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PERSONAL VS. BUSINESS EXPENSES: A COMMENT ON PROFESSOR KLEIN'S APPROACH

William D. Popkin†

In a recent issue of the *Cornell Law Review*, Professor Klein grapples with some of the problems surrounding the deductibility of commuting expenses.¹ I would like to question some of the premises on which he proceeds, primarily part I on "The 'Motivation' Test" and part III on "Equity."²

First, Professor Klein raises doubts about the concept of personal motives as a "cause" for incurring an expense and the role this concept can play in distinguishing between non-deductible personal and deductible business expenses. He states that personal motivation cannot be the sole cause of commuting expenses because the decision to work also contributed to incurring the expenses.³ Causation, therefore, is not the "relevant issue," and reference to it is "futile" because both deduction-generating (choice of job) and non-deduction-generating (choice of residential location) conditions are present.⁴

Second, he suggests that the personal-business dichotomy is a "blind-alley" for identifying the equitable result in the context of commuting expenses.⁵ Instead, he proposes an analytical model for deciding how equitable considerations can be applied to determine whether an expense should be deductible. His model requires deciding whether commuting costs are likely to be only an added burden for the resident which provides him no added psychic satisfaction when compared to taxpayers in residence locations with lesser or no commuting expenses.⁶

I suggest that Professor Klein's discussion obscures the continued usefulness of the concept of personal motives as a "cause" in the context of commuting expenses and, more generally, in distinguishing between deductible business expenses and non-deductible personal

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¹ Klein, *Income Taxation and Commuting Expenses: Tax Policy and the Need for Nonsimplistic Analysis of "Simple" Problems*, 54 CORNELL L. REV. 871 (1969) [hereinafter cited as Klein].

² *Id.* at 874-79, 883-94.

³ *Id.* at 876.

⁴ *Id.* at 890.

⁵ *Id.* at 889.

⁶ *Id.* at 883-90.

expenses; and that tax policy decisions would be better made if Professor Klein's analytical model were not given the significant role he suggests for it. These two points are discussed under the headings "Cause" and "Equity."

I

CAUSE

Apparently, the difficulty with characterizing personal motivation as the "sole cause" of commuting expense arises because the taxpayer must engage in business before the expenses can be incurred. This leads Professor Klein to say that both a business and a personal purpose exist.⁷

As Professor Klein points out, commuting expenses cannot be analogized to food expenses which, although they have a business utility in keeping the taxpayer alive, are personal expenses because they would have been incurred for personal reasons even if there were no business activity.⁸ However, the relationship between personal motivation and commuting expenses still makes it useful to refer to personal reasons as the sole cause, assuming at this point, as does Professor Klein,⁹ that a man is both psychologically free to choose his personal residence and practically able to do so because of the availability of housing. If the entire commuting expense can be avoided but is not avoided because of a personal decision to live beyond walking distance, it is proper to conclude that it is incurred solely for personal reasons.

Professor Klein suggests that this analysis is faulty because personally motivated failure to keep a business-required expense to a minimum has not led to a disallowance of the deduction. He cites as one example the purchase of a first-class, rather than a coach, airline ticket for a business trip.¹⁰ However, the reason for allowing the deduction for the extra expense of the ticket is not that the avoidable portion of the expense is not a personal expense, but that it is administratively burdensome to identify that portion of the expense which

⁷ *Id.* at 890.

⁸ *Id.* at 876. A similar analysis supports the non-deductibility of child care and medical expenses as business expenses. It is usually assumed that they would be incurred for personal reasons in any event. *But see* Reginald Denny, 33 B.T.A. 738 (1935) (medical expense as business expense). Section 214 of the Internal Revenue Code of 1954 allows child care expenses to be deducted under circumstances that decrease the likelihood they would have been incurred in any event for personal reasons.

⁹ Klein at 876-77.

¹⁰ *Id.* at 878.

results from personal choice. The Treasury Department once asserted that the portion of food expenses incurred away from home which equalled food expenses which would have been incurred at home was a non-deductible personal expense; but it abandoned the attempt to identify this amount for administrative reasons.¹¹ Similarly, it seems too burdensome to require the Internal Revenue Service to check whether coach tickets were available when the reservations were made. However, if administrative problems were absent, the amount of the expense that was avoidable but was not avoided for personal reasons would properly be treated as a non-deductible personal expense.

