

## ARTICLES

### REINING IN THE UNRULY HORSE: THE PUBLIC POLICY TEST FOR DISALLOWING TAX DEDUCTIONS

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#### INTRODUCTION

Over the years an administratively and judicially created doctrine has developed which permits the Internal Revenue Service (IRS) to disallow the deduction of items which would otherwise be deductible under the usual rules for determining taxable income. This disallowance is permitted if the deduction is deemed to frustrate public policy. While determination of public policy by an administrative agency may be appropriate in some circumstances, this particular public policy test is fraught with problems of abuse and illustrates in the tax area the truth of the statement that public policy in general "is a very unruly horse, and when once you get astride of it you never know where it will carry you."<sup>1</sup>

This fractious steed, with the assistance of the United States Supreme Court, has already carried the IRS off the path of caution, with negative consequences. It is the premise of this article that the IRS should exercise great restraint in the preclusion of deductions on the basis of public policy except in rare circumstances in which the policy has universal acceptance. Otherwise, preclusion of deductions should remain within the initiative of Congress.<sup>2</sup>

Part I of this article entails a general discussion of whether the IRS should have the power to determine non-revenue oriented tax policy without express guidance from Congress. Part II will then trace the use of the public policy rationale in denying deductions involving business expenses. This section will review the pertinent United States Supreme Court cases with a view towards articulat-

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1. *Richardson v. Mellish*, 2 Bing. 229, 252, 130 Eng. Rep. 294, 303 (1824).

2. Tax deductions are a matter of legislative grace. *Commissioner v. Sullivan*, 356 U.S. 27, 28 (1958).

ing the public policy tests used over the course of its development. Although subsequent congressional enactment of specific nondeduction provisions has settled the treatment of many types of business expenses at issue in these earlier disputes,<sup>3</sup> the Court has revived the dispute over IRS policy-making in a case involving charitable contributions in *Bob Jones University v. United States*.<sup>4</sup> Part III will analyze this case in terms of the recurring issues of tax policy that it raises. I will then illustrate the difficulty of applying the public policy test as it has developed by attempting to apply it in a novel situation to determine the deductibility of treble damage payments under the Racketeering Influence and Corrupt Organizations Act.<sup>5</sup> Given the difficulty in applying the test as established by the IRS and the Court, its lack of justification in the Internal Revenue Code (IRC) and the demonstrated ability of Congress to enact specific nondeductibility provisions, I conclude that it should be Congress who decides, issue by issue, which public policies are of sufficient magnitude to justify the denial of tax deductibility of those expenditures which violate them.

#### I. ADMINISTRATIVE INITIATION OF NON-REVENUE ORIENTED USES OF THE TAX LAWS

The term public policy, in public policy tax deduction situations, refers to policy judgments not related to revenue gathering or fiscal management. The propriety of using such policy judgments in denying tax deductions is part of a larger question concerning the propriety of non-revenue oriented uses of the tax law. There is no question but that such uses are common, albeit often criticized as inequitable and responsible for the increased complexity of tax law.<sup>6</sup>

It is also true that the IRS has a long history of involvement

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3. See 26 U.S.C. §§ 162(b)-(h) (1976 & Supp. V 1981).

4. 103 S. Ct. 2017 (1983).

5. 18 U.S.C. §§ 1961-68 (1976).

6. See Blum, *Federal Income Tax Reform—Twenty Questions*, 41 TAXES 672, 678-79 (1963). The author criticizes the assumption that tax subsidy provisions are the only available way for achieving such goals on the basis that, among other reasons, such subsidies are hidden from the public and vary with the tax brackets rather than with need. Furthermore, he notes, such provisions lead to such complexity in the tax law as to necessitate extensive tax planning advice. Since everyone is not in an equally good position to get effective planning advice, such complexity undermines the fundamental equity which ought to be preserved in the tax law. *Id.* at 674-75. Cf. Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567, 603 (1965).

in the enforcement of laws not related to revenue.<sup>7</sup> It has been suggested, however, that precisely for this reason the IRS should exercise restraint, since expanding involvement in such areas may well exacerbate the public's feelings of alarm to the point of jeopardizing the IRS's freedom to pursue with latitude its primary mission of revenue collection.<sup>8</sup>

Even if non-revenue uses of the tax laws are appropriate and the IRS is appropriately involved in enforcing those laws, an important issue remains as to whether the IRS, an administrative agency, should be permitted to initiate a public policy test based upon its own criteria and determinations of public policy. This is not to say that the IRS or administrative agencies in general can make no contribution to policy development. Administrative bodies do have a proper policy making role to play in interpreting legislation.<sup>9</sup> Sometimes this role involves the explanation of particular

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7. The Internal Revenue Service's (IRS's) involvement primarily takes the form of information gathering pursuant to its broad investigatory powers. Such information has been used to convict known gangsters. See *Capone v. United States*, 56 F.2d 927 (7th Cir. 1932), cert. denied 286 U.S. 553 (1932). It has also been used to assist state officials in prosecuting criminals under state criminal laws. See *United States v. Kahriger*, 345 U.S. 22 (1953); *Boren v. Tucker*, 239 F.2d 767, 772-73 (9th Cir. 1956); but see *United States v. O'Connor*, 118 F. Supp. 248 (D. Mass. 1953) (court refused to enforce subpoena where special agent admitted one of its purposes was to further a criminal prosecution for which he had no official responsibility). The IRS's career manual describes a special agent as one who "will make investigations of suspected and alleged tax fraud and other related criminal violations." IRS Doc. No. 5282 (rev. 10-63) 14 (1963) (emphasis added).

8. Gordon, *The Public Policy Limitation on Deductions From Gross Income: A Conceptual Analysis*, 43 IND. L. J. 406, 416-417 (1968).

9. The question of the propriety of creation, by the IRS, of a public policy test for use in tax deduction determinations must be viewed in the context of the larger question of the propriety of agency policymaking through legislative activity (rulemaking) and adjudicative activity (rulings). In a broad sense, the notion that the legislature cannot make a delegation of its legislative power to an agency has generally been restricted by the caveat that delegation is proper if the enabling statute contains sufficient standards to guide the agency's actions. See Merill, *Standards—A Safeguard for the Exercise of Delegated Power*, 47 NEB. L. REV. 469 (1968). Furthermore, the trend in the federal courts has been increasingly to look to the fairness of the agency procedures and results rather than to some express statutory standards. See generally 1 K. DAVIS, ADMINISTRATIVE LAW TREATISE, Ch. 6 (2d ed. 1978).

Likewise, there is little question that an agency can legislatively be vested with adjudicative power. See *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381 (1940) (to say otherwise would be to turn back the clock on at least a half century of administrative law). See also Brown, *Administrative Commissions and the Judicial Power*, 19 MINN. L. REV. 261 (1935). Furthermore, adjudication often inevitably involves policymaking, particularly where the granting of government subsidy is involved. S. MERMIN, LAW AND THE LEGAL SYSTEM: AN INTRODUCTION, 118 (2d ed. 1982). The argument in favor of agency policymaking through adjudication is the same as that in favor of agency policymaking through rulemaking, namely that the expertise gained by the agency in its day-to-day dealings with its particular

statutory language, for example, the term "gift."<sup>10</sup> At other times it involves the development of a broader concept, such as the concept of assignment of income,<sup>11</sup> to preserve the integrity of the tax law. Even in these latter situations, however, the interpretation is carried on with an orientation towards traditional tax policy, not towards policies having only a tangential connection to the usual concerns of a revenue statute.

Decisions to embody in the tax law non-revenue oriented policies are more appropriately made by Congress. This is because the enumerated powers of Congress extend far beyond matters of revenue and because the range of congressional devices in which these enumerated powers may be exercised is quite broad; for example, Congress may appropriately choose to employ the taxing power to regulate interstate commerce.<sup>12</sup>

Concededly, the complexity inherent in governing our vast federal system mandates delegation of some policymaking responsibility by Congress to administrative agencies. For that reason Congress has developed a pattern of legislating only the main outline of programs or policies.<sup>13</sup> However, such an agency role is best justified by the fact that agencies are most effective—and legislatures least—in "handling *masses of detail*, or for applying to shifting and continuing problems the ideas supplied by *scientists* or other *professional advisors*."<sup>14</sup> In contrast, questions of whether a type of business expense should be deterred or whether all racially discriminatory charitable organizations should be denied tax exempt status are questions which can be answered without technocratic expertise and are therefore questions which Congress can and should answer.

In many situations an agency such as the IRS does have the

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field will result in coherent, coordinated policy development. *Id.* at 118. However, the rulings of the IRS have not yielded coherent results and clear policy development.

10. 26 U.S.C. § 102 (1976). See *Commissioner v. Duberstein*, 363 U.S. 278 (1960) (IRS advocated excluding transfers in a business context from definition of "gift"); See also Gordon, *Public Policy Limitation*, *supra* note 8, at 417.

11. See, e.g., *Lucas v. Earl*, 281 U.S. 111 (1930) (IRS advocated taxing income to person who performed the services which earned it rather than to actual recipient); *Helvering v. Horst*, 311 U.S. 112 (1940) (IRS advocated taxing income from property to person who controlled the property rather than to person who received the income). See also Gordon, *Public Policy Limitation*, *supra* note 8, at 417.

