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## Interpreting Tax Legislation: The Role of Purpose

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*Deborah A. Geier\**

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This paper was delivered in abbreviated form at the January 1995 meeting of the American Association of Law Schools, Tax Section. I want to thank Professor Daniel Halperin for asking me to participate and my panel colleagues for their insightful comments: Professor Bill Popkin, Tax Court Judge Jim Halpern, and Les Samuels, Assistant Treasury Secretary for Tax Policy. I also thank Larry Lokken for his substantial comments on a draft of the manuscript.

It has been my great luck that my visit with the University of Florida College of Law has coincided with a visit by Robert S. Summers, McRoberts Research Professor of Law at Cornell University. I have had illuminating talks with Bob Summers regarding statutory interpretation and am indebted to him for them. Because my mentor in law school (Erik M. Jensen of Case Western Reserve Law School) was a protege of Bob's, Bob and his wife Dorothy have referred to me as his "intellectual grandchild," a status I am honored to have.

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## I. INTRODUCTION

“Sex Illegal in Missouri? Perhaps.” (I knew that would get your attention.) That was the headline of an article in the *Cleveland Plain Dealer* in November 1994.<sup>1</sup> The article described a Missouri statute enacted the preceding August that, if read literally, outlaws all sex in Missouri. One of the legislators is quoted in the article as saying that “[n]o one is going to be prosecuted for having normal sex,”<sup>2</sup> a statement I don’t dare touch.

The connection that this newspaper article has with the topic I discuss here is that tax law has a rich history of nonliteral interpretation in order to avoid results that one person or another has considered to be inconsistent with the purpose of the statute as a whole. This tradition is illustrated by the common law doctrines variously named substance over form, sham transaction, step transaction, business purpose, and assignment of income. In other instances, however, we have an extremely form-conscious approach, such as the approach to bootstrap acquisitions in the *Zenz v. Quinlivan*<sup>3</sup> context. How do we make sense of it all?

Interest in statutory interpretation has been renewed over the last decade, probably prompted—at least in part—by the confluence of two events that have nothing to do with tax law: the elevation to the Supreme Court of Antonin Scalia (whose literal textualist approach to statutory language is now embedded in the Court’s opinions) and the attention paid to literature theorists, the so-called deconstructionists, who seized upon the notion that language is indeterminate. All of a sudden language and its interpretation were once again center stage after a long hiatus during which the theory behind the language dominated academic discourse.

Although a voluminous literature on approaches to statutory interpretation has been published during the last ten years,<sup>4</sup> the authors of these

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1. Joe Lambe, *Sex Illegal in Missouri? Perhaps*, *Cleve. Plain Dealer*, Nov. 25, 1994, at 26A.

2. *Id.*

3. 213 F.2d 914 (6th Cir. 1954). The tax treatment of a bootstrap acquisition, in which money from the corporation being acquired partially finances the acquisition, depends on the transaction form chosen by the parties. Assume that Seller, an individual, owns all the shares of X Corp.; Buyer wishes to acquire X Corp. but has only 50% of the purchase price. If Seller causes X Corp. to distribute 50% of its fair market value as a dividend and then sells the shares to Buyer, Seller has ordinary dividend income on the distribution to the extent of earnings and profits and capital gain or loss on the stock sale. On the other hand, if Seller causes X Corp. to redeem one half of his shares and sells the remaining one half to Buyer, the redemption distribution is treated as a disposition of the stock, entitling Seller to recovery of basis and capital gain.

4. For a fairly lengthy listing of such articles, see Deborah A. Geier, *Commentary: Textualism and Tax Cases*, 66 *Temp. L. Rev.* 445, 448 n.8 & 456 n.42 (1993).

pieces, with the notable exception of Bill Popkin and a few others, did not come from the realm of tax.<sup>5</sup> I think that is unfortunate because tax lawyers have never stopped dealing with and teaching and thinking about statutory interpretation. I believe tax law is a particularly fruitful field in which to examine these issues for several reasons: its sheer volume and length, its complexity, its use for nontax policy purposes, and perhaps most of all, its internal structure, which is not explicit in the statutory language but is implicit in a tax on income with a realization requirement, a characterization regime, and other structural components.

I can say with assurance that nothing you shall read here will be startling or new to you, but sometimes sewing together the familiar bits and pieces of fabric into a larger quilt can help the viewer see the bits and pieces in a new light as part of a larger, more cohesive whole. I want in a short space to provide a broad road map of my views regarding how one should approach the task of interpreting the Code and how purpose informs this task. The article starts with a brief exploration of the uncertainties surrounding the essential terms of the debate. Within the context of these uncertainties, it then explores several roles that purpose plays in different statutory situations. It concludes with some thoughts about the institutional issues at stake in the debate and a caution about reliance in statutory interpretation on what Professor Robert Summers calls a statute's "ultimate purpose."

## II. WHAT IS STATUTORY PURPOSE?

What do we mean by statutory purpose and how is that purpose identified? Some reduce the issue to a tension between approaching a statute's terms literally on the one hand and, on the other, deviating from a textualist approach in order to effectuate the statute's underlying purpose in the view of a particular interpreter's notions of what that purpose is. One reason for this stark dichotomy is the ascendancy within the realm of political economy of public choice theory, which denies that any single purpose, or

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5. Pieces on statutory interpretation written by tax scholars include Paul L. Caron, *Tax Myopia, or Mamas Don't Let Your Babies Grow Up to be Tax Lawyers*, 13 *Va. Tax Rev.* 517, 531-54 (1994); Michael Livingston, *Congress, the Courts, and the Code: Legislative History and the Interpretation of Tax Statutes*, 69 *Tex. L. Rev.* 819 (1991); William D. Popkin, *Law-Making Responsibility and Statutory Interpretation*, 68 *Ind. L.J.* 865 (1993); William D. Popkin, *An "Internal" Critique of Justice Scalia's Theory of Statutory Interpretation*, 76 *Minn. L. Rev.* 1133 (1992); William D. Popkin, *Judicial Use of Presidential Legislative History: A Critique*, 66 *Ind. L.J.* 699 (1991); William D. Popkin, *The Collaborative Model of Statutory Interpretation*, 61 *S. Cal. L. Rev.* 543 (1988) [hereinafter *Collaborative Model*]; Lawrence Zelenak, *Thinking About Nonliteral Interpretations of the Internal Revenue Code*, 64 *N.C. L. Rev.* 623 (1986).

any combination of public-spirited purposes, prompts particular legislation.<sup>6</sup> It is a cynical theory that examines the adoption of legislation from the economic point of view of gains and losses won by politicians for proposing, supporting, or opposing legislation. When the debate is stated in these terms, literal textualists such as Justice Scalia say that “the ordinary meaning of [the statutory] language accurately expresses the legislative purpose.”<sup>7</sup> Because the statute’s words embody political compromises, bought and paid for, they ought to be strictly construed in order to give effect to those compromises. Others, not so cynical, continue to look to other tools to glean a purpose by which to interpret the language.

Overarching these discussions, as thus defined, are issues surrounding the origin (and validity) of law, concerns that cannot be ignored. Law, according to textualists such as Justice Scalia, can be only the literal language adopted by Congress and signed by the President; consultation of other tools is illegitimate judicial lawmaking. I’ll return to this notion in due course.<sup>8</sup>

In the tax world, most see the tension between textualism and purposivism as arising when a taxpayer wants a textualist approach and the IRS wants to deviate from the textual, form-conscious approach in favor of a purposive approach. This perception is exemplified by the hoary substance-over-form doctrine (with its variants, the step transaction and business purpose doctrines), under which the IRS challenges the taxation of a transaction according to its form in favor of taxation according to the transaction’s underlying substance.

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6. See generally William N. Eskridge, Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 Va. L. Rev. 275 (1988); Edward L. Rubin, *Beyond Public Choice: Comprehensive Rationality in the Writing and Reading of Statutes*, 66 N.Y.U. L. Rev. 1 (1991).

7. *Cipollone v. Liggett Group, Inc.*, 112 S. Ct. 2608, 2633 (1992) (Scalia, J., concurring in the judgment in part and dissenting in part) (quoting *Morales v. Trans World Airlines, Inc.*, 112 S. Ct. 2031, 2036 (1992) (emphasis omitted)).

