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Richard A. Westin

*University of Kentucky College of Law*, [rwest0@uky.edu](mailto:rwest0@uky.edu)

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## Recommended Citation

Richard A. Westin, *Dubious Interpretative Rules for Construing Federal Taxing Statutes*, 17 Wake Forest L. Rev. 1 (1981).

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# WAKE FOREST LAW REVIEW

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VOLUME 17

FEBRUARY 1981

NUMBER 1

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## DUBIOUS INTERPRETATIVE RULES FOR CONSTRUING FEDERAL TAXING STATUTES

*Richard A. Westin\**

### INTRODUCTION

Knowing even a substantial portion of the Internal Revenue Code of 1954 is a major achievement. Divining how the courts might react to a complex tax transaction is also terribly difficult, but for this ability lawyers are often well-rewarded on earth. The tools of this esoteric trade include a mass of interpretative rules of a most uncertain nature, as sophisticated tax advisors are well aware. This article discusses the application and limits of a litany of the interpretative rules. The rules are frequently applicable outside the tax field, but the following study is confined to their application to tax decisions. If the tone of the article seems mocking or irreverent, that tone is ultimately unintended. Judges, including those on our United States Supreme Court, face a dismal flood of overwhelmingly complex tax cases which must in fact be decided; and the decisions frequently require makeweights or ready-made rationales for reaching a particular result. The major villain in this story is Congress, with its specialized committees which fail to consider fully or explain the purposes of complicated legislation. Lesser villains might include those members of the legal and accounting professions who structure transactions laden with doubt but know that there is a slight chance of prevailing or of forcing the government to accept an economically sound settlement. Furthermore, there is always the possibility that the Internal Revenue Service's audit personnel may not discover the issue in the first place.

The rules discussed in this article were selected either because they are particularly pervasive (reenactment, traps for the unwary, and the presumptive correctness of regulations) or because they reflect curious judicial attitudes towards the treatment of complex tax matters (respect for

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\* B.A., M.B.A., Columbia College; J.D., University of Pennsylvania. Associate Professor of Law, Illinois Institute of Technology, Chicago-Kent College of Law. Member, California and Vermont Bars.

legislated conditions, placement of the burden on the draftsman, and symmetry). As a final matter, the article suggests several proposals for reforming some or all of the interpretative rules.

## I. SELECTED RULES OF INTERPRETATION

### A. *Reenactment*

According to the reenactment doctrine, Congress implicitly validates judicial and administrative interpretations of legislation when it reenacts that legislation.<sup>1</sup> The doctrine relies upon the fiction that reenactment results from Congressional consideration and approval of at least some of the previous interpretations of the Internal Revenue Code. The doctrine has a limit, however: reenactment does not preclude future changes in administrative and judicial interpretations through the exercise of the rule-making powers of the IRS.<sup>2</sup>

A relevant question concerns the force that is actually accorded to the doctrine in tax cases, and an answer may be found in a sampling of the United States Supreme Court's statements of the rule. The reader will likely conclude that the doctrine means whatever the writer wants it to mean.<sup>3</sup> At one extreme is the position announced by the Court in *Helvering v. Winmill*<sup>4</sup> that "[t]reasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reënacted statutes, are *deemed* to have received congressional approval and have the effect of law."<sup>5</sup> At the opposite extreme, the Court takes a more flexible view, regarding reenactment as no more than an implication of Congressional approval. For example, the Court in *Helvering v. Bliss*,<sup>6</sup> taking this rather timorous approach, stated that the "reënactment . . . of the sections permitting the deduction *indicate* [*sic*]

1. See generally Brown, *Regulations, Reenactment and the Revenue Acts*, 54 HARV. L. REV. 377 (1941); Griswold, *A Summary of the Regulations Problem*, 54 HARV. L. REV. 398 (1941); Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, 49 YALE L.J. 660 (1940); Surrey, *The Scope and Effect of Treasury Regulations Under the Income, Estate and Gift Taxes*, 88 U. PA. L. REV. 556 (1940).

2. *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 100 (1939).

3. Lewis Carroll understood this concept long ago:

"When I use a word," Humpty Dumpty said, in a rather scornful tone, "it means just what I choose it to mean—neither more or less."

"The question is," said Alice, "whether you *can* make words mean so many different things."

"The question is," said Humpty Dumpty, "which is to be master—that's all."

L. CARROLL, *ALICE'S ADVENTURES IN WONDERLAND—THROUGH THE LOOKING GLASS* 230 (Doubleday 1960).

4. 305 U.S. 79 (1938).

5. *Id.* at 83 (emphasis added).

Since the legislative approval of existing regulations by reenactments of the statutory provision to which they appertain gives such regulations *the force of law*, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed.

*Helvering v. R.J. Reynolds Tobacco Co.*, 306 U.S. 110, 116 (1939) (emphasis added).

6. 293 U.S. 144 (1934).

Congressional approval of this administrative interpretation.”<sup>7</sup>

The reenactment rule is subject to some qualifications. For instance, in *Estate of Sanford v. Commissioner*<sup>8</sup> the Court indicated it is important that the administrative interpretation be consistent with the statute and judicial interpretations of the statute:

Administrative practice may be of persuasive weight in determining the construction of a statute of doubtful meaning where the practice does not conflict with other provisions of the statute and is not so inconsistent with applicable decisions of the courts as to produce inconsistency and confusion in the administration of the law.<sup>9</sup>

Congress cannot grant an administrative agency the power to make law; instead, the agency merely has the power to carry out the intention of Congress as shown by the statute.<sup>10</sup> In other words, “[a] regulation which . . . operates to create a rule out of harmony with the statute . . . is a mere nullity.”<sup>11</sup> In at least one example, however, the Court has followed an inconsistent administrative position, finding it well-reasoned and issued pursuant to actual Congressional intent.<sup>12</sup>

The Court has also indicated that an unpublished interpretative regulation cannot be approved by Congress through reenactment.<sup>13</sup> In *Sanford* the Court suggested that it does not give effect to unpublished administrative regulations on which taxpayers could not have relied.<sup>14</sup> Such a view seems unrealistic since, in fact, Congress cannot and does not review the full administrative and judicial gloss at the time of reenactment. Yet this limitation suggests that Congress could have reviewed it, without demanding that it did. If Congress wanted to learn of unpublished Treasury practices, it certainly has the investigative power to do so—perhaps this power underlies the fiction of reenactment.

A similar limitation is the logical but potentially devastating requirement that Congress actually has been aware of the administrative gloss at the time of reenactment. In *Leary v. United States*<sup>15</sup> the Court found

7. *Id.* at 151 (emphasis added).

8. 308 U.S. 39 (1939).

9. *Id.* at 52.

10. *Manhattan Gen. Equip. Co. v. Commissioner*, 297 U.S. 129, 134 (1936).

11. *Id.*

12. In *United States v. Reynolds*, 250 U.S. 104 (1919), the Court said:

This ruling was made in the year 1910, and may be inconsistent with some previous rulings of the Department, as counsel for respondent insists that it is. Nevertheless it is entitled to weight as an administrative interpretation of the act; it comports with our impression of the natural meaning of the language employed by Congress; and it very probably was relied upon by the President . . . .

This construction of the Act . . . puts it in agreement with other acts . . . , which, while subsequently passed and perhaps not strictly to be regarded as a legislative interpretation, nevertheless seem to us to indicate the effect that Congress attributed to the Act . . . .

*Id.* at 109-10.

13. *Estate of Sanford v. Commissioner*, 308 U.S. 39, 52 (1939).

