OFFICE OF
CHIEF COUNSEL

**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Assistant Chief Counsel CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum received in our office on January 5, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Taxpayer =

ISSUE:

.

CONCLUSION:

FACTS:

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*The claim states that the deduction is for “an expense incurred by the Taxpayer in his employment as*

*LAW AND ANALYSIS*

*Section 162(a) allows deductions for all ordinary and necessary expenses paid or incurred in carrying on a trade or business.*

*According to the Supreme Court, for purposes of a section 162 business deduction, the "origin of the liability out of which the expense accrues" or "the kind of transaction out of which the obligation arose" is crucial and controlling. Deputy v. du Pont, 308 U.S. 488 (1940), 494, 496. This is the origin of the claim test, which the Court most clearly enunciated in Gilmore v. United States, 372 U.S. 39 (1963). In Gilmore, the taxpayer's gross income was derived entirely from two related sources: (1) his salary as president of three automobile corporations that were franchised automobile dealers and (2) dividends from his controlling stock in the corporations. His wife sued him for divorce, alimony, and an alleged community property interest in the stock. The taxpayer deducted his legal expenses in defending against the suit, alleging that, had he not succeeded in defeating the claims, he might have lost his stock, his corporate positions, and the franchises.*

*The Court, however, held that "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was 'business' or 'personal' and hence whether it is deductible or not..." 372 U.S. at 49. The Court then noted that the wife's claims against the taxpayer originated entirely from the marital relationship and not from the taxpayer's income producing activity. Accordingly, the deductions were denied because none of the taxpayer's "expenditures resisting these claims" were business expenses. Id. at 52-53. Thus, the rule is that a court, in determining whether a deduction relates to a taxpayer's trade or business, will look to the origin of the taxpayer's claim rather than the effect that could or would have been wrought on the taxpayer's fortunes.*

*Section 7701(a)(26) states that the term "trade or business" includes the performance of the functions of a public office; thus, certain expenses officeholders incur in performing their duties are deductible. Nonetheless, politicians may not*

*deduct the expenses of their political campaigns. Reed v. Commissioner, 13 B.T.A. 513, reversed on another ground, 34 F.2d 263 (3d Cir. 1929), reversed sub. nom. Lucas v. Reed, 281 U.S. 699 (1929); McDonald v. Commissioner, 323 U.S. 57 (1944). In Reed, the Tax Court's holding was based, at least in part, on the premise that the taxpayer, who was not an incumbent, was not engaging in a trade or business by conducting a campaign for public office. 13 B.T.A. at 524. In McDonald, however, the taxpayer was an incumbent running for a subsequent term. By that time the law was, as it is now, that McDonald's holding of a political, albeit judicial, office was a trade or business. Nonetheless, the Court held that section 23(a), the predecessor of section 162(a), "confin[ed] deductible expenses solely to outlays in efforts or services -- here the business of judging -- from which the income flows." 323 U.S. at 60-61. Running for office was not such an "effort" or "service"; consequently, the related expenses were not deductible.*

*Furthermore, this principle that campaign expenses are not deductible has been expanded to encompass other political activities of an officeholder. Diggs v. Commissioner, 715 F.2d 245 (6th Cir. 1983). In Diggs, the Sixth Circuit emphasized that "politicians perform many different functions" and that each function must be examined separately to determine if it generates a deductible expense. 715 F.2d at 250. In ruling that the taxpayer, a congressman, could not deduct the cost of attending his party's quadrennial national convention, the court set a rule that while expenses a legislator incurs in connection with his duty... "to ascertain, assess and advance the interest of constituents"...may be deducted, expenses he or she incurs "in connection with personal and party aggrandizement are not deductible." 715 F.2d at 252.*[3]

[3]Under this standard, for example, a member of Congress may deduct amounts paid from his own funds to hire additional employees to handle an unusually heavy workload. Rev. Rul. 73-464, 1973-2 C.B. 35.