8. The influence of Justice Scalia’s particular brand of literal textualism seems to be waning; witness his dissent, joined only by Justice Thomas, in *United States v. X-Citement Video*, 115 S. Ct. 464, 473 (1994) (Scalia, J., dissenting). It has long been accepted in the common law that the absence of a scienter requirement in the criminal law should not be lightly imputed and that a statute should be interpreted, where possible, to avoid constitutional issues regarding its validity. Justice Scalia downplayed these doctrines in *X-Citement Video*, refusing to interpret a statute that prohibited “knowingly” transporting, shipping, receiving, distributing, or reproducing a visual depiction involving “the use of a minor engaging in sexually explicit conduct” as requiring a showing that the defendant knew the performer was a minor. His view was roundly rejected by the majority.

The less drastic plain-meaning approach to statutory interpretation that predates Scalia is still with us, however. See *infra* notes 16-21 and accompanying text (discussing Justice Brennan’s plain-meaning approach in *Dubenstein*). There is yet much else to pursue here.

A more recent and controversial example of this common take on the debate is the acrimony surrounding the recent issuance of the partnership antiabuse regulation.<sup>9</sup> In its final form, the regulation provides in part that “even though the transaction may fall within the literal words of a particular statutory or regulatory provision,” a partnership can be disregarded if it “is formed or availed of in connection with a transaction a principal purpose of which is to reduce substantially the present value of the partners’ aggregate federal tax liability in a manner that is inconsistent with the intent of subchapter K.”<sup>10</sup> Another part of the regulation provides that “[t]he Commissioner can treat a partnership as an aggregate of its partners in whole or in part as appropriate to carry out the purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder.”<sup>11</sup> I return to this regulation later.

I believe, however, that characterizing the debate merely as a tension between a (presumably pro-taxpayer) textualist approach and a (presumably pro-IRS) purposive approach is a simplistic reduction of the nuances that flavor the role of purpose in tax interpretation. It would seem that literal interpretations conflicting with statutory purpose would benefit the government, on average, about as often as they benefit taxpayers. Beyond that, purpose is, in my opinion, a vague umbrella term for several distinct notions that we need to tease out if we are to think more precisely about the appropriate role of what we call purpose in interpreting the tax Code. I seek to do that here using cases that most tax lawyers are familiar with to illustrate my points. (For the benefit of nontax lawyers among the readers, I describe the cases in some detail.)

I provide examples that I think demonstrate most persuasively that, at least in tax and I think in all statutes, there is no one-size-fits-all approach to all statutory language in every case. A true respect for purpose may in fact require a textualist approach in some cases, a notion foreign to most debates on the topic, which presume that a textualist approach is antithetical to a purposive approach. A true respect for purpose may demand a nonliteral approach in other cases. A broad understanding of purpose should inform a third class of cases that don’t involve a choice between a literal or nonliteral reading of particular words. This third class of cases, where language can be informed by purpose to reach results not inconsistent with the statutory text, is often ignored in the literature, which focuses most heavily on instances where language must either be construed literally or abandoned. A fourth class of cases deals with, in essence, the *absence* of statutory language—cases

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9. See *infra* note 60 and accompanying text (citing sources discussing the controversy).

10. Regs. § 1.701-2(b).

11. Regs. § 1.701-2(e)(1).

in which there is no dispute regarding the language of the Code and in which the transaction at issue literally fits within the language, but the transaction may yet not fit within the purpose of the provision. These cases often implicate common law rules in tax, such as the substance-over-form doctrine. Finally, considering instances of either an evolving purpose or an apparent absence of purpose provides us with a fuller understanding of the role of purpose in interpreting legislation in general and tax legislation in particular.

#### A. *Structure as Purpose*

First—and very fundamental—point: One component of statutory purpose in the income tax is the fundamental structure underlying the income tax. By “structure,” I mean the theoretical construct that overarches the sum total of the entire Internal Revenue Code and is intended to be captured by it. It includes such ideas as the same dollars should not be taxed to the same person more than once or deducted by the same person more than once. It includes the notion that what we are trying to reach under an income tax is, essentially, consumption and net increases in wealth. It also encompasses such constraints as the distinction between ordinary income and capital gain and the realization requirement. This component of purpose is perhaps unique to the income tax, as I sought to demonstrate in an earlier article.<sup>12</sup> Pure social policy legislation (including those components of the income tax that are not fundamental to structure, discussed below in Part B) may be more legitimately subject to the critique of the public choice theorists. But the fundamental structure of the income tax (though it surely is premised on prior social choices regarding the best way to finance government) is a larger constraint, a larger purpose, that must inform interpretation of those provisions that implicate it.

Code provisions ought to be construed so as not to damage this fundamental structure, even if doing so requires that a statutory term be construed in a nonliteral (nontextual) fashion. Recall *Helvering v. Owens*,<sup>13</sup> where the taxpayer’s personal-use automobile was damaged in a fender-bender, reducing its value from \$225 to \$190. The IRS sought to limit the taxpayer’s deduction for the casualty to the \$35 loss in value attributable to the casualty. The taxpayer pointed to what is now section 165(b), which provides that the amount of the loss deduction is calculated using “the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property,” and argued that a literal reading of that

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12. Geier, *supra* note 4.

13. 305 U.S. 468 (1939).



provision permitted deduction of his original cost basis of \$1,825, less the \$190 value of the car after the collision.

The Supreme Court agreed with the IRS, a result now found in the regulations.<sup>14</sup> That result is correct *if* it is permissible to look to the fundamental structure of the Code in determining the outcome. The diminution of the car's value *before* the collision was nondeductible personal consumption that could not be deducted without fundamental damage to the structure of the income tax. One way to read *Owens* is that the Court, in effect, though not expressly, held that the adjusted basis of the car had to be reduced by the nondeductible personal-consumption loss for purposes of computing the deduction for a personal casualty loss, even though such a reduction to basis is *not* listed in section 1016 and thus not reflected in the section 1011 basis referenced in section 165(b).<sup>15</sup>

Commissioner v. Duberstein<sup>16</sup> is an example of a situation in which structure, and thus purpose, was ignored in favor of a plain-meaning approach to statutory language, even though the Court would not have had to ignore a statutory directive, as it did in *Owens*, to protect the statutory structure. *Duberstein* is an example of that class of cases rarely discussed in the literature in which a sensitivity to purpose (in the sense of structure) could have allowed the court to reach an informed result that would not have been inconsistent with the statutory language—a result that even a textualist could love.

*Duberstein* involved a Cadillac that Berman, a businessman, had given Duberstein, a fellow businessman who had steered some business his way. At first Duberstein refused the car, but eventually he accepted it.

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14. Regs. § 1.165-7(b)(1).

15. The basis of personal-use property is not expressly reduced to reflect personal consumption. When such property is sold for less than original cost, the failure to reduce basis for personal-consumption losses does no damage since the artificial loss cannot be deducted. On a sale of a consumer asset that has retained its value or appreciated (e.g., a personal residence or jewelry), the gain is understated because of the failure to reduce basis to reflect personal consumption. See generally Richard A. Epstein, *The Consumption and Loss of Personal Property Under the Internal Revenue Code*, 23 *Stan. L. Rev.* 454 (1971) (noting that the basis of personal-use property should, theoretically, be reduced by personal-consumption loss in value).

There is another way to read *Owens*. Section 165(c)(3) allows a loss on personal-use property to be deducted only if it "arise[s]" from casualty or theft. If § 165(b) and (c)(3) are read as an integrated structure, the only plausible reading of the section as a whole is that the deduction equals the lesser of adjusted basis or the loss resulting from the casualty. In contrast, if business or investment property is totally destroyed by casualty, the deduction should equal the adjusted basis, even if the adjusted basis is higher than the value lost in the casualty, because the decline in value before the casualty would eventually have been deductible absent the casualty, either through depreciation or on a sale or exchange. And Regs. § 1.165-7(b)(1)(ii) so provides.

16. 363 U.S. 278 (1960).