14. *Id.*

15. 395 U.S. 6 (1969).

that regulations were not effectively adopted through reenactment because the accompanying legislative history gave no hint that Congress knew of the particular regulations when it passed the new law.<sup>16</sup> The Court conceded, however, that "congressional re-enactment of a statute, even without any apparent knowledge of a particular regulation, can 'strengthen to some extent' the regulation's claim to validity, but re-enactment cannot save a regulation which 'contradict[s] the requirements' of the statute itself."<sup>17</sup>

Yet another qualification to the doctrine concerns the number of changes Congress makes in a statute upon reenactment. Obviously, Congress indicates disapproval of present applications of a law when it makes wholesale changes in the statute.<sup>18</sup> The proper test is whether Congress reenacts the statute without "material" or "substantial" change.<sup>19</sup> Finally, the Court also mentions the following prerequisites to use of the reenactment doctrine: the interpretations must have been long continued without major change;<sup>20</sup> the regulation must be interpreting an ambiguous statute;<sup>21</sup> and the regulation must be fair to both the government and the taxpayer.<sup>22</sup>

A restatement of the doctrine of reenactment might be as follows: Judicial or administrative interpretations of a Code section will be given legal weight when the related Code section is reenacted, the Code section is ambiguous and enacted without material change, and the interpretation is longstanding, published, consistent with the statute, desirable, and known to Congress at the time of reenactment. Such a constricted rule is credible only to the naive. The rule is in fact flexible in practice, and it appears to operate more as a means for reaching a result already decided upon rather than as a true basis for decision. Accordingly, it is a highly unpredictable doctrine, available in different formulations to either side of a controversy. If it were applied in its most distilled form, it could win a case on its own merits. More likely, however, the doctrine will be used by both sides in the form most attractive to each, freeing the court to do whatever it wants with respect to application of the reenactment doctrine to the case.

### B. *Traps for the Unwary*

The "traps for the unwary" doctrine states that the courts should not

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16. *Id.* at 24.

17. *Id.* at 24-25 (quoting *Massachusetts Trustees v. United States*, 377 U.S. 235, 241-42 (1964)).

18. See *Higgins v. Smith*, 308 U.S. 473 (1940); *Rasquin v. Humphreys*, 308 U.S. 54 (1939).

19. *Helvering v. Winmill*, 305 U.S. 79, 83 (1938) (substantial change); *Hartley v. Commissioner*, 295 U.S. 216, 220 (1935) (material change).

20. *Helvering v. Winmill*, 305 U.S. 79, 83 (1938); *National Lead Co. v. United States*, 252 U.S. 140 (1930).

21. See *Iselin v. United States*, 270 U.S. 245, 250-51 (1926).

22. *Estate of Sanford v. Commissioner*, 308 U.S. 39, 51 (1939); *Burnet v. Chicago Portrait Co.*, 285 U.S. 1, 16 (1932).

develop interpretations of the Code that are so complicated that only sophisticated (wealthy) taxpayers can take advantage of those interpretations. Application of the doctrine is rare.

In *McWilliams v. Commissioner*<sup>23</sup> the Supreme Court faced a taxpayer who had seemingly navigated his way around section 24(b) of the 1939 Code,<sup>24</sup> which barred the deduction of losses on sales between related taxpayers, by his selling stock on the public market followed by a purchase of stock of the same issuer in the name of his spouse.<sup>25</sup> The admitted purpose of the sale and purchase was to create a tax loss for the year.<sup>26</sup> The Court was caught in a complicated interpretative web as the taxpayer and the government clashed over the relationship of section 24(b) to the "wash sales" rules<sup>27</sup> and the risks associated with an overly broad judicial decision.<sup>28</sup> The Court finally concluded that section 24(b) did apply to a sale through an exchange or intermediary, stating that to hold otherwise "would have converted the section into a mere trap for the unwary."<sup>29</sup> The Court did not completely explain its reasoning. Presumably, the Court meant that if it supported the taxpayer's position that section 24(b) did not apply, then only the unsophisticated, uncounseled taxpayer would lose the deduction because of section 24(b).

On the other hand, the doctrine is not always recognized. There is perhaps no better example of this than the *Central Tablet Manufacturing Co. v. United States*<sup>30</sup> decision, in which the Supreme Court dealt with an unfortunate accrual-method taxpayer whose business facilities had burned to the ground.<sup>31</sup> Some time after the fire, the taxpayer received insurance proceeds in excess of its basis in the property.<sup>32</sup> The taxpayer then decided to carry out a tax-free complete liquidation under section 337 of the Code.<sup>33</sup> Had the gain from the insurance proceeds been realized after the liquidation plan's adoption, section 337 would have precluded taxation of the gain.<sup>34</sup> The Internal Revenue Service, however, successfully contended that the gain accrued at the time of the fire.<sup>35</sup> The taxpayer correctly pointed out that one upshot of a pro-government result would be that the well-counseled taxpayer would elect to use section 1033(a)(3),<sup>36</sup> a complex rule under which insurance proceeds gains can be

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23. 331 U.S. 694 (1947).

24. Int. Rev. Code of 1939, ch. 1, § 24(b), 53 Stat. 16 (now I.R.C. § 267(a)(1)).

25. 331 U.S. at 695.

26. *Id.*

27. Int. Rev. Code of 1939, ch. 1, § 118, 53 Stat. 53 (now I.R.C. § 1091(a)) (prohibiting deduction of losses resulting from the sale of stock when the taxpayer repurchases substantially the same stock within a 30-day period).

28. *See* 331 U.S. at 697-703.

29. *Id.* at 702.

30. 417 U.S. 673 (1974).

31. *Id.* at 675.

32. *Id.*

33. *Id.* at 676.

34. *See* I.R.C. § 337(a).

35. 417 U.S. at 678.

36. I.R.C. § 1033(a)(3).

deferred through investments in replacement property followed by a section 337 liquidation.<sup>37</sup> The Court, however, was not impressed. With great dignity, the Court suggested that it dealt with actualities, asserting that "[t]ax consequences follow what has taken place, not what might have taken place."<sup>38</sup> The Court declined to subvert directly the trap for the unwary doctrine and did not refer to it in so many words. In short, the trap for the unwary concept is a trap for the unwary. It is a respected makeweight that can win a close case, but standing alone it is clearly unreliable.

### C. Symmetry

It appears rational to presume that if a transaction in a business context creates income to one person, it should create a business deduction to another. The mind seeks order and balance. Unfortunately, the courts do not. While symmetry is frequently mentioned as a desirable result, the concept does not constitute the sole basis for decisions, although it often triggers dissents and underlies complex decisions.

The strongest positive statements of a judicial preference for symmetry are found in the narrowest subject areas, specifically those that raise accounting questions.<sup>39</sup> For example, in *Commissioner v. Standard Life & Accident Insurance Co.*<sup>40</sup> the Supreme Court said, "Although we do not accept the notion that there must be perfect symmetry in the tax laws, there should be a measure of consistency in the accounting treatment of an item affecting interrelated elements . . . ."<sup>41</sup> On a deeper level, however, symmetry is a handmaiden of equity and good sense;<sup>42</sup> and as such,

37. 417 U.S. at 689-90.

38. *Id.* at 690 (citing *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974)). If the Supreme Court means what it says, the rule in *J. Simpson Dean*, 35 T.C. 1083 (1961), will collapse. In *Dean* the Tax Court treated interest-free loans from a close corporation as not creating income to the borrower because the borrower could have deducted an amount equal to such imputed income as interest paid. *Id.* at 1090. See generally O'Hare, *The Taxation of Interest-Free Loans*, 27 VAND. L. REV. 1085 (1974).