12. Gordon, *Public Policy Limitation*, *supra* note 8, at 418-19.

13. K. DAVIS, *ADMINISTRATIVE LAW TEXT* 13 (3d ed. 1972).

14. *Id.* (emphasis added).

expertise to make policy judgments, for example, in matters of revenue gathering and fiscal management. In such situations, the balance between agency and legislative policymaking has been struck with major policymaking remaining the province of the legislature. As one commentator notes, "[the legislature] is at its best in determining the direction of *major* policy . . . leaving to administrative agencies the task of working out *subsidiary* policies."<sup>15</sup>

What constitutes major versus subsidiary policymaking is, then, a key question. A sensible distinction is one which focuses on the existence of an express and discrete delegation of policymaking power. For example, the IRS has ruled that the reporting of pre-paid income attributable to services to be performed in the year following receipt of the income can be deferred by cash method taxpayers to that later year if the amount of income and timing of services have certainty.<sup>16</sup> This kind of determination could be characterized as subsidiary policymaking because the determination is consistent with the power expressly delegated to the IRS to make an accounting determination so as to "clearly reflect income."<sup>17</sup> Such an approach meets the concern that Congress cannot handle day to day oversight of tax administration decisions. At the same time, it assures that decisions are carefully limited to discrete situations specified legislatively.

Express delegation of policymaking authority becomes even more important when the direction to be taken by the agency is one which reverses express statutory dictates, since such a reversal rises to the level of major policymaking. In this kind of situation Congress has expressly authorized reversal. For example, Congress at one time made disallowance of deductions of overcharges which violated the price control law depend upon a determination and certification by the agency charged with enforcement of that act.

The President shall also prescribe the extent to which any payment made, either in money or property, by any person in violation of any such requirement, order, or regulation shall be disregarded by the executive departments and other governmental agencies in determining the costs or expenses of any such person for the purposes of any other law or regulation, including bases for determining gain *for tax purposes*.<sup>18</sup>

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15. *Id.* (emphasis added).

16. Rev. Proc. 70-21, 1970-2 C.B. 501 (1970).

17. 26 U.S.C. § 44 (1976).

18. Amendments to Defense Production Act of 1950, Pub. L. No. 96-275, § 104(i), 65

The President then delegated authority to the administrator of the appropriate agency to determine the extent of a violation and to certify it to the IRS.<sup>19</sup>

In contrast, the IRS does not contain a congressional delegation of authority to the IRS for the disallowance of deductions under a general public policy rationale.<sup>20</sup> Therefore those charged with construing the IRC should conclude that Congress does not intend to impose a disallowance and that, consistent with legislative intent, none should be imposed.<sup>21</sup>

This has not been the case. The United States Supreme Court, in a series of decisions drawing on and expanding from IRS determinations, has developed an unworkable test for disallowing deductions based upon public policy concerns. In its attempt to be universal, this test fails to be sufficiently specific and therefore fails to give adequate guidance, with the result that the contours of this public policy test are poorly drawn and inconsistent decisions abound. Judicially created tests of broad wording are not appropriate in the tax deduction area where specifically worded tests addressing particular evils can resolve deduction issues with more clarity. Furthermore, Congress has demonstrated an ability to enact such legislation through numerous amendments to the business

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Stat. 131, 136 (1951) (emphasis added).

19. Exec. Order No. 10,161, 15 Fed. Reg. 6105 (1950).

20. *Lilly v. Commissioner*, 343 U.S. 90, 94 (1952); see Schwartz, *Business Expenses Contrary to Public Policy: An Evaluation of the Lilly Case*, 8 TAX L. REV. 241 (1953). Recognition of this lack of any statutory authorization for disallowance led the American Law Institute to propose an addition to the Internal Revenue Code (IRC) expressly disallowing deductions on the basis of public policy. MODEL FED. INCOME TAX CODE § X 154(i) (Draft 1952). Congress, however, did not enact the provision into law.

21. An argument can be made that the continued silence of Congress in the face of long standing administrative and judicial use of the public policy test equates to ratification of the test. However, such silence is at best ambiguous, and perhaps for this reason the ratification argument has been successful primarily when ratification of agency action was express. For example, in *Red Lion Broadcasting v. FCC*, 395 U.S. 367 (1969), the Court concluded that Congress had ratified the agency's long standing construction of the Communications Act by enacting an amendment to the Act adding the "fairness doctrine" to it. In contrast, in *SEC v. Sloan*, 436 U.S. 103, 121 (1978), the Court rejected an agency interpretation unsupported by the language of the statute and its legislative history, even though Congress had been informed of the agency's construction and had reenacted the statute without overturning that construction. The public policy test has in the past been brought to the attention of Congress. See Letter from Commissioner Harrington to Senator Williams, March 11, 1957, 103 CONG. REC. 12,418 (1957); S. Rep. No. 1983, 85th Cong., 2d Sess. (1958). Under the reasoning of *Sloan*, this fact is an insufficient basis for inferring Congressional approval of the test.

deduction section of the IRC.<sup>22</sup> The following section illustrates the numerous problems that such a judicial and administrative doctrine presents.

## II. DEVELOPMENT OF THE PUBLIC POLICY TEST

The public policy test has long been applied in determining the non-deductibility of business expenses.<sup>23</sup> The first case in which the United States Supreme Court expressly used the public policy approach to deny deductibility was *Textile Mills Securities Corp. v. Commissioner*.<sup>24</sup> The expenditures in *Textile Mills* were made to a publicist and lawyers to secure legislation from Congress authorizing the recovery of German properties seized during World War I.<sup>25</sup>

The error of the Court in *Textile Mills* lies in its failure to reach a decision consistent with statutory requirements. Section

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22. See *supra* note 3.

23. See, e.g., *Great Northern Ry. Co.*, 8 B.T.A. 225, 263-65 (1927), *aff'd* 40 F.2d 372, 373 (8th Cir. 1930). The Board of Tax Appeals held that fines paid to the federal government for violation of regulatory statutes were not deductible since they were not "operating expenses" and therefore could not be ordinary and necessary expenses within the statutory meaning. In reaching this result, the board read a public policy requirement into the language of the statute, an approach which the Supreme Court has followed in an attempt to tie policy decisions to express congressional dictate. See *infra* text accompanying notes 58-63. The appellate court, however, acknowledged that the expenditures did arise in connection with the operation of the railroad and were therefore within the statutory language. It justified affirmance of nondeductibility because the expenditures arose from activities prohibited by a specific statute and regulation, a criteria of continuing importance in the public policy test. See *infra* text accompanying notes 58-63. The appellate court also justified its decision with the rationale that deductibility of penalties would indirectly reduce them. *But see infra* text accompanying notes 64-67.

An earlier case had disallowed deduction of penalties, court costs, and attorney fees incurred in connection with an indictment for violation of state antitrust law and a subsequent plea of *nolo contendere*. *Columbus Bread Co.*, 4 B.T.A. 1126 (1926). Because the opinion states only that the taxpayer had failed to prove the expenses were ordinary and necessary, *id.* at 1128, it is of little value in tracing the development of the public policy test.

24. 314 U.S. 326 (1941). In 1930, however, the Court disallowed deductibility of losses otherwise deductible under what is now 28 U.S.C. § 165 (1976 & Supp. V 1981). *Clarke v. Haberle Crystal Springs Brewing Co.*, 280 U.S. 384 (1930). The losses arose when the goodwill of taxpayer's brewery was destroyed by enactment of amendment eighteen of the United States Constitution. Since, as the Court points out, the taxpayer's very business was noxious to the Constitution, the case is not one which truly deals with the public policy test.

25. The unique facts of this case might be said to render its discussion of the public policy rationale of little value but for the subsequent employment of that rationale by the Court. See, J. L. FREELAND, S. A. LIND, & R. B. STEVENS, *FUNDAMENTALS OF FEDERAL INCOME TAXATION, CASES AND MATERIALS* 441 (4th ed. 1982).

162 of the IRC states that: "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ."<sup>26</sup> In denying deductibility of the expenses at issue, the Court makes nominal reference to the "ordinary and necessary" requirements.<sup>27</sup> However, the Court fails to apply or even to discuss the well established definitions of those terms.<sup>28</sup> Ordinary expenses are those which are common in the business community of which the taxpayer's own enterprise is a part;<sup>29</sup> necessary expenses are those which are appropriate and helpful, even though not essential to the conduct of business.<sup>30</sup>

Instead, the Court looked to an IRS regulation as dispositive of deductibility,<sup>31</sup> without regard to consistency between the regu-

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26. 26 U.S.C. § 162 (1976).

27. See *Textile Mills*, 314 U.S. at 335. Congress has added a provision expressly disallowing deductibility of lobbying expenses. 26 U.S.C. § 162(e)(2) (1976). Nevertheless, analysis of *Textile Mills* is still important because the case illustrates a recurring error made by those who defend the public policy test. That error is the assumption that congressional approval of an IRS policy determination exists absent express congressional affirmation of the policy. See *infra* text accompanying notes 87-91 and notes 110-12. Were that the case, Congress would have had no reason to enact section 162(e).

It cannot be said that subsequent congressional action constitutes ratification of prior general public policy determinations by the IRS. When ratification has been found, it has been evidenced by enactments that correlate to discrete and specific agency policies, see *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 379-86 (1969). Congress has never ratified a generalized public policy of disallowance. On the contrary, the Senate Finance Committee Report accompanying the 1969 provisions disallowing the deduction of certain illegal payments and penalties states: "Public policy, in other circumstances, generally is not sufficiently clearly defined to justify the disallowance of deductions." S. Rep. No. 91-552, 91st Cong., 1st Sess. 5, reprinted in 1969 U.S. CODE CONG. & AD. NEWS 2027, 2311.

