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gains, appears to be that of the principal case, which taxes the gain in the hands of the person who has the freedom to dispose of it and who derives a "readily realizable economic value from it."

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INCOME TAX—COSTS IN VIOLATION OF CEILING PRICES HELD DEDUCTIBLE

In their income tax returns, taxpayers included amounts paid in excess of World War II ceiling prices in computing their deductions for cost of goods sold. These over-ceiling payments were disallowed by the Commissioner of Internal Revenue. In the first appellate rulings on the question three Circuit Courts held that in the absence of legislation to the contrary, such payments are deductible from gross receipts as a part of the cost of goods sold, in determining gross income. *Commissioner v. Weisman,* 197 F. 2d 221 (1st Cir. 1952); *Hofferbert v. Anderson Oldsmobile, Inc.,* 197 F. 2d 504 (4th Cir. 1952); *Commissioner v. Guminski,* 198 F. 2d 265 (5th Cir. 1952).

An income tax, levied by Congress under the Sixteenth Amendment to the Constitution, in order to be valid, must be based only upon income, and if other than income is used as the basis for such a tax it is a direct tax requiring apportionment under Art. I § 9 of the Constitution. *Eisner v. Macomber,* 252 U. S. 189 (1920). No income from business operations can be realized until the cost of goods sold has been recovered, and therefore an income tax cannot reach receipts from which that cost has not been subtracted. *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179 (1918); *Sullenger,* 11 T. C. 1076 (1948). Accordingly, the Internal Revenue Code § 22 (a), and U. S. Treas. Reg. 111, § 29.22 (a)-5 (1943), provided that the cost of goods sold should be offset against gross receipts in determining gross income from business for income tax purposes.

Considering the constitutional limitations of the Sixteenth Amendment alone, it is clear that Congress could not pass an *income tax* disallowing the deduction from gross receipts of any part of the cost of goods sold. However, such an otherwise unconstitutional exercise of the taxing power may be found valid when applied as incident to some other power of Congress. Thus, if the tax is an expedient regulation of commerce by Congress, and the end to be attained is one falling within the commerce power, then the tax is not void, although within a loose and more extended sense than was used in the Constitution it was called a tax. *Head Money Cases,* 112 U. S. 580 (1884). Such regulatory taxes are not subject to the rules which would invalidate an ordinary tax. *Veazie Bank v. Fenno,* 8 Wall. 533, 549 (U. S. 1869).

In 1942 Congress in a valid exercise of its war powers, *Yakus v. United States,* 321 U. S. 414 (1944), enacted the Emergency Price Control Act, 56 STAT. 23, 50 U. S. C. App. § 901 (1942), under which the ceiling prices here violated were set up. At that time, or subsequently, Congress through use of its incidental powers, U. S. Const. Art. I § 8, could have implemented the act to include, among the other penalties imposed for violations, income tax disallowances for such parts of deductions for cost of goods sold as represented over ceiling payments. A similar penalty was imposed by the Stabilization Act of 1942, 56 STAT. 767, 50 U. S. C. App. § 965 (a) (1942), disallowing deductions for wage payments made in excess of wage ceilings, being held valid in *Weather-Seal Mfg. Co.,* 16 T. C. 1312 (1951).

Although allowing ceiling price violators deductions on income tax returns for such illegal payments would seem to be contrary to public policy, such deductions for cost of goods sold have been allowed, in the absence of legislation to the contrary, even where the entire business carried on was illegal. *United States v. Sullivan,* 274 U. S. 259 (1927) (illegal liquor business). Penalties are not created by public policy or implication; they must be expressly imposed or they cannot be enforced. *Elliott v. East Penn. R.,* 99 U. S. 573 (1878); *United States v. Winchester & Co.,* 40 F. 2d 472 (2d Cir. 1930).

Thus in the principal cases the courts correctly found for the taxpayers, since constitutionally the only way to justify the Commissioner's disallowances would be as a penalty for price ceiling violations, a penalty which Congress had not invoked. Today this apparent conflict between public policy and the law has been corrected by the 1951 amendments to the Defense Production Act of 1950, 65 STAT. 136 (1951), 50 U. S. C. App. § 2105 (a) (Supp. 1952), which empower the President to prescribe the extent to which payments made in violation of price regulations may be disallowed by the government for tax and other purposes. And the position of the principal cases has been adopted by the Bureau in I. T. 4104, 5 CCH Fed. Tax Rep. ¶6336 (Nov. 12, 1952).

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