approach will achieve a tax saving grossly disproportionate to any savings achieved by deferral or reserves when the amount of the deposit retained is taxable in full.[33]

[33] An illustration of this disproportion can be seen in the Bradford and the Warren cases themselves. In the former, the taxpayer reported as income only approximately $53,000 of the $185,000 it received. In the latter, where the lease had a shorter period to run, the taxpayer reported $85,000 out of $125,000. It would seem highly improbable that this saving would be offset by the taxpayer's gaining interest on deferred taxes, by his possible placement in a lower tax bracket, and by possible loss of any deduction for expenses not accrued if in the future year he should have no income.

"ORDINARY AND NECESSARY AND LEGAL EXPENSES"

THE FEDERAL TAX AND STATE CRIMINAL LAW

I

The Internal Revenue Code provides that the "ordinary and necessary expenses" of a trade or business may be deducted from gross income.[1] Although this provision does not explicitly condition deductibility upon legality, the Tax Court and lower federal courts have over the years established special rules for expenditures illegal in themselves or incurred in connection with illegal activities.[2]

With only a few exceptions,[3] the courts have disallowed deduction of penalties paid for violations of federal[4] and state[5] statutes and municipal ordinances.[6] Disallowance has been justified by some courts on the ground that it is never ordinary and necessary to violate the law.[7] Other courts have

[1] "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, including—(1) a reasonable allowance for salaries or other compensation for personal services actually rendered; . . . (3) rentals. . . ." Int. Rev. Code §162(a), 26 U.S.C.A. §162(a) (1954), formerly §23(a)(1)(A) of the 1939 Code.

[2] 4 Mertens, The Law of Federal Income Taxation §25.131 et seq. (1954). With respect to expenses incurred in connection with illegal activities, the problem of deductibility is raised by the rule that income from such activities is taxable. United States v. Sullivan, 274 U.S. 259 (1927). Contra: Commissioner v. Wilcox, 327 U.S. 404 (1946), limited to its facts in Rutkin v. United States, 343 U.S. 130 (1952).

[3] Most of the exceptions involve non-wilful violation of maximum-price laws; e.g., Jerry Rossman Corp. v. Comm'r, 175 F.2d 711 (C.A.2d, 1949).

[4] E.g., Great Northern Ry. v. Comm'r, 40 F.2d 373 (C.A. 8th, 1930), cert. denied 282 U.S. 855 (1930); David R. Faulk, 26 T.C. 948 (1956); Joseph Saltzman, 21 T.C. 777 (1954).

[5] E.g., Commissioner v. Longhorn Portland Cement Co., 148 F.2d 276 (C.A.5th, 1945); Burroughs Building Material Co. v. Comm'r, 47 F.2d 178 (C.A.2d, 1931).

[6] Harry Wiedetz, 2 T.C. 1262 (1943).

[7] E.g., Great Northern Ry. v. Comm'r, 40 F.2d 372 (C.A. 8th, 1930).

argued that payment of a penalty is ordinary and necessary but the deduction must be denied if it would frustrate public policy by reducing the impact of the penalty.[8]

Deduction has also been uniformly denied for expenditures illegal in themselves, e.g., bribes paid to law enforcement officers for "protection,"[9] purchases of liquor in violation of prohibition laws,[10] and payments to obtain political patronage.[11] Denial of the deduction was usually based on the ground that "the law will not recognize the necessity of engaging in illegal courses in the conduct of a business."[12] Those expenses of an illegitimate business which are not themselves illegal have been held to be deductible,[13] on the basis of the circular reasoning that the income tax should be a levy on net, rather than gross, income.[14] However, in cases involving the litigation costs incurred by a trade or business in unsuccessfully defending a criminal prosecution, the deduction has usually been denied,[15] for a variety of reasons.[16]

Before the October 1957 term the Supreme Court had never put its unqualified stamp of approval on any of these rules. In 1941, in *Textile Mills Corporation v. Commissioner*,[17] the Court disallowed the deduction of lobby-

[8] E.g., David R. Faulk, 26 T.C. 948 (1956).

[9] E.g., Charles A. Clark, 19 T.C. 48 (1952); Frank A. Maddas, 40 B.T.A. 572 (1939), others issues aff'd 114 F.2d 548 (C.A. 3d, 1940).