28. See *infra* text accompanying notes 43-45.

29. *Deputy v. DuPont*, 308 U.S. 488, 495 (1940).

30. *Commissioner v. Tellier*, 383 U.S. 687, 689 (1966).

31. *Textile Mills*, 314 U.S. at 336. The regulation in question was Treas. Reg. § 74 (1928) which read:

Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under Section 23(n). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legisla-

lation and section 162.<sup>32</sup> The regulation applied does expressly preclude deductibility of lobbying expenses, and both the regulation and section 162 use the phrase "ordinary and necessary." This concert of phrasing leads the Court to conclude that both preclude deduction of the same type of expenditures.<sup>33</sup>

However, the regulation was promulgated pursuant to section 170,<sup>34</sup> which deals with deductibility of charitable contributions. As the Court concedes, an expenditure which is not deductible as a charitable contribution may nevertheless be deductible as a business expense.<sup>35</sup> There is a legitimate reason for this distinction. Deductibility of charitable contributions is premised upon a flow of benefits solely to the recipient of the expenditure; deductibility of business expenses, to the contrary, presupposes a quid pro quo, the

tion, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

The regulation had remained unaltered for twenty years at the time of its application in *Textile Mills*, a fact which may have influenced the Court to regard it as dispositive.

32. Regulations must be consistent with statutory language and intent. See *Lynch v. Tilden Produce Co.*, 265 U.S. 315, 320-22 (1924).

33. *Textile Mills*, 314 U.S. at 337-38.

34. 26 U.S.C. § 170 (1976 & Supp. V 1981). This provision allows a deduction for contributions to or for the use of five specific types of organizations listed in 26 U.S.C. § 170(c) (1976). The organizations are described generically, encompassing governmental units, veterans organizations, certain fraternal organizations, and cemetery companies. For a thorough discussion of section 170 charitable organizations, see 2 B. BITTKER, *FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS*, ch. 35 (1981); J. MERTENS, *LAW OF FEDERAL INCOME TAXATION*, 31.01-31.33 (1978); Bittker, *Churches, Taxes and the Constitution*, 78 *YALE L.J.* 1285 (1969); Colliton, *The Meaning of "Contribution of Gift" for Charitable Contribution/Deduction Purposes*, 41 *OHIO ST. L. J.* 973 (1980); Hobbet, *Charitable Contributions—How Charitable Must They Be?*, 11 *SECON HALL L. REV.* 1 (1980).

Another type of charitable organization is:

A corporation, trust, or community chest, fund, or foundation—(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States; (B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals; (C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (D) which is not disqualified for tax exemption under 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office.

26 U.S.C. § 170(c)(2) (1976). It is this type of institution which is the subject of the Court's latest public policy decision. See *infra* text accompanying notes 96-135.

35. *Textile Mills*, 314 U.S. at 338.

expectation of which induced the expenditure.<sup>36</sup> When a taxpayer expends amounts for lobbying, he does so with the expectation of some personal benefit; it may therefore be appropriate to allow him a business expense deduction even though disallowing a charitable one. Because there exists this distinction in benefit and motive between charitable and business expenditures it is necessary to restrict the section 170 regulation disallowing deduction for lobbying expenses to charitable contributions alone.<sup>37</sup>

The Court also appears to assume that the proper role of Congress is that of a reactor to, rather than an initiator of, major tax policy decisions. In considering whether the IRS has usurped the legislative function in promulgating a regulation disallowing lobbying expenses, the Court "fail[s] to find any indication that such a *course contravened* any Congressional policy."<sup>38</sup> The Court thus apparently presumed that in the absence of clear congressional action prohibiting agency initiated policymaking in a particular area, the IRS is free to determine which public policies should lead to disallowance of deductions. Some policymaking by the IRS is appropriate to fashion subsidiary policies to further legislative goals; however, such policymaking should be carried out pursuant to express statutory delegation.<sup>39</sup> The Court's approach sweeps too broadly because it requires Congress to consider an undefined and virtually unlimited universe of possible public policy issues which could arise in connection with tax deductions. This approach further requires Congress to take action regarding every one of those issues to expressly prohibit the IRS from denying deductions on the basis of deemed violations of such policies.

After *Textile Mills*, disallowance of tax deductions on the basis of violations of public policy could have remained limited to those situations in which a longstanding IRS regulation precluded deduction.<sup>40</sup> However, the Court chose to expand the public policy rationale into a test applicable in other situations. In *Commissioner v. Heininger*,<sup>41</sup> the Postmaster General issued a civil fraud

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36. See *Marquis v. Commissioner*, 49 T.C. 695 (1968); and H.R. Rep. No. 1337, 83d Cong., 2d Sess. A44 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 22 (1954).

37. Congress is free to determine that even in a business context lobbying expenses should not be deducted, a determination it has already made. See *supra* note 27.

38. *Textile Mills*, 314 U.S. at 338 (emphasis added).

39. See *supra* text accompanying notes 9-21.

40. The Court distinguished *Textile Mills* on this basis in *Lilly v. Commissioner*, 343 U.S. 90 (1952).

41. 320 U.S. 467 (1943).

order against a dentist who sold false teeth by mail; the dentist sought to deduct attorney fees incurred in his unsuccessful defense against the order. As it had in *Textile Mills*, the Court tried to defer to a long standing IRS regulation to resolve the issue; however, in this instance there was none.<sup>42</sup> Thus the Court was faced with the issue of whether the statute permitted deductibility of the expenditures.

In concluding that the expenditures were both "ordinary and necessary," the Court explored the well developed definition of those terms and applied their commonly accepted meaning, a meaning based upon "ways of conduct and forms of speech prevailing in the business world."<sup>43</sup> In doing so, the Court correctly looked to the circumstances in which the taxpayer incurred the legal expenses, not the circumstances surrounding the alleged fraudulent action which gave rise to the need for legal advice. Although dentists do not ordinarily and necessarily sell false teeth by fraudulent representations, the expenses for attorney fees were ordinary because they were of the type to be expected; business men normally employ lawyers to defend their businesses from threatened destruction.<sup>44</sup> The expenses were necessary since they were appropriate and helpful, neither unreasonable in amount nor incurred in a defense that was in bad faith.<sup>45</sup>

Rather than end its analysis with these determinations, which were sufficient to resolve the case, the Court discussed the propriety of narrowing the generally accepted meaning of section 162 and in doing so announced a public policy test, a test which it conceded is in no way based upon that statutory language.<sup>46</sup> Disallowance of deduction is proper, said the Court, "in order that tax deduction

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42. *Id.* at 470.

43. *Id.* at 472.

44. *Id.* at 471-72. See, e.g., *Kornhauser v. United States*, 276 U.S. 145 (1928) (defense of accounting suit brought by a former partner held deductible as ordinary and necessary expense); *First Nat'l Bank of Atlanta v. United States*, 202 F. Supp. 702 (1962) (defense of lawsuit claiming contracts of taxpayer's business were invalid was a properly deductible expense).

45. *Heininger*, 320 U.S. at 470-72. In the lower court, the IRS attempted to tie the issue of necessity of the attorney services to the issue of necessity of the fraudulent representations, arguing that since it is not necessary to conduct a business in an illegal manner, it is not necessary to defend an illegal activity that results. *Heininger v. Commissioner*, 47 B.T.A. 95, 101-02 (1942). However, the test for "necessary" expenses requires only that the expense be appropriate and helpful to the taxpayer. *Commissioner v. Tellier*, 383 U.S. 687, 689-90 (1966).

46. *Heininger*, 320 U.S. at 474.

consequences might not *frustrate sharply defined national or state policies* proscribing particular types of conduct."<sup>47</sup> The Court did not explain the source of this test; it said only that the IRS, the Board of Tax Appeals, and federal courts had from time to time "narrowed the generally accepted meaning"<sup>48</sup> of the statute with such a test. Again, as in *Textile Mills*, there is a failure to ground public policy analysis in express statutory language.

In *Heininger*, the Court found that the public policy of the civil mail fraud provisions was to protect the public from fraud, not to impose punishment on the defrauding party. It therefore concluded that the statute's policy would not be violated by deduction of attorney's fees.<sup>49</sup> In contrast, statutes which are punitive in nature are assertedly undermined by permitting such deductions since a deduction would soften the financial blow to the defendant. The reasoning would lead to the conclusion that the deduction of attorney fees incurred in defending against criminal charges should be disallowed, since one key purpose of criminal provisions is to impose punishment.

The cases subsequent to *Heininger* had so held.<sup>50</sup> This distinction, though, ignores the important public policy of allowing an individual faced with criminal charges to have assistance of counsel.<sup>51</sup> Where such a conflict exists between policies, some method is needed for establishing priority.

The Court seems to attempt a test for prioritization when it comments that "[i]t has never been thought, however, that the mere fact that an expenditure bears a remote relation to an illegal act makes it nondeductible."<sup>52</sup> However, no guidance is given in the opinion as to the factors bearing on the degree of remoteness required before deductibility is justified. One might assume, for instance, that a distinction should be made between pre-violation and post-violation expenses.

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47. *Id.* at 473 (emphasis added).

48. *Id.*

49. *Id.* at 474.

50. See, e.g., *Acker v. Commissioner*, 258 F.2d 568 (6th Cir. 1958); *Helvering v. Superior Wines & Liquors*, 134 F.2d 373 (8th Cir. 1943).

