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For over fifty years, courts have employed the public policy doctrine to disallow otherwise-permissible deductions from gross income in cases where upholding such deductions would frustrate a well-defined public policy.[1] For example, a ship-repair yard was denied section 162 deductions for "kickbacks" paid to officers of foreign vessels,[2] and truckers were denied similar deductions for fines paid as a result of violating state maximum-weight laws.[3] The doctrine, which is based on a presumption against congressional intent to encourage violations of declared public policy,[4] thus operates to implement substantive policies unrelated to revenue collection. While the doctrine has been applied primarily to section 162 deductions for expenses incurred in a trade or business,[5] courts have employed it to disallow deductions under a number of other Internal Revenue Code sections as well.[6]

Although the basic concept of this judicial doctrine is not complex, courts have had difficulty applying it to specific fact situations and thus have done so inconsistently.[7] As part of the Tax Reform Act of 1969,[8] Congress amended section 162 to deny business-expense deductions for fines and similar penalties, certain bribes and kickbacks, and two thirds of certain antitrust damage payments.[9] In

1. *See, e.g.*, Sarah Backer, 1 B.T.A. 214 (1924). *See also* Ellett & Rubinstein, *Disallowed Deductions: 1969 Tax Reform Act Changes to Code Sec. 162*, 48 TAXES 457, at 457 n.1 (1970); Gordon, *The Public Policy Limitation on Deductions from Gross Income: A Conceptual Analysis*, 43 IND. L.J. 406, 414 n.45 (1968); Taggart, *Fines, Penalties, Bribes, and Damage Payments and Recoveries*, 25 TAX L. REV. 611, 614 n.2 (1970).

2. Dixie Mach. Welding & Metal Works, Inc. v. United States, 315 F.2d 439 (5th Cir. 1963).

3. Hoover Motor Express Co. v. United States, 356 U.S. 38 (1958) (involuntary violations); Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30 (1958) (voluntary and involuntary violations).

4. *See, e.g.*, Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30, 35 (1958).

5. Note, *Business Expenses, Disallowance, and Public Policy: Some Problems of Sanctioning with the Internal Revenue Code*, 72 YALE L.J. 108, at 108 n.1 (1962).

6. *See, e.g.*, Fuller v. Commissioner, 213 F.2d 102 (10th Cir. 1954) (section 165 loss on destruction of illegal whiskey); Benjamin T. Smith, 34 T.C. 1100 (1960), *affd. per curiam*, 294 F.2d 957 (5th Cir. 1961) (section 165 loss or section 166 bad debt deduction for IRS penalty); Luther M. Richey, Jr., 33 T.C. 272 (1959) (section 165 theft loss resulting from counterfeiting scheme); Leon Turnipseed, 27 T.C. 758 (1957) (section 151 dependency exemption for woman illegally cohabitating with taxpayer).

7. *Compare* Edwards v. Bromberg, 232 F.2d 107 (5th Cir. 1956), *with* Luther M. Richey, Jr., 33 T.C. 272 (1959). *See* Raymond Mazzei, 61 T.C. 497, 506 (1974) (Sterrett, J., dissenting).

8. Pub. L. No. 91-172, 83 Stat. 487.

9. Tax Reform Act of 1969, Pub. L. No. 91-172, § 902, 83 Stat. 710-11, *amend-*

1971, Congress further amended section 162 to deny deductions for "other illegal payments."[10] While these amendments partially codify the judicial public policy doctrine,[11] it is not clear whether they preempt application of the judicial doctrine to other types of deductions under section 162 or to deductions under other sections of the Code.

The preemption question was raised most recently in Revenue Ruling 74-323.[12] This ruling allowed an employment agency to deduct advertising payments as a business expense even though the advertisements allegedly violated title VII of the Civil Rights Act of 1964[13] by indicating a sex preference that was not a bona fide occupational qualification. In the ruling, the IRS interpreted the amendments to section 162 as preempting judicial application of the public policy doctrine, at least with regard to deductions under that section. The only provision of section 162 that might have disallowed the deduction at issue was section 162(c)(2), which disallows deductions for "illegal payments" that could subject the taxpayer to "a criminal penalty or the loss of license or privilege to engage in a trade or business." However, since title VII provided no such sanction for the violation,[14] this codified public policy provision was not apposite. Therefore, according to the Service, the deduction could not be denied.

This Note evaluates the merits of Revenue Ruling 74-323. First, it asserts that, while not arbitrary, the Service's resolution of the preemption issue was not mandated by the language of amended section 162 or by the relevant legislative history. Second, it maintains that it is both appropriate and procedurally feasible to apply the judicial public policy doctrine to violations of federal civil rights laws that impose no fine, imprisonment, loss of license, or other criminal penalty. The denial of a deduction in this situation would extend the public policy doctrine beyond both section 162(c)(2) and the judicial doctrine as it has been developed to date. This Note concludes that on the basis of precedent and policy the doctrine should be so extended.

Even before Revenue Ruling 74-323, the Service indicated its belief that the 1969 and 1971 amendments to section 162 preempted the public policy doctrine. A recently finalized regulation for sec-

ing INT. REV. CODE OF 1954, § 162. The disallowance of the deduction for antitrust damage payments was a reaction to the allowance of such deductions by Rev. Rul. 64-224, 1964-2 CUM. BULL. 52. *See* Ellett & Rubinstein, *supra* note 1, at 461; Taggart, *supra* note 1, at 616-18.