Berman deducted the cost of the Cadillac as a business expense, and Duberstein argued that he could exclude the car as a gift under section 102(a), which provides that “gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.” The Service asked the Court to rule as a matter of law that transfers in a business context could never be excludable gifts. Justice Brennan, writing for the Court, declined, adopting instead the test tax professors all know and love, which looks to the plain meaning of the term “gift” by examining whether the donor made the transfer out of generosity. The Court held that whether a transfer is a gift within the meaning of section 102(a) is a question of fact to be determined upon application of the fact-finder’s “experience with the mainsprings of human conduct to the totality of the facts of each case.”<sup>17</sup> “What controls is the *intention* with which payment, however voluntary, has been made.”<sup>18</sup> A gift proceeds from a “‘detached and disinterested generosity’ . . . ‘out of affection, respect, admiration, charity or like impulses,’ ”<sup>19</sup> rather than from “‘the constraining force of any moral or legal duty’ . . . or from ‘the incentive of anticipated benefit.’ ”<sup>20</sup>

If the Court had chosen to do so, it could have easily crafted an opinion adopting the IRS’s position. A textualist interpreter could have reasoned that the lumping together of “gift, bequest, devise, or inheritance” in section 102(a) implies that the exclusion should be limited to transfers in personal contexts—that the purpose of the statute is to limit the exclusion to transfers in the personal sphere. This interpretation could have been buttressed by appealing to a different sort of purpose premised on structure: A business gift, which is deducted as a business expense, should not be excludable by the recipient because the deduction-exclusion combination would allow business profits to escape even a single layer of taxation. A one-tax-cycle-per-gift rule is implicit in the structure of gift treatment under the Code because personal gifts, which are not deductible by the donor, must come from after-tax income.<sup>21</sup> I return to *Duberstein* and the ramifications of the Court’s interpretive choice in Part III.

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17. *Id.* at 289.

18. *Id.* at 286 (quoting *Bogardus v. Commissioner*, 302 U.S. 34, 43 (1937) (dissenting opinion)).

19. *Id.* at 285 (quoting *Commissioner v. LoBue*, 351 U.S. 243, 246 (1956) and *Robertson v. United States*, 343 U.S. 711, 714 (1952)).

20. *Id.* (quoting *Bogardus v. Commissioner*, 302 U.S. 34, 41 (1937)).

21. IRC § 262(a). While gifts can be deducted if made to a charity, the § 170 deduction, one can argue, is premised on nontax grounds and is therefore outside the fundamental structure of an income tax. But see William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 *Harv. L. Rev.* 309, 314-15 (1972) (arguing that charitable contributions should not be considered personal consumption).

A more controversial example of a court ignoring fundamental structure is the Tax Court's first decision in *Brown Group*,<sup>22</sup> withdrawn in September 1994. Under subpart F,<sup>23</sup> an anti-tax haven regime, certain kinds of income of a controlled foreign corporation (CFC) are taxed to U.S. shareholders of the CFC, even if no dividends are distributed. In *Brown Group*, the court held that income earned by a foreign partnership controlled by a CFC was not subpart F income of the partnership (and thus could not be subpart F income of the CFC), even though the CFC's distributive share of the partnership's income would clearly have been subpart F income if earned directly by the CFC. The court refused to characterize the partnership's income at the partner (CFC) level. The CFC's distributive share of partnership income was thus not currently included in the income of the CFC's U.S. shareholder. David Shakow criticized the decision as contrary to the structural constraints of the partnership rules (subchapter K),<sup>24</sup> and Michael McIntyre criticized it as contrary to the structural constraints of subpart F.<sup>25</sup> The brouhaha caused the Tax Court to withdraw its decision, and its revised opinion came down the other way: The interposition of the partnership between the subpart F income and the CFC was ignored, with the result that the CFC was treated as receiving the subpart F income directly.<sup>26</sup>

Most common law doctrines in tax can be described and justified under the structure rationale. For example, by providing higher marginal rates for persons with greater income, Congress implied that it should not be possible to shift income artificially from higher-income to lower-income individuals or entities. This structural attribute spawned the assignment of income doctrine.<sup>27</sup> By providing one set of rules for dividends and another for corporate reorganizations, Congress implied in the statutory structure that there is a substantive difference between these two types of transactions and

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22. *Brown Group, Inc. v. Commissioner*, 102 T.C. 616 (1994) (withdrawn, reconsideration granted).

23. IRC §§ 951-964.

24. David J. Shakow, *How Now Brown K*, 63 Tax Notes 1761 (June 27, 1994).

25. Michael McIntyre, *Tax Court's Brown Group Decision Threatens Subpart F*, 65 Tax Notes 371 (Oct. 17, 1994).

26. *Brown Group, Inc. v. Commissioner*, 104 T.C. No. 5 (1995). This result is consistent with the provision in the partnership antiabuse regulation that requires a partnership to be viewed as an aggregate of its partners whenever necessary to carry out the purpose of any Code or regulation provision. See *supra* notes 10-11 and accompanying text. The final regulations, where this provision was added, were developed after the first decision in *Brown Group* was announced and withdrawn. The provision may have been added to address situations like *Brown Group*.

27. See, e.g., *Helvering v. Horst*, 311 U.S. 112 (1940); *Helvering v. Clifford*, 309 U.S. 331 (1940); *Blair v. Commissioner*, 300 U.S. 5 (1937); *Poe v. Seaborn*, 282 U.S. 101 (1930); *Lucas v. Earl*, 281 U.S. 111 (1930).

that a transaction that is in substance a dividend should be taxed as such, even if it is cloaked in the form of a reorganization. In the famous case of *Gregory v. Helvering*,<sup>28</sup> for example, the Supreme Court disallowed treatment of a transaction as a tax-free corporate reorganization because of a lack of a "business purpose" for the structuring of the transaction, even though the reorganization provisions did not explicitly require that a reorganization have a business purpose. The distribution of assets to Mrs. Gregory in the course of the purported reorganization was therefore treated as a dividend. In other words, although there was no statutory language denying Mrs. Gregory reorganization treatment, that treatment was, under the circumstances, inconsistent with the purpose of the reorganization provisions and with the statutory structure that differentiates between dividends and reorganizations. The lack of a business purpose was latched upon, but the *statute's* purpose, in the form of statutory structure, might have been the better measure, for it is easy to come up with a business purpose when it is convenient to do so.<sup>29</sup>

Another example of a court invoking a common law doctrine to protect statutory structure is *Goldstein v. Commissioner*,<sup>30</sup> where Mrs. Goldstein, who had recently won the Irish Lottery, borrowed at 4% interest to buy government bonds paying 2.5% interest. She prepaid interest on the loan in the same year in which she received the lottery winnings and sought to deduct the prepaid interest against the winnings. The market did not indicate a likelihood that the bonds would increase sufficiently in value to make a profit on the investment, but the tax savings, if allowed, made the uneconomical investment worthwhile. Even though the statute said only that interest was deductible, the court denied the interest deduction because of the taxpayer's lack of profit motive for the debt-financed investment. The lack of profit motive, not required by statute at the time,<sup>31</sup> was simply a common law doctrine that the court invoked in order to protect the statute's larger structure. The purpose of business and investment deductions is to reduce gross income from the business or investment to a net profit (in order to tax income, not gross receipts). If a taxpayer enters into a transaction without a profit motive (i.e., for personal reasons), the deduction would be a personal-

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28. 293 U.S. 465 (1935).

29. See, e.g., Alan Gunn, *Were Reports of Brown Group's Impending Death Greatly Exaggerated?* Letter to the Editor, 65 Tax Notes 640 (Oct. 31, 1994) (noting that the Tax Court found facts that might have satisfied the requirement that the partnership was formed for a "business purpose").

30. 364 F.2d 734 (2d Cir. 1966).

31. Section 183 (prohibiting deduction of net losses arising from activities not engaged in for profit) was not enacted until 1969, and § 183 was not made applicable to the interest deduction until 1986.

consumption deduction unnecessary in ensuring a tax on income instead of gross receipts.

In sum, the structure underlying the Internal Revenue Code and created by the sum of its sections provides a powerful tool in statutory interpretation of tax legislation. And that statutory structure could come within the umbrella of statutory purpose.

### B. *Nontax Code Provisions*

The Code includes many provisions intended to induce changes in behavior, or effect wealth transfers, for nontax reasons based on economic or social policy. There are times when courts are asked to deviate from the plain meaning of the Code, by either the taxpayer or the IRS, because the requesting party thinks the literal interpretation is bad policy, even though not inconsistent with any structural attribute of the Code. Because policy choices in a statute are the province of Congress, courts should not, in my view, deviate from a textualist approach to statutory language when no structural value is implicated. A textualist approach effectuates the policy choice made by Congress or forces Congress to amend the statute if its terms lead to results inconsistent with the intended policy.

My example is *Hernandez v. Commissioner*,<sup>32</sup> which dealt with the terms “contribution or gift” in section 170, allowing the deduction for charitable contributions. Under a literal approach to those terms, a transferor makes no contribution or gift to the extent a quid quo pro is received in exchange. For example, cash transfers to a church by parents of students enrolled in the church school are not deductible charitable contributions when the payments purchase the education services.<sup>33</sup> The taxpayers in *Hernandez* made cash transfers to the Church of Scientology in exchange for services known as “auditing” and “training,” described as follows.

