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J. Wendell Bayles v. Utah State Tax Commission : Defendant's Brief

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

J. WENDELL BAYLES,
Plaintiff,

vs.

UTAH STATE TAX COMMISSION,
Defendant.

Case No. 11144

DEFENDANT'S BRIEF

Review of the Order of the Public Service Commission of Utah

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TABLE OF CONTENTS

Authorities Cited

Statutes and Regulations

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STATEMENT OF THE NATURE OF THE CASE

This is a proceeding to review a determination of the Utah State Tax Commission in which it was held that the amounts received by the plaintiff as a scholarship and fellowship grants for the purpose of enabling him to continue his educational studies were subject to taxation under the applicable statutory provisions of the State of Utah, and particularly Repl. Vol. Utah Code Ann. §59-14-4 (1963).

DISPOSITION BEFORE THE UTAH STATE TAX COMMISSION

An informal hearing on this matter was held before the Utah State Tax Commission on September 28, 1966. The conclusion was that the claim for refund should be denied, and that the deficiency determined by the auditing division should be sustained. A formal hearing was waived by the parties based on the stipulation of facts which has been filed with the Utah State Tax Commission and which is a part of the record before this court.

RELIEF SOUGHT ON APPEAL

The plaintiff seeks to have the decision (R. 35-38) of the Utah State Tax Commission reversed and a judgment entered exempting from income the amounts received by individuals for scholarship and fellowship grants.

STATEMENT OF FACTS

The parties to this action have entered into a stipulation of facts (R. 18-23), and these facts are incorporated herein except to the extent it is necesary to restate them in setting forth the position of the defendant.

ARGUMENT

POINT I

AMOUNTS RECEIVED BY PLAINTIFF AS SCHOLARSHIP OR FELLOWSHIP GRANTS TO ENABLE HIM TO PURSUE HIS EDUCATIONAL STUDIES MUST BE INCLUDED AS INCOME FOR THE PURPOSE OF THE STATUTES OF THE STATE OF UTAH RELATING TO INDIVIDUAL INCOME TAXATION.

The Utah State Tax Commission has for many years held that amounts received as scholarship or fellowship grants are taxable under the applicable statutes. Its reliance has been placed on Repl. Vol. Utah Code Ann. §59-14-4(1) (1963) which provides:

> Gross income includes gains, profits and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trade, businesses, commerce or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, also from interest, rent, royalties, dividends, securities or the transaction of any business carried on for gain or profit, or gains or profits, periodic payments received as alimony only, and income derived from any source whatever.

As this court is well aware, both this type of statute and the comparable federal statute dealing with income taxation has been interpreted as including all sources of

income, no matter how derived. *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 75 S. Ct. 473, 99 L.Ed. 483 (1954), *Helvering* v. *Clifford*, 309 U.S. 3331, 60 S. Ct. 554, 84 L.Ed. 788 (1940); *Helvering* v. *Midland Mutual Life Ins. Co.*, 300 U.S. 216, 57 S. Ct. 423, 81 L.Ed. 612 (1937).

Nevertheless, exceptions have been made for certain types of receipts received as income, specifically Repl. Vol. Utah Code Ann. § 59-14-4(2) (c) (1963) exempts amounts received as gifts:

> The following items shall not be included in gross income and shall be exempt from taxation under this chapter: . . .
>
> The value of property acquired by gift, bequest, devise or inheritance (but the income from such property shall be included in gross income).

It would appear, then, that this court must determine whether the amounts received by the plaintiff are exempt from the income tax provision under this subsection since the law is certainly broad enough to have these included under its general provision.

There appear to be no cases from this court in which it has been determined whether these types of payments are to be included in income. As the plaintiff has noted, in the past the Utah statutory provisions closely paralleled the federal statutes, and some consideration can be given the decisional and statutory developments there.

It should be noted at the outset that prior to 1954 there were no federal statutes dealing specifically with

the treatment that should be accorded scholarship and fellowship grants. Prior to that time there had been confusion as to how these awards shoud be treated. Because of this confusion, in 1954 when Congress rewrote the Internal Revenue Code it was determined that there should be included a provision defining what types of fellowship and scholarship payments should or should not be included in the income of the recipients for the purpose of federal income taxation.

Prior to that time the federal law read much as does our law and was generally interpreted by the Bureau of Internal Revenue (now Internal Revenue Service) to require the inclusion of such amounts in the income reported to the government by the recipients. The basic premise of the defendant is that where a statute requires the inclusion of certain amounts in income, there shall be no exclusion unless specifically provided for. The dedendant further contends that the provisions of the Utah Code relating to the exemption of gifts from income in Repl. Vol. Utah Code Ann. § 59-14-4(2) (c) (1963) does not encompass the awards received by the plaintiff from the University of Utah and the New York University.

