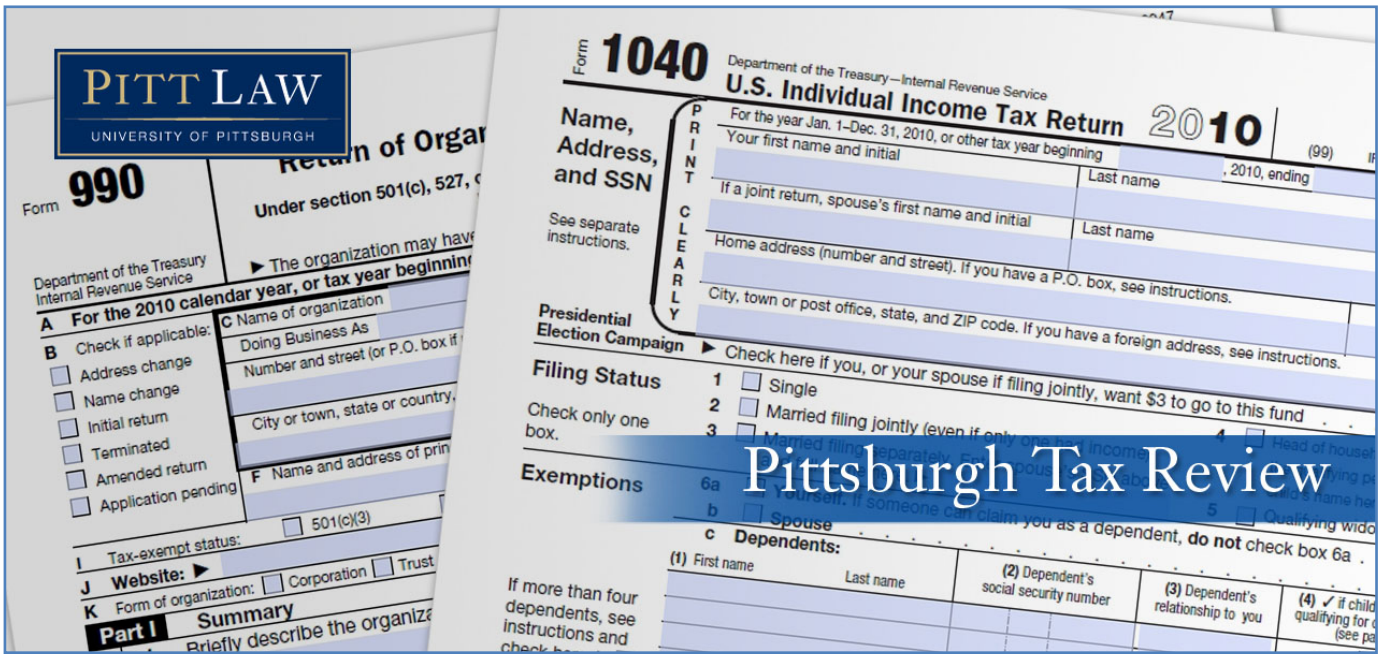

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A SIMPLE TAX CASE COMPLICATED BY RACE

Richard Winchester

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INTRODUCTION

Race and racism are inescapable facts of life in America.[1] The impacts can be found in some of the most unexpected places. Dorothy Brown eloquently made this point with her groundbreaking book *The Whiteness of Wealth*. Despite the absence of any reference to race in the pages of the Internal Revenue Code (Code), U.S. tax rules consistently enrich whites and penalize Blacks, primarily because the law is structured around the way whites live their lives and disregards the differences in the way that Blacks do so.

Brown's observation about the tax code addresses an important aspect of the U.S. income tax system: the law itself.[2] However, as with most laws passed by Congress, the executive and judicial branches play a role. In this case, the Internal Revenue Service (IRS) administers and enforces the Code, while courts resolve disputes between the government and taxpayers. There is a risk that race will affect these aspects of the tax system, too. And it does!

Scholars have already identified some racially inequitable ways that the IRS has performed its role.[3] However, virtually no scholarship addresses the

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[1] *See generally* THE 1619 PROJECT: A NEW ORIGIN STORY (Nikole Hannah-Jones et al. eds., 2021).

