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WELCH v. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

U.S. Supreme Court (Nov 6, 1933)

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ATTORNEY(S)

Mr. Edward S. Stringer, with whom Messrs. Thomas D. O'Brien, and Alexander E. Horn. were on the brief, for petitioner.Mr. H. Brian Holland argued the cause, and Solicitor General Biggs and Messrs. Sewall Key and John G. Remey filed a brief, for respondent.

JUDGES

Benjamin Nathan Cardozo

SUMMARY**Factual and Procedural Background**

In 1922, the petitioner, formerly secretary of the E.L. *Welch* Company, a Minnesota grain business corporation, faced a situation where the company was adjudged an involuntary bankrupt and discharged from its debts. Subsequently, the petitioner entered into a contract as a commission agent with the Kellogg Company. To restore his business reputation and credit with former customers of the *Welch* Company, he voluntarily paid substantial amounts toward the debts of the bankrupt *Welch* Company over several years (1923 to 1928). The Commissioner of Internal Revenue disallowed these payments as deductions from income, classifying them as capital expenditures rather than ordinary and necessary business expenses. The Board of Tax Appeals upheld the Commissioner's ruling, and the Circuit Court of Appeals for the Eighth Circuit affirmed that decision. The case was brought to the Supreme Court on certiorari to resolve the deductibility of these payments.

Legal Issues Presented

1. Whether payments made by a taxpayer to creditors of a bankrupt corporation, intended to strengthen the taxpayer's own business standing and credit, qualify as "ordinary and necessary expenses" deductible under the Revenue Acts.
2. Whether the Commissioner's determination that such payments are capital expenditures rather than deductible business expenses is presumptively correct and supported by the

evidence.

Arguments of the Parties

The opinion does not contain a detailed account of the parties' legal arguments.

Table of Precedents Cited

Precedent	Rule or Principle Cited For	Application by the Court
<i>McCulloch v. Maryland</i> , 4 Wheat. 316	General principle supporting the necessity of payments for business development.	Accepted that payments to creditors were at least appropriate and helpful for business development.
<i>Kornhauser v. United States</i> , 276 U.S. 145	Illustration of "ordinary" expenses as those commonly accepted in business despite being unique to the individual taxpayer.	Used to explain that "ordinary" does not require habitual repetition but depends on community norms.
<i>Old Colony R. Co. v. Commissioner</i> , 284 U.S. 552, 560	Interpretation of language in its natural and common meaning concerning ordinary expenses.	Supported the view that the payments in question were extraordinary rather than ordinary.
<i>Woolford Realty Co. v. Rose</i> , 286 U.S. 319, 327	Clarification of ordinary expense meaning in tax context.	Reinforced that the payments were not ordinary expenses.
<i>Wickwire v. Reinecke</i> , 275 U.S. 101	Presumption of correctness of the Commissioner's determinations.	Placed burden on petitioner to prove the Commissioner's ruling wrong.
<i>Jones v. Commissioner</i> , 38 F.2d 550, 552	Support for presumption of correctness of tax authority decisions.	Affirmed the Commissioner's findings absent contrary proof.
<i>Colony Coal Coke Corp. v. Commissioner</i> , 52 F.2d 923	Reputation and learning as capital assets rather than ordinary expenses.	Used to analogize the payments as akin to capital expenditures for goodwill.

Court's Reasoning and Analysis

The Court analyzed whether the payments made by the petitioner to creditors of the bankrupt *Welch* Company constituted "ordinary and necessary expenses" deductible under the Revenue Acts. It acknowledged that such payments may have been necessary and helpful for the petitioner's business development and credit. However, the Court emphasized that "ordinary" expenses are determined by prevailing business conduct and customs, not merely by the taxpayer's subjective view or uniqueness of the situation.

While some necessary expenses may be capital outlays, the Court found no established business norm supporting the deduction of payments made voluntarily to another's creditors without legal obligation. Such payments were deemed extraordinary rather than ordinary. The Court rejected extending the definition of ordinary expenses to include payments that resemble capital expenditures, such as those enhancing reputation or goodwill.

The Commissioner's determination that these payments were capital expenditures was presumptively correct, and the petitioner bore the burden of proving otherwise. The Court found no evidence or judicial knowledge to override the Commissioner's ruling, concluding that allowing these payments as deductions would open the door to unreasonable analogies and undermine tax principles.

Holding and Implications

The Supreme Court **affirmed** the judgment of the Circuit Court of Appeals, thereby upholding the decision of the Board of Tax Appeals and the Commissioner of Internal Revenue.