51. See Kressner, *Can a Deduction for Legal Expenses Be Against Public Policy?*, 26 TAXES 447, 448 (1948); see also *Jerry Rossman Corp. v. Commissioner*, 175 F.2d 711, 713 (2d Cir. 1949) (L. Hand, J., interpreting *Heininger* as permitting disallowance of attorney fees incurred in an unsuccessful defense).

52. *Heininger*, 320 U.S. at 474.

This distinction is in accord with the facts in *Heininger* in which the attorney fees at issue would not have been incurred but for the taxpayer's fraudulent representations. Given this connection, the fees could be said to be expenditures related to the taxpayer's illegal acts. However, the post-violation services of the attorney did not further the commission of the violation.

In contrast, even legitimate pre-violation legal advice on such matters as contracts or income tax arguably would further the taxpayer's operations, making possible fraudulent representations. A deduction for attorney fees in such a case should be disallowed under this line of reasoning.

Although concededly this argument is weak and cases subsequent to *Heininger* did not draw the distinction, *Heininger* did not preclude its use. Thus, the Court's public policy test is unworkable because it gives no effective method for prioritizing such conflicting public policies.

Furthermore, the Court in *Heininger* failed to spell out in what circumstances a public policy can be considered sharply defined. That issue was raised by the facts of *Lilly v. Commissioner*.<sup>53</sup> In *Lilly*, eye doctors were denied a deduction for kickback payments to opticians. After first determining that the payments were "ordinary and necessary,"<sup>54</sup> the Court reviewed the decision of the tax court that the deduction of kickbacks would frustrate public policy. The kickback payments violated no state statute nor any rules of professional conduct. However, numerous courts in non-tax cases had declared such kickback arrangements contrary to public policy, and the tax court had considered this evidence of public policy sufficient to preclude deductibility.<sup>55</sup>

In reversing the decision, the Court added yet another criterion to the public policy test, stating that: "The policies frustrated must be national or state policies evidenced by some *governmental*

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53. 343 U.S. 90 (1952).

54. *Id.* at 93. The Court characterized the payments as "ordinary" because they arose in transactions whose occurrences were frequent in that type of business. The payments were characterized as "necessary" because discontinuance of the payments would have meant loss of customers to competitor opticians. *Id.*

55. *Lilly v. Commissioner*, 14 T.C. 1066, 1080-81 (1950). The tax court attempted its own definition of the public policy test when it stated: "Everything that tends clearly to undermine that sense of security of individual rights, whether of personal liberty or private property, which any citizen ought to feel, is against public policy." *Id.* at 1079 (citations omitted).

declaration of them."<sup>56</sup> However, there is no indication as to which governmental bodies are authorized to declare public policy. Perhaps the Court intended to limit governmental declarations to legislative pronouncements. Some support for this approach appears in the Court's statement that "[w]e recognize the province of legislatures to translate progressive standards of professional conduct into law. . . ."<sup>57</sup> Deference to legislative determination of policy is to be applauded, but it is not clear that the Court was restricting the public policy test in this way.

One problem with the Court's statement is that it could be read to limit the legislative prerogative only to matters of professional conduct, while allowing other public policy pronouncements, for purposes of tax deduction questions, to arise from virtually any governmental body. If this incongruity is what the Court intended, its reasoning is not clear. Because it leaves unanswered too many essential questions, the *Lilly* case is not one which articulates a sound, workable public policy test.

At least after *Lilly* one could assert with some security that the deduction of a business expense turned on the application of two distinct and sequential tests: first, whether the expense was ordinary and necessary and, second, whether a deduction would frustrate a sharply defined public policy as evidenced by some governmental declaration. However, the parameters of these tests became blurred in *Tank Truck Rentals, Inc. v. Commissioner*,<sup>58</sup> a case in which the taxpayer sought deduction for fines imposed on it for violation of state maximum truck weight laws.<sup>59</sup>

In disallowing the deduction, the Court paid attention to the "necessary" language in section 162, but in doing so stated that a finding of necessity could not be made where public policy was violated.<sup>60</sup> By fusing the public policy test with that of necessity, the Court ignored prior treatment of the public policy test as one separate and distinct from that of necessity. Perhaps the Court was

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56. *Lilly*, 343 U.S. at 97 (emphasis added).

57. *Id.* (emphasis added) (footnote omitted).

58. 356 U.S. 30 (1958). In a comparison case, *Hoover Motor Express Co., Inc. v. United States*, 356 U.S. 38 (1958), the Court likewise read the public policy test into the statutory requirement of necessity in denying a deduction. *Hoover* involved facts identical to those in *Tank Truck Rentals*, except that the taxpayer in *Hoover* had inadvertently violated the truck weight laws, a factual distinction which the Court found unimportant. *Id.* at 40.

59. *Tank Truck Rentals*, 356 U.S. at 31.

60. *Id.* at 33-34.

motivated by a desire to curb the public policy test, as it began to do in *Lilly*, by tying it more closely to express statutory language.

However, if this was the Court's intent, it departed significantly from the accepted interpretation of the statutory language. The test for a necessary expense has long focused on the appropriateness and helpfulness of the expense to the individual taxpayer, not to the body public; in fact, an expense such as the payment of a fine may be extremely appropriate and helpful in furthering a taxpayer's business even though inappropriate to society. A shift in focus from benefit to the individual to benefit to the collective may be appropriate, but the Court omits explanation as to why, if it is making a shift, it chooses to overturn the longstanding approach.

One argument in favor of a narrow construction of the term "necessity" is the argument that deductions are a matter of legislative grace.<sup>61</sup> Consequently, as a premise of statutory construction, deduction provisions should be construed against the taxpayer. On the other hand, it has been argued that the language used by Congress in creating deductions is subject to no special interpretation and should therefore be construed in the same manner as other statutory language.<sup>62</sup> To resort to canons of construction does not clarify the Court's reasoning. Given the silence of the Court, the scope of the statutory term "necessity," as modified by public policy, is unclear.

Furthermore, the Court, in *Tank Truck Rentals, Inc.*, expressly sidestepped the issue left open by its rendition of the test in the *Lilly* decision, namely, whether the requisite government declaration of public policy can be found outside a legislative enactment. In a footnote the Court stated that "[b]ecause state policy in this case was evidenced by specific legislation, it is unnecessary to decide whether the requisite 'governmental declaration' might exist other than in an Act of the Legislature."<sup>63</sup>

Instead, the Court concerned itself with the "frustration" requirement of the test, stating that allowing the deduction would encourage noncompliance with state policy by softening the

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61. See *supra* note 2.

62. See generally, Note, *An Argument Against the Doctrine That Deductions Should Be Construed Narrowly As A Matter Of Legislative Grace*, 56 HARV. L. REV. 1142 (1943).

63. *Tank Truck Rentals*, 356 U.S. at 34, n.6. In 1969, Congress evidenced a clear federal policy against deductibility by enacting specific legislation adding to the IRC what is now 26 U.S.C. § 162(c) (1976). See *infra* note 81.

financial sting of noncompliance.<sup>64</sup> This conclusion assumes that application of these tax laws can have an impact on the deterrent effect of state penalties.

The difficulty with this argument is that disallowance or allowance of a business expense has little effect on the way taxpayers plan their affairs. For example, it is unlikely that the decision of *Tank Truck Rentals, Inc.* to carry overloads on the highways was affected pro or con by the ultimate disallowance of the penalty for doing so. First, it may not have contemplated the disallowance. Second, even if it had contemplated disallowance, it may have gambled that an audit would not raise the question or that if any inquiry resulted, the IRS agent might allow the deduction anyway, given the unsettled state of the public policy test. Third, even had the taxpayer predicted disallowance, the resulting increase in tax may well be so small in comparison to the economic gain resulting from increased load transporting as to merit deliberate violation of the overload law.<sup>65</sup> In addition, imposing financial sanctions through disallowance will have, at most, an ad hoc impact on deterrence of wrongdoers because only those wrongdoers whose returns are selected for audit will be subject to the sanctions. Furthermore, audit selection criteria focus on factors different from those used by state authorities to single out wrongdoers, and therefore do not effectively target wrongdoers.<sup>66</sup>

Even if allowance or disallowance of business deductions were presumed to affect taxpayer behavior, another issue remains. Allowance of the deduction may soften the sting of a penalty, but disallowance arguably increases the burden of the fine by the amount of the additional tax liability and in so doing converts a federal revenue raising measure into a punishment for certain behavior. This raises an important question not addressed by the Court of whether the federal income tax laws should be used to increase monetary sanctions imposed by state criminal statutes.<sup>67</sup>

It is difficult to find an interest of the United States suffi-

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64. *Tank Truck Rentals*, 356 U.S. at 35-36. For a thorough discussion of the "penalty" theory, see Note, *Business Expenses, Disallowance, and Public Policy: Some Problems of Sanctioning with the Internal Revenue Code*, 72 YALE L.J. 108, 116-17 (1962) [hereinafter cited as Note, *Business Expenses*].

65. Gordon, *Public Policy Limitation*, *supra* note 8, at 413 (suggesting that this cost-benefit analysis is controlling in most taxpayer decisions).