It would appear to the defendant that the statutes of this state relating to income are broad enough to cover the amounts received as fellowship or scholarship grants and that it must be determined only whether they constitute a gift under our applicable provisions. It might be noted here parenthetically that the amounts such as those received by the plaintiff while attending the New York

University were excludable from income in that jurisdiction only by virtue of a statute enacted by that state in 1958 closely paralleling the federal statutory provisions and exempting from gross income amounts received as scholarship or fellowship grants. New York Tax Law, § 359(2) (r). While several legislatures of the various states have seen fit to enact this or similar types of statutory provisions, this court should keep in mind that the Utah State Legislature either has not found it necessary or desirable to amend its statutory provisions. This, even though the Utah State Tax Commission has consistently held that such amounts must be reported and included as income. The Legislature presumably is and has been aware of this administration interpretation and practice.

In attempting to determine whether amounts received as scholarship and fellowship grants can be treated as a gift, it should be made plain that the common-law concept of gifts is not the keystone when we are attempting to determine whether certain receipts should be taxed. The defendant feels that in attempting to resolve whether or not these amounts may be excluded under the gift provision of our income tax statute, it must examine the latest and most discursive pronouncement of the United States Supreme Court. This is the case of *Commissioner* v. *Duberstein,* 363 U.S. 278, 80 S.Ct. 1190, 4 L.Ed.2d 1218 (1960) where the court made several pertinent observations which we feel this court should take notice of. First, in determining the meaning of gift within the context of the statute, the court made this observation:

> The course of decision here makes it plain that the statute [federal internal revenue income tax provision] does not use the term "gift" in the common-law sense, but in a more colloquial sense. This court has indicated that a voluntary executed transfer of this property by one to another, without any consideration of compensation therefor, though a common-law gift, it not necessarily a "gift" within the meaning of the statute. For the court has shown that the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift. 363 U.S. at 285, 80 S.Ct. at 1196, 4 L.Ed.2d at 1224.

The court further went on to state that:

> And, importantly, if the payment proceeds primarily from "the constraining force of any moral or legal duty," or from "the incentive of anticipated benefit" of an economic nature (citations) it is not a gift. And, conversely, "where the payment is in return for services rendered, it is irrelevant that the donor recognize no benefit from it." 363 U.S. at 285, 80 S.Ct. at 1196, 4 L.Ed.2d at 1225.

Then, the court indicated what it would feel would be a gift under the revenue statutes. It said that:

> A gift in the statutory sense, on the other hand, proceeds from a "detached and disinterested generosity," . . . "out of affection, respect, admiration, charity or like impulses." 363 U.S. at 2885, 80 S.Ct. at 1197, 4 L.Ed.2d at 1225.

It is the position of the defendant that this case is controlling when determining whether scholarship or fellowship grants should be excluded under the Utah law.

We think, too, that the decision of the United States Supreme Court in the case of *Robertson* v. *United States*, 343 U.S. 711, 72 S.Ct. 994, 96 L.Ed. 1237 (1951) which was cited favorably and frequently in *Duberstein* and which also involved a prominent resident of the State of Utah, establishes the proposition that where an individual performs an act or agrees to perform an act or service, the amounts he receives are properly included in income since this is a type of consideration which extends beyond the boundaries of a gift within the meaning of the revenue statutes.

In *Robertson* the taxpayer composed a musical composition in the late 1930s apparently under no grant and not for the fulfillment of any educational requirement. Some six years later, the composition was submitted to judges of a musical contest established by a philanthropist and taxpayer won the award that had been provided. The court held that, contrary to the taxpayer's contention that the award should be excluded as a gift, the award was properly includable in income. The mere submission of the composition established as income the amount received. Here the plaintiff received amounts through an accredited institution which he attended and at which he pursued a course of study leading to an academic degree — all of which were contemplated in making the grant available to him. His involvement, active participation and agreement to perform certain acts were much greater than those in *Robertson* and the amounts received should be treated as income for Utah state income tax purposes.

The defendant feels that the court should take notice of the one case relied upon by the plaintiff — *George Winchester Stone, Jr.*, 23 T.C. 254 (1954) — which permitted the taxpayer to exclude from income certain amounts which he had received from a foundation. There are a number of factors which would distinguish this case from the situation which the court is now being asked to consider. In *Stone* the taxpayer was not a student attending any accredited school; he was not entitled to any curriculum credits; he was not working toward nor did he receive an academic degree; and the award was not given to him under any circumstances paralleling those of an academic institution. In the instant situation, of course, the taxpayer was attending an accredited and recognized educational institution; the grants were given to him to enable him to pursue his studies; he was expected, though not legally required, to pursue his educational training during the periods of the grants, and had he not done so it is doubtful the institution would have continued to make the amounts available to him; the grants would not have been made had it not been thought the taxpayer would pursue his avowed course of study; and, all of the grants were made with the anticipation that the taxpayer would obtain an accredited educational degree which, in fact, he did in receiving an LL.B. degree from the University of Utah and an LL.M. degree from the New York University.