This analysis distinguishes the commuting expenses from "true" dual purpose expenses whose incurrence is motivated by a mixture of business and personal reasons. There are situations where an expense is incurred only if there is a business and where no specific portion of the expense is avoidable, but where it is nonetheless clear that the expense is motivated to a significant degree by personal considerations. In these situations, if the danger that personal satisfaction will be purchased with deductible business expenses becomes too great, measures must be taken to disallow all or a portion of the deduction. The degree of "danger" and the measures taken should depend upon several factors: the likelihood that personal satisfaction is the primary purpose, the amount of personal expenses that will be deducted if no measures are taken, the risk of stifling business decisions if a deduction is disallowed, and the degree of administrative difficulty caused by handling each situation on a case-by-case basis. If the decision is made to allocate the expenses between a deductible and a non-deductible amount instead of allowing or disallowing the deduction in full, the problem is analogous to allocating overhead expenses among two businesses. Recent legislation, providing a formula for identifying the personal portion of transportation expenses on combined business and pleasure trips, is an attempt to deal with the genuine dual purpose expense by allocation when the element of personal satisfaction becomes too significant to ignore.¹² The occasional case which values a non-transferable benefit received by a taxpayer at less than the market value to those who freely purchase the benefit is engaged in a similar effort.¹³

The validity of the approach I have suggested for using "cause"

¹¹ Compare *Treas. Reg. 45, § 215 (1920)* (excess over normal food expense for business meals deductible), with *H.R. REP. No. 350, 67th Cong., 1st Sess. 11 (1921)* (administrative justification for § 162(a)(2) of the Internal Revenue Code, which does not limit the deduction to the excess over normal food expenses).

¹² *INT. REV. CODE OF 1954, § 274(c)*.

¹³ See, e.g., *Reginald Turner, 23 P-H TAX CT. MEM. ¶ 54,142 (1954)*.

to distinguish between non-deductible personal and deductible business expenses can be tested by analyzing the problems in the recent *Sullivan*¹⁴ and *Tyne*¹⁵ cases involving the expenses of commuting by car where business reasons justified transporting tools to work but where the taxpayer would have driven to work in any event for personal reasons. The Tax Court held in both cases that none of the expense could be a deductible business expense whether or not the tools could only be gotten to work by car and whether or not the commuter would have driven to work in any event for personal reasons.¹⁶ This was a clear departure from an earlier Tax Court holding in the *Kistler*¹⁷ case that the *excess* over normal commuting expenses can be identified as a deductible business expense if the taxpayer would not have driven anyway for personal reasons. It is unclear, however, whether earlier Tax Court cases allowed a deduction for some allocable portion of the expense if the taxpayer would have driven even if there had been no tools to carry. In the *Crowther*¹⁸ case, which the *Kistler* court cited as establishing the allocation rule, the taxpayer would have driven anyway since the only available transportation was by car. *Crowther*, therefore, appeared to treat the expense as an allocable dual purpose expense. Apparently, the Tax Court did not appreciate the difference between the administrative problem of identifying the business portion of an expense and the allocation problem presented by dual purpose expenses.

Before the Second Circuit in *Sullivan*, the Commissioner conceded that the Tax Court erred in disallowing the deduction if the tools had to be gotten to work and using the car was a reasonable method, so long as the taxpayer could show that he would not have driven anyway for personal reasons.¹⁹ In such a case, the Commissioner was willing to allow the *entire* deduction, in accordance with a 1963 revenue ruling,²⁰ thereby avoiding the administrative problem of identifying the *excess* expense made necessary by the business. However, for the Commissioner, the deduction of the entire expense depended upon the tax-

¹⁴ Lawrence D. Sullivan, 45 T.C. 217 (1965), *rev'd*, 368 F.2d 1007 (2d Cir. 1966), *cert. denied*, — U.S. —, 90 S. Ct. 72 (1969).

¹⁵ John J. Tyne, 35 P-H TAX CT. MEM. ¶ 66,214 (1966), *rev'd*, 385 F.2d 40 (7th Cir. 1967), *cert. denied*, — U.S. —, 90 S. Ct. 88 (1969).