Scientologists believe that an immortal spiritual being exists in every person. A person becomes aware of this spiritual dimension through a process known as “auditing.” Auditing involves a one-to-one encounter between a participant (known as a “preclear”) and a Church official (known as an “auditor”). An electronic device, the E-meter, helps the auditor identify the preclear’s areas of spiritual difficulty by measuring skin responses during a question and answer session. Although auditing sessions are conducted one on one, the content of each session is not individually tailored.

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32. 490 U.S. 680 (1989).

33. See Rev. Rul. 83-104, 1983-2 C.B. 46.

The preclear gains spiritual awareness by progressing through sequential levels of auditing, provided in short blocks of time known as “intensives.”

The Church also offers members doctrinal courses known as “training.” Participants in these sessions study the tenets of Scientology and seek to attain the qualifications necessary to serve as auditors. . . . Scientologists are taught that spiritual gains result from participation in such courses.

The Church charges a “fixed donation,” also known as a “price” or a “fixed contribution,” for participants to gain access to auditing and training sessions. These charges are set forth in schedules, and prices vary with a session’s length and level of sophistication. . . . This system of mandatory fixed charges is based on a central tenet of Scientology known as the “doctrine of exchange,” according to which any time a person receives something he must pay something back. In so doing, a Scientologist maintains “inflow” and “outflow” and avoids spiritual decline.<sup>34</sup>

The Supreme Court held in *Hernandez* that to the extent a quid pro quo is received in exchange for a payment to a church, the payment is not a “contribution or gift” within the meaning of section 170(a), even if what is received is a religious benefit, not a benefit that could be purchased in the marketplace. Whether a charitable deduction should be allowed for money paid to a church in exchange for religious benefits is a policy choice that should be made by Congress. The Court ensured that Congress would have to make that choice by adopting a literal interpretation of the words “contribution or gift.”

### C. Purpose as Legislative History

In addition to pertaining to structural norms and constraints, “purpose” can take the form of the history of a provision. I don’t mean legislative history in the sense of specific rules inserted in committee reports—I am uncomfortable with that<sup>35</sup>—but rather the context in which legislation was drafted, the wording of bills passed by one house but altered

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34. 490 U.S. at 684-85 (footnotes and citations omitted).

35. While detailed rules inserted in committee reports should not, in my view, be given the status of law by a court, there is a meaningful distinction between these rules and generalized statements of purpose in a committee report. The latter can be very helpful in providing a grounding for the structural approach, which is ultimately grounded in the statutory language.

in conference, and the state of the old law. And such a purpose may mean that a literal, form-conscious approach should control.

My example is section 1041 and marital property settlements, which are one-time transfers made in connection with a transaction (divorce) not typically undertaken for tax purposes. These transfers are also often undertaken by common folk without tax counsel based on the assumption that they have no immediate tax consequences. Under section 1041(a) and (b), transfers of property incident to divorce are not realization events for the transferor and may be excluded from income by the transferee as though received by gift, and if the property settlement is in-kind rather than in cash, the transferee takes a basis in the property equal to the basis in the hands of the transferor. This means that a transferor in a high tax bracket may transfer property that will produce income to a transferee in a low bracket, just the kind of transaction that, outside of the divorce context, raises assignment of income flags.

The IRS has unevenly and inconsistently invoked the assignment of income doctrine to trump the nonrecognition and exclusion rules in sections 1041(a) and (b)(1), arguing that in some instances taxation should not follow the property under section 1041 but should stay with the transferor, particularly if the property is deferred compensation, a common ingredient in property settlements.<sup>36</sup> If *H* transfers to *W* rights to future payments that represent *H*'s accrued interest in deferred compensation (considered owned solely by him in a common law state), the Service might argue that even though *W* receives the cash, *H* is taxed either at the time of the transfer of title (how much?) or when *W* receives the cash years down the road. Similarly, if *H* and *W* live in a community property state and *W* receives a cash payment to compensate her for a surrender of her marital interest in deferred compensation nominally owned by *H*, the Service might argue that the payment is taxable to *W*, notwithstanding section 1041(b)(1).

Among the reasons prompting enactment of section 1041 were the uncertainty regarding who would be taxed on property settlements, the reality that such uncertainty created traps for the unwary, the whipsaw often experienced by the government when neither party paid tax, and the inconsistency of results depending on whether the parties lived in a community property state or common law state. As I once described in much more detail than I can afford here, the history of section 1041 indicates that it was meant to bring uniformity and certainty to the area of property settlements by allowing form to control.<sup>37</sup> The rulings in which the Service invoked the assignment of income doctrine seem irreconcilable, give no

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36. See Deborah A. Geier, Form, Substance, and Section 1041, 60 Tax Notes 519 (July 26, 1993) (describing cases and rulings).

37. *Id.*

coherent guidance regarding when the Service is going to apply the doctrine, demonstrate how unworkable the doctrine is in this context, and undermine section 1041 by frustrating *ex post* the results of the parties' negotiations.

#### D. *Lack of Purpose*

A statutory provision that lacks an identifiable purpose makes life difficult. When purpose cannot be identified, all we have is the language, including that of both the original enactment and any amendments, and disagreement surrounding the interpretation of the language is not unusual because there is no larger structural or social-policy value that can guide meaning.

Section 104(a)(2), which allows an exclusion from gross income for "damages received on account of personal injuries or sickness," is such a provision. Outlays incurred to create human capital, such as the costs of education, are generally nondeductible (and thus taxable). One would therefore think that compensation received for the loss of human capital would likewise be taxable, yet section 104(a)(2) allows an exclusion. The lack of a good explanation of why personal injury damage awards should not be taxed—either as a structural matter or as a matter of nontax social policy—contributes terribly to the difficulty in interpreting its meaning and scope. Section 104(a)(2) has thus spawned much disagreement among judges interpreting its meaning and provides a study of how the lack of identifiable purpose confounds statutory interpretation.

In the early tax world, personal injury damage awards were not considered "income" because they were not gains from labor or capital or both combined, which was the touchstone definition of income in the Supreme Court's 1920 decision in *Eisner v. Macomber*.<sup>38</sup> Contributing to these early notions were conceptions of income borrowed from trust accounting, under which capital contributions (and gains from sales of corpus) were not income (which went to the beneficiaries) but were rather the means by which income was produced. Income was commonly thought of as the recurring receipts produced by capital, such as the annual rent or crop proceeds earned from Blackacre. Because Blackacre was the capital producing the periodic income, it was thus not income itself. Similarly, nonrecurring receipts, such as lump sum windfalls, were considered capital receipts that would produce income, but were not themselves income. Such notions likely contributed to the enactment of the predecessor to section 104(a)(2) in 1918.

Because taxpayers could rely upon the definition of income in excluding their personal injury damage awards, the statutory exclusion seemed to have little independent significance, and it is not surprising that the

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38. 252 U.S. 189 (1920).



predecessor to section 104(a)(2) was carried forward in the 1954 Code without debate. One year later, however, the Supreme Court decided *Glenshaw Glass*,<sup>39</sup> holding that income includes all accessions to wealth, clearly realized, over which the taxpayer has complete dominion. Because personal injury damages fit comfortably within this definition, the meaning and scope of section 104(a)(2) became important for the first time. It has been troublesome ever since. With the rejection of the antiquated notions of income upon which the original exclusion was likely premised and with no modern rationale having satisfactorily replaced it, the justification for the section 104(a)(2) exclusion has been a matter of scholarly debate.<sup>40</sup>

When purpose in any of the guises that I have discussed cannot be identified, all we have is language. For that reason, Justice Scalia's textual approach to section 104(a)(2) in the *Burke* case<sup>41</sup> made a lot of sense to some.<sup>42</sup> Scalia would have limited the exclusion for "personal injuries or sickness" to damages received on account of *physical* injuries and "perhaps" injuries to mental health.<sup>43</sup> He would have ruled invalid a Treasury regulation defining "personal injuries" to mean tort or tort-like injuries, which can include such nonphysical injuries as defamation, even though the validity of the regulation's tort-based approach was not argued either below or before the Supreme Court.

Although the structural rationale for section 104(a)(2) is difficult to articulate, fairly convincing legislative history accompanying a 1989 amendment to section 104(a) implies that the exclusion is not limited to physical injuries.<sup>44</sup> By "legislative history," I don't mean committee reports; rather, I mean legislative history in the form of statutory language passed by the House that would have replaced the word "personal" with "physical" in section 104(a)(2), combined with statutory language that came out of the Conference Committee that retained the word "personal" in the general clause but disallowed the exclusion of *punitive* damages in cases not involving "physical" injuries. That legislative documentation implies that Congress chose to continue to allow, consistent with dozens of lower court decisions,

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39. 348 U.S. 426 (1955).