39. Negative statements regarding the role of symmetry may also be found. For example, in *Busse v. Commissioner*, 479 F.2d 1147 (7th Cir. 1973), protests of dissimilar treatment of taxpayers through a literal application of the Code were rejected with the following language:

However much the statute, in operation, may offend the Commissioner's sense of symmetry and propriety, we cannot say that the results it causes are either absurd or unintended by Congress. Courts have no power (just as the Commissioner has no power in his capacity as an administrative official) "to rewrite legislative enactments to give effect to" their "ideas of policy and fitness or the desirability of symmetry in statutes."

*Id.* at 1152 (quoting *United States v. Shirah*, 253 F.2d 798, 800 (4th Cir. 1958)).

40. 433 U.S. 148 (1978).

41. *Id.* at 160.

42. When accounting principles conflict with the interests of the Treasury, however, the Supreme Court's preference for symmetry in the accounting field dissolves entirely and is replaced with "logic" that compels cash-method taxpayers to include all income actually or constructively received while denying them deductions for expenses constructively paid and forcing them to capitalize prepaid expenses. (This "logic," in other words, puts them on

it may play a significant role in the formulation of powerful judicial constructions of the Code.

For example, the Court in *Crane v. Commissioner*<sup>43</sup> held that the term "property" for the purpose of section 1001 (defining gains and losses)<sup>44</sup> includes the amount of mortgage debt encumbering the transferred property.<sup>45</sup> The facts involved a taxpayer who inherited land subject to a mortgage that equaled the value of the land, but she did not assume the mortgage.<sup>46</sup> After sale of the land, she asserted that the value of the "property" she acquired from the decedent equaled only her "equity" in the land<sup>47</sup>—the "equity" was said to equal the excess of the value of the land over the amount of the mortgage.<sup>48</sup> Using such a theory, the taxpayer's equity in the land would have been zero on the date she acquired the land;<sup>49</sup> and when she sold the land, the amount realized on the sale would have been the net amount of cash received.<sup>50</sup> The Supreme Court disagreed, however, saying that the taxpayer's basis for determining gain or loss was the value of the land undiminished by the value of

the accrual method.) The same Supreme Court taxes accrual-method taxpayers on receipts of cash or property taken under "claim of right" (evidently limited to earnings), which has the effect of putting them on the cash method as to such amounts, and rejects their efforts to apply "matching" concepts of financial accounting (in order to avoid distortions of income from an accountant's viewpoint) in their efforts to establish deferral of prepayments or reserves for future expenses, unless those deferrals and reserves are the work of perfection. Absent perfection of matching, a worse standard imposed by the Commissioner will prevail as a result of the Supreme Court's finding that a taxpayer's less-than-perfect (but clearly reasonable) method is "purely artificial." The effect of the contrived finding is that the Service's authority to impose an accounting-method adjustment under section 446(b) is upheld as no abuse of discretion. For a discussion of this confusion, see J. CHOMMIE, *FEDERAL INCOME TAXATION* §§ 82-83 (2d ed. 1973).

43. 331 U.S. 1 (1947).

44. Section 1001(a) defines "gain" and "loss":

The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

I.R.C. § 1001(a). Section 1001(b) defines "amount realized":

The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized—

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164(d) as imposed on the purchaser, and (2) there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

I.R.C. § 1001(b).

45. 331 U.S. at 11.

46. *Id.* at 3-4.

47. *Id.* at 3.

48. *Id.*

49. *Id.*

50. *Id.* at 4.



the mortgage.<sup>51</sup> Further, the Court held that the amount realized upon sale of the land was the amount of cash received plus the amount of the mortgage.<sup>52</sup> The Court's holding is perfectly symmetrical and balanced: the liabilities are included in the amount realized, but they are also included in the taxpayer's basis (thus reducing the amount of realized gain upon sale).<sup>53</sup>

In the landmark case of *Corn Products Refining Co. v. Commissioner*,<sup>54</sup> the Court concluded that profits and losses from future transactions designed to "hedge" against increases in corn prices were so bound up with the daily activities of a grain products manufacturing corporation that they could not qualify for capital gains treatment.<sup>55</sup> While the Court relied on several theories for reaching its result, one can fairly argue that the foundation for the decision was fundamental discomfort with the asymmetry of earning capital gains in transactions intimately bound up with a taxpayer's day-to-day manufacturing activities.

Naturally, given the need for makeweights and comfortable syllogisms, the Court has made other positive statements about symmetry. Thus, in *United States v. Olympic Radio & Television, Inc.*<sup>56</sup> Justice Douglas used notions of symmetry to justify the Court's decision to deny an accrual-method taxpayer the right to deduct current payment of excess-profits taxes accrued in a prior year for purposes of determining the taxpayer's net operating loss for the year.<sup>57</sup> While admitting that the result might discriminate against accrual-method taxpayers, the Court refused to give the words "paid" or "accrued" a different meaning for net operating loss purposes than for other purposes in the same chapter of the Code:

We can only take the Code as we find it and give it as great an internal symmetry and consistency as its words permit. We would not be faithful to the statutory scheme, as revealed by the words employed, if we gave "paid or accrued" a different meaning for the purposes of § 122(d)(6) than it has in the other parts of the same chapter.<sup>58</sup>

In *Commissioner v. Lester*<sup>59</sup> the Supreme Court cited *Olympic* as a justification for including in a husband's income all money paid to the divorced wife except to the extent that the money was unequivocally alloca-

51. *Id.* at 11.

52. *Id.* at 13.

53. *Brontas v. Commissioner*, 73 T.C. 491, 574 (1979).

54. 350 U.S. 46 (1955). *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952), requiring the character of losses or deductions related to prior transactions to be correlated with the prior transaction's character (capital versus ordinary), represents another creative landmark decision that can be, but was not, rationalized as an application of the principle of symmetry to the tax laws.

55. 350 U.S. at 50.

56. 349 U.S. 232 (1955).

57. *Id.* at 236.

58. *Id.*

59. 366 U.S. 299 (1961).

ble to child support.<sup>60</sup> The Court proclaimed that “as we have frequently stated, the Code must be given ‘as great an internal symmetry and consistency as its words permit.’”<sup>61</sup>

An assertion that the Supreme Court has frequently said it will seek maximum internal consistency in the Code is a mere invention.<sup>62</sup> Contradictory statements are common,<sup>63</sup> and the fact is that the Supreme Court sometimes manufactures asymmetry.<sup>64</sup> Perhaps its most asymmetrical product is the treatment of gifts. Gifts are not included in the recipient's income,<sup>65</sup> and whether a transfer is a gift depends on the transferor's intent.<sup>66</sup> The standard of intent called for to qualify a transfer as a gift requires “detached and disinterested generosity”<sup>67</sup> resulting from “affection, respect, admiration, charity or like impulses”<sup>68</sup>—in other words, love. Clearly, the standard is narrow. On the other hand, a business expense is deductible only if it is, among other things, “necessary”<sup>69</sup> in the sense of being “appropriate and helpful”<sup>70</sup>—in other words, good for business. One must strain to imagine a transfer that is simultaneously loving and good for business, yet there are situations in which the two concepts coincide. For example, old Bob, the night watchman, tearfully receives his gold watch, given by his adoring employer with fitting ceremony after years of loyal service. Employee morale rises, at least according to the company's accountant, and the cost of the watch is deducted. Old Bob excludes the watch from income. The result is perfect asymmetry—a non-taxable receipt for old Bob, and a deduction with the implicit approval of the Supreme Court. The Internal Revenue Service's effort to fashion a test barring a gift result to the recipient if the transfer is made for business reasons was explicitly rejected by the Supreme Court in *Commissioner v. Duberstein*.<sup>71</sup> The Treasury considers itself robbed, but analytically it is not since deductions and gifts are tested by different standards. If love and good business can co-exist in a single transaction, those differ-

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60. *Id.* at 304.