[2] The federal government has begun to study the magnitude of the racial imbalance in the way the tax system operates. *See* Julie-Anne Cronin et al., *Tax Expenditures by Race and Hispanic Ethnicity: An Application of the U.S. Treasury Department's Race and Hispanic Ethnicity Imputation* (U.S. Dep't of Treasury, Off. of Tax Analysis, Working Paper No. 122, 2023), https://home.treasury.gov/system/files/131/WP-122.pdf.

[3] *See, e.g.*, Hadi Elzayn et al., *Measuring and Mitigating Racial Disparities in Tax Audits* (Jan. 30, 2023) (on file with STAN. INST. FOR ECON. POL'Y RSCH.).

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potential for courts and judges to impact the tax system in racially inequitable ways.[4] This Essay hopes to address this omission by using a little-known Tax Court case to show that judges are not immune from allowing race to affect their judgments and the ramifications that follow when they do so.

The case involves the builder of a segregated Black community in New Orleans called Pontchartrain Park. The judge had to determine whether the builder was eligible to pay tax at a discounted rate on the profits derived from the sale of undeveloped land that was originally intended to be part of the subdivision. Although the operative rule made no reference to race, the judge used the racial identity of the homebuyers as a central part of his analysis. This Essay will examine the court's reasoning and its implications. First, some background.

I. BACKGROUND

Like many cities during the post-World War II years, New Orleans faced an acute housing shortage. The situation was particularly dire for Blacks, partly because the areas of the city where they lived were being demolished in the name of urban renewal.[5] The mayor at the time was a reformist by the name of deLesseps Story Morrison. Worried that the conditions confronting Blacks might lead to the kind of unrest that had already erupted in other cities, he made it a priority to address the housing shortage and other issues that were important to Black families.[6]

Morrison operated in the context of the Jim Crow South at a time when the institution of racial segregation was under attack. Housing for Blacks ordinarily would have taken the form of segregated public housing projects—and that did occur during the Morrison years. However, in order to cast a positive light on racial segregation, the city's anti-integration forces were

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[4] *Cf. Graduate Tax Program*, U.C. IRVINE L. (2023), https://www.law.uci.edu/gradtax/race-tax-resources/academic-research.html. One exception is the discussion of Sam Gilliam's case in Steven A. Dean, *Filing While Black: The Casual Racism of the Tax Law*, 2022 UTAH L. REV. 801, 802–05 (2022).

[5] ANDREW WIESE, PLACES OF THEIR OWN: AFRICAN AMERICAN SUBURBANIZATION IN THE TWENTIETH CENTURY 165 (2004).

[6] *See* ADAM FAIRCLOUGH, RACE & DEMOCRACY: THE CIVIL RIGHTS STRUGGLE IN LOUISIANA, 1915–1972, at 152 (1995).

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willing to allow for the construction of homes for Blacks that were just as nice as those available for whites.[7]

Morrison struck a deal with a Baton Rouge-based builder by the name of Hamilton Crawford to build two communities: one for Blacks (Pontchartrain Park) and one for whites (Gentilly Woods). They would be located adjacent to each other and separated by a ditch.

Both communities were financed by bank loans that were insured by the Federal Housing Administration (FHA).[8] The FHA's role was pivotal. Without such support, mass production builders like Crawford would not exist.[9] They simply lacked the capital to build an entire community, and banks were unwilling to take on the risk associated with financing such large-scale projects. However, a lender could make risk-free profits when the FHA insured the loan. Crucially, however, the agency would withhold its guarantee if the builder's plans did not include a mechanism to prevent homes from being owned or occupied by Blacks.[10] An all-white community like Gentilly Woods could use a racially restrictive covenant to meet this condition. Because Pontchartrain Park was envisioned as an all-Black community, however, the project would ordinarily fail to qualify. It was only after the mayor pressured the FHA to make an exception to its whites-only policy that the agency agreed to insure the loan to build the community.[11]

The FHA's anti-Black rules date back to its origins. Congress created the agency during the Great Depression to play a key part in the economic recovery. The idea was that government-backed mortgage insurance would

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[7] *See id.*; *see also* Kim Lacy Rogers, HUMANITY AND DESIRE: CIVIL RIGHTS LEADERS AND THE DESEGREGATION OF NEW ORLEANS, 1954–1966, at 39 (Aug. 1982) (Ph.D. thesis, University of Minnesota).

