and Patrick decisions to these facts, it is clear that the claim of appellant's wife to a share in the community property arose out of the marital relationship. The legal expenses in question were incurred in connection with that claim. That being so, we conclude that those legal expenses were of a personal nature, and were therefore not deductible under section 17252, subdivision (b) of the Revenue and Taxation Code.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Reuben Merliss

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Reuben Merliss against a proposed assessment of additional personal income tax in the amount of $196.31 for the year 1960, be and the same is hereby sustained.

Done at Pasadena, California, this 28th day of June 1966, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Acting Secretary