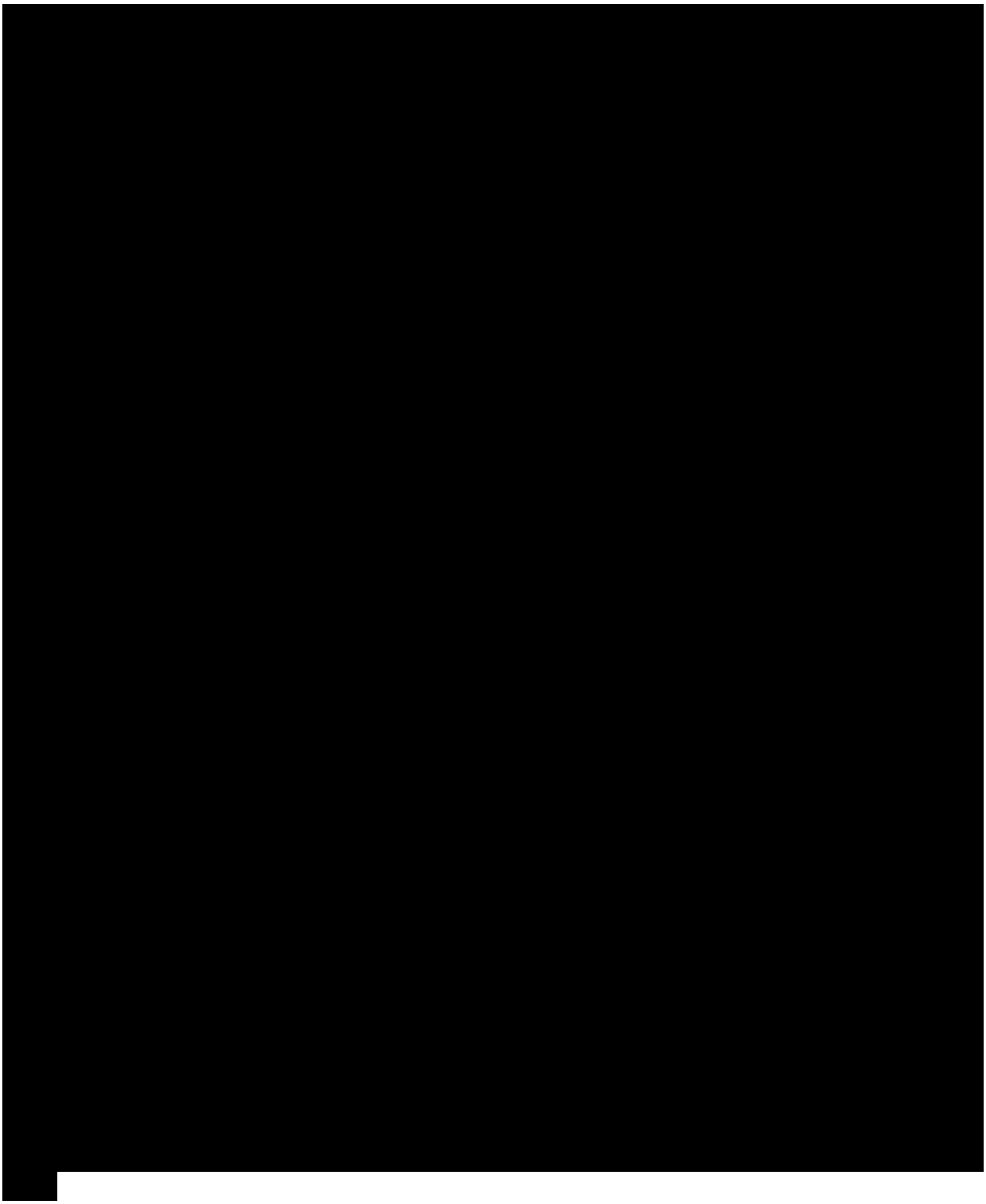
*Under section 7701(a)(26) the Taxpayer's trade or business was performing the functions of a public office. Under Reed, McDonald, and Diggs, not all of the functions of his public office gave rise to deductible expenses. Indeed, as Diggs specifically states, only expenses incurred "to ascertain, assess and advance the interest of constituents" are deductible under section 162(a); expenses incurred "in connection with personal and party aggrandizement" are not." Diggs, 715 F.2d at 252.*

*Here, the origin of the claim was political activities that, under Reed, McDonald, and Diggs, did not give rise to deductible expenses. According, deductions for the payments should be denied.*

*Additionally, Taxpayer's counsel cites a revenue ruling that allowed an elected public official to deduct expenses incurred in defending against a recall. Rev. Rul. 71-470, 1971-2 C.B. 121. The Service distinguished the facts from those of McDonald, and noted that the official was "not a candidate for public office and was not seeking a new term," but "was merely defending his position for his current term." 1971-2 C.B. at 121. The ruling does not apply to these facts, in that the Taxpayer was not subject to a recall drive.*

*CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS*

[redacted]



*Please call if you have any further questions.*

*THOMAS D. MOFFITT*
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*cc: Regional Counsel, Southeast Region*