¹⁶ 45 T.C. at 221; 35 P-H TAX CT. MEM. ¶ 66,214, at 1249.

¹⁷ James A. Kistler, 40 T.C. 657 (1963), *withdrawn* 44 T.C. Errata page in front of volume, referred to in Lawrence D. Sullivan, 45 T.C. 217, 219 n.2 (1965). This was the approach taken to business meals in 1920. See note 11 *supra*.

¹⁸ Charles Crowther, 28 T.C. 1293 (1957), *rev'd*, 269 F.2d 292 (9th Cir. 1959).

¹⁹ 368 F.2d at 1008.

²⁰ Rev. Rul. 63-100, 1963-1 CUM. BULL. 34.

payer's proving that he would not have driven to work for personal reasons and, in this case, the personal reasons for driving were apparent due to the taxpayer's medical problems.

The court stated that the entire expense would have been deductible, as the Commissioner conceded, if the taxpayer would not have driven but for the tools. However, the court held that the part of the expense allocable to transporting the tools could be deducted, *even if* the taxpayer would have driven anyway for personal reasons. The Second Circuit said that it was reinstating the old Tax Court rule requiring allocation. However, it cited both the *Crowther* case,²¹ which appears to treat the expense as a dual purpose expense, and a revenue ruling²² in which the problem was the administrative one of identifying the extra non-deductible personal expense of taking a wife on a business trip. Like the Tax Court, therefore, the Second Circuit failed to distinguish clearly between allocable dual purpose expenses and the administrative problem of identifying the excess over normal commuting costs. On remand the Tax Court allocated one-third of the expense to the business and the Second Circuit affirmed.²³

In *Tyne* the Seventh Circuit also felt that an allocation was appropriate even if the taxpayer would have driven for personal reasons and remanded the case to the Tax Court to determine the allocation.²⁴ In this case, there were no medical reasons for driving but the taxpayer would have driven to work even if there were no tools to carry. Although his reason for driving without regard to the tools might have been primarily his need to use the vehicle on business once he got to work,²⁵ this reason alone has never been enough to overcome the presumption that the commuting expense is a personal expense. A concurring judge seemed to suggest that allocation should lead only to a search for the extra expenses over less expensive commuting expenses.²⁶ Perhaps he found this a convenient formula for allocating a dual purpose expense, although it is not clear how he would have decided the *Crowther* case, where there was no method of commuting less expensive than by car. Since his colleagues did not concur in his opinion, this formula must have been found inappropriate as a guide for all sit-

²¹ The court also cited Francis Eaton, 27 P-H TAX CT. MEM. ¶ 58,013 (1958), in which the facts were essentially the same as in *Crowther*.

²² Rev. Rul. 56-168, 1956-1 CUM. BULL. 93.

²³ 37 P-H TAX CT. MEM. ¶ 68,144 (1968), *aff'd*, 69-2 U.S. Tax Cas. ¶ 9448 (2d Cir. March 6, 1969).

²⁴ 385 F.2d at 41-42.

²⁵ 35 P-H TAX CT. MEM. ¶ 66,214, at 1248.

²⁶ 385 F.2d at 42-43.

uations. Perhaps the majority viewed the rule that normal commuting expenses are not deductible even when there are no tools to be transported as of questionable validity in view of current housing conditions or because, as in *Tyne*, the employer might require the vehicle to be used at work. The majority might then have reasoned that, while the rule in normal commuting cases without tools is too imbedded to be uprooted, a case-by-case estimate of the personal element would be proper when a business element could justifiably be assumed to exist, as in cases where tools must be transported.

After the Tax Court in *Tyne* found it impossible to do anything but accept the Commissioner's fifty-fifty allocation on remand, the Seventh Circuit tried to clarify its mandate.²⁷ First, it held that the Commissioner's allocation is reviewable.²⁸ Second, it adopted the Commissioner's and the Second Circuit's view that the *entire* expense is deductible if the taxpayer would not have driven to work *but for* the tools.²⁹ However, the court made the mistake of stating that the "but for" rule established a "primary business purpose" test.³⁰ In fact, an expense which would not be incurred "but for" the business might have only *a* business purpose, which could fall short of a primary business purpose.³¹

The problems in these cases stem from the failure to understand dual purpose expenses and to develop an approach for dealing with them. First, consider the case of the taxpayer who would have driven to work in any event other than for medical reasons even if there were no tools to be transported. It is improper to analogize the expense of the car to food expenses because, as already noted, there would be no commuting expenses without work. The next question to pose in deciding if the expense is a personal one is whether the car expense is avoidable. If there are tools to be transported, however, the business need to drive suggests that the expense is not avoidable.