61. *Id.*

62. *See, e.g., Rudolph v. United States*, 370 U.S. 269 (1962); *Commissioner v. Duberstein*, 363 U.S. 278 (1960); *United States v. Shaefer Brewing Co.*, 356 U.S. 227 (1958).

63. For example, in *Malat v. Riddell*, 383 U.S. 569 (1966), the Court held that the word “primarily” as used in I.R.C. § 1221(1), which deals with “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business,” means “of first importance.” 383 U.S. at 572. The First Circuit Court of Appeals in *International Shoe Mach. Corp. v. United States*, 491 F.2d 157, 160 (1st Cir.), *cert. denied*, 419 U.S. 834 (1974), and the Court of Claims in *Continental Can Co. v. United States*, 422 F.2d 405, 410-11 (Ct. Cl.), *cert. denied*, 400 U.S. 819 (1970), concluded that the word “primarily” as used in I.R.C. § 123(b)(1)(B) meant “acceptable and predictable” as part of the taxpayer's business.

64. *See* note 42 *supra*.

65. I.R.C. § 102(a).

66. *Commissioner v. Duberstein*, 363 U.S. 278, 285-86 (1960).

67. *Commissioner v. LoBue*, 351 U.S. 243, 246 (1956).

68. *Robertson v. United States*, 343 U.S. 711, 714 (1952).

69. I.R.C. § 162(a).

70. *Welch v. Helvering*, 290 U.S. 111, 113 (1933).

71. 363 U.S. 278, 284 (1960).

ent standards will on occasion dictate fiscally unbalanced results.<sup>72</sup>

The topic of symmetry and asymmetry in the Code is practically limitless. Perhaps the most truthful conclusion about symmetry as an interpretative device is found in *Burck v. United States*:<sup>73</sup> "The tax laws are such a hodgepodge of exceptions, qualifications, special interests and sometimes logically inconsistent treatment that they cannot be treated as symmetrical exigeses [*sic*]."<sup>74</sup>

#### D. Respect for Legislated Conditions

The doctrine of respect for legislated conditions can be roughly stated as follows: The courts will not interpret the tax laws so as to grant tax benefits on conditions less stringent than those imposed by the Congress in granting similar tax benefits.<sup>75</sup> The courts will, in other words, respect the conditions associated with tax relief legislation. The concept might be viewed as an extension of the maxim *expressio unius est exclusio alterius*<sup>76</sup> to tax legislation, although the courts that have applied the "rule" have stopped short of saying so and instead have relied on a doubtful presumption that the Congress meant to limit strictly its tax relief provisions.

The doctrine of respect for legislated conditions is well-illustrated by *Harrison Property Management Co. v. United States*,<sup>77</sup> a decision involving dummy corporations. In *Harrison* the government successfully asserted that to disregard the corporation for federal income tax purposes, while respecting it for state law purposes, would be tantamount to granting its shareholders the benefits of Subchapter S corporate status (in other words, a corporation treated in many respects as a conduit) without the associated limitations.<sup>78</sup> The taxpayers had argued that tax law clearly acknowledges that agents are not taxable on funds they receive for the benefit of their principals.<sup>79</sup>

72. I.R.C. § 274(b) alleviates this problem by limiting annual business gift deductions to particular dollar amounts per donee per year. The right to claim a business gift deduction may be doubtful in any case. For the position that when there are mixed business and personal motives for an expenditure, the business purpose must be paramount, see Kilbourn, *Deductible Expenses: Transactions Entered into for a Profit; Income-Producing Property*, 21 N.Y.U. TAX INSTR. 193 (1962). If this is true, *Duberstein's* requirement that the dominant motive for a gift be "love" leads to the conclusion that such gifts are not deductible.

73. 533 F.2d 768 (2d Cir. 1975).

74. *Id.* at 772 n.7.

75. The phrase "respect for legislated conditions" is an invention of the author.

76. "*Expressio unius est exclusio alterius*" means the expression of one thing is the exclusion of another. BLACK'S LAW DICTIONARY 692 (4th ed. 1968).

77. 475 F.2d 623 (Ct. Cl. 1973).

78. *Id.* at 629-30.

79. *Id.* The court expressed its concerns in the following language:

It appears highly probable that Harrison Property Management Company, though a small business corporation, could not qualify for Subchapter S benefits because more than 20 percent of its receipts in the taxable years was "passive investment income" from rents—a specific exception contained in Section 1372(e)(5). This limitation is still an integral part of the Congressional design for

Another example of judicial respect for legislated conditions is *Warren Jones Co. v. Commissioner*,<sup>80</sup> a case involving the timing of deferred payments on the sale of apartment buildings. The taxpayer attempted to escape the realization provision of section 1001(b) and to defer his gain on the sale until he recovered his basis. He asserted that, aside from cash, the only items taxable as "amounts realized" on sale or exchange are the highly liquid debt instruments set forth in the section 453(b)(3) limitation on the use of the installment-sales election.<sup>81</sup> The Ninth Circuit held, however, that such a narrow interpretation would exclude many types of property from immediate realization, thereby defeating the taxpayer's motivation for using the installment-sales election. According to the court, Congress did not intend that the installment-sales provision be used so infrequently.<sup>82</sup> It seems fair to say that the court refused to interpret the broadly applicable words "amount realized" in a fashion that would subvert the usage of section 453 by granting taxpayers similar tax deferral benefits without meeting the terms of section 453.

This interpretative technique seriously falters when it confronts supportable taxpayer arguments that the statutory provision is a non-exclusive "safe haven," which, when satisfied, assures the taxpayer of his desired result. The statute, according to the taxpayer, merely represents one of many means to achieve a particular result. An arguable conflict between the decision in *Kimbell-Diamond Milling Co.*<sup>83</sup> and section 334(b)(2) of the I.R.C. presents the leading example. The *Kimbell-Dia-*

lifting the tax from the corporation—an existing legislative restriction which would be thwarted if non-eligible companies could attain the same result by the simple procedure of a surfacial "principle"- "agent" agreement which is not in essence divorced from the owner-corporation relationship.

*Id.*

80. 524 F.2d 788 (9th Cir. 1975).

81. *Id.* at 789, 793.

82. The court expressed its concern in much the same way the Court of Claims did in

*Harrison*:

Congress added section 453(b)(3) to the Code for the purpose of excluding from the installment basis those taxpayers who sell property and receive more than 30 percent of the selling price in the form of highly liquid instruments of debt. Congress concluded that such taxpayers, like taxpayers receiving cash, would not suffer the hardships that the installment basis was designed to alleviate . . . . We find no indication that Congress intended that section 453(b)(3) should be given a broader application. If we were to adopt the taxpayer's argument, we would substantially nullify section 453 with respect to cash basis taxpayers receiving deferred payment obligations other than those described in section 453(b)(3). Such taxpayers, not required to include the fair market value of their obligations in determining the amount realized under section 1001(b), would rarely, if ever, elect to report on the installment basis. In the light of the other legislative history of section 453, hitherto discussed, it is clear to us that Congress, in 1969, did not contemplate, or intend, such a result.

*Id.* at 793 (citations omitted).