[8] *Gentilly Woods Plan Book*, New Orleans Public Library, http://archives.nolalibrary.org/~nopl/monthly/july2006/july0602.htm; *see infra* text accompanying note 11 (Pontchartrain Park).

[9] RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA 59–76 (2017).

[10] *See* FED. HOUS. ADMIN., UNDERWRITING MANUAL: UNDERWRITING AND VALUATION PROCEDURE UNDER TITLE II OF THE NATIONAL HOUSING § 934 (1938).

[11] Arnold R. Hirsch, *"The Last and Most Difficult Barrier": Segregation and Federal Housing Policy in the Eisenhower Administration, 1953–1960*, POVERTY & RACE RSCH. ACTION COUNCIL 46, 71 (2005) (citing Letter from A. Maceo Smith to Dr. George W. Snowden (Dec. 15, 1954), and Letter from deLesseps S. Morrison to Ralph Agate (Sept. 20, 1954)).

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eliminate the risk of loss to banks, leading them to be more willing to make loans so that home construction would return, and people would get back to work.[12] The FHA imposed a whites-only requirement in order to fulfill a congressional mandate to operate on an "economically sound" basis.[13] The agency's theory was that the mere presence of Blacks in an area would cause the value of property to decline, thereby exposing the agency's programs to the risk of loss.[14] The FHA did not abandon this rule until the Fair Housing Act of 1968 required it to do so. In the meantime, banks stopped lending to Blacks, and builders stopped building homes for them.[15] Pontchartrain Park was one of the rare exceptions.

II. THE TRANSACTION AND THE TAX ISSUE

Crawford and a business partner bought the land for the community in 1951.[16] By 1954, Crawford teamed up with two New Orleans philanthropists to build the community through a newly formed company called Pontchartrain Park Homes, Inc. (PPHI). Within a year, PPHI purchased the land from Crawford and his business partner, and construction began shortly thereafter, starting with the installation of improvements like streets and drainage infrastructure. Once someone purchased a home and selected an improved homesite, the company would break ground to build the home.

By early 1957, PPHI had completed installing improvements on roughly half the land, but it still had 188 unsold homesites.[17] At that point, it took a pause in installing improvements. Before resuming and completing the project, it accepted an unsolicited offer from the state to buy seventeen acres of undeveloped land to build a satellite campus of Southern University, the Black counterpart to all-white Louisiana State University. PPHI earned a

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[12] FED. HOUS. ADMIN., THE FHA STORY IN SUMMARY 1934–1959, at 5 (1959).

[13] *See* National Housing Act, Pub. L. No. 73-479, §§ 203(c)–(d), 48 Stat. 1246, 1249 (1934).

[14] DAVID M.P. FREUND, THE NEW SUBURBAN HISTORY 22 (Kevin M. Kruse & Thomas J. Sugrue eds., 2006).

[15] Richard Winchester, *Homeownership While Black: A Pathway to Plunder, Compliments of Uncle Sam*, 110 KY. L.J. 613, 615(2022).

[16] *See* Pontchartrain Park Homes, Inc. v. Comm'r, T.C. Memo. 1963-92, *aff'd on other grounds*, 349 F.2d 416 (5th Cir. 1965).

[17] *Pontchartrain*, T.C. Memo 1963-92 at 17–18.

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profit of $154,019 on the sale and claimed it was subject to tax at the discounted rates that apply to capital gains.[18] The government disagreed and asserted that the profit was subject to tax at the regular rates that apply to ordinary business profits, which translated into an additional $41,585 in tax.