The direct effect of this decision is that payments voluntarily made by a taxpayer to creditors of a bankrupt corporation, aimed at enhancing the taxpayer's own business standing and credit, are not deductible as ordinary and necessary business expenses but are instead considered capital expenditures. The opinion does not establish new precedent beyond this ruling but confirms the standards for distinguishing deductible business expenses from capital outlays in income tax computations.

JUDGMENT

1. What are "ordinary and necessary expenses" in carrying on a business, within the meaning of provisions of Revenue Acts allowing deductions of such expenses in computing net income, must be determined by conduct and forms of speech prevailing in the business world. P. 113. 2. The Court can not say, in the absence of proof and as a matter of judicial knowledge, that payments on the debts of a corporation, made by its former officer after its discharge in bankruptcy and for the purpose of strengthening his own business standing and credit, were ordinary and necessary expenses of his business. P. 115. 3. A finding by the Commissioner of Internal Revenue that such payments are not ordinary and necessary expenses of a taxpayer, and hence not deductible under the revenue acts and regulations in computing his net income, is presumptively correct. P. 115. [63 F.2d 976](#), affirmed.

MR. JUSTICE CARDOZO delivered the opinion of the Court.

The question to be determined is whether payments by a taxpayer, who is in business as a commission agent, are allowable deductions in the computation of his income if made to the creditors of a bankrupt corporation in an endeavor to strengthen his own standing and credit.

In 1922 petitioner was the secretary of the *E.L. Welch* Company, a Minnesota corporation, engaged in the grain business. The company was adjudged an involuntary bankrupt, and had a discharge from its debts. Thereafter the petitioner made a contract with the Kellogg Company to purchase grain for it on a commission. In order to reestablish his relations with customers whom he had known when acting for the *Welch* Company and to solidify his credit and standing, he decided to pay the debts of the *Welch* business so far as he was able. In fulfilment of that resolve, he made payments of substantial amounts during five successive years. In 1924, the commissions were \$18,028.20; the payments \$3,975.97; in 1923, the commissions \$31,377.07; the payments \$11,968.20; in 1926, the commissions \$20,925.25, the payments \$12,815.72; in 1927, the commissions \$22,119.61, the payments \$7,379.72; and in 1928, the commissions \$26,177.56, the payments \$11,068.25. The Commissioner ruled that these payments were not deductible from income as ordinary and necessary expenses, but were rather in the nature of capital expenditures, an outlay for the development of reputation and good will. The Board of Tax Appeals sustained the action of the Commissioner (**25 B.T.A. 117**), and the Court of Appeals for the Eighth Circuit affirmed. [63 F.2d 976](#). The case is here on certiorari.

"In computing net income there shall be allowed as deductions . . . all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Revenue Act of 1924, c. 234, 43 Stat. 253, 269, § 214; [26 U.S.C. § 955](#); Revenue Act of 1926, c. 27, 44 Stat. 9, 26, § 214; 26 U.S.C. App. § 955; Revenue Act of 1928, c. 852, 45 Stat. 791, 799, § 23; cf. Treasury Regulations 65, Arts. 101, 292, under the Revenue Act of 1924, and similar regulations under the Acts of 1926 and 1928.

We may assume that the payments to creditors of the *Welch* Company were necessary for the development of the petitioner's business, at least in the sense that they were appropriate and helpful. [McCullochv. Maryland, 4 Wheat. 316](#). He certainly thought they were, and we should be slow to override his judgment. But the problem is not solved when the payments are characterized as necessary. Many necessary payments are charges upon capital. There is need to determine whether they are both necessary and ordinary. Now, what is ordinary, though there must always be a strain of constancy within it, is none the less a variable affected by time and place and circumstance. Ordinary in this context does not mean that the payments must be habitual or normal in the sense that the same taxpayer will have to make them often. A lawsuit affecting the safety of a business may happen once in a lifetime. The counsel fees may be so heavy that repetition is unlikely. None the less, the expense is an ordinary one because we know from experience that payments for such a purpose, whether the amount is large or small, are the common and accepted means of defense against attack. [Cf. Kornhauserv. United States, 276 U.S. 145](#). The situation is

unique in the life of the individual affected, but not in the life of the group, the community, of which he is a part. At such times there are norms of conduct that help to stabilize our judgment, and make it certain and objective. The instance is not erratic, but is brought within a known type.

