10 T.C. 380 (1948)

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Legal fees incurred in contesting federal gift tax liability are not deductible as ordinary and necessary expenses under Section 23(a)(2) of the Internal Revenue Code, even if the payment of the tax liability requires the sale of income-producing assets.

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Summary

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Frank Cobb sought to deduct legal fees incurred while contesting a gift tax deficiency. He had made gifts to his daughters and, upon receiving notice of a proposed gift tax deficiency, hired attorneys who successfully reduced the deficiency. Cobb then deducted the legal fees as expenses for the management, conservation, or maintenance of property held for the production of income. The Tax Court denied the deduction, holding that gift tax litigation expenses are personal and not proximately related to the production or collection of income, or the management of income-producing property, even if paying the tax requires selling income-producing assets.

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Facts

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In 1941, Frank M. Cobb gifted portions of a real estate property to each of his four daughters. Cobb filed a gift tax return and paid the associated taxes. The IRS later proposed a gift tax deficiency. Cobb hired attorneys to protest the proposed adjustment, and ultimately, the attorneys filed a petition with the Tax Court, which settled the deficiency for a reduced amount. Cobb paid the attorneys $2,260 for their services. Cobb’s primary income sources were his salary as general counsel and income from real estate rentals, dividends, and interest. He made the gifts to aid his daughters financially and reduce his income taxes. To pay the reduced gift tax deficiency, Cobb sold income-producing securities at a loss.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Cobb's 1944 income tax return. Cobb petitioned the Tax Court for redetermination, arguing that the attorneys' fees incurred in the gift tax dispute were deductible. The Tax Court ruled against Cobb, finding the legal fees were not deductible under Section 23(a)(2) of the Internal Revenue Code.

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Issue(s)

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Whether attorneys' fees paid in connection with a dispute regarding federal gift taxes are deductible as ordinary and necessary expenses under Section 23(a)(2) of the Internal Revenue Code.

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Holding

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No, because expenses incurred in litigation involving federal gift tax liability are not directly connected with or proximately resulting from the production or collection of income, or the management, conservation, or maintenance of property held for the production of income.

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Court's Reasoning

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The court reasoned that Section 23(a)(2) allows deductions for expenses related to (1) the production or collection of income, or (2) the management, conservation, or maintenance of property held for the production of income. It distinguished between expenses incurred contesting income taxes (which can be deductible if proximately related to income production) and expenses incurred contesting gift taxes. The court stated,

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