83. 14 T.C. 74 (1950), *aff'd*, 187 F.2d 718 (10th Cir.), *cert. denied*, 342 U.S. 827 (1951). See generally Henderson, *Voting Stock in a Two-Step Acquisition: The Kimbell-Diamond Reorganization*, 25 TAX L. REV. 375 (1970); Levin & Bowen, *Taxable and Tax-Free Two-Step Acquisitions and Minority Squeeze-Outs*, 33 TAX L. REV. 425 (1978).

mond decision held, on the principle of substance over form, that a corporation that acquired the stock of a target company and promptly liquidated that company pursuant to an asset-acquisition plan was entitled to take a basis in the former subsidiary's assets equal to the cost of such stock.<sup>84</sup> The 1954 Code later added section 334(b)(2), which assures a stock-price basis if various technical requirements are met.<sup>85</sup>

Later decisions tested the question of whether transactions meeting the requirements of *Kimbell-Diamond* but not section 334(b)(2) would qualify for the special basis rule. The first forum to confront clearly the question was the Court of Claims in *American Potash & Chemical Corp. v. United States*.<sup>86</sup> The particular issue presented was whether a taxpayer with the requisite intent to liquidate a target company that engaged in a transaction within the *Kimbell-Diamond* rule but outside section 334(b)(2)<sup>87</sup> was entitled to a cost-of-stock basis in the target company's assets.<sup>88</sup> The court held that *Kimbell-Diamond* was not pre-empted,<sup>89</sup> reasoning that: (1) the Congress' failure to modify expressly the *Kimbell-Diamond* rule was significant;<sup>90</sup> (2) section 334(b)(2) was designed to create a safe haven within which the knotty matter of taxpayer's intent could be avoided;<sup>91</sup> and (3) Congress intended to prevent the cost-basis rule from being elective.<sup>92</sup> All three reasons were based on the court's interpretation of the intent of Congress.<sup>93</sup>

The Seventh Circuit Court of Appeals came to an opposite result in *Broadview Lumber v. United States*.<sup>94</sup> The court read the same foggy legislative history,<sup>95</sup> especially a Senate report,<sup>96</sup> as limiting the benefits of the *Kimbell-Diamond* rule to those circumstances set forth in section 334(b)(2).<sup>97</sup> Having divined the legislative purpose, it said that the *American Potash* notion that section 334(b)(2) is a mere safe haven "would render Congress' action meaningless."<sup>98</sup> That is true only if section 334(b)(2) was not meant to be a safe haven.

Who is to blame for this mess? Clearly, the Congress is. These cases represent an unjustifiable waste of money and legal talent. A little

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84. 14 T.C. at 80-81.

85. I.R.C. § 334(b)(2).

86. 399 F.2d 194 (Ct. Cl. 1968).

87. The taxpayer corporation failed to meet the regulatory requirement that control of the target company be obtained within any 12-month period. *Id.* at 200.

88. *Id.* at 206.

89. *Id.* at 207-08.

90. *Id.* at 207.

91. *Id.* at 207-08.

92. *Id.* at 208.

93. *See id.* at 208-09.

94. 561 F.2d 698 (7th Cir. 1977); *see Boise Cascade Corp. v. United States*, 288 F. Supp. 429 (D. Idaho 1968), *aff'd per curiam*, 429 F.2d 426 (9th Cir. 1970).

95. *See* 561 F.2d at 711-13.

96. S. REP. No. 1622, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4621.

97. 561 F.2d at 711.

98. *Id.*

thought and a few words in the committee reports would have avoided costly litigation and uncertainty for both the government and the taxpayers. The uncertainty continues.<sup>99</sup>

To summarize, the "respect for legislated conditions" concept is another arrow in the litigant's quiver. It is superficially appealing and certainly confusing, but it should be applied only if it is really a shorthand way of saying that Congress intended the related, potentially subverted Code section to be the exclusive way of attaining tax grace.<sup>100</sup>

### E. *Placing the Burden on the Draftsmen*

It is an established maxim of common law that ambiguities in a contract should be construed against the draftsman. Presumably, penumbral emanations from the fourth<sup>101</sup> and fifth<sup>102</sup> amendments should impose the same rule in resolving the hideous complexities of the Internal Revenue Code. Indeed, Sutherland<sup>103</sup> agrees that this is the rule: "[I]t is a settled rule that tax laws are to be strictly construed against the state and in favor of the taxpayer. Where there is reasonable doubt as to the meaning of a revenue statute, the doubt is resolved in favor of those being taxed."<sup>104</sup> Sutherland goes on to quote<sup>105</sup> forceful language from *Gould v.*

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99. The Tax Court has held that section 334(b)(2) preempts *Kimbell-Diamond, International State Bank v. Commissioner*, 70 T.C. 173 (1978). The Fifth Circuit Court of Appeals agrees with the Tax Court. See *Chrome Plate, Inc. v. District Director of Internal Revenue (In re Chrome Plate, Inc.)*, 614 F.2d 990 (5th Cir. 1980).

100. Sometimes the right result flows from ignoring the concept. In *Joseph P. Pike*, 44 T.C. 787 (1965), the Tax Court ruled that the benefit of section 1341, which provides relief to taxpayers required to return income, was not available to a taxpayer who failed to show that he did not legally own income that he was required to return after receipt. *Id.* at 800. Although the court in *Pike* found that the taxpayer had not shown that the original payment was not legally his, it allowed the taxpayer to take a trade or business deduction under section 162, *id.* at 801, even though to do so arguably rendered the deduction provision of section 1341 redundant and overlooked the possibility that Congress intended section 1341 to be exclusive.

101. The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

U.S. CONST. amend. IV.

102. No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

*Id.* amend. V.

103. 3 J. SUTHERLAND, *STATUTES AND STATUTORY CONSTRUCTION* § 66.01, at 179 (4th ed. 1974).

104. *Id.*

105. *Id.*

*Gould*<sup>106</sup> which would make the taxpayer's heart glow. In *Gould* the Supreme Court held that tax laws should be construed against the government. Unfortunately for taxpayers, further analysis reveals deep cracks in the foundation of Sutherland's authority. Specifically, the Supreme Court has interpreted provisions allowing deductions and capital gains so narrowly (while at the same time interpreting its definition of gross income so expansively) that the fine language of *Gould* has been largely crushed under the wheel of justice.

Courts have been particularly parsimonious in finding deductions from income. The popular expression that "deductions are a matter of legislative grace" carries with it the doubtful implication that taxes should be levied on gross incomes rather than net incomes. This notion entered the tax lexicon in 1934 in *New Colonial Ice Co. v. Helvering*<sup>107</sup> and has been a glibly applied government weapon ever since.

Dean Griswold has provided thoughtful commentary on this issue.<sup>108</sup> He points out that the Supreme Court's position in *Gould* was inevitably rejected because it operated as a mind-deadening substitute for the court's proper function of finding the intent of Congress and interpreting the statute in light of that intention.<sup>109</sup> In his view,<sup>110</sup> *Gould* really perished at the hand of Mr. Justice Stone in *White v. United States*.<sup>111</sup> Stone said:

We are not impressed by the argument that, as the question here decided is doubtful, all doubts should be resolved in favor of the taxpayer. It is the function and duty of courts to resolve doubts. We know of no reason why that function should be abdicated in a tax case more than in any other where the rights of suitors turn on the construction of a statute and it is our duty to decide what that construction fairly should be.<sup>112</sup>

Griswold finds the *New Colonial Ice* rule equally unsound for the same reason.<sup>113</sup>

As to capital gains, *Gould* has no force. Courts take a stingy view of the capital gains provisions because they perceive the favorable taxation of long-term capital gains as an exception to the general rule of taxing gains fully. The Supreme Court's current position on this issue is clearly

106. 245 U.S. 151 (1915).

107. 292 U.S. 435 (1934). "Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed." *Id.* at 440; *accord*, *Commissioner v. Sullivan*, 356 U.S. 27 (1958); *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943); *Helvering v. Inter-Mountain Life Ins. Co.*, 294 U.S. 686 (1935).

108. Griswold, *An Argument Against the Doctrine that Deductions Should be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142 (1943).