However, our analysis of dual purpose expenses suggested that expenses which are incurred only if there is a business and which are not obviously avoidable might still contain a significant element of

²⁷ *Tyne v. Commissioner*, 409 F.2d 485 (7th Cir. 1969).

²⁸ *Id.* at 486.

²⁹ *Id.* at 487.

³⁰ *Id.* at 486. This error was foreshadowed in the earlier opinion and the Commissioner's attorney was apparently responsible. 385 F.2d at 41.

³¹ The recent dispute over the degree of improper purpose required before the accumulated earnings tax would be imposed is an example of how tax results can depend upon the intensity of a particular purpose in causing a taxpayer's decision. See *United States v. Donruss Co.*, 393 U.S. 297, 301, 307-08 (1969) (*a* tax avoidance purpose is enough to attract penalty tax; need not be *dominant* purpose).

personal satisfaction. In the abstract, it would seem that if the expense would have been incurred without regard to the business requirement, then it is a personal expense in its entirety. On the other hand, it seems unreasonable to assume that an expense gives full personal satisfaction if there is a business need to transport tools and the expense is not incurred when there is no business. Furthermore, the weakness of the rule that commuting expenses are always the result of personal choice rather than housing conditions or the need for the car at work encourages a finding that some portion of the expenditure is a business expense. Therefore, the Commissioner's offer to prove that the taxpayer would have traveled to work by car in any event is properly rejected and it is more reasonable to treat the expense as resulting from a combination of business and personal purposes.

While this approach is reasonable, and could even be adopted by a court by citing the *Cohan* case,³² the question remains whether the personal element is likely to be significant enough to warrant the effort at allocation. The Commissioner argued before the Seventh Circuit in *Tyne* that the allocation required by the Second Circuit in *Sullivan* was a practical impossibility.³³ Since the likelihood that the personal element predominates is not great, the total amount of the deduction is not great, and the administrative difficulty in reaching some allocation formula without extensive litigation is considerable, it might be best to accept the taxpayer's view that the entire deduction should be allowed where the business need as evidenced by the need to get tools to work requires driving.

The view of both courts of appeals that a one hundred percent deduction is appropriate if the car expense would not have been incurred "but for" the business need also supports the taxpayer's position. The expense is no less a dual purpose expense because, *but for* the business condition, the expense would not be incurred. As noted above, the "but for" condition is consistent with the business purpose being only *a* purpose, not even the most significant factor in the decision. If the allocation effort is not worth the trouble in these cases where the element of personal satisfaction can be considerable, it is probably not worth the trouble to litigate the issue of whether the taxpayer would have driven to work but for the tools merely to be faced with the further

³² *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930), in which reasonable efforts were made to find the right amount of a deduction, is not limited to cases of administrative difficulty. It was cited in *Reginald Turner*, 23 P-H TAX CT. MEM. ¶ 54,142 (1954), involving prizes, and in *Francis Eaton*, 27 P-H TAX CT. MEM. ¶ 58,013 (1968), involving identification of psychic enjoyment.

³³ 385 F.2d at 41.

troublesome question of how to identify the personal element in those cases where the taxpayer cannot win on the "but for" issue.

A second question is how to apply this analysis if the personal reason for driving is medical. Because proof of dominance of the personal purpose regardless of the business need is not difficult in these cases, the result in *Sullivan* arguably should be to disallow a deduction for any portion of the expense even if the considerations outlined above would lead to a one hundred percent deduction in the *Tyne* case. On the other hand, medical reasons hardly give an individual a choice of whether to walk or drive. This observation goes beyond the case of transporting tools to work and questions the disallowance of the deduction for normal commuting expenses when there are medical reasons for driving. This issue was resolved against the taxpayer with very little thought.³⁴ Perhaps the *Sullivan* case provides an opportunity to take the first step toward re-examining the disallowance of normal commuting expenses when medical reasons are responsible for the expenses.