40. See, e.g., Joseph M. Dodge, *Taxes and Torts*, 77 Cornell L. Rev. 143 (1992); Douglas A. Kahn, *Compensatory and Punitive Damages for a Personal Injury: To Tax or Not to Tax?* 2 Fla. Tax. Rev. 337 (1995).

41. *United States v. Burke*, 112 S. Ct. 1867, 1874 (1992) (Scalia, J., concurring in the judgment).

42. See, e.g., William D. Popkin, *The Tax Treatment of Statutory Torts*, Letter to the Editor, 54 Tax Notes 1570 (Mar. 23, 1992) (urging Justices to do essentially what Justice Scalia did in order to force Congress to decide once and for all the extent to which it wishes damages for nonphysical injuries to be excludable).

43. *Burke*, 112 S. Ct. at 1875 (Scalia, J., concurring in the judgment).

44. See Geier, *supra* note 4, at 470.

the exclusion of compensatory damages for those nonphysical injuries considered to be "personal." Consistent with this conclusion, the majority opinion refused to limit the scope of personal injuries to physical injuries and accepted the tort-like test. It struggled with defining a tort, concluding that the factor differentiating a tort-like injury from other injuries is the breadth of the available remedies for the injury. If the scope of available remedies is sufficiently broad, as in a common law tort, the injury sued upon is tort-like.

The story of section 104(a)(2) demonstrates the difficulty in interpretation when purpose is ambiguous. Had Congress not enacted the 1989 amendment, Justice Scalia's literal approach to the statutory language would have made sense. But that approach is not consistent with the amendment. Perhaps this saga illustrates the limits of statutory interpretation on the part of a judge; there are times when Congress really does need to step in to clarify a statute's purpose. In the case of section 104(a)(2), that would mean enacting a statutory definition of "personal."

#### E. *Evolving Purpose*

Purpose can evolve over time. Section 162, the business expense deduction, contains a provision, section 162(a)(1), that explicitly allows a deduction for a "reasonable" salary. The provision was originally adopted in 1918 to allow a reasonable salary to be deducted for purposes of an excess profits tax, even though no salary was actually paid because profits were being plowed back into the business.<sup>45</sup> The provision's original purpose was entirely pro-taxpayer.

Today, it is a provision raised by the Commissioner against taxpayers to disallow deductions for what are in fact disguised dividends or disguised payments for property.<sup>46</sup> The purpose of the provision has thus evolved over time so that now its purpose is chiefly seen as protecting the double tax in our classical corporate tax structure. Interpretation of the provision must likewise evolve, an example of the kind of dynamic statutory interpretation described in the nontax context by William Eskridge.<sup>47</sup>

### III. THE ROLE OF PURPOSE AND INSTITUTIONAL VALUES

#### A. *The Relationship of Congress, the Courts, and the Treasury Department*

Now let me step back and say a few words about the institutional

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45. Erwin N. Griswold, *New Light on "A Reasonable Allowance" for Services*, 59 *Harv. L. Rev.* 286 (1945) (discussed in William D. Popkin, *Fundamentals of Federal Income Tax Law* 239 (1994)).

46. See Regs. § 1.162-7.

47. William N. Eskridge, Jr., *Dynamic Statutory Interpretation*, 135 *U. Pa. L. Rev.* 1479 (1987).

issues at stake here. Recall that the *Duberstein* Court ignored structure and took a plain meaning approach to the statutory term “gift.” Later, Congress stepped in, enacting sections 274(b)<sup>48</sup> and 102(c)<sup>49</sup> to make it less likely (though not impossible) that a transfer in the business context would escape even a single layer of taxation. These amendments would have been unnecessary had the *Duberstein* Court consulted the structure underlying gift treatment.

The *Duberstein* approach—plain meaning interpretation that ignores structure and causes statutory amendment—is always available, true. But is that the only legitimate approach? For example, was the decision of the *Owens* Court,<sup>50</sup> which ignored the literal words of the statute in order to protect the fundamental structure, an illustration of unconstrained discretion that exemplifies judicial lawlessness by ignoring the words passed by Congress? A decision outside of the rule of law because, on its face, it flouted explicit language in the Code?

I don’t believe so. The *Owens* Court’s decision was *consistent with* the fundamental structure of the scheme that Congress created, not antagonistic to it. As Professor Popkin has argued, the law should be viewed as a joint undertaking between Congress and the courts in the sense that the courts should not deliberately undermine a statutory scheme in the name of bowing to Congress as the sole source of law.<sup>51</sup> Congress’s law also includes that larger statutory structure.

Looking at the world that way provides both a validation of judicial common law doctrines in tax and a constraint on their proper use. In some cases, they are appropriate judicial tools that ensure that the fundamental structure of the income tax created by Congress is not frustrated. The doctrines are inappropriate, however, in situations where purpose of a different sort counsels against their use—where, as in the case of section 1041, form should control in my view because of the history underlying its enactment.

Some argue, from an institutional viewpoint, that literal interpretation is necessary in order to force Congress to avoid ambiguity or sloppiness in its drafting of statutes. But the blame does *not* always lie, as apparently was the case in *Missouri*,<sup>52</sup> with the legislature being sloppy or failing to articulate clearly what the statute reaches. The fault sometimes lies in the constraints of statutory drafting and the limits of language itself. Statutes must be written in self-executing commands rather than in expository form;

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48. Section 274(b) prohibits the deduction (except for \$25) of business gifts.

49. Section 102(c) prohibits the exclusion by an employee of gifts from an employer. *Duberstein* did not deal with an employer and employee.

50. See *supra* notes 13-15 and accompanying text.

51. See Collaborative Model, *supra* note 5.

52. See *supra* notes 1-2 and accompanying text.

they cannot contain paragraphs describing the overarching idea intended to be captured by the necessarily constrained language. The charge of congressional sloppiness might be more compelling with respect to legislation dealing purely with social policy, where hard decisions must be made and consensus is often difficult to achieve. Indeed, that is why I believe a much more literal approach should be taken with respect to nontax Code provisions, as described above in Part II.B. But with respect to the core structure of the income tax, at least, Congress often uses the best words that it could have chosen in the situation to capture an idea—"capital expenditure,"<sup>53</sup> "cost,"<sup>54</sup> "gift,"<sup>55</sup>—but the words nevertheless cannot be given meaning without resort to the larger statutory structure of an income tax.

For example, the words "income from discharge of indebtedness" in section 61(a)(12) are probably the best words that Congress could have chosen to capture the idea that the borrowing exclusion is lost when loans are not repaid, triggering an income inclusion when the assumption that the loan would be repaid proves to be false. Yet, an overly textualist approach to these words, ignoring the larger structure of the taxation of loan proceeds, has caused some courts to wonder whether a loan that is not enforceable can ever create debt-discharge income<sup>56</sup>—a ridiculous inquiry, in my view, caused solely by deliberate ignorance of the larger statutory structure. If a taxpayer borrows \$1,000 from a loan shark at usurious interest rates, spends the money on personal consumption, learns that such loans cannot be enforced under state law and thus refuses to repay, the taxpayer should be charged with \$1,000 of income.<sup>57</sup> The borrowing exclusion was premised on the assumption that the taxpayer would repay; when that assumption proves to be false, the loan proceeds are an accession to wealth, clearly realized, over which the taxpayer has complete dominion. As I wrote elsewhere:

The debt is not "discharged," the argument goes, if it could not be enforced. But the lack of enforceability simply is the impetus for the failure of the debtor to repay

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53. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992). See Geier, *supra* note 4, at 477 n.122 (discussing the court's construction of the term "capital expenditure").

54. *Philadelphia Park Amusement Co. v. United States*, 126 F. Supp. 184 (Ct. Cl. 1954). See Geier, *supra*, note 4, at 474-77 (discussing the court's nonliteral construction of the term "cost").

55. *Commissioner v. Duberstein*, 363 U.S. 278 (1960), discussed *supra* notes 16-21 and accompanying text.

56. See, e.g., *Schlifke v. Commissioner*, 61 T.C. Memo (CCH) 1697, 1698, T.C. Memo (P-H) ¶ 91,019 (1991) (noting that the enforceability of a debt obligation is a "sub-issue" that "inheres" in the issue of debt-discharge income).