10. Revenue Act of 1971, Pub. L. No. 92-178, 85 Stat. 497, *amending* INT. REV. CODE OF 1954, § 162(c)(2).

11. *See* text at notes 23, 26 *infra*.

12. 1974-2 CUM. BULL. 40.

13. 42 U.S.C. § 2000e-3(b) (Supp. III, 1973).

14. *See* 42 U.S.C. § 2000e-5(g) (1970); text at notes 47-49 *infra*.

tion 162 states: "A deduction for an expense paid or incurred after December 30, 1969, which would otherwise be allowable under section 162 shall not be denied on the grounds that allowance of such deduction would frustrate a sharply defined public policy."[15] This interpretation is not necessitated by the language of the statute, however, since the statute nowhere states that the public policy doctrine codified therein was meant to be exclusive. Of course, the IRS might have so interpreted section 162 by applying the maxim of statutory construction *expressio unius est exclusio alterius*. According to this maxim, the fact that Congress delineated specific situations in which deductions will be disallowed implies that it intended to exclude all other situations from the application of the judicial public policy doctrine. The maxim is an aid to construction, however, not a rule of law.[16] Moreover, courts have ignored the maxim where an expansive construction would achieve beneficial results or would accord with established custom, usage, or practice.[17] Thus, in light of the long history of judicial application of the public policy doctrine, it would seem that its abrogation should not be inferred in the absence of a clear expression of legislative intent.

The IRS in fact based its conclusion in Revenue Ruling 74-323 on the legislative history of the Tax Reform Act of 1969.[18] However, an examination of the published legislative history allows no such facile conclusion. The amendments to section 162 were only one part of a tax reform act of immense proportions.[19] Although the issue of the appropriate treatment for antitrust damage payments had been under consideration for some time and therefore received attention in the hearings and debates,[20] the other changes in section 162 received little consideration, at least in the published legislative history.[21] Except for a very similar statement in the Sen-

15. Treas. Reg. § 1.162-1(a) (1975).

16. Neuberger v. Commissioner, 311 U.S. 83, 88 (1940).

17. *See* 2 J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 4917, at 421 (F. Horack ed. 1943).

18. Rev. Rul. 74-323, 1974-2 CUM. BULL. 40, at 40.

19. *See, e.g.*, 115 CONG. REC. 40690 (1969) (remarks of Senator Moss). The main purposes of the Act were to reduce the scope of tax preferences and to give some measure of relief to low-income taxpayers. *See, e.g., id.* at 35485 (remarks of Senator Long), 40865 (remarks of Representative Mills).

20. *See Hearings on H.R. 13270 Before the Senate Comm. on Finance*, 91st Cong., 1st Sess., 743-44, 5224-25, 5241, 5278-87 (1969) [hereinafter *Senate Hearings*]; 115 CONG. REC. 35905, 38301-04 (1969).

21. The initial bill, H.R. 13270, 91st Cong., 1st Sess. (1969), did not include a provision on the public policy doctrine. The changes to section 162 therefore were not considered during the hearings held by the House Ways and Means Committee. The hearings of the Senate Finance Committee, which considered essentially the House version of the bill, contain references only to the treatment of antitrust damages. *See Senate Hearings, supra* note 20, at 743-44, 5224-25, 5241, 5278-87. After completing its hearings, the Senate Finance Committee incorporated into the major bill a second bill (containing essentially the present provisions) that had been intro-

ate report,[22] the only direct reference to the intended effect of the amendments to section 162 is contained in a summary of the bill prepared by the Senate Finance Committee: "The codification of the rule denying deductions for payments in these situations (specified by sections 162(c), (f), and (g)) which are deemed to violate public policy is designed to be all-inclusive. Thus, public policy generally will not be deemed to be sufficiently clearly defined in other circumstances to justify disallowance of deductions."[23] While the phrase "all-inclusive" in the first sentence can be interpreted as a manifestation of congressional intent to abrogate the judicial doctrine in all other situations, the use of the word "generally" in the second sentence implies the opposite. If Congress had intended to foreclose application of the judicial doctrine completely, it could have asserted that it was deeming that public policy is not "sufficiently clearly defined" in any other circumstances. The second sentence thus suggests that courts can deny deductions on public policy grounds in other areas where public policy is "sufficiently clearly defined." Given this apparent contradiction and the dearth of other evidence of legislative intent, the conclusion of the Service does not seem mandated.[24]

The Service could conceivably have buttressed its position by referring to the legislative history accompanying the 1971 amendments to section 162(c), which were enacted because Congress felt that the 1969 provisions might "unduly restrict the denial of deductions" in some cases.[25] The Senate report states: "The committee con-

duced on the floor and sent to the committee. *See* S. 2631, 91st Cong., 1st Sess. (1969). The Senate committee report on the changes to section 162 addressed itself mainly to the antitrust damage payment provision, *see* S. REP. No. 91-552, 91st Cong., 1st Sess. 273-75 (1969), and Senate floor debate on the changes related only to the antitrust provision. *See* 115 CONG. REC. 35905, 38301-04 (1969). The bill presented to the Senate for debate covered 585 pages and was accompanied by a 352-page report. *See* 115 CONG. REC. 37634 (1969). The Senate added 376 substantive amendments to the House bill in the committee and on the floor, 308 of which—including the changes to section 162—were embodied in the conference report. *See* 115 CONG. REC. 40698 (1969). This conference version of the bill was passed with haste by both houses. Three hours after the House received the conference report it began a two-hour debate, with no amendments allowed from the floor. Several members of the House protested; typical are the remarks of Representative Pickle: "I repeat—this is crash legislation and we were faced with the alternative of accepting or rejecting major legislation almost completely on blind faith and newspaper accounts." 115 CONG. REC. 40896 (1969).

