12 T.C. 958 (1949)

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Payments made as liquidated damages for violations of child labor laws under the Walsh-Healey Public Contracts Act are not deductible as ordinary and necessary business expenses because allowing the deduction would frustrate public policy.

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Summary

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Davenshire, Inc. sought to deduct $3,200 paid to the U.S. government as liquidated damages for violating child labor provisions of the Walsh-Healey Public Contracts Act. The Tax Court disallowed the deduction, holding that permitting such a deduction would undermine the Act's purpose of raising labor standards and preventing businesses from profiting from illegal labor practices. The court reasoned that allowing a deduction would mitigate the penalty and frustrate public policy, especially considering excess profits tax rates.

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Facts

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Davenshire, Inc., manufactured Army clothing under contracts with the U.S. Army during 1941-1943. These contracts were subject to the Walsh-Healey Public Contracts Act, which prohibited employing girls under 18. Davenshire hired several underage girls referred by the National Youth Administration (NYA), despite being informed of the age restrictions. While Davenshire used "history sheet" forms to record employee birthdates, they did not require birth certificates. The Department of Labor later notified Davenshire of child labor violations, assessing liquidated damages of $10 per day for each violation. A later investigation revealed further violations relating to the number of hours worked by girls between 16 and 18.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Davenshire's excess profits tax for the year ended November 30, 1944, disallowing the deduction of the $3,200 paid as liquidated damages. Davenshire appealed this determination to the Tax Court.

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Issue(s)

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Whether payments made by Davenshire to the United States government as liquidated damages for child labor violations under the Walsh-Healey Public Contracts Act are deductible as an ordinary and necessary business expense.

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Holding

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No, because allowing the deduction would frustrate the public policy behind the Walsh-Healey Act, which aims to raise labor standards and discourage child labor.

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Court's Reasoning

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The Tax Court relied heavily on the precedent set by *Longhorn Portland Cement Co. v. Commissioner*, which held that penalties for violating government policy are not deductible. The court dismissed the distinction that the payment was labeled "liquidated damages" rather than a "penalty," emphasizing the punitive nature of the payment, which discourages violations of government policy. Quoting from *Longhorn*, the court stated that allowing a deduction would "frustrate the purpose and the effectiveness of that public policy." The court emphasized that the Walsh-Healey Act's purpose, as stated in *Endicott Johnson Corporation v. Perkins*, is "to raise labor standards." It highlighted Congress's intent to penalize child labor violations, citing the House Report on the Walsh-Healey Act, which described the penalty as

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