66. *Id.*

67. Note, *Business Expenses*, *supra* note 64, at 117.

ciently clear to justify imposition of an added sanction on state laws. It has been suggested that since citizens of the United States are also citizens of the state in which they reside, the United States has a reasonable interest in their conduct with respect to the laws of the state and to discourage violation of those laws.<sup>68</sup> The source of this power may lie in "a general common law"<sup>69</sup> or in the federal police power.<sup>70</sup>

In *Commissioner v. Sullivan*,<sup>71</sup> the Court reasoned that the taxpayer's expenses were deductible since they bore only a remote relationship to an illegal act. In so doing, the Court reiterated a criterion for deductibility enunciated earlier in the *Heininger* case.<sup>72</sup> However, the opinion further obfuscates the public policy test because the expenses in question were integral to, rather than remote from, the illegal act. The amounts involved were expended to lease gambling premises and to pay employees to conduct gambling activities. Under state law, this enterprise was illegal as were the payments of such rent and wages.<sup>73</sup> Yet the Court ignored without explanation the Illinois statutes which made the very acts of payment of the rent and wages at issue illegal.

This result may be best explained by the Court's focus on the net income rationale for allowance of deductions.<sup>74</sup> This rationale supports the rejection of the public policy test, a direction in which the Court seemed to be moving. The net income theory was succinctly stated by Senator Williams, manager of the 1913 Revenue Act, when he said:

The object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters . . . .<sup>75</sup>

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68. Gordon, *Public Policy Limitation*, *supra* note 8, at 412.

69. Cahn, *Local Law In Federal Taxation*, 52 YALE L.J. 799, 820 (1943).

70. See Cushman, *Social and Economic Control Through Federal Taxation*, 18 MINN. L. REV. 759 (1934).

71. 356 U.S. 27 (1958).

72. See *supra* text accompanying note 52.

73. *Sullivan v. Commissioner*, 15 T.C.M. 23, 28 (1956).

74. *Sullivan*, 356 U.S. at 29. See Gordon, *Public Policy Limitation*, *supra* note 8, at 408-10 (net income concept is ubiquitous in the law of income tax).

75. 50 CONG. REC. 3,849 (1913). Cf. Paul, *The Use of Public Policy by the Commissioner in Disallowing Deductions*, 6 S. CAL. TAX INST. 715 (1954). "The statute hardly operates in a 'vacuum,' if it serves its own vital functions and leaves other problems to other statutes." *Id.* at 730-31.

Application of the public policy test, however, taxes an individual on gross receipts; disallowance of expenses incurred in the production of income results in a tax on gross rather than net income and is thus inconsistent with the purpose of the commercial provisions of the IRC. It can be said that the net income theory ignores some expenses which ought to be deductible since they are real economic depletions of wealth. The net income theory supports deduction of only those expenses interrelated with the production of gross receipts; expenses which are incurred in connection with purely personal activities are not deductible<sup>76</sup> even though they, like expenses for the generation of income, represent real economic detriment to the taxpayer. Thus, admittedly, the net income theory is somewhat artificial. This distinction between types of expenditures, however, is one which Congress chose to draw, and drew clearly.

Having chosen to establish net income as the appropriate tax base, Congress has from time to time altered that base by permitting additional deductions which do not correlate with actual expenditures for generation of income. Some of these aberrational deductions can be justified on the theory that they create incentives to desirable behavior. For example, the deduction for charitable contributions<sup>77</sup> arguably encourages the private sector to shoulder social welfare tasks which would otherwise fall to government, and the deduction for net capital gain<sup>78</sup> is designed to create incentive for investment in particular types of targeted assets, so-called capital assets, as a stimulus to capital formation in business.

In these instances, the tax base has been altered in a way which narrows the tax base and leaves taxpayers taxed upon no more than net income. Even in instances when Congress has digressed from the net income approach by denying deductions, Congress has done so cautiously. For example, section 162(d) disallows losses from gambling, but the disallowance extends only to net losses, not all losses. Given legislative reluctance to deny deductions in a way which violates net income theory, administrative and adjudicatory bodies should likewise exercise restraint.

Another explanation of the result in *Sullivan* may lie in the

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76. 26 U.S.C. § 262 (1976) provides that no deduction shall be allowed for personal, living, or family expenses.

77. 26 U.S.C. § 170 (1976 & Supp. V 1981).

78. 26 U.S.C. § 1202 (Supp. V 1981).

type of expenditures for which deduction was sought, since operating expenditures instead of penalties were the expenditures in question. The rent and wage payments preceded the violation of the statute; they were not the consequence of the violation as were the penalties in *Tank Truck Rentals*.<sup>79</sup> Support for this distinction is found in the Court's statement: "That [the amounts are ordinary and necessary expenses in the accepted meaning of those words] is enough to permit the deduction, unless it is clear that the allowance is a device to avoid the consequence of violations of a law . . . ."<sup>80</sup>

This explanation of the *Sullivan* case would effectively limit the public policy test to the disallowance of fines and penalties, because only these deductions could properly be called a device to avoid the consequences of a statutory violation. While such a limitation of the public policy test is commendable, there is no indication in the *Sullivan* opinion as to why the Court, without explanation, would choose to overrule numerous prior cases disallowing deduction of illegal expenditures.<sup>81</sup>

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79. *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 31 (1958).

80. *Sullivan*, 356 U.S. at 29 (emphasis added).

81. See Note, *Business Expenses*, *supra* note 64, at 138 (arguing that the silence of the court on this point cannot be read as a *sub silentio* overruling of prior case law). Congress has subsequently added certainty in this area by precluding deduction of certain illegal expenditures with a provision which addresses the issue in great detail. 26 U.S.C. § 162(c) (1976). This section of the IRC provides:

(1) **Illegal payments to government officials or employees.**

No deduction shall be allowed under subsection (a) for any payment made, directly or indirectly to an official or employee of any government, or of any agency or instrumentality of any government, if the payment constitutes an illegal bribe or kickback or, if the payment is to an official or employee of a foreign government, the payment would be unlawful under the laws of the United States if such laws were applicable to such payment and to such official or employee. The burden of proof in respect of the issue, for the purposes of this paragraph, as to whether a payment constitutes an illegal bribe or kickback (or would be unlawful under the laws of the United States) shall be upon the Secretary to the same extent as he bears the burden of proof under section 7454 (concerning the burden of proof when the issue relates to fraud).

(2) **Other illegal payments.**

No deduction shall be allowed under subsection (a) for any payment (other than a payment described in paragraph (1)) made, directly or indirectly, to any person, if the payment constitutes an illegal bribe, illegal kickback, or other illegal payment under any law of the United States, or under any law of a State (but only if such State law is generally enforced), which subjects the payor to a criminal penalty or the loss of license or privilege to engage in a trade or business. For purposes of this paragraph, a kickback includes a payment in consideration of the referral of a client, patient, or

Perhaps a better explanation for the result in *Sullivan* lies in the distinction between expenditures which have been adjudicated illegal and those which have not. The public policy of a jurisdiction is clear when evidenced by an adjudication which results in penalties. But when the illegality of expenditures is still at issue, disallowance of a deduction on public policy grounds would in effect require a determination of illegality by the IRS.

Decisions of this type are beyond the expertise of the IRS. At least one former Tax Commissioner has acknowledged publicly that in making non-revenue oriented policy decisions, the IRS is far afield from the more typical task of tax administrators: determining taxable income.<sup>82</sup> Nor can resort to express statutory prescription simplify the task. Reference to statute may be helpful in determining public policy but it cannot be conclusive, particularly when the statute is not vigorously enforced.

For instance, resort solely to state statute in so called "dry states" may lead to a conclusion that there is a state public policy, clearly evidenced by statutory declaration thereof, against the use of liquor for business entertaining. Following this reasoning, courts have disallowed the deduction of expenses for liquor so used, even when for decades no one has been prosecuted for violation of that statute and that statute has never been construed to apply to busi-

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customer. The burden of proof in respect of the issue, for purposes of this paragraph, as to whether a payment constitutes an illegal bribe, illegal kickback, or other illegal payment shall be upon the Secretary to the same extent as he bears the burden of proof under section 7454 (concerning the burden of proof when the issue relates to fraud).

(3) Kickbacks, rebates, and bribes under medicare and medicaid.

No deduction shall be allowed under subsection (a) for any kickback, rebate, or bribe made by any provider of services, supplier, physician, or other person who furnishes items or services for which payment is or may be made under the Social Security Act, or in whole or in part out of Federal funds under a State plan approved under such Act, if such kickback, rebate, or bribe is made in connection with the furnishing of such items or services or the making or receipt of such payments. For purposes of this paragraph, a kickback includes a payment in consideration of the referral of a client, patient, or customer.

*Id.* The specificity of this provision demonstrates that Congress is capable of grappling with thorny issues of public policy.

82. See Kurtz, *Difficult Definitional Problems in Tax Administration: Religion and Race*, 23 CATH. LAW. 301 (1978) (speech by former Tax Commissioner Kurtz in which he acknowledges that in making decisions on national policy, the IRS is far afield from the more typical tasks of tax administrators such as determining taxable income) [hereinafter cited as Kurtz, *Difficult Problems*].

ness entertainment.<sup>83</sup> This inappropriate result could be avoided by limiting the disallowance of deductions to those situations in which there has been an adjudication reflective of declared public policy.<sup>84</sup> Unfortunately, the Court in *Sullivan* failed to clarify whether or not it intended to add the criterion of adjudication to the public policy test.