57. The income is likely to be offset by a deduction for extraordinary medical expenses.

fully the originally excluded loan proceeds which creates the accession to wealth in the first place. Not only should the tax law avoid placing a favorable premium on entering into loan agreements that are unenforceable (as compared to enforceable loan agreements that are not enforced in fact), it is a Catch-22 to argue that the very unenforceability which created the debt cancellation (because it prevented the creditor from collecting the debt in full) saves it from taxation. The debt in *Tufts* was, in fact, unenforceable to the extent that it exceeded the fair market value of the collateral, and yet the Court confirmed that an accession to wealth occurred on the failure to repay that debt, even though it analyzed that accession to wealth as gain under section 1001. That accession to wealth should not escape taxation *outside* the transfer context, as it would if the unenforceability of debt prevented taxation of [debt-discharge income] when the debt is not repaid in full; the same accession to wealth occurs in both the transfer context and the nontransfer context. Such nonissues as unenforceability cloud the fundamental *tax* point confirmed in *Tufts* that the prior loan proceeds were received *free of tax* on assumptions that prove to be unwarranted when the loan proceeds are not in fact fully repaid with after-tax dollars—for *whatever* reason. The prior receipt coupled with the failure to repay in full should be the beginning and end of the inquiry under debt-discharge theory.<sup>58</sup>

“Such a reliance on the dictionary definition of words focuses on nonissues that arise because of an excessive solicitude to the perceived exactitude of the meaning of words severed from their structural context as part of the Internal Revenue Code.”<sup>59</sup>

One problem with all of this is that those readers who agree with me thought this way before I began my discussion, and those who disagree with me will not have been persuaded. And people do disagree. For example, William S. McKee of King & Spalding—former Tax Legislative Counsel and partnership tax guru—was reported to have said, with reference to the new

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58. Deborah A. Geier, *Tufts and the Evolution of Debt-Discharge Theory*, 1 Fla. Tax Rev. 115, 155 (1992).

59. *Id.* at 169. The unrepaid principal of an unenforceable debt obligation may escape taxation for other tax reasons but not because the debt obligation is unenforceable. See *id.* at 186 n.217 (discussing whether the unenforceable debt in the *Zarin* case should go untaxed when not repaid under a common law rule analogous to § 108(e)(5), which excludes debt discharge income resulting from a reduction of purchase money debt).

partnership antiabuse regulation I earlier mentioned, that “taxpayers are entitled to take the benefit of unintentional . . . glitches in the law that tax advisers find by applying a literal reading of the law until the government somehow stops them.”<sup>60</sup>

Although I may not convince such hard-boiled proponents of literalism, I should at least describe the kind of statutory world they advocate. The Internal Revenue Code contains 1,339,000 words.<sup>61</sup> A textualist approach to statutory language that frustrates purpose in any of the senses that I have discussed here—or a deviation from textualism in those instances demanding it—requires Congress to enact more legislation, as it had to do after *Duberstein*. The Code can only become inexorably longer and more complicated as Congress must overturn decision after decision by statutory amendment, a cumbersome device intentionally made difficult by the framers. (Since statutory proposals that would lose revenue must be matched, under budget laws enacted in the 1980s, by proposals that would raise revenue, the response that Congress can always fix a wrong tax decision is far too facile today.<sup>62</sup>) And as the Code becomes more textual through statutory detail and

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60. Lee A. Shepherd, Partnership Antiabuse Rule: Dirty Minds Meet Mrs. Gregory, 64 Tax Notes 295, 296 (July 18, 1994) (quoting Ms. Shepherd's paraphrase of Mr. McKee's position). Several respected commentators have, however, supported the regulations. Joseph Bankman, The Proposed Partnership Antiabuse Rule: Appropriate Response to Serious Problem, Commentary, 64 Tax Notes 270 (July 11, 1994) (hereinafter Bankman); Peter L. Faber, It's Important to Pave the Way for Antiabuse Rules, Letter to the Editor, 64 Tax Notes 1237 (Aug. 29, 1994); Daniel I. Halperin, The Partnership Antiabuse Reg: A Reasonable Step in the Right Direction, Letter to the Editor, 64 Tax Notes 823 (Aug. 8, 1994); New York State Bar Association, Tax Section, Committee on Partnerships, Report on the Proposed Partnership Antiabuse Rule, 64 Tax Notes 233 (July 11, 1994) (generally supporting the regulation).

61. Guy Gugliotta, Deciphering a Code That is Mostly Just Taxing, *Cleve. Plain Dealer*, Nov. 27, 1994, at 6C.

62. Thus, I strenuously disagree with Professor Edward Zelinsky's statement that “[t]he code is highly correctable legislatively.” Edward Zelinsky, *Albertson's: Why Courts Shouldn't Override Clear Statutory Language*, 66 Tax Notes 1691, 1700 (Mar. 13, 1995). For example, a huge problem encountered by those who advocate overturning the revenue raising result in *Commissioner v. Soliman*, 113 S. Ct. 701 (1993) (narrowing deductions for home offices), is that such an enactment would be marked as a revenue losing provision (as compared with present law under *Soliman*) and thus must be matched by revenue raising provisions under budget law constraints. No longer are tax provisions debated solely on the merits. Indeed, some tax proposals that virtually everyone opposes on tax policy grounds are nevertheless supported *solely* because they may raise revenue to pay for revenue losing provisions. A prime example is the retention of the “neutral cost recovery system” in the recent tax bill proposed by Chairman Archer. See Archer to Stick with “Contract” in Panel Markup, 95 TNT 42-10 (Mar. 2, 1995) (LEXIS, FEDTAX library, TNT file) (“Even one tax cut that has virtually no support among its intended beneficiaries—the neutral cost recovery system—will be left intact because omitting it would create a revenue shortfall.”). *Albertson's* itself was “highly correctable legislatively” only because of the happenstance that an enactment over-

complexity, it breeds inappropriate textualist advice by practitioners and then textual judicial decisions, often causing yet more amendments and more institutional pressure on the agency. As Commissioner Margaret Richardson said last summer, the tax law has become “so complex that mechanical rules have caused some tax lawyers to lose sight of the fact that their stock-in-trade as lawyers should be sound judgment, not an ability to recall an obscure paragraph and manipulate its language to derive unintended tax benefits.”<sup>63</sup> The cycle perpetuates itself, which is one reason why I believe this issue has become more pronounced as time goes on.

On the flip side of the coin, the approach described here requires a lot of the lawyer—and judge for that matter. The lawyer cannot facily rely on the language before him or her but rather must have a good grasp of that larger statutory and conceptual structure and of history in order to appreciate whether a textual or nonliteral approach is required. Outside these polar extremes, the lawyer and judge must be adept at gleaning purpose in order to construe effectively language on the continuum *between* those two ends, such as in *Duberstein*, or to approach effectively a case in which specific language is not at issue but the form of the transaction implicates statutory structure, such as in *Gregory* and *Goldstein*. This level of mastery is not easily achieved, particularly in light of the Catch-22 that failure to operate in this way often contributes to the statutory amendments and growing complexity that makes this approach difficult. Are we asking too much of our lawyers? Are we asking too much of our judges?<sup>64</sup>

From the institutional perspective, perhaps the culmination of the issues discussed here was the issuance of the partnership antiabuse regulation I quoted earlier, which provides that a partnership can be disregarded if it is used in a manner inconsistent with the “intent of Subchapter K” or in order “to carry out the purpose of any provision of the Internal Revenue Code or the regulations.”<sup>65</sup> We gave gotten to the point at which statutory interpretation directives to ignore the literal words of a statute in certain situations in favor of implementing the statute’s purpose are being encapsulated in

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turning it would be marked as a revenue raising provision (which could, ironically, have been used to fund such things as overturning *Soliman*). See *infra* notes 80-86 (discussing the *Albertson*’s decision).

63. Wall St. J., Aug. 10, 1994, at A1.

64. In this vein, I think it’s interesting to note that it seems to me that, oddly enough, it is often the Tax Court—the specialized court with, we presume, intimate knowledge of these matters—that more often, though of course not always, takes the textual approach. *Brown Group*, discussed *supra* notes 22-26 and accompanying text, is just one example. The generalist judge sometimes is more quick to let go of the literal language.

65. See *supra* notes 9-11 and accompanying text.

Treasury regulations.<sup>66</sup> One can't help but wonder whether the perceived need for such regulations is a direct result of the breakdown in consensus regarding how we should approach statutory language and the absence of language, either as a practitioner or as a judge.