II

EQUITY

The analysis pursued above assumes that in the normal commuting situation there is free choice of residence. Professor Klein suggests, however, that the easy assumption that people view the choice of residence as a free one is probably inaccurate; thus Mr. Flowers never really thought that moving to Mobile was a possibility.³⁵

If I understand Professor Klein, he does not assert that because free personal choice is psychologically absent, the expense is automatically deductible because the need to get to work provides the dominant purpose. Apparently, psychic rigidity is a kind of personal motivation which can support a conclusion that an expense is non-deductible if further analysis reveals that there is still a psychic return. He suggests that, once it is found that the choice is psychologically rigid, it becomes relevant to explore further to see whether the cost of commuting is only an added cost for the taxpayer, not associated with an increase in personal satisfaction when compared with taxpayers with lesser or no commuting expenses.³⁶ I gather that while free personal

³⁴ John C. Bruton, 9 T.C. 882 (1947).

³⁵ Klein at 877-78.

³⁶ *Id.* at 888-90.

choice would clearly indicate the presence of psychic return, its absence does not conclusively demonstrate that there is no psychic return.³⁷

The search for psychic return, once psychological rigidity in personal residence decisions is accepted as a reasonable assumption, next leads to deciding whether psychic returns from different residence locations are likely to be equal and whether housing costs are not lower where commuting expenses are high.³⁸ Thus Professor Klein suggests that the lawyer who lives in Aspen where the skiing is good and the lawyer who lives in Chicago where there is a fine symphony and an art gallery are likely to have equal psychic returns.³⁹ While he asserts the need for estimating whether housing is as expensive in areas far from work as in areas close to work, he does not hazard a guess on this point.⁴⁰ If empirical observation and rational estimates can verify these assumptions, Professor Klein concludes that the commuting expense is associated with no personal benefit and is only an extra burden.⁴¹ It would, therefore, be analogous to medical expenses and casualty losses which are deductible.⁴² Professor Klein clearly recognizes that psychic rigidity and psychic returns vary greatly from person to person but suggests that, if one area such as residence location can be separately analyzed with some degree of certainty, it should be separately dealt with by the tax law.⁴³

Professor Klein admits that it is appropriate to maintain existing rules if reliable information is unavailable.⁴⁴ But if psychic choice and psychic return are so difficult to identify and so varied from person to person, should an analysis which makes use of this approach be adopted? The difficulty in identifying psychic satisfaction can be demonstrated in the context of commuting expenses.

First, many taxpayers probably have a psychologically free choice in determining residence. Professor Klein's example of equal psychic

³⁷ I should make clear that I do not understand Professor Klein to be basing his analysis on a challenge to the assumption that housing conditions allow free choice, although it seems plain that non-deductibility is most vulnerable on this score. This observation about actual housing conditions, as opposed to the psychological attitude towards residence choice, seems most apt for the urban poor, as Professor Klein notes at 896. This would explain the deductibility of commuting expenses under welfare law (*see* Klein at 873-74 & 896), even apart from the obvious policy considerations against placing an obstacle in the way of encouraging welfare recipients to work.

³⁸ Klein at 888-89.

³⁹ *Id.* at 887-88.

⁴⁰ *Id.* at 889.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* at 888-89.

⁴⁴ *Id.* at 896.

return, *i.e.*, the Aspen and Chicago lawyers, supports this conclusion. The equal return in such cases often results from a free exercise of residence choice. Indeed, the assumption of free choice was probably the basis for disallowing a deduction for moving expenses by a "new" employee before the law was amended.⁴⁵ However, the more precise question is whether there is a psychologically free choice to commute or not after the work location is chosen. As a psychological matter, the choice would seem free in many cases, especially when the choice is between suburb and city.

Second, even if the choice is not psychologically free, the assumption that psychic returns are equal is likely to be questionable. As noted above, the "equality" in the case of the Aspen and Chicago lawyers probably stems from free choice. In the absence of psychological choice, is it at all clear that residence in the suburbs lacks an extra psychic return? I do not understand Professor Klein to say that if there is psychological rigidity in choosing residence location, equality of psychic returns necessarily follows. If there is not such equality, is there not a significant likelihood that psychic returns are greater in areas with longer commutes or at least that the assumption of equality is highly questionable?