*Sullivan* could be read to suggest that the Court no longer favored the public policy test. But *Sullivan* was decided the same day as *Tank Truck Rentals* in which the Court stressed accommodation with concerns of public policy. The Court stated in *Tank Truck Rentals* that this accommodation can be attained by focusing on "the severity and immediacy of the frustration resulting from allowance of the deduction."<sup>85</sup> However, the Court gives no express guidance in either case as to what degree of frustration should give rise to disallowance. Furthermore, the result in *Sullivan* implies that even the most severe and immediate frustration—a payment in violation of a state statute—would not justify preclusion of deductibility. In effect, the result in *Sullivan* renders useless any reference to severity and immediacy in resolving questions of deductibility. Because it fails to reconcile this test with the result in the case, the Court in *Sullivan* fails to assist in the development of a functional public policy test.

The failure of the Court to develop a justifiable and workable public policy test is further illustrated by the recurrence of the lobbying expense issue supposedly resolved years earlier in *Textile Mills Securities Corp. v. Commissioner*.<sup>86</sup> Another case involving the deductibility of expenses incurred in an attempt to influence legislation was *Cammarano v. United States*.<sup>87</sup> Again the Court looked to regulations for guidance, but again the regulations and the IRC section they were promulgated under were, as in *Textile*

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83. *E.g.*, *United States v. Winters*, 261 F.2d 675 (10th Cir. 1958); *Finely v. Commissioner*, 27 T.C. 413 (1956).

84. Occasional problems of timing may result from this approach, since a final determination of guilt by a state judicial body may not take place until long after the statute of limitations has run on a year in which the payment in question was deducted. This is, however, a relatively minor problem. Furthermore, Congress has sanctioned deference to adjudication in 26 U.S.C. § 1629(c) (1976) which disallows deduction of payments illegal "under any law of a State (but only if such law is generally enforced) . . ." *Id.* (emphasis added). *But see* *Eichbauer v. Commissioner*, 30 T.C.M. 581 (1971) (denying dependency deduction on basis that state law on the books prohibited the parties' relationship).

85. *Tank Truck Rentals*, 356 U.S. at 35.

86. 314 U.S. 326 (1941). *See supra* text accompanying notes 24-39.

87. 358 U.S. 498 (1959).

*Mills*,<sup>88</sup> the ones which apply to charitable expenditures, not business expenses.<sup>89</sup> Furthermore, although Congress had reenacted the business expense provisions many times since the public policy gloss was added, the argument that such reenactments constitute congressional approval is highly questionable because interim judicial interpretations had been conflicting.<sup>90</sup> In addition, if the regulation had indeed sharply defined public policy, then Congress would not have needed to take the step after the decision in *Cammarano* of enacting section 162(e),<sup>91</sup> which expressly proscribes deduction of lobbying expenditures.

In *Commissioner v. Tellier*,<sup>92</sup> the Court addressed an issue left unresolved by its opinion in *Heininger*; that issue was whether legal fees incurred in an unsuccessful defense against a criminal prosecution are deductible. Here the fees were incurred in a defense against charges under federal securities and mail fraud acts. In allowing the deduction, the Court took a restrictive view of the public policy exception by stressing that where Congress is silent, a policy of nondeductibility should be extremely limited.<sup>93</sup> This restrictive view may be explained by the Court's concern with the net income theory which the Court discusses at length.<sup>94</sup> The Court also acknowledged that disallowance would, in effect, be an added penalty not authorized by Congress.<sup>95</sup>

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88. See *supra* notes 31-37 and accompanying text.

89. *Cammarano*, 358 U.S. at 502-03. It should be remembered that both *Textile Mills* and *Cammarano* took place before Congress specifically addressed this issue in 1962 by adding 26 U.S.C. § 162(e) (1976).

90. Compare *Sunset Scavenger Co. v. Commissioner*, 84 F.2d 453 (9th Cir. 1936) (lobbying expenses of garbage collectors' association not ordinary or necessary under the regulation prohibiting lobbying) and *Kyne v. Commissioner*, 35 B.T.A. 202 (1936) (lobbying expenses to legalize horseracing in California not ordinary or necessary under same regulation) with *Emery, Bird, Thayer Dry Goods Co. v. Commissioner*, 20 B.T.A. 796 (1930) (contribution to chamber of commerce for propaganda effort deductible as ordinary and necessary, with no reference made to regulation) and *Independent Brewing Co. of Pittsburgh*, 4 B.T.A. 870 (1926) (dues to brewing trade association deductible as ordinary and necessary, with no reference to regulation).

See also Note, *Deducting Business Expenses Designed to Influence Governmental Policy as "Ordinary and Necessary": Cammarano v. United States and a Bit Beyond*, 69 YALE L. J. 1017, 1021-22 (1969). Cf. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (holding punitive damages taxable despite silence of Congress in the face of contrary holding by the tax court).

91. See *supra* note 89.

92. 383 U.S. 687 (1966).

93. *Id.* at 693-94.

94. *Id.* at 691-92.

95. *Id.* at 694-95.

After *Tellier*, resort to public policy to determine tax deductibility appeared severely restricted. That conclusion is questionable after the Court's decision this past term in *Bob Jones University v. United States*<sup>96</sup> and its companion case, *Goldsboro Christian Schools, Inc. v. United States*.<sup>97</sup> In these cases the Court denied tax-exempt status of, and therefore tax deductibility of contributions to, nonprofit private schools which discriminated on the basis of race.<sup>98</sup> Section 501(c)(3)<sup>99</sup> provides tax exempt status to entities which meet specific requirements, including the requirement that they be "organized and operated exclusively for religious, charitable, scientific, literary or educational purposes . . ."<sup>100</sup> Deduction of contributions is not available to taxpayers if the recipient entity fails to qualify under section 501(c)(3);<sup>101</sup> hence resort to public policy to disallow tax exempt status for an institution is, in effect, use of public policy to disallow a deduction.

In interpreting section 501(c)(3), the Court determined that the provision required not only that the schools prove that they were organized and operated for one of the statutorily listed purposes but also that they served a public purpose and were not contrary to established public policy.<sup>102</sup> In so doing, the Court again, as in *Tank Truck Rentals*, read public policy into the language of the statute. The majority justifies this approach by reference to the canon of statutory construction which allows a court to go beyond the literal language of a statute if reliance on that literal language would defeat its plain purpose.<sup>103</sup>

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96. 103 S. Ct. 2017 (1983).

97. *Id.*

98. Bob Jones University is a nonprofit, private, religious and educational institution enrolling students from kindergarten through graduate school. *Id.* at 2022. Although not affiliated with any religious denomination, Bob Jones University is dedicated to teaching and propagating fundamentalist Christian religious beliefs, including the belief that the Bible forbids interracial dating and marriage. *Id.* Until 1971, the University excluded negroes; from 1971 to May 1975, it accepted applications only from negroes married within their race. *Id.* at 2022-23. In 1975, the IRS revoked the University's tax exempt status, effective as of 1970, on the basis of Revenue Ruling 71-447, 1971 2 C.B. 230 (requiring tax exempt organizations to have a racially nondiscriminatory policy). *Bob Jones Univ.*, 103 S. Ct. at 2023.

The Court also held that the IRS's construction of section 170 and section 501(c)(3) did not violate the school's right to the free exercise of religion under the first amendment. *Bob Jones Univ.*, 103 S. Ct. at 2035. This article does not deal with that constitutional issue.

99. 26 U.S.C. § 501(c)(3) (1976 & Supp. V 1981).

100. *Id.* This same language is found in 26 U.S.C. § 170(c)(2) (1976). See *supra* note 34.

101. See 26 U.S.C. § 170(c) (1976).

102. *Bob Jones Univ.*, 103 S. Ct. at 2028.

103. *Id.* at 2025-26.

The Court first asserted that Congress' plain purpose in promulgating section 501(c)(3) was to extend the exemption only to those organizations which satisfy a criterion established in the common law of charitable trusts.<sup>104</sup> This criterion requires consistency between the charity's activity and public policy.<sup>105</sup>

Even if the term charitable requires reference to public policy as defined by the Court, the issue remains as to what evidence will show a sharply defined public policy. The Court found evidence of the requisite public policy in the fact that "[o]ver the past quarter of a century, every pronouncement of this Court and myriad Acts of Congress and Executive Orders attest a firm national policy to prohibit racial segregation and discrimination in public education."<sup>106</sup> Public policy apparently can be found not only in legislative pronouncements, but also in pronouncements of the other branches of government. To what extent pronouncements other than legislative ones would suffice is not clearly addressed. The Court merely provides the directive that an exempt organization must not act in a manner "affirmatively at odds with this declared

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104. *Id.*

105. *Id.* at 2026. The Court defends at great length its conclusion that section 501(c)(3) embodies the law of charitable trusts. Evaluation of that specific contention is not the subject of this article.

106. *Bob Jones Univ.*, 103 S. Ct. at 2029. The Court expands upon this statement. *Id.* at 2029-30. The Court determines that judicial support arises from an unbroken line of cases following *Brown v. Board of Education*, 347 U.S. 483 (1954). Executive branch support is evidenced by executive orders prohibiting racial discrimination in federal employment decisions, selective service decisions, and federally assisted housing grants as well as orders mobilizing military forces to ensure school desegregation. Legislative agreement is evidenced by federal statutes such as title IV and title VI of the Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241, 246-66 (1964) (codified as amended at 42 U.S.C. §§ 2000c, and 2000e (1976 & Supp. V 1981)) and the Voting Rights Act of 1965, Pub. L. No. 89-110 79 Stat. 437 (1965) (codified as amended at 42 U.S.C. § 1973 (1976 & Supp. V 1981)).

A problem with the Court's statement is that even though unanimity may have existed with respect to racial discrimination in general, the materials cited by the Court on this point reflect no unanimity on the interrelationship between tax policy and racial discrimination.