The presence of the regulation's statutory interpretation directives raises another practical issue in my mind. What will be its likely effect on the resolution of litigated cases? More specifically, some have taken issue with the regulation by arguing that it is unnecessary because the government can always invoke purpose or the substance-over-form doctrine without the regulation. It is a litigating strategy with a long history. Professor Bankman has responded by stating that redundancy doesn't seem a significant harm and, more important, the regulation sends an important message by "signal[ing] the legal community the Treasury's clear intent to go after a class of abusive transactions in Subchapter K."<sup>67</sup> The regulation thus has, in his view, "a valuable *in terrorem* effect in deterring the most aggressive behavior of the private tax bar."<sup>68</sup>

I believe the regulation has that salutary effect, but I wonder whether it also gives more force to the argument made under it because of the deference courts give to valid regulations.<sup>69</sup> In other words, would the Service's litigating position in cases like *Brown Group* have been strengthened by encapsulating its litigating strategies in a regulation? Should it? Should the government get a leg up in litigation by instructing a judge through regulations that the literal words of the statute should be ignored in favor of the government's view of the transaction? How might a judge approach the claim?

### B. *The Importance of Rhetoric*

In this final section, I return to the topic discussed in the introductory section of part II—what is statutory purpose?—and add a cautionary note about proper use of the term "purpose" in light of the examples discussed in Part II.

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66. See Hal Gann & Roy Strowd, *The Recent Evolution of Antiabuse Rules*, 66 Tax Notes 1189 (Feb. 20, 1995) (recounting the growing tendency of the Treasury to issue regulations that provide that the literal language of the Code or regulations should be ignored if necessary to effectuate the statute's or regulation's purpose).

67. Bankman, *supra* note 60, at 271.

68. *Id.* at 272.

69. See *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) (holding that if Congress did not address the precise question at issue, the agency's construction of the statute should be accepted so long as "permissible," even if a court would have construed the statute differently).



I have thus far outlined my views in several discrete situations regarding how statutory purpose ought to inform statutory interpretation in the realm of tax, with an eye toward institutional consequences. I have advocated a literal approach in some situations, but in others, I believe it is defensible to depart from the literal terms of the statute to give effect to the statute's larger structure. I have, however, been careful not to invoke Congress's intent or ultimate purpose in enacting the statute, which is an approach often perceived as located at the opposite end of the spectrum from literalism. I have done so for much the same reason that Professor Summers and his colleague Geoffrey Marshall reject appeals to a statute's ultimate purpose.<sup>70</sup>

Summers and Marshall argue that formal values require statutory interpretation to be rooted primarily in the ordinary and technical language of the statute. They argue that appeals to a statute's *ultimate* purpose (which they distinguish from the statute's "immediate purpose"<sup>71</sup>) undermine formal values, such as predictability, dispute avoidance, and like cases being treated alike. They also believe that interpretation based on ultimate purpose does nothing to curb strong-willed judges from implementing what they see as the correct policy for the country.<sup>72</sup>

The argument from ordinary or technical meaning is much broader than some might think. According to Summers and Marshall, ordinary or technical meaning is different from "plain" or "clear" meaning, as those terms are often used by judges. It covers "technical meaning," "special meaning," "harmonization" of statutory language, and a consciousness that the language user is an educated user with a background of general knowledge, and sometimes special knowledge, who has used language every day with little

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70. See generally Robert S. Summers & Geoffrey Marshall, *The Argument from Ordinary Meaning in Statutory Interpretation*, 43 *N. Ireland Legal Q.* 213 (1992); Robert S. Summers, *The Formal Character of Law*, 51 *Cambridge L.J.* 242 (1992).

71. Summers & Marshall, *supra* note 70, at 221. A statute's "immediate purpose," according to Summers and Marshall, is the implementive purpose that can be gleaned from the face of the statute. That is, legislators use language purposively, and a statute allowing an interest deduction, for example, thus has an "immediate purpose" of allowing a deduction for interest as that concept is ordinarily understood in the tax law. The "ultimate purpose" of why the statute allows an interest deduction might not be apparent on the face of the statute.

72. The authors write:

[T]he ordinary meaning of the statute serves to constrain wilful judges (of the left and of the right), thereby confining them not only within their sphere of competence but also within their appropriate judicial role. Courts lack institutional competence to make fully-fledged legislative judgments about ends and means, and ought not to substitute their judgment for that of the legislature anyway. This erodes the very phenomena of legislation and of legislative power itself.

*Id.* at 226.

or no confusion. Some of the examples they give might surprise some who call themselves textualists. For example:

Suppose a statute limits the amount of contributions to electoral expenditures by persons who “promote or favour the election of a candidate.” Does a person who campaigns against a candidate at an election “promote or favour the election of a candidate”? On the face of it the phrase “opposing a candidate’s election” does not mean “promoting a candidate’s election” and someone who had done the first might say that he had not in the ordinary sense of the words done the second. Nonetheless, a competent, generally knowledgeable and specially informed ordinary language user who was familiar with or had the factual background of elections and electoral machinery drawn to his attention might come to agree that his doing of the one act was equivalent to his doing of the other, given the language and the immediate purpose of the statute evident on its face and inferable from the ordinary meaning of the language used.<sup>73</sup>

A literal textualist might construe the statute not to apply to the person opposing a candidate’s election. Marshall and Summers do not argue that the argument from ordinary or technical meaning is always available. They concede that sometimes the language is too unclear.<sup>74</sup>

What I have called interpretation based on the “structure” of the Internal Revenue Code could, in the nomenclature of Summers and Marshall, come within at least the harmonization aspect of the argument from ordinary or technical meaning. For example, my suggested approach to the definition of “gift” in *Duberstein* based on structure could be restated as an argument for construing the word in terms of other code sections that explicitly or implicitly implement the one-tax-cycle-per-gift rule. Similarly, my structural argument about *Owens*, which required a nonliteral construction of the defined term “adjusted basis,” could be squarely placed in the statute by citing those provisions, such as sections 167(a) and 262, that make it clear that personal-consumption loss in value not attributable to the casualty itself should not support a deduction. Summers and Marshall concede that even “technical” terms, such as “adjusted basis,” can have a “special meaning” if required to harmonize the statute on its face. A special meaning includes “a

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73. *Id.* at 223.

74. *Id.* at 216.

meaning of a technical word that is not the technical meaning of that technical word.”<sup>75</sup>

People such as Justice Scalia, in my opinion, have given ordinary-meaning argumentation something of a bad name by misapplying it in some cases and, ironically, might have contributed to a shunning of a more linguistically anchored approach to statutory interpretation. By shunning a linguistically anchored approach, we abandon the values of formality, values that are important to all law and legal institutions. Because I believe that Justice Scalia sometimes gets ordinary-meaning argumentation wrong,<sup>76</sup> I rejected the language of his literal textualism and embraced the language of purposivism. Yet, I, too, wish judges to be constrained from using outcome-based approaches and have thus struggled to fashion my own set of constraints, outlined both here and elsewhere, within the nomenclature of purpose.<sup>77</sup> Perhaps my desire to cabin proper interpretation could be translated into the language of ordinary or technical meaning, as fashioned by Summers and Marshall.

If the same results are reached under my approach as the approach articulated by Summers and Marshall,<sup>78</sup> why quibble about the language

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75. *Id.*

76. I disagree, for example, that ordinary or technical meaning argumentation requires that the interpretation of words in one statute should govern the interpretation of words in a completely unrelated statute. See *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374 (1992) (Scalia majority opinion in which interpretation of the words “relating to” as construed in a prior case dealing with the Employee Retirement Income Security Act (ERISA) was imported wholesale into interpretation of “relating to” in the Airline Deregulation Act). I disagree with Justice Scalia’s disregard of long-accepted common law rules that affect statutory interpretation and represent widely accepted values. See *supra* note 8 (describing Scalia’s opinion in the *X-Citement Video* case). I also disagree with his minimization of subsequent statutory amendment that gives rise to implications inconsistent with his literal textual reading of the earlier language. See *supra* notes 41-44 and accompanying text (describing Scalia’s opinion in the *Burke* case).

77. See Geier, *supra* note 4; Geier, *supra* note 36. Even my substantive piece in the *Florida Tax Review* is an application of what I have called a structural analysis to a particular issue. See Geier, *supra* note 58.