[10] E.g., R. E. L. Finley, 27 T.C. 413 (1956); Lorraine Corp., 33 B.T.A. 1158 (1936); Cf. Fuller v. Comm'r, 213 F.2d 102 (C.A. 10th, 1954).

[11] E.g., Easton Tractor & Equipment Co., 35 B.T.A. 189 (1936). See Textile Mills v. Comm'r, 314 U.S. 326 (1941), discussed in text at note 17 infra.

[12] National Outdoor Advertising Co. v. Helvering, 89 F.2d 878, 881 (C.A. 2d, 1937).

[13] E.g., G. A. Comeaux, 10 T.C. 201 (1948), aff'd sub nom. Cohen v. Comm'r, 176 F.2d 394 (C.A. 10th, 1949).

[14] G. A. Comeaux, 10 T.C. 201, 207 (1948).

[15] E.g., David R. Faulk, 26 T.C. 948 (1956); Thomas A. Joseph, 26 T.C. 562 (1956); Simon Bloom, 7 T.C.M. 517 (1948). In Commissioner v. Heininger, 320 U.S. 467 (1943), the Supreme Court allowed the deduction of expenses incurred in an unsuccessful attempt to enjoin the Postmaster General from imposing a fraud order. This case has been interpreted as inapplicable to expenses incurred in fighting criminal prosecutions; e.g., Thomas A. Joseph, 26 T.C. 562, 564 (1956).

[16] The Tax Court has stated the usual reasons: "The fees were not incurred in the actual production of the income of the illegal business and did not enable him to continue his gambling business. . . . The petitioner would reduce the cost of unsuccessfully defending himself against a criminal charge by deducting the expense from his taxable income and thus, in effect, have the federal government assist in his defense. The allowance of the deduction would be against public policy. The amount is not an ordinary and necessary expense of any business regularly carried on by the taxpayer." C. W. Thomas, 16 T.C. 1417, 1418 (1951). One court, having decided on public policy grounds that penalties could not be deducted, held that "the legal expenses incurred in litigating the question whether the taxpayer violated the law and whether fines should be imposed should naturally fall with the fines themselves." Burroughs Building Material Co. v. Comm'r, 47 F.2d 178, 180 (C.A. 2d, 1931).

[17] 314 U.S. 326 (1941).

ing expenses, but the decision was based on the congressional re-enactment of the business expense section at a time when a Treasury regulation under that section had for "many" years disallowed such deductions. Two years later the Court, in *Commissioner v. Heininger*,[18] allowed the deduction of attorney fees paid in an unsuccessful resistance to the Postmaster General's issuance of a fraud order which would have destroyed the taxpayer's business. The Court noted that "[t]he language of §23(a) [now §162(a)] contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible."[19] The rules developed by the lower courts for illegal items, the Court said, "narrowed the generally accepted meaning of the language used in §23(a)."[20] The *Heininger* decision, moreover, involved an assumption which is contrary to that of many of the decisions of the lower courts, namely that a business which engages in defrauding the public may have ordinary and necessary expenses.[21]

In 1952 the Court, in the *Lilly* case,[22] again expressed reservations about conditioning deductibility upon legality. It was assumed "for the sake of argument" that some expenses could not be deducted because public policy would thereby be frustrated.[23] But the Court did not pass on the validity of the assumption because it decided that the deduction sought—for kickbacks paid by an optical firm to physicians who referred patients to it—did not frustrate public policy.

In three cases decided during the October, 1957 term the Supreme Court squarely faced for the first time the question of whether legality should be a criterion of deductibility. Two cases, both unanimously decided, involved fines paid by trucking firms for violating state maximum weight laws. In *Tank Truck Rentals v. Commissioner*[24] the taxpayer had incurred a large number of penalties when it deliberately overloaded its trucks as an alternative to economic suicide.[25] A few violations in the *Tank Truck* case and all in *Hoover Motor Express Co. v. United States*[26] were inadvertent. Speaking

[18] 320 U.S. 467 (1943). [19] Id., at 474. [20] Id., at 473.