22. S. REP. No. 91-552, *supra* note 21, at 274.

23. Summary of H.R. 13270 As Reported by the Comm. on Finance, in *Senate Hearings, supra* note 20, at 6629, 6743.

24. One is reminded of the remark of Justice Frankfurter: "Spurious use of legislative history must not swallow the legislation so as to give point to the quip that only when legislative history is doubtful do you go to the statute." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 543 (1947).

25. S. REP. No. 92-437, 92d Cong., 1st Sess. 72-73 (1971).

tinues to believe that the determination of when a deduction should be denied should remain under the control of Congress. However, the committee has concluded that the area in which deductions are denied should be expanded somewhat beyond the limits set in 1969."[26] Arguably, the language of this committee report and the subsequent enactment of the 1971 amendments are evidence of a congressional belief that the 1969 amendments preempted application of the judicial doctrine. Alternatively, however, the language can be read merely as a congressional attempt to ensure that courts would not allow deductions in the specific situations, delineated in section 162, in which Congress wanted all deductions disallowed. On this reading, courts would remain free to expand the public policy doctrine. Moreover, the importance of the language is unclear since it is in effect an interpretation by one congress of legislation enacted by a previous congress: To allow a later congress to interpret definitively the work of a former congress is tantamount to according a function of the judiciary to the legislature or a legislative committee.[27]

Three members of the Tax Court recently concluded that the legislative history of the 1969 and 1971 amendments does not evidence congressional intent to preempt the judicial public policy doctrine. The taxpayer in *Raymond Mazzei*[28] claimed a section 162 deduction for $20,000 that he lost as the victim of an alleged plan or conspiracy to produce counterfeit currency. The court disallowed the deduction on public policy grounds. The 1969 amendments were inapplicable since the taxpayer claimed a section 165 deduction rather than a section 162 deduction and since the loss occurred in taxable year 1965.[29] Eight of the judges, however, offered interpretations of the amendments. In a concurring opinion, three of the judges stated:

> [I]n enacting the amendments to section 162, dealing with the deduction of various items involving such considerations, Congress left the door open by recognizing that "public policy, in other circumstances, *generally* is not sufficiently clearly defined to justify the disallowance of deductions." See S. Rept. No. 91-552, 91st Cong., 1st Sess., p. 274 (1969) (emphasis added). The reference to legislative retention of control over deductions in the Senate committee report accompanying the Revenue Act of 1971 was limited to situations in-

26. *Id.*

27. *Cf.* Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803).

28. 61 T.C. 497 (1974).

29. Although some of the 1969 and 1971 amendments apply retroactively, the amendments disallowing deductions for "other illegal payments" were not given such effect. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, § 902(c), 83 Stat. 711, *amending* INT. REV. CODE OF 1954, § 162; Revenue Act of 1971, Pub. L. No. 92-178, § 310(b), 85 Stat. 525, *amending* INT. REV. CODE OF 1954, § 162.

volving bribes and kickbacks. See S. Rept. No. 92-437, 92d Cong., 1st Sess., p. 72 (1971).[30]

In a dissenting opinion, five of the judges read the 1969 and 1971 amendments as merely calling for "judicial restraint" in applying the doctrine outside of section 162.[31]

Thus, it is fair to state that neither statutory interpretation nor legislative history *compels* the conclusion that the partial codification of the public policy doctrine in section 162 preempted the judicial doctrine under that section. Four interpretations of the intended effect of the amendments can be postulated. An analysis of these interpretations supports the proposition that the amendments did not abrogate the judicial doctrine under section 162.

The first interpretation of the amendments is that Congress intended the public policy doctrine to exist only to the extent that it has been codified. Thus, because the doctrine is presently codified exclusively in section 162, the doctrine may no longer be applied to deductions claimed under any other Code provision. This interpretation could be derived from a literal reading of the language of the 1971 Senate report, which states "that the determination of when a deduction should be denied should remain under the control of Congress."[32] It is clear, however, that neither the Service nor the courts has so construed the amendments: A recently issued regulation under section 212 would incorporate into that section the public policy doctrine codified in section 162,[33] and since the 1969 amendments were enacted, several courts have applied the judicial public policy doctrine to deductions claimed under sections other than 162.[34] Furthermore, while this first interpretation has the advantage of easy application, it would create an anomaly between section 162 and other Code sections. Under section 162(c)(2), a factory owner who bribed a building inspector in violation of a "generally enforced" local or state law could not deduct the bribe as an "ordinary and necessary" business expense. Following this first interpretation, however, a landlord could deduct a similar bribe under section 212 as an "ordinary and necessary" expense incurred in the

30. 61 T.C. at 504 (Tannenwald, J., joined by Dawson and Raum, JJ., concurring).

31. 61 T.C. at 506 (Sterrett, J., joined by Forrester, Featherston, Hall, and Wiles, JJ., dissenting).

32. S. REP. No. 92-437, *supra* note 25, at 72.

33. Treas. Reg. 1.212-1(p) (1975). In addition, the Department of the Treasury has incorporated the public policy doctrine into section 213 medical expense deductions by disallowing deductions for amounts expended for illegal operations or treatments, Treas. Reg. 1.213-1(e)(1)(ii) (1957), and for medicine and drugs not legally procured. Treas. Reg. 1.213-1(e)(2) (1957).