109. *Id.* at 1142-43.

110. *Id.* at 1143.

111. 305 U.S. 281 (1938).

112. *Id.* at 292.

113. Griswold, *An Argument Against the Doctrine that Deductions Should be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142, 1144-45 (1943).

that if it is ambiguous whether something is a capital asset, the presumption is against the taxpayer.<sup>114</sup>

The inversion of *Gould* is virtually complete with the Supreme Court's comprehensive definition of "gross income." It seems fair to say that Congress intends a broad definition of income, but its authority turns on the scope of the term "income" as used in the sixteenth amendment.<sup>115</sup> In *Eisner v. Macomber*<sup>116</sup> the Court held that unless labor or capital (or both) was the source of the receipt, the disputed gain was not subject to taxation.<sup>117</sup> Using this test, the Court excluded from taxation a stock dividend on the ground that it represented merely a balance-sheet transfer.<sup>118</sup> The Court's rather confined definition was undone in *Commissioner v. Glenshaw Glass Co.*,<sup>119</sup> in which the Court held taxable a treble-damages award under the antitrust laws.<sup>120</sup> The Court's new test for defining "income," under what is now section 61,<sup>121</sup> focuses on "unde-

114. In *Corn Prods. Ref. Co. v. Commissioner* the Court said:

Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in [section 1221].

350 U.S. 46, 52 (1955) (citing *Hort v. Commissioner*, 313 U.S. 28, 31 (1941), and *Kieselbach v. Commissioner*, 317 U.S. 399, 403 (1943)).

115. The sixteenth amendment states that "[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

116. 252 U.S. 189 (1920). For an extensive discussion of *Eisner*, see Mullock, *Current Concepts of Taxable Income*, 25 OHIO ST. L.J. 151 (1964).

117. 252 U.S. at 207.

118. *Id.* at 219.

119. 348 U.S. 426 (1955). For a further analysis of *Glenshaw Glass*, see Wright, *The Effect of the Source of Realized Benefits upon the Supreme Court's Concept of Taxable Receipts*, 8 STAN. L. REV. 164 (1956).

120. 348 U.S. at 432-33.

121. Section 61(a) lists certain items included in gross income:

(a) General definition. Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

- (1) Compensation for services, including fees, commissions, and similar items;
- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.



niable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."<sup>122</sup> The word "source" as a limitation left the lexicon; increases in wealth entered. The new standards are much broader than the old. Accordingly, the catch-all provision of section 61 is truly sweeping; any transaction that increases a taxpayer's net worth invites a finding of income under the "accession to wealth" standard.

In short, not only is the rule that ambiguities in the taxing statute should be resolved against the government defunct, but the practical burden is often on the taxpayer. All "accessions to wealth" are income, deductions and exemptions are matters of "legislative grace," and taxpayers have to scramble to show that their transaction resulted in capital gains rather than ordinary income.<sup>123</sup>

Does this mean the taxpayer has no real weapons? By now, the reader should be intuitively confident that the answer is in the negative. While statements that the Constitution authorizes the taxation of gross income are fairly commonplace, so are contradictory statements.<sup>124</sup> For example, although the results were adverse to the crafty taxpayer in *Goldstein v. Commissioner*,<sup>125</sup> the Second Circuit's language seems particularly helpful to taxpayers caught in the web of *New Colonial Ice*:

Although it is by no means certain that Congress constitutionally could tax gross income, . . . it is frequently stated that deductions from "gross income" are a matter of "legislative grace." . . . There is at least this much truth in this oft-repeated maxim: a close question whether a particular Code provision authorizes the deduction of a certain item is best resolved by reference to the underlying Congressional purpose of the deduction provision in question.<sup>126</sup>

Clearly, *Goldstein* at least puts the focus back where it belongs—on Congressional purpose. A reference to *Goldstein* and a few selected tax cases and authorities may put a reasonable judge back on his proper course, but the presumption against taxation has clearly dissolved.

#### F. A Regulation's Presumptive Correctness

It is a bromide that interpretative regulations issued by the Treasury enjoy a presumption of correctness.<sup>127</sup> While one can make a few general statements about the different degrees of authority properly accorded different types of regulations, the judicial pronouncements are in fact wondrously inconsistent. Regulations fall into two distinct classes: those

I.R.C. § 61(a).

122. 348 U.S. at 431.

123. See R. MAGILL, *TAXABLE INCOME* 367-73 (rev. ed. 1945).

124. Compare *Commissioner v. Tellier*, 383 U.S. 687 (1966) (suggesting a judicial distaste for taxing gross income), with *James v. United States*, 366 U.S. 213 (1961) (stating that Congress can tax all gains except those specifically exempted as a matter of legislative grace).

125. 364 F.2d 734 (2d Cir. 1966), *cert. denied*, 385 U.S. 1005 (1967).

126. 364 F.2d at 740-41 (citations omitted).

127. See J. CHOMMIE, *FEDERAL INCOME TAXATION* 13 (2d ed. 1973).

which are "interpretative" and those which are "legislative."<sup>128</sup> Interpretative regulations are issued pursuant to the general rule-making power granted to the Secretary of the Treasury under Code section 7805(a).<sup>129</sup> Legislative regulations are issued pursuant to some specific Code section,<sup>130</sup> such as Code section 1502, which authorizes the Secretary to promulgate "such regulations as he may deem necessary" to determine the tax liability of affiliated corporations on a consolidated federal income tax return.<sup>131</sup> It is generally said that legislative regulations will not be overturned unless they exceed the scope of the statute, contradict the statute, or are unreasonable.<sup>132</sup> Because they are deemed to carry the force of law,<sup>133</sup> they bind the Treasury and taxpayers.<sup>134</sup> They have great weight.<sup>135</sup>

128. See generally Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity—A View From Within*, 43 TAXES 756 (1965); Williams, *Preparation and Promulgation of Treasury Department Regulations Under Internal Revenue Code of 1954*, 1956 U.S. CAL. TAX INST. 733. The third class, procedural regulations, are not considered here.

129. Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

I.R.C. § 7805(a).

130. See J. CHOMMIE, *FEDERAL INCOME TAXATION* 13 (2d ed. 1973).

131. I.R.C. § 1502.

132. Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity—A View From Within*, 43 TAXES 756, 759 (1965).

133. "Treasury regulations carry a presumption of correctness and seldom are invalidated by the courts. Also, legislative regulations are regarded as having the status of law, and interpretive regulations, as well as any consistent prior administrative and judicial interpretation, may acquire the status of law under the reenactment doctrine." J. CHOMMIE, *FEDERAL INCOME TAXATION* 13 (2d ed. 1973).

134. The Supreme Court emphasizes the great judicial deference to be given to legislative regulations:

Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement.

*Koshland v. Helvering*, 298 U.S. 441, 446-47 (1936) (dicta).