[21] See Paul, The Use of Public Policy by the Commissioner in Disallowing Deductions, 1954 So. Cal. Tax. Inst. 715, 733.

[22] Lilly v. Comm'r 343 U.S. 90 (1952). [23] Id., at 94.

[24] 356 U.S. 30 (1958), aff'g 242 F.2d 14 (C.A. 3d, 1957), aff'g 26 T.C. 427 (1956).

[25] "In order to have carried weights within the limitations of the Pennsylvania statute, petitioner [Tank Truck Rentals, Inc.] would have had to reduce its revenue per gallon hauled, while operating costs would have increased because of the additional number of trips required, thus causing petitioner to operate at a loss. Petitioner could not have increased its rental charge to its lessees per gallon hauled to compensate for transporting a smaller number of gallons each trip, since the competitive practices in the industry were such that had petitioner demanded an increased rental from its lessees, while the industry generally was filling its tanks to capacity and exceeding the Pennsylvania weight limitations, petitioner would have forced itself out of business." Tank Truck Rentals, Inc., 26 T.C. 427, 433-34 (1956).

[26] 356 U.S. 38 (1958), aff'g 241 F.2d 459 (C.A. 6th, 1957), aff'g 135 F.Supp. 818 (D.C. Tenn., 1955).

through Mr. Justice Clark, the Court held that Congress would not be presumed to have intended to allow deductions which would reduce the impact of state-imposed penalties and thus frustrate state public policy. Therefore the expenses could not be deemed "necessary" within the meaning of the tax law.[27] Frustration of state policy, the Court was careful to say, is not to result automatically in disallowance. Rather, "the test of nondeductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction."[28] In the Court's view, this test plainly proscribes deduction when the expenditure is in itself illegal; the frustration resulting from deduction of state-imposed penalties seemed to the Court only slightly more remote and well within the class of nondeductible items. The Court refused to distinguish between deliberate and inadvertent violations on the ground that the state statutes prohibited both alike.

In *Commissioner v. Sullivan*,[29] also unanimously decided, the Court held that bookmakers could deduct wages and rent paid in violation of the Illinois Criminal Code. The opinion, by Mr. Justice Douglas, pointed out that a Treasury ruling made the federal excise tax on bets deductible as a business expense. It was concluded that the "policy that allows as a deduction the tax paid to conduct the business seems sufficiently hospitable to allow the normal deductions of the rent and wages necessary to operate it."[30] Moreover, the expenses sought to be deducted, the Court indicated, bore only a remote relation to the illegal act. The Court also argued that disallowance of the deduction would "come close" to taxing the business on the basis of gross, rather than net, income.

II

The *Tank Truck*, *Hoover* and *Sullivan* cases seem to have left much of the prior case law unchanged. The lower courts' rule disallowing deduction of fines was adopted in the *Tank Truck* and *Hoover* cases. The exception created

[27] In the Hoover case the Court undertook an exploration of the facts in order to determine whether the violations were "necessary." The Court concluded that because the violations could have been prevented had the taxpayer properly distributed its cargo and carried scales in its trucks to weigh merchandise picked up between terminals the violations were unnecessary. This is hardly the sort of examination which courts have conducted where the expenses were not tinged with illegality. The Court does not rest on this point but holds further that the expenses were not necessary because their deduction would, as in the Tank Truck case, frustrate public policy.

[28] Tank Truck Rentals v. Comm'r, 356 U.S. 30, 35 (1958).

[29] 356 U.S. 27 (1958), aff'g the combined cases of Neil Sullivan and Grace Sullivan, James Ross and Ann Ross v. Comm'r, 241 F.2d 46 (C.A. 7th, 1957) and Sam Mesi v. Comm'r, 242 F.2d 558 (C.A. 7th, 1957), rev'g respectively, 15 T.C.M. 23 (1956) and 25 T.C. 513 (1955).