34. *See* McGlotten v. Connally, 338 F. Supp. 448, 460 (D.D.C. 1972) (alternative holding); Green v. Connally, 330 F. Supp. 1150 (D.D.C.), *affd. mem. sub nom.* Coit v. Green, 404 U.S. 997 (1971); Raymond Mazzei, 61 T.C. 497 (1974).

production of income. Given the general parallelism of the two Code sections, it is doubtful that Congress intended this result.

The second interpretation is that the amendments had no effect on the application of the judicial doctrine to Code sections other than 162. Thus, business-expense deductions could only be disallowed in those situations specified by Congress, while other deductions could be disallowed by the courts in cases where they deem application of the doctrine appropriate. This interpretation, however, might also create anomalous results. For example, an employment agency that advertised in violation of title VII would be allowed a section 162 deduction for the costs of so advertising. However, a landlord who similarly advertised might be denied a section 212 deduction on the basis of the judicial public policy doctrine.

The third interpretation is that the judicial doctrine has been preempted, but the public policy doctrine as codified in section 162 should be applied to other Code sections. Thus, the courts could deny deductions only for those types of expenditures specified by Congress in section 162. This approach, which apparently has been adopted by the IRS with respect to section 212, has the advantage of eliminating the inter-section disparities the other alternatives may produce. However, there are two problems with this interpretation. First, although sections 162 and 212 are similar enough that the literal language of section 162 could be applied to section 212, that language could not be applied without alteration to other Code sections allowing deductions. For example, section 162 disallows a deduction for "illegal payments." A bad debt incurred as a result of lending money for an illegal purpose is not, literally, an illegal payment. Yet, such a bad debt seems to come within the spirit of the public policy doctrine as codified in section 162. To apply the codified doctrine outside section 162, the Service and the courts would be forced to extract from section 162 certain "principles" to be carried over into other sections and would be exercising discretion in doing so. Thus, the whole purpose of abrogating the judicial doctrine might be defeated. Second, even if the 1969 and 1971 amendments are interpreted merely to provide guidance for courts implementing the doctrine under other Code sections and are not viewed as literally binding outside section 162 (the interpretation adopted by the dissent in *Mazzei*),[35] there is little logical support for this position. Had Congress wanted to amend other sections in addition to 162, it presumably would have done so. Indeed, the fact that Congress amended only section 162 suggests that Congress did not undertake to enact a comprehensive public policy doctrine that would preempt the judicial doctrine.

35. 61 T.C. at 506.

The final interpretation of the amendments to section 162 is that courts remain free to apply the doctrine to deductions under all sections of the Code, including section 162. Under this interpretation, courts *may* disallow deductions in all cases in which they determine that application of the doctrine is appropriate and *must* disallow deductions in those situations set forth by Congress in section 162. Like the third interpretation, this interpretation would avoid the problem of treating inconsistently deductions arising under similar Code sections. Above all, this interpretation allows courts to implement public policy as it becomes more clearly defined. To be sure, inconsistencies may arise when courts disagree about whether public policy is sufficiently clear to warrant invocation of the doctrine. But there is little reason why Supreme Court decisions outlining the proper method for implementing the doctrine cannot minimize the disruptive impact of such inconsistencies. In light of the long history of application of the public policy doctrine by the judiciary and the apparent lack of consideration by Congress regarding the effect of the amendments, the fourth alternative interpretation—that the courts may still apply the judicial doctrine to deductions under all sections of the Code—seems most reasonable.

Having concluded that a court may apply the judicial public policy doctrine to section 162 deductions, this Note will next examine the considerations that should underlie a decision to do so in cases where anti-discrimination legislation has been violated. While Revenue Ruling 74-323 involved allegations of sex discrimination only, the same considerations apply to other forms of illegal discrimination as well.

The first consideration is whether public policy is sufficiently well-defined in this context that judges would be implementing accepted public standards rather than private conceptions of morality. The difficulty in making this determination in many areas has been the basis of criticisms of the doctrine.[36] Federal policy in the area of discrimination, however, is well-established and universally recognized.[37] In addition, since anti-discrimination is a federal policy, application of the doctrine would not lead to a nonuniform tax assessment for similarly situated individuals residing in different states, as might an application of the doctrine to state policy.[38] Thus, any

36. *See, e.g.*, Ellett & Rubenstein, *supra* note 1, at 461.

37. *See, e.g.*, U.S. CONST. amend. XIV; Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241; Frontiero v. Richardson, 411 U.S. 677 (1973) (plurality opinion); Dunn v. Blumstein, 405 U.S. 330 (1972); Strauder v. West Virginia, 100 U.S. 303 (1880).

38. *See generally* Ellett & Rubinstein, *supra* note 1, at 458; Gordon, *supra* note 1, at 412-14; Note, *supra* note 5, at 141-44. This problem of federalism is particularly acute when disallowance of a federal income tax deduction for expenses violating a state law results in an economic loss to the taxpayer that is completely out of proportion to any sanction imposed by the state whose law has been violated. For

criticism must be directed at practical problems (discussed below)[39] in determining when the policy has been violated.