135. The Supreme Court says that "[i]t is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons." *Brewster v. Gage*, 280 U.S. 327, 336 (1930). One circuit court of appeals has adopted a strict standard to be used in determining the validity of a legislative regulation, saying that "[w]hen Congress has used a general term and has empowered an administrator to define it, the courts must respect his construction if this is within the range of reason." *Commissioner v. Pepsi-Cola Niagara Bottling Corp.*, 399 F.2d 390, 393 (2d Cir. 1968); accord, *Farrell-Birmingham Co. v. United States*, 121 F. Supp. 636 (Ct. Cl.), modified, 125 F. Supp. 297 (1954). The United States Supreme Court has also stated, "Those who insist that . . . a regulation is invalid must make its invalidity so manifest that the court has no choice except to hold that the Secretary has exceeded his authority and employed means that are not at all appropriate to the end specified in the act of Congress." *Boske v. Comingore*, 177 U.S. 459, 470 (1900);

The weight accorded to interpretative regulations remains unclear.<sup>136</sup> The words of section 7805 do not invest such regulations with the force of law; however, the application of canons of statutory construction can invest them with substantially more authority than mere interpretations by a partisan tax collector. Although the most common shibboleth in this area is that interpretative regulations are presumptively correct, Randolph Paul's research reveals so extensive a range of judicial pronouncements that all that seems missing is a statement that Treasury regulations are presumptively wrong.<sup>137</sup>

When an interpretative regulation is found to have no weight (in other words, is wrong), it is denounced as either inconsistent with the statute or unreasonable.<sup>138</sup> What constitutes "unreasonableness" is im-

*accord*, *Noble Motor Co. v. United States*, 231 F. Supp. 702, 708 (D. Md. 1964). And in order to invalidate legislative regulations, one must sustain a burden of "greater weight" than when attempting to invalidate interpretative regulations. *Goldman v. Commissioner*, 497 F.2d 382, 383 (6th Cir.), *cert. denied*, 419 U.S. 1021 (1974).

136. It has been stated, however, that in determining the validity of such regulations, the court determines whether the regulation is (1) within the granted power of the statute, (2) issued pursuant to proper procedure, and (3) reasonable. *Kramertown Co. v. Commissioner*, 488 F.2d 728, 730 (5th Cir. 1974); *see* 1 K. DAVIS, *ADMINISTRATIVE LAW* § 5.03, at 299 (1958).

137. *See* Paul, *Use and Abuse of Tax Regulations in Statutory Construction*, 49 *YALE L.J.* 660, 662-63 (1940). In footnotes 13 and 14, Paul comments:

13. The expressions of the courts in speaking of the deference due to regulations vary all the way from statements that a "regulation rises to no higher dignity than an expression of opinion" . . . to statements that they are entitled to "great weight" . . . or are not to be overruled "except for weighty reasons" . . . or even that they have almost the force and effect of law. . . . These degrees of verbal rhetoric, however, merely clutter up the interpretative problem, and could be abolished from the judicial lexicon with little loss; it is most unlikely that an actual judgment in many cases would have been different if the court had started out with exactly the opposite formula. . . .

14. Sometimes, in fact, a ruling contrary to the Court's conclusion is not even accorded the honor of mention. . . . [In one case] Justice Holmes contented himself with the terse statement that there was no reason why the regulations regarding cancelled bonds "should not be accepted as a correct statement of law."

*Id.* at 662-63 nn.13 & 14 (citations omitted).

138. Several general rules can be stated concerning the effect and validity of Treasury Regulations:

[T]he regulations of an administrative agency charged with the duty to carry out a congressional mandate are entitled to great weight. Treasury regulations are invalid, however, if they are out of harmony with the intent of the statute, or they contradict the express terms of the statute. To be valid, they must be consistent with the statute and be reasonable. . . . Often, in speaking of the interpretive regulation-making power of the Treasury, as opposed to the legislative rule-making power of the Treasury, courts speak of the sole purpose of an interpretive regulation as being to reconcile ambiguities in the statute with reasoned interpretation. If the statute is unambiguous on its face, there is no room for Treasury interpretation. . . . All courts recognize the principle, however, that the Treasury has no power to supply an omission or create an exception not already in the statute.

*Caterpillar Tractor Co. v. United States*, 589 F.2d 1040, 1045 (Ct. Cl. 1978) (citations

possible to analyze meaningfully, and the question of inconsistency is too basic to cover. The interesting questions involve matters of degree.<sup>139</sup>

One factor that clearly counts is the length of time that a disputed regulation has been outstanding. Old regulations are, all things being equal, better than young regulations. This rule is frequently announced and rests on sound concepts of tax administration.<sup>140</sup> With the passage of time, one can presume that more people have relied on the interpretation; and a reversal would accordingly engender greater inconvenience and confusion.<sup>141</sup> Following the issuance of a regulation, taxpayers have the opportunity to challenge the regulation judicially. Alternatively, it may be obvious to taxpayers, the Treasury, or both that the regulation is ill-conceived and that it should be reformulated. But once the period to measure and challenge the regulation has passed, the public interest in legal stability dictates enhancement of the regulation's value.

Another major but sometimes paradoxical factor involves contemporaneity with the statute.<sup>142</sup> In other words, the shorter the time span between issuance of the statute and promulgation of the regulation, the greater the weight given to the regulation. This long-favored<sup>143</sup> preference is premised on the notion that the persons involved in drafting regulations are much more likely to do a good job when the legislative history of the statute is fresh in their minds.<sup>144</sup> In fact, the contemporaneous draftsman may be more alert to opportunities for stacking the regulation in the Treasury's favor; but because Treasury personnel take an active role in formulating statutes and committee reports, the preference for contempo-

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omitted).

139. As to the reasonableness of a regulation, the Supreme Court has listed recently several factors to be examined:

[W]e look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute.

National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979).

140. See note 139 *supra*.

141. See Griswold, *A Summary of the Regulations Problem*, 54 HARV. L. REV. 398, 409-11 (1941).

142. National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 477 (1979).

143. *Edwards' Lessee v. Darby*, 25 U.S. (12 Wheat.) 206 (1827). "In the construction of a doubtful and ambiguous law, the contemporaneous construction of those who were called upon to act under the law, and were appointed to carry its provisions into effect, is entitled to very great respect." *Id.* at 210.

144. See *Commissioner v. South Tex. Lumber Co.*, 333 U.S. 496 (1947) (treasury regulations are contemporaneous constructions of the revenue statutes by those charged with the administration of these statutes and should not be invalidated except for overwhelming reasons); *Fawcus Mach. Co. v. United States*, 282 U.S. 375 (1931) (administrative regulations contemporaneously construing a statute, which are not unreasonable or inconsistent with the statute, will not be overruled except for weighty reasons).

aneous statutes has a factual foundation.<sup>145</sup> The crucial point is that the proper way to approach regulations is not to invent presumptions with so little support in logic that the courts will inevitably distort them, but rather to view the subject of the inquiry as being the orderly development of tax administration.

## II. SUGGESTED REFORMS

The foregoing litany certainly does not exhaust the list of interpretative rules. Others include the power of the courts to plug loopholes in the law,<sup>146</sup> horizontal<sup>147</sup> and vertical equity,<sup>148</sup> and the role of equity in construing a statute. Nonetheless, the frailty of the interpretative techniques already discussed and the seeming opportunism with which the courts apply them are causes for concern. There are occasional moments of judicial candor on this subject. Learned Hand's comment on his reaction to a complex tax decision is surely explicit:

In my own case the words of such an act as the Income Tax, for exam-

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145. Williams, *Preparation and Promulgation of Treasury Department Regulations Under Internal Revenue Code of 1954*, 1956 U.S. CAL. TAX INST. 733, 741. The matter of the proper role of tax regulations, as well as thorny questions of retroactivity and an appeal for expelling the reenactment doctrine, are thoughtfully and clearly presented by Dean Griswold. See Griswold, *A Summary of the Regulations Problem*, 54 HARV. L. REV. 398 (1941).

146. See *Corn Prods. Ref. Co. v. Commissioner*, 350 U.S. 46 (1955), apparently the only case in which the Supreme Court used "loophole plugging" as an express basis for deciding a case, even though the concept appears to be unnecessary to the result.