78. One of the areas in which Professor Summers and I disagree is my comfort with the evolution of § 162(a)(1). See *supra* notes 45-47 and accompanying text. He generally believes that without statutory amendment, the meaning of a statute cannot change. I, on the other hand, am comfortable with the notion that a statute’s meaning can change without statutory amendment, so long as the evolution in meaning can either be supported by an argument based on what Professor Summers would call “harmonization” and what I have called “structure” or can be supported by a well-recognized evolution in the meaning of a term in popular culture. Thus, I am comfortable with the use of § 162(a)(1) as a sword (instead of as a shield, as it was originally used) to protect the double tax system because that system is apparent on the statute’s face. Similarly, I am comfortable with the Supreme Court’s holding that the word “charitable” in § 501(c)(3), allowing “charitable” organizations to be tax-exempt,

used to describe the approach? Because the rhetoric of opinions is terribly important. Summers and Marshall fear that if the rhetoric of ultimate purpose is used to reach a result that could have been reached using an ordinary or technical meaning interpretation, that language of ultimate purpose may invite the judge in a different case to go beyond the constraints of ordinary-meaning argumentation to reach substantive results compatible with the judge's policy views. I agree with their discomfort with appeals to a statute's ultimate purpose, as they describe it. Appeals to purpose should be limited, in my view, to those purposes apparent on the face of the statute and its legislative history, as I have defined it.<sup>79</sup>

To illustrate what I mean, I use the controversial *Albertson's* decision, which was first decided by the Ninth Circuit in December of 1993.<sup>80</sup> After an uproar ensued over the decision,<sup>81</sup> the court vacated it and granted a rehearing.<sup>82</sup> Its second opinion reversed the prior decision.<sup>83</sup>

*Albertson's* had "nonqualified" deferred compensation arrangements with some of its top executives and directors. Under a deferred compensation plan, whether qualified or nonqualified, employees generally include deferred

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no longer includes educational institutions that discriminate on the basis of race, *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983), even though § 501(c)(3) was enacted when *Plessy v. Ferguson*, 163 U.S. 537 (1896) (affirming separate but equal doctrine), was the law of the land and had not been amended. See generally Geier, *supra* note 4, at 484-86 (discussing the *Bob Jones* case).

79. See *supra* notes 35 and 44 and accompanying text.

80. *Albertson's, Inc. v. Commissioner*, 12 F.3d 1529 (9th Cir. 1993).

81. A sampling of the commentary on *Albertson's* in Tax Notes includes Zelinsky, *supra* note 62, Edward J. Abahoonie, Ninth Circuit's *Albertson's* Flip-Flop Outrages Practitioner, Letter to the Editor, 66 Tax Notes 898 (Feb. 6, 1995); Edward J. Abahoonie, Critics of *Albertson's* Suffer from Tax Myopia, Letter to the Editor, 63 Tax Notes 913 (May 16, 1994); Jasper L. Cummings, Jr., Statutory Interpretation and *Albertson's*, 66 Tax Notes 559 (Jan. 23, 1995); Daniel Halperin, *Albertson's*: More Outrage, Viewpoint, 63 Tax Notes 1771 (June 27, 1994); Daniel Halperin, Halperin Reiterates His Complaints About *Albertson's*, Letter to the Editor, 63 Tax Notes 483 (Apr. 25, 1994); Daniel Halperin, Ninth Circuit's Decision in *Albertson's* is Outrageous, Viewpoint, 62 Tax Notes 1083 (Feb. 21, 1994); Charles I. Kingson, Some Definitional Issues Ignored in the *Albertson's* Decision, Letter to the Editor, 64 Tax Notes 681 (Aug. 1, 1994); Daniel S. Knight, *Albertson's* Parrying and Thrusting Misses the Point, Letter to the Editor, 63 Tax Notes 483 (Apr. 25, 1994); William D. Popkin, *Albertson's* and Statutory Interpretation, Letter to the Editor, 64 Tax Notes 1207 (Feb. 20, 1995); Meegan M. Reilly, Ninth Circuit Did the Right Thing in *Albertson's*—Or Did It?, Viewpoint, 65 Tax Notes 1322 (Dec. 12, 1994); Steven J. Willis, *Albertson's*: Less Emotion and More Reason Would be Helpful, Viewpoint, 64 Tax Notes 961 (Aug. 15, 1994); Steven J. Willis, Leave *Albertson's* Alone, 63 Tax Notes 1481 (June 13, 1994); Edward A. Zelinsky, The Ninth Circuit's *Albertson's* Decision: Right for 1983, Wrong for Today, 63 Tax Notes 231 (Apr. 11, 1994).

82. 12 F.3d 159 (1994).

83. 42 F.3d 537 (1994).

compensation in income only when received.<sup>84</sup> If the plan is qualified, the employer may nevertheless deduct its contributions to the plan as they are paid into the pension trust; thus, the employer gets an immediate deduction, even though the amounts will not be taxed to employees until years later. If the plan is nonqualified, however, section 404(a)(5) delays the employer's deduction for the "compensation" until "the taxable year in which an amount attributable to the contribution is includable in the gross income of employees participating in the plan." Thus, unlike the case of a qualified plan, the employer deduction under a nonqualified plan is deferred to match the employee's income inclusion.

Albertson's nonqualified arrangement provided that an interest-like component would be added to the deferred compensation to compensate the recipients for the time value of the deferral. The issue in the case was whether the interest-like component was deductible as it accrued or whether section 404(a)(5) delayed deduction until the amounts were paid to the recipients.

One can envision three approaches to this issue of statutory interpretation. Under an ultimate purpose approach, the interpreter would first try to identify the ultimate purpose of the delayed deduction in section 404(a)(5) for nonqualified plans and would then ask whether deductions for accruals of the interest-like component would be inconsistent with that purpose. This was the approach taken by the Ninth Circuit in its final decision, which held the accruals nondeductible until paid. The court believed that the ultimate purpose of delaying the employer deduction under nonqualified plans, while allowing immediate deductions for contributions to qualified plans, was to encourage the use of qualified plans, which must satisfy complex minimum funding, participation, and vesting requirements and avoid discrimination in favor of highly compensated individuals. If substantial amounts could be deducted before inclusion by the employees in the case of a nonqualified plan, the court reasoned, the ultimate purpose of section 404(a)(5) would be frustrated. Thus, the deduction was denied.

Since section 404(a)(5) disallows immediate deduction only of "compensation," a literal textualist, such as Justice Scalia, would look up the word "compensation" in the dictionary, finding that it means payments for services rendered. An adherent of this approach would likely conclude that accruals of the interest-like component were deductible because this component compensates for the time value of the deferral in payment of compensation, not for the services rendered. This approach was, essentially, the one taken by the Ninth Circuit in its first decision in the case.

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84. Under a nonqualified plan, the tax is deferred until payment only if the employee uses the cash method of accounting, which nearly all employees do.

There is yet a third approach. In my world (and perhaps in the world of Professors Summers and Marshall), the court would have disallowed the deduction by using what I call a structural analysis. The statute's immediate implementive purpose (that which could be gleaned from the face of the statute) is to defer the employer deduction for amounts paid to employees under a nonqualified plan until the employees are taxed on these amounts. That is, it creates a matching regime, much like those found in other Code sections with respect to payments between related parties.<sup>85</sup> That structural aspect of the nonqualified plan rules would be frustrated by allowing a deduction for an interest-like component before those amounts were paid to the employees and included in their income. Moreover, the interest-like component involved in *Albertson's* was the portion of the payments to the employees that the contract labelled "interest." Virtually all of the Code's time value of money rules evidence that, in drawing the distinction between interest and principal, economic substance is determinative and labels in the contract are not.<sup>86</sup> Allowing deduction of what the contract called interest would be inconsistent with these structural principles. For both of these structural reasons, the deduction should be disallowed.

In my view, the Ninth Circuit got it wrong the first time by taking a literal textualist approach, but though it got to the right result the second time, it arrived there by the wrong route. Searching legislative history for the ultimate purpose that Congress, or some of its members, had in mind in enacting section 404(a)(5) or, absent such evidence, trying to reconstruct an ultimate purpose that *might* have prompted Congress to act as it did provides just the kind of constraint-free atmosphere that leads to poor results from an institutional point of view. The court should have stopped after identifying the matching principle embedded in the statute (and identifying the structural treatment of interest under the time value of money provisions) and disallowed deduction on those grounds. By going further and appealing to Congress's ultimate purpose in enacting the matching principle, the court legitimizes that approach and thereby opens the door in other cases to similar appeals to ultimate purpose.

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85. See, e.g., IRC §§ 83(h), 267(a)(2), 1271-1275.

86. See, e.g., IRC §§ 483, 1271-1275.