III. THE TAX COURT DECISION

Under longstanding tax law, a taxpayer's gain on the sale of property will not count as a capital gain if the taxpayer holds the property primarily for sale to its customers in the ordinary course of its business.[19] When deciding cases involving taxpayers who are in the real estate business, courts generally do *not* treat land as a capital asset and will only do so in exceptional cases.[20] However, Tax Court Judge Graydon Withey cited five such cases to draw just the opposite conclusion, incorrectly observing that raw land is generally a capital asset in the hands of a real estate developer.[21]

Aside from that, Withey had little regard for any insights that the cases might offer because, in his view, PPHI's customer base of Black buyers made it unique.[22] In his words, he thought it was relevant that PPHI was formed to serve "a market, the potentialities of which were a virtually unknown and untested factor in its experience or that of its incorporators," especially for homes offered at the prices that PPHI was charging.[23] For this reason, he did not believe it would be correct to consider PPHI's intentions with regard to the land "in the same light as that of a dealer in real estate market [sic] and its influential factors are tested and known."[24] In Withey's eyes, PPHI's business was limited to selling land that was "improved to the point where it had been subdivided into lots which were prepared for the erection of houses or to the point where dwellings had actually been erected thereon."

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[18] *Id.* at 19.

[19] I.R.C. § 1221(a)(1).

[20] *See* Morrison v. United States, 449 F. Supp. 663, 667 (N.D. Ohio 1978) (citing cases).

[21] *Pontchartrain*, T.C. Memo 1963-92 at 22–23.

[22] *Id.* at 18, 23–24.

[23] *Id.* at 23.

[24] *Id.* at 24.

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Accordingly, Withey concluded that any raw land (like the acreage it sold to the state) was a mere investment at the time the company acquired it, which made it a capital asset to PPHI from day one.[25]

The only problem is that the facts did not support Withey's premise about the company's business. Withey, himself, cited the company's own charter, which described its business in a manner that resembles that of any other real estate developer: "to buy, own, improve, rent, lease and sell home sites, building sites, houses, garages, and other types of buildings for itself or on behalf of others."[26] Aside from that, Withey noted that the company had always classified its undeveloped land as "inventory" in its books.[27] These considerations mattered little to Withey, who ruled in PPHI's favor all the same.[28]

The IRS appealed the decision, viewing the opinion as "replete with errors, inconsistencies and obscurities."[29] A three-judge panel of the U.S. Court of Appeals for the Fifth Circuit was more restrained but no less emphatic. In a brief *per curiam* opinion, the panel rejected Withey's theory that the raw land was not primarily held for sale to customers immediately after the company acquired it.[30] Because Withey's theory was premised on the racial identity of the company's customers, the Fifth Circuit's reasoning rejected the suggestion that race should have played a role in the court's analysis. The panel indirectly said as much by noting that it declined an invitation by the company to voice its approval of "any broad standards perhaps suggested in the Tax Court's opinion," which would have articulated additional factors believed to have some "unique significance."[31]

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[25] Withey also thought it would have been improper to treat the profits as business profits because the state of Louisiana did not fit the description of a customer to PPHI. *Id.* at 25–26. The statute does not impose such a requirement. It only requires that the land be held for sale to customers, not that the actual buyer be one. *Id.* at 26.

[26] *Id.* at 6.

[27] *Id.* at 18–19.

[28] *Id.*

[29] I.R.S. Action on Decision (Revised), CC-1966-432 (Aug. 26, 1966).

[30] *See* Comm'r v. Pontchartrain Park Homes, Inc., 349 F.2d 416 (5th Cir. 1965) (*per curiam*), *aff'g on other grounds*, T.C. Memo 1963-92.

[31] *Id.*

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Although the panel rejected Withey's reasoning, it still concluded that PPHI could treat the profits as capital gains, but for different reasons.[32] In the panel's view, the company's purpose had been "so altered" since the time it acquired the land that the parcel was no longer held primarily for sale to customers.[33] So, contrary to what Withey asserted, the land was not a capital asset starting from day one; it became a capital asset many years later once PPHI temporarily changed its purpose for holding the land.

IV. An Assessment

The Tax Court opinion is noteworthy partly because race played such a central role in a case that did not have any of the classic markers of race. None of the parties were Black, and the dispute itself did not involve a subject that had an explicitly racial dimension, like a racially restrictive covenant. Even the law itself offered no room for a court to interject racial considerations. This suggests that racial considerations could play a role in a wider range of cases than one might ordinarily expect.