[30] Commissioner v. Sullivan, 356 U.S. 27, 29 (1958).

by the lower courts for exactions which are not punitive in nature[31] has apparently been preserved.[32] In none of the cases was there any disapproval of the doctrines developed by the lower courts with respect to the expenses of an illegitimate business which are not in themselves illegal or the exception made for expenditures incurred in unsuccessfully defending a criminal prosecution.[33]

With respect to expenditures illegal in themselves there is, at least on the surface, a contradiction between the *Tank Truck* and *Sullivan* cases. In a strong dictum in the former case Mr. Justice Clark stated, "Certainly the frustration of state policy is most complete and direct when the expenditure for which deduction is sought is itself prohibited by statute."[34] In the *Sullivan* case, however, although the Court expressly recognized[35] the Tax Court's finding[36] that the expenditures sought to be deducted were in violation of a state statute, deduction was allowed. In the opinion Mr. Justice Douglas did not address himself to a reconciliation of the *Sullivan* case with the *Tank Truck* dictum. But there are several grounds on which the *Sullivan* case may arguably be limited in order to minimize the contradiction. The Court may have intended to limit the holding in *Sullivan* to expenditures of businesses like gambling which pay a deductible federal excise tax.[37] However, there is some indication in the opinion that the Court intended to lay down a broader holding; the other grounds given by the Court are broadly applicable to all expenditures connected with illegal business activity.

It may be argued that the Court intended to limit the *Sullivan* case to wage and rent expenses. The Court may have thought that wages and rent normally constitute such a large percentage of the expenses of a business that to prevent

[31] E.g., Jerry Rossman Corp. v. Comm'r, 175 F.2d 711 (C.A. 2d, 1949). See Deductibility of Business Expenses and the Frustration of Public Policy, 38 Va. L. Rev. 771, 782–85 (1952); Public Policy and Federal Income Tax Deductions, 51 Col. L. Rev. 752, 753–54 (1951).

[32] In the *Tank Truck* opinion Mr. Justice Clark stated, "Petitioner's reliance on Jerry Rossman Corp. v. Commissioner . . . is misplaced. Deductions were allowed the taxpayer in that case for amounts inadvertently collected by him as OPA overcharges and then paid over to the Government, but the allowance was based on the fact that the Administrator, in applying the Act, had differentiated between willful and innocent violators. No such differentiation exists here, either in the application or the literal language of the state maximum weight laws." Tank Truck Rentals v. Comm'r, 356 U.S. 30, 36–37 (1958).

[33] The courts' allowance of deductions for the legitimate expenses of illegal businesses and disallowance of deductions for the cost of unsuccessful defense of a criminal prosecution seem difficult to justify under the remoteness of frustration test adopted in the Tank Truck case. However, the Court in the Tank Truck case did not refer to these expenses. The distinction seems justifiable in light of certain underlying policies in the field. See note 49 infra.

[34] Tank Truck Rentals v. Comm'r, 356 U.S. 30, 35 (1958).

[35] Commissioner v. Sullivan, 356 U.S. 27, 28 (1958).

[36] James Ross v. Comm'r, 15 T.C.M. 23 (1956); Sam Mesi v. Comm'r, 25 T.C. 513 (1955).

[37] See text at note 30 supra.

their deduction results in taxation of gross income. However, denial of any deduction results in a partial taxation of gross income. It is not obvious that deductibility should depend on the extent to which gross income is taxed. Moreover, in some businesses the other illegal expenditures or the fines may, for any particular year, approximate or even exceed wage or rent expenses.

It is also arguable that the Court thought that there is a category of expenditures which, like wages and rent, are so indispensable to the operation of any business that, regardless of illegality, deduction should be permitted. This categorization is similar to that inherent in the "economic integrality" test developed by the Seventh Circuit in *Commissioner v. Doyle*.[38] In explaining its test the Court of Appeals distinguished "integral" from "concomitant" expenditures. Wages paid by a grocer to his employees were said to be "integral"; the grocer's bribe of a policeman to allow an illegal display of wares on the sidewalk was termed "concomitant." "Integral," but not "concomitant," expenditures were said to be deductible. Neither this categorization nor the one which may be used to limit the *Sullivan* opinion seems warranted by the statute. Moreover, in view of the great variety of fact situations that will arise, it would seem extremely difficult to establish categories of expenses accurately reflecting the degree to which any particular expense is "indispensable."