Third, if the psychic return does not vary, are housing costs the same? While Professor Klein does not make an estimate, I would guess that many younger suburban dwellers view the commuting expense as one which equalizes their housing costs with the higher rentals of those living closer to the center of the city.

However, there is a more basic objection to the proposed model, even if psychic rigidity, psychic returns and housing costs could be determined with the certainty required to make the model useful. Why should we be willing to make the adjustment of taxable income suggested by the model when we know that psychic rigidity and psychic returns vary considerably for all sorts of consumption decisions for different consumers? Consumer *A* may get fifty percent satisfaction from his ten-dollar trip to the beach which his mother-in-law insists on but full satisfaction from his ten-dollar dinner at a restaurant; Consumer *B* may have the reverse experience; Consumer *C* might get his twenty-dollars' worth. Neither beach nor restaurant expenditures will yield the certain conclusions about consumer satisfaction required by Professor Klein's model, but Consumers *A* and *B* have received less than twenty-dollar satisfaction because, as individuals, their circum-

⁴⁵ Willis G. Ferebee, 39 T.C. 801, 805 (1963) (Opper, J., concurring). Section 217 of the Internal Revenue Code now authorizes a deduction for moving expenses.

stances varied from Consumer C's. I cannot see why the ability to reach reasonable conclusions about psychic satisfaction in the context of residence location expenses (if that is possible) argues for a deduction of the commuting expenses, when taxpayers have similar but unidentifiable experiences of making expenditures yielding little or no psychic satisfaction in contexts in which generalizations about the expenditures are impossible.⁴⁶

I do not mean to suggest that the likelihood of psychic satisfaction should never be considered. My earlier analysis dealing with "cause" made considerable use of this concept. This effort seems to me to be necessary whenever the personal element might be significant in incurring any expense which might also have a business motive. If the likelihood that there is personal satisfaction is not considered, the risk that personal consumption habits will be converted into deductible business expenses will be too great; the tax system will create irresistible pressures toward fringe benefits.⁴⁷ But I do not think Professor Klein is arguing for the use of his model only in the context of expenses, such as commuting expenses, which would be deductible business expenses if the failure to avoid them is not associated with personal satisfaction. He seems to suggest that personal satisfaction is a useful criterion for judging the equity of a provision even in those cases where there is no problem of preventing the disguising of personal expenses as business expenses. In my view, this effort is too fraught with uncertainty to be useful and too likely to discriminate against taxpayers whose psychic returns are lower than others' in respect to expenditures for which no reliable generalizations are possible.

Professor Klein suggests that the current deductions for medical expenses and casualty losses are supportable on the basis of his analysis.⁴⁸ This seems to me to have undesirable consequences. It is probably no accident that the deductions that have been allowed where psychic satisfaction is likely to be low also involve situations where governmental transfer payments are significant.⁴⁹ Indeed, Medicare has caused the medical expense deduction for aged taxpayers to be

⁴⁶ Professor Klein makes the argument for separate treatment of expenses related to residence locations. Klein at 888.

⁴⁷ There is already evidence that a significant amount of national income is fringe benefits. See Yerman, *Fringe Benefits: Tax Shelter for the Working Man*, 1 COLUM. J. OF LAW AND SOC. PROB. 56 (1965).

⁴⁸ Klein at 889.

⁴⁹ 42 U.S.C. §§ 1395, 1396 (Supp. I, 1966) (Medicare and Medicaid); *id.* §§ 1855-1855(g) (1964) (disaster relief).

reduced.⁵⁰ However, if the low level of psychic satisfaction in these two situations is elevated to independent significance and sanctified by the label of "equity" despite the role of these deductions as "tax subsidies," decisions to allow deductions for expenses that lack the same urgency when viewed as subsidies might be encouraged. For example, it might be appropriate to re-examine the "subsidy" aspects of the casualty loss deduction, which provides free insurance to many taxpayers whose protection against losses should perhaps be left to private insurance. Such an effort might be thwarted if the casualty loss deduction were considered grounded in equitable considerations.

⁵⁰ INT. REV. CODE OF 1954, §§ 213(a), (b), as amended, 26 U.S.C. §§ 213(a), (b) (Supp. IV, 1969).