In this case, Withey invoked an assumption about Blacks that prevented him from faithfully reading and applying the controlling body of cases. He cited two recently decided cases that he claimed stood for the proposition that undeveloped land is ordinarily a capital asset to a builder.[34] Yet the cases do no such thing. In fact, both involved sales of land that occurred under circumstances that were not unlike those surrounding PPHI's sale. In one instance, a builder sold undeveloped land in liquidation.[35] In the other, a builder sold land to its wholly owned corporation.[36] Neither taxpayer was allowed to treat the land as a capital asset. One would expect that those decisions would make a judge inclined to treat PPHI's case the same way. Yet, the race of PPHI's customer base complicated this seemingly simple case for Withey.

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[32] *Id.*

[33] *Id.*

[34] Pontchartrain Park Homes, Inc. v. Comm'r, T.C. Memo. 1963-92 at 23.

[35] Lawrie v. Comm'r, 36 T.C. 1117, 1121 (1961).

[36] Engasser v. Comm'r, 28 T.C. 1173, 1177 (1957).

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Withey's inexperience in the tax field may partly explain the quality of his opinion. Instead of attending law school, he studied law under his father, who was a Michigan state circuit judge.[37] He later received a political appointment as a deputy state attorney general after serving as a county prosecutor.[38] Although this record suggests no meaningful experience or expertise in federal tax law, the U.S. Senate confirmed his nomination to the Tax Court by President Dwight D. Eisenhower.[39] PPHI's dispute with the government was Withey's second occasion to resolve a capital gains dispute on his own.[40]

Still, Withey's assumptions about Blacks as homebuyers play too prominent a role to dismiss his opinion as a product of mere inexperience. His assumptions are consistent with a general tendency for Americans to associate homeownership with whiteness.[41] However, his negative opinions are distinct from other types of anti-Black bias that have been identified elsewhere. The FHA's rule against offering mortgage insurance to Black buyers was based on assumptions about the impact that Blacks had on the value of surrounding property.[42] That assumption remains a powerful force to this day, with homes located in racially integrated areas receiving substantially lower bank appraisals than the ones for comparable homes in all-white areas.[43] That bias is distinct from negative attitudes that individuals may espouse about simply having Blacks as neighbors.[44] It is also distinct

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[37] *Local Native to Be State Aide*, OSCEOLA CNTY. HERALD (Dec. 9, 1948), https://digmichnews.cmich.edu/?a=cl&cl=CL1&sp=OsceolaOCH.

[38] *Id.*

[39] 106 CONG. REC. 9853 (1960).

[40] *See* Broughton v. Comm'r, T.C. Memo. 1962-275.

[41] Leigh Osofsky & Kathleen DeLaney Thomas, *Implicit Legislative Bias: The Case of the Mortgage Interest Deduction*, 56 U.C. DAVIS L. REV. 641, 664–68 (2022).

[42] Terry Gross, *A "Forgotten History" of How the U.S. Government Segregated America*, NPR (May 3, 2017, 12:47 PM), https://www.npr.org/2017/05/03/526655831/a-forgotten-history-of-how-the-u-s-government-segregated-america.

[43] JUNIA HOWELL & ELIZABETH KORVER-GLENN, APPRAISED: THE PERSISTENT EVALUATION OF WHITE NEIGHBORHOODS AS MORE VALUABLE THAN COMMUNITIES OF COLOR 2 (2022), https://doi.org/10.31235/osf.io/6r5zs.

[44] Courtney M. Bonam et al., *Polluting Black Space*, 145 J. EXPERIMENTAL PSYCH. 1561, 1562 (2016).

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from the assumptions that people make about areas where Blacks live, believing them to be physically degraded, unpleasant, unsafe, and lacking resources.[45] Research also shows that homebuyers discount the value of a home if they know that Blacks comprise the largest racial group in the area.[46] Withey's assumption about Blacks as homebuyers is a variation of this general theme. By invoking it, he underscores just how ubiquitous and multi-faceted anti-Black bias is.