The line of demarcation is now visible between the case that is here and the one supposed for illustration. We try to classify this act as ordinary or the opposite, and the norms of conduct fail us. No longer can we have recourse to any fund of business experience, to any known business practice. Men do at times pay the debts of others without legal obligation or the lighter obligation imposed by the usages of trade or by neighborly amenities, but they do not do so ordinarily, not even though the result might be to heighten their reputation for generosity and opulence. Indeed, if language is to be read in its natural and common meaning ([Old Colony R. Co. v. Commissioner, 284 U.S. 552, 560](#); [Woolford Realty Co. v. Rose, 286 U.S. 319, 327](#)), we should have to say that payment in such circumstances, instead of being ordinary is in a high degree extraordinary. There is nothing ordinary in the stimulus evoking it, and none in the response. Here, indeed, as so often in other branches of the law, the decisive distinctions are those of degree and not of kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.

The Commissioner of Internal Revenue resorted to that standard in assessing the petitioner's income, and found that the payments in controversy came closer to capital outlays than to ordinary and necessary expenses in the operation of a business. His ruling has the support of a presumption of correctness, and the petitioner has the burden of proving it to be wrong. [Wickwirev. Reinecke, 275 U.S. 101](#); [Jonesv. Commissioner, 38 F.2d 550, 552](#). Unless we can say from facts within our knowledge that these are ordinary and necessary expenses according to the ways of conduct and the forms of speech prevailing in the business world, the tax must be confirmed. But nothing told us by this record or within the sphere of our judicial notice permits us to give that extension to what is ordinary and necessary. Indeed, to do so would open the door to many bizarre analogies. One man has a family name that is clouded by thefts committed by an ancestor. To add to his own standing he repays the stolen money, wiping off, it may be, his income for the year. The payments figure in his tax return as ordinary expenses. Another man conceives the notion that he will be able to practice his vocation with greater ease and profit if he has an opportunity to enrich his culture. Forthwith the price of his education becomes an expense of the business, reducing the income subject to taxation. There is little difference between these expenses and those in controversy here. Reputation and learning are akin to capital assets, like the good will of an old partnership. Cf. [Colony Coal Coke Corp. v. Commissioner, 52 F.2d 923](#). For many, they are the only tools with which to hew a pathway to success. The money spent in acquiring them is well and wisely spent. It is not an ordinary expense of the operation of a business.

Many cases in the federal courts deal with phases of the problem presented in the case at bar. To attempt to harmonize them would be a futile task. They involve the appreciation of

particular situations, at times with borderline conclusions. Typical illustrations are cited in the margin.

Ordinary expenses: [Commissionerv. People's-Pittsburgh Trust Co., 60 F.2d 187](#), expenses incurred in the defense of a criminal charge growing out of the business of the taxpayer; [American Rolling Mill Co. v. Commissioner, 41 F.2d 314](#), contributions to a civic improvement fund by a corporation employing half of the wage earning population of the city, the payments being made, not for charity, but to add to the skill and productivity of the workmen (ef. the decisions collated in 30 Columbia Law Review 1211, 1212, and the distinctions there drawn); [Corning Glass Worksv. Lucas, 59 App.D.C. 168](#); [37 F.2d 798](#), donations to a hospital by a corporation whose employees with their dependents made up two thirds of the population of the city; [Harrisv. Lucas, 48 F.2d 187](#), payments of debts discharged in bankruptcy, but subject to be revived by force of a new promise. [Cf. Lucasv. Ox Fibre Brush Co., 281 U.S. 115](#), where additional compensation, reasonable in amount, was allowed to the officers of a corporation for services previously rendered.

Not ordinary expenses: [Hubingerv. Commissioner, 36 F.2d 724](#), payments by the taxpayer for the repair of fire damage, such payments being distinguished from those for wear and tear; [Lloydv. Commissioner, 55 F.2d 842](#), counsel fees incurred by the taxpayer, the president of a corporation, in prosecuting a slander suit to protect his reputation and that of his business; [105 West 55th Streetv. Commissioner, 42 F.2d 849](#), and [Blackwell Oil Gas Co. v. Commissioner, 60 F.2d 257](#), gratuitous payments to stockholders in settlement of disputes between them, or to assume the expense of a lawsuit in which they had been made defendants; [Whitev. Commissioner, 61 F.2d 726](#), payments in settlement of a lawsuit against a member of a partnership, the effect being to enable him to devote his undivided efforts to the partnership business and also to protect its credit.

The decree should be

Affirmed.