McGowan v. Commissioner, 67 T. C. 599 (1976)

Compulsory contributions to a state temporary disability insurance fund can be deductible as state income taxes under IRC section 164(a)(3) if they are measured by income.

Summary

In McGowan v. Commissioner, the Tax Court ruled that mandatory employee contributions to the Rhode Island temporary disability insurance fund, withheld from wages, were deductible as state income taxes under IRC section 164(a)(3). The court rejected the IRS's concession of the case and invalidated Revenue Ruling 75-148, which had deemed such contributions nondeductible. The decision was grounded on the contributions being measured by income, thus qualifying as an income tax, and the court's discretion to decide the case's merits despite the concession. This ruling has significant implications for how similar state-mandated contributions are treated for federal tax purposes.

Facts

James R. McGowan, an attorney, had $72 withheld from his 1975 wages by his employer, Salter, McGowan, Arcaro & Swartz, Inc. , pursuant to Rhode Island law. This amount represented 1. 5% of his first $4,800 in wages and was paid to the Rhode Island temporary disability insurance fund. McGowan claimed this as a deduction on his federal income tax return, which the IRS disallowed, citing Revenue Ruling 75-148 that classified these contributions as nondeductible personal expenses.

Procedural History

After the IRS disallowed McGowan's deduction, he filed a petition with the U. S. Tax Court. The IRS later conceded the issue but McGowan opposed the concession, seeking a court decision on the merits due to the issue's recurring nature. The Tax Court rejected the IRS's concession and proceeded to hear the case, ultimately granting McGowan's motion for summary judgment.

Issue(s)

1. Whether the Tax Court retains jurisdiction to decide the merits of a case despite the respondent's concession.
2. Whether compulsory contributions to the Rhode Island temporary disability insurance fund qualify as deductible state income taxes under IRC section 164(a)(3).
3. Whether such contributions are alternatively deductible under IRC section 162(a) as business expenses or under IRC section 212(1) as expenses for the production of income.
4. Whether Revenue Ruling 75-148, which deemed these contributions nondeductible, is valid.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because the court has discretion to reject a concession and decide the case on its merits to serve the interests of justice.
2. Yes, because these contributions are measured by income and thus qualify as state income taxes under IRC section 164(a)(3).
3. Yes, because if not deductible as state income taxes, these contributions would still be deductible as business expenses or expenses for the production of income.
4. No, because Revenue Ruling 75-148 is inconsistent with prior rulings, fails to address the income tax nature of the contributions, and contradicts established case law.

Court's Reasoning

The Tax Court exercised its discretion to reject the IRS's concession, citing the need for a definitive ruling on a recurring issue affecting many taxpayers. The court found that the Rhode Island contributions constituted a "tax" because they were mandatory and paid into a public fund for a public purpose. The court determined these contributions were an "income tax" under IRC section 164(a)(3) because they were measured by wages, akin to other taxes recognized as income taxes by the IRS. The court criticized Revenue Ruling 75-148 for its inconsistencies with prior IRS rulings on foreign tax credits and for ignoring established law that employees carry on a trade or business. The court also noted the long-standing administrative interpretation allowing deductions for such contributions, which Congress had implicitly approved by not changing the law.

Practical Implications

This decision clarifies that state-mandated contributions to social welfare funds can be deductible as state income taxes if they are measured by income, impacting how similar contributions in other states are treated. It highlights the Tax Court's power to reject concessions to serve broader taxpayer interests. Practitioners should be aware that longstanding IRS interpretations, even if reversed, can be challenged and potentially invalidated by courts. This ruling likely influenced subsequent IRS policy and may have led to the revocation of Revenue Ruling 75-148. Legal professionals should consider this case when advising clients on the deductibility of state-mandated contributions and when challenging IRS rulings that appear inconsistent with prior administrative or judicial interpretations.

© 2025 SCOTUSreports.com. All rights reserved.