Withey decided the case at a time when it might not have raised eyebrows to make an explicit reference to a racial stereotype. One would hope that a judge would not do so today. Still, a judge could allow an implicit bias to affect their decision. That is because judges, like all humans, are irrational beings who exhibit biases that cause them to act in predictable ways.[47] These cognitive biases include implicit racial bias.[48] All forms of bias, including implicit racial bias, are produced by the same observable psychological mechanism; there are specific parts of the brain that cause people to use shortcuts when necessary to make quick decisions.[49] Those same parts of the brain also operate when individuals categorize or stereotype people based on race, gender, or other characteristics.[50] Therefore, there is a direct connection between implicit racial bias and other cognitive biases that interfere with rational decision-making.

Research on implicit racial bias has produced three important overarching insights. First, most people display unconscious preferences, attitudes, and stereotypes.[51] Second, these unconscious attitudes often are inconsistent with someone's expressed attitudes.[52] Third, these unconscious

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[45] *Id.* at 1566. Incidentally, this bias is not affected by the race of the participant.

[46] *Id.* at 1571. The discount is estimated to be $20,000.

[47] *See, e.g.*, Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1484–85 (1998).

[48] Christine Jolls & Cass R. Sunstein, *The Law of Implicit Bias*, 94 CALIF. L. REV. 969, 973 (2006).

[49] *Id.* at 974.

[50] *Id.* at 975.

[51] Kristin A. Lane et al., *Implicit Social Cognition and Law*, 3 ANN. REV. L. SOC. SCI. 427, 429 (2007).

[52] *Id.*

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attitudes can predict how people behave in certain situations.[53] This last point is key because it means that the unconscious associations we make not only determine our attitudes but also impact the decisions we make.[54] The decisions by legal actors are not immune from being tainted by implicit racial bias.[55] Withey's opinion in PPHI's case shows that judges hearing tax disputes are no exception.

The Fifth Circuit panel that considered the government's appeal may have been particularly sensitive to Withey's improper use of racial assumptions. Two of the judges would later be referred to as members of the "Fifth Circuit Four" for the role they played in transforming the principles articulated in *Brown v. Board of Education* into a broad mandate for racial justice beyond education.[56] However, their repudiation of Withey's race-based rationale did not prevent it from having an afterlife. Writing in 1982, the Tax Court cited Withey's decision while accepting uncritically his determination that the raw land was initially held as an investment.[57] That determination, and the anti-Black bias that supports it, cannot be reconciled with the Fifth Circuit's view that the land only became a capital asset many years later. Even the IRS has attempted to validate Withey's rationale. In a brief it filed as recently as 2018, the agency asserted that the raw land sold by PPHI was a capital asset because the company was in the business of selling improved lots, as opposed to raw land.[58] That is a true statement about the Tax Court opinion. However, it completely disregards the Fifth Circuit's decision, which rejected that rationale and its underlying racist premise. Thus, Withey's rationale in PPHI's case has retained some persuasive power, despite the Fifth Circuit's admonition.

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[53] *See id.*

[54] For a review of studies examining the strength of the link between someone's implicit associations and their behavior, see Anthony G. Greenwald et al., *Understanding and Using the Implicit Association Test: III. Meta-Analysis of Predictive Validity*, 97 J. PERSONALITY & SOC. PSYCH. 17, 28 (2009).

[55] *See, e.g.*, Isabel Bilotta et al., *How Subtle Bias Infects the Law*, 15 ANN. REV. L. & SOC. SCI. 227, 228 (2019).

[56] Jack Bass, *The "Fifth Circuit Four,"* THE NATION (Apr. 15, 2004), https://www.thenation.com/article/archive/fifth-circuit-four/. The two judges were Richard Rives and John Brown.

[57] Daugherty v. Comm'r, 78 T.C. 623, 634–35 (1982).

[58] *See* Brief for Appellee at 35, Conner v. Comm'r, 770 F. Appx. 1016 (2019), *aff'g*, T.C. Memo. 2018-6.

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If this can happen when a judge has openly expressed an anti-Black bias, then it can also happen when an implicit bias has interfered with a judge's thinking. This underscores something very crucial. Judges, including ones deciding tax cases, must be aware of and sensitive to any implicit racial bias that might cloud their thinking. Otherwise, we should expect that this will not be the only simple tax case complicated by race.

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