However, this stringent requirement of universality is exactly the kind of restriction needed to curb abuses of the public policy test. It is akin to saying that only those expenditures which are *malum in se* ought not be sanctioned by federal tax deduction benefits. For example, a payment to a "hit man" to eliminate one's business competitor might be "ordinary and necessary" in certain business communities, but such an expenditure would be nondeductible as a matter of universally accepted public policy. The problem with the Court's approach to fashioning such a test is first, that the test is not extended by the Court to the business expense arena as well as the charitable deduction one and second, that it is raised in a case where unanimity of public viewpoint was not clearly present. See *supra* note 77 and text accompanying notes 100 and 103.

position of the *whole* government. . . ."<sup>107</sup>

Equally confusing is the Court's assertion that the public policy test applies "only where there is no doubt that the organization's activity violates *fundamental* public policy."<sup>108</sup> Fundamental public policy in this context seems to mean policy expressly supported by all three branches of government; however, the Court does not specifically say so.

If unanimity of governmental branches is required before application of the public policy test, the Court has severely curtailed the public policy test. The test in the area of business expense deductions requires no such unanimity which allows for greater application of the test in denying business expense deductions. This approach bears explanation since the public policy test should be applied more broadly in determining tax exempt status. Denial of tax exemption on public policy grounds does no more than require an institution to pay tax on its net income, as do other taxpayers, whereas denial of deduction on public policy grounds forces the taxpayer to be taxed on more than net income, a result of considerable controversy and one which dictates cautious applicability of the public policy test to business related deductions.<sup>109</sup>

The Court's argument that there is clear legislative declaration of public policy is weak. The Court asserts that a dozen years of congressional silence in the face of IRS rulings denying exemption on the basis of racial discrimination signifies congressional ratification of that policy.<sup>110</sup> However, the failure of Congress to act on a particular issue has no significance, especially where such a finding

would result in a construction of the statute which not only is at odds with the language of the section in question and the pattern of the statute taken as a whole, but also is extremely far reaching in terms of the virtually untrammelled and unreviewable power it would vest in a regulatory agency.<sup>111</sup>

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107. *Bob Jones Univ.*, 103 S. Ct. at 2032 (emphasis added).

108. *Id.* (emphasis added).

109. See *supra* text accompanying notes 74-78.

110. *Bob Jones Univ.*, 103 S. Ct. at 2033.

111. *Id.* at 2044 (Rehnquist, J., dissenting, citing *SEC v. Sloan*, 436 U.S. 103, 121 (1978)). In *Sloan*, the Court rejected an agency interpretation unsupported by the language of the statute and its legislative history, even though Congress had been informed of the agency's construction and had reenacted the statute without overturning that construction. *Sloan*, 436 U.S. at 117-19. See also *Aaron v. SEC*, 446 U.S. 680, 694 n.11 (1980) (similar statutory interpretation); *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381-82 n. 11 (1969) (unsuccessful attempts at legislation are not the best guides of legislative intent);

The Court responded by pointing out that numerous attempts to overturn the IRS's interpretation of section 501(c)(3) had been defeated.<sup>112</sup> While this plethora of defunct bills may show some congressional cognizance of the issue, it also shows a significant and continuing lack of consensus within Congress. This lack of consensus necessitates a conclusion that a legislative public policy against tax exempt status for racially discriminatory schools is anything but sharply defined.

The Court also looks by analogy to another tax provision<sup>113</sup> for evidence of sharply defined public policy, section 501(i),<sup>114</sup> which denies tax exempt status to social clubs whose charters or policy statements discriminates on the basis of race, color, or religion.<sup>115</sup> Admittedly, the existence of that provision, as well as express statements in its legislative history, indicate a sharply defined policy against tax exemption for discriminatory organizations, but only when those organizations are private clubs. What section 501(i) really indicates is that where Congress wants to eradicate a particular evil, it can and will do so by specifically addressing the issue.<sup>116</sup>

Equally troublesome is the Court's conclusion that the IRS is the proper governmental body to decide which public policies warrant preclusion of tax exemption and deduction benefits. The IRS, says the Court, "[i]n the first instance . . . [has] the responsibility for construing the Code . . ."<sup>117</sup> which encompasses the decision of whether an institution is charitable. The determination of whether a particular organization is charitable may require the IRS to ask whether a given activity so violates public policy that the entities involved cannot be found to provide a public benefit worthy of charitable status.<sup>118</sup>

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United States v. Wise, 370 U.S. 405, 411 (1962); *Waterman Steamship Corp. v. United States*, 381 U.S. 252, 268-70 (1965).

112. *Bob Jones Univ.*, 103 S. Ct. at 2033.

113. *Id.* at 2033-34.

114. 26 U.S.C. § 501(i) (Supp. V 1981).

115. *Id.*

116. In *Red Lion Broadcasting v. FCC*, 395 U.S. 367 (1969), the Court concluded that Congress had ratified the agency's long standing construction of the Communications Act of 1934 by amending the act to include the fairness doctrine. *Id.* at 380-82. No such direct and explicit ratification of an agency policy against racial discrimination by private schools is evidenced by section 501(i).

117. *Bob Jones Univ.*, 103 S. Ct. at 2031.

118. *Id.*

The Court emphasized this view when it stated that the role of Congress is to review prior IRS rulings, modifying them if necessary.<sup>119</sup> The Court offered two reasons for attributing this passive role to Congress. First, Congress cannot be expected to anticipate every conceivable problem that can arise in the day-to-day activities of tax administrators.<sup>120</sup> This argument infers that all determinations of public policy are merely matters of administrative detail and ignores the distinction between major policy decisions and those which are subordinate to clear directives. Even in making determinations of subordinate policy, it is recognized that administrators must implement legislative will, not administrative will.<sup>121</sup>

Second, administrators, like judges, are under oath to implement the legislative will.<sup>122</sup> However, moral obligations and good faith efforts are no substitute for an understanding of that legislative will.<sup>123</sup> Here even the members of the Court, discharging their oath of office, cannot agree as to the legislative will regarding tax exemption for private religious schools which discriminate racially.<sup>124</sup>

Even if major policy development is appropriate for an agency, the demonstrated performance of the IRS in this particular area has not been one of clear, steady development of policy but instead has been one of vacillation in response to conflicting dictates of other governmental bodies. Until 1970 the IRS had granted tax exempt status to private schools without regard to any racially discriminatory practices.<sup>125</sup> After the issuance of a permanent injunc-

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119. *Id.* at 2033.

120. *Id.* at 2031. There is a basic difference between filling a gap in legislative statutes or rules and rewriting those statutes or rules. *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978).

121. The Court argued that Congress relies on administrative bodies to implement the legislative will, but the Court failed to put proper emphasis on the word "legislative." *Bob Jones Univ.*, 103 S. Ct. at 2031. "The statute defines the rights of the taxpayer and fixes a standard by which such rights are to be measured." *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 135 (1936) (emphasis added).

122. *Bob Jones Univ.*, 103 S. Ct. at 2031.

123. See generally Kurtz, *Difficult Problems*, *supra* note 82. Former Tax Commissioner Kurtz expressed stoic resignation to the task: "Questions in this area are obviously sensitive and put the IRS, in some cases, on the cutting edge of developing national policy. But this is where we find ourselves and we will do our best." *Id.* at 308.

124. Compare *Bob Jones Univ.*, 103 S. Ct. at 2026-29 (majority opinion concluding that charitable trust law imported public policy test into section 501(c)(3)) with *id.* at 2041-46 (Rehnquist, J., dissenting because continuous refinement of section 501(c)(3) indicates Congress did not intend charitable trust law to effect that provision).

125. *Bob Jones Univ.*, 103 S. Ct. at 2021.

tion which prohibited the IRS from according tax exempt status to private schools in Mississippi that discriminated on the basis of race,<sup>126</sup> the IRS did an about face and issued a ruling declaring that private schools having racially discriminatory policies would henceforth be denied tax exempt status.<sup>127</sup> The IRS then issued guidelines to assist it in determining whether schools seeking or holding exempt status were discriminating.<sup>128</sup> These guidelines were criticized by the United States Commission on Civil Rights<sup>129</sup> and the Civil Rights Division of the Department of Justice.<sup>130</sup>

Prompted by those criticisms as well as lawsuits complaining that the IRS was not effectively identifying racially discriminatory schools,<sup>131</sup> the IRS proposed new procedures for determining if schools were racially discriminatory.<sup>132</sup> Action on the revised version of these guidelines was stayed by Congress in two appropriation bill riders, known as the Dornan and Ashbrook amendments.<sup>133</sup> Backtracking, the IRS then attempted to revoke its 1970 ruling, revoking the use of public policy as a test for tax exempt status.<sup>134</sup> That attempt at revocation was abandoned after the District of Columbia Circuit Court of Appeals permitted a lower court to fashion a remedy against the granting of tax exempt status by the IRS despite the Dornan and Ashbrook amendments.<sup>135</sup> Unable to react with consistency to such continuous and conflicting buffeting, the IRS is an inappropriate entity in which to vest determinations of public policy.

### III. INAPPLICABILITY OF THE PUBLIC POLICY TEST

Failure to establish a justifiable and workable public policy test has left the deductibility of many expenses an open question. For example, in the business expense area the deductibility of

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126. *Green v. Connally*, 330 F. Supp. 1150 (D.C. Cir. 1971), *aff'd sub nom* *Coit v. Green*, 404 U.S. 997 (1971) (per curiam).