147. It appears that this concept, the gist of which is that similarly situated taxpayers should pay the same amount of taxes, has been alluded to exactly once in federal income tax litigation. In *Kampel v. Commissioner*, 72 T.C. 827 (1979), the Tax Court held a wealthy taxpayer bound by Treasury regulations that limited his partnership service income subject to the maximum tax (pursuant to section 1348) to 30% of his partnership distributive share, including his "guaranteed payments" as described in section 707(c):

Finally, petitioners argue that the result we reach violates horizontal equity by affording to a partner who receives a guaranteed payment less favorable tax treatment than that accorded a salaried employee performing similar services for the partnership. In many cases, however, the guaranteed payment will be no less subject to section 1348 than is the salary. Assuming other section 1348 requirements are met, a guaranteed payment is subject in its entirety to maximum tax treatment unless it exceeds 30 percent of the sum of the distributive share and the guaranteed payment. Petitioners have cited nothing in the legislative history which would indicate that Congress intended to allow amounts in excess of the 30-percent limitation to enjoy maximum tax treatment. The committee reports fail to discuss this point but affirm that the 30-percent limitation applies to business in which both personal services and capital are material income-producing factors. . . . Hence, our holding in no way contravenes the legislative purpose of section 1348.

72 T.C. at 837 (citations omitted). For a fairly typical description of horizontal equity, see Rice, *Tax Reform and Tax Incentives*, 34 LAW & CONTEMP. PROB. 782, 788 (1969).

148. It appears that his concept of tax interpretation, the gist of which is that higher levels of income justify higher taxes, is used exclusively in formulating tax policies and not in the determination of tax controversies. The term "vertical equity" has apparently never appeared in tax litigation. For a discussion of the concept, see Rice, *Tax Reform and Tax Incentives*, 34 LAW & CONTEMP. PROB. 782, 786 (1969).

ple, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time.<sup>149</sup>

The average citizen probably has the same reaction when he sits down to prepare his federal income tax return; and if a distinguished jurist felt this way when the Code was substantially less complex, one has good cause to worry.

Something is wrong. The Code is simply too complex, its ambiguities are too numerous, and the legislative direction is too faint. Everyone, except particularly effective special-interest groups and tax specialists, suffers—clearly a perverse result. In the meantime, taxpayers and the government have legitimate tax planning and revenue raising issues to resolve, and judges have cases to decide. All these activities are hampered to the extent the interpretative techniques used to resolve difficult cases are unpredictable in their application. The techniques do have the dubious honor of creating escape hatches through which judges can sometimes flee very difficult, if not impossible, problems of interpreting the nuances of a statute that an overly busy Congress did not bother to explain adequately. What should be the future of the interpretative devices reviewed in this article? There appears to be no single answer, but perhaps the following analysis is a fair one.

First, the reenactment doctrine clearly offers no legal stability except for cases in which Congress in fact contemplated and approved an interpretation. It should be eliminated. Second, the concept of “traps for the unwary” has also been badly tormented; it might be a reasonable interpretative tool, however, if uniformly respected. But even if it were widely accepted, its meaning would still have to be sharpened in order to clarify when a trap should be considered sufficiently serious to merit rejection of a potential interpretation of the Code. Absent such improvement, the concept offers only confusion and judicial evasion. In the present circumstances, it seems well worth discarding. The putative cost of abandoning the doctrine is only an enlarged judicial burden, but that burden seems well outweighed by the potential benefits of forcing decision on rational grounds such as equity and administrative stability.

Third, while symmetry should not be used to subvert even a faint legislative direction, it is a legitimate tool for filling voids. For example, once a term has been defined in the Code, everyone’s task is eased if that term is used in a consistent manner. Certainly, the application of greater symmetry to tax accounting would produce a revenue loss during the transition phase, but the result would be abundantly greater fairness to taxpayers and a more accurate measure of income. The potential list of benefits seems endless, and the inequity invisible.

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149. Hand, *Thomas Walter Swan*, 57 *YALE L.J.* 167, 169 (1947).

Fourth, respect for legislated conditions appears to be no more than a makeweight justification which relies on the silly presumption of an unstated legislative intent. It is, therefore, only a judicial escape hatch. It should be sealed since it offers the opposite of legal stability. If the doctrine is not eliminated, the courts could view themselves as free to adopt the technique and to drop the pretense of a presumed intent. If the technique were precise enough to give taxpayers and the government a clear understanding of when it would apply, it would have the merit of filling an occasional legal void in a predictable manner. It would nonetheless be a substitute for logic, and whether it is necessary at all seems open to debate.

Fifth, the bias against deductions and capital gains that results from the failure to place the burden on the draftsmen of the statute is fixed and predictable. No overwhelming reason exists for reversing the current judicial stance on the issue; therefore, the best answer seem to be to leave matters as they are. The status quo still leaves large portions of the Code without such crude but practical guidance. For those areas, the solution is, of course, to start with a search for the legislature's intent, which is essentially what the implicit reversal of *Gould*<sup>150</sup> accomplished. In other words, the status quo appears tolerable, but it does not solve the problems of how to fill the remaining logical cavities in the tax law. Simplistic answers to that problem include either returning to *Gould's* anti-government posture or taking the opposite view that the Code is, after all, a revenue statute that should be interpreted to maximize revenue, a position sometimes taken at the state level.<sup>151</sup> The former rule would vitiate fair regulations, but the latter rule is unpalatable for the opposite reason. There seems to be no equitable, simple solution; accordingly, the task is to expand the search for legitimate devices for filling the voids in the Code.

Finally, the presumptive correctness of regulations deserves to be expurgated. Recently promulgated regulations should be scrutinized closely and held to high standards of good sense, fairness, administrability, and whatever rational standards, including symmetry, that can be brought to bear upon them. Thereafter, their weight should grow in accordance with the mandates of legal stability. In that regard, "contemporaneousness" with the statute seems to merit some weight, although less than that accorded to the simple passage of time. In brief, the inquiry in this area should focus on concepts of tax administration, rather than on a search for talismans.

### CONCLUSION

This article has reviewed selected interpretative techniques used in construing the Internal Revenue Code. It is impossible, however, not to suggest a few broad reforms. First, the Congressional committees respon-

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150. See text accompanying notes 106-22 *supra*.

151. See *Dostal's Inc. v. Wright*, 129 Vt. 322, 277 A.2d 125 (1971).

sible for tax legislation must explain the purposes and scope of amendments to the Code as clearly as possible. If this task requires hiring a few more technicians, then the money would be well spent. Second, serious thought should be given to limiting the number of tax forums to one, presumably an expanded Tax Court.<sup>152</sup> The present forum-shopping opportunities commonly have the effect of inviting the presentation of tax cases to judges who lack day-to-day contact with the Code. The result is judicial inefficiency and legal anarchy. Finally, the incessant, clumsy tinkering with the statutes should be halted and time given instead to amending the Code to clarify ambiguities and to eliminate statutory provisions oriented strictly to special interests. The last proposal, alas, seems hopeless.

Another approach would be to admit that the present state of affairs is parlous indeed and to try to make the best of it by acknowledging that the Congress will probably never explain its legislation adequately and by simultaneously tying down the various rules of interpretation so that the parties concerned can be confident about how they will be applied. The obvious way to proceed would be to amend the Code to include explicit rules of statutory construction, covering, among other things, the doctrines discussed above. Such an approach would have the additional benefit of meeting the requirement of the Constitution, which states that "all Duties, Imposts, and Excises shall be uniform throughout the United States,"<sup>153</sup> a requirement that has long lain fallow. While such an approach falls far short of curing the anarchy of innumerable federal forums and their diverse rulings, at least it would inject a measure of certainty into the impossible topic of federal income taxation. Certainly, it is hard to imagine how such a proposal could make the situation any worse than it is now.

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152. See Crampton, *Forum Shopping*, 31 TAX LAW. 321 (1978).

153. U.S. CONST. art. I, § 8, cl. 1.