The apparent contradiction between the *Sullivan* and *Tank Truck* cases disappears if the former is interpreted as dealing only with expenditures not illegal in themselves.[39] Except for one reference to the Tax Court's findings, the Supreme Court carefully avoided describing the expenditures. Under this interpretation the *Sullivan* case indicates the Court's approval of the lower court cases allowing deduction for those expenditures of illegitimate businesses which are not illegal in themselves. This interpretation rests on the questionable assumption that the Court deliberately disregarded its knowledge of the character of the expenditures. But any other interpretation means that the Court deliberately disregarded the clear language of the *Tank Truck* opinion.

This dilemma may reflect a basic disagreement which, despite the unanimity of the opinions, perhaps exists within the Court. Thus the language used by Mr. Justice Douglas in reconciling the cases is somewhat equivocal:

> The amounts paid as wages to employees and to the landlord as rent are "ordinary and necessary expenses" in the accepted meaning of the words. That is enough to permit the deduction, unless it is clear that the allowance is a device to avoid the consequences of violations of a law, [citing the *Hoover* and *Tank Truck* cases] or

[38] 231 F.2d 635 (C.A. 7th, 1956). "We construe the statutory words 'ordinary and necessary expenses' to mean those expenses which economically are an integral part of a business, whether it be lawful or unlawful. Integrality is the test." Id., at 637.

[39] This explanation is suggested in Surrey & Warren, Comment to Commissioner v. Sullivan, CCH Federal Taxation: Current Law and Practice §1229 (1958).

otherwise contravenes the *federal* policy expressed in a statute or regulation. . . .[40] (Italics added.)

It is arguable that one of the statutes meant by Mr. Justice Douglas was the very section of the Revenue Code under consideration; by this interpretation the allowance of certain deductions might be said to contravene a federal statute because the related acts were prohibited by state law. This analysis, however, is circular and provides no way to distinguish between fines and other expenditures. Alternatively, the language may suggest disagreement in the Court over the wisdom of the *Tank Truck* case; it seems doubtful that the deductions sought in that case could be considered to contravene a "federal policy expressed in a statute or regulation," despite Justice Douglas' use of the word "otherwise." This interpretation derives support from the fact that the Court failed to follow its usual practice of assigning companion cases to the same Justice[41] and instead divided the cases between two Justices who had previously split over the use of the federal income tax to enforce state criminal laws.[42] It seems reasonable, then, to consider the *Sullivan* case broadly, as holding that deductions may be taken for expenditures illegal in themselves.

III

The doctrine that the illegal character of an expenditure is relevant in determining deductibility has no justification in the language of the Revenue Code. The requirement of that statute is that the expense must be ordinary and necessary.[43] This has been interpreted to mean that the expense must be in aid of or proximately resulting from the taxpayer's business and must be customary for the type of enterprise.[44] The test thus seems to be the relation of the expenditure to the business; that relation seems unaffected by the fact that the expenditure itself, or the business or transaction in connection with

[40] Commissioner v. Sullivan, 356 U.S. 27, 29 (1958). Justice Douglas' language indicates that in his opinion the expenses in the Tank Truck cases were ordinary and necessary within the meaning of the statute but were disallowed on the basis of an additional test; this is contrary to Justice Clark's approach in the Tank Truck case. Justice Douglas' approach seems preferable because it represents more accurately the fact that the courts in certain types of cases will read the word "legal" into the statute as an additional requirement. The Tank Truck case provides an apt illustration: the fines incurred in preference to economic extinction and paid as a result of governmental coercion must be deemed necessary if the word is to have any real meaning.

[41] In the October, 1957 term, for example, the Court followed this practice in the following sets of cases: Benanti v. United States, 355 U.S. 96 (1957) and Rathbun v. United States, 355 U.S. 107 (1957); Nashville Milk Co. v. Carnation Co., 355 U.S. 373 (1958) and Safeway Stores, Inc. v. Vance, 355 U.S. 389 (1958); Detroit v. Murray Corporation of America, 355 U.S. 489 (1958), United States v. Detroit, 355 U.S. 466 (1958) and United States v. Muskegon, 355 U.S. 484 (1958).

[42] Rutkin v. United States, 343 U.S. 130 (1952).

[43] See note 1 supra.