127. Rev. Rul. 71-447, 1971-2 C.B. 230.

128. Rev. Proc. 72-54, 1972-2 C.B. 834; Rev. Proc. 75-50, 1975-2 C.B. 587.

129. *Tax-Exempt Status of Private Schools: Hearings Before the Subcommittee on Oversight of the House Ways and Means Committee*, 96th Cong., 1st Sess. 236-51 (1979) (letter and attachments from Arthur S. Fleming to Jerome Kurtz, IRS Commissioner).

130. *Id.* at 1181-82, 1187-91 (statement of James P. Turner).

131. *Wright v. Regan*, 656 F.2d 820, 825 (D.C. Cir. 1981).

132. 43 Fed. Reg. 37, 296 (1978).

133. Treasury, Postal Service, and General Government Appropriations Act, 1980, Pub. L. No. 96-74, § 615, 93 Stat. 559, 577 (1979).

134. *Bob Jones Univ.*, 103 S. Ct. at 2025, n. 9.

135. *Wright v. Regan*, 656 F.2d 820, 832-35 (D.C. Cir. 1981).

treble damage payments under the Racketeer Influenced and Corrupt Organizations Act<sup>136</sup> (RICO) is unsettled. RICO contains both criminal and civil provisions; under the civil provisions a party may recover treble damages.<sup>137</sup>

The first recourse in determining deductibility of payments should be made to the IRC. However, the IRC is silent with respect to the treatment of RICO treble damages. These treble damage payments could be said to be "ordinary and necessary" within the meaning of section 162, in the same sense that payments of treble damages under the antitrust laws were conceded to be by the IRS.<sup>138</sup> Furthermore, section 162(g) expressly precludes deduction of two-thirds of a treble damage payment under the antitrust laws,<sup>139</sup> and the language of the treble damage provisions of both acts are virtually identical.<sup>140</sup> In *Bob Jones University*, the Court read analogous IRC provisions broadly in order to ground the public policy test in express statutory language.<sup>141</sup> Using the Court's method of analysis, one could argue that section 162(g) evidences a broad legislative intent to preclude tax benefit to a party who engages in any statutorily prohibited anticompetitive activity, and conclude that consistent with such legislative intent two-thirds of a RICO damage payment should be disallowed.

One problem with this analysis is that when Congress addresses a particular area of controversy in regard to tax benefits and chooses to resolve only one aspect of the controversy, the implication arises that Congress has chosen not to resolve the remaining problems.<sup>142</sup> Congress has addressed the propriety of deduction

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136. 18 U.S.C. § 1961-68 (1976 & Supp. V 1981).

137. 18 U.S.C. § 1964(c) (1976). See *infra* note 140.

138. The IRS at one time conceded that treble damages under the Clayton Act were ordinary and necessary. Rev. Rul. 64-224, 1964-2 C.B. 52.

139. 26 U.S.C. § 162(g) (1976).

140. RICO creates a private treble damage action for "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter. . . ." 18 U.S.C. § 1964(c) (1976). The Clayton Act creates a private treble damage action for "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws. . . ." 15 U.S.C. § 15 (1976). This identity of language is not coincidental; RICO civil remedies were patterned after those of the antitrust law. S. Rep. No. 617, 91st Cong., 1st Sess. 80-81 (1969).

141. *Bob Jones Univ.*, 103 S. Ct. at 2017, 2033-34 (1983).

142. For example, Congress enacted a provision excluding from gross income amounts paid by reason of the death of an employee. 26 U.S.C. § 101(b)(1) (1976). Congress subsequently modified that provision to provide that "[t]he aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed \$5,000." 26 U.S.C. § 101(b)(2) (1976). In so doing, Congress foreclosed debate only with respect to the first

of damage payments for anticompetitive activities and has expressly precluded deduction only with regard to violation of the antitrust laws. Hence by failing to expressly extend a policy of disallowance of antitrust damages to treble damages assessed for anticompetitive activities, Congress should be presumed to have left intact their deductibility so long as those damages are truly ordinary and necessary under section 162.

Another problem with the analogy between RICO's treble damage provision and that of the antitrust laws is that the analogy is by no means complete. Two-thirds of an antitrust treble damage payment represents a penalty designed to discourage persons from violating the antitrust laws.<sup>143</sup> The treble damage provisions of RICO, however, do not clearly evidence a legislative intent to punish violators of RICO. Helpful legislative history as to the purpose of the treble damage provision is virtually non-existent.<sup>144</sup> The legislative history of the civil RICO provisions, in general, creates an inference that the treble damage provision was not intended to be punitive, stating, for example, that "Title IV seeks essentially an economic, not a punitive goal."<sup>145</sup>

Since no statutory language disallows deduction of these treble damage payments, the public policy test arguably could be used. The question, then, becomes whether deductibility of RICO payments will frustrate<sup>146</sup> a sharply defined public policy which is evidenced by some governmental declaration thereof. RICO certainly counts as a governmental declaration; the question remains as to whether it reflects a policy which is sharply defined. The key focus of RICO was upon those individuals who were part of organized

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\$5,000 of a death benefit, leaving any excess amounts to be treated as includable gross income or excludable gift, as the facts would warrant. *Frankel v. United States*, 192 F. Supp. 776 (D. Minn. 1961); *Reed v. United States*, 177 F. Supp. 205 (W.D. Ky. 1959); Rev. Rul. 60-326, 1960-2 C.B. 32 (IRS conceding that section 101(b) does not per se limit a taxpayer to only a \$5,000 exclusion of death benefits).

143. Taggart, *Fines, Penalties, Bribes, and Damage Payments and Recoveries*, 25 TAX L. R. 611, 619 (1969-70).

144. *But see* H.R. REP. No. 1549, 91st Cong., 2d Sess. reprinted in 1970 U.S. CODE CONG. & AD. NEWS 4007-91 (1970).

145. S. REP. No. 617, 91st Cong., 1st Sess. 80-81 (1969).

146. The frustration test focuses initially on whether the payment is intended to punish the wrongdoer. If so, then deduction is inappropriate because it could arguably defeat the statute's purpose by diminishing the financial detriment of the penalty and thereby induce commission of the offense. *See supra* text accompanying notes 64-67.

crime.<sup>147</sup> However, RICO nowhere defines organized crime,<sup>148</sup> thus controversy has developed as to whether RICO is applicable to ordinary business men who lack attachment to Mafia style organizations.<sup>149</sup>

Given this equivocation, it appears that there is no sharply defined policy which should lead to punishing all payors of RICO treble damages by denying them deductibility of some or all of their payment. At best, there is a sharply defined policy of punishing RICO violators who are "mobsters" in the traditional sense of the word. This conclusion, however, saddles courts and the IRS with the task of deciding for tax purposes who is and who is not a member of organized crime. Such a task is inappropriate for those bodies, since they lack the expertise to make such a non-tax related determination.<sup>150</sup> Furthermore, in making this determination, they would read into RICO a tax consequence which Congress arguably never intended.<sup>151</sup>

#### CONCLUSION

The public policy test has developed from the assumption that the proper role of the IRS is to initiate policy while Congress serves only as a reactor to, rather than an initiator of, major tax policy decisions. The test as developed is unworkable because it fails to specify which policies are sufficiently sharply defined to cause disallowance of deductions. Furthermore, it fails to specify why and to what degree frustration of public policy should lead to disallowance. Finally, it fails to designate which governmental bodies are to make these decisions.

Congress and Congress alone should determine which public policies should give rise to nondeductibility. Congress has demon-

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147. The Statement of Findings and Purpose of the Organized Crime Control Act of 1970, of which RICO is a part, state that: "It is the purpose of this Act to seek the eradication of organized crime in the United States. . . ." Pub. L. No. 91-452, 84 Stat. 922, 923 (1970). See also *United States v. Turkett*, 452 U.S. 576, 590 (1981) (RICO aims at inhibiting the infiltration of legitimate businesses by organized crime).

148. For legislative history on the use of this term, see 116 CONG. REC. 35, 293 (1970).

149. Compare *Moss v. Morgan Stanley, Inc.*, 553 F. Supp. 1347 (S.D.N.Y. 1983) and *Adair v. Hunt Int'l Resources Corp.*, 526 F. Supp. 736 (N.D. Ill. 1981) and *Waterman Steamship Corp. v. Avendale Ship Yards, Inc.*, 527 F. Supp. 256 (E.D. La. 1981) with *United States v. Aleman*, 609 F.2d 298 (7th Cir. 1979) cert. denied 445 U.S. 946 (1980) and *Bennett v. Burg*, 685 F.2d 1053 (8th Cir. 1982).

150. See *supra* text accompanying notes 82-84.

151. See *supra* text accompanying notes 138-141.

strated the capacity to do so on repeated occasions by enacting express, specific, and distinct provisions.<sup>152</sup> Even when Congress has chosen to delegate public policy determinations, such delegation has been express and discrete.<sup>153</sup> Congressional action however manifested, is preferable to erratic judicial incursions into questions of public policy and tax deduction.<sup>154</sup> Consequently, the Court should curb its use of the public policy test.

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152. See *supra* notes 27, 81, 139.

153. See *supra* text accompanying notes 9-21.

154. Cf. *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952) (Jackson, J., joined by Frankfurter, J., dissenting). The opinion refers to Supreme Court decisionmaking in the tax area as "sporadic omnipotence in a field beset with invisible boomerangs." *Id.* at 12.