***5 T.C. 1032 (1945)***

Legal expenses incurred by an individual in contesting income tax deficiencies from prior years are deductible under Section 23(a)(2) of the Internal Revenue Code, while such expenses are not deductible by a spouse if they relate to the prior community property of the individual and a former spouse.

**Summary**

Herbert Marshall and his wife, Elizabeth, residents of California, claimed deductions on their returns, computed on a community property basis, for legal fees and expenses paid in connection with litigation over Herbert's income taxes for prior years with his former wife. The Tax Court held that Herbert could deduct the legal expenses because they were related to conserving his income-producing property. However, Elizabeth could not deduct the expenses because they related to the community property of Herbert and his former wife, not her own community property with Herbert.

**Facts**

Herbert Marshall, an actor and English subject, previously married to Edna Best Marshall, reported income under California's community property laws. Deficiencies were assessed for 1933-1937, alleging he couldn't use community property basis. Litigation ensued. In February 1940, Herbert married Elizabeth. Legal fees related to the prior tax litigation were paid in 1940 and 1941. Herbert and Elizabeth filed separate returns, splitting Herbert's income per community property laws.

**Procedural History**

The Commissioner of Internal Revenue determined income tax deficiencies against Herbert and Elizabeth for 1940 and 1941. The Marshalls petitioned the Tax Court, arguing the deductibility of legal fees incurred in the prior tax litigation. The Tax Court considered the case, referencing prior decisions of the United States Board of Tax Appeals and the Supreme Court's decision in *Bingham Trust v. Commissioner*.

**Issue(s)**

Whether legal fees and expenses paid in 1940 and 1941, in connection with defending income tax litigation from prior years, are deductible under Section 23 of the Internal Revenue Code, as amended by Section 121(a)(2) of the Revenue Act of 1942.

**Holding**

1. Yes, Herbert Marshall is entitled to deduct the legal expenses because they were incurred to conserve property held for the production of income, as permitted under Section 23(a)(2) of the Internal Revenue Code.

 

2. No, Elizabeth R. Marshall is not entitled to deduct the legal expenses because the expenditures were for services rendered to someone other than her, concerning a community property arrangement in which she had no interest.

## Court's Reasoning

The court relied heavily on *Bingham Trust v. Commissioner*, 325 U.S. 365 (1945), which allowed trustees to deduct expenses contesting income tax deficiencies. The Tax Court extended this rationale to Herbert Marshall, finding his legal fees were also incurred to conserve income-producing property. The court stated, "The rationale of these cases is applicable to petitioner Herbert Marshall, and the deductions claimed by him for legal fees and expenses paid during the taxable years shall be allowed." However, Elizabeth's claim was denied because the expenses related to Herbert's prior community property arrangement, not her current community property with Herbert. The court reasoned, "The deductions claimed by petitioner Elizabeth R. Marshall for the legal fees and expenses paid during the taxable years are disallowed, for the reason that such expenditures were for services rendered to someone other than this petitioner to conserve community income in which she had no interest."

## Practical Implications

This case clarifies that legal fees incurred in defending prior years' tax liabilities can be deductible if they relate to conserving income-producing property, following the precedent set in *Bingham Trust*. However, the deductibility is limited to the individual whose income-producing property is being conserved. Spouses cannot deduct such expenses if they pertain to a prior marital community where they had no vested interest. Legal practitioners should carefully analyze whose tax liability is being contested and the nature of the underlying income or assets when advising on the deductibility of legal fees. This case emphasizes the importance of demonstrating a direct connection between the legal expenses and the conservation of the taxpayer's income-producing property. Subsequent cases may distinguish this ruling based on the specific facts and the relationship between the legal expenses and the taxpayer's income.

 