[44] Deputy v. DuPont, 308 U.S. 488 (1940); Welch v. Helvering, 290 U.S. 111 (1933); 4 Mertens, The Law of Federal Income Taxation §25.09 (1954).

which it is incurred, is prohibited by statute or regulation. Judges have at times failed to recognize this fact and have argued that it is never ordinary and necessary to violate the law and, therefore, that the expenses involved cannot be ordinary and necessary. However, although it may be unnecessary and extraordinary to run a gambling enterprise, if one is operated it may be necessary and, one suspects, ordinary to pay the police for "protection." Similar analysis demonstrates the weakness of the *Tank Truck* case in conditioning deductibility upon the expected effect of the deduction.

It is difficult to find any justification in the legislative history for the courts' distortion of the words "ordinary and necessary" in cases involving illegality. Congress has at least twice refused to phrase the statute so as to disallow illegal items.[45] Moreover, on those occasions when Congress has intended to use the tax laws as an additional sanction for violations of other laws it has expressly spelled out its intention.[46]

If, despite the statutory language, illegality is to be relevant in determining whether an expenditure may be deducted, the line drawn by the Supreme Court between fines and other expenditures seems proper. First, disallowance of deductions for many other expenditures might tend to discourage a taxpayer from filing a return, thus depriving the government of revenue.[47] The extent of discouragement would depend primarily on two factors: (1) the size of the disallowed expense in relation to the size of gross income and (2) the ease with which the expenditures may be concealed among deductible items on the return. Wage and rent expenses are both large and usually difficult to conceal. In most cases fines are probably smaller but perhaps more difficult to hide. Most other items are usually smaller than wages and rent and probably less difficult to report in some deductible category. Thus inability to deduct wages and rent may often result in a tax exceeding profits; the taxpayer would be presented with the choice of going out of business or failing to report income. Inability to deduct fines would raise the tax bill, but usually not to a prohibitive level. The theoretical inability to deduct expenditures such as bribes may be effectively nullified by reporting them as other types of

[45] Deductibility of Illegal Expenses under Section 162 of the Internal Revenue Code: A Justification for Vagueness, 66 Yale L. J. 602 n. 2 (1957).

[46] See Paul, op. cit. supra note 21, at 731 n. 38.

[47] The likelihood that a taxpayer would be discouraged from filing a return would be increased if the courts, having disallowed deduction of an illegal expenditure, carry their campaign of discouraging crime one step further by deciding that the consideration for the expenditure will not be recognized. If this is done, the payment will be taxable as a gift. Int. Rev. Code §2512(b), 26 U.S.C.A. §2512(b) (1954). Since the payment of the gift tax is nondeductible, there would be discouragement of crime with a vengeance—if the taxpayer filed a return. The courts might balk at this step on the ground that the tax laws are to be adjusted only to prevent encouragement of crimes, not to positively discourage it. However, the encouragement resulting from a failure to tax an illegal expenditure as a gift is just as real as the encouragement resulting from a deduction of the expense. Moreover, unlike the refusal to allow a deduction for income tax purposes, the imposition of a gift tax would be based on an explicit statutory provision.

expenses. These considerations lend some support to the possibility of distinguishing wages and rent from expenditures likely to be smaller. However, other considerations lead to the conclusion that it is preferable to draw the line between penalties and all other expenditures.

Disallowance of deduction for fines does not present the administrative problems raised by disallowance of other items involving illegality. In the latter case the Commissioner would be required to keep track of a multitude of ever-changing statutes and to determine whether any of them had been violated. This determination would raise the question of whether the taxpayer was being penalized for an alleged crime without a trial conducted under the safeguards of the Sixth Amendment. Disallowance would create these problems even if it is to be used only to discourage violations of federal statutes and regulations. If the policy of discouragement includes state statutes and regulations the Commissioner's task of keeping track of violations is herculean. Moreover, most states have many statutes, e.g., "Sunday blue laws," which they do not wish to enforce. Enforcement of such laws through the federal tax would hardly aid state policy. Yet nobody knows which laws a state "means" to enforce, and to give the Commissioner power to choose would involve an extremely broad range of administrative discretion. If, in addition, violations of public policy which are not even expressed in a statute or regulation are grounds for disallowing a deduction, the Commissioner's function will approach that of a censor of morals.[48] These problems are not raised by disallowing deduction of penalties.