The second consideration is whether the tax laws should be employed to further public policies unrelated to revenue collection when other means of achieving the desired ends are viable.[40] While the construction of a neutral tax system has been viewed as one goal of the tax laws, this goal has remained secondary: Congress, the IRS, and the courts have often used tax laws to implement various substantive policies.[41] Those who argue for neutrality in this context assert that the federal tax scheme imposes a tax on net income, not gross income.[42] Deductions are not matters of legislative grace, but rather are necessary considerations in determining net income.[43] Thus, they argue, taxpayers should be able to deduct all expenditures regardless of the policy considerations implicated. Yet, the tax laws are only a small portion of all state and federal laws. Tax laws purporting to operate neutrally may actually conflict with nontax laws. Indeed, as originally formulated the purpose of the public policy doctrine was not to implement substantive, nonrevenue policies, but to alter the tax system so as to avoid frustrating the operation of other laws.[44] In the area of advertising expenditures in violation of title VII, for example, it is not clear whether the principle of neutrality is furthered by allowing deductions for such expenditures and thereby sanctioning violations of title VII, or by disallowing deductions and thereby encouraging compliance with the law. Indeed, a neutrality argument could be used to justify an expanded public policy doctrine that tempers the tax laws to avoid conflict with other laws.

Section 162 allows deductions for "ordinary and necessary" business expenses. It is difficult to contend, however, that an expendi-

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example, in Boyle, Flagg & Seaman, Inc., 25 T.C. 43 (1955), an insurance agent paid $75,000 in referral commissions in violation of Illinois law. The state insurance commission merely issued a reprimand and conditioned the agent's license on future compliance with the law since the law in general was not adequately enforced. The tax court denied the taxpayer a federal income tax deduction for the $75,000.

39. *See* text at notes 60-62 *infra.*

40. *See generally* Gordon, *supra* note 1, at 411.

41. *See* McGlotten v. Connally, 338 F. Supp. 448 (D.D.C. 1972); Green v. Connally, 330 F. Supp. 1150 (D.D.C.), *affd. mem. sub nom.* Coit v. Green, 404 U.S. 997 (1971).

42. *See, e.g.*, Note, *supra* note 5, at 114.

43. The legislative grace theory has been subject to much criticism. *See, e.g.*, Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142 (1943); Note, *supra* note 5, at 114. The Supreme Court's reasoning in Commissioner v. Tellier, 383 U.S. 687 (1966), also seems to discount the theory: "We start with the proposition that the federal income tax is a tax on net income . . . ." 383 U.S. at 691.

44. *See* Commissioner v. Tellier, 383 U.S. 687, 694 (1966); Tank Truck Rentals, Inc. v. Commissioner, 356 U.S. 30, 35 (1958).

ture, the payment of which violates federal law, is either ordinary or necessary to the operation of a business. The inconsistency of the laws in such a case is clear: The Civil Rights Act denominates an activity illegal while the tax law views the costs of that activity as ordinary and necessary to the operation of a business. The conclusion that this inconsistency was intended by Congress should not be assumed absent the clearest evidence. In short, allowing taxpayers to deduct all expenditures in computing net income in no sense purifies or neutralizes the tax laws. Such an approach may offer conceptual simplicity, yet it is fraught with policy overtones.

The third consideration underlying the application of the public policy doctrine to expenditures resulting from illegal, discriminatory acts is that the disallowance of deductions for such expenditures imposes an economic sanction that often has no relation to the severity of the offense. Thus, the impact of the disallowance of a deduction depends upon the amount of the expenditures and the tax bracket of the taxpayer rather than on the amount of harm caused and the taxpayer's *mens rea*. In this context, there may be a reasonable correlation between the sanctions and the harm since the amount expended on advertising is roughly related to the number of people the advertising reaches.[45] Yet even when no correlation exists, this criticism of applying the doctrine has little force. The aim of the doctrine is not to penalize illegal expenditures, but rather to coordinate the tax laws to avoid sanctioning violations of substantive policy laws. The disallowance of a deduction is thus a recognition by the tax law of the illegitimacy of a certain expenditure. While the tax laws generally tax net income rather than gross income,[46] adherence to this general policy is not a shibboleth of validity for a particular tax provision. The disallowance of business expenditures not ordinary and necessary, for example, is a clear and intentional deviation from that general policy. In short, there are no conceptual obstacles to disallowing deductions and deviating slightly from the policy of taxing net rather than gross income.

The final consideration is whether existing remedies for a particular act of unlawful discrimination render unnecessary an expansion of the public policy doctrine. While no blanket response to this issue is possible, the remedies that Revenue Ruling 74-323 pointed to as available for the violation of the Civil Rights Act of 1964—injunctive relief against future violations and restoration of lost pay[47]—do not make expansion of the doctrine unnecessary. The

45. Indeed, the disallowance of a deduction may bear a more rational relation to the harm than would a set fine.

46. *See, e.g.*, 50 CONG. REC. 3849 (1913) (remarks of Senator Williams).

47. *See* 42 U.S.C. § 2000e-5(g) (1970). *See generally* Sape & Hart, *Title VII Reconsidered: The Equal Employment Opportunity Act of 1972*, 40 GEO. WASH. L. REV. 824 (1972).

injunctive relief possible is prospective in nature and therefore does little to deter. Lost pay is available only upon a showing that, but for the unlawful advertisement, the plaintiff would have sought and obtained the employment.[48] This second remedy often poses insurmountable problems of proof for a complaining party. Furthermore, relief is limited to back pay and is reduced by the amount of the plaintiff's earnings during the period prior to the judicial award.[49] It therefore seems appropriate to apply the public policy doctrine as a further deterrent against unlawful discrimination.