It appears to the defendant that the taxpayer comes well within the guidelines set forth in *Robertson* and *Duberstein* establishing the incidence of taxation. While

the individuals who establish within the administrative framework of these universities a fund to be used for the purpose of providing scholarship and fellowship grants to deserving students may often have no knowledge of the recipients, it was certainly the intent of these individuals to have their funds made available to deserving students and to individuals who were progressing towards an academic degree. When these students applied for, were awarded, and did accept the grants which had been made available to them, the defendant feels that they came within the guidelines established by *Robertson,* and that this was the type of service or performance considered by the court in *Duberstein* which would hold that the amounts received were taxable even though the donor derived no economic benefit from such service or performance. That the donor receives no economic benefit from the recipient of a scholarship or fellowship grant does not convert such a receipt into a gift within the meaning of the statutes in the hands of the recipient. *Commissioner* v. *Duberstein, supra; Robertson* v. *United States, supra.*

There is attendant upon all funds established by individuals a desire, it would seem, to train persons who will be of a benefit to the community, to add to the prestige of educational institutions, and to attract through the use of their funds individuals who not only need the source of income during this period of training, but who will also be a credit to the institution itself. This, too, it is felt indicates that such awards are not gifts within the meaning of the statute, but are amounts which must be

included in income under the very broad provision established by the Legislature.

POINT II

WHETHER PLAINTIFF MAY DEDUCT FROM HIS REPORTED INCOME AMOUNTS INCURRED AS EDUCATIONAL EXPENSES WHILE ATTENDING THE NEW YORK UNIVERSITY.

Regulation 14-5, para. 19 of the Utah Income Tax Act provides:

> Expenditures made by a taxpayer for his education are deductible if such education is undertaken primarily for the purpose of maintaining or improving skills required by the taxpayer in his employment or other trade or business or meeting the express requirements of a taxpayer's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the taxpayer of his salary, status or employment. *Educational expenses are not deductible if the primary purpose for which they are incurred is to obtain a new position, or a substantial advancement in a present position or to fulfill the general educational aspirations of the taxpayer. Likewise such expenses are not deductible if the education is needed to meet the minimum requirements to qualify for, or become established in a position, business or specialty.* (Emphasis added.)

The taxpayer has made the further argument that the expenses he incurred while attending New York Uni-

versity were deductible since he was only maintaining and improving skills he had already obtained and, further, that he was incurring such expenses at the request of his employer. The defendant feels it is not necessary to deal at length with this issue as raised by the taxpayer. It should be acknowledged only that the taxpayer pursued a course of study which enabled him to obtain an advance degree in a specialized field of law, namely taxation. While an individual may be improving upon the knowledge he obtained in his formal education, it is difficult to imagine that any practitioner in the field of law having obtained his degree from a recognized and even a most prestigious institution would contend that he is so well qualified within a specialty that further education or training is not either necessary or desirable if he can possibly obtain it. The defendant contends that a law school graduate who pursues his studies with the intention of attaining a master of laws degree, and particularly one who pursues such studies immediately after obtaining his initial law degree, at such institutions as well recognized as the New York University, are not only maintaining or improving such basic skills as they may have, but are in the course of acquiring the education necessary to engage in the specialized field of law to which they aspire. Further, we think rather specious the contention that the taxpayer's employer *required* (the term used in the regulation) him to attend the New York University and attain a master of laws degree with a concentration in the field of taxation. Even assuming that the law firm, which this taxpayer had worked for as

a clerk, thought it desirable to have an individual who was highly trained in the field of taxation, it is questionable, recognizing the fluidity of law associations, the relative instability of the association of new law school graduates with major firms, and the availability of lawyers with the requisite educational and governmental training that any firm could be said to *require* an incoming associate to attend an educational study which may take an additional one to two years. It is the contention of the defendant, therefore, that perhaps while the law firm with which the taxpayer was associated would have encouraged and would have desired him to have this additional training, this was not a requirement for his association with the firm, and that his attendance at the New York University was for the ultimate goal of attaining an LL.M. degree. Such attendance was not primarily for the purpose of maintaining and improving skills already acquired, or meeting the express requirements of his employer, but were for the purpose of obtaining and developing his skills in the field of taxation.

CONCLUSION

In conclusion, then, the defendant contends that the type of scholarship and fellowship grants received by the plaintiff at both the University of Utah and at New York University were income within the meaning of the statute; that such amounts were not excludable from income as a gift; and, that the amounts received were not deductible as educational expenses within the meaning

of the statute; that such amounts were not excludable from income as a gift; and, that the amounts received were not deductible as educational expenses within the meaning of the applicable regulatory provision. Therefore, the decision of the Utah State Tax Commission should be affirmed.

Respectfully submitted,

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