Another ground for distinguishing between fines and other expenditures is the difference in state policies involved. In the case of fines, it could be said that the policy frustrated by allowing a deduction is to make the violator poorer by a precisely defined amount; in the case of other expenses it is a more amorphous policy to deter some illegal activity such as gambling. The frustration in the former case could be considered more certain and more sharply defined. However, it may be argued that the policy of imposing a certain penalty is actually only a means to implement a policy of deterring the penalized activity. Allowance of an expenditure incurred in connection with an illegal activity encourages the crime and thereby reduces the deterrent impact of state law fully as much as disallowance of a fine of equivalent size imposed on the activity. Thus allowance of a deduction for $10,000 in expenses decreases the cost of running an illegal business by the same amount as allowance of a deduction for $10,000 in penalties decreases the cost of engaging in the penalized activity. Nevertheless, while the state's primary policy is to deter the illegal activity, deduction of fines may result in direct frustra-

[48] The Court indicated its recognition of the danger of giving the Commissioner too much discretion in Lilly v. Comm'r, 343 U.S. 90 (1952). However, in a footnote to the Tank Truck case the Court seems to retreat from the implication in the Lilly decision that the public policy must be declared by a statute or regulation. Tank Truck Rentals v. Comm'r, 356 U.S. 30, 34 n. 6 (1958).

tion of a subsidiary policy to make variations in a fine depend on the nature of the violation. If fines could be deducted the loss occasioned by the fine would vary according to the tax bracket of the violator, whether he had net income for the year, and his loss carryover and carryback position—purely fortuitous circumstances from the state's point of view. Of course, the state could make its system of fines dependent on the federal income tax law; but this might be too complicated, if only because federal tax laws change so rapidly. Disallowance of deductions for fines seems preferable,[49] if the lack of statutory justification for such a course is to be disregarded.

In accordance with the language of Mr. Justice Douglas in the *Sullivan* case, another line of distinction might be suggested. One criticism of cases disallowing deduction on the grounds of illegality has been that it is not the function of the federal government to enforce state criminal law.[50] It may be that the distinction between fines and other expenses implicit in the *Tank Truck* and *Sullivan* cases reflects this concern for federal-state relations. Thus disallowance of deduction for fines merely aids an enforcement which has already taken place, rather than constituting independent enforcement of state law. However, problems of federalism would not be raised by disallowance of deduction for expenses incurred in connection with violation of federal law. Thus a double line of distinction may emerge from the *Sullivan, Tank Truck,* and *Hoover* cases: where violation of state law is involved, only deduction of fines will be disallowed; where federal law is violated, the prior case law will be followed.

[49] The cost of an unsuccessful defense of a criminal prosecution is an exception to the suggested rule of allowing deduction of all expenditures other than penalties. Litigation costs are likely to be closer to the magnitude of fines than of wage and rent expenditures. Thus, although it may be difficult to conceal a large portion of the litigation expenses, disallowance of such expenses would probably not discourage filing of returns. Moreover, no substantial administrative problems are involved in determining when litigation expenses have been incurred, and a policy of disallowance would not give the Commissioner the broad discretion to which the Court in the Lilly case seemed to object. However, although the disallowance of fines frustrates state policy to make the violator poorer by the amount of the fine, there is no comparable policy regarding litigation expenses.

[50] See Paul, op. cit. supra note 21.

THE EXCLUSIVE REMEDY PROVISION OF WORKMEN'S COMPENSATION ACTS—DISTRIBUTION OF RISK BETWEEN A CONCURRENTLY NEGLIGENT EMPLOYER AND THIRD PARTY

Where the concurrent negligence of an employer and a third party cause injury to an employee, the majority of courts have made the third party bear the whole of the liability.[1] Thus, in suits against third parties by subrogated

[1] (a) *Subrogee-employer v. Third Party Cases:* Aetna Casualty & S. Co. v. Manufacturers Cas. Ins. Co., 140 F.Supp. 579 (W.D. La., 1956); Cyr v. F. S. Payne Co., 112 F.Supp. 526 (D. Conn., 1953); Nyquist v. Batcher, 235 Minn. 491, 51 N.W.2d 566 (1952); Milosevich v. Pacific