Two fairly recent cases provide support for extending the judicial doctrine to section 162 deductions for expenses incurred as a result of engaging in discriminatory practices. In *Green v. Connally*,[50] the plaintiffs, parents of black school children attending public schools in Mississippi, sought to enjoin United States Treasury officials both from according tax-exempt status under section 501(c)(3) to private schools in that state discriminating against black students and from allowing deductions under section 170(c)(2) for contributions to such schools. The three-judge district court, relying on "the general and well-established principle that the Congressional intent in providing tax deductions and exemptions is not construed to be applicable to activities that are either illegal or contrary to public policy,"[51] held that such exemptions and deductions could not be countenanced. As the court stated, "The Code must be construed and applied in consonance with the Federal public policy against support for racial segregation of schools, public or private."[52]

In *McGlotten v. Connally*,[53] the plaintiffs, Blacks allegedly denied membership in a fraternal order because of their race, brought a class action "to enjoin the Secretary of Treasury from granting tax benefits to fraternal and nonprofit organizations which exclude nonwhites from membership."[54] Plaintiffs challenged sections 501(c)(7) and (8) to the extent that those sections authorized the exemption from income taxation of nonprofit clubs and fraternal orders excluding nonwhites from membership, and they challenged section 170(c)(4) to the extent that it permitted deductions for individual contributions to such organizations. Although the three-judge district court focused primarily on the constitutionality of these sections,

48. *See, e.g.*, Lea v. Cone Mills Corp., 438 F.2d 86 (4th Cir. 1971).

49. *See Developments in the Law—Employment Discrimination and Title VII of the Civil Rights Act of 1964*, 84 HARV. L. REV. 1109, 1259 (1971).

50. 330 F. Supp. 1150 (D.D.C.), *affd. mem. sub nom.* Coit v. Green, 404 U.S. 997 (1971). Because the IRS changed its position in the course of the suit, the Supreme Court's affirmance "lacks the precedential weight of a case involving a truly adversary controversy." Bob Jones Univ. v. Simon, 416 U.S. 725, 740 n.11 (1974).

51. 330 F. Supp. at 1161.

52. 330 F. Supp. at 1163.

53. 338 F. Supp. 448 (D.D.C. 1972).

54. 338 F. Supp. at 450 (footnotes omitted).

it also stated: "[T]here is a clearly indicated Congressional policy that the beneficiaries of federal largesse should not discriminate. We think this overriding public policy, even in the absence of our constitutional holding [in favor of the plaintiffs], requires that the Code not be construed to allow the deduction of contributions to organizations which exclude nonwhites from membership."[55]

Green and *McGlotten* can be viewed as extensions of the judicial public policy doctrine. Both cases were decided after the 1969 amendments to section 162 and both denied tax benefits to organizations engaging in discriminatory practices notwithstanding the absence of specific disallowance provisions in the Code. Moreover, the alleged discriminatory acts in both instances were not punishable by criminal penalties or fines. Although both cases involved racial discrimination, which more clearly invokes constitutional overtones[56] than does sex discrimination, their precedential value should not be limited to racial discrimination only. Sex discrimination is also clearly proscribed by federal laws and also merits the support of the public policy doctrine.

Arguably, *Green* and *McGlotten* can be distinguished from cases such as that posed in Revenue Ruling 74-323 on the ground that business-expense deductions under section 162 do not constitute government subsidies as do the provisions on charitable deductions and tax-exempt status. Thus, while business-expense deductions implement the federal policy of taxing net income, deductions under section 170 and tax exemptions under section 501 are deliberate departures from this policy. Such a distinction was suggested by the *McGlotten* court when it stated that, unlike the benefits there in issue, deductions such as those for business expenses "do not act as matching grants, but are merely attempts to provide for an equitable measure of net income."[57] Similarly, it can be argued that since sections 170 and 501 are based upon policy considerations not relevant to revenue collection,[58] it is more appropriate to deny their application because of conflicting nonrevenue policies—in this case the policy against discrimination—than it is to deny the application of section 162.[59] These distinctions, however, are not persuasive. It is

55. 338 F. Supp. at 460.

56. The *McGlotten* court held that the granting of tax-exempt status and the allowance of charitable deductions for contributions constituted government support of discrimination in violation of the fifth amendment. 338 F. Supp. at 456-57. The court in *Green* specifically based its holding on public policy grounds to avoid the constitutional question. 330 F. Supp. at 1164-65.

57. 338 F. Supp. at 457 (footnote omitted). For an argument against such a distinction, see Bittker & Kaufman, *Taxes and Civil Rights: "Constitutionalizing" the Internal Revenue Code*, 82 YALE L.J. 51, 68-74 (1972).

58. *See* H. REP. No. 1860, 75th Cong., 3d Sess. 19 (1938); McGlotten v. Connally, 338 F. Supp. 448, 456 (D.D.C. 1972).

59. *See* Green v. Connally, 330 F. Supp. 1150, 1162 (D.D.C.), *affd. mem. sub nom.* Coit v. Green, 404 U.S. 997 (1971) ("The public policy limitation on tax ben-

not necessary that deductions be considered grants of governmental largess to disallow them on public policy grounds. Nor is it necessary to dispute that the federal tax scheme essentially taxes net income. The issue in each instance is whether the allowance of a tax benefit conflicts with other laws and, with regard to this issue, *Green* and *McGlotten* are relevant. Both cases indicate that the federal policy against discrimination is sufficiently clear to require alteration of the tax scheme to avoid frustrating this policy. Both suggest, therefore, that expenditures stemming from discriminatory advertising should not be considered "ordinary and necessary" under sections 162 and 212 because they violate a well-defined public policy.

One problem with expanding the public policy doctrine in the manner suggested here is that the uniform application of the doctrine to all appropriate situations could turn the IRS into a law enforcement agency.[60] Clearly, it would be both infeasible and undesirable to require the IRS to determine the legality of advertising and similar activities. A reasonable alternative is to require individuals who desire to challenge the legality of various expenditures to complain first to either the Equal Employment Opportunity Commission or a similar administrative body charged in the first instance with adjudicating allegations of discrimination. These administrative bodies could, without undue burden, report their determination to the IRS, and the IRS could then disallow deductions claimed for unlawful expenditures. Because, as noted below,[61] standing to sue in federal court presumably would be restricted to those individuals who have a reasonable claim for damages or injunctive relief, these more specialized tribunals would be resorted to initially in most instances. Individuals who lacked standing to bring claims in the specialized tribunals normally would also lack standing to challenge tax deductions in federal courts. This alternative would, for example, be considerably less burdensome on the IRS than the affirmative duty, imposed by the court in *Green*, to investigate the activities of private schools in Mississippi before granting them tax-exempt status.[62]

Because they arguably prevent third parties from contesting deductions allowed to alleged wrongdoers, the Anti-Injunction Statute,[63] the Declaratory Judgment Act,[64] and the requirement of ap-

efits applies *a fortiori* to the case before us, involving the charitable deduction whose very purpose is rooted in helping institutions because they serve the public good").

60. *See* Taggart, *supra* note 1, at 615. *See also* Note, *supra* note 5, at 129.

61. *See* text at notes 70-83 *infra*.

62. 330 F. Supp. at 1176.

63. INT. REV. CODE OF 1954, § 7421(a). This provision states: "Except as provided in sections 6212(a) and (c), 6213(a), and 7426(a) and (b)(1), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."

64. 28 U.S.C. § 2201 (1970). The Declaratory Judgment Act provides: "In a

propriate standing to sue[65] may also make it difficult to apply the public policy doctrine to discrimination cases. When the government disallows a deduction on public policy grounds, the taxpayer can obtain judicial review either by paying the assessed amount and instituting a refund suit or by refusing to pay and thus forcing the Service to sue for a deficiency.[66] When the Government allows the claimed deduction, however, judicial review is obtainable only through a third-party suit for injunctive or declaratory relief.

Although the Anti-Injunction Statute, which prohibits all actions "for the purpose of restraining the assessment of any tax," and the Declaratory Judgment Act, which specifically excepts cases involving federal taxes from its scope, may be interpreted as barring third-party actions aimed at preventing the allowance of tax benefits, several recent decisions have rejected such an interpretation.[67] These decisions concluded that the Anti-Injunction Statute did not prevent third-party challenges since the effect of such suits was not to restrain the government from collecting taxes but rather to compel the collection of more taxes.[68] Moreover, as several of the decisions noted, the Declaratory Judgment Act does not bar such actions since, in the tax context, that Act is coterminous with the Anti-Injunction Statute.[69] Thus, these statutory obstacles do not appear to interfere with extension of the public policy doctrine to discrimination cases.

More troublesome is the requirement that a third party must have proper standing in order to maintain a cause of action. The recognized standard for determining standing is two-fold: the plaintiff must demonstrate that she has suffered "injury in fact" and that she is within the "zone of interests" sought to be protected or regu-

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case of actual controversy within its jurisdiction, *except with respect to Federal taxes*, any court of the United States, . . . may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such." (Emphasis added.)

65. *See* Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278, 1282 n.6 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975).

66. INT. REV. CODE OF 1954, §§ 6212-13, 7422; 28 U.S.C. §§ 1346(a)(1) (1970), 1491 (Supp. III, 1973).

67. *See* Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975); Tax Analysts & Advocates v. Schultz, 376 F. Supp. 889 (D.D.C. 1974); McGlotten v. Connally, 338 F. Supp. 448 (D.D.C. 1972). The grant of standing in *Eastern Ky. Welfare Rights Organization* was criticized in Bittker & Kaufman, *supra* note 57, at 53-60.

68. *See* Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278, 1284 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975); Tax Analysts & Advocates v. Shultz, 376 F. Supp. 889, 892 (D.D.C. 1974); McGlotten v. Connally, 338 F. Supp. 448, 453-54 (D.D.C. 1972).

69. Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278, 1285 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975). *See* Tax Analysts & Advocates v. Schultz, 376 F. Supp. 889, 894 (D.D.C. 1974); McGlotten v. Connally, 338 F. Supp. 448, 453-54 (D.D.C. 1972).

lated by the statute in question.[70]

It is clear that the requisite "injury in fact" need not be significant or direct: it must be a "distinct and palpable injury" to the plaintiff, but can be "shared by a large class of other possible litigants."[71] In *United States v. Students Challenging Regulatory Agency Procedures (SCRAP)*,[72] the Supreme Court held that the impairment of economic, recreational, and aesthetic opportunities, which would result from an increased use of nonrecyclable goods, was sufficient to confer standing on the plaintiff organization. In *Tax Analysts & Advocates v. Shultz*,[73] the plaintiff organization challenged an IRS ruling that allowed certain contributions to political campaigns to escape the gift tax. The court found the requisite injury in the allegation of one of the organization's officers that "his ability to affect the electoral process and to persuade elected officials to adopt policies and programs he favors"[74] would be substantially diminished.[75] Finally, in *Eastern Kentucky Welfare Rights Organization v. Shultz*,[76] the plaintiffs, "comprising various health and welfare organizations and several private citizens, all alleging indigency and an inability to pay for hospital services,"[77] were conferred standing to challenge an IRS ruling that eliminated the requirement that hospitals must provide free or reduced-rate services to indigents in order to qualify as "charitable" institutions. The court had little difficulty in finding the requisite "injury in fact":

> Prior to that Ruling the policy of the Service, in a very real sense, conferred a cognizable interest to indigents by requiring hospitals seeking tax advantages under the Code to give them special consideration. It simply defies common sense to contend that the plaintiffs have remained, or will remain, unaffected by a decision which all but strips from them basic and substantial benefits which had been previously nurtured by the government.[78]

In a situation like that posited in Revenue Ruling 74-323, individuals seeking employment could allege that the discriminatory advertising caused them to forgo applying for jobs for which they were

70. *See* Association of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150, 152-53 (1970); Eastern Ky. Welfare Rights Org. v. Schultz, 370 F. Supp. 325, 329-33 (D.D.C. 1973), *revd. on other grounds sub nom.* Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975).

71. Warth v. Seldin, 43 U.S.L.W. 4906, 4909 (U.S. June 25, 1975).

72. 412 U.S. 669 (1973).

73. 376 F. Supp. 889 (D.D.C. 1974).

74. 376 F. Supp. at 898.

75. 376 F. Supp. at 899.

76. 370 F. Supp. 325 (D.D.C. 1973), *revd. on other ground sub nom.* Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975).

77. 370 F. Supp. at 326.

78. 370 F. Supp. at 329-30.

legally qualified. A public policy doctrine that disallowed deductions for discriminatory advertising expenditures would constitute part of the remedy for such illegal advertising by sanctioning individual instances and deterring future violations. A tax ruling allowing a deduction would therefore further injure those affected by discriminatory advertisements by denying them full relief, by in effect legitimating the advertisements, and by perhaps encouraging future violations. This injury is considerably more individualized and specific than the general injury suffered by all taxpayers from the decreased tax revenues that result from the allowance of tax deductions.[79] In light of the above precedent, this injury should satisfy the first prong of the standing test. It is clear, however, that plaintiffs cannot assert standing unless they themselves have been sufficiently injured.[80] This limitation may restrict standing to those individuals who can demonstrate a likelihood that they would have obtained employment except for the discriminatory advertisements.

The case law surrounding the second prong of the standing requirement—that the plaintiff's injury must fall within the "zone of interests" regulated or protected by the statute at issue—is somewhat confused. Some cases have held that the second standard adds little to the first—that the two requirements are virtually coterminous.[81] The viability of this second requirement was recently asserted, however, in *Tax Analysts & Advocates v. Simon*.[82] In that case, the court denied standing to plaintiff taxpayers who sought review of the Code provisions and regulations that allowed income tax credits for payments made to foreign countries in connection with oil extraction and production. The inquiry under the second prong, the court concluded, was whether the tax provisions and rulings in question affected the plaintiff taxpayers differently from every other federal taxpayer.[83] Thus, only those tax provisions that recognize and protect an identifiable interest of specific individuals could be challenged by third parties.

This interpretation of the second prong of the standing requirement is restrictive since it precludes third-party challenges to many tax provisions, regulations, and rulings. Yet even this restrictive interpretation would not deny standing to individuals injured by discriminatory advertisements. A public policy doctrine that disallowed deductions for the cost of such advertisements would recognize and protect the interests of those individuals against whom the

79. *Cf.* Frothingham v. Mellon, 262 U.S. 447 (1923).

80. *See* Warth v. Seldin, 43 U.S.L.W. 4906, 4908-09 (U.S. June 25, 1975).

81. *See, e.g.*, Tax Analysts & Advocates v. Schultz, 376 F. Supp. 889, 897 (D.D.C. 1974) (citing cases).

82. 390 F. Supp. 927 (D.D.C.), *appeal dismissed*, 512 F.2d 992 (D.C. Cir. 1975).

83. *See* 390 F. Supp. at 940.

advertisements unlawfully discriminated. Such individuals would be affected by a tax ruling allowing a deduction in a manner distinguishable from the effect on other taxpayers generally. This identifiable interest should satisfy the second prong of the standing requirement.

Finally, policy considerations also support the grant of standing in this situation: If third parties injured by the allowance of a deduction were not permitted to challenge it, the decision would never be subject to judicial review.[84] Although the government clearly has an interest in maintaining a tax structure free from potentially disruptive challenges by those only indirectly affected by a particular ruling, it has little interest in precluding individuals directly injured from challenging rulings under tax laws that recognize and protect specific citizen interests.

84. *See* Eastern Ky. Welfare Rights Org. v. Schultz, 370 F. Supp. 325, 333 (D.D.C. 1973), *revd. on other grounds sub nom.* Eastern Ky. Welfare Rights Org. v. Simon, 506 F.2d 1278 (D.C. Cir. 1974), *cert. granted*, 43 U.S.L.W. 3613 (U.S. May 19, 1975).